AMERICAN INTERNATIONAL GROUP INC
Form 10-Q
May 10, 2007

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from to

Commission File Number 1-8787

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

Delaware **(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

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of April 30, 2007, there were 2,594,237,019 shares outstanding of the registrant s common stock.

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American International Group, Inc. and Subsidiaries

Part I FINANCIAL INFORMATION

ITEM 1. Financial Statements (unaudited)

CONSOLIDATED BALANCE SHEET

(in millions) (unaudited)

	March 31, 2007	December 31, 2006
Assets:		
Investments and financial services assets:		
Fixed maturities:		
Bonds available for sale, at fair value (amortized cost: 2007 $380,104; 2006 $377,698) (includes hybrid financial instruments: 2007 $568; 2006 $522)	**$ 390,141**	$ 387,391
Bonds held to maturity, at amortized cost (fair value: 2007 $22,066; 2006 $22,154)	**21,414**	21,437
Bond trading securities, at fair value (cost: 2007 $8,883; 2006 $9,016)	**8,845**	9,037
Equity securities:		
Common stocks available for sale, at fair value (cost: 2007 $10,791; 2006 $10,662)	**14,457**	13,262
Common and preferred stocks trading, at fair value (cost: 2007 $13,742; 2006 $12,734)	**15,756**	14,421
Preferred stocks available for sale, at fair value (cost: 2007 $2,625; 2006 $2,485)	**2,703**	2,539
Mortgage loans on real estate, net of allowance (2007 $57; 2006 $55)	**18,228**	17,067
Policy loans	**7,521**	7,501
Collateral and guaranteed loans, net of allowance (2007 $7; 2006 $9)	**4,840**	3,850
Financial services assets:		
Flight equipment primarily under operating leases, net of accumulated depreciation (2007 $9,233; 2006 $8,835)	**41,345**	39,875
Securities available for sale, at fair value (cost: 2007 $46,313; 2006 $45,912)	**47,643**	47,205
Trading securities, at fair value	**5,369**	5,031
Spot commodities	**73**	220
Unrealized gain on swaps, options and forward transactions	**16,547**	19,252
Trade receivables	**3,883**	4,317
Securities purchased under agreements to resell, at contract value	**31,775**	31,853
Finance receivables, net of allowance (2007 $707; 2006 $737) (includes finance receivables held for sale: 2007 $983; 2006 $1,124)	**29,508**	29,573
Securities lending collateral, at fair value (which approximates cost)	**74,827**	69,306
Other invested assets	**44,167**	42,114
Short-term investments, at cost (approximates fair value)	**25,866**	25,249
Total investments and financial services assets	**804,908**	790,500
Cash	**1,702**	1,590
Investment income due and accrued	**6,170**	6,077

Premiums and insurance balances receivable, net of allowance (2007 $777; 2006 $756)		**19,731**		17,789
Reinsurance assets, net of allowance (2007 $498; 2006 $536)		**23,130**		23,355
Deferred policy acquisition costs		**37,691**		37,235
Investments in partially owned companies		**1,179**		1,101
Real estate and other fixed assets, net of accumulated depreciation (2007 $5,612; 2006 $5,525)		**4,898**		4,381
Separate and variable accounts		**73,971**		72,655
Goodwill		**8,687**		8,628
Other assets		**17,680**		16,103
Total assets	**$**	**999,747**	$	979,414

