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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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FORM 10-Q  
 QUARTERLY REPORT UNDER SECTION 13 OR 15(D)  
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

FOR THE TRANSITION PERIOD FROM TO

FOR QUARTER ENDED JUNE 30, 1996 COMMISSION FILE NUMBER 1-8787

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AMERICAN INTERNATIONAL GROUP, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE 13-2592361  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER IDENTIFICATION NUMBER)  
INCORPORATION OR ORGANIZATION)  
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  
NONE  
FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT.

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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 the number of shares outstanding of each of the issuer's classes of common stock, as of June 30, 1996 469,532,248.  
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## AMERICAN INTERNATIONAL GROUP, INC.

CONSOLIDATED BALANCE SHEET  
(IN THOUSANDS)

|  | JUNE 30,<br>1996<br>-----<br>(UNAUDITED) | DECEMBER 31,<br>1995<br>----- |
|--|--|-------------------------------|
| ASSETS:  |  |                               |
| Investments and cash:  |  |                               |
| Fixed maturities:  |  |                               |
| Bonds held to maturity, at amortized cost (market value:<br>1996 -- \$12,395,179; 1995 -- \$11,822,190).....                             | \$ 11,932,686                            | \$ 11,086,025                 |
| Bonds available for sale, at market value (amortized<br>cost: 1996 -- \$31,099,607; 1995 -- \$29,417,475).....                           | 31,757,797                               | 30,926,771                    |
| Bonds trading securities, at market value (cost:<br>1996 -- \$403,410; 1995 -- \$411,245).....   | 405,451                                  | 428,296                       |
| Preferred stocks, at amortized cost (market value:<br>1996 -- \$608,742; 1995 -- \$620,217).....   | 468,609                                  | 459,505                       |
| Equity securities:   |  |                               |
| Common stocks (cost: 1996 -- \$4,852,734;<br>1995 -- \$4,555,334).....   | 5,801,549                                | 5,294,867                     |
| Non-redeemable preferred stocks (cost: 1996 -- \$60,648;<br>1995 -- \$73,497).....   | 61,984                                   | 74,454                        |
| Mortgage loans on real estate, policy and collateral<br>loans -- net.....  | 9,635,138                                | 7,860,532                     |
| Financial services assets:   |  |                               |
| Flight equipment primarily under operating leases, net of<br>accumulated depreciation (1996 -- \$1,339,299;<br>1995 -- \$1,182,128)..... | 13,846,720                               | 12,442,010                    |
| Securities available for sale, at market value (cost:<br>1996 -- \$5,080,953; 1995 -- \$3,930,622).....                                  | 5,084,867                                | 3,931,100                     |
| Trading securities, at market value.....   | 2,329,448                                | 2,641,436                     |
| Spot commodities, at market value.....   | 928,663                                  | 1,079,124                     |
| Unrealized gain on interest rate and currency swaps,<br>options and forward transactions.....  | 6,130,356                                | 7,250,954                     |
| Trade receivables.....   | 2,611,978                                | 3,321,985                     |
| Securities purchased under agreements to resell,<br>at contract value.....   | 3,281,959                                | 2,022,056                     |
| Other invested assets.....   | 2,975,994                                | 2,808,158                     |
| Short-term investments, at cost which approximates market<br>value.....  | 2,408,272                                | 2,272,528                     |
| Cash.....  | 97,935                                   | 88,371                        |
|  | -----                                    | -----                         |
| Total investments and cash.....  | 99,759,406                               | 93,988,172                    |
| Investment income due and accrued.....   | 1,236,093                                | 1,212,948                     |
| Premiums and insurance balances receivable -- net.....   | 10,187,943                               | 9,410,185                     |
| Reinsurance assets.....  | 17,524,787                               | 16,878,155                    |
| Deferred policy acquisition costs.....   | 6,169,211                                | 5,767,573                     |
| Investments in partially-owned companies.....  | 880,226                                  | 820,781                       |
| Real estate and other fixed assets, net of accumulated<br>depreciation (1996 -- \$1,347,049; 1995 -- \$1,303,693).....                   | 1,873,560                                | 1,822,061                     |
| Separate and variable accounts.....  | 2,811,257                                | 2,506,791                     |
| Other assets.....  | 2,273,180                                | 1,729,732                     |
|  | -----                                    | -----                         |
| Total assets.....  | \$142,715,663                            | \$134,136,398                 |
|  | =====                                    | =====                         |

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.  
 CONSOLIDATED BALANCE SHEET -- (CONTINUED)  
 (IN THOUSANDS, EXCEPT SHARE AMOUNTS)

|   | JUNE 30,<br>1996     | DECEMBER 31,<br>1995 |
|---|----------------------|----------------------|
|   | -----<br>(UNAUDITED) | -----                |
| <b>LIABILITIES:</b>   |                      |                      |
| Reserve for losses and loss expenses.....   | \$ 33,731,260        | \$ 33,046,717        |
| Reserve for unearned premiums.....  | 7,866,446            | 6,938,064            |
| Future policy benefits for life and accident and health<br>insurance contracts.....   | 21,972,696           | 20,864,635           |
| Policyholders' contract deposits.....   | 11,463,855           | 9,580,983            |
| Other policyholders' funds.....   | 2,159,834            | 2,092,165            |
| Reserve for commissions, expenses and taxes.....  | 1,557,259            | 1,257,246            |
| Insurance balances payable.....   | 2,574,078            | 1,886,403            |
| Funds held by companies under reinsurance treaties.....   | 414,258              | 344,692              |
| Income taxes payable:   |                      |                      |
| Current.....  | 251,751              | 325,113              |
| Deferred.....   | 404,699              | 552,144              |
| Financial services liabilities:   |                      |                      |
| Borrowings under obligations of guaranteed investment<br>agreements.....  | 5,671,959            | 5,423,555            |
| Securities sold under agreements to repurchase, at contract<br>value.....   | 2,368,463            | 1,379,872            |
| Trade payables.....   | 2,389,131            | 2,810,947            |
| Securities sold but not yet purchased, principally<br>obligations of the U.S. Government and Government<br>agencies, at market value..... | 782,582              | 1,204,386            |
| Spot commodities sold but not yet purchased, at market<br>value.....  | 887,682              | 783,302              |
| Unrealized loss on interest rate and currency swaps,<br>options and forward transactions.....   | 4,889,687            | 6,405,045            |
| Deposits due to banks and other depositors.....   | 1,389,112            | 957,441              |
| Commercial paper.....   | 2,883,190            | 1,834,882            |
| Notes, bonds and loans payable.....   | 10,209,968           | 8,932,743            |
| Commercial paper.....   | 1,864,631            | 1,331,753            |
| Notes, bonds, loans and mortgages payable.....  | 377,611              | 467,784              |
| Separate and variable accounts.....   | 2,811,257            | 2,506,791            |
| Other liabilities.....  | 3,003,262            | 2,982,632            |
|   | -----                | -----                |
| Total liabilities.....  | 121,924,671          | 113,909,295          |
|   | -----                | -----                |
| Preferred shareholders' equity in subsidiary company.....   | 400,000              | 400,000              |
| <b>CAPITAL FUNDS:</b>   |                      |                      |
| Common stock, \$2.50 par value: 1,000,000,000 shares<br>authorized; shares issued 1996 -- 506,084,175;<br>1995 -- 506,084,177.....        | 1,265,210            | 1,265,210            |
| Additional paid-in capital.....   | 131,276              | 131,828              |
| Unrealized appreciation of investments, net of taxes.....   | 1,078,122            | 1,395,064            |
| Cumulative translation adjustments, net of taxes.....   | (460,187)            | (456,072)            |
| Retained earnings.....  | 19,013,110           | 17,697,739           |
| Treasury stock, at cost; 1996 -- 36,551,927;<br>1995 -- 31,899,951 shares of common stock.....  | (636,539)            | (206,666)            |
|   | -----                | -----                |
| Total capital funds.....  | 20,390,992           | 19,827,103           |
|   | -----                | -----                |
| Total liabilities and capital funds.....  | \$142,715,663        | \$134,136,398        |
|   | =====                | =====                |

See Accompanying Notes to Financial Statements.

## AMERICAN INTERNATIONAL GROUP, INC.

CONSOLIDATED STATEMENT OF INCOME  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)  
(UNAUDITED)

|  | SIX MONTHS ENDED JUNE 30, |             | THREE MONTHS ENDED JUNE 30, |             |
|--|---------------------------|-------------|-----------------------------|-------------|
|  | 1996                      | 1995        | 1996                        | 1995        |
| General insurance operations:                                |                           |             |                             |             |
| Net premiums written.....                                    | \$6,491,831               | \$6,024,227 | \$3,365,991                 | \$3,145,232 |
| Change in unearned premium reserve.....                      | (764,513)                 | (421,585)   | (464,700)                   | (306,438)   |
| Net premiums earned.....                                     | 5,727,318                 | 5,602,642   | 2,901,291                   | 2,838,794   |
| Net investment income.....                                   | 823,040                   | 757,808     | 413,819                     | 378,143     |
| Realized capital gains.....                                  | 45,053                    | 47,556      | 17,390                      | 23,146      |
|  | 6,595,411                 | 6,408,006   | 3,332,500                   | 3,240,083   |
| Losses and loss expenses incurred.....                       | 4,393,505                 | 4,308,515   | 2,215,445                   | 2,138,305   |
| Underwriting expenses.....                                   | 1,147,936                 | 1,128,399   | 573,508                     | 600,580     |
|  | 5,541,441                 | 5,436,914   | 2,788,953                   | 2,738,885   |
| Operating income.....  | 1,053,970                 | 971,092     | 543,547                     | 501,198     |
| Life insurance operations:                                   |                           |             |                             |             |
| Premium income.....  | 4,294,984                 | 3,837,151   | 2,253,722                   | 2,047,402   |
| Net investment income.....                                   | 1,327,944                 | 1,059,569   | 685,009                     | 557,129     |
| Realized capital gains (losses).....                         | 5,850                     | 1,748       | 1,792                       | (1,183)     |
|  | 5,628,778                 | 4,898,468   | 2,940,523                   | 2,603,348   |
| Death and other benefits.....                                | 1,737,686                 | 1,573,237   | 938,693                     | 855,500     |
| Increase in future policy benefits.....                      | 2,155,631                 | 1,753,386   | 1,101,757                   | 909,446     |
| Acquisition and insurance expenses.....                      | 1,122,852                 | 1,074,170   | 574,408                     | 577,196     |
|  | 5,016,169                 | 4,400,793   | 2,614,858                   | 2,342,142   |
| Operating income.....  | 612,609                   | 497,675     | 325,665                     | 261,206     |
| Agency and service fee operating income.....                 | 29,530                    | 31,966      | 13,748                      | 15,406      |
| Financial services operating income.....                     | 240,823                   | 193,485     | 132,724                     | 117,948     |
| Equity in income of minority-owned insurance operations..... | 48,049                    | 39,119      | 25,865                      | 21,430      |
| Other realized capital losses.....                           | (1,721)                   | (14,304)    | (922)                       | (6,570)     |
| Minority interest.....                                       | (24,006)                  | (17,508)    | (11,891)                    | (8,136)     |
| Other income (deductions) -- net.....                        | (33,475)                  | (36,436)    | (20,712)                    | (23,187)    |
| Income before income taxes.....                              | 1,925,779                 | 1,665,089   | 1,008,024                   | 879,295     |
| Income taxes (benefits) -- Current.....                      | 513,712                   | 475,956     | 233,065                     | 298,060     |
| -- Deferred....  | 16,481                    | (16,808)    | 50,591                      | (52,550)    |
|  | 530,193                   | 459,148     | 283,656                     | 245,510     |
| Net income.....  | \$1,395,586               | \$1,205,941 | \$ 724,368                  | \$ 633,785  |
| Earnings per common share (a).....                           | \$ 2.95                   | \$ 2.54     | \$ 1.53                     | \$ 1.34     |
| Cash dividends per common share.....                         | \$ 0.170                  | \$ 0.153    | \$ 0.085                    | \$ 0.077    |
| Average shares outstanding (a).....                          | 472,420                   | 473,933     | 471,087                     | 474,016     |

(a) The 1995 share information is adjusted to reflect a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995.

