ASSOCIATION REPORT ON EXAMINATION

OF THE

AIG NATIONAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

ZONES REPRESENTED	STATES PARTICIPATING	EXAMINERS
NORTHEASTERN	NEW YORK	ANNIE LAU, CFE
WESTERN	CALIFORNIA	FRANCIS M. MATEJIK, CFE

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

Honorable Walter Bell
NAIC President
Chairman, Ex Committee
Commissioner of Insurance
State of Alabama

Honorable Joseph Torti, III
Chairman, Northeastern Zone
Superintendent
State of Rhode Island
Department of Business Regulation

Honorable Eric R. Dinallo
Superintendent of Insurance
State of New York

Honorable Linda Hall
Chairwoman, Western Zone
Director
State of Alaska

Sirs and Madam:

Pursuant to your instructions an examination has been made into the condition and affairs of the AIG National Insurance Company, hereinafter referred to as “the Company” at its administrative office located at One AIG Center, Wilmington, DE 19803.

The examination was conducted by the New York State Insurance Department, hereinafter referred to as “the Department” with participation from the State of California representing the Western Zone.

The report on examination is respectfully submitted.

REPORT ON EXAMINATION

OF THE

AIG NATIONAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT	JANUARY 11, 2008
EXAMINER	ANNIE LAU, CFE

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

January 11, 2008

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 22583 dated January 3, 2007 attached hereto, I have made an examination into the condition and affairs of AIG National Insurance as of December 31, 2006, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate AIG National 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 administrative office located at One AIG Center, Wilmington, DE 19803.

1. SCOPE OF EXAMINATION

The Department has performed an examination of AIG National Insurance Company. The previous examination was conducted as of December 31, 2001. This examination covered the five-year period from January 1, 2002 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with statutory accounting principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company's own control environment assessment and evaluation based upon the Company's Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

Significant subsequent events
Company history
Corporate records
Management and control
Fidelity bonds and other insurance
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

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

AIG National Insurance Company, formerly known as Abeille General Insurance Company, Inc., commenced business as a United States Branch of a foreign insurer on September 4, 1975. On December 12, 1994, the Company was incorporated in New York State. On July 16, 1996, The Company was acquired as a wholly-owned subsidiary of New Hampshire Indemnity Company, Inc. (“NHIC”), a Pennsylvania domiciled corporation. NHIC is a wholly-owned subsidiary of New Hampshire Insurance Company, a Pennsylvania domiciled insurer, which is a wholly-owned subsidiary of AIG Commercial Insurance Group, Inc., (formerly known as New Hampshire Insurance Group Holdings Corporation), a wholly-owned subsidiary of AIG Property Casualty Group, Inc., which is a wholly-owned subsidiary of the ultimate parent, American International Group, Inc. (“AIG”)

At December 31, 2006, capital paid in was $6,000,000 consisting of 60,000 shares of $100 par value per share common stock. Gross paid in and contributed surplus was $4,791,928. There were no changes in capital and paid in and contributed surplus during the examination period.

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 or more than twenty-one members. At December 31, 2006, the board of directors was comprised of the following fourteen members:

Name and Residence	Principal Business Affiliation
Merton Bernard Aidinoff New York, NY	Retired Partner, Sullivan and Cromwell
Esta Lee Cain Bel Air, MD	Senior Vice President & General Counsel, AIG Marketing, Inc.

Name and Residence	Principal Business Affiliation
Lucille Nash Evans Atlanta, GA	Vice President of Finance, AIG Agency Auto
Christopher Brooks Greene Kennesaw, GA	Legal Counsel, AIG Agency Auto
Jacob Ernest Hansen Kennett Square, PA	Retired Former President & Chief Executive Officer, AIG Marketing, Inc.
Michael Francis Long Roswell, GA	Senior Vice President & Chief Information Officer, AIG Marketing, Inc.
William Donald Loucks Jr. Glen Mills, PA	Senior Vice President, AIG Marketing, Inc.
Cecilia Elena Norat New York, NY	Director of State Relations, American International Group, Inc.
Anthony Prospie Pavia Jr. Alpharetta, GA	President & Chief Executive Officer, AIG Agency Auto
Glenn Alan Pfeil Wilmington, DE	Chief Financial Officer, Executive Vice President & Treasurer, AIG Marketing, Inc.
James Anthony Porcari III Alpharetta, GA	Senior Vice President, AIG Marketing, Inc.
Donald Walter Procopio Aldan, PA	Senior Vice President & Chief Actuary, AIG Marketing, Inc.
Mark Edward VanDam Alpharetta, GA	Former Regional Vice President, AIG Agency Auto
Charles Edward Williamson Westfield, NJ	President, AIG Private Client Group

