

**"The following report on examination was conducted as of
December 31, 2005, and therefore does not contain information
regarding the financial crisis subsequently encountered by the
American International Group."**

REPORT ON EXAMINATION

OF

COMMERCE AND INDUSTRY INSURANCE COMPANY

AS OF

DECEMBER 31, 2005

DATE OF REPORT

DECEMBER 10, 2007

EXAMINER

PATRICK R. WHITE, CFE

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

December 10, 2007

Honorable Eric R. Dinallo
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22492 dated April 13, 2006 attached hereto, I have made an examination into the condition and affairs of Commerce and Industry Insurance Company as of December 31, 2005, and submit the following report thereon.

Wherever the designation the “Company” appears herein without qualification, it should be understood to indicate Commerce and Industry Insurance Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company’s home office located at 70 Pine Street, New York, New York.

1. SCOPE OF EXAMINATION

The previous filed examination report for the Company was as of December 31, 1996. In 2002, the Department commenced a financial examination of the Company as of December 31, 2001. However, during the course of the examination and as a result of regulatory inquiries into certain transactions, American International Group, Inc. (“AIG”) conducted an internal review of information and certain transactions from January 2000 to May 2005. As part of the internal review, the Company reviewed the statutory accounting treatment for matters identified during the internal review and concluded that certain transactions were materially misstated. With the agreement of the Department, the Company amended and refiled its 2004 annual statement using the methodology described under Statement of Statutory Accounting Principles (SSAP) No. 3, “Accounting Changes and Corrections of Errors”. In applying this methodology, the Company reflected the impact to its 2003 and prior unassigned surplus as an adjustment to unassigned surplus as of January 1, 2004. Due to the financial reporting misstatements acknowledged by the Company as part of the restatement of its 2004 annual statement, the Department’s 2001 report was not filed.

This examination covered the one year period from January 1 through December 31, 2005 and also included a review of the 2005 adjustments to the Company’s 2004 statutory financial statements. For legal and statutory compliance purposes, this examination covers the period from January 1, 1997 through December 31, 2005.

The current examination was organized, planned, and conducted based upon the application of the risk surveillance approach in accordance with the guidelines and procedures established in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners (“NAIC”). To the extent considered appropriate, work performed by the Company’s independent public accountants and the Sarbanes Oxley documentation was considered. A review was also made of the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

- History of Company
- Management and control
- Corporate records
- Territory and plan of operation
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

The examination of Commerce and Industry Insurance Company was performed concurrently with the examinations of the following insurers: National Union Fire Insurance Company of Pittsburgh, Pa. (“National Union”) (PA), Birmingham Fire Insurance Company of Pennsylvania (n/k/a AIG Casualty Company) (PA), The Insurance Company of the State of Pennsylvania (PA), Granite State Insurance Company (PA), American International South Insurance Company (PA), New Hampshire Insurance Company (PA), American Home Assurance Company (“American Home”) (NY), Illinois National Insurance Co. (IL) and AIU Insurance Company (NY). These companies are members of and participate in an intercompany pooling arrangement hereinafter referred to as the “Commercial Pool” (see Section 2C “Reinsurance”).

The examination was conducted in conjunction with the State of Pennsylvania, which was the lead state for the examination of the Commercial Pool. The Pennsylvania examination of the Commercial Pool was conducted using a modified risk surveillance basis.

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on December 11, 1957, as the American Reciprocal Insurers. On June 6, 1966, ownership shifted when the Company was absorbed by merger with its organizer, the American Reciprocal. The subscribers of the reciprocal exchanged their equity in surplus funds for stock of the company. Ownership passed to the Combined Insurance Company of America of Chicago, Illinois on February 15, 1968 through an exchange of shares. On July 15, 1968, American International Group, Inc. (“AIG”) acquired financial control of the Company.

The Company is a wholly-owned subsidiary of AIG since 1968. AIG is a publicly traded company, with approximately 11.89% of its shares owned by C.V. Starr & Co., Inc., Starr International Company, Inc., and The Starr Foundation as of December 31, 2005. This is more fully discussed in item 2D herein, “Holding Company System”.

At December 31, 2005, the capital paid in was \$5,022,500, which consists of 2,050,000 shares of \$2.45 par value per share common stock. Gross paid in and contributed surplus was \$680,312,223.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than thirty members. The board meets at least once during each calendar year. At December 31, 2005, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Merton B. Aidinoff New York, NY	Retired Attorney, Sullivan & Cromwell
Steven J. Bensinger New York, NY	Executive Vice President & Chief Financial Officer, AIG, Inc.
Joseph L. Boren New York, NY	President and Chief Executive Officer, Commerce and Industry Insurance Company
Charles H. Dangelo Manasquan, NJ	Vice President, AIG, Inc.
John Q. Doyle Rye, NY	President, American Home Assurance Company
David L. Herzog St. Albans, MO	Senior Vice President & Comptroller, AIG, Inc.
John W. Keogh Manhasset, NY	Vice President, AIG, Inc.
Robert E. Lewis New York, NY	Senior Vice President & Chief Risk Officer, AIG, Inc.
Kristian P. Moor Fairfield, CT	Executive Vice President, AIG, Inc.
Win J. Neuger New York, NY	Executive Vice President & Chief Investment Officer, AIG, Inc.
Ernest T. Patrikis New York, NY	Senior Vice President & General Counsel, AIG, Inc.

Robert S. H. Schimek
Newtown, PA

Senior Vice President & Chief Financial Officer,
Domestic Brokerage Group

Nicholas C. Walsh
New York, NY

President & Chief Executive Officer,
American International Underwriters

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended.

As of December 31, 2005, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Joseph L. Boren	President
Robert S. H. Schimek	Senior Vice President & Treasurer
Elizabeth M. Tuck	Secretary

B. Territory and Plan of Operation

As of December 31, 2005, the Company was licensed to write business in all fifty states, the District of Columbia, Canada, and the Philippines (reinsurance only).

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
26	Gap Insurance

Effective March 27, 2007, the Company's certificate of authority was amended to add the following lines of insurance: accident and health, credit, residual value, credit unemployment, prize indemnification, service contract reimbursement and legal services insurance, as described in paragraphs 3, 17, 22, 24, 27, 28 and 29 of Section 1113(a) of the New York Insurance Law.

The Company is also authorized to write worker's compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113 of the New York Insurance Law, including coverages described in the Longshoremen's and Harbor Worker's Compensation Act and the kinds of insurance and reinsurance of every kind or description, except with respect to life insurance, title insurance and contracts for the payment of annuities, as specified in Section 4102(c) of the New York Insurance Law. The Company is authorized to transact business of special risk insurance as defined in Article 63 of the New York Insurance Law.

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$35,000,000.

Related companies of the Commercial Pool operate as specialty multiple line carriers with emphasis on business developed and serviced by brokers. Underwriting facilities are maintained for handling virtually all forms of property and casualty insurance and reinsurance. Marketing efforts are directed mainly towards commercial and industrial risks. Related companies of the Commercial Pool specialize in assumed reinsurance, surplus lines, and risk management programs for large national insureds.

