AMERICAN INTERNATIONAL GROUP, INC.
ECONOMIC CAPITAL
August 2008 Update

INTRODUCTION

This summary describes AIG's economic capital model and addresses the following questions:

I. What is economic capital?
II. How is AIG using economic capital to help manage its businesses?
III. What is AIG's view of group capital adequacy in these volatile financial markets?

I. WHAT IS ECONOMIC CAPITAL?

Definitions

Economic capital is an assessment of the capital required to cover potential, unexpected losses within a target confidence level and timeframe. AIG's required economic capital estimates are calculated at a 99.95 percent confidence level and a one-year time horizon.

Required economic capital is compared to available economic capital. Available economic capital is defined as the difference between the economic value of AIG's assets and the economic value of AIG's liabilities, across all of AIG's segments. Period to period, available economic capital is increased by earnings and capital issuances (e.g. sale of shares of AIG common stock and hybrid equity in the form of equity units and fixed maturity securities that receive substantial equity credit from rating agencies) and reduced by losses, share repurchases and dividend payments.

Required Economic Capital – Pillar I and Pillar II Approach

AIG determines required economic capital in two steps: Pillar I and Pillar II requirements. Pillar I required economic capital represents the results from simulation-based modeling at the chosen confidence level and incorporating a reasonable allowance for diversification. In Pillar II, AIG applies a series of stress tests to determine capital "add-ons" to the Pillar I economic capital requirements to cover "difficult to model" events, such as the risk of a coordinated terrorist attack in the United States, Europe and Asia, a severe global pandemic outbreak, a persistent low interest rate environment in Asia (i.e. lasting several decades), severe credit defaults and spread widening from risk aversion/inactive markets affecting AIG's various exposures to the sub-prime residential mortgage crisis in the U.S., latent risks in AIG's casualty lines of business ("liability Cats"), etc.

Pillar II economic capital requirements also reflect a "haircut" to the diversification benefits captured under Pillar I for AIG's regulated insurance businesses. This haircut allows for the effect of the applicable regulatory solvency capital requirements and reduced mobility of capital consequent to those requirements under an optimized portfolio of capital and risk transfer instruments. AIG's benchmarking of the percentage reduction to required economic capital from diversification benefits after incorporation of the Pillar II "haircut" for fungibility of capital shows that, relative to its global insurance industry peers, the credit taken by AIG for diversification is among the most conservative in the peer group.[1]

Available Economic Capital – Market Consistent Valuation

AIG uses the excess of the "market value" of assets over the "market consistent value" of the liabilities as the basis for measuring available economic capital to ensure consistency between the measurement of required and available economic capital.[2]

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[1] Benchmarked using CRO Forum (refer www.croforum.org) and IFRI (refer www.riskinstiut.ch) published studies on diversification from 2005 and 2007 respectively.

[2] This follows the general principles recommended by the CRO Forum in its July 2008 paper titled "Market Value of Liabilities for Insurance Firms - Implementing elements for Solvency II" available on www.croforum.org.

II. HOW IS AIG USING ECONOMIC CAPITAL TO HELP MANAGE ITS BUSINESSES?

Management is able to apply the economic capital model and its results to a number of areas. Some of AIG's applications of the economic capital model are as follows:

- *Risk appetite and strategic risk management*: The process and methodology used to derive AIG's economic capital requirements provides a unique framework that aggregates risks and exposures consistently across different segments, businesses, geographies, products and risk types and therefore provides a foundation to manage AIG's risk appetite (e.g. in terms of regulatory, rating agency and economic capital-at-risk and in terms of GAAP, Statutory and economic earnings volatility). Management's risk appetite can be analyzed taking into account the benefits of portfolio diversification.
- *Business Performance*: The analysis of operating performance on a risk-adjusted basis provides a consistent measure of business performance across segments.
- *Capital Allocation and Business Planning*: The use of a quantitative framework to derive a consistent risk based cost of capital charge for AIG's diverse businesses facilitates the allocation of capital to businesses providing the most attractive risk-adjusted returns as part of AIG's business planning process.
- *Active Capital Management*: The use of a more complete methodology for optimizing AIG's capital structure and lowering its cost of capital, in part through utilization of the capital and debt markets, allows AIG to leverage its capital base more efficiently.
- *Mergers and Acquisitions*: The economic capital model has been used to provide quantitative input to decisions related to mergers, acquisitions, divestitures and strategic investments.
- *Strategic Asset Allocation:* The analysis of the economic risks and benefits of alternative investment strategies and financial risk mitigation options, taking into account the characteristics of the liabilities, management's strategic business objectives and risk appetite facilitates the determination of AIG insurance business units' strategic asset allocations.
- *Risk Retention and Reinsurance Strategies:* The analysis of alternative risk retention and reinsurance strategies, for exposures to catastrophic events has been carried out using the economic capital modeling platform to assist management in reinsurance purchasing decisions. AIG has also used the framework for assessing the benefits of increasing the fungibility of capital by using intra-group reinsurance in AIG's regulated insurance businesses to improve efficiency in the use of regulatory capital requirements.
- *Cost of Regulation and Ratings*: The framework provides a mechanism for analyzing the cost of maintaining capital to meet rating agency and regulatory standards for capital required to be held in excess of the economic capital required to support AIG's risk profile.
- *Product Development*: Components of AIG's economic capital model have been used to develop and price products to meet market demand and to maximize economic value added.
- *Management Compensation*: The economic capital framework facilitates the inclusion of economic value added measures into management compensation programs. In 2008, the economic value added for each of AIG's business segments is being considered as an element, alongside other existing measures, in the evaluation of senior management performance.

