

AMERICAN INTERNATIONAL GROUP INC

Form 10-Q/A

May 10, 2006

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q/A**

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended March 31, 2005

or

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

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

Commission File Number 1-8787

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**American International Group, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

13-2592361  
(I.R.S. Employer  
Identification No.)

70 Pine Street, New York, New York  
(Address of principal executive offices)

10270  
(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

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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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of March 31, 2005: 2,594,907,032.

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American International Group, Inc. and Subsidiaries

**Explanatory Note**

**Overview.** This amendment to the Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005 (First Quarter Form 10-Q/A) is being filed for purposes of amending Items 1, 2, 3 and 4 of Part I and Item 6 of Part II of the Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005 (First Quarter Form 10-Q) of American International Group, Inc. (AIG), which was originally filed on June 28, 2005, and provides information about the financial results for the three month periods ended March 31, 2005 and 2004 as restated for the restatements described in AIG's Annual Report on Form 10-K for the year ended December 31, 2005 (2005 Annual Report on Form 10-K). Information in this First Quarter Form 10-Q/A is generally stated as of March 31, 2005 and generally does not reflect any subsequent information or events other than the restatements, except that certain forward looking statements throughout this First Quarter Form 10-Q/A have been revised to reflect events and developments subsequent to March 31, 2005. Information regarding subsequent periods with respect to AIG is contained in the 2005 Annual Report on Form 10-K and other filings with the Securities and Exchange Commission (SEC). This filing should be considered, and read, in conjunction with such filings.

**First Restatement.** In connection with the preparation of AIG's consolidated financial statements included in AIG's Annual Report on Form 10-K for the year ended December 31, 2004 (2004 Annual Report on Form 10-K), AIG's management initiated an internal review of its books and records, which was substantially expanded in mid-March 2005 with the oversight of the Audit Committee of the Board of Directors of AIG. The review spanned AIG's major business units globally, and included a number of transactions from 2000 to 2004. As disclosed in the 2004 Annual Report on Form 10-K, as a result of the findings of the internal review, together with the results of investigations by outside counsel at the request of AIG's Audit Committee and in consultation with PricewaterhouseCoopers LLP, AIG's independent registered public accounting firm, AIG restated its consolidated financial statements for the years ended December 31, 2003, 2002, 2001 and 2000, the quarters ended March 31, June 30 and September 30, 2004 and 2003 and the quarter ended December 31, 2003 (the First Restatement).

**Second Restatement.** As announced on November 9, 2005, AIG identified certain errors, the preponderance of which were identified during the remediation of the material weaknesses in internal control over financial reporting, principally relating to internal controls surrounding accounting for derivatives and related assets and liabilities under Statement of Financial Accounting Standards No. 133 Accounting for Derivative Instruments and Hedging Activities (FAS 133), reconciliation of certain balance sheet accounts and income tax accounting. AIG also announced it was correcting errors that were identified since the First Restatement, including those relating to the accounting for certain payments received from aircraft and engine manufacturers by International Lease Finance Corporation (ILFC), which were originally corrected in AIG's Form 10-Q for the quarter ended June 30, 2005 (Second Quarter Form 10-Q). The adjustments to correct the foregoing errors are referred to in this First Quarter Form 10-Q/A as the Initial Adjustments.

In connection with the remediation of material weaknesses in internal control over financial reporting referred to above, AIG identified certain additional errors, principally relating to internal controls over reconciliation of certain balance sheet accounts in the Domestic Brokerage Group (DBG). As a result, AIG included further adjustments (the Additional Adjustments) in its restatement of the consolidated financial statements and financial statement schedules for the years ended December 31, 2004, 2003 and 2002, along with 2001 and 2000 for purposes of preparation of the Selected Consolidated Financial Data for 2001 and 2000, and quarterly financial information for 2004 and 2003 and in the restated consolidated financial statements included in this First Quarter Form 10-Q/A. The Initial Adjustments and the Additional Adjustments are referred to herein as the Second Restatement. AIG's quarterly report on Form 10-Q for the quarter ended September 30, 2005 (September 2005 Form 10-Q) will not be amended because the Additional Adjustments to the financial statements included therein are not material to those financial statements.

The financial information that is included in this First Quarter Form 10-Q/A has been restated as part of the First Restatement and the Second Restatement (the Restatements). Only restated financial information that is being presented for the first time in this First Quarter Form 10-Q/A is identified herein as Restated. All previously presented, restated financial information is identified as such in the respective SEC filing in which the information was restated.

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American International Group, Inc. and Subsidiaries

**CONSOLIDATED BALANCE SHEET***(in millions) (unaudited)*

	March 31, 2005 (Restated)	December 31, 2004
<b>Assets:</b>		
Investments and financial services assets:		
Fixed maturities:		
Bonds available for sale, at market value (amortized cost: 2005 \$338,161; 2004 \$329,838)	\$ 350,400	\$ 344,399
Bonds held to maturity, at amortized cost (market value: 2005 \$21,734; 2004 \$18,791)	21,477	18,294
Bond trading securities, at market value (cost: 2005 \$3,562; 2004 \$2,973)	3,580	2,984
Equity securities:		
Common stocks available for sale, at market value (cost: 2005 \$9,075; 2004 \$8,424)	10,751	9,772
Common stocks trading, at market value (cost: 2005 \$5,947; 2004 \$5,651)	6,379	5,894
Preferred stocks, at market value (cost: 2005 \$2,272; 2004 \$2,017)	2,280	2,040
Mortgage loans on real estate, net of allowance (2005 \$62; 2004 \$65)	14,065	13,146
Policy loans	7,109	7,035
Collateral and guaranteed loans, net of allowance (2005 \$16; 2004 \$18)	3,309	3,303
Financial services assets:		
Flight equipment primarily under operating leases, net of accumulated depreciation (2005 \$6,718; 2004 \$6,390)	33,896	32,130
Securities available for sale, at market value (cost: 2005 \$28,946; 2004 \$29,171)	29,660	31,225
Trading securities, at market value	3,091	2,746
Spot commodities	654	534
Unrealized gain on swaps, options and forward transactions	20,149	22,670
Trading assets	1,507	3,433
Securities purchased under agreements to resell, at contract value	32,593	26,272
Finance receivables, net of allowance (2005 \$573; 2004 \$571)	24,929	23,574
Securities lending collateral, at market value (which approximates cost)	51,890	49,169
Other invested assets	25,608	23,559
Short-term investments, at cost (approximates market value)	22,017	16,102
<b>Total investments and financial services assets</b>	<b>665,344</b>	<b>638,281</b>
Cash	2,361	2,009
Investment income due and accrued	5,609	5,556
Premiums and insurance balances receivable, net of allowance (2005 \$682; 2004 \$690)	16,222	15,622
Reinsurance assets, net	19,372	19,613
Deferred policy acquisition costs	31,625	29,817
Investments in partially owned companies	1,544	1,495
Real estate and other fixed assets, net of accumulated depreciation (2005 \$4,688; 2004 \$4,650)	6,190	6,192
Separate and variable accounts	57,417	57,741
Goodwill	8,532	8,556
Income taxes receivable - current		138
Other assets	16,261	16,125
<b>Total assets</b>	<b>\$ 830,477</b>	<b>\$ 801,145</b>

See Accompanying Notes to Consolidated Financial Statements.



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American International Group, Inc. and Subsidiaries

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

	March 31, 2005 (Restated)	December 31, 2004
<b>Liabilities:</b>		
Reserve for losses and loss expenses	\$ 63,570	\$ 61,878
Reserve for unearned premiums	24,088	23,400
Future policy benefits for life and accident and health insurance contracts	108,186	104,740
Policyholders' contract deposits	225,690	216,474
Other policyholders' funds	10,212	10,280
Reserve for commissions, expenses and taxes	4,772	4,629
Insurance balances payable	4,269	3,661
Funds held by companies under reinsurance treaties	3,137	3,404
Income taxes payable:		
Current	585	
Deferred	6,118	6,588
Financial services liabilities:		
Borrowings under obligations of guaranteed investment agreements	22,691	18,919
Securities sold under agreements to repurchase, at contract value	21,642	23,581
Trading liabilities	1,482	2,503
Securities and spot commodities sold but not yet purchased, at market value	5,586	5,404
Unrealized loss on swaps, options and forward transactions	12,866	15,985
Trust deposits and deposits due to banks and other depositors	4,612	4,248
Commercial paper	8,477	6,724
Notes, bonds, loans and mortgages payable	64,327	61,296
Commercial paper	3,479	2,969
Notes, bonds, loans and mortgages payable	5,558	5,502
Liabilities connected to trust preferred stock	1,489	1,489
Separate and variable accounts	57,417	57,741
Minority interest	5,208	4,831
Securities lending payable	52,693	49,972
Other liabilities	30,517	25,055
<b>Total liabilities</b>	<b>748,671</b>	<b>721,273</b>
<b>Preferred shareholders' equity in subsidiary companies</b>	<b>198</b>	<b>199</b>
Commitments and Contingent Liabilities (See Note 7)		
<b>Shareholders' equity:</b>		
Common stock, \$2.50 par value; 5,000,000,000 shares authorized; shares issued 2005 2,751,327,476; 2004 2,751,327,476	6,878	6,878
Additional paid-in capital	2,104	2,094
Retained earnings	66,813	63,468
Accumulated other comprehensive income (loss)	8,125	9,444
Treasury stock, at cost; 2005 156,420,444; 2004 154,904,286 shares of common stock	(2,312)	(2,211)
<b>Total shareholders' equity</b>	<b>81,608</b>	<b>79,673</b>
<b>Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity</b>	<b>\$ 830,477</b>	<b>\$ 801,145</b>

*See Accompanying Notes to Consolidated Financial Statements.*

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American International Group, Inc. and Subsidiaries

**CONSOLIDATED STATEMENT OF INCOME***(in millions, except per share data) (unaudited)*

<b>Three Months Ended March 31,</b>	<b>2005 (Restated)</b>	<b>2004</b>
<b>Revenues:</b>		
Premiums and other considerations	\$ 17,680	\$ 15,979
Net investment income	5,332	4,600
Realized capital gains (losses)	137	(86)
Other revenues	4,053	2,729
<b>Total revenues</b>	<b>27,202</b>	<b>23,222</b>
<b>Benefits and expenses:</b>		
Incurred policy losses and benefits	14,873	13,590
Insurance acquisition and other operating expenses	6,680	5,790
<b>Total benefits and expenses</b>	<b>21,553</b>	<b>19,380</b>
<b>Income before income taxes, minority interest and cumulative effect of an accounting change</b>	<b>5,649</b>	<b>3,842</b>
<b>Income taxes (benefits):</b>		
Current	968	1,345
Deferred	738	(215)
	<b>1,706</b>	<b>1,130</b>
<b>Income before minority interest and cumulative effect of an accounting change</b>	<b>3,943</b>	<b>2,712</b>
<b>Minority interest</b>	<b>(144)</b>	<b>(70)</b>
<b>Income before cumulative effect of an accounting change</b>	<b>3,799</b>	<b>2,642</b>
<b>Cumulative effect of an accounting change, net of tax</b>		<b>(144)</b>
<b>Net income</b>	<b>\$ 3,799</b>	<b>\$ 2,498</b>
<b>Earnings per common share:</b>		
Basic		
Income before cumulative effect of an accounting change	\$ 1.46	\$ 1.01
Cumulative effect of an accounting change, net of tax		(0.06)
Net income	<b>1.46</b>	<b>0.95</b>
Diluted		
Income before cumulative effect of an accounting change	\$ 1.45	\$ 1.00
Cumulative effect of an accounting change, net of tax		(0.06)
Net income	<b>1.45</b>	<b>0.94</b>

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<b>Dividends declared per common share</b>	<b>\$ 0.175</b>	<b>\$ 0.065</b>
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<b>Average shares outstanding:</b>		
Basic	<b>2,597</b>	2,610
Diluted	<b>2,624</b>	2,642
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*See Accompanying Notes to Consolidated Financial Statements.*

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American International Group, Inc. and Subsidiaries

**CONSOLIDATED STATEMENT OF CASH FLOWS***(in millions) (unaudited)*

Three Months Ended March 31,	2005  (Restated)	2004  (Restated)
<b>Summary:</b>		
Net cash (used in) provided by operating activities	\$ (434)	\$ 8,006
Net cash used in investing activities	(20,118)	(29,658)
Net cash provided by financing activities	20,961	22,348
Effect of exchange rate changes on cash	(57)	302
<b>Change in cash</b>	<b>352</b>	<b>998</b>
<b>Cash at beginning of period</b>	<b>2,009</b>	<b>922</b>
<b>Cash at end of period</b>	<b>\$ 2,361</b>	<b>\$ 1,920</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 3,799	\$ 2,498
<b>Adjustments to reconcile net income to net cash (used in) provided by operating activities:</b>		
<b>Noncash revenues, expenses, gains and losses included in income:</b>		
Change in:		
General and life insurance reserves	5,605	6,698
Premiums and insurance balances receivable and payable net	8	(728)
Reinsurance assets	241	(403)
Deferred policy acquisition costs	(944)	(1,082)
Investment income due and accrued	(53)	(337)
Funds held under reinsurance treaties	(267)	102
Other policyholders funds	(68)	473
Current and deferred income taxes net	1,457	1,209
Reserve for commissions, expenses and taxes	143	389
Other assets and liabilities net	(962)	(410)
Bonds and common stocks trading, at market value	(1,082)	(732)
Trading assets and liabilities net	905	(638)
Trading securities, at market value	(345)	(1,458)
Spot commodities	(120)	67
Net unrealized (gain) loss on swaps, options and forward transactions	(598)	139
Securities purchased under agreements to resell	(6,321)	1,819
Securities sold under agreements to repurchase	(1,939)	260
Securities and spot commodities sold but not yet purchased, at market value	182	(244)
Realized capital (gains) losses	(137)	86
Equity in income of partially owned companies and other invested assets	(445)	(316)
Amortization of premium and discount on securities	113	77
Depreciation expenses, principally flight equipment	526	486
Provision for finance receivable losses	86	90
Other net	(218)	(39)

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Total adjustments		(4,233)		5,508
<hr/>				
<b>Net cash (used in) provided by operating activities</b>		<b>\$ (434)</b>		<b>\$ 8,006</b>
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*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)*

<b>Three Months Ended March 31,</b>	<b>2005 (Restated)</b>	<b>2004 (Restated)</b>
<b>Cash flows from investing activities:</b>		
Cost of bonds, at market sold	\$ 27,572	\$ 28,449
Cost of bonds, at market matured or redeemed	2,823	3,947
Cost of equity securities sold	2,724	3,258
Realized capital gains (losses)	137	(86)
Purchases of fixed maturities	(42,094)	(46,832)
Purchases of equity securities	(3,608)	(3,987)
Mortgage, policy and collateral loans granted	(1,578)	(206)
Repayments of mortgage, policy and collateral loans	575	539
Sales of securities available for sale	804	620
Maturities of securities available for sale	2,164	324
Purchases of securities available for sale	(2,316)	(3,066)
Sales of flight equipment	41	1,080
Purchases of flight equipment	(2,141)	(1,815)
Change in securities lending collateral	(2,721)	(10,500)
Net additions to real estate and other fixed assets	(188)	(182)
Sales or distributions of other invested assets	2,163	2,171
Investments in other invested assets	(3,339)	(3,747)
Change in short-term investments	301	1,356
Investments in partially owned companies	4	(6)
Finance receivable originations and purchases	(10,605)	(5,579)
Finance receivable principal payments received	9,164	4,604
<b>Net cash used in investing activities</b>	<b>\$ (20,118)</b>	<b>\$ (29,658)</b>
<b>Cash flows from financing activities:</b>		
Receipts from policyholders contract deposits	\$ 16,279	\$ 13,062
Withdrawals from policyholders contract deposits	(7,149)	(4,507)
Change in trust deposits and deposits due to banks and other depositors	364	50
Change in commercial paper	2,263	1,875
Proceeds from notes, bonds, loans and mortgages payable	16,244	7,153
Repayments on notes, bonds, loans and mortgages payable	(13,081)	(5,641)
Proceeds from guaranteed investment agreements	4,955	1,505
Maturities of guaranteed investment agreements	(1,183)	(1,428)
Change in securities lending payable	2,721	10,500
Proceeds from common stock issued	31	40
Cash dividends to shareholders	(325)	(170)
Acquisition of treasury stock	(166)	(92)
Other net	8	1

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<b>Net cash provided by financing activities</b>	<b>\$</b>	<b>20,961</b>	<b>\$</b>	<b>22,348</b>
<hr/>				
<b>Supplementary information:</b>				
<b>Taxes paid</b>	<b>\$</b>	<b>382</b>	<b>\$</b>	<b>493</b>
<hr/>				
<b>Interest paid</b>	<b>\$</b>	<b>1,147</b>	<b>\$</b>	<b>1,032</b>
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*See Accompanying Notes to Consolidated Financial Statements.*

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American International Group, Inc. and Subsidiaries

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME***(in millions) (unaudited)*

<b>Three Months Ended March 31,</b>	<b>2005</b>		2004
	<b>(Restated)</b>		
<b>Comprehensive income (loss):</b>			
Net income	\$	<b>3,799</b>	\$ 2,498
<b>Other comprehensive income (loss):</b>			
Unrealized (depreciation) appreciation of investments net of reclassification adjustments		<b>(2,535)</b>	4,546
Deferred income tax benefit (expense) on above changes		<b>1,256</b>	(1,436)
Foreign currency translation adjustments		<b>(53)</b>	302
Applicable income tax benefit (expense) on above changes		<b>4</b>	(34)
Net derivative gains arising from cash flow hedging activities		<b>150</b>	21
Deferred income tax (expense) benefit on above changes		<b>(111)</b>	3
Retirement plan liabilities adjustment, net of tax		<b>(30)</b>	(27)
<b>Other comprehensive income (loss)</b>		<b>(1,319)</b>	3,375
<b>Comprehensive income (loss)</b>	<b>\$</b>	<b>2,480</b>	<b>\$ 5,873</b>

*See Accompanying Notes to Consolidated Financial Statements.*

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American International Group, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Financial Statement Presentation**

These statements are unaudited. In the opinion of management, all material adjustments including normal recurring accruals have been made for a fair statement of the results presented herein. All material intercompany accounts and transactions have been eliminated. Certain accounts have been reclassified in the 2004 financial statements to conform to their 2005 presentation. For further information, refer to the Annual Report on Form 10-K of American International Group, Inc. (AIG) for the year ended December 31, 2005 (2005 Annual Report on Form 10-K).

As more fully described in AIG's 2004 Annual Report on Form 10-K for the year ended December 31, 2004, which was originally filed May 31, 2005 (2004 Annual Report on Form 10-K), and AIG's Forms 10-Q/A for the quarterly periods ended March 31, 2004 and June 30, 2004, AIG restated the accounting for certain transactions and certain relationships for the quarters ended March 31, 2004 and June 30, 2004, as part of the restatement of its financial statements for the years ended December 31, 2003, 2002, 2001 and 2000, the quarters ended March 31, June 30 and September 30, 2004 and 2003 and the quarter ended December 31, 2003 (the First Restatement).

As announced on November 9, 2005, AIG identified certain errors, the preponderance of which were identified during the remediation of the material weaknesses in internal control over financial reporting, principally relating to internal controls surrounding accounting for derivatives and related assets and liabilities under FAS 133, reconciliation of certain balance sheet accounts and income tax accounting. Due to the significance of these corrections, AIG restated its consolidated financial statements for the years ended December 31, 2004, 2003 and 2002, along with 2001 and 2000 for purposes of preparation of the Selected Consolidated Financial Data for 2001 and 2000, and quarterly financial information for 2004 and 2003 and the first three quarters of 2005 (the Second Restatement, and together with the First Restatement, the Restatements). As part of the Second Restatement, AIG also corrected errors that have been identified since the First Restatement, including those relating to the accounting for certain payments received from aircraft and engine manufacturers by International Lease Finance Corporation (ILFC), which were originally corrected as an out-of-period item in AIG's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 (Second Quarter Form 10-Q).

**2. Restatements of Previously Issued  
Financial Statements**

The following provides a description of the accounting adjustments included in the Restatements of AIG's consolidated financial statements and the effect of the adjustments on AIG's Consolidated Balance Sheet at March 31, 2005 and December 31, 2004 and its Consolidated Statement of Income for the three month periods ended March 31, 2005 and 2004 and Consolidated Statement of Cash Flows for the quarters ended March 31, 2005 and 2004. All prior period amounts included in this report affected by the Restatements are presented on a restated basis.

***(a) First Restatement***

In connection with the preparation of AIG's consolidated financial statements included in AIG's 2004 Annual Report on Form 10-K, AIG's management initiated an internal review of its books and records, which was substantially expanded in mid-March 2005 with the oversight of the Audit Committee of the Board of Directors of AIG. The review spanned AIG's major business units globally, and included a number of transactions from 2000 to 2004. As disclosed in the 2004 Annual Report on Form 10-K, as a result of the findings of the internal review, together with the results of investigations by outside counsel at the request of AIG's Audit Committee and in consultation with PricewaterhouseCoopers LLP, AIG's independent registered public accounting firm, AIG restated its consolidated financial statements and financial statement schedules for the years ended December 31, 2003, 2002, 2001 and 2000, the quarters ended March 31, June 30 and September 30, 2004 and 2003 and the quarter ended December 31, 2003 (the First Restatement).

AIG disclosed in its 2004 Annual Report on Form 10-K that it had identified a number of material weaknesses in internal control over financial reporting, including controls over certain balance sheet reconciliations, controls over the accounting for certain derivative transactions and controls over income tax accounting. AIG has been and continues to be actively engaged in the implementation of remediation efforts to address all of these material weaknesses in internal control over financial reporting.



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See Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 2 of Notes to Consolidated Financial Statements in the 2004 Annual Report on Form 10-K for a discussion of the First Restatement and a reconciliation of previously reported amounts to the restated amounts for the years ended December 31, 2003, 2002, 2001 and 2000, and see below for reconciliation of such amounts for the quarter ended March 31, 2004.

### ***(b) Second Restatement***

As announced on November 9, 2005, AIG identified certain additional errors, the preponderance of which were identified during the remediation of the material weaknesses in internal control over financial reporting, principally relating to internal controls surrounding accounting for derivatives and related assets and liabilities under FAS 133, reconciliation of certain balance sheet accounts and income tax accounting.

AIG also announced it was correcting errors that were identified since the First Restatement, including those relating to the accounting for certain payments received from aircraft

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American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued****Financial Statements** *(continued)*

and engine manufacturers by ILFC, which were originally corrected in AIG's Second Quarter Form 10-Q. The adjustments to correct the foregoing errors are referred to in this First Quarter Form 10-Q/A as the Initial Adjustments.

In connection with the remediation of material weaknesses in internal control over financial reporting referred to above, AIG identified certain additional errors, principally relating to internal controls over reconciliation of certain balance sheet accounts in DBG. As a result, AIG included further adjustments (the Additional Adjustments) in its restatement of the consolidated financial statements and financial statement schedules for the years ended December 31, 2004, 2003 and 2002, along with 2001 and 2000 for purposes of preparation of the Selected Consolidated Financial Data for 2001 and 2000, and quarterly financial information for 2004 and 2003 and is restating the first three quarters of 2005. The Initial Adjustments and the Additional Adjustments are referred to herein as the Second Restatement. AIG's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 will not be amended because the Additional Adjustments to the financial statements included therein are not material to those financial statements.

**Details of the Initial Adjustments in the Second Restatement.** The accounting adjustments relate primarily to the categories described below.

**Accounting for Derivatives (FAS 133 Hedge Accounting).** During the third quarter of 2005, AIG identified and corrected additional errors identified during the remediation of the previously disclosed material weakness in internal controls surrounding accounting for derivatives and related assets and liabilities under FAS 133.

Included in the Initial Adjustments to correct AIG's accounting for derivatives are adjustments correcting the errors in accounting for certain secured financings where AIGFP had sold an available-for-sale security and concurrently entered into a total return swap with a repurchase obligation. The Initial Adjustments for these errors increased both securities available for sale, at market value, and securities sold under agreements to repurchase, by approximately \$2 billion as of December 31, 2004.

The Initial Adjustments to reflect appropriate GAAP accounting for these derivatives and related assets and liabilities, including related currency translation gains and losses, increased net income by approximately \$70 million and decreased net income by approximately \$28 million for the quarters ended March 31, 2005 and 2004, respectively, and increased total shareholders' equity by approximately \$367 million as of December 31, 2004.

**Asset Realization - Domestic Brokerage Group (DBG) Issues.** During the third quarter of 2005, AIG concluded that additional adjustments should be made to the value of certain DBG reserves and allowances for doubtful accounts for time periods prior to January 1, 2003, resulting in an after-tax reduction in total shareholders' equity at December 31, 2004 of approximately \$205 million. The adjustments had no effect on net income for the quarters ended March 31, 2005 and 2004.

**Income Tax Accounting.** During the third quarter of 2005, AIG identified and corrected additional errors in its income tax accounting. The most significant adjustment resulted from AIG incorrectly recording the income tax benefit resulting from employee exercises of stock options as a reduction in income tax expense rather than as an increase in additional paid-in capital as required by GAAP. This adjustment has no effect on total shareholders' equity. The effect of the income tax adjustments was to increase total tax expense by approximately \$36 million and \$5 million for the quarters ended March 31, 2005 and 2004, respectively, and to increase total shareholders' equity as of December 31, 2004 by approximately \$131 million.

**Manufacturers - Payments Received by ILFC.** In the course of the ILFC review of its application of FAS 133 in connection with AIG's internal review, ILFC, in consultation with its independent registered public accounting firm, identified an error in its accounting for certain payments received from aircraft and engine manufacturers. Under arrangements with these manufacturers, in certain circumstances, the manufacturers established notional accounts for the benefit of ILFC to which amounts were credited by the manufacturers in connection with the purchase by and delivery to ILFC and the lease of aircraft. Amounts credited to the notional accounts were used at ILFC's direction to protect ILFC from certain events, including loss when airline customers of ILFC defaulted on lease payment obligations, to provide lease subsidies and other incentives to ILFC's airline customers in connection with leases of certain aircraft, and to reduce ILFC's cost of aircraft purchased.

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Historically, ILFC recorded as revenues gross lease receipts from lessees who had received lease subsidies from the notional accounts and amounts paid directly to ILFC from the notional accounts in connection with lessee defaults. Amounts recorded as revenue at the time they were disbursed to ILFC or its lessees should have been recorded as a reduction of the purchase price of the aircraft at the time of delivery.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued Financial Statements** *(continued)*

Although ILFC restated its financial statements for the years 2000 through 2004 and for the quarter ended March 31, 2005 to correct its accounting for the payments from aircraft and engine manufacturers described above, AIG had previously considered these adjustments not to be sufficiently material to require correction by restatement in AIG's consolidated financial statements. The effect of the adjustments included in the Second Restatement relating to the manufacturers' payments was to decrease other revenues and net income by approximately \$31 million and \$12 million and \$18 million and \$4 million, respectively, for the quarters ended March 31, 2005 and 2004. Additionally, total shareholders' equity was reduced by approximately \$320 million as of December 31, 2004.

**Details of Additional Adjustments in the Second Restatement.** The accounting adjustments relate primarily to the categories described below.

**Asset Realization and Revenue Recognition - Domestic Brokerage Group (DBG) Issues.** During the remediation of material weaknesses in internal controls, AIG concluded that additional adjustments should be made to the value of certain DBG reserves and allowances for doubtful accounts, and revisions were necessary to the revenues previously recognized for certain long-tail environmental policies. The Additional Adjustments to reflect the asset realization and revenue recognition revisions had the following effects on consolidated net income and total shareholders' equity:

Increase (Decrease) For the Three Months Ended March 31, <i>(in millions)</i>	2005	2004
<b>Consolidated Statement of Income:</b>		
Net income	\$ (1)	\$
<b>Increase (Decrease) at March 31, 2005 and at December 31, 2004, <i>(in millions)</i></b>		
<b>Consolidated Balance Sheet:</b>		
Total shareholders' equity	(536)	(534)

**Accounting for Derivatives and Related Assets and Liabilities (FAS 133 Hedge Accounting).** During the fourth quarter of 2005, AIG identified and corrected additional errors identified during the remediation of the previously disclosed material weaknesses in internal controls surrounding accounting for derivatives and related assets and liabilities under FAS 133. The Additional Adjustments to reflect appropriate GAAP accounting for these derivatives which also included related currency translation gains and losses, had the following effects on certain of AIG's consolidated statement of income and balance sheet accounts:

Increase (Decrease) For the Three Months Ended March 31, <i>(in millions)</i>	2005	2004
<b>Consolidated Statement of Income:</b>		
Other revenues	\$ 79	\$ (26)
Net income	11	(14)
<b>Increase (Decrease) at March 31, 2005 and at December 31, 2004, <i>(in millions)</i></b>		
	2005	2004

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Consolidated Balance Sheet:		
Total shareholders' equity	(17)	(65)

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**Income Tax Accounting.** During the fourth quarter of 2005, AIG identified and corrected additional errors in its income tax accounting. The income tax adjustments had the following effects on certain of AIG's consolidated statement of income and balance sheet accounts:

Increase (Decrease) For the Three Months Ended March 31, (in millions)	2005	2004
<hr/>		
Consolidated Statement of Income:		
Income tax expense	\$ (24)	\$ 13
Net income	24	(13)

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Increase (Decrease) at March 31, 2005 and at December 31, 2004, (in millions)	2005	2004
<hr/>		
Consolidated Balance Sheet:		
Total shareholders' equity	(29)	(98)

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**Statement of Cash Flows Classification of Certain Trading Securities.** AIG identified and corrected the classification of certain trading securities activity from investing activities to operating activities.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued****Financial Statements** *(continued)*

The following tables present the previously reported and the restated Consolidated Balance Sheet, Consolidated Statement of Income, and Condensed Consolidated Statement of Cash Flows:

**CONSOLIDATED BALANCE SHEET**

	March 31, 2005		December 31, 2004
	As Previously Reported	As Restated	
<i>(in millions) (unaudited)</i>			
<b>Assets:</b>			
Investments and financial services assets:			
Fixed maturities:			
Bonds available for sale, at market value	\$ 350,400	\$ 350,400	\$ 344,399
Bonds held to maturity, at amortized cost	21,477	21,477	18,294
Bond trading securities, at market value	3,580	3,580	2,984
Equity securities:			
Common stocks available for sale, at market value	10,896	10,751	9,772
Common stocks trading, at market value	6,379	6,379	5,894
Preferred stocks, at market value	2,280	2,280	2,040
Mortgage loans on real estate, net of allowance	14,065	14,065	13,146
Policy loans	7,109	7,109	7,035
Collateral and guaranteed loans, net of allowance	2,261	3,309	3,303
Financial services assets:			
Flight equipment primarily under operating leases, net of accumulated depreciation	34,550	33,896	32,130
Securities available for sale, at market value	29,332	29,660	31,225
Trading securities, at market value	3,485	3,091	2,746
Spot commodities	98	654	534
Unrealized gain on swaps, options and forward transactions	20,149	20,149	22,670
Trading assets	1,372	1,507	3,433
Securities purchased under agreements to resell, at contract value	32,593	32,593	26,272
Finance receivables, net of allowance	24,929	24,929	23,574
Securities lending collateral, at market value (which approximates cost)	52,693	51,890	49,169
Other invested assets	24,532	25,608	23,559
Short-term investments, at cost	22,017	22,017	16,102
<b>Total investments and financial services assets</b>	<b>664,197</b>	<b>665,344</b>	<b>638,281</b>
Cash	2,361	2,361	2,009
Investment income due and accrued	5,653	5,609	5,556
Premiums and insurance balances receivable, net of allowance	15,724	16,222	15,622
Reinsurance assets, net of allowance	19,719	19,372	19,613
Deferred policy acquisition costs	31,536	31,625	29,817
Investments in partially owned companies	1,469	1,544	1,495
Real estate and other fixed assets, net of accumulated depreciation	6,190	6,190	6,192
Separate and variable accounts	57,417	57,417	57,741
Goodwill	8,577	8,532	8,556
Income taxes receivable - current			138
Other assets	15,413	16,261	16,125
<b>Total assets</b>	<b>\$ 828,256</b>	<b>\$ 830,477</b>	<b>\$ 801,145</b>



