SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 1996

OR

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

For the Transition period from________________________to_______________________

Commission file number 1-8787

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

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

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

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

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

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

| Title of each class |
|---|
| None |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No __________

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

The aggregate market value of the shares of all classes of voting stock of the registrant held by non-affiliates of the registrant on January 31, 1997 was approximately $40,736,413,000 computed upon the basis of the closing sales price of the Common Stock on that date.

As of January 31, 1997, there were outstanding 469,493,068 shares of Common Stock, $2.50 par value, of the registrant.

Documents Incorporated by Reference:

The registrant's definitive proxy statement filed or to be filed with the Securities and Exchange Commission pursuant to Regulation 14A involving the election of directors at the annual meeting of the shareholders of the registrant scheduled to be held on May 21, 1997 is incorporated by reference in Part III of this Form 10-K.

================================================================================



# PART I

================================================================================

## ITEM 1.Business

American International Group, Inc. ("AIG"), a Delaware corporation, is a holding company which through its subsidiaries is primarily engaged in a broad range of insurance and insurance-related activities and financial services in the United States and abroad. AIG's primary activities include both general and life insurance operations. The principal insurance company subsidiaries are American Home Assurance Company ("American Home"), National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union"), New Hampshire Insurance Company ("New Hampshire"), Lexington Insurance Company ("Lexington"), American International Underwriters Overseas, Ltd. ("AIUO"), American Life Insurance Company ("ALICO"), American International Assurance Company, Limited ("AIA"), Nan Shan Life Insurance Company, Ltd. ("Nan Shan"), The Philippine American Life Insurance Company ("PHILAM"), American International Reinsurance Company, Ltd. and United Guaranty Residential Insurance Company. For information on AIG's business segments, see Note 18 of Notes to Financial Statements.

All per share information herein gives retroactive effect to all stock dividends and stock splits. As of January 31, 1997, beneficial ownership of approximately 16.1 percent, 3.4 percent and 2.4 percent of AIG's Common Stock, $2.50 par value ("Common Stock"), was held by Starr International Company, Inc. ("SICO"), The Starr Foundation and C. V. Starr & Co., Inc. ("Starr"), respectively.

At December 31, 1996, AIG and its subsidiaries had approximately 36,600 employees.

The following table shows the general development of the business of AIG on a consolidated basis, the contributions made to AIG's consolidated revenues and operating income and the assets held, in the periods indicated by its general insurance, life insurance, agency and service fee and financial services operations, equity in income of minority-owned insurance companies and other realized capital losses. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes 1 and 18 of Notes to Financial Statements.)

(dollars in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|
| GENERAL INSURANCE OPERATIONS: | | | | | |
| Gross premiums written | $ 18,319,132 | $ 17,895,120 | $ 16,392,409 | $ 14,901,255 | $ 13,615,715 |
| Net premiums written | 12,691,679 | 11,893,022 | 10,865,753 | 10,025,903 | 9,138,528 |
| Net premiums earned | 11,854,815 | 11,405,731 | 10,286,831 | 9,566,640 | 9,209,390 |
| Adjusted underwriting profit (loss) (a) | 398,944 | 361,583 | 147,517 | 10,391 | (195,084) |
| Net investment income | 1,689,371 | 1,545,717 | 1,435,092 | 1,340,480 | 1,252,086 |
| Realized capital gains | 64,985 | 68,075 | 52,487 | 65,264 | 67,134 |
| Operating income | 2,153,300 | 1,975,375 | 1,635,096 | 1,416,135 | 1,124,136 |
| Identifiable assets | 58,702,967 | 56,074,024 | 51,372,100 | 46,981,720 | 42,416,509 |
| Loss ratio | 75.9 | 75.9 | 77.8 | 79.2 | 81.5 |
| Expense ratio | 21.0 | 21.1 | 20.9 | 20.9 | 20.9 |

| | | | | | |
|---|---|---|---|---|---|
| Combined ratio | 96.9 | 97.0 | 98.7 | 100.1 | 102.4 |
| LIFE INSURANCE OPERATIONS: | | | | | |
| Premium income | 8,978,246 | 8,038,150 | 6,724,321 | 5,746,046 | 4,853,087 |
| Net investment income | 2,675,881 | 2,264,905 | 1,748,428 | 1,499,714 | 1,313,838 |
| Realized capital gains | 34,798 | 32,703 | 86,706 | 54,576 | 43,257 |
| Operating income | 1,323,758 | 1,090,605 | 952,484 | 781,611 | 667,453 |
| Identifiable assets | 48,376,033 | 43,280,484 | 34,496,652 | 28,381,164 | 23,472,687 |
| Insurance in-force at end of year | 421,983,133 | 376,097,107 | 333,378,811 | 257,162,102 | 210,605,862 |
| AGENCY AND SERVICE FEE OPERATIONS: | | | | | |
| Commissions, management and other fees | 262,705 | 260,018 | 236,778 | 237,738 | 225,686 |
| Net investment income | 1,427 | 1,855 | 1,162 | 1,903 | 2,611 |
| Operating income | 52,267 | 56,909 | 54,129 | 60,247 | 52,570 |
| Identifiable assets | 88,768 | 149,392 | 184,310 | 179,297 | 157,280 |
| FINANCIAL SERVICES OPERATIONS: | | | | | |
| Commissions, transaction and other fees | 2,555,477 | 2,204,090 | 1,783,239 | 1,529,079 | 1,404,902 |
| Operating income | 523,906 | 417,741 | 404,853 | 390,038 | 346,442 |
| Identifiable assets | 43,861,592 | 36,833,772 | 30,660,776 | 25,514,258 | 27,138,230 |
| EQUITY IN INCOME OF MINORITY-OWNED INSURANCE OPERATIONS | 99,359 | 81,722 | 56,005 | 39,589 | 27,929 |
| OTHER REALIZED CAPITAL LOSSES | (11,792) | (28,944) | (52,340) | (12,742) | (11,293) |
| REVENUES (B) | 28,205,272 | 25,874,022 | 22,358,709 | 20,068,287 | 18,388,627 |
| TOTAL ASSETS | 148,431,002 | 134,136,398 | 114,346,117 | 101,014,848 | 92,722,182 |

(a) Adjusted underwriting profit (loss) is statutory underwriting income (loss) adjusted primarily for changes in deferral of acquisition costs. This adjustment is necessary to present the financial statements in accordance with generally accepted accounting principles.

(b) Represents the sum of general net premiums earned, life premium income, agency commissions, management and other fees, net investment income, financial services commissions, transaction and other fees, equity in income of minority-owned insurance operations and realized capital gains (losses).





The following table shows identifiable assets, revenues and income derived from operations in the United States and Canada and from operations in other countries for the year ended December 31, 1996. (See also Note 18 of Notes to Financial Statements.)

(dollars in thousands)

| | | | | PERCENT OF TOTAL | |
|---|---|---|---|---|---|
| | TOTAL | UNITED STATES AND CANADA | OTHER COUNTRIES | UNITED STATES AND CANADA | OTHER COUNTRIES |
| GENERAL INSURANCE OPERATIONS: | | | | | |
| Net premiums earned | $ 11,854,815 | $ 7,821,605 | $ 4,033,210 | 66.0% | 34.0% |
| Adjusted underwriting profit | 398,944 | 1,039 | 397,905 | 0.3 | 99.7 |
| Net investment income | 1,689,371 | 1,350,159 | 339,212 | 79.9 | 20.1 |
| Realized capital gains | 64,985 | 47,492 | 17,493 | 73.1 | 26.9 |
| Operating income | 2,153,300 | 1,398,690 | 754,610 | 65.0 | 35.0 |
| Identifiable assets | 58,702,967 | 45,134,163 | 13,568,804 | 76.9 | 23.1 |
| LIFE INSURANCE OPERATIONS: | | | | | |
| Premium income | 8,978,246 | 535,579 | 8,442,667 | 6.0 | 94.0 |
| Net investment income | 2,675,881 | 930,350 | 1,745,531 | 34.8 | 65.2 |
| Realized capital gains | 34,798 | 671 | 34,127 | 2.0 | 98.0 |
| Operating income | 1,323,758 | 101,158 | 1,222,600 | 7.6 | 92.4 |
| Identifiable assets | 48,376,033 | 12,183,892 | 36,192,141 | 25.2 | 74.8 |
| AGENCY AND SERVICE FEE OPERATIONS: | | | | | |
| Commissions, management and other fees | 262,705 | 259,701 | 3,004 | 98.9 | 1.1 |
| Net investment income | 1,427 | 1,404 | 23 | 98.4 | 1.6 |
| Operating income | 52,267 | 50,859 | 1,408 | 97.3 | 2.7 |
| Identifiable assets | 88,768 | 88,768 | -- | 100.0 | -- |
| FINANCIAL SERVICES OPERATIONS: | | | | | |
| Commissions, transaction and other fees | 2,555,477 | 2,207,417 | 348,060 | 86.4 | 13.6 |
| Operating income | 523,906 | 372,422 | 151,484 | 71.1 | 28.9 |
| Identifiable assets | 43,861,592 | 37,532,716 | 6,328,876 | 85.6 | 14.4 |
| EQUITY IN INCOME OF MINORITY-OWNED INSURANCE OPERATIONS | 99,359 | 70,143 | 29,216 | 70.6 | 29.4 |
| OTHER REALIZED CAPITAL LOSSES | (11,792) | (9,932) | (1,860) | -- | -- |
| INCOME BEFORE INCOME TAXES | 4,013,222 | 1,877,203 | 2,136,019 | 46.8 | 53.2 |
| REVENUES | 28,205,272 | 13,214,589 | 14,990,683 | 46.9 | 53.1 |
| TOTAL ASSETS | 148,431,002 | 92,088,305 | 56,342,697 | 62.0 | 38.0 |

## GENERAL INSURANCE OPERATIONS

AIG's general insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance. One or more of these companies is licensed to write substantially all of these lines in all states of the United States and in more than 100 foreign countries.

AIG's business derived from brokers in the United States and Canada is conducted through its domestic brokerage group, consisting of American Home, National Union, Lexington and certain other insurance company subsidiaries of AIG. The primary casualty/risk management division of this group provides insurance and risk management programs for large corporate customers. The AIG Risk Finance division designs and implements creative risk financing alternatives using the insurance and financial services capabilities of AIG. Also included are the operations of New Hampshire and its subsidiaries, which focus specifically on providing AIG products and services through brokers to middle market companies, and regional insurance companies which service the commercial middle market.

The domestic brokerage division accepts business mainly from insurance brokers, enabling selection of specialized markets and retention of underwriting control. Any licensed broker is able to submit business to these companies without the traditional agent-company contractual relationship, but such broker usually has no authority to commit the companies to accept a risk.

In addition to writing substantially all classes of business insurance, including large commercial or industrial property insurance, excess liability, inland marine, workers' compensation and excess and umbrella coverages, the domestic brokerage division offers many specialized forms of insurance such as directors and officers liability, difference-in-conditions, kidnap-ransom, export credit and political risk, and various types of professional errors and omissions coverages. Lexington writes surplus lines, those risks for which conventional insurance companies do not readily provide insurance coverage, either because of complexity or because the coverage does not lend itself to conventional contracts.

Audubon Insurance Company and its subsidiaries ("Audubon") conduct agency marketing of personal and small commercial coverages in certain Southern and Western States.

AIG engages in mass marketing of personal lines coverages, primarily private passenger auto, through American International Insurance Company and New Hampshire





Indemnity Company, Inc. as well as through joint ventures with The Robert Plan Corporation and 20th Century Industries.

The business of United Guaranty Corporation ("UGC") and its subsidiaries is also included in the domestic operations of AIG. The principal business of the UGC subsidiaries is the writing of residential mortgage loan insurance, which is guaranty insurance on conventional first mortgage loans on single-family dwellings and condominiums. Such insurance protects lenders against loss if borrowers default. UGC subsidiaries also write home equity and property improvement loan insurance on loans to finance residential property improvements, alterations and repairs and for other purposes not necessarily related to real estate. UGC had approximately $15 billion of mortgage guarantee risk in-force at December 31, 1996.

AIG's foreign general insurance business is comprised primarily of risks underwritten through American International Underwriters ("AIU"), a marketing unit consisting of wholly owned agencies and insurance companies. It also includes business written by foreign-based insurance subsidiaries of AIUO for their own accounts. In general, the same types of policies and marketing methods, with certain refinements for local laws, customs and needs, are used in these foreign operations as have been described above in connection with the domestic operations.

During 1996, domestic general and foreign general insurance business accounted for 65.9 percent and 34.1 percent, respectively, of AIG's net premiums written.

AIG's general insurance company subsidiaries worldwide operate primarily by underwriting and accepting any size risk for their direct account and securing reinsurance on that portion of the risk in excess of the limit which they wish to retain. This operating policy differs from that of many insurance companies which will underwrite only up to their net retention limit, thereby requiring the broker or agent to secure commitments from other underwriters for the remainder of the gross risk amount.

The following table summarizes general insurance premiums written and earned:

(in thousands)

| Years Ended December 31, | Written | Earned |
|---|---|---|
| 1996 | | |
| Gross premiums | $18,319,132 | $17,579,868 |
| Ceded premiums | (5,627,453) | (5,725,053) |
| Net premiums | $12,691,679 | $11,854,815 |
| 1995 | | |
| Gross premiums | $17,895,120 | $17,243,829 |
| Ceded premiums | (6,002,098) | (5,838,098) |
| Net premiums | $11,893,022 | $11,405,731 |
| 1994 | | |
| Gross premiums | $16,392,409 | $15,665,787 |
| Ceded premiums | (5,526,656) | (5,378,956) |
| Net premiums | $10,865,753 | $10,286,831 |

The utilization of reinsurance is closely monitored by an internal reinsurance security committee, consisting of members of AIG's Senior Management. No single reinsurer is a material reinsurer to AIG nor is AIG's business substantially dependent upon any reinsurance contract. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 5 of Notes to Financial Statements.)

AIG is well diversified both in terms of lines of business and geographic locations. Of the general insurance lines of business, workers' compensation was approximately 14 percent of AIG's net premiums written. This line is well diversified geographically and is generally written on a loss sensitive basis which reduces its exposure to material uncertainty or risks.

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





The following table is a summary of the general insurance operations, including ratios, by major operating category for the year ended December 31, 1996. (See also Note 18(b) of Notes to Financial Statements.)

(dollars in thousands)

| | Net Premiums | | Ratio of Losses and Loss Expenses Incurred to Net Premiums Earned | Ratio of Underwriting Expenses Incurred to Net Premiums Written | Combined Ratio |
|---|---|---|---|---|---|
| | Written | Earned | | | |
| Foreign | $ 4,324,847 | $ 4,033,210 | 57.8 | 31.8 | 89.6 |
| Commercial casualty (a) | 6,398,039 | 5,853,271 | 81.2 | 14.7 | 95.9 |

| | | | | | |
|---|---|---|---|---|---|
| Commercial property | 490,644 | 480,388 | 104.6 | 21.2 | 125.8 |
| Pools and associations (b) | 435,127 | 429,565 | 146.4 | 12.2 | 158.6 |
| Personal lines (c) | 725,295 | 734,042 | 85.1 | 15.3 | 100.4 |
| Mortgage guaranty | 317,727 | 324,339 | 47.7 | 24.8 | 72.5 |
| Total | $12,691,679 | $11,854,815 | 75.9 | 21.0 | 96.9 |

(a) Including workers' compensation and retrospectively rated risks.
(b) Including involuntary pools.
(c) Including mass marketing and specialty programs.

Loss and expense ratios of AIG's consolidated general insurance operations are set forth in the following table. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

(dollars in thousands)

| YEARS ENDED DECEMBER 31, | NET PREMIUMS WRITTEN | NET PREMIUMS EARNED | RATIO OF LOSSES AND LOSS EXPENSES INCURRED TO NET PREMIUMS EARNED | RATIO OF UNDERWRITING EXPENSES INCURRED TO NET PREMIUMS WRITTEN | COMBINED RATIO | UNDERWRITING MARGIN | INDUSTRY COMBINED RATIO* |
|---|---|---|---|---|---|---|---|
| 1996 | $12,691,679 | $11,854,815 | 75.9 | 21.0 | 96.9 | 3.1 | 105.5 |
| 1995 | 11,893,022 | 11,405,731 | 75.9 | 21.1 | 97.0 | 3.0 | 106.7 |
| 1994 | 10,865,753 | 10,286,831 | 77.8 | 20.9 | 98.7 | 1.3 | 108.9 |
| 1993 | 10,025,903 | 9,566,640 | 79.2 | 20.9 | 100.1 | (0.1) | 107.9 |
| 1992 | 9,138,528 | 9,209,390 | 81.5 | 20.9 | 102.4 | (2.4) | 119.1 |

* Source: Best's Aggregates & Averages (Stock insurance companies, after dividends to policyholders) and the ratio for 1996 reflects estimated results provided by Conning & Company.

During 1996, of the direct general insurance premiums written (gross premiums less return premiums and cancellations, excluding reinsurance assumed and before deducting reinsurance ceded), 7.6 percent and 7.7 percent were written in California and New York, respectively (no other state accounted for more than 5 percent of such premiums).

There was no significant adverse effect on AIG's results of operations from the economic environments in any one state, country or geographic region for the year ended December 31, 1996.

DISCUSSION AND ANALYSIS OF CONSOLIDATED NET LOSSES AND LOSS EXPENSE RESERVE DEVELOPMENT

The reserve for net losses and loss expenses is exclusive of applicable reinsurance and represents the accumulation of estimates for reported losses ("case basis reserves") and provisions for losses incurred but not reported ("IBNR"). AIG does not discount its loss reserves other than for minor amounts related to certain workers' compensation claims.

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

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

The "Analysis of Consolidated Net Losses and Loss Expense Reserve Development", which follows, presents the development of net losses and loss expense reserves for calendar years 1986 through 1996. The upper half of the table shows the cumulative amounts paid during successive years related to the opening loss reserves. For example, with respect to the net losses and loss expense reserve of $12,958.5 million as of December 31, 1989, by the end of 1996 (seven years later) $11,517.3 million had actually been paid in settlement of these net loss reserves. In addition, as reflected in the lower section of the table, the original reserve of $12,958.5 million was reestimated to be $13,930.7 million at December 31, 1996. This increase from the original estimate would generally be a combination of a number of factors, including reserves being settled for larger amounts than originally estimated. The original estimates will also be increased or decreased as more information becomes known about the individual claims and overall claim frequency and severity patterns. The redundancy (deficiency) depicted in the table, for any particular calendar year, shows the aggregate change in estimates over the period of years subsequent to the calendar year reflected at the top of the respective column heading. For example, the redundancy of $280.0 million at December 31, 1996 related to December 31, 1995 net losses and loss expense reserves of $19,692.8 million represents the cumulative amount by which reserves for 1995 and prior years have developed redundantly during 1996.

Over the past several years, AIG has significantly strengthened its net loss and loss expense reserves with respect to asbestos and environmental losses. This strengthening is the primary cause of the adverse development reflected in certain calendar years in the net loss and loss expense reserves shown in the following table.

ANALYSIS OF CONSOLIDATED NET LOSSES AND
LOSS EXPENSE RESERVE DEVELOPMENT

(in millions)

| | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Reserve for Net Losses and Loss Expenses, December 31, | $6,199.3 | $8,670.7 | $11,086.1 | $12,958.5 | $14,699.2 | $15,839.9 | $16,756.8 | $17,557.0 | $18,418.9 |
| Paid (Cumulative) as of: | | | | | | | | | |
| One Year Later | 2,300.1 | 2,619.2 | 3,266.9 | 3,940.3 | 4,315.2 | 4,747.8 | 4,882.7 | 5,146.3 | 4,775.0 |
| Two Years Later | 3,676.4 | 4,315.9 | 5,451.5 | 6,476.6 | 7,349.7 | 8,015.4 | 8,289.4 | 8,241.7 | 8,072.6 |
| Three Years Later | 4,340.7 | 5,496.6 | 6,904.5 | 8,350.8 | 9,561.0 | 10,436.2 | 10,433.1 | 10,403.5 | |
| Four Years Later | 4,919.1 | 6,207.5 | 7,966.2 | 9,721.3 | 11,223.5 | 11,814.8 | 11,718.1 | | |
| Five Years Later | 5,260.3 | 6,757.2 | 8,792.1 | 10,764.8 | 12,111.6 | 12,611.4 | | | |
| Six Years Later | 5,593.1 | 7,246.1 | 9,449.6 | 11,284.8 | 12,614.9 | | | | |
| Seven Years Later | 5,902.7 | 7,616.7 | 9,737.0 | 11,517.3 | | | | | |
| Eight Years Later | 6,113.2 | 7,771.9 | 9,813.0 | | | | | | |
| Nine Years Later | 6,183.0 | 7,764.7 | | | | | | | |
| Ten Years Later | 6,123.7 | | | | | | | | |
| Net Liability Reestimated as of: | | | | | | | | | |
| End of Year | 6,199.3 | 8,670.7 | 11,086.1 | 12,958.5 | 14,699.2 | 15,839.9 | 16,756.8 | 17,557.0 | 18,418.9 |
| One Year Later | 6,268.3 | 8,523.6 | 10,923.8 | 12,844.5 | 14,596.2 | 15,828.1 | 16,807.0 | 17,434.3 | 18,138.5 |
| Two Years Later | 6,354.3 | 8,492.4 | 10,856.9 | 12,843.9 | 14,595.4 | 15,902.9 | 16,603.4 | 17,479.1 | 18,268.9 |
| Three Years Later | 6,397.5 | 8,488.1 | 10,811.9 | 12,809.2 | 14,723.7 | 15,989.7 | 16,778.3 | 17,781.7 | |
| Four Years Later | 6,491.1 | 8,472.3 | 10,774.9 | 12,896.4 | 14,965.4 | 16,254.2 | 17,181.7 | | |
| Five Years Later | 6,531.2 | 8,472.0 | 10,805.1 | 13,064.6 | 15,361.2 | 16,712.4 | | | |
| Six Years Later | 6,598.0 | 8,470.0 | 10,953.6 | 13,426.0 | 15,844.5 | | | | |
| Seven Years Later | 6,681.0 | 8,577.4 | 11,301.5 | 13,930.7 | | | | | |
| Eight Years Later | 6,770.0 | 8,912.3 | 11,798.9 | | | | | | |
| Nine Years Later | 7,074.5 | 9,391.1 | | | | | | | |
| Ten Years Later | 7,546.4 | | | | | | | | |
| Redundancy/(Deficiency) | (1,347.1) | (720.4) | (712.8) | (972.2) | (1,145.3) | (872.5) | (424.9) | (224.7) | 150.0 |

(in millions)

| | 1995 | 1996 |
|---|---|---|
| Reserve for Net Losses and Loss Expenses, December 31, | $19,692.8 | $20,407.3 |
| Paid (Cumulative) as of: | | |
| One Year Later | 5,281.4 | |
| Two Years Later | | |
| Three Years Later | | |
| Four Years Later | | |
| Five Years Later | | |
| Six Years Later | | |
| Seven Years Later | | |
| Eight Years Later | | |

| | | |
|---|---|---|
| Nine Years Later | | |
| Ten Years Later | | |
| Net Liability Reestimated as of: | | |
| End of Year | 19,692.8 | 20,407.3 |
| One Year Later | 19,412.8 | |
| Two Years Later | | |
| Three Years Later | | |
| Four Years Later | | |
| Five Years Later | | |
| Six Years Later | | |
| Seven Years Later | | |
| Eight Years Later | | |
| Nine Years Later | | |
| Ten Years Later | | |
| Redundancy/(Deficiency) | 280.0 | |





The following table excludes for each calendar year the net loss and loss expense reserves and the development thereof with respect to asbestos and environmental claims. Thus, AIG's loss and loss expense reserves excluding asbestos and environmental claims are developing adequately. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

ANALYSIS OF CONSOLIDATED NET LOSSES AND LOSS EXPENSE RESERVE DEVELOPMENT EXCLUDING ASBESTOS AND ENVIRONMENTAL NET LOSSES AND LOSS EXPENSE RESERVE DEVELOPMENT.

(in millions)

| | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Reserve for Net Losses and Loss Expenses, Excluding Asbestos and Environmental Losses and Loss Expenses, December 31, | $6,199.3 | $8,630.6 | $11,005.9 | $12,838.3 | $14,538.9 | $15,639.5 | $16,503.4 | $17,248.7 | $18,088.6 |
| Paid (Cumulative) as of: | | | | | | | | | |
| One Year Later | 2,300.1 | 2,619.2 | 3,266.9 | 3,940.3 | 4,259.7 | 4,690.8 | 4,766.1 | 5,060.9 | 4,699.6 |
| Two Years Later | 3,676.4 | 4,315.9 | 5,451.5 | 6,422.0 | 7,237.4 | 7,842.0 | 8,087.9 | 8,081.5 | 7,890.5 |
| Three Years Later | 4,340.7 | 5,496.6 | 6,850.5 | 8,240.1 | 9,332.8 | 10,178.1 | 10,157.3 | 10,137.0 | |
| Four Years Later | 4,919.1 | 6,155.7 | 7,856.9 | 9,495.6 | 10,911.6 | 11,482.9 | 11,336.9 | | |
| Five Years Later | 5,208.9 | 6,655.0 | 8,569.4 | 10,456.3 | 11,726.6 | 12,174.8 | | | |
| Six Years Later | 5,493.3 | 7,032.7 | 9,145.1 | 10,904.3 | 12,125.9 | | | | |
| Seven Years Later | 5,709.9 | 7,322.1 | 9,361.6 | 11,033.5 | | | | | |
| Eight Years Later | 5,841.1 | 7,407.3 | 9,338.8 | | | | | | |
| Nine Years Later | 5,845.4 | 7,306.3 | | | | | | | |
| Ten Years Later | 5,698.7 | | | | | | | | |
| Net Liability Reestimated as of: | | | | | | | | | |
| End of Year | 6,199.3 | 8,630.6 | 11,005.9 | 12,838.3 | 14,538.9 | 15,639.5 | 16,503.4 | 17,248.7 | 18,088.6 |
| One Year Later | 6,228.2 | 8,443.4 | 10,803.6 | 12,684.2 | 14,340.7 | 15,518.4 | 16,382.3 | 17,019.2 | 17,556.0 |
| Two Years Later | 6,274.1 | 8,372.2 | 10,696.6 | 12,590.9 | 14,231.6 | 15,422.4 | 16,072.6 | 16,812.6 | 17,355.2 |
| Three Years Later | 6,277.3 | 8,327.8 | 10,562.2 | 12,449.4 | 14,190.1 | 15,402.9 | 15,996.7 | 16,790.0 | |
| Four Years Later | 6,330.8 | 8,227.0 | 10,419.9 | 12,367.5 | 14,326.7 | 15,416.9 | 16,081.1 | | |
| Five Years Later | 6,289.4 | 8,127.6 | 10,282.2 | 12,430.8 | 14,472.0 | 15,562.1 | | | |
| Six Years Later | 6,260.8 | 7,961.4 | 10,325.8 | 12,544.1 | 14,648.3 | | | | |
| Seven Years Later | 6,197.2 | 7,962.8 | 10,429.9 | 12,747.8 | | | | | |
| Eight Years Later | 6,181.2 | 8,056.3 | 10,635.4 | | | | | | |
| Nine Years Later | 6,248.8 | 8,254.5 | | | | | | | |
| Ten Years Later | 6,453.3 | | | | | | | | |
| Redundancy/(Deficiency): | (254.0) | 376.1 | 370.5 | 90.5 | (109.4) | 77.4 | 422.3 | 458.7 | 733.4 |

(in millions)

| | 1995 | 1996 |
|---|---|---|
| Reserve for Net Losses and Loss Expenses, Excluding Asbestos and Environmental Losses and Loss Expenses, December 31, | $19,185.6 | $19,664.4 |
| Paid (Cumulative) as of: | | |

| | | |
|---|---|---|
| One Year Later | 5,174.1 | |
| Two Years Later | | |
| Three Years Later | | |
| Four Years Later | | |
| Five Years Later | | |
| Six Years Later | | |
| Seven Years Later | | |
| Eight Years Later | | |
| Nine Years Later | | |
| Ten Years Later | | |
| Net Liability Reestimated as of: | | |
| End of Year | 19,185.6 | 19,664.4 |
| One Year Later | 18,567.7 | |
| Two Years Later | | |
| Three Years Later | | |
| Four Years Later | | |
| Five Years Later | | |
| Six Years Later | | |
| Seven Years Later | | |
| Eight Years Later | | |
| Nine Years Later | | |
| Ten Years Later | | |
| Redundancy/(Deficiency): | 617.9 | |

RECONCILIATION OF NET RESERVE FOR LOSSES AND LOSS EXPENSES

(in millions)

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Net reserve for losses and loss expenses at beginning of year | $19,692.8 | $18,418.9 | $17,557.0 |
| Losses and loss expenses incurred: | | | |
| Current year | 9,272.4 | 8,935.4 | 8,158.4 |
| Prior years* | (276.0) | (275.6) | (152.8) |
| | 8,996.4 | 8,659.8 | 8,005.6 |
| Losses and loss expenses paid: | | | |
| Current year | 3,000.5 | 2,610.9 | 1,997.4 |
| Prior years | 5,281.4 | 4,775.0 | 5,146.3 |
| | 8,281.9 | 7,385.9 | 7,143.7 |
| Net reserve for losses and loss expenses at end of year | $20,407.3 | $19,692.8 | $18,418.9 |

* Does not include the effects of foreign exchange adjustments which are reflected in the "Net Losses and Loss Expense Reserve Development" table.

Approximately 45 percent of the net losses and loss expense reserves are paid out within two years of the date incurred. The remaining net losses and loss expense reserves, particularly those associated with the casualty lines of business, may extend to 20 years or more.

For further discussion regarding net reserves for losses and loss expenses, see Management's Discussion and Analysis of Financial Condition and Results of Operations.





The reserve for losses and loss expenses as reported in AIG's Consolidated

Balance Sheet at December 31, 1996, differs from the total reserve reported in the Annual Statements filed with state insurance departments and, where appropriate, with foreign regulatory authorities. The difference at December 31, 1996 is primarily because of minor discounting on certain workers' compensation claims, estimates for unrecoverable reinsurance and additional reserves relating to certain foreign operations. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

The reserve for gross losses and loss expenses is prior to reinsurance and represents the accumulation for reported losses and IBNR. Management reviews the adequacy of established gross loss reserves in the manner previously described for net loss reserves.

The "Analysis of Consolidated Gross Losses and Loss Expense Reserve Development", which follows, presents the development of gross losses and loss expense reserves for calendar years 1992 through 1996. As with the net losses and loss expense reserve development, the deficiencies of $468.2 million and $315.8 million for 1992 and 1993, and redundancies of $475.4 million and $675.0 million for 1994 and 1995, respectively, are relatively insignificant both in terms of an aggregate amount and as a percentage of the initial reserve balance.

ANALYSIS OF CONSOLIDATED GROSS LOSSES AND
LOSS EXPENSE RESERVE DEVELOPMENT
(in millions)

| | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|
| Gross losses and loss expenses, December 31, | $28,156.8 | $30,046.2 | $31,435.4 | $33,046.7 | $33,429.8 |
| Paid (cumulative) as of: | | | | | |
| One Year Later | 7,280.9 | 8,807.1 | 7,640.0 | 8,392.1 | |
| Two Years Later | 13,006.0 | 13,278.7 | 13,035.8 | | |
| Three Years Later | 16,432.3 | 17,311.4 | | | |
| Four Years Later | 18,550.0 | | | | |
| Gross Liability Reestimated as of: | | | | | |
| End of Year | 28,156.8 | 30,046.2 | 31,435.4 | 33,046.7 | 33,429.8 |
| One Year Later | 28,253.4 | 29,865.9 | 30,758.9 | 32,371.7 | |
| Two Years Later | 27,824.8 | 29,536.5 | 30,960.0 | | |
| Three Years Later | 27,726.8 | 30,362.0 | | | |
| Four Years Later | 28,625.0 | | | | |
| Redundancy/(Deficiency) | (468.2) | (315.8) | 475.4 | 675.0 | |

LIFE INSURANCE OPERATIONS

AIG's life insurance subsidiaries offer a wide range of traditional insurance and financial and investment products. One or more of these subsidiaries is licensed to write life insurance in all states in the United States and in over 70 foreign countries. Traditional products consist of individual and group life, annuity, and accident and health policies. Financial and investment products consist of single premium annuity, variable annuities, guaranteed investment contracts, universal life and pensions. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

In the United States, AIG has four domestic life subsidiaries: American International Life Assurance Company of New York, AIG Life Insurance Company, Delaware American Life Insurance Company, and Pacific Union Assurance Company. These companies utilize multiple distribution channels including brokerage and career and general agents to offer primarily financial and investment products and specialty forms of accident and health coverage for individuals and groups, including employee benefit plans. The domestic life business comprised 6.0 percent of total life premium income in 1996.

Life insurance operations in foreign countries comprised 94.0 percent of life premium income and 92.4 percent of operating income in 1996. AIG operates overseas principally through four subsidiary companies, ALICO, AIA , Nan Shan and PHILAM. Although ALICO is incorporated in Delaware, all of its business is written outside of the United States. ALICO has operations either directly or through subsidiaries in approximately 50 countries located in Europe, Africa, Latin America, the Caribbean, the Middle East, and the Far East, with Japan being the largest territory. AIA operates primarily in Hong Kong, Singapore, Malaysia and Thailand. Nan Shan operates in Taiwan while PHILAM operates in the Philippines.

Traditional life insurance products such as whole life and endowment continue to be significant in the overseas companies, especially in Southeast Asia, while a mixture of traditional, accident and health and financial products are sold in Japan.

In addition to the above, AIG also has subsidiary operations in Switzerland (Ticino Societa d'Assicurazioni Sulla Vita), Puerto Rico (AIG Life Insurance Company of Puerto Rico) and conducts life insurance business through AIUO subsidiary companies in certain countries in Central and South America.

The foreign life companies have approximately 110,000 career agents and sell their products largely to indigenous persons in local currencies. In addition to the agency outlets, these companies also distribute their products through direct marketing channels, such as mass marketing, and through brokers and other distribution outlets such as financial institutions.





The following table summarizes the life insurance operating results for the year ended December 31, 1996. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

(dollars in thousands)

| | PREMIUM INCOME | NET INVESTMENT INCOME | OPERATING INCOME(A) | DIRECT INSURANCE IN-FORCE | AVERAGE TERMINATION RATE LAPSE | OTHER |
|---|---|---|---|---|---|---|
| Individual: | | | | | | |
| Life | $ 6,815,334 | $ 1,873,011 | $ 827,906 | $325,857,244(b) | 6.9% | 1.5% |
| Annuity | 121,227 | 424,664 | 57,088 | (c) | | |
| Accident and health | 1,151,520 | 96,351 | 304,574 | (c) | | |
| Group: | | | | | | |
| Life | 375,896 | 25,114 | 50,124 | 96,125,889 | 10.8% | 5.4% |
| Pension | 102,544 | 244,268 | 27,099 | (c) | | |
| Accident and health | 411,725 | 22,611 | 32,307 | (c) | | |
| Realized capital gains | -- | -- | 34,798 | (c) | | |
| Consolidation adjustments | -- | (10,138) | (10,138) | (c) | | |
| Total | $ 8,978,246 | $ 2,675,881 | $ 1,323,758 | $421,983,133 | | |

(a) Including income related to investment type products.
(b) Including $222.5 billion of whole life insurance and endowments.
(c) Not applicable.

INSURANCE INVESTMENT OPERATIONS

A significant portion of AIG's general and life operating revenues are derived from AIG's insurance investment operations. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes 1, 2, 8 and 18 of Notes to Financial Statements.)

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

(dollars in thousands)

| | General | Life | Total | Percent of Total | Percent Distribution Domestic | Foreign |
|---|---|---|---|---|---|---|
| Fixed maturities: | | | | | | |
| Available for sale, at market value(a) | $ 9,713,937 | $26,058,027 | $35,771,964 | 53.2% | 34.6% | 65.4% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Held to maturity, at amortized cost(b) | 12,736,225 | -- | 12,736,225 | 18.9 | 100.0 | -- |
| Equity securities, at market value(c) | 3,265,756 | 2,608,309 | 5,874,065 | 8.7 | 33.9 | 66.1 |
| Mortgage loans on real estate, policy and collateral loans | 50,578 | 6,224,878 | 6,275,456 | 9.3 | 43.1 | 56.9 |
| Short-term investments, including time deposits, and cash | 598,076 | 1,002,060 | 1,600,136 | 2.4 | 19.0 | 81.0 |
| Real estate | 409,808 | 843,933 | 1,253,741 | 1.9 | 18.2 | 81.8 |
| Investment income due and accrued | 493,338 | 697,891 | 1,191,229 | 1.8 | 44.4 | 55.6 |
| Other invested assets | 1,511,135 | 1,056,772 | 2,567,907 | 3.8 | 51.6 | 48.4 |
| Total | $28,778,853 | $38,491,870 | $67,270,723 | 100.0% | 47.9% | 52.1% |

(a) Includes $364,069 of bonds trading securities, at market value.
(b) Includes $477,247 of preferred stocks, at amortized cost.
(c) Includes $46,732 of preferred stocks, at market value.

The following table summarizes the investment results of the general insurance operations. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 8 of Notes to Financial Statements.)