C. Reinsurance

Assumed

Assumed reinsurance accounted for 60% of the Company's gross premium written at December 31, 2005. The Company's assumed reinsurance program consists primarily of its participation in the Inter-Company Reinsurance Pooling Agreement as described further herein. Activity under this agreement represents 98.8% of the Company's total assumed premium. Additionally, the Company's participation in various mandated pools is reflected in its assumed reinsurance activity. The Company utilizes reinsurance accounting as defined in NAIC Accounting

Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62 for all of its assumed reinsurance business.

Pooling Agreement

The majority of the Company's assumed reinsurance business emanated from its participation with ten affiliates in an inter-company reinsurance pooling agreement, known as the "Commercial Pool." Pursuant to the terms of this agreement, the Company and the affiliated entities share in premiums, losses, and expenses based on their respective pool participation. This agreement was amended twice during the examination period. Both amendments were approved by the Department. Neither the participants nor their pooling percentages were affected by these amendments.

Business written in Japan by AIU Insurance Company and American Home Assurance Company is not included in this pooling agreement.

On December 31, 2005, the pool included the following wholly-owned subsidiaries of AIG:

<u>Pool Company</u>	<u>State of Domicile</u>	<u>Pool %</u>
National Union Fire Insurance Company of Pittsburgh, Pa.	Pennsylvania	38%
American Home Assurance Company	New York	36%
Commerce and Industry Insurance Company	New York	10%
The Insurance Company of the State of Pennsylvania	Pennsylvania	5%
Birmingham Fire Insurance Company of Pennsylvania (n/k/a AIG Casualty Company)	Pennsylvania	5%
New Hampshire Insurance Company	Pennsylvania	5%
AIU Insurance Company	New York	1%
American International Pacific Insurance Company	Colorado	0%
American International South Insurance Company	Pennsylvania	0%
Granite State Insurance Company	Pennsylvania	0%
Illinois National Insurance Co.	Illinois	0%

Effective July 1, 2007, American International Pacific Insurance Company ("AIP") terminated its 0% participation in the Commercial Pooling Agreement. Commercial risks ceded to the Commercial Pool by AIP prior to its exit will remain in the pool until their natural expiry. AIP's cessions of personal lines risks to the Commercial Pool were commuted and 100% ceded to AIG's Personal Lines Pool, which AIP joined effective July 1, 2007, also with a 0% participation.

Effective January 1, 2008 AIU Insurance Company ("AIUI") terminated its 1% participation in the Commercial Pooling Agreement. Risks ceded to the Commercial Pool by AIUI will be run off

and AIUI's 1% participation will be reduced to zero. The Company's pooling participation will be increased to 11%.

Non-pooled, Intra-company Reinsurance

The Company is a member of an AIG internal facility known as the Compulsory Cessions Auxiliary Account ("CCAA"). The CCAA allows AIG to retain business by ceding selected business to affiliated companies. The facility retains additional amounts over the retentions determined by the profit center managers.

Ceded

External treaty reinsurance is placed by AIG's Global Reinsurance Division ("GRD"). Reinsurance officers within GRD are aligned with specific AIG Profit Centers and are responsible for determining structures, negotiating, and placing individual treaty reinsurance programs. GRD's Catastrophe ("CAT") Unit reviews, analyzes, and assists in placing AIG's overall CAT reinsurance. GRD places reinsurance for various legal entities within AIG.

AIG maintains extensive reinsurance, with programs placed with United States domestic, international and offshore reinsurance facilities. Management's goal is to fully place its traditional excess of loss catastrophe reinsurance cover in order to limit the effect of a severe catastrophic event. AIG's reinsurance strategy is to retain a higher amount of low layer exposures, which could be absorbed through its earnings stream.

Business written by the pool companies is produced through numerous profit centers. Reinsurance is managed by profit center, as opposed to legal entity, as follows:

American Home Assurance Company ("AHAC")

AHAC is a major writer of excess casualty & umbrella and workers' compensation insurance. There is a minimum reliance on treaty reinsurance thus resulting in high net retentions. Facultative reinsurance is purchased for selected risks. There were no treaty placements for AHAC for 2005.

AIG Risk Management (“AIGRM”)

AIGRM is a major writer of primary casualty business tailored to serve the needs of construction and transportation businesses, as well as commercial accounts and national accounts. Lines of business include excess casualty, umbrella, auto liability, general liability, workers’ compensation, and surety. There is a minimum reliance on treaty reinsurance. Facultative reinsurance is purchased for selected risks. There were no significant treaty placements in 2005. All current reinsurance is facultative or captive treaties.

National Union Fire Insurance Company of Pittsburgh, Pa. (“NUFIC”)

NUFIC is the focal point for financial products within the Domestic Brokerage Group (“DBG”), including directors and officers liability insurance (“D&O”), errors and omissions coverage (“E&O”), employment practices liability insurance (“EPLI”) and fidelity coverage. Product lines are supported by a number of specific treaties. Due to the number of existing and new products being offered by NUFIC, there exist a number of treaties to support the individual and less mature products. Facultative reinsurance is purchased, but is not pervasive due to the number of existing treaty reinsurance arrangements.

AIG Environmental

AIG Environmental is a major writer of environmental liability. The portfolio includes umbrella and primary liability, environmental surety and auto liability. Most of the reinsurance requirements of this profit center are met by the two treaty programs; casualty excess and surety.

WorldSource (“WSource”)

WSource provides access to world markets for U.S. domestic companies. Major lines of business include property, casualty, auto, products recall, and workers’ compensation. As many of the exposures written exist overseas, WSource accesses the international property treaty and facultative markets. Facultative reinsurance is purchased primarily for property capacity. Treaty coverages exist for the more exposed casualty lines.

Lexington Insurance Company (“Lexington”)

Lexington is AIG’s major surplus lines writer writing multiple lines of business. Business is written through its major divisions which are property, casualty, marine, programs, and medical/healthcare. The approach to reinsurance structures for this profit center varies by line of business and size of the portfolio. The retention under the program portfolio is significantly lower than most of the directly written books. Lexington has extensive property reinsurance which is placed through domestic and foreign reinsurers. The program consists of working and excess layers that cover all property business. Traditionally, Lexington has been a big purchaser of pro rata treaty reinsurance. Lexington will purchase facultative reinsurance to provide capacity or supplement treaty reinsurance.

Starr Excess

Starr Excess is a writer of high excess casualty business, primarily in casualty and financial lines. This profit center will write excess over AIG or other third party companies. Reinsurance is purchased mainly to control high aggregates, both on a treaty and facultative basis.

Aviation

This profit center covers all aviation related exposures; products include liability, hull risks, warranty risk and satellite liability. Due to the focus of the business unit, reinsurance is purchased on a more traditional treaty reinsurance basis.

