

ASSOCIATION REPORT ON EXAMINATION
OF THE
AMERICAN INTERNATIONAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2006

ZONES
REPRESENTED

NORTHEASTERN
WESTERN

STATES
PARTICIPATING

NEW YORK
CALIFORNIA

EXAMINERS

ANNIE LAU, CFE
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 American International 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

AMERICAN INTERNATIONAL 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 22582 dated January 3, 2007 attached hereto, I have made an examination into the condition and affairs of American International Insurance Company 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 American International 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, Delaware 19803.

1. SCOPE OF EXAMINATION

The Department has performed an examination of American International 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 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

American International Insurance Company was incorporated under the laws of the State of New York on September 19, 1985, as the Belgian General Insurance Company ("BGIC"). It began business with paid-in capital of \$500,000, consisting of 1,000 shares of common stock with a par value of \$500 per share.

Effective September 30, 1985, the "Compagnie Belge D'Assurances Generales Incendie, Accident Et Risques Divers" of Belgium, which conducted business in the United States via a United States Branch, entered into a domestication agreement whereby it transferred all the assets and liabilities of its United States Branch to BGIC, in return for all of the outstanding shares of common stock of BGIC. The Department approved this agreement.

On January 8, 1986, American International Group, Inc. ("AIG") purchased the aforementioned 1,000 shares of capital stock from the "Compagnie Belge D'Assurances Generales Incendie, Accident Et Risques Divers" of Belgium to become the sole shareholder of BGIC.

On February 24, 1986, BGIC's authorized capital was increased to \$2,500,000. This was accomplished by issuing 4,000 additional shares of common stock with a par value of \$500 per share. This transaction was approved by this Department on March 14, 1986.

On April 22, 1986, pursuant to the terms provided under the acquisition agreement with AIG, BGIC's name was changed to American International Insurance Company ("AIIC"), the Company's present corporate title. The Department approved the change in name on May 14, 1986.

On April 1, 1987, AIG sold its ownership of the Company to three of its wholly-owned domestic insurance subsidiaries, as follows:

<u>Shareholder</u>	<u>Percentage Owned</u>
Commerce and Industry Insurance Company	50%
American Home Assurance Company	25
AIU Insurance Company	<u>25</u>
Total	<u>100%</u>

On March 24, 1992, the Company amended its charter to increase its paid-in capital to \$5,000,000, consisting of 5,000 shares of common stock with a par value of \$1,000 per share; all issued to the AIG affiliates as stated above.

At December 31, 2006, gross paid in and contributed surplus was \$133,800,000. Gross paid in and contributed surplus increased by \$44,250,000 due to non-cash capital contribution as part of the 2004 annual statement restatement approved by the Department on September 30, 2005, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2001	Beginning gross paid in and contributed surplus	\$ 89,550,000
2004	Non-cash capital contribution – Eagle Insurance Company guaranty as part of Robert Plan settlement	<u>\$ 44,250,000</u>
	Total surplus contributions during the examination period	<u>44,250,000</u>
2006	Ending gross paid in and contributed surplus	<u><u>\$133,800,000</u></u>

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. The board meets on an average twice a year. At December 31, 2006, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Merton Bernard Aidinoff New York, NY	Retired Partner, Sullivan and Cromwell
Esta Lee Cain Bel Air, MD	Senior Vice President and General Counsel, AIG Marketing, Inc.
Anthony James DeSantis Wilmington, DE	President & Chief Executive Officer, AIG Marketing, Inc.
Lucille Nash Evans Atlanta, GA	Vice President of Finance, AIG Agency Auto
Jacob Ernest Hansen Kennett Square, PA	Retired 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, 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.
Charles Edward Williamson Westfield, NJ	President, AIG Private Client Group

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:

<u>Name</u>	<u>Title</u>
Anthony J. DeSantis	President & Chief Executive Officer
Glenn A. Pfeil	Chief Financial Officer, Executive VP & Treasurer
Elizabeth M. Tuck	Secretary
Robert McLaughlin	Controller
Esta L. Cain	Senior Vice President & General Counsel
John G. Colona	Senior Vice President
William D. Loucks, Jr.	Senior Vice President
James A. Porcari, III	Senior Vice President
Donald W. Procopio	Senior Vice President & Chief Actuary

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to write business in thirty-nine 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:

<u>Paragraph</u>	<u>Line of Business</u>
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 \$5,000,000.

