S&P Global
Market Intelligence

American International Group, Inc. NYSE:AIG

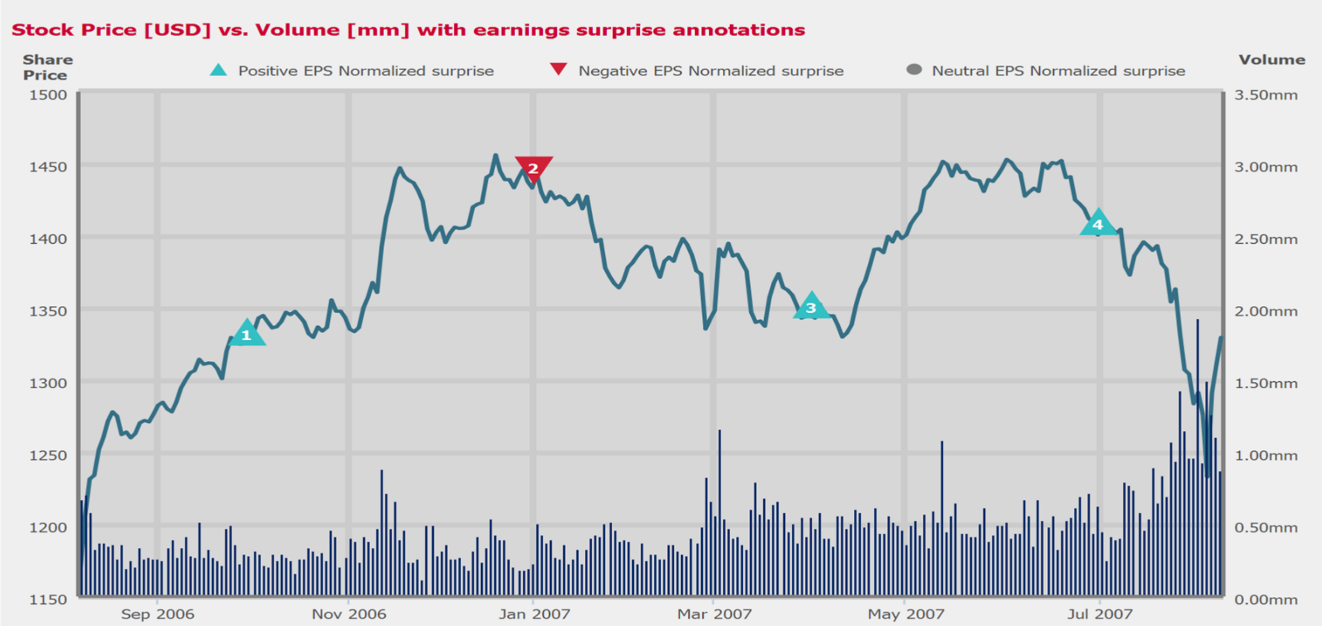
FQ4 2007 Earnings Call Transcripts

Thursday, February 28, 2008 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2007-			-FQ4 2007-		-FY 2007-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS
EPS Normalized	32.46	28.80	(11.28 %)	(2.91)	NM	98.04
Revenue	-	-	(0.26 %)	-	(39.53 %)	-
Revenue (mm)	29912.97	29836.00	-	30484.36	-	120352.33

Currency: USD
Consensus as of Feb-28-2008 11:26 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2006	28.54	30.60	7.22 %
FQ4 2006	29.96	29.40	(1.87 %)
FQ1 2007	30.91	33.60	8.70 %
FQ2 2007	32.34	35.40	9.46 %

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Call Participants

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Presentation

Operator

Welcome and thank you for standing by. At this time, all participants are in a listen-only mode. [Operator Instructions]. Today's call is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to Ms. Charlene Hamrah. Ma'am, you may begin.

Charlene M. Hamrah

Thank you very much. Good morning and thank you for joining us today. Before we begin, I would like to remind you that the remarks made today may contain projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management operations, products and services and assumptions underlying these projections and statements.

It is possible that AIG's actual results and financial condition may differ, possibly materially, from the anticipated results and financial conditions indicated in these projections and statement. Factors that could cause AIG's actual results to differ possibly materially from those in the specific projections and statements are discussed in item 1A Risk Factors of AIG's Annual Report on Form 10-K for the year ended December 31, 2007.

AIG is not under any obligation and expressly disclaims any such obligations to update or alter its projections and other statements, whether as a result of new information, future events or otherwise.

The information provided today may also contain certain non-GAAP financial measures. The reconciliation of such measures to the comparable GAAP figures are included in the fourth quarter 2007 financial supplement, which is available in the information... Investor Information section of AIG's corporate website.

And now, I would like turn the call over to Martin Sullivan.

Martin J. Sullivan

Thank you very much Charlene, and good morning ladies and gentlemen. As usual, I am joined this morning by a number of my senior management colleagues.

AIG's results in 2007 were clearly unsatisfactory. This was a very challenging quarter and year. Rapid deterioration in the U.S. residential, real estate and credit markets significantly affected several of our operations and investments. This offset the strong results generated through the first half of the year. As expected, a number of our businesses were adversely affected by their exposure to the domestic residential real estate market and we expect these businesses will continue to be challenged in the foreseeable future. As you have seen, AIG reported a net loss of $5.3 billion in the fourth quarter of 2007 and an adjusted net loss of $3.2 billion.

Two large items have adversely affected the quarter's result. First, adjusted net income for the fourth quarter was reduced by the net unrealized market valuation loss of $11.12 billion pretax or $7.23 billion after-tax, related to AIG financial products' Super Senior credit Default Swap Portfolio. These losses occurred in the context of a significant widening of spreads of asset-backed securities, principally those related to U.S. residential mortgages, the severe liquidity crisis affecting the structured finance markets and the affects of rating agency downgrades on the underlying collateral.

Second, net income was affected by $1.7 billion in after-tax net realized capital losses, as well as $418 million in after-tax other than temporary impairment charges related to AIGFP's 'Available for Sale' investment securities.

Two of our other operations exposed to the U.S. residential real estate market, were also affected in the fourth quarter. United Guaranty reported an operating loss of $348 million and American General Finance reported $9 million in fourth quarter operating income, principally due to an increase in the provision for finance receivable losses and a decline in mortgage banking revenues.

We expect operating results in both these businesses to continue to be challenged. In UGC, our best estimate is that future premiums on the existing in-force broking, of both domestic first and secondly lien risks will exceed future losses incurred. However, losses will likely emerge in advance of premiums earned and we expect that negative operating results will persist throughout 2008 as a result of continued weakness of the U.S. housing market.

While not immune to the downward cycle of the housing market, AGF's adherence to disciplined underwriting standards will continue to help maintain credit quality. We also believe opportunity is to acquire high-quality portfolios, similar to the pending acquisition of Equity One's branch loan portfolio will continue.

We are obviously witnessing and living through extraordinary market conditions. And we are trying as all many others to value very complex instruments. These valuations are not mechanical. They involve difficult estimates and judgments. I can tell you that we have at all times brought our best judgment to bear in making these valuations.

I want to take a few minutes now to further comment on the valuation of AIGFP's credit default swap portfolio, and the circumstances that lead to the filing of our recent 8-K. In response to strong investor interest in November, we decided to devote a previously scheduled investor conference on December 5th that is subject AIG's exposure to the residential mortgage market. During that webcast conference, the AIGFP team discussed the model and the methodologies that they use to value the Super Senior credit default swaps. They also discussed that their estimated numbers accounted for the differences between most described as: one, the cash prices for the underlying securities and two, the pricing of the Super Senior credit default swap derivatives. This is the negative basis adjustment.

The AIGFP team also noted that their numbers also took into account, structural support that provided additional protection to AIGFP in adverse circumstances. For example, cash flow diversion features, this is the structural adjustment.

AIGFP did not detail the dollar of these adjustments, or the gross amount of the unrealized market valuation loss without those adjustments. In early February, as we prepared our year-end financials, we concluded that we should clarify and expand our prior disclosures relating to the methodology and better inputs used to determine the values of the Super Senior Credit Default Swap portfolio. We also understood at that time, that we would not be using a negative basis adjustment when we filed our 10-K. When we made that determination, we decided to inform the market what the estimated November 30th number would be without the negative basis adjustment. At the same time, our regulators concluded that the company had a material weakness in the valuation process and the oversight of that process for the AIGFP Super Senior Credit Default Swap Portfolios.

We then promptly filed an 8-K describing all of this information in detail. We have heard from some that our 8-K was confusing. We did provide a lot of detail. But it was detailed because we were trying to ensure that investors could see exactly how the gross number related to the net number used in December presentation through the adjustments that we have referenced in that presentation. We've already begun the process to remediate the material weakness identified by PWC.

Since becoming CEO, I have made increased transparency and improved disclosure, a high priority. We have taken considerable steps in the right direction and we will continue to do so. We believe that disclosure in the 10-K, the presentation we have just put on our website and the discussion my colleagues will lead you through shortly, will help our investors better understand how the extreme market conditions are affecting our businesses. In my respects, we are in uncharted waters. In this context, let me make a few observations.

The mark we reported this quarter essentially values the Super Senior notes, nets over the benefit from the cash flow diversion features go into these transactions, rather than the value of the credit derivatives that AIGFP has written to protect these notes. This is clearly not representative of the risk AIGFP holds on the Super Senior Credit Default Swap transactions. We could not find observable data points in this highly disrupted and a liquid market to value to the protection we provide. This business was carefully underwritten and structured using models to ensure that attachment points would withstand highly stressed economic conditions. We continue to believe, however, that the unrealized market valuation losses on this Super Senior Credit Default Swap Portfolio are not indicative of the losses AIGFP may realize over time.

Under the terms of these credit derivatives, losses to AIG would result from the credit impairment of any bonds AIG would acquire in satisfying its swap obligations. Based upon our most current analysis, we believe that any credit impairment losses realized over time by AIGFP would not be material to AIG's consolidated financial condition, although it is possible that they could be material to results of operations for an individual reporting period. Except to the extent of any such realized credit impairment losses, AIG expects AIGFP unrealized market valuation losses to reverse over the remaining life of the Super Senior Credit Default Swap Portfolio. My colleagues will speak to the valuation methodologies in further details in just a few minutes.

Of the many years AIGFP has provided excellent returns efficiently utilizing capital and manages business to generate low volatility in its economic results. It has also been a tremendous source of intellectual capital and innovation within AIG. With our other financial services businesses, AIGFP complements and will continue to provide further diversification to add core insurance operations. In that regard Joe Cassano has decided with our concurrence that he would like to pursue opportunities outside of AIG and effective March 31st, he will be retiring form AIGFP. Joe has been a very valuable member of the AIGFP senior management team for over 20 years. He has had a great career with us and we wish him the very best in the future.

Effective of April 1st, Bill Dooley will assume interim responsibility for the day-to-day operating of AIGFP's business along with his current duties. Joe will be continuing as a consultant to AIGFP for the rest of the year, so we will continue to benefit from his expertise. Joe has recruited and trained a very strong senior management team at AIGFP and I am confident that AIGFP is in excellent hands pending the appointment of a new CEO. Now, I would like to turn to our Investment Portfolio.

As I mentioned earlier, the significant credit market disruption adversely affected that portfolio too. In the fourth quarter, AIG recorded pretax charges of $3.3 billion for other than temporary declines in value, including $2.32 billion in pretax impairments related to AIG's investments and structure securities including RMBS. Most of these impairment charges resulted from the significant rapid declines in market values of certain residential mortgage-backed securities in the fourth quarter. Even while retaining their investment grade ratings, these securities where priced at a severe discount to book. Despite our continuing intent and the ability to hold them and despite structures that would indicate a substantial amount will continue to perform in accordance with their original terms, AIG concluded that it could not reasonably determine that the recovery period will be near term or the impairment temporary.

In the fourth quarter, we also recorded $2.54 billion after-tax or $3.8 billion pretax in unrealized depreciation of investments included in other comprehensive income. Details are included in the investment presentation posted on our website.

With regard to assure, repurchase program during the fourth quarter, we repurchased over 21 million shares bringing the total to 76.4 million purchased for the full year 2007. An additional 12 million shares were purchased in 2008 through February 15th. Substantially all of the shares purchased in 2007 and in 2008 through February 15th, were funded by hybrid debt issuances. We view this as an efficient use of capital as these transactions replaced high cost common stock with more cost efficient hybrid securities. AIG does not expect to purchase additional shares for the foreseeable future, other than for filling commitments that existed at December 31st.