Property Catastrophe

AIG purchases catastrophe protection separately for its commercial and personal lines business. Property catastrophe covers as of December 31, 2005:

Corporate Property Catastrophe Covers

<u>Treaty Name</u>	<u>Max Limits</u>	<u>AIG Net Retention</u>
1st Domestic cat excess of loss	\$250M excess of \$500M	50%
2 nd Domestic cat excess of loss	\$250M excess of \$750M	10%
3 rd Domestic cat excess of loss	\$250M excess of \$1B	10%
4 th Domestic cat excess of loss	\$250M excess of \$1.25B	20%

Personal Lines Property Catastrophe Covers

<u>Treaty Name</u>	<u>Max Limits</u>	<u>AIG Net Retention</u>
1st Domestic personal lines cat excess of loss	\$100M excess of \$100M	2.50%
2nd Domestic personal lines cat excess of loss	\$100M excess of \$200M	2.50%
3rd Domestic personal lines cat excess of loss	\$100M excess of \$300M	2.50%
4th Domestic personal lines cat excess of loss	\$100M excess of \$400M	2.50%

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that seventy-four affiliated reinsurance agreements were not filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law. A recommendation regarding the Company's failure to file these agreements with the Department is included in Item 2D of this report.

The examination of the reinsurance process within the Company determined that, in 2005, management identified a significant deficiency on the reinsurance operations and concluded that it had not maintained effective controls over the monitoring of the completeness, accuracy, and reporting (internal and external) of certain reinsurance transactions in a timely manner.

A sample of ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Although the examination of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions, exceptions were noted relative to trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers, which were found not to comply with the provisions of Department Regulation 114. Descriptions of the amount and nature of adjustments related to the review of Schedule F data is found in Item 7 of this report under the caption "Provision for reinsurance."

At December 31, 2005, the Company reduced its provision for reinsurance by securities held in a trust agreement that had been assigned to the Company by the American International Reinsurance Company ("AIRCO"), an unauthorized affiliated reinsurer, for security under a reinsurance agreement between AIRCO and a retrocessionaire of AIRCO. The trust agreement was related to a program pursuant to which the Company issued policies to various companies owned by

the parent of the retrocessionaire. The Company then ceded 100% those exposures to AIRCO, who then retroceded the exposures to the retrocessionaire.

Effective December 14, 2005, the retrocessionaire, as grantor, established a trust account naming AIRCO as the beneficiary. On December 16, 2005, a "Transfer of Beneficiary for Security Trust Agreement" was executed substituting the Company in place of AIRCO as the beneficiary of the trust account. The Transfer agreement was signed by the retrocessionaire and acknowledged and agreed to by the Trustee, the Company and AIRCO.

The examiners note that this Transfer of Beneficiary for Security Trust Agreement does not comply with Part 126.2(a) and (b) of Department Regulation 114 which states:

126.2 Definitions. As used in this Part, the following terms shall have the following meanings:

(a) Beneficiary means the entity for whose sole benefit the trust has been established. The trust agreement shall contain a provision that includes within the term beneficiary any successor of the beneficiary by operation of law, including, without limitation, any liquidator, rehabilitator, receiver or conservator. When established in conjunction with a reinsurance agreement, the beneficiary is the licensed ceding insurer.

(b) Grantor means the entity that has established a trust for the sole benefit of the beneficiary. When established in conjunction with a reinsurance agreement, the grantor is the unlicensed, unaccredited reinsurer.

Further, Part 126.3(d) states that the trust agreement must be "clean and unconditional."

No adjustment has been made to the examination financial statements set forth in this report since the Company was subsequently able to draw upon the trust and has since remediated this condition. However, it is recommended that the company comply with the provisions of Department Regulation 114 when utilizing trust agreements to calculate its provision for reinsurance.

Risk Transfer

Treaty placement is in accordance with the AIG Risk Transfer Policy that was adopted October 1, 2005. All assumed and ceded treaties and autofac and obligatory facultative arrangements (excluding captives) must be evaluated by reinsurance services personnel. In the case of a captive, the risk transfer assessment will be conducted at the business unit level. If the treaty/certificate contains one or more characteristics or contractual features that are intended to mitigate risk transfer, they are summarized in a safe harbor document. The Reinsurance Officer and the Business Unit

CFO, or his designee must assist in the determination of whether or not an actuarial analysis is required and whether or not there is sufficient risk transfer to allow for reinsurance accounting treatment. Evidence of this analysis and approval by the Reinsurance Manager, a Reinsurance Officer, and the Business Unit CFO, or his designee is required. In accordance with SFAS No. 113 (paragraph 11), a risk transfer analysis is not required if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer. If none of these features summarized in the safe harbor agreement are present, risk transfer is deemed to be self evident and the insurance transaction qualifies for insurance accounting treatment.

When a risk transfer assessment is required, it must be included in the underwriting file no later than the effective date of the certificate and be available on request. The documentation of the risk transfer assessment will vary based on circumstances, but the general requirements are outlined in the safe harbor agreement. The documentation must state the conclusion and the basis thereof, and be sufficient to support the conclusion.

Because of issues of control (including the nature and timing of certain commutations) over reinsurance ceded (both directly and indirectly) to Union Excess Reinsurance Company, a Barbados domiciled company, AIG concluded that cessions to Union Excess did not result in risk transfer from AIG as consolidated and therefore did not qualify for reinsurance accounting treatment. Accordingly, these cessions were adjusted to reflect deposit accounting. Union Excess has been included in AIG's consolidated financial statements.

As a result of certain facts and circumstances related to the ownership and control of Richmond Insurance Company, a Barbados domiciled company; Richmond Insurance Company has been included in AIG's consolidated financial statements. Because of AIG's ability to exert control over Richmond, reinsurance ceded to that entity did not result in sufficient transfer of risk. These transactions have been adjusted to deposit accounting.

Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62 with the exception of those treaties that were accounted for as Deposit Accounting in accordance with SSAP No. 75. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer.

During the period covered by this examination, the Company commuted various assumed and ceded reinsurance agreements that resulted in a net loss of \$11,983,443 to the Company's surplus.

D. Holding Company System

The Company is a wholly-owned subsidiary of American International Group, Inc. ("AIG"), a Delaware holding company organized in 1967, which includes insurance companies, management companies, agencies and other enterprises doing business in all states of the United States and around the world. AIG, is a publicly traded company, with approximately 11.89% of the shares owned by C.V. Starr & Co., Inc., Starr International Company, Inc., and the Starr Foundation as of December 31, 2005. AIG directly or indirectly owns all of the capital stock of several insurance companies including the American Home/National Union Group.

