AMERICAN FINANCIAL GROUP INC
Form 10-K
March 01, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2006 Commission File No. 1-13653

AMERICAN FINANCIAL GROUP

, INC.

Incorporated under the Laws of Ohio IRS Employer I.D. No. 31-1544320

One East Fourth Street, Cincinnati, Ohio 45202
(513) 579-2121

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	New York Stock Exchange and Nasdaq Global Select Market
7-1/8% Senior Debentures due December 15, 2007	New York Stock Exchange
7-1/8% Senior Debentures due April 15, 2009	New York Stock Exchange
7-1/8% Senior Debentures due February 3, 2034	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

Other securities for which reports are submitted pursuant to Section 15(d) of the Act:

None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes_X_ No___

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes___ No_X_

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes_X_ No___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer_X_ Accelerated Filer___ Non-Accelerated Filer___

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes___ No_X_

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant's most recently completed second fiscal quarter: $2.4 billion.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 119,415,711 shares (excluding 14,930,088 shares owned by a subsidiary) as of February 1, 2007.

Documents Incorporated by Reference:

Proxy Statement for 2007 Annual Meeting of Stockholders (portions of which are incorporated by reference into Part III hereof).

AMERICAN FINANCIAL GROUP, INC.

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FORWARD-LOOKING STATEMENTS

This Form 10-K, chiefly in Items 1, 3, 5, 7 and 8, contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Some of the forward-looking statements can be identified by the use of words such as "anticipates", "believes", "expects", "estimates", "intends", "plans", "seeks", "could", "may", "should", "will" or the negative version of those words or other comparable terminology. Such forward-looking statements include statements relating to: expectations concerning market and other conditions and their effect on future premiums, revenues, earnings and investment activities; recoverability of asset values; expected losses and the adequacy of reserves for asbestos, environmental pollution and mass tort claims; rate increases; and improved loss experience.

Actual results could differ materially from those contained in or implied by such forward-looking statements for a variety of factors including:

- *changes in economic conditions, including interest rates, performance of securities markets, and the availability of capital;*
- *regulatory actions;*
- *changes in legal environment affecting AFG or its customers;*
- *tax law changes;*
- *levels of natural catastrophes, terrorist events (including any nuclear, biological, chemical or radiological events), incidents of war and other major losses;*
- *development of insurance loss reserves and other reserves, particularly with respect to amounts associated with asbestos and environmental claims;*
- *the unpredictability of possible future litigation;*
- *trends in persistency, mortality and morbidity;*
- *availability of reinsurance and ability of reinsurers to pay their obligations;*
- *competitive pressures, including the ability to obtain rate increases; and*
- *changes in debt and claims paying ratings.*

The forward-looking statements herein are made only as of the date of this report. The Company assumes no obligation to publicly update any forward-looking statements

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PART I

ITEM 1

Business

Please refer to "Forward-Looking Statements" following the Index in front of this Form 10-K.

Introduction

American Financial Group, Inc. ("AFG") is a holding company that, through subsidiaries, is engaged primarily in property and casualty insurance, focusing on specialized commercial products for businesses, and in the sale of traditional fixed, indexed and variable annuities and a variety of supplemental insurance products. AFG was incorporated as an Ohio corporation in 1997. Its address is One East Fourth Street, Cincinnati, Ohio 45202; its phone number is (513) 579-2121. SEC filings, news releases, AFG's Code of Ethics applicable to directors, officers and

employees and other information may be accessed free of charge through AFG's Internet site at: ***www.afginc.com.*** (Information on AFG's Internet site is not part of this Form 10-K.)

At February 1, 2007, AFG's Chairman of the Board (Carl H. Lindner) and its Co-CEOs (Carl H. Lindner III and S. Craig Lindner, sons of the Chairman) beneficially owned 11.2%, 6.9% and 6.8%, respectively, of AFG's outstanding Common Stock. Another son (Keith E. Lindner) publicly reported in April 2006 that he beneficially owned shares representing 7.7% of AFG's outstanding Common Stock.

Three-for-two Stock Split

All share and per share amounts (except number of shares authorized and the stated value of $1.00 per share) presented in this Annual Report on Form 10-K have been adjusted for all periods presented to reflect the effect of a three-for-two Common Stock split that became effective December 15, 2006.

Property and Casualty Insurance Operations

The property and casualty group reports to a single senior executive and is comprised of multiple business units that operate autonomously but with certain central controls and accountability. The decentralized approach allows each unit the autonomy necessary to respond to local and specialty market conditions while capitalizing on the efficiencies of centralized investment and administrative support functions. AFG's property and casualty insurance operations employed approximately 5,200 persons as of December 31, 2006.

The primary objectives of AFG's property and casualty insurance operations are to achieve solid underwriting profitability and provide excellent service to its policyholders. Underwriting profitability is measured by the combined ratio, which is a sum of the ratios of losses, loss adjustment expenses ("LAE"), underwriting expenses and policyholder dividends to premiums. A combined ratio under 100% is indicative of an underwriting profit. The combined ratio does not reflect investment income, other income, or federal income taxes.

While many costs included in underwriting are readily determined (commissions, administrative expenses, and many of the losses on claims reported), the process of determining overall underwriting results is highly dependent upon the use of estimates in the case of losses incurred or expected but not yet reported or developed. Actuarial procedures and projections are used to obtain "point estimates" of ultimate losses. While the process is imprecise and develops amounts which are subject to change over time, management believes that the liabilities for unpaid losses and loss adjustment expenses are adequate.

AFG's statutory combined ratio averaged 95.7% for the period 2004 to 2006 (or 93.1% excluding a 2005 charge of $179 million related to asbestos, environmental and other mass tort matters) as compared to 97.5% for the property and casualty industry over the same period (Source: "Best's Review/Preview - Property/Casualty" - January 2007 Edition). AFG believes that its specialty niche focus, product line

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diversification and underwriting discipline have contributed to the Company's ability to consistently outperform the industry's underwriting results. Management's philosophy is to refrain from writing business that is not expected to produce an underwriting profit even if it is necessary to limit premium growth to do so.

Generally, financial data is reported in accordance with generally accepted accounting principles ("GAAP") for shareholder and other investment purposes and reported on a statutory basis for insurance regulatory purposes. In general, statutory accounting results in lower capital and surplus and lower net earnings than result from application of GAAP. Major differences include charging policy acquisition costs to expense as incurred rather than spreading the

costs over the periods covered by the policies; reporting investment-grade bonds and redeemable preferred stocks at amortized cost rather than fair value; netting of reinsurance recoverables and prepaid reinsurance premiums against the corresponding liabilities; and charging to surplus certain assets, such as furniture and fixtures and agents' balances over 90 days old.

Unless indicated otherwise, the financial information presented for the property and casualty insurance operations herein is presented based on GAAP. Statutory information is provided for industry comparisons or where comparable GAAP information is not readily available.