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

<u>DIRECT PREMIUMS WRITTEN</u>			
<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a percentage of United States Premium</u>
2002	\$23,399,156	\$237,415,432	9.86%
2003	\$35,873,954	\$263,395,482	13.62%
2004	\$46,617,697	\$285,638,055	16.32%
2005	\$64,809,644	\$297,680,075	21.77%
2006	\$77,491,990	\$308,172,821	25.15%

American International Insurance Company is the lead company in the AIG Personal Lines Pool ("PLP"). The PLP primarily writes private passenger auto, homeowners and other personal lines products. The Company 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. The Company 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 retains 31% of the remaining balance and cedes back to the other twelve pool participants in accordance with the percentages as stated in the intercompany pooling agreement. This intercompany company pooling arrangement is more fully described under the caption "Reinsurance".

The PLP consists of 4 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 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. 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.

Agency Auto 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.

Assigned Risk segment covers automobile residual market business written through various state Assigned Risk Programs. As of December 31, 2005, the claims administration services provided by the Robert Plan Corporation for the AIG Personal Lines Pool’s personal auto assigned risk business was terminated. Those claims are now being handled by York Insurance Services Group, Inc., a non-affiliate. As of April 1, 2006, the policy administration services provided by the Robert Plan Corporation for the AIG Personal Lines Pool’s personal assigned risk business was terminated. Those policy administration services are now being handled by AIG Marketing, Inc., an affiliated agency.

C. Reinsurance

Assumed Reinsurance

The Company assumed business from affiliates and non-affiliates. The assumed reinsurance from affiliates consists mainly of private passenger auto liability, auto physical damage and homeowners on a 100% quota share basis with National Union Fire Insurance Company of Pittsburgh, PA., American Home Assurance Company, Commerce and Industry Insurance Company, AIU Insurance Company, Granite State Insurance Company, AIG Casualty Company (formerly known as Birmingham Fire Insurance Company of Pennsylvania), Insurance Company of the State of

Pennsylvania and other AIG affiliates in the AIG Domestic Brokerage Group (“DBG”) and through the business assumed as a result of the intercompany pooling agreement.

Intercompany Pooling Agreement

The Company is the lead insurer in an intercompany pooling agreement for personal lines business. The direct business written on the companies that are members of the AIG Personal Lines Pool (“PLP”) is subject to the following reinsurance transactions:

- State mandated pools
- Cessions to Heritage Casualty Insurance Company as a result of General Electric Acquisition Excluded Business Contracts (for former General Electric Companies only)
- External reinsurance

Besides assuming business from DBG and PLP members, the Company also assumes business from Old American County Mutual, an unaffiliated reinsurer.

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 remaining business is allocated to the AIG Personal Lines Pool participants based on the pooling percentages as listed below as of December 31, 2006:

<u>Intercompany Pool Member</u>	<u>State of Domicile</u>	<u>Pooling Percentage</u>
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”) (formally 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%

The Company amended the intercompany pooling agreement three times since the last examination. Amendment Number 4 effective December 31, 2004 and Amendment Number 5 effective July 1, 2007 were non-disapproved by the Department in accordance with Article 15 of the New York Insurance Law. The Company submitted Amendment Number 6 in December 2007 to include in the pool certain companies of the 21st Century Insurance Group as discussed in the Subsequent Events section of this report. The amendment was subsequently non-disapproved.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk by segment as follows:

Direct Segment

The Direct segment consists of mainland auto, mainland homeowners, mainland personal umbrella, GE Companies, Hawaii auto, Hawaii workers Compensation, Hawaii homeowners, Hawaii temporary disability and Hawaii commercial auto. The reinsurance coverages for property, casualty and catastrophe coverages are as follows:

Property Lines

The property lines program provides for the following coverages:

- Excess of loss coverage for \$7,000,000 excess of \$500,000 for the mainland homeowners and Hawaii homeowners business segments on a combined basis. This treaty was 100% placed with an authorized affiliate.
- Excess of loss layered coverage for the Hawaii automobile business for \$27.5 million excess of \$2.5 million. This treaty was 100% placed with an authorized affiliate.
- Excess of loss treaty for the Hawaii commercial auto business for \$2.7 million excess of \$300,000 for commercial auto. The treaty was 100% placed with an authorized non-affiliate.
- Quota share treaty for Hawaii personal umbrella business for 90% of first \$1,000,000 and 100% in excess of \$1,000,000. The treaty was 100% placed with an authorized non-affiliate.
- 50% quota share treaty for the personal automobile business produced through a sponsor and ceded to an authorized affiliate.

