PRICEWATERHOUSECOOPERS

Memo

To: / Location:	AIG work paper files / New York - 300 Madison Avenue
From: / Location:	PwC audit team / New York - 300 Madison Avenue
Date:	November 7, 2007
Subject:	AIG07 SS00 PwC 3Q07 Critical Matter - Super Senior CDS

Background

AIGFP as a core part of its business writes credit default swaps on portfolios of reference obligations to a variety of market counterparties on a second loss basis. These transactions have levels of subordination as noted by management that are designed to never suffer economic loss even under recessionary scenarios. The rationale for these transactions from the perspective of the counterparty to the transaction may be for two distinct reasons as discussed in management's analysis - to achieve regulatory capital relief under Basel for European banks, or other reasons which may include US regulatory treatment on money funds, or other reasons. As noted by management, the pricing on these is typically considered to be a negotiated level to reflect sharing of economic benefits obtained by the counterparty and the time and effort involved by AIGFP to determine a reasonable return to AIGFP, rather than a reflection of the economic risk in the portfolios.

Such transactions are derivatives under FAS 133 and recorded at fair value on the balance sheet with changes recorded in the income statement. At inception, in accordance with EITF 02-3, no Day 1 P&L is recorded on these transactions, given there is no "observable market" for these transactions which are one-way in nature with few participants. On an ongoing basis these transactions have historically continued to be recorded at a fair value of zero given their relative insensitivity to factors such as credit spreads (where relevant) or interest rates.

During the 3rd quarter of 2007, however, the wider capital markets experienced severe dislocations initiated by the adverse developments in MBS securities with subprime collateral underlying these transactions, which then impacted the capital markets as a whole, with significant adverse impacts on the markets as a whole as shown by the movements in the industry standard ABX and CDX indices, ultimately resulting in a very significant liquidity crunch.

Under these extreme scenarios, the Super Senior portfolio of transactions was re-evaluated to determine whether in the current market conditions there was a need to mark the positions for an adverse change in fair value given the dislocation in the markets and the size of the AIGFP portfolio of $513bn notional at risk as of September 30, 2007 ($467bn as of June 30, 2007).

Response:

Notes:

- footnote references through this document refer to the relevant appendix attached below
- "we" or "our" refers to the engagement team and their views, primarily including Henry Daubeney, Ptnr, and Justin Keane, SMgr with consultation with other PwC personnel noted in Section B unless specifically stated

This document should also be read in conjunction with the client's summary "Memorandum Concerning the Valuations of Super Senior Credit Derivatives" and the key assumptions discussed in the PwC memo "AIG07 SS20 PwC notes on key assumptions", as well as the other supporting documents noted in the appendix

A. Management's approach

For the structuring of the transactions at inception, AIGFP uses an actuarial model (the Gorton model) to determine the attachment point required on each structure such that even under stressed recessionary scenarios, the risk of loss is considered to be insignificant. Based on the discussions with management[1], this is set such that the mean distribution is stressed to be set at the worst post World War II recessionary scenario, and then the subordination required to give a 99.85% confidence level that there will be no economic losses in the portfolio is determined.

On this basis, the risk of default on such a portfolio has effectively been removed and as a result from a risk management perspective, there are no substantive economic risks in the portfolio and as a result the fair value of the liability stream on these positions from a risk management perspective (i.e. based on the expected cost or risk managing the market risk on such positions, an approach which can be applied in the market to determine an approximation of fair value for complex derivative positions) could reasonably be considered to be zero.

Management has historically reviewed the existing portfolios under the Gorton model to ensure that for periodic financial reporting purposes these positions continue to be considered to be "super senior" as that term is used by AIGFP, and that if that was the case then for financial reporting purposes these positions would continue to be held at a fair value of zero, given the conditions under EITF 02-3 such that the Day 1 NPV of the premium stream cannot be recognized. This periodic analysis continued to be applied during the quarter, and indeed was refreshed monthly and these positions were considered to remain "super senior".

Given the dislocations in the market, management sought to identify an approach to determine the fair value of the existing transactions for reporting purposes. After discussions with market participants in related products and review of public information provided by the monoline insurers, the determination was made that an adaptation of a rating agency model, the Moody's Binomial Expansion Technique (the "BET" model) could be considered to be one approach to determine an estimate of fair value.

As a result, AIGFP management under took an exercise to adapt the BET model to calibrate the model using market spreads rather than ratings to reflect the current market information available, and to determine a discount expected loss model, as well as the discounted value of the expected premium stream, to determine and NPV based approximation of fair value. This is discussed further in section C below.

In evaluating these transactions, it is also worth considering them as deep out of the money put options - essentially under these contracts, economically the protection buyer has bought the right to sell the underlying reference obligations to AIGFP in the event that a severe threshold due to cumulative losses on the portfolio (initially absorbed by the subordination in these transactions) is breached. This conceptual approach would also be consistent with the data that is seen in terms of pricing - as is the case in other derivative products, and based on our experience with other clients as well as AIGFP, even in situations where the option is considered to be so out of the money that the chance of exercise is remote, there is a premium required by the writer of the option that in such cases that will be driven by a negotiation between the counterparties, rather than by the model determined value of the market risk.