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, 2007	December 31, 2006
Liabilities:		
Reserve for losses and loss expenses	**$ 81,135**	$ 79,999
Unearned premiums	**27,135**	26,271
Future policy benefits for life and accident and health insurance contracts	**123,806**	122,230
Policyholders contract deposits	**246,301**	246,615
Other policyholders funds	**8,476**	8,281
Commissions, expenses and taxes payable	**6,053**	5,305
Insurance balances payable	**4,537**	3,789
Funds held by companies under reinsurance treaties	**2,446**	2,602
Income taxes payable	**10,992**	9,546
Financial services liabilities:		
Borrowings under obligations of guaranteed investment agreements	**19,771**	20,664
Securities sold under agreements to repurchase, at contract value	**17,581**	19,677
Trade payables	**7,546**	6,174
Hybrid financial instrument liabilities, at fair value	**8,459**	8,856
Securities and spot commodities sold but not yet purchased, at market value	**4,056**	4,076
Unrealized loss on swaps, options and forward transactions	**9,679**	11,401
Trust deposits and deposits due to banks and other depositors	**4,245**	5,249
Commercial paper	**9,228**	8,208
Notes, bonds, loans and mortgages payable	**91,186**	87,602
Commercial paper	**4,149**	4,821
Notes, bonds, loans and mortgages payable	**19,185**	17,088
Junior subordinated debt	**3,793**	
Liabilities connected to trust preferred stock	**1,440**	1,440
Separate and variable accounts	**73,971**	72,655
Securities lending payable	**75,913**	70,198
Minority interest	**8,166**	7,778
Other liabilities (includes hybrid financial instruments: 2007 $42; 2006 $111)	**27,343**	27,021
Total liabilities	**896,592**	877,546
Preferred shareholders equity in subsidiary companies	**100**	191
Commitments and Contingent Liabilities (See Note 6)		
Shareholders equity:		
Common stock, $2.50 par value; 5,000,000,000 shares authorized; shares issued 2007 and 2006 2,751,327,476	**6,878**	6,878
Additional paid-in capital	**2,674**	2,590
Payments advanced to purchase shares	**(2,851)**	

Retained earnings	**88,493**	84,996
Accumulated other comprehensive income (loss)	**9,854**	9,110
Treasury stock, at cost; 2007 151,556,041; 2006 150,131,273 shares of common stock	**(1,993)**	(1,897)
Total shareholders equity	**103,055**	101,677
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	**$ 999,747**	$ 979,414

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF INCOME

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

	Three Months Ended March 31,	
	2007	2006
Revenues:		
Premiums and other considerations	**$ 19,642**	$ 18,270
Net investment income	**7,124**	5,971
Realized capital gains (losses)	**(70)**	169
Other income	**3,949**	2,868
Total revenues	**30,645**	27,278
Benefits and expenses:		
Incurred policy losses and benefits	**16,146**	15,089
Insurance acquisition and other operating expenses	**8,327**	7,396
Total benefits and expenses	**24,473**	22,485
Income before income taxes, minority interest and cumulative effect of an accounting change	**6,172**	4,793
Income taxes	**1,726**	1,435
Income before minority interest and cumulative effect of an accounting change	**4,446**	3,358
Minority interest	**(316)**	(197)
Income before cumulative effect of an accounting change	**4,130**	3,161
Cumulative effect of an accounting change, net of tax		34
Net income	**$ 4,130**	$ 3,195
Earnings per common share:		
Basic		
Income before cumulative effect of an accounting change	**$ 1.58**	$ 1.21
Cumulative effect of an accounting change, net of tax		0.01
Net income	**$ 1.58**	$ 1.22
Diluted		
Income before cumulative effect of an accounting change	**$ 1.58**	$ 1.21
Cumulative effect of an accounting change, net of tax		0.01

Net income	**$**	**1.58**	$	1.22
Dividends declared per common share	**$**	**0.165**	$	0.150
Average shares outstanding:				
Basic		**2,612**		2,605
Diluted		**2,621**		2,624