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued  
Financial Statements** *(continued)*  
**CONSOLIDATED BALANCE SHEET** *(continued)*

<i>(in millions) (unaudited)</i>	March 31, 2005		December 31, 2004
	As Previously Reported	As Restated	
<b>Liabilities:</b>			
Reserve for losses and loss expenses	\$ 64,061	\$ 63,570	\$ 61,878
Reserve for unearned premiums	23,764	24,088	23,400
Future policy benefits for life and accident and health insurance contracts	108,182	108,186	104,740
Policyholders' contract deposits	225,860	225,690	216,474
Other policyholders' funds	10,212	10,212	10,280
Reserve for commissions, expenses and taxes	4,783	4,772	4,629
Insurance balances payable	4,307	4,269	3,661
Funds held by companies under reinsurance treaties	3,137	3,137	3,404
Income taxes payable:			
Current	667	585	
Deferred	6,622	6,118	6,588
Financial services liabilities:			
Borrowings under obligations of guaranteed investment agreements	22,691	22,691	18,919
Securities sold under agreements to repurchase, at contract value	19,463	21,642	23,581
Trading liabilities	1,283	1,482	2,503
Securities and spot commodities sold but not yet purchased, at market value	4,881	5,586	5,404
Unrealized loss on swaps, options and forward transactions	14,751	12,866	15,985
Trust deposits and deposits due to banks and other depositors	4,612	4,612	4,248
Commercial paper	8,477	8,477	6,724
Notes, bonds, loans and mortgages payable	63,082	64,327	61,296
Commercial paper	3,479	3,479	2,969
Notes, bonds, loans and mortgages payable	5,557	5,558	5,502
Liabilities connected to trust preferred stock	1,489	1,489	1,489
Separate and variable accounts	57,417	57,417	57,741
Minority interest	4,960	5,208	4,831
Securities lending payable	52,693	52,693	49,972
Other liabilities	28,945	30,517	25,055
<b>Total liabilities</b>	<b>745,375</b>	<b>748,671</b>	<b>721,273</b>
<b>Preferred shareholders' equity in subsidiary companies</b>	<b>198</b>	<b>198</b>	<b>199</b>
<b>Shareholders' equity:</b>			
Common stock	6,878	6,878	6,878
Additional paid-in capital	1,991	2,104	2,094
Retained earnings	67,752	66,813	63,468
Accumulated other comprehensive income (loss)	8,374	8,125	9,444
Treasury stock, at cost	(2,312)	(2,312)	(2,211)
<b>Total shareholders' equity</b>	<b>82,683</b>	<b>81,608</b>	<b>79,673</b>
<b>Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity</b>	<b>\$ 828,256</b>	<b>\$ 830,477</b>	<b>\$ 801,145</b>





**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued  
Financial Statements** *(continued)*  
**CONSOLIDATED STATEMENT OF INCOME**

	For the Three Months Ended March 31, 2005		For the Three Months Ended March 31, 2004
	As Previously Reported	As Restated	
<i>(in millions, except per share data) (unaudited)</i>			
<b>Revenues:</b>			
Premiums and other considerations	\$ 17,682	\$ 17,680	\$ 15,979
Net investment income	5,292	5,332	4,600
Realized capital gains (losses)	88	137	(86)
Other revenues	4,050	4,053	2,729
<b>Total revenues</b>	<b>27,112</b>	<b>27,202</b>	<b>23,222</b>
<b>Benefits and expenses:</b>			
Incurred policy losses and benefits	14,865	14,873	13,590
Insurance acquisition and other operating expenses	6,804	6,680	5,790
<b>Total benefits and expenses</b>	<b>21,669</b>	<b>21,553</b>	<b>19,380</b>
<b>Income before income taxes, minority interest and cumulative effect of an accounting change</b>	<b>5,443</b>	<b>5,649</b>	<b>3,842</b>
<b>Income taxes (benefits):</b>			
Current	987	968	1,345
Deferred	626	738	(215)
	1,613	1,706	1,130
<b>Income before minority interest and cumulative effect of an accounting change</b>	<b>3,830</b>	<b>3,943</b>	<b>2,712</b>
<b>Minority interest</b>	<b>(146)</b>	<b>(144)</b>	<b>(70)</b>
<b>Income before cumulative effect of an accounting change</b>	<b>3,684</b>	<b>3,799</b>	<b>2,642</b>
<b>Cumulative effect of an accounting change, net of tax</b>			<b>(144)</b>
<b>Net income</b>	<b>\$ 3,684</b>	<b>\$ 3,799</b>	<b>\$ 2,498</b>
<b>Earnings per common share:</b>			
Basic			
Income before cumulative effect of an accounting change	\$ 1.42	\$ 1.46	\$ 1.01
Cumulative effect of an accounting change, net of tax			(0.06)

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Net income	\$	1.42	\$	1.46	\$	0.95
<b>Diluted</b>						
Income before cumulative effect of an accounting change	\$	1.40	\$	1.45	\$	1.00
Cumulative effect of an accounting change, net of tax						(0.06)
Net income	\$	1.40	\$	1.45	\$	0.94
<b>Dividends declared per common share</b>						
	\$	0.175	\$	0.175	\$	0.065
<b>Average shares outstanding:</b>						
Basic		2,597		2,597		2,610
Diluted		2,624		2,624		2,642

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued  
Financial Statements** *(continued)***CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**

	<b>Three Months Ended March 31, 2005</b>		
	As Previously Reported	As Restated	Three Months Ended March 31, 2004
<i>(in millions) (unaudited)</i>			
<b>Net cash provided by (used in) operating activities</b>	<b>\$ 654</b>	<b>\$ (434)</b>	<b>\$ 8,006</b>
<b>Net cash used in investing activities</b>	<b>(18,801)</b>	<b>(20,118)</b>	<b>(29,658)</b>
<b>Net cash provided by financing activities</b>	<b>18,620</b>	<b>20,961</b>	<b>22,348</b>
<b>Effect of exchange rate changes on cash</b>	<b>(121)</b>	<b>(57)</b>	<b>302</b>
<b>Change in cash</b>	<b>352</b>	<b>352</b>	<b>998</b>
<b>Cash at beginning of period</b>	<b>2,009</b>	<b>2,009</b>	<b>922</b>
<b>Cash at end of period</b>	<b>\$ 2,361</b>	<b>\$ 2,361</b>	<b>\$ 1,920</b>

The following two tables reflect the effect of the aforementioned adjustments on each component of revenue:

<b>For the Three Months Ended March 31, 2005 and <i>(in millions) (unaudited)</i></b>	<b>Other Considerations</b>	<b>Net Investment Income</b>	<b>Realized Capital Gains (Losses)</b>	<b>Other Revenues</b>	<b>Total Revenues</b>
As Previously Reported	<b>\$ 17,682</b>	<b>\$ 5,292</b>	<b>\$ 88</b>	<b>\$ 4,050</b>	<b>\$ 27,112</b>
Initial Adjustments in the Second Restatement:					
Accounting for Derivatives (FAS 133 Hedge Accounting)		<b>4</b>	<b>103</b>	<b>(48)</b>	<b>59</b>
Manufacturers Payments Received by ILFC				<b>(31)</b>	<b>(31)</b>
All Other Adjustments Net		<b>53</b>		<b>3</b>	<b>56</b>
Total Initial Adjustments in the Second Restatement		<b>57</b>	<b>103</b>	<b>(76)</b>	<b>84</b>
Revenues, as Restated for the Initial Adjustments	<b>17,682</b>	<b>5,349</b>	<b>191</b>	<b>3,974</b>	<b>27,196</b>

Additional Adjustments in the  
Second Restatement:

Asset Realization:							
Domestic Brokerage Group							
(DBG) Issues							
		(1)		2			1
All Other Adjustments	Net	(1)	(19)	(54)	79		5
Total Additional Adjustments in the Second Restatement							
		(2)	(17)	(54)	79		6
Revenues, as Restated in the Second Restatement							
		\$	17,680	\$	5,332	\$	137
				\$	4,053	\$	27,202

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued Financial Statements** (continued)

For the Three Months Ended March 31, 2004 (in millions) (unaudited)	Premiums and Other Considerations	Net Investment Income	Realized Capital Gains (Losses)	Other Revenues	Total Revenues
As Previously Reported	\$ 16,139	\$ 4,720	\$ 83	\$ 2,695	\$ 23,637
Adjustments in the First Restatement:					
Risk Transfer:					
Union Excess	97	65	(12)		150
Other Risk Transfer	(49)	(2)			(51)
Net Investment Income:					
Covered Calls		10	18		28
Synthetic Fuel Investment		(61)		(54)	(115)
Hedge Fund Accounting		13		(17)	(4)
Muni Tender Option Bond Program		21	8		29
DBG/AIG Capital Corporation Intercompany Dividend		(25)			(25)
Top Level Adjustments and Other Directed Entries (other than loss reserves)	44	(99)	22	12	(21)
Conversion of Underwriting Losses to Capital Losses			73		73
Asset Realization:					
Other Than Temporary Declines			40		40
Other GAAP Corrections:					
Accounting for Derivatives (FAS 133 Hedge Accounting)			(81)	(80)	(161)
Foreign Currency Translation (FAS 52)			(74)		(74)
Life Settlements	(196)	(39)			(235)
Commutations	(40)				(40)
Dollar Roll Transactions			38		38
All Other Adjustments Net	(13)	(28)		147	106
<b>Total Adjustments in the First Restatement</b>	<b>(157)</b>	<b>(145)</b>	<b>32</b>	<b>8</b>	<b>(262)</b>
As Adjusted in the First Restatement	15,982	4,575	115	2,703	23,375
Initial Adjustments in the Second Restatement:					
Accounting for Derivatives (FAS 133 Hedge Accounting)			(195)	53	(142)
Manufacturers Payments Received by ILFC				(18)	(18)
All Other Adjustments Net	2	(2)		3	3
<b>Total Initial Adjustments in the Second Restatement</b>	<b>2</b>	<b>(2)</b>	<b>(195)</b>	<b>38</b>	<b>(157)</b>
Revenues, as Restated for the Initial Adjustments	15,984	4,573	(80)	2,741	23,218
Additional Adjustments in the Second Restatement:					
Asset Realization:					
Domestic Brokerage Group (DBG) Issues	(7)	26			19
All Other Adjustments Net	2	1	(6)	(12)	(15)
<b>Total Additional Adjustments in the Second Restatement</b>	<b>(5)</b>	<b>27</b>	<b>(6)</b>	<b>(12)</b>	<b>4</b>
Revenues, as Restated in the Second Restatement	\$ 15,979	\$ 4,600	\$ (86)	\$ 2,729	\$ 23,222



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued****Financial Statements** *(continued)*

The following two tables reflect the effect of the aforementioned adjustments on each component of Benefits and Expenses:

For the Three Months Ended March 31, 2005 <i>(in millions) (unaudited)</i>	Incurred Policy Losses and Benefits	Insurance Acquisition and Other Operating Expenses	Total Benefits and Expenses
As Previously Reported	\$ 14,865	\$ 6,804	\$ 21,669
Initial Adjustments in the Second Restatement:			
Accounting for Derivatives (FAS 133 Hedge Accounting)		(65)	(65)
Manufacturers Payments Received by ILFC		(12)	(12)
All Other Adjustments Net	3	(49)	(46)
<b>Total Initial Adjustments in the Second Restatement</b>	<b>3</b>	<b>(126)</b>	<b>(123)</b>
<b>Benefits and Expenses, as Restated for the Initial Adjustments</b>	<b>14,868</b>	<b>6,678</b>	<b>21,546</b>
Additional Adjustments in the Second Restatement:			
Asset Realization:			
Domestic Brokerage Group (DBG) Issues	1	1	2
All Other Adjustments Net	4	1	5
<b>Total Additional Adjustments in the Second Restatement</b>	<b>5</b>	<b>2</b>	<b>7</b>
<b>Benefits and Expenses, as Restated in the Second Restatement</b>	<b>\$ 14,873</b>	<b>\$ 6,680</b>	<b>\$ 21,553</b>

For the Three Months Ended March 31, 2004 <i>(in millions) (unaudited)</i>	Incurred Policy Losses and Benefits	Insurance Acquisition and Other Operating Expenses	Total Benefits and Expenses
As Previously Reported	\$ 13,734	\$ 5,612	\$ 19,346
Adjustments in the First Restatement:			
Risk Transfer:			
Union Excess	168	12	180
Other Risk Transfer	(47)	(16)	(63)
Loss Reserves	60		60
Net Investment Income:			
DBG/AIG Capital Corporation Intercompany Dividend		(25)	(25)
Top Level Adjustments and Other Directed Entries (other than loss reserves)	25	(68)	(43)
Conversion of Underwriting Losses to Capital Losses		(1)	(1)
Asset Realization:			
Domestic Brokerage Group (DBG) Issues		47	47
Other GAAP Corrections:			
Accounting for Derivatives (FAS 133 Hedge Accounting)		(20)	(20)
Foreign Currency Translation (FAS 52)		2	2
Life Settlements	(180)		(180)
Deferred Acquisition Costs (DAC)	(74)	105	31
SICO Deferred Compensation		14	14
Commutations	(40)		(40)
All Other Adjustments Net	(49)	177	128



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Total Adjustments in the First Restatement	(137)	227	90
As Adjusted in the First Restatement	13,597	5,839	19,436
Initial Adjustments in the Second Restatement:			
Accounting for Derivatives (FAS 133 Hedge Accounting)		(66)	(66)
Manufacturers Payments Received by ILFC		(11)	(11)
All Other Adjustments Net	2	1	3
Total Initial Adjustments in the Second Restatement	2	(76)	(74)
Benefits and Expenses, as Restated for the Initial Adjustments	13,599	5,763	19,362
Additional Adjustments in the Second Restatement:			
Asset Realization:			
Domestic Brokerage Group (DBG) Issues	(7)	26	19
All Other Adjustments Net	(2)	1	(1)
Total Additional Adjustments in the Second Restatement	(9)	27	18
Benefits and Expenses, as Restated in the Second Restatement	\$ 13,590	\$ 5,790	\$ 19,380

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**2. Restatement of Previously Issued****Financial Statements** *(continued)*

The following table reflects the effect of the aforementioned adjustments on income taxes:

<b>For the Three Months Ended March 31,</b> <i>(in millions) (unaudited)</i>	<b>2005</b>	<b>2004</b>
Income Taxes, as Previously Reported	<b>\$ 1,613</b>	\$ 1,356
Adjustments in the First Restatement:		
Risk Transfer:		
Union Excess		(11)
Other Risk Transfer		2
Loss Reserves		(21)
Net Investment Income:		
Covered Calls		10
Synthetic Fuel Investment		(115)
Top Level Adjustments and Other Directed Entries (other than loss reserves)		8
Asset Realization:		
Domestic Brokerage Group (DBG) Issues		5
Other Than Temporary Declines		14
Other GAAP Corrections:		
Accounting for Derivatives (FAS 133 Hedge Accounting)		(49)
Accounting for Deferred Taxes		(4)
Foreign Currency Translation (FAS 52)		(26)
Life Settlements		(20)
Deferred Acquisition Costs (DAC)		(9)
All Other Adjustments Net		29
<b>Total Adjustments in the First Restatement</b>		<b>(187)</b>
Income Taxes, as Adjusted in the First Restatement	<b>1,613</b>	1,169
Initial Adjustments in the Second Restatement:		
Income Tax Accounting	<b>36</b>	5
All Other Adjustments Net	<b>65</b>	(51)
<b>Total Initial Adjustments in the Second Restatement</b>	<b>101</b>	<b>(46)</b>
Income Taxes, as Restated for the Initial Adjustments	<b>1,714</b>	1,123
Additional Adjustments in the Second Restatement	<b>(8)</b>	7
Income Taxes, as Restated in the Second Restatement	<b>\$ 1,706</b>	\$ 1,130

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American International Group, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)**3. Segment Information**

The following table summarizes the operations by major operating segment for the three months ended March 31, 2005 and 2004:

Operating Segments (in millions) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Revenues<sup>(a)</sup>:</b>		
General Insurance <sup>(b)</sup>	\$ 11,219	\$ 10,097
Life Insurance & Retirement Services <sup>(c)</sup>	11,775	10,485
Financial Services <sup>(d)</sup>	2,436	1,814
Asset Management <sup>(e)</sup>	1,377	1,050
Other	395	(224)
<b>Consolidated</b>	<b>\$ 27,202</b>	<b>\$ 23,222</b>
<b>Operating income<sup>(a)(f)</sup>:</b>		
General Insurance	\$ 1,642	\$ 1,442
Life Insurance & Retirement Services	2,181	1,749
Financial Services	1,045	584
Asset Management	590	436
Other <sup>(g)</sup>	191	(369)
<b>Consolidated</b>	<b>\$ 5,649</b>	<b>\$ 3,842</b>

(a) Revenues and operating income reflect changes in market or estimated fair value associated with hedging activities that do not qualify for hedge accounting pursuant to FAS 133.

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

(c) Represents the sum of Life Insurance & Retirement Services GAAP premiums, net investment income and realized capital gains (losses).

(d) Represents interest, lease and finance charges.

(e) Represents management and advisory fees and net investment income with respect to GICs.

(f) Represents income before income taxes, minority interest and cumulative effect of an accounting change.

(g) Represents other income (deductions) net and other realized capital gains (losses).

The following table summarizes AIG's General Insurance operations by major internal reporting unit for the three months ended March 31, 2005 and 2004:

General Insurance (in millions) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Revenues:</b>		
Domestic Brokerage Group	\$ 6,289	\$ 5,531
Transatlantic	982	973
Personal Lines	1,171	1,088
Mortgage Guaranty	169	162
Foreign General	2,602	2,337
Reclassifications and Eliminations	6	6
<b>Total General Insurance</b>	<b>\$ 11,219</b>	<b>\$ 10,097</b>

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<b>Operating Income:</b>			
Domestic Brokerage Group	\$	713*	\$ 556
Transatlantic		114	117
Personal Lines		109	96
Mortgage Guaranty		104	96
Foreign General		596	571
Reclassifications and Eliminations		6	6
<hr/>			
Total General Insurance	\$	1,642	\$ 1,442

\* Includes \$118 million of additional losses incurred resulting from increased labor and material costs related to the 2004 Florida hurricanes. The following table summarizes AIG's Life Insurance & Retirement Services operations by major internal reporting unit for the three months ended March 31, 2005 and 2004:

<b>Life Insurance &amp; Retirement Services</b> <i>(in millions) (unaudited)</i>	<b>2005</b> <b>(Restated)</b>	<b>2004</b> <b>(Restated)</b>
<b>Revenues<sup>(a)</sup>:</b>		
<b>Foreign:</b>		
AIA, AIRCO and Nan Shan <sup>(b)</sup>	\$ 4,066	\$ 3,775
ALICO, AIG Star Life and AIG Edison Life <sup>(c)</sup>	3,519	2,765
Philamlife and Other	130	117
<b>Domestic:</b>		
AGLA and AG Life <sup>(d)</sup>	2,388	2,122
VALIC, AIG Annuity and AIG SunAmerica <sup>(e)</sup>	1,672	1,706
<hr/>		
Total Life Insurance & Retirement Services	\$ 11,775	\$ 10,485
<hr/>		
<b>Operating Income:</b>		
<b>Foreign:</b>		
AIA, AIRCO and Nan Shan <sup>(b)</sup>	\$ 588	\$ 527
ALICO, AIG Star Life and AIG Edison Life <sup>(c)</sup>	596	280
Philamlife and Other	16	28
<b>Domestic:</b>		
AGLA and AG Life <sup>(d)</sup>	466	283
VALIC, AIG Annuity and AIG SunAmerica <sup>(e)</sup>	515	631
<hr/>		
Total Life Insurance & Retirement Services	\$ 2,181	\$ 1,749

- (a) Represents the sum of Life Insurance & Retirement Services GAAP premiums, net investment income and realized capital gains (losses).  
 (b) Represents the operations of American International Assurance Company, Limited together with American International Assurance Company (Bermuda) Limited (AIA), American International Reinsurance Company, Ltd. (AIRCO), and Nan Shan Life Insurance Company, Ltd. (Nan Shan).  
 (c) Represents the operations of American Life Insurance Company (ALICO), AIG Star Life Insurance Co., Ltd. (AIG Star Life), and AIG Edison Life Insurance Company (AIG Edison Life).  
 (d) AG Life includes the life operations of AIG Life Insurance Company and American International Life Assurance Company of New York. Also includes the operations of American General Life and Accident Insurance Company (AGLA).  
 (e) AIG SunAmerica represents the annuity operations of AIG SunAmerica Life Assurance Company, as well as those of First SunAmerica Life Insurance Company and SunAmerica Life Insurance Company. Also includes the operations of The Variable Annuity Life Insurance Company (VALIC) and AIG Annuity Insurance Company (AIG Annuity).

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

American International Group, Inc. and Subsidiaries

**3. Segment Information** (continued)

The following table summarizes AIG's Financial Services operations by major internal reporting unit for the three months ended March 31, 2005 and 2004:

Financial Services (in millions) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Revenues<sup>(a)</sup>:</b>		
Aircraft Finance <sup>(b)</sup>	\$ 827	\$ 734
Capital Markets <sup>(c)(d)</sup>	756	361
Consumer Finance <sup>(e)</sup>	833	693
Other	20	26
<b>Total Financial Services</b>	<b>\$ 2,436</b>	<b>\$ 1,814</b>
<b>Operating income<sup>(a)</sup>:</b>		
Aircraft Finance	\$ 187	\$ 172
Capital Markets <sup>(d)</sup>	620	214
Consumer Finance	231	183
Other	7	15
<b>Total Financial Services</b>	<b>\$ 1,045</b>	<b>\$ 584</b>

(a) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the first three months of 2005 and 2004, the effect was \$15 million and \$20 million, respectively, in operating income for Aircraft Finance and \$468 million and \$83 million in both revenues and operating income for Capital Markets.

(b) Revenues were primarily from ILFC aircraft lease rentals.

(c) Revenues, shown net of interest expense, are primarily from hedging activities that do not qualify for hedge accounting treatment under FAS 133 described in (a) above.

(d) Certain transactions entered into by AIGFP generate tax credits and benefits which are shown in the income tax line on the consolidated statement of income. The amount of tax credits and benefits for the first three months of March 31, 2005 and 2004 are \$19 million, and \$35 million, respectively.

(e) Revenues were primarily finance charges.

The following table summarizes AIG's Asset Management revenues and operating income for the three months ended March 31, 2005 and 2004:

Asset Management (in millions) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Revenues:</b>		
Guaranteed investment contracts	\$ 896	\$ 737
Institutional Asset Management	319	187
Brokerage Services and Mutual Funds	63	61
Other	99	65
<b>Total Asset Management</b>	<b>\$ 1,377</b>	<b>\$ 1,050</b>
<b>Operating income:</b>		
Guaranteed investment contracts <sup>(a)</sup>	\$ 319	\$ 295
Institutional Asset Management <sup>(b)</sup>	161	59
Brokerage Services and Mutual Funds	13	20

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Other		97		62
Total Asset Management	\$	590	\$	436

- (a) The effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 was \$62 million and \$64 million for the first quarter of 2005 and 2004, respectively.
- (b) Includes the results of certain AIG managed private equity and real estate funds that are consolidated effective December 31, 2003 pursuant to FIN46R, Consolidation of Variable Interest Entities . For the first three months of 2005 and 2004, operating income includes \$75 million and \$4 million, respectively, of third-party limited partner earnings offset in Minority interest expense.

#### 4. Earnings Per Share

Earnings per share of AIG are based on the weighted average number of common shares outstanding during the period.

##### Computation of Earnings Per Share:

Three Months Ended March 31, (in millions, except per share data) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Numerator for basic earnings per share:</b>		
Income before cumulative effect of an accounting change	\$ 3,799	\$ 2,642
Cumulative effect of an accounting change, net of tax		(144)
Net income applicable to common stock	\$ 3,799	\$ 2,498
<b>Denominator for basic earnings per share:</b>		
Average shares outstanding used in the computation of per share earnings:		
Common stock issued	2,752	2,752
Common stock in treasury	(155)	(142)
Average shares outstanding basic	2,597	2,610

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

American International Group, Inc. and Subsidiaries

**4. Earnings Per Share** (continued)

Three Months Ended March 31, (in millions, except per share data) (unaudited)	2005 (Restated)	2004 (Restated)
<b>Numerator for diluted earnings per share:</b>		
Income before cumulative effect of an accounting change	\$ 3,799	\$ 2,642
Cumulative effect of an accounting change, net of tax		(144)
Net income applicable to common stock	3,799	2,498
Interest on contingently convertible bonds, net of tax <sup>(a)</sup>	3	3
Adjusted net income applicable to common stock <sup>(a)</sup>	\$ 3,802	\$ 2,501
<b>Denominator for diluted earnings per share:</b>		
Average shares outstanding	2,597	2,610
Incremental shares from potential common stock:		
Average number of shares arising from outstanding employee stock plans (treasury stock method) <sup>(b)</sup>	18	23
Contingently convertible bonds <sup>(a)</sup>	9	9
Adjusted average shares outstanding diluted <sup>(d)</sup>	2,624	2,642
<b>Earnings per share:</b>		
Basic:		
Income before cumulative effect of an accounting change	\$ 1.46	\$ 1.01
Cumulative effect of an accounting change, net of tax		(0.06)
Net income	\$ 1.46	\$ 0.95
Diluted:		
Income before cumulative effect of an accounting change	\$ 1.45	\$ 1.00
Cumulative effect of an accounting change, net of tax		(0.06)
Net income	\$ 1.45	\$ 0.94

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

(b) Certain shares arising from employee stock plans were not included in the computation of diluted earnings per share where the exercise price of the options exceeded the average market price and would have been antidilutive. The number of shares excluded were 22 million and 8 million for the first three months of 2005 and 2004, respectively.

Pursuant to Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment to FASB Statement No. 123 (FAS 148), AIG adopted the Prospective Method of accounting for stock-based employee compensation effective January 1, 2003. FAS 148 also requires that AIG disclose the effect of stock-based compensation expense that would have been recognized if the fair value based method had been applied to all the awards vesting in the current period.

The effect with respect to stock-based compensation expense that would have been recognized if the fair value based method had been applied to all the awards vesting in both the first three months of 2005 and 2004 was less than \$0.005 per share.

The quarterly dividend rate per common share, commencing with the dividend paid March 18, 2005 is \$0.125.

## **5. Benefits Provided by Starr International Company, Inc.**

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

Participation in the SICO Plans by any person, and the amount of such participation, has been at the sole discretion of SICO's Board of Directors. 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 entry to additional paid-in capital reflecting amounts deemed contributed by SICO. The SICO Plans provide that shares currently owned by SICO may be 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. In addition, SICO's Board of Directors currently may elect to pay a participant cash in lieu of shares of AIG common stock. See also Note 7(f) herein.

SICO has also provided certain personal benefits to AIG employees. The cost of such benefits, primarily attributable to personal use of corporate aircraft, has not been included in compensation expense.

Compensation expense with respect to the SICO Plans aggregated \$7 million and \$14 million for the first three months of 2005 and 2004, respectively.



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

American International Group, Inc. and Subsidiaries

**6. Ownership and Transactions With Related Parties**

*(a) Ownership:* The directors and officers of AIG, together with C.V. Starr & Co., Inc. (Starr), a private holding company, The Starr Foundation, and SICO, a private holding company, owned or otherwise controlled approximately 19 percent of the voting stock of AIG as of March 31, 2005. Five directors of AIG served as directors of Starr and SICO as of March 31, 2005 and December 31, 2004. As of April 30, 2005, no director of AIG serving as an executive officer of AIG served as a director of Starr or SICO.

*(b) Transactions with Related Parties:* During the ordinary course of business, AIG and its subsidiaries pay commissions to Starr and its subsidiaries for the production and management of insurance business. There are no significant receivables from/payables to related parties as of March 31, 2005.

**7. Commitments and Contingent Liabilities**

In the normal course of business, various commitments and contingent liabilities are entered into by AIG and certain of its subsidiaries. In addition, AIG guarantees various obligations of certain subsidiaries.

*(a)* AIG and certain of its subsidiaries become parties to derivative financial instruments with market risk resulting from both dealer and end user activities and to reduce currency, interest rate, equity and commodity exposures. These instruments are carried at their estimated fair values in the consolidated balance sheet. The vast majority of AIG's derivative activity is transacted by AIG's Capital Markets operations, comprised of AIG Financial Products Corp. and AIG Trading Group Inc. and their subsidiaries (AIGFP). (See also Note 20 in AIG's 2005 Annual Report on Form 10-K.)

*(b)* Securities sold, but not yet purchased and spot commodities sold but not yet purchased represent obligations of AIGFP to deliver specified securities and spot commodities at their contracted prices. AIGFP records a liability to repurchase the securities and spot commodities in the market at prevailing prices.

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. Revenues for the three months ended March 31, 2005 and 2004 from Capital Markets operations were \$756 million and \$361 million, respectively.

*(c)* At March 31, 2005, ILFC had committed to purchase 322 new and used aircraft deliverable from 2005 through 2010 at an estimated aggregate purchase price of \$19.5 billion and had options to purchase 6 new aircraft deliverable through 2007 at an estimated aggregate purchase price of \$361 million. 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.

*(d)* AIG and its subsidiaries, in common with the insurance industry in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. The recent trend of increasing jury awards and settlements makes it difficult to assess the ultimate outcome of such litigation.

AIG continues to receive claims asserting injuries from toxic waste, hazardous substances, and other environmental pollutants and alleged damages to cover the cleanup costs of hazardous waste dump sites (hereinafter collectively referred to as environmental claims) and indemnity claims asserting injuries from asbestos. Estimation of asbestos and environmental claims loss reserves is a difficult process, as these claims, which emanate from policies written in 1984 and prior years, cannot be estimated by conventional reserving techniques. Asbestos and environmental claims development is affected by factors such as inconsistent court resolutions, the broadening of the intent of policies and scope of coverage and increasing number of new claims. AIG, together with other industry members, has and will continue to litigate the broadening judicial interpretation of policy coverage and the liability issues. If the courts continue in the future to expand the intent of the policies and the scope of the coverage, as they have in the past, additional liabilities would emerge for amounts in excess of reserves held. This emergence cannot now be reasonably estimated, but could have a material effect on AIG's future operating results. The reserves carried for these claims at March 31, 2005 (\$3.48 billion gross; \$1.49 billion net) are believed to be adequate as these reserves are based on known facts and current law.

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(e) 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.

(f) On June 27, 2005, AIG entered into agreements pursuant to which AIG agrees, subject to certain conditions, to (i) 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 defined in Note 5) and (ii) make any payment to the extent not promptly paid by Starr with respect to amounts that become payable to certain

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

American International Group, Inc. and Subsidiaries

**7. Commitments and Contingent Liabilities** *(continued)*

employees of AIG and its subsidiaries who are also stockholders of Starr after the giving of a notice of repurchase or redemption under Starr's organizational documents. In January 2006, Starr announced that it had completed its tender offer to purchase interests in Starr and that all eligible shareholders had tendered their shares. As a result of completion of the tender offer, no executive currently holds any Starr interests.