B. Oversight & Review by AIG

The methodology applied and discussions held were reviewed and subject to oversight by a wide range of individuals from AIGFP, AIG Corporate and PwC. The interaction and involvement of these individuals with the key meetings and the primary distribution lists on key e-mails is noted in the table below.

		PwC Internal			Client presentations			Update discussions	Client Q&A discussions		
		Accounting model for Super Senior	AIGFP Presentation on Super Senior	Second AIGFP Presentation on Super Senior	Sidebar to Second AIGFP Presentation on			Q&A v1	Q&A v2	Q&A v3	Q&A PwC1
	Date	9/10	9/26	10/11	10/11	11/1	11/2	11/5	9/21	10/4	10/8	10/30
	Key Appendix Refs	14	13, 15	16	N/A	19	27	28	5	6	7	8
AIG Financial Products												
Joseph Cassano	CEO, AIGFP		X	X		X	X	X	X	X	X	X
Andrew Forster	EVP, Asset Desk		X	X		X	X	X	X	X	X	X
Gary Gorton	Asset Desk		X									
Pierre Micottis	Chief Risk Officer		X	X			X	X	X	X	X	X
James Bridgwater	Head, New Products Group				X		X	X			X	X
Peter Robinson	New Products Group				X							
William Kolbert	COO, AIGFP		X	X					X	X	X	
Diane Cenci	CFO, AIGFP		X	X						X	X	X
Mark Balfan[1]	Former CFO, AIGFP		X	X					X	X	X	
Jamie Alexander	Controller, AIGFP		X									
Joe St. Denis[2]	AIGFP OAP		X						X			
AIG Corporate												
Elias Habayeb	CFO, FS Division		X			X	X	X	X	X	X	X[5]
Steve Bensinger	CFO, AIG Group					X						
David Herzog	Controller, AIG Group		X				X	X	X	X	X	
Joe Cook	Deputy Controller, AIG Group		X				X					
Erja Jackson	Special Projects, FS Division		X									
William Dooley	CEO, FS Division					X		X	X	X	X	
AIG Corporate - Office of Accounting Policy												
Anthony Valoroso	Head, OAP		X	X		X	X	X	X	X	X	
Ken Lau	OAP			X								
AIG Corporate - Risk Management												
Bob Lewis	Head of Enterprise RM					X	X	X				
Kevin McGinn	Head of Credit Risk			X[4]			X	X				
Jamie Bolton	Market Risk Management		X	X	X				X	X	X	X[5]
Paul Narayan	Credit Risk Management			X	X							

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	Key Appendix Refs	14	13, 15	16	N/A	19	27	28	5	6	7	8
AIG Internal Audit												
Mike Roemer	Head, Internal Audit		X									
Joe Nocera	Director, FS Internal Audit		X									
Kamala Anantharam[3]	Director, FS Internal Audit		X									
PricewaterhouseCoopers personnel												
Tim Ryan	EL - AIG Group	X	X			X	X	X				
Henry Daubeney	EL - AIGFP & FS	X		X		X	X	X	X[5]	X[5]	X[5]	X[5]
Justin Keane	Snr Manager, AIGFP & FS	X	X	X		X	X	X	X[5]	X[5]	X[5]	X[5]
Bob Sullivan	QRP - AIGFP	X					X					
Jim Scanlan	QRP - AIG Group											
Doug Summa	Partner, Risk & Regulatory											
John Lawton	Partner, National Office	X										
Alan Lee	Partner, TAG group	X										

Notes to table:
1. Former CFO, currently managing FAS 157 project
2. Subsequently resigned
3. Moved from internal audit to FS Division
4. By telephone
5. Forwarded, indirect recipients

In addition to the table noted above, we understand the matter has been discussed with a number of other parties including but not limited to:

- The Audit Committee at the October meeting as part of the presentation[2] by PwC "Accounting and Valuation Considerations Relating to AIG's Investments" and as part of the quarterly report[1] to the Audit Committee at the November meeting
- Tim Ryan and Henry Daubeney with Martin Sullivan and Steve Bensinger on 11/5/07
- Tim Ryan with Mike Sutton and Mike Roemer on 4/11/07 and with Mike Sutton Bob Willumstad and Mike Roemer on 11/6/07 prior to the audit committee meeting.
- Elias Habayeb and Joe Cassano with Steve Bensinger, CFO AIG Group on October 12, 2007

as well as other internal conversations.

C. Model & Input approach and limitations

As described in the client's modeling documentation[11], the approach taken by the client has been to take the Moody's BET model, which has been well known in the industry as being a key model used for determining ratings for securitized assets and tranches of such assets, and adapt it to calibrate to spreads. Under the normal ratings approach, the rating gives a default function - the spread calibration is used to imply a default function given the current market levels of spreads, which are typically more reactive and current than ratings. In addition, these functions are then used to model the behavior of the reference portfolios over time and determine the expected default function and severity, which can then be discounted back, compared to the discounted premium stream, and the net of the two taken as a proxy for the fair value of the positions.

Whilst the approach noted above is appropriate and supportable, and based on our discussions with other engagement teams and industry specialists is similar to the way that some other market participants in related credit products are evaluating their portfolios (see section G below), there are certain limitations which are discussed here.