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.  
 CONSOLIDATED STATEMENT OF CASH FLOWS  
 (DOLLARS IN THOUSANDS)  
 (UNAUDITED)

|  | SIX MONTHS ENDED JUNE 30, |              |
|--|---------------------------|--------------|
|  | 1996                      | 1995         |
| Cash Flows From Operating Activities:  |                           |              |
| Net income.....  | \$ 1,395,586              | \$ 1,205,941 |
| Adjustments to reconcile net income to net cash provided by operating activities:              |                           |              |
| Non-cash revenues, expenses, gains and losses included in income:                              |                           |              |
| Change in:   |                           |              |
| General and life insurance reserves.....   | 2,852,372                 | 4,535,030    |
| Premiums and insurance balances receivable and payable -- net.....                             | (90,083)                  | (514,890)    |
| Reinsurance assets.....  | (646,632)                 | (522,932)    |
| Deferred policy acquisition costs.....   | (401,638)                 | (628,515)    |
| Investment income due and accrued.....   | (23,145)                  | (134,387)    |
| Funds held under reinsurance treaties.....   | 69,566                    | 1,947        |
| Other policyholders' funds.....  | 67,669                    | 221,096      |
| Current and deferred income taxes -- net.....  | (56,881)                  | (156,001)    |
| Reserve for commissions, expenses and taxes.....   | 300,013                   | 71,341       |
| Other assets and liabilities -- net.....   | (522,818)                 | 108,948      |
| Trade receivables and payables -- net.....   | 288,191                   | 515,430      |
| Trading securities, at market value.....   | 311,988                   | (838,620)    |
| Spot commodities, at market value.....   | 150,461                   | (274,988)    |
| Net unrealized gain on interest rate and currency swaps, options and forward transactions..... | (394,760)                 | 174,523      |
| Securities purchased under agreements to resell.....   | (1,259,903)               | (23,213)     |
| Securities sold under agreements to repurchase.....  | 988,591                   | 985,808      |
| Securities sold but not yet purchased.....   | (421,804)                 | 537,857      |
| Spot commodities sold but not yet purchased, at market value.....                              | 104,380                   | 172,742      |
| Realized capital gains.....  | (49,182)                  | (35,000)     |
| Equity in income of partially-owned companies and other invested assets.....                   | (82,726)                  | (53,296)     |
| Depreciation expenses, principally flight equipment.....                                       | 393,645                   | 350,844      |
| Change in cumulative translation adjustments.....  | (26,097)                  | 45,451       |
| Other -- net.....  | 23,233                    | (46,474)     |
| Total Adjustments.....   | 1,574,440                 | 4,492,701    |
| Net cash provided by operating activities.....   | 2,970,026                 | 5,698,642    |

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.  
 CONSOLIDATED STATEMENT OF CASH FLOWS -- (CONTINUED)  
 (DOLLARS IN THOUSANDS)  
 (UNAUDITED)

|  | SIX MONTHS ENDED JUNE 30, |                    |
|--|---------------------------|--------------------|
|  | 1996                      | 1995               |
| <b>Cash Flows From Investing Activities:</b>                         |                           |                    |
| Cost of fixed maturities, at amortized cost matured or redeemed..... | 1,119,907                 | 387,974            |
| Cost of bonds, at market sold.....                                   | 4,576,089                 | 4,829,308          |
| Cost of bonds, at market matured or redeemed.....                    | 1,225,979                 | 1,302,178          |
| Cost of equity securities sold.....                                  | 1,534,830                 | 1,363,587          |
| Realized capital gains.....  | 49,182                    | 35,000             |
| Purchases of fixed maturities.....                                   | (9,407,634)               | (10,401,337)       |
| Purchases of equity securities.....                                  | (1,823,533)               | (1,578,128)        |
| Mortgage, policy and collateral loans granted.....                   | (2,407,468)               | (2,135,487)        |
| Repayments of mortgage, policy and collateral loans.....             | 632,862                   | 388,030            |
| Sales of securities available for sale.....                          | 1,072,627                 | 1,519,889          |
| Maturities of securities available for sale.....                     | 63,522                    | 131,595            |
| Purchases of securities available for sale.....                      | (2,299,167)               | (1,949,525)        |
| Sales of flight equipment.....                                       | 374,230                   | 268,405            |
| Purchases of flight equipment.....                                   | (2,033,581)               | (2,398,067)        |
| Net additions to real estate and other fixed assets.....             | (190,503)                 | (197,988)          |
| Sales or distributions of other invested assets.....                 | 586,836                   | 166,667            |
| Investments in other invested assets.....                            | (677,685)                 | (299,113)          |
| Change in short-term investments.....                                | (132,542)                 | 180,983            |
| Investments in partially-owned companies.....                        | (37,441)                  | (20,752)           |
| <b>Net cash used in investing activities.....</b>                    | <b>(7,773,490)</b>        | <b>(8,406,781)</b> |
| <b>Cash Flows From Financing Activities:</b>                         |                           |                    |
| Change in policyholders' contract deposits.....                      | 1,882,872                 | 1,989,667          |
| Change in deposits due to banks and other depositors.....            | 431,671                   | (34,908)           |
| Change in commercial paper.....                                      | 1,581,186                 | 713,429            |
| Proceeds from notes, bonds, loans and mortgages payable.....         | 2,278,387                 | 2,738,973          |
| Repayments on notes, bonds, loans and mortgages payable.....         | (1,098,852)               | (1,978,036)        |
| Proceeds from guaranteed investment agreements.....                  | 2,213,213                 | 1,210,364          |
| Maturities of guaranteed investment agreements.....                  | (1,964,809)               | (1,978,107)        |
| Proceeds from subsidiary company preferred stock issued.....         | (98)                      | 98,476             |
| Proceeds from common stock issued.....                               | 10,804                    | 11,886             |
| Cash dividends to shareholders.....                                  | (80,215)                  | (72,668)           |
| Acquisition of treasury stock.....                                   | (445,425)                 | (1,167)            |
| Other - net.....   | 4,294                     | --                 |
| <b>Net cash provided by financing activities.....</b>                | <b>4,813,028</b>          | <b>2,697,909</b>   |
| Change in cash.....  | 9,564                     | (10,230)           |
| Cash at beginning of period.....                                     | 88,371                    | 76,237             |
| <b>Cash at end of period.....</b>                                    | <b>\$ 97,935</b>          | <b>\$ 66,007</b>   |

See Accompanying Notes to Financial Statements.

## AMERICAN INTERNATIONAL GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1996

- a) These statements are unaudited. In the opinion of management, all adjustments consisting of normal recurring accruals have been made for a fair presentation of the results shown.
- b) Earnings per share of American International Group, Inc. (AIG) are based on the weighted average number of common shares outstanding during the period, adjusted to reflect all stock splits. The effect of potentially dilutive securities is not significant.

Cash dividends per common share reflect a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995. The quarterly dividend rate per common share, commencing with the dividend paid September 22, 1995 is \$0.085.

- c) Supplemental cash flow information for the six month periods ended June 30, 1996 and 1995 is as follows:

|                        | 1996           | 1995      |
|------------------------|----------------|-----------|
|                        | -----          | -----     |
|                        | (IN THOUSANDS) |           |
| Income taxes paid..... | \$583,300      | \$616,500 |
| Interest paid.....     | \$786,500      | \$651,000 |

- d) For further information, refer to the Annual Report on Form 10-K of AIG for the year ended December 31, 1995.

AMERICAN INTERNATIONAL GROUP, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OPERATIONAL REVIEW

General Insurance Operations

General insurance operations for the six month periods ending June 30, 1996 and 1995 were as follows:

(in thousands)

|  | 1996        | 1995         |
|--|-------------|--------------|
| -----  |             |              |
| Net premiums written:                              |             |              |
| Domestic   | \$4,272,563 | \$ 3,878,334 |
| Foreign  | 2,219,268   | 2,145,893    |
| -----  |             |              |
| Total  | \$6,491,831 | \$ 6,024,227 |
| -----  |             |              |
| Net premiums earned:                               |             |              |
| Domestic   | \$3,756,616 | \$ 3,560,164 |
| Foreign  | 1,970,702   | 2,042,478    |
| -----  |             |              |
| Total  | \$5,727,318 | \$ 5,602,642 |
| -----  |             |              |
| Adjusted underwriting<br>profit (loss):            |             |              |
| Domestic   | \$ (8,651)  | \$ (1,223)   |
| Foreign  | 194,528     | 166,951      |
| -----  |             |              |
| Total  | \$ 185,877  | \$ 165,728   |
| -----  |             |              |
| Net investment income:                             |             |              |
| Domestic   | \$ 649,825  | \$ 611,132   |
| Foreign  | 173,215     | 146,676      |
| -----  |             |              |
| Total  | \$ 823,040  | \$ 757,808   |
| -----  |             |              |
| Operating income before<br>realized capital gains: |             |              |
| Domestic   | \$ 641,174  | \$ 609,909   |
| Foreign  | 367,743     | 313,627      |
| -----  |             |              |
| Total  | 1,008,917   | 923,536      |
| Realized capital gains                             | 45,053      | 47,556       |
| -----  |             |              |
| Operating income                                   | \$1,053,970 | \$ 971,092   |
| -----  |             |              |

During the first six months of 1996, the net premiums written and net premiums earned in AIG's general insurance operations increased 7.8 percent and 2.2 percent, respectively, from those of 1995.

The growth in net premiums written in the first six months of 1996 resulted from a combination of several factors. Domestically, AIG continued to achieve some general price increases in certain specialty markets and smaller commercial markets as well as volume growth in mortgage guarantee insurance and in personal lines. Overseas, the primary reasons for growth were price and volume increases. Foreign general insurance operations produced 34.2 percent of the general insurance net premiums written in the first six months of 1996 and 35.6 percent in the same period of 1995.

In comparing the foreign exchange rates used to translate AIG's foreign general operations during the first six months of 1996 to those foreign exchange rates used to translate AIG's foreign general operations during the same period of 1995, the U.S. dollar strengthened in value in relation to most major foreign currencies in which AIG transacts business. Accordingly, when foreign net premiums written were translated into U.S. dollars for the purposes of consolidation, total general insurance net premiums written were approximately 8.6 percentage points less than they would have been if translated utilizing those exchange rates which prevailed during that same period of 1995.

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

The statutory general insurance ratios were as follows:

|                | 1996   | 1995   |
|----------------|--------|--------|
| -----          |        |        |
| Domestic:      |        |        |
| Loss Ratio     | 86.13  | 86.63  |
| Expense Ratio  | 14.75  | 14.09  |
| -----          |        |        |
| Combined Ratio | 100.88 | 100.72 |
| -----          |        |        |
| Foreign:       |        |        |
| Loss Ratio     | 58.76  | 59.94  |
| Expense Ratio  | 30.73  | 31.74  |
| -----          |        |        |
| Combined Ratio | 89.49  | 91.68  |
| -----          |        |        |
| Consolidated:  |        |        |
| Loss Ratio     | 76.71  | 76.90  |
| Expense Ratio  | 20.21  | 20.38  |
| -----          |        |        |
| Combined Ratio | 96.92  | 97.28  |
| -----          |        |        |

Adjusted underwriting profit or loss (operating income less net investment income and realized capital gains) represents statutory underwriting profit or loss adjusted primarily for changes in deferred acquisition costs. The adjusted underwriting profits were \$185.9 million in the first six months of 1996 and \$165.7 million in the same period of 1995.

AIG's results reflect the net impact with respect to incurred losses of catastrophes approximating \$56 million in 1996 and \$55 million in 1995. AIG's gross incurred losses from catastrophes approximated \$200 million and \$115 million in 1996 and 1995, respectively. The Kobe Japan earthquake which struck in early 1995 resulted in gross and net incurred losses to AIG of approximately \$73 million and \$30 million, respectively. If these catastrophes were excluded from the losses incurred in each period, the pro forma consolidated statutory general insurance ratios would be as follows:

|                | 1996  | 1995  |
|----------------|-------|-------|
| Loss Ratio     | 75.73 | 75.92 |
| Expense Ratio  | 20.21 | 20.38 |
| Combined Ratio | 95.94 | 96.30 |

Excluding the effects of the aforementioned catastrophes, the results from general insurance operations have improved significantly period over period. AIG's ability to maintain the pro forma combined ratio below 100 is primarily attributable to the profitability of AIG's foreign general insurance operations and AIG's emphasis on maintaining its disciplined underwriting, especially in the domestic specialty markets. In addition, AIG does not seek net premium growth where rates do not adequately reflect its assessment of exposures.

General insurance net investment income in the first six months of 1996 increased 8.6 percent when compared to the same period of 1995. The growth in net investment income in 1996 was primarily attributable to new cash flow for investment. The new cash flow was generated from net general insurance operating cash flow and included the compounding of previously earned and reinvested net investment income. (See also the discussion under "Liquidity" herein.)

General insurance realized capital gains were \$45.1 million in the first six months of 1996 and \$47.6 million in 1995. These realized gains resulted from the ongoing management of the general insurance investment portfolios within the overall objectives of the general insurance operations and arose primarily from the disposition of equity securities and available for sale and trading fixed maturities as well as redemptions of fixed maturities.

General insurance operating income in the first six months of 1996 increased 8.5 percent when compared to the same period of 1995. The contribution of general insurance operating income to income before income taxes was 54.7 percent in 1996 compared to 58.3 percent in 1995.

A period to period comparison of operating income is significantly influenced by the catastrophe losses in any one period as well as the volatility from one period to the next in realized capital gains. Adjusting each period to exclude the effects of both catastrophe losses and realized capital gains, operating income would have increased by 8.8 percent in the first six months of 1996. The increase in the growth rate of 1996 over 1995 after the aforementioned adjustments was a result of the increased net investment income and improvement in underwriting results.

AIG is a major purchaser of reinsurance for its general insurance operations. 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. AIG insures risks in over 100 countries and its reinsurance programs must be coordinated in order to provide AIG the level of reinsurance protection that it desires. These reinsurance arrangements do not relieve AIG from its direct obligations to its insureds.

