UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

# FORM 10-Q

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

OR

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

For the Transition Period From ------ to ------

For Quarter Ended September 30, 1994 Commission File Number 0-4652

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 Number) |
| 70 Pine Street, New York, New York | 10270 |
| (Address of principal executive offices) | (Zip Code) |

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

NONE

Former name, former address and former fiscal year, if changed since last report.

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

YES X NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of September 30, 1994 316,064,101.

AMERICAN INTERNATIONAL GROUP, INC.
CONSOLIDATED BALANCE SHEET
(dollars in thousands)
(unaudited)

| | SEPTEMBER 30, 1994 | DECEMBER 31, 1993 |
|---|---|---|
| ASSETS: | | |
| Investments and cash: | | |
| Fixed maturities: | | |
| Bonds held to maturity, at amortized cost (market value: 1994-$13,110,000; 1993-$13,278,300) | $ 12,715,086 | $ 12,193,701 |
| Bonds available for sale, at market value (cost: 1994-$20,569,400; 1993-$16,599,600) | 20,351,602 | 17,562,411 |
| Bonds trading securities, at market value (cost: 1994-$300,800; 1993-$307,900) | 290,899 | 310,834 |
| Preferred stocks, at amortized cost (market value: 1994-$206,200; 1993-$18,000) | 208,645 | 17,428 |
| Equity securities: | | |
| Common stocks (cost: 1994-$4,538,200; 1993-$3,720,000) | 5,145,771 | 4,364,410 |
| Non-redeemable preferred stocks (cost: 1994-$91,300; 1993-$108,200) | 110,363 | 123,837 |
| Mortgage loans on real estate, policy and collateral loans | 4,811,462 | 3,576,516 |
| Financial services assets: | | |
| Flight equipment primarily under operating leases, net of accumulated depreciation (1994-$863,300; 1993-$599,800) | 10,147,985 | 8,555,356 |
| Securities available for sale, at market value (cost: 1994-$3,499,200; 1993-$4,971,800) | 3,500,151 | 4,991,105 |
| Trading securities, at market value | 2,565,939 | 2,516,166 |
| Spot commodities, at market value | 1,387,387 | 764,215 |
| Net unrealized gain on interest rate and currency swaps, options and forward transactions | - | 640,120 |
| Unrealized gain on interest rate and currency swaps, options and forward transactions | 4,631,189 | - |
| Trade receivables | 3,106,977 | 1,328,391 |
| Securities purchased under agreements to resell, at contract value | 2,708,055 | 2,737,507 |
| Other invested assets | 1,862,292 | 1,265,056 |
| Short-term investments, at cost which approximates market value | 3,094,635 | 5,072,893 |
| Cash | 89,443 | 157,481 |
| Total investments and cash | 76,727,881 | 66,177,427 |
| Investment income due and accrued | 866,031 | 808,268 |
| Premiums and insurance balances receivable - net | 9,139,835 | 8,364,096 |
| Reinsurance assets | 16,497,964 | 15,883,788 |
| Deferred policy acquisition costs | 4,917,747 | 4,249,409 |
| Investments in partially-owned companies | 618,320 | 571,680 |
| Real estate and other fixed assets, net of accumulated depreciation (1994-$1,077,800; 1993-$950,000) | 1,760,108 | 1,615,742 |
| Separate and variable accounts | 2,444,660 | 1,914,815 |
| Other assets | 1,586,908 | 1,429,623 |
| Total assets | $ 114,559,454 | $ 101,014,848 |

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.
CONSOLIDATED BALANCE SHEET
(dollars in thousands)
(unaudited)

| | SEPTEMBER 30, 1994 | DECEMBER 31, 1993 |
|---|---|---|
| LIABILITIES: | | |
| Reserve for losses and loss expenses | $ 31,105,579 | $ 30,046,172 |
| Reserve for unearned premiums | 6,445,024 | 5,515,670 |
| Future policy benefits for life and accident and health insurance contracts | 16,685,096 | 14,638,382 |
| Policyholders' contract deposits | 5,996,990 | 4,439,839 |
| Other policyholders' funds | 1,898,495 | 1,739,290 |
| Reserve for commissions, expenses and taxes | 1,368,006 | 1,113,397 |
| Insurance balances payable | 1,649,115 | 1,458,383 |
| Funds held by companies under reinsurance treaties | 370,915 | 406,902 |
| Income taxes payable: | | |
| Current | 358,520 | 358,219 |
| Deferred | 218,701 | 447,790 |
| Financial services liabilities: | | |
| Borrowings under obligations of guaranteed investment agreements | 5,342,755 | 6,735,579 |
| Securities sold under agreements to repurchase, at contract value | 2,188,185 | 2,299,563 |
| Trade payables | 2,802,632 | 1,688,147 |
| Securities sold but not yet purchased, principally obligations of the U.S. Government and Government agencies, at market value | 1,250,142 | 696,454 |
| Spot commodities sold but not yet purchased, at market value | 483,642 | 285,757 |
| Unrealized loss on interest rate and currency swaps, options and forward transactions | 3,703,655 | - |
| Deposits due to banks and other depositors | 465,580 | 557,372 |
| Commercial paper | 1,790,872 | 1,618,979 |
| Notes, bonds and loans payable | 6,973,303 | 5,021,941 |
| Commercial paper | 1,446,449 | 1,529,906 |
| Notes, bonds, loans and mortgages payable | 625,585 | 782,660 |
| Separate and variable accounts | 2,444,660 | 1,914,815 |
| Other liabilities | 2,545,745 | 2,295,436 |
| Total liabilities | 98,159,646 | 85,590,653 |
| Preferred shareholders' equity in subsidiary company | 200,000 | 200,000 |
| CAPITAL FUNDS: | | |
| Common stock, $2.50 par value; 500,000,000 shares authorized; shares issued 1994 - 337,390,984; 1993 - 337,390,986 | 843,477 | 843,477 |
| Additional paid-in capital | 568,359 | 572,142 |
| Unrealized appreciation of investments, net of taxes | 482,645 | 922,646 |
| Cumulative translation adjustments, net of taxes | (290,377) | (348,186) |
| Retained earnings | 14,799,567 | 13,301,529 |
| Treasury stock, at cost; 1994 - 21,326,883; 1993 - 19,762,919 shares of common stock | (203,863) | (67,413) |
| Total capital funds | 16,199,808 | 15,224,195 |
| Total liabilities and capital funds | $ 114,559,454 | $ 101,014,848 |

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.
CONSOLIDATED STATEMENT OF INCOME
(in thousands, except per share amounts)
(unaudited)