Catastrophe excess of loss coverage for the domestic personal lines including inland and ocean marine for the Private Client Group as follows:

- 1st layer \$100,000,000 excess of \$200,000,000. It was 89.47% placed, 43.22% with authorized non affiliates and 46.25% with unauthorized non affiliates.
- 2nd layer \$100,000,000 excess of \$300,000,000. It was 86.07% placed, 37.32% with authorized non affiliates and 48.75% with unauthorized non affiliates.
- 3rd layer \$100,000,000 excess of \$400,000,000. It was 62.07% placed, 27.82% with authorized non affiliates and 34.25% with unauthorized non affiliates.

Casualty Lines

The program provides for a layered excess of loss treaty for the Hawaii workers compensation offering protection of \$14,250,000 excess of \$750,000. The treaty was 100% placed with an authorized non-affiliate.

Agency Auto Segment

The program provides for an excess of loss treaty for the Agency Auto Segment offering protection of \$600,000 excess of \$400,000 for commercial automobile liability business. The treaty was 100% placed with authorized non-affiliates.

Private Client Group Segment

Property Lines:

The property lines program provides for the following coverages:

- Homeowners Course of Construction excess of loss treaty for \$3,000,000 excess of \$3,000,000. This treaty was 100% placed with an authorized non-affiliate.
- Equipment Breakdown 100% quota share with a limit of \$1,000,000. This treaty was 100% placed with authorized affiliate.
- Homeowners excess of loss coverage - 1st layer for \$5,000,000 excess of \$5,000,000. This treaty was 100% placed, 42.5% with authorized non-affiliates, 50% with one authorized affiliate and one unauthorized affiliate and 7.5% with an unauthorized non-affiliate.
- Homeowners excess of loss coverage - 2nd layer for \$20,000,000 excess of \$10,000,000. This treaty was 100% placed, 92.5% with authorized non-affiliates and affiliates and 7.5% with an unauthorized non-affiliate.
- Private collections quota share coverage with a limit of \$25,000,000 and retention of 28.5% or \$7,125,000 per risk. This treaty was 71.5% placed, 30.5% with authorized non affiliates and 41% with an unauthorized affiliate and non affiliate.

- Personal excess umbrella quota share for \$50,000,000 excess of \$15,000,000 retention. This treaty was 70% placed, 45% with authorized non-affiliates and 25% with one authorized affiliate and one unauthorized affiliate.
- Four layers of catastrophe excess of loss coverage for \$410,000,000 excess of \$40,000,000 which was 100% placed with authorized affiliate.

Inland Marine

- Yacht clash excess of loss coverage – 1st Layer for \$3,000,000 excess of \$3,000,000. This treaty was 100% placed, 90% with authorized non affiliates and 10% with unauthorized non affiliates.
- Yacht clash excess of loss coverage – 2nd Layer for \$4,000,000 excess of \$6,000,000. This treaty was 100% placed, 77.5% with authorized non affiliates and 22.5% with unauthorized non affiliates.
- Yacht clash excess of loss coverage – 3rd Layer for \$10,000,000 excess of \$10,000,000. This treaty was 100%, 85.4% with authorized non affiliates and 14.6% with unauthorized non affiliates.

Other Liability

- Limited charitable directors and trustees liability for \$1,000,000 excess of \$500,000. This treaty was 50% placed with authorized affiliates.
- Employment practices liability quota share for \$25,000,000 excess of \$15,000,000. This treaty was 40% placed, 14.5% placed with authorized non-affiliates and 25.5% placed with one authorized affiliate, one unauthorized affiliate.