The following is an organizational chart of the U.S. domiciled insurance companies within the AIG insurance holding company system as of December 31, 2005:

American International Group, Inc. (Parent)

- AIU Insurance Company (AIG 52%-Ownership and Group A (see below) -48%)
- American Home Assurance Company
 - 21st Century Insurance Group (16.3%- Ownership Group I - 83.7%)
 - 21st Century Insurance Company
 - 21st Century Casualty Company
 - 21st Century Insurance Company of the Southwest
 - AIG Hawaii Insurance Company, Inc.
 - Transatlantic Holdings, Inc. (33.86%-Ownership Group B-17.84%)
 - Transatlantic Reinsurance Company
 - Putnam Reinsurance Company
- AIG Life Insurance Company (78.9%-Ownership Group C-21.1%)
- AIG Global Trade and Political Risk Insurance Company
- American International Insurance Company of Delaware, Inc.
- American International Life Assurance Company of N.Y. (77.5%-Ownership Group D-22.5%)
- American Life Insurance Company
- Birmingham Fire Insurance Company of Pennsylvania (n/k/a AIG Casualty Company)
- **Commerce and Industry Insurance Company**
 - American International Insurance Company (50%-Ownership Group E-50%)
 - Minnesota Insurance Company (n/k/a AIG Advantage Insurance Company)
 - American International Insurance Company of CA., Inc.
 - American International Insurance Company of New Jersey
- Delaware American Life Insurance Company
- The Insurance Company of the State of Pennsylvania
- Landmark Insurance Company
- National Union Fire Insurance Company of Pittsburgh, Pa.
 - American International Specialty Lines Insurance Company (70%-Ownership Group F-30%)
 - Lexington Insurance Company (70%-Ownership Group F-30%)
 - JI Accident & Fire Insurance Company Ltd. (50%)
 - National Union Fire Insurance Company of Louisiana
- NHIG Holding Corporation
 - Audubon Insurance Company
 - Audubon Indemnity Company
 - New Hampshire Insurance Company
 - American International Pacific Insurance Company (Formerly, American Fidelity Insurance Company)
 - American International South Insurance Company (Formerly, American Global Insurance Company)
 - Granite State Insurance Company
 - Illinois National Insurance Co.
 - New Hampshire Indemnity Company, Inc.
 - AIG National Insurance Company, Inc.
 - New Hampshire Life Insurance Company
 - United Guaranty Corporation (6.95%-Ownership Group G-93.05%)
 - United Guaranty Insurance Company
 - United Guaranty Mortgage Insurance Company
 - United Guaranty Mortgage Insurance Company of North Carolina
 - United Guaranty Residential Insurance Company (75%-Ownership Group H-25%)
 - United Guaranty Commercial Insurance Company (n/k/a United Guaranty Mortgage Indemnity Company)
 - United Guaranty Commercial Insurance Company of North Carolina
 - United Guaranty Credit Insurance Company
- The Philippine American Life & General Insurance Company (99.78%)
 - Pacific Union Assurance Company

Referenced Groups:

- A - The Insurance Company of the State of Pennsylvania (8%)
Birmingham Fire Insurance Company of Pennsylvania (n/k/a AIG Casualty Company) (8%)
National Union Fire Insurance Company of Pittsburgh, Pa. (32%)
- B - American International Group, Inc. (17.84%)
- C - Commerce and Industry Insurance Company (21.1%)
- D - American Home Assurance Company (22.5%)
- E - American Home Assurance Company (25%)
AIU Insurance Company (25%)
- F - The Insurance Company of the State of Pennsylvania (20%)
Birmingham Fire Insurance Company of Pennsylvania (n/k/a AIG Casualty Company)(10%)
- G - National Union Fire Insurance Company of Pittsburgh, Pa. (45.9%)
American International Group, Inc. (36.3%)
The Insurance Company of the State of Pennsylvania (0.9%)
- H - United Guaranty Residential Insurance Company of North Carolina (25%)
- I - Commerce and Industry Insurance Company (31.1%)
New Hampshire Insurance Company (20.6%)
National Union Fire Insurance Company of Pittsburgh, Pa. (32%)

The Company's ownership in affiliated entities is as follows:

<u>Entity</u>	<u>Percent of Ownership</u>
American International Insurance Company	50%
AIG Life Insurance Company	21%
AIG Czech Republic Pojistouna, S.A.	50%
AIG Poland Insurance Company-General	100%
AIG Poland Insurance Company-Life	44%
AIG Romania Insurance Company S.A.	100%
First American Hungarian Insurance Company, RT.	50%
21st Century Insurance Group	6%
American International Realty Corp.	5%
Eastgreen, Inc.	2%
Pine Street Real Estate Holdings	5%
Pine Street Holdings LLC Pfd Membership Insurance	7%

The Company is a party to numerous agreements with affiliated entities. Descriptions of the principal agreements follow:

Service and Expense Agreement

The Company is a party to a service and expense sharing agreement with AIG. Pursuant to this agreement, AIG and its affiliates are to share/supply certain operating expenses, equipment, office space, overhead expenses, services (including, but not limited to, data center systems, salvage,

subrogation and recovery and claims management) and personnel. Settlement shall be quarterly, as per the agreement.

Intercompany Pooling Agreements

The Commercial Pool (also known as the American Home/National Union Pool or the Domestic Brokerage Group (“DBG”) Pool) was formed by the execution of an inter-company pooling agreement (“pooling agreement”), as more fully discussed in Item 2C. of this report.

Tax Allocation Agreement

The Company files a consolidated federal income tax return with AIG, pursuant to the terms of a filed tax allocation agreement.

Capital Maintenance Agreements

These agreements provide that in the event that the respective Company’s Total Adjusted Capital falls below 200% of the Company’s Authorized Control Level Risk Based Capital (“RBC”), AIG shall provide a capital contribution to the Company in the amount that equals the difference between the Company’s Total Adjusted Capital and 200% of the Company’s Authorized Control Level RBC.

Securities Lending Agreement

The Company is a party to a securities lending agreement with AIG Global Securities Lending Corp. This agreement allows AIG Global Securities Lending Corp. to negotiate the terms and conditions of transactions necessary for a securities lending program. The agreement also allows for AIG Global Securities Lending Corp. to take such actions to manage the “Lenders” relationship with banks, brokers, and counterparties in connection with security lending transactions.

Investment Advisory Agreement

The Company is a party to an agreement with AIG Global Investment Corp. (“AIGGIC”) whereby AIGGIC provides investment advisory services to the Company. The agreement authorizes the manager to supervise and direct all investments and to exercise whatever powers the Company may possess with respect to its invested assets. Investment transactions are to be in accordance with investment objectives of the Company and subject to restrictions established by the Company, as

communicated to the manager in writing from time to time. With regard to these limitations, the manager may buy, sell, exchange, convert and otherwise trade in and engage in investment transactions of any nature whatsoever involving any stocks, bonds, commercial paper, money market instruments and other securities and assets when it deems appropriate and without prior consultation with the Company.