We believe this is prudent in the light of continued market volatility and credit market uncertainty as well as our ongoing discussions with the rating agencies. I know these issues are of great concern to all of AIG's stakeholders and it is important that I emphasize again that we believe AIG can and will manage through them efficiently and effectively. It is also important that we have not let these issues distract us from our focus on AIG's underlying businesses.

Before turning to what we have currently seen in our specific businesses, let me just say that AIG is well positioned to grow shareholder value despite the current turbulent environment. We have a diverse portfolio of global businesses with the scale and world class expertise that extends throughout the organization. We also have a strong capital base and we are not raising additional capital.

We have accomplished a number of important objectives in 2007, including increasing distribution through acquisitions and new partnership. We appointed W¨uBA a middle market commercial insurer in Germany and Matrix Direct, a direct marketing life insurance business in the U.S. We also struck new distribution agreements with Japan Post and Signopec in Taiwan.

In China we secured a license for our Foreign General business to establish a wholly-owned foreign enterprise. We also completed several new ventures, including establishing an asset management company in India and launching three new mutual funds there, breaking ground on the 5.4 million square foot International Financial Center in Seoul, obtaining permissions from the Qatar Financial Center to conduct individual and group life as well non-life businesses and setting up a private pension fund administrator in Romania.

In 2007, we also made progress on streamlining our portfolio of businesses, including selling our stake in Allied World Assurance for an attractive return and completing the acquisition of the remainder of 21st Century, creating a personal alliance insurer with approximately $5 billion of premium, covering the most attractive segments and distribution channels. While it is clear that certain of AIG's businesses did not perform up to expectations others are. I would now like to briefly touch on the performance of our major business segments.

DBG reported record results in 2007 with pretax operating income of $7.4 billion with a combined ratio of 85.52 and nearly 4 point, 5 point improvement from the prior year. Throughout the year, DBG posted improved underwriting results due to favorable loss trends and a higher net investment income. Despite increased competition DBG remained disciplined, taking advantage of opportunities offered by an expensive product set and expanding distribution platform and an innovative culture responsible for an average of one new products of service launched per week in 2007.These competitive advantages will enable DBG to identify attractive opportunities that meet our underwriting criteria in a softening property-casualty marketplace.

Issues related to the U.S. residential mortgage market may affect our management and professional reliability lines. We have provided detailed information on potential exposures on page 12 of the financial supplement and needless to say, we are monitoring the issue closely. At this point, it appears to be manageable.

Like DBG Foreign General performed well posting a combined ratio of 85.51 for the full year 2007. Foreign General was also a successful in expanding its Personal Lines presence in the high network segment with strong growth in the United Kingdom. In 2008 and beyond, Foreign General is particularly well positioned for growth. They continue to shift their Personal Lines products mix to a higher margin, non-auto business and to expand our private client group operations into new growth markets, such as Australia and Dubai. We are the leading provider of Financial Lines in Continental Europe, a distinct advantage when serving the needs of top corporations, while providing a platform to expand into other lines and market segments. We'll also continue expanding our operations in emerging markets.

In 2007 domestic Personal Lines reported a loss due to increased loss frequency, California wildfire losses and upfront costs related to the integration of 21st Century. The 21st Century integration is progressing well and is on-track to deliver significant cost savings, which we expect to begin emerging this year. We've also begun marketing on a unified platform in the first quarter.

With regard to our Life Insurance & Retirement Services businesses, within the domestic life insurance operations, as previously discussed, we took aggressive steps to address investor-owned life insurance activity, which put pressure on sales in 2007. In the fourth quarter, sales of universal life picked up due to enhanced unwitting methods at the older ages and continued success from in Exhibit [ph] indexed universal life products offerings. In addition, the domestic life team is committed to building a presence in the variable life product area, with plans to expand distribution in this markets segment.

With the addition of Matrix Direct, we are aggressively pursuing a direct-response approach, as part of their multi-distribution strategy. We believe these and other initiatives to innovative products offerings and to expand distribution will improve sales in 2008. AIG Global [ph] while not a growth-oriented company, has been able to improve the persistency and profitability of its business through combination of better agent selection and training and are focused on expense efficiencies in distribution and the home office. We did see continued strength in our payout annuity business which is expected to continue into 2008 with favorable conditions in the terminal funding markets and the opportunities to cross-sell structured settlement products with the DVG, an example of AIG deliver the firm strategy.

In domestic Retirement Services, individual variable annuity fourth quarter 2007 operating income was adversely affected by a change in actuarial estimates related to a system conversion and to a lesser extent of back on lock-in. However, this business reported a record fee income in assets under management in 2007.

Sales growth should improve in 2008, due to AIG SunAmerica's competitive living benefit features and initiatives to expand the wholesale organization and warehouse distribution. Our fixed annuity businesses experienced continued outflows in 2007, as a large volume of five-year business came out of that this surrender charge period. Surrenders from business written during record sales periods are expected to continue at a higher level in 2008. However, the current rate environment should provide for improved deposit and net flows through AIG annuities continued leadership in bank distribution.

AIG retirement also known as AIG VALIC experienced double-digit deposit growth in 2007 and a steady increase in fee income and assets under management. We expect that to continue in 2008, as independent distribution is being added to an already strong captive distribution force and our advisors continued to focus on the rollover retirement market to retain assets.

AIG's foreign life insurance operations performed well overall. Growth in first year premium and single premiums were very strong, while bottom-line results were affected by actuarial changes in estimates, remediation activities and the losses in the UK from variable annuities. In Asia, we remained focused on meeting the growing demand for investment-oriented products through increasingly broad distribution channels, including bank assurance and independent produces.

Market conditions in Japan are expected to remain challenging, however, on the strength of their multi-products, multi-distribution platform; we expect to exceed industry growth in the long term. The planned integration of AIG Star and AIG Edison anticipated to be completed in 2009 will provide enhanced distribution opportunities and operating efficiencies. As we progress in 2008, we expect to take advantage of the full deregulation of insurance product sales in banks and privatization of the Japan Post.

Our Central in Eastern European operations performed well in 2007 and demographic and economic conditions in these countries provide excellent opportunities to growth in 2008 and beyond. We are encouraged by the sales momentum and distribution expansion gained by foreign life in 2007. In 2008, we expect to achieve good growth in foreign life. However, further market dislocation will affect investment returns and diminish demand for certain products.

ILFC's excellent results reflect it's status as the world's premier aircraft-leasing franchise. Despite the potential for an economic slowdown, the outlook for ILFC remains favorable, as demand for top modern fuel efficient fleet remain strong and all 73 of its 2008 new aircraft deliveries have been placed. ILFC also concentrates on placing leases in strengthening regions such as Asia. Asia and the Pacific region has grown to account for 27% of ILFC's revenues.

Our Institutional and Retail Asset Management business reported strong results this quarter, as we continue to attract client assets and growth this business. As the world's seventh largest institutional asset manager, total assets under management have grown to more than $750 billion. And non-affiliated client assets under management have grown 26% in 2007 to approximately $94 billion primarily as a result of a diverse robust product line up across all asset classes.

While our institutional clients have always benefited from a strong local presence in developed and emerging markets, we have further enhanced their capabilities serving the needs of local retail investors with funds launched in China, the Philippines and Taiwan. With regard to our investments, domestic Retirement Services as well as domestic General Insurance and to a lesser extent other lines of business will be affected by future returns from partnerships and other alternative investments.

As we have stated previously, particularly strong performance in recent period is not indicative of future returns. We expect the partnership asset classes to generate a 10% to 15% return over the long-term, but in today's environment even those returns could be challenging. While 2007 was a very challenging year, we executed on several strategic initiatives and many of our businesses performed well. The businesses that did not perform well to our expectations, we have concrete plans to address the issues and we expect improved performance in 2008.

As in the past two quarters we are providing additional informative disclosures. This quarter we are providing a presentation on AIG's businesses with exposure to the current credit market disruption. This presentation and additional supplementary materials are currently available on our website. Now let me turn the call over to my colleagues, first Steve Bensinger.

Steven J. Bensinger

Thank you very much Martin and good morning. Overt the next few minutes, Win Neuger, Bob Lewis and I will update you on various developments in certain of our businesses during 2007.

First, I will discuss the Super Senior credit derivative business at AIGFP, including comments concerning the unrealized market valuation loss we have taken. Second, Win will comment on selected components of AIG's insurance investment portfolios, concentrating on the U.S. residential mortgage-related investments, commercial mortgage-backed securities, our exposures to monoline insurers and our exposures to CDOs and CLOs. Finally, Bob will conclude with brief remarks on United Guaranty, our mortgage insurance business and American General Finance, our domestic consumer finance business.

We've posted two presentations to the Investor Relations section of our website. During our discussion this morning, we will be referring to the one entitled Conference Call Credit Presentation. The other one is entitled Conference Call Credit Presentation Supplemental Materials. This presentation contains more detailed information regarding our businesses and portfolios for your information and review.

Now if you would turn to slide four, in the Conference Call Credit Presentation. One of the businesses in which AIGFP is engaged is the business of writing credit derivatives to cover the risk of incurring realized credit losses on the most senior tranche in the capital structure of the securitization, referred to as the Super Senior Risk Layer. The terms Super Senior is used by market participants to denote very remote credit risk, but there is no single definition of the term. Each transaction is spoke [ph] highly customized and designed to withstand extreme stress, and yet incur no expected loss. Great care has been exercised in structuring the deals starting with due-diligence of the counterparty's motivation for entering into the transaction, positive selection of the assets, experience of the manager and definition of portfolio maintenance characteristics to name just a few.

Each underling security is assigned an internal credit rating by AIGFP where possible, based on the fundamental credit analysis and judgment of AIGFP's credit officers and on the ratings assigned to the collateral from the three rating agencies where available, along with the review of its current market spread. AIGFP augments the Super Senior structuring process with its own actuarial models, using assumptions more conservative than those used by the rating agencies.

The minimum attachment point for the Super Senior portion of the portfolio is modeled as a minimum threshold above which there is no expected loss to AIGFP. The final attachment point is negotiated to exceed the model detachment point and we will discuss typical transaction structures in a moment. AIGFP started writing this business in 1998 and to-date has not incurred or realized loss in any of its Super Senior transactions.

Now if you turn to slide five, AIGFP has entered into Super Senior credit derivative transactions in three broad categories: Regulatory capital-motivated corporate and European residential mortgages, corporate arbitrage, and multisector CDOs. Our net notional exposure, the largest category of the business is regulatory capital motivated, almost $230 billion in corporate and $149.1 billion in European mortgages and is typically subject to both regulatory and contractual calls by the counterparties with the former, starting in January 2008, when Basel II took effect in Europe. These transactions were structured to provide the counterparty with capital release in their regulatory jurisdiction and not structured to transfer a significant credit risk. The counterparties achieved lower capital charges by transferring a portion of their regulatory capital requirements to AIG.

As shown in the table, the expected maturity of the regulatory capital-motivated transactions is only on the contractual call dates is 1.2 and 2.3 years respectively, but many of these trades may be or are being terminated earlier than that, as AIGFP's counterparties implement models compliant with the new Basel II accord. As of February 26, 2008, $54 billion in notional exposures have either been terminated or are in the process of being terminated.

AIGFP's arbitrage-motivated corporate book represented $70.4 billion in notional exposure as of year end 2007. The underlying collateral in these deals, this comprised of primarily investment-grade corporate debt and collateralized loan obligations. AIGFP recorded an unrealized market valuation loss of $226 million, or about 0.3% of the national exposure in the fourth quarter as a result of general credit spread widening experienced in the markets.

AIGFP's exposure to multisector CDOs in its Super Senior Credit Derivative Portfolio, the third category of exposure, totaled $78.2 billion as of December 31, 2007 of which $61.4 billion had some level of exposure to sub-prime mortgages. The attachment point is the most important feature of the risk mitigants built into these deals. Of the deals with some sub-prime exposure that ranges from an average of 15% on the high-grade deals to an average of 37% on the deals with mezzanine collateral. At inception the attachment points are always higher than the attachment points used by the rating agencies for the AAA-rating equivalent. Another important risk mitigant in the Super Senior structures of AIGFP is the priority of the cash flow waterfall to the Super Senior layer. While we always sit at the top of the waterfall when it comes to being paid, this position is typically further enhanced by the existence of one or more over-collateralization or interest coverage tests that further direct available cash flows to amortize our position more rapidly, if they are breached.