| | NINE MONTHS ENDED SEPTEMBER 30, 1994 | NINE MONTHS ENDED SEPTEMBER 30, 1993 | THREE MONTHS ENDED SEPTEMBER 30, 1994 | THREE MONTHS ENDED SEPTEMBER 30, 1993 |
|---|---|---|---|---|
| General insurance operations: | | | | |
| Net premiums written | $ 8,321,504 | $ 7,681,131 | $ 2,820,609 | $ 2,602,081 |
| Change in unearned premium reserve | (649,653) | (623,383) | (182,162) | (148,369) |
| Net premiums earned | 7,671,851 | 7,057,748 | 2,638,447 | 2,453,712 |
| Net investment income | 1,062,547 | 992,353 | 356,653 | 333,330 |
| Realized capital gains | 55,587 | 53,646 | 7,099 | 12,810 |
| | 8,789,985 | 8,103,747 | 3,002,199 | 2,799,852 |
| Losses and loss expenses incurred | 6,025,791 | 5,618,860 | 2,025,533 | 1,944,341 |
| Underwriting expenses | 1,563,847 | 1,436,732 | 553,427 | 532,404 |
| | 7,589,638 | 7,055,592 | 2,578,960 | 2,476,745 |
| Operating income | 1,200,347 | 1,048,155 | 423,239 | 323,107 |
| Life insurance operations: | | | | |
| Premium income | 4,849,759 | 4,146,739 | 1,678,104 | 1,450,518 |
| Net investment income | 1,272,354 | 1,093,884 | 437,099 | 377,021 |
| Realized capital gains | 62,701 | 39,099 | 29,982 | 11,498 |
| | 6,184,814 | 5,279,722 | 2,145,185 | 1,839,037 |
| Death and other benefits | 1,939,849 | 1,695,221 | 696,781 | 619,560 |
| Increase in future policy benefits | 2,204,626 | 1,865,377 | 726,612 | 606,334 |
| Acquisition and insurance expenses | 1,354,905 | 1,155,505 | 476,743 | 421,306 |
| | 5,499,380 | 4,716,103 | 1,900,136 | 1,647,200 |
| Operating income | 685,434 | 563,619 | 245,049 | 191,837 |
| Agency and service fee operating income | 42,496 | 47,945 | 13,326 | 15,672 |
| Financial services operating income | 314,490 | 284,496 | 100,347 | 98,691 |
| Equity in income of minority-owned insurance operations | 38,381 | 28,784 | 16,360 | 10,698 |
| Other realized capital gains (losses) | (41,513) | (4,990) | (21,826) | 1,086 |
| Other income (deductions) - net | (72,219) | (57,262) | (28,182) | (20,854) |
| Income before income taxes and cumulative effect of accounting changes | 2,167,416 | 1,910,747 | 748,313 | 620,237 |
| Income taxes (benefits) - Current | 648,854 | 703,736 | 222,492 | 161,354 |
| - Deferred | (79,277) | (200,910) | (16,706) | 7,822 |
| | 569,577 | 502,826 | 205,786 | 169,176 |
| Income before cumulative effect of accounting changes | 1,597,839 | 1,407,921 | 542,527 | 451,061 |
| Cumulative effect of accounting changes, net of tax Minority-owned insurance operations | - | 20,695 | - | - |
| Net income | $ 1,597,839 | $ 1,428,616 | $ 542,527 | $ 451,061 |
| Earnings per common share : | | | | |
| Income before cumulative effect of accounting changes | $ 5.04 | $ 4.43 | $ 1.71 | $ 1.42 |
| Cumulative effect of accounting changes, net of tax Minority-owned insurance operations | - | 0.07 | - | - |
| Net income | $ 5.04 | $ 4.50 | $ 1.71 | $ 1.42 |
| Cash dividends per common share | $ 0.315 | $ 0.29 | $ 0.115 | $ 0.10 |
| Average shares outstanding | 316,822 | 317,419 | 316,368 | 317,438 |

See Accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(unaudited)

| | NINE MONTHS ENDED SEPT 30, 1994 | 1993 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net Income | $ 1,597,839 | $ 1,428,616 |
| Adjustments to reconcile net income to net cash provided by operation activities: | | |
| Non-cash revenues, expenses, gains and losses included in income: | | |
| Change in: | | |
| General and life insurance reserves | 4,035,475 | 4,071,776 |
| Premiums and insurance balances receivable and payable-net | (585,007) | (600,870) |
| Reinsurance assets | (614,176) | (515,752) |
| Deferred policy acquisition costs | (668,338) | (561,465) |
| Investment income due and accrued | (57,763) | (19,955) |
| Funds held under reinsurance treaties | (35,987) | 47,658 |
| Other policyholders' funds | 159,205 | 229,979 |
| Current and deferred income taxes - net | (78,976) | 81,674 |
| Reserve for commissions, expenses and taxes | 254,609 | 236,396 |
| Other assets and liabilities - net | 93,871 | (126,505) |
| Trade receivables and payables - net | (664,101) | 1,570,502 |
| Trading securities, at market value | (49,773) | (634,399) |
| Spot commodities, at market value | (623,172) | (268,238) |
| Net unrealized gain on interest rate and currency swaps, options, and forward transactions | (287,414) | 421,853 |
| Securities purchased under agreements to resell | 29,452 | 2,161,993 |
| Securities sold under agreements to repurchase | (111,378) | (1,174,746) |
| Securities sold but not yet purchased | 553,688 | 280,191 |
| Spot commodities sold but not yet purchased, at market value | 197,885 | (1,298,155) |
| Realized capital gains | (76,776) | (87,755) |
| Equity in income of partially-owned companies and other invested assets | (60,628) | (44,823) |
| Depreciation expenses, principally flight equipment | 418,331 | 341,736 |
| Cumulative effect of accounting changes | - | (20,695) |
| Change in cumulative translation adjustments | 70,573 | 81,424 |
| Other - net | 502,033 | (59,581) |
| Total Adjustments | 2,401,633 | 4,112,243 |
| Net cash provided by operating activities | 3,999,472 | 5,540,859 |
| Cash Flows From Investing Activities: | | |
| Cost of fixed maturities, at amortized cost sold | - | 1,023,917 |
| Cost of fixed maturities, at amortized cost matured or redeemed | 451,611 | 1,586,341 |
| Cost of bonds, at market sold | 6,004,055 | 3,996,312 |
| Cost of bonds, at market matured or redeemed | 1,145,938 | 402,063 |
| Cost of equity securities sold | 1,935,316 | 1,360,222 |
| Realized capital gains | 76,776 | 87,755 |
| Purchases of fixed maturities | (11,185,332) | (9,008,075) |
| Purchases of equity securities | (2,728,734) | (1,949,175) |
| Mortgage, policy and collateral loans granted | (1,867,120) | (793,622) |
| Repayments of mortgage, policy and collateral loans | 534,190 | 469,363 |
| Sales or maturities of securities held for investment | - | 1,290,414 |
| Sales or maturities of securities available for sale | 4,394,516 | - |
| Purchases of securities held for investment | - | (2,026,196) |
| Purchases of securities available for sale | (2,903,288) | - |
| Sales of flight equipment | 166,068 | 164,003 |
| Purchases of flight equipment | (2,020,742) | (1,936,948) |
| Net additions to real estate and other fixed assets | (300,653) | (269,547) |
| Sales or distributions of other invested assets | 171,481 | 198,477 |
| Investments in other invested assets | (511,144) | (325,972) |
| Change in short-term investments | 911,806 | (94,726) |
| Investments in partially-owned companies | (52,095) | (99,274) |
| Net cash used in investing activities | (5,777,351) | (5,924,668) |
| Cash Flows From Financing Activities: | | |
| Change in policyholders' contract deposits | 1,557,151 | (84,435) |
| Change in deposits due to banks and other depositors | (91,792) | (729,436) |
| Change in commercial paper | 88,436 | (288,757) |
| Proceeds from notes, bonds, loans and mortgages payable | 3,469,316 | 2,136,162 |
| Repayments on notes, bonds, loans and mortgages payable | (1,680,413) | (630,510) |
| Proceeds from guaranteed investment agreements | 2,331,808 | 2,355,304 |
| Maturities of guaranteed investment agreements | (3,724,632) | (2,120,549) |
| Proceeds from common stock issued | 10,360 | 9,868 |
| Cash dividends to shareholders | (99,801) | (92,080) |
| Acquisition of treasury stock | (150,592) | (13,018) |
| Redemption of preferred stock | - | (150,000) |
| Other - net | - | (38) |
| Net cash provided by financing activities | 1,709,841 | 392,511 |

| | | |
|---|---|---|
| Change in cash | (68,038) | 8,702 |
| Cash at beginning of period | 157,481 | 136,628 |
| Cash at end of period | $ 89,443 | $ 145,330 |

See accompanying Notes to Financial Statements.

AMERICAN INTERNATIONAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 1994

(a) These statements are unaudited. In the opinion of management, all adjustments consisting of normal recurring accruals have been made for a fair presentation of the results shown.

(b) Earnings per share of American International Group, Inc. (AIG) are based on the weighted average number of common shares outstanding during the period. The effect of potentially dilutive securities is not significant.

(c) Supplemental cash flow information for the nine month period ended September 30, 1994 and 1993 is as follows:

| | (in thousands) 1994 | 1993 |
|---|---|---|
| Income taxes paid | $ 627,900 | $ 387,000 |
| Interest paid | $ 729,200 | $ 695,000 |

(d) In March 1992, the Financial Accounting Standards Board (FASB) issued Interpretation No. 39 "Offsetting of Amounts Related to Certain Contracts" (Interpretation), which is effective for fiscal years beginning after December 15, 1993. The Interpretation requires that unrealized gains and losses on swaps, forwards, options and similar contracts be recognized as assets and liabilities. Previously, AIG's policy was to record such unrealized gains and losses on a net basis in the consolidated balance sheet. The Interpretation allows the netting of such unrealized gains and losses with the same counterparty when they are included under a master netting arrangement with the counterparty and the contracts are reported at market value.

Although there was no effect on AIG's operating income upon the adoption of the Interpretation, AIG now presents certain of its financial services assets and liabilities, primarily unrealized gain (loss) on interest rate and currency swaps, options and forward transactions, on a gross basis. Thus, both consolidated assets and liabilities have increased. The effect of presenting these assets and liabilities on a gross basis on AIG's consolidated balance sheet was not significant. Prior years' balance sheets were not reclassified.