Filing of Affiliated Agreements with the Department

The prior report on examination recommended that the Company submit all intercompany agreements to the Department prior to their implementation and to establish an effective method of tracking its holding company filings. Upon review, it was noted that the Company could not provide adequate documentation to evidence that all of its affiliated agreements entered into during the examination period had been filed with the Department. As previously mentioned in Item 2C of this report, seventy-four affiliated reinsurance agreements entered into during the examination period were not filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law. The following chart shows the number of intercompany agreements filed and non-disapproved for the years 2002-2005:

<u>Year</u>	<u>Filed and non-disapproved</u>	<u>Notes:</u>
2002	7	An additional 12 agreements were submitted late. Department indicated that these agreements would be placed on file.
2003	6	An additional 17 agreements were submitted late. Department indicated that these agreements would be placed on file.
2004	37	
2005	45	The 2005 number reflects total filings with NY parties. The Department and AIG Global Reinsurance had extensive discussions concerning wording issues and pool sessions after the 2005 filings. After an agreement was reached on standard template language and pool sessions, the Department agreed that any remaining outstanding agreements filed prior to 12/1/2005 would be “grandfathered.”

While it is evident that the number of intercompany filings has increased from prior years, the Company could not demonstrate that it had fully complied with the recommendations in the prior report regarding filing of intercompany agreements. It is recommended, as in the prior report on examination, that the Company file all of its inter-company agreements pursuant to Section 1505 of the New York Insurance Law and maintain complete documentation to evidence such filings. It is

noted that in September 2005, the Company instituted procedures to address the lack of controls over the filing of affiliated reinsurance agreements.

Indirect Agreements

Members of the AIG Pool entered into various reinsurance and service agreements with other members of the AIG holding company system. Although the Company was not a direct party to these agreements it was often indirectly affected by these agreements by virtue of the pooling agreement. The prior report on examination recommended that the Company disclose such indirect agreements with the Department

The Company did not submit any indirect agreements for the years 2001 through 2004. In 2005, the Company agreed to file indirect agreements with the Department if filing of such agreements was required by the Pennsylvania Department of Insurance under the Pennsylvania Holding Company Act. It is recommended that the Company continue to file such indirect agreements with New York whenever filing is required by the Pennsylvania Insurance Department under the Pennsylvania Holding Company Act's materiality threshold.

E. Accounts and Records

During the course of this examination, the examiner noted financial items where the financial statement impact could not be quantified or where the financial statement impact was not material. These items are as follows:

i. Agents Balances In Course Of Collection

Paragraph 9 of SSAP No. 6 provides that unearned premiums may be used to offset the not admitted asset for overdue premiums on direct billed business, but not for overdue premiums due from agents. Upon review, it was noted that the Company used unearned premiums to offset all overdue deferred premiums regardless of whether the premium was direct billed or due from agents.

It is recommended that the Company segregate its direct bill receivable balances from those due from agents in the calculation of its statutory penalty for over 90 days past due balances in accordance with the guidelines of SSAP No. 6.

ii. Schedule D Reporting

In Note 10F of its 2005 annual statement, the Company disclosed that securities with a market value of \$5,100,413 were on loan. Examination review of Schedule D Part 1 found that such securities on loan did not include the “LS” designation as required by the NAIC Property and Casualty Annual Statement Instructions to indicate that the securities were loaned.

It is recommended that, for future annual statement filings, the Company comply with the NAIC Property and Casualty Annual Statement Instructions when reporting loaned securities on Schedule D – Part 1.

F. Internal Control Review

As mentioned elsewhere in this report, under the caption “Scope of Examination”, the Company acknowledged that certain transactions were materially misstated in its Statutory Annual Statements for the years 2004 and prior. The examiners also noted that the December 31, 2005 Annual Statement was amended and re-filed during the course of this examination.

Examination review of the 2005 “Report on Significant Deficiencies in Internal Controls” issued by the Company’s external auditor indicated the following reportable conditions:

(i) Controls Over Income Tax Accounting

As noted in the Commerce and Industry Insurance Company 2005 Material Weakness Letter dated May 31, 2006, the Company did not maintain effective controls over the determination and reporting of certain components of the provision for income taxes and related income tax balances. Specifically, the Company did not maintain effective controls to review and monitor the accuracy of the components of the income tax provision calculations and related income tax balances and to monitor the differences between the income tax basis and the financial reporting basis of assets and liabilities to effectively reconcile the differences to the deferred income tax balances.

As of the date of this report, remediation efforts have included hiring additional resources to assist with reviewing and monitoring of the accuracy of the components of the income tax provision calculations and related income tax balances and the differences between the income tax basis and the financial reporting basis of assets and liabilities to reconcile the differences to the deferred income tax balances effectively.

It is recommended that the Company continue its efforts to remediate the material weakness related to controls over federal income tax.

(ii) Controls Over The Accounting For Certain Derivative Transactions

The Commerce and Industry Insurance Company 2005 Material Weakness Letter dated May 31, 2006 stated that the Company did not maintain controls to ensure the completeness and accuracy of the recording of derivative transactions. Specifically, the Company lacks a centralized inventory system for the recording of derivatives and needs greater operational involvement in the booking and reconciling of interest rate swaps, over-the-counter and exchange traded options.

The Company is actively reviewing potential software solutions which will be implemented to enhance the control and monitoring of all derivative investments. In the interim, management has strengthened operational controls to include secondary reviews by Investment operations and accounting

It is recommended that the Company continue its efforts to strengthen its internal controls over accounting for certain derivative transactions.

(iii) Controls Over Certain Balance Sheet Reconciliations

The Company did not maintain effective controls to ensure the accuracy of certain balance sheet accounts in certain key segments of the Company's operations. Specifically, accounting personnel did not perform timely reconciliations and did not properly resolve reconciling items for premium receivables, reinsurance recoverables and intercompany accounts

The Company has undertaken a significant effort to remediate this material weakness in internal control which includes hiring additional resources, reorganizing responsibilities within the DBG Comptroller's department and formalizing the reconciliation policies, procedures and approach to evaluating financial statement exposure.

It is recommended that the Company continue its efforts to strengthen internal controls over its balance sheet reconciliations.

(iv) Premium Key Functional Activity (Machine only)

Premium transactions enter the reporting system as either “Machine” or “Non-Machine” entries. Machine transactions are generated by the underwriting systems, which in turn interface with the billings and collections (“B&C”) system and ultimately post to the general ledger. “Non-Machine” entries are manual journal entries initiated by various profit centers or the Domestic Brokerage Group (“DBG”) Comptrollers department. Examples of non-machine entries would be accrual of business booked in the last 7-10 days of each calendar quarter where direct posting to the general ledger is halted for quarter-end closing (pipeline), recording of the business written overseas, and other “Topside” adjusting entries.

In testing of controls over the premium process, the Company’s independent auditors identified three main control deficiencies:

- In testing of premium transactions processed through various underwriting systems, the Company’s auditors noted several coding exceptions existed within several of the underwriting systems.
- Test of controls included review of letters of authority to ensure the validity of the premium entered into the underwriting system. Approximately 5 percent of the sampled transactions failed this test and were not supported by any referral or approval.
- The Underwriting Resources Division (“URD”) is one of the key controls identified by the Company. The review of the URD reports indicated URD had also identified issues related to coding, pricing, and insufficient or missing documentation. However, this control was not operating properly since the same types of errors were still present at the time of the independent audit, indicating no effective action was taken to address errors reported by URD.

Management concluded, and the auditors concurred, that significant effort was required to ensure that controls over the premium process would be robust and could be sustained going forward.