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, 2007	2006
Summary:		
Net cash provided by operating activities	**$ 8,633**	$ 3,848
Net cash used in investing activities	**(16,863)**	(18,107)
Net cash provided by financing activities	**8,352**	13,587
Effect of exchange rate changes on cash	**(10)**	23
Change in cash	**112**	(649)
Cash at beginning of period	**1,590**	1,897
Cash at end of period	**$ 1,702**	$ 1,248
Cash flows from operating activities:		
Net income	**$ 4,130**	$ 3,195
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash revenues, expenses, gains and losses included in income:		
Net gains on sales of securities available for sale and other assets	**(250)**	(210)
Foreign exchange transaction (gains) losses	**305**	214
Net unrealized (gains) losses on non-AIGFP derivative assets and liabilities	**61**	(370)
Equity in income of partially owned companies and other invested assets	**(1,329)**	(480)
Amortization of deferred policy acquisition costs	**2,921**	2,635
Amortization of premium and discount on securities	**38**	390
Depreciation expenses, principally flight equipment	**646**	554
Provision for finance receivable losses	**87**	160
Impairment losses	**467**	226
Changes in operating assets and liabilities:		
General and life insurance reserves	**4,190**	4,483
Premiums and insurance balances receivable and payable net	**(1,192)**	(2,245)
Reinsurance assets	**223**	121
Capitalization of deferred policy acquisition costs	**(3,750)**	(4,252)
Investment income due and accrued	**(109)**	(6)
Funds held under reinsurance treaties	**(158)**	21
Other policyholders funds	**223**	(459)
Income taxes payable	**1,076**	744
Commissions, expenses and taxes payable	**661**	170
Other assets and liabilities net	**774**	(1,967)

Bonds, common and preferred stocks trading, at fair value		**(1,260)**		(1,596)
Trade receivables and payables net		**1,805**		(168)
Trading securities, at fair value		**(337)**		149
Spot commodities		**147**		(138)
Net unrealized (gain) loss on swaps, options and forward transactions		**962**		2
Securities purchased under agreements to resell		**78**		2,302
Securities sold under agreements to repurchase		**(2,100)**		(1,604)
Securities and spot commodities sold but not yet purchased, at market value		**(20)**		454
Finance receivables held for sale originations and purchases		**(2,433)**		(2,267)
Sales of finance receivables held for sale		**2,573**		2,671
Other, net		**204**		1,119
Total adjustments		**4,503**		653
Net cash provided by operating activities	**$**	**8,633**	$	3,848

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)

	Three Months Ended March 31, 2007	2006
Cash flows from investing activities:		
Proceeds from (payments for)		
Sales and maturities of fixed maturity securities available for sale	**$ 30,145**	$ 27,456
Sales of equity securities available for sale	**2,112**	3,627
Proceeds from fixed maturity securities held to maturity	**18**	9
Sales of flight equipment	**27**	159
Sales or distributions of other invested assets	**2,698**	2,352
Payments received on mortgage, policy, collateral and guaranteed loans	**658**	168
Principal payments received on finance receivables held for investment	**3,349**	3,076
Purchases of fixed maturity securities available for sale	**(34,273)**	(34,331)
Purchases of equity securities available for sale	**(2,436)**	(4,020)
Purchases of fixed maturity securities held to maturity	**(9)**	(16)
Purchases of flight equipment	**(1,917)**	(1,897)
Purchases of other invested assets	**(4,586)**	(3,320)
Acquisitions of new businesses, net of cash acquired	**(584)**	
Mortgage, policy, collateral and guaranteed loans issued	**(2,326)**	(1,525)
Finance receivables held for investment originations and purchases	**(3,409)**	(3,401)
Change in securities lending collateral	**(5,521)**	(3,496)
Net additions to real estate, fixed assets, and other assets	**(259)**	(248)
Net change in short-term investments	**(588)**	(2,676)
Net change in non-AIGFP derivative assets and liabilities	**38**	(24)
Net cash used in investing activities	**$ (16,863)**	$ (18,107)
Cash flows from financing activities:		
Proceeds from (payments for)		
Policyholders contract deposits	**$ 14,080**	$ 13,469
Policyholders contract withdrawals	**(14,682)**	(10,191)
Change in other deposits	**(1,340)**	(427)
Change in commercial paper	**279**	4,250
Notes, bonds, loans and mortgages payable, and hybrid financial instrument liabilities issued	**19,186**	9,403
Repayments on notes, bonds, loans and mortgages payable, and hybrid financial instrument liabilities	**(14,549)**	(6,835)
Issuance of junior subordinated debt	**3,740**	
Issuance of guaranteed investment agreements	**979**	3,546
Maturities of guaranteed investment agreements	**(1,775)**	(2,846)
Change in securities lending payable	**5,716**	3,550
Issuance of treasury stock	**52**	34

