

AMERICAN INTERNATIONAL GROUP INC

Form 10-K/A

March 16, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A

(Amendment No. 1)

(Mark One)

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

For the fiscal year ended December 31, 2004

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

American International Group, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Title of each class

None

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

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

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

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

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 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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant computed by reference to the price at which the common equity was last sold as of June 30, 2004 (the last business day of the registrant's most recently completed second fiscal quarter), was approximately \$148,570,190,000.

As of March 31, 2005, there were outstanding 2,594,907,032 shares of Common Stock, \$2.50 par value per share, of the registrant.

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Explanatory Note

Overview. This amendment to the Annual Report on Form 10-K for the year ended December 31, 2004 (2004 Annual Report on Form 10-K/A) is being filed for the purpose of amending Items 1 and 3 of Part I, Items 6, 7, 7A, 8 and 9A of Part II and Item 15 of Part IV of the Annual Report on Form 10-K for the year ended December 31, 2004 of American International Group, Inc. (AIG), which was originally filed on May 31, 2005 (2004 Annual Report on Form 10-K), as well as Item 1 of Part I of AIG's filings on Forms 10-Q/A and 10-Q for the quarterly periods ended March 31, June 30 and September 30, 2004. All of the amendments are being filed to reflect the restatements of AIG's financial results described herein. All other Items of the 2004 Annual Report on Form 10-K, as well as all other Items of the original filings on Forms 10-Q/A and 10-Q for the quarterly periods ended March 31, June 30 and September 30, 2004, are unaffected by the changes described above and have been omitted from this amendment.

Information in this 2004 Annual Report on Form 10-K/A is generally stated as of December 31, 2004 and generally does not reflect any subsequent information or events other than the restatements described below and the fourth quarter 2004 changes in estimates described in Management's Discussion and Analysis of Financial Condition and Results of Operations, except that certain forward looking statements throughout this 2004 Annual Report on Form 10-K/A, Certain Factors Affecting AIG's Business in Item 1 of Part I, Legal Proceedings in Item 3 of Part I and Controls and Procedures in Item 9A of Part II have been revised to reflect events and developments subsequent to December 31, 2004. Information regarding subsequent periods with respect to AIG will be contained in the Annual Report on Form 10-K for the year ended December 31, 2005 (2005 Annual Report on Form 10-K) and other filings with the Securities and Exchange Commission (SEC). This filing should be read and considered in conjunction with such filings.

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 controls over financial reporting. See also Controls and Procedures Management's Report on Internal Control Over Financial Reporting.

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 controls over financial reporting referred to above, 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 (June 2005 Form 10-Q). The adjustments to correct the foregoing errors are referred to in this 2004 Annual Report on Form 10-K/A as the Initial Adjustments.

In connection with the remediation of material weaknesses in internal controls 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 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 preparation of the Selected Consolidated Financial Data for 2001 and 2000, and quarterly financial information for 2004 and 2003 and will restate 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 2004 Annual Report on Form 10-K/A has been restated as part of

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the First Restatement (as previously filed in the 2004 Annual Report on Form 10-K on May 31, 2005) and the Second Restatement (the Restatements).

Subsequent Events. Prior to the date of this filing, AIG has announced subsequent events, which will be described fully in AIG's 2005 Annual Report on Form 10-K and other filings with the SEC. Other than as included in Note 25 of Notes to Consolidated Financial Statements, the financial information contained in this 2004 Annual Report on Form 10-K/A does not reflect the subsequent events described below.

On February 9, 2006, AIG announced that it has reached a resolution of claims and matters under investigation with the United States Department of Justice (DOJ), the SEC, the Office of the New York Attorney General (NYAG) and the New York State Department of Insurance (DOI). These settlements will result in an after-tax charge of approximately \$1.15 billion to be recorded in the fourth quarter of 2005.

The settlements resolve outstanding litigation filed by the SEC, NYAG and DOI against AIG and conclude 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.

As a result of these settlements, AIG will make payments totaling approximately \$1.64 billion. A substantial portion of the monies will be available to resolve claims asserted in various regulatory and civil proceedings, including shareholder lawsuits.

As part of these 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 controls over financial reporting and the remediation plan that AIG has implemented as a result of its own internal review.

The settlements are described more fully under Item 3. Legal Proceedings.

In addition, as announced previously, AIG commissioned Milliman Inc. (Milliman) to provide an independent, comprehensive review of the loss reserves of AIG's principal property-casualty insurance operations, including an independent ground up study of AIG's asbestos and environmental (A&E) exposures. The Milliman review encompassed nearly all of AIG's carried loss reserves, other than those pertaining to the operations of Transatlantic Holdings, Inc. and 21st Century Insurance Group.