(g) 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). An excess policy issued by a subsidiary of AIG with respect to the 1999 litigation was expressly stated to be without limit of liability. In the current actions, plaintiffs allege that the judge approving the 1999 settlement was misled as to the extent of available insurance coverage and would not have approved the settlement had he known of the existence and/or unlimited nature of the excess policy. They further allege that AIG, its subsidiaries, and Caremark are liable for fraud and suppression for misrepresenting and/or concealing the nature and extent of coverage. In their complaint, plaintiffs request compensatory damages for the 1999 class in the amount of \$3.2 billion, plus punitive damages. AIG and its subsidiaries deny the allegations of fraud and suppression and have asserted, *inter alia*, that information concerning the excess policy was publicly disclosed months prior to the approval of the settlement. AIG and its subsidiaries further assert that the current claims are barred by the statute of limitations and that plaintiffs' assertions that the statute was tolled cannot stand against the public disclosure of the excess coverage. Plaintiffs, in turn, have asserted that the disclosure was insufficient to inform them of the nature of the coverage and did not start the running of the statute of limitations. On January 28, 2005, the Alabama trial court determined that one of the current actions may proceed as a class action on behalf of the 1999 classes that were allegedly defrauded by the settlement. AIG, its subsidiaries, and Caremark are seeking appellate relief from the Alabama Supreme Court. AIG cannot now estimate either the likelihood of its prevailing in these actions or the potential damages in the event liability is determined.

(h) On December 30, 2004, an arbitration panel issued its ruling in connection with a 1998 workers compensation quota share reinsurance agreement under which Superior National Insurance Company, among others, was reinsured by The United States Life Insurance Company in the City of New York (USLIFE), a subsidiary of American General Corporation. In its 2-1 ruling the arbitration panel refused to rescind the contract as requested by USLIFE. Instead, the panel reformed the contract to reduce USLIFE's participation by ten percent. USLIFE disagrees with the ruling and is pursuing all appropriate legal remedies. USLIFE has certain reinsurance recoverables in connection with the contract and the arbitration ruling established a second phase of arbitration in which USLIFE will present its challenges to cessions to the contract.

AIG recorded approximately a \$178 million pre-tax charge in the fourth quarter of 2004 related to this matter and holds a reserve of approximately \$349 million as of March 31, 2005.

(i) Regulators from several states have commenced investigations into insurance brokerage practices related to contingent commissions and other broker-related conduct, such as alleged bid rigging. Various parties, including insureds and shareholders, have also asserted putative class action and other claims against AIG or its subsidiaries alleging, among other things, violations of the antitrust and federal securities laws, and AIG expects that additional claims may be made.

In February 2006, AIG reached a resolution of claims and matters under investigation with the United States Department of Justice (DOJ), the Securities and Exchange Commission (SEC), the Office of the New York Attorney General (NYAG) and the New York State Department of Insurance (DOI). The settlements resolved outstanding litigation filed by the SEC, NYAG and DOI against AIG and concluded negotiations with these authorities and the DOJ in connection with the accounting, financial reporting and insurance brokerage practices of AIG and its subsidiaries, as well as claims relating to the underpayment of certain workers compensation premium taxes and other assessments. The 2005 financial statements include a fourth quarter after-tax charge of \$1.15 billion to record the settlements.

As a result of these settlements, AIG made payments totaling approximately \$1.64 billion, \$225 million of which represented fines and penalties. A substantial portion of the money will be available to resolve claims asserted in various regulatory and civil proceedings, including shareholder lawsuits.

Also, as part of the settlements, AIG has agreed to retain for a period of three years an independent consultant who will conduct a review that will include the adequacy of AIG's internal control over financial reporting and the remediation plan that AIG has implemented as a result of its own internal review.

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

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**7. Commitments and Contingent Liabilities** *(continued)*

A number of lawsuits have been filed regarding the subject matter of the investigations of insurance brokerage practices, including derivative actions, individual actions and class actions under the federal securities laws, Racketeer Influenced and Corrupt Organizations Act (RICO), Employee Retirement Income Security Act (ERISA) and state common and corporate laws in both federal and state courts, including the United States District Court for the Southern District of New York (Southern District of New York), in the Commonwealth of Massachusetts Superior Court and in Delaware Chancery Court. All of these actions generally allege that AIG and its subsidiaries violated the law by allegedly concealing a scheme to rig bids and steer business between insurance companies and insurance brokers.

Since October 19, 2004, AIG or its subsidiaries have been named as a defendant in fifteen complaints that were filed in federal court and two that were originally filed in state court (Massachusetts and Florida) and removed to federal court. These cases generally allege that AIG and its subsidiaries violated federal and various state antitrust laws, as well as federal RICO laws, various state deceptive and unfair practice laws and certain state laws governing fiduciary duties. The alleged basis of these claims is that there was a conspiracy between insurance companies and insurance brokers with regard to the use of contingent commission agreements, bidding practices, and other broker-related conduct concerning coverage in certain sectors of the insurance industry. The Judicial Panel on Multidistrict Litigation entered an order on February 17, 2005, consolidating most of these cases and transferring them to the United States District Court for the District of New Jersey (District of New Jersey). The remainder of these cases have been transferred to the District of New Jersey. On August 15, 2005, the plaintiffs in the multidistrict litigation filed a Corrected First Consolidated Amended Commercial Class Action Complaint, which, in addition to the previously named AIG defendants, names new AIG subsidiaries as defendants. Also on August 15, 2005, AIG and two subsidiaries were named as defendants in a Corrected First Consolidated Amended Employee Benefits Class Action Complaint filed in the District of New Jersey, which asserts similar claims with respect to employee benefits insurance and a claim under ERISA on behalf of putative classes of employers and employees. On November 29, 2005, the AIG defendants, along with other insurer defendants and the broker defendants filed motions to dismiss both the Commercial and Employee Benefits Complaints. Plaintiffs have filed a motion for class certification in the consolidated action. In addition, complaints were filed against AIG and several of its subsidiaries in Massachusetts and Florida state courts, which have both been stayed. In the Florida action, the plaintiff has filed a petition for a writ of certiorari with the District Court of Appeals of the State of Florida, Fourth District with respect to the stay order. On February 9, 2006, a complaint against AIG and several of its subsidiaries was filed in Texas state court, making claims similar to those in the federal cases above.

In April and May 2005, amended complaints were filed in the consolidated derivative and securities cases, as well as in one of the ERISA lawsuits, pending in the Southern District of New York adding allegations concerning AIG's accounting treatment for non-traditional insurance products. In September 2005, a second amended complaint was filed in the consolidated securities cases adding allegations concerning AIG's First Restatement. Also in September 2005, a new securities action complaint was filed in the Southern District of New York, asserting claims premised on the same allegations made in the consolidated cases. Motions to dismiss have been filed in the securities actions. In September 2005, a consolidated complaint was filed in the ERISA case pending in the Southern District of New York. Motions to dismiss have been filed in that ERISA case. Also in April 2005, new derivative actions were filed in Delaware Chancery Court, and in July and August 2005, two new derivative actions were filed in the Southern District of New York asserting claims duplicative of the claims made in the consolidated derivative action.

In July 2005, a second amended complaint was filed in the consolidated derivative case in the Southern District of New York, expanding upon accounting-related allegations, based upon the First Restatement and, in August 2005, an amended consolidated complaint was filed. In June 2005, the derivative cases in Delaware were consolidated. AIG's Board of Directors has appointed a special committee of independent directors to review the matters asserted in the derivative complaints. The courts have approved agreements staying the derivative cases pending in the Southern District of New York and in Delaware Chancery Court while the special committee of independent directors performs its work. In September 2005, a shareholder filed suit in Delaware Chancery Court seeking documents relating to some of the allegations made in the derivative suits. AIG filed a motion to dismiss in October 2005.

In late 2002, a derivative action was filed in Delaware Chancery Court in connection with AIG's transactions with certain entities affiliated with Starr and SICO. In May 2005, the plaintiff filed an amended complaint which adds additional claims premised on allegations relating to insurance brokerage practices and AIG's non-traditional insurance products. Plaintiffs in that case have agreed to dismiss newly added allegations unrelated to transactions with entities affiliated with Starr and SICO without prejudice to pursuit of these claims in the separate derivative actions described above. On February 16, 2006, the Delaware Chancery Court



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

American International Group, Inc. and Subsidiaries

**7. Commitments and Contingent Liabilities** *(continued)*

entered an order dismissing the litigation with prejudice with respect to AIG's outside directors and dismissing the claims against the remaining AIG defendants without prejudice.

AIG cannot predict the outcome of the matters described above or estimate the potential costs related to these matters and, accordingly, no reserve is being established in AIG's financial statements at this time. In the opinion of AIG management, AIG's ultimate liability for the matters referred to above is not likely to have a material adverse effect on AIG's consolidated financial condition, although it is possible that the effect would be material to AIG's consolidated results of operations for an individual reporting period.

(j) On July 8, 2005, SICO filed a complaint against AIG in the United States District Court for the Southern District of New York. The complaint alleges that AIG is in the possession of items, including artwork, which SICO claims it owns, and seeks an order causing AIG to release those items as well as actual, consequential, punitive and exemplary damages. On September 27, 2005, AIG filed its answer to SICO's complaint denying SICO's allegations and asserting counter-claims for breach of contract, unjust enrichment, conversion and breach of fiduciary duty relating to SICO's breach of its commitment to use its AIG shares for the benefit of AIG and its employees. On October 17, 2005, SICO replied to AIG's counter-claims and additionally sought a judgment declaring that SICO is neither a control person nor an affiliate of AIG for purposes of Schedule 13D under the Securities Exchange Act of 1934, as amended (the Exchange Act), and Rule 144 under the Securities Act of 1933, as amended (the Securities Act), respectively. AIG responded to the SICO claims and sought a dismissal of SICO's claims on November 7, 2005.

(k) AIG subsidiaries own interests in certain limited liability companies (LLCs) which invested in six coal synthetic fuel production facilities. The sale of coal synthetic fuel produced by these six facilities generates income tax credits. One of the conditions a taxpayer must meet to qualify for coal synfuel tax credits is that the synfuel production facility must have been placed in service before July 1, 1998. On July 1, 2005, Internal Revenue Service (IRS) field agents issued notices of proposed adjustment to the LLCs proposing to disallow all of the credits taken by the LLCs during the years 2001 through 2003. The IRS field agents subsequently conceded that one of the facilities was timely placed in service, but they contend that none of the other underlying production facilities were placed in service by the statutory deadline. On October 3, 2005, IRS field agents issued 60-day letters to the LLCs proposing to disallow the tax credits taken with respect to synfuel sales by the remaining five production facilities. By letters dated February 17, 2006, the IRS field agents have advised the LLCs that they have, after further review, concluded that all six production facilities were placed in service before July 1, 1998 and that they will withdraw the 60-day letters issued to the LLCs.

Tax credits generated from the production and sale of synthetic fuel under section 29 of the Internal Revenue Code are subject to an annual phase-out provision that is based on the average wellhead price of domestic crude oil. The price range within which the tax credits are phased-out was originally established in 1980 and is adjusted annually for inflation. Depending on the price of domestic crude oil for a particular year, all or a portion of the tax credits generated in that year might be eliminated. Although AIG cannot predict the future price of domestic crude oil for the years 2006 and 2007 (the final year the tax credits are available), AIG does not expect the phase-out provision to affect tax credits generated in 2005. AIG has also entered into hedges designed to mitigate a portion of its future exposure to a sustained high price of oil. However, no assurance can be given as to the effectiveness of the hedging in actually reducing such exposure or whether such hedging will continue.

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

(m) In August 2005, the Bureau of Labor Insurance in Taiwan began to levy a monthly administrative penalty against Nan Shan for not providing its agency leaders a choice between alternative government pension plans. Nan Shan has reached an agreement with the agency union and the ultimate liability is not material to AIG's consolidated financial condition or results of operations.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**8. Employee Benefits**

The following table presents the components of the net periodic benefit costs with respect to pensions and other benefits for the three months ended March 31, 2005 and 2004:

<i>(in millions)</i>	Pensions			Postretirement		
	Non-U.S. Plans	U.S. Plans	Total	Non-U.S. Plans	U.S. Plans	Total
<b>2005</b>						
Components of net period benefit cost:						
Service cost	\$ 19	\$ 26	\$ 45	\$ 1	\$ 2	\$ 3
Interest cost	8	37	45		4	4
Expected return on assets	(5)	(41)	(46)			
Amortization of prior service cost	(3)	(1)	(4)		(2)	(2)
FAS 88 loss due to settlements	1		1			
Recognized actuarial loss	6	16	22		1	1
Net period benefit cost	\$ 26	\$ 37	\$ 63	\$ 1	\$ 5	\$ 6
<b>2004</b>						
Components of net period benefit cost:						
Service cost	\$ 15	\$ 23	\$ 38	\$	\$ 1	\$ 1
Interest cost	8	40	48		4	4
Expected return on assets	(5)	(43)	(48)			
Amortization of prior service cost	(1)	1			(1)	(1)
Amortization of transitional liability	1		1			
Recognized actuarial loss	5	14	19			
Net period benefit cost	\$ 23	\$ 35	\$ 58	\$	\$ 4	\$ 4

**9. Recent Accounting Standards**

At the March 2004 meeting, the Emerging Issue Task Force (EITF) reached a consensus with respect to Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. On September 30, 2004, the FASB issued FASB Staff Position (FSP) EITF No. 03-1-1, Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments delaying the effective date of this guidance until the FASB has resolved certain implementation issues with respect to this guidance, but the disclosures remain effective. This FSP, retitled FSP FAS 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, replaces the measurement and recognition guidance set forth in Issue No. 03-1 and codifies certain existing guidance on impairment. Adoption of FSP FAS 115-1 is not expected to have a material effect on AIG's financial condition or results of operations.

At the September 2004 meeting, the EITF reached a consensus with respect to Issue No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share. This Issue addresses when the dilutive effect of contingently convertible debt (Co-Cos) with a market price trigger should be included in diluted earnings per share (EPS). The adoption of Issue No. 04-8 did not have a material effect on AIG's



diluted EPS.

In December 2004, the FASB issued Statement No. 123 (revised 2004), Share-Based Payment (FAS 123R). FAS 123R and its related interpretive guidance replaces FAS No. 123, Accounting for Stock-Based Compensation (FAS 123), and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. FAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. On January 1, 2003, AIG adopted the recognition provisions of FAS 123. In April 2005, the Securities and Exchange Commission (SEC) delayed the effective date for FAS 123R until the first fiscal year beginning after June 15, 2005. As a result, AIG expects to adopt the provisions of the revised FAS 123R and its related interpretive guidance in the first quarter of 2006. For its service-based awards (1999 Stock Option Plan, 2002 Stock Incentive Plan, and 1999 Employee Stock Purchase Plan), AIG recognizes compensation on a straight-line basis over the scheduled vesting period. Upon adoption of FAS 123R, AIG will recognize compensation expense to the scheduled retirement date for employees near retirement. AIG does not expect the effect of this change to be material to AIG's results of operations. Consistent with the requirements of FAS 123R, AIG will recognize the unvested portion of its APB 25 awards as compensation expense over the remaining vesting period.

In December 2005 and January 2006, Starr made tender offers to AIG employees holding Starr common and preferred stock. In conjunction with AIG's adoption of FAS 123R, Starr is considered to be an economic interest holder in

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

American International Group, Inc. and Subsidiaries

**9. Recent Accounting Standards** *(continued)*

AIG. As a result, AIG expects to include the compensation expense related to the 2006 tender offer in its consolidated financial statements for the first quarter of 2006.

AIG is currently assessing the effect of FAS 123R and believes the effect will not be material to AIG's financial condition or results of operations.

On December 16, 2004, the FASB issued Statement No. 153, *Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29* (FAS 153). FAS 153 amends APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. The amendments made by FAS 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, APB Opinion No. 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. The provisions in FAS 153 are effective for nonmonetary asset exchanges beginning July 1, 2005. The adoption of FAS 153 did not have a material effect on AIG's financial condition or results of operations.

In March 2005, FASB issued FSP FIN46R-5 *Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities (FSP FIN46R-5)* to address whether a reporting enterprise has an implicit variable interest in a variable interest entity (VIE) or potential VIE when specific conditions exist. Although implicit variable interests are mentioned in FIN46(R), the term is not defined and only one example is provided. This FSP FIN46R-5 offers additional guidance, stating that implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. An implicit variable interest acts the same as an explicit variable interest except it involves the absorbing and/or receiving of variability indirectly from the entity (rather than directly). The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances. FSP FIN46R-5 is effective for the second quarter of 2005. The adoption of FSP FIN46R-5 did not have a material effect on AIG's financial condition or results of operations.

On June 1, 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections (FAS 154)*. FAS 154 replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. FAS 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. FAS 154 also provides that a correction of errors in previously issued financial statements should be termed a restatement. The new standard is effective for accounting changes and correction of errors beginning January 1, 2006.

At the June 2005 meeting, the EITF reached a consensus with respect to Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*. The Issue addresses what rights held by the limited partner(s) preclude consolidation in circumstances in which the sole general partner would consolidate the limited partnership in accordance with generally accepted accounting principles absent the existence of the rights held by the limited partner(s). Based on that consensus, the EITF also agreed to amend the consensus in Issue No. 96-16, *Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholders Have Certain Approval or Veto Rights*. The guidance in this Issue is effective after June 29, 2005 for general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified. For general partners in all other limited partnerships, the guidance in this Issue is effective beginning January 1, 2006. The effect of the adoption of this EITF Issue on existing partnerships that were modified and new partnerships entered into after June 29, 2005, was not material to AIG's financial condition or results of operations. For all other partnerships, AIG is currently assessing the effect of adopting this EITF Issue.

On June 29, 2005, FASB issued Statement 133 Implementation Issue No. B38, *Embedded Derivatives: Evaluation of Net Settlement with Respect to the Settlement of a Debt Instrument through Exercise of an Embedded Put Option or Call Option*. This implementation guidance relates to the potential settlement of the debtor's obligation to the creditor that would occur upon exercise of the put option or call option, which meets the net settlement criterion in FAS 133 paragraph 9(a). The effective date of the implementation guidance is January 1, 2006. AIG is currently assessing the effect of implementing this guidance.

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On June 29, 2005, FASB issued Statement 133 Implementation Issue No. B39, Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor. The conditions in FAS 133 paragraph 13(b) do not apply to an embedded call option in a hybrid instrument containing a debt host contract if the right to accelerate the settlement of the debt can be exercised only by the debtor (issuer/ borrower). This guidance does not apply to other embedded

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

American International Group, Inc. and Subsidiaries

**9. Recent Accounting Standards** *(continued)*

derivative features that may be present in the same hybrid instrument. The effective date of the implementation guidance is January 1, 2006. AIG is currently assessing the effect of implementing this guidance.

On September 19, 2005, FASB issued Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*. SOP 05-1 provides guidance on accounting for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*. The SOP defines an internal replacement as a modification in product benefits, features, rights, or coverage that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. The effective date of the implementation guidance is January 1, 2007. AIG is currently assessing the effect of implementing this guidance.

On February 16, 2006, the FASB issued FAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (FAS 155), an amendment of FAS 140 and FAS 133. FAS 155 permits the Company to elect to measure any hybrid financial instrument at fair value (with changes in fair value recognized in earnings) if the hybrid instrument contains an embedded derivative that would otherwise be required to be bifurcated and accounted for separately under FAS 133. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irrevocable. FAS 155 will be effective for all instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of AIG's fiscal year that begins after September 15, 2006, with earlier adoption permitted as of the beginning of 2006, provided that financial statements for any interim period of that fiscal year have not been issued. AIG has elected to early adopt FAS 155 as of January 1, 2006. This change in accounting will not have a material effect on AIG's results of operations or financial condition.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**10. Information Provided in Connection with Outstanding Debt**

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

(a) American General Corporation (AGC) is a holding company and a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all outstanding debt of AGC.

**American General Corporation:****Condensed Consolidating Balance Sheet**

March 31, 2005 (Restated) <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Eliminations	Consolidated AIG
<b>Assets:</b>					
Invested assets	\$ 764	\$	\$ 677,335	\$ (12,755)	\$ 665,344
Cash	150		2,211		2,361
Carrying value of subsidiaries and partially owned companies, at equity	82,963	25,889	15,846	(123,154)	1,544
Other assets	2,811	2,691	159,978	(4,252)	161,228
<b>Total assets</b>	<b>\$ 86,688</b>	<b>\$ 28,580</b>	<b>\$ 855,370</b>	<b>\$ (140,161)</b>	<b>\$ 830,477</b>
<b>Liabilities:</b>					
Insurance liabilities	\$ 391	\$	\$ 443,604	\$ (71)	\$ 443,924
Debt	3,650	2,483	112,158	(12,270)	106,021
Other liabilities	1,039	4,264	198,234	(4,811)	198,726
<b>Total liabilities</b>	<b>5,080</b>	<b>6,747</b>	<b>753,996</b>	<b>(17,152)</b>	<b>748,671</b>
Preferred shareholders' equity in subsidiary companies			198		198
<b>Total shareholders' equity</b>	<b>81,608</b>	<b>21,833</b>	<b>101,176</b>	<b>(123,009)</b>	<b>81,608</b>
<b>Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity</b>	<b>\$ 86,688</b>	<b>\$ 28,580</b>	<b>\$ 855,370</b>	<b>\$ (140,161)</b>	<b>\$ 830,477</b>

December 31, 2004 <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Eliminations	Consolidated AIG
<b>Assets:</b>					
Invested assets	\$ 1,027	\$	\$ 650,238	\$ (12,984)	\$ 638,281
Cash	17		1,992		2,009
Carrying value of subsidiaries and partially owned companies, at equity	80,966	26,179	12,763	(118,413)	1,495
Other assets	2,786	2,546	154,417	(389)	159,360

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Total assets	\$	84,796	\$ 28,725	\$	819,410	\$	(131,786)	\$	801,145
<b>Liabilities:</b>									
Insurance liabilities	\$	405	\$		\$ 428,130	\$	(69)	\$	428,466
Debt		3,647		2,482	103,027		(12,257)		96,899
Other liabilities		1,071		4,076	191,967		(1,206)		195,908
Total liabilities		5,123		6,558	723,124		(13,532)		721,273
Preferred shareholders' equity in subsidiary companies					199				199
Total shareholders' equity		79,673		22,167	96,087		(118,254)		79,673
Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity	\$	84,796	\$ 28,725	\$	819,410	\$	(131,786)	\$	801,145

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

American International Group, Inc. and Subsidiaries

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

Three Months Ended March 31, 2005 (Restated) (in millions) (unaudited)	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Eliminations	Consolidated AIG
Operating income	\$ (10) <sup>(a)</sup>	\$ (36) <sup>(b)</sup>	\$ 5,695 <sup>(c)</sup>	\$	\$ 5,649 <sup>(d)</sup>
Equity in undistributed net income of consolidated subsidiaries	3,646	701		(4,347)	
Dividend income from consolidated subsidiaries	271			(271)	
Income taxes (benefits)	108	(12)	1,610		1,706
Minority interest			(144)		(144)
Net income (loss)	\$ 3,799	\$ 677	\$ 3,941	\$ (4,618)	\$ 3,799

Three Months Ended March 31, 2004 (Restated) (in millions) (unaudited)	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Eliminations	Consolidated AIG
Operating income	\$ 88 <sup>(e)</sup>	\$ (30) <sup>(f)</sup>	\$ 3,784 <sup>(g)</sup>	\$	\$ 3,842 <sup>(h)</sup>
Equity in undistributed net income of consolidated subsidiaries	2,259	578		(2,837)	
Dividend income from consolidated subsidiaries	322	24		(346)	
Income taxes (benefits)	171	(10)	969		1,130
Minority interest			(70)		(70)
Cumulative effect of an accounting change, net of tax			(144)		(144)
Net income (loss)	\$ 2,498	\$ 582	\$ 2,601	\$ (3,183)	\$ 2,498

*(a) Includes other income (deductions) net and other realized capital gains (losses) of \$(103) million.**(b) Includes other income (deductions) net and other realized capital gains (losses) of \$(36) million.**(c) Includes other income (deductions) net and other realized capital gains (losses) of \$330 million.**(d) Includes other income (deductions) net and other realized capital gains (losses) of \$191 million.**(e) Includes other income (deductions) net and other realized capital gains (losses) of \$43 million.**(f) Includes other income (deductions) net and other realized capital gains (losses) of \$(30) million.**(g) Includes other income (deductions) net and other realized capital gains (losses) of \$(382) million.**(h) Includes other income (deductions) net and other realized capital gains (losses) of \$(369) million.***Condensed Consolidating Statements of Cash Flow**

Three Months Ended March 31, 2005 (Restated) (in millions) (unaudited)	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Consolidated AIG
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Net cash provided by (used in) operating activities	\$	373	\$	155	\$	(962)	\$	(434)
Cash flows from investing:								
Invested assets disposed		265				48,207		48,472
Invested assets acquired						(68,402)		(68,402)
Other		(72)		(120)		4		(188)
Net cash used in investing activities		193		(120)		(20,191)		(20,118)
Cash flows from financing activities:								
Change in debts		(34)		1		9,231		9,198
Other		(429)		(36)		12,228		11,763
Net cash provided by (used in) financing activities		(463)		(35)		21,459		20,961
Effect of exchange rate changes on cash		30				(87)		(57)
Change in cash		133				219		352
Cash at beginning of period		17				1,992		2,009
Cash at end of period	\$	150	\$		\$	2,211	\$	2,361



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

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

Three Months Ended March 31, 2004 (Restated) <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AGC Issuer	Other Subsidiaries	Consolidated AIG
Net cash provided by operating activities	\$ 527	\$ 468	\$ 7,011	\$ 8,006
Cash flows from investing:				
Invested assets disposed	315		45,941	46,256
Invested assets acquired	(176)		(75,556)	(75,732)
Other	(345)	(302)	465	(182)
Net cash used in investing activities	(206)	(302)	(29,150)	(29,658)
Cash flows from financing activities:				
Change in debts	(24)	(147)	3,635	3,464
Other	(192)	(19)	19,095	18,884
Net cash (used in) provided by financing activities	(216)	(166)	22,730	22,348
Effect of exchange rate changes on cash	(120)		422	302
Change in cash	(15)		1,013	998
Cash at beginning of period	19		903	922
Cash at end of period	\$ 4	\$	\$ 1,916	\$ 1,920

(b) AIG Liquidity Corp. is a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all obligations of AIG Liquidity Corp., which commenced operations in 2003.

**AIG Liquidity Corp.:****Condensed Consolidating Balance Sheet**

March 31, 2005 (Restated) <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AIG Liquidity Corp.	Other Subsidiaries	Eliminations	Consolidated AIG
Assets:					
Invested assets	\$ 764	\$ *	\$ 677,335	\$ (12,755)	\$ 665,344
Cash	150	*	2,211		2,361
Carrying value of subsidiaries and partially owned companies, at equity	82,963		41,735	(123,154)	1,544
Other assets	2,811	*	162,669	(4,252)	161,228
Total assets	\$ 86,688	\$ *	\$ 883,950	\$ (140,161)	\$ 830,477

Liabilities:						
Insurance liabilities	\$	391	\$	\$ 443,604	\$ (71)	\$ 443,924
Debt		3,650	*	114,641	(12,270)	106,021
Other liabilities		1,039	*	202,498	(4,811)	198,726
<hr/>						
Total liabilities		5,080	*	760,743	(17,152)	748,671
<hr/>						
Preferred shareholders' equity in subsidiary companies				198		198
Total shareholders' equity		81,608	*	123,009	(123,009)	81,608
<hr/>						
Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity	\$	86,688	\$ *	\$ 883,950	\$ (140,161)	\$ 830,477

\* Amounts significantly less than \$1 million.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

American International Group, Inc. and Subsidiaries

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

December 31, 2004 (in millions) (unaudited)	American International Group, Inc. Guarantor	AIG Liquidity Corp.	Other Subsidiaries	Eliminations	Consolidated AIG
<b>Assets:</b>					
Invested assets	\$ 1,027	\$ *	\$ 650,238	\$ (12,984)	\$ 638,281
Cash	17	*	1,992		2,009
Carrying value of subsidiaries and partially owned companies, at equity	80,966		38,942	(118,413)	1,495
Other assets	2,786	*	156,963	(389)	159,360
<b>Total assets</b>	<b>\$ 84,796</b>	<b>\$ *</b>	<b>\$ 848,135</b>	<b>\$ (131,786)</b>	<b>\$ 801,145</b>
<b>Liabilities:</b>					
Insurance liabilities	\$ 405	\$ *	\$ 428,130	\$ (69)	\$ 428,466
Debt	3,647	*	105,509	(12,257)	96,899
Other liabilities	1,071	*	196,043	(1,206)	195,908
<b>Total liabilities</b>	<b>5,123</b>	<b>*</b>	<b>729,682</b>	<b>(13,532)</b>	<b>721,273</b>
Preferred shareholders' equity in subsidiary companies			199		199
Total shareholders' equity	79,673	*	118,254	(118,254)	79,673
<b>Total liabilities, preferred shareholders' equity in subsidiary companies and shareholders' equity</b>	<b>\$ 84,796</b>	<b>\$ *</b>	<b>\$ 848,135</b>	<b>\$ (131,786)</b>	<b>\$ 801,145</b>

\*Amounts significantly less than \$1 million.

**Condensed Consolidating Statement of Income**

Three Months Ended March 31, 2005 (Restated) (in millions) (unaudited)	American International Group, Inc. Guarantor	AIG Liquidity Corp.	Other Subsidiaries	Eliminations	Consolidated AIG
Operating income	\$ (10)(a)	\$ *	\$ 5,659(b)	\$	\$ 5,649(c)
Equity in undistributed net income of consolidated subsidiaries	3,646		701	(4,347)	
Dividend income from consolidated subsidiaries	271			(271)	
Income taxes	108	*	1,598		1,706
Minority interest			(144)		(144)
<b>Net income (loss)</b>	<b>\$ 3,799</b>	<b>\$ *</b>	<b>\$ 4,618</b>	<b>\$ (4,618)</b>	<b>\$ 3,799</b>

\*Amounts significantly less than \$1 million.

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International      AIG

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Three Months Ended March 31, 2004 (Restated) (in millions) (unaudited)	Group, Inc. Guarantor	Liquidity Corp.	Other Subsidiaries	Eliminations	Consolidated AIG
Operating income	\$ 88(d)	\$ *	\$ 3,754(e)	\$	\$ 3,842(f)
Equity in undistributed net income of consolidated subsidiaries	2,259		578	(2,837)	
Dividend income from consolidated subsidiaries	322		24	(346)	
Income taxes	171	*	959		1,130
Minority interest			(70)		(70)
Cumulative effect of an accounting change, net of tax			(144)		(144)
Net income (loss)	\$ 2,498	\$ *	\$ 3,183	\$ (3,183)	\$ 2,498

\*Amounts significantly less than \$1 million.

(a) Includes other income (deductions) net and other realized capital gains (losses) of \$(103) million.

(b) Includes other income (deductions) net and other realized capital gains (losses) of \$294 million.

(c) Includes other income (deductions) net and other realized capital gains (losses) of \$191 million.

(d) Includes other income (deductions) net and other realized capital gains (losses) of \$43 million.

(e) Includes other income (deductions) net and other realized capital gains (losses) of \$(412) million.

(f) Includes other income (deductions) net and other realized capital gains (losses) of \$(369) million.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

American International Group, Inc. and Subsidiaries

**10. Information Provided in Connection with Outstanding Debt** *(continued)***Condensed Consolidating Statements of Cash Flow**

Three Months Ended March 31, 2005 (Restated) <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AIG Liquidity Corp.	Other Subsidiaries	Consolidated AIG
Net cash provided by (used in) operating activities	\$ 373	\$ *	\$ (807)	\$ (434)
Cash flows from investing:				
Invested assets disposed	265		48,207	48,472
Invested assets acquired			(68,402)	(68,402)
Other	(72)	*	(116)	(188)
Net cash used in investing activities	193	*	(20,311)	(20,118)
Cash flows from financing activities:				
Change in debts	(34)		9,232	9,198
Other	(429)	*	12,192	11,763
Net cash provided by financing activities	(463)	*	21,424	20,961
Effect of exchange rate changes on cash	30		(87)	(57)
Change in cash	133	*	219	352
Cash at beginning of period	17		1,992	2,009
Cash at end of period	\$ 150	\$ *	\$ 2,211	\$ 2,361

\*Amounts significantly less than \$1 million.