(dollars in thousands)

| | Annual Average Cash and Invested Assets | | | | | | |
|---|---|---|---|---|---|---|---|
| Years Ended December 31, | Cash (including short-term investments) | Invested Assets(a) | Total | Net Investment Income(b) | Rate of Return on Invested Assets | | Realized Capital Gains |
| 1996 | $ 617,393 | $27,047,250 | $27,664,643 | $1,689,371 | 6.1%(c) | 6.2%(d) | $64,985 |
| 1995 | 795,805 | 24,415,940 | 25,211,745 | 1,545,717 | 6.1 (c) | 6.3 (d) | 68,075 |
| 1994 | 1,387,704 | 21,836,228 | 23,223,932 | 1,435,092 | 6.2 (c) | 6.6 (d) | 52,487 |
| 1993 | 1,779,647 | 19,766,959 | 21,546,606 | 1,340,480 | 6.2 (c) | 6.8 (d) | 65,264 |
| 1992 | 1,766,031 | 18,285,417 | 20,051,448 | 1,252,086 | 6.2 (c | 6.8 (d) | 67,134 |

(a) Including investment income due and accrued and real estate.
(b) Net investment income is after deduction of investment expenses and excludes realized capital gains.
(c) Net investment income divided by the annual average sum of cash and invested assets.
(d) Net investment income divided by the annual average invested assets.





The following table summarizes the investment results of the life insurance operations. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 8 of Notes to Financial Statements.)

(dollars in thousands)

| | ANNUAL AVERAGE CASH AND INVESTED ASSETS | | | | | | |
|---|---|---|---|---|---|---|---|
| YEARS ENDED DECEMBER 31, | CASH (INCLUDING SHORT-TERM INVESTMENTS) | INVESTED ASSETS(A) | TOTAL | NET INVESTMENT INCOME(B) | RATE OF RETURN ON INVESTED ASSETS | | REALIZED CAPITAL GAINS |
| 1996 | $1,116,938 | $35,563,517 | $36,680,455 | $2,675,881 | 7.3%(c) | 7.5%(d) | $34,798 |
| 1995 | 1,222,375 | 29,557,181 | 30,779,556 | 2,264,905 | 7.4 (c) | 7.7 (d) | 32,703 |
| 1994 | 2,045,747 | 22,317,914 | 24,363,661 | 1,748,428 | 7.2 (c) | 7.8 (d) | 86,706 |
| 1993 | 2,697,282 | 17,286,171 | 19,983,453 | 1,499,714 | 7.5 (c) | 8.7 (d) | 54,576 |
| 1992 | 2,304,043 | 14,190,868 | 16,494,911 | 1,313,838 | 8.0 (c) | 9.3 (d) | 43,257 |

(a) Including investment income due and accrued and real estate.
(b) Net investment income is after deduction of investment expenses and excludes realized capital gains.
(c) Net investment income divided by the annual average sum of cash and invested assets.
(d) Net investment income divided by the annual average invested assets.

AIG's worldwide insurance investment policy places primary emphasis on investments in high quality, fixed income securities in all of its portfolios and, to a lesser extent, investments in marketable common stocks in order to preserve policyholders' surplus and generate net investment income. The ability to implement this policy is somewhat limited in certain territories as there may be a lack of qualified long term investments or investment restrictions may be imposed by the local regulatory authorities. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

AGENCY AND SERVICE FEE OPERATIONS

AIG's agency and service fee operations contribute to AIG earnings through fees as agents and managers, the premiums they generate for AIG's insurance companies and the revenues they produce from technical and support service activities.

Several AIG companies act as managing general agents for both AIG subsidiaries and non-affiliated insurance companies, accepting liability on risks and actively managing the business produced. These general agencies deal directly with the producing agents and brokers, exercise full underwriting control, issue policies, collect premiums, arrange reinsurance, perform accounting, actuarial and safety and loss control services, adjust and pay losses and claims, and settle net balances with the represented companies. In some cases, they also maintain their own and the represented companies' authority to do business in the jurisdictions in which they operate.

Agency and service fee operations are conducted primarily through AIG Risk Management, Inc., which provides risk management services to independent insurance agents, brokers and their customers on a worldwide basis and AIG Aviation, Inc., which sells aviation insurance. AIG Reinsurance Advisors, Inc. provides access to structured reinsurance for insurers and reinsurers worldwide.

FINANCIAL SERVICES OPERATIONS

AIG operations which contribute to financial services income include primarily A.I. Credit Corp. ("AICCO"), AIG Financial Products Corp. and its subsidiary companies ("AIGFP"), AIG Trading Group Inc. and its subsidiaries ("AIGTG"), International Lease Finance Corporation ("ILFC") and UeberseeBank AG. AICCO's business is principally in premium financing. AIGFP structures financial transactions, including long-dated interest rate and currency swaps and structures borrowings through notes, bonds and guaranteed investment agreements. AIGTG engages in various commodities trading, foreign exchange trading and market making activities. ILFC is engaged primarily in the acquisition of new and used commercial jet aircraft and the leasing and remarketing of such aircraft to airlines around the world. UeberseeBank AG operates as a Swiss bank. Other financial services operations are AIG Global Investment Corp., which manages the investment portfolios of various AIG subsidiaries, as well as third-party assets. AIG Asset Management Services, Inc. and AIG Capital Partners, Inc. are responsible for product design and origination, as well as marketing and distribution of third-party asset management products, including retail mutual funds and direct investment products. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes 1, 9 and 11 of Notes to Financial Statements.)





The following table is a summary of the composition of AIG's financial services invested assets and liabilities at December 31, 1996. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1 of Notes to Financial Statements.)

| (in thousands) | |
|---|---|
| Financial services invested assets: | |
| Flight equipment primarily under operating leases, net of accumulated depreciation | $13,808,660 |
| Securities available for sale, at market value | 9,785,909 |
| Trading securities, at market value | 2,357,812 |
| Spot commodities, at market value | 204,705 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 6,906,012 |
| Securities purchased under agreements to resell, | |

| | |
|---|---|
| at contract value | 1,642,591 |
| Trading assets | 3,793,433 |
| Other, including short-term investments | 2,439,749 |
| Total financial services invested assets | $40,938,871 |
| Financial services liabilities: | |
| Borrowings under obligations of guaranteed investment agreements | $ 5,723,228 |
| Securities sold under agreements to repurchase, at contract value | 3,039,423 |
| Trading liabilities | 3,313,508 |
| Securities and spot commodities sold but not yet purchased, at market value | 1,568,542 |
| Unrealized loss on interest rate and currency swaps, options and forward transactions | 5,414,433 |
| Deposits due to banks and other depositors | 1,206,374 |
| Commercial paper | 2,739,388 |
| Notes, bonds and loans payable | 12,312,805 |
| Total financial services liabilities | $35,317,701 |

The following table is a summary of the revenues and operating income of AIG's financial services operations for the year ended December 31, 1996. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1 of Notes to Financial Statements.)

| (in thousands) | Revenues | Operating Income |
|---|---|---|
| ILFC | $1,560,228 | $306,853 |
| AIGFP* | 369,194 | 189,157 |
| AIGTG* | 288,551 | 80,156 |
| Other | 337,504 | (52,260) |
| Total financial service revenues | $2,555,477 | $523,906 |

* Represents net trading revenues.

Other financial services activities include AIG's 30 percent interest in AB Asesores CFMB, S.L., a Spanish brokerage, investment banking and private investment management firm, and certain investment management and venture capital operations in various overseas financial services sectors.

OTHER OPERATIONS

Small AIG subsidiaries provide insurance-related services such as adjusting claims and marketing specialized products. AIG has several other relatively minor subsidiaries which carry on various businesses. American International Technology Enterprises, Inc. provides information technology and processing services to businesses worldwide. Mt. Mansfield Company, Inc. owns and operates the ski slopes, lifts, school and an inn located at Stowe, Vermont.

ADDITIONAL INVESTMENTS

As of March 14, 1997, AIG holds a 49.1 percent interest in Transatlantic Holdings, Inc., a reinsurance holding company, and a 19.9 percent interest in Richmond Insurance Company, Ltd., a reinsurer. (See also Note 1(n) of Notes to Financial Statements.) AIG holds a 23.9 percent interest in SELIC Holdings, Ltd., an insurance holding company and a 24.4 percent interest in IPC Holdings, Ltd., a reinsurance holding company. Other significant investments include minority positions in The Robert Plan Corporation and 20th Century Industries.

LOCATIONS OF CERTAIN ASSETS

As of December 31, 1996, approximately 38 percent of the consolidated assets of AIG were located in foreign countries (other than Canada), including $1.10 billion of cash and securities on deposit with foreign regulatory authorities. Foreign operations and assets held abroad may be adversely affected by political developments in foreign countries, including such possibilities as tax changes, nationalization and changes in regulatory policy, as well as by consequence of hostilities and unrest. The risks of such occurrences and their overall effect upon AIG vary from country to country and cannot easily be predicted. If expropriation or nationalization does occur, AIG's policy is to take all appropriate measures to seek recovery of such assets. Certain of the countries in which AIG's business is conducted have currency restrictions which generally cause a delay in a company's ability to repatriate assets and profits. (See also Notes 1, 2 and 18 of Notes to Financial Statements.)

INSURANCE REGULATION AND COMPETITION

Certain states require registration and periodic reporting by insurance companies which are licensed in such states and are controlled by other corporations. Applicable legislation typically requires periodic disclosure concerning the corporation which controls the registered insurer and the other companies in the holding company system and prior approval of intercorporate transfers of assets (including in some instances payment of dividends by the insurance subsidiary) within the holding company system. AIG's subsidiaries are registered under such legislation in those states which have such requirements. (See also Note 10 of Notes to Financial Statements.)

AIG's insurance subsidiaries, in common with other insurers, are subject to regulation and supervision by the states and by other jurisdictions in which they do business. Within the United States, the method of such regulation varies but generally has its source in statutes that delegate regulatory and supervisory powers to an insurance official. The regulation and supervision relate primarily to approval of policy forms and rates, the standards of solvency that must be met and maintained, including risk based capital measurements, the licensing of insurers and their agents, the nature of and limitations on investments, restrictions on the





size of risks which may be insured under a single policy, deposits of securities for the benefit of policyholders, methods of accounting, periodic examinations of the affairs of insurance companies, the form and content of reports of financial condition required to be filed, and reserves for unearned premiums, losses and other purposes. In general, such regulation is for the protection of policyholders rather than security holders. (See also Management's Discussion and Analysis of Financial Condition and Results of Operations.)

Risk Based Capital (RBC) is designed to measure the adequacy of an insurer's statutory surplus in relation to the risks inherent in its business. Thus, inadequately capitalized general and life insurance companies may be identified.

The RBC formula develops a risk adjusted target level of adjusted statutory capital by applying certain factors to various asset, premium and reserve items. Higher factors are applied to more risky items and lower factors are applied to less risky items. Thus, the target level of statutory surplus varies not only as a result of the insurer's size, but also on the risk profile of the insurer's operations.

The RBC Model Law provides for four incremental levels of regulatory attention for insurers whose surplus is below the calculated RBC target. These levels of attention range in severity from requiring the insurer to submit a plan for corrective action to actually placing the insurer under regulatory control.

The statutory surplus of each of AIG's domestic general and life insurance subsidiaries exceeded their RBC standards by considerable margins as of December 31, 1996.

To the extent that any of AIG's insurance entities would fall below prescribed levels of surplus, it would be AIG's intention to infuse necessary capital to support that entity.

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. Licenses issued by foreign authorities to AIG subsidiaries are subject to modification or revocation by such authorities, and AIU or other AIG subsidiaries could be prevented from conducting business in certain of the jurisdictions where they currently operate. In the past, AIU has been allowed to modify its operations to conform with new licensing requirements in most jurisdictions.

In addition to licensing requirements, AIG's foreign operations are also regulated in various jurisdictions with respect to currency, policy language and terms, amount and type of security deposits, amount and type of reserves, amount and type of local investment and the share of profits to be returned to policyholders on participating policies. Some foreign countries regulate rates in various types of policies. Certain countries have established reinsurance institutions, wholly or partially owned by the state, to which admitted insurers are obligated to cede a portion of their business on terms which do not always allow foreign insurers, including AIG, full compensation. Regulations governing constitution of technical reserves and remittance balances in some countries may hinder remittance of profits and repatriation of assets.

The insurance industry is highly competitive. Within the United States, AIG's general insurance subsidiaries compete with approximately 4,300 other stock companies, specialty insurance organizations, mutual companies and other underwriting organizations. AIG's life insurance companies compete in the United States with some 1,600 life insurance companies and other participants in related financial service fields. Overseas, AIG subsidiaries compete for business with foreign insurance operations of the larger U.S. insurers and local companies in particular areas in which they are active.

AIG's financial services subsidiaries, particularly AIGTG and AIGFP, operate in a highly competitive environment, both domestically and overseas. Principal sources of competition are banks, investment banks and other non-bank financial institutions.

ITEM 2.PROPERTIES

AIG and its subsidiaries operate from approximately 250 offices in the United States, 5 offices in Canada and numerous offices in other foreign countries. The offices in Springfield, Illinois; Houston, Texas; Atlanta, Georgia; Baton Rouge, Louisiana; Wilmington, Delaware; Hato Rey, Puerto Rico; San Diego, California; Greensboro, North Carolina; Livingston, New Jersey; 70 Pine Street, 72 Wall Street and 175 Water Street in New York City; and offices in approximately 30 foreign countries including Bermuda, Hong Kong, the Philippines, Japan, England, Singapore, Taiwan and Thailand are located in buildings owned by AIG and its subsidiaries. The remainder of the office space utilized by AIG subsidiaries is leased.

ITEM 3.LEGAL PROCEEDINGS

AIG and its subsidiaries, in common with the insurance industry in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. AIG does not believe that such litigation will have a material adverse effect on its financial condition, future operating results or liquidity. (See also the Discussion and Analysis of Consolidated Net Losses and Loss Expense Reserve Development and Management's Discussion and Analysis of Financial Condition and Results of Operations.)

ITEM 4.SUBMISSION OF MATTERS TO A
VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of 1996.





DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below is certain information concerning the directors and executive officers of AIG. All directors are elected at the annual meeting of shareholders. All officers serve at the pleasure of the Board of Directors, but subject to the foregoing, are elected for terms of one year expiring in May of each year.

| Name | Title | Age | Served as Director or Officer Since |
|---|---|---|---|
| M. Bernard Aidinoff* | Director | 68 | 1984 |
| Lloyd M. Bentsen | Director | 76 | 1995 |
| Pei-yuan Chia | Director | 58 | 1996 |
| Marshall A. Cohen | Director | 61 | 1992 |
| Barber B. Conable, Jr. | Director | 74 | 1991 |
| Martin S. Feldstein | Director | 57 | 1987 |
| Leslie L. Gonda | Director | 77 | 1990 |
| Evan G. Greenberg | Director and Executive Vice President-Foreign General Insurance | 42 | 1995 |
| M. R. Greenberg* | Director, Chairman, and Chief Executive Officer | 71 | 1967 |
| Carla A. Hills | Director | 63 | 1993 |
| Frank J. Hoenemeyer* | Director | 77 | 1985 |
| Edward E. Matthews* | Director and Vice Chairman-Investments and Financial Services | 65 | 1973 |
| Dean P. Phypers | Director | 68 | 1979 |
| John J. Roberts* | Director and Vice Chairman-External Affairs | 74 | 1967 |
| Thomas R. Tizzio* | Director and President | 59 | 1982 |
| Edmund S. W. Tse | Director and Executive Vice President-Life Insurance | 59 | 1991 |
| Edwin E. Manton | Senior Advisor | 88 | 1967 |
| Ernest E. Stempel | Senior Advisor | 80 | 1967 |
| Robert M. Sandler | Executive Vice President, Senior Casualty Actuary and Senior Claims Officer | 54 | 1980 |
| Howard I. Smith | Executive Vice President, Chief Financial Officer and Comptroller | 52 | 1984 |
| Lawrence W. English | Senior Vice President-Administration | 55 | 1985 |
| Axel I. Freudmann | Senior Vice President-Human Resources | 50 | 1986 |
| Win J. Neuger | Senior Vice President and Chief Investment Officer | 47 | 1995 |
| Petros K. Sabatacakis | Senior Vice President-Financial Services | 50 | 1992 |
| Florence A. Davis | Vice President-General Counsel | 42 | 1995 |
| Robert E. Lewis | Vice President and Chief Credit Officer | 46 | 1993 |
| Frank Petralito II | Vice President and Director of Taxes | 60 | 1978 |
| Kathleen E. Shannon | Vice President and Secretary | 47 | 1986 |
| John T. Wooster, Jr. | Vice President-Communications | 57 | 1989 |
| William N. Dooley | Vice President and Treasurer | 43 | 1992 |

* Member of Executive Committee.

Except as hereinafter noted, each of the directors who is also an executive officer of AIG and each of the other executive officers has, for more than five years, occupied an executive position with AIG or companies that are now its subsidiaries, or with Starr. Evan G. Greenberg is the son of M.R. Greenberg. There are no other arrangements or understandings between any director or officer and any other person pursuant to which the director or officer was elected to such position. Ms. Davis was a Principal in the legal department and Worldwide Director of Compliance at Morgan Stanley & Co. Incorporated prior to joining AIG in April, 1995. Mr. Lewis was Assistant General Manager for North America, Chief Credit Officer, and senior executive responsible for risk and exposure management of ING Bank in New York, the bank division of Internationale Nederlanden Group, from 1988 until joining AIG in October, 1993. Mr. Sabatacakis was Managing Director and head of the Capital Markets and Treasury Group of Chemical Banking Corporation prior to joining AIG in February, 1992. Mr. Neuger was Managing Director, Global Investment Management-Equity at Bankers Trust Company prior to joining AIG in February, 1995.





# PART II

## ITEM 5.MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS

(a) The table below shows the high and low closing sales prices per share of AIG's common stock, as reported on the New York Stock Exchange Composite Tape, for each quarter of 1996 and 1995, as adjusted for the common stock split in the form of a 50 percent common stock dividend paid July 28, 1995. All prices are as reported by the National Quotation Bureau, Incorporated.

| | 1996 | | 1995 | |
|---|---|---|---|---|
| | High | Low | High | Low |

| | | | | |
|---|---|---|---|---|
| First Quarter | 102 3/4 | 89 3/8 | 71 7/8 | 64 5/8 |
| Second Quarter | 98 5/8 | 88 1/8 | 79 1/4 | 68 7/8 |
| Third Quarter | 100 7/8 | 90 1/8 | 86 1/2 | 71 5/8 |
| Fourth Quarter | 115 1/8 | 101 1/2 | 94 7/8 | 82 5/8 |

(b) In 1996, AIG paid a quarterly dividend of 8.5 cents in March and June and 10.0 cents in September and December for a total cash payment of 37.0 cents per share of common stock. In 1995, AIG paid a quarterly dividend of 7.7 cents in March and June and 8.5 cents in September and December for a total cash payment of 32.4 cents per share of common stock. These amounts reflect the adjustment for a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995. Subject to the dividend preference of any of AIG's serial preferred stock which may be outstanding, the holders of shares of common stock are entitled to receive such dividends as may be declared by the Board of Directors from funds legally available therefor.

See Note 10(b) of Notes to Financial Statements for a discussion of certain restrictions on the payment of dividends to AIG by some of its insurance subsidiaries.

(c) The approximate number of holders of Common Stock as of January 31, 1997, based upon the number of record holders, was 18,000.





## ITEM 6.SELECTED FINANCIAL DATA

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA

The following Selected Consolidated Financial Data is presented in accordance with generally accepted accounting principles. This data should be read in conjunction with the financial statements and accompanying notes included elsewhere herein.

(in thousands, except per share amounts)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|
| Revenues (a) | $ 28,205,272 | $ 25,874,022 | $ 22,358,709 | $ 20,068,287 | $ 18,388,627 |
| General insurance: | | | | | |
| Net premiums written | 12,691,679 | 11,893,022 | 10,865,753 | 10,025,903 | 9,138,528 |
| Net premiums earned | 11,854,815 | 11,405,731 | 10,286,831 | 9,566,640 | 9,209,390 |
| Adjusted underwriting profit (loss) | 398,944 | 361,583 | 147,517 | 10,391 | (195,084) |
| Net investment income | 1,689,371 | 1,545,717 | 1,435,092 | 1,340,480 | 1,252,086 |
| Realized capital gains | 64,985 | 68,075 | 52,487 | 65,264 | 67,134 |
| Operating income | 2,153,300 | 1,975,375 | 1,635,096 | 1,416,135 | 1,124,136 |
| Life insurance: | | | | | |
| Premium income | 8,978,246 | 8,038,150 | 6,724,321 | 5,746,046 | 4,853,087 |
| Net investment income | 2,675,881 | 2,264,905 | 1,748,428 | 1,499,714 | 1,313,838 |
| Realized capital gains | 34,798 | 32,703 | 86,706 | 54,576 | 43,257 |
| Operating income | 1,323,758 | 1,090,605 | 952,484 | 781,611 | 667,453 |
| Agency and service fee operating income | 52,267 | 56,909 | 54,129 | 60,247 | 52,570 |
| Financial services operating income | 523,906 | 417,741 | 404,853 | 390,038 | 346,442 |
| Equity in income of minority-owned insurance operations | 99,359 | 81,722 | 56,005 | 39,589 | 27,929 |
| Other realized capital losses | (11,792) | (28,944) | (52,340) | (12,742) | (11,293) |
| Income before income taxes and cumulative effect of accounting changes | 4,013,222 | 3,465,883 | 2,951,979 | 2,601,081 | 2,137,048 |
| Income taxes | 1,115,965 | 955,500 | 776,464 | 683,003 | 512,033 |
| Income before cumulative effect of accounting changes | 2,897,257 | 2,510,383 | 2,175,515 | 1,918,078 | 1,625,015 |
| Cumulative effect of accounting changes, net of tax: | | | | | |
| AIG | -- | -- | -- | -- | 31,941 |
| Minority-owned insurance operations | -- | -- | -- | 20,695 | -- |
| Net income | 2,897,257 | 2,510,383 | 2,175,515 | 1,938,773 | 1,656,956 |
| Earnings per common share: | | | | | |
| Income before cumulative effect of accounting changes | 6.15 | 5.30 | 4.58 | 4.03 | 3.40 |
| Cumulative effect of accounting changes, net of tax: | | | | | |
| AIG | -- | -- | -- | -- | .07 |
| Minority-owned insurance operations | -- | -- | -- | .04 | -- |
| Net income | 6.15 | 5.30 | 4.58 | 4.07 | 3.47 |
| Cash dividends per common share | .37 | .32 | .29 | .26 | .23 |
| Total assets | 148,431,002 | 134,136,398 | 114,346,117 | 101,014,848 | 92,722,182 |

| | | | | | |
|---|---|---|---|---|---|
| Long-term debt (b) | 17,506,359 | 14,452,851 | 12,613,907 | 10,955,963 | 9,517,595 |
| Capital funds (shareholders' equity) | 22,044,224 | 19,827,103 | 16,421,661 | 15,224,195 | 12,782,152 |

(a) Represents the sum of general net premiums earned, life premium income, agency commissions, management and other fees, net investment income, financial services commissions, transaction and other fees, equity in income of minority-owned insurance operations and realized capital gains (losses). (See also tables under Item 1, "Business".)

(b) Including commercial paper and excluding that portion of long-term debt maturing in less than one year.







ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operational Review

General Insurance Operations

General insurance operations for the twelve month periods ending December 31, 1996, 1995 and 1994 were as follows:

(in thousands)

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Net premiums written: | | | |
| Domestic | $ 8,366,832 | $ 7,690,207 | $ 7,132,367 |
| Foreign | 4,324,847 | 4,202,815 | 3,733,386 |
| Total | $12,691,679 | $11,893,022 | $10,865,753 |
| Net premiums earned: | | | |
| Domestic | $ 7,821,605 | $ 7,322,531 | $ 6,683,656 |
| Foreign | 4,033,210 | 4,083,200 | 3,603,175 |
| Total | $11,854,815 | $11,405,731 | $10,286,831 |
| Adjusted underwriting profit (loss): | | | |
| Domestic | $ 1,039 | $ 57,514 | $ (56,190) |
| Foreign | 397,905 | 304,069 | 203,707 |
| Total | $ 398,944 | $ 361,583 | $ 147,517 |
| Net investment income: | | | |
| Domestic | $ 1,350,159 | $ 1,240,174 | $ 1,147,595 |
| Foreign | 339,212 | 305,543 | 287,497 |
| Total | $ 1,689,371 | $ 1,545,717 | $ 1,435,092 |
| Operating income before realized capital gains: | | | |
| Domestic | $ 1,351,198 | $ 1,297,688 | $ 1,091,405 |
| Foreign | 737,117 | 609,612 | 491,204 |
| Total | 2,088,315 | 1,907,300 | 1,582,609 |
| Realized capital gains | 64,985 | 68,075 | 52,487 |

| | | | |
|---|---|---|---|
| Operating income | $ 2,153,300 | $ 1,975,375 | $ 1,635,096 |

In AIG's general insurance operations, 1996 net premiums written and net premiums earned increased 6.7 percent and 3.9 percent, respectively, from those of 1995. In 1995, net premiums written increased 9.5 percent and net premiums earned increased 10.9 percent when compared to 1994.

The growth in net premiums written in 1996 and 1995 resulted from a combination of several factors. Domestically, AIG continued to achieve some general price increases in certain commercial property and specialty casualty markets, as well as volume growth in mortgage guaranty insurance and personal lines. Overseas, the primary reason for growth was volume increases. Foreign general insurance operations produced 34.1 percent of the general insurance net premiums written in 1996, 35.3 percent in 1995 and 34.4 percent in 1994.

In comparing the foreign exchange rates used to translate AIG's foreign general operations during 1996 to those foreign exchange rates used to translate AIG's foreign general operations during 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 2.9 percentage points less than they would have been if translated utilizing those exchange rates which prevailed during 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 | 1994 |
|---|---|---|---|
| Domestic: | | | |
| Loss Ratio | 85.21 | 85.11 | 86.83 |
| Expense Ratio | 15.40 | 14.88 | 14.59 |
| Combined Ratio | 100.61 | 99.99 | 101.42 |
| Foreign: | | | |
| Loss Ratio | 57.82 | 59.46 | 61.12 |
| Expense Ratio | 31.77 | 32.51 | 33.04 |
| Combined Ratio | 89.59 | 91.97 | 94.16 |
| Consolidated: | | | |
| Loss Ratio | 75.89 | 75.93 | 77.82 |
| Expense Ratio | 20.98 | 21.11 | 20.93 |
| Combined Ratio | 96.87 | 97.04 | 98.75 |

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 $398.9 million in 1996, $361.6 million in 1995 and $147.5 million in 1994. (See also Notes 4 and 18 of Notes to Financial Statements.)

AIG's results reflect the net impact with respect to incurred losses from catastrophes approximating $78 million in 1996, $100 million in 1995 and $55 million in 1994. AIG's gross incurred losses from catastrophes approximated $240 million in 1996, $190 million in 1995 and $174 million in 1994. 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. A substantial portion of the remaining balances resulted from storms which struck portions of the United States and the Caribbean. The Northridge earthquake which struck the Los Angeles area of California in January, 1994, resulted in gross and net incurred losses of approximately $174 million and $55 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 | 1994 |
|---|---|---|---|
| Loss Ratio | 75.23 | 75.05 | 77.29 |
| Expense Ratio | 20.98 | 21.11 | 20.93 |
| Combined Ratio | 96.21 | 96.16 | 98.22 |







AIG's ability to maintain its 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 1996 increased 9.3 percent when compared to 1995. In 1995, net investment income increased 7.7 percent over 1994. The growth in net investment income in each of the three years 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 and Note 8 of Notes to Financial Statements.)

General insurance realized capital gains were $65.0 million in 1996, $68.1 million in 1995 and $52.5 million in 1994. 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 fixed maturities as well as redemptions of fixed maturities.

General insurance operating income in 1996 increased 9.0 percent when compared to 1995. The 1995 results reflect an increase of 20.8 percent from 1994. The contribution of general insurance operating income to income before income taxes was 53.7 percent in 1996 compared to 57.0 percent in 1995 and 55.4 percent in 1994.

A year to year comparison of operating income can be significantly influenced by the catastrophe losses in any one year as well as the volatility from one year to the next in realized capital gains. Adjusting each year to exclude the effects of both catastrophe losses and realized capital gains, operating income would have increased by 7.9 percent in 1996 and 22.6 percent in 1995. The decrease in the growth rate of 1996 over 1995 was caused in part by the effects of the strengthening U.S. dollar against major foreign currencies as previously described and the slightly increased domestic combined ratio. The increase in the growth rate of 1995 over 1994 after the aforementioned adjustments was a result of the increased net investment income and significant 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 AIG desires. These reinsurance arrangements do not relieve AIG from its direct obligations to its insureds.

AIG's general reinsurance assets amounted to $16.31 billion and resulted from AIG's reinsurance arrangements. Thus, a credit exposure existed at December 31, 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 on an individual reinsurer basis. This development includes losses incurred but not reported (IBNR). At December 31, 1996, approximately 50 percent of the general reinsurance assets were from unauthorized reinsurers. In order to obtain statutory recognition, nearly all of these balances are collateralized. The remaining 50 percent of the general reinsurance assets were from authorized reinsurers and over 97 percent of such balances are 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 unauthorized pertain to regulatory categories, not creditworthiness.

AIG maintains an allowance for estimated unrecoverable reinsurance and has been largely successful in its previous recovery efforts. At December 31, 1996, 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 has not entered into any material cessions that would provide surplus relief.

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 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.





The consolidated general reinsurance assets of $16.31 billion at December 31, 1996 include reinsurance recoverables for (i) paid losses and loss expenses of $1.83 billion and (ii) $13.02 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 December 31, 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 December 31, 1996, general insurance reserves for losses and loss expenses (loss reserves) amounted to $33.43 billion, an increase of $383.1 million or 1.2 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 $714.5 million or 3.6 percent to $20.41 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 December 31, 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. For the majority of long tail casualty lines, net loss trend factors approximated eight percent. 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. 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 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 referred to collectively as environmental claims) and indemnity claims asserting injuries from asbestos. The vast majority of these asbestos and environmental claims emanate from policies written in 1984 and prior years. AIG has established a specialized claims unit which investigates and adjusts all such asbestos and environmental claims. 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.

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 and influence the development of asbestos and environmental claims are the inconsistent court resolutions and judicial interpretations which broaden the intent of the policies and scope of coverage. The current case law can be characterized as still evolving and there is little likelihood that any firm direction will develop in the near future. Additionally, the 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 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 December 31, 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 December 31, 1996, 1995 and 1994 was as follows:

(in millions)

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net |
| Asbestos: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $ 744.8 | $ 127.9 | $ 686.0 | $130.2 | $ 656.0 | $116.7 |
| Losses and loss expenses incurred(a) | 392.5 | 102.7 | 197.7 | 20.5 | 149.2 | 45.8 |
| Losses and loss expenses paid(b) | (261.4) | (58.3) | (138.9) | (22.8) | (119.2) | (32.3) |
| Reserve for losses and loss expenses at end of year | $ 875.9 | $ 172.3 | $ 744.8 | $127.9 | $ 686.0 | $130.2 |
| Environmental: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $1,197.9 | $ 379.3 | $ 728.1 | $200.1 | $ 684.8 | $191.5 |
| Losses and loss expenses incurred(a) | 379.6 | 240.3 | 684.9 | 231.7 | 187.5 | 61.8 |
| Losses and loss expenses paid | (150.1) | (49.0) | (215.1) | (52.5) | (144.2) | (53.2) |
| Reserve for losses and loss expenses at end of year | $1,427.4 | $ 570.6 | $1,197.9 | $379.3 | 728.1 | $200.1 |
| Combined: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $1,942.7 | $ 507.2 | $1,414.1 | $330.3 | $1,340.8 | $308.2 |
| Losses and loss expenses incurred | 772.1 | 343.0 | 882.6 | 252.2 | 336.7 | 107.6 |
| Losses and loss expenses paid | (411.5) | (107.3) | (354.0) | (75.3) | (263.4) | (85.5) |
| Reserve for losses and loss expenses at end of year | $2,303.3 | $ 742.9 | $1,942.7 | $507.2 | $1,414.1 | $330.3 |

(a) At December 31, 1996 and 1995, incurred losses for asbestos and environmental claims reflect reserve strengthening in the IBNR carried.

(b) For 1996, paid losses for asbestos include certain unusual and non-recurring payments that satisfied historical settlement agreements.

The gross and net IBNR included in the aforementioned reserve for losses and loss expenses at December 31, 1996, 1995 and 1994 were estimated as follows:

(in thousands)

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net |
| Combined | $1,070,000 | $ 436,500 | $ 665,000 | $ 218,000 | $ 150,000 | $ 30,000 |





A summary of asbestos and environmental claims count activity for the years ended December 31, 1996, 1995 and 1994 was as follows:

| | 1996 | | | 1995 | | |
|---|---|---|---|---|---|---|
| | Asbestos | Environmental | Combined | Asbestos | Environmental | Combined |
| Claims at beginning of year | 5,244 | 17,858 | 23,102 | 5,947 | 16,223 | 22,170 |
| Claims during year: | | | | | | |
| Opened | 1,083 | 3,836 | 4,919 | 1,026 | 5,045 | 6,071 |
| Settled | (117) | (466) | (583) | (93) | (663) | (756) |
| Dismissed or otherwise resolved | (542) | (3,833) | (4,375) | (1,636) | (2,747) | (4,383) |
| Claims at end of year | 5,668 | 17,395 | 23,063 | 5,244 | 17,858 | 23,102 |

| | 1994 | | |
|---|---|---|---|
| | Asbestos | Environmental | Combined |
| Claims at beginning of year | 5,522 | 16,661 | 22,183 |
| Claims during year: | | | |
| Opened | 1,626 | 3,178 | 4,804 |
| Settled | (106) | (501) | (607) |
| Dismissed or otherwise resolved | (1,095) | (3,115) | (4,210) |
| Claims at end of year | 5,947 | 16,223 | 22,170 |

The average cost per claim settled, dismissed or otherwise resolved for the years ended December 31, 1996, 1995 and 1994 was as follows:

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net |
| Asbestos* | $396,700 | $ 88,500 | $ 80,300 | $ 13,200 | $ 99,300 | $ 26,900 |
| Environmental | 34,900 | 11,400 | 63,100 | 15,400 | 39,900 | 14,700 |
| Combined | 83,000 | 21,600 | 68,900 | 14,700 | 54,700 | 17,700 |

* For 1996, paid losses for asbestos include certain unusual and non-recurring payments that satisfied historical settlement agreements.

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 ending reserves for losses and loss expenses over the 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 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.

AIG's survival ratios for involuntary asbestos and environmental claims, separately and combined, were based upon a three year average payment in order to present a more meaningful trend. These ratios for the years ended December 31, 1996, 1995 and 1994 were as follows:

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net |
| Involuntary survival ratios: | | | | | | |
| Asbestos* | 5.1 | 4.6 | 5.5 | 4.2 | 5.2 | 3.9 |
| Environmental | 16.2 | 18.8 | 15.6 | 12.4 | 11.0 | 6.7 |
| Combined | 9.4 | 11.5 | 9.7 | 8.8 | 7.4 | 5.4 |

* For 1996, paid losses for asbestos include certain unusual and non-recurring payments that satisfied historical settlement agreements.





MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

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 assessments net of credits for 1996, 1995 and 1994 were $18.8 million, $23.5 million and $28.2 million, respectively.

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. (See also Note 18 of Notes to Financial Statements.)

LIFE INSURANCE OPERATIONS

Life insurance operations for the twelve month periods ending December 31, 1996, 1995 and 1994 were as follows:

(in thousands)

| | 1996 | 1995 | 1994 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Premium income: | | | |
| Domestic | $ 535,579 | $ 463,533 | $ 370,112 |
| Foreign | 8,442,667 | 7,574,617 | 6,354,209 |
| Total | $ 8,978,246 | $ 8,038,150 | $ 6,724,321 |
| Net investment income: | | | |
| Domestic | $ 930,350 | $ 846,345 | $ 600,616 |
| Foreign | 1,745,531 | 1,418,560 | 1,147,812 |
| Total | $ 2,675,881 | $ 2,264,905 | $ 1,748,428 |
| Operating income before realized capital gains: | | | |
| Domestic | $ 100,487 | $ 59,014 | $ 38,243 |
| Foreign | 1,188,473 | 998,888 | 827,535 |
| Total | 1,288,960 | 1,057,902 | 865,778 |
| Realized capital gains | 34,798 | 32,703 | 86,706 |
| Operating income | $ 1,323,758 | $ 1,090,605 | $ 952,484 |
| Life insurance in-force: | | | |
| Domestic | $ 60,419,342 | $ 54,272,118 | $ 43,849,682 |
| Foreign | 361,563,791 | 321,824,989 | 289,529,129 |
| Total | $421,983,133 | $376,097,107 | $333,378,811 |

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 in 1996 represented an 11.7 percent increase from the prior year. This compares with an increase of 19.5 percent in 1995 over 1994. Foreign life operations produced 94.0 percent, 94.2 percent and 94.5 percent of the life premium income in 1996, 1995 and 1994, respectively. (See also Notes 1, 4 and 6 of Notes to Financial Statements.)

As previously discussed, the U.S. dollar strengthened in value in relation to most major foreign currencies in which AIG transacts business. Accordingly, when foreign life premium income was translated into U.S. dollars for purposes of consolidation, total life premium income was approximately 5.2 percentage points less than it would have been if translated utilizing exchange rates prevailing in 1995.

Life insurance net investment income increased 18.1 percent in 1996 compared to an increase of 29.5 percent in 1995. The slowing of the growth rate was impacted by the redemption of policy loans with respect to some large corporate life insurance policies (COLI products). The redemptions of the COLI products were a result of recently enacted unfavorable Federal Tax legislation. Such redemptions had an insignificant impact on operating income, financial condition and liquidity. The growth in net investment income in 1996 and 1995 was primarily attributable to foreign new cash flow for investment and, to a lesser degree in 1995, growth in interest income earned on policy loans related to domestic COLI 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.)

The growth in the premium income of the domestic life segment resulted primarily from the sales of individual and terminal funded pension plan annuities.

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 $34.8 million in 1996, $32.7 million in 1995 and $86.7 million in 1994. 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.