After carefully considering the results of the Milliman review and AIG's own actuarial analyses, AIG will take a fourth quarter 2005 after-tax charge to net income of approximately \$1.2 billion, relating to an increase to its net reserve for losses and loss expenses of approximately \$1.8 billion, or approximately 3 percent of its total General Insurance net reserve for losses and loss expenses. This net reserve increase comprises approximately \$960 million for non-A&E reserves and approximately \$870 million for A&E reserves.

Loss reserves for DBG for non-A&E exposures will increase by approximately \$1.4 billion. The reserve increase is attributable to adverse development from the directors and officers liability, excess casualty and excess workers compensation classes of business, including a provision for commuted reinsurance. Together, these three classes of business experienced approximately \$4 billion of adverse development in 2005, primarily related to 2002 and prior accident years, offset by favorable development for the majority of DBG's classes of business for accident years 2003 through 2005. Additionally, DBG will increase loss reserves for A&E by approximately \$700 million, including a provision for insolvent reinsurers and commuted reinsurance.

Loss reserves for AIG's Foreign General business unit will be reduced by approximately \$280 million. The net reduction of reserves in Foreign General reflects a reduction of approximately \$450 million in non-A&E reserves, primarily related to financial lines, crisis management and property classes of business, partially offset by an increase of approximately \$170 million in A&E reserves.

AIG's estimate of its total expected losses relating to third quarter 2005 catastrophe events included in the September 2005 Form 10-Q totaled approximately \$1.6 billion after-tax. AIG also expects to record a fourth quarter after-tax charge of approximately \$150 million, an increase of approximately 9.4 percent from the previous estimate, relating to adverse development from third quarter 2005 catastrophe events. In addition, AIG expects its after-tax insurance related losses from Hurricane Wilma, net of reinsurance recoverables and including net reinstatement premium costs, to be approximately \$400 million for the fourth quarter 2005.

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PART I**ITEM 1. Business**

American International Group, Inc. (AIG), a Delaware corporation, is a holding company which, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad. AIG's primary activities include both General Insurance and Life Insurance & Retirement Services operations. Other significant activities include Financial Services and Asset Management. The principal General Insurance company subsidiaries are American Home Assurance Company (American Home), National Union Fire Insurance Company of Pittsburgh, Pa. (National Union), New Hampshire Insurance Company (New Hampshire), Lexington Insurance Company (Lexington), The Hartford Steam Boiler Inspection and Insurance Company (HSB), Transatlantic Reinsurance Company, American International Underwriters Overseas, Ltd. (AIUO) and United Guaranty Residential Insurance Company. Significant Life Insurance & Retirement Services operations include those conducted through American Life Insurance Company (ALICO), American International Reinsurance Company, Ltd. (AIRCO), American International Assurance Company, Limited together with American International Assurance Company (Bermuda) Limited (AIA), Nan Shan Life Insurance Company, Ltd. (Nan Shan), The Philippine American Life and General Insurance Company (Philamlife), AIG Star Life Insurance Co., Ltd. (AIG Star Life), AIG Edison Life Insurance Company (AIG Edison Life), AIG Annuity Insurance Company (AIG Annuity), the AIG American General Life Companies (AIG American General), American General Life and Accident Insurance Company (AGLA), The United States Life Insurance Company in the City of New York (USLIFE), The Variable Annuity Life Insurance Company (VALIC), SunAmerica Life Insurance Company (SunAmerica Life) and AIG SunAmerica Life Assurance Company. AIG's Financial Services operations are conducted primarily through International Lease Finance Corporation (ILFC), AIG Financial Products Corp. and AIG Trading Group Inc. (AIGTG) and their respective subsidiaries (collectively referred to as AIGFP), and American General Finance, Inc. and its subsidiaries (AGF). AIG's Asset Management operations include AIG SunAmerica Asset Management Corp. (SAAMCo) and AIG Global Asset Management Holdings Corp. (formerly known as AIG Global Investment Group, Inc.) and its subsidiaries and affiliated companies (AIG Global Investment Group). For information on AIG's business segments, see Note 3 of Notes to Consolidated Financial Statements.

All financial information herein gives effect to the Restatements and adjustments for changes in estimates described in Management's Discussion and Analysis of Financial Condition and Results of Operations. As of March 31, 2005, beneficial ownership of approximately 12.0 percent, 2.0 percent and 1.8 percent of AIG common stock, was held by Starr International Company, Inc. (SICO), The Starr Foundation and C.V. Starr & Co., Inc. (Starr), respectively. For a discussion of AIG's current relationship with Starr and SICO, see Certain Factors Affecting AIG's Business - The Relationships Between AIG and Starr and SICO.