AIG's general reinsurance assets amounted to \$17.52 billion and resulted from AIG's reinsurance arrangements. Thus, a credit exposure existed at June 30, 1996, 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. The application of this collateral against balances due or any changes to the amount of collateral are based on the development of losses recoverable on an individual reinsurer basis. This development includes losses incurred but not reported (IBNR). At December 31, 1995, approximately 50 percent of the general reinsurance assets were from unauthorized reinsurers. In order to obtain statutory recognition, nearly all of these balances were collateralized. The remaining 50 percent of the general reinsurance assets were from authorized reinsurers and over 96 percent of such balances were from reinsurers rated A- (excellent) or better, as rated by A.M. Best. This rating is a measure of financial strength. The terms authorized and unau-

thorized pertain to regulatory categories, not creditworthiness. Through June 30, 1996, these distribution percentages have not significantly changed.

AIG's provision for estimated unrecoverable reinsurance has not significantly changed from December 31, 1995. AIG had allowances for unrecoverable reinsurance approximating \$125 million. At that date, and prior to this allowance, AIG had no significant reinsurance recoverables from any individual reinsurer which is 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 the local economic environment in which a foreign reinsurer operates. This department also reviews the nature of the risks ceded and the need for collateral. In addition, AIG's Credit Risk Committee reviews the credit limits for and concentrations with any one reinsurer.

AIG enters into certain intercompany reinsurance transactions for its general and life operations. AIG enters into these transactions as a sound and prudent business practice in order to maintain underwriting control and spread insurance risk among various legal entities. These reinsurance agreements have been approved by the appropriate regulatory authorities. All material intercompany transactions have been eliminated in consolidation.

At June 30, 1996, the consolidated general reinsurance assets of \$17.52 billion include reinsurance recoverables for (i) paid losses and loss expenses of \$1.89 billion and (ii) \$13.63 billion with respect to the ceded reserve for losses and loss expenses, including ceded IBNR (ceded reserves). 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. Any adjustments therefrom are reflected in income currently. It is AIG's belief that the ceded reserves at June 30, 1996 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.

At June 30, 1996, general insurance reserves for losses and loss expenses (loss reserves) amounted to \$33.73 billion, an increase of \$684.5 million or 2.1 percent over the prior year end and represent the accumulation of estimates of ultimate losses, including IBNR, and loss expenses and minor amounts of discounting related to certain workers' compensation claims. General insurance net loss reserves increased \$407.9 million or 2.1 percent to \$20.10 billion and represent loss reserves reduced by reinsurance recoverable, net of an allowance for unrecoverable reinsurance. The methods used to determine such estimates and to establish the resulting reserves are continually reviewed and updated. 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 at June 30, 1996. In the future, if the general insurance net loss reserves develop deficiently, such deficiency would have an adverse impact on such future results of operations.

In a very broad sense, the general loss reserves can be categorized into two distinct groups: one group being long tail casualty lines of business; the other being short tail lines of business consisting principally of property lines and including certain classes of casualty lines.

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. In the more recent accident years of long tail casualty lines there is limited statistical credibility in reported net losses. That is, a relatively low proportion of net losses would be reported claims and expenses and an even smaller proportion would be net losses paid. A relatively high proportion of net losses would therefore be IBNR.

A variety of actuarial methods and assumptions are 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. Loss trend factors reflect many items including changes in claims handling, exposure and policy forms and current and future estimates of monetary inflation and social inflation. Thus, many factors are implicitly considered in estimating the year to year growth in loss costs. Therefore, AIG's carried net long tail

loss reserves are judgmentally set as well as tested for reasonableness using the most appropriate loss trend factors for each class of business. In the evaluation of AIG's net loss reserves, loss trend factors vary slightly, depending on the particular class and nature of the business involved. For the majority of long tail casualty lines, net loss trend factors approximating nine percent were employed. These factors are periodically reviewed and subsequently adjusted, as appropriate, to reflect emerging trends which are based upon past loss experience.

Estimation of net losses for short tail business is less complex than for long tail casualty lines. Loss cost trends for many property lines can generally be assumed to be similar to the growth in exposure of such lines. For example, if the fire insurance coverage remained proportional to the actual value of the property, the growth in the property's exposure to fire loss can be approximated by the amount of insurance purchased.

For other property and short tail casualty lines, the loss trend is implicitly assumed to grow at the rate that reported net losses grow from one year to the next. The concerns noted above for longer tail casualty lines with respect to the limited statistical credibility of reported net losses generally do not apply to shorter tail lines.

AIG continues to receive indemnity 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. 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. However, AIG currently underwrites pollution impairment liability insurance on a claims made basis and excluded such claims from the analyses included herein. AIG has established a specialized claims unit which investigates and adjusts all such asbestos and environmental claims.

Estimation of asbestos and environmental claims loss reserves is a difficult process. These asbestos and environmental claims cannot be estimated by conventional reserving techniques as previously described. Quantitative techniques frequently have to be supplemented by subjective considerations including managerial judgment. Significant factors which affect the trends which influence the development of asbestos and environmental claims are the inconsistent court resolutions, judicial interpretations which broaden the intent of the policies and scope of coverage and the increasing number of new claims. The case law that has emerged can be characterized as still being in its infancy and the likelihood of any firm direction in the near future is very small. Additionally, the exposure for cleanup costs of hazardous waste dump sites involves issues such as allocation of responsibility among potentially responsible parties and the government's refusal to release parties. The cleanup cost exposure may significantly change if the Congressional reauthorization of Superfund expected in 1996 dramatically changes, thereby reducing or increasing litigation and cleanup costs.

In the interim, AIG and other industry members have and will continue to litigate the broadening judicial interpretation of the policy coverage and the liability issues. At the current time, it is not possible to determine the future development of asbestos and environmental claims. Such 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 changes in Superfund and waste dump site coverage issues. Additional liabilities could emerge for amounts in excess of the current reserves held. Although this emergence cannot now be reasonably estimated, it could have a material adverse impact on AIG's future operating results. The reserves carried for these claims at June 30, 1996 are believed to be adequate as these reserves are based on the known facts and current law. Furthermore, as AIG's net exposure retained relative to the gross exposure written was lower in 1984 and prior years, the potential impact of these claims is much smaller on the net loss reserves than on the gross loss reserves. (See the previous discussion on reinsurance collectibility 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.

A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined at June 30, 1996 and 1995 was as follows:

(in millions)

|   | 1996      |         | 1995      |         |
|---|-----------|---------|-----------|---------|
|   | GROSS     | NET     | Gross     | Net     |
| <b>Asbestos:</b>  |           |         |           |         |
| Reserve for losses and loss expenses at beginning of period | \$ 744.8  | \$127.9 | \$ 686.0  | \$130.2 |
| Losses and loss expenses incurred                           | 131.3     | 28.9    | 15.9      | 7.9     |
| Losses and loss expenses paid                               | (176.4)   | (36.0)  | (62.1)    | (15.1)  |
| Reserve for losses and loss expenses at end of period       | \$ 699.7  | \$120.8 | \$ 639.8  | \$123.0 |
| <b>Environmental:</b>                                       |           |         |           |         |
| Reserve for losses and loss expenses at beginning of period | \$1,197.9 | \$379.3 | \$ 728.1  | \$200.1 |
| Losses and loss expenses incurred                           | 123.6     | 54.3    | 190.0     | 57.6    |
| Losses and loss expenses paid                               | (54.4)    | (18.1)  | (79.6)    | (30.2)  |
| Reserve for losses and loss expenses at end of period       | \$1,267.1 | \$415.5 | \$ 838.5  | \$227.5 |
| <b>Combined:</b>  |           |         |           |         |
| Reserve for losses and loss expenses at beginning of period | \$1,942.7 | \$507.2 | \$1,414.1 | \$330.3 |
| Losses and loss expenses incurred                           | 254.9     | 83.2    | 205.9     | 65.5    |
| Losses and loss expenses paid                               | (230.8)   | (54.1)  | (141.7)   | (45.3)  |
| Reserve for losses and loss expenses at end of period       | \$1,966.8 | \$536.3 | \$1,478.3 | \$350.5 |

The gross and net IBNR included in the aforementioned reserve for losses and loss expenses at June 30, 1996 and 1995 were estimated as follows:

(in thousands)

|          | 1996      |           | 1995      |          |
|----------|-----------|-----------|-----------|----------|
|          | GROSS     | NET       | Gross     | Net      |
| Combined | \$801,000 | \$264,100 | \$190,000 | \$50,000 |

A summary of asbestos and environmental claims count activity for the six month periods ended June 30, 1996 and 1995 was as follows:

|                                 | 1996     |               |          | 1995     |               |          |
|---------------------------------|----------|---------------|----------|----------|---------------|----------|
|                                 | ASBESTOS | ENVIRONMENTAL | COMBINED | Asbestos | Environmental | Combined |
| Claims at beginning of period   | 5,244    | 17,858        | 23,102   | 5,947    | 16,223        | 22,170   |
| Claims during period:           |          |               |          |          |               |          |
| Opened                          | 424      | 1,442         | 1,866    | 781      | 2,157         | 2,938    |
| Settled                         | (70)     | (302)         | (372)    | (80)     | (304)         | (384)    |
| Dismissed or otherwise resolved | (315)    | (1,964)       | (2,279)  | (373)    | (1,067)       | (1,440)  |

The average cost per claim settled, dismissed or otherwise resolved for the six month periods ended June 30, 1996 and 1995 was as follows:

|               | 1996      |          | 1995      |          |
|---------------|-----------|----------|-----------|----------|
|               | GROSS     | NET      | Gross     | Net      |
| Asbestos      | \$458,200 | \$93,500 | \$137,000 | \$33,000 |
| Environmental | 24,000    | 8,000    | 58,100    | 22,000   |
| Combined      | 87,100    | 20,400   | 77,700    | 24,800   |

An insurance rating agency has developed a survival ratio to measure the number of years it would take a company to exhaust both its asbestos and environmental reserves for losses and loss expenses based on that company's current level of asbestos and environmental claims payments. The higher the ratio, the more years the reserves for losses and loss expenses cover these claims payments. These ratios are computed based on the

respective ending reserves for losses and loss expenses over the respective claims settlements during the fiscal year. Such payments include indemnity payments and legal and loss adjustment payments. It should be noted, however, that this is an extremely simplistic approach to measuring asbestos and environmental reserve levels. Many factors, such as aggressive settlement procedures, mix of business and level of coverage provided, have significant impact on the amount of asbestos and environmental losses and loss expense reserves, ultimate payments thereof and the resultant ratio. The aforementioned insurance rating agency has recently published the findings of its current studies with respect to the ultimate aggregate costs for toxic waste cleanups for the insurance industry. This agency has significantly lowered its ultimate aggregate cost projections that were published in 1994. Other published studies also project lower ultimate aggregate costs for toxic waste cleanups for the insurance industry.

The developed survival ratios include both involuntary and voluntary indemnity payments. Involuntary payments include court judgments, court orders, covered claims with no coverage defenses, state mandated cleanup costs, claims where AIG's coverage defenses are minimal, and settlements made less than six months before the first trial setting. Also, AIG considers all legal and loss adjustment payments as involuntary.

AIG believes voluntary indemnity payments should be excluded from the survival ratio. The special asbestos and environmental claims unit actively manages AIG's asbestos and environmental claims and proactively pursues early settlement of environmental claims for all known and unknown sites. As a result, AIG reduces its exposure to future environmental loss contingencies.

Accordingly, AIG's annualized survival ratios for involuntary asbestos and environmental claims, separately and combined, were estimated as follows for the six month periods ended June 30, 1996 and 1995:

|                              | 1996  |      | 1995  |     |
|------------------------------|-------|------|-------|-----|
|                              | GROSS | NET  | Gross | Net |
| Involuntary survival ratios: |       |      |       |     |
| Asbestos                     | 2.0   | 1.7  | 5.2   | 4.1 |
| Environmental                | 16.6  | 15.7 | 12.8  | 8.8 |
| Combined                     | 5.1   | 6.1  | 8.2   | 8.2 |

AIG's operations are negatively impacted 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 assessment, net of credits for 1995 was \$23.5 million. Based upon current information, AIG does not anticipate that its net assessment will be significantly different in 1996.

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.

#### Life Insurance Operations

Life insurance operations for the six month periods ending June 30, 1996 and 1995 were as follows:

(in thousands)

|                        | 1996         |  | 1995         |  |
|------------------------|--------------|--|--------------|--|
| Premium income:        |              |  |              |  |
| Domestic               | \$ 251,351   |  | \$ 245,653   |  |
| Foreign                | 4,043,633    |  | 3,591,498    |  |
| Total                  | \$ 4,294,984 |  | \$ 3,837,151 |  |
| Net investment income: |              |  |              |  |
| Domestic               | \$ 496,058   |  | \$ 394,157   |  |
| Foreign                | 831,886      |  | 665,412      |  |

|   |               |               |
|---|---------------|---------------|
| Total   | \$ 1,327,944  | \$ 1,059,569  |
| Operating income before realized capital gains: |               |               |
| Domestic  | \$ 52,330     | \$ 26,070     |
| Foreign   | 554,429       | 469,857       |
| Total   | 606,759       | 495,927       |
| Realized capital gains                          | 5,850         | 1,748         |
| Operating income                                | \$ 612,609    | \$ 497,675    |
| Life insurance in-force:*                       |               |               |
| Domestic  | \$ 56,983,356 | \$ 54,272,118 |
| Foreign   | 335,511,980   | 321,824,989   |
| Total   | \$392,495,336 | \$376,097,107 |

\* Amounts presented were as at June 30, 1996 and December 31, 1995, respectively.

