AIG Life of Bermuda, Ltd.

Audited GAAP Financial Statements

December 31, 2017 and 2016

AIG LIFE OF BERMUDA, LTD.

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Report of Independent Auditors

To the Board of Directors and Shareholder of
AIG Life of Bermuda, Ltd.

We have audited the accompanying consolidated financial statements of AIG Life of Bermuda, Ltd. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and December 31, 2016, and the related consolidated statements of income, comprehensive income (loss), equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AIG Life of Bermuda, Ltd. and its subsidiaries as of December 31, 2017 and December 31, 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

April 27, 2018

AIG LIFE OF BERMUDA, LTD.
CONSOLIDATED BALANCE SHEETS

	December 31,	
(in millions, except for share data)	**2017**	2016
Assets:		
Investments:		
Fixed maturity securities:		
Bonds available for sale, at fair value (amortized cost: 2017 – $331; 2016 – $315)	**$ 342**	$ 324
Policy loans	**80**	80
Short-term investments (portion measured at fair value: 2017 – $46; 2016 – $13)	**54**	19
Total investments	**476**	423
Accrued investment income	**4**	4
Amounts due from related parties	**1,510**	2,095
Reinsurance assets	**4**	4
Other assets	**56**	-
Separate account assets, at fair value	**1,316**	1,296
Total assets	**$ 3,366**	$ 3,822
Liabilities:		
Future policy benefits for life insurance contracts	**$ 1,215**	$ 1,104
Policyholder contract deposits	**80**	80
Policy claims and benefits payable	**13**	10
Income taxes payable to parent	**576**	409
Deferred income taxes	**45**	86
Amounts due to related parties	**2**	4
Other liabilities	**29**	3
Separate account liabilities	**1,316**	1,296
Total liabilities	**3,276**	2,992
Contingencies (see Note 8)		
AIG Life of Bermuda, Ltd. shareholder's equity:		
Preferred stock, $0.36 par value; 6,500,000,000 shares authorized; issued and outstanding: 2017 – 0 and 2016 - 1,208,008,141	**-**	434
Common stock, $1 par value; 250,000 shares authorized, 250,000 issued and outstanding	**-**	-
Additional paid-in capital	**169**	331
Retained earnings (accumulated deficit)	**(111)**	13
Accumulated other comprehensive income	**32**	44
Total AIG Life of Bermuda, Ltd. shareholder's equity	**90**	822
Noncontrolling interest	**-**	8
Total equity	**90**	830
Total liabilities and equity	**$ 3,366**	$ 3,822

See accompanying Notes to Consolidated Financial Statements.

AIG LIFE OF BERMUDA, LTD.
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,	
(in millions)	**2017**	2016
Revenues:		
Premiums	**$ (20)**	$ (21)
Policy fees	**19**	19
Net investment income	**30**	26
Net realized capital gains	**72**	175
Other income	**23**	23
Total revenues	**124**	**222**
Benefits and expenses:		
Policyholder benefits	**26**	191
Interest credited to policyholders	**4**	5
General operating and other expenses	**8**	8
Total benefits and expenses	**38**	204
Income before income tax expense	**86**	18
Income tax expense	**203**	34
Net loss attributable to AIG Life of Bermuda, Ltd.	**$ (117)**	$ (16)

See accompanying Notes to Consolidated Financial Statements.

AIG LIFE OF BERMUDA, LTD.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Years Ended December 31,	
(in millions)	**2017**	2016
Net loss	**$ (117)**	$ (16)
Other comprehensive income (loss), net of tax		
Change in unrealized appreciation of fixed maturity investments	**1**	1
Change in foreign currency translation adjustments	**(18)**	29
Other comprehensive income (loss)	**(17)**	30
Comprehensive income (loss) attributable to AIG Life of Bermuda, Ltd.	**$ (134)**	$ 14

See accompanying Notes to Consolidated Financial Statements.

AIG LIFE OF BERMUDA, LTD.
CONSOLIDATED STATEMENTS OF EQUITY

(in millions)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Total AIG Bermuda Shareholder's Equity	Non Controlling Interest	Total Share-holder's Equity
Balance, January 1, 2016	$ 434	$ -	$ 321	$ 30	$ 14	$ 799	$ 8	$ 807
Net loss	-	-	-	(16)	-	(16)	-	(16)
Dividends	-	-	-	(1)	-	(1)	-	(1)
Other comprehensive income	-	-	-	-	30	30	-	30
Capital contributions from AGC Life	-	-	10	-	-	10	-	10
Balance, December 31, 2016	$ 434	$ -	$ 331	$ 13	$ 44	$ 822	$ 8	$ 830
Net loss	**-**	**-**	**-**	**(117)**	**-**	**(117)**	**-**	**(117)**
Dividends	**-**	**-**	**-**	**(2)**	**-**	**(2)**	**-**	**(2)**
Other comprehensive loss	**-**	**-**	**-**	**-**	**(17)**	**(17)**	**-**	**(17)**
Capital contributions from AGC Life	**-**	**-**	**149**	**-**	**-**	**149**	**-**	**149**
Return of capital	**-**	**-**	**(311)**	**-**	**-**	**(311)**	**-**	**(311)**
Preferred stock redemption	**(434)**	**-**	**-**	**-**	**-**	**(434)**	**-**	**(434)**
Decrease from deconsolidation	**-**	**-**	**-**	**-**	**-**	**-**	**(8)**	**(8)**
Reclassification of certain tax effects from AOCI	**-**	**-**	**-**	**(5)**	**5**	**-**	**-**	**-**
Balance, December 31, 2017	**$ -**	**$ -**	**$ 169**	**$ (111)**	**$ 32**	**$ 90**	**$ -**	**$ 90**

See accompanying Notes to Consolidated Financial Statements.

AIG LIFE OF BERMUDA, LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)	Years Ended December 31, **2017**	2016
Cash flows from operating activities:		
Net loss	**$ (117)**	$ (16)
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest credited to policyholders	**4**	5
Net realized capital gains	**(72)**	(175)
Equity in income of partnerships and other invested assets	**(4)**	(3)
Amortization of net premium on investments	**-**	1
Provision for deferred income taxes	**26**	(211)
Capitalized interest	**(5)**	(5)
Changes in operating assets and liabilities:		
Accrued investment income	**-**	1
Amounts due to/from related parties	**(16)**	(5)
Current income tax receivable/payable	**205**	212
Future policy benefits and other insurance reserves	**7**	174
Other, net	**1**	(2)
Total adjustments	**146**	(8)
Net cash provided by (used in) operating activities	**29**	(24)
Cash flows from investing activities:		
Proceeds from (payments for)		
Sale of available for sale investments	**22**	69
Divestiture of interest in a consolidated subsidiary	**5**	-
Redemption and maturities of fixed maturity securities available for sale	**20**	15
Principal payments received on maturities of policy loans	**6**	39
Principal payments received on settlement of notes receivables*	**745**	-
Purchases of:		
Available for sale investments	**(59)**	(42)
Policy loans	**(1)**	(31)
Net change in short-term investments	**(35)**	(17)
Other, net	**3**	1
Net cash provided by investing activities	**706**	34
Cash flows from financing activities:		
Net exchanges to/from separate accounts	**(5)**	(9)
Dividends and return of capital paid to Parent Company, net of contributions	**(294)**	-
Dividends paid to preferred shareholders	**(2)**	(1)
Preferred stock redemption	**(434)**	-
Net cash used in financing activities	**(735)**	(10)
Net decrease in cash	**-**	-
Cash at beginning of year	**-**	-
Cash at end of year	**$ -**	$ -

Supplementary Disclosure of Consolidated Cash Flow Information		
Cash paid during the period for:		
Taxes	**$ (29)**	$ 33
Non-cash activities:		
Non-cash deemed capital contribution for settlement of taxes from AGC Life	**97**	10
Other non-cash capital contribution from AGC Life	**35**	-

* Included in the amounts due from related parties on the Consolidated Balance Sheets

See accompanying Notes to Consolidated Financial Statements.