Performance measures such as underwriting profit or loss and related combined ratios are often used by property and casualty insurers to help users of their financial statements better understand the Company's performance. See *Note C - "Segments of Operations"* to the financial statements for the reconciliation of AFG's operating profit by significant business segment to the Statement of Earnings.

The following table shows the performance of AFG's property and casualty insurance operations (dollars in millions):

	2006	2005	2004
Gross written premiums (a)	$3,921	$3,640	$3,646
Ceded reinsurance (a)	(1,263)	(1,192)	(1,417)
Net written premiums	$2,658	$2,448	$2,229
Net earned premiums	$2,563	$2,366	$2,110
Loss and LAE	1,480	1,510	1,416
Asbestos, environmental and other mass tort charge	-	179	-
Underwriting expenses	765	652	582
Underwriting gain	$ 318	$ 25	$ 112
GAAP ratios:			
Loss and LAE ratio	57.7%	71.4%	67.2%
Underwriting expense ratio	29.9	27.6	27.6
Combined ratio (b)	87.6%	99.0%	94.8%
Statutory ratios:			
Loss and LAE ratio	58.7%	74.7%	68.5%
Underwriting expense ratio	29.9	27.9	27.8

Combined ratio (b)	88.6	102.6	96.3
	%	%	%
Industry statutory combined ratio (c)			
All lines	93.3%	100.8%	98.5%
Commercial lines	94.3%	99.7%	100.2%

(a) Excludes the following premiums that were written under special arrangements on behalf of, and fully reinsured to, a former subsidiary (following its sale in 2003) and the purchaser of the Japanese division (sold in 2001): 2006 - $13 million; 2005 - $59 million; and 2004 - $91 million.

(b) The combined ratios include 7.6 percentage points for GAAP and 7.7 percentage points for statutory in 2005 related to the strengthening of reserves for asbestos, environmental and other mass tort exposures and 2.2 percentage points for GAAP and 2.3 percentage points for statutory in 2005 and 1.8 percentage points in 2004 related to hurricanes.

(c) Ratios are derived from "Best's Review/Preview - Property/Casualty" (January 2007 Edition).

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As with other property and casualty insurers, AFG's operating results can be adversely affected by unpredictable catastrophe losses. Certain natural disasters (hurricanes, earthquakes, tornadoes, floods, forest fires, etc.) and other incidents of major loss (explosions, civil disorder, terrorist events, fires, etc.) are classified as catastrophes by industry associations. Losses from these incidents are usually tracked separately from other business of insurers because of their sizable effects on overall operations. Total net losses to AFG's insurance operations from catastrophes, primarily hurricanes and tornadoes, were $22 million in 2006; $60 million in 2005; and $36 million in 2004.

AFG generally seeks to reduce its exposure to catastrophes through individual risk selection, including minimizing coastal exposures, and the purchase of reinsurance. Due to recent upward revisions in industry models of correlated catastrophe exposure associated with writing both workers' compensation and excess property coverage in California, AFG decided to stop writing most of its earthquake-exposed excess property coverage in California beginning in April 2006. This excess property business had net written premiums of $17 million in 2005. Prior to this action, AFG's excess property exposure to a catastrophic earthquake that industry models indicate could occur once in every 500 years (a "500-year event") was approximately 10% of AFG's shareholders' equity. Once the existing excess property policies expire in 2007, AFG's excess property exposure to a California earthquake 500-year event will be reduced to less than 1% of AFG's equity.

AFG is focused on growth opportunities in what it believes to be more profitable specialty businesses where AFG personnel are experts in particular lines of business or customer groups. The following are examples of such specialty businesses:

Property and Transportation

Inland and Ocean Marine	Provides coverage primarily for builder's risk, contractor's equipment, property, motor truck cargo, marine cargo, boat dealers, marina operators/dealers and excursion vessels.
Agricultural-related	Provides federally reinsured multi-peril crop (allied lines) insurance covering most perils as well as crop hail, equine mortality and other

	coverages for full-time operating farms/ranches and agribusiness operations on a nationwide basis.
Commercial Automobile	Markets customized insurance programs for various transportation operations (such as busses and trucks), and a specialized physical damage product for the trucking industry.
Specialty Casualty	
Executive and Professional Liability	Markets coverage for attorneys and for directors and officers of businesses and not-for-profit organizations.
Umbrella and Excess Liability	Provides higher layer liability coverage in excess of primary layers.
Excess and Surplus	Specially designed insurance products offered to those that can't find coverage in standard markets.
Specialty Financial	
Fidelity and Surety	Provides fidelity and crime coverage for government, mercantile and financial institutions and surety coverage for various types of contractors and public and private corporations.
Collateral Protection	Provides coverage for insurance risk management programs for lending and leasing institutions.

California Workers' Compensation	
Workers' Compensation	Writes coverage for prescribed benefits payable to employees (principally in California) who are injured on the job.

Management believes specialization is the key element to the underwriting success of these business units. Each unit has separate management with significant operating autonomy to oversee the important operational functions of its business such as underwriting, pricing, marketing, policy processing and claims service. These specialty businesses are opportunistic and their premium volume will vary based on prevailing market conditions. AFG continually evaluates expansion in existing markets and opportunities in new specialty markets that meet its profitability objectives. For example, in 2006, AFG gained new multi-peril crop premium volume from the 2005 acquisition of Farmers Crop Insurance Alliance and expanded the geographic focus of its property and inland marine operations.

The U.S. geographic distribution of these businesses' statutory direct written premiums in 2006 compared to 2002 is shown below. Amounts exclude business written under special arrangements on behalf of, and fully reinsured to, the purchasers of the divisions sold.

	2006	2002		2006	2002
California	17.8%	21.4%	Pennsylvania	2.5%	2.7%
Texas	8.8	9.9	Ohio	2.4	2.9
Florida	8.8	5.5	Michigan	2.4	2.1
Illinois	5.4	4.3	Georgia	2.3	3.0

New York	4.6	5.7	North Carolina	2.1	*
Oklahoma	2.7	2.8	Indiana	2.0	*
New Jersey	2.7	2.6	Missouri	*	2.0
			Other	35.5	35.1
				100.0%	100.0%

(*) less than 2%, included in "Other"

The following table sets forth a distribution of statutory net written premiums for AFG's specialty insurance businesses by NAIC annual statement line for 2006 compared to 2002.

	2006	2002
Other liability	24.1%	30.1%
Workers' compensation	12.9	16.2
Inland marine	11.1	7.2
Allied lines	8.6	2.5
Auto physical damage	7.9	4.8
Auto liability	7.8	8.7
Commercial multi-peril	7.0	8.6
Fidelity and surety	5.2	5.8
Collateral protection	4.9	5.3
Product liability	4.3	2.7
Ocean marine	2.7	3.7
Other	3.5	4.4
	100.0%	100.0%

For a discussion of the performance of AFG's specialty businesses see *Management's Discussion and Analysis - "Results of Operations - Property and Casualty Insurance - Underwriting."*

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The following table shows independent ratings and 2006 net written premiums (in millions) of AFG's major property and casualty insurance subsidiaries. Such ratings are generally based on concerns for policyholders and agents and are not directed toward the protection of investors. AFG believes that maintaining an S&P rating of at least "A-" is important to compete successfully in certain lines of business.