AIG's life insurance operations, demonstrating the strength of its franchise, continued to show

growth primarily as a result of overseas operations, particularly in Asia. AIG's life premium income during the first six months of 1996 represented a 11.9 percent increase from the same period in 1995. Foreign life operations produced 94.1 percent and 93.6 percent of the life premium income in 1996 and 1995, respectively.

As previously discussed, the U.S. dollar strengthened in value in relation to most major foreign currencies in which AIG transacts business. Accordingly, for the first six months of 1996, when foreign life premium income was translated into U.S. dollars for purposes of consolidation, total life premium income was approximately 5.7 percentage points less than it would have been if translated utilizing exchange rates prevailing in the same period of 1995.

Life insurance net investment income increased 25.3 percent during the first six months of 1996 from the same period in 1995. The growth in net investment income was primarily attributable to foreign new cash flow for investment and, to a lesser degree, growth in interest income earned on policy loans related to domestic corporate-owned life insurance products. The new cash flow was generated from life insurance operations and included the compounding of previously earned and reinvested net investment income. (See also the discussion under "Liquidity" herein.)

In the second quarter of 1995, the growth in the premium income of the domestic life segment was significantly impacted by the terminal funded pension plan annuity premium. This premium did not recur to the same extent in the second quarter of 1996. Also, AIG's domestic life companies did not write credit life business during 1996. Excluding the terminal funded pension plan annuity and credit life premiums from domestic life premiums in 1995, the pro forma premium growth would have been 22.6 percent during the first six months in 1996. Both accident and health and annuity premium contributed to this growth.

The traditional life products, such as whole and term life and endowments, were the major contributors to the growth in foreign premium income and investment income, particularly in Asia, and continue to be the primary source of growth in the life segment. A mixture of traditional, accident and health and financial products are being sold in Japan.

Life insurance realized capital gains were \$5.9 million in 1996 and \$1.7 million in 1995. These realized gains resulted from the ongoing management of the life insurance investment portfolios within the overall objectives of the life insurance operations and arose primarily from the disposition of equity securities and available for sale fixed maturities and redemptions of fixed maturities.

Life insurance operating income during the first six months of 1996 increased 23.1 percent from the same period in 1995 to \$612.6 million. Excluding realized capital gains from life insurance operating income, the percent increase would be 22.3 percent during the first six months of 1996 from the same period in 1995. The contribution of life insurance operating income to income before income taxes amounted to 31.8 percent during the first six months of 1996 compared to 29.9 percent in the same period of 1995.

The risks associated with the traditional life and accident and health products are underwriting risk and investment risk. The risk associated with the financial and investment contract products is 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. AIG's life companies limit their maximum underwriting exposure on traditional life insurance of a single life to approximately one million dollars of coverage by using yearly renewable term reinsurance. The life insurance operations have not entered into assumption reinsurance transactions or surplus relief transactions during the two year period ended June 30, 1996.

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.

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 rebalancing of the invested assets to the policy and contract claims became necessary and did not occur, a demand could be placed upon liquidity. (See also the discussion under "Liquidity" herein.)

The asset-liability relationship is appropriately managed in AIG's foreign operations, as it has been throughout AIG's history, even though certain territories lack qualified long-term investments or there are investment restrictions imposed by the local regulatory authorities. For example, in Japan and several Southeast Asia territories, the duration of the investments is often for a shorter period than the effective maturity of such policy liabilities. Therefore, there is a risk that the reinvestment of the proceeds at the maturity of the investments may be at a yield below that of the interest required for the accretion of the policy liabilities. At December 31, 1995, the average duration of the investment portfolio was 5.5 years, while the related policy liabilities were estimated to be 11.8 years. These durations have not changed significantly during 1996. To maintain an adequate yield to match the interest required over the duration of the liabilities, constant management focus is required to reinvest the proceeds of the maturing securities without sacrificing investment quality. To the extent permitted under local regulation, AIG may invest in qualified longer-term securities outside Japan to achieve a closer matching in both duration and the required yield. AIG is able to manage any asset-liability duration difference through maintenance of sufficient global liquidity and to support any operational shortfall through its international financial network. Domestically, the asset-liability matching process is appropriately functioning as there are investments available to match the duration and the required yield. (See also the discussion under "Liquidity" herein.)

AIG uses asset-liability matching as a management tool to determine the composition of the invested assets and 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.

#### Agency and Service Fee Operations

Agency and service fee operating income during the first six months of 1996 decreased 7.6 percent to \$29.5 million compared to \$32.0 million in 1995. Agency and service fee operating income contributed 1.5 percent to AIG's income before income taxes in the first six months of 1996 compared to 1.9 percent in 1995.

#### Financial Services Operations

Financial services operations for the six month periods ending June 30, 1996 and 1995 were as follows:

(in thousands)

|   | 1996        | 1995        |
|---|-------------|-------------|
| Revenues:                                 |             |             |
| International Lease Finance Corp.         | \$ 743,279  | \$ 656,091  |
| AIG Financial Products Corp.*             | 180,248     | 110,359     |
| AIG Trading Group Inc.*                   | 119,133     | 122,388     |
| Other                                     | 154,815     | 114,419     |
| Total                                     | \$1,197,475 | \$1,003,257 |
| Operating income:                         |             |             |
| International Lease Finance Corp.         | \$ 151,012  | \$ 135,561  |
| AIG Financial Products Corp.              | 79,858      | 53,768      |
| AIG Trading Group Inc.                    | 32,135      | 29,916      |
| Other, including intercompany adjustments | (22,182)    | (25,760)    |
| Total                                     | \$ 240,823  | \$ 193,485  |

\*Represents net trading revenues.

Financial services operating income increased 24.5 percent in the first six months of 1996 over 1995.

International Lease Finance Corporation (ILFC) 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. Revenues in the first six months of 1996 increased 13.3 percent from 1995. The revenue increase resulted primarily from the growth both in the size and relative cost of the fleet. During the first six months of 1996, operating income increased 11.4 percent from 1995. The composite borrowing rates during the first six months of 1996 and 1995 were 6.22 percent and 6.59 percent, respectively. (See

also the discussions under "Capital Resources" and "Liquidity" herein.)

ILFC is exposed to loss through non-performance of aircraft lessees, through owning aircraft which it would be unable to lease or re-lease at acceptable rates or sell at lease expiration and through committing to purchase aircraft which it would be unable to lease. ILFC manages its lessee non-performance exposure through credit reviews and security deposit requirements. At June 30, 1996, only 3 of 312 aircraft owned were not leased

and these 3 aircraft have been committed for sale. All other aircraft remain leased. At June 30, 1996, 75 percent of the fleet was leased to foreign airlines. (See also the discussions under "Capital Resources" and "Liquidity" herein.)

AIG Financial Products Corp. and its subsidiaries (AIGFP) participate in the derivatives dealer market conducting, primarily as principal, an interest rate, currency and equity derivative products business. AIGFP also enters into long-dated forward foreign exchange contracts, option transactions, liquidity facilities, investment agreements and other structured transactions and invests in a diversified portfolio of securities. Thus, AIGFP derives substantially all its revenues from proprietary positions entered in connection with counterparty transactions rather than for speculative transactions. Revenues in the first six months of 1996 increased 63.3 percent from the same period of 1995. During the first six months of 1996, operating income increased 48.5 percent from the same period of 1995. As AIGFP is a transaction-oriented operation, current and past revenues and operating results may not provide a basis for predicting future performance. (See also the discussions under "Capital Resources," "Liquidity" and "Derivatives" herein.)

AIG Trading Group Inc. and its subsidiaries (AIGTG) derive a substantial portion of their revenues from market making and trading activities, as principals, in foreign exchange, interest rates, precious and base metals and natural gas and other energy products. Revenues in the first six months of 1996 decreased 2.7 percent from the same period of 1995. During the first six months of 1996, operating income increased 7.4 percent from the same period of 1995. (See also the discussions under "Capital Resources," "Liquidity" and "Derivatives" herein.)

Financial services operating income represented 12.5 percent of AIG's income before income taxes in the first six months of 1996. This compares to 11.6 percent in the same period of 1995.

#### Other Operations

In the first six months of 1996, AIG's equity in income of minority-owned insurance operations was \$48.0 million compared to \$39.1 million in the same period of 1995. In the first six months of 1996, the equity interest in insurance companies represented 2.5 percent of income before income taxes compared to 2.3 percent in the same period of 1995.

Other realized capital losses amounted to \$1.7 million and \$14.3 million in the first six months of 1996 and 1995, respectively.

Minority interest represents minority shareholders' equity in income of certain consolidated subsidiaries. In the first six months of 1996, minority interest amounted to \$24.0 million. In the first six months of 1995, minority interest amounted to \$17.5 million.

Other income (deductions)--net includes AIG's equity in certain minority-owned subsidiaries and certain partially-owned companies, realized foreign exchange transaction gains and losses in substantially all currencies and unrealized gains and losses in hyperinflationary currencies, as well as the income and expenses of the parent holding company and other miscellaneous income and expenses. In the first six months of 1996, net deductions amounted to \$33.5 million. In the same period of 1995, net deductions amounted to \$36.4 million.

Income before income taxes amounted to \$1.93 billion in the first six months of 1996, and \$1.67 billion in the same period of 1995.

In the first six months of 1996, AIG recorded a provision for income taxes of \$530.2 million compared to the provision of \$459.1 million in the same period of 1995. These provisions represent effective tax rates of 27.5 percent in the first six months of 1996, and 27.6 percent in the same period of 1995.

Net income amounted to \$1.40 billion in the first six months of 1996 and \$1.21 billion in the same period of 1995. The increases in net income over the periods resulted from those factors described above.

#### CAPITAL RESOURCES

At June 30, 1996, AIG had total capital funds of \$20.39 billion and total borrowings of \$21.01 billion. At that date, \$15.85 billion of such borrowings were either not guaranteed by AIG or were matched borrowings under obligations of guaranteed investment agreements (GIAs).

Total borrowings at June 30, 1996 and December 31, 1995 were as follows:

(in thousands)

|                              | 1996         | 1995         |
|------------------------------|--------------|--------------|
| GIA's -- AIGFP               | \$ 5,671,959 | \$ 5,423,555 |
| Commercial Paper:            |              |              |
| Funding                      | 1,202,500    | 687,182      |
| ILFC(a)                      | 2,883,190    | 1,834,882    |
| AICCO                        | 662,131      | 644,571      |
| Total                        | 4,747,821    | 3,166,635    |
| Medium Term Notes:           |              |              |
| ILFC(a)                      | 2,481,835    | 2,391,535    |
| AIG                          | 52,800       | 115,000      |
| Total                        | 2,534,635    | 2,506,535    |
| Notes and Bonds Payable:     |              |              |
| ILFC(a)                      | 3,550,000    | 3,550,000    |
| AIGFP                        | 2,916,337    | 1,868,943    |
| AIG: Lire bonds              | 159,067      | 159,067      |
| Zero coupon notes            | 77,436       | 73,348       |
| Total                        | 6,702,840    | 5,651,358    |
| Loans and Mortgages Payable: |              |              |
| ILFC(a)(b)                   | 1,261,796    | 1,122,265    |
| AIG                          | 88,308       | 120,369      |
| Total                        | 1,350,104    | 1,242,634    |
| Total Borrowings             | 21,007,359   | 17,990,717   |
| Borrowings not guaranteed by |              |              |
| AIG                          | 10,176,821   | 8,898,682    |
| Matched GIA borrowings       | 5,671,959    | 5,423,555    |
|                              | 15,848,780   | 14,322,237   |
| Remaining borrowings of AIG  | \$ 5,158,579 | \$ 3,668,480 |

(a)AIG does not guarantee or support these borrowings.

(b)Primarily capital lease obligations.

Although financing was obtained through other sources, GIAs serve as the primary source of proceeds for AIGFP's investments in a diversified portfolio of securities and derivative transactions. (See also the discussions under "Operational Review", "Liquidity" and "Derivatives" herein.)

AIG Funding, Inc. (Funding), through the issuance of commercial paper, fulfills the short-term cash requirements of AIG and its subsidiaries. Funding intends to continue to meet AIG's funding requirements through the issuance of commercial paper guaranteed by AIG. This issuance of Funding's commercial paper is subject to the approval of AIG's Board of Directors. ILFC and A.I. Credit Corp. (AICCO) issue commercial paper for the funding of their own operations. AIG does not guarantee AICCO's or ILFC's commercial paper. However, AIG has entered into an agreement in support of AICCO's commercial paper. From time to time, AIGFP may issue commercial paper to fund its operations. AIG guarantees AIGFP's commercial paper. At June 30, 1996, AIGFP had no commercial paper outstanding. (See also the discussion under "Derivatives" herein.)