Model relevance

The model in its current form, due to time constraints, has been built off a standard BET framework and adapted for spreads. However, within the structure of the transactions executed by AIGFP, there are certain provisions that are designed to help AIGFP mitigate its risk in the event that adverse events should start to affect the portfolio. These include factors such as waterfall provisions with respect to the underlying reference portfolios such that as assets pay down, the notional amount AIGFP is protecting is reduced first, rather than being pro-rata between the AIGFP and subordinated tranches. These are considered by management to be an important element of their transactions as discussed in the assumptions and judgments document section 14 but have not yet been built into the models. Accordingly, in this respect management believe the model is expected to produce a greater present value of the expected loss stream.

Model validation

The model has been subject to review by an independent group, and a sample of transactions has been validated against a simplified Monte Carlo model as an alternative. Across AIGFP's derivative portfolios, the approach adopted has consistently been to build two independent models out of the New Products Group (AIGFP's internal quant group) and compare the results of these models against each other under a range of scenarios to determine if they can be considered to give reasonable estimates of fair value and risk management outputs. Typically, the one that is most appropriate, or if no significant difference the one that will operate most effectively in the JAVAH environment is used.

Due to the time constraints this quarter, this approach has not yet been fully completed, and the model validation will continue into the 4th quarter of 2007 at the least. AIGFP is currently evaluating another alternative approach such as a Monte Carlo or numeric closed form based model in addition to the BET model, including the waterfall and other credit mitigant features.

This development time is not considered by the engagement team to be unreasonable given the complexity of the models involved, and based on experience in evaluating other model developments over the years.

Accordingly the model has been subject to an internal validation at AIGFP by Jean-Michel Fayolle in the New Products Group, and has also been reviewed at a high level by Paul Narayanan (AIG Credit Risk Management).

AIGFP management will continue to extend the model validation to the internal standards they would typically apply to their own "trading models" including validating the results under a number of scenarios against another independently built model. This work will continue during 4Q07.

Input validation

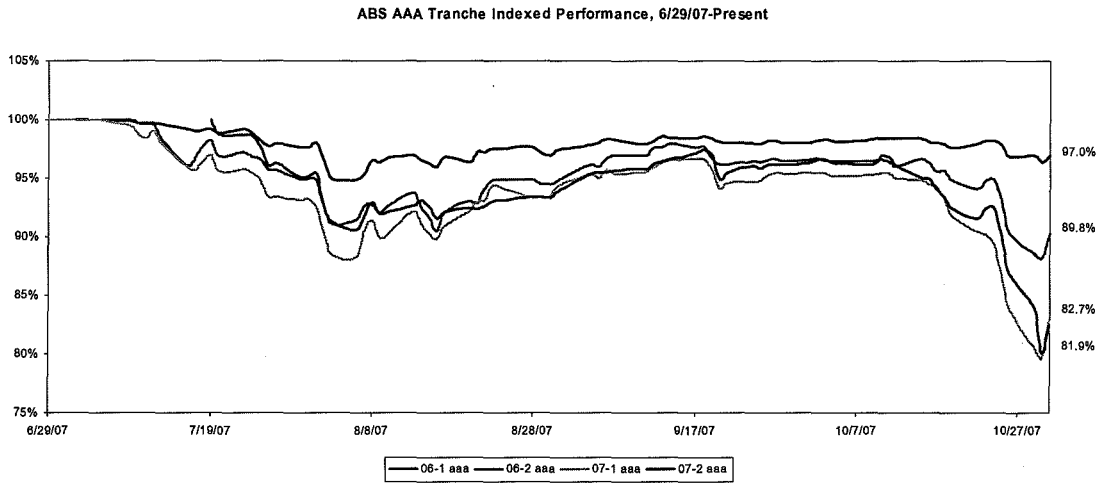
The area that arguably provides the most significant challenges relates to the inputs required to the model. In order to apply the BET model with spreads instead of ratings, spread information on each of the underlying assets is required. However, this would be difficult for the 18-20 thousand individual underlying reference obligations in a normal market environment, and in the current market environment it was not possible to obtain a sufficient coverage and objective set of data for these transactions.

In order to apply an objective set of data, AIGFP leveraged market information obtained from JP Morgan Chase ("JPMC") that based on discussions with JPMC the pricing information reflects "best estimates of generic new issue pricing in the various asset classes". Whilst not specific to each of the individual names, this was considered a reasonable approximation given the lack of observability in the market to obtain asset specific data, and reduce the level of management intervention in these transactions.

The spreads used are the reference spreads for funded assets, which will result increase the fair value of the loss stream under the BET approach. As confirmed with management, given the impact of liquidity drivers in current market prices, synthetic positions could be expected to be trading tighter than the implied spreads on the funded or cash positions since they are theoretically less affected by liquidity requirements as derivatives. This is consistent with the market information we have been aware of, and the arbitrage widening between funded and unfunded positions during the quarter, and which had partially tightened back by September. Accordingly, the liquidity impact on the funded positions will depress their price, and since the impact of liquidity and credit cannot be reliably estimated, AIGFP has allocated the entire basis to credit, resulting in a potentially more severe expected loss profile in the BET model than for the individual assets.