The board met on an average twice a year. A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

As of December 31, 2006, the principal officers of the Company were as follows:

Name	Title
Anthony P. Pavia, Jr.	President & Chief Executive Officer
Glenn A. Pfeil	Chief Financial Officer, Executive Vice President & Treasurer
Elizabeth M. Tuck	Secretary
Robert McLaughlin	Controller
Esta L. Cain	Senior Vice President & General Counsel
Christopher B. Greene	Vice President
Ronald B. Laconi	Vice President
James A. Porcari III	Senior Vice President
Donald W. Procopio	Chief Actuary

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to write business in forty-one states and the District of Columbia.

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:

Paragraph	Line of Business
3	Accident & health
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	Worker’s compensation and employer’s liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company was also licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraph 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Congress as amended; 33 USC Section 901 et seq. as amended).

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 $6,000,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

DIRECT PREMIUMS WRITTEN

Calendar Year	New York State	Total United States	Premiums Written in New York State as a percentage of United States Premium
2002	$ 0	$ 10,204,731	0%
2003	$ 285	$ 19,562,337	0%
2004	$ 8,171,081	$108,647,042	7.52%
2005	$30,105,232	$283,846,182	10.61%
2006	$40,855,397	$382,641,835	10.68%

The Company is a participant in the AIG Personal Lines Pool ("PLP") of which American International Insurance Company ("AIIC"), a New York domiciled affiliate, is the lead company. The PLP mainly writes private passenger auto, homeowners and other personal lines products. AIIC assumes 100% of business written by each of the other twelve pool participants, net of external reinsurance, under the terms of an intercompany pooling agreement. AIIC also assumes personal lines business written by other affiliates and non-affiliates. After external reinsurance, 50% of the PLP business is ceded to an affiliate, National Union Fire Insurance Company of Pittsburgh, PA., pursuant to a 50% quota share agreement. The Company assumes 2% of the remaining balance in accordance with the participating percentages as stated in the pooling agreement. This intercompany company pooling arrangement is more fully described under the caption "Reinsurance".

The PLP consists of four business segments as follows:

1. AIG Direct (Wilmington, DE).

2. Agency Auto (Alpharetta, GA).
3. Private Client Group (Berkeley Heights, NJ).
4. Assigned Risk (previously handled by the Robert Plan, now in Wilmington, DE)

AIG Direct writes preferred and standard personal auto risks in forty-nine states and the District of Columbia and maintains five call centers throughout the country. AIG Direct also markets personal umbrella insurance. PLP also offers homeowners insurance through a third party relationship with Homesite Insurance Company. AIG Direct writes business on a direct response and mass marketing basis through direct mail, telemarketing, endorsement of sponsoring affinity groups and the internet.

The Company concentrates its business in the Agency Auto segment which mainly writes non-standard personal auto and multi-tiered personal auto, motorcycle, light and local commercial vehicles and recreational vehicles, including motor homes and travel trailers. Agency Auto also writes commercial business in ten states. Agency Auto maintains designated customer service call centers in multiple time zones to provide service to its agents and policyholders.

The Private Client Group ("PCG") targets high net worth individuals with over five million of net worth and one million in primary residences. PCG markets through agents, brokers and bank owned agencies. PCG writes homeowners, auto, private collections, high limit excess liability, yacht, aviation, kidnap and ransom and security services.

C. Reinsurance

As of December 31, 2006, the Company was a participant in an intercompany pooling agreement among members of the AIG Personal Lines Pool ("Pool Members"), in which American International Insurance Company was the lead company.