In November of 1992, FASB issued Statement of Financial Accounting Standards No. 112 "Employers' Accounting for Post-employment Benefits" (FASB 112). FASB 112 established accounting standards for employers who provide benefits to former or inactive employees after employment but before retirement. FASB 112 was effective January 1, 1994 and had no significant effect on AIG's results of operations or financial condition.

(e) For further information, refer to the Form 10-K filing of AIG for the year ended December 31, 1993.

## Operational Review

### General Insurance Operations

In AIG's general insurance operations, net premiums written and net premiums earned were $8.32 billion and $7.67 billion, respectively, in the first nine months of 1994. These were increases of 8.3 percent and 8.7 percent, respectively, over the same period of 1993.

The growth in net premiums written in 1994 over 1993 resulted from a combination of several factors. Although AIG continued to achieve general price increases in domestic commercial property and some specialty casualty markets, the primary reasons for growth were price and volume increases overseas. AIG continues to be disciplined in its underwriting approach, especially in the domestic primary casualty market, and does not seek net premium growth where rates do not adequately reflect the assessment of exposures.

Net premiums written are initially deferred and earned based upon the terms of the underlying policies. The net unearned premium reserve constitutes the deferred earnings 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.

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 profit in the first nine months of 1994 was $82.2 million compared to an adjusted underwriting profit of $2.2 million recorded in the same period of 1993.

The statutory general insurance ratios for the first nine months were as follows:

| | 1994 | 1993 |
|---|---|---|
| Loss Ratio | 78.54 | 79.61 |
| Expense Ratio | 20.42 | 20.40 |
| Combined Ratio | 98.96 | 100.01 |

As a result of the Northridge earthquake which struck the Los Angeles area of California in January, 1994, the gross and net incurred losses were impacted approximately $150 million and $55 million, respectively. Although there were severe winter storms during the first quarter of 1994, AIG recognized these as losses in the ordinary course of business, not as catastrophes. The gross and net catastrophe losses recorded during the first nine months of 1993 approximated $120 million and $65 million, respectively. There were no catastrophes during the third quarter of 1994 and $47.3 million in catastrophe net losses in the same period of 1993.

If the catastrophes were excluded from the losses incurred in each nine month period, the pro forma statutory general insurance ratios would be as follows:

| | 1994 | 1993 |
|---|---|---|
| Loss Ratio | 77.83 | 78.73 |
| Expense Ratio | 20.42 | 20.40 |
| Combined Ratio | 98.25 | 99.13 |

The maintenance of the proforma statutory combined ratio in both periods at a level below 100 is a result of AIG's emphasis on maintaining its underwriting discipline within the continued overall competitiveness of the domestic market environment as well as AIG's expense control.

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 the first nine months of 1994 and 1993 were insignificant. Also, AIG is 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.

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 which AIG desires. These reinsurance arrangements do not relieve AIG from its direct obligation to its insureds.

AIG's general reinsurance assets amounted to $16.16 billion and resulted from its reinsurance arrangements. Thus, a credit exposure existed at September 30, 1994 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 protects itself under related reinsurance agreements by transacting with reinsurers that are financially sound and when necessary AIG holds substantial collateral in the form of funds, securities and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods. The application of this collateral against balances due or any changes to the amount of collateral are based on the development of losses recoverable on an individual reinsurer basis. Approximately 50 percent of reinsurance recoverable is from unauthorized reinsurers. In order to obtain statutory recognition, nearly all of these balances are collateralized. The remaining 50 percent of the reinsurance recoverable is from authorized reinsurers and approximately 80 percent of these 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/unauthorized pertain to regulatory catagories not credit-worthiness. Additionally, AIG maintains a provision for estimated unrecoverable reinsurance and has been largely successful in its prior recovery efforts.

AIG enters into certain intercompany reinsurance transactions for both 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.

At September 30, 1994, general insurance reserves for losses and loss expenses (loss reserves) amounted to $31.11 billion, an increase of $1.06 billion or 3.5 percent over the prior year end. General insurance net loss reserves represent the accumulation of estimates of ultimate losses, including provisions for losses incurred but not reported (IBNR), and loss expenses, reduced by reinsurance recoverable net of an allowance for unrecoverable reinsurance and minor amounts of discounting related to certain workers' compensation claims. Since December 31, 1993, the net loss reserves have increased $618.0 million or 3.5 percent to $18.17 billion. 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 September 30, 1994. In the future, if the general insurance net loss reserves develop deficiently, such deficiency could have an adverse impact on AIG's future results of operations.

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

Estimation of ultimate net losses and loss expenses (net losses) for long tail casualty lines of business is a complex process and depends on a number of factors, including the line and volume of the business involved. In the more recent accident years of long tail casualty lines there is limited statistical credibility in reported net losses. That is, a relatively low proportion of net losses would be reported claims and expenses and an even smaller proportion would be net losses paid. A relatively high proportion of net losses would therefore be IBNR.

A variety of actuarial methods and assumptions are normally employed to estimate net losses for long tail casualty lines. These methods ordinarily involve the use of loss trend factors intended to reflect the estimated annual growth in loss costs from one accident year to the next. Loss trend factors reflect many items including changes in claims handling, exposure and policy forms and current and future estimates of 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 have ranged from 7 percent to 22 percent of average loss costs, depending on the particular class and nature of the business involved. For the majority of long tail casualty lines, net loss trend factors approximating 10 percent were employed. These factors are periodically reviewed and subsequently adjusted, as appropriate, to reflect emerging trends which are based upon past loss experience.

Estimation of net losses for short tail business is less complex than for long tail casualty lines. Loss cost trends for many property lines can generally be assumed to be similar to the growth in exposure of such lines. For example, if the fire insurance coverage remained proportional to the actual value of the property, the growth in 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, asbestos and other environmental pollutants and alleged damages to cover the cleanup costs of hazardous waste dump sites (environmental claims). The vast majority of these environmental claims emanate from policies written in 1984 and prior years. Commencing in 1985, standard policies contained an absolute exclusion for pollution related damage. AIG has established a special environmental claims unit which investigates and adjusts all such claims.

Estimation of environmental claims loss reserves is a difficult process. These environmental claims cannot be estimated by conventional reserving techniques as previously described. Quantitative techniques frequently have to be supplemented by subjective considerations including managerial judgment. Significant factors which affect the trends which influence the development of environmental claims are the inconsistent court resolutions, the broadening of the intent of the policies and scope of coverage and the increasing number of new claims. The case law that has emerged can be characterized as still being in its infancy and the likelihood of any firm direction in the near future is very small. Additionally, the exposure for cleanup costs of hazardous waste dump sites involves coverage issues such as allocation of responsibility among potential responsible parties and the government's refusal to release parties. The cleanup cost exposure may significantly change if the Congressional reauthorization of Superfund in 1995 is dramatically changed 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 environmental claims. Such development will be impacted 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 as at September 30, 1994 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 those 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 gross and net IBNR included in the reserve for losses and loss expenses at September 30, 1994 for environmental claims approximated $270 million and $100 million, respectively; for 1993 the amounts approximated $240 million and $83 million, respectively. Most of the claims included in the following table relate to policies written in 1984 and prior years.

A summary of reserve activity, including estimates for applicable IBNR, relating to environmental claims for the nine months ended September 30, 1994 and 1993 was as follows:

(in millions)

| | 1994 | | 1993 | |
|---|---|---|---|---|
| | Gross | Net | Gross | Net |
| Reserve for losses and loss expense at beginning of year | $1,478.5 | $386.3 | $1,221.1 | $318.0 |
| Losses and loss expenses incurred | 231.1 | 111.8 | 283.6 | 105.2 |
| Losses and loss expenses paid | (259.1) | (97.6) | (229.5) | (71.1) |
| Reserve for losses and loss expenses at end of period | $1,450.5 | $400.5 | $1,275.2 | $352.1 |

The majority of AIG's exposures for 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 claims count activity relating to environmental claims for the nine months ended September 30, 1994 and 1993 was as follows:

| | 1994 | 1993 |
|---|---|---|
| Claims at beginning of year: | 23,163 | 20,473 |
| Claims during year: | | |
| Opened | 4,428 | 5,012 |
| Settled | ( 504) | ( 457) |
| Dismissed or otherwise resolved | (3,408) | (2,339) |
| Claims at end of period | 23,679 | 22,689 |

The estimated average cost per claim settled, dismissed or otherwise resolved for nine months ending September 30, 1994 and 1993 was as follows:

| | 1994 | 1993 |
|---|---|---|
| Gross reserve for losses and loss expenses | $66,200 | $82,100 |
| Net reserve for losses and loss expenses | $25,000 | $25,400 |

AIG actively manages its environmental claims. During 1994, a significant portion of claims dismissed or otherwise resolved were closed as a result of successful litigation.