AIG and Funding have entered into two syndicated revolving credit facilities (the Facilities) aggregating \$1 billion. The Facilities consist of a \$500 million 364 day revolving credit facility and a \$500 million five year revolving credit facility. The Facilities can be used for general corporate purposes and also provide backup for AIG's commercial paper programs administered by Funding. There are currently no borrowings outstanding under either of the Facilities, nor were any borrowings outstanding as of June 30, 1996.

At June 30, 1996, ILFC had increased the aggregate principal amount outstanding of its medium term and term notes to \$6.03 billion, a net increase of \$90.3 million, and recorded a net decline in its capital lease obligations of \$46.3 million and a net increase in its commercial paper of \$1.05 billion. At June 30, 1996, ILFC had \$1.33 billion in aggregate principal amount of debt securities registered for issuance from time to time. The cash used to purchase flight equipment, including progress payments during the construction phase, is primarily derived 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 of prior debt. (See also the discussions under "Operational Review" and "Liquidity" herein.)

During the first six months of 1996, AIG did not issue any medium term notes and \$62.2 million of previously issued notes matured. At June 30, 1996, AIG had \$747.0 million in aggregate principal amount of debt securities registered for issuance from time to time, including \$500 million principal amount which was registered in February, 1996. On August 12, 1996, AIG issued \$50 million principal amount of medium term notes at a rate of 6.25 percent per annum for a three year term. (See also the discussion under "Derivatives" herein.)

AIG's capital funds have increased \$563.9 million in the first six months of 1996. Unrealized appreciation of investments, net of taxes declined \$316.9 million, primarily as a result of the effect of rising domestic interest rates impacting the market value of the bonds available for sale portfolio. As a result of AIG's adoption of Financial Accounting Standards No. 115 "Accounting for Certain Investments on Debt and Equity Securities", unrealized

appreciation of investments, net of taxes, is now subject to increased volatility resulting from the changes in the market value of bonds available for sale. During the first six months of 1996, the cumulative translation adjustment loss, net of taxes, increased \$4.1 million and retained earnings increased \$1.32 billion, resulting from net income less dividends.

During the first six months of 1996, AIG repurchased in the open market 4.9 million shares of its common stock at a cost of \$444.9 million. AIG intends to continue to buy its common shares in the open market from time to time and to satisfy its obligations under various employee benefit plans through such purchases.

Payments of dividends to AIG by its insurance subsidiaries are subject to certain restrictions imposed by statutory authorities. 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. At June 30, 1996, there were no significant statutory or regulatory issues which would impair AIG's financial condition, results of operations or liquidity. (See also the discussion under "Liquidity" herein.)

In 1989, the National Association of Insurance Commissioners (NAIC) adopted the "NAIC Solvency Policing Agenda for 1990". Included in this agenda was the development of Risk-Based Capital (RBC) requirements. RBC relates an individual insurance company's statutory surplus to the risk inherent in its overall operations.

At December 31, 1995, the adjusted capital of each of AIG's domestic general companies and of each of AIG's domestic life companies exceeded each of their RBC standards by considerable margins. There has been no significant change through June 30, 1996.

A substantial portion of AIG's general insurance business and a majority of its life insurance business is carried on in foreign countries. The degree of regulation and supervision in foreign jurisdictions varies from minimal in some to stringent in others. Generally, AIG, as well as the underwriting companies operating in such jurisdictions, must satisfy local regulatory requirements.

To AIG's knowledge, no AIG company is on any regulatory or similar "watch list".

#### LIQUIDITY

At June 30, 1996, AIG's consolidated invested assets included approximately \$2.51 billion of cash and short-term investments. Consolidated net cash provided from operating activities in the first six months of 1996 amounted to approximately \$2.97 billion.

Management believes that AIG's liquid assets, its net cash provided by operations, and access to the capital markets will enable it to meet any foreseeable cash requirements.

AIG's liquidity is primarily derived from the operating cash flows of its general and life insurance operations.

The liquidity of the combined insurance operations is derived both domestically and abroad. The combined insurance pretax operating cash flow is derived from two sources, underwriting operations and investment operations. In the aggregate, AIG's insurance operations generated approximately \$5 billion in pretax cash flow during the first six months of 1996. Cash flow includes periodic premium collections, including policyholders' contract deposits, paid loss recoveries less reinsurance premiums, losses, benefits, acquisition and operating expenses paid. 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. AIG's insurance investment operations generated over \$2 billion in investment income cash flow during the first six months of 1996. Investment income cash flow is primarily derived from interest and dividends received and includes realized capital gains.

The combined insurance pretax operating cash flow coupled with the cash and short-term investments of \$2.12 billion provided the insurance operations with a significant amount of liquidity during the first six months of 1996. This liquidity is available to purchase 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. With this liquidity together with proceeds of approximately \$8.4 billion from the maturities, sales and redemptions of fixed income securities and from the sale of marketable equity securities, AIG purchased approximately \$11.2 billion of fixed income securities and marketable equity securities during the first six months of 1996.

During the first six months of 1996, AIG received approximately \$1.1 billion from redemptions of held to maturity municipal bonds. Prior to redemption, the yield to maturity on these bonds approximated 7.3 percent. The average yield to maturity on the reinvestment of the proceeds in bonds with similar characteristics during this same period of time approximated 5.6 percent. AIG does not anticipate that these redemptions will have a significant effect on AIG's general investment income, operations, financial condition or liquidity.

The following table is a summary of AIG's invested assets by significant segment, including investment income due and accrued and real estate, at June 30, 1996 and December 31, 1995:

(dollars in thousands)

|                    | JUNE 30, 1996   |                  | December 31, 1995 |                  |
|--------------------|-----------------|------------------|-------------------|------------------|
|                    | INVESTED ASSETS | PERCENT OF TOTAL | Invested Assets   | Percent of Total |
| General insurance  | \$ 27,261,756   | 26.7%            | \$26,550,431      | 27.5%            |
| Life insurance     | 37,604,564      | 36.8             | 34,869,040        | 36.2             |
| Financial services | 36,843,427      | 36.1             | 34,468,961        | 35.8             |
| Other              | 468,667         | 0.4              | 449,832           | 0.5              |
| Total              | \$102,178,414   | 100.0%           | \$96,338,264      | 100.0%           |

The following tables summarize the composition of AIG's insurance invested assets by insurance segment, including investment income due and accrued and real estate, at June 30, 1996 and December 31, 1995:

(dollars in thousands)

| JUNE 30, 1996  | GENERAL      | LIFE         | TOTAL        | PERCENT OF TOTAL | PERCENT DISTRIBUTION |         |
|--|--------------|--------------|--------------|------------------|----------------------|---------|
|  |              |              |              |                  | DOMESTIC             | FOREIGN |
| Fixed Maturities:  |              |              |              |                  |                      |         |
| Available for sale, at market value(a)                     | \$ 8,905,904 | \$23,148,242 | \$32,054,146 | 49.4%            | 35.9%                | 64.1%   |
| Held to maturity, at amortized cost(b)                     | 12,401,295   | --           | 12,401,295   | 19.1             | 100.0                | --      |
| Equity securities, at market value(c)                      | 3,024,576    | 2,619,128    | 5,643,704    | 8.7              | 31.4                 | 68.6    |
| Mortgage loans on real estate, policy and collateral loans | 53,128       | 7,966,186    | 8,019,314    | 12.4             | 57.7                 | 42.3    |
| Short-term investments, including time deposits, and cash  | 717,247      | 1,399,582    | 2,116,829    | 3.3              | 12.4                 | 87.6    |
| Real estate  | 402,369      | 643,322      | 1,045,691    | 1.6              | 22.1                 | 77.9    |
| Investment income due and accrued                          | 485,088      | 740,322      | 1,225,410    | 1.9              | 54.5                 | 45.5    |
| Other invested assets                                      | 1,272,149    | 1,087,782    | 2,359,931    | 3.6              | 46.9                 | 53.1    |
| Total  | \$27,261,756 | \$37,604,564 | \$64,866,320 | 100.0%           | 50.2%                | 49.8%   |

(a)Includes \$405,451 of bonds trading securities, at market value.

(b)Includes \$468,609 of preferred stock, at amortized cost.

(c)Includes \$32,849 of preferred stock, at market value.

(dollars in thousands)

| December 31, 1995  | General      | Life         | Total        | Percent<br>of Total | Percent Distribution |         |
|--|--------------|--------------|--------------|---------------------|----------------------|---------|
|  |              |              |              |                     | Domestic             | Foreign |
| -----  |              |              |              |                     |                      |         |
| Fixed Maturities:  |              |              |              |                     |                      |         |
| Available for sale, at market value(a)                           | \$ 9,068,133 | \$22,168,672 | \$31,236,805 | 50.9%               | 37.5%                | 62.5%   |
| Held to maturity, at amortized cost(b)                           | 11,545,530   | --           | 11,545,530   | 18.8                | 100.0                | --      |
| Equity securities, at market value(c)                            | 3,011,249    | 2,131,897    | 5,143,146    | 8.4                 | 35.8                 | 64.2    |
| Mortgage loans on real estate, policy<br>and<br>collateral loans | 54,852       | 6,887,329    | 6,942,181    | 11.3                | 52.8                 | 47.2    |
| Short-term investments, including time<br>deposits, and cash     | 636,709      | 1,231,817    | 1,868,526    | 3.0                 | 25.6                 | 74.4    |
| Real estate  | 345,336      | 660,954      | 1,006,290    | 1.6                 | 17.3                 | 82.7    |
| Investment income due and accrued                                | 466,744      | 732,380      | 1,199,124    | 2.0                 | 55.3                 | 44.7    |
| Other invested assets  | 1,421,878    | 1,055,991    | 2,477,869    | 4.0                 | 50.6                 | 49.4    |
| -----  |              |              |              |                     |                      |         |
| Total  | \$26,550,431 | \$34,869,040 | \$61,419,471 | 100.0%              | 51.0%                | 49.0%   |
| -----  |              |              |              |                     |                      |         |

(a)Includes \$428,296 of bonds trading securities, at market value.

(b)Includes \$459,505 of preferred stock, at amortized cost.

(c)Includes \$38,989 of preferred stock, at market value.

With respect to fixed maturities, AIG's strategy is to invest in high quality securities while maintaining diversification to avoid significant exposure to issuer, industry and/or country concentrations.

At June 30, 1996, approximately 54 percent of the fixed maturity investments were domestic securities. Approximately 40 percent of such domestic securities were rated AAA, and approximately two percent were below investment grade.

A significant portion of the foreign insurance fixed income portfolio is rated by Moody's, Standard & Poor's (S&P) or similar foreign services. Similar credit quality rating services are not available in all overseas locations. AIG annually reviews the credit quality of the foreign portfolio nonrated fixed income investments, including mortgages. At June 30, 1996, approximately 41 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. Less than one percent of these investments were deemed below investment grade and approximately 4 percent were not rated at that date.

Although AIG's fixed income insurance portfolios contain only minor amounts of securities below investment grade, any fixed income security may be subject to downgrade for a variety of reasons subsequent to any balance sheet date. There have been no significant downgrades as at August 1, 1996.

At June 30, 1996, approximately 5 percent of the fixed maturities portfolio was Collateralized Mortgage Obligations (CMOs). All of the CMOs were investment grade and approximately 75 percent of the CMOs were backed by various U.S. government agencies. The remaining 25 percent is rated at least A. Thus, credit risk was minimal. CMOs are exposed to interest rate risk as the duration and ultimate realized yield would be affected by the accelerated prepayments of the underlying mortgages. There were no interest only or principal only CMOs.

When permitted by regulatory authorities and when deemed necessary to protect insurance assets, including invested assets, from currency risk and interest rate risk, AIG and its insurance subsidiaries enter into derivative transactions as end users. To date, such activities have been minor. (See also the discussion under "Derivatives" herein.)

Mortgage loans on real estate, policy and collateral loans comprised 12.4 percent of AIG's insurance invested assets at June 30, 1996. AIG's insurance holdings of real estate mortgages amounted to \$2.19 billion of which 32.9 percent was domestic. At June 30, 1996, no domestic mortgages and only a nominal amount of foreign mortgages were in default. At June 30, 1996, AIG's insurance holdings of collateral loans amounted to \$896.9 million, all of which were foreign. It is AIG's practice to maintain a maximum loan to value ratio of 75 percent at loan origination. AIG's policy loans increased from \$3.95 billion at December 31, 1995 to \$4.93 billion at June 30, 1996, with most of this increase relating to the domestic corporate-owned life insurance product.

Short-term investments represent amounts invested in various internal and external money market funds, time deposits and cash.

AIG's real estate investment properties are primarily occupied by AIG's various operations. The current market value of these properties considerably exceeds their carrying value.

Other invested assets were primarily comprised of both foreign and domestic private placements, limited partnerships and outside managed funds.

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. These barriers generally cause only minor delays in the outward remittance of the funds.

The following table is a summary of the composition of AIG's financial services invested assets at June 30, 1996 and December 31, 1995. (See also the discussions under "Operational Review," "Capital Resources" and "Derivatives" herein.)