Assigned Risk Segment

This business segment covers automobile residual market business written through various state Assigned Risk programs. For policy years 2002 and subsequent, the business is written exclusively on AIG affiliated companies and assumed into the pool through the 100% quota share reinsurance treaty. As of December 31, 2005, the claims administration services provided by Robert Plan Corporation for the AIG Personal Lines Pool's personal auto assigned-risk business was terminated. Those claims are now being handled by York Insurance Services Group, Inc. As of April 1, 2006, the policy administration services provided by the Robert Plan Corporation for the AIG Personal Lines Pool's personal assigned risk business was terminated. Those policy administration services are now being handled by AIGM.

All Segments

After external reinsurance is ceded, the combined results are ceded to National Union Fire Insurance Company of Pittsburgh, PA according to the following schedule:

Retroactive Reinsurance

As a result of the acquisition of the General Electric companies in 2003, certain members of the AIG Personal Lines Pool, AIG Auto Insurance Company of New Jersey, AIG Preferred Insurance Company, AIG Indemnity Company, AIG Premier Insurance Company and AIG Centennial Insurance Company, entered into several reinsurance agreements with Heritage Casualty Insurance Company (“HCIC”), formerly known as Montgomery Ward Insurance Company. One of the reinsurance agreements is an excess of loss agreement considered as retroactive reinsurance. The direct reserves are held in the pool subject to the reinsurance arrangement and the retroactive reinsurance liability in the amount of \$17,014,785 at December 31, 2006. That amount is related to these reserves assumed by the pooled companies based on appropriate pooling percentages. This contract was subsequently commuted in 2007.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that not all affiliated reinsurance agreements and amendments were filed with the Department in a timely manner pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

There were no commutations or loss portfolio transfers during the period under examination.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114. No exceptions were noted.

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. All agreements placed through reinsurance intermediaries contained the proper clauses required by Department Regulation 98.

Examination review of the New 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 NAIC Accounting Practices and Procedures Manual, Statements of the Statutory

Accounting Practices (“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 paragraphs 17 - 34 of SSAP No. 62.

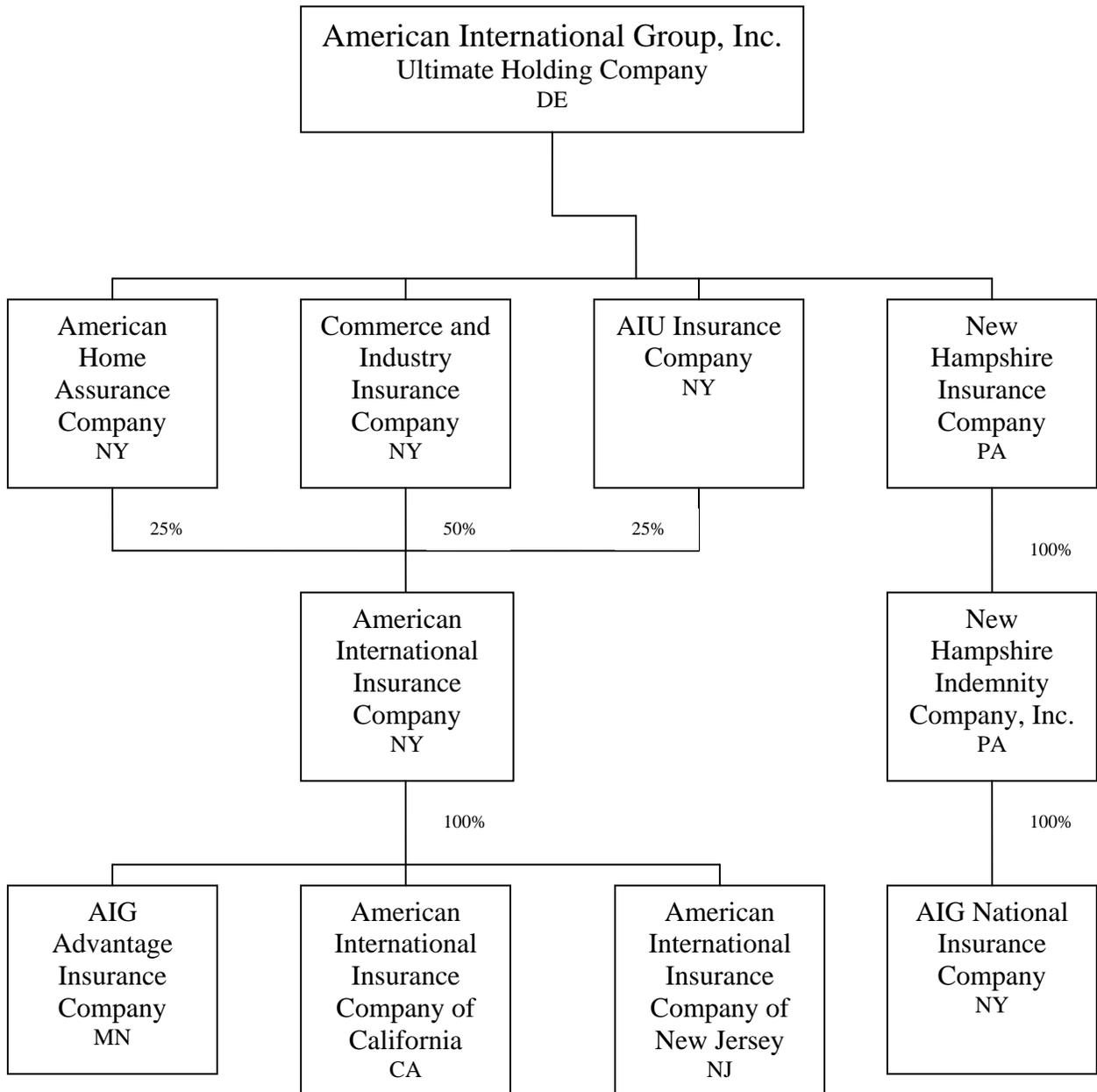
AIG enhanced its reinsurance review process in 2005 and created a risk transfer worksheet for reinsurance (“the Worksheet”) for reviewing reinsurance contract features for assessment of risk transfer. The Worksheet identifies certain contract features based on specific benchmarks for profit, premiums 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