Payments advanced to purchase shares		**(3,000)**		
Acquisition of treasury stock		**(16)**		(2)
Cash dividends paid to shareholders		**(430)**		(390)
Other, net		**112**		26
Net cash provided by financing activities	**$**	**8,352**	$	13,587
Supplementary disclosure of cash flow information:				
Cash paid during the period for:				
Interest	**$**	**1,901**	$	1,263
Taxes	**$**	**640**	$	460
Non-cash financing activities:				
Interest credited to policyholder accounts	**$**	**2,879**	$	2,741
Treasury stock acquired using payments advanced to purchase shares	**$**	**149**		
Non-cash investing activities:				
Debt assumed on acquisitions	**$**	**1,208**		

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)

	Three Months Ended March 31, 2007	2006
Net income	**$ 4,130**	$ 3,195
Other comprehensive income (loss):		
Unrealized (depreciation) appreciation of investments net of reclassification adjustments	**1,309**	(2,599)
Deferred income tax benefit (expense) on above changes	**(458)**	1,100
Foreign currency translation adjustments	**(165)**	550
Deferred income tax benefit (expense) on above changes	**28**	(290)
Net derivative gains arising from cash flow hedging activities net of reclassification adjustments	**1**	4
Deferred income tax expense on above changes	**27**	13
Change in pension and postretirement unrecognized periodic benefit (cost)	**3**	(3)
Deferred income tax benefit (expense) on above changes	**(1)**	(33)
Other comprehensive income (loss)	**744**	(1,258)
Comprehensive income	**$ 4,874**	$ 1,937

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

1. Financial Statement Presentation

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

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

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

2. Segment Information

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

In order to better align financial reporting with the manner in which AIG s chief operating decision makers have managed their businesses, for the three months ended March 31, 2007, AIG realigned certain products among reportable segments and major internal reporting units. AIG also began reporting realized capital gains and losses for the Financial Services and Asset Management segments in the results of these segments. Historically, realized capital gains and losses were included in the Other category. There has been no change in AIG s management structure or in its reportable segments. All prior period amounts presented in the tables below have been revised to conform to the current year s presentation of these items.

The following table summarizes the operations by the major operating segments:

Operating Segments *(in millions)*	Three Months Ended March 31, **2007**	2006
Revenues[(a)]:		
General Insurance[(b)]	$ **12,903**	$ 11,656
Life Insurance & Retirement Services[(c)]	**13,682**	12,850
Financial Services[(d)(e)]	**2,201**	1,666
Asset Management[(f)]	**1,908**	1,139
Other	**102**	90
Consolidation and eliminations	**(151)**	(123)
Consolidated	$ **30,645**	$ 27,278
Operating income (loss)[(a)(g)]:		
General Insurance	$ **3,096**	$ 2,331
Life Insurance & Retirement Services	**2,281**	2,630
Financial Services[(e)]	**292**	(108)
Asset Management	**994**	449
Other[(h)]	**(499)**	(509)
Consolidation and eliminations	**8**	

Consolidated	**$ 6,172**	$ 4,793

(a) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) or for which hedge accounting was not applied, including the related foreign exchange gains and losses. For the first three months of 2007 and 2006, respectively, the effect was $(452) million and $(212) million in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are hedging investments and borrowings.