Under the agreement, each pool participant cedes 100% of its losses, loss adjustment expenses, net earned premiums, unearned premiums and agents' balances for which they receive a percentage of the pooled results as noted below:

Intercompany Pool Member	State of Domicile	Pooling Percentage
American International Insurance Company (“AIIC”)	NY	31%
AIG Centennial Insurance Company (“AIGCI”)	PA	18%
AIG Premier Insurance Company (“AIGPI”)	PA	13%
New Hampshire Indemnity Company, Inc. (“NHI”)	PA	12%
AIG Hawaii Insurance Company, Inc. (“AIGH”)	HI	8%
American International Insurance Company of California, Inc. (“AIICCA”)	CA	3%
AIG Advantage Insurance Company (“AIGA”) (formerly known as Minnesota Insurance Company)	MN	3%
AIG Preferred Insurance Company (“AIGPR”)	PA	3%
American International Insurance Company of New Jersey (“AIICNJ”)	NJ	2%
AIG Indemnity Insurance Company (“AIGII”)	PA	2%
AIG National Insurance Company, Inc. (“AIGN”)	NY	2%
AIG Auto Insurance Company of New Jersey (“AIGNJ”)	NJ	2%
American Pacific Insurance Company, Inc. (“APIC”)	HI	1%

Besides its participation in the intercompany pool and the National Flood Insurance Program, the Company has the following ceding coverage:

- Excess of loss coverage for $600,000 excess of $400,000 for commercial auto liability. This treaty was 100% placed with authorized non-affiliates.

The Company utilizes reinsurance accounting as defined in the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principle ("SSAP") No. 62 for all of its assumed reinsurance business.

All 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.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by an attestation from the Company's chief executive Officer pursuant to Department Circular Letter No. 8 (2005). Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements which were not previously disclosed in the Notes to the Financial Statements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 17 – 34 of SSAP No. 62.

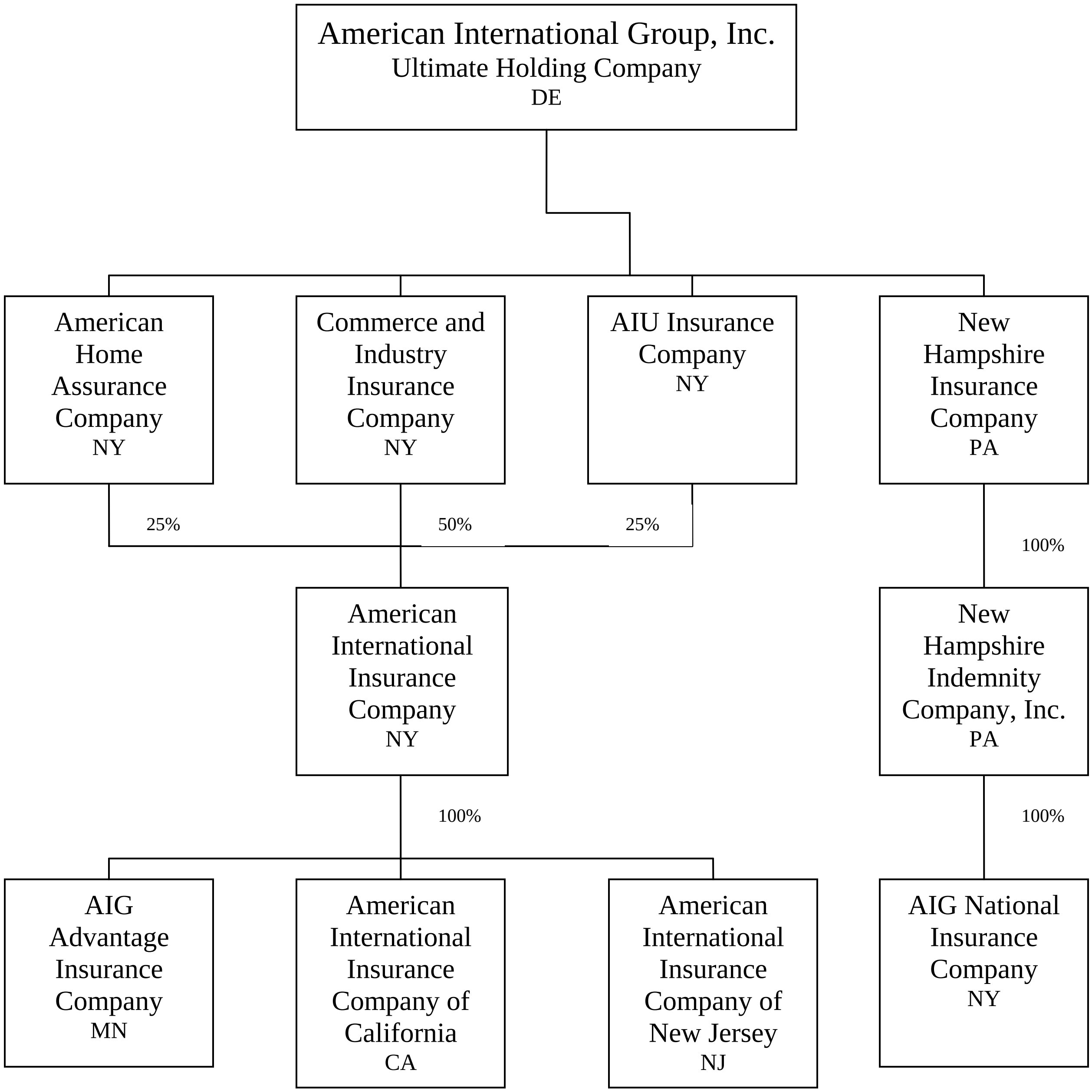
AIG enhanced its reinsurance review process in 2005 and created a risk transfer worksheet for reinsurance ("the Worksheet") for reviewing reinsurance contract features for assessment of risk transfer. The Worksheet identifies certain contract features based on specific benchmarks for profit, premiums written or losses. The Company believes that its risk transfer procedures provide a practical protocol to arrive at a conclusion that risk transfer is reasonably self evident and complies with the intent of the statutory risk transfer requirements. However, due to the worksheet's reference to two internally developed benchmarks, the Department believes that it does not provide a 100% guarantee that all reinsurance agreements contain absolute risk transfer. As a result, the examiners performed a review of the Company's reinsurance agreements and noted no adverse findings relative to risk transfer. Notwithstanding this conclusion, it is recommended that the Company re-evaluate the benchmarks referenced in the risk transfer worksheet and advise the Department of the results of this review.