The data applied was initially adjusted by management for the vintages of the underlying collateral. This was done based on the belief that the market recognized that there were structural differences in the underlying collateral and that these were priced accordingly, with the 05 and earlier vintages not being as heavily penalized for the impact of the subprime issues. The calibration was done based on the differentials between the ABX 06-1 (predominantly late 05 and early 06 vintages) as a proxy for the earlier collateral compared to the ABX 07-2 (06 and 07 vintages) as a proxy for the generic collateral.

However, with the benefit of additional information available as of the end of October 2007, management determined that whilst there was some differentiation in the market for the collateral vintages as of September 2007, it did not truly materialize until mid to late October 2007. The graph below shows the level and timing of the differentiation effect.



Accordingly, for the September 2007 valuation, management elected to revise their assumptions on collateral vintages and marked the book using the unadjusted collateral spreads from JPMC.

This is relevant from an AIG FP perspective as they stopped issuing SS CDS on pools with sub prime loans in early 2006 and hence their exposure is to the new vintages is less significant and the significant majority of their exposure is to 2005 and before which currently are not as severely impacted by current market events.

Another assumption required to be made is in respect of the weighted average life ("WAL") of these underlying assets since again this information is not available on a specific reference obligation basis. WAL is relevant on these assets since the reference obligations pay down over time as underlying collateral is repaid through the trustee/servicer, such that the portfolio notional decreases over time. Where WAL information was not available, the WAL at inception and the WAL on those securities where information was available was assessed, and when applied against the portfolio a WAL of 5 years was used. This was considered to be consistent with the AIGFP portfolio when adjusted for the passage of time.

For the CDO portfolio (portfolio "A"), spread data was more readily available on the underlying reference obligations, and where available, this was used. The WAL input is typically not relevant, or at least significantly less relevant, for the corporate portfolio since the underlying obligations are considered to behave as bullet debt.

Based on the above factors, the inputs and model approaches used were considered to represent a reasonable basis to determine data supporting management's best estimate. These assumptions are discussed more fully in the document "AIG07 SS20 PwC notes on key assumptions". As at the date of the 10-Q filing, these represent management's best estimate at this time. Management believe these are reasonable assumptions based upon there knowledge to date and we agree.

Management will continue to update these assumptions where additional information is obtained.

D. Portfolio results

Although not a "fair value" model, the results of the Gorton model re-ran on the existing portfolio indicated that the transactions continued to remain to be Super Senior in nature as that term is used by AIGFP and accordingly the impact on the fair value as noted in (A) above would be expected to be zero.

B&C - Regulatory Capital portfolios

For the B&C portfolios, comprising the regulatory capital transactions, no assessment using the BET approach was applied. The nature of these transactions is the regulatory capital transactions entered into by the European and Asian banks to achieve regulatory capital relief under the current Basel rules. This is reflected in the nature of the counterparties, who are European and Asian banks, whereas in the A, D & E portfolios the major US investment banks are predominant.

The underlying collateral on these transactions is bespoke and unobservable - for example an ABN Amro transaction based on ~14,000 Dutch mortgages, or transactions with counterparties such as Barclays and Deutsche bank reference SME (small & medium enterprises) loans. As a result, the JPMC data is not relevant for these transactions, and no comparable data exists.

These types of transactions are well known in that market, and the pricing and structuring on these has been, and continues to be, driven by the benefits obtained by the counterparty under regulatory capital. There is little challenge on the attachment structuring of these trades, and the economic risks are retained by the counterparty.

The pricing on recent transactions has also been represented by management to have been affected by a perceived need for the capital benefit, rather than any inference that the underlying economic risk in the portfolio has been changed. Furthermore, transactions undertaken in the 3rd quarter are predominantly within the regulatory capital arena and the banks typically looking for such transactions have been those most exposed to regulatory capital risk from having to bring SIVs etc. back onto their balance sheets.

The pricing on these newer transactions also reflects the time to the first call and the expectation that these regulatory benefits will start to end in 2008 under the new Basel treatment, and accordingly AIGFP seeks to make its profit in the shortened expected life for the transaction.

D&E - Multisector CDO portfolios

The D&E Multisector CDO portfolios or ABS portfolios were valued as at the end of June and September under the BET model approach. The key inputs into this model include:

- credit spreads (obtained from JP Morgan Chase for generic new issue funded assets
- weighted average lives based on the current quoted WAL (or inception data if not available, or average of the portfolio if neither was available)
- diversity score (based on quoted data if available, portfolio average if not)
- ratings (based on quoted data or conservative average for the portfolio if not)

As a result of the valuation procedures performed, the change in fair value for the quarter was determined as a decline in fair value of $352mn derived as (in millions):

Value at June 30, 2007	$	214.3
Value at September 30, 2007	$	(160.3)
Change in value	$	(374.6)
Adjust for accruals in 3Q	$	22.5
Mark to market in 3Q	$	(352.1)

Note that based on the work performed by management in updating the results through the end of October 2007, it appears that the initial estimates for the month of October show a further deterioration of an incremental $550mn.