General insurance net investment income in the first nine months of 1994 was $1.06 billion, an increase of 7.1 percent from the same period of 1993. The growth in net investment income 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.

General insurance realized capital gains were $55.6 million in the first nine months of 1994 and $53.6 million for the same period of 1993. These realized gains resulted from the ongoing management of the general insurance investment portfolios within the overall objectives of the general insurance operations and arose primarily from the disposition of equity securities, and available for sale and trading fixed maturities as well as redemptions of fixed maturities.

General insurance operating income in the first nine months of 1994 was $1.20 billion, an increase of 14.5 percent when compared to $1.05 billion in the same period of 1993. Excluding the impact of both years' catastrophes, operating results would have increased 13.0 percent in 1994. The contribution of general insurance operating income to income before income taxes and the cumulative effect of accounting changes was 55.4 percent in the first nine months of 1994 compared to 54.9 percent in the same period of 1993. The increase in the contribution percentage was a result of the effects of the aforementioned catastrophe losses in 1993.

Life Insurance Operations

AIG's life insurance operations continued to show growth as a result of overseas operations, particularly in Asia. AIG's life premium income of $4.85 billion for the first nine months of 1994 represented a 17.0 percent increase from the same period of the prior year. The foreign ordinary life products were the major contributor to premium growth. In 1994, foreign life operations produced 94.3 percent of the life premium income and 95.7 percent of the life insurance operating income as compared to 95.3 percent of life premium income and 95.1 percent of life insurance operating income for the same period of 1993.

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 being sold in Japan.

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

Underwriting risk represents the exposure to loss resulting from the actual policy experience adversely emerging in comparison to the assumptions made in the product pricing associated with mortality, morbidity, termination and expenses. AIG's life companies limit their maximum underwriting exposure on traditional life insurance of a single life to approximately $1 million of coverage by using yearly renewable term reinsurance. The life insurance operations have not entered into assumption reinsurance transactions or surplus relief transactions either in 1993 or 1994.

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 determine if a liquidity excess or deficit is perceived to exist. 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.

The asset-liability relationship is appropriately managed in AIG's foreign operations, 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 approximates 5 years, while the related policy liabilities are estimated to be 7 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 short-fall through its international financial network. Domestically, the asset-liability matching process is appropriately functioning as there are investments available to match the duration and the required yield.

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.

Life insurance net investment income increased 16.3 percent to $1.27 billion in the first nine months of 1994 compared to $1.09 billion in the same period of 1993. The growth in net investment income was primarily attributable to new cash flow for investment. The new cash flow was generated from net life insurance operating cash flow and included the compounding of previously earned and reinvested net investment income.

Life insurance realized capital gains were $62.7 million and $39.1 million in the first nine months of 1994 and 1993, respectively. These realized gains resulted from the ongoing management of the life insurance investment portfolios within the overall objectives of the life insurance operations and arose primarily from the disposition of equity securities and available for sale fixed maturities and redemptions of fixed maturities.

Life insurance operating income in the first nine months of 1994 increased 21.6 percent to $685.4 million compared to $563.6 million in the same period of 1993. Excluding realized capital gains from life insurance operating income, the increase in 1994 over 1993 would be 18.7 percent. The contribution of life insurance operating income to income before income taxes and the cumulative effect of accounting changes amounted to 31.6 percent in 1994 compared to 29.5 percent in 1993. The increase in the contribution percentage was a result of both the growth in life premium income and net investment income as well as higher realized capital gains.

## Agency and Service Fee Operations

Agency and service fee operating income in the first nine months of 1994 decreased 11.4 percent to $42.5 million compared to $47.9 million in the same period of 1993. Although the growth in domestic risk management services continues, revenues from AIG's aviation insurance management operations has declined slightly. Agency and service fee operating income contributed 2.0 percent to AIG's income before income taxes and the cumulative effect of accounting changes in 1994 compared to 2.5 percent in 1993.

## Financial Services Operations

Financial services operating income amounted to $314.5 million in the first nine months of 1994, an increase of 10.5 percent. This compared to $284.5 million in the same period of 1993. The financial services operating income in 1994 increased over that of 1993 primarily as a result of an increase in the operating income of International Lease Finance Corporation (ILFC). ILFC primarily engages in the acquisition of new and used commercial jet aircraft and the leasing and sale of such aircraft to airlines around the world. ILFC derives a substantial portion of its revenues from its leasing operations and is also engaged in the remarketing of commercial jets to and for airlines and financial institutions. (See also the discussions under "Capital Resources" and "Liquidity" herein.)

ILFC is exposed to loss through non-performance of aircraft lessees and through owning and committing to purchase aircraft which it would be unable to lease or re-lease or sell (at sufficient amounts) at lease expiration. ILFC manages its lessee non-performance exposure through credit reviews and security deposit requirements. At September 30, 1994, only 2 of 253 aircraft owned were not leased. Currently, 86.8 percent of the fleet is leased to foreign carriers. In 1994, ILFC has leased all aircraft for which it has taken delivery and the remaining aircraft for which ILFC will take delivery in 1994 have been placed.

AIG Trading Group Inc. and its subsidiaries (AIGTG) experienced a decline in operating income compared to the first nine months of 1993. AIGTG, acting as principal, derives a substantial portion of its revenues from market making and trading activities in foreign exchange, interest rate, precious and base metals, petroleum and natural gas. (See also the discussion under "Liquidity" herein.)

AIG Financial Products Corp. and its subsidiaries (AIGFP) operating income decreased modestly as compared to the first nine months of 1993. AIGFP derives substantially all its revenues from proprietary positions entered in connection with customer transactions. AIGFP conducts, as principal, an interest rate, currency and equity derivative products business and enters into long-dated swaps, foreign exchange forwards, options, synthetic securities and guaranteed investment agreement transactions. AIGFP's operations are transaction oriented. As such, current and past performance do not provide a trend for future performance. (See also the discussions under "Capital Resources" and "Liquidity" herein.)

Through AIGFP and AIGTG, AIG participates as a dealer in the derivatives market. In these derivative operations, AIG acts primarily as a principal, structuring transactions to satisfy the risk management needs of its clients. AIG structures transactions which allow its clients to manage their risk exposures to interest and exchange rate changes, to prices of securities and to certain commodities and financial or commodity indices. As a result of these transactions, AIG, in its financial services operations, is also an end-user of derivatives in adjusting its asset and liability risk profiles. All significant derivatives activities are conducted through AIGFP and AIGTG. AIG's other subsidiaries, including its insurance subsidiaries, are not dealers nor are they significant end users of derivatives.

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

Derivatives are financial transactions among two or more parties whose payments are based on or "derived" from the performance of some agreed upon benchmark. Derivatives payments may be based on interest and exchange rate changes, prices of certain securities and certain commodities and financial or commodity indices. Derivatives include swaps, options, forwards, futures and related instruments.

In 1993, the Group of Thirty, an international, private business advisory organization, published a set of risk management recommendations for derivatives. These recommendations provide a measure of sound practices for the industry as well as a comprehensive overview of derivatives that is intended to promote an understanding of such instruments. The recommendations cover valuation and market risk management; credit risk measurement and management; contract enforceability; systems, operations, and controls; and accounting and disclosure. AIG supports the Group of Thirty recommendations as a framework in the management of AIG's derivatives operations.

The most commonly used swaps are interest rate swaps 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 specified principal or notional 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.

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

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

Derivatives are generally either negotiated over-the-counter contracts or standardized contracts executed on an exchange. Standardized exchange-traded derivatives include futures and options. Negotiated over-the-counter derivatives include forwards, swaps and options. Over-the-counter derivatives are generally not traded like securities. However, in the normal course of business, with the agreement of the original counterparty, these contracts may be terminated or assigned to another counterparty.

Derivatives are used by AIG's customers such as corporations, financial institutions, multinational organizations, sovereign entities, government agencies and municipalities to manage the financial risks associated with their activities. For example, a future, forward or option contract can be used to protect the customers' assets and liabilities against price fluctuations; a swap can be used to change fixed interest rate payments into floating interest rate payments.