At December 31, 2004, AIG and its subsidiaries had approximately 92,000 employees.

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

Throughout this 2004 Annual Report on Form 10-K/A, AIG presents its operations in the way it believes will be most meaningful, as well as most transparent. Certain of the measurements used by AIG management are non-GAAP financial measures under SEC rules and regulations. Statutory underwriting profit (loss) and combined ratios are determined in accordance with accounting principles prescribed by insurance regulatory authorities. For an explanation of why AIG management considers these non-GAAP measures useful to investors, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table shows the general development of the business of AIG on a consolidated basis, the contributions made to AIG's consolidated revenues and operating income and the assets held, in the periods indicated, by its General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management operations and other realized capital gains (losses). For additional information, see Selected Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes 1, 2 and 3 of Notes to Consolidated Financial Statements. AIG has restated its financial statements for 2004, 2003, 2002, 2001 and 2000. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Restatements of Previously Issued Financial Statements for a description of the adjustments included in the Restatements and Selected Financial Data and Note 2 of Notes to Consolidated Financial Statements for a reconciliation of previously reported amounts to the restated amounts.

| Years Ended December 31, (in millions) | 2004 (Restated) | 2003 (Restated) | 2002 (Restated) | 2001 (Restated) | 2000 (Restated) |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| General Insurance operations: | | | | | |
| Gross premiums written | \$ 52,046 | \$ 46,938 | \$ 36,678 | \$ 28,341 | \$ 24,410 |
| Net premiums written | 40,623 | 35,031 | 26,718 | 19,793 | 17,588 |
| Net premiums earned | 38,537 | 31,306 | 23,595 | 18,661 | 16,345 |
| Underwriting profit (loss)(a) | (247)(c) | 1,975 | (1,082)(d) | (777)(e) | (540) |
| Net investment income | 3,196 | 2,566 | 2,350 | 2,551 | 2,697 |
| Realized capital gains (losses) | 228 | (39) | (345) | (189) | (26) |
| Operating income | 3,177(c) | 4,502 | 923(d) | 1,585(e) | 2,131 |
| Identifiable assets | 131,658 | 117,511 | 105,891 | 88,250 | 80,583 |
| Loss ratio | 78.8 | 73.1 | 83.1 | 79.3 | 79.1 |
| Expense ratio | 21.5 | 19.6 | 21.8 | 24.3 | 23.8 |
| Combined ratio(b) | 100.3(c) | 92.7 | 104.9(d) | 103.6(e) | 102.9 |
| Life Insurance & Retirement Services operations: | | | | | |
| GAAP premiums | 28,088 | 23,496 | 20,694 | 19,600 | 17,702 |
| Net investment income | 15,269 | 12,942 | 11,243 | 10,451 | 10,022 |
| Realized capital gains (losses) | 43 | 240 | (372) | (400) | 33 |
| Operating income | 7,923 | 6,807 | 5,181 | 4,633(f) | 4,641 |
| Identifiable assets | 447,841 | 372,126 | 289,914 | 256,767 | 217,898 |
| Insurance in-force at end of year | 1,858,094 | 1,583,031 | 1,298,592 | 1,228,501 | 971,892 |
| Financial Services operations: | | | | | |
| Interest, lease and finance charges(g) | 7,495 | 6,242 | 6,822 | 6,321 | 7,049 |
| Operating income(g) | 2,180 | 1,182 | 2,125 | 1,769 | 2,777 |
| Identifiable assets | 165,995 | 141,667 | 128,104 | 107,719 | 93,899 |
| Asset Management operations: | | | | | |
| Advisory and management fees and net investment income from GICs | 4,714 | 3,651 | 3,467 | 3,565 | 3,125 |
| Operating income | 2,125 | 1,316 | 1,125 | 1,019 | 929 |
| Identifiable assets | 80,075 | 64,047 | 53,732 | 42,961 | 33,792 |
| Other realized capital gains (losses) | (227) | (643) | (936) | (321) | (247) |
| Revenues(h) | 97,666 | 79,421 | 66,171 | 59,958 | 56,700 |
| Total operating income(i) | 14,845 | 11,907 | 7,808 | 5,917 | 8,939 |
| Total assets | 801,145 | 675,602 | 561,598 | 490,614 | 422,709 |

(a) Underwriting profit (loss), a Generally Accepted Accounting Principles (GAAP) measure, is statutory underwriting profit (loss) adjusted primarily for changes in the deferral of policy acquisition costs. This adjustment is necessary to present the financial statements in accordance with GAAP.