D. Holding Company System

The Company is a member of the American International Group, Inc. The Company is as a wholly owned subsidiary of New Hampshire Indemnity Company, Inc. ("NHIC"), a Pennsylvania domiciled corporation. NHIC is a wholly owned subsidiary of New Hampshire Insurance Company, a Pennsylvania domiciled insurer, which is a wholly-owned subsidiary of AIG Commercial Insurance, Inc., (formerly known as New Hampshire Insurance Group Holdings Corporation), a wholly-owned subsidiary of AIG Property Casualty Group, Inc., which is a wholly owned subsidiary of the ultimate parent, American International Group, Inc. ("AIG")

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article the Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2006:



At December 31, 2006, the Company was party to the following agreements with other members of its holding company system:

<u>Tax Payment Allocation Agreement</u>

AIG and the Company entered into a tax payment allocation agreement effective January 1, 1996. A review of the agreement revealed that it does not contain language required by the Department Circular Letter No. 33 (1979). Specifically the agreement provides for calculation of its tax liability under a method similar to "Method B" specified in the Department Circular Letter.

However there is no provision that savings generated by the parent's use of tax credits should be recorded as contributed surplus and there is no provision for an escrow account as required by the Circular Letter.

It is recommended that the Company amend the tax payment allocation agreement in accordance with the Department Circular Letter No. 33 (1979) and submit the agreement to the Department for non disapproval in accordance with Circular Letter No. 33 (1979).

A review of settlements for federal tax balances between the Company and AIG noted that the Company did not comply with the Department Circular Letter No. 33 (1979). The settlements were beyond the 30 days required period after filing of the consolidated tax returns as set forth in the Circular Letter.

It is recommended that the Company settle intercompany federal income tax balances within 30 days of filing of the consolidated federal tax returns in accordance with the Department Circular Letter No. 33 (1979).

Investment Advisory Agreement

The Company entered into an investment advisory agreement with AIG Global Investment Corp. ("AIGGIC"), an affiliated Company, effective October 10, 1996, to manage the Company's investment portfolio. Under the terms of the contract, AIGGIC is authorized to make all investment decisions, including buying, selling and trading securities and to ensure that all investments qualify as legal investments under New York Insurance Law.

It is recommended that the Company amend the investment advisory agreement to reflect the current name of the Company and the custodian, as well as the officers and directors authorized to take action under the agreement. The amendment should be filed with the New York State Insurance Department in accordance with Section 1505(d)(3) of the New York Insurance Law.

Service and Expense Agreement

The Company was added to the service and expense agreement dated February 1, 1979 between AIG and its subsidiaries with Addendum No. 17 effective November 1996. The agreement called for certain subsidiaries of AIG to share among themselves expenses, equipment, office space, services and personnel. All the amendments during the examination period involved adding new

AIG companies to the agreement. The amendments involving New York domiciled companies during the examination period were non-disapproved by the Department.