It is recommended that the Company continue its efforts to strengthen internal controls over its premium processing.

(v) Additional Allowance Provision (FAS-5 Reserve)

During the examination period, the Company continued its remediation efforts in order to address the material weaknesses and significant deficiencies identified in the evaluation of internal controls and the effectiveness of those controls.

As a result of this undertaking in the billings & collection key activity area, approximately \$174 million of provision (FAS-5 Reserve) was set aside as of the examination date.

(vi) Non-Machine Key Functional Activity (all underwriting areas)

Financial data flows into the general ledger through journal entries classified by the Company as either machine or non-machine. Machine entries are those transactions which are system generated and require no manual intervention. These entries are automated transactions between various systems that are interfaced with each other as well as the general ledger. Non-machine entries are those transactions that are manually posted into the various systems due to lack of system interface or as an adjustment which cannot be generated through the machine process. There are also certain entries classified as non-machine that are actually entered through a semi-automated process which requires only minimal manual intervention such as pooling and apportionment transactions. Machine and non-machine entries are categorized as self-reversing or permanent transactions. Permanent entries are actual values (not estimates) or other entries that would have a permanent impact on the accounts. Self-reversing entries are used to record transactions such as accruals, estimates and transactions that would otherwise be machine entries, made necessary after the general ledger cut-off. Non-machine transactions are entered through specific journal codes assigned to the various departments throughout the Company and are supported by batch numbers that are used to identify the actual entry into the general ledger. The use of non-machine entries is prevalent throughout all companies and processes, and has a significant impact on financial reporting.

The Commerce and Industry Insurance Company 2005 Material Weakness Letter dated May 31, 2006; stated that Company controls to ensure the validity of journal entries into certain financially significant systems needed to be improved. Specifically, the Company needs to enhance its review of journal entries, ensuring that each entry is fully supported by robust and appropriate documentation.

During 2005, Company management began remediation efforts to address the control weakness. As part of the remediation effort, on December 1, 2005, a non-machine journal entry procedure went into effect throughout DBG that is required to be followed by all departments. The procedure requires that each non-machine entry have a cover page, a detailed journal entry, auditable support and a transaction posting report. The procedure also requires the preparer and approver to initial the auditable support attached to the journal entry for completeness and accuracy and that the journal entries be part of the monthly reconciliation process to ensure that each entry is accounted for and accompanied by adequate documentation.

To ensure compliance with the procedure, the Company established a Quality Control Department (“QCD”) to conduct periodic examinations of sample journal entries to ensure that the procedure is being followed and that the recorded transactions are accurate and complete. Non-machine transactions were sampled and reviewed by the QCD for compliance in 2006 on a quarterly basis. Initial QCD reviews in 2006 indicated that a primary concern was the lack of adequate auditable documentation supporting the journal entries reviewed which is consistent with examination findings relative to 2005 sampled transactions. By the fourth quarter of 2006, the Company received a high internal rating from the QCD for compliance with the procedure indicating that the entries posted to the general ledger have been reviewed and were posted completely and accurately. Before the control deficiencies noted in this process can be considered remediated, the Company will need to demonstrate that the improvements derived by the control enhancements are sustainable over several periods and that the results are independently verified. While enhancements to the control environment will continue to be developed and implemented, management expects the remediation of the control weaknesses in this process to be completed by the fourth quarter of 2007.

It is recommended that the Company continue its efforts to strengthen internal controls over its “non-machine key functional activity”.

(vii) DBG – Fusion

Fusion is an accounting and service unit responsible for post-bind service functions such as billing of premium and losses to the insured, program adjustments, and ensuring income statement and balance sheet integrity and customer service for complex accounts written by AIG for all Risk Management Group divisions, World Source and Global Energy. The annual gross written premium of these businesses is approximately \$5 billion of the \$32.7 billion written by AIG DBG.

The Company did not maintain effective controls to ensure the accuracy of certain balance sheet accounts in certain key segments of the Company’s operations, including Fusion. Specifically, accounting personnel did not perform timely reconciliations and did not properly resolve reconciling items for premium and insurance balances receivable, reinsurance recoverable and other assets were misstated. This material weakness resulted in management concluding, and the Company’s independent auditor concurring, that the establishment of a FAS 5 reserve was required as of December 31, 2005.

Management undertook a 2005 reserve reassessment of all Fusion clients in a legal status (i.e., in bankruptcy, legal collection or a buyout situation) and established a FAS 5 provision in the amount

of \$55.9 million as of December 31, 2005, with respect to this default exposure. In addition, a \$151.3 million provision for other contingent liabilities had been established for the Commercial Pool companies relating to potential premium tax underpayment for deductible policies and related settlements with regulatory authorities.

It is recommended that the Company continue its efforts to strengthen internal controls over its "Fusion" accounts.

(viii) Outstanding Loss Drafts

Outstanding loss drafts ("OLD") at December 31, 2005 on a pooled basis totaled \$1,415,474,005. The Company uses the term "OLD" for paid loss clearing. The OLD account is not related to outstanding loss drafts. This balance is net of approximately \$12 billion in unmatched debit amounts and \$10.5 billion in unmatched credits. The amount allocated to the Company based on its 10% pooling percentage is \$141,547,401 (10% of \$1,415,474,005). During the years 2004 and 2005 the Company was in the process of remediating this account. As of December 31, 2005, \$70 million in unsupported pooled debit amounts were reserved for future write off.

The remediation process has continued into years 2006 and 2007. In the third quarter of 2006, an additional unsupported \$225 million was reserved for future write-off. In the fourth quarter another \$111.5 million was reserved for future write-off. Unsupported December 31, 2005 balances of \$406.5 million have thus far been reserved for future write-off as of December 31, 2006. The Company's share of this reserve is \$40,650,000.

As of December 31, 2005, the Company continues to require significant outside resources to assist them in this remediation process. This is due to the fact that many of the numerous accounts, whose activity has flowed through the outstanding loss drafts account, have not been reconciled for many years. The Company continues to monitor activity in the OLD account. The examiners are uncertain whether additional reserves / write-offs of OLD amounts will be necessary.