The notional amounts used to express the extent of AIG's involvement in derivatives transactions do not represent a quantification of the market or credit risks of the positions and are not necessarily recorded on the balance sheet. Except for certain contracts such as currency swaps and foreign exchange forwards, notional amounts are generally not paid or received. Rather, notional amounts represent amounts used to calculate cash flows to be exchanged. The timing and the amount of cash receipts and payments relating to derivatives are determined by contractual agreements.

The senior management of AIG approves the policies and establishes general operating parameters for AIGFP and AIGTG. AIG's senior management and Board of Directors have established various oversight committees to review the various financial market, operational and credit issues of AIGFP and AIGTG. AIG's senior management has established limits which can only be exceeded with express permission. The senior managements of AIGFP and AIGTG report monthly the results of their respective operations to AIG's senior management and Board of Directors and review with them future strategies.

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. Although market risk may be minimized, credit risk remains an exposure which is separately managed. (See the discussion on the management of credit risk below).

AIGFP does not seek to manage the market risk of each of its individual transactions through an individual offsetting transaction. Rather, AIGFP takes a portfolio approach to the management of its market risk. AIGFP values its portfolio through the use of an integrated valuation and hedging computer system. This system uses reliable current market data where available or uses various valuation techniques when such market data is not available. This system reflects AIGFP's evaluation of current market conditions, maturities within the portfolio and uses current interest rates, volatility and other relevant factors associated with the type of derivative, and applies these to the present value of the cash flow structure of the overall portfolio. The system analyzes these discounted cash flow structures or representative financial instruments and suggests for management's decision what, if any, offsetting instruments would be appropriate to purchase or sell.

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 certain overseas locations 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. Offsetting adjustments are 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 derivative portfolios. 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. These measures are changed as appropriate in order to reflect AIGFP's 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.

The aforementioned valuation models and conditions are examined by AIGFP's management and changed, as appropriate, to reflect management's judgments. Both AIG and AIGFP employ outside consultants to provide the managements of AIG and AIGFP with comfort that the system produces representative values.

AIGTG's approach to protect itself from 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 retain.

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

A significant portion of AIGTG's business is transacted in liquid markets. 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.

Credit risk exists at a particular point in time when a derivative has a positive fair value. Also, 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. 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, credit 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 the industry and country of the counterparty. Transactions which fall outside these pre-established guidelines require the approval of the AIG Credit Risk Committee. This policy includes the establishment of reserves for potential credit impairments.

AIGFP and AIGTG determine the credit quality of each of their counterparties taking into account credit ratings assigned by nationally 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 and margin agreements.

The significant majority of AIGFP's transactions are contracted and documented under master netting agreements that provide for set- off and close out netting in the event of default. Additionally, AIGFP is currently negotiating with its principal foreign exchange counterparties to implement cross-netting between swap transactions and foreign exchange transactions to further reduce credit risk.

Excluding regulated exchange transactions, AIGTG, whenever possible, enters into netting agreements with its counterparties which are similar in effect to those discussed above.

Management of AIG's liquidity profile is designed to ensure that even under adverse conditions AIG is able to raise funds at the most economical cost to fund maturing liabilities and capital and liquidity requirements of its subsidiaries. Sources of funds considered in meeting these objectives include guaranteed investment agreements, issuance of long and short-term debt, maturities and sales of securities available for sale, securities sold under repurchase agreements, trade payables, securities and spot commodities sold, 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.

Financial services operating income represented 14.5 percent of AIG's income before income taxes and the cumulative effect of accounting changes in the first nine months of 1994, which compares to 14.9 percent in the same period of 1993. This slight decline is a result of the relative growth in life operating income.

Other Operations

In the first nine months of 1994, AIG's equity in income of minority-owned insurance operations was $38.4 million compared to $28.8 million in the same period of 1993. The equity interest in insurance companies represented 1.8 percent of income before income taxes and the cumulative effect of accounting changes in 1994, compared to 1.5 percent in 1993.

Other realized capital losses amounted to $41.5 million and $5.0 million in 1994 and 1993, respectively.

Other income (deductions)-net includes AIG's equity in certain minor majority-owned subsidiaries and certain partially-owned companies, minority interest in certain consolidated companies, realized foreign exchange transaction gains and losses in substantially all currencies and unrealized gains and losses in hyperinflationary currencies, as well as the income and expenses of the parent holding company and other miscellaneous income and expenses. In the first nine months of 1994, net deductions amounted to $72.2 million. In the same period of 1993, net deductions amounted to $57.3 million. Included in each of these amounts were $18.7 million and $14.2 million in 1994 and 1993, respectively, resulting from the recognition of minority interests and $4.2 million and $5.2 million in 1994 and 1993, respectively, due to net foreign exchange effects as described above.

Income before income taxes and the cumulative effect of accounting changes amounted to $2.17 billion in the first nine months of 1994 and $1.91 billion in the same period of 1993.

In the first nine months of 1994, AIG recorded a provision for income taxes of $569.6 million compared to the provision of $502.8 million in the same period of 1993. These provisions represent effective tax rates of 26.3 percent in each of the respective periods. Income before the cumulative effect of accounting changes amounted to $1.60 billion in the first nine months of 1994 and $1.41 billion in the same period of 1993. The increase in net income resulted from those factors described above.

At January 1, 1993, AIG's equity in income of minority-owned insurance operations was positively impacted by the cumulative effect of accounting changes on such operations from the adoption of Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" which was partially offset by the adoption of Statement of Financial Accounting Standards No. 106 "Employer's Accounting for Post-Retirement Benefits Other than Pension Plans". AIG's equity in the cumulative effect of such accounting changes was a net benefit of $20.7 million.

Net income amounted to $1.60 billion in the first nine months of 1994 and $1.43 billion in the same period of 1993. The increase in net income in 1994 over that of 1993 resulted from those factors described above.

Capital Resources

At September 30, 1994, AIG had total capital funds of $16.20 billion and total borrowings of $16.18 billion.

Total borrowings at September 30, 1994 and December 31, 1993 were as follows:

(in thousands)

| | September 30, 1994 | December 31, 1993 |
|---|---|---|
| Borrowings under Obligations of Guaranteed Investment Agreements | | |
| AIGFP | $ 5,342,800 | $6,735,600 |
| Commercial Paper: | | |
| AIG Funding, Inc. | 700,900 | 891,700 |
| ILFC* | 1,788,000 | 1,442,400 |
| AICCO | 745,500 | 638,200 |
| AIGFP | 2,900 | 176,600 |
| Total | 3,237,300 | 3,148,900 |
| Medium Term Notes: | | |
| ILFC* | 1,857,400 | 1,753,700 |
| AIG | 155,000 | 295,000 |
| Total | 2,012,400 | 2,048,700 |
| Notes and Bonds Payable: | | |
| ILFC* | 3,000,000 | 2,550,000 |
| AIGFP | 781,800 | 521,400 |
| AIG: Lire bonds | 159,100 | 159,100 |
| Zero coupon notes | 64,100 | 59,100 |
| Total | 4,005,000 | 3,289,600 |
| Loans and Mortgages Payable | 1,581,500 | 466,300 |
| ($1,334,100 and $196,900 were not guaranteed by AIG in 1994 and 1993.) | | |
| Total Borrowings | 16,179,000 | 15,689,100 |
| Borrowings not guaranteed by AIG | 7,979,500 | 5,943,000 |
| Matched GIA borrowings | 5,342,800 | 6,735,600 |
| | 13,322,300 | 12,678,600 |
| Remaining borrowings of AIG | $ 2,856,700 | $ 3,010,500 |

* AIG does not guarantee or support these borrowings.

Guaranteed investments agreements (GIAs) serve as the source of proceeds for AIGFP's investments in a diversified portfolio of securities and derivative transactions thereon. (See also the discussions under "Operational Review" and "Liquidity" herein.)

AIG Funding, Inc. intends to continue to meet AIG's funding requirements through the issuance of commercial paper guaranteed by AIG. This issuance of commercial paper is subject to the approval of AIG's Board of Directors. ILFC, A.I. Credit Corp. (AICCO) and AIGFP 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. AIG guarantees AIGFP's commercial paper.

ILFC increased the aggregate principal amount outstanding of its medium term and term notes to $4.9 billion during the first nine months of 1994, a net increase of $553.8 million. ILFC primarily uses the proceeds of its borrowings to acquire new and used commercial jet aircraft to lease and/or remarket to airlines around the world. At September 30, 1994, ILFC had approximately $2 billion in aggregate principal amount of debt securities registered for issuance from time to time. (See also the discussions under "Operational Review" and "Liquidity" herein.)