Three Months Ended March 31, 2004 (Restated) <i>(in millions) (unaudited)</i>	American International Group, Inc. Guarantor	AIG Liquidity Corp.	Other Subsidiaries	Consolidated AIG
Net cash provided by operating activities	\$ 527	\$ *	\$ 7,479	\$ 8,006
Cash flows from investing:				
Invested assets disposed	315		45,941	46,256
Invested assets acquired	(176)		(75,556)	(75,732)
Other	(345)	*	163	(182)
Net cash used in investing activities	(206)	*	(29,452)	(29,658)
Cash flows from financing activities:				
Change in debts	(24)		3,488	3,464
Other	(192)	*	19,076	18,884

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Net cash (used in) provided by financing activities	(216)	*	22,564	22,348
Effect of exchange rate changes on cash	(120)		422	302
Change in cash	(15)	*	1,013	998
Cash at beginning of period	19		903	922
Cash at end of period	\$ 4	\$ *	\$ 1,916	\$ 1,920

\*Amounts significantly less than \$1 million.

American International Group, Inc. and Subsidiaries

**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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EX-12: STATEMENT RE COMPUTATION OF RATIOS

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

This Quarterly Report and other publicly available documents may include, and AIG's officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and services, and assumptions underlying these projections and statements. These projections and statements are not historical facts but instead represent only AIG's belief regarding future events, many of which, by their nature, are inherently uncertain and outside AIG's control. These projections and statements may address, among other things, the status and potential future outcome of the current regulatory and civil proceedings against AIG and their potential effect on AIG's businesses, financial position, results of operations, cash flows and liquidity, the effect of the credit rating downgrades on AIG's businesses and competitive position, the unwinding and resolving of various relationships between AIG and Starr and SICO, and AIG's strategy for growth, product development, market position, financial results and reserves. It is possible that AIG's actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these projections and statements. Factors that could cause AIG's actual results to differ, possibly materially, from those in the specific projections and statements are discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations and in Risk Factors in Item 1A, Part I of AIG's 2005 Annual Report on Form 10-K. AIG is not under any obligation (and expressly disclaims any such obligations) to update or alter any projection or other statement, whether written or oral, that may be made from time to time, whether as a result of new information, future events or otherwise.



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American International Group, Inc. and Subsidiaries

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

## **Restatement of Previously Issued Financial Statements**

In connection with preparation of AIG's consolidated financial statements included in AIG's 2004 Annual Report on Form 10-K, AIG's current management initiated an internal review of AIG's books and records, which was substantially expanded in mid-March 2005. As a result of the internal review, AIG concluded that the accounting for certain transactions and certain relationships needed to be restated or adjusted. AIG restated the accounting for certain transactions and certain relationships for the years ended December 31, 2003, 2002, 2001 and 2000, the quarters ended March 31, June 30 and September 30, 2004 and 2003 and the quarter ended December 31, 2003 (the First Restatement).

As announced on November 9, 2005, AIG identified certain errors, the preponderance of which were identified during the remediation of material weaknesses in internal controls referred to in the Explanatory Note, principally relating to internal controls surrounding accounting for derivatives and related assets and liabilities under FAS 133, reconciliation of certain balance sheet accounts and income tax accounting. AIG also announced it was correcting errors that were identified since the First Restatement, including those related to the accounting for certain payments received from aircraft and engine manufacturers by ILFC, which were originally corrected in AIG's Second Quarter Form 10-Q. The adjustments to correct the foregoing errors are referred to in this First Quarter Form 10-Q/A as the Initial Adjustments.

In connection with the remediation of material weaknesses in internal control over financial reporting referred to in the Explanatory Note, AIG identified certain additional errors, principally relating to internal controls over reconciliation of certain balance sheet accounts in DBG. As a result, AIG is including further adjustments (the Additional Adjustments) in its restatement of the consolidated financial statements and financial statement schedules for the years ended December 31, 2004, 2003 and 2002, along with 2001 and 2000 for purposes of the preparation of the Selected Consolidated Financial Data for 2001 and 2000, and quarterly financial information for 2004 and 2003 and is restating the first three quarters of 2005. The Initial Adjustments and the Additional Adjustments are referred to herein as the Second Restatement. AIG's quarterly report on Form 10-Q for the quarter ended September 30, 2005 (September 2005 Form 10-Q) will not be amended because the Additional Adjustments to the financial statements included therein are not material to those financial statements.

The financial information that is included in this First Quarter Form 10-Q/A has been restated as part of the First Restatement and the Second Restatement (the Restatements).

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

AIG identifies its reportable segments by product line consistent with its management structure. AIG's major product and service groupings are General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management. AIG's operations in 2005 are conducted by its subsidiaries principally through these segments. Through these segments, AIG provides insurance and investment products and services to both businesses and individuals in more than 130 countries and jurisdictions. This geographic, product and service diversification is one of AIG's major strengths and sets it apart from its competitors. The importance of this diversification was especially evident in 2004, when record catastrophe losses in certain insurance operations were more than offset by profitability in those operations as well as in other segments and product lines. Although regional economic downturns or political upheaval could negatively affect parts of AIG's operations, AIG believes that its diversification makes it unlikely that regional difficulties would have a material effect on its operating results, financial condition or liquidity.

AIG's subsidiaries serve commercial, institutional and individual customers through an extensive property-casualty and life insurance and retirement services network. In the United States, AIG companies are the largest underwriters of commercial and industrial insurance and one of the largest life insurance and retirement services operations as well. AIG's Financial Services businesses include commercial aircraft and equipment leasing, capital markets operations and consumer finance, both in the United States and abroad. AIG also provides asset management services and offers guaranteed investment contracts, also known as funding agreements, (GICs) to institutions and individuals.

AIG's operating performance reflects implementation of various long-term strategies and defined goals in its various operating segments.

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A primary goal of AIG in managing its General Insurance operations is to achieve an underwriting profit. To achieve this goal, AIG must be disciplined in its risk selection and premiums must be adequate and terms and conditions

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appropriate to cover the risk accepted. AIG believes in strict control of expenses.

Another central focus of AIG operations in current years is the development and expansion of new distribution channels. In 2004, AIG expanded its distribution channels in many Asian countries, which now include banks, credit card companies and television-media home shopping. In late 2003, AIG entered into an agreement with PICC Property and Casualty Company, Limited (PICC), which will enable the marketing of accident and health products throughout China through PICC's branch networks and agency system. AIG participates in the underwriting results through a reinsurance agreement and also holds a 9.9 percent ownership interest in PICC. Other examples of new distribution channels used both domestically and overseas include banks, affinity groups, direct response and e-commerce.

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

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

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

**The following table summarizes AIG's revenues, income before income taxes, minority interest and cumulative effect of an accounting change and net income for the three months ended March 31, 2005 and 2004:**

<i>(in millions)</i>	<b>2005 (Restated)</b>	2004 (Restated)
Total revenues	\$ 27,202	\$ 23,222
Income before income taxes, minority interest and cumulative effect of an accounting change	5,649	3,842
Net income	\$ 3,799	\$ 2,498

**Consolidated Results**

The 17.1 percent growth in revenues in the first three months of 2005 was primarily attributable to the growth in net premiums earned from global General Insurance operations as well as growth in both General Insurance and Life Insurance & Retirement Services net investment income and Life Insurance & Retirement Services GAAP premiums.

AIG's income before income taxes, minority interest and cumulative effect of an accounting change increased 47.0 percent in the first three months of 2005 when compared to the same period of 2004. General Insurance, Life Insurance & Retirement Services, Financial Services, and Asset Management operating income gains were the primary factors for the increase over 2004 in both pretax income and net income.

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The following table summarizes the operations of each principal segment for the three months ended March 31, 2005 and 2004. (See also Note 3 of Notes to Consolidated Financial Statements.)

<i>(in millions)</i>	<b>2005 (Restated)</b>	2004 (Restated)
<b>Revenues<sup>(a)</sup>:</b>		
General Insurance <sup>(b)</sup>	\$ 11,219	\$ 10,097
Life Insurance & Retirement Services <sup>(c)</sup>	11,775	10,485
Financial Services <sup>(d)</sup>	2,436	1,814
Asset Management <sup>(e)</sup>	1,377	1,050
Other	395	(224)
<b>Consolidated</b>	<b>\$ 27,202</b>	<b>\$ 23,222</b>
<b>Operating Income<sup>(a)(f)</sup>:</b>		
General Insurance	\$ 1,642	\$ 1,442
Life Insurance & Retirement Services	2,181	1,749
Financial Services	1,045	584
Asset Management	590	436
Other <sup>(g)</sup>	191	(369)
<b>Consolidated</b>	<b>\$ 5,649</b>	<b>\$ 3,842</b>

(a) Revenues and operating income reflect changes in market or estimated fair value associated with hedging activities that do not qualify for hedge accounting pursuant to FAS 133.

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

(c) Represents the sum of Life Insurance & Retirement Services GAAP premiums, net investment income and realized capital gains (losses).

(d) Represents interest, lease and finance charges.

(e) Represents management and advisory fees and net investment income with respect to GICs.

(f) Represents income before income taxes, minority interest and cumulative effect of an accounting change.

(g) Represents other income (deductions) net and other realized capital gains (losses).

**General Insurance**

AIG's General Insurance operations provide property and casualty products and services throughout the world. The increase in General Insurance operating income in the first three months of 2005 compared to the same period of 2004 was primarily attributable to strong growth in operating income with respect to Domestic Brokerage Group's and Foreign General's operations, offset by a decrease in realized capital gains for the segment in the first three months of 2005 compared to the same period of 2004. DBG's operating income included additional losses in the first three months of 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes.

**Life Insurance & Retirement Services**

AIG's Life Insurance & Retirement Services operations provide insurance, financial and investment products throughout the world. Foreign operations provided approximately 55 percent of AIG's Life Insurance & Retirement Services operating income for the first quarter of 2005.

Life Insurance & Retirement Services operating income increased by 24.7 percent in the first three months of 2005 when compared to the same period of 2004. This increase resulted from growth in AIG's principal Life Insurance & Retirement Services businesses, and the decline in realized capital losses in 2005 compared to 2004.

**Financial Services**

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

Financial Services operating income increased by 78.9 percent in the first three months of 2005 compared to the same period of 2004, primarily due to the fluctuation in earnings resulting from the accounting effect of FAS 133. Fluctuations in revenues and operating income from quarter to quarter are not unusual because of the transaction-oriented nature of Capital Markets operations and the effect of not qualifying for hedge accounting treatment under FAS 133 for hedges on securities available for sale and borrowings. Consumer Finance operations increased revenues and operating income, both domestically and internationally.

### ***Asset Management***

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

Asset Management operating income increased 35.3 percent in the first three months of 2005 when compared to the same period of 2004 as a result of the upturn in worldwide financial markets and a strong global product portfolio.

### ***Capital Resources***

At March 31, 2005, AIG had total consolidated shareholders' equity of \$81.61 billion and total consolidated borrowings of \$106.02 billion. At that date, \$96.51 billion of such borrowings were either not guaranteed by AIG or were AIGFP's matched borrowings under obligations of guaranteed investment agreements (GIAs), liabilities connected to trust preferred stock, or matched notes and bonds payable.

During the period from January 1, 2005 through March 31, 2005, AIG purchased in the open market 2,477,100 shares of its common stock.

### ***Liquidity***

At March 31, 2005, AIG's consolidated invested assets included \$24.38 billion in cash and short-term investments. Consolidated net cash used in operating activities in the first three months of 2005 amounted to \$434 million. The \$434 million in consolidated net cash used in operating activities is net of approximately \$8 billion used by AIGFP to purchase securities purchased under agreements to resell and to repurchase securities sold under agreements to repurchase in the ordinary course of AIGFP's business. This operating

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activity was funded in part by proceeds from security sales under similar repurchase and reverse repurchase agreements, but primarily by AIGFP's financing activities, specifically proceeds from guaranteed investment agreements and notes, bonds, loans and mortgages payable. Approximately half of the \$8 billion was subsequently invested in securities available for sale. AIG believes that its liquid assets and access to short term funding through commercial paper and bank credit facilities will enable it to meet any anticipated cash requirements.

**Outlook**

From March through June of 2005, the major rating agencies downgraded AIG's ratings in a series of actions. Standard & Poor's, a division of the McGraw-Hill Companies, Inc. (S&P), lowered the long-term senior debt and counterparty ratings of AIG from AAA to AA (second highest of eight rating categories) and changed the rating outlook to negative. S&P's outlook indicates the potential direction of a rating over the intermediate term (typically six months to two years). A negative outlook means that a rating may be lowered; however, an outlook is not necessarily a precursor to a rating change. Moody's Investors Service (Moody's) lowered AIG's long-term senior debt rating from Aaa to Aa2 (second highest of nine rating categories) with a stable outlook. Moody's appends numerical modifiers 1, 2, and 3 to the generic rating categories to show relative position within rating categories. Fitch Ratings (Fitch) downgraded the long-term senior debt ratings of AIG from AAA to AA (second highest of nine rating categories) and placed the ratings on Rating Watch Negative. A Fitch Rating Watch notifies investors that there is a reasonable probability of a rating change and the likely direction of such change. A Rating Watch Negative indicates a potential downgrade. Rating Watch is typically resolved over a relatively short period. In April 2006, Fitch removed AIG from Rating Watch Negative and affirmed its rating with a stable outlook.

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

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

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

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

These ratings actions have affected and will continue to affect AIG's business and results of operations in a number of ways.

**Downgrades in AIG's debt ratings will adversely affect AIG's results of operations.** AIG relies on external sources of financing to fund several of its operations. The cost and availability of unsecured financing are generally dependent on the issuer's long-term and short-term debt ratings. These downgrades and any future downgrades in AIG's debt ratings will increase AIG's borrowing costs and therefore adversely affect AIG's results of operations.

**The downgrade in AIG's long-term senior debt ratings will adversely affect AIGFP's ability to compete for cer-**



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**tain businesses.** Credit ratings are very important to the ability of financial institutions to compete in the derivative and structured transaction marketplaces. Historically, AIG's triple-A ratings provided AIGFP a competitive advantage. The downgrades have reduced this advantage and, for specialized financial transactions that generally are conducted only by triple-A rated financial institutions, counterparties may be unwilling to transact business with AIGFP except on a secured basis. This could require AIGFP to post more collateral to counterparties in the future. See below for a further discussion of the effect that posting collateral may have on AIG's liquidity.

**Although the financial strength ratings of AIG's insurance company subsidiaries remain high compared to many of their competitors, the downgrades have reduced the previous ratings differential.** The competitive advantage of the ratings to AIG's insurance company subsidiaries may be lessened accordingly. The regulatory inquiries, internal investigations, and delay in the filing of the 2004 Annual Report on Form 10-K, as well as negative publicity, had caused independent producers and distributors of AIG's domestic life and retirement services products to be more cautious in placing business with AIG subsidiaries. AIG is unable to predict the effect of these issues on AIG's business, including any increase in associated surrender or replacement activity.

**As a result of the downgrades of AIG's long-term senior debt ratings, AIG was required to post approximately \$1.16 billion of collateral with counterparties to municipal guaranteed investment agreements and financial derivatives transactions.** In the event of a further downgrade, AIG will be required to post additional collateral. It is estimated that, as of the close of business on February 28, 2006, based on AIG's outstanding municipal guaranteed investment agreements and financial derivatives transactions as of such date, a further downgrade of AIG's long-term senior debt ratings to Aa3 by Moody's or AA- by S&P would permit counterparties to call for approximately \$962 million of additional collateral. Further, additional downgrades could result in requirements for substantial additional collateral, which could have a material effect on how AIG manages its liquidity. The actual amount of additional collateral that AIG would be required to post to counterparties in the event of such downgrades depends on market conditions, the market value of the outstanding affected transactions and other factors prevailing at the time of the downgrade. Any additional obligations to post collateral will increase the demand on AIG's liquidity.

Despite industry price erosion in some classes of general insurance, AIG expects to continue to identify profitable opportunities and build attractive new General Insurance businesses as a result of AIG's broad product line and extensive distribution networks. AIG expects total General Insurance premiums to increase for 2005 and expects cash flow for investments to remain strong. Thus, General Insurance net investment income is expected to rise in future quarters even in a continued low interest rate environment.

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

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

Domestically, AIG anticipates continued operating growth in 2005 as distribution channels are expanded and new products are introduced. The home service operation has not met business objectives, although its cash flow has been strong, and domestic group life/health was also weak. AIG American General's current ratings remain equal to or higher than many of its principal competitors. Nevertheless, recent events have caused independent producers and distributors of AIG American General's products to be more cautious in placing business with AIG. Therefore, AIG is unable to predict the effect of these issues on AIG's business, including any increase in associated surrender or replacement activity.

In the airline industry, changes in market conditions are not immediately apparent in operating results. Lease rates have firmed considerably, as a result of strong demand spurred by the recovering global commercial aviation market, especially in Asia. Sales have begun to increase, and AIG expects an increasing level of interest from a variety of purchasers. Therefore, AIG believes that the improvements in that market which commenced in 2003 will be gradually reflected in ILFC's results in 2005. In the Capital Markets operations, the integration of AIG Trading Group Inc. and its





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American International Group, Inc. and Subsidiaries subsidiaries into the operations of AIGFP created operating efficiencies that will continue to be realized and product synergies that should enhance 2005 results, although quarter to quarter variations are to be expected in this transaction-oriented business. AIG also expects increased contributions to Financial Services revenues and income from its consumer finance operations both domestically and overseas. However, the downgrades of AIG's credit ratings may adversely affect funding costs for AIG and its subsidiaries and AIGFP's ability to engage in derivative transactions and certain structured products. See Risk Factors AIG's Credit Ratings in Item 1A. of Part I of AIG's 2005 Annual Report on Form 10-K.

GICs, which are sold domestically and abroad to both institutions and individuals, are written on an opportunistic basis when market conditions are favorable. AIG expects to launch a matched investment program utilizing issuances of AIG debt securities, which will become AIG's principal spread-based investment activity. However, in light of recent developments, the timing of the launch of this program is uncertain. Because AIG's credit spreads in the capital markets have widened following the ratings declines, there may be a reduction in the earnings on new business in AIG's spread based funding businesses.

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

## **Critical Accounting Estimates**

AIG considers its most critical accounting estimates those with respect to reserves for losses and loss expenses, future policy benefits for life and accident and health contracts, deferred policy acquisition costs, estimated gross profits for investment-oriented products, fair value determinations for certain Capital Markets assets and liabilities and other than temporary declines in the value of investments. 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:* for example, accident year 2004 for the year end 2004 loss reserve analysis. For low frequency, high severity classes such as excess casualty and directors and officers liability (D&O), expected loss ratios generally are utilized for at least the three most recent accident years.

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

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

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

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

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

*Estimated gross profits* to be realized over the estimated duration of the contracts (investment-oriented products) affects the carrying value of deferred policy acquisition costs under FAS 97. Estimated gross profits include investment income and gains and losses on investments less required interest, actual mortality and other expenses.

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

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

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

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

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### *Fair Value Determinations of Certain Assets and Liabilities (Financial Services – Capital Markets):*

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

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

### *Other Than Temporary Declines in the Value of Investments:*

Securities are considered a candidate for impairment based upon the following criteria:

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

The occurrence of a discrete credit event resulting in the debtor default, seeking bankruptcy or insolvency protection or voluntary reorganization.

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

*Flight Equipment Recoverability (Financial Services):*

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

**Operating Review**

***General Insurance Operations***

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

Domestic General Insurance operations are comprised of the Domestic Brokerage Group (DBG), which includes the operations of The Hartford Steam Boiler Inspection and Insurance Company (HSB), Transatlantic Holdings, Inc. (Transatlantic); Personal Lines, including 21st Century Insurance Group (21st Century); and United Guaranty Corporation (UGC).

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

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

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

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

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

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

AIG's Personal Lines operations provide automobile insurance through AIG Direct, the mass marketing operation of AIG, Agency Auto Division and 21st Century Insurance Group, as well as a broad range of coverages for high-net-worth individuals through the AIG Private Client Group.

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The principal business of the UGC subsidiaries is the writing of residential mortgage loan insurance, which is guaranty insurance on conventional first mortgage loans on single-family dwellings and condominiums. This type of insurance protects lenders against loss if borrowers default. UGC subsidiaries also write home equity and property improvement loan insurance on loans to finance residential property improvements, alterations and repairs and for other purposes not necessarily related to real estate.

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

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

A critical discipline of a successful general insurance business is the objective to produce profit from underwriting activities exclusive of investment-related income. When un-

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

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

GAAP provides for the recognition of expenses at the same time revenues are earned, the accounting principle of matching. Therefore, acquisition expenses are deferred and amortized over the period the related net premiums written are earned. DAC is reviewed for recoverability, and such review requires management judgment. (See also Critical Accounting Estimates herein.)

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

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

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

**General Insurance operating income is comprised of statutory underwriting results, changes in DAC, net investment income and realized capital gains and losses. Operating income, as well as net premiums written, net premiums earned, net investment income and realized capital gains (losses) and statutory ratios for the three months ended March 31, 2005 and 2004 were as follows:**

<i>(in millions, except ratios)</i>	2005 (Restated)	2004 (Restated)
<b>Net premiums written:</b>		
Domestic General		
DBG	\$ 5,720	\$ 5,355
Transatlantic	885	907
Personal Lines	1,186	1,119
Mortgage Guaranty	165	154
Foreign General	2,834	2,503
<b>Total</b>	<b>\$ 10,790</b>	<b>\$ 10,038</b>
<b>Net premiums earned:</b>		
Domestic General		
DBG	\$ 5,573	\$ 4,930
Transatlantic	888	893
Personal Lines	1,120	1,042
Mortgage Guaranty	140	134
Foreign General	2,419	2,089
<b>Total</b>	<b>\$ 10,140</b>	<b>\$ 9,088</b>

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Net investment income:			
Domestic General			
DBG	\$	659	\$ 501
Transatlantic		85	72
Personal Lines		52	43
Mortgage Guaranty		28	29
Intercompany adjustments and eliminations net		1	
Foreign General		190	176
<hr/>			
Total	\$	1,015	\$ 821
<hr/>			
Realized capital gains (losses)		64	188
<hr/>			
Operating income:			
Domestic General:			
DBG	\$	713(a)	\$ 556
Transatlantic		114	117
Personal Lines		109	96
Mortgage Guaranty		104	96
Foreign General		596	571
Reclassifications and eliminations		6	6
<hr/>			
Total	\$	1,642	\$ 1,442
<hr/>			
Domestic General:			
Loss Ratio		77.23(a)	78.52
Expense Ratio		19.76	19.99
<hr/>			
Combined Ratio		96.99	98.51
<hr/>			
Foreign General:			
Loss Ratio		54.43	57.67
Expense Ratio <sup>(b)</sup>		27.25	25.45
<hr/>			
Combined ratio <sup>(b)</sup>		81.68	83.12
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<i>(in millions, except ratios)</i>	<b>2005 (Restated)</b>	2004 (Restated)
<b>Consolidated:</b>		
Loss Ratio	<b>71.79(a)</b>	73.73
Expense Ratio	<b>21.73</b>	21.35
<hr/>		
Combined Ratio	<b>93.52</b>	95.08

(a) Includes \$118 million of additional losses incurred resulting from increased labor and material costs related to the 2004 Florida Hurricanes (1.53 points increase on the domestic general loss ratio and 1.16 points increase on the consolidated general loss ratio).

(b) Includes the results of wholly owned AIU agencies.

General Insurance Results

General Insurance operating income in the first three months of 2005 showed excellent results. The increase in General Insurance operating income in the first three months of 2005 was primarily attributable to strong profitable growth in Foreign General s underwriting results and DBG s and Foreign General s net investment income partially offset by a decrease in realized capital gains relative to the same period of 2004. DBG s underwriting results included additional losses incurred resulting from increased labor and material costs related to the 2004 Florida hurricanes.

Like most AIG units, DBG benefited in the first three months of 2005 from a strong profit center focus and growing distribution channels. Overall, DBG s net premiums written increased in the first three months of 2005 over 2004, as new business, generally higher renewal retention rates and a modest change in the mix of business towards classes (i.e. smaller accounts) that purchase less reinsurance more than offset modest rate decreases in some classes (i.e. property, D&O, healthcare, aviation). Domestic property-casualty premium rates are generally satisfactory at this time, although AIG has begun to see evidence in some classes of business, including property, D&O, energy and healthcare, where rates quoted by other carriers on selected accounts or segments do not meet AIG s view of satisfactory. The loss ratio decreased from same period of 2004 principally as a result of the impact of prior year rate increases on premiums earned in the quarter, lower losses in the quarter in short tail classes of business, such as property and accident & health, offset by \$118 million of additional losses incurred resulting from increased labor and material costs related to the 2004 Florida hurricanes.

Transatlantic s net premiums written and net premiums earned for the first quarter of 2005 decreased compared with the same period in 2004, principally as a result of decreased domestic business, partially offset by increased international business.

Personal Lines net premiums written in the first three months of 2005 increased when compared to the same period of 2004 due to good growth in its core business units through expanded marketing efforts, increased agent/broker appointments, and enhanced product offerings. These gains were partially offset by reductions in its involuntary auto business due to aggressive re-underwriting of the previously acquired GE business. Underwriting income increased as a result of earned premium growth and favorable development of prior accident years.

Mortgage Guaranty s net premiums written increased in the first three months of 2005 when compared to the same period of 2004. Strong growth in junior liens, student loans and international business were offset by continued low persistency in the residential first lien business, caused by high refinance activity fueled by low mortgage interest rates.

Foreign General Insurance had strong results in the first three months of 2005. Growth in net premiums written was achieved due to new business as well as new distribution channels partially offset by rate decreases in Australia and the United Kingdom commercial lines. The Far East region had excellent results. Personal accident business exhibited strong growth. In Japan, the purchase of the Royal & SunAlliance branch operations opened new distribution channels. Commercial lines in Europe and the Ascot syndicate continue to exhibit strong growth, as did Personal Lines operations in Brazil and Latin America. This growth translated to improved underwriting results.

**AIG transacts business in most major foreign currencies. The following table summarizes the effect of changes in foreign currency exchange rates on the growth of General Insurance net premiums written for the first three months of 2005:**



	2005
Growth in original currency	6.2%
Foreign exchange effect	1.3
Growth as reported in U.S. dollars	7.5%

As previously noted, DBG's results include \$118 million of additional losses incurred in the first three months of 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes. Other effects of catastrophes incurred in the first three months of 2005 and 2004 were insignificant. The effect on losses caused by catastrophes can fluctuate widely from year to year, making comparisons of recurring type business more difficult. With respect to catastrophe losses, AIG believes that it has taken appropriate steps, such as careful exposure selection and obtaining reinsurance coverage, to reduce the effect of the magnitude of possible future losses. The occurrence of one or more catastrophic events of unanticipated frequency or severity, such as terrorist attack, earthquake or hurricane, that causes insured losses, however, could have a material adverse effect on AIG's results of operations, liquidity or financial condition.

General Insurance net investment income grew in the first three months of 2005 when compared to the same period of 2004. AIG is benefiting from strong cash flow, higher interest rates as well as increased partnership income. Addi-

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tionally, net investment income was positively affected by the compounding of previously earned and reinvested net investment income. As AIG believes that net premiums written will continue to increase in 2005, AIG expects that cash flow for investment will continue to be strong, resulting in growth in net investment income in 2005.

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

The contribution of General Insurance operating income to AIG's consolidated income before income taxes, minority interest and cumulative effect of an accounting change was 29.1 percent in the first three months of 2005 compared to 37.5 percent in the same period of 2004.

**Reinsurance**

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

AIG's consolidated general reinsurance assets amounted to \$17.96 billion at March 31, 2005 and resulted from AIG's reinsurance arrangements. Thus, a credit exposure existed at March 31, 2005 with respect to reinsurance recoverable to the extent that any reinsurer may not be able to reimburse AIG under the terms of these reinsurance arrangements. AIG manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound, and when necessary AIG holds substantial collateral in the form of funds, securities and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis. At December 31, 2004, approximately 43 percent of the general reinsurance assets were from unauthorized reinsurers. In order to obtain statutory recognition, the majority of these balances were collateralized. The remaining 57 percent of the general reinsurance assets were from authorized reinsurers. The terms authorized and unauthorized pertain to regulatory categories, not creditworthiness. Approximately 90 percent of the balances with respect to authorized reinsurers are from reinsurers rated A (excellent) or better, as rated by A.M. Best, or A (strong) or better, as rated by Standard & Poor's. Through March 31, 2005, these distribution percentages have not changed significantly. These ratings are measures of financial strength.

AIG maintains a reserve for estimated unrecoverable reinsurance, but it has been largely successful in its previous recovery efforts. At December 31, 2004 AIG had allowances for unrecoverable reinsurance approximating \$800 million. At that date, AIG had no significant reinsurance recoverables due from any individual reinsurer that was financially troubled (e.g., liquidated, insolvent, in receivership or otherwise subject to formal or informal regulatory restriction).

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

AIG enters into intercompany reinsurance transactions, primarily through AIRCO, for its General Insurance and Life Insurance operations. AIG enters into these transactions as a sound and prudent business practice in order to maintain underwriting control and spread insurance risk among AIG's various legal entities. These reinsurance agreements have been approved by the appropriate regulatory authorities. All material intercompany transactions have been eliminated in consolidation. AIG generally obtains letters of credit in order to obtain statutory recognition of these intercompany reinsurance transactions. At March 31, 2005, approximately \$3.3 billion of letters of credit were outstanding to cover



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intercompany reinsurance transactions with AIRCO or other General Insurance subsidiaries.

At March 31, 2005, the consolidated general reinsurance assets of \$17.96 billion include reinsurance recoverables for paid losses and loss expenses of \$597 million, \$14.24 billion with respect to the ceded reserve for losses and loss expenses, including ceded losses incurred but not reported (IBNR) (ceded reserves) and ceded reserve for unearned premiums of \$3.12 billion. The ceded reserves represent the accumulation of estimates of ultimate ceded losses including provisions for ceded IBNR and loss expenses. The methods used to determine such estimates and to establish the resulting ceded reserves are continually reviewed and updated by management. Any adjustments thereto are reflected in income currently. It is AIG's belief that the ceded reserves at March 31, 2005 were representative of the ultimate losses recoverable. In the future, as the ceded reserves continue to develop to ultimate amounts, the ultimate loss recoverable may be greater or less than the reserves currently ceded.

Reserve for Losses and Loss Expenses

The table below classifies as of March 31, 2005 the components of the General Insurance reserve for losses and loss expenses (loss reserves) with respect to major lines of business on a statutory basis<sup>\*</sup>:

(in millions)

Other liability occurrence	\$16,833
Other liability claims made	10,336
Workers compensation	9,435
Auto liability	5,512
Property	4,223
International	3,608
Reinsurance	2,480
Medical malpractice	2,236
Aircraft	1,697
Products liability	1,384
Commercial multiple peril	1,154
Accident and health	1,097
Fidelity/ surety	960
Other	2,615
<b>Total</b>	<b>\$63,570</b>

<sup>\*</sup>Presented pursuant to statutory reporting requirements as prescribed by the National Association of Insurance Commissioners.

These loss reserves represent the accumulation of estimates of ultimate losses, including IBNR and loss expenses on a statutory accounting basis.

At March 31, 2005, General Insurance net loss reserves increased \$2.08 billion from the prior year end to \$49.33 billion. The net loss reserves represent loss reserves reduced by reinsurance recoverables, net of an allowance for unrecoverable reinsurance and the discount for future investment income. The table below classifies the components of the General Insurance net loss reserves by business unit as of March 31, 2005.

(in millions)

DBG <sup>(a)</sup>	\$33,891
Personal Lines <sup>(b)</sup>	2,314
Transatlantic	5,062
Mortgage Guaranty	353
Foreign General <sup>(c)</sup>	7,714

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Total Net Loss Reserve

\$49,334

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*(a) DBG loss reserves include approximately \$3.37 billion (\$3.98 billion before discount) related to business written by DBG but ceded to AIRCO and reported in AIRCO's statutory filings.*

*(b) Personal Lines loss reserves include \$700 million related to business ceded to DBG and reported in DBG's statutory filings.*

*(c) Foreign General loss reserves include approximately \$1.95 billion related to business reported in DBG's statutory filings.*

The DBG net loss reserve of \$33.89 billion is comprised principally of the business of AIG subsidiaries participating in the American Home/National Union pool (11 companies) and the surplus lines pool (Lexington, Starr Excess Liability Insurance Company and Landmark Insurance Company).