Life insurance operating income in 1996 increased 21.4 percent to $1.32 billion compared to an increase of 14.5 percent in 1995. Excluding realized capital gains from life insurance operating income, the percent increases would be 21.8 percent and 22.2 percent in 1996 and 1995, respectively. The contribution of life insurance operating income to income before income taxes amounted to 33.0 percent in 1996 compared to 31.5 percent in 1995 and 32.3 percent in 1994.

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 with respect to 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 three year period ended December 31, 1996. (See also Note 5 of Notes to Financial Statements.)

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. In Japan, the average duration of the investment portfolio is 5.9 years, while the related policy liabilities are estimated to be 12.3 years. 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, active monitoring assures appropriate asset-liability matching 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 in 1996 decreased 8.2 percent to $52.3 million compared to $56.9 million in 1995 which was an increase of 5.1 percent from 1994. The increase in operating income from 1994 resulted from the growth of risk management services. The decline in 1996 was due to reduced commission revenue in certain of AIG's managing general agencies. Agency and service fee operating income contributed 1.3 percent to AIG's income before income taxes in 1996 compared to 1.6 percent in 1995 and 1.8 percent in 1994.

FINANCIAL SERVICES OPERATIONS

Financial services operations for the twelve month periods ending December 31, 1996, 1995 and 1994 were as follows:

(in thousands)

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Revenues: | | | |
| International Lease Finance Corp. | $1,560,228 | $1,378,353 | $1,097,599 |
| AIG Financial Products Corp.* | 369,194 | 289,020 | 279,058 |
| AIG Trading Group Inc.* | 288,551 | 317,207 | 246,643 |
| Other | 337,504 | 219,510 | 159,939 |
| Total | $2,555,477 | $2,204,090 | $1,783,239 |
| Operating income: | | | |
| International Lease Finance Corp. | $ 306,853 | $ 263,790 | $ 248,191 |
| AIG Financial Products Corp. | 189,157 | 140,245 | 131,032 |
| AIG Trading Group Inc. | 80,156 | 68,765 | 55,249 |
| Other, including intercompany adjustments | (52,260) | (55,059) | (29,619) |
| Total | $ 523,906 | $ 417,741 | $ 404,853 |

* Represents net trading revenues.

Financial services operating income increased 25.4 percent in 1996 over 1995. This compares with an increase of 3.2 percent in 1995 over 1994.

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 1996 increased 13.2 percent from 1995 compared to a 25.6 percent increase during 1995 from 1994. The revenue growth in each year resulted primarily from the growth both in the size and relative cost of the fleet. During 1996, operating income increased 16.3 percent from 1995 and 6.3 percent during 1995 from 1994. The average borrowing cost during 1996 was 6.23 percent while the 1995 and 1994 costs were 6.47 percent and 6.41 percent, respectively. Declines in interest rates generally have a positive effect on leasing margins. (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 December 31, 1996, only four of 296 aircraft owned





were not leased. Subsequently, two of these aircraft have been sold and two aircraft have been committed for lease. During 1996, slightly over 80 percent of the revenue derived from the rental of aircraft equipment was from foreign carriers. (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 structured transactions including long-dated forward foreign exchange contracts, option transactions, liquidity facilities and investment agreements and invests in a diversified portfolio of securities. AIGFP derives substantially all its revenues from proprietary positions entered in connection with counterparty transactions rather than from speculative transactions. Revenues in 1996 increased 27.7 percent from 1995 compared to a 3.6 percent increase during 1995 from 1994. During 1996, operating income increased 34.9 percent from 1995 and increased 7.0 percent during 1995 from 1994. 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. As a result of a decline in the volatility of AIGTG's major markets and fewer structured transactions, revenues in 1996 decreased 9.0 percent from 1995 compared to a 28.6 percent increase during 1995 from 1994. During 1996, operating income increased 16.6 percent from 1995 and 24.5 percent during 1995 from 1994. (See also the discussions under "Capital Resources," "Liquidity" and "Derivatives" herein.)

Financial services operating income represented 13.1 percent of AIG's income before income taxes in 1996. This compares to 12.1 percent and 13.7 percent in 1995 and 1994, respectively.

## OTHER OPERATIONS

In 1996, AIG's equity in income of minority-owned insurance operations was $99.4 million compared to $81.7 million in 1995 and $56.0 million in 1994. In 1996, the equity interest in insurance companies represented 2.5 percent of income before income taxes compared to 2.4 percent in 1995 and 1.9 percent in 1994.

Other realized capital losses amounted to $11.8 million, $28.9 million and $52.3 million in 1996, 1995 and 1994, respectively.

Minority interest represents minority shareholders' equity in income of certain consolidated subsidiaries. In 1996, minority interest amounted to $43.2 million. In 1995 and 1994, minority interest amounted to $36.3 million and $29.7 million, respectively.

Other income (deductions)-net includes AIG's equity in certain minor majority-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 1996, net deductions amounted to $84.4 million. In 1995 and 1994, net deductions amounted to $91.2 million and $68.6 million, respectively.

Income before income taxes amounted to $4.01 billion in 1996, $3.47 billion in 1995 and $2.95 billion in 1994.

In 1996, AIG recorded a provision for income taxes of $1.12 billion compared to the provisions of $955.5 million and $776.5 million in 1995 and 1994, respectively. These provisions represent effective tax rates of 27.8 percent in 1996, 27.6 percent in 1995 and 26.3 percent in 1994. The increase in the effective tax rate in 1996 over prior years is primarily due to the profitability of domestic general adjusted underwriting relative to income before income taxes. (See Note 3 of Notes to Financial Statements.)

Net income amounted to $2.90 billion in 1996, $2.51 billion in 1995 and $2.18 billion in 1994. The increases in net income over the three year period resulted from those factors described above.





## CAPITAL RESOURCES

At December 31, 1996, AIG had total capital funds of $22.04 billion and total borrowings of $23.52 billion. At that date, $20.10 billion of such borrowings were either not guaranteed by AIG or were matched borrowings under obligations of guaranteed investment agreements (GIAs) or matched notes and bonds payable.

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

(in thousands)

| December 31, | 1996 | 1995 |
|---|---|---|
| GIAs-- AIGFP | $ 5,723,228 | $ 5,423,555 |
| Commercial Paper: | | |
| Funding | 1,018,510 | 687,182 |
| ILFC(a) | 2,739,388 | 1,834,882 |
| AICCO | 740,078 | 644,571 |
| Total | 4,497,976 | 3,166,635 |
| Medium Term Notes: | | |
| ILFC(a) | 2,551,485 | 2,391,535 |
| AIG | 140,000 | 115,000 |
| Total | 2,691,485 | 2,506,535 |
| Notes and Bonds Payable: | | |
| ILFC(a) | 3,500,000 | 3,550,000 |
| AIGFP | 5,243,042 | 2,383,699 |
| AIGTG | 10,442 | -- |
| AIG: Lire bonds | 159,067 | 159,067 |
| Zero coupon notes | 81,761 | 73,348 |
| Total | 8,994,312 | 6,166,114 |
| Loans and Mortgages Payable: | | |
| ILFC(a)(b) | 1,007,836 | 1,122,265 |
| AIG | 605,677 | 120,369 |
| Total | 1,613,513 | 1,242,634 |
| Total Borrowings | 23,520,514 | 18,505,473 |
| Borrowings not guaranteed by AIG | 9,798,709 | 8,898,682 |
| Matched GIA borrowings | 5,723,228 | 5,423,555 |
| Matched notes and bonds payable-- AIGFP | 4,576,900 | 2,138,400 |
| | 20,098,837 | 16,460,637 |
| Remaining borrowings of AIG | $ 3,421,677 | $ 2,044,836 |

(a) AIG does not guarantee or support these borrowings.
(b) Primarily capital lease obligations.

See also Note 9 of Notes to Financial Statements.

AIGFP increased the aggregate principal amount outstanding of its notes and bonds payable to $5.24 billion, a net increase of $2.86 billion and increased its net GIA borrowings by $299.7 million. AIGFP uses the proceeds from the issuance of notes and bonds to invest in a segregated portfolio of securities available for sale. Funds received from GIA borrowings are invested in a diversified portfolio of securities and derivative transactions. (See also the discussions under "Operational Review", "Liquidity" and "Derivatives" herein and Notes 1, 8, 9 and 11 of Notes to Financial Statements.)

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, which AIG guarantees, to fund its operations. At December 31, 1996, AIGFP had no commercial paper outstanding. (See also the discussion under "Derivatives" herein and Note 9 of Notes to Financial Statements.)

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 December 31, 1996.

At December 31, 1996, ILFC had increased the aggregate principal amount outstanding of its medium term and term notes to $6.05 billion, a net increase of $110.0 million, and recorded a net decline in its capital lease obligations of $92.6 million and a net increase in its commercial paper of $904.5 million. At December 31, 1996, ILFC had $636 million in aggregate principal amount of debt securities registered for issuance from time to time. In February 1997, ILFC reduced this registered amount through the sale of debt securities amounting to $546 million aggregate principal amount and registered for issuance from time to time $2.1 billion in aggregate principal amount of debt securities. The cash used to purchase flight equipment, including progress payments during the construction phase, is primarily derived 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. (See also the discussions under "Operational Review" and "Liquidity" herein.)

During 1996, AIG issued $100.0 million principal amount of medium term notes at rates ranging from 6.05 percent to 6.25 percent per annum for three year terms. During 1996, $75.0 million of previously issued medium term notes matured. At December 31, 1996 AIG had $647.0 million in aggregate principal amount of debt securities registered for issuance from time to time.

AIG's capital funds increased $2.22 billion during 1996. Unrealized appreciation of investments, net of taxes declined $16.7 million. Subsequent to 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 subject to increased volatility resulting from the changes in the market value of bonds available for sale. During 1996, the cumulative translation adjustment loss, net of taxes, increased $37.1 million and retained earnings increased $2.72 billion, resulting from net income less dividends.





During 1996, AIG repurchased 5.4 million shares of its common stock in the open market at a cost of $492.5 million. During 1995, AIG repurchased 236,443 shares of its common stock in the open market at a cost of $17.6 million. AIG intends to continue to buy its common shares in the open market to satisfy its obligations under various employee benefit plans and for other purposes.

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 December 31, 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 and Note 10 of Notes to Financial

Statements.)

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, 1996, 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.

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 December 31, 1996, AIG's consolidated invested assets included approximately $2.07 billion of cash and short-term investments. Consolidated net cash provided from operating activities in 1996 amounted to approximately $9.57 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 operating cash flow is derived from two sources, underwriting operations and investment operations. In the aggregate, AIG's insurance operations generated approximately $7 billion in post-tax cash flow during 1996. Cash flow includes periodic premium collections, including policyholders' contract deposits, paid loss recoveries less reinsurance premiums, losses, benefits, acquisition and operating expenses and income taxes 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 approximately $4.4 billion in investment income cash flow during 1996. Investment income cash flow is primarily derived from interest and dividends received and includes realized capital gains.

The combined insurance post-tax operating cash flow coupled with the cash and short-term investments of $1.6 billion provided the insurance operations with a significant amount of liquidity during 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 and collateral and guaranteed loans. This liquidity coupled with proceeds of over $16 billion from the maturities, sales and redemptions of fixed income securities and from the sales of marketable equity securities, AIG purchased approximately $22.5 billion of fixed income securities and marketable equity securities during 1996.

AIG received approximately $1.6 billion and $1.1 billion from redemptions of held to maturity municipal bonds during 1996 and 1995, respectively. Prior to redemption, the yield on these bonds approximated seven percent and eight percent in 1996 and 1995, respectively. The yield on the reinvestment of the proceeds in bonds with similar characteristics averaged approximately 5.6 percent and 6.0 percent in 1996 and 1995, respectively. 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 December 31, 1996 and 1995:

(dollars in thousands)

| | December 31, 1996 | | December 31, 1995 | |
|---|---|---|---|---|
| | Invested Assets | Percent of Total | Invested Assets | Percent of Total |
| General insurance | $ 28,778,853 | 26.5% | $26,550,431 | 27.5% |
| Life insurance | 38,491,870 | 35.4 | 34,869,040 | 36.2 |
| Financial services | 40,938,871 | 37.7 | 34,468,961 | 35.8 |
| Other | 408,535 | 0.4 | 449,832 | 0.5 |
| Total | $108,618,129 | 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 December 31, 1996 and 1995:

(dollars in thousands)

| DECEMBER 31, 1996 | GENERAL | LIFE | TOTAL | PERCENT OF TOTAL | PERCENT DISTRIBUTION DOMESTIC | FOREIGN |
|---|---|---|---|---|---|---|
| Fixed Maturities: | | | | | | |
| Available for sale, at market value(a) | $ 9,713,937 | $26,058,027 | $35,771,964 | 53.2% | 34.6% | 65.4% |
| Held to maturity, at amortized cost(b) | 12,736,225 | -- | 12,736,225 | 18.9 | 100.0 | -- |
| Equity securities, at market value(c) | 3,265,756 | 2,608,309 | 5,874,065 | 8.7 | 33.9 | 66.1 |
| Mortgage loans on real estate, policy and collateral loans | 50,578 | 6,224,878 | 6,275,456 | 9.3 | 43.1 | 56.9 |
| Short-term investments, including time deposits, and cash | 598,076 | 1,002,060 | 1,600,136 | 2.4 | 19.0 | 81.0 |
| Real estate | 409,808 | 843,933 | 1,253,741 | 1.9 | 18.2 | 81.8 |
| Investment income due and accrued | 493,338 | 697,891 | 1,191,229 | 1.8 | 44.4 | 55.6 |
| Other invested assets | 1,511,135 | 1,056,772 | 2,567,907 | 3.8 | 51.6 | 48.4 |
| Total | $28,778,853 | $38,491,870 | $67,270,723 | 100.0% | 47.9% | 52.1% |

(a) Includes $364,069 of bonds trading securities, at market value.
(b) Includes $477,247 of preferred stock, at amortized cost.
(c) Includes $46,732 of preferred stock, at market value.

(dollars in thousands)

| DECEMBER 31, 1995 | GENERAL | LIFE | TOTAL | PERCENT 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 and collateral loans | 54,852 | 6,887,329 | 6,942,181 | 11.3 | 52.8 | 47.2 |
| Short-term investments, including time 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 general strategy is to invest in high quality securities while maintaining diversification to avoid significant exposure to issuer, industry and/or country concentrations.

At December 31, 1996, approximately 52 percent of the fixed maturity investments were domestic securities. Approximately 39 percent of such domestic securities were rated AAA. Approximately 5 percent were below investment grade or not rated.

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. At December 31, 1996, approximately 40 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 four 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 March 1, 1997.

At December 31, 1996, approximately 5 percent of the fixed maturities portfolio was Collateralized Mortgage Obligations (CMOs). All of the CMOs were investment grade and approximately 72 percent of the CMOs were backed by various U.S. government agencies. 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 9.3 percent of AIG's insurance invested assets at December 31, 1996. AIG's insurance operations holdings of real estate mortgages amounted to $2.38 billion of which 34.1 percent was domestic. At December 31, 1996, no domestic mortgages and only a nominal amount of foreign mortgages were in default. At December 31, 1996, AIG's insurance holdings of collateral loans amounted to $897.3 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 decreased from $3.95 billion at December 31, 1995 to $3.00 billion at December 31, 1996. Nearly all of this decrease relates to the redemption of COLI products.

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

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 December 31, 1996 and 1995. (See also the discussions under "Operational Review," "Capital Resources" and "Derivatives" herein.)

(dollars in thousands)

| | 1996 Invested Assets | 1996 Percent of Total | 1995 Invested Assets | 1995 Percent of Total |
|---|---|---|---|---|
| Flight equipment primarily under operating leases, net of accumulated depreciation | $13,808,660 | 33.7% | $12,442,010 | 36.1% |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 6,906,012 | 16.9 | 7,250,954 | 21.0 |
| Securities available for sale, at market value | 9,785,909 | 23.9 | 3,931,100 | 11.4 |
| Trading securities, at market value | 2,357,812 | 5.7 | 2,641,436 | 7.7 |
| Securities purchased under agreements to resell, at contract value | 1,642,591 | 4.0 | 2,022,056 | 5.9 |
| Trading assets | 3,793,433 | 9.3 | 4,017,735 | 11.6 |
| Spot commodities, at market value | 204,705 | 0.5 | 383,374 | 1.1 |
| Other, including short-term investments | 2,439,749 | 6.0 | 1,780,296 | 5.2 |
| Total | $40,938,871 | 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 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. During 1996, ILFC acquired flight equipment costing $3.25 billion.

At December 31, 1996, ILFC had committed to purchase or had secured positions for 243 aircraft deliverable from 1997 through 2004 at an estimated aggregate purchase price of $13.3 billion and had options to purchase an additional 35 aircraft deliverable through 2005 at an estimated aggregate purchase price of $2.8 billion. As at March 11, 1997, ILFC has entered into leases, letters of intent to lease or is in various stages of negotiation for all of the aircraft to be delivered in 1997 and 44 of 179 aircraft to be delivered subsequent to 1997. ILFC will be required to find customers for any aircraft presently on order and any aircraft to be ordered, and it must arrange financing for portions of the purchase price of such equipment. In a rising interest rate environment, ILFC negotiates higher lease rates on any new contracts. ILFC has been successful to date both in placing its new aircraft on lease or under sales contract and obtaining adequate financing.

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 risk exposure through similarly valued offsetting transactions including swaps, trading securities, options, forwards and futures. The estimated fair values of these transactions represent assessments of the present value of expected future cash flows. Some of 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 December 31, 1996, the average credit rating of this portfolio was AA or the equivalent thereto as determined through rating agencies or internal review. AIGFP has also entered into credit derivative transactions to hedge its credit risk associated with $2.4 billion of these securities. There were no securities deemed below investment grade. There have been no significant downgrades through March 1,

1997. Securities purchased under agreements to resell are treated as collateralized transactions. AIGFP takes possession of or obtains a security interest in securities purchased under agreements to resell. AIGFP further minimizes its credit risk by monitoring counterparty credit exposure and, when 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 trading liabilities, 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 legal 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 or commodity 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 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).





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

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 may determine 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 December 31, 1996 were as follows:

(in thousands)

| | Gross Unrealized Gains | Gross Unrealized Losses | Balance Sheet Amount |
|---|---|---|---|
| Securities available for sale, at market value(a) | $ 382,807 | $ 372,603 | $9,785,909 |
| Unrealized gain/loss on interest rate and currency swaps, options and forward transactions(b) (c) | 6,906,012 | 5,414,433 | -- |
| Trading securities, at market value | -- | -- | 2,357,812 |
| Trading assets | 6,220,863 | 4,035,715 | 3,793,433 |
| Spot commodities, at market value | -- | 18,145 | 204,705 |
| Trading liabilities | -- | 2,486,700 | 3,313,508 |
| Securities and spot commodities sold but not yet purchased, at market value | 30,335 | -- | 1,568,542 |

(a) See also Note 8 (e) of Notes to Financial Statements.
(b) These amounts are also presented as the respective balance sheet amounts.
(c) At December 31, 1996, AIGTG's replacement values with respect to interest rate and currency swaps were $514.0 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 December 31, 1996, the unrealized gains and losses remaining after benefit of the offsets were $14.7 million and $4.5 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 and AIGTG's derivatives transactions at December 31, 1996.

The notional amounts used to express the extent of AIGFP's and AIGTG's involvement in swap transactions represent a standard of measurement of the volume of AIGFP's and AIGTG'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 AIGFP's and AIGTG's 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 December 31, 1996:

(in thousands)

| | Remaining Life | | | | | |
|---|---|---|---|---|---|---|
| | One Year | Two Through Five Years | Six Through Ten Years | After Ten Years | Total 1996 | Total 1995 |
| Interest rate, currency and equity/commodity swaps and swaptions: | | | | | | |
| Notional amount: | | | | | | |
| Interest rate swaps | $43,310,500 | $72,311,900 | $40,928,300 | $ 9,221,100 | $165,771,800 | $130,441,000 |
| Currency swaps | 11,252,100 | 16,316,500 | 8,184,500 | 3,429,800 | 39,182,900 | 28,829,000 |
| Equity/commodity swaps | 32,900 | 20,700 | -- | 50,000 | 103,600 | 320,000 |
| Swaptions | 566,400 | 1,544,500 | 2,530,200 | 976,600 | 5,617,700 | 4,374,000 |
| Total | $55,161,900 | $90,193,600 | $51,643,000 | $13,677,500 | $210,676,000 | $163,964,000 |
| Futures and forward contracts: | | | | | | |
| Exchange traded futures contracts contractual amount | $ 6,867,300 | -- | -- | -- | $ 6,867,300 | $ 16,050,000 |
| Over the counter forward contracts contractual amount | $ 5,952,200 | -- | -- | -- | $ 5,952,200 | $ 2,238,000 |

AIGFP determines counterparty credit quality by reference to ratings from independent rating agencies or internal analysis. At December 31, 1996, 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 | | | |
|---|---|---|---|---|
| | Swaps and Swaptions | Futures and Forward Contracts | Total 1996 | Total 1995 |
| Counterparty credit quality: | | | | |
| AAA | $1,720,511 | $ 11,804 | $1,732,315 | $1,994,122 |
| AA | 2,009,599 | 12,279 | 2,021,878 | 2,146,085 |
| A | 1,450,877 | 10,186 | 1,461,063 | 1,442,854 |
| BBB | 1,150,420 | -- | 1,150,420 | 1,239,338 |
| Below investment grade | 26,293 | -- | 26,293 | 48,462 |
| Not externally rated--exchanges* | -- | -- | -- | 23,364 |
| Total | $6,357,700 | $ 34,269 | $6,391,969 | $6,894,225 |

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

At December 31, 1996, 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 | | | |
|---|---|---|---|---|
| | Swaps and Swaptions | Futures and Forward Contracts | Total 1996 | Total 1995 |
| Non-U.S. banks | $2,306,059 | $ 24,422 | $2,330,481 | $2,443,265 |
| Insured municipalities | 656,373 | -- | 656,373 | 879,642 |
| U.S. industrials | 894,942 | -- | 894,942 | 1,025,014 |
| Governmental | 894,284 | -- | 894,284 | 844,810 |
| Non-U.S. financial service companies | 34,356 | 27 | 34,383 | 39,742 |
| Non-U.S. industrials | 495,082 | 2,757 | 497,839 | 530,611 |
| Special purpose | 121,137 | -- | 121,137 | 113,401 |
| U.S. banks | 248,666 | 2,975 | 251,641 | 318,905 |
| U.S. financial service companies | 530,877 | 4,088 | 534,965 | 424,498 |
| Supranationals | 175,924 | -- | 175,924 | 250,973 |
| Exchanges* | -- | -- | -- | 23,364 |
| Total | $6,357,700 | $ 34,269 | $6,391,969 | $6,894,225 |

* Exchange traded futures 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 December 31, 1996. In addition, the estimated positive fair values associated with the derivatives portfolio are also provided and include a maturity profile for the December 31, 1996 balances based upon the expected timing of the future cash flows.

The gross replacement values presented represent the sum of the estimated positive fair values of all of AIGTG's derivatives contracts at December 31, 1996. 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 December 31, 1996:

(in thousands)

| | Remaining Life | | | |
|---|---|---|---|---|
| | One Year | Two Through Five Years | Six Through Ten Years | After Ten Years |
| Futures and forward contracts and interest rate and currency swaps: | | | | |
| Exchange traded futures contracts contractual amount | $ 11,129,657 | $ 2,899,957 | $ 71,490 | $ 6,896 |
| Over the counter forward contracts contractual amount | $ 204,590,640 | $ 11,097,976 | $ 1,083,771 | $ 3,379 |
| Interest rate and currency swaps: | | | | |
| Notional amount: | | | | |
| Interest rate swaps and forward rate agreements | $ 53,424,188 | $ 11,385,794 | $ 1,305,078 | $ 191,420 |
| Currency swaps | 43,131 | 3,681,390 | 1,740,495 | 388,178 |
| Total | $ 53,467,319 | $ 15,067,184 | $ 3,045,573 | $ 579,598 |
| Futures and forward contracts and interest rate and currency swaps: | | | | |
| Credit exposure: | | | | |
| Gross replacement value | $ 5,509,109 | $ 816,656 | $ 316,606 | $ 26,455 |
| Master netting arrangements | (3,130,370) | (358,071) | (68,882) | -- |
| Collateral | (83,746) | (56,223) | (6,118) | -- |
| Net replacement value | $ 2,294,993 | $ 402,362 | $ 241,606 | $ 26,455 |

(in thousands)

| | Remaining Life | | | |
|---|---|---|---|---|
| | One Year | Two Through Five Years | Six Through Ten Years | After Ten Years |
| Option contracts: | | | | |
| Contractual amounts for purchased options: | | | | |
| Exchange traded | $ 1,462,677 | $ 104,738 | $ -- | -- |
| Over the counter | 21,435,238 | 5,100,197 | 841,782 | -- |
| Total | $ 22,897,915 | $ 5,204,935 | $ 841,782 | -- |
| | | | | -- |
| Credit exposure for purchased options: | | | | |
| Gross replacement value | $ 524,253 | $ 233,903 | $ 62,784 | -- |
| Master netting arrangements | (241,692) | (68,615) | (4,661) | -- |
| Collateral | (1,198) | (2,062) | -- | -- |
| Net replacement value | $ 281,363 | $ 163,226 | $ 58,123 | -- |
| Contractual amounts for sold options* | $ 25,697,386 | $ 5,900,034 | $ 781,386 | -- |

| | Total 1996 | Total 1995 |
|---|---|---|
| Futures and forward contracts and interest rate and currency swaps: | | |
| Exchange traded futures contracts contractual amount | $ 14,108,000 | $ 26,804,947 |
| Over the counter forward contracts contractual amount | $ 216,775,766 | $ 183,709,518 |
| Interest rate and currency swaps: | | |
| Notional amount: | | |
| Interest rate swaps and forward rate agreements | $ 66,306,480 | $ 29,935,395 |
| Currency swaps | 5,853,194 | 4,540,896 |
| Total | $ 72,159,674 | $ 34,476,291 |
| Futures and forward contracts and interest rate and currency swaps: | | |
| Credit exposure: | | |
| Gross replacement value | $ 6,668,826 | $ 4,723,747 |
| Master netting arrangements | (3,557,323) | (2,505,337) |
| Collateral | (146,087) | (148,582) |
| Net replacement value | $ 2,965,416 | $ 2,069,828 |

| | Total 1996 | Total 1995 |
|---|---|---|
| Option contracts: | | |
| Contractual amounts for purchased options: | | |
| Exchange traded | $ 1,567,415 | $ 1,258,028 |
| Over the counter | 27,377,217 | 25,278,914 |
| Total | $ 28,944,632 | $ 26,536,942 |
| Credit exposure for purchased options: | | |
| Gross replacement value | $ 820,940 | $ 705,180 |
| Master netting arrangements | (314,968) | (229,513) |
| Collateral | (3,260) | (16,469) |
| Net replacement value | $ 502,712 | $ 459,198 |
| Contractual amounts for sold options* | $ 32,378,806 | $ 28,080,000 |

* 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 December 31, 1996, 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 Interest Rate and Currency Swaps | Over the Counter Purchased Options | Total 1996 | Total 1995 |
| Counterparty credit quality: | | | | |
| AAA | $ 372,433 | $ 74,803 | $ 447,236 | $ 214,202 |
| AA | 836,465 | 239,248 | 1,075,713 | 906,039 |
| A | 1,049,812 | 83,520 | 1,133,332 | 528,546 |
| BBB | 466,922 | 51,563 | 518,485 | 72,030 |
| Below investment grade | 99,234 | 16,576 | 115,810 | 22,653 |
| Not externally rated, including exchange traded futures and options* | 140,550 | 37,002 | 177,552 | 785,556 |
| Total | $ 2,965,416 | $ 502,712 | $ 3,468,128 | $ 2,529,026 |

* 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 December 31, 1996, 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 Interest Rate and Currency Swaps | Over the Counter Purchased Options | Total 1996 | Total 1995 |
| Non-U.S. banks | $ 1,010,612 | $ 258,787 | $ 1,269,399 | $ 834,265 |
| U.S. industrials | 744,840 | 16,794 | 761,634 | 340,071 |
| Governmental | 120,648 | 630 | 121,278 | 152,058 |
| Non-U.S. financial service companies | 147,792 | 38,684 | 186,476 | 257,824 |
| Non-U.S. industrials | 178,894 | 13,775 | 192,669 | 115,641 |
| U.S. banks | 255,290 | 53,864 | 309,154 | 324,915 |
| U.S. financial service companies | 366,790 | 83,176 | 449,966 | 231,014 |
| Exchanges* | 140,550 | 37,002 | 177,552 | 273,238 |
| Total | $ 2,965,416 | $ 502,712 | $ 3,468,128 | $ 2,529,026 |

* 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 purchases 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, trading liabilities, securities and spot commodities sold, 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.

Accounting Standards

In June 1996, the Financial Accounting Standards Board (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.

Subsequent to June 1996, FASB issued Statement of Financial Accounting Standards No. 127 "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125" (FASB 127). FASB 127 delays the implementation of certain provisions of FASB 125 for one year. AIG will delay implementation with respect to those affected provisions.

In February 1997, FASB issued Statement of Financial Accounting Standards No. 128 "Earnings Per Share" (FASB 128). This statement simplifies the existing computational guidelines, revises the disclosure requirements and increases earnings per share comparability on an international basis.

FASB 128 is effective for year end 1997. Although earlier application is not permitted, all prior period information is required to be restated upon adoption.

In February 1997, the Securities and Exchange Commission (SEC) issued Financial Reporting Release No. 48 "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments"(FRR No. 48).

FRR No. 48 amends rules and forms for registrants and requires clarification and expansion of existing disclosures for derivative financial instruments, other financial instruments and derivative commodity instruments, as defined therein. The amendments require enhanced disclosure with respect to these derivative instruments in the footnotes to the financial statements. Additionally, the amendments expand existing disclosure requirements to include quantitative and qualitative discussions with respect to market risk inherent in market risk sensitive instruments such as equity and fixed maturity securities, as well as these derivative instruments. These amendments are designed to provide additional information about market risk sensitive instruments which investors can use to better understand and evaluate market risk exposures of registrants, including AIG. These disclosures will be effective with AIG's reporting during 1997.





---

ITEM 8.Financial Statements and Supplementary Data

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
INDEX TO FINANCIAL STATEMENTS AND SCHEDULES







---

Report of Independent Accountants

The Board of Directors and Shareholders
American International Group, Inc.:

We have audited the consolidated financial statements and the financial statement schedules of American International Group, Inc. and subsidiaries listed in the index on page 34 of this Form 10-K. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the account-ing principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of American International Group, Inc. and subsidiaries as of December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statements schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.

New York, New York
February 20, 1997.





CONSOLIDATED BALANCE SHEET
American International Group, Inc. and Subsidiaries

(in thousands)

| December 31, | 1996 | 1995 |
|---|---|---|
| Assets: | | |
| Investments and cash: | | |
| Fixed maturities: | | |
| Bonds held to maturity, at amortized cost (market value: 1996-$12,865,357; 1995-$11,822,190) | $ 12,258,978 | $ 11,086,025 |
| Bonds available for sale, at market value (amortized cost: 1996-$34,243,127; 1995-$29,417,475) | 35,524,932 | 30,926,771 |
| Bonds trading securities, at market value (cost: 1996-$357,023; 1995-$411,245) | 364,069 | 428,296 |
| Preferred stocks, at amortized cost (market value: 1996-$591,091; 1995-$620,217) | 477,247 | 459,505 |
| Equity securities: | | |
| Common stocks (cost: 1996-$4,993,799; 1995-$4,555,334) | 5,989,572 | 5,294,867 |
| Non-redeemable preferred stocks (cost: 1996-$64,705; 1995-$73,497) | 76,068 | 74,454 |
| Mortgage loans on real estate, policy and collateral loans-net | 7,876,820 | 7,860,532 |
| Financial services assets: | | |
| Flight equipment primarily under operating leases, net of accumulated depreciation (1996-$1,465,031; 1995-$1,182,128) | 13,808,660 | 12,442,010 |
| Securities available for sale, at market value (cost: 1996-$9,775,705; 1995-$3,930,622) | 9,785,909 | 3,931,100 |
| Trading securities, at market value | 2,357,812 | 2,641,436 |
| Spot commodities, at market value | 204,705 | 383,374 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 6,906,012 | 7,250,954 |
| Trading assets | 3,793,433 | 4,017,735 |
| Securities purchased under agreements to resell, at contract value | 1,642,591 | 2,022,056 |
| Other invested assets | 2,915,302 | 2,808,158 |
| Short-term investments, at cost which approximates market value | 2,008,123 | 2,272,528 |
| Cash | 58,740 | 88,371 |
| Total investments and cash | 106,048,973 | 93,988,172 |

| | | |
|---|---|---|
| Investment income due and accrued | 1,198,348 | 1,212,948 |
| Premiums and insurance balances receivable-net | 9,617,061 | 9,410,185 |
| Reinsurance assets | 16,526,566 | 16,878,155 |
| Deferred policy acquisition costs | 6,471,357 | 5,767,573 |
| Investments in partially-owned companies | 951,352 | 820,781 |
| Real estate and other fixed assets, net of accumulated depreciation (1996-$1,390,225; 1995-$1,303,693) | 2,122,762 | 1,822,061 |
| Separate and variable accounts | 3,271,716 | 2,506,791 |
| Other assets | 2,222,867 | 1,729,732 |
| Total assets | $148,431,002 | $134,136,398 |

See Accompanying Notes to Financial Statements.



CONSOLIDATED BALANCE SHEET (CONTINUED)

American International Group, Inc. and Subsidiaries

(in thousands, except share amounts)

| December 31, | 1996 | 1995 |
|---|---|---|
| Liabilities: | | |
| Reserve for losses and loss expenses | $ 33,429,807 | $ 33,046,717 |
| Reserve for unearned premiums | 7,598,928 | 6,938,064 |
| Future policy benefits for life and accident and health insurance contracts | 24,002,860 | 20,864,635 |
| Policyholders' contract deposits | 9,803,409 | 9,580,983 |
| Other policyholders' funds | 2,219,907 | 2,092,165 |
| Reserve for commissions, expenses and taxes | 1,511,122 | 1,257,246 |
| Insurance balances payable | 1,832,649 | 1,886,403 |
| Funds held by companies under reinsurance treaties | 383,306 | 344,692 |
| Income taxes payable: | | |
| Current | 201,978 | 325,113 |
| Deferred | 586,703 | 552,144 |
| Financial services liabilities: | | |
| Borrowings under obligations of guaranteed investment agreements | 5,723,228 | 5,423,555 |
| Securities sold under agreements to repurchase, at contract value | 3,039,423 | 1,379,872 |
| Trading liabilities | 3,313,508 | 3,594,249 |
| Securities and spot commodities sold but not yet purchased, at market value | 1,568,542 | 1,204,386 |
| Unrealized loss on interest rate and currency swaps, options and forward transactions | 5,414,433 | 5,890,289 |
| Deposits due to banks and other depositors | 1,206,374 | 957,441 |
| Commercial paper | 2,739,388 | 1,834,882 |
| Notes, bonds and loans payable | 12,312,805 | 9,447,499 |
| Commercial paper | 1,758,588 | 1,331,753 |
| Notes, bonds, loans and mortgages payable | 986,505 | 467,784 |
| Separate and variable accounts | 3,271,716 | 2,506,791 |
| Other liabilities | 3,081,599 | 2,982,632 |
| Total liabilities | 125,986,778 | 113,909,295 |
| Commitments and contingent liabilities | | |
| Preferred shareholders' equity in subsidiary company | 400,000 | 400,000 |
| Capital funds: | | |
| Common stock, $2.50 par value; 1,000,000,000 shares authorized; shares issued 1996-506,084,172; 1995-506,084,177 | 1,265,210 | 1,265,210 |
| Additional paid-in capital | 127,415 | 131,828 |
| Unrealized appreciation of investments, net of taxes | 1,378,318 | 1,395,064 |
| Cumulative translation adjustments, net of taxes | (493,218) | (456,072) |
| Retained earnings | 20,420,881 | 17,697,739 |
| Treasury stock; 1996-36,643,026; 1995-31,899,951 shares of common stock (including 27,817,986 and 27,814,386 shares, respectively, held by subsidiaries) | (654,382) | (206,666) |
| Total capital funds | 22,044,224 | 19,827,103 |
| Total liabilities and capital funds | $148,431,002 | $134,136,398 |

See Accompanying Notes to Financial Statements.