American International Insurance Company is a member of the American International Group, Inc. The Company is 50% owned by Commerce and Industry Insurance Company, 25% owned by American Home Assurance Company and 25% owned by AIU Insurance Company, all New York domiciled insurers. The Company is ultimately controlled by 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 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:

Tax Payment Allocation Agreement

The original tax payment allocation agreement within the American International Group, Inc. was effective January 1, 1973. Under the terms of the agreement, the parent agrees to file a consolidated federal income tax return for all companies in the holding company system that is party to the agreement. The parent agrees that the liability of the Company will not exceed a greater portion of the consolidated federal income tax liability than would have been paid by the Company if it had filed a separate return.

It was recommended in the prior report on examination that the Company revise the tax payment allocation agreement effective date to one subsequent to the acquisition of the Company by American International Group, Inc., holding company system and submit this agreement to the Department for non-disapproval. The Company has not complied with this recommendation.

It is again recommended that the Company revise the tax allocation agreement with AIG to reflect the effective date of this arrangement to one subsequent to the acquisition of the Company by AIG and file the amendment with the Department in accordance with the Department 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 Management Contract

The Company entered into an investment management contract with AIG Global Investors Inc., an affiliated Company, effective January 1, 1991, to manage the Company's investment portfolio. Under the terms of the contract, AIG Global Investors Inc. 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. Since inception of the

agreement, AIG Global Investors Inc. has changed its name to AIG Global Investment Corp. (“AIGGIC”).

The filed investment management contract stated that:

“A fee for investment management and advisory services shall be an annual fee of seventy-five cents (\$0.75) per thousand dollars of assets under management. Fees are billed quarterly in advance based on total assets under management at the end of each quarter.”

The examiner noted that AIGGIC is charging the Company’s service a fee of four basis points on the total assets under management billed and payable quarterly.

It is recommended that the Company amend the investment management contract to reflect the name change of the investment advisor to AIG Global Investment Corporation and to reflect the current fees charged. It is also recommended that the Company submit the amendment to the Department for non-disapproval in accordance with Section 1505(d)(3) of the New York Insurance Law.

Revolving Credit Agreement

The Company entered into a revolving credit agreement with AIG Marketing, Inc., effective February 15, 1998. Effective January 1, 2001, the revolving credit agreement was amended to allow AIGM to borrow from the Company an amount not exceeding 5% of the Company’s admitted assets on December 31, 2000 at the stated interest rate of 5.75%. The January 1, 2001 amendment requires the full principal amount to be repaid to the Company on or before December 31, 2004. Effective January 1, 2005, the agreement was amended again to allow AIGM to borrow from the Company an amount not exceeding 5% of the Company’s admitted assets on December 31, 2004 and to require full payment on or before December 31, 2007.