1. BASIS OF PRESENTATION

AIG Life of Bermuda, Ltd. (AIG Bermuda), including its wholly owned subsidiaries (American General Life Insurance of Bermuda, Ltd., AIG Credit Corp of Canada (AI Credit Canada) and Alabaster Capital LLC (Alabaster Capital)) is a wholly owned subsidiary of AGC Life Insurance Company (AGC Life), an indirect, wholly owned subsidiary of American International Group, Inc. (AIG Parent). Unless the context indicates otherwise, the terms ”the Company,” “we,” “us” or “our” mean AIG Life of Bermuda, Ltd. and its consolidated subsidiaries, and the term “AIG Parent” means American International Group, Inc. and not any of AIG Parent’s consolidated subsidiaries.

Our wholly-owned subsidiary, American General Life Insurance of Bermuda, Ltd., was established in 2004 and does not have any business activity at this time.

In December 2017, we received additional capital contribution of $35 million from AGC Life in form 100% equity holdings with AI Credit Canada and Alabaster Capital. The 2017 consolidated financial statements of the Company include the accounts of AI Canada and Alabaster Capital.

In July 2017, we sold our equity interest with Rokland Limited (Rokland) to an affiliate. Prior to the sale, Rokland was a direct wholly owned subsidiary and was the primary beneficiary of our consolidated VIEs. After the sale, we derecognized our equity interest with Rokland, including its investments on VIEs that were previously consolidated. Our principal activities are the insurance of flexible premium variable universal life insurance, reinsurance of term life, annuity and pension insurance risk, and certain investment operations through our affiliates.

Our operations are influenced by many factors, including general economic conditions, financial condition of AIG Parent, monetary and fiscal policies of the government of Bermuda and policies of the Bermuda Monetary Authority (BMA). The level of sales of our insurance and financial products is influenced by many factors, including general market rates of interest, the strength, weakness and volatility of equity markets and terms and conditions of competing products. We are exposed to the risks normally associated with a portfolio of fixed income securities, which include interest rate, option, liquidity and credit risks. We control our exposure to these risks by, among other things, closely monitoring and managing the duration and cash flows of our assets and liabilities, engaging in a disciplined process of underwriting, and reviewing and monitoring credit risk. We are also exposed to market risk and mortality/longevity risk. Market volatility may result in increased risks related to death benefits, as well as reduced fee income on variable product assets held in segregated accounts.

We have private placement variable universal life insurance issued to high net worth individuals and generally retained $5 thousand per insured and cede the remaining net amount at risk to our U.S. affiliate, American General Life Insurance Company (AGL). This product is no longer offered.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). All significant intercompany accounts and transactions have been eliminated. Certain prior period items have been reclassified to conform to the current period’s presentation.

The consolidated financial statements include the accounts of the Company, our controlled subsidiaries (generally through a greater than 50 percent ownership of voting rights of a voting interest entity).

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires the application of accounting policies that often involve a significant degree of judgment. Accounting policies that we believe are most dependent on the application of estimates and assumptions are considered our critical accounting estimates and are related to the determination of:

- income tax assets and liabilities, including recoverability of our deferred tax assets and the predictability of future tax operating profitability of the character necessary to realize the deferred tax assets and provisional estimates associated with the enactment of the Tax Cuts and Jobs Act of 2017 (Tax Act);
- valuation of future policy benefit liabilities and timing and extent of loss recognition; and
- fair value measurements of certain financial assets and liabilities.

These accounting estimates require the use of assumptions about matters, some of which are highly uncertain at the time of estimation. To the extent actual experience differs from the assumptions used, our consolidated financial condition, results of operations and cash flows could be materially affected.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following table identifies our significant accounting policies presented in other Notes to these Consolidated Financial Statements, with a reference to the Note where a detailed description can be found:

Note 4. Investments
- Fixed maturity securities
- Short-term investments
- Net investment income
- Net realized capital gains (losses)

Note 5. Reinsurance
- Reinsurance assets, net of allowance

Note 7. Insurance Liabilities
- Future policy benefits
- Policyholder contract deposits

Note 11. Income Taxes

Other significant accounting policies

Premiums received for universal life and variable universal life products are reported as deposits to policyholder contract deposits and/or separate account liabilities. Reinsurance premiums ceded are recognized as a reduction in revenues over the period the reinsurance coverage is provided in proportion to the risks to which the premiums relate.

Policy fees represent revenues recognized from universal life and variable universal life products consisting of policy charges for cost of insurance and policy administration charges. Policy fees are recognized as revenues in the period in which they are assessed against policyholders, unless the fees are designed to compensate us for services to be provided in the future.

Other income primarily includes ceded commissions, risk charges and interests associated with the reinsurance agreements.

Cash represents cash on hand and non-interest bearing demand deposits.

Short-term investments consist of interest-bearing cash equivalents and investments, such as commercial paper, with original maturities within one year from the date of purchase.

Policy loans are carried at unpaid principal balances. There is no allowance for policy loans because these loans serve to reduce the death benefit paid when the death claim is made and the balances are effectively collateralized by the cash surrender value of the policy.

Separate accounts represent funds for which investment income and investment gains and losses accrue directly to the contract holders who bear the investment risk. Each account has specific investment objectives and the assets are carried at fair value. The assets of each account are legally segregated and are not subject to claims that arise from any of our other businesses. The liabilities for these accounts are equal to the account assets.

Foreign currency: Financial statement accounts expressed in foreign currencies are translated into U.S. dollars. Functional currency assets and liabilities are translated into U.S. dollars generally using rates of exchange prevailing at the balance sheet date and the related translation adjustments are recorded as a separate component of other comprehensive income, net of any related taxes. Income statement accounts expressed in functional currencies are translated using average exchange rates during the period. Functional currencies are generally the currencies of the local operating environment.

Accounting Standards Adopted During 2017

Derivative Contract Novations

In March 2016, the Financial Accounting Standards Board (FASB) issued an accounting standard that that clarifies that a change in the counterparty (novation) to a derivative instrument that has been designated as a hedging instrument does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met.

We adopted the standard on its required effective date of January 1, 2017. The adoption of this standard did not have a material effect on our consolidated financial condition, results of operations or cash flows.

Interest Held through Related Parties that are under Common Control

In October 2016, the FASB issued an accounting standard that amends the consolidation analysis for a reporting entity that is the single decision maker of a VIE. The new guidance will require the decision maker's evaluation of its interests held through related parties that are under common control on a proportionate basis (rather than in their entirety) when determining whether it is the primary beneficiary of that VIE. The amendment does not change the characteristics of a primary beneficiary.

We adopted the standard on its required effective date of January 1, 2017. The adoption of this standard did not have a material effect on our consolidated financial condition, results of operations or cash flows.

Clarifying the Definition of a Business

In January 2017, the FASB issued an accounting standard that changes the definition of a business to assist entities in evaluating when a set of transferred assets and activities is a business. The new standard will require an entity to evaluate if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar assets; if so, the set of transferred assets and activities is not a business. At a minimum, a set must include an input and a substantive process that together significantly contribute to the ability to create output.

We adopted this standard effective on October 1, 2017. The adoption of this standard did not have a material effect on our consolidated financial condition, results of operations or required disclosures.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (AOCI)

In February 2018, the FASB issued an accounting standard that allows the optional reclassification of stranded tax effects within accumulated other comprehensive income to retained earnings that arise due to the enactment of the Tax Act. We have elected to early adopt the accounting standard in our financial statements for the year ended December 31, 2017. Accordingly, we have recorded a reclassification adjustment of $5.2 million related to the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts at the date of enactment of the Tax Act. Consistent with Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118), released by the Securities and Exchange Commission, these are provisional adjustments and may be revised as relevant guidance is released.

We use the security-by-security approach when releasing stranded income tax effects from AOCI for available for sale securities.

Future Application of Accounting Standards

Revenue Recognition

In May 2014, the FASB issued an accounting standard that supersedes most existing revenue recognition guidance. The standard excludes from its scope the accounting for insurance contracts, leases, financial instruments, and certain other agreements that are governed under other GAAP guidance, but could affect the revenue recognition for certain of our other activities.