A - Corporate portfolio

The A portfolio represents transactions on CDOs with corporate underlyers that are rated or have a shadow rating. The value of this portfolio was also run as of June 30 and September 30 under the BET model, with information based on credit spreads as available. The corporate names market has not in general been as severely affected as the ABS market, although names with significant exposure to the ABS sector such as financials and mortgage lenders have been affected.

The results of the valuation work performed indicated that after adjusting for the impact of the accruals earned during the 3rd quarter, there was no change in fair value for the quarter on this portfolio.

E. Other Factors

There certain other factors that were considered in evaluating these portfolios.

Collateral

As with many derivatives, the provisions of the contract allow for the exchange of collateral as the fair value of the transactions move. The provision in respect of the super senior transactions may refer to the collateral provisions being based on the market value of the underlying reference obligations with a threshold for the minimum collateral call to reflect the subordination in the contracts. This reflects the difficulty in getting the CDS values and uses the cash collateral as a proxy as in normal market conditions these are likely to trade close together.

As such, where collateral calls are agreed and collateral exchanged, these provide information as to the value of the transactions agreed between the two counterparties.

As of June 30, 2007, no collateral calls had been made. As of September 30, 2007, 2 counterparties had made initial collateral calls, but had not then followed up once AIGFP disputed the claim. One counterparty (Goldman Sachs) had made a collateral call during August 2007, initially of $1.8bn which was amended on dispute to $1.6bn, $1.2bn and $0.6bn. AIGFP did not agree with the collateral call and continued to reject the call.

At the end of August 2007, cash of $450mn was posted by AIGFP to GS, along with a letter signed by both parties indicating that neither party considered this to be a collateral amount agreed between the two parties, and that the ongoing dispute should continue to seek to be resolved.

As of September 30, the GS collateral call was the only one outstanding. Management assessed the call based on the information available including the structural questions regarding the basis of determining the call amount under discussion, and the range of pricing being shown by GS versus other dealers. Based on that information, management's best estimate of fair value was determined to continue to be the BET model.

As of the end of October, the market had deteriorated further (as noted above resulting in approximately $550mn of additional charge) and additional collateral calls were received. Based on the initial calls received AIGFP appears to be marking the book closer to par than some other dealers, however the differential is tighter than versus Goldman Sachs. The information obtained from GS continues to imply GS has marked its values down more severely, and the model values driving their calls have increased to $3bn. FP management have told us that GS management noted they knew they were not getting the collateral call paid until the dispute was resolved.

AIGFP and AIG management reviewed the additional information available as of the end of October and early November, and continue to believe that the BET model provides management's best estimate of fair value, and will continue to seek to resolve the collateral

disputes. Management also determined that it would be appropriate to make reference in the MD&A of the 10-Q filing to the disputes on collateral and the inference one might draw regarding differences in fair value estimates on these highly complex illiquid structures.

Boundary conditions
Management continues to believe that these transactions are structured to meet AIGFP's definition of Super Senior i.e. that they are modeled on an actuarial basis such that there is a 99.85% confidence level that even if the transaction life occurs during the worst recession since World War II that the transactions will never pay out.

As an assessment of a boundary condition, on that basis the value of all 5 portfolios can be considered to be equal to the present value of the premium streams, discounted over the expected life of the transactions.

Note that this amount should not be considered equivalent to the GAAP fair value, since all such P&L is derived from the Day 1 value since it is the inception spread being present valued and accordingly none of the unearned portion should be recognized, pursuant to EITF 02-3.

As at the end of September 2007, the fair value of the income stream through to 1st call date was in excess of $900mn

History of losses
Based on the portfolio to date, AIGFP has never paid out on any Super Senior transactions. Over the life of the portfolios, the experienced losses on the underlying collateral have varied from approximately 2-5bps of notional, versus subordination levels of 12%-15% on average for the Super Senior tranche.

Even in the early 2000s when corporate defaults were at their highest, the totaled incurred loss on the underlying collateral reached approximately 80bps, versus a subordination level of on average 15%-16%.

F. Accounting considerations
The engagement team and management evaluated whether the change in fair value applied to the super senior portfolio and the use of the BET model should be considered to be reflective of an error in the prior period, or a change in estimate of fair value and hence a current period charge.

The transactions have always been accounted for under FAS 133 and EITF 02-3. These illiquid complex one way transactions are clearly unobservable and hence not recognizing P&L on day 1 was and continues to be the correct accounting approach.

The transactions are structurally designed to be insensitive to factors such as credit risk. Management have continued to review the transactions on a periodic basis, including for quarterly reporting, and based on the Gorton model the transactions have continued to attach at the super senior level, as defined by AIGFP. Management has stated that this continues to be the case as at the end of October 2007. Furthermore, these transactions have been executed during a period where the general credit environment has been benign. Accordingly, the prior period decision to continue to record these transactions at zero as a proxy for fair value is considered to have been appropriate.

The nature of the market is such that it has remained one-way, bespoke, and highly illiquid. As a result, the transaction inputs remain unobservable and hence it continues to be appropriate not to crystallize any Day 1 gains other than those that accrue in over time.