It is recommended that the Company continue its efforts to reconcile and strengthen internal controls over the "OLD" accounts.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2005 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Examination</u>		<u>Company</u>		<u>Surplus Increase (Decrease)</u>
	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Net Admitted Assets</u>	
Bonds	\$3,300,025,529	\$ 0	\$3,300,025,529	\$3,300,025,529	\$ 0
Preferred stocks	194,597,951	0	194,597,951	194,597,951	0
Common stocks	657,632,703	0	657,632,703	657,632,703	0
Cash, cash equivalents and short-term investments	15,562,194	0	15,562,194	15,562,194	0
Other invested assets	553,044,137	0	553,044,137	553,044,137	0
Investment income due and accrued	47,832,167	0	47,832,167	47,832,167	0
Uncollected premiums and agents' balances in the course of collection	219,956,825	34,309,316	185,647,509	185,647,509	0
Deferred premiums, agents' balances and installments booked but deferred and not yet due	246,967,171	3,114,695	243,852,476	243,852,476	0
Accrued retrospective premiums	8,567,364	856,736	7,710,628	7,710,628	0
Amounts recoverable from reinsurers	110,502,977	0	110,502,977	110,502,977	0
Funds held by or deposited with reinsured companies	6,585,704	0	6,585,704	6,585,704	0
Current federal and foreign income tax recoverable and interest thereon	164,411,266	33,324,000	131,087,266	131,087,266	0
Net deferred tax asset	242,564,361	164,966,000	77,598,361	77,598,361	0
Guaranty funds receivable or on deposit	5,583,041	0	5,583,041	5,583,041	0
Electronic data processing equipment and software	26,061,570	26,061,570	0	26,061,570	(26,061,570)
Receivables from parent, subsidiaries and affiliates	252,497,873	0	252,497,873	252,497,873	0
Health care and other amounts receivable	0	0	0	0	0
Deposit Accounting Asset	393,497,168	22,290,884	371,206,284	371,206,284	0
Equities and Deposits in Pools and Associations	182,782,204	22,315,920	160,466,284	160,466,284	0
Outstanding Loss Drafts	141,547,400	0	141,547,400	141,547,400	0
Deposit Accounting Asset -Funds Held	120,274,255	9,412,540	110,861,715	120,274,255	(9,412,540)
Amounts Receivable Under High Deductible Policies	92,336,982	4,622,404	87,714,578	87,714,578	0
Loss Funds on Deposit	17,695,277	0	17,695,277	17,695,277	0
Other Assets	5,475,163	0	5,475,163	5,475,163	0
Accrued Recoverables	1,883,300	0	1,883,300	1,883,300	0
Allowance Provision	(124,096,127)	0	(124,096,127)	(124,096,127)	0
Retroactive Reinsurance Recoverable	(2,369,439)	0	(2,369,439)	(2,369,439)	0
Servicing Carrier Receivable	0	0	0	0	0
Other Assets - N/A	<u>725,223</u>	<u>725,223</u>	<u>0</u>	<u>0</u>	<u>0</u>
Totals	<u>\$6,882,144,239</u>	<u>\$321,999,288</u>	<u>\$6,560,144,951</u>	<u>\$6,595,619,061</u>	<u>\$ (35,474,110)</u>

<u>Liabilities, surplus and other funds</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase (Decrease)
Losses and loss adjustment expenses	\$3,256,614,815	\$3,199,168,815	\$ (57,446,000)
Reinsurance payable on paid losses and loss adjustment expenses	40,429,023	40,429,023	0
Commissions payable, contingent commissions and other similar charges	730,975	730,975	0
Other expenses (excluding taxes, licenses and fees)	317,585	317,585	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	30,584,400	30,584,400	0
Unearned premiums	1,129,269,428	1,129,269,428	0
Ceded reinsurance premiums payable (net of ceding commissions)	112,980,690	112,980,690	0
Funds held by company under reinsurance treaties	70,457,799	70,457,799	0
Amounts withheld or retained by company for account of others	8,703,159	8,703,159	0
Provision for reinsurance	83,595,008	53,095,008	(30,500,000)
Payable to parent, subsidiaries and affiliates	74,258,378	74,258,378	0
Payable for securities	14,157,664	14,157,664	0
Deposit Accounting Liability - Funds Held	279,562,732	279,562,732	0
Deposit Accounting Liability	135,252,867	135,252,867	0
Other Liabilities	21,465,606	21,465,606	0
Accrued Retrospective Premiums	14,062,200	14,062,200	0
Deferred Commission Earnings	10,496,504	10,496,504	0
Loss Clearing	3,780,680	3,780,680	0
Servicing Carrier Liability	1,643,938	1,643,938	0
Retroactive Reinsurance Reserves - Ceded	(8,930,799)	(8,930,799)	0
Retroactive Reinsurance Payable	<u>(3,381,080)</u>	<u>(3,381,080)</u>	<u>0</u>
Total liabilities	<u>\$5,276,051,572</u>	<u>\$5,188,105,572</u>	<u>\$ (87,946,000)</u>
Special Surplus from Retroactive Reinsurance	\$ 18,918,510	\$ 18,918,510	\$ 0
Common capital stock	5,022,500	5,022,500	0
Gross paid in and contributed surplus	680,312,223	680,312,223	0
Unassigned funds (surplus)	<u>579,840,146</u>	<u>703,260,256</u>	<u>(123,420,110)</u>
Surplus as regards policyholders	<u>\$1,284,093,379</u>	<u>\$1,407,513,489</u>	<u>\$ (123,420,110)</u>
Totals	<u>\$6,560,144,951</u>	<u>\$6,595,619,061</u>	<u>\$ (35,474,110)</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 1996. AIG has filed letters of protest for the 1997, 1998 and 1999 tax years. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 2000 through 2002 are currently under examination. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2003 through 2005. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

4. ELECTRONIC DATA PROCESSING EQUIPMENT AND SOFTWARE

The Company reported an admitted asset in the amount of \$26,061,570 as of December 31, 2005. Pursuant to this examination, the admitted asset has been eliminated.

Upon investigation, it was noted that this asset consisted of company-developed software. Pursuant to Section 1301(a)(18) of the New York Insurance Law, an insurer may only report an admitted asset for “electronic data processing apparatus and related equipment constituting a data processing, record keeping, or accounting system if the cost of each such system is fifty thousand dollars or more.” Further, Part 83.4(c)(3)(i) of Department Regulation 172 provides that “non-operating system software shall be nonadmitted.”

Beginning with its 2006 annual statement, the Company has reported all amounts reported under this caption as nonadmitted.

5. DEPOSIT ACCOUNTING ASSET

The examination asset for the captioned item of \$110,861,715 is \$9,412,540 less than the \$120,274,255 reported by the Company as of December 31, 2005. The “Deposit accounting asset” held under the Company’s facultative obligatory surplus treaty with Union Excess Insurance Company exceeded the Company’s liabilities thereon in the amount of \$94,125,398. Paragraph 20 of SSAP No. 62 states:

“Funds held or deposited with reinsured companies, whether premiums withheld as security for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by an insolvent reinsured shall be nonadmitted”

The non-admitted amount of \$9,412,540 represents the Company’s 10% share of the adjustment based on their participation in the Commercial Lines Pool.

6. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$3,256,614,815 is \$57,446,000 more than the \$3,199,168,815 reported by the Company as of December 31, 2005. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the company's internal records and in its filed annual statement.

7. PROVISION FOR REINSURANCE

The examination liability for the captioned item of \$83,595,008 is \$30,500,000 more than the \$53,095,008 reported by the Company as of December 31, 2005. The examination adjustment represents the disallowance of certain foreign securities in a reinsurance trust used by the Company to reduce this liability.