Ratings	Net Written

Company	AM Best	S&P	Premiums
Great American Pool(*)	A	A	$1,666
Republic Indemnity	A	A	285
Mid-Continent	A	A	321
American Empire Surplus Lines	A	A	115
National Interstate	A	not rated	242
Other			29
			$2,658

(*) The Great American Pool represents Great American Insurance Company ("GAI") and 10 subsidiaries.

Reinsurance

Consistent with standard practice of most insurance companies, AFG reinsures a portion of its business with other insurance companies and assumes a relatively small amount of business from other insurers. AFG uses reinsurance for two primary purposes: (i) to provide higher limits of coverage than it would otherwise be willing to provide (i.e. large line capacity) and (ii) to protect its business from the impact of catastrophes. The availability and cost of reinsurance are subject to prevailing market conditions, which may affect the volume and profitability of business that is written. AFG is subject to credit risk with respect to its reinsurers, as the ceding of risk to reinsurers generally does not relieve AFG of its liability to its insureds until claims are fully settled.

The commercial marketplace requires large policy limits ($25 million or more) in several of AFG's lines of business, including certain executive and professional liability, umbrella and excess liability, and fidelity and surety coverages. Since these limits exceed management's desired exposure to an individual risk, AFG enters into reinsurance agreements to reduce its net exposure under such policies to an acceptable level. Reinsurance continues to be available for this type of exposure with satisfactory pricing and terms.

AFG has taken steps to limit its exposure to wind and earthquake losses by purchasing catastrophe reinsurance. In addition, AFG purchases catastrophe reinsurance for its workers' compensation businesses. Although market availability at reasonable prices for such reinsurance has become more difficult over the past two years, AFG has been able to obtain reinsurance coverage in adequate amounts at acceptable rates due to management's decision to limit overall exposure to catastrophe losses through individual risk selection (including minimizing coastal exposures) and the Company's limited historical catastrophe losses.

In addition to the large line capacity and catastrophe reinsurance programs discussed above, AFG purchases reinsurance on a line-by-line basis. AFG increased its overall net premium retention by approximately $150 million in 2006 compared to 2004 in order to retain the benefit of certain profitable specialty businesses.

AFG regularly reviews the financial strength of its current and potential reinsurers. These reviews include consideration of credit ratings, available capital, claims paying history and expertise. This process periodically results in the transfer of risks to more financially secure reinsurers. Substantially all reinsurance is ceded to companies with investment grade or better S&P ratings or is secured by "funds withheld" or other collateral. Under "funds withheld" arrangements, AFG retains ceded premiums to fund ceded losses as they become due from the reinsurer. Excluding Infinity Property and Casualty Corporation, Mitsui Marine and Fire Insurance Company of America and Ohio

Casualty Corporation (discussed below), recoverables from the following companies were individually

between 5% and 10% of AFG's total reinsurance recoverable (net of payables to reinsurers) at December 31, 2006: Swiss Reinsurance America Corporation, XL Reinsurance America, Inc., Munich Reinsurance America, Inc., Berkley Insurance Company, Everest Reinsurance Company and General Reinsurance Corporation.

During 2004, AFG negotiated commutations (lump-sum cash settlements) totaling $58.3 million with certain of its reinsurance carriers who had experienced deteriorating financial condition. AFG's $28.9 million loss on these commutations represents the differential between the consideration received from the reinsurers and the related reduction of reinsurance recoverable.

Reinsurance is provided on one of two bases, facultative or treaty. Facultative reinsurance is generally provided on a risk by risk basis. Individual risks are ceded and assumed based on an offer and acceptance of risk by each party to the transaction. AFG purchases facultative reinsurance, both pro rata and excess of loss, depending on the risk and available reinsurance markets. Treaty reinsurance provides for risks meeting prescribed criteria to be automatically ceded and assumed according to contract provisions.

The following table presents (by type of coverage) the amount of each loss above the specified retention maximum generally covered by treaty reinsurance programs (in millions):

Coverage	Retention Maximum	Reinsurance Coverage(a)
California Workers' Compensation	$ 1.0	$149.0
Other Workers' Compensation	2.0	48.0
Commercial Umbrella	4.0	46.0
Property - General	2.0	28.0
Property - Catastrophe (other than earthquake)	21.2	98.8
Property - Catastrophe (earthquake)	21.2	128.8

(a)Reinsurance covers substantial portions of losses in excess of retention. However, in general, losses resulting from terrorism are not covered.

In addition to the coverage shown above, AFG reinsures a portion of its crop insurance business through the Federal Crop Insurance Corporation ("FCIC"). The FCIC offers both proportional (or "quota share") and non-proportional coverages. The proportional coverage provides that a fixed percentage of risk is assumed by the FCIC. The non-proportional coverage allows AFG to select desired retention of risk on a state-by-state, county, crop or plan basis. AFG typically reinsures 20% to 30% of gross written premium with the FCIC. AFG also purchases quota share reinsurance in the private market. This quota share provides for a ceding commission to AFG and a profit sharing provision. AFG currently reinsures 50% of premiums not reinsured by the FCIC in the private market and purchases stop loss protection coverage for the remaining portion of the business.

Included in the Balance Sheet caption "recoverables from reinsurers and prepaid reinsurance premiums" were approximately $245 million on paid losses and LAE and $2.3 billion on unpaid losses and LAE at December 31, 2006. These amounts are net of allowances of approximately $20 million for doubtful collection of reinsurance recoverables. The collectibility of a reinsurance balance is based upon the financial condition of a reinsurer as well as individual claim considerations.

Reinsurance premiums ceded and assumed are presented in the following table (in millions):

	2006	2005	2004
Reinsurance ceded	$1,276	$1,251	$1,508
Reinsurance assumed - including involuntary pools and associations	189	65	62

Reinsurance assumed includes $152 million in 2006 and $20 million in 2005 related to the purchase of the multi-peril crop and crop hail insurance business of Farmers Crop Insurance Alliance, Inc.

In connection with the transfer of a portion of GAI's personal lines business to Infinity in 2003 and the sales of the Japanese division to Mitsui in 2001 and the commercial lines division to Ohio Casualty in 1998, GAI agreed to issue and renew

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policies related to the businesses transferred until each purchaser received the required approvals and licensing to begin writing business on their own behalf. The Infinity agreement was effective until January 1, 2006. The Mitsui and Ohio Casualty agreements ended at the end of 2003 and in early 2001, respectively. Under these agreements, GAI ceded 100% of these premiums to the respective purchaser. In 2006, 2005, and 2004, premiums (included in the table above) of $13 million, $59 million and $91 million, respectively, were ceded under these agreements. At December 31, 2006, AFG's recoverables from reinsurers included $384 million related to these transactions.