## CONSOLIDATED STATEMENT OF INCOME

American International Group, Inc. and Subsidiaries

(in thousands, except per share amounts)

| Years Ended December 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| General insurance operations: | | | |
| Net premiums written | $ 12,691,679 | $ 11,893,022 | $ 10,865,753 |
| Change in unearned premium reserve | (836,864) | (487,291) | (578,922) |
| Net premiums earned | 11,854,815 | 11,405,731 | 10,286,831 |
| Net investment income | 1,689,371 | 1,545,717 | 1,435,092 |
| Realized capital gains | 64,985 | 68,075 | 52,487 |
| | 13,609,171 | 13,019,523 | 11,774,410 |
| Losses incurred | 7,278,815 | 7,071,238 | 6,645,223 |
| Loss expenses incurred | 1,717,616 | 1,588,597 | 1,360,378 |
| Underwriting expenses (principally policy acquisition costs) | 2,459,440 | 2,384,313 | 2,133,713 |
| | 11,455,871 | 11,044,148 | 10,139,314 |
| Operating income | 2,153,300 | 1,975,375 | 1,635,096 |
| Life insurance operations: | | | |
| Premium income | 8,978,246 | 8,038,150 | 6,724,321 |
| Net investment income | 2,675,881 | 2,264,905 | 1,748,428 |
| Realized capital gains | 34,798 | 32,703 | 86,706 |
| | 11,688,925 | 10,335,758 | 8,559,455 |
| Death and other benefits | 3,733,523 | 3,348,058 | 2,716,093 |
| Increase in future policy benefits | 4,370,055 | 3,739,976 | 3,066,468 |
| Acquisition and insurance expenses | 2,261,589 | 2,157,119 | 1,824,410 |
| | 10,365,167 | 9,245,153 | 7,606,971 |
| Operating income | 1,323,758 | 1,090,605 | 952,484 |
| Agency and service fee operating income | 52,267 | 56,909 | 54,129 |
| Financial services operating income | 523,906 | 417,741 | 404,853 |
| Equity in income of minority-owned insurance operations | 99,359 | 81,722 | 56,005 |
| Other realized capital losses | (11,792) | (28,944) | (52,340) |
| Minority interest | (43,226) | (36,317) | (29,657) |
| Other income (deductions)-net | (84,350) | (91,208) | (68,591) |
| Income before income taxes | 4,013,222 | 3,465,883 | 2,951,979 |
| Income taxes (benefits): | | | |
| Current | 1,070,868 | 1,025,774 | 836,764 |
| Deferred | 45,097 | (70,274) | (60,300) |
| | 1,115,965 | 955,500 | 776,464 |
| Net income | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 |
| Earnings per common share | $ 6.15 | $ 5.30 | $ 4.58 |
| Average shares outstanding | 471,045 | 474,022 | 474,879 |

See Accompanying Notes to Financial Statements.





## CONSOLIDATED STATEMENT OF CAPITAL FUNDS

American International Group, Inc. and Subsidiaries

(in thousands, except per share amounts)

| Years Ended December 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Common stock: | | | |
| Balance at beginning of year | $ 1,265,210 | $ 843,477 | $ 843,477 |
| Stock split effected as dividend | -- | 421,733 | -- |
| Balance at end of year | 1,265,210 | 1,265,210 | 843,477 |

| | | | |
|---|---|---|---|
| Additional paid-in capital: | | | |
| Balance at beginning of year | 131,828 | 565,410 | 572,142 |
| Deficit of proceeds under cost of common stock issued under stock option and stock purchase plans | (15,439) | (15,097) | (6,732) |
| Stock split effected as dividend | -- | (421,733) | -- |
| Other | 11,026 | 3,248 | -- |
| Balance at end of year | 127,415 | 131,828 | 565,410 |
| Unrealized appreciation (depreciation) of investments, net of taxes: | | | |
| Balance at beginning of year | 1,395,064 | 184,556 | 922,646 |
| Changes during year | 8,872 | 1,809,365 | (1,084,566) |
| Deferred income tax (expense) benefit on changes | (25,618) | (598,857) | 346,476 |
| Balance at end of year | 1,378,318 | 1,395,064 | 184,556 |
| Cumulative translation adjustments, net of taxes: | | | |
| Balance at beginning of year | (456,072) | (288,074) | (348,186) |
| Changes during year | (66,993) | (156,523) | 37,089 |
| Applicable income tax benefit (expense) on changes | 29,847 | (11,475) | 23,023 |
| Balance at end of year | (493,218) | (456,072) | (288,074) |
| Retained earnings: | | | |
| Balance at beginning of year | 17,697,739 | 15,340,928 | 13,301,529 |
| Net income | 2,897,257 | 2,510,383 | 2,175,515 |
| Cash dividends to shareholders: | | | |
| Common ($.37, $.32 and $.29 per share, respectively) | (174,115) | (153,572) | (136,116) |
| Balance at end of year | 20,420,881 | 17,697,739 | 15,340,928 |
| Treasury stock, at cost: | | | |
| Balance at beginning of year | (206,666) | (224,636) | (67,413) |
| Cost of shares acquired during year | (493,872) | (17,646) | (178,676) |
| Issued under stock option and stock purchase plans | 38,452 | 35,616 | 21,453 |
| Other | 7,704 | -- | -- |
| Balance at end of year | (654,382) | (206,666) | (224,636) |
| Total capital funds at end of year | $ 22,044,224 | $ 19,827,103 | $ 16,421,661 |

See Accompanying Notes to Financial Statements





## CONSOLIDATED STATEMENT OF CASH FLOWS

American International Group, Inc. and Subsidiaries

(in thousands)

| Years Ended December 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Summary: | | | |
| Net cash provided by operating activities | $ 9,574,907 | $ 6,693,625 | $ 5,388,795 |
| Net cash used in investing activities | (14,455,657) | (11,218,986) | (9,139,291) |
| Net cash provided by financing activities | 4,851,119 | 4,537,495 | 3,669,252 |
| Change in cash | (29,631) | 12,134 | (81,244) |
| Cash at beginning of year | 88,371 | 76,237 | 157,481 |
| Cash at end of year | $ 58,740 | $ 88,371) | $ 76,237 |
| Cash flows from operating activities: | | | |
| Net income | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 |
| 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 | 4,130,962 | 5,182,203 | 5,426,572 |
| Premiums and insurance balances receivable and payable-net | (260,630) | (184,120) | (433,949) |
| Reinsurance assets | 351,589 | (588,548) | (405,819) |
| Deferred policy acquisition costs | (703,784) | (635,328) | (882,836) |
| Investment income due and accrued | 14,600 | (284,997) | (119,683) |
| Funds held under reinsurance treaties | 38,614 | (38,161) | (24,049) |
| Other policyholders' funds | 127,742 | 140,807 | 212,068 |
| Current and deferred income taxes-net | (78,038) | (165,730) | 2,050 |
| Reserve for commissions, expenses and taxes | 253,876 | (61,937) | 205,786 |
| Other assets and liabilities-net | (394,168) | 511,489 | (123,796) |
| Trading assets and liabilities-net | (56,439) | 97,985 | (881,227) |
| Trading securities, at market value | 283,624 | (157,799) | 32,529 |
| Spot commodities, at market value | 178,669 | 533,459 | (152,618) |
| Net unrealized gain on interest rate and currency swaps, options and forward transactions | (130,914) | (369,372) | (351,173) |
| Securities purchased under agreements to resell | 379,465 | (812,653) | 1,528,104 |
| Securities sold under agreements to repurchase | 1,659,551 | 37,808 | (957,499) |
| Securities and spot commodities sold but not yet purchased, at market value | 364,156 | 642,399 | (420,224) |
| Realized capital gains | (87,992) | (71,834) | (86,853) |
| Equity in income of partially-owned companies and other invested assets | (152,946) | (119,116) | (108,378) |
| Depreciation expenses, principally flight equipment | 805,581 | 734,560 | 581,930 |
| Change in cumulative translation adjustments | (66,993) | (156,523) | 37,089 |
| Other-net | 21,125 | (51,350) | 135,256 |

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Total adjustments | 6,677,650 | 4,183,242 | 3,213,280 |
| Net cash provided by operating activities | $ 9,574,907 | $ 6,693,625 | $ 5,388,795 |

See Accompanying Notes to Financial Statements.





CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

(in thousands)

| Years Ended December 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Cash flows from investing activities: | | | |
| Cost of fixed maturities, at amortized cost matured or redeemed | $ 1,626,925 | $ 1,111,864 | $ 580,098 |
| Cost of bonds, at market sold | 9,514,381 | 7,633,674 | 7,945,587 |
| Cost of bonds, at market matured or redeemed | 2,480,629 | 2,695,319 | 1,451,753 |
| Cost of equity securities sold | 2,758,264 | 2,517,697 | 2,675,545 |
| Realized capital gains | 87,992 | 71,834 | 86,853 |
| Purchases of fixed maturities | (19,511,037) | (16,947,508) | (16,168,618) |
| Purchases of equity securities | (3,218,375) | (2,588,994) | (3,518,311) |
| Mortgage, policy and collateral loans granted | (3,276,378) | (3,488,856) | (2,691,600) |
| Repayments of mortgage, policy and collateral loans | 3,260,090 | 902,378 | 780,406 |
| Sales of securities available for sale | 2,061,776 | 1,896,109 | 4,421,682 |
| Maturities of securities available for sale | 1,603,215 | 1,183,742 | 464,301 |
| Purchases of securities available for sale | (9,530,755) | (3,210,125) | (3,695,670) |
| Sales of flight equipment | 1,362,632 | 1,158,151 | 266,262 |
| Purchases of flight equipment | (3,254,344) | (3,279,356) | (2,726,791) |
| Net additions to real estate and other fixed assets | (581,221) | (340,563) | (469,759) |
| Sales or distributions of other invested assets | 1,197,620 | 294,855 | 370,047 |
| Investments in other invested assets | (1,262,910) | (970,580) | (913,346) |
| Change in short-term investments | 264,405 | 194,925 | 2,081,866 |
| Investments in partially-owned companies | (38,566) | (53,552) | (79,596) |
| Net cash used in investing activities | $(14,455,657) | $(11,218,986) | $ (9,139,291) |
| Cash flows from financing activities: | | | |
| Change in policyholders' contract deposits | $ 222,426 | $ 3,093,557 | $ 2,047,587 |
| Change in deposits due to banks and other depositors | 248,933 | 301,468 | 98,601 |
| Change in commercial paper | 1,331,341 | (622,924) | 640,674 |
| Proceeds from notes, bonds, loans and mortgages payable | 6,150,471 | 6,115,546 | 4,810,073 |
| Repayments on notes, bonds, loans and mortgages payable | (2,775,482) | (4,290,938) | (2,427,351) |
| Proceeds from guaranteed investment agreements | 3,583,158 | 2,940,563 | 3,650,957 |
| Maturities of guaranteed investment agreements | (3,283,485) | (3,052,326) | (4,851,218) |
| Proceeds from subsidiary company preferred stock issued | (131) | 197,144 | -- |
| Proceeds from common stock issued | 23,013 | 20,519 | 14,721 |
| Cash dividends to shareholders | (174,115) | (153,572) | (136,116) |
| Acquisition of treasury stock | (493,872) | (17,646) | (178,676) |
| Other-net | 18,862 | 6,104 | -- |
| Net cash provided by financing activities | $ 4,851,119 | $ 4,537,495 | $ 3,669,252 |
| Taxes paid | $ 1,068,500 | $ 1,065,700 | $ 741,900 |
| Interest paid | $ 1,594,700 | $ 1,318,700 | $ 1,055,500 |

See Accompanying Notes to Financial Statements.





NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of American International Group, Inc. and all significant subsidiaries (AIG). All material intercompany accounts and transactions have been eliminated.

(B) BASIS OF PRESENTATION: The accompanying financial statements have been prepared on the basis of generally accepted accounting principles (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Certain accounts have been reclassified in the 1995 and 1994 financial statements to conform to their 1996 presentation.

General Insurance Operations: AIG's general insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance. One or more of these companies is licensed to write substantially all of these lines in all states of the United States and in more than 100 foreign countries. Premiums are earned primarily on a pro rata basis over the term of the related coverage. The reserve for unearned premiums represents the portion of premiums written relating to the unexpired terms of coverage.

Acquisition costs are deferred and amortized over the period in which the related premiums written are earned. Investment income is not anticipated in the deferral of acquisition costs. (See Note 4.)

Losses and loss expenses are charged to income as incurred. The reserve for losses and loss expenses represents the accumulation of estimates for reported losses and includes provisions for losses incurred but not reported. The methods of determining such estimates and establishing resulting reserves, including amounts relating to reserves for estimated unrecoverable reinsurance, are continually reviewed and updated. Adjustments resulting therefrom are reflected in income currently. AIG does not discount its loss reserves, other than for minor amounts related to certain workers' compensation claims. (See Note 6.)

Life Insurance Operations: AIG's life insurance subsidiaries offer a wide range of traditional insurance and financial and investment products. One or more of these subsidiaries is licensed to write life insurance in all states of the United States and in over 70 foreign countries. Traditional products consist of individual and group life, annuity, and accident and health policies. Financial and investment products consist of single premium annuity, variable annuities, guaranteed investment contracts and universal life. Premiums for traditional life insurance products are generally recognized as revenues over the premium paying period of the related policies. Benefits and expenses are provided against such revenues to recognize profits over the estimated life of the policies. Revenues for universal life and investment-type products consist of policy charges for the cost of insurance, administration, and surrenders during the period. Expenses include interest credited to policy account balances and benefit payments made in excess of policy account balances. Investment income reflects certain minor amounts of realized capital gains where the gains are deemed to be an inherent element in pricing certain life products in some foreign countries.

Policy acquisition costs for traditional life insurance products are generally deferred and amortized over the premium paying period of the policy. Deferred policy acquisition costs and policy initiation costs related to universal life and investment-type products are amortized in relation to expected gross profits over the life of the policies. (See Note 4.)

The liabilities for future policy benefits and policyholders' contract deposits are established using assumptions described in Note 6.

Financial Services Operations: AIG participates in the derivatives dealer market conducting, primarily as principal, an interest rate, currency and equity derivative products business. AIG also enters into structured transactions including long-dated forward foreign exchange contracts, option transactions, liquidity facilities and investment agreements and invests in a diversified portfolio of securities.

AIG engages in market making and trading activities, as principal, in foreign exchange, interest rates, precious and base metals and natural gas and other energy products. AIG 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.

AIG, as lessor, leases flight equipment principally under operating leases. Accordingly, income is reported over the life of the lease as rentals become receivable under the provisions of the lease or, in the case of leases with varying payments, under the straight-line method over the noncancelable term of the lease. In certain cases, leases provide for additional amounts contingent on usage. AIG is also a remarketer of flight equipment and revenues from such operations consist of net gains on sales of flight equipment, commissions and net gains on disposition of leased flight equipment.

(C) INVESTMENTS IN FIXED MATURITIES AND EQUITY SECURITIES: Bonds and preferred stocks held to maturity, both of which are principally owned by the insurance subsidiaries, are carried at amortized cost where AIG has the ability and positive intent to hold these securities until maturity. Where AIG may not have the positive intent to hold these securities until maturity, those bonds are considered to be available for sale and carried at current market values. Included in the bonds available for sale are collateralized mortgage obligations (CMOs). Premiums and discounts arising from the purchase of CMOs are treated as yield adjustments over their estimated life. Bond trading securities are carried at current market values, as it is AIG's intention to sell these securities in the near term. Common and non-redeemable preferred stocks are carried at current market values.





1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Unrealized gains and losses from investments in equity securities and fixed maturities available for sale are reflected in capital funds currently, net of any related deferred income taxes. Unrealized gains and losses from investments in trading securities are reflected in income currently.

Realized capital gains and losses are determined principally by specific identification. Where declines in values of securities below cost or amortized cost are considered to be other than temporary, a charge is reflected in income for the difference between amortized cost and estimated net realizable value.

(D) MORTGAGE LOANS ON REAL ESTATE, POLICY AND COLLATERAL LOANS--NET: Mortgage loans on real estate, policy loans and collateral loans are carried at unpaid principal balances. Impairment of mortgage loans on real estate and collateral loans is generally measured based on the present value of expected future cash flows discounted at the loan's effective interest rate subject to the fair value of underlying collateral. Interest income on such loans is recognized as cash is received.

(E) FLIGHT EQUIPMENT: Flight equipment is stated at cost. Major additions and modifications are capitalized. Normal maintenance and repairs, airframe and engine overhauls and compliance with return conditions of flight equipment on lease are provided by and paid for by the lessee. Under the provisions of most leases for certain airframe and engine overhauls, the lessee is reimbursed for costs incurred up to but not exceeding contingent rentals paid to AIG by the lessee. AIG provides a charge to income for such reimbursements based upon the hours utilized during the period and the expected reimbursement during the life of the lease. Depreciation and amortization are computed on the straight-line basis to a residual value of approximately 15 percent over the estimated useful lives of the related assets but not exceeding 25 years. This caption also includes deposits for aircraft to be purchased.

At the time the assets are retired or disposed of, the cost and associated accumulated depreciation and amortization are removed from the related accounts and the difference, net of proceeds, is recorded as a gain or loss.

(F) SECURITIES AVAILABLE FOR SALE, AT MARKET VALUE: These securities are held to meet long term investment objectives and are accounted for as available for sale, carried at current market values and recorded on a trade date basis. Unrealized gains and losses from valuing these securities and any related hedges are reflected in capital funds currently, net of any related deferred income taxes.

(G) TRADING SECURITIES, AT MARKET VALUE: Trading securities are held to meet short term investment objectives, including hedging securities. These securities are recorded on a trade date basis and carried at current market values. Unrealized gains and losses are reflected in income currently.

(H) SPOT COMMODITIES, AT MARKET VALUE: Spot commodities are carried at current market values and are recorded on a settlement date basis. Unrealized gains and losses are reflected in income currently. The exposure to market risk may be reduced through the use of forwards, futures and option contracts.

(I) UNREALIZED GAIN AND UNREALIZED LOSS ON INTEREST RATE AND CURRENCY

SWAPS, OPTIONS AND FORWARD TRANSACTIONS: Swaps, options and forward transactions are accounted for as contractual commitments recorded on a trade date basis and are carried at current market values or estimated fair values when market values are not available. Unrealized gains and losses are reflected in income currently. Estimated fair values are based on the use of valuation models that utilize, among other things, current interest, foreign exchange and volatility rates. These valuations represent an assessment of the present values of expected future cash flows of these transactions and may include reserves for market risk as deemed appropriate. The portfolio's discounted cash flows are evaluated with reference to current market conditions, maturities within the portfolio and other relevant factors. Based upon this evaluation, it is determined what, if any, offsetting transactions are necessary to reduce the market risk of the portfolio. AIG manages its market risk with a variety of transactions, including swaps, trading securities, futures contracts and other transactions as appropriate. Because of the limited liquidity of some of these instruments, the recorded values of these transactions may be different than the values that might be realized if AIG were to sell or close out the transactions prior to maturity. AIG believes that such differences are not significant to the results of operations, financial condition or liquidity.

(J) TRADING ASSETS AND TRADING LIABILITIES: Trading assets and trading liabilities include option premiums paid and received and receivables from and payables to counterparties which relate to unrealized gains and losses on futures, forwards and options and balances due from and due to clearing brokers and exchanges.

Futures, forwards and options purchased and written are accounted for as contractual commitments on a trade date basis and are carried at fair values. Unrealized gains and losses are reflected in income currently. The fair values of futures contracts are based on closing exchange quotations. Commodity forward transactions are carried at fair values derived from dealer quotations and underlying commodity exchange quotations. For long dated forward transactions, where there are no dealer or exchange quotations, fair values are derived using internally developed valuation methodologies based on available market information. Options are carried at fair values based on the use of valuation models that utilize, among other things, current interest or commodity rates and foreign exchange and volatility rates, as applicable.





1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(K) SECURITIES PURCHASED (SOLD) UNDER AGREEMENTS TO RESELL (REPURCHASE), AT CONTRACT VALUE: Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are accounted for as collateralized transactions and are recorded at their contracted resale or repurchase amounts, plus accrued interest. Generally, it is AIG's policy to take possession of or obtain a security interest in securities purchased under agreements to resell.

AIG minimizes the credit risk that counterparties to transactions might be unable to fulfill their contractual obligations by monitoring customer credit exposure and collateral value and generally requiring additional collateral to be deposited with AIG when deemed necessary.

(L) OTHER INVESTED ASSETS: Other invested assets consist primarily of investments in joint ventures and partnerships and other investments not classified elsewhere herein. The joint ventures and partnerships are carried at equity or cost depending on the nature of the invested asset and the ownership percentage thereof. Other investments are carried at cost or market values depending upon the nature of the underlying assets. Unrealized gains and losses from the revaluation of those investments carried at market values are reflected in capital funds, net of any related deferred income taxes.

(M) REINSURANCE ASSETS: Reinsurance assets include the balances due from both reinsurance and insurance companies under the terms of AIG's reinsurance arrangements for paid and unpaid losses and loss expenses, ceded unearned premiums and ceded future policy benefits for life and accident and health insurance contracts and benefits paid and unpaid. It also includes funds held under reinsurance treaties.

(N) INVESTMENTS IN PARTIALLY-OWNED COMPANIES: The equity method of accounting is used for AIG's investment in companies in which AIG's ownership interest approximates twenty but is not greater than fifty percent (minority-owned companies). Equity in income of minority-owned insurance operations is presented separately in the consolidated statement of income. Equity in realized capital gains of such companies is included in other realized capital gains (losses). Equity in net income of other unconsolidated companies is principally included in other income (deductions)-net. At December 31, 1996, AIG's significant investments in partially-owned companies included its 49.1 percent interest in Transatlantic Holdings, Inc. (Transatlantic), which derives approximately 20 percent of its assumed reinsurance from AIG subsidiaries; its 19.9 percent interest in Richmond Insurance Company; its 23.9 percent interest in SELIC Holdings, Ltd; and its 24.4 percent interest in IPC Holdings, Ltd. This balance sheet caption also includes investments in less significant partially-owned companies and in certain minor majority-owned subsidiaries. At December 31, 1996, the market value of AIG's investment in Transatlantic exceeded its carrying value by approximately $320.4 million.

(O) REAL ESTATE AND OTHER FIXED ASSETS: The costs of buildings and furniture and equipment are depreciated principally on a straight-line basis over their estimated useful lives (maximum of 40 years for buildings and 10 years for furniture and equipment). Expenditures for maintenance and repairs are charged to income as incurred; expenditures for betterments are capitalized anddepreciated.

(P) SEPARATE AND VARIABLE ACCOUNTS: Separate and variable accounts represent funds for which investment income and investment gains and losses accrue directly to the policyholders. Each account has specific investment objectives, and the assets are carried at market value. The assets of each account are legally segregated and are not subject to claims which arise out of any other business of AIG.

(Q) SECURITIES AND SPOT COMMODITIES SOLD BUT NOT YET PURCHASED, AT MARKET VALUE: Securities and spot commodities sold but not yet purchased represent sales of securities and spot commodities not owned at the time of sale. Securities are recorded on a trade date basis and are carried at current market values. Spot commodities are carried at current market values based upon current commodity prices. Unrealized gains and losses are reflected in income currently.

(R) PREFERRED SHAREHOLDERS' EQUITY IN SUBSIDIARY COMPANY: Preferred shareholders' equity in subsidiary company relates to outstanding market auction preferred stock of International Lease Finance Corporation (ILFC), a wholly owned subsidiary of AIG.

(S) TRANSLATION OF FOREIGN CURRENCIES: Financial statement accounts expressed in foreign currencies are translated into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52 "Foreign Currency Translation" (FASB 52). Under FASB 52, functional currency assets and liabilities are translated into U.S. dollars generally using current rates of exchange and the related translation adjustments are recorded as a separate component of capital funds net of any related taxes. Functional currencies are generally the currencies of the local operating environment. Income statement accounts expressed in functional currencies are translated using average exchange rates. The adjustments resulting from translation of financial statements of foreign entities operating in highly inflationary economies are recorded in income. Exchange gains and losses resulting from foreign currency transactions are also recorded in income currently. The exchange gain or loss with respect to utilization of foreign exchange hedging instruments is recorded as a component of capital funds.

(T) INCOME TAXES: Deferred federal and foreign income taxes are provided for temporary differences for the expected future tax consequences of events that have been recognized in AIG's financial statements or tax returns.

(U) EARNINGS PER SHARE: Earnings per common share are based on the weighted average number of common shares outstanding, retroactively adjusted to reflect all stock dividends





- --------------------------------------------------------------------------------

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

and stock splits. The effect of all other common stock equivalents is not significant for any period presented.

(V) ACCOUNTING STANDARDS: In June 1996, the Financial Accounting Standards Board (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.

Subsequent to June 1996, FASB issued Statement of Financial Accounting Standards No. 127 "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125" (FASB 127). FASB 127 delays the implementation of certain provisions of FASB 125 for one year. AIG will delay implementation with respect to those affected provisions.

In February 1997, FASB issued Statement of Financial Accounting Standards No. 128 "Earnings Per Share" (FASB 128). This statement simplifies the existing computational guidelines, revises the disclosure requirements and increases earnings per share comparability on an international basis.

FASB 128 is effective for year end 1997. Although earlier application is not permitted, all prior period information is required to be restated upon adoption.

In February 1997, the Securities and Exchange Commission (SEC) issued Financial Reporting Release No. 48 "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments"(FRR No. 48).

FRR No. 48 amends rules and forms for registrants and requires clarification and expansion of existing disclosures for derivative financial instruments, other financial instruments and derivative commodity instruments, as defined therein. The amendments require enhanced disclosure with respect to these derivative instruments in the footnotes to the financial statements. Additionally, the amendments expand existing disclosure requirements to include quantitative and qualitative discussions with respect to market risk inherent in market risk sensitive instruments such as equity and fixed maturity securities, as well as these derivative instruments. These amendments are designed to provide additional information about market risk sensitive instruments which investors can use to better understand and evaluate market risk exposures of registrants, including AIG. These disclosures will be effective with AIG's reporting during 1997.

2. FOREIGN OPERATIONS

Certain subsidiaries operate solely outside of the United States. Their assets and liabilities are located principally in the countries where the insurance risks are written and/or investment and non-insurance related operations are located. In addition, certain of AIG's domestic subsidiaries have branch and/or subsidiary operations and substantial assets and liabilities in foreign countries. Certain countries have restrictions on the conversions of funds which generally cause a delay in the outward remittance of such funds. Approximately 38 percent and 37 percent of consolidated assets at December 31, 1996 and 1995, respectively, and 53 percent of revenues for each of the years ended December 31, 1996, 1995 and 1994, respectively, were located in or derived from foreign countries (other than Canada). (See Note 18.)

3. FEDERAL INCOME TAXES

(a) AIG and its domestic subsidiaries file a consolidated U.S. Federal income tax return. A Revenue Agent's Report assessing additional taxes for the years

1987 and 1988 has been issued and a Letter of Protest contesting the assessments has been filed with the Internal Revenue Service. It is management's belief that there are substantial arguments in support of the positions taken by AIG in its Letter of Protest. Management also believes that the final result of these examinations will be immaterial to the financial statements.

Foreign income not expected to be taxed in the United States has arisen because AIG's foreign subsidiaries were generally not subject to U.S. income taxes on income earned prior to January 1, 1987. Such income would become subject to U.S. income taxes at current tax rates if remitted to the United States or if other events occur which would make these amounts currently taxable. The cumulative amount of undistributed earnings of AIG's foreign subsidiaries currently not subject to U.S. income taxes was approximately $3.1 billion at December 31, 1996. Management presently has no intention of subjecting these accumulated earnings to material U.S. income taxes and no provision has been made in the accompanying financial statements for such taxes.

Income taxes paid in 1996, 1995 and 1994 amounted to $1,068,500,000, $1,065,700,000 and $741,900,000, respectively.

The Uruguay Round of the General Agreement on Tariffs and Trade Agreements Act (GATT), which was approved in 1994, contains several revenue raising provisions. One of GATT's funding measures requires AIG to include, in its estimated tax payments, income taxes resulting from the Subpart F income of foreign subsidiaries. Previously, payment was required when the return was filed.





3. FEDERAL INCOME TAXES (continued)

During 1994, the Internal Revenue Service issued Treasury Regulations that affect the tax accounting method for companies which enter into hedging transactions. The effect of these Regulations was to accelerate the timing of AIG's income tax payments.

(b) The U.S. Federal income tax rate is 35 percent for 1996, 1995 and 1994. Actual tax expense on income differs from the "expected" amount computed by applying the Federal income tax rate because of the following:

(dollars in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | AMOUNT | PERCENT OF PRE-TAX INCOME | Amount | Percent of pre-tax income | Amount | Percent of pre-tax income |
| "Expected" tax expense | $1,404,627 | 35.0% | $1,213,059 | 35.0% | $1,033,193 | 35.0% |
| Adjustments: | | | | | | |
| Tax exempt interest | (278,545) | (6.9) | (274,090) | (7.9) | (260,146) | (8.8) |
| Dividends received deduction | (23,790) | (0.6) | (18,583) | (0.5) | (12,326) | (0.4) |
| State income taxes | 46,925 | 1.2 | 48,579 | 1.4 | 36,025 | 1.2 |
| Foreign income not expected to be taxed in the U.S., less foreign income taxes | (6,619) | (0.2) | (5,010) | (0.1) | 4,708 | 0.2 |
| Other | (26,633) | (0.7) | (8,455) | (0.3) | (24,990) | (0.9) |
| Actual tax expense | $1,115,965 | 27.8% | $ 955,500 | 27.6% | $ 776,464 | 26.3% |
| Foreign and domestic components of actual tax expense: | | | | | | |
| Foreign: | | | | | | |
| Current | $ 391,791 | | $ 341,998 | | $ 244,405 | |
| Deferred | (1,333) | | 45,685 | | 38,625 | |
| Domestic*: | | | | | | |
| Current | 679,077 | | 683,776 | | 592,359 | |
| Deferred | 46,430 | | (115,959) | | (98,925) | |
| Total | $1,115,965 | | $ 955,500 | | $ 776,464 | |

* Including U.S. tax on foreign income.

(c) The components of the net deferred tax liability as of December 31, 1996 and December 31, 1995 were as follows:

(in Thousands)

| | 1996 | 1995 |
|---|---|---|
| Deferred tax assets: | | |
| Loss reserve discount | $1,236,858 | $1,266,292 |
| Unearned premium reserve reduction | 312,819 | 271,119 |
| Accruals not currently deductible | 385,892 | 392,192 |
| Adjustment to life policy reserves | 638,702 | 506,896 |
| Cumulative translation adjustment | 50,152 | 16,509 |
| Other | 9,122 | 28,136 |
| | 2,633,545 | 2,481,144 |
| Deferred tax liabilities: | | |
| Deferred policy acquisition costs | 1,338,501 | 1,213,557 |
| Financial service products mark to market differential | 153,265 | 175,952 |
| Depreciation of flight equipment | 819,375 | 669,742 |
| Acquisition net asset basis adjustments | 175,698 | 225,081 |
| Unrealized appreciation of investments | 681,705 | 656,572 |
| Other | 51,704 | 92,384 |
| | 3,220,248 | 3,033,288 |
| Net deferred tax liability | $ 586,703 | $ 552,144 |





4. DEFERRED POLICY ACQUISITION COSTS

The following reflects the policy acquisition costs deferred for amortization against future income and the related amortization charged to income for general and life insurance operations, excluding certain amounts deferred and amortized in the same period:

(in Thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| General insurance operations: | | | |
| Balance at beginning of year | $1,289,788 | $1,179,494 | $1,009,545 |
| Acquisition costs deferred | | | |
| Commissions | 591,708 | 570,180 | 602,014 |
| Other | 714,491 | 648,154 | 523,246 |
| | 1,306,199 | 1,218,334 | 1,125,260 |
| Amortization charged to income | | | |
| Commissions | 557,092 | 590,415 | 469,181 |
| Other | 623,046 | 517,625 | 486,130 |
| | 1,180,138 | 1,108,040 | 955,311 |
| Balance at end of year | $1,415,849 | $1,289,788 | $1,179,494 |
| Life insurance operations: | | | |

| | | | |
|---|---|---|---|
| Balance at beginning of year | $4,477,785 | $3,952,751 | $3,239,864 |
| Acquisition costs deferred | | | |
| Commissions | 941,491 | 819,596 | 741,532 |
| Other | 400,319 | 387,438 | 337,066 |
| | 1,341,810 | 1,207,034 | 1,078,598 |
| Amortization charged to income | | | |
| Commissions | 426,569 | 426,456 | 368,448 |
| Other | 201,145 | 194,031 | 168,916 |
| | 627,714 | 620,487 | 537,364 |
| (Decrease) increase due to foreign exchange | (136,373) | (61,513) | 171,653 |
| Balance at end of year | $5,055,508 | $4,477,785 | $3,952,751 |
| Total deferred policy acquisition costs | $6,471,357 | $5,767,573 | $5,132,245 |

5. REINSURANCE

In the ordinary course of business, AIG's general and life insurance companies cede reinsurance to other insurance companies in order to provide greater diversification of AIG's business and limit the potential for losses arising from large risks.

General reinsurance is effected under reinsurance treaties and by negotiation on individual risks. Certain of these reinsurance arrangements consist of excess of loss contracts which protect AIG against losses over stipulated amounts. Amounts recoverable from general reinsurers are estimated in a manner consistent with the claims liabilities associated with the reinsurance and presented as a component of reinsurance assets.

AIG life companies limit exposure to loss on any single life. For ordinary insurance, AIG retains a maximum of approximately one million dollars of coverage per individual life. There are smaller retentions for other lines of business. Life reinsurance is effected principally under yearly renewable term treaties. Amounts recoverable from life reinsurers are estimated in a manner consistent with the assumptions used for the underlying policy benefits and are presented as a component of reinsurance assets.

General insurance premiums written and earned were comprised of the following:

(in thousands)

| YEARS ENDED DECEMBER 31, | WRITTEN | EARNED |
|---|---|---|
| 1996 | | |
| Gross premiums | $18,319,132 | $17,579,868 |
| Ceded premiums | (5,627,453) | (5,725,053) |
| Net premiums | $12,691,679 | $11,854,815 |
| 1995 | | |
| Gross premiums | $17,895,120 | $17,243,829 |
| Ceded premiums | (6,002,098) | (5,838,098) |
| Net premiums | $11,893,022 | $11,405,731 |
| 1994 | | |
| Gross premiums | $16,392,409 | $15,665,787 |
| Ceded premiums | (5,526,656) | (5,378,956) |
| Net premiums | $10,865,753 | $10,286,831 |

In the normal course of their operations, certain AIG subsidiaries are provided reinsurance coverages from AIG's minority-owned reinsurance companies. During 1996, 1995 and 1994, the premiums written which were ceded to Transatlantic amounted to $232,000,000, $189,000,000 and $200,000,000, respectively.

For the years ended December 31, 1996, 1995 and 1994, reinsurance recoveries, which reduced loss and loss expenses incurred, amounted to $5.07 billion, $5.14 billion and $4.84 billion, respectively.

Life insurance net premium income was comprised of the following:

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Gross premium income | $9,239,388 | $8,245,422 | $6,886,249 |
| Ceded premiums | (261,142) | (207,272) | (161,928) |
| Net premium income | $8,978,246 | $8,038,150 | $6,724,321 |

Life insurance recoveries, which reduced death and other benefits, approximated $113.5 million, $111.4 million and $96.0 million, respectively, for the years ended December 31, 1996, 1995 and 1994.

AIG's reinsurance arrangements do not relieve AIG from its direct obligation to its insureds. Thus, a credit exposure exists with respect to both general and life reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. AIG holds substantial collateral as security under related reinsurance agreements in the form of funds, securities and/or letters of credit. A provision has been recorded for estimated unrecoverable reinsurance. AIG has been largely successful in prior recovery efforts.

AIG evaluates the financial condition of its reinsurers through an internal reinsurance security committee consisting of members of AIG's Senior Management. No single reinsurer is a material reinsurer to AIG nor is AIG's business substantially dependent upon any reinsurance contract.





5. REINSURANCE (continued)

Life insurance ceded to other insurance companies was as follows:

(in Thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Life insurance in-force | $36,887,659 | $34,779,331 | $30,184,126 |

Life insurance assumed represented 0.2 percent of gross life insurance in-force at December 31, 1996 and 0.1 percent for 1995 and 1994, and life insurance premium income assumed represented 0.1 percent of gross premium income for each of the periods ended December 31, 1996, 1995 and 1994.

Supplemental information for gross loss and benefit reserves net of ceded reinsurance at December 31, 1996 and 1995 follows:

(in thousands)

| | AS REPORTED | NET OF REINSURANCE |
|---|---|---|
| DECEMBER 31, 1996 | | |
| Reserve for losses and loss expenses | $(33,429,807) | $(20,407,307) |
| Future policy benefits for life and accident and health insurance contracts | (24,002,860) | (23,858,860) |
| Premiums and insurance balances receivable-net | 9,617,061 | 11,442,791 |
| Funds held under reinsurance treaties | -- | 74,236 |
| Reserve for unearned premiums | (7,598,928) | (6,138,828) |
| Reinsurance assets | 16,526,566 | -- |
| December 31, 1995 | | |
| Reserve for losses and loss expenses | $(33,046,717) | $(19,692,817) |
| Future policy benefits for life and accident and health insurance contracts | (20,864,635) | (20,728,035) |
| Premiums and insurance balances receivable-net | 9,410,185 | 11,150,516 |
| Funds held under reinsurance treaties | -- | 89,624 |
| Reserve for unearned premiums | (6,938,064) | (5,380,364) |
| Reinsurance assets | 16,878,155 | -- |

6. RESERVE FOR LOSSES AND LOSS EXPENSES AND FUTURE LIFE POLICY BENEFITS AND POLICYHOLDERS' CONTRACT DEPOSITS

(a) The following analysis provides a reconciliation of the activity in the reserve for losses and loss expenses:

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| At beginning of year: | | | |
| Reserve for losses and loss expenses | $ 33,046,700 | $ 31,435,400 | $ 30,046,200 |
| Reinsurance recoverable | (13,353,900) | (13,016,500) | (12,489,200) |
| | 19,692,800 | 18,418,900 | 17,557,000 |
| Losses and loss expenses incurred: | | | |
| Current year | 9,272,400 | 8,935,400 | 8,158,400 |
| Prior year | (276,000) | (275,600) | (152,800) |
| Total | 8,996,400 | 8,659,800 | 8,005,600 |
| Losses and loss expenses paid: | | | |
| Current year | 3,000,500 | 2,610,900 | 1,997,400 |
| Prior year | 5,281,400 | 4,775,000 | 5,146,300 |
| Total | 8,281,900 | 7,385,900 | 7,143,700 |
| At end of year: | | | |
| Net reserve for losses and loss expenses | 20,407,300 | 19,692,800 | 18,418,900 |
| Reinsurance recoverable | 13,022,500 | 13,353,900 | 13,016,500 |
| Total | $ 33,429,800 | $ 33,046,700 | $ 31,435,400 |

(b) The analysis of the future policy benefits and policyholders' contract deposits liabilities as at December 31, 1996 and 1995 follows:

(in thousands)

| | 1996 | 1995 |
|---|---|---|
| Future policy benefits: | | |
| Long duration contracts | $23,382,945 | $20,281,527 |
| Short duration contracts | 619,915 | 583,108 |
| Total | $24,002,860 | $20,864,635 |
| Policyholders' contract deposits: | | |
| Annuities | $ 4,138,141 | $ 3,617,579 |
| Guaranteed investments contracts (GICs) | 2,329,558 | 1,694,030 |
| Corporate-owned life insurance | 2,323,788 | 3,204,913 |
| Universal life | 480,720 | 473,400 |
| Other investment contracts | 531,202 | 591,061 |
| Total | $ 9,803,409 | $ 9,580,983 |

(c) Long duration contract liabilities included in future policy benefits, as presented in the table above, result from traditional life products. Short duration contract liabilities are primarily accident and health products. The liability for future life policy benefits has been established based upon the following assumptions:

(i) Interest rates (exclusive of immediate/terminal funding annuities), which vary by territory, year of issuance and products, range from 2.5 percent to 12.0 percent within the first 20 years. Interest rates on immediate/terminal funding annuities are at a maximum of 12.2 percent and grade to not greater than 7.5 percent.