By way of illustration, and please turn to slide six, you will see the make up of a typical multisector CDO Super Senior transaction. Various assets, such as residential and commercial mortgages, auto loans and student loans are packaged together into asset-backed securities, RMBS in the case of residential mortgages and CMBS in the case of commercial mortgages. These securities are structured into tranches with various ratings from AAA down to an underrated equity tranche. Typically 125 to 200 securities are purchased to form the collateral pool of the CDO. So called high-grade CDOs have investment-grade collateral securities, typically rated AA or AAA at inception and so called mezzanine CDOs consist of primarily low investment grade, with some sub-investment grade securities in certain deals.

These portfolios of securities constitute the transaction growth notionals of the CDOs. The CDO itself issues several tranches of debt securities from unrated equity to BB, BBB, A and finally Junior AAA rated up to a more Senior AAA-rated tranche called the Super Senior Tranche. Cash flow waterfalls dictate our principle and interest flows are allocated to the various tranches of the CDO. Various tests including over-collateralization and interest coverage tests divert principle and our interest flows to the more senior tranches of the CDOs.

AIGFP writes credit protection to the holders of the Super Senior Tranche of the CDO through the issuance of a credit derivative. AIGFP's exposure to the CDO through the credit derivative is called the Net National Exposure. As we stated in past communications, after thorough due-diligence, analysis and modeling, AIGFP determines an acceptable attachment point or subordination level over which it is willing to write protection. At inception AIGFP conducts extensive due-diligence, including a thorough analysis of the historical and expected future performance of the collateral and the manager, each underlying obligor, assets service and originator. Considerable effort is spent to avoid concentrations to single obligors, servicers and the geographies. AIGFP then utilizes proprietary data-driven actuarial models to analyze the fundamentals in the transactions.

The models are calibrated to be worst than the worst recession experienced post World War II. The Models produce loss distributions by stimulating the credit performance of the underlying obligations in the portfolio. Also, if the CDO managers have latitude to substitute or exchange collateral and approvals, the transaction is modeled assuming the CDO managers select the worst possible portfolio within approved criteria. The final results of AIGFP due-diligence and modeling are then used to negotiate attachment points by the Super Senior structure.

On slide seven, you can see that the AIGFP Super Senior business is subject to the oversight processes of AIG Enterprise Risk Management, which includes components of credit risk, market risk and operational risk management. Super Senior transactions entered into by AIGFP are subject to the approval of AIG's Chief Risk Officer and Chief Credit Officer under the delegations approved by AIG's Credit Risk Committee.

Each transaction is independently subjected to an analytical review by credit risk management. Every quarter AIG ERM independently reviews the exposures, which are updated to show realized loss trends and current subordination levels. In addition, AIGFP's actuarial models are rerun with updated credit ratings to show the model attachment points relative to the available subordination levels to confirm to what extent the transaction still constitute Super Senior risk of incurring any realize loss.

ERM identifies all transactions that show unexpected deterioration and will add these to AIG's internal watch list. ERM also assesses whether any transactions could represent probable loss, thus potentially requiring the establishment of credit reserves, of which there have been none to-date. It is also noteworthy at this point to mention that the credit processes at AIGFP working in close collaboration with AIG ERM began to see evidence that mortgage underwriting standards had declined and pulled back from this sector towards the end of 2005.

For that reason, the notational of 2006 and 2007 sub-prime collateral comprises a modest 4.9% of the total collateral pools underlying the entire portfolio of CDOs with credit protection at year-end 2007. Furthermore AIGFP's multisector CDOs have only a modest exposure to higher risk secondly-lien mortgages. Please turn to slide eight.

Recent credit quality deterioration in the sub-prime mortgage sector has led to market concerns about the credit quality of securities backed wholly or in part by sub-prime residential mortgages. In order to cause an economic or realize loss to the Super Senior layer, mortgage delinquencies have to deteriorate to default losses and at the fall losses in turn must cause loss to the securities in the collateral pool underlying the CDO.

The securities losses have to accumulate to a level above the attachment point and reach the Super Senior layer after the waterfall diversions have been exhausted. Contractually, the credit derivative protects the Super Senior CDO holder only for actual default losses in the underlying collateral, not the loss of market value of the collateral securities or the CDO itself. The test of potential for unexpected realized losses to the Super Senior layers under prevailing condition, both AIG's ERM and AIGFP have conducted risk analysis of the portfolio. Moreover, AIG has conducted an analysis to assess the risk of incurring net realized losses over the remaining life of the portfolio.

In addition to analysis of each individual risk in the portfolio, AIG conducted certain ratings-based stress tests which centered around further stressing of broad classes of the portfolio collateral from current rating levels. The results of these stress tests indicated possible realized losses on a static basis, since the assumption in these stress test assumed immediate realization of loss. But actual realized losses would only be experienced over time, given the timing of losses incurred in the underlying portfolios and the timing of breaches in the subordination. No benefit was taken in these stress tests for cash flow diversion features, recoveries upon default for other risk mitigant benefits. Furthermore, the stress tests were applied at December 31, 2007 using the lowest ratings of the major rating agencies, updated through January 3, 2008.

On this slide, we characterized the conditions of the severe stress scenarios and show the result in the graph. Under this severe stress scenario, the realized loss would be approximately $900 million, in contrast to the current unrealized market valuation loss of $11.25 billion. Clearly, this market valuation estimate is biased by factors in addition to credit risk, although the Super Senior structures in AIGFP transactions only cover credit risk.

Based on these analyses and stress tests, AIG believes that any losses realized over time by AIGFP as a result of meeting its obligations under these derivatives will not be material to AIG's consolidated financial condition, although it is possible that such realized losses could be material to AIG's consolidated results of operations for any individual reporting period.

Please turn to slide nine, which indicates that AIGFP accounts for its Super Senior credit derivatives in accordance with FAS 133 and EITF 02-3. We also considered the guidance in FAS 157 and the paper issued in the October 2007 by the Center for Audit Quality entitled, Measurements of Fair Value in Ill-Liquid or Less Liquid Markets. AIGFP does not recognize income and earnings at the inception of each transaction, because the inputs to value these instruments are not derivable from observable market data. Income is recognized over the life of the contract and as observable market data becomes available.

A fair valuation of AIGFP's Super Senior Credit Derivative Portfolio is challenging given that the spoke [ph] nature of each transaction and the like of market observable transactions or information. In the absence of any observable market, in accordance with GAAP, AIGFP must estimate fair value using the assistance of models. In estimating fair value under GAAP, AIGFP uses a combination of valuation models, principally the Binomial Expansion Technique or BET, third-party prices, relevant market indices and where necessary, management's own judgment.

Through June 30, 2007, AIGFP concluded that there was a minimal change in fair value since the inception of derivatives as the Super Senior Credit Derivatives were in essence put options significantly out of the money that are insensitive to a normal changes in market credit spreads.

Now the table on slide ten breaks down the notional amount of AIGFP's exposure by Super Senior underlying type and the respective cumulative mark-to-market losses experienced in the third quarter and fourth quarter. For the $70.4 billion notional exposure for corporate arbitrage transactions, AIGFP value these transactions using relevant market indices or third party prices and reported in unrealized market valuation loss in the amount of $226 million for the fourth quarter. At September 30, 2007 AIGFP employed the binomial expansion model to value this portfolio and that resulted in no noticeable change in fair value.

Our regulatory capital trades, both corporate and European residential mortgage related and please time to slide 11, where you see that explain that these transaction were concluded with counterparties, primarily to facilitate regulatory capital relief for them rather than rather than to transfer credit risk to AIGFP. As I said earlier, these transactions are expected to terminate within the next 12 to 18 months, as the counterparties implement the new capital provision under Basel II. AIG conducted a comprehensive analysis of available information at year end 2007, including the counterparties' motivation and behavior, the portfolios performance, marketplace indicators and transaction-specific considerations. As a result of this analysis, AIG believes that these regulatory-driven trades are appropriately valued at zero fair value as of December 31, 2007.

The most compelling market observable data to support this conclusion is the fact that $54 billion notional transactions have been terminated in early 2008 without AIG being required to make any payments and in some cases with AIG being paid a fee. As can be recognized from the information on slide 12, the fair valuation of the Super Senior Credit Derivative has become increasingly challenging, given the limited availability of market observable information due to the lack of trading and price transparency in the structured financed market, particularly in the fourth quarter of 2007.

These market conditions have increased reliance on management estimates and judgments, in arriving at an estimate of fair value for financial reporting purposes. Furthermore, disparities in the valuation methodologies employed, the degree to which market data may be available to a market participant and the varying judgments reached by such participants when assessing volatile markets has increased the likelihood that the various parties to these instruments may arrive at significantly different estimates of their fair values.

AIGFP's valuation methodologies and processes with the Super Senior Credit Derivative Portfolio have evolved in response to the deteriorating market conditions and the lack of sufficient market observable information. In the third quarter, as market credit spreads started to widen considerably, AIGFP implemented a Modified Binomial Expansion Technique, the BET model, using credit spread inputs on generic ABS obtained from a third-party source and the other inputs like Moody's historical recovery rates.

The BET model will utilizes diversity scores, weighted average lives and discounts rates. The model accounts for the specific features of each transaction, such as portfolio amortization and tranche subordination. Our valuation indicated an unrealized loss of $352 million at the September 30, 2007. As the market continued to deteriorate in October, AIGFP continued to refine its model. It enhanced the existing data inputs by adjusting RMBS, and CDO credit spreads for the relative change in the ABX Home Equity Index.

At November 30th, AIGFP ran two versions of the BET model that have been used for the October estimate of the portfolio mark. Method A was similar to the October version of the BET model, but incorporated the net benefit of structural risk mitigants, principally the cash flow diversions benefits that resulted in a reduction of the net unrealized market valuation loss.

Method B incorporated two new features; first during the month of November, AIGFP obtains third-party prices of the underlying collateral securities collected by CDO managers as of October 31, 2007. These prices were used as inputs to the modified BET model to derive credit spreads more closely associated with the underlying collateral securities than the general spreads used in Method A. Second, Method B incorporated a negative basis adjustment to reflect the fact that cash and synthetic instruments frequently trade at different levels, with cash instruments normally at a wider spread than CDS for high-quality assets.

Under method B, the BET model is effectively evaluation model that estimates the fair value of the CDO, which AIGFP's credit derivative protects. Using cash spreads as inputs to the model, in substance assumes that the entire spread is comprised of only one risk, credit risk. However the spread achieved from holding a cash instruments incorporates not only credit risk but also other risks, such as funding costs differentials, liquidity risks and risk aversion costs.

In times of market stress, these and other risk tend to widen together with credit spread widening. The wider the spreads becomes from these other risks, the wider the negative basis. You can think of negative spread as the difference between total spread and the credit spread. When AIGFP entered into a Super Senior CDS transactions or multisector CDOs, there was an observable negative basis, driven by the fact that the major motivation of the deals was to earn a net positive spread between the spread earned by the investor of the CDO and the premium cost the investor paid to AIGFP for its credit derivative hedge.

Under Method B, AIGFP estimated the benefit of this negative basis, based upon best estimate assumptions provided by major market participants. Under GAAP, sufficient observable evidence supporting the existence and quantification of negative basis for AIGFP's transactions is needed to take into account any negative basis in its fair value determinations. Currently, despite the fact that the ABS market is quite ill-liquid entering into new transactions that demonstrate the existence of the negative basis is possible. However, evidence of negative basis in AIGFP's existing transactions is currently unobservable in these market conditions. On the completion of its review of the evidence available, AIG concluded that recording a negative basis adjustment at this time is not consistent with GAAP fair value requirements.

Now as described on slide 13, AIGFP has filed a rigorous process to determine its best estimate of fair value for AIGFP's Super Senior Credit Derivatives on multisector CDOs at December 31, 2007. This process is required, because there are no observable market prices for the credit derivatives AIGFP has written. Therefore, AIGFP utilizes a model to determine fair value similar to Method B in the previous slide. The method maximizes the use of third party market observable inputs where possible. There are five key components to the process.