Managing General Agent Agreement

The Company was added to the managing general agent agreement between AIG Marketing, Inc. ("AIGM") and certain affiliates with Addendum E of the agreement effective December 1, 2004.

The agreement provides for AIGM to solicit, bind and write automobile, homeowners, inland marine, personal excess liability insurance and other personal lines business on behalf of the Company. The agreement was amended effective December 1, 2004 ("Addendum E") to include the authority to settle all claims arising from business placed with the Company under the agreement. Addendum E was non-disapproved by the Department on May 6, 2005.

The agreement provides for AIGM to be compensated for services performed based on a percentage of gross premiums written. The Company changed the premium section of the agreement with Addendum E to allow AIGM to collect and retain certain policy or other fees, such as cancellation fees; reinstatement fees; NSF fees; and other fees, as allowable by law and as mutually agreed to by the parties.

The Company amended the managing general agency agreement ("Addendum F") again on February 25, 2005 for motorcycle business commissions. The Company could not provide evidence that Addendum F was submitted to the Department for prior non-disapproval in a timely manner as required by Section 1505(d)(3) of the New York Insurance Law.

It is recommended that the Company file all future intercompany reinsurance and service agreements and amendments with the Department in a timely manner in accordance with Article 15 of the New York Insurance Law.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2006 based upon the results of this examination:

Net premiums written to surplus as regards policyholders	183%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	67%
Premiums in course of collection to surplus as regards policyholders	12%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five-year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$46,206,190	72.82%
Other underwriting expenses incurred	19,407,792	30.58
Net underwriting loss	(2,157,033)	(3.40)
Premiums earned	$63,456,949	100.00%

F. Accounts and Records

Record Retention for Independent Auditors' workpapers

A review of the engagement letters for the Company's independent audits during the examination period, noted that they are missing the required record retention clause set forth in the Department Regulation 152.

Part 89.2(c) of New York Regulation 118 states:

> "Every insurer subject to this Part shall retain an independent Certified Public Accountant (CPA) who agrees by written contract with such insurer to comply with the provisions of section 307(b) of the Insurance Law, this Part and the Code of

> Professional Conduct adopted by the American Institute of Certified Public Accountants (AICPA). Such contract must specify that:
>
> (c) the workpapers and any communications between the CPA and the insurer relating to the audit of the insurer shall be made available for review by the superintendent at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the superintendent. The CPA must retain for review such workpapers and communications in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this Title. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent."

Part 243.2(b)(7) of New York Regulation 152, which, in addition to other language, contains the following:

> "(7) A financial record necessary to verify the financial condition of an insurer, including ledgers, journals, trial balances, annual and quarterly statement workpapers, evidence of asset, ownership, and source documents, for six calendar years from its creation or until after the filing of the report on examination in which the record was subject to review, whichever is longer."

It is recommended that the Company require their independent auditors to include the required record retention clause in the engagement letters for future audits in accordance with Part 89.2(c) of New York Department Regulation 118 and Part 243.2(b)(7) of New York Department Regulation 152.

Remittances and Items Not Allocated

A review of the Company's accounting treatment for unapplied cash noted that it nets unapplied cash against agents' balances. Annual Statement Instructions specifies that:

> "Remittances and Items Not Allocated Account is for reporting a liability for cash receipts that the insurer cannot identify for a specific purposes, or, for other reasons, the insurer cannot apply to a specific account when received. Refer to SSAP No. 67, Other Liabilities, for accounting guidance. Include: Items in suspense."

SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual establishes the accounting principles for Remittance and items not allocated:

> "Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall

record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts. Examples include:

a. Premium payments received with the applications for policies which have not yet been issued;
b. Premium payments in an amount different than the amount billed by the reporting entity
c. Unidentified cash receipts."

It is recommended that the Company report unapplied cash as a liability in "Remittances and items not allocated" in accordance with the Annual Statement Instructions and SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual.