Loss and Loss Adjustment Expense Reserves

The consolidated financial statements include the estimated liability for unpaid losses and LAE of AFG's insurance subsidiaries. This liability represents estimates of the ultimate net cost of all unpaid losses and LAE and is determined by using case-basis evaluations, actuarial projections and management's judgment. These estimates are subject to the effects of changes in claim amounts and frequency and are periodically reviewed and adjusted as additional information becomes known. In accordance with industry practices, such adjustments are reflected in current year operations. Generally, reserves for reinsurance assumed and involuntary pools and associations are reflected in AFG's results at the amounts reported by those entities.

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The following table presents the development of AFG's liability for losses and LAE, net of reinsurance, on a GAAP basis for the last ten years. The top line of the table shows the estimated liability (in millions) for unpaid losses and LAE recorded at the balance sheet date for the indicated years. The second line shows the re-estimated liability as of December 31, 2006. The remainder of the table presents intervening development as percentages of the initially estimated liability. The development results from additional information and experience in subsequent years, particularly with regard to A&E charges, settlements and reallocations as detailed below. The middle line shows a cumulative deficiency (redundancy), which represents the aggregate percentage increase (decrease) in the liability initially estimated. The lower portion of the table indicates the cumulative amounts paid as of successive periods as a percentage of the original loss reserve liability. For purposes of this table, reserves of businesses sold are considered paid at the date of sale. For example, the percentage of the December 31, 2002 reserve liability paid in 2003 includes approximately 20 percentage points for reserves of Infinity at its sale date in February 2003. See *Note O - "Insurance - Insurance Reserves"* to the Financial Statements for an analysis of changes in AFG's estimated liability for losses and LAE, net and gross of reinsurance, over the past three years on a GAAP basis.

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2
Liability for unpaid losses and loss adjustment expenses:										
As originally estimated	$3,404	$3,489	$3,305	$3,224	$3,192	$3,253	$3,400	$2,850	$3,103	$3,5
As re-estimated at December 31, 2006	4,035	4,086	3,624	3,686	3,879	4,028	4,046	3,254	3,275	3,4
Liability re-estimated:										
One year later	100.9%	104.5%	97.8%	98.1%	105.1%	105.2%	104.9%	104.9%	105.8%	98.
Two years later	105.9%	104.6%	96.3%	100.1%	105.1%	111.3%	110.3%	113.6%	105.5%	
Three years later	105.2%	102.9%	97.4%	99.0%	109.9%	115.2%	118.2%	114.2%		
Four years later	103.6%	105.4%	96.0%	102.6%	113.1%	122.1%	119.0%			
Five years later	106.9%	105.7%	99.2%	105.7%	119.7%	123.8%				
Six years later	107.7%	108.1%	102.0%	112.6%	121.5%					
Seven years later	109.8%	110.2%	108.1%	114.3%						
Eight years later	111.5%	115.8%	109.7%							
Nine years later	117.3%	117.1%								
Ten years later	118.5%									
Cumulative deficiency (redundancy) (a)	18.5%	17.1%	9.7%	14.3%	21.5%	23.8%	19.0%	14.2%	5.5%	%)
Cumulative paid as of:										
One year later	33.8%	41.7%	28.3%	34.8%	38.3%	33.6%	43.1%	27.7%	25.8%	24.
Two years later	58.0%	56.6%	51.7%	52.7%	52.2%	62.9%	62.1%	47.3%	41.4%	
Three years later	66.7%	70.8%	62.4%	60.0%	71.4%	76.3%	74.1%	59.9%		
Four years later	77.3%	78.6%	65.6%	72.5%	81.6%	84.9%	81.8%			
Five years later	82.8%	81.1%	73.9%	80.6%	87.5%	90.7%				
Six years later	84.6%	86.9%	80.8%	84.6%	91.9%					
Seven years later	89.6%	92.8%	83.8%	88.1%						

Eight years later	95.1%	95.0%	86.7%
Nine years later	97.1%	97.2%	
Ten years later	99.1%		

(a) Cumulative deficiency (redundancy):

Special A&E charges, settlements and reallocations	15.3%	15.0%	9.4%	9.6%	9.7%	6.4%	5.3%	6.3%	5.8%	
Other	3.2%	2.1%	0.3%	4.7%	11.8%	17.4%	13.7%	7.9%	(0.3%)	%)
Total	18.5%	17.1%	9.7%	14.3%	21.5%	23.8%	19.0%	14.2%	5.5%	%)

The following is a reconciliation of the net liability to the gross liability for unpaid losses and LAE.

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2
As originally estimated:										
Net liability shown above	$3,404	$3,489	$3,305	$3,224	$3,192	$3,253	$3,400	$2,850	$3,103	$3,5
Add reinsurance recoverables	720	736	1,468	1,571	1,324	1,525	1,804	2,059	2,234	2,
Gross liability	$4,124	$4,225	$4,773	$4,795	$4,516	$4,778	$5,204	$4,909	$5,337	$5,
As re-estimated at December 31, 2006:										
Net liability shown above	$4,035	$4,086	$3,624	$3,686	$3,879	$4,028	$4,046	$3,254	$3,275	$3,4
Add reinsurance recoverables	1,324	1,422	2,028	2,211	2,117	2,301	2,445	2,598	2,492	2,
Gross liability	$5,359	$5,508	$5,652	$5,897	$5,996	$6,329	$6,491	$5,852	$5,767	$5,

Gross cumulative deficiency (a)	29.9%	30.4%	18.4%	23.0%	32.8%	32.5%	24.7%	19.2%	8.1%	%

(a) Gross cumulative deficiency:

Special A&E charges, settlements and reallocations	16.3%	16.1%	8.0%	8.0%	8.5%	5.0%	3.9%	4.2%	3.9%	
Other	13.6%	14.3%	10.4%	15.0%	24.3%	27.5%	20.8%	15.0%	4.2%	%
Total	29.9%	30.4%	18.4%	23.0%	32.8%	32.5%	24.7%	19.2%	8.1%	%

In evaluating the re-estimated liability and cumulative deficiency (redundancy), it should be noted that each percentage includes the effects of changes in amounts for prior periods. For example, AFG's $179 million of special charges ($169 million for A&E and $10 million for other mass tort claims) related to losses recorded in 2005, but incurred before 1995, is included in the re-estimated liability and cumulative deficiency (redundancy) percentage for each of the previous years shown. Conditions and trends that have affected development of the liability in the past may not necessarily exist in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

A significant portion of the adverse development in the tables is due to A&E exposures for which AFG has been held liable under general liability policies written years ago, even though such coverage was not intended. Other factors affecting development in recent years included changes in the legal environment, including more liberal coverage decisions and higher jury awards, higher legal fees, the general state of the economy and medical cost inflation.