Beginning in 1998, DBG ceded a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 40 percent in 1998, 65 percent in 1999, 75 percent in 2000 and 2001, 50 percent in 2002 and 2003, 40 percent in 2004 and 35 percent in 2005 and covered all business written in these years for these lines by participants in the American Home/National Union pool. In 1998 the cession reflected only the other liability occurrence business, but in 1999 and subsequent years included products liability occurrence. AIRCO's loss reserves relating to these quota share cessions from DBG are recorded on a discounted basis. As of March 31, 2005, AIRCO carried a discount of approximately \$610 million applicable to the \$3.98 billion in undiscounted reserves it assumed from the American Home/National Union pool via this quota share cession. AIRCO also carries approximately \$375 million in net loss reserves relating to Foreign General insurance business. These reserves are carried on an undiscounted basis.

Beginning in 1997, the Personal Lines division ceded a percentage of all business written by the companies participating in the personal lines pool to the American Home/National Union pool. As noted above, the total reserves carried by participants in the American Home/National Union pool relating to this cession amounted to \$700 million as of March 31, 2005.

The companies participating in the American Home/National Union pool have maintained a participation in the business written by AIU for decades. As of March 31, 2005, these AIU reserves carried by participants in the American Home/National Union pool amounted to approximately \$1.95 billion. The remaining Foreign General reserves are carried by AIUO, AIRCO, and other smaller AIG subsidiaries

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American International Group, Inc. and Subsidiaries domiciled outside the United States. Statutory filings in the U.S. by AIG companies reflect all the business written by U.S. domiciled entities only, and therefore exclude business written by AIUO, AIRCO, and all other internationally domiciled subsidiaries. The total reserves carried at March 31, 2005 by AIUO and AIRCO were approximately \$3.41 billion and \$3.74 billion, respectively. AIRCO's \$3.74 billion in total general insurance reserves consist of approximately \$3.37 billion from business assumed from the American Home/National Union pool and an additional \$375 million relating to Foreign General Insurance business.

At March 31, 2005, AIG's overall General Insurance net loss reserves reflects a loss reserve discount of \$1.56 billion, including tabular and non-tabular calculations. The tabular workers compensation discount is calculated using a 3.5 percent interest rate and the 1979-81 Decennial Mortality Table. The non-tabular workers compensation discount is calculated separately for companies domiciled in New York and Pennsylvania, and follows the statutory regulations for each state. For New York companies, the discount is based on a five percent interest rate and the companies' own payout patterns. For Pennsylvania companies, the statute has specified discount factors for accident years 2001 and prior, which are based on a six percent interest rate and an industry payout pattern. For accident years 2002 and subsequent, the discount is based on the yield of U.S. Treasury securities ranging from one to twenty years and the company's own payout pattern, with the future expected payment for each year using the interest rate associated with the corresponding Treasury security yield for that time period. The discount is comprised of the following: \$401 million tabular discount for workers compensation in DBG; \$544 million non-tabular discount for workers compensation in DBG; and, \$610 million non-tabular discount for other liability occurrence and products liability occurrence in AIRCO. The total undiscounted workers compensation loss reserve carried by DBG is approximately \$6.9 billion as of March 31, 2005. The other liability occurrence and products liability occurrence business in AIRCO that is assumed from DBG is discounted using a 5.5 percent interest rate and the DBG payout pattern for this business. The undiscounted reserves assumed by AIRCO from DBG totaled approximately \$3.98 billion at March 31, 2005.

The methods used to determine loss reserve estimates and to establish the resulting reserves are continually reviewed and updated by management. Any adjustments resulting therefrom are reflected in operating income currently. It is management's belief that the General Insurance net loss reserves are adequate to cover all General Insurance net losses and loss expenses as of March 31, 2005. While AIG annually reviews the adequacy of established loss reserves, there can be no assurance that AIG's ultimate loss reserves will not adversely develop and materially exceed AIG's loss reserves as of March 31, 2005. In the opinion of management, such adverse development and resulting increase in reserves is not likely to have a material adverse effect on AIG's consolidated financial position, although it could have a material adverse effect on AIG's consolidated results of operations for an individual reporting period.

**The table below presents the reconciliation of net loss reserves for the first three months ended March 31, 2005 and 2004 as follows:**

<i>(in millions)</i>	<b>2005 (Restated)</b>	2004 (Restated)
Net reserve for losses and loss expenses at beginning of year	\$ 47,254	\$ 36,228
Foreign exchange effect	28	222
<b>Losses and loss expenses incurred:</b>		
Current year	7,039	6,333
Prior years*	240	368
Losses and loss expenses incurred	7,279	6,701
Losses and loss expenses paid	5,227	4,645
Net reserve for losses and loss expenses at end of period	\$ 49,334	\$ 38,506

\*Includes accretion of discount of \$97 million in the first three months of 2005 and \$94 million in the first three months of 2004. Additionally, includes \$55 million in the first three months of 2005 and \$45 million in the first three months of 2004 for the general reinsurance operations of Transatlantic, and \$118 million of additional losses incurred in the first three months of 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes.

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

certain classes of casualty lines.

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

Estimation of ultimate net losses and loss expenses (net losses) for long-tail casualty lines of business is a complex process and depends on a number of factors, including the line and volume of the business involved. Experience in the more recent accident years of long-tail casualty lines shows limited statistical credibility in reported net losses because a

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relatively low proportion of net losses would be reported claims and expenses and an even smaller proportion would be net losses paid. Therefore, IBNR would constitute a relatively high proportion of net losses.

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

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

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

Expected loss ratios for the latest accident year (i.e., accident year 2004 for the year end 2004 loss reserve analysis) and, in some cases, for accident years prior to the latest accident year. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend (see above) and the effect of rate changes and other quantifiable factors. For low-frequency, high-severity classes such as excess casualty and D&O, expected loss ratios generally are utilized for at least the three most recent accident years.

Loss development factors which are used to project the reported losses for each accident year to an ultimate basis.

AIG records quarterly changes in loss reserves for each of its many General Insurance profit centers. The overall change in AIG's loss reserves is based on the sum of these profit center level changes. For most profit centers which write longer tail classes of casualty coverage, the process of recording quarterly loss reserve changes involves determining the estimated current loss ratio for each class of coverage. This loss ratio is multiplied by the current quarter's net earned premium for that class of coverage to determine the quarter's total estimated net incurred loss and loss expense. The change in loss reserves for the quarter for each class is thus the difference between the net incurred loss and loss expense, estimated as described above, and the net paid losses and loss expenses in the quarter.

The process of determining the current loss ratio for each class or business segment begins in the profit centers in the latter part of the previous year. The loss ratios determined for each profit center are based on a variety of factors. These include, but are not limited to, the following considerations: prior accident year and policy year loss ratios; actual and anticipated rate changes; actual and anticipated changes in coverage, reinsurance, or mix of business; actual and anticipated changes in external factors affecting results, such as trends in loss costs or in the legal and claims environment. Each profit center's loss ratio for the following year is subject to review by the profit center's management, by actuarial and accounting staffs, and ultimately by senior management. At the close of each quarter, the assumptions underlying the loss ratios are reviewed to determine if the loss ratios based thereon remain appropriate. This process includes a review of the actual claims experience in the quarter, actual rate changes achieved, actual changes in coverage, reinsurance or mix of business, and changes in certain other factors that may affect the loss ratio. When this review suggests that the initially determined loss ratio is no longer appropriate, the loss ratio for current business would be changed to reflect the revised assumptions.

A comprehensive annual loss reserve review is conducted in the fourth quarter of each year for each AIG General Insurance subsidiary. These reviews are conducted in full detail for each class or line of business for each subsidiary, and thus consist of literally hundreds of individual analyses. The purpose of these reviews is to confirm the reasonableness of the reserves carried by each of the individual subsidiaries, and thereby of AIG's overall carried reserves. The reserve analysis for each business class is performed by the actuarial personnel who are most familiar with that class of business. In completing these detailed actuarial reserve analyses, the actuaries are required to make numerous assumptions, including for example the selection of loss development factors and loss cost trend factors. They are also required to determine and select the most appropriate actuarial method(s) to employ for each business class. Additionally, they must determine the appropriate segmentation of data or segments from which the adequacy of the reserves can be most accurately tested. In the course of these detailed reserve reviews for each business segment, a point estimate of the loss reserve is generally determined. The sum of these point estimates for each of the individual business classes for each subsidiary provides an overall actuarial point estimate of the loss reserve for that subsidiary. The overall actuarial point estimate is compared to the subsidiary's carried loss reserve. If the carried reserve can be supported by actuarial methods and assumptions which are also believed to be reasonable, then the carried reserve would generally be considered reasonable and no adjustment would be considered. The ultimate process by which the actual carried reserves are determined considers not only the actuarial





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point estimate but a myriad of other factors. Other crucial internal and external factors considered include a qualitative assessment of inflation and other economic conditions in the United States and abroad, changes in the legal, regulatory, judicial and social environments, underlying policy pricing, terms and conditions, and claims handling. Loss reserve development can also be affected by commutations of assumed and ceded reinsurance agreements.

With respect to the 2004 year-end actuarial loss reserve analysis for DBG, the actuaries continued to utilize the modified assumptions which gave additional weight to actual loss development from the more recent years, as identified during the 2002 and 2003 analysis, with appropriate adjustments to account for the additional year of loss experience which emerged in 2004. Although the actuaries continued to use actuarial assumptions that rely on expected loss ratios based on the results of prior accident years, the expected loss ratio assumptions used continue to give far greater weight to the more recent accident year experience than was the case in the prior year-end assumptions. For example, for the excess casualty lead umbrella class of business, 100 percent weight was given to the experience of accident years 1998-2001, with no weight given to the more favorable experience of accident years prior to 1998.

AIG's annual loss reserve review does not calculate a range of loss reserve estimates. Because a large portion of the loss reserves from AIG's General Insurance business relates to long-tail casualty lines driven by severity rather than frequency of claims, such as excess casualty and D&O, developing a range around loss reserve estimates would not be meaningful. An estimate is calculated which AIG's actuaries believe provides a reasonable estimate of the required reserve. This amount is then evaluated against actual carried reserves.

There is potential for significant variation in the development of loss reserves, particularly for long-tail casualty classes of business such as excess casualty, when actual costs differ from the assumptions used to test the reserves. Such assumptions include those made for loss trend factors and loss development factors, as described earlier. Set forth below is a sensitivity analysis demonstrating the estimated effect on the loss reserve position of alternative loss trend or loss development factor assumptions as compared to those actually used to test the carried reserves.

For the excess casualty class of business the assumed loss cost trend was five percent. Thus, in establishing the expected loss ratios for accident years 2002 through 2004, the loss costs from accident years 1998 through 2001 were trended by this five percent factor per annum. A five percent change in the assumed loss cost trend from each accident year to the next would cause approximately a \$600 million change (either positively or negatively) to the net loss and loss expense reserve for this business. For the D&O and related management liability classes of business the assumed loss cost trend was four percent. Thus, in establishing the expected loss ratios for accident years 2002 through 2004, the loss costs from accident years 1997 through 2001 were trended by this four percent factor per annum. A five percent change in this assumed loss cost trend would cause approximately a \$500 million change (either positively or negatively) to the net loss and loss expense reserve for such business. For healthcare liability business, including hospitals and other healthcare exposures, a five percent change in the assumed loss cost trend would cause approximately a \$150 million change (either positively or negatively) to the loss and loss expense reserve for this business. Actual loss cost trends in the early 1990's were negative for these classes, whereas in the late 1990's loss costs trends ran well into the double digits for each of these three classes. The sharp increase in loss costs in the late 1990's was thus much greater than the five percent changes cited above, and caused significant increases in the overall loss reserve needs for these classes. While changes in the loss cost trend assumptions can have a significant effect on the reserve needs for other smaller classes of liability business, the potential effect of these changes on AIG's overall carried reserves would be much less than for the classes noted above.

Loss reserves pertaining to the excess casualty class of business are generally included in the Other Liability Occurrence line of business, with a small portion of the excess casualty reserves included in the Other Liability Claims Made line of business, as presented in the table on page 44. For the excess casualty class, if future loss development factors differed by five percent from those utilized in the year-end 2004 loss reserve review, there would be approximately a \$450 million change (either positively or negatively) to the overall AIG loss reserve position. The comparable effect on the D&O and related management liability classes would be approximately \$200 million (either positively or negatively) if future loss development factors differed by five percent from those utilized in the year-end 2004 loss reserve review. For healthcare liability classes, the effect would be approximately \$125 million (either positively or negatively). For workers compensation reserves, the effect of a five percent deviation from the loss development factors utilized in the year-end 2004 reserve reviews would be approximately \$750 million (either positively or negatively). Because loss development factors for this class have shown less volatility than higher severity classes such as excess casualty, however, actual changes in loss development factors are expected to be less than five percent. There is some degree of volatility in loss development patterns for other longer tail liability classes as well. However, the potential effect on AIG's reserves would be much less than for the classes cited above.

The calculations of the effect of the five percent change in loss development factors are made by selecting the stage of accident year development where it is believed reasonable for such a deviation to occur. For example, for workers compensation, the \$750 million amount is calculated by assuming



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that each of the most recent eight accident years develop five percent higher than estimated by the current loss development factors utilized in the reserve study, *i.e.* the factor 1.05 is multiplied by the incurred losses (including IBNR and loss expenses) for these accident years.

AIG management believes that using a five percent change in the assumptions for loss cost trends and loss development factors provides a reasonable benchmark for a sensitivity analysis of the reserves of AIG's most significant lines of general insurance business. For excess casualty business, both the loss cost trend and the loss development factor assumptions are critical. 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, as excess casualty is a long-tail class of business, any deviation in loss cost trends or in loss development factors might not be discernible for an extended period of time subsequent to the recording of the initial loss reserve estimates for any accident year. Thus, there is the potential for the reserves with respect to a number of accident years to be significantly affected by changes in the loss cost trends or loss development factors that were initially relied upon in setting the reserves. These changes in loss trends or loss development factors could be attributable to changes in inflation or in the judicial environment, or in other social or economic phenomena affecting claims. For example, during the lengthy periods during which losses develop for excess casualty, actual changes in loss costs from one accident year to the next have ranged from negative values to double-digit amounts. Thus, there is the potential for significant volatility in loss costs for excess casualty and, although five percent is considered a reasonable benchmark for sensitivity analysis for this business, there is the potential for variations far greater than this amount (either positively or negatively). Likewise, in the judgment of AIG's actuaries, five percent is considered an appropriate benchmark for sensitivity analysis with respect to the loss development factor assumptions used to test the reserves. It should be noted that the loss cost trend factor for excess casualty was reduced to five percent in the year-end 2004 loss reserve review compared to the 7.5 percent loss trend factor used in the 2003 review for excess casualty. This reduction was made by AIG's actuaries in response to a significant favorable loss trend that had emerged from accident year 2000 to 2001. This favorable trend appears to be continuing in accident years 2002 and 2003, although these accident years are still immature.

Loss reserves pertaining to D&O and related management liability classes of business are included in the Other Liability Claims Made line of business, as presented in the table on page 44. For D&O and related management liability classes of business, the loss cost trend assumption is critical. The loss development factor assumption is important but less critical than for excess casualty. As this coverage is written on a claims-made basis, claims for a given accident year are all reported within that year. Actual changes in loss costs from one accident year to the next in the 1990s ranged from double digit negative values for several accident years in the early 1990s to nearly 50 percent per year for the period from accident year 1996 to accident year 1999. Thus, there is the potential for extreme volatility in loss costs for this business and, although five percent is considered a reasonable benchmark for sensitivity analysis, there is the potential for variations far greater than this amount (either positively or negatively). Five percent is also considered an appropriate benchmark for sensitivity analysis with respect to the loss development factor assumptions used to test the reserves for these classes. However, as noted above, the effect of such a deviation is less than that of a similar deviation in loss cost trends. It should be noted that the loss cost trend factor for D&O and related management liability classes was reduced to four percent in the year end 2004 loss reserve reviews compared to six percent in the 2003 review. This reduction was made by AIG's actuaries in response to a relative stabilization in loss costs from accident year 1999 to 2001 following the period of sharp increases in loss costs through 1999. The stabilization in loss costs appears to be continuing in accident years 2002 and 2003, although these accident years are still immature.

For healthcare liability classes, both the loss cost trend and the loss development factor assumptions are critical. The nature of the potential volatility would be analogous to that described above for the excess casualty business. However, AIG's volume of business in the healthcare classes is much smaller than for excess casualty, hence the potential effect on AIG's overall reserves is smaller for these classes than for excess casualty. AIG's healthcare liability business includes both primary and excess exposures.

For workers compensation, the loss development factor assumptions are important. Generally, AIG's actual historical workers compensation loss development would be expected to provide a reasonably accurate predictor of future loss development. A five percent sensitivity indicator for workers compensation would thus be considered to be toward the high end of potential deviations for this class of business. AIG's workers compensation reserves include a small portion relating to excess workers compensation coverage. The analysis applicable to excess casualty would apply to these reserves. However, the volume of such business is de minimis compared to the volume of excess casualty. The loss cost trend assumption for workers compensation is not believed to be material with respect to AIG's loss reserves other than for that portion representing excess workers compensation. This is primarily because AIG's actuaries are generally able to use loss development projections for all but the most recent accident year's reserves, so there is limited need to rely on loss cost trend assumptions for workers compensation business.

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For casualty business other than the classes noted above, there is generally some potential for deviation in both the loss cost trend and loss development factor selections. However, the effect of such deviations would not be material when compared to the effect cited above for excess casualty and D&O.

The comprehensive annual loss reserve review process results in an accumulation of point estimates for AIG's General Insurance business. The loss reserve carried at year-end 2004 for AIG's General Insurance business was approximately equal to the aggregate reserve indicated by the actuarial point estimates. This represents a relative improvement of approximately two percent from AIG's position as of December 31, 2003. This comparison excludes the reserves relating to asbestos and environmental exposures, which are determined using different methodologies, as described below.

*Asbestos and Environmental Reserves*

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

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

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

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

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

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

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

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

aforementioned approach and adjusted as necessary to reflect the current information.

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

With respect to asbestos claims handling, AIG's specialized claims staff operates to mitigate losses through proactive handling, supervision and resolution of asbestos cases. Thus, while AIG has resolved all claims with respect to miners and

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American International Group, Inc. and Subsidiaries major manufacturers (Tier One), its claims staff continues to operate under the same proactive philosophy to resolve claims involving accounts with products containing asbestos (Tier Two), products containing small amounts of asbestos, companies in the distribution process, and parties with remote, ill defined involvement in asbestos (Tiers Three and Four). Through its commitment to appropriate staffing, training, and management oversight of asbestos cases, AIG mitigates to the extent possible its exposure to these claims.

In order to evaluate the overall reasonableness of the asbestos and environmental reserves established using the claim-by-claim approach as described above, AIG uses two methods, the market share method and the frequency/severity or report year method.

The market share method produces indicated asbestos and environmental reserve needs by applying the appropriate AIG market share to estimated potential industry ultimate loss and loss expenses based on the latest estimates from A.M. Best and Tillinghast. The market share method is a series of tests. Six estimates of potential industry ultimate losses for asbestos and environmental claims are tested. Additionally, a second series of tests are performed, using estimated industry unpaid losses, instead of industry ultimate losses. The market share tests are also performed using estimates of AIG's market share. The reason AIG's market share is an estimate is that there are assumptions as to which years and classes of business the asbestos and environmental exposure applies. For example, commercial multiple peril business is included in the market share calculation in some, but not all, of the scenarios.

AIG's estimate of the carried net asbestos and environmental reserves were approximately \$50 million greater than the mean indication of the outcomes of market share testing. However, the market share method does not give weight to AIG's actual asbestos and environmental loss experience.

The frequency/severity or report year approach, is also a series of tests which are performed separately for asbestos and for environmental exposures. For asbestos, these tests project the expected losses to be reported over the next twenty years, *i.e.* from 2005 through 2024, based on the actual losses reported through 2004 and the expected future loss emergence for these claims. Three scenarios are tested, with a series of assumptions ranging from more optimistic to more conservative. In the first scenario, all carried asbestos case reserves, as determined above using the claim-by-claim approach, are assumed to be within ten percent of their ultimate settlement value.

The second scenario relies on an actuarial projection of report year developments for asbestos claims reported from 1993 to the present to estimate case reserve adequacy as of year-end 2004. The third scenario also relies on an actuarial projection of report year claims for asbestos, but reflects claims reported from 1989 to the present to estimate case reserve adequacy as of year-end 2004. As of year-end 2004, the results of the second and third scenarios varied significantly. In the second scenario, case reserves were indicated to be at slightly less than 60 percent of the ultimate settlement value at year-end 2004, whereas in the third scenario they were indicated to be at less than 25 percent of ultimate settlement value.

Based on the results of the prior report years for each of the three scenarios described above, the report year approach then projects forward to the year 2024 the expected future report year losses, based on AIG's estimate of reasonable loss trend assumptions.

These calculations are performed on losses gross of reinsurance. The IBNR (including a provision for development of reported claims) on a net basis is based on applying a factor reflecting the expected ratio of net losses to gross losses for future loss emergence.

For environmental claims, an analogous series of frequency/severity tests are produced. In general, the case reserve adequacy assumptions are narrower, as case reserve adequacy is indicated within approximately 25 percent of adequacy in all scenarios tested. Environmental claims from future report years (*i.e.* IBNR) are projected out ten years, *i.e.* through the year 2014.

As of year-end 2004, the range of outcomes from the scenarios tested for environmental ranged from \$20 million below AIG's carried reserve to approximately \$200 million greater than AIG's carried reserve. The range of outcomes for asbestos was greater. The indication from the first scenario, as described above, was approximately \$140 million below AIG's carried reserve. The indication from the second scenario was approximately \$10 million below AIG's carried reserves. The indication from the third scenario was approximately \$650 million greater than AIG's carried reserve.

At year-end 2004, AIG considered a number of factors and recent experience to determine the appropriate reserve that should be carried for these claims, including the following:

1. *Actual calendar experience for past ten years, five years, three years, and one year.* AIG experienced consistent adverse development on its carried asbestos and environmental reserves over the years. The net carried reserves from ten years ago ran off \$1.45 billion deficient; from

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five years ago \$430 million deficient; from three years ago \$350 million deficient; and from one year ago \$150 million deficient. Thus the reserves consistently produced adverse development per year, with no evidence of recent improvement. These figures are prior to the year-end 2004 reserve increase.

On a gross of reinsurance basis, the adverse developments were analogous, with approximately \$450 million in the latest year and \$4.8 billion over the past ten years.



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2. *Input from claims officers on latest year events.* DBG's claims officers observed an increasing trend toward adverse claims experience in the layers underlying its excess attachment points for a number of Tier Two claims, increasing the probability of further adverse loss developments going forward. They also noted the emergence of several asbestos non-products cases recently, raising a concern that asbestos non-products cases could become a more serious problem in the future.

3. *Deterioration in Report Year claims experience.* As noted above, the Scenario Two and Scenario Three indications for case reserve adequacy in AIG's 2004 year-end actuarial report indicated an increasing deficiency in carried case reserves for asbestos. This was the result of continued adverse development on prior year case reserves and suggests future loss development will be at higher levels than previously indicated. As a result, the Scenario Three indicated reserve deficiency increased from approximately \$480 million in the 2003 year-end reserve review to a deficiency of approximately \$650 million in the year-end 2004 review. Furthermore, the year-end 2004 review utilized data evaluated as of June 30, 2004. An update to this data was produced (for all large claims) with claims evaluated as of March 31, 2005, *i.e.*, an additional nine months of data beyond the year-end 2004 reserve study. This update showed that report year losses in the nine months from June 2004 to March 2005 produced additional adverse loss development. In fact, more loss development was observed during these nine months than for the twelve months from the June 2003 through June 2004 period. Thus, both the latest year's data used in the year-end 2004 actuarial study and the nine months of additional data subsequent to that study indicated the experience was deteriorating beyond what was expected at year-end 2003.

4. *Survival Ratios.* AIG's year-end 2004 survival ratio for asbestos was 5.7 and 5.2 on a gross and a net basis, respectively, prior to the year-end 2004 reserve increase. AIG's year-end 2004 survival ratio for environmental was 4.8 and 3.8 on a gross and a net basis, respectively, prior to the year-end 2004 reserve increase. These survival ratios indicated AIG's carried reserves were sufficient to fund four to five years of payments for these claims, assuming payment levels remain stable. Based on the latest two years of actual paid losses, AIG did not expect its losses to decline as quickly as these ratios imply.

5. *Industry experience.* The industry has experienced a significant wave of adverse development for asbestos since 2001, with little, if any, signs of recent improvement. Furthermore, the litigation environment has become increasingly adverse.

6. *Reinsurance Recoverable.* Although AIG has been successful in collecting the vast majority of its reinsurance on asbestos and environmental claims, the greater the future losses and the longer the exposure persists, the greater the likelihood of increased problems in collecting reinsurance. Thus, the continued adverse developments and lack of any signs that loss experience is beginning to diminish increases the risk of uncollectible reinsurance.

After considering all of these factors, particularly its recent experience, AIG determined that its carried reserve for asbestos and environmental claims would be best estimated by scenario three described above. This resulted in a \$650 million increase in net asbestos reserves, and a \$200 million increase in net environmental reserves. The corresponding increases in gross reserves were \$1.2 billion for asbestos and \$250 million for environmental reserves.

Significant uncertainty remains as to AIG's ultimate liability relating to asbestos and environmental claims. This uncertainty is due to several factors including:

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

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

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

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

Diverging legal interpretations;

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

The possibility of federal legislation that would address the asbestos and environmental issue.



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A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined for the three months ended March 31, 2005 and 2004 follows:

(in millions)	2005		2004	
	Gross	Net	Gross	Net
<b>Asbestos:</b>				
Reserve for losses and loss expenses at beginning of year	\$ 2,559	\$ 1,060	\$ 1,235	\$ 386
Losses and loss expenses incurred*	78	24	49	20
Losses and loss expenses paid*	(91)	(29)	(109)	(38)
Reserve for losses and loss expenses at end of period	\$ 2,546	\$ 1,055	\$ 1,175	\$ 368
<b>Environmental:</b>				
Reserve for losses and loss expenses at beginning of year	\$ 974	\$ 451	\$ 789	\$ 283
Losses and loss expenses incurred*	(13)	(3)		(10)
Losses and loss expenses paid*	(30)	(16)	(33)	(13)
Reserve for losses and loss expenses at end of period	\$ 931	\$ 432	\$ 756	\$ 260
<b>Combined:</b>				
Reserve for losses and loss expenses at beginning of year	\$ 3,533	\$ 1,511	\$ 2,024	\$ 669
Losses and loss expenses incurred*	65	21	49	10
Losses and loss expenses paid*	(121)	(45)	(142)	(51)
Reserve for losses and loss expenses at end of period	\$ 3,477	\$ 1,487	\$ 1,931	\$ 628

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

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

(in millions)	2005		2004	
	Gross	Net	Gross	Net
Asbestos	\$ 1,864	\$ 786	\$ 686	\$ 196
Environmental	554	248	342	81
Combined	\$ 2,418	\$ 1,034	\$ 1,028	\$ 277

A summary of asbestos and environmental claims count activity for the three months ended March 31, 2005 and 2004 was as follows:

2005			2004		
Asbestos	Environmental	Combined	Asbestos	Environmental	Combined

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Claims at beginning of year	7,575	8,216	15,791	7,474	8,852	16,326
Claims during year:						
Opened	259	759	1,018	201	967	1,168
Settled	(19)	(52)	(71)	(60)	(50)	(110)
Dismissed or otherwise resolved	(130)	(879)	(1,009)	(229)	(856)	(1,085)
Claims at end of period	7,685	8,044	15,729	7,386	8,913	16,299

The table below presents AIG's survival ratios for asbestos and environmental claims at March 31, 2005 and 2004. The survival ratio is derived by dividing the current carried loss reserve by the average payments for the three most recent calendar years for these claims. Therefore, the survival ratio is a simplistic measure estimating the number of years it would be before the current ending loss reserves for these claims would be paid off using recent year average payments. Many factors, such as aggressive settlement procedures, mix of business and level of coverage provided, have a significant effect on the amount of asbestos and environmental reserves and payments and the resultant survival ratio. Thus, caution should be exercised in attempting to determine reserve adequacy for these claims based simply on this survival ratio.

**AIG's survival ratios for asbestos and environmental claims, separately and combined were based upon a three-year average payment. These ratios at March 31, 2005 and 2004 were as follows:**

	Gross	Net
<b>2005</b>		
<b>Survival ratios:</b>		
Asbestos	9.8	12.7
Environmental	6.3	6.7
Combined	8.5	10.1
<b>2004</b>		
<b>Survival ratios:</b>		
Asbestos	4.4	4.4
Environmental	4.9	4.0
Combined	4.6	4.3

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**Life Insurance & Retirement Services Operations**

AIG's Life Insurance & Retirement Services subsidiaries offer a wide range of insurance and retirement savings products both domestically and abroad. Insurance-oriented products consist of individual and group life, payout annuities, endowment and accident and health policies. Retirement savings products consist generally of fixed and variable annuities. (See also Note 3 of Notes to Consolidated Financial Statements.)

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

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

**Life Insurance & Retirement Services operations presented on a major product basis for the three months ended March 31, 2005 and 2004 were as follows:**

<i>(in millions)</i>	<b>2005</b> <b>(Restated)</b>	2004 (Restated)
<b>GAAP premiums:</b>		
<b>Domestic Life:</b>		
Life insurance	\$ 514	\$ 432
Home service	203	206
Group life/health	251	268
Payout annuities <sup>(a)</sup>	397	374
<b>Total</b>	<b>1,365</b>	<b>1,280</b>
<b>Domestic Retirement Services:</b>		
Group retirement products	84	76
Individual fixed annuities	20	13
Individual variable annuities	112	100
Individual annuities-runoff <sup>(b)</sup>	23	20
<b>Total</b>	<b>239</b>	<b>209</b>
<b>Total Domestic</b>	<b>1,604</b>	<b>1,489</b>
<b>Foreign Life:</b>		
Life insurance	4,089	3,861
Personal accident & health	1,221	1,029
Group products	517	415
<b>Total</b>	<b>5,827</b>	<b>5,305</b>
<b>Foreign Retirement Services:</b>		
Individual fixed annuities	84	85
Individual variable annuities	25	12
<b>Total</b>	<b>109</b>	<b>97</b>

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Total Foreign	5,936	5,402
Total GAAP premiums	\$ 7,540	\$ 6,891
Net investment income:		
Domestic Life:		
Life insurance	\$ 386	\$ 341
Home service	147	152
Group life/health	32	31
Payout annuities	210	199
Total	775	723
Domestic Retirement Services:		
Group retirement products	549	542
Individual fixed annuities	827	758
Individual variable annuities	58	55
Individual annuities-runoff <sup>(b)</sup>	254	276
Total	1,688	1,631
Total Domestic	2,463	2,354
Foreign Life:		
Life insurance	1,164	1,005
Personal accident & health	54	42
Group products	131	105
Intercompany adjustments	(8)	(4)
Total	1,341	1,148
Foreign Retirement Services:		
Individual fixed annuities	377	199
Individual variable annuities	136	78
Total	513	277
Total Foreign	1,854	1,425
Total net investment income	\$ 4,317	\$ 3,779
Pricing net investment gains <sup>(c)</sup>	81	78
Realized capital gains (losses)	(163)	(263)
Total realized gains (losses) <sup>(c)</sup>	(82)	(185)
Total operating income	\$ 2,181	\$ 1,749
Life insurance in-force <sup>(d)</sup> :		
Domestic	\$ 760,104	\$ 772,251
Foreign	1,084,529	1,085,843
Total	\$ 1,844,633	\$ 1,858,094

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

(b) Represents runoff annuity business sold through discontinued distribution relationships.