(b) Calculated on a statutory basis, includes catastrophe losses of \$1.05 billion, \$83 million, \$61 million, \$867 million and \$44 million in 2004, 2003, 2002, 2001 and 2000, respectively.

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- (c) Includes fourth quarter 2004 increase of \$850 million to net loss reserves reflecting the change in estimate for asbestos and environmental reserves.*
- (d) In the fourth quarter of 2002, after completion of its annual review of General Insurance loss and loss adjustment expense reserves, AIG increased its net loss reserves relating to accident years 1997 through 2001 by \$2.1 billion.*
- (e) Includes \$769 million in World Trade Center and related losses (WTC losses).*
- (f) Includes \$100 million in WTC losses.*
- (g) Includes the unrealized gain (loss) attributable to hedging activities that do not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2004, 2003, 2002, 2001 and 2000, respectively, the amounts included in interest, lease and finance charges are \$(122) million, \$(1.01) billion, \$220 million, \$56 million and \$1.17 billion, and the amounts included in Financial Services operating income are \$(149) million, \$(964) million, \$240 million, \$75 million and \$1.17 billion. See also Management's Discussion and Analysis of Financial Condition and Results of Operations - Restatements of Previously Issued Financial Statements.*
- (h) Represents the sum of General Insurance net premiums earned, Life Insurance & Retirement Services GAAP premiums, net investment income, Financial Services interest, lease and finance charges, Asset Management advisory and management fees and net investment income from Guaranteed Investment Contracts (GICs), and realized capital gains (losses).*
- (i) Represents income before income taxes, minority interest and cumulative effect of accounting changes. Includes segment operating income and other realized capital gains (losses) presented above, as well as AIG Parent and other operations of \$(333) million, \$(1.26) billion, \$(610) million, \$(751) million and \$(977) million in 2004, 2003, 2002, 2001 and 2000, respectively, and acquisition, restructuring and related charges of \$(2.02) billion in 2001 and \$(315) million in 2000.*

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General Insurance Operations

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

AIG's primary domestic division is DBG. DBG's business is derived from brokers in the United States and Canada and 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. Through 2004 AIG used managing general agents owned by Starr to produce business in certain lines.

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

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

The AIG Worldsource Division introduces and coordinates AIG's products and services to U.S.-based multinational clients and foreign corporations doing business in the U.S. Transatlantic subsidiaries offer reinsurance capacity on both a treaty and facultative basis both in the U.S. and abroad. Transatlantic structures programs for a full range of property and casualty products with an emphasis on specialty risk.

AIG's personal lines operations engage in mass marketing of personal lines coverages, primarily private passenger auto and personal umbrella coverages, principally through American International Insurance Company and 21st Century. In 2003, AIG acquired the U.S.-based auto and home insurance business of General Electric Company (GE).

The business of UGC and its subsidiaries is also included in the domestic operations of AIG. 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. During 2003, UGC commenced providing guaranty insurance to providers of student loans. UGC had approximately \$22 billion of guaranty risk in force at December 31, 2004.

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,

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the Pacific Rim, the United Kingdom, Europe, Africa, the Middle East and Latin America. See also Note 3 of Notes to Consolidated Financial Statements.

During 2004, DBG and the Foreign General Insurance group accounted for 55.4 percent and 23.2 percent, respectively, of AIG's General Insurance net premiums written.

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

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ments from other underwriters for the remainder of the gross risk amount.

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

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

AIG is diversified both in terms of classes of business and geographic locations. In General Insurance, approximately 13 percent of net premiums written for the year ended December 31, 2004 represented workers compensation business. During 2004, of the direct General Insurance premiums written (gross premiums less return premiums and cancellations, excluding reinsurance assumed and before deducting reinsurance ceded), 12.0 percent and 6.7 percent were written in California and New York, respectively. No other state accounted for more than five percent of such premiums.

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

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

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

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

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

As a result of its internal review and remediation efforts, AIG has determined that its carried reserves for net losses and loss expenses are required to be restated and adjusted. The tables below present those amounts as so restated and adjusted. In addition, AIG has increased the reserves for asbestos and environmental exposures included within the reserve for net losses and loss expenses by \$850 million in the fourth quarter of 2004 to reflect a change in estimate. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Restatements of Previously Issued Financial Statements, Fourth Quarter 2004 Changes in Estimates and Operating Review - Asbestos and Environmental Reserves. See also Notes 1(cc) and 2 of Notes to Consolidated Financial Statements.