We will adopt this standard using the modified retrospective approach on its required effective date of January 1, 2018. Our analysis of revenues indicates that substantially all of our revenues are from sources excluded from the scope of the standard. For those revenue sources within the scope of the standard, there are no material changes in the timing or measurement of revenues based upon the guidance. As substantially all of our revenue sources are excluded from the scope of the standard, the adoption of the standard will not have a material effect on our reported consolidated financial condition, results of operations, cash flows or required disclosures.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued an accounting standard that will require equity investments that do not follow the equity method of accounting or are not subject to consolidation to be measured at fair value with changes in fair value recognized in earnings, while financial liabilities for which fair value option accounting has been elected and changes in fair value due to instrument-specific credit risk will be presented separately in other comprehensive income. The standard allows the election to record equity investments without readily determinable fair values at cost, less impairment, adjusted for subsequent observable price changes with changes in the carrying value of the equity investments recorded in earnings. The standard also updates certain fair value disclosure requirements for financial instruments carried at amortized cost.

We will adopt this standard on its effective date of January 1, 2018 using the modified retrospective approach. Based on our review, substantially all of our assets and liabilities are not within the scope of the standard. The adoption of the standard will not have a material effect on our reported consolidated financial condition, results of operations, cash flows or required disclosures.

Financial Instruments – Credit Losses

In June 2016, the FASB issued an accounting standard that will change how entities account for credit losses for most financial assets, trade receivables and reinsurance receivables. The standard will replace the existing incurred loss impairment model with a new "current expected credit loss model" that generally will result in earlier recognition of credit losses. The standard will apply to financial assets subject to credit losses, including those measured at amortized cost, reinsurance receivables and certain off-balance sheet credit exposures. Additionally, the impairment of available-for-sale debt securities are subject to the new guidance and will be measured in a similar manner, except that losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The standard will also require additional information to be disclosed in the footnotes.

The standard is effective on January 1, 2020, with early adoption permitted on January 1, 2019. We are continuing to develop our implementation plan to adopt the standard and are assessing the impact of the standard on our reported consolidated financial condition, results of operations, cash flows and required disclosures. While we expect an increase in our allowances for credit losses for the financial instruments within scope of the standard, given the objective of the new standard, the amount of any change will be dependent on our portfolios' composition and quality at the adoption date as well as economic conditions and forecasts at that time.

Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued an accounting standard that addresses diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments provide clarity on the treatment of eight specifically defined types of cash inflows and outflows.

We will adopt this standard retrospectively on its effective date of January 1, 2018. The standard addresses presentation in the statement of cash flows only and will have no effect on our reported consolidated financial condition, results of operations or required disclosures.

Intra-Entity Transfers of Assets Other than Inventory

In October 2016, the FASB issued an accounting standard that will require an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset is sold to a third party.

We will adopt the standard on its effective date of January 1, 2018 using a modified retrospective approach. The adoption of this standard will not have a material impact on our reported consolidated financial condition, results of operations, cash flows or required disclosures.

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued an accounting standard that shortens the amortization period for certain callable debt securities held at a premium by requiring the premium to be amortized to the earliest call date. The standard does not require an accounting change for securities held at a discount, which continue to be amortized to maturity.

We plan to adopt the standard retrospectively on its effective date, January 1, 2019. We do not expect the standard to have a material impact on our reported consolidated financial condition, results of operations, cash flows or required disclosures.

Derivatives and Hedging

In August 2017, the FASB issued an accounting standard that improves and expands hedge accounting for both financial and commodity risks. The provisions of the amendment are intended to better align the accounting with an entity's risk management activities, enhance the transparency on how the economic results are presented in the financial statements and the footnote, and simplify the application of hedge accounting treatment.

The standard is effective on January 1, 2019, with early adoption permitted. We are evaluating the timing of adoption and are assessing the impact of the standard on our reported consolidated financial condition, results of operations, cash flows and required disclosures.

3. FAIR VALUE MEASUREMENTS

Fair Value Measurements on a Recurring Basis

We carry certain of our financial instruments at fair value. We define the fair value of a financial instrument as the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We are responsible for the determination of the value of the investments carried at fair value and the supporting methodologies and assumptions.

The degree of judgment used in measuring the fair value of financial instruments generally inversely correlates with the level of observable valuation inputs. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgment is used in measuring fair value. Conversely, financial instruments for which no quoted prices are available have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgment. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction, liquidity and general market conditions.

Fair Value Hierarchy

Assets and liabilities recorded at fair value in the Consolidated Balance Sheets are measured and classified in accordance with a fair value hierarchy consisting of three “levels” based on the observability of valuation inputs:

- **Level 1:** Fair value measurements based on quoted prices (unadjusted) in active markets that we have the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets. We do not adjust the quoted price for such instruments.
- **Level 2:** Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.
- **Level 3:** Fair value measurements based on valuation techniques that use significant inputs that are unobservable. Both observable and unobservable inputs may be used to determine the fair values of positions classified in Level 3. The circumstances for using these measurements include those in which there is little, if any, market activity for the asset or liability. Therefore, we must make certain assumptions about the inputs a hypothetical market participant would use to value that asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The following is a description of the valuation methodologies used for instruments carried at fair value. These methodologies are applied to assets and liabilities across the levels discussed above, and it is the observability of the inputs used that determines the appropriate level in the fair value hierarchy for the respective asset or liability.

Valuation Methodologies of Financial Instruments Measured at Fair Value

Incorporation of Credit Risk in Fair Value Measurements

- **Our Own Credit Risk.** Fair value measurements for certain liabilities incorporate our own credit risk by determining the explicit cost for each counterparty to protect against its net credit exposure to us at the balance sheet date by reference to observable AIG CDS or cash bond spreads. We calculate the effect of credit spread changes using discounted cash flow techniques that incorporate current market interest rates. A derivative counterparty’s net credit exposure to us is determined based on master netting agreements, when applicable, which take into consideration all derivative positions with us, as well as collateral we post with the counterparty at the balance sheet date.

- **Counterparty Credit Risk.** Fair value measurements for freestanding derivatives incorporate counterparty credit by determining the explicit cost for us to protect against our net credit exposure to each counterparty at the balance sheet date by reference to observable counterparty CDS spreads, when available. When not available, other directly or indirectly observable credit spreads will be used to derive the best estimates of the counterparty spreads. Our net credit exposure to a counterparty is determined based on master netting agreements, which take into consideration all derivative positions with the counterparty, as well as collateral posted by the counterparty at the balance sheet date.

Fair values for fixed maturity securities based on observable market prices for identical or similar instruments implicitly incorporate counterparty credit risk. Fair values for fixed maturity securities based on internal models incorporate counterparty credit risk by using discount rates that take into consideration cash issuance spreads for similar instruments or other observable information.

For fair values measured based on internal models, the cost of credit protection is determined under a discounted present value approach considering the market levels for single name CDS spreads for each specific counterparty, the mid-market value of the net exposure (reflecting the amount of protection required) and the weighted average life of the net exposure. CDS spreads are provided to us by an independent third party. We utilize an interest rate based on the benchmark London Interbank Offered Rate (LIBOR) curve to derive our discount rates.

While this approach does not explicitly consider all potential future behavior of the derivative transactions or potential future changes in valuation inputs, we believe this approach provides a reasonable estimate of the fair value of the assets and liabilities, including consideration of the impact of non-performance risk.

Fixed Maturity Securities

Whenever available, we obtain quoted prices in active markets for identical assets at the balance sheet date to measure fixed maturity securities at fair value. Market price data is generally obtained from dealer markets.

We employ independent third-party valuation service providers to gather, analyze, and interpret market information to derive fair value estimates for individual investments, based upon market-accepted methodologies and assumptions. The methodologies used by these independent third-party valuation service providers are reviewed and understood by management, through periodic discussion with and information provided by the independent third-party valuation service providers. In addition, as discussed further below, control processes are applied to the fair values received from independent third-party valuation service providers to ensure the accuracy of these values.