(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 premiums and other considerations, net investment income and realized capital gains (losses). Included in realized capital gains (losses) and operating income is the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, which were $(123) million and $352 million for the first three months of 2007 and 2006, respectively, and the application of Statement of Financial Accounting Standards No. 52 Foreign Currency Translation (FAS 52), which were $123 million and $4 million for the first three months of 2007 and 2006, respectively.

(d) Represents interest, lease and finance charges.

(e) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133 or for which hedge accounting was not applied, including the related foreign exchange gains and losses. For the three months ended March 31, 2007 and 2006, respectively, the effect was $(160) million, and $(619) million in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. In the first quarter of 2007, AIG began applying hedge accounting for certain transactions, primarily in its Capital Markets operations.

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

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

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

2. Segment Information *(continued)*

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

(in millions)	Three Months Ended March 31, 2007	2006
Other operating income (loss):		
Equity earnings in unconsolidated entities	**$ 41**	$ 19
Interest expense	**(252)**	(183)
Unallocated corporate expenses	**(162)**	(184)
Compensation expense SICO Plans	**(10)**	(76)
Compensation expense Starr tender offer		(54)
Realized capital gains (losses)	**(78)**	(5)
Other miscellaneous, net	**(38)**	(26)
Total Other	**$ (499)**	$ (509)

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

General Insurance *(in millions)*	Three Months Ended March 31, 2007	2006
Revenues:		
Domestic Brokerage Group	**$ 7,091**	$ 6,561
Transatlantic	**1,096**	1,016
Personal Lines	**1,213**	1,215
Mortgage Guaranty	**248**	198
Foreign General	**3,262**	2,664
Reclassifications and eliminations	**(7)**	2
Total General Insurance	**$ 12,903**	$ 11,656
Operating Income*:		
Domestic Brokerage Group	**$ 1,929**	$ 1,305
Transatlantic	**151**	141
Personal Lines	**106**	101
Mortgage Guaranty	**8**	109
Foreign General	**909**	673
Reclassifications and eliminations	**(7)**	2

Total General Insurance	**$ 3,096**	$ 2,331

**Includes additional losses incurred and net reinstatement premiums related to prior year catastrophes of $35 million and $99 million for the three months ended March 31, 2007 and 2006, respectively.*

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

Life Insurance & Retirement Services *(in millions)*	Three Months Ended March 31, **2007**	2006
Revenues:		
Foreign:		
Japan and Other	**$ 4,770**	$ 4,264
Asia	**4,491**	4,460
Domestic:		
Domestic Life Insurance	**2,521**	2,367
Domestic Retirement Services	**1,900**	1,759
Total Life Insurance & Retirement Services	**$ 13,682**	$ 12,850
Operating Income:		
Foreign:		
Japan and Other	**$ 913**	$ 978
Asia	**371**	708
Domestic:		
Domestic Life Insurance	**345**	366
Domestic Retirement Services	**652**	578
Total Life Insurance & Retirement Services	**$ 2,281**	$ 2,630

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

American International Group, Inc. and Subsidiaries

2. Segment Information *(continued)*

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

Financial Services *(in millions)*	Three Months Ended March 31, **2007**	2006
Revenues:		
Aircraft Leasing[(a)]	**$ 1,058**	$ 1,012
Capital Markets[(b)(c)]	**228**	(300)
Consumer Finance[(d)(e)]	**883**	925
Other, including intercompany adjustments	**32**	29
Total Financial Services	**$ 2,201**	$ 1,666
Operating income (loss):		
Aircraft Leasing[(a)]	**$ 164**	$ 176
Capital Markets[(b)(c)]	**68**	(470)
Consumer Finance[(d)(e)]	**36**	176
Other, including intercompany adjustments	**24**	10
Total Financial Services	**$ 292**	$ (108)

(a) Revenues are primarily aircraft lease rentals from International Lease Finance Corporation (ILFC). Both revenues and operating income include the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three months ended March 31, 2007 and 2006, the effect was $(37) million and $45 million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings.