6. RESERVE FOR LOSSES AND LOSS EXPENSES AND FUTURE LIFE POLICY BENEFITS AND POLICYHOLDERS' CONTRACT DEPOSITS (continued)

(ii) Mortality and surrender rates are based upon actual experience by geographical area modified to allow for variations in policy form. The weighted average lapse rate, including surrenders, for individual and group life approximated 8.1 percent.

(iii) The portions of current and prior net income and of current unrealized appreciation of investments that can inure to the benefit of AIG are restricted in some cases by the insurance contracts and by the local insurance regulations of the countries in which the policies are in force.

(iv) Participating life business represented approximately 31 percent of the gross insurance in-force at December 31, 1996 and 49 percent of gross premium income in 1996. The amount of dividends to be paid is determined annually by the Boards of Directors. Anticipated dividends are considered as a planned contractual benefit in computing the value of future policy benefits and are provided ratably over the premium-paying period of the contracts.

(d) The liability for policyholders' contract deposits has been established based on the following assumptions:

(i) Interest rates credited on deferred annuities vary by year of issuance and range from 3.0 percent to 8.0 percent. Credited interest rate guarantees are generally for a period of one year. Withdrawal charges generally range from 6.0 percent to 10.0 percent grading to zero over a period of 6 to 10 years.

(ii) Domestically, GICs have market value withdrawal provisions for any funds withdrawn other than benefit responsive payments. Interest rates credited generally range from 4.7 percent to 8.1 percent and maturities range from 2 to 7 years. Overseas, primarily in the United Kingdom, GIC type contracts are credited at rates ranging from 4.4 percent to 6.2 percent with guarantees generally being one year. Contracts in other foreign locations have interest rates, maturities and withdrawal charges based upon local economic and regulatory conditions.

(iii) Interest rates on corporate-owned life insurance business are guaranteed at 4.0 percent and the weighted average rate credited in 1996 was 9.4 percent.

(iv) The universal life funds have credited interest rates of 4.5 percent to 7.5 percent and guarantees ranging from 3.5 percent to 5.5 percent depending on the year of issue. Additionally, universal life funds are subject to surrender charges that amount to 10.0 percent of the fund balance grading to zero over a period not longer than 20 years.

(e) Experience adjustments, relating to future policy benefits and policyholders' contract deposits, vary according to the type of contract and the territory in which the policy is in force. In general terms, investments, mortality and morbidity results may be passed through by experience credits or as an adjustment to the premium mechanism, subject to local regulatory guidance.

7. STATUTORY FINANCIAL DATA

Statutory surplus and net income for general insurance and life insurance operations as reported to regulatory authorities were as follows:

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Statutory surplus: | | | |
| General insurance | $12,311,358 | $11,142,956 | $ 9,521,550 |
| Life insurance | 5,541,910 | 4,788,833 | 3,834,269 |
| Statutory net income (including net realized capital gains and losses): | | | |
| General insurance | 1,727,286 | 1,499,345 | 1,304,022 |
| Life insurance | 851,382 | 681,189 | 730,170 |

AIG's insurance subsidiaries file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by domestic or foreign insurance regulatory authorities. The differences between statutory financial statements and financial statements prepared in accordance with GAAP vary between domestic and foreign jurisdictions. The principal differences are that statutory financial statements do not reflect deferred policy acquisition costs and deferred income taxes, all bonds are carried at amortized cost and reinsurance assets and liabilities are presented net of reinsurance. AIG's use of permitted statutory accounting practices does not have a significant impact on statutory surplus.

8. INVESTMENT INFORMATION

(A) STATUTORY DEPOSITS: Cash and securities with carrying values of $3.94 billion and $3.65 billion were deposited by AIG's subsidiaries under requirements of regulatory authorities as of December 31, 1996 and 1995, respectively.

(B) NET INVESTMENT INCOME: An analysis of the net investment income from the general and life insurance operations follows:

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| General insurance: | | | |
| Fixed maturities | $1,391,580 | $1,323,180 | $1,198,432 |
| Equity securities | 75,228 | 53,052 | 90,773 |
| Short-term investments | 39,082 | 44,615 | 48,023 |
| Other (net of interest expense on funds held) | 253,032 | 199,563 | 158,718 |
| Total investment income | 1,758,922 | 1,620,410 | 1,495,946 |
| Investment expenses | 69,551 | 74,693 | 60,854 |
| Net investment income | $1,689,371 | $1,545,717 | $1,435,092 |
| Life insurance: | | | |
| Fixed maturities | $1,773,211 | $1,517,990 | $1,194,686 |
| Equity securities | 86,850 | 70,794 | 58,017 |
| Short-term investments | 62,268 | 67,218 | 92,484 |
| Interest on mortgage, policy and collateral loans | 678,476 | 605,251 | 369,935 |
| Other | 193,614 | 105,119 | 119,769 |
| Total investment income | 2,794,419 | 2,366,372 | 1,834,891 |
| Investment expenses | 118,538 | 101,467 | 86,463 |
| Net investment income | $2,675,881 | $2,264,905 | $1,748,428 |







8. INVESTMENT INFORMATION (continued)

(C) INVESTMENT GAINS AND LOSSES: The realized capital gains (losses) and increase (decrease) in unrealized appreciation of investments for 1996, 1995 and 1994 were as follows:

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Realized capital gains (losses) on investments: | | | |
| Fixed maturities(a) | $ (32,600) | $ 54,293 | $ (116,903) |
| Equity securities | 156,839 | 69,639 | 223,603 |
| Other | (36,248) | (52,098) | (19,847) |
| Realized capital gains | $ 87,991 | $ 71,834 | $ 86,853 |
| Increase (decrease) in unrealized appreciation of investments: | | | |
| Fixed maturities | $ (227,491) | $ 1,905,315 | $(1,357,521) |
| Equity securities | 266,648 | 335,006 | (254,518) |
| Other(b) | (30,285) | (430,956) | 527,473) |
| Increase (decrease) in unrealized appreciation | $ 8,872 | $ 1,809,365 | $(1,084,566) |

(a) The realized gains (losses) resulted from the sale of available for sale fixed maturities.

(b) Includes $51.2 million increase, $480.9 million increase and $440.5 million decrease in unrealized appreciation attributable to participating policyholders at December 31, 1996, 1995 and 1994, respectively.

The gross gains and gross losses realized on the disposition of available for sale securities for 1996, 1995 and 1994 follow:

(in thousands)

| | GROSS REALIZED GAINS | GROSS REALIZED LOSSES |
|---|---|---|
| 1996 | | |
| Bonds | $ 55,031 | $ 80,337 |
| Common Stocks | 353,865 | 200,837 |
| Preferred Stocks | 4,304 | 493 |
| Financial services securities available for sale | 6,668 | 932 |
| Total | $419,868 | $282,599 |
| 1995 | | |
| Bonds | $ 60,205 | $ 42,633 |
| Common Stocks | 276,036 | 215,162 |
| Preferred Stocks | 10,189 | 1,510 |
| Financial services securities available for sale | 8,244 | 799 |
| Total | $354,674 | $260,104 |
| 1994 | | |
| Bonds | $ 50,416 | $139,224 |
| Common Stocks | 302,318 | 92,257 |
| Preferred Stocks | 13,911 | 369 |
| Financial services securities available for sale | 41,029 | 8,334 |
| Total | $407,674 | $240,184 |

(D) MARKET VALUE OF FIXED MATURITIES AND UNREALIZED APPRECIATION OF INVESTMENTS: At December 31, 1996 and 1995, the balance of the unrealized appreciation of investments in equity securities (before applicable taxes) included gross gains of approximately $1,683,000,000 and $1,286,600,000 and gross losses of approximately $675,800,000 and $546,100,000, respectively.

The deferred tax payable related to the net unrealized appreciation of investments was $681,705,000 at December 31, 1996 and $656,572,000 at December 31, 1995.

The amortized cost and estimated market value of investments in fixed maturities carried at amortized cost at December 31, 1996 and December 31, 1995 were as follows:

(in thousands)

| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | ESTIMATED MARKET VALUE |
|---|---|---|---|---|
| 1996 | | | | |
| Fixed maturities held to maturity: | | | | |
| Bonds: | | | | |
| U.S. Government(a) | $ 5,500 | $ 368 | $ 57 | $ 5,811 |
| States(b) | 12,251,042 | 613,340 | 7,279 | 12,857,103 |
| Foreign governments | 937 | 2 | -- | 939 |
| All other corporate | 1,499 | 5 | -- | 1,504 |
| Total bonds | 12,258,978 | 613,715 | 7,336 | 12,865,357 |
| Preferred stocks | 477,247 | 114,088 | 244 | 591,091 |
| Total fixed maturities | $12,736,225 | $ 727,803 | $ 7,580 | $13,456,448 |
| 1995 | | | | |

| | | | | |
|---|---|---|---|---|
| Fixed maturities held to maturity: | | | | |
| Bonds: | | | | |
| U.S. Government(a) | $ 4,908 | $ 604 | $ 5 | $ 5,507 |
| States(b) | 11,078,968 | 743,726 | 8,144 | 11,814,550 |
| Foreign governments | 124 | 9 | -- | 133 |
| All other corporate | 2,025 | -- | 25 | 2,000 |
| Total bonds | 11,086,025 | 744,339 | 8,174 | 11,822,190 |
| Preferred stocks | 459,505 | 160,956 | 244 | 620,217 |
| Total fixed maturities | $11,545,530 | $ 905,295 | $ 8,418 | $12,442,407 |

(a) Including U.S. Government agencies and authorities.

(b) Including municipalities and political subdivisions.





8. INVESTMENT INFORMATION (continued)

The amortized cost and estimated market value of bonds available for sale and carried at market value at December 31, 1996 and 1995 were as follows:

(in thousands)

| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | ESTIMATED MARKET VALUE |
|---|---|---|---|---|
| 1996 | | | | |
| Fixed maturities available for sale: | | | | |
| Bonds: | | | | |
| U.S. Government(a) | $ 1,520,202 | $ 74,112 | $ 24,023 | $ 1,570,291 |
| States(b) | 5,430,777 | 216,421 | 13,046 | 5,634,152 |
| Foreign governments | 8,487,838 | 402,373 | 4,722 | 8,885,489 |
| All other corporate | 18,804,310 | 681,513 | 50,823 | 19,435,000 |
| Total bonds | $34,243,127 | $ 1,374,419 | $ 92,614 | $35,524,932 |
| 1995 | | | | |
| Fixed maturities available for sale: | | | | |
| Bonds: | | | | |
| U.S. Government(a) | $ 1,380,182 | $ 121,977 | $ 1,426 | $ 1,500,733 |
| States(b) | 5,232,316 | 277,086 | 3,275 | 5,506,127 |
| Foreign governments | 7,255,915 | 343,931 | 8,642 | 7,591,204 |
| All other corporate | 15,549,062 | 852,878 | 73,233 | 16,328,707 |
| Total bonds | $29,417,475 | $ 1,595,872 | $ 86,576 | $30,926,771 |

(a) Including U.S. Government agencies and authorities.

(b) Including municipalities and political subdivisions.

The amortized cost and estimated market values of fixed maturities held to maturity and fixed maturities available for sale at December 31, 1996, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

(in thousands)

| | AMORTIZED COST | ESTIMATED MARKET VALUE |
|---|---|---|
| Fixed maturities held to maturity: | | |
| Due in one year or less | $ 631,362 | $ 660,592 |
| Due after one year through five years | 2,061,784 | 2,209,372 |
| Due after five years through ten years | 2,762,501 | 2,948,242 |
| Due after ten years | 7,280,578 | 7,638,242 |
| Total held to maturity | $12,736,225 | $13,456,448 |
| Fixed maturities available for sale: | | |
| Due in one year or less | $ 2,681,882 | $ 2,718,066 |
| Due after one year through five years | 12,399,317 | 12,793,660 |
| Due after five years through ten years | 11,978,014 | 12,559,314 |
| Due after ten years | 7,183,914 | 7,453,892 |
| Total available for sale | $34,243,127 | $35,524,932 |

(E) SECURITIES AVAILABLE FOR SALE: AIGFP follows a policy of minimizing interest rate, equity and currency risks associated with securities available for sale by entering into swap or other transactions. In addition, to reduce its credit risk, AIGFP has entered into credit derivative transactions with respect to $2.40 billion of securities available for sale. At December 31, 1996, the cumulative increase in carrying value of the securities available for sale and related hedges as a result of marking to market such securities net of hedging transactions was $10.2 million.

The amortized cost, related hedges and estimated market value of securities available for sale and carried at market value at December 31, 1996 and 1995 were as follows:

(in thousands)

| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | UNREALIZED GAINS (LOSSES) - NET ON HEDGING TRANSACTIONS | ESTIMATED MARKET VALUE |
|---|---|---|---|---|---|
| 1996 | | | | | |
| Securities available for sale: | | | | | |
| Corporate and bank debt | $4,800,081 | $ 69,294 | $ 20,140 | $ (45,385) | $4,803,850 |
| Foreign government obligations | 2,252,477 | 159,484 | 64,710 | (88,683) | 2,258,568 |
| Asset-backed and collateralized | 1,666,894 | 54,754 | 4,043 | (50,268) | 1,667,337 |
| Preferred stocks | 553,050 | 2,947 | 2,719 | (30) | 553,248 |
| U.S. Government obligations | 503,203 | 1,877 | 2,865 | 691 | 502,906 |
| Total | $9,775,705 | $ 288,356 | $ 94,477 | $ (183,675) | $9,785,909 |
| 1995 | | | | | |
| Securities available for sale: | | | | | |
| Corporate and bank debt | $1,248,881 | $ 33,801 | $ 1,590 | $ (31,410) | $1,249,682 |
| Foreign government obligations | 1,152,656 | 33,475 | 75,878 | 43,381 | 1,153,634 |
| Asset-backed and collateralized | 631,574 | 7,007 | 2,156 | (5,074) | 631,351 |
| Preferred stocks | 453,870 | 3,462 | 3,363 | 16 | 453,985 |
| U.S. Government obligations | 443,641 | 48,906 | 773 | (49,326) | 442,448 |
| Total | $3,930,622 | $ 126,651 | $ 83,760 | $ (42,413) | $3,931,100 |







8. INVESTMENT INFORMATION (continued)

The amortized cost and estimated market values of securities available for sale at December 31, 1996, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

(in thousands)

| | AMORTIZED COST | ESTIMATED MARKET VALUE |
|---|---|---|
| Securities available for sale: | | |
| Due in one year or less | $3,073,563 | $3,073,603 |
| Due after one year through five years | 3,160,001 | 3,168,307 |
| Due after five years through ten years | 1,611,692 | 1,613,278 |
| Due after ten years | 263,555 | 263,384 |
| Asset-backed and collateralized | 1,666,894 | 1,667,337 |
| Total available for sale | $9,775,705 | $9,785,909 |

(F) CMOS: At December 31, 1996, CMOs, held by AIG's life companies, were presented as a component of bonds available for sale, at market value. All of the CMOs were investment grade and approximately 72 percent of the CMOs were backed by various U.S. government agencies. The remaining 28 percent were corporate issuances.

At December 31, 1996 and 1995, the market value of the CMO portfolio was $2.24 billion; the amortized cost was approximately $2.18 billion in 1996 and $2.12 billion in 1995. AIG's CMO portfolio is readily marketable. There were no derivative (high risk) CMO securities contained in this portfolio at December 31, 1996 and 1995.

The distribution of the CMOs at December 31, 1996 and 1995 was as follows:

| | 1996 | 1995 |
|---|---|---|
| GNMA | 25% | 31% |
| FHLMC | 23 | 23 |
| FNMA | 20 | 20 |
| VA | 4 | 5 |
| Other | 28 | 21 |
| | 100% | 100% |

At December 31, 1996, the gross weighted average coupon of this portfolio was 7.4 percent. The gross weighted average life of this portfolio was 6.3 years.

(G) FIXED MATURITIES BELOW INVESTMENT GRADE: At December 31, 1996, the fixed maturities and securities available for sale held by AIG that were below investment grade were insignificant.

(H) At December 31, 1996, non-income producing invested assets were insignificant.

9. DEBT OUTSTANDING

At December 31, 1996, AIG's debt outstanding of $23.52 billion, shown below, included borrowings of $20.10 billion which were either not guaranteed by AIG or were matched borrowings under obligations of guaranteed investment agreements (GIAs) or matched notes and bonds payable.

(in thousands)

| | |
|---|---|
| Borrowings under Obligations of GIAs-- AIGFP | $ 5,723,228 |
| Commercial Paper: | |
| AIG Funding Inc. (Funding) | 1,018,510 |
| ILFC(a) | 2,739,388 |
| A.I. Credit Corp. (AICCO) | 740,078 |
| Total | 4,497,976 |
| Medium Term Notes: | |
| ILFC(a) | 2,551,485 |
| AIG | 140,000 |
| Total | 2,691,485 |
| Notes and Bonds Payable: | |
| ILFC(a) | 3,500,000 |
| AIGFP | 5,243,042 |
| AIGTG | 10,442 |
| AIG: Lire bonds | 159,067 |
| Zero coupon notes | 81,761 |
| Total | 8,994,312 |
| Loans and Mortgages Payable: | |
| ILFC(a) (b) | 1,007,836 |
| AIG | 605,677 |
| Total | 1,613,513 |
| Total Borrowings | 23,520,514 |
| Borrowings not guaranteed by AIG | 9,798,709 |
| Matched GIA borrowings | 5,723,228 |
| Matched notes and bonds payable-- AIGFP | 4,576,900 |
| | 20,098,837 |
| Remaining borrowings of AIG | $ 3,421,677 |

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

(b) Primarily capital lease obligations.

(A) COMMERCIAL PAPER: At December 31, 1996, the commercial paper issued and outstanding was as follows:

(dollars in thousands)

| | NET BOOK VALUE | UNAMORTIZED DISCOUNT | FACE AMOUNT | WEIGHTED AVERAGE INTEREST RATE | WEIGHTED AVERAGE MATURITY |
|---|---|---|---|---|---|
| Funding | $1,018,510 | $ 3,065 | $1,021,575 | 5.79% | 20 days |
| AICCO | 740,078 | 3,036 | 743,114 | 5.50 | 29 days |
| ILFC | 2,739,388 | 18,029 | 2,757,417 | 5.48 | 98 days |
| Total | $4,497,976 | $24,130 | $4,522,106 | -- | -- |

Commercial paper issued by Funding is guaranteed by AIG. AIG has entered into an agreement in support of AICCO's commercial paper. AIG does not guarantee ILFC's commercial paper.

9. DEBT OUTSTANDING (continued)

(B) BORROWINGS UNDER OBLIGATIONS OF GUARANTEED INVESTMENT AGREEMENTS: Borrowings under obligations of guaranteed investment agreements, which are guaranteed by AIG, are recorded at the amount outstanding under each contract. Obligations may be called at various times prior to maturity at the option of the counterparty. Interest rates on these borrowings are primarily fixed and range up to 10.6 percent.

Payments due under these investment agreements in each of the next five years ending December 31, and the periods thereafter based on the earliest call dates, were as follows:

(in thousands)

| | PRINCIPAL AMOUNT |
|---|---|
| 1997 | $2,619,938 |
| 1998 | 620,409 |
| 1999 | 211,582 |
| 2000 | 5,709 |
| 2001 | 120,070 |
| Remaining years after 2001 | 2,145,520 |
| Total | $5,723,228 |

At December 31, 1996, the market value of securities pledged as collateral with respect to these obligations approximated $1.2 billion.

Funds received from GIA borrowings are invested in a diversified portfolio of securities and derivative transactions.

(C) MEDIUM TERM NOTES PAYABLE:

(i) Medium Term Notes Payable Issued by AIG: AIG's Medium Term Notes are unsecured obligations which may not be redeemed by AIG prior to maturity and bear interest at either fixed rates set by AIG at issuance or variable rates determined by reference to an interest rate or other formula.

An analysis of the Medium Term Notes for the year ended December 31, 1996 was as follows:

(in thousands)

| MEDIUM TERM NOTE SERIES: | B | C | E | TOTAL |
|---|---|---|---|---|
| Balance December 31, 1995 | $40,000 | $ 75,000 | $ -- | $ 115,000 |
| Issued during year | -- | -- | 100,000 | 100,000 |
| Matured during year | -- | (75,000) | -- | (75,000) |
| Balance December 31, 1996 | $40,000 | $ -- | $100,000 | $140,000 |

The interest rates on this debt range from 6.05 percent to 8.12 percent. To the extent deemed appropriate, AIG may enter into swap transactions to reduce its effective short-term borrowing rate.

At December 31, 1996, the maturity schedule for AIG's outstanding Medium Term Notes was as follows:

(in thousands)

| | PRINCIPAL AMOUNT |
|---|---|
| 1998 | $ 40,000 |
| 1999 | 100,000 |
| Total | $140,000 |

At December 31, 1996, AIG had $647 million principal amount of Series E Medium Term Notes registered and available for issuance from time to time.

(ii) Medium Term Notes Payable Issued by ILFC: ILFC's Medium Term Notes are unsecured obligations which may not be redeemed by ILFC prior to maturity and bear interest at fixed rates set by ILFC at issuance.

As of December 31, 1996, notes in aggregate principal amount of $2.55 billion were outstanding with maturity dates from 1997 to 2005 at interest rates ranging from 4.9 percent to 9.88 percent. These notes provide for a single principal payment at the maturity of each note.

At December 31, 1996, the maturity schedule for ILFC's outstanding Medium Term Notes was as follows:

(in thousands)

| | PRINCIPAL AMOUNT |
|---|---|
| 1997 | $ 580,200 |
| 1998 | 707,535 |
| 1999 | 578,250 |
| 2000 | 407,500 |
| 2001 | 111,000 |
| Remaining years after 2001 | 167,000 |
| Total | $2,551,485 |

(D) NOTES AND BONDS PAYABLE:

(i) Zero Coupon Notes:On October 1, 1984, AIG issued Eurodollar zero coupon notes in the aggregate principal amount at stated maturity of $750 million. The notes were offered at 12 percent of principal amount at stated maturity, bear no interest and are due August 15, 2004. The net proceeds to AIG from the issuance were $85.6 million. The notes are redeemable at any time in whole or in part at the option of AIG at 100 percent of their principal amount at stated maturity. The notes are also redeemable at the option of AIG or bearer notes may be redeemed at the option of the holder in the event of certain changes involving taxation in the United States at prices ranging from 42.59 percent currently, to 89.88 percent after August 15, 2003, of the principal amount at stated maturity together with accrued amortization of original issue discount from the preceding August 15. During 1996 and 1995, no notes were repurchased. At December 31, 1996, the notes outstanding had a face value of $189.2 million, an unamortized discount of $107.4 million and a net book value of $81.8 million. The amortization of the original issue discount was recorded as interest expense.

Notes to Financial Statements (CONTINUED)

9. DEBT OUTSTANDING (continued)

(ii) Italian Lire Bonds: In December, 1991, AIG issued unsecured bonds denominated in Italian Lire. The principal amount of 200 billion Italian Lire Bonds matures December 4, 2001 and accrues interest at a rate of 11.7 percent which is paid annually. These bonds are not redeemable prior to maturity, except in the event of certain changes involving taxation in the United States or the imposition of certain certification, identification or reporting requirements.

Simultaneous with the issuance of this debt, AIG entered into a swap transaction which effectively converted AIG's net interest expense to a U.S. dollar liability of approximately 7.9 percent, which requires the payment of proceeds at maturity of approximately $159 million in exchange for 200 billion Italian Lire and interest thereon.

(iii) Term Notes Issued by ILFC: ILFC has issued unsecured obligations which may not be redeemed prior to maturity.

As of December 31, 1996, notes in aggregate principal amount of $3.5 billion were outstanding with maturity dates from 1997 to 2004 and interest rates ranging from 4.75 percent to 8.88 percent. $500 million of such term notes are at floating interest rates and the remainder are at fixed rates. These notes provide for a single principal payment at maturity.

At December 31, 1996, the maturity schedule for ILFC's Term Notes was as follows:

(in thousands)

| | PRINCIPAL AMOUNT |
|---|---|
| 1997 | $ 650,000 |
| 1998 | 950,000 |
| 1999 | 1,050,000 |
| 2000 | 500,000 |
| 2001 | 250,000 |
| Remaining years after 2001 | 100,000 |
| Total | $3,500,000 |

AIG does not guarantee any of the debt obligations of ILFC.

(iv) Notes and Bonds Payable Issued by AIGFP:At December 31, 1996, AIGFP's bonds outstanding, the proceeds of which are invested in a segregated portfolio of securities available for sale, were as follows:

(in thousands)

| YEAR OF ISSUE | MATURITY | CURRENCY | INTEREST RATE | U.S. DOLLAR CARRYING VALUE |
|---|---|---|---|---|
| 1993 | 1999 | French franc | 4.60% | $ 514,800 |
| 1995 | 2000 | Great Britain pound | 5.88 | 384,900 |
| 1995 | 2003 | Australian dollar | 5.87 | 73,900 |
| 1995 | 1998 | Italian lire | 7.76 | 122,600 |
| 1996 | 2001 | Great Britain pound | 6.09 | 387,100 |
| 1996 | 2003 | Australian dollar | 6.59 | 152,000 |
| 1996 | 1998 | Italian lire | 6.60 | 326,700 |

| | | | | |
|---|---|---|---|---|
| 1996 | 1998 | U.S. dollar | 9.00 | 178,200 |
| 1996 | 1998 | New Zealand dollar | 8.51 | 354,200 |
| Total | | | | $2,494,400 |

AIGFP has also issued various credit linked notes maturing from 1997 through 2000. These notes have been issued to hedge certain credit risks in AIGFP's portfolio of securities available for sale. The notes are primarily U.S. dollar denominated and have U.S. dollar interest rates ranging from 5.4 percent to 6.3 percent. AIGFP's payment obligations under these notes would be reduced or eliminated upon the occurrence of a payment default or a bankruptcy event with respect to certain third party credit that is being hedged. At December 31, 1996, these notes had a U.S. dollar carrying value of $2.08 billion. No obligations under these notes were reduced or eliminated during 1996.

AIGFP is also obligated under various notes maturing from 1997 through 2026. The majority of these notes are denominated in U.S. dollar, Japanese yen, and Danish kroner and bear interest at various interest rates. At December 31, 1996, these notes had a U.S. dollar carrying value of $666.1 million.

AIG guarantees all of AIGFP's debt.

(E) LOANS AND MORTGAGES PAYABLE: Loans and mortgages payable at December 31, 1996, consisted of the following:

(in thousands)

| | FINANCIAL SERVICES | AIG | TOTAL |
|---|---|---|---|
| Uncollateralized loans payable | $ 11,964 | $494,846 | $ 506,810 |
| Collateralized loans and mortgages payable* | 995,872 | 110,831 | 1,106,703 |
| Total | $1,007,836 | $605,677 | $1,613,513 |

* Primary capital lease obligations.

At December 31, 1996, ILFC's capital lease obligations were $995.9 million. Fixed interest rates with respect to these obligations range from 6.18 percent to 6.89 percent; variable rates are referenced to LIBOR. These obligations mature through 2005. The flight equipment associated with the capital lease obligations had a net book value of $1.17 billion.

(F) REVOLVING CREDIT FACILITIES: 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 December 31, 1996.

(G) INTEREST EXPENSE FOR ALL INDEBTEDNESS: Total interest expense for all indebtedness, net of capitalized interest, aggregated $1,491,318,000 in 1996, $1,361,140,000 in 1995 and $1,289,277,000 in 1994. Interest expense paid approximated $1,594,733,000 in 1996, $1,318,736,000 in 1995 and $1,055,503,000 in 1994.





10. CAPITAL FUNDS

(a) At December 31, 1996, there were 6,000,000 shares of AIG's $5 par value serial preferred stock authorized, issuable in series.

(b) AIG parent depends on its subsidiaries for cash flow in the form of loans, advances and dividends. AIG's insurance subsidiaries are subject to regulatory restrictions on the amount of dividends which can be remitted to AIG parent. These restrictions vary by state. For example, unless permitted by the New York Superintendent of Insurance, general insurance companies domiciled in New York may not pay dividends to shareholders which in any twelve month period exceed the lesser of 10 percent of the company's statutory policyholders' surplus or 100 percent of its "adjusted net investment income", as defined. Generally, less severe restrictions applicable to both general and life insurance companies exist in most of the other states in which AIG's insurance subsidiaries are domiciled. Certain foreign jurisdictions have restrictions which generally cause only a temporary delay in the remittance of dividends. There are also various local restrictions limiting cash loans and advances to AIG by its subsidiaries. Largely as a result of the restrictions, approximately 60 percent of consolidated capital funds were restricted from immediate transfer to AIG parent at December 31, 1996.

(c) The common stock activity for the three years ended December 31, 1996 was as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Shares outstanding at beginning of year | 474,184,226 | 315,840,626 | 317,628,067 |
| Acquired during year | (5,384,672) | (236,443) | (2,086,113) |
| Issued under stock option and purchase plans | 540,768 | 517,844 | 298,672 |
| Issued in connection with acquisition | 100,824 | -- | -- |
| Stock split effected as stock dividend | -- | 168,693,199 | -- |
| Other* | -- | (10,631,000) | -- |
| Shares outstanding at end of year | 469,441,146 | 474,184,226 | 315,840,626 |

* Shares issued to AIG and subsidiaries as part of stock split effected as stock dividend.

Common stock increased and additional paid-in capital decreased $421.7 million as a result of a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995.

## 11. COMMITMENTS AND CONTINGENT LIABILITIES

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

(a) Commitments to extend credit are agreements to lend subject to certain conditions. These commitments generally have fixed expiration dates or termination clauses and typically require payment of a fee. At December 31, 1996 and 1995, these commitments, made principally by AIG Capital Corp., approximated $95,200,000 and $96,300,000, respectively. AIG uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. AIG evaluates each counterparty's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by AIG upon extension of credit, is based on management's credit evaluation of the counterparty.

(b) AIG and certain of its subsidiaries become parties to financial instruments with market risk resulting from both dealer and end user activities and to reduce currency, interest rate, equity and commodity exposures. To the extent those instruments are carried at their estimated fair value, the elements of currency, interest rate, equity and commodity risks are reflected in the consolidated balance sheet. In addition, these instruments involve, to varying degrees, elements of credit risk not explicitly recognized in the consolidated balance sheet. Collateral is required, at the discretion of AIG, on certain transactions based on the creditworthiness of the counterparty.

(c) AIGFP becomes a party to off-balance sheet financial instruments in the normal course of its business and to reduce its currency, interest rate and equity exposures. Interest rate, currency and equity risks related to such instruments are reflected in the consolidated financial statements to the extent these instruments are carried at a market or a fair value, whichever is appropriate. Because of limited liquidity of certain of these instruments, the recorded estimated fair values of such instruments may be different than the values that might be realized if AIGFP were to sell or close out the transactions prior to maturity.

AIGFP, as principal and for its own account, enters into interest rate, currency and equity swaps, swaptions and forward commitments. Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. AIGFP typically becomes a principal in the exchange of interest payments between the parties and, therefore, may be exposed to loss, if counterparties default. Currency and equity swaps are similar to interest rate swaps, but may involve the exchange of principal amounts at the beginning and end of the transaction. At December 31, 1996, the notional principal amount of the sum of the swap pays and receives approximated $210.7 billion, primarily related to interest rate swaps of approximately $165.8 billion.





11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The following tables provide the notional and contractual amounts of AIGFP's, AIGTG's and ILFC's derivatives transactions at December 31, 1996.

The notional amounts used to express the extent of AIGFP's, AIGTG's and ILFC's involvement in swap transactions represent a standard of measurement of the volume of AIGFP's, AIGTG's and ILFC'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 AIGFP's and AIGTG's foreign exchange forwards and exchange traded futures and options contracts are determined by each of the respective contractual agreements.

The following table presents AIGFP's swaps and swaptions portfolio by maturity and type of derivative at December 31, 1996:

(in thousands)

| | REMAINING LIFE | | | | | |
|---|---|---|---|---|---|---|
| | ONE YEAR | TWO THROUGH FIVE YEARS | SIX THROUGH TEN YEARS | AFTER TEN YEARS | TOTAL 1996 | Total 1995 |
| INTEREST RATE, CURRENCY AND EQUITY/COMMODITY SWAPS AND SWAPTIONS: | | | | | | |
| Notional amount: | | | | | | |
| Interest rate swaps | $43,310,500 | $ 72,311,900 | $ 40,928,300 | $ 9,221,100 | $165,771,800 | $130,441,000 |
| Currency swaps | 11,252,100 | 16,316,500 | 8,184,500 | 3,429,800 | 39,182,900 | 28,829,000 |
| Equity/commodity swaps | 32,900 | 20,700 | -- | 50,000 | 103,600 | 320,000 |
| Swaptions | 566,400 | 1,544,500 | 2,530,200 | 976,600 | 5,617,700 | 4,374,000 |
| Total | $55,161,900 | $ 90,193,600 | $ 51,643,000 | $13,677,500 | $210,676,000 | $163,964,000 |

Futures and forward contracts are contracts for delivery of foreign currencies or financial indices in which the seller/purchaser agrees to make/take delivery at a specified future date of a specified instrument, at a specified price or yield. Risks arise as a result of movements in current market prices from contracted prices and the potential inability of counterparties to meet their obligations under the contracts. At December 31, 1996, the contractual amount of AIGFP's futures and forward contracts approximated $12.8 billion.

The following table presents AIGFP's futures and forward contracts portfolio by maturity and type of derivative at December 31, 1996:

(in thousands)

| | REMAINING LIFE | | | | | |
|---|---|---|---|---|---|---|
| | ONE YEAR | TWO THROUGH FIVE YEARS | SIX THROUGH TEN YEARS | AFTER TEN YEARS | TOTAL 1996 | Total 1995 |
| FUTURES AND FORWARD CONTRACTS: | | | | | | |
| Exchange traded futures contracts contractual amount | $6,867,300 | -- | -- | -- | $6,867,300 | $16,050,000 |
| Over the counter forward contracts contractual amount | $5,952,200 | -- | -- | -- | $5,952,200 | $ 2,238,000 |

These instruments involve, to varying degrees, elements of credit risk not explicitly recognized in the consolidated financial statements. AIGFP utilizes various credit enhancements, including collateral, credit triggers and credit derivatives to reduce the credit exposure relating to these off-balance sheet financial instruments. AIGFP requires credit enhancements in connection with specific transactions based on, among other things, the creditworthiness of the counterparties and the transaction's size and maturity. In addition, AIGFP's derivative transactions are generally documented under ISDA Master Agreements. Such agreements provide for legally enforceable set-off and close out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, AIGFP is permitted to set off its receivables from a counterparty against its payables to the same counterparty arising out of all included transactions. As a result, the net replacement value represents the net sum of estimated positive fair values after the application of such strategies, agreements and collateral held. The net replacement value most closely represents the net credit risk to AIGFP or the maximum amount exposed to potential loss. The net replacement value of all interest rate, currency, and equity swaps, swaptions and forward commitments at December 31, 1996, approximated $6.4 billion. The net replacement value for futures and forward contracts at December 31, 1996, approximated $34.3 million.

AIGFP independently evaluates the creditworthiness of its counterparties, taking into account credit ratings assigned by recognized statistical rating organizations. In addition, AIGFP's credit approval process involves pre-set counterparty, country and industry credit exposure limits and, for particularly credit intensive transactions, obtaining approval from AIG's Credit Risk Committee. The average credit rating of AIGFP's counterparties as a whole (as measured by AIGFP) is equivalent to AA. The maximum potential loss will increase or decrease during the life of the derivative commitments as a function of maturity and market conditions.