First, AIGFP was able to acquire third-party prices on about 70% of the underlying collateral securities in the multisector CDOs. In cases where AIGFP received multiple quotes, an averaging of pricing was used. Prices were reviewed for consistency across ratings and time. Matrix pricing was used where third-party prices were unavailable.

Second, AIGFP benchmarked these third-party prices to independent pricing services and sources. Third, other key inputs were obtained for the modified BET model; for example, weighted average life of securities, diversity scores, discount curves and Moody's recovery rates.

Next, AIGFP performed a valuation review and stress testing of the modified BET results. Finally, AIGFP obtained a number of Super Senior bond tranche quotes for the underlying CDOs or implied them from collateral calls and 12 major dealers to adjust the BET results, where appropriate, to make a best estimate of the exit value of the transactions. No negative basis adjustment was utilized for the reasons I explained earlier.

In effect, the $11.25 billion unrealized market valuation loss, we've recorded, intrinsically assumes that we own the cash CDOs. No credit is given to the synthetic nature of our obligations, since the credit component of the spread widening is not presently observable.

In summary, AIG believes that its $11.25 billion best estimates for the unrealized market valuation loss represents fair value under GAAP. AIG also believes that the result of its fundamental credit analysis and stress testing provide confidence that any realized losses in the portfolio, as I said, will be materially below the GAAP fair value estimates.

Let's turn to slide 14. I'll talk a little bit about economic capital. In determining the available economic capital at AIG, so far in our development of the methodology, reviewed GAAP capital as a proxy for available economic capital. We do not feel it is appropriate to deduct the after-tax unrealized market valuation loss from available economic capital, since if we did so, it would assume that the appropriate economic capital required for these obligations will be based upon the current distressed and ill-liquid capital markets. Rather, AIG intends to hold what we believe are good risks on our books until the transactions mature. Economically, we would assume the severe stress loss described the earlier, plus a cost of capital charge, would constitute the current market consistent settlement value of the loss.

Slide 14 explains the net after-tax adjustment to GAAP we would apply to determine AIG's available economic capital as of December 31, 2007. You can refer to the Economic Capital Update memo, we posted to our website, for a thorough explanation of this process.

Turning to slide 15, in accordance with GAAP, AIG recognized the sizable unrealized market valuation loss in 2007 consequent to the severe market disruption and credit deterioration, particularly of sub-prime mortgage-backed collateral. This market valuation loss represents management's best estimate of the exit value of this portfolio into the current ill-liquid and distressed markets. However, AIGFP under-wrote its Super Senior Credit Derivative business to a zero loss standard, incorporating conservative stress scenarios at inception. Although, there is likely to be continued volatility and perhaps further deterioration in the credit markets, based upon AIG's analysis and stress tests, AIG does believe that any credit impairment losses realized over time by AIGFP will not be material to AIG's consolidated financial position, nor to it's excess economic capital position, although as I stated, they could be material to an individual reporting period.

Finally on slide 16, AIG recognizes that continued improvement in its internal controls is necessary and remediation of the identified material weakness will be a very high priority in 2008. Over time, AIG intends to reduce its reliance on certain manual controls that have been established and to migrate models that have been developed in response to market events to a more robust production environment. AIG is also currently developing new systems and processes, which will allow it to rely on front-end preventive and detective controls that will be more sustainable over the long term. AIG is committed to making the significant investment necessary to make these improvements.

Now I'll turn it over to Win to disuses our invest portfolio.

Win Jay Neuger

Thanks Steve. I will provide you with an update on AIG insurance investment exposure to residential mortgages, commercial mortgage-backed securities, monoline insurers and collateralized debt obligations. We posted a more detailed presentation on the website, as Steve mentioned. Here also we incurred the significant negative realized and unrealized accounting losses during the fourth quarter. The overall, market dislocation had an impact on investment valuations, which resulted in realized capital losses in 2007 of $3.6 billion. We also have reported an unrealized depreciation on investments of $8 billion, reducing accumulated other comprehensive income to a still positive $4.4 billion net of tax.

On slide 19, the components of the 2007 losses and declines are detailed. Above all risk assets were impacted the RMBS securities were most affected, as shown in the far right column. I also want to point out that these combined realized and unrealized losses are approximately 2% of the total insurance investment portfolio and not all of the losses on the left hand column are even related to these portfolios, and non-RMBS losses amount to 1% of non-RMBS insurance investment portfolios.

Beginning with realized losses, more than 100% of the net number is accounted for by the $4.1 billion, other than temporary impairment. Of that OTTI loss approximately $3.1 billion is expected to recover in value. The 3.1 billion amount that we expect to recover is associated with either our inability to reasonably assert that certain severe declines in valuations are temporary, our lack of intent to hold to recovery or an adverse change in the timing, but not the amount of cash flows in structured securities. Another $500 million is associated with other than temporary changes in currency valuations and that leaves the remaining approximately $500 million which is associated with credit and structured securities impairments, with all the expectation of full recovery of principle. Please note that actual transactions during the year generated net gains of $1.2 billion and only $30 million of losses were taken on sale of RMBS.

Moving to the $8 billion of unrealized depreciation for the year, $5.1 billion or 63% is associated with RMBS mostly rated AAA and AA. In addition we have also seen declines in valuation of monoline insurers, commercial mortgage-backed securities and CDOs. We continue to believe that these market value declines are driven predominantly by market conditions, not by significant changes to the risk of principal repayments.

I will now move to talk in more detail about the key segments of the RMBS portfolio and explain our current position and why we believe that will be mostly repaid. I am going to skip from slide 20 to 21 and talk about the breakdown of the $89.9 billion of RMBS exposure. Our sub-prime RMBS holdings totaled $24.1 billion down from $28.6 billion at the end of June and $29.9 billion at the end of September. Alt-A RMBS holdings totaled $25.3 billion also down from earlier periods.

Slide 22 displays further details of the RMBS portfolio by rating for each type of mortgage-backed security. The slide underscores the point that we overall RMBS portfolio is high quality with 91% rated AAA by agencies and 7% rated AA.

On slides 23 and 24 are details of the sub-prime and Alt-A portfolios, by vintage year, rating and weighted average expected life. Slide 23 shows the details of AIG's investments $24.1 billion of sub-prime holdings. 87% of sub-prime is rated AAA and another 12% is rated AA.

Slide 24 provides details of our Alt-A holdings totaling $25.3 billion, of which 95% are rated AAA, and 4% are rated AA.

An important component in understanding the risk in our RMBS holding is the degree of credit enhancement.

On slide 25 we presented our original and current average credit enhancement for this sub-prime 2006 vintage, the largest vintage year among our portfolio sub prime holdings. Although the market's loss expectation has increased, our portfolio has delevered significantly, with an average credit enhancement of 29.6% for our AAA holding, and 21.5% for all holding below AAA. While sub-prime 2006 vintage loss estimates have risen into the high-teens or even low 20s, the combination of excess spread and current credit enhancement is providing the intended cushion.

Slide 26 shows comparable information for the Alt-A portfolio. As shown on slide 27, the major rating agencies have been downgrading and placing many securities on negative watch during the past six months. About $443 million of AIG's RMBS securities were downgraded in the fourth quarter of 2007 and an additional $3.6 billion were downgraded through February, 25th. $9.7 billion of the portfolio is on negative watch as of that date.

Of these downgraded securities, $2.7 billion were sub-prime exposures and represented 11% of the total sub-prime holdings. Taking into account all rating actions through yesterday, 93% of our sub-prime RMBS exposure is still rated AAA and AA. It's important to note also that rating agency downgrades do not affect the structural priority of payments, so the securities originally rated AAA retain their payment priorities including trigger or treble rates irrespective of their current ratings.

Turning to Commercial Mortgage-Backed Securities or CMBS, on slide 28, our holdings are $23.9 billion with close to 89% rated AAA or AA and only 0.2% below investment grade. Moreover $21 billion are traditional CMBS securities. Of the 9% of the CMBS exposure that come from resecuritizations of CMBS and Commercial Real Estate or CRE CDOs two-thirds of the loan underlying these securities are seasoned 25 months or more.

Side 29 presents the CMBS portfolio's current delinquency profile compared to market experience, showing positive comparison with only 23 basis points of delinquencies on the portfolio.

Next, slide 30 shows our CDO portfolio, shows that our CDO portfolio amounts to $4.6 billion, most of which are CDOs of corporate bank loans. In general, the pricing of this portfolio has been adversely affected by current marketing conditions. However, after fourth quarter write-downs, the portfolio has only $58 million of remaining ABS CDOs with sub-prime exposure and only 1.6% of the holdings in the total portfolio were downgraded in 2007. Based on our current analysis, the ultimate loss of principle in the CDO holdings is expected to be minimal.

Turning to AIG's exposure to the monoline insurers on slide 31, the investment portfolios have $42.2 billion of exposure, of which more than 99% are financial guarantees from the monoline companies. $31.4 billion of the monoline exposure supports the municipal bond portfolio, which has a high underlying credit quality of AA.

Slide 32, which shows or slide 32 rather, shows that the 84 % the monoline exposure has an underlying rating of A or better, in other words the bonds that are being insured are rated A or better without the guarantee. Financial guarantees are viewed by AIG purely as a secondary source of payment for all wrapped investments.

On slide 33, is the breakdown of our exposure to each monoline insurer. You'll see that 96% of the monoline exposure is to MBIA, FSA, Ambac, and FGIC.

Slide 34 summarizes the characteristics of our RMBS, CMBS and ABS wraps that are wrapped by the monolines. The RMBS, CMBS positions with internal ratings below investment grade represent primarily Second Lien and HELOG, Home Equity Loan Goals that have worst experienced... that have experienced worst than anticipated performance. Currently, there are 10 RMBS Second Lien and Home Equity transactions totaling at $380 million, or less than 1% of AIG's total insured portfolio that are known to be receiving contractual payments through their financial guarantees.

Concluding with slide 35, since August 2007, the broader capital markets have emphasized liquidity and aversion to risk. The U.S. residential mortgage market has continued to deteriorate, with limited financing opportunities from mortgage borrowers and substantial increases in lifetime loss expectation on 2006 and 2007 U.S. mortgages. This deterioration has increased our mark-to-market and downgrade risk. However, our preference for RMBS exposure is high in the capital structure, continues to guide a current expectation that the risk of an ultimate loss to investment principle in these securities remains low.

We've also focused on monoline, CMBS and CDOs in this presentation, all to varying degrees have been focal points of market volatility in the past six months. So our CMBS holdings have suffered from volatile market pricing, underlying fundamentals remained strong with very low delinquencies. Furthermore our CDO holdings have suffered minimal downgrades in 2007 and have little exposure to the current struggling sub-prime CDO market

Because AIG focuses on fundamental credit analyses, our holdings did not rely on financial guarantees for monoline insurers... from monoline insurers as a primary source of repayments at the time of acquisition. In this environment, in our insurance portfolio as we have been opportunistically increasing liquidity, further downgrading migrations are... seem fairly likely but its important to note that ratings changes do not affect the structural protection and unless we expect substantially full recovery of principle interest from most of our investment holdings. Furthermore, we are looking for opportunities to take advantage here as the markets create what are truly compelling opportunities in the market.

And I will turn it to Bob.

Robert E. Lewis

Moving on briefly to AIG's mortgage insurance subsidiary, United Guaranty in slide 37, UGC has been providing lenders mortgage insurance on first and second lien mortgage since 1963. As the broad market participates in the cyclical business, UGC's performance is highly correlated to the fortunes of the housing market. The current housing downturn has affected performance in asset quality, but UGC continues to outperform the industry on average.

Several underwriting and eligibility adjustments being implemented by UGC and their lender customers are improving the quality of new business production. The composition of UGC's portfolio has not changed significantly as shown on slide 38. Loans to borrowers with FICO scores less than 620 constituted about 8.4% of UGC's domestic mortgage risk enforced and 70% of their net risk-in-force has FICO scores greater than 660. Furthermore, high risk products such as interest only and option ARMS remain less than 10% of the risk-in-force. The 2007 vintage exposure was driven by higher utilization of mortgage insurance in the overall mortgage market. However UGC's market share of its traditional first lien flow business did decline by 1.2 percentage points quarter-over-quarter and 2.3 percentage points year-over-year.