(c)

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

*(d) Amounts presented were as at March 31, 2005 and December 31, 2004. The decline in Domestic in-force was due to the non-renewal of a single large group life case of \$36 billion. Foreign in-force includes Tata AIG Life Insurance Company, Ltd.*

AIG's Life Insurance & Retirement Services subsidiaries report their operations through the following operating units: Domestic Life AIG American General, including American

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General Life Insurance Company (AG Life), USLIFE and AGLA; Domestic Retirement Services VALIC, AIG Annuity and AIG SunAmerica; Foreign Life ALICO, AIG Edison Life, AIG Star Life, AIA, Nan Shan and Philamlife.

Life Insurance & Retirement Services Results

The increase in operating income in the first three months of 2005 when compared to the same period of 2004 was caused in part by strong growth overseas, and the decline in realized capital losses in 2005 compared to 2004.

Life Insurance & Retirement Services GAAP premiums grew in the first three months of 2005 when compared with the same period in 2004. AIG's Domestic Life operations had continued strong growth in term and universal life sales and good performance from the independent distribution channels. Payout annuities also had strong growth. The domestic group business is below AIG's growth standards, largely because several accounts where pricing was unacceptable were not renewed and loss experience was higher than anticipated. Restructuring efforts in this business are focused on new product introductions, cross selling and other growth strategies. AGLA, the home service business, is diversifying product offerings, enhancing the capabilities and quality of the sales force and broadening the markets served beyond those historically serviced in an effort to accelerate growth.

Domestic Retirement Services businesses faced a challenging environment in the first three months of 2005, as deposits declined approximately nine percent compared to the same period in 2004 and operating income for the retirement services businesses remained relatively flat when compared with the first three months of 2004. The sales environment for the first three months of 2005 for individual variable annuities was unfavorably affected by the combination of weak equity market performance and the cumulative effect of more restrictive regulatory compliance procedures imposed by the broker-dealer and bank distributors in recent periods.

AIG's domestic fixed annuity business has been affected by a significant flattening of the treasury yield curve over the past several quarters, which has affected sales as yields on competing products, such as bank CDs, approach those available on AIG's fixed annuities. There are some indications that negative press coverage of AIG has adversely affected surrenders and withdrawals of fixed annuities. In addition, surrenders have increased from prior year levels as annuities sold in 2000 can now be surrendered without charges, and as a result of the competitive interest rate environment. The combination of reduced sales and increased surrenders and withdrawals resulted in significantly lower net flows when compared to prior year. AIG expects that net flows will remain lower than in prior years as long as an environment of poor equity market performance and the yield curve remains flat.

The majority of the growth in Life Insurance & Retirement Services GAAP premiums in Foreign Life operations was attributable to the life insurance, personal accident & health, and group products lines of business. Globally, AIG's deep and diverse distribution, which includes bancassurance, worksite marketing, direct marketing and strong agency organizations, provides a powerful platform for growth. This growth was most significant in Southeast Asia where AIG maintains significant market share established by its strong agency force, and in Japan, where AIG has benefited from a flight to quality and development of multiple distribution channels. In light of AIG's recent credit rating downgrades, it is unclear whether this flight to quality will continue to benefit AIG. Also in Japan, AIG Edison Life's back office operations are being integrated successfully into AIG's life operations. AIG Star Life is growing first year premiums as a result of new product introductions and an expanded agency force, and is benefiting from more successful conservation of in-force business. The Foreign Retirement Services business continues its strong growth based upon its success in Japan and Korea by expanding its extensive distribution network and leveraging AIG's product expertise. AIG is introducing annuity products in new markets. In January 2005, AIG Star Life entered into an agreement with the Bank of Tokyo Mitsubishi, one of Japan's largest banks, to market a multi-currency fixed annuity.

Foreign Life Insurance & Retirement Services operations produced 78.7 percent and 78.4 percent of Life Insurance & Retirement Services GAAP premiums in the first three months of 2005 and 2004, respectively.

**AIG transacts business in most major foreign currencies. The following table summarizes the effect of changes in foreign currency exchange rates on the growth of Life Insurance & Retirement Services GAAP premiums.**

	2005
Growth in original currency	6.0%
Foreign exchange effect	3.4
Growth as reported in U.S. dollars	9.4%



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Under U.S. GAAP, deposits and certain other consideration received under deferred annuity (variable and fixed) and universal life contracts are not included as GAAP premiums.

The growth in net investment income in the first three months of 2005 was attributable to both foreign and domestic invested new cash flow for investment. Additionally, net investment income was positively affected by the compounding of previously earned and reinvested net investment income.

Life Insurance & Retirement Services investment portfolios are managed within the overall objectives of the Life Insurance & Retirement Services operations. AIG subsidiaries invest in certain limited liability companies that invest in synthetic fuel production facilities as a means of generating income tax credits. Net investment income includes operating

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losses of approximately \$36 million and \$30 million, respectively, for the first three months of 2005 and 2004 and income taxes includes tax credits and benefits of approximately \$54 million and \$40 million, respectively, for the first three months of 2005 and 2004 from these investments.

The contribution of Life Insurance & Retirement Services operating income to AIG's consolidated income before income taxes, minority interest and cumulative effect of an accounting change amounted to 38.6 percent in the first three months of 2005, compared to 45.5 percent in the same period of 2004.

**Underwriting and Investment Risk**

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

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

AIG's Foreign Life companies generally limit their maximum underwriting exposure on life insurance of a single life to approximately \$1.7 million of coverage and AIG's Domestic Life companies generally limit their maximum underwriting exposure on life insurance of a single life to \$5 million of coverage by using yearly renewable term reinsurance. (See also the discussion under "Liquidity" herein.)

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

AIG's domestic Life Insurance and Retirement Services operations utilize internal and third-party reinsurance relationships to manage insurance risks and to facilitate capital management strategies. Pools of highly-rated third-party reinsurers are utilized to manage net amounts at risk in excess of retention limits. AIG's domestic life insurance companies also cede excess, non-economic reserves carried on a statutory-basis only on certain term and universal life insurance policies and certain fixed annuities to AIG Life of Bermuda Ltd., a wholly owned Bermuda reinsurer.

AIG generally obtains letters of credit in order to obtain statutory recognition of these intercompany reinsurance transactions. For this purpose, AIG entered into a \$2.5 billion syndicated letter of credit facility in December 2004. Letters of credit totaling \$2.17 billion was outstanding as of December 31, 2004, and all \$2.5 billion was outstanding as of September 30, 2005. The letter of credit facility has a ten-year term, but the facility can be reduced or terminated by the lenders beginning after seven years.

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

To minimize its exposure to investment risk, AIG tests the cash flows from the invested assets and the policy and contract liabilities using various interest rate scenarios to assess whether there is a liquidity excess or deficit. If a necessary rebalancing of the invested assets to the policy and contract claims does not occur, a demand could be placed upon liquidity. (See also the discussion under "Liquidity" herein.)

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

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To maintain an adequate yield to match the interest necessary to support future policy liabilities, management focus is required to reinvest the proceeds of the maturing securities and to invest the future premium receipts while continuing to maintain satisfactory investment quality.

Certain foreign jurisdictions, including Japan, have limited long-dated bond markets and AIG may use alternative investments, including equities, real estate and foreign currency denominated fixed income instruments to extend the effective duration and increase the yield of the investment portfolio to more closely match the requirements of the policyholder liabilities and DAC recoverability, particularly in Taiwan, where Nan Shan has approximately 30 percent of invested assets in foreign currencies. Using foreign currency denominated investments to support policyholder liabilities could increase the risk to and volatility of cash flows and income. AIG actively manages this risk through regular monitoring and selected hedging strategies.

AIG actively manages the asset-liability relationship in its domestic operations. This relationship is more easily man-

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aged through the ample supply of qualified long-term investments.

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

A number of guaranteed benefits are offered on certain variable life and variable annuity products.

DAC for life insurance and retirement services products arises from the deferral of those costs that vary with, and are directly related to, the acquisition of new or renewal business. Policy acquisition costs for life insurance products are generally deferred and amortized over the premium paying period of the policy. Policy acquisition costs which relate to universal life and investment-type products, including variable and fixed annuities (investment-oriented products) are deferred and amortized, with interest, as appropriate, in relation to the historical and future incidence of estimated gross profits to be realized over the estimated lives of the contracts. With respect to universal life and investment-oriented products, AIG's policy, as appropriate, has been to adjust amortization assumptions for DAC when estimates of current or future gross profits to be realized from these contracts are revised. With respect to variable annuities sold domestically (representing the vast majority of AIG's variable annuity business), the assumption for the long-term annual net growth rate of the equity markets used in the determination of DAC amortization is approximately ten percent. A methodology referred to as reversion to the mean is used to maintain this long-term net growth rate assumption, while giving consideration to short-term variations in equity markets. Estimated gross profits include investment income and gains and losses on investments less interest required as well as other charges in the contract less actual mortality and expenses. Current experience and changes in the expected future gross profits are analyzed to determine the effect on the amortization of DAC. The estimation of projected gross profits requires significant management judgment. The elements with respect to the current and projected gross profits are reviewed and analyzed quarterly and are adjusted appropriately.

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

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

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*Invested Assets*

The following tables summarize the composition of AIG's insurance and asset management invested assets by segment, at March 31, 2005 and December 31, 2004:

<i>(in millions)</i>	General Insurance	Life Insurance & Retirement Services	Asset Management	Financial Services	Other	Total
<b>2005 (Restated)</b>						
<b>Fixed maturities:</b>						
Bonds available for sale, at market value	\$ 43,158	\$ 266,288	\$ 39,604	\$ 1,350	\$	\$ 350,400
Bonds held to maturity, at amortized cost	21,477					21,477
Bond trading securities, at market value		658	2,922			3,580
<b>Equity securities:</b>						
Common stocks available for sale, at market value	4,208	6,223	266		54	10,751
Common stocks trading, at market value	3	6,376				6,379
Preferred stocks, at market value	1,541	729		10		2,280
Mortgage loans on real estate, net of allowance	15	9,024	4,970	56		14,065
Policy loans	3	7,056	48	2		7,109
Collateral and guaranteed loans, net of allowance	4	1,347	498	1,460		3,309
<b>Financial services assets:</b>						
Flight equipment primarily under operating leases, net of accumulated depreciation				33,896		33,896
Securities available for sale, at market value				29,660		29,660
Trading securities, at market value				3,091		3,091
Spot commodities				654		654
Unrealized gain on swaps, options and forward transactions				20,149		20,149
Trading assets				1,507		1,507
Securities purchased under agreements to resell, at contract value		23		32,570		32,593
Finance receivables, net of allowance				24,929		24,929
Securities lending collateral, at market value	5,519	36,271	10,100			51,890
Other invested assets	6,522	7,216	9,203	2,324	343	25,608
Short-term investments, at cost	2,107	10,160	9,342	408		22,017
<b>Total investments and financial services assets as shown in the balance sheet</b>						
	<b>84,557</b>	<b>351,371</b>	<b>76,953</b>	<b>152,066</b>	<b>397</b>	<b>665,344</b>
Cash	324	589	1,221	223	4	2,361
Investment income due and accrued	916	4,192	482	19		5,609
Real estate, net of accumulated depreciation	586	3,027	324	25	26	3,988
<b>Total invested assets</b>	<b>\$ 86,383</b>	<b>\$ 359,179</b>	<b>\$ 78,980</b>	<b>\$ 152,333</b>	<b>\$ 427</b>	<b>\$ 677,302</b>

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<i>(in millions)</i>	General Insurance	Life Insurance & Retirement Services	Asset Management	Financial Services	Other	Total
<b>2004</b>						
Fixed maturities:						
Bonds available for sale, at market value	\$ 44,376	\$ 259,602	\$ 39,077	\$ 1,344	\$	\$ 344,399
Bonds held to maturity, at amortized cost	18,294					18,294
Bond trading securities, at market value		600	2,384			2,984
Equity securities:						
Common stocks available for sale, at market value	4,163	5,389	177		43	9,772
Common stocks trading, at market value	2	5,891			1	5,894
Preferred stocks, at market value	1,466	565		9		2,040
Mortgage loans on real estate, net of allowance	15	8,520	4,558	53		13,146
Policy loans	3	6,980	50	2		7,035
Collateral and guaranteed loans, net of allowance	4	1,358	485	1,456		3,303
Financial services assets:						
Flight equipment primarily under operating leases, net of accumulated depreciation				32,130		32,130
Securities available for sale, at market value				31,225		31,225
Trading securities, at market value				2,746		2,746
Spot commodities				534		534
Unrealized gain on swaps, options and forward transactions				22,670		22,670
Trading assets				3,433		3,433
Securities purchased under agreements to resell, at contract value				26,272		26,272
Finance receivables, net of allowance				23,574		23,574
Securities lending collateral, at market value	4,889	34,923	9,357			49,169
Other invested assets	5,604	7,072	8,316	2,230	337	23,559
Short-term investments, at cost	1,823	5,013	8,713	549	4	16,102
<b>Total investments and financial services assets as shown in the balance sheet</b>						
	80,639	335,913	73,117	148,227	385	638,281
<b>Cash</b>						
	290	502	966	250	1	2,009
<b>Investment income due and accrued</b>						
	997	4,035	461	63		5,556
<b>Real estate, net of accumulated depreciation</b>						
	592	3,007	326	26	28	3,979
<b>Total invested assets</b>						
	\$ 82,518	\$ 343,457	\$ 74,870	\$ 148,566	\$ 414	\$ 649,825

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**Insurance and Asset Management Invested Assets**

AIG's investment strategy is to invest primarily in high quality securities while maintaining diversification to avoid significant exposure to issuer, industry and/or country concentrations. With respect to General Insurance, AIG's strategy is to invest in longer duration fixed maturity investments to maximize the yields at the date of purchase. With respect to Life Insurance & Retirement Services, AIG's strategy is to produce cash flows required to meet maturing insurance liabilities. (See also the discussion under Operating Review: Life Insurance & Retirement Services Operations herein.) AIG invests in equities for various reasons, including diversifying its overall exposure to interest rate risk. Available for sale bonds and equity securities are subject to declines in fair value. Such declines in fair value are presented in unrealized appreciation or depreciation of investments, net of taxes as a component of accumulated other comprehensive income. Generally, insurance regulations restrict the types of assets in which an insurance company may invest. When permitted by regulatory authorities and when deemed necessary to protect insurance assets, including invested assets, from adverse movements in foreign currency exchange rates, interest rates and equity prices, AIG and its insurance subsidiaries may enter into derivative transactions as end users. (See also the discussion under Derivatives herein.) In certain jurisdictions, significant regulatory and/or foreign governmental barriers exist which may not permit the immediate free flow of funds between insurance subsidiaries or from the insurance subsidiaries to AIG parent.

The following tables summarize the composition of AIG's insurance and asset management invested assets by segment, at March 31, 2005 and December 31, 2004:

March 31, 2005 (Restated) (dollars in millions)	General Insurance	Life Insurance & Retirement Services	Asset Management	Total	Percent of Total	Percent Distribution	
						Domestic	Foreign
<b>Fixed maturities:</b>							
Bonds available for sale, at market value	\$ 43,158	\$ 266,288	\$ 39,604	\$ 349,050	66.5%	59.8%	40.2%
Bonds held to maturity, at amortized cost	21,477			21,477	4.1	100.0	
Bond trading securities, at market value		658	2,922	3,580	0.7	0.8	99.2
<b>Equity securities:</b>							
Common stocks available for sale, at market value	4,208	6,223	266	10,697	2.0	32.4	67.6
Common stocks trading, at market value	3	6,376		6,379	1.3	0.2	99.8
Preferred stocks, at market value	1,541	729		2,270	0.4	87.9	12.1
Mortgage loans on real estate, net of allowance	15	9,024	4,970	14,009	2.7	85.7	14.3
Policy loans	3	7,056	48	7,107	1.4	42.3	57.7
Collateral and guaranteed loans, net of allowance	4	1,347	498	1,849	0.3	0.1	99.9
Securities purchased under agreements to resell, at contract value		23		23			100.0
Securities lending collateral, at market value	5,519	36,271	10,100	51,890	9.9	86.4	13.6
Other investment assets	6,522	7,216	9,203	22,941	4.4	87.8	12.2
Short-term investments, at cost	2,107	10,160	9,342	21,609	4.1	52.2	47.8
Cash	324	589	1,221	2,134	0.4	8.1	91.9
Investment income due and accrued	916	4,192	482	5,590	1.1	57.3	42.7
Real estate, net of accumulated depreciation	586	3,027	324	3,937	0.7	23.9	76.1

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<b>Total</b>	<b>\$ 86,383</b>	<b>\$ 359,179</b>	<b>\$ 78,980</b>	<b>\$ 524,542</b>	<b>100.0%</b>	<b>63.1%</b>	<b>36.9%</b>
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December 31, 2004 (dollars in millions)	General Insurance	Life Insurance & Retirement Services	Asset Management	Total	Percent of Total	Percent Distribution	
						Domestic	Foreign
<b>Fixed maturities:</b>							
Bonds available for sale, at market value	\$ 44,376	\$ 259,602	\$ 39,077	\$ 343,055	68.5%	61.2%	38.8%
Bonds held to maturity, at amortized cost	18,294			18,294	3.7	100.0	
Bonds trading securities, at market value		600	2,384	2,984	0.6	1.2	98.8
<b>Equity securities:</b>							
Common stocks available for sale, at market value	4,163	5,389	177	9,729	1.9	34.9	65.1
Common stocks trading, at market value	2	5,891		5,893	1.2	0.5	99.5
Preferred stocks, at market value	1,466	565		2,031	0.4	91.9	8.1
Mortgage loans on real estate, net of allowance	15	8,520	4,558	13,093	2.6	87.0	13.0
Policy loans	3	6,980	50	7,033	1.4	43.0	57.0
Collateral and guaranteed loans, net of allowance	4	1,358	485	1,847	0.4	0.2	99.8
Securities lending collateral, at market value	4,889	34,923	9,357	49,169	9.8	86.7	13.3
Other invested assets	5,604	7,072	8,316	20,992	4.2	86.7	13.3
Short-term investments, at cost	1,823	5,013	8,713	15,549	3.1	40.2	59.8
Cash	290	502	966	1,758	0.3	9.3	90.7
Investment income due and accrued	997	4,035	461	5,493	1.1	57.3	42.7
Real estate, net of accumulated depreciation	592	3,007	326	3,925	0.8	22.8	77.2
<b>Total</b>	<b>\$ 82,518</b>	<b>\$ 343,457</b>	<b>\$ 74,870</b>	<b>\$ 500,845</b>	<b>100.0%</b>	<b>63.8%</b>	<b>36.2%</b>

**Credit Quality**

At March 31, 2005, approximately 62 percent of the fixed maturities investments were domestic securities. Approximately 33 percent of such domestic securities were rated AAA by one or more of the principal rating agencies. Approximately six percent were below investment grade or not rated.

A significant portion of the foreign fixed income portfolio is rated by Moody's, S&P or similar foreign services. Similar credit quality rating services are not available in all overseas locations. AIG reviews the credit quality of the foreign portfolio nonrated fixed income investments, including mortgages. At March 31, 2005, approximately 20 percent of the foreign fixed income investments were either rated AAA or, on the basis of AIG's internal analysis, were equivalent from a credit standpoint to securities so rated. Approximately four percent were below investment grade or not rated at that date. A large portion of the foreign fixed income portfolio are sovereign fixed maturity securities supporting the policy liabilities in the country of issuance.

Any fixed income security may be subject to downgrade for a variety of reasons subsequent to any balance sheet date.

**Valuation of Invested Assets**

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AIG has the ability to hold any fixed maturity security to its stated maturity, including those fixed maturity securities classified as available for sale. Therefore, the decision to sell any such fixed maturity security classified as available for sale reflects the judgment of AIG's management that the security sold is unlikely to provide, on a relative value basis, as attractive a return in the future as alternative securities entailing comparable risks. With respect to distressed securities, the sale decision reflects management's judgment that the risk-discounted anticipated ultimate recovery is less than the value achievable on sale.

The valuation of invested assets involves obtaining a market value for each security. The source for the market value is generally from market exchanges or dealer quotations, with the exception of nontraded securities.

If AIG chooses to hold a security, it evaluates the security for an impairment in valuation. As a matter of policy, the determination that a security has incurred an other-than-temporary decline in value and the amount of any loss recognition requires the judgment of AIG's management and a continual review of its investments.

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In general, a security is considered a candidate for 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 months or longer);

The occurrence of a discrete credit event resulting in (i) the issuer defaulting on a material outstanding obligation; or (ii) the issuer seeking protection from creditors under the bankruptcy laws or any similar laws intended for the 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

In the opinion of AIG's management, it is possible that AIG may not realize a full recovery on its investment, irrespective of the occurrence of one of the foregoing events.

Once a security has been identified as other-than-temporarily impaired, the amount of such impairment is determined by reference to that security's contemporaneous market price and recorded as a charge to earnings.

As a result of these policies, AIG recorded impairment losses, net of taxes, of \$61 million and \$79 million in the first three months of 2005 and 2004, respectively.

No impairment charge with respect to any one single credit was significant to AIG's consolidated financial condition or results of operations, and no individual impairment loss exceeded 1.0 percent of consolidated net income for the first three months of 2005.

Excluding the other-than-temporary impairments noted above, the changes in market value for AIG's available for sale portfolio, which constitutes the vast majority of AIG's investments, were recorded in accumulated other comprehensive income as unrealized gains or losses, net of tax.

At March 31, 2005, the fair value of AIG's fixed maturities and equity securities aggregated to \$395.1 billion. At March 31, 2005, aggregate unrealized gains after taxes for fixed maturity and equity securities were \$10.9 billion. At March 31, 2005, the aggregate unrealized losses after taxes of fixed maturity and equity securities were approximately \$1.8 billion.

The effect on net income of unrealized losses after taxes will be further mitigated upon realization, because certain realized losses will be charged to participating policyholder accounts, or realization will result in current decreases in the amortization of certain deferred policy acquisition costs.

At March 31, 2005, unrealized losses for fixed maturity securities and equity securities did not reflect any significant industry concentrations.

**The amortized cost of fixed maturities available for sale in an unrealized loss position at March 31, 2005, by contractual maturity, is shown below:**

<i>(in millions)</i>	Amortized Cost
Due in one year or less	\$ 3,075
Due after one year through five years	23,137
Due after five years through ten years	38,423
Due after ten years	43,305
<b>Total</b>	<b>\$ 107,940</b>

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In the three months ended March 31, 2005, the pretax realized losses incurred with respect to the sale of fixed maturities and equity securities were \$419 million. The aggregate fair value of securities sold was \$13.4 billion, which was approximately 99 percent of amortized cost. The average period of time that securities sold at a loss during the three months ended March 31, 2005 were trading continuously at a price below book value was approximately four months.

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At March 31, 2005, aggregate pretax unrealized gains were \$16.7 billion, while the pretax unrealized losses with respect to investment grade bonds, below investment grade bonds and equity securities were \$2.1 billion, \$450 million and \$248 million, respectively. Aging of the pretax unrealized losses with respect to these securities, distributed as a percentage of cost relative to unrealized loss (the extent by which the market value is less than amortized cost or cost), including the number of respective items, was as follows:

Aging (dollars in millions)	Less than or equal to 20% of Cost <sup>(a)</sup>			Greater than 20% to 50% of Cost <sup>(a)</sup>			Greater than 50% of Cost <sup>(a)</sup>			Total		
	Unrealized Cost <sup>(a)</sup>	Unrealized Loss	Items	Unrealized Cost <sup>(a)</sup>	Unrealized Loss	Items	Unrealized Cost <sup>(a)</sup>	Unrealized Loss	Items	Unrealized Cost <sup>(a)</sup>	Unrealized Loss <sup>(b)</sup>	Items
Investment grade bonds												
0-6 months	\$ 71,953	\$ 1,012	7,008	\$ 19	\$ 7	3	\$ 2	\$ 2	8	\$ 71,974	\$ 1,021	7,019
7-12 months	15,887	409	1,563	29	6	36			2	15,916	415	1,601
>12 months	13,774	659	1,617	85	15	6	6	4	2	13,865	678	1,625
Total	\$ 101,614	\$ 2,080	10,188	\$ 133	\$ 28	45	\$ 8	\$ 6	12	\$ 101,755	\$ 2,114	10,245
Below investment grade bonds												
0-6 months	\$ 3,928	\$ 145	943	\$ 193	\$ 58	32	\$ 11	\$ 8	15	\$ 4,132	\$ 211	990
7-12 months	731	48	141	38	10	27	3	2	14	772	60	182
>12 months	961	85	251	310	87	97	10	7	13	1,281	179	361
Total	\$ 5,620	\$ 278	1,335	\$ 541	\$ 155	156	\$ 24	\$ 17	42	\$ 6,185	\$ 450	1,533
Total bonds												
0-6 months	\$ 75,881	\$ 1,157	7,951	\$ 212	\$ 65	35	\$ 13	\$ 10	23	\$ 76,106	\$ 1,232	8,009
7-12 months	16,618	457	1,704	67	16	63	3	2	16	16,688	475	1,783
>12 months	14,735	744	1,868	395	102	103	16	11	15	15,146	857	1,986
Total	\$ 107,234	\$ 2,358	11,523	\$ 674	\$ 183	201	\$ 32	\$ 23	54	\$ 107,940	\$ 2,564	11,778
Equity securities												
0-6 months	\$ 2,245	\$ 100	826	\$ 126	\$ 31	72	\$ 7	\$ 6	47	\$ 2,378	\$ 137	945
7-12 months	311	19	162	216	88	70	2	2	45	529	109	277
>12 months	23	1	15	3	1	3			10	26	2	28
Total	\$ 2,579	\$ 120	1,003	\$ 345	\$ 120	145	\$ 9	\$ 8	102	\$ 2,933	\$ 248	1,250

(a) For bonds, represents amortized cost.

(b) As more fully described above, upon realization, certain realized losses will be charged to participating policyholder accounts, or realization will result in a current decrease in the amortization of certain deferred policy acquisition costs.

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As stated previously, the valuation for AIG's investment portfolio comes from market exchanges or dealer quotations, with the exception of nontraded securities. AIG considers nontraded securities to mean certain fixed income investments, certain structured securities, direct private equities, limited partnerships and hedge funds. The aggregate carrying value of these securities at March 31, 2005 was approximately \$75 billion.

The methodology used to estimate fair value of nontraded fixed income investments is by reference to traded securities with similar attributes and using a matrix pricing methodology. This technique takes into account such factors as the industry, the security's rating and tenor, its coupon rate, its position in the capital structure of the issuer, and other relevant factors. The change in fair value is recognized as a component of accumulated other comprehensive income, net of tax.

For certain structured securities, the carrying value is based on an estimate of the security's future cash flows pursuant to the requirements of Emerging Issues Task Force Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The change in carrying value is recognized in income.

Hedge funds and limited partnerships in which AIG holds in the aggregate less than a five percent interest are carried at fair value. The change in fair value is recognized as a component of accumulated other comprehensive income, net of tax.

With respect to hedge funds and limited partnerships in which AIG holds in the aggregate a five percent or greater interest, AIG uses the equity method to record these investments. Changes in value are recorded in earnings.

AIG obtains the fair value of its investments in limited partnerships and hedge funds from information provided by the general partner or manager of each of these investments, the accounts of which are generally audited on an annual basis.

Each of these investment categories is regularly tested to determine if impairment in value exists. Various valuation techniques are used with respect to each category in this determination.

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American International Group, Inc. and Subsidiaries

***Financial Services Operations***

AIG's Financial Services subsidiaries engage in diversified activities including aircraft and equipment leasing, capital market transactions, consumer finance and insurance premium financing. (See also Note 3 of Notes to Consolidated Financial Statements.)

**Aircraft Finance**

AIG's Aircraft Finance operations represent the operations of International Lease Finance Corporation (ILFC), which generates its revenues primarily from leasing new and used commercial jet aircraft to domestic and foreign airlines. Revenues also result from the remarketing of commercial jets for its own account, for airlines and for financial institutions.

ILFC finances its purchases of aircraft primarily through the issuance of a variety of debt instruments. The composite borrowing rates at the end of the first three months of 2005 and 2004 were 4.49 percent and 4.34 percent, respectively. (See also the discussions under *Capital Resources* and *Liquidity* herein and Note 3 of Notes to Consolidated Financial Statements.)

ILFC's sources of revenue are principally from scheduled and charter airlines and companies associated with the airline industry. The airline industry is cyclical, economically sensitive and highly competitive. Airlines and related companies may be affected by political or economic instability, terrorist activities, changes in national policy, competitive pressures on certain air carriers, fuel prices and shortages, labor stoppages, insurance costs, recessions, and other political or economic events adversely affecting world or regional trading markets. ILFC's revenues and income will be affected by its customers' ability to react and cope with the volatile competitive environment in which they operate, as well as ILFC's own competitive environment.

ILFC is exposed to operating loss and liquidity strain through nonperformance of aircraft lessees, through owning aircraft which it would be unable to sell or re-lease at acceptable rates at lease expiration and, in part, through committing to purchase aircraft which it would be unable to lease.

ILFC manages the risk of nonperformance by its lessees with security deposit requirements, through repossession rights, overhaul requirements, and closely monitoring industry conditions through its marketing force. However, there can be no assurance that ILFC would be able to successfully manage the risks relating to the effect of possible future deterioration in the airline industry. Approximately 90 percent of ILFC's fleet is leased to non-U.S. carriers, and this fleet, comprised of the most efficient aircraft in the airline industry, continues to be in high demand from such carriers.

ILFC typically contracts to re-lease aircraft before the end of the existing lease term. For aircraft returned before the end of the lease term, ILFC has generally been able to re-lease such aircraft within two to six months of its return. As a lessor, ILFC considers an aircraft *idle* or *off lease* when the aircraft is not subject to a signed lease agreement or signed letter of intent. ILFC had one aircraft off lease at March 31, 2005. (See also the discussions under *Capital Resources* and *Liquidity* herein.)

ILFC sold a portfolio consisting of 34 aircraft in 2004 to a trust connected to a securitization transaction. Certain of AIG's Life Insurance & Retirement Services businesses purchased a large share of the securities issued in connection with this securitization, which included both debt and equity securities.

Management formally reviews regularly, and no less frequently than quarterly, issues affecting ILFC's fleet, including events and circumstances that may cause impairment of aircraft values. Management evaluates aircraft in the fleet as necessary, based on these events and circumstances in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144). ILFC has not recognized any impairment related to its fleet, as the existing service potential of the aircraft in ILFC's portfolio has not been diminished. Further, ILFC has been able to re-lease the aircraft without diminution in lease rates to an extent that would require an impairment write-down. (See also the discussions under *Liquidity* herein.)

**Capital Markets**

AIG's Capital Markets operations represents the integrated operations of AIGFP and AIGTG. As Capital Markets is a transaction-oriented operation, current and past revenues and operating results may not provide a basis for predicting future performance. Also, AIG's Capital Markets operations may be adversely affected by the downgrades in AIG's credit ratings. See *Outlook*, for a further discussion of the potential

effect of the rating downgrades on AIG's Capital Markets businesses herein.

AIG's Capital Markets operations derive substantially all their revenues from hedged financial positions entered in connection with counterparty transactions rather than from speculative trading transactions. These subsidiaries participate in the derivatives dealer market conducting, primarily as principal, an interest rate, currency, equity, commodity and credit products business.

As a dealer, AIGFP marks all derivative and trading transactions to fair value daily. Thus, a gain or loss on each transaction is recognized daily. Under GAAP, in certain instances, gains and losses are required to be recorded in earnings immediately, whereas in other instances, they are required to be recognized over the life of the underlying instruments. AIGFP economically hedges the market risks arising from its transactions. However, for GAAP financial statements, hedge accounting, as described in FAS 133, is not



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American International Group, Inc. and Subsidiaries currently being applied to any of the derivatives and related assets and liabilities. Accordingly, revenues and operating income are exposed to volatility resulting from differences in the timing of revenue recognition between the derivatives and the hedged assets and liabilities. Revenues of the Capital Markets operations and the percentage change in revenues for any given period are significantly affected by the number and size of transactions entered into by these subsidiaries during that period relative to those entered into during the prior period as well as the volatility noted above for the accounting under FAS 133. Operating income and the percentage change in operating income for any period are determined by the number, size and profitability of the transactions attributable to that period relative to those attributable to the prior period as well as the volatility noted above for the accounting under FAS 133. Generally, the realization of trading revenues as measured by the receipt of funds is not a significant reporting event as the gain or loss on AIGFP's trading transactions are currently reflected in operating income as the fair values change from period to period.