The differences between the liability for losses and LAE reported in the annual statements filed with the state insurance departments in accordance with statutory accounting principles ("SAP") and that reported in the accompanying consolidated financial statements in accordance with GAAP at December 31, 2006 are as follows (in millions):

Liability reported on a SAP basis, net of $202 million of retroactive reinsurance	$3,697
Reinsurance recoverables, net of allowance	2,309
Other	22
Liability reported on a GAAP basis	$6,028

Asbestos and Environmental Reserves ("A&E")

AFG's property and casualty group, like many others in the industry, has A&E claims arising in most cases from general liability policies written in years before 1987. The establishment of reserves for such A&E claims presents unique and difficult challenges and is subject to uncertainties significantly greater than those presented by other types of claims. For a discussion of these uncertainties, see Item 7 - *Management's Discussion and Analysis - "Uncertainties - Asbestos and Environmental-related Reserves" and Note M - "Commitments and Contingencies" to the Financial Statements.*

AFG has undertaken periodic reviews of its A&E reserves with the aid of an independent actuarial firm and specialty outside counsel. In the third quarter of 2005, AFG completed a comprehensive study of its asbestos and environmental exposures relating to the run-off operations of its property and casualty group. As a result of its study, AFG recorded a pretax charge of $169 million, net of $32 million in reinsurance recoverables. Management expects to conduct such a study every two years with the next study in 2007. For a discussion of the A&E reserve strengthening, see *Management's Discussion and Analysis - "Results of Operations - Asbestos and Environmental Reserve Charge."*

The following table (in millions) is a progression of A&E reserves.

	2006	2005	2004
Reserves at beginning of year	$461.0	$330.6	$399.9
Incurred losses and LAE	-	169.3	-
Paid losses and LAE	(32.2)	(38.9)	(45.4)
Reserves transferred with sale of a subsidiary	-	-	(49.4)
Reserves not previously classified as A&E	3.5	-	25.5
Reserves at end of year, net of reinsurance recoverable	432.3	461.0	330.6
Reinsurance recoverable, net of allowance	85.4	79.4	55.9
Gross reserves at end of year	$517.7	$540.4	$386.5

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The survival ratio, which is an industry measure of A&E claim reserves, is derived by dividing reserves for A&E exposures by average annual paid losses over the past three years. At December 31, 2006, AFG's survival ratio is approximately 19.5 times paid losses for the asbestos reserves (13.5 times excluding amounts associated with the A.P. Green settlement) and 11.4 times paid losses for total A&E reserves (8.6 times excluding A.P. Green), see *Legal Proceedings* for a discussion of the A.P. Green settlement. In March 2006, A.M. Best reported its estimate that the property and casualty insurance industry's three year survival ratio for A&E reserves was approximately 7.8 times paid losses at December 31, 2004.

Other Mass Tort Reserves

In addition to A&E claims, AFG faces exposure from other types of mass tort claims including those relating to breast implants, lead, silica, exposure to industrial chemicals, and other

latent injuries. Similar to A&E, other mass tort claims are subject to uncertainties that are significantly greater than those presented by other types of claims.

AFG's reserves for other mass torts, net of $3.5 million in reinsurance recoverable, were $15.6 million at December 31, 2006. AFG recorded a pretax charge of $10 million in the third quarter of 2005 to increase its liability for other mass torts. Other mass tort paid losses and LAE were $2.5 million in 2006, $3.6 million in 2005 and $2.4 million in 2004.

Marketing

The property and casualty insurance group directs its sales efforts primarily through independent property and casualty insurance agents and brokers, although portions are written through employee agents. Independent agents and brokers generally receive a commission on the sale of each policy. Some agents and brokers are eligible for a bonus commission based on the profitability of all of the policies placed with AFG by the broker or agent in a particular year. The property and casualty insurance group writes insurance through several thousand agents and brokers.

Competition

AFG's property and casualty insurance businesses compete with other individual insurers, state funds and insurance groups of varying sizes, some of which are mutual insurance companies possessing competitive advantages in that all their profits inure to their policyholders. They also compete with self-insurance plans, captive programs and risk retention groups. Due to the specialty nature of these coverages, competition is based primarily on service to policyholders and agents, specific characteristics of products offered and reputation for claims handling. Price, commissions and profit sharing terms are also important factors. Management believes that sophisticated data analysis for refinement of risk profiles, extensive specialized knowledge and loss prevention service have helped AFG compete successfully.

Annuity and Supplemental Insurance Operations

General

AFG's annuity and supplemental insurance operations are conducted through Great American Financial Resources, Inc. ("GAFRI"), an 81% owned subsidiary. GAFRI's primary insurance subsidiaries include Great American Life Insurance Company ("GALIC"), Annuity Investors Life Insurance Company ("AILIC"), Loyal American Life Insurance Company ("Loyal"), United Teacher Associates Insurance Company ("UTA"), Continental General Insurance Company ("CGIC") and Central Reserve Life Insurance Company ("CRLIC"). These companies market retirement products, primarily fixed, indexed and variable annuities, and various forms of supplemental insurance. All of these companies sell their products through independent producers. In addition, CGIC and CRLIC use captive agents. GAFRI and its subsidiaries employed approximately 1,000 persons at December 31, 2006.

In August 2006, GAFRI acquired Ceres Group, Inc. ("Ceres") for approximately $204 million in cash. Prior to the acquisition, Ceres' two primary insurance subsidiaries, CGIC and CRLIC, sold health and life insurance products through two primary business segments. Its senior segment included Medicare supplement and other senior health, life and annuity products for individuals age 55 and over.

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Its medical segment included major medical health insurance for individuals, families, associations and small businesses. In connection with the acquisition, Ceres' insurance subsidiaries entered into reinsurance agreements under which all of Ceres' medical business and half of its in-force senior business were ceded to unaffiliated companies. Following the acquisition, Ceres paid a $60 million return of capital distribution to GAFRI. GAFRI expects the

retained Ceres business to generate approximately $150 million in statutory premiums in 2007.

In January 2006, GAFRI acquired the fixed annuity business written by Old Standard Life Insurance Company through a reinsurance transaction resulting in an increase of approximately $280 million in both annuity benefits accumulated and cash and investments.

In January 2006, GAFRI sold its subsidiary, Great American Life Assurance Company of Puerto Rico ("GAPR"), for $37.5 million in cash.

Following is certain information concerning GAFRI's subsidiaries (excluding GAPR)(dollars in millions).