11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

AIGFP determines counterparty credit quality by reference to ratings from independent rating agencies or internal analysis. At December 31, 1996, 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 | | | |
|---|---|---|---|---|
| | SWAPS AND SWAPTIONS | FUTURES AND FORWARD CONTRACTS | TOTAL 1996 | Total 1995 |
| Counterparty credit quality: | | | | |
| AAA | $1,720,511 | $ 11,804 | $1,732,315 | $1,994,122 |
| AA | 2,009,599 | 12,279 | 2,021,878 | 2,146,085 |

| | | | | |
|---|---|---|---|---|
| A | 1,450,877 | 10,186 | 1,461,063 | 1,442,854 |
| BBB | 1,150,420 | -- | 1,150,420 | 1,239,338 |
| Below investment grade | 26,293 | -- | 26,293 | 48,462 |
| Not externally rated--exchanges* | -- | -- | -- | 23,364 |
| Total | $6,357,700 | $ 34,269 | $6,391,969 | $6,894,225 |

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

At December 31, 1996, 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 | | | |
|---|---|---|---|---|
| | SWAPS AND SWAPTIONS | FUTURES AND FORWARD CONTRACTS | TOTAL 1996 | Total 1995 |
| Non-U.S. banks | $2,306,059 | $ 24,422 | $2,330,481 | $2,443,265 |
| Insured municipalities | 656,373 | -- | 656,373 | 879,642 |
| U.S. industrials | 894,942 | -- | 894,942 | 1,025,014 |
| Governmental | 894,284 | -- | 894,284 | 844,810 |
| Non-U.S. financial service companies | 34,356 | 27 | 34,383 | 39,742 |
| Non-U.S. industrials | 495,082 | 2,757 | 497,839 | 530,611 |
| Special purpose | 121,137 | -- | 121,137 | 113,401 |
| U.S. banks | 248,666 | 2,975 | 251,641 | 318,905 |
| U.S. financial service companies | 530,877 | 4,088 | 534,965 | 424,498 |
| Supranationals | 175,924 | -- | 175,924 | 250,973 |
| Exchanges* | -- | -- | -- | 23,364 |
| Total | $6,357,700 | $ 34,269 | $6,391,969 | $6,894,225 |

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

AIGFP has entered into commitments to provide liquidity for certain tax-exempt variable rate demand notes issued by municipal entities. The agreements allow the holders, in certain circumstances, to tender the notes to the issuer at par value. In the event a remarketing agent of an issuer is unable to resell such tendered notes, AIGFP would be obligated to purchase the notes at par value. With respect to certain notes that have been issued, AIGFP has fulfilled its liquidity commitments by arranging bank liquidity facilities. These banks agree to purchase the notes that AIGFP is otherwise obligated to purchase in connection with a failed remarketing. It is the intention of AIGFP to arrange similar liquidity with respect to the $603.3 million aggregate amount of notes that are expected to be issued through 1999. In connection with one transaction that has a bank liquidity facility, AIGFP has committed through December 31, 1997 to purchase up to $278.0 million of notes in the event the bank is required to purchase notes under the liquidity facility. Any notes so purchased by AIGFP would be insured as to both principal and interest and, while held by AIGFP, would bear interest at an above-market tax-exempt rate. It is AIGFP's intention, as with existing obligations, to remove itself from this risk through bank participations before the issuance of the underlying notes.

Securities sold, but not yet purchased represent obligations of AIGFP to deliver specified securities at their contracted prices, and thereby create a liability to repurchase the securities in the market at prevailing prices.

AIGFP monitors and controls its risk exposure on a daily basis through financial, credit and legal reporting systems and, accordingly, believes that it has in place effective procedures for evaluating and limiting the credit and market risks to which it is subject. Management is not aware of any potential counterparty defaults.





11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The net trading revenues for the twelve months ended December 31, 1996 from AIGFP's operations were $369.2 million.

(d) AIG Trading Group Inc. and its subsidiaries (AIGTG) becomes a party to off-balance sheet financial instruments in the normal course of its business and to reduce its currency, interest rate and commodity exposures.

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

Futures and forward contracts are contracts for delivery of foreign currencies, commodities or financial indices in which the seller/purchaser agrees to make/take delivery at a specified future date of a specified instrument, at a specified price or yield. Risks arise as a result of movements in current market prices from contracted prices and the potential inability of counterparties to meet their obligations under the contracts. At December 31, 1996, the contractual amount of AIGTG's futures and forward contracts approximated $230.9 billion.

The gross replacement values presented represent the sum of the estimated positive fair values of all of AIGTG's derivatives contracts at December 31, 1996. 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. At December 31, 1996, the net replacement value of AIGTG's futures and forward contracts and interest rate and currency swaps approximated $2.97 billion.

The following table presents AIGTG's derivatives portfolio and the associated credit exposure, if applicable, by maturity and type of derivative at December 31, 1996:

(in thousands)

| | REMAINING LIFE | | | |
|---|---|---|---|---|
| | ONE YEAR | TWO THROUGH FIVE YEARS | SIX THROUGH TEN YEARS | AFTER TEN YEARS |
| FUTURES AND FORWARD CONTRACTS AND INTEREST RATE AND CURRENCY SWAPS: | | | | |
| Exchange traded futures contracts contractual amount | $ 11,129,657 | $ 2,899,957 | $ 71,490 | $ 6,896 |
| Over the counter forward contracts contractual amount | $ 204,590,640 | $ 11,097,976 | $ 1,083,771 | $ 3,379 |
| Interest rate and currency swaps: | | | | |
| Notional amount: | | | | |
| Interest rate swaps and forward rate agreements | $ 53,424,188 | $ 11,385,794 | $ 1,305,078 | $ 191,420 |
| Currency swaps | 43,131 | 3,681,390 | 1,740,495 | 388,178 |
| Total | $ 53,467,319 | $ 15,067,184 | $ 3,045,573 | $ 579,598 |
| FUTURES AND FORWARD CONTRACTS AND INTEREST RATE AND CURRENCY SWAPS: | | | | |
| Credit exposure: | | | | |
| Gross replacement value | $ 5,509,109 | $ 816,656 | $ 316,606 | $ 26,455 |
| Master netting arrangements | (3,130,370) | (358,071) | (68,882) | -- |
| Collateral | (83,746) | (56,223) | (6,118) | -- |
| Net replacement value | $ 2,294,993 | $ 402,362 | $ 241,606 | $ 26,455 |

| | TOTAL 1996 | Total 1995 |
|---|---|---|
| FUTURES AND FORWARD CONTRACTS AND INTEREST RATE AND CURRENCY SWAPS: | | |
| Exchange traded futures contracts contractual amount | $ 14,108,000 | $ 26,804,947 |
| Over the counter forward contracts contractual amount | $216,775,766 | $183,709,518 |
| Interest rate and currency swaps: | | |
| Notional amount: | | |
| Interest rate swaps and forward rate agreements | $ 66,306,480 | $ 29,935,395 |
| Currency swaps | 5,853,194 | 4,540,896 |
| Total | $ 72,159,674 | $ 34,476,291 |

| | | |
|---|---|---|
| FUTURES AND FORWARD CONTRACTS AND INTEREST RATE AND CURRENCY SWAPS: | | |
| Credit exposure: | | |
| Gross replacement value | $ 6,668,826 | $ 4,723,747) |
| Master netting arrangements | (3,557,323) | (2,505,337) |
| Collateral | (146,087) | (148,582) |
| Net replacement value | $ 2,965,416 | $ 2,069,828 |





11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Options are contracts that allow the holder of the option to purchase or sell the underlying commodity, currency or index at a specified price and within, or at, a specified period of time. Risks arise as a result of movements in current market prices from contracted prices, and the potential inability of the counterparties to meet their obligations under the contracts. At December 31, 1996, the contractual amount of AIGTG's purchased options approximated $28.9 billion.

As a writer of options, AIGTG generally receives an option premium and then manages the risk of any unfavorable change in the value of the underlying commodity, currency or index. At December 31, 1996, the contractual amount for sold options approximated $32.4 billion.

The following table presents AIGTG's options portfolio and the associated credit exposure, if applicable, by maturity and type of derivative at December 31, 1996:

(in thousands)

| | REMAINING LIFE | | | | | |
|---|---|---|---|---|---|---|
| | ONE YEAR | TWO THROUGH FIVE YEARS | SIX THROUGH TEN YEARS | AFTER TEN YEARS | TOTAL 1996 | Total 1995 |
| OPTION CONTRACTS: | | | | | | |
| Contractual amounts for purchased options: | | | | | | |
| Exchange traded | $ 1,462,677 | $ 104,738 | $ -- | -- | $ 1,567,415 | $ 1,258,028 |
| Over the counter | 21,435,238 | 5,100,197 | 841,782 | -- | 27,377,217 | 25,278,914 |
| Total | $ 22,897,915 | $ 5,204,935 | $ 841,782 | -- | $ 28,944,632 | $ 26,536,942 |
| Credit exposure for purchased options: | | | | | | |
| Gross replacement value | $ 524,253 | $ 233,903 | $ 62,784 | -- | $ 820,940 | $ 705,180 |
| Master netting arrangements | (241,692) | (68,615) | (4,661) | -- | (314,968) | (229,513) |
| Collateral | (1,198) | (2,062) | -- | -- | (3,260) | (16,469) |
| Net replacement value | $ 281,363 | $ 163,226 | $ 58,123 | -- | $ 502,712 | $ 459,198 |
| Contractual amounts for sold options* | $ 25,697,386 | $ 5,900,034 | $ 781,386 | -- | $ 32,378,806 | $ 28,080,000 |

* 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 independently evaluates the creditworthiness of its counterparties, taking into account credit ratings assigned by recognized statistical rating organizations. In addition, AIGTG's credit approval process involves pre-set counterparty, country and industry credit exposure limits and, for particularly credit intensive transactions, obtaining approval from AIG's Credit Risk Committee. The maximum potential loss will increase or decrease during the life of the derivative commitments as a function of maturity and market conditions.

AIGTG determines counterparty credit quality by reference to ratings from independent rating agencies or internal analysis. At December 31, 1996, 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 INTEREST RATE AND CURRENCY SWAPS | OVER THE COUNTER PURCHASED OPTIONS | TOTAL 1996 | Total 1995 |
|---|---|---|---|---|
| Counterparty credit quality: | | | | |
| AAA | $ 372,433 | $ 74,803 | $ 447,236 | $ 214,202 |
| AA | 836,465 | 239,248 | 1,075,713 | 906,039 |
| A | 1,049,812 | 83,520 | 1,133,332 | 528,546 |
| BBB | 466,922 | 51,563 | 518,485 | 72,030 |
| Below investment grade | 99,234 | 16,576 | 115,810 | 22,653 |
| Not externally rated, including exchange traded futures and options* | 140,550 | 37,002 | 177,552 | 785,556 |
| Total | $2,965,416 | $ 502,712 | $3,468,128 | $2,529,026) |

* 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.





NOTES TO FINANCIAL STATEMENTS (CONTINUED)

11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

At December 31, 1996, 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 INTEREST RATE AND CURRENCY SWAPS | OVER THE COUNTER PURCHASED OPTIONS | TOTAL 1996 | Total 1995 |
|---|---|---|---|---|
| Non-U.S. banks | $1,010,612 | $258,787 | $1,269,399 | $ 834,265 |
| U.S. industrials | 744,840 | 16,794 | 761,634 | 340,071 |
| Governmental | 120,648 | 630 | 121,278 | 152,058 |
| Non-U.S. financial service companies | 147,792 | 38,684 | 186,476 | 257,824 |
| Non-U.S. industrials | 178,894 | 13,775 | 192,669 | 115,641 |
| U.S. banks | 255,290 | 53,864 | 309,154 | 324,915 |
| U.S. financial service companies | 366,790 | 83,176 | 449,966 | 231,014 |
| Exchanges* | 140,550 | 37,002 | 177,552 | 273,238 |
| Total | $2,965,416 | $502,712 | $3,468,128 | $2,529,026 |

* 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.

AIGTG limits its risks by holding offsetting positions. In addition, AIGTG monitors and controls its risk exposures through various monitoring systems which evaluate AIGTG's market and credit risks, and through credit approvals and limits. At December 31, 1996, AIGTG did not have a significant concentration of credit risk from either an individual counterparty or group of counterparties.

The net trading revenues for the twelve months ended December 31, 1996 from AIGTG's operations were $288.6 million.

At December 31, 1996, AIGTG had issued and outstanding $230.6 million principal amount of letters of credit. These letters of credit were issued primarily to various exchanges.

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

(e) At December 31, 1996, ILFC had committed to purchase or had secured positions for 243 aircraft deliverable from 1997 through 2004 at an estimated aggregate purchase price of $13.3 billion and had options to purchase an additional 35 aircraft deliverable through 2005 at an estimated aggregate purchase price of $2.8 billion. ILFC will be required to find customers for any aircraft presently on order and any aircraft to be ordered, and it must arrange financing for portions of the purchase price of such equipment.

In the normal course of business, ILFC employs a variety of off-balance sheet derivative transactions with the objective to lower its overall borrowing cost and to maintain its optimal mix of variable and fixed rate interest obligations. These derivative products include interest rate swaps, swaptions and interest rate floors (off-balance sheet derivative transactions).

ILFC accounts for its off-balance sheet derivative transactions on an accrual basis. Accrued future payments or receipts are reflected in operating income in the period incurred or earned. Credit risk exposure arises from the potential that the counterparty may not perform under these agreements with respect to the off-balance sheet derivative transactions. ILFC minimizes such exposure through transacting with recognized U.S. derivative dealers rated at least A by a recognized statistical rating organization. The counterparties to the majority of the off-balance sheet derivative transactions are rated AAA. ILFC monitors each counterparty's assigned credit rating throughout the life of each of the off-balance sheet derivative transactions. ILFC currently does not require security nor is security required by its counterparties for its positions. ILFC has the right to require security under certain circumstances.

The following table provides the notional and contractual amounts of ILFC's off-balance sheet derivative transactions at December 31, 1996. The timing and the amount of the cash flows relating to swaption and other interest rate option contracts are determined by each of the respective contractual agreements.





11. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The following table presents ILFC's notional amounts of its interest rate swaps, swaptions and interest rate floors by maturity at December 31, 1996:

(in thousands)

| | REMAINING LIFE | | | | |
|---|---|---|---|---|---|
| | ONE YEAR | TWO TO FIVE YEARS | AFTER FIVE YEARS | TOTAL 1996 | Total 1995 |
| Interest Rate: | | | | | |
| Swaps | $161,707 | $ 840,673 | $ 346,854 | $1,349,234 | $ 974,568 |
| Swaptions* | -- | 100,000 | -- | 100,000 | 565,670 |
| Floors | 33,369 | 133,681 | 733,384 | 900,434 | 412,626 |
| Total | $195,076 | $1,074,354 | $1,080,238 | $2,349,668 | $1,952,864 |

* Swaptions obligate ILFC to convert certain fixed note obligations to floating rate obligations if the swaption purchaser chooses to exercise. These amounts do not represent credit exposure.

AIG does not anticipate any losses in connection with the aforementioned activities that would have a material effect on its financial condition or results of operations.

(f) AIG and its subsidiaries, in common with the insurance industry in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. AIG does not believe that such litigation will have a material effect on its operating results and financial condition.

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. Estimation of asbestos and environmental claims loss reserves is a difficult process, as these claims, which emanate from policies written in 1984 and prior years, cannot be estimated by conventional reserving techniques. Asbestos and environmental claims development is affected by factors such as inconsistent court resolutions, the broadening of the intent of policies and scope of coverage and increasing number of new claims. AIG and other industry members have and will continue to litigate the broadening judicial interpretation of policy coverage and the liability issues. If the courts continue in the future to expand the intent of the policies and the scope of the coverage, as they have in the past, additional liabilities would emerge for amounts in excess of reserves held. This emergence cannot now be reasonably estimated, but could have a material impact on AIG's future operating results. The reserves carried for these claims as at December 31, 1996 ($2.30 billion gross; $742.9 million net) are believed to be adequate as these reserves are based on known facts and current law.

A summary of reserve activity, including estimates for applicable incurred but not reported losses and loss expenses, relating to asbestos and environmental claims separately and combined at December 31, 1996, 1995 and 1994 was as follows:

(in millions)

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | GROSS | NET | Gross | Net | Gross | Net |
| Asbestos: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $ 744.8 | $127.9 | $ 686.0 | $130.2 | $ 656.0 | $116.7 |
| Losses and loss expenses incurred(a) | 392.5 | 102.7 | 197.7 | 20.5 | 149.2 | 45.8 |
| Losses and loss expenses paid(b) | (261.4) | (58.3) | (138.9) | (22.8) | (119.2) | (32.3) |
| Reserve for losses and loss expenses at end of year | $ 875.9 | $172.3 | $ 744.8 | $127.9 | $ 686.0 | $130.2 |
| Environmental: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $1,197.9 | $379.3 | $ 728.1 | $200.1 | $ 684.8 | $191.5 |
| Losses and loss expenses incurred(a) | 379.6 | 240.3 | 684.9 | 231.7 | 187.5 | 61.8 |
| Losses and loss expenses paid | (150.1) | (49.0) | (215.1) | (52.5) | (144.2) | (53.2) |
| Reserve for losses and loss expenses at end of year | $1,427.4 | $570.6 | $1,197.9 | $379.3 | $ 728.1 | $200.1 |
| Combined: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | $1,942.7 | $507.2 | $1,414.1 | $330.3 | $1,340.8 | $308.2 |
| Losses and loss expenses incurred | 772.1 | 343.0 | 882.6 | 252.2 | 336.7 | 107.6 |
| Losses and loss expenses paid | (411.5) | (107.3) | (354.0) | (75.3) | (263.4) | (85.5) |
| Reserve for losses and loss expenses at end of year | $2,303.3 | $742.9 | $1,942.7 | $507.2 | $1,414.1 | $330.3 |

(a) At December 31, 1996 and 1995, incurred losses for asbestos and environmental claims reflect reserve strengthening in the IBNR carried.

(b) For 1996, paid losses for asbestos include certain unusual and non-recurring payments that satisfied historical settlement agreements.





NOTES TO FINANCIAL STATEMENTS (CONTINUED)

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107 "Disclosures about Fair Value of Financial Instruments" (FASB 107) requires disclosure of fair value information about financial instruments for which it is practicable to estimate such fair value. These financial instruments may or may not be recognized in the consolidated balance sheet. In the measurement of the fair value of certain of the financial instruments, quoted market prices were not available and other valuation techniques were utilized. These derived fair value estimates are significantly affected by the assumptions used. FASB 107 excludes certain financial instruments, including those related to insurance contracts.

The following methods and assumptions were used by AIG in estimating the fair value of the financial instruments presented:

Cash and short-term investments: The carrying amounts reported in the consolidated balance sheet for these instruments approximate fair values.

Fixed maturity securities: Fair values for fixed maturity securities carried at amortized cost or at market value were generally based upon quoted market prices. For certain fixed maturity securities for which market prices were not readily available, fair values were estimated using values obtained from independent pricing services. No other fair valuation techniques were applied to these bonds as AIG believes it would have to expend excessive costs for the benefits derived.

Equity securities: Fair values for equity securities were based upon quoted market prices.

Mortgage loans on real estate, policy and collateral loans: Where practical, the fair values of loans on real estate and collateral loans were estimated using discounted cash flow calculations based upon AIG's current incremental lending rates for similar type loans. The fair values of the policy loans were not calculated as AIG believes it would have to expend excessive costs for the benefits derived.

Trading assets and trading liabilities: Fair values for trading assets and trading liabilities approximate the carrying values presented in the consolidated balance sheet.

Securities available for sale: Fair values for securities available for sale and related hedges were based on quoted market prices. For securities and related hedges for which market prices were not readily available, fair values were estimated using quoted market prices of comparable investments.

Trading securities: Fair values for trading securities were based on current market value where available. For securities for which market values were not readily available, fair values were estimated using quoted market prices of comparable investments.

Spot commodities: Fair values for spot commodities were based on current market prices.

Unrealized gains and losses on interest rate and currency swaps, options and forward transactions: Fair values for swaps, options and forward transactions were based on the use of valuation models that utilize, among other things, current interest, foreign exchange and volatility rates, as applicable.

Securities purchased (sold) under agreements to resell (repurchase), at contract value: As these securities (obligations) are short-term in nature, the contract values approximate fair values.

Other invested assets: For assets for which market prices were not readily available, fair valuation techniques were not applied as AIG believes it would have to expend excessive costs for the benefits derived.

Policyholders' contract deposits: Fair values of policyholder contract deposits were estimated using discounted cash flow calculations based upon interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

GIAs: Fair values of AIG's obligations under investment type agreements were estimated using discounted cash flow calculations based on interest rates currently being offered for similar agreements with maturities consistent with those remaining for the agreements being valued. Additionally, AIG follows a policy of minimizing interest rate risks associated with GIAs by entering into swap transactions.

Securities and spot commodities sold but not yet purchased: The carrying amounts for the financial instruments approximate fair values. Fair values for spot commodities sold short were based on current market prices.

Deposits due to banks and other depositors: To the extent certain amounts are not demand deposits or certificates of deposit which mature in more than one year, fair values were not calculated as AIG believes it would have to expend excessive costs for the benefits derived.

Commercial paper: The carrying amount of AIG's commercial paper borrowings approximates fair value.

Notes, bonds, loans and mortgages payable: Where practical, the fair values of these obligations were estimated using discounted cash flow calculations based upon AIG's current incremental borrowing rates for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

The carrying values and fair values of AIG's financial instruments at December 31, 1996 and December 31, 1995 and the average fair values with respect to derivative positions during 1996 and 1995 were as follows:





12. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(in thousands)

| | 1996 | | |
|---|---|---|---|
| | CARRYING VALUE | FAIR VALUE | AVERAGE FAIR VALUE |
| Fixed maturities | $48,625,226 | $49,345,449 | $ -- |
| Equity securities | 6,065,640 | 6,065,640 | -- |
| Mortgage loans on real estate, policy and collateral loans | 7,876,820 | 7,881,348 | -- |
| Securities available for sale | 9,785,909 | 9,785,909 | 6,172,883 |
| Trading securities | 2,357,812 | 2,357,812 | 2,344,717 |
| Spot commodities | 204,705 | 204,705 | 278,941 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 6,906,012 | 6,906,012 | 6,450,376 |
| Trading assets | 3,793,433 | 3,793,433 | 3,427,781 |
| Securities purchased under agreement to resell | 1,642,591 | 1,642,591 | -- |
| Other invested assets | 2,915,302 | 2,915,302 | -- |
| Short-term investments | 2,008,123 | 2,008,123 | -- |
| Cash | 58,740 | 58,740 | -- |
| Policyholders' contract deposits | 9,803,409 | 9,888,685 | -- |
| Borrowings under obligations of guaranteed investment agreements | 5,723,228 | 6,195,954 | -- |
| Securities sold under agreements to repurchase | 3,039,423 | 3,039,423 | -- |
| Trading liabilities | 3,313,508 | 3,313,508 | 3,227,531 |
| Securities and spot commodities sold but not yet purchased | 1,568,542 | 1,568,542 | 263,722 |
| Unrealized loss on interest rate and currency swaps, options and forward transactions | 5,414,433 | 5,414,433 | 4,976,258 |
| Deposits due to banks and other depositors | 1,206,374 | 1,206,374 | -- |
| Commercial paper | 4,497,976 | 4,497,976 | -- |
| Notes, bonds, loans and mortgages payable | 13,299,310 | 13,596,511 | -- |

| | 1995 | | |
|---|---|---|---|
| | Carrying Value | Fair Value | Average Fair Value |
| Fixed maturities | $42,900,597 | $43,797,474 | $ -- |
| Equity securities | 5,369,321 | 5,369,321 | -- |
| Mortgage loans on real estate, policy and collateral loans | 7,860,532 | 7,885,655 | -- |
| Securities available for sale | 3,931,100 | 3,931,100 | 4,089,766 |
| Trading securities | 2,641,436 | 2,641,436 | 3,193,973 |
| Spot commodities | 383,374 | 383,374 | 491,551 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 7,250,954 | 7,250,954 | 6,477,814 |
| Trading assets | 4,017,735 | 4,017,735 | 3,886,500 |
| Securities purchased under agreement to resell | 2,022,056 | 2,022,056 | -- |
| Other invested assets | 2,808,158 | 2,808,158 | -- |
| Short-term investments | 2,272,528 | 2,272,528 | -- |
| Cash | 88,371 | 88,371 | -- |
| Policyholders' contract deposits | 9,580,983 | 9,673,374 | -- |
| Borrowings under obligations of guaranteed investment agreements | 5,423,555 | 6,247,398 | -- |
| Securities sold under agreements to repurchase | 1,379,872 | 1,379,872 | -- |
| Trading liabilities | 3,594,249 | 3,594,249 | 3,993,489 |
| Securities and spot commodities sold but not yet purchased | 1,204,386 | 1,204,386 | 4,823 |
| Unrealized loss on interest rate and currency swaps, options and forward transactions | 5,890,289 | 5,890,289 | 4,900,569 |
| Deposits due to banks and other depositors | 957,441 | 957,441 | -- |
| Commercial paper | 3,166,635 | 3,166,635 | -- |
| Notes, bonds, loans and mortgages payable | 9,915,283 | 10,214,945 | -- |

Off-balance sheet financial instruments: Financial instruments which are not currently recognized in the consolidated balance sheet of AIG are principally commitments to extend credit and financial guarantees. The unrecognized fair values of these instruments represent fees currently charged to enter into similar agreements, taking into account the remaining terms of the current agreements and the counterparties' credit standings. No valuation was made as AIG believes it would have to expend excessive costs for the benefits derived.

13. STOCK COMPENSATION PLANS

At December 31, 1996, AIG had two types of stock-based compensation plans. One was a stock option plan; the other, an employee stock purchase plan. AIG applies APB Opinion 25 "Accounting for Stock Issued to Employees" and related Interpretations in accounting for its plans. Accordingly, no compensation costs have been recognized for either plan.

Had compensation costs for these plans been determined consistent with the method of FASB 123, AIG's net income and earnings per share for the years ended December 31, 1996 and 1995 would have been reduced to the pro forma amounts as follows:

(in thousands, except per share amounts)

| | 1996 | 1995 |
|---|---|---|
| Net income: | | |
| As reported | $ 2,897,257 | $ 2,510,383 |
| Pro forma | 2,892,422 | 2,509,261 |
| Earnings per share: | | |
| As reported | $ 6.15 | $ 5.30 |
| Pro forma | 6.14 | 5.29 |

The fair value of stock grants included in the pro forma amounts is not necessarily indicative of future effects on net income and earnings per share.

(A) STOCK OPTION PLAN: On December 19, 1991, the AIG Board of Directors adopted a 1991 employee stock option plan, which provides that options to purchase a maximum of 4,500,000 shares of common stock could be granted to officers and other key employees at prices not less than fair market value at the date of grant. Both the 1991 plan, and the options with respect to 112,387 shares granted thereunder on December 19, 1991, were approved by shareholders at the 1992 Annual Meeting. At December 31, 1996, 1,513,764 shares were reserved for future grants under the 1991 plan. As of March 18, 1992, no further options could be granted under the 1987 plan, but outstanding options granted under the 1987 plan continue in force until exercise or expiration. At December 31, 1996, there were 4,313,771 shares reserved for issuance under the 1991 and 1987 plans.

Under each plan, 25 percent of the options granted become exercisable on the anniversary of the date of grant in each of the four years following that grant and all options expire 10 years from the date of the grant. As of December 31, 1996, outstanding options granted with respect to 2,918,092 shares qualified for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.





13. STOCK COMPENSATION PLANS (continued)

Additional information with respect to AIG's plans at December 31, 1996, and changes for the three years then ended, was as follows:

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | SHARES | WEIGHTED AVERAGE EXERCISE PRICE | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| SHARES UNDER OPTION: | | | | | | |
| Outstanding at beginning of year | 4,130,713 | $ 48.89 | 4,148,082 | $ 40.31 | 3,933,389 | $ 35.60 |
| Granted | 623,400 | 108.55 | 557,675 | 90.33 | 593,550 | 64.39 |
| Exercised | (394,551) | 33.37 | (517,204) | 24.84 | (312,579) | 25.17 |
| Forfeited | (45,791) | 63.49 | (57,840) | 48.21 | (66,278) | 48.12 |
| Outstanding at end of year | 4,313,771 | $ 58.77 | 4,130,713 | $ 48.89 | 4,148,082 | $ 40.31 |
| Options exercisable at year-end | 2,902,883 | $ 43.14 | 2,749,517 | $ 37.00 | 2,700,035 | $ 31.12 |
| Weighted average fair value per share of options granted | | $ 41.01 | | $ 32.92 | | -- |

Information about stock options outstanding at December 31, 1996, is summarized as follows:

| | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|---|---|---|---|---|---|
| RANGE OF EXERCISE PRICES | NUMBER OUTSTANDING | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER EXERCISABLE | WEIGHTED AVERAGE EXERCISE PRICE |
| $18.13-26.06 | 758,812 | 2.3 years | $ 21.87 | 758,812 | $21.87 |
| $32.00-43.00 | 875,925 | 4.0 years | 35.63 | 875,925 | 35.63 |
| $53.00-61.00 | 993,680 | 6.4 years | 55.91 | 871,798 | 55.44 |
| $64.33-94.38 | 1,096,504 | 8.4 years | 78.14 | 396,348 | 73.37 |
| $98.75-110.63 | 588,850 | 9.9 years | 109.53 | -- | -- |
| | 4,313,771 | | | 2,902,883 | |

The fair values of stock options granted during the years ended December 31, 1996 and 1995 were $25,566,000 and $18,356,000, respectively. The fair value of each option is estimated on the date of the grant using the Black-Scholes option-pricing model.

The following weighted average assumptions were used for grants in 1996 and 1995, respectively: dividend yields of 0.33 percent and 0.32 percent, expected volatilities of 20.0 percent and 20.4 percent, risk-free interest rates of 6.29 percent and 5.77 percent, and expected terms of 7 years.

(B) EMPLOYEE STOCK PURCHASE PLAN: AIG's 1984 employee stock purchase plan was adopted at its 1984 shareholders' meeting and became effective as of July 1, 1984. Eligible employees could receive privileges to purchase up to an aggregate of 1,968,750 shares of AIG common stock, at a price equal to 85 percent of the fair market value on the date of grant of the purchase privilege. Purchase privileges were granted annually and were limited to the number of whole shares that could be purchased by an amount equal to 5 percent of an employee's annual salary or $3,750, whichever was less. Beginning with the January 1, 1996 subscription, the maximum allowable purchase limitation increased to $5,500.

There were 146,217 shares, 152,406 shares and 135,992 shares issued under the 1984 plan at weighted average prices of $66.88, $50.22 and $50.37 for the years ended December 31, 1996, 1995 and 1994, respectively. The excess or deficit of the proceeds over the par value or cost of the common stock issued was credited or charged to additional paid-in capital.

AIG's 1996 employee stock purchase plan was adopted at its 1996 shareholders' meeting and became effective as of July 1, 1996, replacing the 1984 plan. Eligible employees may receive privileges to purchase up to an aggregate of 1,000,000 shares of AIG common stock, at a price equal to 85 percent of the fair market value on the date of the grant of the purchase privilege. Purchase privileges are granted annually and are limited to the number of whole shares that can be purchased by an amount equal to 5 percent of an employee's annual salary or $5,500, whichever is less. In all other respects, the 1996 plan is identical to the 1984 plan.

As of December 31, 1996, there were 129,453 shares of common stock subscribed to at a weighted average price of $82.70 per share pursuant to grants of privileges under both plans. There were 919,334 shares available for the grant of future purchase privileges under the 1996 plan at December 31, 1996.

The fair values of purchase privileges granted during the years ended December 31, 1996 and 1995 were $3,039,000 and $2,005,000, respectively. The weighted average fair values per share of those purchase rights granted in 1996 and 1995





13. STOCK COMPENSATION PLANS (continued)

were $19.71 and $14.90, respectively. The fair value of each purchase right is estimated on the date of the subscription using the Black-Scholes model.

The following weighted average assumptions were used for grants in 1996 and 1995, respectively: dividend yields of 0.37 percent and 0.32 percent, expected volatilities of 21.9 percent and 16.9 percent, risk-free interest rates of 5.54 percent and 5.64 percent, and expected terms of 1 year.

14. EMPLOYEE BENEFITS

(a) Employees of AIG, its subsidiaries and certain affiliated companies, including employees in foreign countries, are generally covered under various funded and insured pension plans. Eligibility for participation in the various plans is based on either completion of a specified period of continuous service or date of hire, subject to age limitation. While benefits vary, they are usually based on the employees' years of credited service and average compensation in the three years preceding retirement.

AIG's U.S. retirement plan is a qualified, noncontributory, defined benefit plan. All qualified employees who have attained age 21 and completed twelve months of continuous service are eligible to participate in this plan. An employee with 5 or more years of service is entitled to pension benefits beginning at normal retirement at age 65. Benefits are based upon a percentage of average final compensation multiplied by years of credited service limited to 44 years of credited service. The average final compensation is subject to certain limitations. Annual funding requirements are determined based on the "projected unit credit" cost method which attributes a pro rata portion of the total projected benefit payable at normal retirement to each year of credited service.

AIG has adopted a Supplemental Executive Retirement Program (Supplemental Plan) to provide additional retirement benefits to designated executives and key employees. Under the Supplemental Plan, the annual benefit, not to exceed 60 percent of average final compensation, accrues at a percentage of average final pay multiplied for each year of credited service reduced by any benefits from the current and any predecessor retirement plans, Social Security, if any, and from any qualified pension plan of prior employers. The Supplemental Plan also provides a benefit equal to the reduction in benefits payable under the AIG retirement plan as a result of Federal limitations on benefits payable thereunder. Currently, the Supplemental Plan is unfunded.

Eligibility for participation in the various non-U.S. retirement plans is either based on completion of a specified period of continuous service or date of hire, subject to age limitation. While benefits vary, they are generally based on the employees' years of credited service and average compensation in the years preceding retirement.

Assumptions associated with the projected benefit obligation and expected long-term rate of return on plan assets at December 31, 1996 were as follows:

RANGE OF

| | NON-U.S. PLANS)* | U.S. PLANS |
|---|---|---|
| Discount rate | 3.5-10.0% | 7.5% |
| Salary increase rate | 2.5-10.0 | 5.0 |
| Expected long-term rate of return on plan assets | 4.0-9.5 | 9.0 |

* The ranges for the non-U.S. plans reflect the local socioeconomic environments in which AIG operates.

The following table sets forth the funded status of the various pension plans and the amounts recognized in the accompanying consolidated balance sheet as of December 31, 1996 and 1995:

(in thousands)

| | 1996 | | | 1995 | | |
|---|---|---|---|---|---|---|
| | NON-U.S. PLANS | U.S. PLANS | TOTAL | Non-U.S. Plans | U.S. Plans | Total |
| Plan assets at fair value* | $ 171,037 | $ 230,767 | $ 401,804 | $ 161,112 | $ 193,511 | $ 354,623 |
| Actuarial present value of benefit obligations: | | | | | | |
| Accumulated benefits earned prior to valuation date: | | | | | | |
| Vested | 240,023 | 155,738 | 395,761 | 209,936 | 142,250 | 352,186 |
| Nonvested | 30,222 | 22,222 | 52,444 | 33,640 | 20,245 | 53,885 |
| Accumulated benefit obligation | 270,245 | 177,960 | 448,205 | 243,576 | 162,495 | 406,071 |
| Additional benefits based on estimated future salary levels | 69,981 | 94,956 | 164,937 | 67,478 | 90,636 | 158,114 |
| Projected benefit obligation | 340,226 | 272,916 | 613,142 | 311,054 | 253,131 | 564,185 |
| Projected benefit obligation in excess of plan assets | 169,189 | 42,149 | 211,338 | 149,942 | 59,620 | 209,562 |
| Unrecognized prior service cost | (19,288) | (17,102) | (36,390) | (10,920) | (18,457) | (29,377) |
| Unrecognized net gain (loss) | (59,897) | 29,550 | (30,347) | (49,831) | 5,529 | (44,302) |
| Unamortized balance of the initial transition amounts | (15,241) | (9,137) | (24,378) | (19,925) | (10,639) | (30,564) |
| Net amounts to be applied to future periods | (94,426) | 3,311 | (91,115) | (80,676) | (23,567) | (104,243) |
| Adjustment to reflect minimum liability | 61,024 | 3,217 | 64,241 | 40,166 | 3,401 | 43,567 |
| Accrued pension liability | $ 135,787 | $ 48,677 | $ 184,464 | $ 109,432 | $ 39,454 | $ 148,886 |

* Plan assets are invested primarily in fixed-income securities and listed stocks.





NOTES TO FINANCIAL STATEMENTS (CONTINUED)

14. Employee Benefits (CONTINUED)

Net pension cost for the years ended December 31, 1996, 1995 and 1994 included the following components:

(in thousands)

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Cost of benefits earned during the period | $ 47,783 | $ 40,015 | $ 41,986 |
| Interest cost on the projected benefit obligation | 31,603 | 27,320 | 24,795 |
| Actual return on all retirement plan assets | (41,387) | (53,904) | (8,789) |

| | | | |
|---|---|---|---|
| Net amortization and deferral of actuarial gains and losses | 17,918 | 30,114 | (15,466) |
| Amortization of the initial transition amount | 3,323 | 3,720 | 3,749 |
| Net pension expense* | $ 59,240 | $ 47,265 | $ 46,275 |

* Net pension expense included $34,584, $30,978 and $26,727 related to non-U.S. plans for 1996, 1995 and 1994, respectively.

(b) AIG sponsors a voluntary savings plan for domestic employees (a 401(k) plan), which, during the year ended December 31, 1994, provided for salary reduction contributions by employees and matching contributions by AIG of up to 2 percent of annual salary. Commencing January 1, 1995, the 401(k) plan provided for matching contributions by AIG of up to 6 percent of annual salary depending on the employees' years of service.

(c) In addition to AIG's defined benefit pension plan, AIG and its subsidiaries provide a postretirement benefit program for medical care and life insurance, domestically and in certain foreign countries. Eligibility in the various plans is generally based upon completion of a specified period of eligible service and reaching a specified age. Benefits vary by geographic location.

AIG's U.S. postretirement medical and life insurance benefits are based upon the employee reaching age 55 with 10 years of service to be eligible for an immediate benefit from the U.S. retirement plan. Retirees and their dependents who were age 65 by May 1, 1989 participate in the medical plan at no cost. Employees who retired after May 1, 1989 and on or prior to January 1, 1993 pay the active employee premium if under age 65 and 50 percent of the active employee premium if over age 65. Retiree contributions are subject to adjustment annually. Other cost sharing features of the medical plan include deductibles, coinsurance and Medicare coordination and a lifetime maximum benefit of $1,000,000. The maximum life insurance benefit prior to age 70 is $32,500, with a maximum of $25,000 thereafter.