(dollars in thousands)

|   | 1996            |                  | 1995            |                  |
|---|-----------------|------------------|-----------------|------------------|
|   | INVESTED ASSETS | PERCENT OF TOTAL | Invested Assets | Percent of Total |
| Flight equipment primarily under operating leases, net of accumulated depreciation    | \$13,846,720    | 37.6%            | \$12,442,010    | 36.1%            |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 6,130,356       | 16.6             | 7,250,954       | 21.0             |
| Securities available for sale, at market value  | 5,084,867       | 13.8             | 3,931,100       | 11.4             |
| Trading securities, at market value   | 2,329,448       | 6.3              | 2,641,436       | 7.7              |
| Securities purchased under agreements to resell, at contract value                    | 3,281,959       | 8.9              | 2,022,056       | 5.9              |
| Trade receivables   | 2,611,978       | 7.1              | 3,321,985       | 9.6              |
| Spot commodities, at market value   | 928,663         | 2.5              | 1,079,124       | 3.1              |
| Other, including short-term investments   | 2,629,436       | 7.2              | 1,780,296       | 5.2              |
| Total   | \$36,843,427    | 100.0%           | \$34,468,961    | 100.0%           |

As previously discussed, the cash used for the purchase of flight equipment is derived primarily from the proceeds of ILFC's debt financing. 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 of prior debt. During the first six months of 1996, ILFC acquired flight equipment costing \$2.03 billion.

AIGFP's derivative transactions are carried at market value or at estimated fair value when market prices are not readily available. AIGFP reduces its economic 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 to sell or close out the transactions prior to maturity. AIG believes that the impact of any such limited liquidity would not be significant to AIG's financial condition or its overall liquidity. (See also the discussion under "Derivatives" herein.)

Securities available for sale, at market value and securities purchased under agreements to resell are purchased with the proceeds of AIGFP's GIA financings and other long and short-term borrowings. The proceeds from the disposal of securities available for sale and securities purchased under agreements to resell have been used to fund the maturing GIAs or other AIGFP financing. (See also the discussion under "Capital Resources" herein.)

Securities available for sale is mainly a portfolio of debt securities, where the individual securities have varying degrees of credit risk. At June 30, 1996, the average credit rating of this portfolio was AA or the equivalent thereto as determined through rating agencies or internal review.

At that date, AIGFP has also entered into credit derivative transactions to hedge its credit risk associated with \$1.7 billion of these securities. There were no securities deemed below investment grade. There have been no significant downgrades through August 1, 1996. Securities purchased under agreements to resell are treated as collateralized transactions. AIGFP generally takes possession of securities purchased under agreements to resell. AIGFP further minimizes its credit risk by monitoring counterparty credit exposure and, when AIGFP deems necessary, it requires additional collateral to be deposited. Trading securities, at market value are marked to market daily and are held to meet the short-term risk management objectives of AIGFP.

AIGTG conducts, as principal, market making and trading activities in foreign exchange, interest rates, precious and base metals and natural gas and other energy products. AIGTG 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. AIGTG uses derivatives to manage the economic exposure of its various trading positions and transactions from adverse movements of interest rates, exchange rates and commodity prices. AIGTG supports its trading activities largely through trade payables, unrealized losses on swaps, short-term borrowings and spot commodities sold but not yet purchased. (See also the discussions under "Capital Resources" and "Derivatives" herein.)

#### DERIVATIVES

Derivatives are financial arrangements among two or more parties whose returns are linked to or "derived" from some underlying equity, debt, commodity or other asset, liability, or some index. Derivatives payments may be based on interest rates and exchange rates and/or prices of certain securities, certain commodities, or financial or commodity indices. The more significant types of derivative arrangements in which AIG transacts are swaps, forwards, futures, options and related instruments.

The most commonly used swaps are interest rate and currency swaps. An interest rate swap is a contract between two parties to exchange interest rate payments (typically a fixed interest rate versus a variable interest rate) calculated on a notional principal amount for a specified period of time. The notional amount is not exchanged. A currency swap is similar but the notional amounts are different currencies which are typically exchanged at the commencement and termination of the swap based upon negotiated exchange rates.

A futures or forward contract is a contract between two parties to purchase or sell at a specified future date a specified quantity of a commodity, security, currency, financial index or other instrument, at a specified price. A futures contract is traded on an exchange, while a forward contract is executed over the counter.

An option contract generally provides the option purchaser with the right but not the obligation to buy or sell during a period of time or at a specified date the underlying instrument at a set price. The option writer is obligated to sell or buy the underlying item if the option purchaser chooses to exercise his right. The option writer receives a nonrefundable fee or premium paid by the option purchaser.

Derivatives are generally either negotiated over the counter contracts or standardized contracts executed on an exchange. Standardized exchange traded derivatives include futures and options which can be readily bought or sold over recognized security exchanges and settled daily through such clearing houses. Negotiated over the counter derivatives include forwards, swaps and options. Over the counter derivatives are generally not traded like exchange traded securities. However, in the normal course of business, with the agreement of the original counterparty, these contracts may be terminated early or assigned to another counterparty.

All significant derivatives activities are conducted through AIGFP and AIGTG, 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. Generally, derivatives are used by AIG's customers such as corporations, financial institutions, multinational organizations, sovereign entities, government agencies and municipalities. For example, a futures, forward or option contract can be used to protect the customers' assets or liabilities against price fluctuations.

The senior management of AIG, with review by the Board of Directors, defines the policies and establishes general operating parameters for AIGFP and AIGTG. AIG's senior management has established various oversight committees to review the various financial market, operational and credit issues of AIGFP and AIGTG. The senior managements of AIGFP and AIGTG report the results of their respective operations to and review 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 manage a variety of exposures including credit, market, liquidity, operational and legal risks.

Market risk principally arises from the uncertainty that future earnings are exposed to potential

changes in volatility, interest rates, foreign exchange rates, and equity and commodity prices. AIG generally controls its exposure to market risk by taking offsetting positions. AIG's philosophy with respect to its financial services operations is to minimize or set limits for open or uncovered positions that are to be carried. Credit risk exposure is separately managed. (See the discussion on the management of credit risk below.)

AIGFP does not seek to manage the market risk of each of its transactions through an individual offsetting transaction. Rather, AIGFP takes a portfolio approach to the management of its market risk exposure. AIGFP values its portfolio at market value or estimated fair value when market values are not readily available. These valuations represent an assessment of the present values of expected future cash flows of AIGFP's transactions and may include reserves for such risks as are deemed appropriate by AIGFP's and AIG's management. AIGFP evaluates the portfolio's discounted cash flows with reference to current market conditions, maturities within the portfolio and other relevant factors. Based upon this evaluation, AIGFP determines what, if any, offsetting transactions are necessary to reduce the market risk exposure of the portfolio.

The aforementioned estimated fair values are based upon the use of valuation models. These models utilize, among other things, current interest, foreign exchange and volatility rates. These valuation models are integrated into the evaluation of the portfolio, as described above, in order to provide timely information for the market risk management of the portfolio.

Additionally, depending upon the nature of interest rates and market movements during the day, the system will produce reports for management's consideration for intra-day offsetting positions. Overnight, the system generates reports which recommend the types of offsets management should consider for the following day. Additionally, AIGFP operates in major business centers overseas and is essentially open for business 24 hours a day. Thus, the market exposure and offset strategies are monitored, reviewed and coordinated around the clock. Therefore, offsetting adjustments can be made as and when necessary from any AIGFP office in the world.

As part of its monitoring and controlling of its exposure to market risk, AIGFP applies various testing techniques which reflect potential market movements. These techniques vary by currency and are regularly changed to reflect factors affecting the derivatives portfolio. In addition to the daily monitoring, AIGFP's senior management and local risk managers conduct a weekly review of the derivatives portfolio and existing hedges. This review includes an examination of the portfolio's risk measures, such as aggregate option sensitivity to movements in market variables. AIGFP's management may change these measures to reflect their judgment and evaluation of the dynamics of the markets. This management group will also determine whether additional or alternative action is required in order to manage the portfolio. AIG utilizes an outside consultant to provide the managements of AIG and AIGFP with comfort that the system produces representative values.

AIGTG's approach to managing market risk is to establish an appropriate offsetting position to a particular transaction or group of transactions depending upon the extent of market risk AIGTG wishes to reduce.

AIGTG's senior management has established positions and stop-loss limits for each line of business. AIGTG's traders are required to maintain positions within these limits. These positions are monitored during the day either manually or through on-line computer systems. In addition, these positions are reviewed by AIGTG's management. Reports which present each trading book's position and the prior day's profit and loss are reviewed by traders, head traders and AIGTG's senior management. Based upon these and other reports, AIGTG's senior management determines whether to adjust AIGTG's risk profile.

AIGTG attempts to secure reliable current market prices, such as published prices or third party quotes, to value its derivatives. Where such prices are not available, AIGTG uses an internal methodology which includes interpolation or extrapolation from verifiable prices nearest to the dates of the transactions. The methodology may reflect interest and exchange rates, commodity prices, volatility rates and other relevant factors.

A significant portion of AIGTG's business is transacted in liquid markets. Certain of AIGTG's derivative product exposures are evaluated using simulation techniques which consider such factors as changes in currency and commodity prices, interest rates, volatility levels and the effect of time. Though not indicative of the future, past volatile

market scenarios have represented profit opportunities for AIGTG.

The gross unrealized gains and gross unrealized losses of AIGFP and AIGTG included in the financial services assets and liabilities at June 30, 1996 were as follows:

(in thousands)

|   | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES | BALANCE<br>SHEET<br>AMOUNT |
|---|------------------------------|-------------------------------|----------------------------|
| Securities<br>available for<br>sale, at market<br>value   | \$ 183,728                   | \$ 179,815                    | \$5,084,867                |
| Unrealized<br>gain/loss on<br>interest rate<br>and currency<br>swaps, options<br>and forward<br>transactions(a)(b)  | 6,130,356                    | 4,889,687                     | --                         |
| Trading<br>securities, at<br>market value   | --                           | --                            | 2,329,448                  |
| Securities sold<br>but not yet<br>purchased,<br>principally<br>obligations of<br>the U.S.<br>government and<br>government<br>agencies, at<br>market value | --                           | --                            | 782,582                    |
| Trade<br>receivables(b)   | 5,158,388                    | 3,130,989                     | 2,611,978                  |
| Spot commodities,<br>at market<br>value(c)  | 141,010                      | 228,738                       | 928,663                    |
| Trade payables  | --                           | 2,126,881                     | 2,389,131                  |
| Spot commodities<br>sold but not yet<br>purchased, at<br>market value   | 159,339                      | 167,983                       | 887,682                    |

(a)These amounts are also presented as the respective balance sheet amounts.

(b)At June 30, 1996, AIGTG's net replacement values were \$305.2 million with respect to interest rate and currency swaps and \$2.28 billion with respect to futures and forward contracts which were included in trade receivables.

(c)The net replacement value with respect to purchased option contracts of AIGTG at June 30, 1996 was \$487.0 million.

The interest rate risk on securities available for sale, at market, is managed by taking offsetting positions on a security by security basis, thereby offsetting a significant portion of the unrealized appreciation or depreciation. At June 30, 1996, the unrealized gains and losses remaining after benefit of the offsets were \$9.3 million and \$5.4 million, respectively.

AIGFP carries its derivatives at market or estimated fair value, whichever is appropriate. Because of limited liquidity of certain of these instruments, the recorded estimated fair values of these derivatives may be different than the values that might be realized if AIGFP were to sell or close out the transactions prior to maturity. (See also the discussions under "Operational Review: Financial Services" and "Liquidity" herein.)

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

AIGTG conducts, as principal, market making and trading activities in foreign exchange, interest rates, precious and base metals and natural gas and other energy products. AIGTG owns inventories in the commodities in which it trades. These inventories are carried at market and may be substantially hedged. AIGTG uses derivatives to manage the economic exposure of its various trading positions and transactions from adverse movements in interest rates, exchange rates and commodity prices. (See also the discussions under "Operational Review: Financial Services" and "Liquidity" herein.)

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 an estimated positive fair value. To help manage this risk, the credit departments of AIGFP and AIGTG operate within the guidelines of the AIG Credit Risk Committee, which sets credit policy and 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 these pre-established guidelines require the approval of the AIG Credit Risk Committee. It is also AIG's policy to establish reserves for potential credit impairment when necessary.

AIGFP and AIGTG determine the credit quality of each of their counterparties taking into account credit ratings assigned by recognized statistical rating organizations. If it is determined that a counterparty requires credit enhancement, then one or more enhancement techniques will be used. Examples of such enhancement techniques include letters of credit, guarantees, collateral credit triggers and credit derivatives and margin agreements.

A significant majority of AIGFP's transactions are contracted and documented under ISDA Master Agreements that provide for legally enforceable set-off and close out netting of exposures in the event of default. Under such agreements, in connection with the early termination of a transaction, AIGFP is permitted to set-off its receivables from a counterparty against AIGFP's payables to that same counterparty arising out of all included transactions. Excluding regulated exchange transactions, AIGTG, whenever possible, enters into netting agreements with its counterparties which are similar in effect to those discussed above.