Company	Principal Products	2006 Statutory Premiums	Policies In Force	AM Best Rating	S&P Rating
GALIC	Fixed and indexed annuities	$1,135	395,000	A	A-
AILIC	Fixed and variable annuities	277	93,000	A	A-
UTA	Supplemental insurance	229	206,000	A-	Not rated
Loyal	Supplemental insurance	33	180,000	A	Not rated
CGIC	Supplemental insurance	42	130,000	B++	Not rated
CRLIC	Supplemental insurance	11	32,000	B++	Not rated

GAFRI's statutory premiums over the last three years were as follows (in millions):

		Premiums	
	2006	2005	2004
Indexed-annuities	$ 681	$ 78	$ 6
Traditional single premium fixed annuities	335	440	401
403(b) traditional fixed annuities	273	239	255
Variable annuities	87	92	105
Total annuities	1,376	849	767
Supplemental insurance	309	254	229
Life insurance	42	44	47
Total	$1,727	$1,147	$1,043

GAFRI believes that the ratings assigned by independent insurance rating agencies are important because agents, potential policyholders and school districts often use a company's rating as an initial screening device in considering annuity products. GAFRI believes that (i) a rating in the "A" category by A.M. Best is necessary to successfully market tax-deferred annuities to public education employees and other not-for-profit groups and (ii) a rating in the "A" category by at least one rating agency is necessary to successfully compete in other annuity markets. GAFRI's insurance entities also compete in markets other than the sale of tax-deferred annuities. Ratings are an important competitive factor; GAFRI believes that these entities can successfully compete in these markets with their respective ratings.

GAFRI's operations could be materially and adversely affected by ratings downgrades. In connection with recent reviews by independent rating agencies, management indicated that it intends to maintain lower ratios of debt to capital than it has in recent years and intends to maintain the capital of its significant insurance subsidiaries at levels

currently indicated by the rating agencies as appropriate for the current ratings. Items that could adversely affect capital levels include (i) an extended period of low interest rates and a resulting significant narrowing of annuity "spread" (the difference between earnings received by GAFRI on its investments less amount credited to policyholders' annuity accounts); (ii) investment impairments; (iii) a sustained decrease in the stock market; (iv) adverse mortality or morbidity; (v) changes in capital levels associated with current rating agency requirements; and (vi) higher than planned dividends paid due to liquidity needs of GAFRI's holding companies.

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Annuities

GAFRI's principal retirement products are Flexible Premium Deferred Annuities ("FPDAs") and Single Premium Deferred Annuities ("SPDAs"). Annuities are long-term retirement saving instruments that benefit from income accruing on a tax-deferred basis. The issuer of the annuity collects premiums, credits interest or earnings on the policy and pays out a benefit upon death, surrender or annuitization. FPDAs are characterized by premium payments that are flexible in both amount and timing as determined by the policyholder and are generally made through payroll deductions. SPDAs are generally issued in exchange for a one-time lump-sum premium payment.

Annuity contracts are generally classified as either fixed rate (including indexed) or variable. With a traditional fixed rate annuity, GAFRI seeks to maintain a desired spread between the yield on its investment portfolio and the rate it credits. GAFRI accomplishes this by: (i) offering crediting rates that it has the option to change

after any initial guarantee period (subject to minimum interest rate guarantees); (ii) designing annuity products that encourage persistency; and (iii) maintaining an appropriate matching of assets and liabilities.

During 2006, GAFRI sold nearly $700 million in indexed annuities, almost nine times the amount sold in 2005. This growth reflects both the success of new products introduced in mid-2005 and agent recruitment. An indexed annuity provides policyholders with a crediting rate tied, in part, to the performance of an existing market index (generally the S&P 500) while protecting against the related downside risk through a guarantee of principal (excluding surrender charges). GAFRI purchases call options designed to offset the effect of the index participation in the liabilities associated with indexed annuities.

In addition to traditional fixed rate and indexed annuities, GAFRI offers variable annuities. With a variable annuity, the earnings credited to the policy vary based on the investment results of the underlying investment options chosen by the policyholder, generally without any guarantee of principal except in the case of death of the insured. Premiums directed to the underlying investment options maintained in separate accounts are invested in funds managed by various independent investment managers. GAFRI earns a fee on amounts deposited into separate accounts. Subject to contractual provisions, policyholders may also choose to direct all or a portion of their premiums to various fixed rate options, in which case GAFRI earns a spread on amounts deposited.

Supplemental Insurance Products

Loyal and UTA offer a variety of supplemental insurance products through independent agents. Principal products include coverage for Medicare supplement, cancer, long-term care, accidental injury, short-term disability and hospital indemnity. CGIC and CRLIC offer Medicare supplement and other supplemental insurance products for individuals age 55 and older through independent agents and a captive agency force.

Although GALIC no longer issues new life insurance policies, it continues to service and receive renewal premiums on its in-force block of approximately 180,000 policies and $30 billion gross ($9 billion net) of life insurance in force at December 31, 2006.

Marketing

The majority of GAFRI's FPDAs are sold in qualified markets under sections 403(b), 457 and 401(k) of the Internal Revenue Code. In the 403(b) and 457 markets, schools, government agencies and certain other not-for-profit organizations may allow employees to save for retirement through contributions made on a before-tax basis. In the 401(k) market, both for-profit and not-for-profit organizations may establish qualified retirement plans whereby employees are eligible to save for retirement through contributions made primarily on a before-tax basis. Federal income taxes are not payable on pretax contributions or earnings until amounts are withdrawn.

GAFRI sells its fixed rate annuities primarily through a network of 200 managing general agents ("MGAs") who, in turn, direct approximately 2,800 actively producing

independent agents. The top 15 MGAs accounted for approximately one-half of GAFRI's fixed rate annuity premiums in 2006. No one MGA represented more than 10% of total fixed annuity premiums in 2006.

In recent years, GAFRI has offered its variable annuity as an ancillary product solely through its 403(b) and 401(k) sales channels. Nearly one-half of GAFRI's variable annuity sales in 2006 were made through a wholly-owned subsidiary, Great American Advisors, Inc. ("GAA"). GAA is a broker/dealer licensed in all 50 states to sell stocks, bonds, options, mutual funds and variable insurance contracts through independent representatives and financial institutions. GAA also acts as the principal underwriter and distributor for GAFRI's variable annuity products.

GAFRI is licensed to sell its fixed annuity products in all 50 states; it is licensed to sell its variable products in all states except New York and Vermont. In 2006, no individual state accounted for more than 10% of GAFRI's annuity premiums other than California (14%) and Washington (13%). At December 31, 2006, GAFRI had approximately 385,000 annuity policies in force.

Competition

GAFRI's insurance companies operate in highly competitive markets. They compete with other insurers and financial institutions based on many factors, including: (i) ratings; (ii) financial strength; (iii) reputation; (iv) service to policyholders and agents; (v) product design (including interest rates credited, index participation and premium rates charged); (vi) commissions; and (vii) number of school districts in which a company has approval to sell. Since most policies are marketed and distributed through independent agents, the insurance companies must also compete for agents.