Effective January 1, 1993, both plans' provisions were amended. Employees who retire after January 1, 1993 are required to pay the actual cost of the medical benefits reduced by a credit which is based upon age and years of service at retirement. The life insurance benefit varies by age at retirement from $5,000 for retirement at ages 55 through 59 to $15,000 for retirement at ages 65 and over.

Assumptions associated with the accrued postretirement benefit liability at December 31, 1996 were as follows:

| | NON-U.S. PLANS | U.S. PLANS |
|---|---|---|
| Discount rate | 7.0-10.0% | 7.5% |
| Medical trend rate year 1* | 14.0 | 8.5 |
| Medical trend rate year 4 and 9 | 6.0 | 5.5 |

* The Medical trend rate grades downward from years 1 through 4 domestically and years 1 through 9 for the foreign benefits. The trend rates remain level thereafter.

The following table sets forth the liability for the accrued postretirement benefits of the various plans, and amounts recognized in the accompanying consolidated balance sheet as of December 31, 1996 and 1995. These plans are not funded currently. (in thousands)

| | NON-U.S. | U.S. |
|---|---|---|

| | MEDICAL PLANS | LIFE INSURANCE PLANS | TOTAL |
|---|---|---|---|
| 1996 | | | |
| Accumulated postretirement benefit obligation: | | | |
| Retirees | $ 2,025 | $44,568 | $46,593 |
| Fully eligible active employees | 6,127 | 2,127 | 8,254 |
| Other active employees | 8,757 | 11,926 | 20,683 |
| | 16,909 | 58,621 | 75,530 |
| Unrecognized net loss | -- | (5,299) | (5,299) |
| Unrecognized prior service cost | -- | 27,287 | 27,287 |
| Accrued postretirement benefit liabilities | $16,909 | $80,609 | $97,518 |
| 1995 | | | |
| Accumulated postretirement benefit obligation: | | | |
| Retirees | $ 2,128 | $42,771 | $44,899 |
| Fully eligible active employees | 5,790 | 1,715 | 7,505 |
| Other active employees | 7,898 | 11,204 | 19,102 |
| | 15,816 | 55,690 | 71,506 |
| Unrecognized net loss | -- | (3,355) | (3,355) |
| Unrecognized prior service cost | -- | 28,802 | 28,802 |
| Accrued postretirement benefit liabilities | $15,816 | $81,137 | $96,953 |





The net periodic postretirement costs for the years ended December 31, 1996, 1995 and 1994 included the following components:

(in thousands)

| | MEDICAL PLANS | LIFE INSURANCE PLANS | TOTAL |
|---|---|---|---|
| 1996 | | | |
| Cost of benefits earned during the period | $ 1,315 | $ 574 | $ 1,889 |
| Interest cost on accumulated postretirement benefit obligations | 3,992 | 1,307 | 5,299 |
| Amortization of prior service cost | (1,344) | (172) | (1,516) |
| Amortization of net actuarial losses | 59 | 22 | 81 |
| Net periodic postretirement benefit costs | $ 4,022 | $1,731 | $ 5,753 |
| 1995 | | | |
| Cost of benefits earned during the period | $ 1,011 | $ 448 | $ 1,459 |
| Interest cost on accumulated postretirement benefit obligations | 3,744 | 1,246 | 4,990 |
| Amortization of prior service cost | (1,344) | (172) | (1,516) |

| | | | |
|---|---|---|---|
| Net periodic postretirement benefit costs | $ 3,411 | $1,522 | $ 4,933 |
| 1994 | | | |
| Cost of benefits earned during the period | $ 1,160 | $ 499 | $ 1,659 |
| Interest cost on accumulated postretirement benefit obligations | 4,055 | 1,032 | 5,087 |
| Amortization of prior service cost | (1,344) | (172) | (1,516) |
| Amortization of net actuarial losses | 318 | -- | 318 |
| Net periodic postretirement benefit costs | $ 4,189 | $1,359 | $ 5,548 |

The medical trend rate assumptions have a significant effect on the amounts reported. Increasing each trend rate by 1 percent in each year would increase the accumulated postretirement benefit obligations as of December 31, 1996 by $6.9 million and the aggregate service and interest cost components of the periodic postretirement benefit costs for 1996 by $640,000.

(d) AIG has certain benefits provided to former or inactive employees who are not retirees. Certain of these benefits are insured and expensed currently; other expenses are provided for currently. Such uninsured expenses include long and short-term disability medical and life insurance continuation, short-term disability income continuation and COBRA medical subsidies. The provision for these benefits at December 31, 1996 was $6.0 million. The incremental expense was insignificant.

15. LEASES

(a) AIG and its subsidiaries occupy leased space in many locations under various long-term leases and have entered into various leases covering the long-term use of data processing equipment.

At December 31, 1996, the future minimum lease payments under operating leases were as follows:

| (in thousands) | |
|---|---|
| 1997 | $198,912 |
| 1998 | 142,962 |
| 1999 | 99,333 |
| 2000 | 82,572 |
| 2001 | 74,314 |
| Remaining years after 2001 | 209,556 |
| Total | $807,649 |

Rent expense approximated $219,100,000, $215,600,000, and $208,000,000 for the years ended December 31, 1996, 1995 and 1994, respectively.

(b) Minimum future rental income on noncancelable operating leases of flight equipment which have been delivered at December 31, 1996 was as follows:

| (in thousands) | |
|---|---|
| 1997 | $1,292,030 |
| 1998 | 1,057,695 |
| 1999 | 835,580 |
| 2000 | 649,204 |
| 2001 | 473,549 |
| Remaining years after 2001 | 743,476 |

| | |
|---|---|
| Total | $5,051,534 |

Flight equipment is leased, under operating leases, for periods ranging from one to ten years.

16. OWNERSHIP AND TRANSACTIONS WITH RELATED PARTIES

(A) OWNERSHIP: The directors and officers of AIG, the directors and holders of common stock of C. V. Starr & Co., Inc. (Starr), a private holding company, The Starr Foundation, Starr International Company, Inc. (SICO), a private holding company, and Starr own or otherwise control approximately 29 percent of the voting stock of AIG. Six directors of AIG also serve as directors of Starr and SICO.

(B) TRANSACTIONS WITH RELATED PARTIES: During the ordinary course of business, AIG and its subsidiaries pay commissions to Starr and its subsidiaries for the production and management of insurance business. Net commission payments to Starr aggregated approximately $48,400,000 in 1996, $42,600,000 in 1995 and $31,200,000 in 1994, from which Starr is required to pay commissions due originating brokers and its operating expenses. AIG also received approximately $15,300,000 in 1996, $14,100,000 in 1995 and $12,900,000 in 1994 from Starr and paid approximately $34,000 in both 1996 and 1995 and $42,000 in 1994 to Starr as reimbursement for services provided at cost. AIG also received approximately $1,000,000 in 1996, $1,500,000 in 1995 and $900,000 in 1994 from SICO and paid approximately $1,200,000 in each of the years 1996, 1995 and 1994 to SICO as reimbursement for services rendered at cost. AIG also paid to SICO $4,400,000 in 1996, $5,000,000 in 1995 and $3,000,000 in 1994 in rental fees.





17. SUMMARY OF QUARTERLY FINANCIAL INFORMATION-- UNAUDITED

The following quarterly financial information for each of the three months ended March 31, June 30, September 30 and December 31, 1996 and 1995 is unaudited. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the results of operations for such periods, have been made for a fair presentation of the results shown.

| | THREE MONTHS ENDED | | | |
|---|---|---|---|---|
| | MARCH 31, | | JUNE 30, | |
| (in thousands, except per share amounts) | 1996 | 1995 | 1996 | 1995 |
| Revenues | $6,645,216 | $6,006,709 | $6,955,856 | $6,457,734 |
| Net income | $ 671,218 | $ 572,156 | $ 724,368 | $ 633,785 |
| Net income per common share | $ 1.42 | $ 1.20 | $ 1.53 | $ 1.34 |
| Average shares outstanding | 473,970 | 473,848 | 471,087 | 474,016 |

| | THREE MONTHS ENDED | | | |
|---|---|---|---|---|
| | SEPTEMBER 30, | | DECEMBER 31, | |
| (in thousands, except per share amounts) | 1996 | 1995 | 1996 | 1995 |
| Revenues | $7,181,763 | $6,546,990 | $7,422,437 | $6,862,589 |
| Net income | $ 731,437 | $ 630,686 | $ 770,234 | $ 673,756 |
| Net income per common share | $ 1.56 | $ 1.33 | $ 1.64 | $ 1.43 |
| Average shares outstanding | 469,436 | 474,130 | 469,468 | 474,130 |

18. SEGMENT INFORMATION

(a) AIG's operations are conducted principally through five business segments. These segments and their respective operations are as follows:

Parent - AIG parent is a holding company owning directly or indirectly all of the capital stock of certain insurance, insurance related and financial services companies in both the United States and abroad.

General Insurance - AIG's general insurance operations are multiple line property and casualty companies writing substantially all lines of insurance other than title insurance. The general insurance operations also include mortgage guaranty insurance operations.

Life Insurance - AIG's life insurance operations offer a broad line of individual and group life, annuity and accident and health policies.

Agency and Service Fee - AIG's agency operations are engaged in the production and management of various types of insurance for affiliated and non-affiliated companies.

Financial Services - AIG's financial services operations engage in diversified financial services for affiliated and non-affiliated companies. Such operations include, but are not limited to, asset management, short-term cash management and financing, premium financing, interest rate, currency, equity and commodity derivative products business, various commodities trading and market making activities, banking services and operations and leasing and remarketing of flight equipment.





The following table is a summary of the operations by major operating segments for the years ended December 31, 1996, 1995 and 1994:



18. SEGMENT INFORMATION (continued)

| | INDUSTRY SEGMENTS-1996 | | | | | | |
|---|---|---|---|---|---|---|---|
| (in thousands) | PARENT | GENERAL INSURANCE | LIFE INSURANCE | AGENCY AND SERVICE FEE | FINANCIAL SERVICES | ADJUSTMENTS AND ELIMINATIONS(A) | CONSOLIDATED |
| Revenues | $ 1,148,627(B) | $13,609,171 | $11,688,925 | $ 264,132 | $ 2,555,477 | $ (1,061,060) | $28,205,272 |
| Income before income taxes | $ 1,148,627(B) | $ 2,153,300 | $ 1,323,758 | $ 52,267 | $ 523,906 | $ (1,188,636) | $ 4,013,222 |
| Equity in net income of partially-owned companies | $ 50,488 | $ 49,799 | $ 73 | $ -- | $ 1,240 | $ 157 | $ 101,757 |
| Depreciation expense | $ 42 | $ 84,147 | $ 54,102 | $ 786 | $ 592,841 | $ 73,663 | $ 805,581 |
| Capital expenditures | $ 342 | $ 132,430 | $ 236,945 | $ 525 | $ 3,357,506(C) | $ 167,355 | $ 3,895,103(C) |
| Identifiable assets | $22,608,843 | $58,702,967 | $48,376,033 | $ 88,768 | $43,861,592 | $(25,207,201) | $148,431,002 |

| | Industry Segments-1995 | | | | | | |
|---|---|---|---|---|---|---|---|
| (in thousands) | Parent | General Insurance | Life Insurance | Agency and Service Fee | Financial Services | Adjustments and Eliminations(a) | Consolidated |
| Revenues | $ 730,057(b) | $13,019,523 | $10,335,758 | $ 261,873 | $ 2,204,090 | $ (677,279) | $ 25,874,022 |
| Income before income taxes | $ 730,057(b) | $ 1,975,375 | $ 1,090,605 | $ 56,909 | $ 417,741 | $ (804,804) | $ 3,465,883 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Equity in net income of partially-owned companies | $ 38,308 | $ 43,204 | $ 3,150 | $ -- | $ -- | $ 358 | $ 85,020 |
| Depreciation expense | $ -- | $ 88,773 | $ 49,786 | $ 2,339 | $ 522,141 | $ 71,521 | $ 734,560 |
| Capital expenditures | $ 141 | $ 126,096 | $ 53,936 | $ 1,731 | $ 3,359,468(c) | $ 95,745 | $ 3,637,117(c) |
| Identifiable assets | $20,445,762 | $56,074,024 | $43,280,484 | $ 149,392 | $36,833,772 | $(22,647,036) | $134,136,398 |

Industry Segments-1994

| (in thousands) | Parent | General Insurance | Life Insurance | Agency and Service Fee | Financial Services | Adjustments and Eliminations(a) | Consolidated |
|---|---|---|---|---|---|---|---|
| Revenues | $ 899,698(b) | $11,774,410 | $ 8,559,455 | $ 237,940 | $ 1,783,239 | $ (896,033) | $22,358,709 |
| Income before income taxes | $ 899,698(b) | $ 1,635,096 | $ 952,484 | $ 54,129 | $ 404,853 | $ (994,281) | $ 2,951,979 |
| Equity in net income (loss) of partially-owned companies | $ 25,476 | $ 32,687 | $ 829 | $ (61) | $ -- | $ 182 | $ 59,113 |
| Depreciation expense | $ -- | $ 66,514 | $ 43,317 | $ 3,514 | $ 402,741 | $ 65,844 | $ 581,930 |
| Capital expenditures | $ 545 | $ 131,721 | $ 106,957 | $ 2,822 | $ 2,841,317(c) | $ 87,882 | $ 3,171,244(c) |
| Identifiable assets | $17,295,644 | $51,372,100 | $34,496,652 | $ 184,310 | $30,660,776 | $(19,663,365) | $114,346,117 |

(a) Including other operations and other income (deductions)-net, which are not deemed to be reportable segments.
(b) Substantially dividend income from subsidiaries.
(c) Relating primarily to ILFC.





NOTES TO FINANCIAL STATEMENTS (CONTINUED)

18. SEGMENT INFORMATION (continued)

(b) The following table is a summary of AIG's general insurance operations by major operating category for the years ended December 31, 1996, 1995 and 1994:

| | NET PREMIUMS | | | | | |
|---|---|---|---|---|---|---|
| | WRITTEN | | | EARNED | | |
| (in thousands) | 1996 | 1995 | 1994 | 1996 | 1995 | 1994 |
| Underwriting: | | | | | | |
| Foreign | $ 4,324,847 | $ 4,202,815 | $ 3,733,386 | $ 4,033,210 | $ 4,083,200 | $ 3,603,175 |
| Commercial casualty(a) | 6,398,039 | 5,895,757 | 5,684,895 | 5,853,271 | 5,645,281 | 5,296,272 |
| Commercial property | 490,644 | 452,323 | 306,631 | 480,388 | 403,037 | 290,195 |
| Pools and associations(b) | 435,127 | 400,951 | 444,526 | 429,565 | 394,088 | 427,272 |
| Personal lines(c) | 725,295 | 692,747 | 492,122 | 734,042 | 628,068 | 464,120 |
| Mortgage guaranty | 317,727 | 248,429 | 204,193 | 324,339 | 252,057 | 205,797 |
| Total underwriting | $12,691,679 | $11,893,022 | $10,865,753 | $11,854,815 | $11,405,731 | $10,286,831 |
| Net investment income | | | | | | |
| Realized capital gains | | | | | | |
| General insurance operating income | | | | | | |

| | OPERATING INCOME | | |
|---|---|---|---|
| (in thousands) | 1996 | 1995 | 1994 |
| Underwriting: | | | |
| Foreign | $ 397,905 | $ 304,069 | $ 203,707 |
| Commercial casualty(a) | 288,366 | 252,673 | 253,677 |
| Commercial property | (136,638) | (9,238) | (77,933) |
| Pools and associations(b) | (240,932) | (263,291) | (293,907) |
| Personal lines(c) | (1,344) | (6,558) | (17,147) |

| | | | |
|---|---|---|---|
| Mortgage guaranty | 91,587 | 83,928 | 79,120 |
| Total underwriting | 398,944 | 361,583 | 147,517 |
| Net investment income | 1,689,371 | 1,545,717 | 1,435,092 |
| Realized capital gains | 64,985 | 68,075 | 52,487 |
| General insurance operating income | $2,153,300 | $1,975,375 | $1,635,096 |

(a) Including workers' compensation and retrospectively rated risks.

(b) Including involuntary pools.

(c) Including mass marketing and specialty programs.

(c) AIG's individual life insurance and group life insurance portfolio accounted for 68 percent, 66 percent and 62 percent of AIG's consolidated life insurance operating income before realized capital gains or losses for the years ended December 31, 1996, 1995 and 1994, respectively. For those years, 92 percent, 94 percent and 96 percent, respectively, of consolidated life operating income before realized capital gains or losses was derived from foreign operations.

(d) A substantial portion of AIG's business is conducted in countries other than the United States and Canada. The following table is a summary of AIG's business by geographic segments. Allocations have been made on the basis of location of operations and assets.

| | GEOGRAPHIC SEGMENTS-1996 | | | |
|---|---|---|---|---|
| (in thousands) | DOMESTIC(A) | FAR EAST | OTHER FOREIGN | CONSOLIDATED |
| Revenues(b) | $13,214,589 | $10,690,814 | $ 4,299,869 | $ 28,205,272 |
| Income before income taxes | $ 1,877,203 | $ 1,521,650 | $ 614,369 | $ 4,013,222 |
| Identifiable assets | $92,088,305 | $32,222,889 | $24,119,808 | $148,431,002 |

| | Geographic Segments-1995 | | | |
|---|---|---|---|---|
| (in thousands) | Domestic(a) | Far East | Other Foreign | Consolidated |
| Revenues(b) | $12,097,038 | $ 9,859,833 | $ 3,917,151 | $ 25,874,022 |
| Income before income taxes | $ 1,698,606 | $ 1,375,307 | $ 391,970 | $ 3,465,883 |
| Identifiable assets | $84,456,853 | $27,580,921 | $22,098,624 | $134,136,398 |

| | Geographic Segments-1994 | | | |
|---|---|---|---|---|
| (in thousands) | Domestic(a) | Far East | Other Foreign | Consolidated |
| Revenues(b) | $10,591,559 | $ 8,374,195 | $ 3,392,955 | $ 22,358,709 |
| Income before income taxes | $ 1,455,733 | $ 1,192,969 | $ 303,277 | $ 2,951,979 |
| Identifiable assets | $71,838,459 | $24,199,044 | $18,308,614 | $114,346,117 |

(a) Including general insurance operations in Canada.

(b) Revenues are derived from revenues of the general, life, agency and service fee and financial services operations, equity in income of minority-owned insurance operations and realized capital gains attributable to the segments.





ITEM 9.CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL

DISCLOSURE

There have been no changes in or disagreements with accountants on accounting and financial disclosure within the twenty-four months ending December 31, 1996.

---

PART III

ITEM 10.DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Except for the information provided in Part I under the heading "Directors and Executive Officers of the Registrant", this item is omitted because a definitive proxy statement which involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A.

ITEM 11.EXECUTIVE COMPENSATION

This item is omitted because a definitive proxy statement which involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A.

ITEM 12.SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

This item is omitted because a definitive proxy statement which involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A.

ITEM 13.CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

This item is omitted because a definitive proxy statement which involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A.

---

PART IV

ITEM 14.EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(A) FINANCIAL STATEMENTS AND EXHIBITS.

1. Financial Statements and Schedules. See accompanying Index to Financial Statements.

2. Exhibits.

3--Articles of Incorporation and By-Laws.

10--Material Contracts.

11--Computation of Earnings Per Share for the Years Ended December 31, 1996, 1995, 1994, 1993 and 1992.

12--Computation of Ratios of Earnings to Fixed Charges for the Years Ended December 31, 1996, 1995, 1994, 1993 and 1992.

21--Subsidiaries of Registrant.

23--Consent of Coopers & Lybrand L.L.P.

24--Power of Attorney.

27--Financial Data Schedule.

99--Undertakings.

(B) REPORTS ON FORM 8-K.

There have been no reports on Form 8-K filed during the quarter ended December 31, 1996.

SCHEDULE I

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
SUMMARY OF INVESTMENTS--OTHER THAN INVESTMENTS IN RELATED PARTIES
AS OF DECEMBER 31, 1996

(in thousands)

| TYPE OF INVESTMENT | COST* | VALUE | AMOUNT AT WHICH SHOWN IN THE BALANCE SHEET |
|---|---|---|---|
| Fixed maturities: | | | |
| Bonds: | | | |
| United States Government and government agencies and authorities | $ 1,530,643 | $ 1,581,003 | $ 1,580,692 |
| States, municipalities and political subdivisions | 17,887,865 | 18,702,277 | 18,096,216 |
| Foreign governments | 8,628,342 | 9,027,867 | 9,027,866 |
| Public utilities | 2,752,182 | 2,961,460 | 2,961,460 |
| All other corporate | 16,060,096 | 16,481,751 | 16,481,745 |
| Total bonds | 46,859,128 | 48,754,358 | 48,147,979 |
| Preferred stocks | 477,247 | 591,091 | 477,247 |
| Total fixed maturities | 47,336,375 | 49,345,449 | 48,625,226 |
| Equity securities: | | | |
| Common stocks: | | | |
| Public utilities | 140,982 | 159,780 | 159,780 |
| Banks, trust and insurance companies | 879,639 | 1,224,012 | 1,224,012 |
| Industrial, miscellaneous and all other | 3,973,178 | 4,605,780 | 4,605,780 |
| Total common stocks | 4,993,799 | 5,989,572 | 5,989,572 |
| Non-redeemable preferred stocks | 64,705 | 76,068 | 76,068 |
| Total equity securities | 5,058,504 | 6,065,640 | 6,065,640 |
| Mortgage loans on real estate, policy and collateral loans | 7,876,820 | 7,881,348 | 7,876,820 |
| Financial services assets: | | | |
| Flight equipment primarily under operating leases, net of accumulated depreciation | 13,808,660 | -- | 13,808,660 |
| Securities available for sale, at market value | 9,775,705 | 9,785,909 | 9,785,909 |
| Trading securities, at market value | -- | 2,357,812 | 2,357,812 |
| Spot commodities, at market value | -- | 204,705 | 204,705 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | -- | 6,906,012 | 6,906,012 |
| Trading assets | 3,793,433 | -- | 3,793,433 |
| Securities purchased under agreements to resell, at contract value | 1,642,591 | -- | 1,642,591 |
| Other invested assets | 2,915,302 | -- | 2,915,302 |
| Short-term investments, at cost which approximates market value | 2,008,123 | -- | 2,008,123 |
| Total investments | $ 94,215,513 | -- | $105,990,233 |

* Original cost of equity securities and, as to fixed maturities, original cost reduced by repayments and adjusted for amortization of premiums or accrual of discounts.





SCHEDULE II

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
BALANCE SHEET -- PARENT COMPANY ONLY

(in thousands)

| DECEMBER 31, | 1996 | 1995 |
|---|---|---|
| ASSETS: | | |
| Cash | $ 676 | $ 142 |
| Short-term investments | 13 | 10,159 |
| Invested assets | 305,895 | 342,585 |
| Carrying value of subsidiaries and partially-owned companies, at equity | 22,194,522 | 20,106,697 |
| Premiums and insurance balances receivable-net | 37,880 | 47,757 |
| Other assets | 615,716 | 290,546 |
| TOTAL ASSETS | $ 23,154,702 | $ 20,797,886 |

| | | |
|---|---|---|
| LIABILITIES: | | |
| Insurance balances payable | $ 148,477 | $ 136,044 |
| Due to affiliates-net | 467,140 | 298,904 |
| Medium term notes payable | 140,000 | 115,000 |
| Zero coupon notes | 81,761 | 73,348 |
| Italian Lire bonds | 159,067 | 159,067 |
| Other liabilities | 114,033 | 188,420 |
| TOTAL LIABILITIES | $ 1,110,478 | $ 970,783 |
| CAPITAL FUNDS: | | |
| Common stock | $ 1,265,210 | $ 1,265,210 |
| Additional paid-in capital | 127,415 | 131,828 |
| Unrealized appreciation of investments, net of taxes | 1,378,318 | 1,395,064 |
| Cumulative translation adjustments, net of taxes | (493,218) | (456,072) |
| Retained earnings | 20,420,881 | 17,697,739 |
| Treasury stock | (654,382) | (206,666) |
| TOTAL CAPITAL FUNDS | 22,044,224 | 19,827,103 |
| TOTAL LIABILITIES AND CAPITAL FUNDS | $ 23,154,702 | $ 20,797,886 |

STATEMENT OF INCOME--PARENT COMPANY ONLY

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| Agency income | $ 484 | $ 1,561 | $ 1,207 |
| Financial services income | 227,242 | 119,541 | 65,899 |
| Dividend income from consolidated subsidiaries: | | | |
| Cash | 1,141,468 | 728,825 | 898,659 |
| Dividend income from partially-owned companies | 7,159 | 1,232 | 1,039 |
| Equity in undistributed net income of consolidated subsidiaries and partially-owned companies | 1,900,389 | 1,901,252 | 1,499,330 |
| Other income (deductions)-net | (80,989) | (76,537) | (125,821) |
| Income before income taxes | 3,195,753 | 2,675,874 | 2,340,313 |
| Income taxes | 298,496 | 165,491 | 164,798 |
| Net income | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 |





SCHEDULE II

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONDENSED FINANCIAL INFORMATION OF REGISTRANT--(CONTINUED)
STATEMENT OF CASH FLOWS--PARENT COMPANY ONLY

(in thousands)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 |
| ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Non-cash revenues, expenses, gains and losses included in income: | | | |
| Equity in undistributed net income of consolidated subsidiaries and partially-owned companies | (1,900,389) | (1,901,252) | (1,499,330) |
| Change in premiums and insurance balances receivable and payable-net | 22,310 | 20,142 | (666) |
| Change in cumulative translation adjustments | 65,427 | 18,196 | (138,528) |
| Other-net | (293,680) | (402,841) | 84,185 |
| Total adjustments | (2,106,332) | (2,265,755) | (1,554,339) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 790,925 | 244,628 | 621,176 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of investments | (300) | (15,400) | (101,553) |
| Sale of investments | 34,343 | 395 | -- |
| Change in short-term investments | 10,146 | (9,090) | 1,693 |
| Change in collateral and guaranteed loans | 2,000 | 15,000 | -- |
| Contributions to subsidiaries and investments in partially-owned companies | (292,069) | (68,398) | (462,056) |
| Other-net | (94,099) | (135) | (2,874) |
| NET CASH USED IN INVESTING ACTIVITIES | (339,979) | (77,628) | (564,790) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Change in medium term notes | 25,000 | (40,000) | (140,000) |
| Proceeds from common stock issued | 23,013 | 20,519 | 14,721 |
| Change in loans payable | 150,700 | 17,680 | 383,135 |
| Cash dividends to shareholders | (174,115) | (153,572) | (136,116) |
| Acquisition of treasury stock | (493,872) | (17,646) | (178,676) |

| | | | |
|---|---|---|---|
| Other-net | 18,862 | 6,104 | -- |
| NET CASH USED IN FINANCING ACTIVITIES | (450,412) | (166,915) | (56,936) |
| CHANGE IN CASH | 534 | 85 | (550) |
| CASH AT BEGINNING OF YEAR | 142 | 57 | 607 |
| CASH AT END OF YEAR | $ 676 | $ 142 | $ 57 |

NOTES TO FINANCIAL STATEMENTS--PARENT COMPANY ONLY

(1) Agency operations conducted in New York through the North American Division of AIU are included in the financial statements of the parent company.

(2) Certain accounts have been reclassified in the 1995 and 1994 financial statements to conform to their 1996 presentation.

(3) "Equity in undistributed net income of consolidated subsidiaries and partially-owned companies" in the accompanying Statement of Income--Parent Company Only--includes equity in income of the minority-owned insurance operations.

(4) See also Notes to Consolidated Financial Statements.





SCHEDULE III

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
SUPPLEMENTARY INSURANCE INFORMATION
AS OF DECEMBER 31, 1996, 1995 AND 1994 AND FOR THE YEARS THEN ENDED

(in thousands)

| Segment | Deferred Policy Acquisition Costs | Reserves for Losses and Loss Expenses, Future Policy Benefits(a) | Reserve for Unearned Premiums | Policy and Contract Claims(b) | Premium Revenue | Net Investment Income |
|---|---|---|---|---|---|---|
| 1996 | | | | | | |
| General insurance | $ 1,415,849 | $33,429,807 | $ 7,598,928 | $ -- | $11,854,815 | $ 1,689,371 |
| Life insurance | 5,055,508 | 24,002,860 | -- | 794,181 | 8,978,246 | 2,675,881 |
| | $ 6,471,357 | $57,432,667 | $ 7,598,928 | $ 794,181 | $20,833,061 | $ 4,365,252 |
| 1995 | | | | | | |
| General insurance | $ 1,289,788 | $33,046,717 | $ 6,938,064 | $ -- | $11,405,731 | $ 1,545,717 |
| Life insurance | 4,477,785 | 20,864,635 | -- | 708,878 | 8,038,150 | 2,264,905 |
| | $ 5,767,573 | $53,911,352 | $ 6,938,064 | $ 708,878 | $19,443,881 | $ 3,810,622 |
| 1994 | | | | | | |
| General insurance | $ 1,179,494 | $31,435,355 | $ 6,318,754 | $ -- | $10,286,831 | $ 1,435,092 |
| Life insurance | 3,952,751 | 17,432,222 | -- | 548,243 | 6,724,321 | 1,748,428 |
| | $ 5,132,245 | $48,867,577 | $ 6,318,754 | $ 548,243 | $17,011,152 | $ 3,183,520 |

| Segment | Losses and Loss Expenses Incurred, Benefits | Amortization of Deferred Policy Acquisition Costs(c) | Other Operating Expenses | Net Premiums Written |
|---|---|---|---|---|
| 1996 | | | | |
| General insurance | $ 8,996,431 | $1,180,138 | $1,279,302 | $12,691,679 |
| Life insurance | 8,103,578 | 627,714 | 1,633,875 | -- |
| | $17,100,009 | $1,807,852 | $2,913,177 | $12,691,679 |

| | | | | |
|---|---|---|---|---|
| 1995 | | | | |
| General insurance | $ 8,659,835 | $1,108,040 | $1,276,273 | $11,893,022 |
| Life insurance | 7,088,034 | 620,487 | 1,536,632 | -- 0 |
| | $15,747,869 | $1,728,527 | $2,812,905 | $11,893,022 |
| 1994 | | | | |
| General insurance | $ 8,005,601 | $ 955,311 | $1,178,402 | $10,865,753 |
| Life insurance | 5,782,561 | 537,364 | 1,287,046 | -- |
| | $13,788,162 | $1,492,675 | $2,465,448 | $10,865,753 |

(a) Reserves for losses and loss expenses with respect to the general insurance operations are net of discounts of $62 million, $21 million and $21 million for 1996, 1995 and 1994, respectively.

(b) Reflected in insurance balances payable on the accompanying balance sheet.

(c) Amounts shown for general insurance segment exclude amounts deferred and amortized in the same period.





SCHEDULE IV

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
REINSURANCE
AS OF DECEMBER 31, 1996, 1995 AND 1994 AND FOR THE YEARS THEN ENDED

(dollars in thousands)

| | GROSS AMOUNT | CEDED TO OTHER COMPANIES | ASSUMED FROM OTHER COMPANIES | NET AMOUNT | PERCENT OF AMOUNT ASSUMED TO NET |
|---|---|---|---|---|---|
| 1996 | | | | | |
| Life insurance in-force | $421,983,133 | $ 36,887,659 | $ 815,650 | $385,911,124 | 0.2% |
| Premiums: | | | | | |
| General insurance | $ 16,696,419 | $ 5,627,453 | $ 1,622,713 | $ 12,691,679 | 12.8% |
| Life insurance | 9,226,821 | 261,142 | 12,567 | 8,978,246 | 0.1 |
| Total premiums | $ 25,923,240 | $ 5,888,595 | $ 1,635,280 | $ 21,669,925 | 7.5% |
| 1995 | | | | | |
| Life insurance in-force | $376,097,107 | $ 34,779,331 | $ 239,787 | $341,557,563 | 0.1% |
| Premiums: | | | | | |
| General insurance | $ 16,357,919 | $ 6,002,098 | $ 1,537,201 | $ 11,893,022 | 12.9% |
| Life insurance | 8,234,425 | 207,272 | 10,997 | 8,038,150 | 0.1 |
| Total premiums | $ 24,592,344 | $ 6,209,370 | $ 1,548,198 | $ 19,931,172 | 7.8% |
| 1994 | | | | | |
| Life insurance in-force | $333,378,811 | $ 30,184,126 | $ 235,278 | $303,429,963 | 0.1% |
| Premiums: | | | | | |
| General insurance | $ 15,368,001 | $ 5,526,656 | $ 1,024,408 | $ 10,865,753 | 9.4% |
| Life insurance | 6,877,256 | 161,928 | 8,993 | 6,724,321 | 0.1 |
| Total premiums | $ 22,245,257 | $ 5,688,584 | $ 1,033,401 | $ 17,590,074 | 5.9% |





## SIGNATURES

PURSUANT TO THE REQUIREMENTS OF SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, THE ISSUER HAS DULY CAUSED THIS ANNUAL REPORT ON FORM

10-K TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED, IN THE CITY OF NEW YORK AND STATE OF NEW YORK, ON THE 28TH DAY OF MARCH, 1997.

AMERICAN INTERNATIONAL GROUP, INC.

By S/S M.R. GREENBERG

(M. R. Greenberg, Chairman)

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, THIS ANNUAL REPORT ON FORM 10-K HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS IN THE CAPACITIES INDICATED ON THE 28TH DAY OF MARCH, 1997 AND EACH OF THE UNDERSIGNED PERSONS, IN ANY CAPACITY, HEREBY SEVERALLY CONSTITUTES M.R. GREENBERG, EDWARD E. MATTHEWS AND HOWARD I. SMITH AND EACH OF THEM, SINGULARLY, HIS TRUE AND LAWFUL ATTORNEY WITH FULL POWER TO THEM AND EACH OF THEM TO SIGN FOR HIM, AND IN HIS NAME AND IN THE CAPACITIES INDICATED BELOW, THIS ANNUAL REPORT ON FORM 10-K AND ANY AND ALL AMENDMENTS THERETO.

| SIGNATURE | TITLE |
|---|---|
| S/S M.R. GREENBERG<br>(M. R. GREENBERG) | Chairman and Director (Principal Executive Officer) |
| S/S HOWARD I. SMITH<br>(HOWARD I. SMITH) | EXECUTIVE VICE PRESIDENT, CHIEF FINANCIAL OFFICER AND COMPTROLLER (PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER) |
| S/S M. BERNARD AIDINOFF<br>(M. BERNARD AIDINOFF) | Director |
| S/S LLOYD M. BENTSEN<br>(LLOYD M. BENTSEN) | Director |
| S/S PEI-YUAN CHIA<br>(PEI-YUAN CHIA) | Director |
| S/S MARSHALL A. COHEN<br>(MARSHALL A. COHEN) | Director |
| S/S BARBER B. CONABLE, JR.<br>(BARBER B. CONABLE, JR.) | Director |
| S/S MARTIN S. FELDSTEIN<br>(MARTIN S. FELDSTEIN) | Director |





SIGNATURES- (CONTINUED)

| SIGNATURE | TITLE |
|---|---|
| S/S LESLIE L. GONDA<br>(LESLIE L. GONDA) | Director |
| S/S EVAN G. GREENBERG<br>(EVAN G. GREENBERG) | Director |

S/S CARLA A. HILLS — Director

(CARLA A. HILLS)

S/S FRANK J. HOENEMEYER — Director

(FRANK J. HOENEMEYER)

S/S EDWARD E. MATTHEWS — Director

(EDWARD E. MATTHEWS)

S/S DEAN P. PHYPERS — Director

(DEAN P. PHYPERS)

S/S JOHN J. ROBERTS — Director

(JOHN J. ROBERTS)

S/S THOMAS R. TIZZIO — Director

(THOMAS R. TIZZIO)

S/S EDMUND S.W. TSE — Director

(EDMUND S.W. TSE)





# EXHIBIT INDEX

| EXHIBIT NUMBER | DESCRIPTION | LOCATION |
|---|---|---|
| 2 | Plan of acquisition, reorganization, arrangement, liquidation or succession | None |
| 3(i) | Restated Certificate of Incorporation of AIG | Filed herewith. |
| 3(ii) | By-laws of AIG | Incorporated by reference from Exhibit 3(ii) to AIG's Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 1-8787). |
| 4 | Instruments defining the rights of security holders, including indentures | |
| | (a) Fiscal Agency Agreement dated as of October 1, 1984 between AIG and Citibank, N.A. | Not required to be filed. The Registrant hereby agrees to file with the Commission a copy of any instrument defining the rights of holders of the Registrant's long-term debt upon request of the Commission. |
| | (b) Indenture dated as of July 15, 1989 between AIG and The Bank of New York | Not required to be filed. The Registrant hereby agrees to file with the Commission a copy of any instrument defining the rights of holders of the Registrant's long-term debt upon request of the Commission. |





| EXHIBIT NUMBER | DESCRIPTION | LOCATION |
|---|---|---|
| 9 | Voting Trust Agreement | None |

| | | | |
|---|---|---|---|
| 10 | Material contracts | | |
| | (a) | AIG 1969 Employee Stock Option Plan and Agreement Form........................................ | Filed as exhibit to AIG's Registration Statement (File No. 2-44043) and incorporated herein by reference. |
| | (b) | AIG 1972 Employee Stock Option Plan.................... | Filed as exhibit to AIG's Registration Statement (File No. 2-44702) and incorporated herein by reference. |
| | (c) | AIG 1972 Employee Stock Purchase Plan.................. | Filed as exhibit to AIG's Registration Statement (File No. 2-44043) and incorporated herein by reference. |
| | (d) | AIG 1984 Employee Stock Purchase Plan.................. | Filed as exhibit to AIG's Registration Statement (File No. 2-91945) and incorporated herein by reference. |
| | (e) | AIG1996 Employee Stock Purchase Plan................... | Filed as exhibit to AIG's Definitive Proxy Statement dated April 2, 1996 (File No. 1-8787) and incorporated herein by reference. |
| | (f) | AIG 1977 Stock Option and Stock Appreciation Rights Plan.................................................. | Filed as exhibit to AIG's Registration Statement (File No. 2-59317) and incorporated herein by reference. |
| | (g) | AIG 1982 Employee Stock Option Plan.................... | Filed as exhibit to AIG's Registration Statement (File No. 2-78291) and incorporated herein by reference. |
| | (h) | AIG 1987 Employee Stock Option Plan.................... | Filed as exhibit to AIG's Definitive Proxy Statement dated as of April 6, 1987 (File No. 0-4652) and incorporated herein by reference. |
| | (i) | AIG 1991 Employee Stock Option Plan.................... | Filed as exhibit to AIG's Definitive Proxy Statement dated as of March 30, 1992 (File No. 0-4652) and incorporated herein by reference. |
| | (j) | AIRCO 1972 Employee Stock Option Plan.................. | Incorporated by reference to AIG's Joint Proxy Statement and Prospectus (File No. 2-61994). |
| | (k) | AIRCO 1977 Stock Option and Stock Appreciation Rights Plan.............................. | Incorporated by reference to AIG's Joint Proxy Statement and Prospectus (File No.2-61994). |
| 11 | Statement re computation of per share earnings................... | | Filed herewith. |
| 12 | Statements re computation of ratios.............................. | | Filed herewith. |
| 13 | Annual report to security holders................................ | | Not required to be filed. |
| 18 | Letter re change in accounting principles........................ | | None. |
| 21 | Subsidiaries of the Registrant................................... | | Filed herewith. |
| 22 | Published report regarding matters submitted to vote of security holders................................................ | | None. |





| EXHIBIT NUMBER | DESCRIPTION | LOCATION |
|---|---|---|
| 23 | Consent of Coopers & Lybrand L.L.P............................... | Filed herewith. |
| 24 | Power of attorney................................................ | Included on the signature page hereof. |
| 27 | Financial Data Schedule.......................................... | Provided herewith. |
| 99 | Undertakings by the Registrant required by Item 17 of Form S-3 and Item 21 of Form S-8, deemed to be incorporated by reference into AIG's Registration Statements on Forms S-3 and S-8 (No. 2-38768, No.2-44043, No. 2-45346, No. 2-51498, No. 2-59317, No. 2-61858, No. 2-62760, No. 2-64336, No. 2-67600, No. 2-72058, No. 2-75874, No. 2-75875, No. 2-78291, No. 2-87005, No. 2-82989, No. 2-90756, No. 2-91945, No. 2-95589, No. 2- 97439, No. 33-8495, No. 33-13874, No. 33-18073, No. 33-25291, No. 33-41643, No. 33-48996, No. 33-57250, No. 33-60327, No. 33-60827, No. 33-62821 and No. 333-21365).............................................. | Filed herewith. |

EXHIBIT 3(i)

# RESTATED CERTIFICATE OF INCORPORATION

of

# AMERICAN INTERNATIONAL GROUP, INC.

--------------------

American International Group, Inc. (the "Company"), a corporation which is organized and existing under and by virtue of the General Corporation Law of the State of Delaware and which was originally incorporated under such law as "American International Enterprises, Inc." on June 9, 1967, DOES HEREBY CERTIFY:

FIRST: That at a meeting of the Board of Directors of the Company resolutions were duly adopted setting forth a proposed Restated Certificate of Incorporation of said Company, declaring the restatement and amendment of the Restated Certificate of Incorporation of said Company to be advisable and directing that the amendment proposed be considered at the next annual meeting of the stockholders of said Company. The resolution setting forth the restatement is as follows:

R E S O L V E D

That the Certificate of Incorporation of AMERICAN INTERNATIONAL GROUP, INC. (the "Company") is restated and amended so that as restated and amended it will read in its entirety as follows:

## "ARTICLE ONE.

### Name.

The name of the Company is AMERICAN INTERNATIONAL GROUP, INC.