Valuation service providers typically obtain data about market transactions and other key valuation model inputs from multiple sources and, through the use of market-accepted valuation methodologies, which may utilize matrix pricing, financial models, accompanying model inputs and various assumptions, provide a single fair value measurement for individual securities. The inputs used by the valuation service providers include, but are not limited to, market prices from completed transactions for identical securities and transactions for comparable securities, benchmark yields, interest rate yield curves, credit spreads, prepayment rates, default rates, recovery assumptions, currency rates, quoted prices for similar securities and other market-observable information, as applicable. If fair value is determined using financial models, these models generally take into account, among other things, market observable information as of the measurement date as well as the specific attributes of the security being valued, including its term, interest rate, credit rating, industry sector, and when applicable, collateral quality and other security or issuer-specific information. When market transactions or other market observable data is limited, the extent to which judgment is applied in determining fair value is greatly increased.

We have control processes designed to ensure that the fair values received from independent third-party valuation service providers are accurately recorded, that their data inputs and valuation techniques are appropriate and consistently applied and that the assumptions used appear reasonable and consistent with the objective of determining fair value. We assess the reasonableness of individual security values received from independent third-party valuation service providers through various analytical techniques, and have procedures to escalate related questions internally and to the independent third-party valuation service providers for resolution. To assess the degree of pricing consensus among various valuation service providers for specific asset types, we conduct comparisons of prices received from available sources. We use these comparisons to establish a hierarchy for the fair values received from independent third-party valuation service providers to be used for particular security classes. We also validate prices for selected securities through reviews by members of management who have relevant expertise and who are independent of those charged with executing investing transactions.

When our independent third-party valuation service providers are unable to obtain sufficient market observable information upon which to estimate the fair value for a particular security, fair value is determined either by requesting brokers who are knowledgeable about these securities to provide a price quote, which is generally non-binding, or by employing market accepted valuation models. Broker prices may be based on an income approach, which converts expected future cash flows to a single present value amount, with specific consideration of inputs relevant to particular security types. For structured securities, such inputs may include ratings, collateral types, geographic concentrations, underlying loan vintages, loan delinquencies and defaults, loss severity assumptions, prepayments, and weighted average coupons and maturities. When the volume or level of market activity for a security is limited, certain inputs used to determine fair value may not be observable in the market. Broker prices may also be based on a market approach that considers recent transactions involving identical or similar securities. Fair values provided by brokers are subject to similar control processes to those noted above for fair values from independent third-party valuation service providers, including management reviews. For those corporate debt instruments (for example, private placements) that are not traded in active markets or that are subject to transfer restrictions, valuations reflect illiquidity and non-transferability, based on available market evidence. When observable price quotations are not available, fair value is determined based on discounted cash flow models using discount rates based on credit spreads, yields or price levels of comparable securities, adjusted for illiquidity and structure. Fair values determined internally are also subject to management review to ensure that valuation models and related inputs are reasonable.

The methodology above is relevant for all fixed maturity securities including commercial mortgage backed securities (CMBS) and fixed maturity securities issued by corporate entities.

Short-term Investments

For short-term investments that are measured at amortized cost, the carrying amounts of these assets approximate fair values because of the relatively short period of time between origination and expected realization, and their limited exposure to credit risk.

Separate Account Assets

Separate account assets are composed primarily of registered and unregistered open-end mutual funds. We generally obtain the fair value of separate account assets from net asset value information provided by mutual funds. In addition, certain mutual funds are traded daily. We measure fair value for such mutual funds by obtaining quoted prices in active markets for identical assets at the balance sheet date. Market price data is generally obtained from exchange or dealer markets.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about assets and liabilities measured at fair value on a recurring basis, and indicates the level of the fair value measurement based on the observability of the inputs used:

(in millions)	Level 1	Level 2	Level 3	Total
December 31, 2017				
Assets:				
Bonds available for sale:				
Non-U.S. governments	**$ -**	**$ 4**	**$ -**	**$ 4**
Corporate debt	**-**	**304**	**-**	**304**
CMBS	**-**	**34**	**-**	**34**
Total bonds available for sale	**-**	**342**	**-**	**342**
Short-term investments	**-**	**46**	**-**	**46**
Separate account assets	**183**	**1,133**	**-**	**1,316**
Total	**$ 183**	**$ 1,521**	**$ -**	**$ 1,704**
December 31, 2016				
Assets:				
Bonds available for sale:				
Non-U.S. governments	$ -	$ 4	$ -	$ 4
Corporate debt	-	304	-	304
CMBS	-	16	-	16
Total bonds available for sale	-	324	-	324
Short-term investments	-	13	-	13
Separate account assets	186	1,110	-	1,296
Total	$ 186	$ 1,447	$ -	$ 1,633

Transfers of Level 1 and Level 2 Assets and Liabilities

Our policy is to record transfers of assets and liabilities between Level 1 and Level 2 at their fair values as of the end of each reporting period, consistent with the date of the determination of fair value. Assets are transferred out of Level 1 when they are no longer transacted with sufficient frequency and volume in an active market. Conversely, assets are transferred from Level 2 to Level 1 when transaction volume and frequency are indicative of an active market. We had no significant transfers between Level 1 and Level 2 during the years ended December 31, 2017 and 2016.

FAIR VALUE INFORMATION ABOUT FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE

Information regarding the estimation of fair value for financial instruments not carried at fair value (excluding insurance contracts) is discussed below.

- **Policy loans:** The fair value of policy loans is estimated based on unpaid principal amount. No consideration is given to credit risk because policy loans are effectively collateralized by the cash surrender value of the policies.
- **Cash and short-term investments:** The carrying amounts of these assets approximate fair values because of the relatively short period of time between origination and expected realization, and their limited exposure to credit risk.

The following table presents the carrying values and estimated fair values of our financial instruments not measured at fair value and indicates the level in the fair value hierarchy of the estimated fair value measurement based on the observability of the inputs used:

	Estimated Fair Value				Carrying
(in millions)	Level 1	Level 2	Level 3	Total	Value
December 31, 2017					
Assets:					
Policy loans	**$ -**	**$ -**	**$ 80**	**$ 80**	**$ 80**
Short-term investments	**-**	**6**	**-**	**6**	**6**
December 31, 2016					
Assets:					
Policy loans	$ -	$ -	$ 80	$ 80	$ 80
Short-term investments	-	6	-	6	6

4. INVESTMENTS

Fixed Maturity Securities

Bonds held to maturity are carried at amortized cost when we have the ability and positive intent to hold these securities until maturity. When we do not have the ability or positive intent to hold bonds until maturity, these securities are classified as available for sale and are measured at fair value. None of our fixed maturity securities met the criteria for held to maturity classification at December 31, 2017 or 2016.

Fixed maturity securities classified as available-for-sale are carried at fair value. Unrealized gains and losses from available for sale investments in fixed maturity securities are reported as a separate component of accumulated other comprehensive income, net of deferred income taxes, in shareholder’s equity. Investments in fixed maturity securities are recorded on a trade-date basis.

Premiums and discounts arising from the purchase of bonds classified as available for sale are treated as yield adjustments over their estimated holding periods, until maturity, or call date, if applicable. For investments in certain CMBS (structured securities), recognized yields are updated based on current information regarding the timing and amount of expected undiscounted future cash flows. For high credit quality structured securities, effective yields are recalculated based on actual payments received and updated prepayment expectations, and the amortized cost is adjusted to the amount that would have existed had the new effective yield been applied since acquisition with a corresponding charge or credit to net investment income. For structured securities that are not high credit quality, effective yields are recalculated and adjusted prospectively based on changes in expected undiscounted future cash flows.

Securities Available for Sale

The following table presents the amortized cost or cost and fair value of our available for sale securities:

(in millions)	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Bonds available for sale:[a]				
Non-U.S. Governments	**$ 4**	**$ -**	**$ -**	**$ 4**
Corporate debt	**294**	**10**	**-**	**304**
CMBS	**33**	**1**	**-**	**34**
Total bonds available for sale[b]	**$ 331**	**$ 11**	**$ -**	**$ 342**
December 31, 2016				
Bonds available for sale:[a]				
Non-U.S. Governments	$ 4	$ -	$ -	$ 4
Corporate debt	295	11	(2)	304
CMBS	16	-	-	16
Total bonds available for sale[b]	$ 315	$ 11	$ (2)	$ 324

(a) There were no other-than-temporary impairments recognized in accumulated other comprehensive income as of December 31, 2017 and 2016.