AIG's economic capital model has augmented a review of some segment specific business issues and assisted in the development of new business strategies. For example, economic capital analysis is now routinely incorporated into the assessment phase for some mergers, acquisitions and divestures, and in the assessment of specific capital markets solutions. In the reinsurance area, economic capital considerations are a fundamental component in the development of optimal risk retention and reinsurance strategies. In the Life Insurance & Retirement Services segment, the economic capital model has been used for product development, pricing and hedging strategies for living benefits in variable annuities. For life insurance products in Asian markets, enhanced asset-liability management strategies have been formed for long duration liability structures and low interest rate environments in some markets.

III. WHAT IS AIG'S VIEW OF GROUP CAPITAL ADEQUACY IN THESE VOLATILE FINANCIAL MARKETS?

AIG regularly assesses capital adequacy incorporating all relevant views of capital including statutory capital requirements for its regulated insurance businesses, rating agency capital requirements, based on target financial strength ratings (i.e., reflecting rating agency opinions of AIG's ability to meet policyholder obligations) and economic capital requirements. AIG believes that as of June 30, 2008, AIG had the ability to satisfy all relevant capital requirements for these businesses commensurate with its target financial strength ratings and strategic business objectives. The economic capital model also confirms AIG's ability to meet its consolidated obligations (i.e., for insurance and non-insurance businesses) at the chosen confidence level [3] as of June 30, 2008.

Over the quarter ended June 30, 2008, AIG's economic capital adequacy improved significantly as a result of the following factors:

- AIG's capital raise through the sale of shares of AIG common stock and hybrid equity in the form of equity units and fixed maturity securities;
- The rise in long term interest rates in Taiwan, Singapore and Thailand, more than offsetting the effects of the depreciation of the U.S. dollar against these foreign currencies and hence materially reducing the market consistent value of AIG's insurance liabilities in those regions. (This reduction in the economic value of the liabilities more than offset the reduction in the fair value of the assets backing those liabilities, that was recorded as part of the unrealized depreciation of investments component of "other comprehensive income" in the quarter ended June 30, 2008).

However, given (i) the lack of liquidity and severe risk aversion in the credit markets - brought about by the U.S. housing recession and subsequent economic slowdown - and their effect on the fair valuation of credit and credit related products, (ii) the increased volatility in the commodity and equity markets and (iii) fears of global recession and/or stagflation, AIG believes it is very difficult to develop a stable measure of excess capital at the present time. These markets have the ability to materially affect available capital measured from a regulatory, rating agency and economic basis.

AIG will continue to monitor its capital adequacy on all views of capital and take appropriate action to ensure that it continues to maintain group capitalization levels consistent with its target ratings. AIG will also regularly monitor the capitalization levels of AIG's insurance businesses to ensure that available group capital is optimally deployed to meet those businesses' local regulatory requirements and, where relevant, their financial strength rating targets. The economic capital model provides a valuable reference point for the medium/long-term management of alternative views of capital and for balancing these diverse intra-group capital requirements.

[3] Calibrated to a 99.95% level of confidence, that in AIG's opinion is commensurate with a AA range target level of security.

CONCLUSION

AIG will continue to use its economic capital model to:

(i) manage capital requirements to support the growth of existing and new businesses that meet AIG's risk-adjusted return expectations;

(ii) meet market demands to actively optimize AIG's weighted average cost of capital; and

(iii) satisfy regulatory and rating agency capital requirements.

AIG will use the results of the economic capital model as an effective tool in managing the competing demands for capital, optimizing risk-adjusted returns for AIG's investors and maintaining the capital strength required to support AIG's businesses and future growth opportunities. However, since the majority of AIG's regulators and rating agencies do not yet quantitatively recognize the results of AIG's internal model, AIG must continue to meet existing regulatory and rating agency requirements that in some cases are substantially different than AIG's economic capital requirements.