Turning to slide 39, the deterioration of the U.S. housing market has affected all segments of the mortgage business, but the high LTV second-lien product is particularly sensitive and accounts for 51% of UGCs 2007 domestic mortgage net losses incurred. Due to the accelerated claim cycle of second-lien mortgages, these net losses incurred should work through the portfolio much faster and peaked in 2007. First lien net losses incurred however are starting to have a significant affect on operating results and some further deterioration is expected in 2008.

Nevertheless, as of December 31, 2007, expected losses are significantly below the net risk-in-force. Moreover future premiums are projected to exceed future losses on the existing domestic mortgage portfolio, despite an inherent mismatch in the timing of premium earnings and incurred losses. UGC's decision to be only a minor participant in the higher risk bulk channel which is predominantly sub-prime, Alt-A, and option ARM business is the primary driver behind UGC's better delinquency performance on first-lien mortgages than the rest of the mortgage insurance industry, as depicted by the graph on slide 40.

The graph is narrower than historical levels due to a rapid deterioration in the overall markets. However in January the gap widened to 73 basis points from the 64 basis points in December. The slides 42 and 41 describe UGC continues to implement key risk initiatives to improve the quality of new business production in both the first and second lien businesses, including tightening eligibility guidelines and increasing rates in select high-risk business segments.

There are a number of risk-mitigating factors described on 43. In light of this the cyclical nature of the mortgage insurance business, UGC employs risk-sharing arrangements or captive reinsurance with most of its major lender customers. It also purchases quarter share reinsurance on quotients of its sub-prime first lien business and segments of its second lien product. UGC maintains an important exclusion for fraud on both its first and second lien business and it has a geographically diverse book and continues to focus on ensuring single-family owner occupied residency.

In summary on slide 44, UGC has engaged in the highly cyclical business and downturns in the housing industry have negatively affected short-term results. UGC continues to implement key risk initiatives to improve the quality of new business production. However, UGC expects the downward market cycle will continue to adversely affect its operating results for the foreseeable future and is likely to result in another significant operating loss in 2008.

Turning to slide 46, American General Finance is AIG's domestic consumer finance business. AGF is a portfolio-based lender whose product includes real estate, non-real estate and retail sales finance loans. It originates real estate loans through a 1600 branches. AGF also originates and acquires loans through its centralized real estate operations.

Slide 47, depicts the slowdown in AGF real estate production beginning in the third quarter of 2005. As we have mentioned in previous calls, AGF did not relax underwriting standards in the market overheated in late '05 and '06. Rather they anticipated many of the real estate market issues and scarified growth for long-term credit quality and earnings stability. The results of AGF's underwriting discipline has resulted in a mortgage portfolio with credit quality far superior to that of the sub-prime asset-backed security real estate market as shown on slide 48.

On slide 49, AGS Real Estate 60 plus delinquency rate was 2.64% and its real estate net charge-off ratio was 0.47% at year end '07. The current housing downturn has resulted in delinquencies and losses that have risen form recent all-time lows and credit quality remains subject to future of macroeconomic conditions. Nevertheless, AGF's credit quality remains below its target ranges which were set by AIG and AGF management years ago, to the sound credit quality parameters.

Slide 50 highlights key risk mitigants in the mortgage portfolio. AGF has required full income verification on almost its entire real estate book. In addition 88% of the portfolios are fixed-rate mortgages which have much lower delinquencies and losses than adjustable risk products. The limited ARM customer base is qualified on a fully indexed and fully amortizing basis at origination and only 9% of the overall real estate loan portfolio is due to reset interest rates by year end 2008. Furthermore, AGF did not delegate underwriting on purchase loans and has not made option ARMs. Essentially all other real estate loans are first mortgages and owner-occupied. AGF recently announced the pending acquisition of $1.5 billion and outstanding balances of branch-based consumer loans of Equity One Inc. representing approximately 130,000 accounts.

As described on slide 51, this transaction is expected to close during the first quarter of '08. AGF believes this is an excellent opportunity to augment organic growth with a large portfolio of first and second fixed rate mortgages, consumer loans and retail receivables that is similar to AGF's customer profile and credit quality performance.

In summary, on slide 52, at the end of the fourth quarter, the real estate portfolio remained at $19.5 billion, flat to the end of the third quarter. AGF believes that the housing market will likely continue to deteriorate for the remainder for '08, but the company's business model and underwriting approach are sound and will allow the company to continue to pursue opportunities, as they arise.

Back to you Martin?

Martin J. Sullivan

Thank you Bob. I want to conclude by reinforcing that AIG remains a great company. With unmet competitive advantages, strong brand recognition and a unique global franchise, we believe AIG is extremely well positioned for the upcoming market opportunities. We know that this has been a very long presentation that there has been much to cover and I hope that that our disclosure has been helpful for you to understand these issues in more detail and in more depth. We appreciate your patience and now we will be more than happy to take your questions.
Question And Answer

Question and Answer

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions]. And our first question comes from Jimmy Bhullar with J.P. Morgan.

Jamminder Bhullar
J. P. Morgan Securities

Hi thank you.

Martin J. Sullivan

Good morning Jimmy.

Jamminder Bhullar
J. P. Morgan Securities

Hi good morning. I just have a few questions. The first one is for Edmund, if he is there. You mentioned that there is a chance that you had to contribute additional capital to your dial-on [ph] business, because of higher capital requirement. If you could quantify that on what that could be and secondly, on your $14.5 billion to $19.5 billion estimate for excess capital, what's the potential that this number could decline when you revise your excess capital estimate, once you use the updated 1231 inputs. I think it's made your publishing utilized number.

And the final question is on your economic loss language for the capital market business. If you can discuss the rationale behind the change in language, how much of it's driven by the deterioration in the market and how much of it is just conservatism on your part and then just generally talk about the factors that could affect your realized loss estimate of $900 million, that would be revised higher or lower over time?

Martin J. Sullivan

Okay Jimmy.

Edmund S.W. Tse

Hi Jimmy, Edmund here. I am here with the group. I'd just answer your first question relating to the capital requirement in Taiwan, namely Nan Shan. In fact we have a very strong underlying performance in our life company in Taiwan. Nan Shan is making a operating income of like $900 million for the year, but there is some new capital requirement as regulated by the insurance commissioner and they had some capital charge to certain type of investments and as a result that our RBC, Risk Based Capital maybe in case of investment performance below the requirement of 200%.

Right now, we don't have a problem, we that impairment ahead. In case, we are below that, then we may have a problem to increase our offshore investments as only if our RBC is above 200%, they will approve further increase in offshore investment from the 35% to 40%. But based on a current situation, we do not need an injection of capital to support our local operation there. It's very profitable and the financial is very strong.

We are thinking of different ways to see if we could further improve our RBC including possible reinsurance and/or realized some capital gains from sudden investment asset and so forth. But the last resort to probably thinking of issue preferred shares to enhance our further capital base in Taiwan. But that's really for precaution.

Steven J. Bensinger

Let me, it's Steve, with regard to your second question on excess capital. The $14.5 billion to $19.5 billion range that we just published is based upon the roll forward of our current modeling as I have talked about earlier. To what extent that might change when we do the full review on the December 31, 2007 numbers. I mean it's very difficult for me right now to project that. If we look at the past circumstances the updates have been pretty consistent with the roll forward. But it's really impossible for me to give you any real level of confidence on that, although I would say, we feel pretty good about how we've derived these numbers at this point of time. With regard to your third question on economic capital, loss estimates or I am sorry the cost estimates on the stress studies, I'll turn it over to Bob Lewis.

Robert E. Lewis

Yes, Jimmy, you asked given our conservative estimate of excess capital at the end of '07 of between $14.5 billion and $19.5 billion. But when we actually run the numbers and validate whether you think that there will be a substantial change in that number. No, we do not but the initial assessment, our estimate is based upon our roll forward of certain assets and liabilities, which we of course need some time to fully to fully model. So there is no expectation that there would be a major adjustment. That range does already take to account the results, the financial results that we have reported.

Regarding your third question on the stresses, regarding on that, as far as effect of further rating changes, I think you can see from the stress description on page eight, that we have taken into account one, the current ratings that exists through January in our current estimates and then also we have stress those ratings substantially from here. And so that I think that stress that we provide there in detail shows a significant change of potential quality in the portfolios that is really driven from the current analysis of expected delinquencies and loss development as well as recovery rates or housing price depreciation. So by assessing are own views and also those of third party, third party analyst particularly the rating agencies, who have used that in determining the stress test that we have shown there.

Regarding how that estimate could move and what could move it? Obviously no one knows exactly how deep and how long live this downturn will be. However, given the assumptions of delinquencies and losses and housing price appreciations that effect, we are quite comfortable with that stress really is a severe stress to our business and then that number is right now our current best estimate of a real severe stress loss.

Jamminder Bhullar
J. P. Morgan Securities

Okay and are the $6.2 billion credit that you are taking or the benefit in your excess capital assessment is that something that the rating agencies are okay with or there is some, are the rating agencies are okay with that treatment.

Martin J. Sullivan

Well Jimmy I think we have been pretty clear as we discussed this over the last year that the rating agency is right now, are not as far along as we are in terms of our own economic capital modeling. So the rating agencies are using their own testing. Now, I think you have seen from some of the publications over the past few weeks that a number of the rating agencies are doing their own modeling of our underlying Super Senior portfolios, some of them gave some initial views a couple of weeks ago, when they changed our outlook or put the company on rating watch or review.

So they are not on... they are not using the same methodology as we are, but we expect that as we continue to converse with them over the next few weeks in the immediate future that will be showing them the rationale for our own modeling and comparing that with them to their own and providing them with the information they need to come to their own conclusions.

Jamminder Bhullar
J. P. Morgan Securities

Okay, thank you.

Martin J. Sullivan

Thanks Jimmy.

Operator

Our next question comes from Ron Bobman with Capital Returns [ph].

Unidentified Analyst

Hi. Good morning. It would seem to me given the circumstances that the greatest area in your control to create value and make money is in getting better rates in the property and casualty area. And I wanted to know what you are doing on that end? Thank you.

Martin J. Sullivan

Thanks Ron. Well obviously, during the fourth quarter and year end, we continue to see rating pressures in the P&C environment and domestically in the United States overall I think rates were down around 9% and I think internationally in our commercial business rates were down about 11%. The good news is that so far again generally speaking terms and conditions high policy wordings and deductibles holding reasonably well. They're always of course examples where that is challenged. But both Kris Moor and Nick Walsh are here to give a little more color maybe by line, where we are seeing continued rate pressures. One area I am particularly concerned about is the aviation sector, which continues to see significant rating pressures over many years, but I'll let Chris and Nick add a few words.

Kristian P. Moor

Yes Ron, this is Kris. Overall monetary that was 9%, but on the... excluding the property and workers comp for the fourth quarter they were down 10% and for a whole year about down 8%. The property rates declined in the fourth quarter about 13%. We're seeing similar in the first quarter so far overall rates are down about 10% and property rates are down about 12%, but with that said, we still feel that in almost all our lines the business set for a few that rates are plenty, adequate and there is a lot of opportunity out there for us. The areas that we are watching very closely or looking at closely is the aviation area and also in some of the states for workers comp, but besides that we still see a lot of opportunity out there.

Nicholas C. Walsh

Ron from a Foreign Gen standpoint, the comments on pricing are pretty much the same. But we have some terrific opportunities across the world. We have excellent growth in Latin America where there are some pricing opportunities because of reducing local capacity. We are doing extremely well in Continental Europe, where we are primarily under scale, so there is lots of upside as well there. I am very excited about Middle East and some of the emerging markets. So it may be tough in some of the more conventional markets, but there are still lots of opportunities for Foreign Gen.

Unidentified Analyst

I appreciate the commentary and the discussion of opportunity. I am surprised I don't hear any talk about rating action that you are taking as a leader in large swaps of lines of business and in P&C, basically taking a leadership position to hold rates or take rates up.