(b) At December 31, 2017 and 2016, bonds available for sale held by us that were below investment grade or not rated totaled $7 million and $12 million, respectively.

Securities Available for Sale in a Loss Position

The following table summarizes the fair value and gross unrealized losses on our available for sale securities, aggregated by major investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
(in millions)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2017						
Bonds available for sale:						
Corporate debt	**$ 26**	**$ -**	**$ 14**	**$ -**	**$ 40**	**$ -**
CMBS	**10**	**-**	**-**	**-**	**10**	**-**
Total bonds available for sale	**$ 36**	**$ -**	**$ 14**	**$ -**	**$ 50**	**$ -**
December 31, 2016						
Bonds available for sale:						
Corporate debt	$ 56	(2)	$ 5	$ -	$ 61	$ (2)
Total bonds available for sale	$ 56	$ (2)	$ 5	$ -	$ 61	$ (2)

At December 31, 2017, we held nine individual fixed maturity securities that were in an unrealized loss position, of which three individual fixed maturity security was in a continuous unrealized loss position for 12 months or more. At December 31, 2017, the gross unrealized losses associated with these fixed maturity securities were insignificant. We did not recognize the unrealized losses in earnings on these fixed maturity securities at December 31, 2017, because we neither intend to sell the securities nor do we believe that it is more likely than not that we will be required to sell these securities before recovery of their amortized cost basis. For fixed maturity securities with significant declines, we performed fundamental credit analyses on a security-by-security basis, which included consideration of credit enhancements, expected defaults on underlying collateral, review of relevant industry analyst reports and forecasts and other available market data.

Contractual Maturities of Fixed Maturity Securities Available for Sale

The following table presents the amortized cost and fair value of fixed maturity securities available for sale by contractual maturity:

	Total Fixed Maturity Securities Available for Sale		Fixed Maturity Securities in a Loss Position Available for Sale	
(in millions)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2017				
Due in one year or less	$ 13	$ 13	$ -	$ -
Due after one year through five years	111	116	-	-
Due after five years through ten years	157	160	40	40
Due after ten years	17	19	-	-
Mortgage-backed, asset-backed and collateralized	33	34	10	10
Total	$ 331	$ 342	$ 50	$ 50
December 31, 2016				
Due in one year or less	$ 11	$ 11	$ -	$ -
Due after one year through five years	129	136	2	2
Due after five years through ten years	143	143	61	59
Due after ten years	17	18	-	-
Mortgage-backed, asset-backed and collateralized	15	16	-	-
Total	$ 315	$ 324	$ 63	$ 61

Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

The following table presents the gross realized gains and gross realized losses from sales or maturities of our available for sale securities:

	Years Ended December 31,			
	2017		2016	
(in millions)	Gross Realized Gains	Gross Realized Losses	Gross Realized Gains	Gross Realized Losses
Fixed maturity securities	**$ -**	**$ -**	$ 1	$ 1

In 2017 and 2016, the aggregate fair value of available for sale securities sold was $22 million and $69 million, respectively. In 2017, the gross realized gains and gross realized losses from sales or maturities of our available for sale securities were insignificant.

Net Investment Income

Net investment income represents income primarily from the following sources:

- Interest income and related expenses, including amortization of premiums and accretion of discounts on bonds with changes in the timing and the amount of expected principal and interest cash flows reflected in yield, as applicable.
- Interest income on policy loans.
- Earnings from the underlying investment of funds held by a reinsurer under insurance treaties.

The following table presents the components of net investment income:

	Years Ended December 31,	
(in millions)	**2017**	2016
Fixed maturity securities, including short-term investments	**$ 14**	$ 14
Policy loans	**5**	5
Other investments	**11**	8
Total investment income	**30**	27
Investment expenses	**-**	1
Net investment income	**$ 30**	$ 26

Net Realized Capital Gains and Losses

Net realized capital gains and losses are determined by specific identification. The net realized capital gains and losses are generated primarily from the following sources:

- Sales or full redemption of available for sale fixed maturity securities.
- Changes in fair value of derivatives assumed from AIRCO.

The following table presents the components of net realized capital gains (losses):

	Years Ended December 31,	
(in millions)	**2017**	2016
Derivatives	**$ 72**	$ 173
Other	**-**	2
Net realized capital gains	**$ 72**	$ 175

Evaluating Investments for Other-Than-Temporary Impairments

Fixed Maturity Securities

If we intend to sell a fixed maturity security or it is more likely than not that we will be required to sell a fixed maturity security before recovery of its amortized cost basis and the fair value of the security is below amortized cost, an other-than-temporary impairment has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized capital losses. When assessing our intent to sell a fixed maturity security, or whether it is more likely than not that we will be required to sell a fixed maturity security before recovery of its amortized cost basis, management evaluates relevant facts and circumstances including, but not limited to, decisions to reposition our investment portfolio, sales of securities to meet cash flow needs and sales of securities to take advantage of favorable pricing.

For fixed maturity securities for which a credit impairment has occurred, the amortized cost is written down to the estimated recoverable value with a corresponding charge to realized capital losses. The estimated recoverable value is the present value of cash flows expected to be collected, as determined by management. The difference between fair value and amortized cost that is not related to a credit impairment is presented in unrealized appreciation (depreciation) of fixed maturity securities on which other-than-temporary credit impairments were recognized (a separate component of accumulated other comprehensive income).

When estimating future cash flows for structured fixed maturity securities (e.g., RMBS, CMBS, CDO, ABS) management considers historical performance of underlying assets and available market information as well as bond-specific structural considerations, such as credit enhancement and priority of payment structure of the security. In addition, the process of estimating future cash flows includes, but is not limited to, the following critical inputs, which vary by asset class:

- Current delinquency rates;
- Expected default rates and the timing of such defaults;

- Loss severity and the timing of any recovery; and
- Expected prepayment speeds.

For corporate, municipal and sovereign fixed maturity securities determined to be credit impaired, management considers the fair value as the recoverable value when available information does not indicate that another value is more relevant or reliable. When management identifies information that supports a recoverable value other than the fair value, the determination of a recoverable value considers scenarios specific to the issuer and the security, and may be based upon estimates of outcomes of corporate restructurings, political and macroeconomic factors, stability and financial strength of the issuer, the value of any secondary sources of repayment and the disposition of assets.

We consider severe price declines in our assessment of potential credit impairments. We may also modify our model inputs when we determine that price movements in certain sectors are indicative of factors not captured by the cash flow models.

In periods subsequent to the recognition of an other-than-temporary impairment charge for available for sale fixed maturity securities that is not foreign exchange related, we prospectively accrete into earnings the difference between the new amortized cost and the expected undiscounted recoverable value over the remaining expected holding period of the security.

5. REINSURANCE

In the ordinary course of business, we utilize internal reinsurance relationships to facilitate capital management strategies. We generally limit our exposure to loss on any single insured to $5,000 by ceding additional risks through reinsurance contracts with a U.S. AIG affiliate.

Our reinsurance arrangements do not relieve us from our direct obligations to our beneficiaries. Thus, a credit exposure exists with respect to reinsurance ceded, to the extent that any reinsurer fails to meet the obligations assumed under any reinsurance agreement. We believe that no exposure to a single reinsurer represents an inappropriate concentration of credit risk to us.

Amounts recoverable from reinsurers are estimated in a manner consistent with the assumptions used for the underlying policy benefits and are presented as a component of reinsurance assets. The premiums with respect to these treaties are earned over the contract period in proportion to the protection provided.

The following table presents the effect of reinsurance on our premiums:

	Years Ended December 31,	
(in millions)	**2017**	2016
Ceded premiums	**$ (20)**	$ (21)

We have various reinsurance agreements with affiliated companies whereby we reinsure term life, annuity and pension products. In March 2002, we began assuming certain term life and universal life products of a U.S. AIG affiliate under a combination coinsurance and modified coinsurance agreement (co-modco). The affiliated ceding company's life reserves subject to this agreement were $318 million and $283 million at December 31, 2017 and 2016, respectively. In 2003, we also began assuming certain annuity products of a U.S. AIG affiliate under a co-modco agreement. The affiliated ceding company's annuity reserves subject to this agreement were $8.1 billion and $8.9 billion at December 31, 2017 and 2016, respectively. These agreements do not meet the criteria for reinsurance accounting under GAAP; therefore, deposit accounting is applied.