No single insurer dominates the markets in which GAFRI's insurance companies compete. Competitors include (i) individual insurers and insurance groups, (ii) mutual funds and (iii) other financial institutions. In a broader sense, GAFRI's insurance companies compete for retirement savings with a variety of financial institutions offering a full range of financial services. Financial institutions have demonstrated a growing interest in marketing investment and savings products other than traditional deposit accounts.

Sales of annuities, including renewal premiums, are affected by many factors, including: (i) competitive annuity products and rates; (ii) the general level and volatility of interest rates, including the shape of the yield curve; (iii) the favorable tax treatment of annuities; (iv) commissions paid to agents; (v) services offered; (vi) ratings from independent insurance rating agencies; (vii) other alternative investments; (viii) performance and volatility of the equity markets; (ix) media coverage of annuities; (x) regulatory developments regarding suitability and the sales process; and (xi) general economic conditions.

Other Operations

Through subsidiaries, AFG is engaged in a variety of other operations, including commercial real estate operations in Cincinnati (office buildings and The Cincinnatian Hotel), New Orleans (Le Pavillon Hotel), New Hampshire (Mountain View Grand Resort), Chesapeake Bay (Skipjack Cove Yachting Resort and Bay Bridge Marina), Charleston (Charleston Harbor Resort and Marina), Palm Beach (Sailfish Marina and Resort) and apartments in Louisville, Pittsburgh and Tampa Bay. These operations employed approximately 500 full-time employees at December 31, 2006.

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Investment Portfolio

General

A summary of AFG's fixed maturity investments and other stocks is shown in Note D to the financial statements. Portfolio yields are shown below.

	2006	2005	2004
Yield on Fixed Income Securities (a):			
Excluding realized gains and losses	5.8%	5.7%	5.7%
Including realized gains and losses	5.6%	5.6%	6.1%
Yield on Stocks (a):			
Excluding realized gains and losses	3.0%	3.8%	6.1%
Including realized gains and losses	8.8%	11.9%	72.5%
Yield on Investments (a)(b):			
Excluding realized gains and losses	5.7%	5.6%	5.7%
Including realized gains and losses	5.7%	5.8%	7.9%

(a) Based on amortized cost; excludes effects of changes in unrealized gains.
(b) Excludes "Real Estate and Other Investments."

The table below compares total returns on AFG's fixed income and equity securities to comparable public indices. While there are no directly comparable indices to AFG's portfolio, the two shown below are widely used benchmarks in the industry. Both AFG's performance and the indices include changes in unrealized gains and losses.

	2006	2005	2004
Total return on AFG's fixed income securities	5.0%	3.4%	6.0%
Lehman Universal Bond Index	5.0%	2.7%	5.0%
Total return on AFG's equity securities	19.1%	5.8%	31.5%
Standard & Poors 500 Index	15.8%	4.9%	10.9%

Fixed Maturity Investments

AFG's bond portfolio is invested primarily in taxable bonds. The National Association of Insurance Commissioners ("NAIC") assigns quality ratings which range from Class 1 (highest quality) to Class 6 (lowest quality). The following table shows AFG's available for sale bonds and redeemable preferred stocks, by NAIC designation (and comparable Standard & Poor's Corporation rating) as of December 31, 2006 (dollars in millions).

NAIC Rating	Comparable S&P Rating	Amortized Cost	Fair Value Amount	Fair Value %
1	AAA, AA, A	$11,558	$11,491	79%
2	BBB	2,240	2,242	15
	Total investment grade	13,798	13,733	94
3	BB	353	356	2
4	B	396	404	3
5	CCC, CC, C	95	96	1
6	D	21	35	*
	Total noninvestment grade	865	891	6
	Total	$14,663	$14,624	100 %

(*) less than 1%

AFG invests in bonds and redeemable preferred stocks that have primarily intermediate-term maturities. This practice is designed to allow flexibility in reacting to fluctuations of interest rates.

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Equity Investments

At December 31, 2006, AFG held $729 million in stocks, the largest of which represents a $123 million investment in National City Corporation, a Cleveland-based commercial bank. In 2004, AFG received National City shares in the merger of Provident Financial Group and National City and realized a pretax gain of $214 million on the transaction.

Regulation

AFG's insurance company subsidiaries are subject to regulation in the jurisdictions where they do business. In general, the insurance laws of the various states establish regulatory agencies with broad administrative powers governing, among other things, premium rates, solvency standards, licensing of insurers, agents and brokers, trade practices, forms of policies, maintenance of specified reserves and capital for the protection of policyholders, deposits of securities for the benefit of policyholders, investment activities and relationships between insurance subsidiaries and their parents and affiliates. Material transactions between insurance subsidiaries and their parents and affiliates

generally must receive prior approval of the applicable insurance regulatory authorities and be disclosed. In addition, while differing from state to state, these regulations typically restrict the maximum amount of dividends that may be paid by an insurer to its shareholders in any twelve-month period without advance regulatory approval. Such limitations are generally based on net earnings or statutory surplus. Under applicable restrictions, the maximum amount of dividends available to AFG in 2007 from its insurance subsidiaries without seeking regulatory clearance is approximately $484 million.

Legislation has been proposed to establish a procedure for larger, commercial insurers to be regulated under an optional federal charter. The implications of this proposal on AFG's insurance operations cannot be determined at this time.

In October 2004, the New York State Attorney General brought suit against Marsh and McLennan Companies, Inc. alleging, among other things, that the firm had manipulated the insurance market through specified conduct, including bid rigging and price fixing. The New York State Attorney General also stated that the evidence implicated certain insurance companies, none of which were AFG subsidiaries. Some of the parties identified in these matters have resolved their issues with the Attorney General, and, in addition to paying fines, have agreed to change their business practices with respect to contingent commissions and certain other matters. Regulators in other states commenced investigations of insurance companies concerning the specified practices identified by the New York Attorney General. Insurance subsidiaries of AFG received and responded to inquiries from several states where AFG does business. AFG cannot estimate the scope or breadth of the issues that may be investigated by the various insurance departments, the results, timeframe and impact, if any, that the resolution of these inquiries may have on its business or the property and casualty insurance industry generally.

In response to inquiries from several insurance departments, AFG has engaged in an extensive internal review of its business arrangements with insurance producers. After a significant amount of document review, AFG identified only two policy quotations requested by Marsh & McLennan which may have been used by Marsh in a manner similar to the actions described in the New York Attorney General's complaint against that company. The aggregate premium in the policy quotations was less than $1 million.

The NAIC is an organization comprised of the chief insurance regulator for each of the 50 states and the District of Columbia. One of the NAIC's major roles is to develop model laws and regulations affecting insurance company operations and encourage uniform regulation through the adoption of such model laws in all states.

Most states have created insurance guaranty associations to provide for the payment of claims of insurance companies that become insolvent. Annual assessments for AFG's insurance companies have not been material.

ITEM 1A

Risk Factors

Following is a discussion of the most significant risk factors to investors in AFG securities.

Intense competition could adversely affect AFG's profitability.