The Company obtained non-disapproval from the Department for these amendments.

Service and Expense Agreement

A service and expense agreement between American International Insurance Company and certain affiliates and American International Group, Inc., dated February 1, 1974, allowed 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's direct business is produced by AIG Marketing, Inc. ("AIGM"), an affiliated company, pursuant to the terms of a managing general agency agreement that was approved by the Department on May 2, 1989.

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	139%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	118% *
Premiums in course of collection to surplus as regards policyholders	9%

The above ratio denoted with an asterisk falls outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners due to change in pooling percentage.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$1,954,338,256	68.99%
Other underwriting expenses incurred	687,364,811	24.27
Net underwriting gain	<u>190,938,046</u>	<u>6.74</u>
Premiums earned	<u>\$2,832,641,113</u>	<u>100.00%</u>

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 # 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:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 539,932,429	\$ 0	\$ 539,932,429
Common stocks	73,739,833	0	73,739,833
Cash, cash equivalents and short-term investments	32,176,702	0	32,176,702
Other invested assets	12,566,342	0	12,566,342
Receivable for securities	102,888	0	102,888
Investment income due and accrued	8,026,866	0	8,026,866
Uncollected premiums and agents' balances in the course of collection	33,831,750	265,389	33,566,361
Deferred premiums, agents' balances and installments booked but deferred and not yet due	134,618,943	0	134,618,943
Accrued retrospective premiums	708,055	0	708,055
Amounts recoverable from reinsurers	307,470,000	0	307,470,000
Current federal and foreign income tax recoverable and interest thereon	2,706,167	0	2,706,167
Net deferred tax asset	19,331,841	2,605,298	16,726,543
Receivables from parent, subsidiaries and affiliates	<u>13,008,148</u>	<u>0</u>	<u>13,008,148</u>
Total assets	<u>\$1,178,219,964</u>	<u>\$2,870,687</u>	<u>\$1,175,349,277</u>

Liabilities, Surplus and Other Funds

	<u>Amount</u>
<u>Liabilities</u>	
Losses	\$ 248,617,333
Reinsurance payable on paid losses and loss adjustment expenses	157,000
Loss adjustment expenses	53,397,349
Commissions payable, contingent commissions and other similar charges	851,251
Other expenses (excluding taxes, licenses and fees)	5,379,159
Taxes, licenses and fees (excluding federal and foreign income taxes)	8,187,754
Unearned premiums	179,387,293
Ceded reinsurance premiums payable (net of ceding commissions)	304,073,000
Provision for reinsurance	309,000
Reserve for escheatable outstanding checks	11,624,221
Retroactive reinsurance	<u>5,274,583</u>
Total liabilities	\$ 817,257,943
<u>Surplus and Other Funds</u>	
Common capital stock	\$ 5,000,000
Gross paid in and contributed surplus	133,800,000
Unassigned funds (surplus)	<u>219,291,334</u>
Surplus as regards policyholders	<u>358,091,334</u>
Total liabilities, surplus and other funds	<u>\$1,175,349,277</u>

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 \$339,444,301 during the five-year examination period January 1, 2002 through December 31, 2006, detailed as follows:

Statement of IncomeUnderwriting Income

Premiums earned		\$2,832,641,113
Deductions:		
Losses incurred	\$1,585,959,247	
Loss adjustment expenses incurred	368,379,009	
Other underwriting expenses incurred	780,091,890	
Aggregate write-ins for underwriting deductions	<u>(92,727,079)</u>	
Total underwriting deductions		<u>2,641,703,067</u>
Net underwriting gain or (loss)		\$ 190,938,046

Investment Income

Net investment income earned	\$ 110,096,451	
Net realized capital gain	<u>(7,824,287)</u>	
Net investment gain or (loss)		102,272,164

Other Income

Premium deposit	\$ (43,365,000)	
Net gain or (loss) from agents' or premium balances charged off	(13,101,003)	
Finance and service charges not included in premiums	71,205,651	
Aggregate write-ins for miscellaneous income	<u>(8,637,602)</u>	
Total other income		6,102,046
Net income after dividends to policyholders but before federal and foreign income taxes		\$ 299,312,256
Federal and foreign income taxes incurred		<u>18,053,701</u>
Net income		<u>\$ 281,258,555</u>

6. 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.