(b) Revenues, shown net of interest expense of $1.1 billion and $639 million in the first three months of 2007 and 2006, respectively, were primarily from hedged financial positions entered into in connection with counterparty transactions. Both revenues and operating income include the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133 or for which hedge accounting was not applied, including the related foreign exchange gains and losses. For the three months ended March 31, 2007 and 2006, the effect was $(85) million and $(678) million, respectively.

(c) Certain transactions entered into by AIGFP generate tax credits and benefits which are included in income taxes in the consolidated statement of income. The amounts of such tax credits and benefits for the three months ended March 31, 2007 and 2006 were $17 million and $18 million, respectively.

(d) Revenues are primarily finance charges. Both revenues and operating income include the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three months ended March 31, 2007 and 2006, the effect was $(36) million and $3 million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings.

(e) The three months ended March 31, 2007 includes a pre-tax charge of $128 million ($83 million after tax) in connection with domestic consumer finance s mortgage banking activities.

3. Shareholders Equity and Earnings Per Share (EPS)

Earnings Per Share

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

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

(in millions, except per share data)	Three Months Ended March 31, **2007**	2006
Numerator for basic earnings per share:		
Income before cumulative effect of an accounting change	**$ 4,130**	$ 3,161
Cumulative effect of an accounting change, net of tax		34
Net income applicable to common stock for basic EPS	**$ 4,130**	$ 3,195
Interest on contingently convertible bonds, net of tax [(a)]		3
Net income applicable to common stock for diluted EPS	**$ 4,130**	$ 3,198
Cumulative effect of an accounting change, net of tax		(34)
Income before cumulative effect of an accounting change applicable to common stock for diluted EPS	**$ 4,130**	$ 3,164
Denominator for earnings per share:		
Weighted-average shares outstanding used in the computation of EPS:		
Common stock issued	**2,751**	2,751
Common stock in treasury	**(150)**	(154)
Deferred shares	**11**	8
Weighted-average shares outstanding basic	**2,612**	2,605
Incremental shares from potential common stock:		
Weighted-average number of shares arising from outstanding employee stock plans (treasury stock method) [(b)]	**9**	10
Contingently convertible bonds[(a)]		9
Weighted average shares outstanding diluted[(b)]	**2,621**	2,624

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

American International Group, Inc. and Subsidiaries

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

(in millions, except per share data)	Three Months Ended March 31, **2007**	2006
Earnings per share:		
Basic:		
Income before cumulative effect of an accounting change	**$ 1.58**	$ 1.21
Cumulative effect of an accounting change, net of tax		0.01
Net income	**$ 1.58**	$ 1.22
Diluted:		
Income before cumulative effect of an accounting change	**$ 1.58**	$ 1.21
Cumulative effect of an accounting change, net of tax		0.01
Net income	**$ 1.58**	$ 1.22

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

(b) *Certain shares arising from employee stock plans were not included in the computation of diluted earnings per share where the exercise price of the options exceeded the average market price and would have been antidilutive. The number of shares excluded was 7 million for both the three months ended March 31, 2007 and 2006.*

Shareholders Equity

From time to time, AIG may buy shares of its common stock for general corporate purposes, including to satisfy its obligations under various employee benefit plans. At December 31, 2006, an additional 36,542,700 shares could be purchased under the then current authorization by AIG s Board of Directors. In February 2007, AIG s Board of Directors increased the repurchase program by authorizing the repurchase of shares with an aggregate purchase price of $8 billion. During March 2007, AIG made open market share repurchases and entered into a $3 billion structured share repurchase arrangement. A total of 2,470,499 shares were repurchased during March 2007. The portion of the payment advanced by AIG under the structured share repurchase arrangement that had not yet been utilized to repurchase shares at March 31, 2007, amounting to $2.85 billion, has been recorded as a component of shareholders equity under the caption Payments advanced to purchase shares. Purchases have continued since March 31, 2007, with an additional 6,643,052 shares purchased during April 2007, and purchases are anticipated to occur throughout 2007. All shares repurchased are recorded as treasury stock at cost.