During the first nine months of 1994, AIG did not issue any new medium term notes and $140.0 million of previously issued notes matured. At September 30, 1994, AIG had $247.0 million in aggregate principal amount of debt securities registered for issuance from time to time.

AIG's capital funds have increased $975.6 million in the first nine months of 1994. Unrealized appreciation of investments, net of taxes, decreased $440.0 million, primarily resulting from the rise in domestic interest rates and their effects on the market values of bonds worldwide. As a result of adopting Statement of Financial Accounting Standards No. 115 "Accounting for Certain Investments on Debt and Equity Securities", unrealized appreciation of investments, net of taxes, is now subject to increased volatility resulting from the changes in the market value of bonds available for sale. The cumulative translation adjustment loss, net of taxes, decreased $57.8 million as a result of the general weakness of the U.S. dollar against most major currencies. Retained earnings increased $1.50 billion, resulting from net income less dividends.

During the first nine months of 1994, AIG repurchased 1.76 million shares of its common stock in the open market at a cost of $150.0 million.

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 September 30, 1994 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.)

Liquidity

At September 30, 1994, AIG's consolidated invested assets included $3.18 billion of cash and short-term investments. Consolidated net cash provided from operating activities in the first nine months of 1994 amounted to $4.00 billion.

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

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

The liquidity of the combined insurance operations is derived both domestically and abroad. The combined insurance pretax operating cash flow is derived from two sources, underwriting operations and investment operations. In the aggregate, AIG's insurance operations generated approximately $5.6 billion in pretax operating cash flow during the first nine months of 1994. The underwriting cash flow approximated $3.3 billion in the first nine months of 1994. Underwriting cash flow represents periodic premium collections, including policyholders' contracts deposits, as well as paid loss recoveries less reinsurance premiums, losses, benefits, and acquisition and operating expenses paid. Generally, there is a time lag from when premiums are collected and, when as a result of the occurrence of events specified in the policy, the losses and benefits are paid. AIG's insurance operations generated approximately $2.3 billion in investment income cash flow during this period of 1994. Investment income cash flow is primarily derived from interest and dividends received and includes realized capital gains.

The combined insurance pretax cash flow coupled with its cash and short-term investments of $2.75 billion provided the insurance operations with a significant amount of liquidity. 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. With this liquidity coupled with proceeds of approximately $9.2 billion from the maturities, sales and redemptions of fixed income securities and from the sales of marketable equity securities, AIG purchased approximately $14.0 billion of fixed income securities and marketable equity securities. Additionally, over $1.6 billion were disbursed for mortgage loans on real estate, policy and collateral loans. Approximately $900 million of this amount was in connection with new policy loans issued as a result of domestic life insurance operations associated with corporate owned life insurance products.

The following table is a summary of AIG's invested assets by significant segment, including investment income due and accrued and real estate, at September 30, 1994 and December 31, 1993:

(dollars in thousands)

| | September 30, 1994 | | December 31, 1993 | |
|---|---|---|---|---|
| | Invested Assets | Percent of Total | Invested Assets | Percent of Total |
| General insurance | $23,308,000 | 29.6% | $ 22,573,800 | 33.2% |
| Life insurance | 25,425,300 | 32.3% | 22,037,300 | 32.4% |
| Financial services* | 29,573,000 | 37.5% | 22,957,300 | 33.7% |
| Other | 495,600 | 0.6% | 464,100 | 0.7% |
| Total | $ 78,801,900 | 100.0% | $ 68,032,500 | 100.0% |

* See also the discussion under "Accounting Standards: Standards adopted in 1994" herein.

The following tables are summaries of the composition of AIG's insurance invested assets by insurance segment, including investment income due and accrued and real estate, at September 30, 1994 and December 31, 1993:

(dollars in thousands)

| September 30, 1994 | General | Life | Total | Percent of Total | Percent Distribution Domestic | Foreign |
|---|---|---|---|---|---|---|
| Bonds available for sale, | | | | | | |
| at market value* | $4,616,200 | $15,936,800 | $20,553,000 | 42.2% | 33.5% | 66.5% |
| Bonds held to maturity, | | | | | | |
| at amortized cost | 12,715,100 | --- | 12,715,100 | 26.1% | 100.0% | -- |
| Common stocks | 2,909,900 | 2,061,300 | 4,971,200 | 10.2% | 28.7% | 71.3% |
| Mortgage loans on real estate, | | | | | | |
| policy and collateral loans | 41,500 | 3,960,000 | 4,001,500 | 8.2% | 40.9% | 59.1% |
| Short-term investments, | | | | | | |
| including time deposits, | | | | | | |
| and cash | 1,204,600 | 1,546,400 | 2,751,000 | 5.6% | 25.1% | 74.9% |
| Real estate | 348,600 | 627,800 | 976,400 | 2.0% | 18.8% | 81.2% |
| Investment income due and | | | | | | |
| accrued | 414,100 | 439,100 | 853,200 | 1.8% | 55.0% | 45.0% |
| Other invested assets | 1,058,000 | 853,900 | 1,911,900 | 3.9% | 55.9% | 44.1% |
| Total | $23,308,000 | $25,425,300 | $48,733,300 | 100.0% | 51.4% | 48.6% |

* Includes Bonds trading securities, at market value.

(dollars in thousands)

| December 31, 1993 | General | Life | Total | Percent of Total | Percent Distribution Domestic | Foreign |
|---|---|---|---|---|---|---|
| Bonds available for sale, at market value* | $ 4,387,800 | $13,387,800 | $17,775,600 | 39.9% | 39.0% | 61.0% |
| Bonds held to maturity, at amortized cost | 12,193,700 | --- | 12,193,700 | 27.3% | 100.0% | -- |
| Common stocks | 2,761,800 | 1,527,200 | 4,289,000 | 9.6% | 36.1% | 63.9% |
| Mortgage loans on real estate, policy and collateral loans | 96,300 | 2,678,200 | 2,774,500 | 6.2% | 24.6% | 75.4% |
| Short-term investments, including time deposits, and cash | 1,820,500 | 2,878,600 | 4,699,100 | 10.6% | 23.1% | 76.9% |
| Real estate | 284,300 | 572,000 | 856,300 | 1.9% | 16.2% | 83.8% |
| Investment income due and accrued | 429,700 | 363,900 | 793,600 | 1.8% | 54.0% | 46.0% |
| Other invested assets | 599,700 | 629,600 | 1,229,300 | 2.7% | 53.2% | 46.8% |
| Total | $22,573,800 | $22,037,300 | $44,611,100 | 100.0% | 53.0% | 47.0% |

* Includes Bonds trading securities, at market value.

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

Approximately 59 percent of the fixed maturity investments are domestic securities. Approximately 41 percent of such domestic securities were rated AAA and approximately three percent were below investment grade or non-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. However, credit quality rating services similar to the aforementioned rating agencies are not available in all overseas locations. Thus, AIG annually reviews the credit quality of the nonrated fixed income investments, including mortgages, in its foreign portfolio. AIG applies a scale similar to that of Moody's and S&P to the rating of these securities. Coupling the ratings of this internal review with those of the independent agencies indicates that approximately 49 percent of the foreign fixed income investments were rated AAA and approximately one percent were deemed below investment grade at December 31, 1993. AIG believes that there has been no significant change in these ratings through September 30, 1994.

Although AIG's fixed income insurance portfolios contain minor amounts of securities below investment grade, potentially any fixed income security is subject to downgrade for a variety of reasons subsequent to any balance sheet date.

At September 30, 1994 approximately 6 percent of the fixed maturities portfolio are Collateralized Mortgage Obligations (CMOs). All the CMOs are investment grade and approximately 86 percent of the CMOs are backed by various U.S. government agencies. Thus, credit risk is minimal.

There are no interest only or principal only CMOs. 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.

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 consider entering into derivative transactions as end users. To date, such activities have been insignificant.

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

Mortgage loans on real estate, policy, collateral and guaranteed loans comprised 8.2 percent of AIG's insurance invested assets at September 30, 1994. AIG's insurance holdings of real estate mortgages amounted to $1.58 billion of which 34.1 percent was domestic. At September 30, 1994, no domestic mortgages and only a nominal amount of foreign mortgages were in default. At September 30, 1994, AIG's insurance holdings of collateral loans amounted to $518.1 million, all of which were foreign. It is AIG's practice to require a maximum loan to value ratio of 75 percent at loan origination.