7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. 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.	
ii. It is recommended that the minutes of the Company's board of directors' meetings accurately account for the number of directors eligible for each meeting.	7
The Company has complied with this recommendation.	
B. <u>Reinsurance</u>	
i. It is recommended that the Company amend the pooling agreement to clarify each participant's obligations relative to accounts subject to pooling.	10
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.	
ii. It is recommended that the Company require that the letter of credit posted by American International Insurance Company of New Jersey for the benefit of the Company be revised to comply with Department Regulation 133.	10
The Company has complied with this recommendation.	

<u>ITEM</u>		<u>PAGE NO.</u>
iii.	It is recommended that the Company amend all reinsurance contracts placed through reinsurance intermediaries to comply with Department Regulation 98.	12
	The Company has complied with this recommendation.	
iv.	It is recommended that the Company report all unauthorized reinsurance transactions in accordance with the National Association of Insurance Commissioners' Annual Statement instructions.	12
	The Company has complied with this recommendation.	
v.	It is recommended that the Company account for the January 1, 2000 stop-loss cover treaty with a Barbados domiciled reinsurer in accordance with SSAP No. 75 in future statements filed with the Department.	14
	The Company has complied with this recommendation.	
C.	<u>Holding Company System</u>	
	<u>Management General Agent</u>	
i.	It is recommended that the Company amend the managing general agent's agreement with AIG Marketing, Inc. ("AIGM") to include administrative and claims services, and file such amendment with this Department pursuant to Section 1505(d)(3) of the New York Insurance Law.	17
	The Company has complied with this recommendation.	
ii.	If it is management's intent for policy fees to be included as part of the compensation to AIGM, it is recommended that the Company amend the agreement to reflect the revised compensation schedule. Any amendments were to be submitted to the Department prior to implementation, in accordance with Section 1505(d)(3) of the New York Insurance Law.	17
	The Company has complied with this recommendation.	
iii.	It is further recommended that the Company collect from its managing general agent (AIGM) any compensation associated with the policy fees, plus interest.	17
	The Company has not complied with this recommendation. However, the Company obtained the Department non disapproval for collecting policy fees effective December 31, 2004.	

<u>ITEM</u>		<u>PAGE NO.</u>
iv.	It is recommended that the Company refrain from using any increased fee schedule until it has received non-disapproval from this Department. The Company has complied with this recommendation.	18
	<u>Tax Payment Allocation Agreement</u>	
	It is recommended that the Company revise the tax payment allocation agreement effective date to one subsequent to the acquisition of the Company by American International Group, Inc., holding company system and submit this agreement to the Department for non-disapproval. The Company has not complied with this recommendation. A similar comment is made in this report.	20
	<u>Service Agreement</u>	
	It is recommended that the Company retain copies of its executed agreements as well as documentation that such agreements were submitted to this Department for non-disapproval in accordance with section 1505(d)(3) of the New York Insurance Law. Further, it was recommended that the Company submit a fully executed, dated copy of the agreement to this Department for non-disapproval. The services are covered under the service and expense agreement which was non-disapproved by the Department.	20
	<u>Claims Settlement Agreement</u>	
	It is recommended that the Company comply with Section 1505 (d) of the New York Insurance Law and notify the superintendent in writing thirty days prior to rendering services on a regular or systematic basis to a member of its holding company system. The services are covered under the intercompany pooling agreement which was non-disapproved by the Department.	21
D.	<u>Abandoned Property Law</u>	
	It is again recommended that the Company comply with Section 1316 of the New York Abandoned Property Law and file, with the State of New York, any checks or drafts that have been outstanding for three or more years. The Company has complied with this recommendation.	23