The following tables provide the notional and contractual amounts of AIGFP's derivatives portfolio at June 30, 1996 and December 31, 1995. The notional amounts used to express the extent of AIGFP's involvement in swap transactions represent a standard of measurement of the volume of AIGFP's swaps business. Notional amount is not a quantification of market risk or credit risk and it may not necessarily be recorded on the balance sheet. Notional amounts represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps. The timing and the amount of cash flows relating to foreign exchange forwards and exchange traded futures and options contracts are determined by each of the respective contractual agreements.

The net replacement value most closely represents the net credit risk to AIGFP or the maximum amount exposed to potential loss after the application of the aforementioned strategies, ISDA Master Agreements and collateral held.

The following table presents AIGFP's derivatives portfolio by maturity and type of derivative at June 30, 1996 and December 31, 1995:

(in thousands)

|   | REMAINING LIFE |                           |                          |                    | TOTAL<br>1996 | Total<br>1995 |
|---|----------------|---------------------------|--------------------------|--------------------|---------------|---------------|
|   | ONE<br>YEAR    | TWO THROUGH<br>FIVE YEARS | SIX THROUGH<br>TEN YEARS | AFTER TEN<br>YEARS |               |               |
| -----   |                |                           |                          |                    |               |               |
| Interest rate, currency and<br>equity/commodity swaps and<br>swaptions: |                |                           |                          |                    |               |               |
| Notional amount:  |                |                           |                          |                    |               |               |
| Interest rate swaps   | \$32,394,000   | \$69,670,000              | \$32,457,000             | \$ 9,627,000       | \$144,148,000 | \$130,441,000 |
| Currency swaps  | 6,814,000      | 16,054,000                | 6,764,000                | 3,645,000          | 33,277,000    | 28,829,000    |
| Equity/commodity swaps  | 64,000         | 20,000                    | --                       | 50,000             | 134,000       | 320,000       |
| Swaptions   | 498,000        | 978,000                   | 2,577,000                | 923,000            | 4,976,000     | 4,374,000     |
| -----   |                |                           |                          |                    |               |               |
| Total   | \$39,770,000   | \$86,722,000              | \$41,798,000             | \$14,245,000       | \$182,535,000 | \$163,964,000 |
| -----   |                |                           |                          |                    |               |               |
| Futures and forward contracts:  |                |                           |                          |                    |               |               |
| Exchange traded futures contracts<br>contractual amount                 | \$12,733,000   | \$ --                     | \$ --                    | \$ --              | \$ 12,733,000 | \$ 16,050,000 |
| -----   |                |                           |                          |                    |               |               |
| Over the counter forward contracts<br>contractual amount                | \$ 1,467,000   | \$ 2,000                  | \$ --                    | \$ --              | \$ 1,469,000  | \$ 2,238,000  |
| -----   |                |                           |                          |                    |               |               |

AIGFP determines counterparty credit quality by reference to ratings from independent rating agencies or internal analysis. At June 30, 1996 and December 31, 1995, the counterparty credit quality by derivative product with respect to the net replacement value of AIGFP's derivatives portfolio was as follows:

(in thousands)

|                                 | NET REPLACEMENT VALUE  |                                  |               | Total<br>1995 |
|---------------------------------|------------------------|----------------------------------|---------------|---------------|
|                                 | SWAPS AND<br>SWAPTIONS | FUTURES AND<br>FORWARD CONTRACTS | TOTAL<br>1996 |               |
| Counterparty credit quality:    |                        |                                  |               |               |
| AAA                             | \$1,444,000            | \$ --                            | \$1,444,000   | \$1,994,000   |
| AA                              | 2,127,000              | 18,000                           | 2,145,000     | 2,146,000     |
| A                               | 1,167,000              | 6,000                            | 1,173,000     | 1,443,000     |
| BBB                             | 990,000                | --                               | 990,000       | 1,239,000     |
| Below investment grade          | 24,000                 | --                               | 24,000        | 49,000        |
| Not externally rated exchanges* | --                     | --                               | --            | 23,000        |
| Total                           | \$5,752,000            | \$24,000                         | \$5,776,000   | \$6,894,000   |

\*Exchange traded futures and options are not deemed to have significant credit exposure as the exchanges guarantee that every contract will be properly settled on a daily basis.

At June 30, 1996 and December 31, 1995, the counterparty breakdown by industry with respect to the net replacement value of AIGFP's derivatives portfolio was as follows:

(in thousands)

|                                      | NET REPLACEMENT VALUE  |                                  |               | Total<br>1995 |
|--------------------------------------|------------------------|----------------------------------|---------------|---------------|
|                                      | SWAPS AND<br>SWAPTIONS | FUTURES AND<br>FORWARD CONTRACTS | TOTAL<br>1996 |               |
| Non-U.S. banks                       | \$2,194,000            | \$20,000                         | \$2,214,000   | \$2,443,000   |
| Insured municipalities               | 578,000                | --                               | 578,000       | 880,000       |
| U.S. industrials                     | 709,000                | --                               | 709,000       | 1,025,000     |
| Governmental                         | 957,000                | --                               | 957,000       | 845,000       |
| Non-U.S. financial service companies | 28,000                 | --                               | 28,000        | 40,000        |
| Non-U.S. industrials                 | 377,000                | --                               | 377,000       | 531,000       |
| Special purpose                      | 102,000                | --                               | 102,000       | 113,000       |
| U.S. banks                           | 220,000                | 4,000                            | 224,000       | 319,000       |
| U.S. financial service companies     | 365,000                | --                               | 365,000       | 424,000       |
| Supranationals                       | 222,000                | --                               | 222,000       | 251,000       |
| Exchanges*                           | --                     | --                               | --            | 23,000        |
| Total                                | \$5,752,000            | \$24,000                         | \$5,776,000   | \$6,894,000   |

\*Exchange traded futures and options are not deemed to have significant credit exposure as the exchanges guarantee that every contract will be properly settled on a daily basis.

The following tables provide the notional and contractual amounts of AIGTG's derivatives portfolio at June 30, 1996 and December 31, 1995. In addition, the estimated positive fair values associated with the derivatives portfolio are also provided and include a maturity profile for the June 30, 1996 balances based upon the expected timing of the future cash flows.

The notional amounts used to express the extent of AIGTG's involvement in derivatives transactions represent a standard of measurement of the volume of AIGTG's derivatives business. Notional amount is not a quantification of the market or credit risks of the positions and is not necessarily recorded on the balance sheet. Notional amounts represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps. The timing and the amount of cash flows relating to foreign exchange forwards and exchange traded futures and options contracts are determined by the contractual agreements.

The gross replacement values presented represent the sum of the estimated positive fair values of all of AIGTG's derivatives contracts at June 30, 1996 and December 31, 1995. These values do not represent the credit risk to AIGTG.

Net replacement values presented represent the net sum of estimated positive fair values after



the application of legally enforceable master closeout netting agreements and collateral held. The net replacement values most closely represent the net credit risk to AIGTG or the maximum amount exposed to potential loss.

The following tables present AIGTG's derivatives portfolio and the associated credit exposure, if applicable, by maturity and type of derivative at June 30, 1996 and December 31, 1995:

(in thousands)

|   | REMAINING LIFE |                           |                          |                    | TOTAL<br>1996 | TOTAL<br>1995 |
|---|----------------|---------------------------|--------------------------|--------------------|---------------|---------------|
|   | ONE<br>YEAR    | TWO THROUGH<br>FIVE YEARS | SIX THROUGH<br>TEN YEARS | AFTER TEN<br>YEARS |               |               |
| Futures and forward contracts and interest rate and currency swaps: |                |                           |                          |                    |               |               |
| Exchange traded futures contracts contractual amount                | \$ 29,733,000  | \$ 8,171,000              | \$ 74,000                | \$ --              | \$ 37,978,000 | \$ 26,805,000 |
| Over the counter forward contracts contractual amount               | \$205,283,000  | \$11,035,000              | \$1,256,000              | \$ 5,000           | \$217,579,000 | \$183,710,000 |
| Interest rate and currency swaps:                                   |                |                           |                          |                    |               |               |
| Notional amount:  |                |                           |                          |                    |               |               |
| Interest rate swaps and forward rate agreements                     | \$ 54,149,000  | \$14,332,000              | \$1,326,000              | \$ 415,000         | \$ 70,222,000 | \$ 29,936,000 |
| Currency swaps  | 46,000         | 3,190,000                 | 1,431,000                | 765,000            | 5,432,000     | 4,541,000     |
| Total   | \$ 54,195,000  | \$17,522,000              | \$2,757,000              | \$ 1,180,000       | \$ 75,654,000 | \$ 34,477,000 |
| Futures and forward contracts and interest rate and currency swaps: |                |                           |                          |                    |               |               |
| Credit exposure:  |                |                           |                          |                    |               |               |
| Gross replacement value   | \$ 4,500,000   | \$ 817,000                | \$ 258,000               | \$ 120,000         | \$ 5,695,000  | \$ 4,724,000  |
| Master netting arrangements   | (2,327,000)    | (478,000)                 | (124,000)                | (46,000)           | (2,975,000)   | (2,505,000)   |
| Collateral  | (84,000)       | (40,000)                  | (6,000)                  | --                 | (130,000)     | (149,000)     |
| Net replacement value*  | \$ 2,089,000   | \$ 299,000                | \$ 128,000               | \$ 74,000          | \$ 2,590,000  | \$ 2,070,000  |

\*The net replacement value of \$305.2 million with respect to interest rate and currency swaps is presented as a component of unrealized gain on interest rate and currency swaps, options and forward transactions.

(in thousands)

|  | REMAINING LIFE |                           |                          |                    | TOTAL<br>1996 | TOTAL<br>1995 |
|--|----------------|---------------------------|--------------------------|--------------------|---------------|---------------|
|  | ONE<br>YEAR    | TWO THROUGH<br>FIVE YEARS | SIX THROUGH<br>TEN YEARS | AFTER TEN<br>YEARS |               |               |
| Option contracts:                          |                |                           |                          |                    |               |               |
| Contractual amounts for purchased options: |                |                           |                          |                    |               |               |
| Exchange traded                            | \$ 1,533,000   | \$ 94,000                 | \$ --                    | \$ --              | \$ 1,627,000  | \$ 1,258,000  |
| Over the counter                           | 19,419,000     | 3,647,000                 | 923,000                  | --                 | 23,989,000    | 25,279,000    |
| Total                                      | \$20,952,000   | \$3,741,000               | \$ 923,000               | \$ --              | \$25,616,000  | \$26,537,000  |
| Credit exposure for purchased options:     |                |                           |                          |                    |               |               |
| Gross replacement value                    | \$ 475,000     | \$ 192,000                | \$ 69,000                | \$ --              | \$ 736,000    | \$ 706,000    |
| Master netting arrangements                | (162,000)      | (60,000)                  | (9,000)                  | --                 | (231,000)     | (230,000)     |
| Collateral                                 | (16,000)       | (2,000)                   | --                       | --                 | (18,000)      | (17,000)      |
| Net replacement value(a)                   | \$ 297,000     | \$ 130,000                | \$ 60,000                | \$ --              | \$ 487,000    | \$ 459,000    |
| Contractual amounts for sold options(b)    | \$22,880,000   | \$3,801,000               | \$ 946,000               | \$ --              | \$27,627,000  | \$28,080,000  |

(a)The net replacement value with respect to purchased options is presented as a component of spot commodities, at market value.

(b)Options obligate AIGTG to buy or sell the underlying item if the option purchaser chooses to exercise. The amounts do not represent credit exposures.

AIGTG determines counterparty credit quality by reference to ratings from independent rating agencies or internal analysis. At June 30, 1996 and December 31, 1995, the counterparty credit quality by derivative product with respect to the net replacement value of AIGTG's derivatives portfolio was as follows:

(in thousands)

|  | NET REPLACEMENT VALUE   |                                       |               |               |
|--|---|---------------------------------------|---------------|---------------|
|  | FUTURES AND FORWARD CONTRACTS AND<br>INTEREST RATE AND CURRENCY SWAPS | OVER THE COUNTER<br>PURCHASED OPTIONS | TOTAL<br>1996 | Total<br>1995 |
| Counterparty credit quality:   |   |                                       |               |               |
| AAA  | \$ 266,000  | \$ 55,000                             | \$ 321,000    | \$ 214,000    |
| AA   | 835,000   | 182,000                               | 1,017,000     | 906,000       |
| A  | 927,000   | 113,000                               | 1,040,000     | 530,000       |
| BBB  | 274,000   | 56,000                                | 330,000       | 72,000        |
| Below investment grade   | 76,000  | 32,000                                | 108,000       | 22,000        |
| Not externally rated, including<br>exchange traded futures and<br>options* | 212,000   | 49,000                                | 261,000       | 785,000       |
| Total  | \$ 2,590,000  | \$ 487,000                            | \$3,077,000   | \$2,529,000   |

\* Exchange traded futures and options are not deemed to have significant credit exposure as the exchanges guarantee that every contract will be properly settled on a daily basis.