Certain agreements with our U.S. AIG affiliates provide for an experience refund of all profits, less a reinsurance risk charge. The most significant impact of the agreements on our consolidated results of operations in both 2017 and 2016 was pre-tax income of approximately $12 million, representing the risk charge and interest associated with the reinsurance agreements. Amounts due from related parties at December 31, 2017 and 2016 included $132 million and $106 million, respectively, related to these reinsurance agreements.

We provide letters of credit (LOCs) to secure the reserve credits taken for these reserves by the AIG affiliated ceding company on their respective statutory balance sheets. The LOCs are subject to reimbursement by AIG Parent in the event of a drawdown. Total outstanding LOCs were $450 million at both December 31, 2017 and 2016. The cost of the LOCs was $3 million in both 2017 and 2016.

We have a reinsurance agreement effective November 30, 2010, with AIRCO under which we assume a 100% quota share of an in force closed block of deferred and payout annuities that AIRCO assumed from Phoenix Life Limited (Phoenix, formerly ALBA Life, Ltd.). In February 2018, AIG Bermuda's rights and obligation under this agreement was novated to DSA Re effective January 1, 2017. See Note 13 for additional details about the novation.

Under the terms of the reinsurance agreement with AIRCO, AIRCO retained assets in a funds withheld account that would otherwise have been paid to us, which is included in amounts due from related parties in our Consolidated Balance Sheets. The balance of the funds withheld totaled $925 million and $830 million at December 31, 2017 and 2016, respectively. These funds withheld by AIRCO are supported by a specified portfolio of assets, subject to a security agreement between AIRCO and Phoenix. Under the contractual terms of the reinsurance agreement, the realized and unrealized gains and losses and net investment income related to the specified portfolio of assets inure to our benefit.

In addition, the funds withheld account contains an embedded derivative, which is deemed similar to a total return swap on the specified underlying investment portfolio. The fair value of the embedded derivative is included in amounts due from related parties, with changes in the fair value of the embedded derivative recorded in net realized capital gains (losses). The fair value of the embedded derivative was $107 million and $100 million at December 31, 2017 and 2016, respectively.

In connection with AIRCO's reinsurance agreement with Phoenix, AIRCO entered into a series of interest rate and currency swap agreements. Gains and losses associated with these derivatives inure to our benefit and are recorded in net realized capital gains (losses). Amounts due from related parties associated with these swap agreements at December 31, 2017 and 2016 was $452 million and $406 million, respectively.

6. VARIABLE INTEREST ENTITIES

A variable interest entity (VIE) is a legal entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support or is structured such that equity investors lack the ability to make significant decisions relating to the entity's operations through voting rights or do not substantively participate in the gains and losses of the entity. Consolidation of a VIE by its primary beneficiary is not based on majority voting interest, but is based on other criteria discussed below.

We consolidate VIEs when we determine we are the primary beneficiary. This analysis includes a review of the VIE's capital structure, related contractual relationships and terms, nature of the VIE's operations and purpose, nature of the VIE's interests issued and our involvement with the entity. When assessing the need to consolidate a VIE, we evaluate the design of the VIE as well as the related risks the entity was designed to expose the variable interest holders to.

The primary beneficiary is the entity that has both (1) the power to direct the activities of the VIE that most significantly affect the entity's economic performance and (2) the obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. While also considering these factors, the consolidation conclusion depends on the breadth of our decision-making ability and our ability to influence activities that significantly affect the economic performance of the VIE.

We calculate our maximum exposure to loss to be the amount invested in the debt or equity of the VIE and other commitments and guarantees to the VIE. Interest holders in VIEs sponsored by us generally have recourse only to the assets and cash flows of the VIEs and do not have recourse to us, except in limited circumstances when we have provided a guarantee to the VIE's interest holders.

As discussed in Note 1, we sold our equity interest with Rockland as a result we derecognized our equity interest with Rokland, including its investments on VIEs that were previously consolidated. At December 31, 2017, we no longer have any consolidated VIEs.

At December 31, 2016, our consolidated VIEs reported total assets, consisting solely of notes receivable of $753 million, which were included in amounts due from related parties in the Consolidated Balance Sheets. The consolidated VIEs had no liabilities as of December 31, 2016.

7. INSURANCE LIABILITIES

Future Policy Benefits

Future policy benefits primarily include reserves for deferred and annuity payout contracts, which represent an estimate of the present value of future benefits less the present value of future net premiums.

The deferred annuity contracts we reinsured on a retrocession agreement were issued in conjunction with the termination of occupational pension programs in the United Kingdom (UK). To the extent that annuitization at retirement is required, they are accounted for as “limited-payment contacts” under GAAP. The liability for future policy benefits is computed using mortality tables published by the Institute and Faculty of Actuaries in the UK, and assumptions for mortality improvement based on a combination of historical mortality trends and published industry information. Present values at December 31, 2017 and 2016 were calculated at an interest rate of 2.4 percent and 3.1 percent, respectively.

For long duration traditional products, a “locked-in” assumption applies. The assumptions used to calculate benefit liabilities are set when a contract is issued and do not change with changes in actual experience, unless a loss recognition event occurs. These “locked-in” assumptions include mortality, morbidity, persistency, maintenance expenses, and investment returns and include margins for adverse deviation to reflect uncertainty given that actual experience might deviate from these assumptions. Periodically, we evaluate assumptions used in establishing liabilities for long duration traditional insurance contracts, which include assumed liabilities for certain deferred annuities. A loss recognition event occurs when there is a shortfall between the carrying amount of future policy benefit liabilities, and what the future policy benefit liabilities would be when applying updated current assumptions. When we determine a loss recognition event has occurred, we record additional liabilities through a charge to policyholder benefits, the old assumption set is replaced and the assumption set used for the loss recognition would then be subject to the lock-in principle.

For the deferred and payout annuity contracts, if the assets supporting the liabilities maintain a temporary net unrealized gain position at the balance sheet date, loss recognition testing assumptions are updated to exclude such gains from future cash flows by reflecting the impact of reinvestment rates on future yields. If a future loss is anticipated under this basis, any additional shortfall indicated by loss recognition tests is recognized as a reduction in accumulated other comprehensive income (shadow loss recognition) and an increase in liabilities for future policy benefits. The change in these adjustments, net of tax, is included with the change in net unrealized appreciation of investments that is credited or charged directly to other comprehensive income.

In 2017, the Company did not recognize any pre-tax adjustments related to actual loss recognition. In 2016, the Company recognized pre-tax adjustments of $169 million, which increased policyholder benefit expense to record actual loss recognition.

Policyholder Contract Deposits

The liability for policyholder contract deposits is primarily recorded at accumulated value (deposits received and net transfers from separate accounts, plus accrued interest credited, less withdrawals and assessed fees).

Policy Claims and Benefits Payable

Policy claims and benefits payable include amounts representing: (i) the actual in-force amounts for reported variable universal life claims; and (ii) valid proof of loss claims (as defined in the reinsurance agreement) for all contracts eligible to receive benefits at balance sheet date. There is no discounting for possible non-receipt of the appropriate proofs of loss due to unreported deaths. The methods of making estimates and establishing the resulting reserves are continually reviewed and updated and any adjustments are reflected in current period income.