Finally, the change in fair value calculated under the models is considered to have arisen from and be reflective of the distressed market conditions that have occurred during the latter half of 2007. As such, these represent changes in value as a result of events that occurred during the period, and consequently the charge recorded in 3Q07 in relation to the Super Senior portfolio is considered to be an appropriate 3rd quarter charge.

G. Evaluation of other counterparties portfolios

As noted in "AIG07 SS20 PwC notes on key assumptions" management had stated they had sought, based on the publicly available information, to evaluate other counterparties and other models to determine the approach AIGFP would use to determine fair value.

Based on their work, they concluded that the BET model would be appropriate for their portfolio, given structure, attachment points and the availability of data. In addition, management noted that MBIA had reported in their disclosures that they were using it, and they are a counterparty who AIGFP consider to be most similar to themselves in relation to this business, out of the counterparties for which some level of information was available or could be inferred.

In addition, Elias Habayeb, CFO of the FS Division, advised Henry Daubeney by phone that on 11/06/07 AIG had met with 3 of the rating agencies AM Best, Moody's and S&P. The approach being adopted by AIG in relation to the super senior portfolio was discussed and EH inquired as to whether the approach being taken was considered by the rating agencies to be inline with monoline insurers in similar portfolios (i.e. use of the BET approach and JPMC spread data) and was informed that other were applying similar models.

In addition, the engagement team consulted with firm specialists including Doug Summa, PwC Advisory Risk & Regulatory Partner and valuation specialists, as well as inquiring of other key engagement teams that were believed to have similar or related exposures of high level characteristics of the nature of their book, and the models being applied.

Entity specific information was not shared with the client, however key points of these inquiries were shared with the client including:

- There is a range of products traded in the market that various different organizations define as super senior
- Many counterparties rely on the rating agencies to determine attachment points for the super senior, although some will adjust these
- There are a range of valuation models and approaches being applied in the market, dependent on the capabilities of the firm, the nature of their portfolio, and the similarity of their book to industry standard indices.
- There are a number of key assumptions that needed to be addressed but AIGFP were in an acceptable range on these (see separate assumption memo).

Based on the information obtained, there is range of approaches in the market. We note that management's assertion that there are other organizations using the BET model and the JPMC generic spread data appears to be borne out. Accordingly, based on the current market information the approach adopted by AIGFP does not appear inconsistent with the range of approaches in the market. It is noted that the market continues to evolve and respond to this issue and the range of approaches will likely need to be re-confirmed at year end.

H. Evaluation of additional portfolio - Horizon

During the course of the evaluation of the Super Senior portfolio, it was noted by management that the Horizon portfolio should also be considered. Previously this portfolio had not been valued by management as it was believed to have de-minimis impact, and management did not have a model in place that would value this portfolio.

Horizon is a program where AIGFP effectively buys protection on ABS mezzanine tranches either through the issuance of credit linked notes referencing a pool of reference obligations, or through bought credit default swaps. As a result, with the widening of spreads in the market, the value of the bought protection would be expected to increase.

Certain assumptions were required to be applied in the application of the BET model to the portfolio, including treating the value of the positions as the net value of the portfolio less the super senior tranche since that senior tranche is what the BET model was appropriate for, and that the equity tranche was considered to have de-minimis value.

In addition, one Horizon portfolio, Horizon VII was excluded from the calculation since this was believed offset by the sold senior Combs transactions. See "AIG07 SS20 PwC notes on key assumptions" for further details on the assumptions.

As a result of the procedures performed, management booked a life to date gain on this portfolio of $130mn due primarily to the widening of spreads, including a $22mn immaterial out of period adjustment that should have been recorded as of June 30, 2007.

J. Work performed by PwC

The work performed by PwC can be broken down into a number of areas

Understand the approach adopted by the client

- Extensive involvement in the discussions and presentations with AIGFP and AIG

Validation of the model and approach

- Review of the documents prepared by management and discussions in respect of those items to assess if reasonable
- Internal PwC validation with specialists and through informal discussions with other engagement teams of the use of the BET adapted model in the market, and the limitations of this
- Internal PwC discussions of the limitations and assumptions in the model, and evaluation of management's judgments in this respect
- High level discussion by Doug Summa and Witold Gesing from PwC Risk and Regulatory group of the work performed by AIG Credit Risk management (Paul Narayanan) to review the model
- Review by Doug Summa of supporting documentation related to the model, inputs and valuation approach

Validation of the inputs into the model

- Review of the documents prepared by management and discussions in respect of those items to assess if reasonable
- Review of the inputs used in respect of spreads against the JPMC data
- Review of the inputs used in respect of recoveries against the Moody's data

Validation of the transaction data

- Reconciliation of the BET model output for portfolios D&E to summary schedule
- Review of Top Deals transactions conducted by AIGFP audit team during quarterly reviews in relation to significant new transactions and terminations, tying back to contracts (these procedures are performed each quarter for new SS trades).
- Review of work performed in 2006 audit to tie back details on a sample of items feeding into commitments footnote versus system Bibles, (all new trades and unwinds are reviewed during the year via the top deals quarterly work).
- Review of summary report and BET model output versus original executed documents for reasonableness