Kristian P. Moor

Ron this is Kris again. It's a good comment. In areas... there are always areas that have exposures that you feel that you are coming close or you are at the point where the rates have to change and obviously in today's environment, financial institutions is an area that rates we are pushing and leading the market and there are one or two others that are with us on that and increasing the rates in that area. And in some other product lines and if you go don very specifically, you will see spots where we are increasing rates. Then in other areas we see opportunities, where the rates don't need to be increased. But we look at that and we do lead the market in that area.

Unidentified Analyst

Thank you.

Martin J. Sullivan

Thank you Ron.

Operator

And our next question comes from Andrew Kligerman with UBS.

Andrew Kligerman
UBS Securities

Hey good morning. Couple of question more conceptually; what was it that led to the conclusion by Price Waterhouse Coopers that you have a material weakness. Where did that... when did that thinking coming into play? And with that and correct me if I am wrong, I don't want to focus on the monoline insurers, but don't they use a fair amount of manual marks in their accounting. So that would be question one.

Part two is I know you've just touched a bit on your economic capital on the $14.5 billion to $19 billion I think it is and it's not clear what the rating agencies are thinking. Is there a risk that they're going to ask you for more capital may be you can... I assume in your comments early you indicated no, but could you give us a sense of what you're thinking on that front? And mainly in terms of the Japanese market, it looked like there were a few pressure points, you had let's see your Japan sales were down in the fixed annuity area about 10%. You saw some weakness in the group premiums about 9% and the personal accident area actually showed an 8% increase, also weakness in variable annuity sales so. So may be if you could I don't mean to this a long one, but may just a quick color around each of these products, real quick in Japan and what the environment is like?

Martin J. Sullivan

Thank you Andrew. Well I'll take question number one. I'm sure Steve will tackle question two and Bob Clyde is on the line from Japan, so what I'll defer number three to him. He can give lot more color.

Just on the first part of your first question, obviously given the extreme dislocation in the markets, affecting obviously AIGFP's Super Senior Credit Default Swaps, we were working during the fourth quarter of implement system and controls to accurately report financial results. While obviously we didn't succeed, obviously because we have the material weakness that evolved during the close process in implementing an oversea and a sufficient valuation process before the end of the fiscal year, we obviously have addressed those issues in preparing our year-end numbers by obviously inserting compensating controls.

The good news and of course in the bottom line is that we have a clean ordered opinion and that the accountants signed off on the numbers and as Steve mentioned earlier, we are obviously working very hard to remediate as soon as possible, the material weakness. Obviously on the second part of your question, I obviously can't comment, on the other companies, particularly the monolines as you suggest and haven't formulated their numbers.

Andrew Kligerman
UBS Securities

Then Mart then may be just, you seem so confident at that December Investor Day and it just makes me wonder where what was, Price Waterhouse Coopers thinking, at the time to where go into that Investor Day, and be so confident. May be this stuff could have been corrected in time before the material weakness and actually on that note, when do you think it's possible that could get lifted?

Martin J. Sullivan

Yes, well on the first part of your question there Andrew, obviously those numbers that were presented at December 5th were unaudited. And secondly, as I have indicated we are going to work very diligently to remediate the material weakness as quickly as we possibly can and we will be working very hard to do that through the balance of 2008. And as soon as we have fully remediated obviously we will advice you as soon as possible.

Andrew Kligerman
UBS Securities

Okay, alright...

Steven J. Bensinger

Andrew on the question of the rating agencies, obviously I can't speak for them. However, I think if you read the publications that all four of the major rating agencies made a couple of weeks ago after we filed the 8-K, I don't think that you will see any indication that they feel that we have capital issues discussed and that has not been the subject of any discussion with them so far. Now again, I can't speak for them or what their conclusions might be, once they digest our year-end numbers. But so far that has not been discussion topic.

Andrew Kligerman
UBS Securities

Steve spread had widened a fair amount in January and February. If you had to remarks today, would you be looking at something similar again for the first quarter and then will the agencies get concerned?

Steven J. Bensinger

Andrew I think a lot of what we have discussed with the rating agencies and what they have written has not only been focusing on the fair value marks for GAAP but they are also looking at the economic stress test analysis and the underlying strength of the portfolios. If you go back to the presentation that we discussed a few minutes ago, these Super Senior structures were designed to withstand very severe economic stress, that's how they were underwritten. And so far from an economic standpoint they certainly seem to be performing as they were designed. So I think the substance of that is also going to be a significant factor in the actions that the rating agencies take, based upon the conversations we've had with them and also what they have actually already written. So I think we just have to see how it evolves and again, I really can't speak for them other then to point you to what they have been saying publicly.

Andrew Kligerman
UBS Securities

Steve, do you think the mark will be similar in the first quarter to what we have just seen in the fourth quarter?

Steven J. Bensinger

Andrew I really... we really don't know that at this point in time. I mean there has been more deterioration in the underlying market as a whole. There has been as you stated further spread widening. What that precisely implies through our overall portfolio, we just know at this point in time. The processes that we now employ that I went through with you are highly complex. They involve a great deal of market information that takes time to obtain. We will have our best estimate mark, when we publish our first quarter financials. But right now, I think it would be just too difficult to really give any kind of an answer to that precisely.

Martin J. Sullivan

Okay, thanks Andrew. Bob if I can ask you to respond to the third part of Andrews' question.

Unidentified Company Representative

Yes, hi, Andrew. Let me start with your questions about annuities. The sales of fixed annuities were 11% below the fourth quarter of the prior year but it improved by 6% versus the third quarter, which marks the third straight quarter of increasing sales, due largely to strengthening yen and steepening of the yield curved in the recent equity market volatility, and also fixed annuity sales for face-to-face channel has shown some nice gains to with the new not got wider option that we offer.

Now we'd initially introduced that in the face-to-face channel. We also introduced in the bank insurance channel in fourth quarter and thus far. Three banks have taken up and that we are in the process for launching a number of others. With respect to variable annuities, we were 5% of our fourth quarter but we were declining... we declined 22% versus the third quarter due to the turbulent equity markets. And of course, the risk characterization applied to these products which the... because the new financial instruments and exchange law that has created some of... bit of current going the other direction, but the new lifetime guarantee minimum withdrawal benefit VA for life product saw really significant growth in the fourth quarter. The sales grew to 65%, versus the third quarter and 53%, versus against the fourth quarter and that's helped. That was helped in large part by a third quarter launch by SMBC one of the mega banks and a mid fourth quarter launch by BTMU another mega bank.

And as a result at the end of December, we had launched that product in 35 banks and we are the only VA... similar VA products sold off for mega banks incidentally. And the sales of that GMWB for life VA had continued to increase every month. Let me just move over to the A&H sales which in fourth quarter declined by 15.6% over prior year, mainly due to deliberate measures that we had to reduce our advertising spend in ALICO's direct marketing channel to improve profitability.

And to offset that decline, we had increased A&H sales through face-to-face channels. As we look forward, we're anticipating a stronger outlook for A&H sales as concerns raised by the claims payment issue are starting to fade. We are into the final phase of the bank deregulation which has opened up new opportunities as well. In fact on 22nd December, as you know that was the final phase of deregulation and ALICO started to sell four A&H products including a new innovative single premium whole life FIH in 20 major banks including four mega-banks and we're, again we're the only provider of products in all four mega-banks.

And the mandates in the banks are running ahead of our plans that we have 24 tie ups by the end of February. And we expect 30 banks by the end of April, until we have several other product initiatives as well. We got a new cancer product that we'll be launching in June, we are excited about, it will be competitively priced, it will be particularly important to the female and younger market segments.

We expect a new FIH product to be developed in December. Just briefly, I would like to... you didn't ask about life, but let me just mention one thing that about why life insurance is down 12.3% for fourth quarter. Major driver of that negative term was the suspension of the lapse-supported increasing term product back in April 2007. And following that suspension, our sales totally dried out. If you exclude that increasing term products, sales were up 14% in the fourth quarter and 8.6% for the year and we had other products to overcome that impact with the suspension of LSIT and for example we posted record sales of dollar products which have profit margins but are significantly higher, than our yen based products, so that was a really positive outcome.

If we look forward in life, the outlook I think is very favorable. Single premium dollar and whole life products remain very strong in both face-to-face and bank channels. ALICO launched a very innovative product called ESDN [ph] or yen so to dollar [ph] which is a product that's yen on the outside and dollar on the inside. And that product has surpassed our expectations in the first couple of months and we have a suite of about six products now through the banks.

Unidentified Company Representative

Bob, if can and I'm going to have to try and end your response there. Because we've got a lot of people on the call. Andrew, if you like any more information, obviously we can get back to you on that.

Andrew Kligerman
UBS Securities

That was great.

Unidentified Company Representative

Okay thank you very much, indeed. And ladies and gentlemen I think we've got enough number of callers obviously and if may ask that you kindly limit may be to one or two questions. And then so we can take as many calls we possibly can. Thank you very much indeed.

Operator

And our next question comes from Nigel Daly with Morgan Stanley.

Nigel Daly
Morgan Stanley

Great, thank you Good morning.

Unidentified Company Representative

Good morning Nigel.

Nigel Daly
Morgan Stanley

You... coming into that consumer financed delinquencies and charge-offs remained below your target ranges; you're barely breaking even in these operations. So perhaps you can provide some additional color on what's driving the significant pressure on the earnings, if it's not the performance of your loan portfolio. Second, just numbers question, if you can break down the mark-to-market losses between the high grade and the mezzanine model CDOs and subprime?

Martin J. Sullivan

Great, Nigel we have Rick Geissinger with us, obviously he runs our domestic consumer finance business. So I'll ask him to respond.

Frederick W. Geissinger

What was driving the fourth quarter is basically three or four major factors. We continue to have problems in our mortgage company. We have taken a number of actions to correct that and we'll continue to do so. We also added about $70 million to our allowance for loan losses, the reason for that is that we came off historical lows for the company in summer of '06. And delinquency and charge-offs are up somewhat. We are not immune to what's happening in credit markets. But we are still below the target ranges that the we published in the 1997 in all of our products. So this is a little bit of margin spread... margin squeeze I should say and that's fundamentally what's driving the earnings in the fourth quarter.

Martin J. Sullivan

Nigel, on the second part of your question. We're looking for that information and we'll try and get back to you during the period of this call.

Nigel Daly
Morgan Stanley

Okay that will be great. Thanks.

Steven J. Bensinger

Appreciate it. Nigel just a clarification you are talking about the investment losses correct?

Nigel Daly
Morgan Stanley

The TDS mark-to-market loss which you took in the quarter, is breaking it down between the high grades and the mezzanine?

Steven J. Bensinger

Are you talking about the super senior block?

Nigel Daly
Morgan Stanley

In the super senior, yes that's right.

Steven J. Bensinger

Alright. I am not sure would we be able to have that information in this call but we can try to provide that.

Nigel Daly
Morgan Stanley

Great, thank you.

Martin J. Sullivan

Thank you Nigel.

Operator

And our next question comes from Josh Shanker with Citi. Your line is open.

Joshua Shanker
Citigroup

Thank you. Two questions the first I want to discuss the $900 million stress test scenario number. How that relates to the less than $600 million discussion, and what seems like a worst case scenario described at the December 5th conference call. And then I want to also ask about the $900 million during the commentary and the Q&A you said that that number was as of January 31st. I just want to confirm that that's actually as of December 31st. And finally I wonder if you could get any commentary on the D&O subprime exposure. I noticed you added some new disclosure there I am curious to know if you can talk about number of potential policies affected or what's kind of rate online per million of coverage, we are talking about in that book of business?

Martin J. Sullivan

Sorry Josh, Bob will respond to the first part of your question there and we have John Doyle with us who is responsible for executive liability business and he'll give you some color on the last part and I think Nick will chime in there with some information on the international side as well. But first Bob.

Robert E. Lewis

Good morning Josh, Bob Lewis. As far as the comparison of your, of the $900 million and the $600 million, the $600 million I assume you are referring to one of the frequently asked questions in the December 5th presentation which described in it what the actual stress, if you will what's defined as being. And the $900 million, the stress there is identified for you on slide eight of the presentation, we just referred to. So the actual components of the stress are slightly different. I don't have the actual $600 million in front of me here. But the $900 million that we have just discussed is really as we articulated there what we feel from current situation and rating situations that are in the marketplace. What we feel is a severe stress from here and that is rolled up on the portfolio too. This $900 million potential unexpected loss.