8. CONTINGENCIES

Legal and Regulatory Matters

We are party to various lawsuits and proceedings arising in the ordinary course of business. We believe it is unlikely that contingent liabilities arising from such lawsuits will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Various regulatory and governmental agencies may from time to time review, examine or inquire into our operations, practices and procedures, such as through financial examinations, market conduct exams or regulatory inquiries. Based on the current status of pending regulatory examinations and inquiries involving us, we believe it is not likely that these regulatory examinations or inquiries will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

9. EQUITY

Accumulated Other Comprehensive Income

The following table presents the components of accumulated other comprehensive income:

	December 31,	
(in millions)	**2017**	2016
Unrealized appreciation of fixed maturity securities, available for sale	**$ 11**	$ 9
Foreign currency translation adjustments	**29**	57
Deferred income tax	**(8)**	(22)
Accumulated other comprehensive income	**$ 32**	$ 44

The following table presents the other comprehensive income (loss) reclassification adjustments:

(in millions)	Unrealized Appreciation of Fixed Maturity Investments	Foreign Currency Translation Adjustments	Total
Year ended December 31, 2016			
Unrealized change arising during period	$ 2	$ 45	$ 47
Less: Reclassification adjustments included in net income	-	2	2
Total other comprehensive income, before income tax expense	2	43	45
Less: Income tax expense	1	14	15
Total other comprehensive income, net of income tax expense	$ 1	$ 29	$ 30
Year ended December 31, 2017			
Unrealized change arising during period	**$ 2**	**$ (28)**	**$ (26)**
Less: Reclassification adjustments included in net income	**-**	**-**	**-**
Total other comprehensive income (loss), before income tax expense (benefit)	**2**	**(28)**	**(26)**
Less: Income tax expense (benefit)	**1**	**(10)**	**(9)**
Total other comprehensive income (loss), net of income tax expense (benefit)	**$ 1**	**$ (18)**	**$ (17)**

The following table presents the effect of the reclassification of significant items out of accumulated other comprehensive income on the respective line items in the Consolidated Statements of Income:

(in millions)	Amount Reclassified from Accumulated Other Comprehensive Income December 31, 2017	2016	Affected Line Item in the Consolidated Statements of Income
Foreign currency translation adjustments	-	2	Net realized capital gains (losses)
Total reclassifications for the period	$ -	$ 2	

Preferred Stock

We entered into transactions with AIG Financial Products (AIG-FP) and certain of its affiliates whereby AIG-FP purchased shares of the Company's preferred stock or loaned funds to us. We loaned or contributed all funds received from AIG-FP to our investees, which in turn used the funds as capital for their investment operations. All the original investment activity of the investees has terminated.

In June 2017, we redeemed the Company's preferred stock held by AIG-FP and settled any accrued dividends. Total amount paid to AIG-FP was $438 million.

10. STATUTORY FINANCIAL DATA AND RESTRICTIONS

The following table presents our statutory net income and capital and surplus:

(in millions)	**2017**
Year Ended December 31,	
Statutory net loss	**$ (117)**
At December 31,	
Statutory capital and surplus	**440**
Aggregate minimum required statutory capital and surplus	**38**

We file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by the BMA. The principal differences between statutory financial statements and financial statements prepared in accordance with GAAP relate to the presentation of both consolidated and unconsolidated data within the statutory financial statements. In addition, we received approval from the BMA to recognize AIG Parent's contingent tax liability as an asset in our statutory financial statements. The contingent tax liability is secured by LOCs issued for our benefit.

Dividend Restrictions

Dividends that we may pay to AGC Life in any year without prior approval of the BMA are limited by the restrictions set out under the Insurance Act of 1978. As a Class E insurer, we cannot reduce our total statutory capital by greater than 15% of the amount set out in our previous year's statutory financial statements without obtaining the prior approval of the BMA. The maximum dividend payout that may be made in 2018 without prior approval of the BMA is $78 million.

11. INCOME TAXES

U.S. Tax Reform Overview

On December 22, 2017, the U.S. enacted Public Law 115-97, known as the Tax Cuts and Jobs Act (the Tax Act). The Tax Act reduces the statutory rate of U.S. federal corporate income tax to 21 percent and enacts numerous other changes impacting AIG Bermuda and the life insurance industry in tax years beginning January 1, 2018.

Provisions of the Tax Act include reductions or elimination of deductions for certain items, e.g., reductions to corporate dividends received deductions, disallowance of entertainment expenses, and limitations on the deduction of certain executive compensation costs. These provisions, generally, result in an increase in AIG Bermuda's taxable income in the years beginning after December 31, 2017. Changes specific to the life insurance industry include changes to the calculation of insurance tax reserves and related transition adjustments and computation of the separate accounts dividends received deduction.

The SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 addresses situations where accounting for certain income tax effects of the Tax Act under Accounting Standards Codification (ASC) 740 may be incomplete upon issuance of an entity's financial statements and provides a one-year measurement period from the enactment date to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the following:

- Income tax effects of those aspects of the Tax Act for which accounting under ASC 740 is complete.
- Provisional estimate of income tax effects of the Tax Act to the extent accounting is incomplete but a reasonable estimate is determinable.
- If a provisional estimate cannot be determined, ASC 740 should still be applied on the basis of tax law provisions that were in effect immediately before the enactment of the Tax Act.

Consistent with current income tax accounting requirements, we have remeasured our deferred tax assets and liabilities with reference to the statutory income tax rate of 21 percent and taken into consideration other provisions of the Tax Act. As of December 31, 2017, we had not fully completed our accounting for the tax effects of the Tax Act. Our provision for income taxes for the period ended December 31, 2017, is based in part on a reasonable estimate of the effects on existing deferred tax balances and of certain provisions of the Tax Act. To the extent a reasonable estimate of the impact of certain provisions was determinable, we recorded provisional estimates as a component of our provision for income taxes. To the extent a reasonable estimate of the impact of certain provisions was not determinable, we have not recorded any adjustments and continued accounting for them in accordance with ASC 740 on the basis of the tax laws in effect before enactment of the Tax Act.

The Tax Act includes provisions for Global Intangible Low-Taxed Income (GILTI) under which taxes on foreign income are imposed on the excess of a deemed return on tangible assets of foreign corporations and for Base Erosion and Anti-Abuse Tax (BEAT) under which taxes are imposed on certain base eroding payments to affiliated foreign companies. Where applicable, consistent with accounting guidance, we will treat BEAT as an in period tax charge when incurred in future periods for which no deferred taxes need to be provided and made an accounting policy election to treat GILTI taxes in a similar manner. Accordingly, no provision for income tax related to GILTI or BEAT was recorded as of December 31, 2017.

For the period ended December 31, 2017, we recognized a provisional estimate of income tax effects of the Tax Act of $57 million.

Tax effects for which a reasonable estimate can be determined

Provisions Impacting Life Insurance Companies

The Tax Act modified computations of insurance reserves for life insurance companies. Specifically, the Act directs that tax reserves be computed with reference to NAIC reserves. Adjustments related to the differences in insurance reserves balances computed historically versus the Tax Act have to be taken into income over eight years.

Tax effects for which no estimate can be determined

The Tax Act may affect the results in certain investments and partnerships in which we are the non-controlling interest owner. The information needed to determine a provisional estimate is not currently available (such as for interest deduction limitations in those entities and the changed definition of a U.S. Shareholder). Accordingly, no provisional estimates were recorded.

We have made a reasonable estimate of accounting for certain effects of tax reform which impact current and deferred income taxes incurred; however, these estimates are not fully complete because information has yet to be finalized or further analyzed relating to certain provisions. These estimates will be revised in the period the necessary information is determined and as relevant guidance is released by the U.S. Treasury. We do not believe such revisions would have a material effect on our consolidated financial condition, results of operations or cash flows.

The U.S. statutory income tax rate was 35 percent for 2017 and 2016. Actual income tax (benefit) expense differed from the statutory U.S. federal amount computed by applying the federal income tax rate, due to the following:

Years Ended December 31, *(in millions)*		**2017**		2016
U.S federal income tax expense at statutory rate	**$**	**30**	$	6
Adjustments:				
Reserve for uncertain tax position		**116**		28
Audit adjustments		**-**		(1)
Impact of Tax Act		**57**		-
Other credits, taxes and settlements		**-**		1
Total income tax expense	**$**	**203**	$	34

Deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of assets and liabilities, at the enacted tax rates expected to be in effect when the temporary differences reverse. The effect of a tax rate change is recognized in income in the period of enactment.