- Comparison of transaction information on summary report versus GS collateral call details

Validation of the journal posting
- Tied out post closing journal to supporting schedules in relation to the Super Senior valuation adjustment
- Tied out post closing journal to supporting schedules in relation to the Horizon valuation adjustment, including allocation between CDS and CLNs
- Tied out SAB 99 entry to supporting schedules in relation to the Horizon valuation adjustment for June 30, 2007, including allocation between CDS and CLNs (note SAB 99 is does not split BS lines)

Appropriateness of communication and disclosure
- Participated in conference calls including senior AIG management as documented in supporting information
- Communicated directly with AIG CEO and CFO to ensure they were aware of and sufficiently understood the issues through meetings as noted in section (B) above
- Communicated directly with Audit Committee to ensure they were aware of and sufficiently understood the issues through meetings as noted in section (B) above and in presentations to the committee
- Reviewed 10-Q disclosure and MD&A for appropriate communication of these matters specifically it covers:
    - The complexity and subjective nature of valuing these derivatives
    - The fact that FP has collateral calls that are disputed
    - The fact that the impact of the fair value movements do not impact FP's bonus pool
    - The market is very dynamic and additional charges may well occur.
    - The fact that the valuations are a mark to model use market observable inputs where these exist.
    - The reliance on management's estimates and judgments is a key element of arriving at the fair value of the SS CDS.
    - Different people could arrive at different valuations using the same data.
    - There are some benefits from credit mitigants but nothing has been booked.

The engagement team has ensured that appropriate consultations and communication with PwC personnel has been executed in relation to this matter.
- Key consultations and calls have been documented in the supporting data; this does not reflect informal meetings and calls.
- PwC specialists (Doug Summa, Witold Gesing, John Lawton, Alan Lee) have been involved and consulted
- Issue has been discussed with QRPs for AIG and AIGFP (James Scanlan and Robert Sullivan, respectively)
- AIG GRP Tim Ryan has been extensively involved in the resolution and presentation of this issue.

K. Conclusion

As stated previously, this document should also be read in conjunction with the client's summary "Memorandum Concerning The Valuations Of Super Senior Credit Derivatives" and the key assumptions discussed in the PwC memo "AIG07 SS20 PwC notes on key assumptions".

The information shown in the appendices, listed below also provide further information on the process undertaken by management, the internal validation and review process, the communication to AIG senior management and the audit committee, and the disclosure in the AIG 10-Q filing.

Based on the work performed by management, and the review procedures performed by PwC:

- the assumptions made and conclusions reached by management appear reasonable
- they provide a basis for the entries booked in 3Q07 comprising the $352mn negative change in fair value on the super senior portfolio
- they also provide a basis for the $130mn positive change in fair value on the Horizon portfolio, of which $22mn relates to prior periods and has been reported as such on the SAB 99.
- Appropriate disclosure has been made in the 10-Q filing and the matters have been appropriately communicated to and discussed with both senior AIG management and with the AIG Audit Committee.

Management will continue to refine the model, review key assumptions and reassess the inputs during the fourth quarter as new information becomes available.

Listing of Appendices

Ref:	Type	Notes
Appx 01	PwC Pres'n	Extract from quarterly AC report made to Audit Committee November 2007. Document outlines the Super Senior portfolio and some of the valuation issues, and the work performed by management to determine the required mark. Note this document was prepared prior to the decision to adjust the mark to $352mn based on the information obtained at the end of October (i.e. subsequent to the AC mailing date)
Appx 02	PwC Pres'n	Extract from valuation presentation made to Audit Committee October 2007. Document outlines the Super Senior portfolio and some of the valuation issues.
Appx 03	PBC Data	Summary of portfolio as of June 2007, broken down by categories
Appx 04	PBC Data	See tab "LewisExh1" for summary of portfolio as of September 2007, broken down by categories
Appx 05	PBC Q&A	Internal AIG dicussions on SS - first round of Q&As
Appx 06	PBC Q&A	Internal AIG dicussions on SS - second round of Q&As
Appx 07	PBC Q&A	Internal AIG dicussions on SS - third round of Q&As
Appx 08	PBC Q&A	AIGFP responses to PwC questions after conference calls on valuation
Appx 09	PBC Method	Discussion of credit spread input approach and validation. Use of JPMC spread information. Document reflects the initial intention to flex the spreads used for the vintage differentiation implied from the ABX indices
Appx 10	PBC **OLD**	**SUPERSEDED** Results of initial valuation on portfolios D&E under the BET model
Appx 11	PBC **OLD**	**SUPERSEDED** Methodology paper on BET model
Appx 12	PBC Data	JPMC raw spread data for BET model
Appx 13	PBC Pres'n	Presentation by AIGFP on September 26th, 2007 regarding the Super Senior portfolio and approach
Appx 14	PwC Minutes	Notes of internal PwC call on September 10th regarding accounting model
Appx 15	PwC Minutes	Notes of meeting at AIGFP on September 26th, 2007 regarding the Super Senior portfolio and approach
Appx 16	PwC Minutes	Notes of meeting at AIGFP on October 11th, 2007 regarding the Super Senior portfolio and approach
Appx 17	PwC Minutes	Minutes of call between Bob Sullivan, Henry Daubeney, Joe Cassano and Elias Habayeb
Appx 18	PwC Minutes	Summary of internal consultations within PwC
Appx 19	PwC Minutes	Minutes of conference call between AIG, AIGFP and PwC on November 1, 2007
Appx 20	PwC **MEMO**	**KEY** PwC documentation on key assumptions used by management in the valuation approaches
Appx 21	PwC	Comparison of GS data to AIGFP data for accuracy of underlying information - no exceptions noted. Testing provides assurance over the existence of the transactions