The Analysis of Consolidated Losses and Loss Expense Reserve Development table presents the development of net losses and loss expense reserves for calendar years 1994 through 2004. Immediately following this table is a second table that presents all data on a basis that excludes asbestos and environmental net losses and loss expense reserve development. The opening reserves held are shown at the top of the table for each year end date. The amount of loss reserve discount included in the opening reserve at each date is shown immediately below the reserves held for each year. The undiscounted reserve at each date is thus the sum of the discount and the reserve held. The upper half of the table shows the cumulative amounts paid during successive years related to the undiscounted opening loss reserves. For example, in the table that excludes

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asbestos and environmental losses, with respect to the net losses and loss expense reserve of \$20.73 billion as of December 31, 1997, by the end of 2004 (seven years later) \$18.97 billion had actually been paid in settlement of these net loss reserves. In addition, as

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reflected in the lower section of the table, the original reserve of \$20.73 billion was reestimated to be \$21.84 billion at December 31, 2004. This increase from the original estimate would generally result from a combination of a number of factors, including reserves being settled for larger amounts than originally estimated. The original estimates will also be increased or decreased as more information becomes known about the individual claims and overall claim frequency and severity patterns. The redundancy (deficiency) depicted in the table, for any particular calendar year, shows the aggregate change in estimates over the period of years subsequent to the calendar year reflected at the top of the respective column heading. For example, the deficiency of \$2.19 billion at December 31, 2004 related to December 31, 2003 net losses and loss expense reserves of \$37.08 billion represents the cumulative amount by which reserves for 2003 and prior years have developed deficiently during 2004. The deficiency that has emerged in the last year can be attributed primarily to approximately \$750 million in development from claims for accident year 2002 and prior for D&O, and \$500 million in development from claims for accident year 2000 and prior for excess casualty. Additionally, the general reinsurance operations of Transatlantic accounted for approximately \$300 million of the adverse development in the latest year. Other classes of business contributed deficiencies or redundancies of lesser amounts. For most other classes, accident years 2001 and prior generally produced adverse development in the latest year, whereas accident year 2003 generally produced favorable development. In total, the favorable development for accident year 2003 was approximately \$1.5 billion. The accident year emergence can be seen by comparing the respective development in 2004 for each column's loss reserve in the table that follows. Loss development patterns utilized to test the reserves generally rely on the actual historical loss development patterns of prior accident years for each class of business. Additionally, as shown in the table excluding asbestos and environmental losses below, loss emergence from year end 1994 and 1995 has been favorable on an inception-to-date basis through year end 2004. Loss cost trends deteriorated significantly in the late 1990's, creating the adverse development for years after 1996.

The bottom of each table below shows the remaining undiscounted and discounted net loss reserve for each year. For example, in the table that excludes asbestos and environmental losses, for the 2000 year-end, the remaining undiscounted reserves held as of December 31, 2004 are \$8.66 billion, with a corresponding discounted net reserve of \$8.06 billion.

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

Analysis of Consolidated Losses and Loss Expense Reserve Development

The following table presents for each calendar year the losses and loss expense reserves and the development thereof including those with respect to asbestos and environmental claims. As a result of the internal review and remediation efforts discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations, the amounts of carried reserves and the liabilities reestimated have been restated or adjusted for all periods presented. See also Management's Discussion and Analysis of Financial Condition and Results of Operations.

| <i>(in millions)</i> | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|----------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) | (Restated) |
| Net Reserves Held | \$ 18,754 | \$ 19,755 | \$ 20,496 | \$ 20,901 | \$ 25,418 | \$ 25,636 | \$ 25,684 | \$ 26,005 | \$ 29,347 | \$ 36,228 | \$ 47,254 |
| Discount (in Reserves Held) | 157 | 217 | 393 | 619 | 897 | 1,075 | 1,287 | 1,423 | 1,499 | 1,516 | 1,553 |
| Net Reserves Held (Undiscounted) | 18,911 | 19,972 | 20,889 | 21,520 | 26,315 | 26,711 | 26,971 | 27,428 | 30,846 | 37,744 | 48,807 |
| Paid (Cumulative) as of: | | | | | | | | | | | |
| One year later | 4,922 | 5,416 | 5,712 | 5,607 | 7,205 | 8,266 | 9,709 | 11,007 | 10,775 | 12,163 | |
| Two years later | 8,338 | 8,982 | 9,244 | 9,754 | 12,382 | 14,640 | 17,149 | 18,091 | 18,589 | | |