## ARTICLE TWO.

### Registered Office and Registered Agent.

Its principal office is to be located in the City of Dover, in The County of Kent, in the State of Delaware. The name of its resident agent is the UNITED STATES CORPORATION COMPANY, whose address is 32 Loockerman Square, Suite L-100 in said City.



## ARTICLE THREE.

### Corporate Purposes and Powers.

The nature of the business or purposes to be conducted or promoted by the Company is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, including, but not limited to, the business of insurance agent, broker or adjuster.

## ARTICLE FOUR.

### Capital Stock

The total number of shares of all classes of stock which the Company shall have authority to issue is 1,006,000,000, of which 6,000,000 shares are to be Serial Preferred Stock, par value $5.00 per share (hereinafter called the "Serial Preferred Stock") and 1,000,000,000 shares are to be Common Stock, par value $2.50 per share (hereinafter called the "Common Stock").

The voting powers, designations, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof, of the Serial Preferred Stock and the Common Stock, in addition to those set forth elsewhere herein, are as follows:

(1) The Serial Preferred Stock may be issued from time to time by the Board of Directors, as shares of one or more series of Serial Preferred Stock, and, subject to subdivisions (2) through (6) of this Article Four, the Board of Directors or a duly authorized committee thereof is expressly authorized, prior to issuance, in the resolution or resolutions providing for the issue of shares of each particular series, to fix the relative rights, preferences or limitations of the shares of the series, including but not limited to the following:

(a) The distinctive serial designation of such series which shall distinguish it from other series:

(b) The number of shares included in such series, which number may be increased or decreased from time to time unless otherwise provided in the resolutions creating the series;

(c) The dividend rate or rates (or method of determining such rate or rates) for shares of such series and the date or dates (or the method of determining such date or dates) upon which such dividends shall be payable;





(d) Whether dividends on the shares of such series shall be cumulative, and, in the case of shares of any series having cumulative dividend rights, the date or dates or method of determining the date or dates from which dividends on the shares of such series shall be cumulative;

(e) The amount or amounts which shall be paid out of the assets of the Company to the holders of the shares of such series upon voluntary or involuntary liquidation, dissolution or winding up of the Company;

(f) The price or prices at which, the period or periods within which and the terms and conditions upon which the shares of such series may be redeemed or exchanged, in whole or in part;

(g) The obligation, if any, of the Company to purchase or redeem shares of such series pursuant to a sinking fund or otherwise and the price or prices at which, the period or periods within which and the terms and conditions upon which the shares of such series shall be redeemed, in whole or in part, pursuant to such obligation;

(h) The period or periods within which and the terms and conditions, if any, including the price or prices or the rate or rates of conversion and the terms and conditions of any adjustments thereof, upon which the shares of such series shall be convertible at the option of the holder into shares of any other class of stock or into shares of any other series of Serial Preferred Stock, except into shares of a class having rights or preferences as to dividends or distribution of assets upon liquidation which are prior or superior in rank to those of the shares being converted;

(i) The voting rights, if any, of the shares of such series in addition to those required by law, including the number of votes per share and any requirement for the approval by the holders of up to 66 2/3% of all Serial Preferred Stock, or of the shares of one or more series, or of both, as a condition to specified corporate action or amendments to the Restated Certificate of Incorporation; and

(j) Any other relative rights, preferences or limitations of the shares of the series not inconsistent herewith or with applicable law.

(2) All Serial Preferred Stock (a) shall rank senior to the Common Stock in respect of the right to receive dividends and the right to receive payments out of the assets of the Company upon voluntary or involuntary liquidation, dissolution or winding up of the Company and (b) shall be of equal rank with all other shares of the Serial Preferred Stock as to the right to receive dividends and





the right to receive payments out of the assets of the Company upon voluntary or involuntary liquidation, dissolution or winding up of the Company.

(3) No dividend shall be paid upon, or declared or set apart for, any share of Serial Preferred Stock or any other share of preferred stock ranking on a parity with the Serial Preferred Stock as to dividends unless at the same time a like proportionate dividend, ratably in proportion to the respective dividend rates fixed therefor, shall be paid upon, or declared and set apart for, all shares of Serial Preferred Stock and preferred stock of all series ranking on a parity as to dividends then issued and outstanding and on which dividends are accrued and payable for all dividend periods terminating on or prior to the dividend payment date.

(4) In no event, so long as any shares of Serial Preferred Stock shall be outstanding, shall any dividend, whether in cash or property, be paid or declared, nor shall any distribution be made, on any junior stock, nor shall any shares of any junior stock be purchased, redeemed or otherwise acquired for value by the Company, unless all dividends on the Serial Preferred Stock of all series and any series of preferred stock ranking on a parity with the Serial Preferred Stock as to dividends for all past dividend periods and for the then current period shall have been paid or declared and a sum sufficient for the payment thereof set apart, and unless the Company shall not be in default with respect to any of its obligations with respect to any past period with respect to any sinking fund for any series of Serial Preferred Stock and preferred stock ranking on a parity with the Serial Preferred Stock as to dividends. The foregoing provisions of this sub-division (4) shall not, however, apply to a dividend payable on any junior stock, or to the acquisition of shares of any junior stock in exchange for, or through application of the proceeds of the sale of, shares of any other junior stock.

(5)In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Company, then, before any distribution or payment shall be made to the holders of any junior stock, the holders of the Serial Preferred Stock and any shares of preferred stock ranking on a parity therewith as to liquidation shall be entitled to be paid in full the respective amounts of the liquidation preferences thereof, which in the case of Serial Preferred Stock shall be the amounts fixed in accordance with the provisions of subdivision (1) of this Article Four, together with accrued dividends to such distribution or payment date whether or not earned or declared. If such payment shall have been made in full to the holders of the Serial Preferred Stock and any series of preferred stock ranking on a parity therewith as to liquidation, the remaining assets and funds of the Company shall be distributed among the holders of the junior stock, according to their respective rights and preferences and in each case according





to their respective shares. If, upon any liquidation, dissolution or winding up of the affairs of the Company, the amounts so payable are not paid in full to the holders of all outstanding shares of Serial Preferred Stock and any series of preferred stock ranking on a parity therewith as to liquidation, the holders of all series of Serial Preferred Stock and any series of preferred stock ranking on a parity therewith as to liquidation shall share ratably in any distribution of assets in proportion to the full amounts to which they would otherwise be respectively entitled. Neither the consolidation or merger of the Company, nor the sale, lease or conveyance of all or a part of its assets, shall be deemed a liquidation, dissolution or winding up of the affairs of the Company within the meaning of the foregoing provisions of this subdivision (5).

(6) No holder of Serial Preferred Stock shall be entitled as a matter of right to subscribe for or purchase, or have any preemptive right with respect to, any part of any new or additional issue of stock of any class whatsoever, or of securities convertible into any stock of any class whatsoever, whether now or hereafter authorized and whether issued for cash or other consideration or by way of dividend.

(7) As used herein with respect to the Serial Preferred Stock or in any resolution adopted by the Board of Directors providing for the issue of any particular series of the Serial Preferred Stock as authorized by subdivision (1) of this Article Four, the following terms shall have the following meanings:

(a) The term "junior stock" shall mean the Common Stock and any other class of stock of the Company hereafter authorized over which the Serial Preferred Stock has preference or priority in the payment of dividends or in the distribution of assets on any liquidation, dissolution or winding up of the Company.

(b) The term "sinking fund" shall mean any fund or requirement for the periodic requirement for the periodic retirement of shares.

(c) The term "accrued dividend", with respect to any share of any series, shall mean an amount computed at the annual dividend rate for the series of which the particular share is a part, from the date on which dividends on such share is a part, from the date on which dividends on such share became cumulative to and including the date to which such dividends are to be accrued, less the aggregate amount of all dividends theretofore paid thereon.

(8) No holder of any share or shares of stock of the Company shall be entitled as of right to subscribe for, purchase or receive any shares of stock of any class or any other securities which the Company may issue, whether now or hereafter authorized, and whether such stock or securities be issued for money or for a consideration





other than money or by way of a dividend and all such shares of stock or other securities may be issued or disposed of by the Board of Directors to such persons, firms, corporations, and associations and on such terms as it, in its absolute discretion, may deem advisable, without offering to stockholders then of record or any class of stockholders any thereof upon the same terms or upon any terms.

(9) The holders of the shares of Common Stock will be entitled to one vote per share of such stock on all matters except as herein or by statute otherwise provided.

ARTICLE FIVE.

Minimum Capital.

The minimum amount of capital with which the Company will commence business is $1,000.

ARTICLE SIX.

Corporate Existence.

The Company is to have perpetual existence.

ARTICLE SEVEN.

Liability of Holders of Capital Stock
for Corporate Debts.

The private property of the stockholders shall not be subject to the payment of corporate debts to any extent whatever.

ARTICLE EIGHT.

Powers of Board of Directors; Meetings;
Corporate Books; Etc.

The following provisions are inserted for the management of the business and for the conduct of the affairs of the Company, and for further definition, limitation and regulation of the powers of the Company and of its directors and stockholders:

(1) Subject to the provisions of subdivision (6) of Article Four hereof, the number of directors of the Company shall be such as from time to time shall be fixed by, or in the manner provided in the By-Laws. Election of directors need not be by ballot unless the By-Laws so provide.





(2) The Board of Directors shall have power:

(a) Without the assent or vote of the stockholders, to make, alter, amend, change, add to, or repeal the By-Laws of the Company; to fix any vary the amount to be reserved for any proper purpose and to abolish any such reserve in the manner in which it was created; to authorize and cause to be executed mortgages and liens upon any part of the property of the Company provided it be less than substantially all; to determine the use and disposition of any surplus or net profits and to fix the times for the declaration and payment of dividends.

(b) To determine from time to time whether, and to what extent, and at what times and places, and under what conditions and regulations, the accounts and books of the Company (other than the stock ledger) or any of them, shall be open to the inspection of the stockholders.

(c) By resolution passed by a majority of the whole board, to designate one or more committees, each committee to consist of two or more of the directors of the Company, which, to the extent provided in the resolution or in the By-Laws of the Company, shall have and may exercise the powers of the Board of Directors in the management of the business and affairs of the Company, and may authorize the seal of the Company to be affixed to all papers which may require it. Such committee or committees shall have such name or names as may be stated in the By-Laws of the Company or as may be determined from time to time by resolution adopted by the Board of Directors.

(d) When and as authorized by the affirmative vote of the holders of a majority of the stock issued and outstanding having voting power given at a stockholders' meeting duly called for that purpose, or when authorized by the written consent of the holders of a majority of the voting stock issued and outstanding, to sell, lease or exchange all of the property and assets of the Company, including its good will and its corporate franchises, upon such terms and conditions and for such consideration, which may be in whole or in part shares of stock in, and/or other securities of, any other corporation or corporations, as its Board of Directors shall deem expedient and for the best interests of the Company.

(3) The directors in their discretion may submit any contract or act

for approval or ratification at any annual meeting of the stockholders or at any meeting or the stockholders called for the purpose of considering any such act or contract, and any contract or act that shall be approved or be ratified by the vote of the holders of a majority of the stock of the Company which is represented in person or by proxy at such meeting and entitled to





vote thereat (provided that a lawful quorum of stockholders be there represented in person or by proxy) shall be as valid and as binding upon the Company and upon all the stockholders, as though it had been approved or ratified by every stockholder of the Company, whether or not the contract or act would otherwise be open to legal attack because of directors' interest, or for any other reason.

(4) The stockholders and directors shall have power to hold their meetings if the By-Laws so provide and (except as the laws of the State of Delaware shall otherwise provide) keep the books, documents and papers of the Company, outside of the State of Delaware, and to have one or more offices within or without the State of Delaware, at such places as may be from time to time designated by the By-Laws or by resolution of the stockholders or directors, except as otherwise required by the laws of Delaware.

(5) In addition to the powers and authorities hereinbefore or by statute expressly conferred upon them, the directors are hereby empowered to exercise all such powers and do all such acts and things as may be exercised or done by the Company; subject, nevertheless, to the provisions of the statutes of Delaware, of this certificate, and to any By-Laws from time to time made by the stockholders; provided, however, that no By-Laws so made shall invalidate any prior act of the directors which would have been valid if such By-Laws had not been made.

## ARTICLE NINE.

### Transactions with Directors.

No contract or other transaction between the Company and any other corporation, whether or not a majority of the shares of the capital stock of such other corporation is owned by the Company, and no act of the Company shall in any way be affected or invalidated by the fact that any of the directors of the Company are financially or otherwise interested in, or are directors or officers of, such other corporation; any director individually, or any firm of which such director may be a member, may be a party to, or may be financially or otherwise interested in, any contract or transaction of the Company, provided that the fact that he or such firm is so interested shall be disclosed or shall have been known to the Board of Directors or a majority thereof; and any director of the Company who is also a director or officer of such other corporation, or who is so interested, may be counted in determining the existence of a quorum at any meeting of the Board of Directors of the Company which shall authorize such contract or transaction and may vote thereat to authorize such contract or transaction, with like force and effect as if he were not such director or officer of such other corporation or not so interested.





## ARTICLE TEN.

### Indemnification of Directors and Officers.

The Company shall indemnify to the full extent permitted by law any person made, or threatened to be made, a party to an action, suit or proceeding (whether civil, criminal, administrative or investigative) by reason of the fact that he, his testator or intestate is or was a director, officer or employee of the Company or serves or served any other enterprise at the request of the Company.

ARTICLE ELEVEN.

Reservation of Right to Amend
Certificate of Incorporation.

The Company reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation in the manner now or hereafter prescribed by law, and all rights and powers conferred herein on stockholders, directors and officers are subject to this reserved power.

ARTICLE TWELVE.

No director of the Company shall be liable to the Company or its stockholders for monetary damages for breach of fiduciary duty as a director, except to the extent such an exemption from liability or limitation thereof is not permitted under the Delaware General Corporation Law as presently in effect or as the same may hereafter be amended. No amendment to or repeal of these provisions shall apply to or have any effect on the liability or alleged liability of any director of the Company for or with respect to any acts or omissions of such director occurring prior to such amendment or repeal."

SECOND: That, pursuant to resolution of its Board of Directors, the annual meeting of the stockholders of said Company was duly called and held, at which meeting the necessary number of shares as required by statute were voted in favor of the aforesaid amendment.

THIRD: That said restatement and amendment was duly adopted in accordance with the provisions of Sections 242 and 245 of the General Corporation Law of the State of Delaware.





FOURTH: That the capital of said Company will not be reduced under or by reason of said restatement and amendment.

IN WITNESS WHEREOF, said AMERICAN INTERNATIONAL GROUP, INC. has caused its corporate seal to be hereunto affixed and this Certificate to be signed by Edward E. Matthews, its Vice Chairman, and Kathleen E. Shannon, its Secretary this 2nd day of June, 1995.

AMERICAN INTERNATIONAL GROUP, INC.

By /s/ Edward E. Matthews
Vice Chairman

By /s/ Kathleen E. Shannon
Secretary

STATE OF NEW YORK }<br>
} ss.:<br>
COUNTY OF NEW YORK }

BE IT REMEMBERED that on this 2nd day of June, 1995, personally came before me, a Notary Public in and for the County and State aforesaid, Edward E. Matthews, Vice Chairman of American International Group, Inc., (the "Company"), a corporation of the State of Delaware, the Company described in and which executed the foregoing certificate, known to me personally to be such, and he, the said Edward E. Matthews as such Vice Chairman, duly executed said certificate before me and acknowledged the said certificate to be his act and deed and the act, and deed of said Company; that the signature of the said Vice Chairman and of the Secretary of said Company to said certificate are in the handwriting of the said Vice Chairman and Secretary of said Company, respectively, and that the seal affixed to said certificate is the common or corporate seal of said Company, and that the facts stated therein are true.

IN WITNESS WHEREOF, I have hereunto set my hand and seal of office the day and year aforesaid.

/s/ Patrick R. McAuliffe

______________________________________
Notary Public

PATRICK R. MCAULIFFE<br>
NOTARY PUBLIC, State of New York<br>
No. 30-4862118<br>
Qualified in Nassau County<br>
Commission Expire June 23, 1996

EXHIBIT 11

Computation of Earnings Per Share — American International Group, Inc. and Subsidiaries

(in thousands, except per share amounts)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994(a) | 1993(a) | 1992(a) |
|---|---|---|---|---|---|
| Average outstanding shares used in the computation of per share earnings: | | | | | |
| Common stock issued | 506,084 | 506,085 | 506,086 | 506,089 | 506,093 |
| Common stock in treasury | (35,039) | (32,063) | (31,207) | (29,897) | (29,637) |
| Average outstanding shares | 471,045 | 474,022 | 474,879 | 476,192 | 476,456 |
| Income before cumulative effect of accounting changes | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 | $ 1,917,035 | $ 1,620,544 |
| Cumulative effect of accounting changes, net of tax | | | | | |
| AIG | -- | -- | -- | -- | 31,941 |
| Minority-owned insurance operations | -- | -- | -- | 20,695 | -- |
| Net income (applicable to common stock)(b) | $ 2,897,257 | $ 2,510,383 | $ 2,175,515 | $ 1,937,730 | $ 1,652,485 |
| Earnings per share:(c) | | | | | |
| Income before cumulative effect of accounting changes | $ 6.15 | $ 5.30 | $ 4.58 | $ 4.03 | $ 3.40 |
| Cumulative effect of accounting changes, net of tax | | | | | |
| AIG | -- | -- | -- | -- | 0.07 |
| Minority-owned insurance operations | -- | -- | -- | 0.04 | -- |
| Net income | $ 6.15 | $ 5.30 | $ 4.58 | $ 4.07 | $ 3.47 |

(a) Adjusted to reflect a common stock split in the form of a 50 percent common stock dividend paid July 28, 1995.

(b) After deductions in 1993 and 1992 of preferred stock dividends of $1,043 and $4,471, respectively.

(c) The effect of all other common stock equivalents is not significant; therefore, this information is not presented.

Computation of Ratios of Earnings to Fixed Charges

EXHIBIT 12

American International Group, Inc. and Subsidiaries

(in thousands, except ratios)

| YEARS ENDED DECEMBER 31, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|
| Income before income taxes and cumulative effect of accounting changes | $4,013,222 | $3,465,883 | $2,951,979 | $2,601,081 | $2,137,048 |
| Less-Equity income of less than 50% owned persons | 121,347 | 91,444 | 54,091 | 43,966 | 40,148 |
| Add-Dividends from less than 50% owned persons | 13,431 | 6,515 | 4,660 | 4,349 | 5,147 |
| | 3,905,306 | 3,380,954 | 2,902,548 | 2,561,464 | 2,102,047 |
| Add-Fixed charges | 1,614,703 | 1,483,752 | 1,404,633 | 1,213,487 | 1,233,132 |
| Less-Capitalized interest | 50,352 | 50,746 | 46,023 | 42,699 | 38,725 |
| Income before income taxes, cumulative effect of accounting changes and fixed charges | $5,469,657 | $4,813,960 | $4,261,158 | $3,732,252 | $3,296,454 |
| Fixed charges: | | | | | |
| Interest costs | $1,541,670 | $1,411,886 | $1,335,300 | $1,146,654 | $1,166,732 |
| Rental expense* | 73,033 | 71,866 | 69,333 | 66,833 | 66,400 |
| Total fixed charges | $1,614,703 | $1,483,752 | $1,404,633 | $1,213,487 | $1,233,132 |
| Ratio of earnings to fixed charges | 3.39 | 3.24 | 3.03 | 3.08 | 2.67 |

* The proportion deemed representative of the interest factor.

The ratios shown are 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, excluding the effects of the operating results of AIGFP, are 5.18, 4.77, 5.25, 5.66 and 5.15 for 1996, 1995, 1994, 1993 and 1992, 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.

EXHIBIT 21

## Subsidiaries of Registrant

| NAME OF CORPORATION | JURISDICTION OF INCORPORATION | % OF VOTING SECURITIES OWNED BY ITS IMMEDIATE PARENT(1) |
|---|---|---|
| Starr | Delaware | (2) |
| SICO | Panama | (2) |
| AIG (Registrant)(3) | Delaware | (4) |
| AICCO | New Hampshire | 100% |
| AIG Asset Management Group, Inc. | Delaware | 100% |
| AIG Capital Partners, Inc. | Delaware | 100% |
| AIG Aviation, Inc. | Georgia | 100% |
| AIG Capital Corp. | Delaware | 100% |
| AIG Capital Management Corp. | Delaware | 100% |
| AIG Claim Services, Inc. | Delaware | 100% |
| AIG Consumer Finance, Inc. | Delaware | 100% |
| AIG Financial Products Corp. | Delaware | 100% |
| AIG Funding, Inc. | Delaware | 100% |
| AIG Global Investment Group, Inc. | Delaware | 100% |
| AIG Global Trade &Political Risk Insurance Company | New Jersey | 100% |
| AIG Life Insurance Company | Delaware | 78.9%(5) |
| AIG Life Insurance Company of Puerto Rico | Puerto Rico | 100% |
| AIG Marketing, Inc. | Delaware | 100% |
| AIG Realty, Inc. | New Hampshire | (6) |
| American International Realty Corp. | Delaware | 100% |
| AIG Risk Management, Inc. | New York | 100% |
| AIG Trading Group Inc. | Delaware | 80% |
| AIU Insurance Company | New York | 52%(7) |
| AIU North America, Inc. | New York | 100% |
| American Home | New York | 100% |
| AIG Hawaii Insurance Company, Inc. | Hawaii | 100% |
| American International Insurance Company | New York | 100% |
| American International Insurance Company of California, Inc. | California | 100% |
| American International Insurance Company of New Jersey | New Jersey | 100% |
| Minnesota Insurance Company | Minnesota | 100% |
| Transatlantic Holdings, Inc. | Delaware | 34.02%(8) |
| American International Group Data Center, Inc. | New Hampshire | 100% |
| American International Life Assurance Company of New York | New York | 77.52%(9) |
| American International Reinsurance Company Limited | Bermuda | 100% |
| AIA | Hong Kong | 100% |
| Australian American Assurance Company Limited | Australia | 100% |
| American International Assurance Company (Bermuda) Limited | Bermuda | 100% |
| Nan Shan Life Insurance Company, Ltd. | Taiwan | 94.12% |
| American International Underwriters Corporation | New York | 100% |
| AIUO | Bermuda | 100% |
| AIG Europe (Ireland) Ltd. | Ireland | 100% |
| Universal Insurance Co., Ltd. | Thailand | 100% |
| Interamericana Compania de Seguros Gerais (Brazil) | Brazil | 100% |
| La Seguridad de Centroamerica, Compania de Seguros, Sociedad Anonima | Guatemala | 100% |
| American International Insurance Company of Puerto Rico | Puerto Rico | 100% |
| La Interamerica Compania de Seguros Generales S.A | Colombia | 100% |
| American International Underwriters G.m.b.H | Germany | 100% |
| Underwriters Adjustment Company, Inc. | Panama | 100% |





## Subsidiaries of Registrant--(continued)

| NAME OF CORPORATION | JURISDICTION OF INCORPORATION | % OF VOTING SECURITIES OWNED BY ITS IMMEDIATE PARENT(1) |
|---|---|---|
| American Life Insurance Company | Delaware | 100% |
| Kenya American Insurance Company Limited | Kenya | 100% |
| ALICO | France | 89% |
| Birmingham Fire Insurance Company of Pennsylvania | Pennsylvania | 100% |
| China America Insurance Company, Ltd. | Delaware | 50% |
| Commerce and Industry Insurance Company | New York | 100% |
| Commerce and Industry Insurance Company of Canada | Ontario | 100% |
| Delaware American Life Insurance Company | Delaware | 100% |
| Hawaii Insurance Consultants, Ltd. | Hawaii | 100% |
| The Insurance Company of the State of Pennsylvania | Pennsylvania | 100% |
| Landmark Insurance Company | California | 100% |
| Le Metropolitana de Seguros, C. por A | Dominican Republic | 100% |
| Mt. Mansfield Company, Inc. | Vermont | 100% |
| National Union | Pennsylvania | 100% |
| American International Specialty Lines Insurance Company | Alaska | 70%(10) |
| International Lease Finance Corporation | California | 100% |
| Lexington | Delaware | 70%(10) |
| JI Accident & Fire Insurance Co. Ltd. | Japan | 50% |
| National Union Fire Insurance Company of Louisiana | Louisiana | 100% |
| NHIG Holding Corp. | Delaware | 100% |
| Audubon Insurance Company | Louisiana | 100% |
| Audubon Indemnity Company | Mississippi | 100% |

| | | |
|---|---|---|
| Agency Management Corporation | Louisiana | 100% |
| The Gulf Agency, Inc. | Alabama | 100% |
| New Hampshire | Pennsylvania | 100% |
| AIG Europe, S.A | France | (11) |
| A.I. Network Corporation | New Hampshire | 100% |
| Marketpac International, Inc. | Delaware | 100% |
| American International Pacific Insurance Company | Colorado | 100% |
| American International South Insurance Company | Pennsylvania | 100% |
| Granite State Insurance Company | Pennsylvania | 100% |
| New Hampshire Indemnity Company, Inc. | Pennsylvania | 100% |
| Illinois National Insurance Co. | Illinois | 100% |
| New Hampshire Insurance Services, Inc. | New Hampshire | 100% |
| PHILAM | Philippines | 99% |
| Pacific Union Assurance Company | California | 100% |
| The Philippine American General Insurance Company, Inc. | Philippines | 100% |
| Philam Insurance Company, Inc. | Philippines | 100% |
| The Philippine American Assurance Company, Inc. | Philippines | 25% |





Subsidiaries of Registrant--(continued)

| NAME OF CORPORATION | JURISDICTION OF INCORPORATION | % OF VOTING SECURITIES OWNED BY ITS IMMEDIATE PARENT(1) |
|---|---|---|
| Risk Specialist Companies, Inc. | Delaware | 100% |
| Ticino Societa d' Assicurazioni Sulla Vita | Switzerland | 99.8% |
| 20th Century Insurance Company of Arizona | Arizona | 51% |
| UeberseeBank, AG | Switzerland | 100% |
| UGC | North Carolina | 36.31%(12) |
| United Guaranty Insurance Company | North Carolina | 100% |
| United Guaranty Mortgage Insurance Company | North Carolina | 100% |
| United Guaranty Mortgage Insurance Company of North Carolina | North Carolina | 100% |
| United Guaranty Residential Insurance Company of North Carolina | North Carolina | 100% |
| United Guaranty Residential Insurance Company | North Carolina | 75%(13) |
| United Guaranty Commercial Insurance Company of North Carolina | North Carolina | 100% |
| United Guaranty Commercial Insurance Company | North Carolina | 100% |
| United Guaranty Credit Insurance Company | North Carolina | 100% |
| United Guaranty Services, Inc. | North Carolina | 100% |

(1) Percentages include directors' qualifying shares.

(2) The directors and officers of AIG as a group own 94.51 percent of the voting common stock of Starr and 81.82 percent of the voting stock of SICO. Six of the directors of AIG also serve as directors of Starr and SICO.

(3) All subsidiaries listed except for minority-owned Transatlantic Holdings, Inc., which is included under the equity method, are consolidated in the accompanying financial statements. Certain subsidiaries have been omitted from the tabulation. The omitted subsidiaries, when considered in the aggregate as a single subsidiary, do not constitute a significant subsidiary.

(4) The common stock is owned 16.1 percent by SICO, 2.4 percent by Starr and 3.4 percent by The Starr Foundation.

(5) Also owned 21.1 percent by Commerce & Industry Insurance Company.

(6) Owned by 13 AIG subsidiaries.

(7) Also owned 8 percent by The Insurance Company of the State of Pennsylvania, 32 percent by National Union, and 8 percent by Birmingham.

(8) Also owned 15.05 percent by American International Group, Inc.

(9) Also owned 22.48% by American Home.

(10) Also owned 20 percent by The Insurance Company of the State of Pennsylvania and 10 percent by Birmingham.

(11) 100 percent to be held with other AIG companies.

(12) Also owned 45.88 percent by National Union, 16.95 percent by New Hampshire and 0.86 percent by The Insurance Company of the State of Pennsylvania.

(13) Also owned 25 percent by United Guaranty Residential Insurance Company of

North Carolina.

EXHIBIT 23

Consent of Independent Accountants

We consent to the incorporation by reference in the Registration Statements of American International Group, Inc. on Forms S-3 and S-8 (No. 2-38768, No. 2-44043, No. 2-45346, No. 2-51498, No. 2-59317, No. 2-61858, No. 2-62760, No. 2-64336, No. 2-67600, No. 2-72058, No. 2-75874, No. 2-75875, No. 2-78291, No. 2-87005, No. 2-82989, No. 2-90756, No. 2-91945, No. 2-95589, No. 2-97439, No. 33-8495, No. 33-13874, No. 33-18073, No. 33-25291, No. 33-41643, No. 33-48996, No. 33-57250, No. 33-60327, No. 33-60827, No. 33-62821 and No. 333-21365) of our report dated February 20, 1997, on our audits of the consolidated financial statements and financial statement schedules of American International Group, Inc. and subsidiaries as of December 31, 1996 and 1995 and for each of the three years in the period ended December 31, 1996, which report is included in the Annual Report on Form 10-K of American International Group, Inc. for the year 1996, and to the reference to our firm under the heading "Financial Statements" included in the Prospectuses.

COOPERS & LYBRAND L.L.P.

New York, New York
March 28, 1997.

<ARTICLE> 7
<LEGEND>
AMERICAN INTERNATIONAL GROUP, INC.
FINANCIAL DATA SCHEDULE
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1996
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
</LEGEND>
<MULTIPLIER> 1000

| | | |
|---|---|---|
| <PERIOD-TYPE> | 12-MOS | |
| <FISCAL-YEAR-END> | | DEC-31-1996 |
| <PERIOD-START> | | JAN-01-1996 |
| <PERIOD-END> | | DEC-31-1996 |
| <DEBT-HELD-FOR-SALE> | | 35,524,932 |
| <DEBT-CARRYING-VALUE> | | 12,258,978 |
| <DEBT-MARKET-VALUE> | | 12,865,357 |
| <EQUITIES> | | 6,065,640 |
| <MORTGAGE> | | 2,805,604 |
| <REAL-ESTATE> | | 1,370,808 |
| <TOTAL-INVEST> | | 105,990,233 |
| <CASH> | | 58,740 |
| <RECOVER-REINSURE> | | 16,526,566 |
| <DEFERRED-ACQUISITION> | | 6,471,357 |
| <TOTAL-ASSETS> | | 148,431,002 |
| <POLICY-LOSSES> | | 57,432,667 |
| <UNEARNED-PREMIUMS> | | 7,598,928 |
| <POLICY-OTHER> | | 0 |
| <POLICY-HOLDER-FUNDS> | | 12,023,316 |
| <NOTES-PAYABLE> | | 17,797,286 |
| <PREFERRED-MANDATORY> | | 0 |
| <PREFERRED> | | 0 |
| <COMMON> | | 1,265,210 |
| <OTHER-SE> | | 20,779,014 |
| <TOTAL-LIABILITY-AND-EQUITY> | | 148,431,002 |
| <PREMIUMS> | | 20,833,061 |
| <INVESTMENT-INCOME> | | 4,365,252 |
| <INVESTMENT-GAINS> | | 87,991 |
| <OTHER-INCOME> | | (84,350) |
| <BENEFITS> | | 17,100,009 |
| <UNDERWRITING-AMORTIZATION> | | 1,807,852 |
| <UNDERWRITING-OTHER> | | 2,913,177 |
| <INCOME-PRETAX> | | 4,013,222 |
| <INCOME-TAX> | | 1,115,965 |
| <INCOME-CONTINUING> | | 2,897,257 |
| <DISCONTINUED> | | 0 |
| <EXTRAORDINARY> | | 0 |
| <CHANGES> | | 0 |
| <NET-INCOME> | | 2,897,257 |
| <EPS-PRIMARY> | | 6.15 |
| <EPS-DILUTED> | | 6.15 |
| <RESERVE-OPEN> | | 19,692,800 |
| <PROVISION-CURRENT> | | 9,272,400 |
| <PROVISION-PRIOR> | | (276,000) |
| <PAYMENTS-CURRENT> | 3,000,500 | |
| <PAYMENTS-PRIOR> | | 5,281,400 |
| <RESERVE-CLOSE> | | 20,407,300 |
| <CUMULATIVE-DEFICIENCY> | | 280,000 |

EXHIBIT 99

Undertakings

(a) The undersigned registrant hereby undertakes:

(1) to file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement:

(i) to include any prospectus required by Section 10(a) (3) of the Securities Act of 1933 unless the information required to be included in such post-effective amendment is contained in a periodic report filed by registrant pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and incorporated herein by reference,

(ii) to reflect in the prospectus any facts or events arising after the effective date of this Registration Statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in this Registration Statement unless the information required to be included in such post-effective amendment is contained in a periodic report filed by the registrant pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and incorporated herein by reference, and

(iii) to include any material information with respect to the plan of distribution not previously disclosed in this Registration Statement or any material change to such information in this Registration Statement;

(2) that, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment that is incorporated by reference in this Registration Statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof;

(3) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering; and

(4) that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(b) The undersigned registrant hereby undertakes to deliver or cause to be delivered with the prospectus to each employee to whom the prospectus is sent or given, a copy of the registrant's annual report to shareholders for its last fiscal year, unless such employee otherwise has received a copy of such report in which case the registrant shall state in the prospectus that it will promptly furnish, without charge, a copy of such report on written request of the employee. If the last fiscal year of the registrant has ended within 120 days prior to the use of the prospectus, the annual report of the registrant for the preceding fiscal year may be so delivered, but within such 120-day period the annual report for the last fiscal year will be furnished to each such employee.

(c) The undersigned registrant hereby undertakes to transmit or cause to be transmitted to all employees participating in the plan, who do not otherwise receive such material as shareholders of the registrant, at the time and in the manner such material is sent to its shareholders, copies of all reports, proxy statements and other communications distributed to its shareholders generally.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.