Joshua Shanker
Citigroup

To be fair, the 600 million was writing off all 2005 subprime RMBS BBB and below in all '07 and '06 regardless of Vintage as well as ABS CDOs from those here, I think because of the Vintage and... it seems like an extreme structure do you think the $900 million isn't even more extreme stressing then that?

Robert E. Lewis

I think it said what principally say is that there is a different stress we have done a number of stresses and the one that we have articulated in the presentation today is that one that we feel given where the current stress is being shown in the marketplace which is in the subprime and all day areas. This is a stress that we feel is the most appropriate for our own internal purposes to use as a severe stress.

Joshua Shanker
Citigroup

And that's as of December not January.

Robert E. Lewis

Yes, as of December incorporating however rating actions that through January 3rd. So there were significant rating actions taken in January 3rd and our stress is a stress from that.

Joshua Shanker
Citigroup

Okay very good. And on the D&O front?

John Q. Doyle

As Good morning Josh as Martin mentioned we continue to monitor the issue very, very closely and claim activity remains manageable on at this time. We have as of a week ago and dating back to the beginning of 2007, were unnoticed of claims or potential claims on 261 policies its 334 potential moves.

Joshua Shanker
Citigroup

And is there any way to, get any more granular about how that $347 million in premium is divided among various clients about now?

John Q. Doyle

Sure. That number of claims by the way, is a global number its our worldwide operations, $301 million of the $347 million in written premium is from our domestic operations. I am not sure what other information we can pull there.

Joshua Shanker
Citigroup

Can you talk of rate online for D&O at times or anyway that we can translate that in to $347 million coverage, how many clients or anything of that nature?

Unidentified Company Representative

How many clients we have...

Joshua Shanker
Citigroup

How many possible clients, you talked, you totaled the total sub prime potential exposure, how many clients does that actually cover?

John Q. Doyle

I don't have any number in front of me but we did an extensive ground up review in a domestic insurance operation to come up with the, the profile of the accounts that are potentially exposed in the footnote, it notes all the various class of that business that, that we took a look at, as Chrisman mentioned we are pushing price in the financial institutional area, and prices very widely from private, private to public risk. From inner risk, the other part of portfolio, So prices are very, very different from one segment to another.

Joshua Shanker

Citigroup

Okay. Well you guys are going to get further disclosure on that, I am sure I would appreciate. Thank you very much.

Martin J. Sullivan

Thank you.

Operator

Next question comes from Larry Greenberg with Langen McAlenney. Your line is open.

Larry Greenberg
Langen McAlenney

Thank you and Good morning.

Unidentified Company Representative

Good morning, Larry.

Larry Greenberg
Langen McAlenney

On the FP side, I know that AIG guarantees the debt capital there. Is there any possibility that the rating agencies will reflect some more capital into FP?

Martin J. Sullivan

Larry that again, that has not been a subject matter of discussion, because of the guarantee that AIG provides to AIG financial products. They are relying on AIG's overall financial strength and support to operation. So that has not been a subject of discussion, now.

Larry Greenberg
Langen McAlenney

Okay great. Have any other key management of FP left or are planning to leave beyond June?

Martin J. Sullivan

Yes, Larry and they are getting back to work straight after this call.

Larry Greenberg
Langen McAlenney

Great and just a couple of small pieces, what was the FX impact in the foreign life earnings?

Martin J. Sullivan

Kristian.

Kristian P. Moor

For the quarter it was 3%, 2% year-to-date. And it was less. It was a benefit on revenue, on operating income bottom-line. We disclosed the impact on revenues and GAAP premiums in our step supplement, but bottom-line was of 3% for the quarter, 2% year-to-date.

Larry Greenberg
Langen McAlenney

Great. And you made reference to some unusual expenses in the foreign gen expense ratio, I mean it looks there was about 4 points above normal which is about $130 million. Is that reasonable for me to assume?

Unidentified Company Representative

Nick's, Nick Walsh has got some color on that Larry in great detail.

Nicholas C. Walsh

For those of you don't have supplements in front of you, the fourth quarter '07 expense ratio is 42.25 against the prior 38.48, which is a difference of 3.77 and the year is at 34.95. First comment is that the fourth quarter expense ratio is always the highest of the year for seasonalization issues. But the reasons for the difference is primarily through the realignment of certain legal entities and integration costs and major part of that is the, we call it part transfer of organization in the U.K. from a U.S. branch to a local subsidiary that started on time and it will finish on time, it is finished. Give you some numbers involved, 200 people for the majority of the year. We send out information pact to 2.2 million customers and that was 10.5 million pieces of paper and we received 47,000 in cards [ph] with which we dealt with. The other part of integration is between our acquisition in Taiwan Central and AIG operations.

Asides from that Ascot had a... Lloyd [ph] business had a spectacular year and the increase profit commission shares up as an impact on fourth quarter expense ratio. Aside from that we have a continuing emphasis on the consumer business and part of our strategic imperative is to change the format of some our commercial business we're targeting are expecting about this in previous events. We're targeting smaller businesses, because we think we have an opportunity there and the commission cost and of course the operating expenses around that are higher, but that's all according to our plans.

Martin J. Sullivan

Thanks Larry.

Larry Greenberg
Langen McAlenney

Thank you

Operator

Our next question from Jay Cohen with Merrill Lynch.

Jay A. Cohen
Merrill Lynch

Yes. Thank you. Two questions, first on UGC, clearly you're suggesting the '08 year is going to be another pretty bad one. I am wondering if you can put any parameters around this. Should be we expecting losses in '08 to essentially mimic what we saw in the fourth quarter of '07, that's the first question. And secondly, in lot of your analysis you make a reasonable distinction between '06 to '07 vintages and the five vintages which I think up until this point has been pretty reasonable, but with real estate prices continuing to come down. Do you see a risk or why don't you see a risk at the '05 year will you look may be as bad as '06 given that the real estate prices continue to fall?

Martin J. Sullivan

Jay, Bill is Nutt is with us, so I'll ask Billy to respond to the first part of your question.

William V. Nutt, Jr.

Sure good morning Jay. First question is we all seen the housing indicator as we're trending negative, trending negative at it and an accelerating pace particularly in fourth quarter and likely to continue to do so. We've pushed our economic forecast to suggest that the housing market is going continue to experience a lot of stress through '08 and probably will not bottom out until the first half of '09, if then. So the combination of deterioration in the housing market combined with obviously a slowing economy is going put quite a bit of stress on our domestic portfolio and as Bob Lewis said it is likely to result in another significant operating loss in 2008. Without giving any specifics we would anticipate that, that operating loss would be somewhere in the range of where we were in '07 to some what higher then that.

As regards the decline in home price appreciation and the impact on the '05 book, the '05 book was underwritten with more conservative underwriting criteria then the '06 book in the first half of '07 book. So it should perform better although, it will experience some additional stress as property values continue to decline and we are estimating a decline or forecasting, a decline in property values of another 7% or 8% for 2008. On the line with me is Lynn Swiny [ph], our Chief Risk Officer. Lynn would you like to add any color to the '05 in the prior books?

Unidentified Company Representative

No Billy, I think you said it well. The '05 book we have about $5 billion risk in force again it is stating to see the same level of stress, it's as the more recent books, but it did enjoy some early appreciation, so again under stress, but probably not to the level of the '06 and '07 books.

Jay A. Cohen
Merrill Lynch

Actually with that distinction I was thinking more on the credit derivative business, where in the stress test, obviously you are stressing the '06, '07 year as more intensely and I am wondering in really that business why don't you do a similar stress on the '05 year?

William V. Nutt, Jr.

Jay I've got Kevin McGinn with us, our Chief Credit Officer. So I am going to ask Kevin just to respond on that.

Kevin B. McGinn

Yes hi Jay. The rating agency is definitely and all the delinquency default data suggest that the '06 and '07 loses are going to continue to the decline and you're now seeing the estimates size in the high teens, low 20s. The '05 is definitely showing some deterioration, but the numbers are not nearly as bad and that's probably a large part, because of lot of the resets have already happened in the '05 vintages. The highest loss assumptions we are seeing in the '05 were really around 7.5. The ratings stress test that we ran essentially took that into... specifically took that into account, because we're expecting some more downgrades in the '05 vintages. We think we are in top of that and we've essentially stressed it appropriately.

Jay A. Cohen
Merrill Lynch

That's helpful, I hope if you can point about the reset too. Thank you.

William V. Nutt, Jr.

Thank you, Jay.

Operator

And our next question comes from line Alain Karaoglan with Banc of America Securities.

Alain Karaoglan
Banc of America Securities

Good morning, a couple of questions of on capital and on the property casualty business. From an enterprise risk management point of view are you considering weather you should be in the AIG financial products business at all, given the heartache that it's given to the stock and mark-to-markets on the portfolio and the volatility to the book value and from an excess capital point of view you mentioned $14.5 billion to $19 billion, but that seems to be little inconsistent with the fact that we are stopping the share repurchases. Could you... would it be possible to us the excess capital, versus what the capital requirements from the rating agency at the ratings that you would like would be, if there would be any excess capital at that level?

Martin J. Sullivan

But Alian on the first part of your question I said in my earlier remarks, AIGFP has been very important and continues to be a very important part of AIG. Its produced very good returns over many, many years and a very good return on capital. Obviously, like all of that, businesses everybody stays under constant review. But the business has performed exceptionally well that they were in what I have described as unchartered waters and like everybody else they'll continue to be reviewed, but at the present movement I think they add significantly to the diversification. On the second part Steve...

Alain Karaoglan
Banc of America Securities

If I could follow up a just on that, but on that capital Martin isn't that a notional amount of capital that you are allocating that AIGFP wouldn't be able to operate on a standalone basis and so the return on capital are high, but they are not similar or comparable to the rest of the business?

Martin J. Sullivan

It's notional, but it's a... they are... it's also drawing on the implied guarantee of AIG. So that would when AIGFP's capital position is being reviewed by the agencies or by its clients I think they are looking at the entire financial strength of AIG. Joe.

Joseph J. Cassano

Yes hi, Alain its Joe Cassano, how are you?

Alain Karaoglan
Banc of America Securities

Good thank you.

Joseph J. Cassano

One of the things that we've done historically, when we go through our own capital management within FP and measure the usage of capital with FP that we then, is it's basically a charge against the AIG for capital booked and when we've done that up until this period of time where we have these unrealized loses right now. We have always been a very high performer in terms of return on capital if you can think back or if you can find the files where we gave a presentation in May where we posted some of the historical return on capital; it's actually been relatively good. It is the case that right now with the unrealized losses it's a completely different story, but I wouldn't one of the things we do look at and one of the things we've been presenting over the last six months is the fundamental positive attribute of the portfolio we've written. And looking at that we really and if you look at that at that basis we think the return on capital is still very robust and when we get through this period. The company and the team will continue and will return back to the very-very positive types of returns that we've had in the past, hope that helps.

Alain Karaoglan
Banc of America Securities

Thanks Joe.

Unidentified Company Representative

Alain with the respect to your second question on excess capital, again the $14.5 billion to $19.5 billion range is our estimate based on our own internal economic capital modeling. It does not reflect the rating agencies views of our excess capital. They all have their own different perspective on what level of any of excess capital that we have and again I really can't speak for them. I think as we go through the process in the near term, hopefully settling our ratings which are now, as I said some on negative outlook and two on rating watch and review that we will have more of a dialog on that to see where they are relative to us. So for the time being given the fact that our ratings right now are negative outlook and in some cases on review we think it's prudent to suspend any new share repurchase activity until we have a better view on capital with all four of the major rating agencies.

Alain Karaoglan
Banc of America Securities

And on the property casualty business could you comment on the adverse reserve development on the 2000 to 2002 year, is that still bothering you and not the allowing the benefit of the recent year reserve releases to flow to the bottom line completely. And on the personnel line segment, if I did the math correctly, even excluding cash and adverse reserve development. I get a combined ratio of 112. Wouldn't anything additional happen in the quarter in personal lines to lead to such a high combined ratio?

Martin J. Sullivan

Alain, Frank Douglas is here. So I'm going to ask him to respond to the first part and then Bob will respond, Bob Sandler will respond to the second part.