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.

There exist in certain jurisdictions significant regulatory and/or foreign governmental barriers 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, including real estate, at September 30, 1994 and December 31, 1993:

(dollars in thousands)

| | September 30, 1994 | | December 31, 1993 | |
|---|---|---|---|---|
| | Invested Assets | Percent of Total | Invested Assets | Percent of Total |
| Flight equipment primarily under operating leases, net of accumulated depreciation | $ 10,148,000 | 34.3% | $ 8,555,400 | 37.3% |
| Unrealized gain on interest rate and currency swaps, options and forward transactions * | 4,631,200 | 15.7% | -- | -- |
| Securities available for sale, at market value | 3,500,200 | 11.8% | 4,991,100 | 21.7% |
| Trade receivables | 3,107,000 | 10.5% | 1,328,400 | 5.8% |
| Securities purchased under agreements to resell, at contract value | 2,708,100 | 9.2% | 2,737,500 | 11.9% |
| Trading securities, at market value | 2,565,900 | 8.7% | 2,516,200 | 11.0% |
| Spot commodities, at market value | 1,387,400 | 4.7% | 764,200 | 3.3% |
| Net unrealized gain on interest rate and currency swaps, options and forward transactions | -- | -- | 640,100 | 2.8% |
| Other, including short-term investments | 1,525,200 | 5.1% | 1,424,400 | 6.2% |
| Total | $29,573,000 | 100.0% | $22,957,300 | 100.0% |

* See also the discussion under "Accounting Standards: Standards adopted in 1994" herein.

As previously discussed, cash used for the purchase of flight equipment is derived primarily from the proceeds of ILFC's debt financing. The primary sources for the repayment of this debt and the interest expense thereon are the lease receipts received and proceeds from the sale of flight equipment. During 1994, ILFC increased its net financing $1.34 billion for the acquisition of flight equipment costing $2.02 billion.

The gross unrealized gains and unrealized losses of AIGFP and AIGTG included in the financial services assets as at September 30, 1994 were as follows:

(in thousands)

| | Gross Unrealized Gains | Gross Unrealized Losses | Balance Sheet Amount |
|---|---|---|---|
| Securities available for sale, at market value | $ 230,500 | $ 229,500 | $3,500,200 |
| Trade receivables | 2,343,000 | 20,512 | 3,107,000 |
| Trading securities, at market value | -- | -- | 2,565,900 |
| Spot commodities, at market value | 267,400 | 145,900 | 1,387,400 |
| Unrealized gain/loss on interest rate and currency swaps, options and forward transactions * | 4,631,200 | 3,703,700 | -- |

* See also the discussion under "Accounting Standards: Standards adopted in 1994" herein.

Trading securities, at market value, 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.

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. The unrealized gains and losses remaining after benefit of the offsets were $6.3 million and $5.3 million.

Securities available for sale and securities purchased under agreements to resell are primarily purchased with the proceeds of AIGFP's GIA financing. The securities purchased involve varying degrees of credit risk. The average credit rating of AIGFP's securities available for sale at September 30, 1994 was AA. Securities purchased under agreements to resell are treated as collateralized transactions. AIGFP generally takes possession of securities purchased under agreements to resell. AIGFP further minimizes its credit risk by monitoring customer credit exposure and requiring additional collateral to be deposited when deemed necessary.

AIGFP, as principal, enters into interest rate, currency, equity and commodity swaps and forward commitments. The average credit rating of AIGFP's counterparties as a whole, as measured by AIGFP, was AA- at September 30, 1994. As previously described, AIGFP carries its derivatives at fair value. To the extent there are reliable current market data, these derivatives are valued accordingly. Where such market data are not available, AIGFP uses internal valuation models. The recorded fair values of these derivative products may be different than the values that might be realized if AIGFP were to sell or close out the transactions because of limited liquidity for these instruments. (See also the discussions under "Operational Review: Financial Services" and "Accounting Standards: Standards Adopted in 1994" herein.)

AIGTG acts as principal in certain foreign exchange, precious and base metals, petroleum and petroleum products and natural gas trading activities. AIGTG owns and may maintain substantially hedged inventories in the commodities in which it trades. AIGTG supports its trading and market making activities largely through trade payables, securities sold under agreements to repurchase and spot commodities sold but not yet purchased. Thus, AIGTG's liquidity is provided through its high volume and rapid turnover activities in market making and hedging. AIGTG uses derivatives to hedge various trading positions and transactions from adverse movements in interest rates, exchange rates and commodity prices. (See also the discussion under "Operational Review: Financial Services" herein.)

## Recent Developments

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. AIG believes that the development of RBC standards is a positive step for the insurance industry but further believes the standards in their present form may lead to an inefficient deployment of industry capital. As experience is gained with the application of RBC standards, it is likely that adjustments to the formula will be made.

RBC standards for property and casualty insurers have been finalized and are effective with the 1994 statutory financial statements to be filed in 1995. Applying these RBC standards to AIG's domestic general operations at December 31, 1993 and September 30, 1994 reveals that the capital of each of the domestic general insurance companies exceeded the RBC requirements. Additionally, no AIG company is on any regulatory or similar "watch list".

Standards for the life RBC formula and a model act have been approved by regulators and were effective with the 1993 statutory financial statements. At December 31, 1993, the adjusted capital of each of AIG's four domestic life companies exceeded the levels of their RBC capital by multiples approximating from two to more than four. There has been no significant change in the RBC capital of each of these companies through September 30, 1994.

In 1992, domestic life insurance companies were required for regulatory purposes to adopt two investment reserves, the Asset Valuation Reserve (AVR) and the Interest Maintenance Reserve (IMR). The AVR is formula based and applies to all invested assets which are subject to either credit or market risk. The IMR defers realized capital gains and losses on the sale of fixed maturities and mortgage loans. The realized gains and losses are subsequently amortized into investment income over the original term of the disposed assets. The impact of these reserves on the separately reported statutory income of certain domestic life companies may be significant in 1994. However, there was no impact on AIG's GAAP consolidated life insurance operating income presented herein.

In July 1994, AIG acquired $200 million of 8 percent convertible preferred stock of Alexander & Alexander Services Inc. (A&A), an independent insurance brokerage operation. The preferred stock is convertible into common stock of A&A at $17 per share. Both the convertible preferred stock and the common stock are non-voting in the hands of AIG. AIG may elect in the future to exchange its non-voting common stock for up to 9.9 percent of A&A's voting common stock. The dividend will be paid in-kind for the first two years; and, at A&A's option, for an additional three years.

In October 1994, AIG signed a definitive agreement with 20th Century Industries, (20th Century) under which AIG will invest $200 million in a new issue of 9 percent cumulative convertible preferred stock of 20th Century. Dividends on the preferred stock will be paid in cash or in kind for the first three years at 20th Century's option, and in cash thereafter. Additionally, under the definitive agreement, AIG will invest $16 million in warrants for 16 million common shares of 20th Century at a per share exercise price of $13.50. 20th Century has also granted to AIG, at a per share exercise price of $11.33, an option to purchase up to 15 percent of 20th Century's common stock under certain conditions. AIG and 20th Century will enter a strategic alliance to extend the direct marketing of personal automobile insurance into certain western states.

This transaction is subject to the approval of the 20th Century shareholders.

On October 31, 1994, ILFC filed a registration statement with respect to 1,000 shares of money market auction preferred stock in two series with a liquidation preference of $100,000 per share. The proceeds of this offering will be used to repay maturing commercial paper.

ILFC currently has six model 757 and three model MD83 aircraft and one spare engine on lease to Aeromexico. At September 30, 1994, the aggregate net book value of these nine aircraft and one spare engine was $356 million. In September 1994, Aeromexico ceased making lease payments on these and its other leased aircraft due to its financial difficulties. The aggregate monthly rentals due with respect to the nine aircraft and the engine leased to Aeromexico is approximately $2.7 million. ILFC has obtained court orders which would allow ILFC to repossess any of the aircraft if they are flown into certain airports in the United States. However, ILFC understands that these aircraft have been diverted for use only on Mexican domestic flights. Under the terms of its leases, ILFC has the right to and has applied deposits from Aeromexico to the payment of rent. Through October 31, 1994, the amounts of unpaid rents were less than the amount of deposits from Aeromexico held by ILFC. Commencing in November 1994, no additional rents will be accrued on these aircraft and engine until a resolution of this matter has been reached.