G. Risk Management and Internal Control

The Company has identified certain control deficiencies in underwriting, claims, information technology and taxes as part of their internal audits and Sarbanes-Oxley Act ("SOX") compliance review. While these deficiencies have no apparent material affect on the Company's financial conditions as of December 31, 2006, it is recommended that the Company continue to monitor and remediate the control deficiencies as an on-going effort to enhance the control environment.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2006 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$36,858,601	$ 0	$36,858,601
Cash, cash equivalents and short-term investments	6,399,368	0	6,399,368
Investment income due and accrued	459,350	0	459,350
Uncollected premiums and agents' balances in the course of collection	2,182,694	17,122	2,165,572
Deferred premiums, agents' balances and installments booked but deferred and not yet due	8,685,093	0	8,685,093
Accrued retrospective premiums	45,681	0	45,681
Current federal and foreign income tax recoverable and interest thereon	22,925	0	22,925
Net deferred tax asset	1,150,416	77,263	1,073,153
Aggregate write-ins for other than invested assets	17,594	0	17,594
Total assets	$55,821,722	$94,385	$55,727,337

Liabilities, surplus and other funds

		Amount
Liabilities		
Losses		$16,039,827
Loss adjustment expenses		3,444,991
Commissions payable, contingent commissions and other similar charges		54,920
Other expenses (excluding taxes, licenses and fees)		347,042
Taxes, licenses and fees (excluding federal and foreign income taxes)		528,242
Unearned premiums		11,573,349
Ceded reinsurance premiums payable (net of ceding commissions)		278,000
Payable to parent, subsidiaries and affiliates		5,544,408
Retroactive reinsurance reserve		340,296
Total liabilities		$38,151,075
Surplus and other funds		
Common capital stock	$ 6,000,000	
Gross paid in and contributed surplus	4,791,928	
Unassigned funds (surplus)	6,784,334	
Surplus as regards policyholders		17,576,262
Total liabilities and surplus and other funds		$55,727,337

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax returns through tax year 1999. 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 and subsequent. 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.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $4,302,957 during the five-year examination period January 1, 2002 through December 31, 2006, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$63,456,949
Deductions:		
Losses incurred	$37,869,839	
Loss adjustment expenses incurred	8,336,351	
Other underwriting expenses incurred	19,394,280	
Aggregate write-ins for underwriting deductions	13,512	
Total underwriting deductions		65,613,982
Net underwriting gain or (loss)		$ (2,157,033)
Investment Income		
Net investment income earned	$ 6,017,156	
Net realized capital gain	284,011	
Net investment gain or (loss)		6,301,167
Other Income		
Net gain or (loss) from agents' or premium balances charged off	$ (845,226)	
Finance and service charges not included in premiums	1,697,505	
Aggregate write-ins for miscellaneous income	(540,286)	
Total other income		311,993
Net income after dividends to policyholders but before federal and foreign income taxes		$ 4,456,127
Federal and foreign income taxes incurred		1,185,004
Net income		$ 3,271,123

Capital and Surplus Accounts

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2001			$13,273,304
Net income	$3,271,122		
Net unrealized capital gains or (losses)		$ 71,832	
Change in net deferred income tax	1,150,415		
Change in nonadmitted assets		73,971	
Aggregate write-ins for gains and losses in surplus	27,223		
Total gains and losses	$4,448,760	$145,803	
Net increase (decrease) in surplus			4,302,957
Surplus as regards policyholders per report on examination as of December 31, 2006*			$17,576,261

* Small difference due to rounding.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $19,484,818 is the same as reported by the Company as of December 31, 2006. 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 statements.

5. SUBSEQUENT EVENTS

AIG, through its subsidiary, completed the acquisition of the remaining 39 percent of 21st Century Insurance Group in September 2007. The personal lines business in the 21st Century Group was integrated into the AIG Personal Lines Pool. The finance administrative office for the personal lines business will remain in Wilmington, Delaware.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained eleven recommendations as follows (page numbers refer to the prior report):

ITEM			PAGE NO.
A.		Management	
	i.	It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
		The Company has complied with this recommendation.	
	ii.	It is recommended that the Company comply with its by-laws and hold at least the minimum number of board of directors meetings.	5
		The Company has complied with this recommendation.	
B.		Reinsurance	
	i.	It is recommended that the Company amend the current pooling agreement to clarify each participant's obligations relative to accounts subject to poling.	7
	ii.	The recommendation specifically related to "agents' balances and uncollected premiums" on a pre-pooled basis. The Company did not amend the pooling agreement; however, the Company began pooling agents' balances and uncollected premiums as of December 31, 2002.	
C.		Holding Company Matters	
	i.	It is recommended that the Company either draft a separate agreement between itself and New Hampshire Indemnity Company or submit an addendum to the service agreement with AIG specifying the services to be performed by New Hampshire Indemnity Company, Inc., pursuant to the provisions of Section 1505 of the New York Insurance Law.	9
		The aforementioned services were covered under the service and expense agreement between AIG and the Company.	
D.		Accounts and Records	
	i.	It is recommended that the Company amend its custodial agreement with Mellon Bank to include the necessary safeguards and controls in accordance with the NAIC Financial Condition Examiners Handbook.	11
		The Company has complied with this recommendation.	