Part 126.5(a)(2) of Department Regulation No. 114 states in part:

“(a) A reinsurance agreement, which is entered into in conjunction with a trust agreement and the establishment of a trust account, must contain provisions that:(2) stipulate that assets deposited in the trust account shall be valued according to their current fair market value, and shall consist only of cash (United States legal tender), certificates of deposit (issued by a United States bank and payable in United States legal tender), and investments of the types specified in paragraphs (1), (2), (3), (8) and (10) of subsection (a) of section 1404 of the New York Insurance Law...”

The referenced paragraphs of Section 1404 of the New York Insurance Law state that the securities held pursuant to these trusts are required to be in United States securities with an NAIC rating equal to or higher than 3.

The Company has indicated that it has significantly limited the amount of foreign investments held in the trust. The October 2007 trust holdings contained foreign securities totaling \$102.4 million (par value) and \$112.3 million (market value). The Company's 10% share of the reduced amount of foreign securities is \$10.24 million (par value). This remaining amount will be either replaced with qualifying U.S. securities or transferred to a segregated trust account that will not be applied for New York purposes. The Company expects that this will be completed before December 31, 2007 for purposes of supporting the 2007 annual statement Schedule F collateral with AIRCO.

8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The previous examination was conducted as of December 31, 2001; however a report of examination was not issued relating to that examination. The most recent examination report was issued for the period January 1, 1992 to December 31, 1996. Compliance with the prior report on examination has been evaluated based on the recommendations noted for the report for the period January 1, 1992 to December 31, 1996 (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company comply consistently with the provisions of Section 1202(a)(2) of the New York Insurance Law and adhere to the provisions of its charter.	5
The Company has complied with this recommendation.	
ii. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	6
The Company has complied with this recommendation.	
B. <u>Reinsurance</u>	
It is recommended that the Company continue its effort to electronically scan treaty reinsurance contracts and facultative reinsurance certificates, and that such scanned documentation be maintained in a secure central repository.	25
The Company has complied with this recommendation.	
C. <u>Holding Company System</u>	
i. It is recommended that the Company establish an effective method of tracking its holding company filings.	27
The Company has not fully complied with this recommendation. A similar comment is contained in the current report on examination.	
ii. It is recommended that the inter-company agreements be submitted to the Department prior to their implementation, in accordance with the provisions of Section 1505(d)(2) and (3) of the New York Insurance Law.	27
The Company has not fully complied with this recommendation. A similar comment is contained in the current report on examination.	

ITEMPAGE NO.

- iii. Since indirect transactions affect the Company by virtue of the pooling agreement, it is recommended that the Company disclose these arrangements with the Department. 28

The Company did not submit any indirect agreements for the years 2001 through 2004. In 2005, the Company agreed to file indirect agreements with the Department if filing of such agreements was required by the Pennsylvania Department of Insurance under the Pennsylvania Holding Company Act.

D. Accounts and Records

High Deductible on Policies Written in New York State

- i. The Company did not include deductible reimbursements when computing its New York corporate franchise tax. It is recommended that these amounts be included when computing the tax imposed by Section 1510 of the New York Corporate Franchise Tax Law. 29

The Company has complied with this recommendation.

- ii. The Company responded “no” to Annual Statement General Interrogatory when it should have responded “yes”. It is recommended that the Company exercise greater care when responding to this General Interrogatory. 29

The Company has complied with this recommendation

E. Losses

- i. It is recommended that AIG strive to improve the clarity and consistency of its actuarial analyses. Each reserve review should contain a clear summary of the estimates, separately by business segment and in total for all business segments combined. 34

The Company has complied with this recommendation.

- ii. It was also noted that, for some divisions, it was difficult to determine exactly what the final estimates were, since the results were not clearly presented in a uniform manner. It is recommended that the findings resulting from each reserve review be clearly presented. 34

The Company has complied with this recommendation.

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance</u>	
It is recommended that the Company comply with the provisions of Department Regulation 114 when utilizing trust agreements to calculate its provision for reinsurance.	12
B. <u>Holding Company System</u>	
i. It is recommended that the Company file all of its inter-company agreements pursuant to Section 1505 of the New York Insurance Law and maintain complete documentation to evidence such filings. It is noted that in September 2005, the Company instituted procedures to address the lack of controls over the filing of affiliated reinsurance agreements.	18
ii. It is recommended that the Company continue to file all indirect agreement with New York whenever filing is required under the materiality thresholds set forth in the Pennsylvania Insurance Department's Holding Company Act.	19
C. <u>Accounts and Records</u>	
i. <u>Agents balances in course of collection</u>	
It is recommended that the Company segregate its direct bill receivable balances from those due from agents in the calculation of its statutory penalty for over 90 days past due balances in accordance with the guidelines of SSAP No. 6.	19
ii. <u>Schedule D Reporting</u>	
It is recommended that, for future annual statement filings, the Company comply with the NAIC Property and Casualty Annual Statement Instructions when reporting loaned securities on Schedule D – Part 1.	20
D. <u>Internal Control Review</u>	
i. <u>Controls over income tax accounting</u>	
It is recommended that the Company continue its efforts to remediate the material weakness related to controls over federal income tax.	21

<u>ITEM</u>		<u>PAGE NO.</u>
ii.	<u>Controls over the accounting for certain derivative transactions</u>	
	It is recommended that the Company continue its efforts to strengthen its internal controls over accounting for certain derivative transactions.	21
iii.	<u>Controls over certain balance sheet reconciliations</u>	
	It is recommended that the Company continue its efforts to strengthen internal controls over its balance sheet reconciliations.	21
v.	<u>Premium Key Functional Activity</u>	
	It is recommended that the Company continue its efforts to strengthen internal controls over its premium processing.	22
v.	<u>Non-Machine Key Functional Activities</u>	
	It is recommended that the Company continue its efforts to strengthen internal controls over its “non-machine key functional activity”	24
vi.	<u>DBG -Fusion</u>	
	It is recommended that the Company continue its efforts to strengthen internal controls over its “Fusion” accounts.	25
vii.	<u>OLD Accounts</u>	
	It is recommended that the Company continue its efforts to reconcile and strengthen internal controls over the “OLD” accounts.	25

Respectfully submitted,

Patrick R White, CFE

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

PATRICK R.WHITE, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

Patrick R White,

Subscribed and sworn to before me

this _____ day of _____, 20__.

Appointment No. 21492

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Patrick White

as proper person to examine into the affairs of the

COMMERCE AND INDUSTRY INSURANCE COMPANY

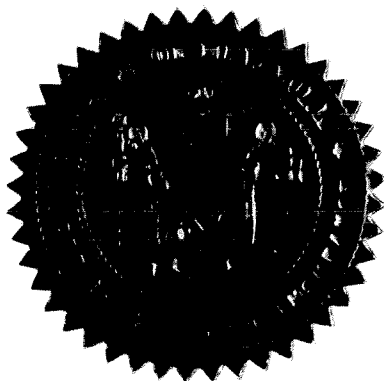
and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of New York,*

this 13th day of April, 2006



A handwritten signature in cursive script, appearing to read "Howard Mills", written over a horizontal line.

HOWARD MILLS
Superintendent of Insurance