Derivative transactions are entered into in the ordinary course of Capital Markets operations. Therefore, income on interest rate, currency, equity, commodity and credit derivatives along with their related hedges is recorded at fair value, determined by references to the mark to market value of the derivative or their estimated fair value where market prices are not readily available. The resulting aggregate unrealized gains or losses from the derivative is reflected in the income statement in the current year. In the first quarter of 2005, less than five percent of revenues resulted from transactions valued at estimated fair value. Where Capital Markets cannot verify significant model inputs to observable market data and verify the model value to market transactions, Capital Markets values the contract at the transaction price at inception and, consequently, records no initial gain or loss in accordance with Emerging Issues Task Force 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). Such initial gain or loss is amortized into income over the life of the transaction. Capital Markets periodically reevaluates its revenue recognition under EITF 02-3 based on the observability of market parameters. The mark to fair value of derivative transactions is reflected in the balance sheet in the captions *Unrealized gain on swaps, options and forward transactions* and *Unrealized loss on swaps, options and forward transactions*. Unrealized gains represent the present value of the aggregate of each net receivable by counterparty, and the unrealized losses represent the present value of the aggregate of each net payable by counterparty as of March 31, 2005. These amounts will change from one period to the next due to changes in interest rates, currency rates, equity and commodity prices and other market variables, as well as cash movements, execution of new transactions and the maturing of existing transactions. (See also the discussion under *Derivatives* herein.)

Spread income on investments and borrowings is recorded on an accrual basis over the life of the transaction. Investments are classified as securities available for sale and are marked to market with the resulting unrealized gains or losses reflected in accumulated other comprehensive income. U.S. dollar denominated borrowings are carried at cost, while borrowings in any currency other than the U.S. dollar result in unrealized foreign exchange gains or losses reported in income. AIGFP hedges the economic exposure on its investments and borrowings through its derivatives portfolio. The requirements under FAS 133 hedge accounting were not met for certain of these hedge transactions for the period ended March 31, 2005. Thus, these hedges are marked to fair value with the unrealized gains or losses reported in income.

**Consumer Finance**

Domestically, AIG's Consumer Finance operations derive a substantial portion of their revenues from finance charges assessed on outstanding mortgages, home equity loans, secured and unsecured consumer loans and retail merchant financing. Credit quality continues to be strong and receivables grew substantially. Overseas operations, particularly those in emerging markets, provide credit cards, personal and auto loans, term deposits, savings accounts, sales finance and mortgages.

Consumer Finance operations are exposed to loss when contractual payments are not received. Collection exposure is managed through underwriting controls, mix of loans and collateral thereon.

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American International Group, Inc. and Subsidiaries

**Financial Services operations for the three month periods ending March 31, 2005 and 2004 were as follows:**

<i>(in millions)</i>	<b>2005 (Restated)</b>	<b>2004 (Restated)</b>
<b>Revenues<sup>(a)</sup>:</b>		
Aircraft Finance <sup>(b)</sup>	\$ 827	\$ 734
Capital Markets <sup>(c)(d)</sup>	756	361
Consumer Finance <sup>(e)</sup>	833	693
Other	20	26
<b>Total</b>	<b>\$ 2,436</b>	<b>\$ 1,814</b>
<b>Operating income<sup>(a)</sup>:</b>		
Aircraft Finance	\$ 187	\$ 172
Capital Markets <sup>(d)</sup>	620	214
Consumer Finance	231	183
Other, including intercompany adjustments	7	15
<b>Total</b>	<b>\$ 1,045</b>	<b>\$ 584</b>

*(a) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the first three months of 2005 and 2004, the effect was \$15 million and \$20 million, respectively, in operating income for Aircraft Finance and \$468 million and \$83 million in both revenues and operating income for Capital Markets.*

*(b) Revenues were primarily from ILFC aircraft lease rentals.*

*(c) Revenues, shown net of interest expense, are primarily from hedging activities that do not qualify for hedge accounting treatment under FAS 133 described in (a) above.*

*(d) Certain transactions entered into by AIGFP generate tax credits and benefits which are included in income taxes on the consolidated statement of income. The amount of such tax credits and benefits for the first three months of March 31, 2005 and 2004 are \$19 million, and \$35 million, respectively.*

*(e) Revenues were primarily finance charges.*

**Financial Services Results**

Financial Services operating income increased in the first three months of 2005 compared to the same period of 2004 due to strong results in all the businesses and the accounting effect of FAS 133. Fluctuations in revenues and operating income from quarter to quarter are not unusual because of the transaction-oriented nature of Capital Markets operations and the effect of hedging activities that do not qualify for hedge accounting under FAS 133.

To the extent the Financial Services subsidiaries, other than AIGFP, use derivatives to hedge their assets or liabilities with respect to their future cash flows, and such hedges do not qualify for hedge accounting treatment under FAS 133, the changes in fair value of such derivatives are recorded in realized capital gains (losses) or other revenues.

Financial market conditions in the first three months of 2005 compared with the same period of 2004 were characterized by a general flattening of interest rate curves across fixed income markets globally, some tightening of credit spreads, and equity valuations that were broadly unchanged. Capital Markets results in 2005 compared with 2004 reflected a shift in product segment activity to respond to these conditions.

The most significant component of Capital Markets operating expenses is compensation, which was approximately \$111 million and \$114 million in the first three months of 2005 and 2004, respectively. The amount of compensation was not affected by gains and losses not qualifying for hedge accounting treatment under FAS 133.

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With respect to ILFC, the revenue growth in the first three months of 2005 compared to the same period of 2004 resulted primarily from the increase in flight equipment under operating lease, and the increase in the relative value of the leased fleet. ILFC continued to see net improvements in lease rates and an increasing level of interest from traditional buyers, third-party investors and debt providers for the purchase of aircraft from ILFC's extensive lease portfolio. Thus, the outlook for the remainder of 2005 is positive.

In connection with a global aircraft lease transaction entered into in 2000 for a total of 14 aircraft, ILFC acquired certain securities of and issued certain guarantees to ATA Airlines and related entities (ATA). During the fourth quarter of 2004, ATA filed for protection under Chapter 11 of the U.S. Bankruptcy Code. On the basis of estimates of the probable outcome of the ATA bankruptcy, ILFC recorded a charge in the fourth quarter to write down the value of the ATA securities and record obligations assumed under the guarantee. The pre-tax charges aggregated \$54 million (reported as a realized capital loss) and did not have a material effect on AIG's results of operations, financial condition or liquidity.

ATA has cured all of the defaults under the existing leases and continues to perform under the leases at the pre-bankruptcy contracted lease terms.

Consumer Finance operations, both domestically and internationally, did very well with increased revenues and operating income.

The increase in Consumer Finance revenues in 2005 was the result of growth in average finance receivables. Credit quality of those receivables continues to be strong. Foreign Consumer Finance operations performed well as the operations in Poland continued its strong growth and the Hong Kong credit card business benefited from the strengthening local economy resulting in less need for loan loss provisions. Further, the continuing low interest rate and charge-off environment led to an improvement in the operating income in 2005 over 2004.

Financial Services operating income represented 18.5 percent of AIG's consolidated income before income taxes, minority interest and cumulative effect of accounting changes in the first quarter of 2005. This compares to 15.2 percent in the first quarter of 2004. The increase in contribution percentage in 2005 was due to the effect of hedge accounting treatment under FAS 133.

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American International Group, Inc. and Subsidiaries

Financial Services Invested Assets

The following table is a summary of the composition of AIG's Financial Services invested assets at March 31, 2005 and December 31, 2004. (See also the discussions under Operating Review: Financial Services Operations, Capital Resources and Derivatives herein.)

(dollars in millions)	2005 (Restated)		2004	
	Invested Assets	Percent of Total	Invested Assets	Percent of Total
Fixed maturities:				
Bonds available for sale, at market value	\$ 1,350	0.9%	\$ 1,344	0.9%
Equity securities:				
Preferred stocks at market value	10		9	
Mortgage loans on real estate, net of allowance	56		53	
Policy loans	2		2	
Collateral and guaranteed loans, net of allowance	1,460	1.0	1,456	1.0
Financial services assets:				
Flight equipment primarily under operating leases, net of accumulated depreciation	33,896	22.3	32,130	21.6
Securities available for sale, at market value	29,660	19.5	31,225	21.0
Trading securities, at market value	3,091	2.0	2,746	1.8
Spot commodities	654	0.4	534	0.4
Unrealized gain on swaps, options and forward transactions	20,149	13.2	22,670	15.3
Trading assets	1,507	1.0	3,433	2.3
Securities purchased under agreements to resell, at contract value	32,570	21.4	26,272	17.7
Finance receivables, net of allowance	24,929	16.4	23,574	15.9
Other invested assets	2,324	1.5	2,230	1.5
Short-term investments, at cost	408	0.3	549	0.4
Cash	223	0.1	250	0.2
Investment income due and accrued	19		63	
Real estate, net of accumulated depreciation	25		26	
<b>Total</b>	<b>\$ 152,333</b>	<b>100.0%</b>	<b>\$ 148,566</b>	<b>100.0%</b>

As previously discussed, the cash used for the purchase of flight equipment is derived primarily from the proceeds of ILFC's debt financings. The primary sources for the repayment of this debt and the interest expense thereon are the cash flow from operations, proceeds from the sale of flight equipment and the rollover and refinancing of the prior debt. During the first three months of 2005, ILFC acquired flight equipment costing \$2.14 billion. (See also the discussion under Operating Review: Financial Services Operations and Capital Resources herein.)

AIG's Consumer Finance operations provide a wide variety of consumer finance products both domestically and overseas. Such products include real estate mortgages, consumer loans, and retail sales finance. These products are funded through deposits and various borrowings including commercial paper and medium term notes. AIG's Consumer Finance operations are exposed to credit risk and risk of loss resulting from adverse fluctuations in interest rates. Over half of the loan balance is related to real estate loans which are substantially collateralized by the related properties.

With respect to credit losses, the allowance for finance receivable losses is maintained at a level considered adequate to absorb anticipated credit losses existing in that portfolio.

Capital Markets derivative transactions are carried at market value or at estimated fair value when market prices are not readily available. AIGFP reduces its economic risk exposure through similarly valued offsetting transactions including swaps, trading securities, options, forwards and futures. The estimated fair values of these transactions represent assessments of the present value of expected future cash flows. These transactions are exposed to liquidity risk if AIGFP were required to sell or close out the transactions prior to maturity. AIG believes that the effect of any such event would not be significant to AIG's financial condition or its overall liquidity. (See also the discussion under Operating Review: Financial Services Operations and Derivatives herein.)

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AIGFP uses the proceeds from the issuance of notes and bonds and GIA borrowings to invest in a diversified portfolio of securities, including securities available for sale, at market, and derivative transactions. The funds may also be temporarily invested in securities purchased under agreements to resell. The proceeds from the disposal of the aforementioned securities available for sale and securities purchased under agreements to resell have been used to fund the maturing GIAs or other AIGFP financings, or invest in new assets. (See also the discussion under Capital Resources herein.)

Securities available for sale is predominantly a portfolio of fixed income securities, where the individual securities have varying degrees of credit risk. At March 31, 2005, the

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American International Group, Inc. and Subsidiaries average credit rating of this portfolio was AA+ or the equivalent thereto as determined through rating agencies or internal review. AIGFP has also entered into credit derivative transactions to economically hedge its credit risk associated with \$149 million of these securities. There have been no significant downgrades through March 31, 2005.

AIGFP's risk management objective is to minimize interest rate, currency, commodity and equity risks associated with its securities available for sale. That is, when AIGFP purchases a security for its securities available for sale investment portfolio, it simultaneously enters into an offsetting internal hedge such that the payment terms of the hedging transaction offset the payment terms of the investment security, which achieves the economic result of converting the return on the underlying security to USD LIBOR plus or minus a spread based on the underlying profit on each security on the initial trade date. The market risk associated with such internal hedges is managed on a portfolio basis, with third party hedging transactions executed as necessary. As hedge accounting treatment is not achieved in accordance with FAS 133, the unrealized gains and losses on these securities, resulting from changes in interest rates, currency rates, commodity and equity prices, are recorded in accumulated other comprehensive income while the unrealized gains and losses on the related economic hedges are reflected in operating income. When a security is sold, the related hedging transaction is terminated. The realized gain or loss with respect to each security is then recorded in operating income.

Securities purchased under agreements to resell are treated as collateralized financing transactions. AIGFP takes possession of or obtains a security interest in securities purchased under agreements to resell. AIGFP further minimizes its credit risk by monitoring counterparty credit exposure and, when it deems necessary, it requires additional collateral to be deposited.

AIGFP is exposed to credit risk. If its securities available for sale portfolio were to suffer significant default and the collateral held declined significantly in value with no replacement or the credit default swap counterparty failed to perform, AIGFP could have a liquidity strain. AIG guarantees AIGFP's payment obligations, including its debt obligations.

AIGFP also conducts, as principal, market making and trading activities in foreign exchange, and commodities, primarily precious metals. AIGFP owns inventories in the commodities in which it trades and may reduce the exposure to market risk through the use of swaps, forwards, futures and option contracts. AIGFP uses derivatives to manage the economic exposure of its various trading positions and transactions from adverse movements of interest rates, foreign currency exchange rates and commodity prices. AIGFP supports its trading activities largely through trading liabilities, unrealized losses on swaps, short-term borrowings, securities sold under agreements to repurchase and securities and commodities sold but not yet purchased. (See also the discussions under Capital Resources. )

**The gross unrealized gains and gross unrealized losses of Capital Markets included in the financial services assets and liabilities at March 31, 2005 were as follows:**

<i>(in millions)</i>	<b>Gross Unrealized Gains (Restated)</b>	<b>Gross Unrealized Losses (Restated)</b>
Securities available for sale, at market value	\$ 1,320	\$ 606
Unrealized gain/ loss on swaps, options and forward transactions*	20,149	12,866

\* *These amounts are also presented as the respective balance sheet amounts.*

Trading securities, at market value, and securities and spot commodities sold but not yet purchased, at market value are marked to market daily with the unrealized gain or loss being recognized in income at that time. These trading securities are held to meet the short-term risk management objectives of Capital Markets operations.

The senior management of AIG defines the policies and establishes general operating parameters for Capital Markets operations. AIG's senior management has established various oversight committees to review the various financial market, operational and credit issues of the Capital Markets operations. The senior management of AIGFP reports the results of its operations to and reviews future strategies with AIG's senior management.

AIG actively manages the exposures to limit potential losses, while maximizing the rewards afforded by these business opportunities. In doing so, AIG must continually manage a variety of exposures including credit, market, liquidity, operational and legal risks.

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At March 31, 2005, AIGFP held a large portfolio of privately negotiated financing transactions with institutional counterparties in the United Kingdom. Certain provisions in the UK Finance Bill that was published by the House of Commons on March 22, 2005 have caused AIGFP's counterparties to exercise rights to unwind these transactions early. Although the unwinding of these transactions will not cause AIGFP to suffer any losses, the unwinds do mean that AIGFP will not realize spread income in the future that AIGFP expects it would have realized had the transactions remained outstanding. The aggregate reduction in 2005 operating income attributable to such foregone future accrual earnings was approximately \$75 million.

### *Asset Management Operations*

AIG's Asset Management operations comprise a wide variety of investment-related services and investment products including institutional and retail asset management, broker dealer services and spread-based investment business from the sale of guaranteed investment contracts, also known as

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funding agreements (GICs). Such services and products are offered to individuals and institutions both domestically and overseas.

As discussed above, AIG Retirement Services operations are now reported with Life Insurance operations. Therefore, Asset Management operations now represent the results of AIG's asset management and brokerage services operations, mutual fund operations and the foreign and domestic GIC operations.

**Asset Management revenues and operating income for the three months ended March 31, 2005 and 2004 were as follows:**

<i>(in millions)</i>	<b>2005 (Restated)</b>	2004 (Restated)
<b>Revenues:</b>		
Guaranteed investment contracts	\$ <b>896</b>	\$ 737
Institutional Asset Management	<b>319</b>	187
Brokerage Services and Mutual Funds	<b>63</b>	61
Other	<b>99</b>	65
<b>Total</b>	<b>\$ 1,377</b>	\$ 1,050
<b>Operating income:</b>		
Guaranteed investment contracts <sup>(a)</sup>	\$ <b>319</b>	\$ 295
Institutional Asset Management <sup>(b)</sup>	<b>161</b>	59
Brokerage Services and Mutual Funds	<b>13</b>	20
Other	<b>97</b>	62
<b>Total</b>	<b>\$ 590</b>	\$ 436

(a) The effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 was \$62 million and \$64 million for the first quarter of 2005 and 2004, respectively.

(b) Includes the results of certain AIG managed private equity and real estate funds that are consolidated effective December 31, 2003 pursuant to FIN46R, Consolidation of Variable Interest Entities. For the first three months of 2005 and 2004, operating income includes \$75 million and \$4 million of third-party limited partner earnings offset in Minority interest expense.

**Asset Management Results**

Asset Management operating income increased in the first three months of 2005 compared to the same period of 2004 as a result of a strong global product portfolio. The operating income growth results from fees related to the management of mutual funds and various investment portfolios that are in great part contingent upon the growth in the equity markets and customer interest in equity sensitive products. Thus, as equity markets expand and contract, the appetite for listed and private equity investment changes. The revenues and operating income with respect to this segment are similarly affected. GICs are sold domestically and abroad to both institutions and individuals. These products are written on an opportunistic basis when market conditions are favorable. GIC revenues include income from SunAmerica partnerships supporting the GIC line of business and are significantly affected by performance in the equity markets. Thus, revenues, operating income and cash flow attributable to GICs will vary from one reporting period to the next. Growth in GIC operating income compared to the first quarter of 2004 reflects improved partnership returns and increased assets under management, partially offset by spread compression on the core GIC portfolio. Spread compression has occurred as the base portfolio yield declined due to declining interest rates and the effect of recognizing capital gains in prior periods, and also due to an increase in the cost of funds in the short-term floating rate portion of the GIC portfolio only partially offset by increased investment income from the floating rate assets backing the portfolio. AIG expects to launch a matched investment program utilizing issuances of AIG debt securities, which will become AIG's principal spread-based investment activity. In light of recent developments, the timing of the launch of this program is unclear. Because AIG's credit spreads in the capital markets have widened following the ratings declines, there may be a reduction in the earnings on new business in AIG's institutional spread based funding business.

Asset Management operating income represented 10.4 percent of AIG's consolidated income before income taxes, minority interest and cumulative effect of an accounting change in the first three months of 2005. This compares to 11.3 percent in the same period of 2004.



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At March 31, 2005, AIG's third party assets under management, including both retail mutual funds and institutional accounts, exceeded \$55 billion and the aggregate GIC reserve was \$55.8 billion.

### *Other Operations*

Other income (deductions)-net includes AIG's equity in certain partially owned companies, the cash distributions on the liabilities connected to trust preferred stock, as well as the income and expenses of the parent holding company and other miscellaneous income and expenses. Other income (deductions)-net amounted to \$36 million and \$(280) million in the first three months of 2005 and 2004, respectively.

### **Capital Resources**

At March 31, 2005, AIG had total consolidated shareholders' equity of \$81.61 billion and total consolidated borrowings of \$106.02 billion. At that date, \$96.51 billion of such borrowings were either not guaranteed by AIG or were AIGFP's matched borrowings under obligations of guaranteed investment agreements (GIAs), liabilities connected to trust preferred stock, or matched notes and bonds payable.

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**Borrowings**

At March 31, 2005, AIG's net borrowings were \$9.51 billion after reflecting amounts that were matched borrowings under AIGFP's obligations of GIAs, matched notes and bonds payable, amounts not guaranteed by AIG and liabilities connected to trust preferred stock. The following table summarizes borrowings outstanding at March 31, 2005 and December 31, 2004:

<i>(in millions)</i>	2005 (Restated)	2004
AIG's net borrowings	\$ 9,512	\$ 8,498
Liabilities connected to trust preferred stock	1,489	1,489
AIGFP		
GIAs	22,691	18,919
Matched notes and bonds payable	24,322	22,257
Borrowings not guaranteed by AIG	48,007	45,736
<b>Total</b>	<b>\$ 106,021</b>	<b>\$ 96,899</b>

Borrowings issued or guaranteed by AIG and those borrowings not guaranteed by AIG at March 31, 2005 and December 31, 2004 were as follows:

<i>(in millions)</i>	2005 (Restated)	2004
AIG borrowings:		
Medium term notes	\$ 667	\$ 667
Notes and bonds payable	2,983	2,980
Loans and mortgages payable	316	349
<b>Total</b>	<b>3,966</b>	<b>3,996</b>
Borrowings guaranteed by AIG:		
AIGFP		
GIAs	22,691	18,919
Notes and bonds payable	25,293	22,695
<b>Total</b>	<b>47,984</b>	<b>41,614</b>
AIG Funding, Inc. commercial paper	3,479	2,969
AGC Notes and bonds payable	1,096	1,095
Liabilities connected to trust preferred stock	1,489	1,489
<b>Total borrowings issued or guaranteed by AIG</b>	<b>58,014</b>	<b>51,163</b>
Borrowings not guaranteed by AIG:		
ILFC		
Commercial paper	4,448	2,670
Medium term notes	5,503	5,972

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Notes and bonds payable <sup>(a)</sup>	15,716	15,734
Loans and mortgages payable <sup>(b)</sup>	20	40
<b>Total</b>	<b>25,687</b>	<b>24,416</b>
<b>AGF</b>		
Commercial paper	3,695	3,686
Medium term notes	14,830	13,709
Notes and bonds payable	1,540	1,585
<b>Total</b>	<b>20,065</b>	<b>18,980</b>
<b>Commercial paper:</b>		
AIG Credit Card Company (Taiwan)	329	359
AIG Finance (Taiwan) Limited	5	9
<b>Total</b>	<b>334</b>	<b>368</b>
<b>Loans and mortgages payable:</b>		
AIGCFG	647	792
AIG Finance (Hong Kong) Limited	103	49
<b>Total</b>	<b>750</b>	<b>841</b>
<b>Other Subsidiaries</b>	<b>822</b>	<b>832</b>
<b>Variable Interest Entity debt:</b>		
AIG Global Real Estate Investment	7	8
AIG Capital Partners	165	165
AIG SunAmerica	177	126
<b>Total</b>	<b>349</b>	<b>299</b>
<b>Total borrowings not guaranteed by AIG</b>	<b>48,007</b>	<b>45,736</b>
<b>Total Debt</b>	<b>\$ 106,021</b>	<b>\$ 96,899</b>

(a) Includes borrowings under Export Credit Facility of \$2.1 billion and \$1.7 billion, at March 31, 2005 and December 31, 2004, respectively.

(b) Capital lease obligations.

For a description of the effects on AIG's capital resources, including the cost of borrowing, of recent downgrades and rating actions by the major rating agencies, see the discussion under "Outlook" herein.

During the first three months of 2005, AIG did not issue any medium term notes. AIG intends to continue its customary practice of issuing debt securities from time to time to meet its financing needs and those of certain of its subsidiaries for general corporate purposes, as well as to initiate a matched investment program.

On May 15, 2003, AIG sold \$1.5 billion principal amount of notes in a Rule 144A/Regulation S offering, \$500 million of which bear interest at a rate of 2.875 percent per annum and mature in 2008 and \$1.0 billion of which bear interest at a rate of 4.250 percent per annum and mature in 2013. The notes are senior unsecured obligations of AIG and rank equally with all of AIG's other senior debt outstanding. AIG completed an exchange offer in April 2004 with respect to the Rule 144A/Regulation S Notes and issued in exchange substantially identical notes that are registered under the Securities Act.

AIGFP uses the proceeds from the issuance of notes and bonds and GIA borrowings to invest in a diversified portfolio of securities and derivative transactions. The borrowings may also be temporarily invested in securities purchased under agreements to resell. (See also the discussions under "Operating Review," "Liquidity" and "Derivatives" herein.)

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AIGFP has established a Euro Medium Term Note Program under which an aggregate principal amount of up to \$5.0 billion of notes may be outstanding. The Program provides that additional notes may be issued to replace matured or redeemed notes. As of March 31, 2005, \$8.25 billion of notes had been issued under the program, \$4.94 billion of which were outstanding including \$124 million resulting from foreign exchange translation into U.S. dollars. Notes

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American International Group, Inc. and Subsidiaries issued under this program are included in Notes and Bonds Payable in the preceding table of borrowings.

AIG Funding, Inc. (AIG Funding), through the issuance of commercial paper, helps fulfill the short-term cash requirements of AIG and its subsidiaries. AIG Funding intends to continue to meet AIG's funding requirements through the issuance of commercial paper guaranteed by AIG. The issuance of AIG Funding's commercial paper is subject to the approval of AIG's Board of Directors.

AIG and AIG Funding are parties to unsecured syndicated revolving credit facilities aggregating \$2.75 billion, consisting of \$1.375 billion in a 364-day revolving credit facility that expires in July of 2005 and \$1.375 billion in a five-year revolving credit facility that expires in July of 2007. The 364-day facility allows for the conversion by AIG of any outstanding loans at expiration into one-year term loans. The facilities can be used for general corporate purposes and also to provide backup for AIG's commercial paper programs administered by AIG Funding. AIG expects to replace or extend these credit facilities on or prior to their expiration. There are currently no borrowings outstanding under these facilities, nor were any borrowings outstanding as of March 31, 2005.

AIG obtained waivers from the lenders under these revolving credit facilities providing for the extension of the delivery date of AIG's consolidated financial statements for the first quarter of 2005 through June 30, 2005.

AIG is also a party to an unsecured inter-company revolving credit facility provided by certain of its subsidiaries aggregating \$2 billion that expires in October of 2005. The facility allows for the conversion of any outstanding loans at expiration into one-year term loans. The facility can be used for general corporate purposes and also to provide backup for AIG's commercial paper programs. AIG expects to replace or extend this credit facility on or prior to its expiration. There are currently no borrowings outstanding under the inter-company facility, nor were any borrowings outstanding as of March 31, 2005.

As of November 2001, AIG guaranteed the notes and bonds of AGC.

Preferred stock issued by an AGC subsidiary, American General Capital I, with a liquidation value of \$200 million was redeemed for cash on September 8, 2004. AGC redeemed the related Junior Subordinated Debentures at that time, extinguishing the liabilities connected to the trust preferred stock.

ILFC fulfills its short term cash requirements through the issuance of commercial paper. The issuance of commercial paper is subject to the approval of ILFC's Board of Directors and is not guaranteed by AIG. ILFC is a party to unsecured syndicated revolving credit facilities aggregating \$6.0 billion at March 31, 2005. The facilities can be used for general corporate purposes and also to provide backup for ILFC's commercial paper program and consist of \$4.0 billion in a 364-day revolving credit facility that expires in October 2005, with a one-year term out option, and \$2.0 billion in a five-year revolving credit facility that expires in October 2009. ILFC expects to replace or extend these credit facilities on or prior to their expiration. There are currently no borrowings under these facilities, nor were any borrowings outstanding as of March 31, 2005.

At March 31, 2005, ILFC had increased the aggregate principal amount outstanding of its medium term and long-term notes. The foreign exchange adjustment for the foreign currency denominated debt was \$933 million at March 31, 2005 and \$1.2 billion at December 31, 2004. ILFC had \$13.13 billion of debt securities registered for public sale at March 31, 2005. As of March 31, 2005, \$6.11 billion of debt securities were issued. In addition, ILFC has a Euro Medium Term Note Program for \$7.0 billion, under which \$4.48 billion in notes were sold through March 31, 2005. ILFC has substantially eliminated the currency exposure arising from foreign currency denominated notes by economically hedging that portion of the note exposure not already offset by Euro denominated operating lease payments. Notes issued under this program are included in Notes and Bonds Payable in the preceding table of borrowings.

ILFC had a \$4.3 billion Export Credit Facility for use in connection with the purchase of approximately 75 aircraft delivered through 2001. This facility was guaranteed by various European Export Credit Agencies. The interest rate varies from 5.75 percent to 5.90 percent on these amortizing ten-year borrowings depending on the delivery date of the aircraft. At March 31, 2005, ILFC had \$1.5 billion outstanding under this facility. The debt is collateralized by a pledge of the shares of a subsidiary of ILFC, which holds title to the aircraft financed under the facility. In May 2004, ILFC entered into a similarly structured Export Credit Facility (ECA) for up to a maximum of \$2.64 billion for Airbus aircraft to be delivered in 2004 and 2005. The facility becomes available as the various European Export Credit Agencies provide their guarantees for aircraft based on a six-month forward-looking calendar, and the interest rate is determined through a bid process. At March 31, 2005, ILFC has \$604 million outstanding under this facility. Borrowings with respect to these facilities are included in Notes and Bonds Payable in the preceding table of borrowings.

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In August 2004, ILFC received a commitment for an Ex-Im Bank comprehensive guarantee in the amount of \$1.68 billion to support the financing of up to 30 new Boeing aircraft. The delivery period initially extends from September 1, 2004 through August 31, 2005, but may be extended to August 31, 2006. ILFC did not have any borrowings outstanding under this facility at March 31, 2005. During 2003, ILFC entered into various bank financings for a total funded amount of \$1.3 billion. The financings mature through 2009.

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One tranche of one of the loans totaling \$410 million was funded in Japanese yen and swapped to U.S. dollars.

The proceeds of ILFC's debt financing are primarily used to purchase flight equipment, including progress payments during the construction phase. The primary sources for the repayment of this debt and the interest expense thereon are the cash flow from operations, proceeds from the sale of flight equipment and the rollover and refinancing of the prior debt. (See also the discussions under "Operating Review" and "Liquidity herein.")

AGF fulfills its short term cash requirements through the issuance of commercial paper. The issuance of commercial paper is subject to the approval of AGF's Board of Directors and is not guaranteed by AIG. AGF is a party to unsecured syndicated revolving credit facilities aggregating \$3.25 billion, consisting of \$1.75 billion in a 364-day revolving credit facility that expires in July of 2005 and \$1.5 billion in a five-year revolving credit facility that expires in July of 2007. The 364-day facility allows for the conversion by AGF of any outstanding loans at expiration into one-year term loans. The facilities can be used for general corporate purposes and also to provide backup for AGF's commercial paper programs. AGF expects to replace or extend these credit facilities on or prior to their expiration. There are currently no borrowings under these AGF facilities, nor were any borrowings outstanding as of March 31, 2005.

AGF is also party to several bilateral credit agreements aggregating \$260 million at March 31, 2005. The terms and conditions of these agreements are identical to AGF's 364-day revolving credit facility.

During the first three months of 2005, AGF issued \$1.77 billion fixed rate and variable rates medium term notes ranging in maturities from two to five years. As of March 31, 2005, notes aggregating \$14.83 billion were outstanding with maturity dates ranging from 2005 to 2014 at interest rates ranging from 1.25 percent to 7.50 percent. To the extent deemed appropriate, AGF may enter into swap transactions to manage its effective borrowing with respect to these notes.

In addition, AGF issued \$2.86 billion of long-term funding in 2004 from sources including Euro-denominated and Sterling-denominated transactions totaling the equivalent of \$1.82 billion. Other funding sources included private placement debt, retail note issuances and bank financings.

AIG Credit Company (Taiwan) (AIGCCC-Taiwan) and AIG Finance (Taiwan) Limited (AIGF-Taiwan), both consumer finance subsidiaries in Taiwan, have issued commercial paper for the funding of their own operations. At March 31, 2005, AIG did not guarantee the commercial paper of any of its subsidiaries other than AIG Funding. (See also the discussion under "Derivatives" herein).