At June 30, 1996 and December 31, 1995, the counterparty breakdown by industry with respect to the net replacement value of AIGTG's derivatives portfolio was as follows:

(in thousands)

|   | NET REPLACEMENT VALUE   |                                       |               |               |
|---|---|---------------------------------------|---------------|---------------|
|   | FUTURES AND FORWARD CONTRACTS AND<br>INTEREST RATE AND CURRENCY SWAPS | OVER THE COUNTER<br>PURCHASED OPTIONS | TOTAL<br>1996 | Total<br>1995 |
| Non-U.S. banks                          | \$ 831,000  | \$ 230,000                            | \$1,061,000   | \$ 834,000    |
| U.S. industrials                        | 599,000   | 19,000                                | 618,000       | 340,000       |
| Governmental                            | 80,000  | 11,000                                | 91,000        | 152,000       |
| Non-U.S. financial service<br>companies | 93,000  | 40,000                                | 133,000       | 258,000       |
| Non-U.S. industrials                    | 170,000   | 20,000                                | 190,000       | 116,000       |
| U.S. banks                              | 325,000   | 38,000                                | 363,000       | 325,000       |
| U.S. financial service companies        | 280,000   | 80,000                                | 360,000       | 231,000       |
| Exchanges*                              | 212,000   | 49,000                                | 261,000       | 273,000       |
| Total                                   | \$ 2,590,000  | \$ 487,000                            | \$3,077,000   | \$2,529,000   |

\* Exchange traded futures and options are not deemed to have significant credit exposure as the exchanges guarantee that every contract will be properly settled on a daily basis.

Generally, AIG manages and operates its businesses in the currencies of the local operating environment. Thus, exchange gains or losses occur when AIG's foreign currency net investment is affected by changes in the foreign exchange rates relative to the U.S. dollar from one reporting period to the next.

As an end user, AIG and its subsidiaries, including its insurance subsidiaries, use derivatives to aid in managing AIG's foreign exchange translation exposure. Derivatives may also be used to minimize certain exposures with respect to AIG's debt financing and insurance investment operations; to date, such activities have been minor.

AIG, through its Foreign Exchange Operating Committee, evaluates its worldwide consolidated net asset or liability positions and manages AIG's translation exposure to adverse movement in currency exchange rates. AIG may use forward exchange contracts and purchase options where the cost of such is reasonable and markets are liquid to reduce these exchange translation exposures. The exchange gain or loss with respect to these hedging instruments is recorded on an accrual basis as a component of the cumulative translation adjustment account in capital funds. AIG's largest currency net investments have had historically stable exchange rates with respect to the U.S. dollar.

Management of AIG's liquidity profile is designed to ensure that, even

under adverse conditions, AIG is able to raise funds at the most economical cost to fund maturing liabilities and capital and liquidity requirements of its subsidiaries. Sources of funds considered in meeting these objectives include guaranteed investment agreements,

issuance of long and short-term debt, maturities and sales of securities available for sale, securities sold under repurchase agreements, trade payables, securities and spot commodities sold but not yet purchased, issuance of equity, and cash provided from operations. AIG's strong capital position is integral to managing liquidity, as it enables AIG to raise funds in diverse markets worldwide. (See also the discussions under "Capital Resources" and "Liquidity" herein.)

Legal risk arises from the uncertainty of the enforceability, through legal or judicial processes, of the obligations of AIG's clients and counterparties, including contractual provisions intended to reduce credit exposure by providing for the netting of mutual obligations. (See also the discussion on master netting agreements above.) AIG seeks to eliminate or minimize such uncertainty through continuous consultation with internal and external legal advisors, both domestically and abroad, in order to understand the nature of legal risk, to improve documentation and to strengthen transaction structure.

Over the counter derivatives are not transacted in an exchange traded environment. The futures exchanges maintain considerable financial requirements and surveillance to ensure the integrity of exchange traded futures and options.

Over the counter derivatives dealers have drafted a code of conduct to provide standards for their industry. The alternative to self-regulation is federal regulation. AIG supports self-regulation and expects to adhere to promulgated standards.

#### ACCOUNTING STANDARDS

In March 1995, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of " (FASB 121). This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and an impairment loss must be recognized.

FASB 121 was effective for AIG commencing January 1, 1996. The adoption of this statement at that date did not have a material impact on AIG's results of operations, financial condition and liquidity.

In June 1996, FASB issued Statement of Financial Accounting Standards No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (FASB 125). This statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. This statement provides consistent standards for distinguishing transfer of financial assets that are sales from transfers that are secured borrowings.

FASB 125 is effective January 1, 1997 and is to be applied prospectively. AIG is currently assessing the impact of this statement and believes FASB 125 will not have a material impact on AIG's results of operations, financial condition and liquidity.

## PART II -- OTHER INFORMATION

## ITEM 4 -- SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Annual Meeting of Shareholders held on May 20, 1996, the Shareholders:

(a) elected fifteen directors as follows:

| NOMINEE<br>-----          | SHARES FOR<br>----- | SHARES WITHHELD<br>----- |
|---------------------------|---------------------|--------------------------|
| M. Bernard Aidinoff       | 434,696,713         | 5,704,228                |
| Lloyd M. Bentsen          | 434,505,286         | 5,895,655                |
| Marshall A. Cohen         | 438,556,327         | 1,844,614                |
| Barber B. Conable,<br>Jr. | 438,586,378         | 1,814,563                |
| Martin Feldstein          | 437,785,982         | 2,614,959                |
| Leslie L. Gonda           | 438,036,868         | 2,364,073                |
| Evan G. Greenberg         | 437,815,869         | 2,585,072                |
| Maurice R. Greenberg      | 437,805,360         | 2,595,581                |
| Carla A. Hills            | 434,713,808         | 5,687,133                |
| Frank J. Hoenemeyer       | 438,424,338         | 1,976,603                |
| Edward E. Matthews        | 437,916,241         | 2,484,700                |
| Dean P. Phypers           | 438,552,124         | 1,848,817                |
| John J. Roberts           | 437,792,546         | 2,608,395                |
| Thomas R. Tizzio          | 437,845,008         | 2,555,933                |
| Edmund S.W. Tse           | 437,902,035         | 2,498,906                |

(b) approved, by a vote of 433,795,245 shares to 4,176,972 shares, with 2,428,724 abstentions, a proposal to adopt a 1996 Employee Stock Purchase Plan;

(c) approved, by a vote of 439,293,568 shares to 371,429 shares, with 735,944 abstentions, a proposal to select Coopers & Lybrand L.L.P. as independent accountants for 1996;

(d) rejected, by a vote of 86,518,423 shares for and 324,467,535 shares against, with 4,291,169 shares abstaining and 25,123,814 shares not voting, a shareholder proposal requesting AIG to change the composition of the Nominating Committee; and

(e) rejected, by a vote of 50,579,684 shares for and 344,714,631 shares against, with 19,982,812 shares abstaining and 25,123,814 shares not voting, a shareholder proposal requesting AIG to provide a report on certain Board matters.

## PART II -- OTHER INFORMATION

## ITEM 6 -- EXHIBITS AND REPORTS ON FORM 8-K

## (a) Exhibits

See accompanying Exhibit Index.

- (b) During the three months ended June 30, 1996, AIG filed a current report on Form 8-K, dated June 11, 1996, which reported that AIG had entered into a distribution agreement pursuant to which AIG may offer certain of its debt securities from time to time.

## SIGNATURES

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/s HOWARD I. SMITH

-----  
Howard I. Smith  
Executive Vice President and  
Comptroller  
(Chief Accounting Officer)

Dated: August 13, 1996

## EXHIBIT INDEX

| EXHIBIT<br>NUMBER | DESCRIPTION  | LOCATION                  |
|-------------------|--|---------------------------|
| 2                 | Plan of acquisition, reorganization, arrangement, liquidation or succession..... | None                      |
| 4                 | Instruments defining the rights of security holders, including indentures.....   | Not required to be filed. |
| 10                | Material contracts.....  | None                      |
| 11                | Statement re computation of per share earnings.....                              | Filed herewith.           |
| 12                | Statement re computation of ratios.....  | Filed herewith.           |
| 15                | Letter re unaudited interim financial information.....                           | None                      |
| 18                | Letter re change in accounting principles.....                                   | None                      |
| 19                | Report furnished to security holders.....  | None                      |
| 22                | Published report regarding matters submitted to vote of security holders.....    | None                      |
| 23                | Consents of experts and counsel.....   | None                      |
| 24                | Power of attorney.....   | None                      |
| 27                | Financial Data Schedule.....   | Provided herewith.        |
| 99                | Additional exhibits.....   | None                      |

## AMERICAN INTERNATIONAL GROUP, INC.

COMPUTATION OF EARNINGS PER SHARE  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

|   | SIX MONTHS ENDED<br>JUNE 30, |             | THREE MONTHS ENDED<br>JUNE 30, |           |
|---|------------------------------|-------------|--------------------------------|-----------|
|   | 1996                         | 1995        | 1996                           | 1995      |
| Average outstanding shares used in the<br>computation of per share earnings(a): |                              |             |                                |           |
| Common stock(b).....  | 506,084                      | 506,086     | 506,084                        | 506,086   |
| Common stock in treasury(b).....  | (33,664)                     | (32,153)    | (34,997)                       | (32,070)  |
|   | -----                        | -----       | -----                          | -----     |
|   | 472,420                      | 473,933     | 471,087                        | 474,016   |
|   | =====                        | =====       | =====                          | =====     |
| Net income (applicable to common<br>stock).....                                 | \$1,395,586                  | \$1,205,941 | \$724,368                      | \$633,785 |
|   | =====                        | =====       | =====                          | =====     |
| Net income per share.....   | \$ 2.95                      | \$ 2.54     | \$ 1.53                        | \$ 1.34   |
|   | =====                        | =====       | =====                          | =====     |

(a) The 1995 share information is adjusted to reflect a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995.

(b) The effects of all other common stock equivalents are not significant.

## AMERICAN INTERNATIONAL GROUP, INC.

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES  
(IN THOUSANDS, EXCEPT RATIOS)

|   | SIX MONTHS ENDED JUNE |             | THREE MONTHS ENDED JUNE |             |
|---|-----------------------|-------------|-------------------------|-------------|
|   | 30,                   | 30,         | 30,                     | 30,         |
|   | 1996                  | 1995        | 1996                    | 1995        |
| Income before income taxes.....                           | \$1,925,779           | \$1,665,089 | \$1,008,024             | \$ 879,295  |
| Less -- Equity income of less than 50% owned persons..... | 56,687                | 41,042      | 30,443                  | 22,741      |
| Add -- Dividends from less than 50% owned persons.....    | 4,981                 | 2,940       | 2,396                   | 1,791       |
|   | 1,874,073             | 1,626,987   | 979,977                 | 858,345     |
| Add --  |                       |             |                         |             |
| Fixed charges.....  | 769,158               | 780,720     | 407,256                 | 411,357     |
| Less --   |                       |             |                         |             |
| Capitalized interest.....                                 | 24,694                | 27,490      | 12,774                  | 13,578      |
| Income before income taxes and fixed charges.....         | \$2,618,537           | \$2,380,217 | \$1,374,459             | \$1,256,124 |
| Fixed charges:  |                       |             |                         |             |
| Interest costs.....                                       | \$ 731,896            | \$ 740,880  | \$ 388,625              | \$ 391,437  |
| Rent expense *.....                                       | 37,262                | 39,840      | 18,631                  | 19,920      |
| Total fixed charges.....                                  | \$ 769,158            | \$ 780,720  | \$ 407,256              | \$ 411,357  |
| Ratio of earnings to fixed charges.....                   | 3.40                  | 3.05        | 3.37                    | 3.05        |

\* The proportion deemed representative of the interest factor.

The ratio shown is significantly affected as a result of the inclusion of the fixed charges and operating results of AIG Financial Products Corp. and its subsidiaries (AIGFP). AIGFP structures borrowings through guaranteed investment agreements and engages in other complex financial transactions, including interest rate and currency swaps. In the course of its business, AIGFP enters into borrowings that are primarily used to purchase assets that yield rates greater than the rates on the borrowings with the intent of earning a profit on the spread and to finance the acquisition of securities utilized to hedge certain transactions. The pro forma ratios of earnings to fixed charges, which exclude the effects of the operating results of AIGFP, are 5.18 and 4.74 for the second quarter and 5.15 and 4.66 for the first six months of 1996 and 1995, respectively. As AIGFP will continue to be a subsidiary, AIG expects that these ratios will continue to be lower than they would be if the fixed charges and operating results of AIGFP were not included therein.

6-MOS  
DEC-31-1996  
JAN-01-1996  
JUN-30-1996  
1  
31,757,797  
11,932,686  
12,395,179  
5,863,533  
2,546,053  
1,182,916  
99,661,471  
97,935  
17,524,787  
6,169,211  
142,715,663  
55,703,956  
7,866,446  
0  
13,623,689  
15,335,400  
0  
0  
1,265,210  
19,125,782  
142,715,663  
10,022,302  
2,150,984  
49,182  
(33,475)  
8,286,822  
864,262  
1,406,526  
1,925,779  
530,193  
1,395,586  
0  
0  
0  
1,395,586  
2.95  
2.95  
19,692,800  
4,393,500  
0  
1,408,900  
2,576,600  
20,100,800  
0