The quarterly dividend per common share, commencing with the dividend declared in May 2006 and paid on September 15, 2006, was $0.165.

The following table summarizes the changes in retained earnings:

Three Months Ended March 31,

(in millions)		**2007**	2006
Retained earnings:			
Balance at beginning of year	**$**	**84,996**	$ 72,330
Cumulative effect of accounting changes, net of tax		**(203)**	308
Adjusted balance, beginning of year		**84,793**	72,638
Net income		**4,130**	3,195
Dividends to shareholders		**(430)**	(400)
Balance, end of period	**$**	**88,493**	$ 75,433

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

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

None of the costs of the various benefits provided under the SICO Plans has been paid by AIG, although AIG has recorded a charge to reported earnings for the deferred compensation amounts paid to AIG employees by SICO, with an offsetting amount credited to additional paid-in capital reflecting amounts deemed contributed by SICO. The SICO Plans provide that shares currently owned by SICO are set aside by SICO for the benefit of the participant and distributed upon retirement. The SICO Board of Directors currently

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

may permit an early payout of units under certain circumstances. Prior to payout, the participant is not entitled to vote, dispose of or receive dividends with respect to such shares, and shares are subject to forfeiture under certain conditions, including but not limited to the participant s voluntary termination of employment with AIG prior to normal retirement age. Under the SICO Plans, SICO s Board of Directors may elect to pay a participant cash in lieu of shares of AIG common stock. Following notification from SICO to participants in the SICO Plans that it will settle specific future awards under the SICO Plans with shares rather than cash, AIG modified its accounting for the SICO Plans from variable to fixed measurement accounting. AIG gave effect to this change in settlement method beginning on December 9, 2005, the date of SICO s notice to participants in the SICO Plans. See also Note 6(b) Commitments herein.

In January 2006, C.V. Starr & Co., Inc. (Starr) completed its tender offer to purchase Starr interests from AIG employees. In conjunction with AIG s adoption of FAS 123R, Starr is considered to be an economic interest holder in AIG. As a result, compensation expense of $54 million was included in the first three months of 2006 with respect to the Starr tender offer.

Compensation expense with respect to the SICO Plans aggregated $10 million and $76 million for the first three months of 2007 and 2006, respectively. Compensation expense in 2006 included various out of period adjustments totaling $61 million, primarily relating to stock splits and other miscellaneous items for the SICO plans.

5. Ownership

According to the Schedule 13D filed on March 20, 2007 by Starr, SICO, Edward E. Matthews, Maurice R. Greenberg, the Maurice R. and Corinne P. Greenberg Family Foundation, Inc., the Universal Foundation, Inc., the Maurice R. and Corinne P. Greenberg Joint Tenancy Company, LLC and the C.V. Starr & Co., Inc. Trust, these reporting persons could be deemed to beneficially own 354,987,261 shares of AIG s common stock at that date. Based on the shares of AIG s common stock outstanding as of April 30, 2007, this ownership would represent approximately 14 percent of the voting stock of AIG. Although these reporting persons have made filings under Section 16 of the Exchange Act, reporting sales of shares of common stock, no amendment to the Schedule 13D has been filed to report a change in ownership subsequent to March 20, 2007.

6. Commitments, Contingencies and Guarantees

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

(a) Litigation and Investigations

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

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

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

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

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

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

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

As a result of these settlements, AIG made payments or placed amounts in escrow in 2006 totaling approximately $1.64 billion, $225 million of which represented fines and penalties. Amounts held in escrow totaling $380 million, including interest thereon, are included in other assets at March 31, 2007. At that date, approximately $317 million of the funds were escrowed for settlement of claims resulting from the underpayment by AIG of its residual market assessments for workers compensation. The National Workers Compensation Reinsurance Pool on behalf of its participant members and various states have communicated to AIG that they may assert claims with respect to the underpayment of such assessments. In addition, the National Association of Insurance Commissioners has formed a Settlement Review Working Group, which has commenced its own investigation into the underpayment of such assessments, directed by the State of Indiana. AIG cannot currently estimate whether the amount ultimately required to settle these claims will exceed the funds escrowed for this purpose.