ILFC is currently negotiating with Aeromexico to resolve this matter. No agreement has yet been reached. Management does not believe that this matter will have a material adverse effect on AIG's results of operations, liquidity or financial condition.

Accounting Standards

Standards adopted in 1994:

In March 1992, the Financial Accounting Standards Board (FASB) issued Interpretation No. 39 "Offsetting of Amounts Related to Certain Contracts" (Interpretation), which is effective for fiscal years beginning after December 15, 1993. The Interpretation requires that unrealized gains and losses on swaps, forwards, options and similar contracts be recognized as assets and liabilities. Previously, AIG's policy was to record such unrealized gains and losses on a net basis in the consolidated balance sheet. The Interpretation allows the netting of such unrealized gains and losses with the same counterparty when they are included under a master netting arrangement with the counterparty and the contracts are reported at market or fair value.

Although there was no effect on AIG's operating income upon the adoption of the Interpretation, AIG adopted this Interpretation effective January 1, 1994 and now presents certain of its financial services assets and liabilities, primarily unrealized gain (loss) on interest rate and currency swaps, options and forward transactions, on a gross basis. Thus, both consolidated assets and liabilities have increased. The effect of presenting these assets and liabilities on a gross basis on AIG's consolidated balance sheet was not significant. The prior years' balance sheet was not reclassified.

In November of 1992, FASB issued Statement of Financial Accounting Standards No. 112 "Employers' Accounting for Post-employment Benefits" (FASB 112). FASB 112 established accounting standards for employers who provide benefits to former or inactive employees after employment but before retirement. FASB 112 was adopted by AIG effective January 1, 1994 and had no significant effect on AIG's results of operations, financial condition or liquidity.

Standards to be adopted in the future:

In May 1993, FASB issued Statement of Financial Accounting Standards No. 114 "Accounting by Creditors for Impairment of a Loan" (FASB 114). FASB 114 addresses the accounting by all creditors for impairment of certain loans. The impaired loans are to be measured at the present value of all expected future cash flows. The present value may be determined by discounting the expected future cash flows at the loan's effective rate or valued at the loan's observable market price or valued at the fair value of the collateral if the loan is collateral dependent. This methodology is not expected to produce a material effect on AIG's results of operations, financial condition or liquidity. FASB 114 will be effective for the 1995 financial statements. AIG does not anticipate adoption prior to the effective date.

In October 1994, FASB issued Statement of Financial Accounting Standards No. 118 "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures" (FASB 118). FASB 118 amends FASB 114 to allow a creditor to use existing methods to recognize interest income on an impaired loan. FASB 118 also amends certain disclosure requirements of FASB 114. This statement is effective at the same time as FASB 114.

In October 1994, FASB issued Statement of Financial Accounting Standards No. 119 "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments" (FASB 119). FASB 119 requires disclosure about derivative financial instruments and amends FASB Statement No. 105 "Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk" (FASB 105) and FASB Statement No. 107 "Disclosure about Fair Value of Financial Instruments".

FASB 119 requires disclosure about the amounts, nature and terms of derivatives that are not subject to FASB 105. Also, FASB 119 requires disclosure about financial instruments held or issued for trading purposes and purposes other than trading. This statement is effective for year end 1994.

PART II - OTHER INFORMATION

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

(a) Exhibits
See accompanying Exhibit Index.

(b) There were no reports on Form 8-K filed for the nine months ended September 30, 1994.

SIGNATURES

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

AMERICAN INTERNATIONAL GROUP, INC.
----------------------------------
(Registrant)

s/s Howard I. Smith
----------------------------------
Howard I. Smith
Senior Vice President - Comptroller
(Chief Accounting Officer)

Dated: November 11, 1994

# EXHIBIT INDEX

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

Exhibit 11

AMERICAN INTERNATIONAL GROUP, INC.
COMPUTATION OF EARNINGS PER SHARE
(in thousands, except per share amounts)

| | NINE MONTHS ENDED SEPTEMBER 30, | | THREE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 1994 | 1993 | 1994 | 1993 |
| Average outstanding shares used in the computation of per share earnings: | | | | |
| Common stock (a) | 337,391 | 337,393 | 337,391 | 337,392 |
| Common stock in treasury (a) | (20,569) | (19,974) | (21,023) | (19,954) |
| | 316,822 | 317,419 | 316,368 | 317,438 |
| Income before cumulative effect of accounting changes | $ 1,597,839 | $ 1,406,878 | $ 542,527 | 451,061 |
| Cumulative effect of accounting changes: (b) | | | | |
| Minority-owned insurance operations | - | 20,695 | - | - |
| Net income (applicable to common stock) (c) | $ 1,597,839 | $ 1,427,573 | $ 542,527 | $ 451,061 |
| Earnings per common share: | | | | |
| Income before cumulative effect of accounting changes | $ 5.04 | $ 4.43 | $ 1.71 | $ 1.42 |
| Cumulative effect of accounting changes: | | | | |
| Minority-owned insurance operations | - | 0.07 | - | - |
| Net income | $ 5.04 | $ 4.50 | $ 1.71 | $ 1.42 |

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

(b) Represents a net benefit for the cumulative effect of the adoption of accounting pronouncements related to postretirement benefits (FASB 106) and income taxes (FASB 109) by minority-owned insurance operations in 1993.

(c) After deduction of preferred stock dividends of $1,043,000 and $0 for the first nine months and third quarter of 1993, respectively.

Exhibit 12

AMERICAN INTERNATIONAL GROUP, INC.
COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES
(in thousands, except ratios)

| | NINE MONTHS ENDED SEPTEMBER 30, | | THREE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 1994 | 1993 | 1994 | 1993 |
| Income before income taxes and cumulative effect of accounting changes | $ 2,167,416 | $ 1,910,747 | $ 748,313 | $ 620,237 |
| Less - Equity income of less than 50% owned persons | 32,153 | 34,024 | 11,423 | 12,425 |
| Add - Dividends from less than 50% owned persons | 3,701 | 3,465 | 958 | 716 |
| | 2,138,964 | 1,880,188 | 737,848 | 608,528 |
| Add - | | | | |
| Fixed charges | 1,044,165 | 931,419 | 339,209 | 236,227 |
| Less - | | | | |
| Capitalized interest | 33,293 | 31,538 | 11,021 | 9,807 |
| Income before income taxes, cumulative effect of accounting changes and fixed charges | $ 3,149,836 | $ 2,780,069 | $ 1,066,036 | $ 834,948 |
| Fixed charges: | | | | |
| Interest costs | $ 994,041 | $ 872,487 | $ 322,501 | $ 216,583 |
| One-third rental expenses * | 50,124 | 58,932 | 16,708 | 19,644 |
| Total fixed charges | $ 1,044,165 | $ 931,419 | $ 339,209 | $ 236,227 |
| Ratio of earnings to fixed charges | 3.02 | 2.98 | 3.14 | 3.53 |

* The proportion deemed representative of the interest factor.

The ratio shown is significantly affected as a result of the inclusion of the fixed charges and operating results of AIG Financial Products Corp. and its subsidiaries (AIGFP). AIGFP structures borrowings through guaranteed investment agreements and engages in other complex financial transactions, including interest rate and currency swaps. In the course of its business, AIGFP enters into borrowings that are primarily used to purchase assets that yield rates greater than the rates on the borrowings with the intent of earning a profit on the spread and to finance the acquisition of securities utilized to hedge certain transactions. The pro forma ratios of earnings to fixed charges, which exclude the effects of the operating results of AIGFP, are 5.17 and 5.15 for the third quarter and 5.45 and 5.55 for the first nine months of 1994 and 1993, 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.

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Exhibit 27

AMERICAN INTERNATIONAL GROUP, INC.
Financial Data Schedule
For the nine months ended September 30, 1994
(in thousands, except per share amounts)

1

USD

9-MOS
DEC-31-1994
JUL-01-1994
SEP-30-1994
1
20,351,602
12,715,086
13,110,000
5,256,134
1,610,125
1,208,016
76,638,438
89,443
16,497,964
4,917,747
114,559,454
47,790,675
6,445,024
0
7,895,485
10,836,209
843,477
0
0
15,356,331
114,559,454
12,521,610
2,334,901
76,775
(72,219)
10,170,266
1,065,344
1,853,408
2,167,416
569,577
1,597,839
0
0
0
1,597,839
5.04
5.04
17,557,000
6,025,800
0
1,514,200
3,893,700
18,174,900
0