<u>ITEM</u>		<u>PAGE NO.</u>
E.	<u>Accounts and Records</u>	
	<u>Invested Assets</u>	
i.	It is again recommended that the Company submit its investments to the National Association of Insurance Commissioners' Securities Valuation Office for valuation.	23
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company exercise more care in the preparation of its filed annual statements.	23
	The Company has complied with this recommendation.	
iii.	It is recommended that the Company put all procedures required by the National Association of Insurance Commissioners' Securities Valuation Office in place prior to filing its annual statements.	24
	The Company has complied with this recommendation.	
F.	<u>Custodian Agreement</u>	
i.	It is recommended that the Company amend its current custodial agreement to include the necessary safeguards and controls, in accordance with the NAIC Financial Condition Examiners Handbook.	24
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company require all internal corporate funds in which it invests to have adequate safeguards and controls in place that comply with the requirements of the NAIC Financial Condition Examiners Handbook.	25
	The Company has complied with this recommendation.	
G.	<u>Agents' Balances Uncollected Premiums</u>	
i.	It is recommended that the Company report agents' balances in accordance with the annual statement instructions and reclassify all inter-company transactions to the appropriate balance sheet item.	26
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company write-off all uncollectible premium balances and purge the database of these premiums.	26
	The Company has complied with this recommendation.	

ITEMPAGE NO.H. Motor Vehicle Law Enforcement Fees

It is recommended that the Company collect, report and pay the motor vehicle law enforcement fees in the manner prescribed in Section 9110 of the New York Insurance Law.

27

The Company has complied with this recommendation.

L. Losses and Loss Adjustment Expenses

- i. It is recommended that the Company maintain appropriate records, worksheets, correspondence and other documents pertaining to the actuarial work product, and make them available for review. The documentation should be sufficient for another actuary practicing in the same field to evaluate the work. The documentation should clearly describe the sources of data, material assumptions and methods. Any changes from last analysis should be documented.

33

The Company has complied with this recommendation.

- ii. For specialty auto business, it is recommended that the Company keep accurate record of claim count information.

33

The Company has complied with this recommendation.

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance</u>	
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.	14
B. <u>Holding Company System</u>	
<u>Tax Payment Allocation Agreement</u>	
i. It is again recommended that the Company revise the tax allocation agreement with AIG to reflect the effective date of this arrangement to one subsequent to the acquisition of the Company by AIG and file the amendment with the Department in accordance with the Department Circular Letter No. 33 (1979).	16
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).	16
<u>Investment Management Contract</u>	
It is recommended that the Company amend the investment management contract to reflect the name change of the investment advisor to AIG Global Investment Corporation and to reflect the current fees. It is also recommended that the Company submit the amendment to the Department for non-disapproval in accordance with Section 1505(d)(3) of the New York Insurance Law.	17
<u>Managing General Agent Agreement</u>	
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.	18
C. <u>Accounts and Records</u>	
<u>Record Retention Clause for Independent Auditors' Workpapers</u>	
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 Regulation 152.	20

ITEMPAGE NO.Remittances and Items Not Allocated

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. 21

D. Risk Management and Internal Control

It is recommended that the Company continue to monitor and remediate the control deficiencies as an on-going effort to enhance the control environment. 21

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. Matzila BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of California in the examination of American International 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 American International Insurance Company was performed in a manner consistent with the standards and procedures required by the State of California

The affiant says nothing further.

FS/
Examiner's Signature

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

FS/
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, 2010

Appointment No.22582

**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

AMERICAN INTERNATIONAL INSURANCE COMPANY

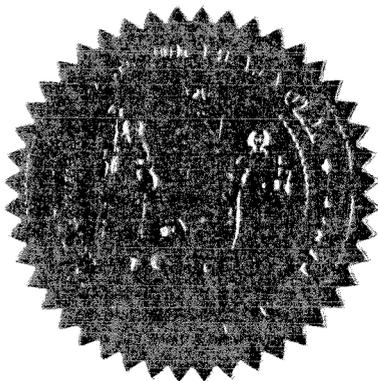
and to make a report to me in writing of the condition of the said

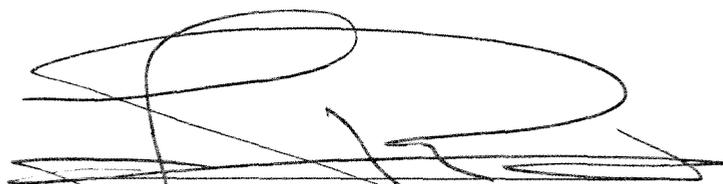
Company

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