The remaining escrowed funds, which amounted to $63 million at March 31, 2007, are set aside for settlements with certain AIG policyholders specified in the settlements who claimed to have been harmed by AIG s insurance brokerage practices. During the first three months of 2007, approximately $323 million was paid out from escrow in exchange for releasing AIG and its subsidiaries from any alleged liability relating to such brokerage practices. Any funds remaining at the end of the escrow period will be used to resolve claims asserted by policyholders relating to such insurance brokerage practices, including those described in Private Litigation below.

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

At the current time, AIG cannot predict the outcome of the matters described above, or estimate any potential additional cost related to these matters.

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, among other things, the adequacy of AIG s internal control over financial reporting, the policies, procedures and effectiveness of AIG s regulatory, compliance and legal functions and the remediation plan that AIG has implemented as a result of its own internal review.

Private Litigation

Securities Actions. Beginning in October 2004, a number of putative securities fraud class action suits were filed against AIG and consolidated as *In re American International Group, Inc. Securities Litigation.* Subsequently, a separate, though similar, securities fraud action was also brought against AIG by certain Florida pension funds. The lead plain-

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

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

tiff in the class action is a group of public retirement systems and pension funds benefiting Ohio state employees, suing on behalf of themselves and all purchasers of AIG s publicly traded securities between October 28, 1999 and April 1, 2005. The named defendants are AIG and a number of present and former AIG officers and directors, as well as Starr, SICO, General Reinsurance Corporation, and PricewaterhouseCoopers LLP (PwC), among others. The lead plaintiff alleges, among other things, that AIG: (1) concealed that it engaged in anti-competitive conduct through alleged payment of contingent commissions to brokers and participation in illegal bid-rigging; (2) concealed that it used income smoothing products and other techniques to inflate its earnings; (3) concealed that it marketed and sold income smoothing insurance products to other companies; and (4) misled investors about the scope of government investigations. In addition, the lead plaintiff alleges that AIG s former Chief Executive Officer manipulated AIG s stock price. The lead plaintiff asserts claims for violations of Sections 11 and 15 of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, and Section 20A of the Exchange Act. In April 2006, the court denied the defendants motions to dismiss the second amended class action complaint and the Florida complaint. In December 2006, a third amended class action complaint was filed, which does not differ substantially from the prior complaint. Fact and class discovery is currently ongoing.

ERISA Action. Between November 30, 2004 and July 1, 2005, several ERISA actions were filed on behalf of purported class of participants and beneficiaries of three pension plans sponsored by AIG or its subsidiaries. A consolidated complaint filed on September 26, 2005 alleges a class period between September 30, 2000 and May 31, 2005 and names as defendants AIG, the members of AIG s Retirement Board and the Administrative Boards of the plans at issue, and four present or former members of AIG s Board of Directors. The factual allegations in the complaint are essentially identical to those in the securities actions described above. Plaintiffs allege that defendants violated duties under ERISA by allowing the plans to offer AIG stock as a permitted investment, when defendants allegedly knew it was not a prudent investment, and by failing to provide participants with accurate information about AIG stock. AIG s motion to dismiss was denied by order dated December 12, 2006. Discovery will be consolidated with proceedings in the securities actions.

Derivative Actions Southern District of New York. Between October 25, 2004 and July 14, 2005, seven separate derivative actions were filed in the Southern District of New York, five of which were consolidated into a single action. The New York derivative complaint contains nearly the same types of allegations made in the securities fraud and ERISA actions described above. The named defendants include current and