**Contractual Obligations and Other Commercial Commitments**

**The maturity schedule of AIG's contractual obligations at March 31, 2005 (Restated) was as follows:**

(in millions)

	Total Payments	Payments due by Period			
		Less Than One Year	One Through Three Years	Four Through Five Years	After Five Years
Borrowings <sup>(a)</sup>	\$ 93,716	\$ 33,608	\$ 19,287	\$ 16,086	\$ 24,735
Loss reserves <sup>(b)</sup>	63,570	17,482	19,388	9,218	17,482
Insurance and investment contract liabilities <sup>(c)</sup>	590,385	28,419	\$ 42,178	44,286	475,502
Aircraft purchase commitments	19,552	3,804	10,132	5,249	367
<b>Total</b>	<b>\$ 767,223</b>	<b>\$ 83,313</b>	<b>\$ 90,985</b>	<b>\$ 74,839</b>	<b>\$ 518,086</b>

- (a) Excludes commercial paper and obligations included as debt pursuant to FIN 46R and includes ILFC's capital lease obligations.
- (b) Represents future loss and loss adjustment expense payments estimated based on historical loss development payment patterns.
- (c) Insurance and investment contract liabilities include various investment-type products with contractually scheduled maturities including periodic payments of a term certain nature and guaranteed maturities under guaranteed investment contracts. Insurance and investment contract liabilities also include benefit and claim liabilities, of which a significant portion represents policies and contracts that do not have stated contractual maturity dates and may not result in any future payment obligation. For these policies and contracts (i) AIG is currently not making payments until the occurrence of an insurable event, such as death or disability, (ii) payments are conditional on survivorship, or (iii) the occurrence of a payment due to surrender or other non-scheduled event out of AIG's control. AIG has made significant assumptions to determine the estimated undiscounted cash flows of these contractual policy benefits which include mortality, morbidity, future lapse rates, expenses, investment returns and interest crediting rates, offset by expected future deposits and premium on in-force policies. Due to the significance of the assumptions used, the amounts presented could be materially different from actual required payments. The amounts presented in this table are undiscounted and therefore exceed the future policy benefits and policyholder contract deposits included in the balance sheet.



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**The maturity schedule of AIG's other commercial commitments by segment at March 31, 2005 was as follows:***(in millions)*

	Total Amounts Committed	Amount of Commitment Expiration			
		Less Than One Year	One Through Three Years	Four Through Five Years	After Five Years
Letters of credit:					
Life Insurance & Retirement Services	\$ 185	\$ 91	\$ 1	\$	\$ 93
DBG	199	105	94		
Standby letters of credit:					
Capital Markets	1,556	4	39	31	1,482
Guarantees:					
Life Insurance & Retirement Services <sup>(a)</sup>	2,617	225	413		1,979
Asset Management	119	62	57		
Other commercial commitments <sup>(b)</sup> :					
Capital Markets <sup>(c)</sup>	16,403	557	2,057	2,750	11,039
Aircraft Finance <sup>(d)</sup>	689	23	362		304
Life Insurance & Retirement Services <sup>(e)</sup>	2,392	437	821	319	815
Asset Management	495	340	155		
DBG <sup>(f)</sup>	1,380				1,380
<b>Total</b>	<b>\$ 26,035</b>	<b>\$ 1,844</b>	<b>\$ 3,999</b>	<b>\$ 3,100</b>	<b>\$ 17,092</b>

*(a) Primarily AIG SunAmerica construction guarantees connected to affordable housing investments.**(b) Excludes commitments with respect to pension plans. The annual pension contribution for 2005 was \$393 million.**(c) Primarily liquidity facilities provided in connection with certain municipal swap transactions and collateralized bond obligations.**(d) Primarily in connection with options to acquire aircraft.**(e) Primarily AIG SunAmerica commitments to invest in partnerships.**(f) Primarily commitments to invest in limited partnerships.*

Rating triggers have been defined by one independent rating agency to include clauses or agreements the outcome of which depends upon the level of ratings maintained by one or more rating agencies. Rating triggers generally relate to events which (i) could result in the termination or limitation of credit availability, or require accelerated repayment, (ii) could result in the termination of business contracts or (iii) could require a company to post collateral for the benefit of counterparties.

AIG believes that any of its or its subsidiaries contractual obligations that are subject to ratings triggers or financial covenants relating to ratings triggers would not have a material adverse effect on its financial condition, future operating results or liquidity.

As a result of the downgrades of AIG's long-term senior debt ratings, AIG was required to post approximately \$1.16 billion of collateral with counterparties to municipal guaranteed investment agreements and financial derivatives transactions. In the event of a further downgrade, AIG will be required to post additional collateral. It is estimated that, as of the close of business on February 28, 2006, based on AIG's outstanding municipal guaranteed investment agreements and financial derivatives transactions as of such date, a further downgrade of AIG's long-term senior debt ratings to Aa3 by Moody's or AA- by S&P would permit counterparties to call for approximately \$962 million of additional collateral. Further, additional downgrades could result in requirements for substantial additional collateral, which could have a material effect on how AIG manages its liquidity. The actual amount of additional collateral that AIG would be required to post to counterparties in the event of such downgrades depends on market conditions, the market value of the outstanding affected transactions and other factors prevailing at the time of the downgrade. Any additional obligations to post collateral will increase the demand on AIG's liquidity.

Shareholders' Equity

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AIG's consolidated shareholders' equity increased \$1.94 billion during the first three months of 2005. During the first three months of 2005, retained earnings increased \$3.35 billion, resulting from net income less dividends. Unrealized appreciation of investments, net of taxes decreased \$1.28 billion and the cumulative translation adjustment loss, net of taxes, increased \$49 million. During the first three months of 2005, there was a gain of \$39 million, net of taxes, relating to derivative contracts designated as cash flow hedging instruments. (See also the discussion under "Operating Review" and "Liquidity" herein and the Consolidated Statement of Comprehensive Income.)

AIG has in the past reinvested most of its unrestricted earnings in its operations and believes such continued reinvestment in the future will be adequate to meet any foreseeable capital needs. However, AIG may choose from time to time to raise additional funds through the issuance of additional securities.

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Stock Purchase

During the period January 1, 2005 through March 31, 2005, AIG purchased in the open market 2,477,100 shares of its common stock. AIG from time to time may buy shares of its common stock in the open market for general corporate purposes, including to satisfy its obligations under various employee benefit plans. At March 31, 2005, an additional 36,542,700 shares could be purchased under the then current authorization by AIG's Board of Directors.

Dividends from Insurance Subsidiaries

Payments of dividends to AIG by its insurance subsidiaries are subject to certain restrictions imposed by regulatory authorities. With respect to AIG's domestic insurance subsidiaries, the payment of any dividend requires formal notice to the insurance department in which the particular insurance subsidiary is domiciled. Under the laws of many states, an insurer may pay a dividend without prior approval of the insurance regulator when the amount of the dividend is below certain regulatory thresholds.

With respect to AIG's foreign insurance subsidiaries, the most significant insurance regulatory jurisdictions include Bermuda, Japan, Hong Kong, Taiwan, the United Kingdom, Thailand and Singapore.

AIG cannot predict whether the regulatory investigations currently underway or future regulatory issues will impair AIG's financial condition, results of operations or liquidity. To AIG's knowledge, no AIG company is currently on any regulatory or similar "watch list" with regard to solvency. (See also the discussion under "Liquidity" herein.)

Regulation and Supervision

AIG's insurance subsidiaries, in common with other insurers, are subject to regulation and supervision by the states and jurisdictions in which they do business. In the U.S. the National Association of Insurance Commissioners (NAIC) has developed Risk-Based Capital (RBC) requirements. RBC relates an individual insurance company's statutory surplus to the risk inherent in its overall operations. At March 31, 2005, the risk-based adjusted surplus of each of AIG's Domestic General companies and of each of AIG's Domestic Life companies exceeded each of their RBC standards. As discussed above, various regulators have commenced investigations into certain insurance business practices, including with respect to AIG. While such investigations are in their early stages, it is possible that they may result in additional regulation of the insurance industry and specific action with respect to AIG and AIG cannot predict the ultimate effect that such additional regulation might have on its business. Federal, state or local legislation may affect AIG's ability to operate and expand its various financial services businesses and changes in the current laws, regulations or interpretations thereof may have a material adverse effect on these businesses.

AIG's U.S. operations are negatively affected under guarantee fund assessment laws which exist in most states. As a result of operating in a state which has guarantee fund assessment laws, a solvent insurance company may be assessed for certain obligations arising from the insolvencies of other insurance companies which operated in that state. AIG generally records these assessments upon notice. Additionally, certain states permit at least a portion of the assessed amount to be used as a credit against a company's future premium tax liabilities. Therefore, the ultimate net assessment cannot reasonably be estimated. The guarantee fund assessments net of credits for 2004 were \$118 million.

AIG is also required to participate in various involuntary pools (principally workers compensation business) which provide insurance coverage for those not able to obtain such coverage in the voluntary markets. This participation is also recorded upon notification, as these amounts cannot reasonably be estimated.

A substantial portion of AIG's General Insurance business and a majority of its Life Insurance & Retirement Services business are conducted in foreign countries. The degree of regulation and supervision in foreign jurisdictions varies. Generally, AIG, as well as the underwriting companies operating in such jurisdictions, must satisfy local regulatory requirements. Licenses issued by foreign authorities to AIG subsidiaries are subject to modification and revocation. Thus, AIG's insurance subsidiaries could be prevented from conducting future business in certain of the jurisdictions where they currently operate. AIG's international operations include operations in various developing nations. Both current and future foreign operations could be adversely affected by unfavorable political developments up to and including nationalization of AIG's operations without compensation. Adverse effects resulting from any one country may affect AIG's results of operations, liquidity and financial condition depending on the magnitude of the event and AIG's net financial exposure at that time in that country.

Foreign operations are individually subject to local solvency margin requirements that require maintenance of adequate capitalization, which AIG complies with by country. In addition, certain foreign locations, notably Japan, have established regulations that can result in guarantee fund assessments. These have not had a material effect on AIG's operations.

## **Liquidity**

AIG's liquidity is primarily derived from the operating cash flows of its General and Life Insurance & Retirement Services operations. Management believes that AIG's liquid assets and access to short-term funding through commercial paper and

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bank credit facilities will enable it to meet any anticipated cash requirements.

At March 31, 2005, AIG's consolidated invested assets included \$24.38 billion of cash and short-term investments. Consolidated net cash used in operating activities in the first three months of 2005 amounted to \$434 million. The \$434 million in consolidated net cash used in operating activities is net of approximately \$8 billion used by AIGFP to purchase securities purchased under agreements to resell and to repurchase securities sold under agreements to repurchase in the ordinary course of AIGFP's business. This operating activity was funded in part by proceeds from security sales under similar repurchase and reverse repurchase agreements, but primarily by AIGFP's financing activities, specifically proceeds from guaranteed investment agreements and notes, bonds, loans and mortgages payable. Approximately half of the \$8 billion was subsequently invested in securities available for sale.

The liquidity of the combined insurance operations is derived both domestically and abroad. The combined insurance operating cash flow is derived from two sources, underwriting operations and investment operations. Cash flow includes periodic premium collections, including policyholders' contract deposits, cash flows from investment operations and paid loss recoveries less reinsurance premiums, losses, benefits, and acquisition and operating expenses. Generally, there is a time lag from when premiums are collected and, when as a result of the occurrence of events specified in the policy, the losses and benefits are paid. Investment income cash flow is primarily derived from interest and dividends received and includes realized capital gains net of realized capital losses. (See also the discussions under Operating Review: General Insurance Operations and Life Insurance & Retirement Services Operations herein.)

With respect to General Insurance operations, if paid losses accelerated beyond AIG's ability to fund such paid losses from current operating cash flows, AIG might need to liquidate a portion of its General Insurance investment portfolio and/or arrange for financing. Potential events causing such a liquidity strain could be the result of several significant catastrophic events occurring in a relatively short period of time. Additional strain on liquidity could occur if the investments sold to fund such paid losses were sold into a depressed market place and/or reinsurance recoverable on such paid losses became uncollectible or collateral supporting such reinsurance recoverable significantly decreased in value. (See also the discussions under Operating Review: General Insurance Operations herein.)

With respect to Life Insurance & Retirement Services operations, if a substantial portion of the Life Insurance & Retirement Services operations bond portfolio diminished significantly in value and/or defaulted, AIG might need to liquidate other portions of its Life Insurance & Retirement Services investment portfolio and/or arrange financing. Potential events causing such a liquidity strain could be the result of economic collapse of a nation or region in which AIG Life Insurance & Retirement Services operations exist, nationalization, terrorist acts or other such economic or political upheaval. In addition, a significant rise in interest rates leading to a significant increase in policyholder surrenders could also create a liquidity strain. (See also the discussions under Operating Review: Life Insurance & Retirement Services Operations herein.)

In addition to the combined insurance pretax operating cash flow, AIG's insurance operations held \$13.18 billion in cash and short-term investments at March 31, 2005. Operating cash flow and the cash and short-term balances held provided AIG's insurance operations with a significant amount of liquidity.

This liquidity is available, among other things, to purchase predominately high quality and diversified fixed income securities and, to a lesser extent, marketable equity securities, and to provide mortgage loans on real estate, policy loans and collateral loans. This cash flow coupled with proceeds of approximately \$33 billion from the maturities, sales and redemptions of fixed income securities and from the sale of equity securities was used to purchase approximately \$46 billion of fixed income securities and marketable equity securities during the first three months of 2005.

AIG's major Financial Services operating subsidiaries consist of AIGFP, ILFC, AGF and AIGCFG. Sources of funds considered in meeting the liquidity needs of AIGFP's operations include execution of guaranteed investment agreements, issuance of long-term and short-term debt, proceeds from maturities and sales of securities available for sale, securities sold under repurchase agreements, and securities and spot commodities sold but not yet purchased. ILFC, AGF and AIGCFG all utilize the commercial paper markets, bank loans and bank credit facilities as sources of liquidity. ILFC and AGF also fund in the domestic and international capital markets without reliance on any guarantee from AIG. An additional source of liquidity for ILFC is the use of export credit facilities. AIGCFG also uses wholesale and retail bank deposits as sources of funds. On occasion, AIG has provided equity capital to ILFC, AGF and AIGCFG and provides intercompany loans to AIGCFG. Cash flow provided from operations is a major source of liquidity for AIG's primary Financial Services operating subsidiaries.

AIG, the parent company, funds its short-term working capital needs through commercial paper issued by AIG Funding. As of March 31, 2005, AIG Funding had \$3.48 billion of commercial paper outstanding with an average maturity of 26 days. As additional liquidity, AIG parent has a \$2 billion inter-company revolving credit facility provided by certain of its subsidiaries, a \$1.375 billion 364-day revolving bank credit

facility that expires in July 2005 and a \$1.375 billion

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five year revolving bank credit facility that expires in July 2007. AIG parent's primary sources of cash flow are dividends and loans from its subsidiaries. AIG parent's primary uses of cash flow are for debt service and the payment of dividends to shareholders. As of March 31, 2005, including debt obligations of AGC that are guaranteed by AIG, remaining debt maturities due in 2005 are \$300 million, \$55 million and \$500 million for the second, third and fourth quarters, respectively. See also Note 9 of Notes to Consolidated Financial Statements in AIG's 2005 Form 10-K for additional information on debt maturities for AIG and its subsidiaries.

## **Special Purpose Vehicles and Off Balance Sheet Arrangements**

AIG uses special purpose vehicles (SPVs) and off balance sheet arrangements in the ordinary course of business. As a result of recent changes in accounting, a number of SPVs and off balance sheet arrangements have been reflected in AIG's consolidated financial statements. In January 2003, FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 addressed the consolidation and disclosure rules for nonoperating entities that are now defined as Variable Interest Entities (VIEs). In December 2003, FASB issued a revision to Interpretation No. 46 (FIN 46R).

AIG has restrictive guidelines with respect to the formation of and investment in SPVs and off balance sheet arrangements. In particular, AIG has expanded the responsibility of its Complex Structured Financial Transaction Committee (CSFT) to include the review of any transaction that could enable a third party to achieve an accounting or financial reporting result that is not in conformity with applicable GAAP or subject AIG to heightened legal, reputational, regulatory or other risk. See Management's Report on Internal Control Over Financial Reporting in Item 9A of Part II included in AIG's 2005 Form 10-K for a further discussion of the CSFT.

For additional information related to AIG's activities with respect to VIEs and certain guarantees see Recent Accounting Standards herein and also Note 9 of Notes to Consolidated Financial Statements. Also, for additional disclosure regarding AIG's commercial commitments (including guarantors), see Contractual Obligations and Other Commercial Commitments herein.

## **Derivatives**

Derivatives are financial instruments among two or more parties with returns linked to or derived from some underlying equity, debt, commodity or other asset, liability, or index. Derivatives payments may be based on interest rates and exchange rates and/or prices of certain securities, certain commodities, financial or commodity indices, or other variables. The more significant types of derivative arrangements in which AIG transacts are swaps, forwards, futures and options. In the normal course of business, with the agreement of the original counterparty, these contracts may be terminated early or assigned to another counterparty.

The overwhelming majority of AIG's derivatives activities are conducted by the Capital Markets operations, thus permitting AIG to participate in the derivatives dealer market acting primarily as principal. In these derivative operations, AIG structures agreements which generally allow its counterparties to enter into transactions with respect to changes in interest and exchange rates, securities prices and certain commodities and financial or commodity indices. AIG's customers such as corporations, financial institutions, multinational organizations, sovereign entities, government agencies and municipalities use derivatives to hedge their own market exposures. For example, a futures, forward or option contract can be used to protect the customers' assets or liabilities against price fluctuations.

A counterparty may default on any obligation to AIG, including a derivative contract. Credit risk is a consequence of extending credit and/or carrying trading and investment positions. Credit risk exists for a derivative contract when that contract has a positive fair value to AIG. To help manage this risk, AIGFP's credit department operates within the guidelines set and authorities granted by the AIG Credit Risk Committee. This committee establishes the credit policy, sets limits for counterparties and provides limits for derivative transactions with counterparties having different credit ratings. In addition to credit ratings, this committee takes into account other factors, including the industry and country of the counterparty. Transactions which fall outside pre-established guidelines and limits require the specific approval of the AIG Credit Risk Committee. It is also AIG's policy to establish reserves for potential credit impairment when necessary.

In addition, AIGFP utilizes various credit enhancements, including letters of credit, guarantees, collateral, credit triggers, credit derivatives, and margin agreements to reduce the credit risk relating to its outstanding derivative financial transactions. AIGFP requires credit enhancements in connection with specific transactions based on, among other things, the creditworthiness of the counterparties, and the transaction's size and maturity.

AIG's Derivatives Review Committee provides an independent review of any proposed derivative transaction or program except those derivative transactions entered into by AIGFP with third parties. The committee examines, among other things, the nature and purpose of the

derivative transaction, its potential credit exposure, if any, and the estimated benefits.

FAS 133 requires that third-party derivatives used for hedging must be specifically matched with the underlying exposures to an outside third party and documented contem-



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 poraneously to qualify for hedge accounting treatment. In many cases, AIG did not meet these hedging requirements with respect to certain hedging transactions. Not meeting the requirements of FAS 133 does not result in any changes in AIG's liquidity or its overall financial condition even though inter-period volatility of earnings increased.

**Managing Market Risk**

Market risk is the risk of loss of fair value resulting from adverse fluctuations in interest rates, foreign currencies, equities and commodity prices. AIG has exposures to these risks.

AIG analyzes market risk using various statistical techniques including Value at Risk (VaR). VaR is a summary statistical measure that applies the estimated volatility and correlation of market factors to AIG's market positions. The output from the VaR calculation is the maximum loss that could occur over a defined period of time given a certain probability. While VaR models are relatively sophisticated, the quantitative market risk information generated is limited by the assumptions and parameters established in creating the related models. AIG believes that statistical models alone do not provide a reliable method of monitoring and controlling market risk. Therefore, such models are tools and do not substitute for the experience or judgment of senior management.

**Insurance**

AIG has performed a separate VaR analysis for the General Insurance and Life Insurance & Retirement Services segments and for each market risk within each segment. For purposes of the VaR calculation, the insurance assets and liabilities from GICs are included in the Life Insurance & Retirement Services segment. For the calculations in the analyses the financial instrument assets included are the insurance segments' invested assets, excluding real estate and investment income due and accrued, and the financial instrument liabilities included are reserve for losses and loss expenses, reserve for unearned premiums, future policy benefits for life and accident and health insurance contracts and other policyholders' funds.

AIG calculated the VaR with respect to the net fair value of each of AIG's insurance segments as of March 31, 2005 and December 31, 2004. The VaR number represents the maximum potential loss that could be incurred with a 95 percent confidence (i.e., only 5 percent of historical scenarios show losses greater than the VaR figure) within a one-month holding period. AIG uses the historical simulation methodology that entails repricing all assets and liabilities under explicit changes in market rates within a specific historical time period. AIG uses the most recent three years of historical market information for interest rates, foreign exchange rates, and equity index prices. For each scenario, each transaction was repriced. Portfolio, business unit and finally AIG-wide scenario values are then calculated by netting the values of all the underlying assets and liabilities.

**The following table presents the VaR on a combined basis and of each component of market risk for each of AIG's insurance segments as of March 31, 2005 and December 31, 2004. Due to diversification effects, the combined VaR is always smaller than the sum of its components.**

	General Insurance		Life Insurance & Retirement Services	
	2005	2004	2005	2004
<i>(in millions)</i>				
Market risk:				
Combined	\$ 1,672	\$ 1,396	\$ 4,626	\$ 5,024
Interest rate	1,931	1,563	4,442	4,750
Currency	121	139	534	478
Equity	671	727	1,015	1,024

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The following table presents the average, high and low VaRs on a combined basis and of each component of market risk for each of AIG's insurance segments as of March 31, 2005 and December 31, 2004. Due to diversification effects, the combined VaR is always smaller than the sum of its components.

(in millions)	2005			2004		
	Average	High	Low	Average	High	Low
<b>General Insurance:</b>						
Market risk:						
Combined	\$ 1,534	\$ 1,672	\$ 1,396	\$ 1,299	\$ 1,497	\$ 1,100
Interest rate	1,747	1,931	1,563	1,407	1,591	1,173
Currency	130	139	121	111	139	88
Equity	699	727	671	744	797	688
<b>Life Insurance &amp; Retirement Services:</b>						
Market risk:						
Combined	\$ 4,825	\$ 5,024	\$ 4,626	\$ 4,021	\$ 5,024	\$ 3,075
Interest rate	4,596	4,750	4,442	3,831	4,750	2,967
Currency	506	534	478	326	478	257
Equity	1,019	1,024	1,015	884	1,024	758

**Financial Services**

AIG generally manages its market exposures within Financial Services by maintaining offsetting positions. Capital Markets seeks to minimize or set limits for open or uncovered market positions. Credit exposure is managed separately. (See the discussion on the management of credit risk above.)

AIG's Market Risk Management Department provides detailed independent review of AIG's market exposures, particularly those market exposures of the Capital Markets operations. This department determines whether AIG's market risks, as well as those market risks of individual subsidiaries, are within the parameters established by AIG's senior management. Well established market risk management techniques such as sensitivity analysis are used. Additionally, this department verifies that specific market risks of each of certain subsidiaries are managed and hedged by that subsidiary.

ILFC is exposed to market risk and the risk of loss of fair value and possible liquidity strain resulting from adverse fluctuations in interest rates. As of March 31, 2005 and December 31, 2004, AIG statistically measured the loss of fair value through the application of a VaR model. In this analysis, the net fair value of Aircraft Finance operations was determined using the financial instrument assets which included the tax adjusted future flight equipment lease revenue, and the financial instrument liabilities which included the future servicing of the current debt. The estimated effect of the current derivative positions was also taken into account.

AIG calculated the VaR with respect to the net fair value of Aircraft Finance operations using the historical simulation methodology, as previously described. As of March 31, 2005 and December 31, 2004, the average VaR with respect to the net fair value of Aircraft Finance operations was approximately \$76 million and \$70 million, respectively.

Capital Markets operations are exposed to market risk due to changes in the level and volatility of interest rates, foreign currency exchange rates, equity prices and commodity prices. AIGFP hedges its exposure to these risks primarily through swaps, options, forwards and futures. To economically hedge interest rate risks, AIGFP may also purchase U.S. and foreign government obligations.

AIGFP does not seek to manage the market risk of each transaction through an individual third party offsetting transaction. Rather, AIGFP takes a portfolio approach to the management of its market risk exposures. AIGFP values the predominant portion of its market-sensitive transactions by marking them to market currently through income. A smaller portion is priced by estimated fair value based upon a conservative extrapolation of market factors. There is another limited portion of transactions where the initial fair value is not recorded through income currently and gains or losses are accrued over the life of the transactions. These valuations represent an assessment of the present values of

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expected future cash flows and may include reserves for such risks as are deemed appropriate by AIGFP and AIG management.

AIGFP manages market risk with a variety of transactions, including swaps, trading securities, futures and forward contracts, and other transactions as appropriate. The recorded values of these transactions may be different from the values that might be realized if AIGFP were required to sell or close out the transactions prior to maturity. AIG believes that such differences are not significant to the results of operations, financial condition or liquidity. Such differences would be immediately recognized when the transactions are sold or closed out prior to maturity.

AIGFP attempts to secure reliable and independent current market prices, such as published exchange prices, external subscription services such as from Bloomberg or Reuters or third-party broker quotes for use in this model. When such prices are not available, AIGFP use an internal methodology which includes extrapolation from observable and verifiable

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prices nearest to the dates of the transactions. Historically, actual results have not materially deviated from these models.

Systems used by Capital Markets operations can monitor each unit's respective market positions on an intraday basis. AIGFP operates in major business centers overseas and therefore is open for business essentially 24 hours a day. Thus, the market exposure and offset strategies are monitored, reviewed and coordinated around the clock.

AIGFP applies various testing techniques which reflect significant potential market movements in interest rates, foreign exchange rates, commodity and equity prices, volatility levels and the effect of time. These techniques vary by currency and are regularly changed to reflect factors affecting the derivatives portfolio. The results from these analyses are regularly reviewed by AIG management.

As described above, Capital Markets operations are exposed to the risk of loss of fair value from adverse fluctuations in interest rate and foreign currency exchange rates and equity and commodity prices as well as implied volatilities thereon. AIG statistically measures the losses of fair value through the application of a VaR model across Capital Markets.

Capital Markets asset and liability portfolios for which the VaR analyses were performed included over the counter and exchange traded investments, derivative instruments and commodities. Because the market risk with respect to securities available for sale, at market, is substantially hedged, segregation of market sensitive instruments into trading and other than trading was not deemed necessary. The VAR calculation is unaffected by the accounting treatment of hedged transactions under FAS 133.

In the calculation of VaR for Capital Markets operations, AIG uses the same historical simulation methodology, described under Insurance above, which entails repricing all assets and liabilities under explicit changes in market rates within a specific historical time period. AIGFP has recently enhanced its library of factors by including implied option volatilities to construct the historical scenarios for simulation.

**The following table presents the VaR on a combined basis and of each component of Capital Markets risk as of March 31, 2005 and December 31, 2004. Due to diversification effects, the combined VaR is always smaller than the sum of its components.**

<i>(in millions)</i>	2005	2004
Combined	\$ 15	\$ 17
Interest rate	11	11
Currency	3	4
Equity	5	16
Commodity	8	7

**The following table presents the average, high and low VaRs on a combined basis and of each component of Capital Markets risk as of March 31, 2005 and December 31, 2004. Due to diversification effects, the combined VaR is always smaller than the sum of its components.**

<i>(in millions)</i>	2005			2004		
	Average	High	Low	Average	High	Low
Combined	\$ 16	\$ 17	\$ 15	\$ 19	\$ 24	\$ 13
Interest rate	11	11	11	9	12	5
Currency	3	4	3	4	4	3
Equity	11	16	5	13	16	5
Commodity	8	8	7	6	7	4

**Recent Accounting Standards**

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At the March 2004 meeting, the Emerging Issue Task Force (EITF) reached a consensus with respect to Issue No. 03-1, The Meaning of Other-Than Temporary Impairment and Its Application to Certain Investments. On September 30, 2004, the FASB issued FASB Staff Position (FSP) EITF Issue 03-1-1, Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. In November 2005, FASB issued FSP FAS 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which replaces the measurement and recognition guidance set forth in Issue No. 03-1 and codifies certain existing guidance on impairment.

At the September 2004 meeting, the EITF reached a consensus with respect to Issue No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share.

In December 2004, the FASB issued Statement No. 123 (revised 2004) (FAS 123R), Share Based Payment. In April 2005, the SEC delayed the effective date for the revised FAS No. 123.

On December 16, 2004, the FASB issued Statement No. 153, Exchanges of Nonmonetary Assets An Amendment of APB Opinion No. 29 (FAS 153). FAS 153 amends APB Opinion No. 29, Accounting for Nonmonetary Transactions.

In March 2005, FASB issued FSP FIN46R-5 Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities.

On June 1, 2005, the FASB issued Statement No. 154, Accounting Changes and Error Corrections (FAS 154). FAS 154 replaces APB Opinion No. 20, Accounting Changes and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements.

At the June 2005 meeting, the EITF reached a consensus with respect to Issue No. 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a

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Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights .

On June 29, 2005, FASB issued Statement 133 Implementation Issue No. B38, Embedded Derivatives: Evaluation of Net Settlement with Respect to the Settlement of a Debt Instrument through Exercise of an Embedded Put Option or Call Option.

On June 29, 2005, FASB issued Statement 133 Implementation Issue No. B39, Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor.

On September 19, 2005, FASB issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts.

On February 16, 2006, FASB issued Statement No. 155, Accounting for Certain Hybrid Financial Instruments.

For further discussion of these recent accounting standards and their application to AIG, see Note 9 of Notes to Consolidated Financial Statements.

**CONTROLS AND PROCEDURES**

In connection with the preparation of this First Quarter Form 10-Q/A, an evaluation was carried out by AIG's management, with the participation of AIG's current Chief Executive Officer and Chief Financial Officer, of the effectiveness of AIG's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (Exchange Act)). Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures. Based on its evaluation, and in light of the material weaknesses in internal control over financial reporting identified as existing as of December 31, 2004, which are described within the 2005 Annual Report on Form 10-K, AIG's Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2005, AIG's disclosure controls and procedures were ineffective.

AIG is actively engaged in the implementation of remediation efforts to address the material weaknesses in AIG's internal control over financial reporting. These remediation efforts are outlined in the 2005 Annual Report on Form 10-K and further remediation developments will be described in future filings with the SEC.

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**PART II OTHER INFORMATION**

*ITEM 6. Exhibits*

See accompanying Exhibit Index.

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**SIGNATURE**

**Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.**

**AMERICAN INTERNATIONAL GROUP, INC.**

(Registrant)

/s/ Steven J. Bensinger

Steven J. Bensinger  
Executive Vice President and Chief Financial Officer

/s/ David L. Herzog

David L. Herzog  
Senior Vice President and Comptroller  
(Principal Accounting Officer)

Dated: May 10, 2006



**Table of Contents****EXHIBIT INDEX**

Exhibit Number	Description	Location
3(ii)(a)	By-laws	Incorporated by reference to Exhibit 3.1 to AIG's Current Report on Form 8-K filed on March 17, 2005.
3(ii)(b)	By-laws	Incorporated by reference to Exhibit 3.1 to AIG's Current Report on Form 8-K filed June 20, 2005.
4	Instruments defining the rights of security holders, including indentures	Certain instruments defining the rights of holders of long-term debt securities of AIG and its subsidiaries are omitted pursuant to Item 601(b)(4)(iii) of Regulation S-K. AIG hereby undertakes to furnish to the Commission, upon request, copies of any such instruments.
11	Statement re computation of per share earnings	Included in Note (4) of Notes to Consolidated Financial Statements.
12	Statement re computation of ratios	Filed herewith.
31	Rule 13a-14(a)/15d-14(a) Certifications	Filed herewith.
32	Section 1350 Certifications	Filed herewith.