The following table presents the components of the net deferred tax assets (liabilities):

Years Ended December 31, *(in millions)*		**2017**		2016
Deferred tax assets:				
Basis differential of investments	**$**	**13**	$	81
Deferred policy acquisition costs		**2**		6
Accrued expense		**61**		89
Total deferred tax assets		**76**		176
Deferred tax liabilities:				
Net unrealized gains on fixed maturity securities available for sale		**(2)**		(3)
Policy reserves		**(119)**		(259)
Total deferred tax liabilities		**(121)**		(262)
Net deferred tax liability	**$**	**(45)**	$	(86)

At December 31, 2017 and 2016, we had no tax loss carryforwards and no deferred tax valuation allowance.

We are included in the consolidated federal income tax return of our ultimate parent, AIG. Under our Amended and Restated Tax Payment Allocation Agreement dated June 6, 2011 (“AIG Tax Sharing Agreement”) with AIG Parent, taxes are recognized and computed on a separate company basis. To the extent that benefits for net operating losses, foreign tax credits or net capital losses are utilized on a consolidated basis, we will recognize tax benefits based upon the amount of the deduction and credits utilized in the consolidated federal income tax return. Under the AIG Tax Sharing Agreement, AIG Parent has agreed to indemnify us for any tax liability (including interest and penalties) resulting from adjustments made by the Internal Revenue Service (“IRS ”) or other appropriate authorities to taxable income, special deductions or credits related to transactions between our investees and AIG-FP.

Assessment of Deferred Tax Asset Valuation Allowance

The evaluation of the recoverability of the deferred tax asset and the need for a valuation allowance requires us to weigh all positive and negative evidence to reach a conclusion that it is more likely than not that all or some portion of the deferred tax asset will not be realized. The weight given to the evidence is commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, the more positive evidence is necessary and the more difficult it is to support a conclusion that a valuation allowance is not needed.

Our framework for assessing the recoverability of deferred tax assets requires us to consider all available evidence, including:

- the nature, frequency and severity of cumulative financial reporting losses in recent years;
- the predictability of future operating profitability of the character necessary to realize the net deferred tax asset; and
- prudent and feasible tax planning strategies that would be implemented, if necessary, to protect against the loss of deferred tax assets.

Estimates of future taxable income, including income generated from prudent and feasible actions and tax planning strategies could change in the near term, perhaps materially, which may require us to consider any potential impact to our assessment of the recoverability of the deferred tax asset. Such potential impact could be material to our consolidated financial condition or results of operations for an individual reporting period.

Accounting For Uncertainty in Income Taxes

The following table presents a reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits, excluding interest and penalties:

	Years Ended December 31,	
(in millions)	**2017**	2016
Gross unrecognized tax benefits at beginning of year	**$ 181**	$ 166
Increases in tax position for prior years	**94**	15
Gross unrecognized tax benefits at end of year	**$ 275**	$ 181

At December 31, 2017 and 2016, the amounts of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate were $275 million and $181 million, respectively.

Interest and penalties related to unrecognized tax benefits are recognized in income tax expense. At December 31, 2017 and 2016, we had accrued liabilities of $228 million and $166 million, respectively, for the payment of interest (net of the federal benefit) and penalties. In 2017 and 2016, we recognized expense of $62 million and $14 million, respectively, for interest (net of the federal benefit) and penalties related to unrecognized tax benefits.

We regularly evaluate proposed adjustments by taxing authorities. At December 31, 2017, such proposed adjustments would not have resulted in a material change to our consolidated financial condition for an individual reporting period, although it is possible that the effect could be material to our consolidated results of operations for an individual reporting period. Although it is reasonably possible that a change in the balance of unrecognized tax benefits may occur within the next twelve months, based on the information currently available, we do not expect any change to be material to our consolidated financial condition.

We are currently under IRS examination for taxable years 2007 through 2010. Although the final outcome of possible issues raised in any future examination is uncertain, we believe that the ultimate liability, including interest, will not materially exceed amounts recorded in the consolidated financial statements. Taxable years 2001 through 2016 remain subject to examination by major tax jurisdictions.

12. RELATED PARTY TRANSACTIONS

Events Related to AIG

On September 29, 2017, the Financial Stability Oversight Council (Council) rescinded its determination that material financial distress at AIG could pose a threat to U.S. financial stability and as a result, AIG is no longer designated as a nonbank systemically important financial institution (nonbank SIFI). With the rescission of its designation as a nonbank SIFI, AIG is no longer subject to the consolidated supervision of the Board of Governors of the Federal Reserve System or subject to the enhanced prudential standards set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act and its implementing regulations.

On September 25, 2017, AIG announced organizational changes designed to position AIG a growing, more profitable insurer that is focused on underwriting excellence. In the fourth quarter of 2017, AIG finalized its plan to reorganize its operating model. Commercial Insurance and Consumer Insurance segments transitioned to General Insurance and Life and Retirement, respectively. AIG’s core businesses include General Insurance, Life and Retirement and Other Operations. General Insurance consists of two operating segments – North America and International. Life and Retirement consists of four operating segments – Individual Retirement, Group Retirement, Life Insurance and Institutional Markets. Blackboard U.S. Holdings, Inc. (Blackboard), AIG’s technology-driven subsidiary, is reported within Other Operations. AIG also reports a Legacy Portfolio consisting of run-off insurance lines and legacy investments, which are considered non-core.

Additional information on AIG is publicly available in AIG Parent’s regulatory filings with the U.S. Securities and Exchange Commission (SEC), which can be found at www.sec.gov. Information regarding AIG Parent as described herein is qualified by regulatory filings AIG Parent files from time to time with the SEC.

Operating Agreements

Pursuant to a cost allocation agreement, we purchase administrative, investment management, accounting, marketing and data processing services from AIG Parent or its subsidiaries. The allocation of costs for investment management services is based on the level of assets under management. The allocation of costs for other services is based on estimated level of usage, transactions or time incurred in providing the respective services. We incurred approximately $1 million and $3 million for such services in 2017 and 2016, respectively. Accounts payable for such services at December 31, 2017 and 2016 were not significant.

Agreements with Affiliates

See Note 5 for discussion of affiliated reinsurance.

We issued cumulative preferred stock to AIG-FP, which was redeemed in June 2017. See Notes 9 for additional information about the redemption. Dividends on the preferred stock accrue at LIBOR times 65% and accrue on a quarterly basis. Dividend payment made in 2017 was $4 million. No dividend payment was made in 2016. No dividends payable was outstanding at December 31, 2017. Dividends payable outstanding at December 31, 2016 was $2 million.

We have a Cut-through Agreement with AGL pursuant to which policyowners and their beneficiaries were granted a direct right of action against AGL in the event we become insolvent or otherwise cannot or refuse to perform our obligations under certain life insurance policies issued by us. The Cut-through Agreement was approved by the Texas Department of Insurance. We believe the probability of loss under this agreement is remote.

AIG Parent agreed to exclude any income or loss attributable to an intercompany retrocession reinsurance treaty between us and any subsidiary of AIG Parent from the subsidiary's separate return tax liability when that subsidiary has elected under section 953 (d) of the Internal Revenue Code to be treated as a U.S. entity subject to U.S. tax law. We calculate the tax expense (benefit) on the excluded income and record tax liabilities as deemed capital contributions and tax assets as dividends. In 2017 and 2016, we recorded such deemed capital contributions of $97 million and $10 million, respectively, which were included in dividends to and the capital contributions from AGC Life in the Consolidated Statements of Equity.

13. SUBSEQUENT EVENTS

We consider events or transactions that occur after the balance sheet date, but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosures. We have evaluated subsequent events through April 27, 2018, the date the financial statements were issued.

In February 2018, AIG Bermuda and its affiliated Bermuda-based insurance companies, American International Reinsurance Company, Ltd. (AIRCO) and DSA Reinsurance Company Limited (DSA Re), signed a tri-party agreement novating AIG Bermuda's rights and obligations under its November 30, 2010 retrocession agreement with AIRCO to DSA Re, a wholly owned subsidiary of AIG Parent and registered Class 4 and Class E reinsurer in Bermuda. The novation and release agreement was executed on February 12, 2018 and involves the transfer of approximately $1 billion of reinsured reserves. In addition to the outstanding balances transferred on the execution date, the initial consideration also included the net results experienced under the retrocession agreement from the January 1, 2017 effective date in the agreement through the execution date.

See Note 5 for additional details about the AIG Bermuda's retrocession agreement with AIRCO.