Frank H. Douglas

We've seen continued development, as we've described really all years, it's not new this quarter from acting years 2002 and prior, in general the development has been less adverse and than it was in prior years. I think if you'll look in the 10-K, you'll see that 2002 and prior has about $1 billion less adverse development, but $800 million actually less than it did last year. So it is trending down, not as fast as we'd like. It's coming largely from excess casualty to some degree form Transatlantic and to some degree from workers compensation those three areas, this we've talked about I think throughout the year. We are seeing a lot of latent claims still emerge from our excess casualty books that are function of the soft market years. And we've improved our terms and conditions and underwriting guidelines to the point where we just don't think we're going see that kind of latent development from the more recent accident years. And as those all, the year continue to wind down, we should less of those surprises. But they did happen this year. They probably won't go away tomorrow, but we are certainly expecting minimal adverse development, certainly as we go forward, we expect those numbers to diminish.

Operator

And our next question comes form Eric Berg with...

Frank H. Douglas

No we have a response to the second part of that question.

Operator

Pardon me.

Unidentified Company Representative

Okay.

Robert M. Sandler

This is Bob Sandler. Let me take you through some of the pieces. You've mentioned some of them, but not all of the pieces that distort the quarter and there is a lot of noise in the quarter. There was $75 million roughly of wildfire losses that are included in those numbers from the private claims. You've got about $33 million of integration merger integration cost coming out of the merger of AIG and 21st Century. We've got about $36 million of adverse development in the quarter. We increased our lowest pick in the quarter for the year for current accident year loss pick and that had about $50 million impact on the first three quarters of 2007.

Though if you look at those pieces in total and subtract then you actually find the quarter is probably running more on the 104-105 range, if you do the math, which is not a brilliant quarter. I would just remind you that it's the... fourth quarter is typically seasonality generally affects that quarter last year for example we ran about 102 in the quarter, so we are running may be 2 to 2.5 points higher than that. And some of that is being caused by the newer business that we've been writing in 2007 to the higher proportion of our in force than in previous periods that's particularly true of the 21st Century business outside California.

So that business first year business does carry higher loss ratios typically and so while the... 104-105 is not a number we aspire to. I think the underlying book is pretty strong. We still anticipate that the direct business is going to produce a pretty good underwriting profit in the year '08, and the fourth quarter we probably read in the 97-98 range on that direct book, anyway when you count for some of this.

Alain Karaoglan
Banc of America Securities

Thank you, very much.

Unidentified Company Representative

Thanks Alain.

Martin J. Sullivan

Next question please.

Operator

And the next question comes from Eric Berg. Your line is open.

Eric N. Berg
Lehman Brothers

Thanks, very much I have two questions, both for Steve Bensinger. Steve with respect to this line on page 8 that culminates with the discussion of the realizable loss of $900 million, can you just...

Steven J. Bensinger

You are breaking up there.

Eric N. Berg
Lehman Brothers

Can you here me now?

Steven J. Bensinger

Yes.

Eric N. Berg
Lehman Brothers

Steve, with respect to the slide on page 8, that culminates with a realized loss under the severe stress scenario of $900 million, can you just clarify what is being expressed in the right hand side of the table, what the various percentages mean?

Steven J. Bensinger

Okay yes, so I think I will let Bob and Kevin give you more color on that one, they are the architects of that stress tests.

Robert E. Lewis

Well if I understand. This is Bob Lewis here. I want to understand what this means. You're talking about the severe stress criteria..

Eric N. Berg
Lehman Brothers

Yes.

Robert E. Lewis

Okay, I got it. I think, that it will be useful for Kevin McGinn, our Chief Credit Officer, who has been the managing the stress scenario work that we do to describe input that stress in overall context which I think is your question.

Eric N. Berg
Lehman Brothers

Yes.

Robert E. Lewis

That we essentially stress three categories of asset, sub-prime RMBS, Alt-As and CDOs and going from the top, you will the... we essentially took all the to 2007 vintage, and anything below AAA and loaded off a 100% with no recoveries. We took... we did the same thing for the second half of '06 and for the first half of '06, we essentially took a 100% of anything A+ and below and 50% of the AA and we thought that was the appropriate stress given all the rating activity that's happened around the '06 and '07 vintages.

In the '05 area, we essentially wrote-off 50% of all the second half of '05, the BBB and below. Now this is of again a lot of rating activity took place for all the way through the fourth quarter. So we think we basically captured that pretty well. We took also 100% of anything BB+ and below from the first half of 2005. We then wrote-off a 100% of all the... what we call the inner CDOs, so this would be any CDO buckets within the CDOs themselves, A+ or below regardless of vintage and regardless of type whether you are high-grade and mezzanine. And finally we took a 100% of the... we wrote-off everything A+ and below of Alt-A for '06 and '07 that basically takes you though the various categories there.

Kevin B. McGinn

And again just to reemphasis Eric that those stresses were performed as static stresses, that's what that footnote says. I'll assume to result an immediate losses which they wouldn't, they would occur over time and also there is no benefit in this scenario for cash flow diversion features and other litigants that AIGFP has structured into these portfolios. So that's why we call it severe.

Eric N. Berg
Lehman Brothers

My second question Steve relates to your discussion or in connection with the negative spread or the negative basis. And I think you said, I hope I have it right when I say that you said that one can think of this negative basis as the difference between the value of a CDO, if it were uniquely a credit instrument verses the or the spread no the CDO, if it were only a credit instrument, verses the actual spread that is observed given the multiple risks on the CDO liquidity of aversion to risk and so forth. Is that what you were saying?

Steven J. Bensinger

What I was saying, I think that's yes. I think you have got it. Let me restate it in.

Eric N. Berg
Lehman Brothers

Yes please.

Steven J. Bensinger

Different way. A bond has a total spread attached to it, a cash bond. That spread has various components that I outlined credit, liquidity in this market perhaps market aversion risk and others. And the difference between the total spread on the bond and just the credit spread on the bond would be the negative basis.

Eric N. Berg

Lehman Brothers

Okay so here is then is my... I think I have it right and I understand and thanks for that follow up explanation. Here is my second and final question. If you were, if the dealers were able to identify this spread differential on December 5th and you felt like it was perfectly fine to use it then, what exactly happened between December 5th and when you issued your 8-K that no longer made application of the spread differential appropriate under U.S. GAAP?

Steven J. Bensinger

Yes, it was a matter of absorbability. As of the December 5th call, our colleagues at AIG Financial Products had indications, as I stated from market participants on different levels of negative spreads and they made a judgment regarding how those spreads that they were... that they gathered from the market were related to their book of business. At year end, I've found an exhausted review what we learnt is that in today's market which had deteriorated much more significantly that those spreads were no longer identifiable and therefore, we could not take credit for those in coming up with the fair value determination at year end.

Eric N. Berg
Lehman Brothers

Thank you.

Martin J. Sullivan

Thank you very much. Ladies and gentlemen, I think we probably got time for one or two more questions.

Operator

Okay, our next question comes from Ian Gutterman with Adage Capital.

Ian Gutterman
Adage Capital

Hi. Thanks for keeping call going, so long. I just also want to clarify but on the negative basis, really from the material weakness side and just... can you clarify is there is material weakness... do you have to resolve the material weakness to take credit for the negative basis. Or is the material weakness is much about procedures and that you might be able do if the market gets more robust and you can identify the negative basis in a way that Pw agrees, can you start taking that earlier in a material weaknesses result?

Steven J. Bensinger

Yes. I don't really see them connected on a perspective basis, or it's like the credit for negative basis will come about based upon market changes that will illuminate the spreads more clearly. It's not connected to the material weakness. The material weakness is surrounding resources, the additional controls and procedures we're putting in place and what I talked about earlier in terms of sustainability of those controls. So I wouldn't connect them on a perspective basis.

Ian Gutterman
Adage Capital

Okay. And is there anything you're doing procedurally to try to use limited information to get more clarity, or is it really just have to be patient and wait for the market structure any better?

Robert E. Lewis

Well we did a lot of work around year end to see if we could, if there was market clarity and I don't think there, the opacity of the market has clarified any further since then. In fact, I think it's probably even less liquid and more opaque than it has been. So right now certainly I wouldn't say that we see that in the immediate future.

Ian Gutterman

Adage Capital

Okay and then you can clarify the ratings agency issues to the extent that is your sense of the concern is an overall perception of consistency of results or is it some thing very like that or they've been more specific, we're worried about the CDS losses or investments portfolio losses and I guess where I am going with this is to the extent that market seems to be most worried about the CDS, if that's really the issue. Is the possible that the rating agency concerns were more around FP and may at the corporate debt rating and less around the P&C and life and subsidiaries, maybe do you just see where I am trying to go. Why they were talking about corporate excess capital and why they were talking about possible rating, versus the P&C or life companies actually would affect your business more?

Robert E. Lewis

I think different rating agencies have different views. So I can't... it'll take too long for me to recount each of them, but some of the ratings agencies are looking more at the AIG, debt rating, some are looking more at the underlying subsidiary financial strength rating. And so I would say everything right now is under review or under outlook and we are taking all that very seriously in terms of providing all of them with as much information as we can descriptions of what we've done to try to clarify it and ensure that we can try to stabilize as soon as reasonably possible.

Ian Gutterman
Adage Capital

Okay, just one quick numbers question, you had at the tip of you fingers, you said there was remaining repurchase that was already committed, so it is the dollar amount of what that would be coming through?

Robert E. Lewis

Yes, it's a little over $1 billion.

Ian Gutterman
Adage Capital

Okay,

Robert E. Lewis

After that we would have about $9 billion remaining in the current authorization that the board provided but as I... as we stated we don't intent to utilize that in the immediate future.

Ian Gutterman
Adage Capital

Right.I just wanted to clarify that thing. Okay thank you so much.

Unidentified Company Representative

Thanks Ian.

Operator

And our last question comes from Gary Ransom with Fox-Pitt Kelton.

Gary Ransom
Fox-Pitt Kelton

Thank you. I sneaked in here. I just wanted to ask about the business of the CDO wrapping and how all this mark-to-market that has occurred is at all changing your strategy and whether there are certain parts of that business you never want to do again or want to get in to again, when times improve and just how has it changed your thought process abut the business itself?

Martin J. Sullivan

We have Andrew Foster with us Gary, so he will respond to that.

Unidentified Company Representative

Yes I think, really since we pulled out I thing the subprime sectors back at the end of '05, beginning of '06. Our focus has predominately been in the regulatory capital space and where we've continue to do business, we did an additional $39 billion of business in the fourth quarter and that's really been the focus, that's been still been a very strong sector for us. And again that's probably declining, as well with the onset of volatility [ph] that was mentioned before. So in general, it is a space that is going down in our priorities.

Gary Ransom
Fox-Pitt Kelton

And in the multi-sector and the arbitrage type deal, especially is that since that's the area where we've had these big marks, can you see a possibility in the future that you would get back in to it, would there be or would this size of a mark more or less or the potential for the size of the mark we've seen more or less permanently take you out of that marketplace?

Unidentified Company Representative

I think that marketplace in general is very much reduced anyway. I mean the new issues space there with that sort of clutch [ph] release is pretty much dead and has been for sometime and it's likely to comeback at anytime. But going forward, I think we expect a lot of... most of the losses to be reversed and we will always look at to the different opportunities that are available to us and assess them on an ongoing basis.

Gary Ransom
Fox-Pitt Kelton

All right thank you. And that speaking [ph] one little probably casualty question on loss ratio picks for current accident year. You already address that for personal lines, were there any other changes of note or significance in any of the other classes for the current year accident pick in the fourth quarter?

Frank H. Douglas

This is Frank Douglas. Nothing significant in the fourth quarter, what we've seen throughout the year is downward pressure from the favorable development as you know in accident years 2006, 2005 and 2004 tended to offset the rate decreases that have earned into 2007 year-end rate decrease were probably only about 5% though. So obviously, you don't have to watch that going forward, when the rate decreases may be a little bit larger. But for now the answer was very little change was needed in loss picks, virtually none.

Gary Ransom
Fox-Pitt Kelton

Alright thank you very much.

Martin J. Sullivan

Thank you, Gary. Ladies and gentlemen let me apologize to those who didn't have to opportunity of asking their question. If you like to call Charlene, we will try and respond as quickly as we can. Thank you very much indeed for your patience. It's much appreciated. Thank you.

Operator
And that concludes today's call. Please disconnect your line at this time.