Listing of Appendices

Ref:	Type	Notes
	Testing	and the approximate current notionals and maturity dates for the transactions. Comprises 20 transactions (sample selected all items >$10mn call per GS)
Appx 22	PwC Testing	Comparison of Lewis and BET data to original contracts obtained from FP systems. Note that this is intended to be only a reasonableness check since these transactions will amortise over time. 18 items tested and noted to be reasonable. Exceptions noted in comparing BET current subordination levels to those on the Lewis report - confirmed with EH this was due to an error in data. See 26a for revised tie out.
Appx 22a	PwC **OLD**	**SUPERSEDED** Errors noted in tie out of contract subordination between Lewis and BET models. See 26a for revsied tie out.
Appx 23	PBC Data	Valuation results for Horizon portfolio including resulting journal for split of CDS and CLN elements. Journal testing support derived from this data set
Appx 24	PBC Data	Final valuation output for D&E portfolios, including summary information prepared by JK to support journal number of $352mn
Appx 25	PwC Testing	Tie out of the current period journal entry in relation to the Super Senior and Horizon adjustments. See Appx 23 and 24 for data support rolling into this. $45mn prior adjustment also reversed. Confirmed with Gayle Kraden and Don Farnan tax rate should be booked at 35% and is then adjusted by corporate tax on consolidaion.
Appx 26	PBC Data	Duplicate attachment of Appx 24, with revised subordination levels for the purposes of testing back to Lewis sheet.
Appx 26a	PwC Testing	Comparison on subordination levels between Lewis data and BET output. See Appx 38 for explanation.
Appx 27	PwC Minutes	Minutes of conference call between AIG, AIGFP and PwC on November 2, 2007
Appx 28	PwC Minutes	Minutes of conference call between AIG, AIGFP and PwC on November 5, 2007
Appx 29	PwC Testing	Support for 2Q07 SAB 99 noted as the end of 3Q07 in relation to the Horizon transactions
Appx 30	PBC Data	Journal entries booked by corporate in relation to Super Senior and Horizon. See Appx 25 for tie out.
Appx 31	PBC Q&A	Key judgments and assumptions questions cross referenced into the previously supplied supporting information, with additional information.
Appx 32	PBC Data	Summary prepared by client of GS call information and status
Appx 33	PBC Data	Side letter between GS and AIGFP recognising the $450mn posted does not represent collateral
Appx 34	PBC Data	Sensitivity analysis prepared by James Bridgwater
Appx 35	PBC Data	Moody's CDOROM User guide - cover pages supporting Recovery data in Appx 36
Appx 36	PBC Data	Moody's recovery rates - see Appx 50 for tie out to AIGFP levels
Appx 37	PBC Q&A	AIGFP responses to EH and JK questions on Horizon transactions and other related documents
Appx 38	PBC Q&A	AIGFP responses to EH and JK questions on BET model exclusions and on Lewis vs. BET mapping questions
Appx 39	PBC Data	Supporting information from AIGFP in relation to the revisions to the BET model values from $90mn to $352mn

Listing of Appendices

Ref:	Type	Notes
Appx 40	PBC Method	Final methodology document on BET model approach
Appx 41	PBC Method	Updated to credit spread calibration discussion in Appx 09
Appx 42	PBC **DUP**	**DUPLICATE** Duplicate of item #24
Appx 43	PBC **OLD**	**SUPERSEDED** Original Horizon valuation prior to the exclusion of Horizon VII as the offset to Combs
Appx 44	PBC Method	Summary of the Horizon program
Appx 45	PBC Pres'n	Presentation made by AIG to the Audit Committee on 11/6 with information in relation to the change in fair value from $45mn to $352mn. Note in particular the graph on slide 4 showing divergence
Appx 46	PBC Data	Information update relating to GS deals under collateral call
Appx 47	PBC Data	Information update relating to GS deals under collateral call - detailed asset collateral data
Appx 48	PBC Data	Summary of the Horizon program - information by tranche
Appx 49	PBC Method	Proposed approach to be applied in relation to the treatment of the Horizon notes under FAS 155 as CDS or CLN
Appx 50	PwC Testing	Tie out of Moody's recovery rate data to policy document
Appx 51	PBC Testing	Review of AIGFP model by Paul Narayanan, AIG Credit Risk Management
Appx 52	PBC Method	AIG memorandum on the treatment of the Horizon program
Appx 53	PwC Testing	Testing of spread data from raw information in #12 to the information in the policy document contained in #40, based on the rules noted in #9. Sample basis tested CDO, Subprime and RMBS collateral types. No exceptions noted.