ITEM		PAGE NO.
ii.	It is recommended that the Company comply with the NAIC’s annual statement instruction and report its investment in AIG Domestic Fund, an internal investment fund, in the Schedule BA of its future filed annual statements.	11
	The Company has complied with this recommendation.	
iii.	It is recommended that the Company exercise due care in preparing its future filed annual statements.	11, 13
	The Company has complied with this recommendation.	
iv.	It is recommended that the Company comply with Section 1409 of the New York State Insurance Law and report investments in excess of those limitations as non-admitted in its future filed annual statements.	12
	The Company has complied with this recommendation.	
v.	It is recommended that the Company comply with the NAIC’s requirements to submit its investments to the SVO for valuation and report its bond investments according to the quality designations as determined by the Security Valuation Office.	12
	The Company has complied with this recommendation.	
vi.	It is recommended that the Company discontinue the practice of offsetting its income from “finance and service charges not included in premiums” by its expenses associated with finance and service charges.	13
	The Company has complied with this recommendation.	
vii.	It is recommended that the board of directors retroactively adopt a plan to relocate its books and records to Atlanta, Georgia and submit the plan to this Department for approval.	14
	The Company revised its plan to relocate its books and records from New York State to Wilmington, DE. The plan was approved by the Department in accordance with Section 325(b) of the New York Insurance Law.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Reinsurance	
	It is recommended that the Company re-evaluate the benchmarks referenced in the risk transfer worksheet and advise the Department of the results of this review.	9
B.	Holding Company System	
	Tax Payment Allocation Agreement	
i.	It is recommended that the Company amend the tax payment allocation agreement in accordance with the Department Circular Letter No. 33 (1979) and submit the agreement to the Department for non disapproval in accordance with the Department Circular Letter No. 33 (1979).	11
ii.	It is recommended that the Company settle intercompany federal income tax balances within 30 days of filing of the consolidated federal tax returns in accordance with the Department Circular Letter No. 33 (1979).	11
	Investment Advisory Agreement	
	It is recommended that the Company amend the investment advisory agreement to reflect the current name of the Company and the custodian, as well as the officers and directors authorized to take action under the agreement. The amendment should be filed with the New York State Insurance Department in accordance with Section 1505(d)(3) of the New York Insurance Law.	11
	Managing General Agent Agreement	
	It is recommended that the Company file all future intercompany reinsurance and service agreements and amendments with the Department in a timely manner in accordance with Article 15 of the New York Insurance Law.	12
C.	Accounts and Records	
i.	Record Retention for Independent Auditors' Workpapers	
	It is recommended that the Company require their independent auditors to include the required record retention clause in the engagement letters for future audits in accordance with Part 89.2(c) of New York Department Regulation 118 and Part 243.2(b)(7) of New York Department Regulation 152.	14

Respectfully submitted,

/S/
Annie Lau, CFE
Associate Insurance Examiner

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

ANNIE LAU, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

/S/
Annie Lau

Subscribed and sworn to before me

this__________ day of ____________________, 2008.

State of New York

County of New York

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES
USED IN AN EXAMINATION

Francis M Matyik BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of California in the examination of AIG National Insurance Company,

2. California is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.

3. I have reviewed the examination work papers and examination report and the examination of AIG National Insurance Company was performed in a manner consistent with the standards and procedures required by the State of California

The affiant says nothing further.

/S/
Examiner's Signature

Subscribed and sworn before me by Francis M. Matyik on this 25 day of November 2008

/S/
Notary Public

My commission expires 3/30/2010

Camille A. Taylor
Notary Public, State of New York
No. 43-OITA4994058
Qualified in Richmond County
Certificate Filed in New York County
Commission Expires March 30, 20 10

*Appointment No.*22583

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Louis W. Pietroluongo, *Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Annie Lau

as proper person to examine into the affairs of the

AIG NATIONAL INSURANCE COMPANY

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

Company

with such other information as she 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 3rd *day of* January, *2007*

LOUIS W. PIETROLUONGO
Acting Superintendent of Insurance