The specialty insurance business is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. AFG's specialty insurance businesses compete with other individual insurers, state funds and insurance groups of varying sizes, some of which are mutual insurance companies possessing competitive advantages

in that all their profits inure to their policyholders. In addition, certain foreign insurers can write business in the U.S. on a tax-advantaged basis and therefore hold a competitive advantage over AFG. AFG also competes with self-insurance plans, captive programs and risk retention groups. Peer companies and major competitors in some or all of AFG's specialty lines include ACE Ltd., American International Group Inc., Arch Capital Group Ltd., Chubb Corp., Cincinnati Financial Corp., CNA Financial Corp., Philadelphia Consolidated Holdings Corp., Ohio Casualty Corp., Markel Corp., Hartford Financial Services Group, HCC Insurance Holdings, Inc., Rural Community Insurance Company, The St. Paul Travelers Companies Inc., W.R. Berkley Corp., XL Capital Ltd., and Zenith National Insurance Corp.

AFG's annuity and supplemental insurance businesses compete with individual insurers and insurance groups, mutual funds and other financial institutions. Competitors include ING Life Insurance and Annuity Company, Life Insurance Company of the Southwest, Midland National Life Insurance Company, Allianz Life Insurance Company of North America, Fidelity and Guaranty Life Insurance Company, Mutual of Omaha Insurance Company and Bankers Life and Casualty Company.

Competition is based on many factors, including service to policyholders and agents, product design, reputation for claims handling, ratings and financial strength. Price, commissions, profit sharing terms and interest crediting rates are also important factors. Some of AFG's competitors have more capital and greater resources than AFG, and may offer a broader range of products and lower prices than AFG offers. If competition limits AFG's ability to write new or renewal business at adequate rates, its results of operations will be adversely affected.

AFG's revenues could be negatively affected if it is not able to attract and retain independent agents.

AFG's reliance on the independent agency market makes it vulnerable to a reduction in the amount of business written by agents. Many of AFG's competitors also rely significantly on the independent agency market. Accordingly, AFG must compete with other insurance carriers for independent agents' business. Some of its competitors offer a wider variety of products, lower price for insurance coverage or higher commissions. Loss of a substantial portion of the business that AFG writes through independent agents could adversely affect AFG's revenues and profitability.

AFG is subject to comprehensive regulation, and its ability to earn profits may be restricted by these regulations.

As previously discussed under "Regulation," AFG is subject to comprehensive regulation by government agencies in the states where its insurance company subsidiaries are domiciled and where these subsidiaries issue policies and handle claims. AFG must obtain prior approval for certain corporate actions. The regulations may limit AFG's ability to obtain rate increases or take other actions designed to increase AFG's profitability. Such regulation is generally intended for the protection of policyholders rather than securityholders.

There can be no assurance that existing insurance-related laws and regulations will not become more restrictive in the future or that new restrictive laws will not be enacted and, therefore, it is not possible to predict the potential effects of these laws and regulations. The costs of compliance or the failure to comply with existing or future regulations could harm AFG's financial results and its reputation with customers.

The failure of AFG's insurers to maintain a commercially acceptable financial strength rating would have a significant negative effect on their ability to compete successfully.

As discussed under "Property and Casualty Insurance Operations" and "Annuity and Supplemental Insurance Operations - General," financial strength ratings are an important factor in establishing the competitive position of insurance companies and

may be expected to have an effect on an insurance company's sales. A downgrade out of the "A" category in AFG's insurers' claims-paying and financial strength ratings could significantly reduce AFG's business volumes, adversely impact AFG's ability to access the capital markets and increase AFG's borrowing costs.

AFG's results may fluctuate as a result of cyclical changes in the specialty insurance industry.

The property and casualty group operates in a highly competitive industry that is affected by many factors that can cause significant fluctuations in its results of operations. The industry has historically been subject to pricing cycles characterized by periods of intense competition and lower premium rates (a "downcycle") followed by periods of reduced competition, reduced underwriting capacity due to lower policyholders' surplus and higher premium rates (an "upcycle"). The trend of AFG's underwriting results typically follows that of the industry and a prolonged downcycle could adversely affect AFG's results of operations.

AFG's property and casualty reserves may be inadequate, which could significantly affect AFG's financial results.

AFG's property and casualty insurance subsidiaries record reserve liabilities for the estimated payment of losses and loss adjustment expenses for both reported and unreported claims. Due to the inherent uncertainty of estimating reserves, it has been necessary in the past, and will continue to be necessary in the future, to revise estimated liabilities as reflected in AFG's reserves for claims and related expenses. While AFG recorded favorable development of $59 million in 2006, it recorded charges of $181 million (primarily the A&E charge discussed under *Item 7 - "Management's Discussion and Analysis - Uncertainties"*) in 2005 and $140 million in 2004 to increase reserves relating to prior accident years. The historic development of reserves for losses and loss adjustment expense may not necessarily reflect future trends in the development of these amounts. Accordingly, it is not appropriate to extrapolate redundancies or deficiencies based on historical information. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period in which the deficiency is recognized.

AFG's results could be negatively impacted by severe weather conditions or other catastrophes.

AFG recorded catastrophe losses in 2006 (primarily from tornadoes) and in 2005 and 2004 (primarily due to hurricanes). Catastrophes (some of which are seasonal) can be caused by natural events such as hurricanes, windstorms, tornadoes, hailstorms, severe winter weather, earthquakes, explosions and fire, and by man-made events, such as terrorist attacks and riots. The extent of losses from a catastrophe is a function of the amount of insured exposure in the area affected by the event and the severity of the event. In addition, certain catastrophes could result in both property and non-property claims from the same event. For example, AFG has a correlated catastrophe exposure as a result of writing both workers' compensation and excess property coverage in California. A severe catastrophe or a series of catastrophes could result in losses exceeding AFG's reinsurance protection and may have a material adverse impact on its results of operations or financial condition.

Volatility in crop prices could negatively impact AFG's financial results.

Weather conditions and the level of crop prices in the commodities market heavily impact AFG's crop insurance business. These factors are inherently unpredictable and could result in significant volatility in the results of the crop insurance business from one year to the next.

A significant decline in used car prices could negatively impact AFG's financial results.

AFG's residual value business is heavily impacted by the level of used car prices obtained at auction. A significant decrease in the market value of used automobiles could result in significant losses and may have a material adverse

impact on AFG's results of operations or its financial condition.

The inability to obtain reinsurance or to collect on ceded reinsurance could adversely impact AFG's results.

AFG relies on the use of reinsurance to limit the amount of risk it retains. The following amounts of gross property and casualty premiums have been ceded to other insurers: 2006 - $1.3 billion (32%); 2005 - $1.3 billion (34%); and 2004 - $1.5 billion (40%). The availability and cost of reinsurance are subject to prevailing market conditions, which are beyond AFG's control and which may affect

AFG's level of business and profitability. AFG is also subject to credit risk with respect to its reinsurers, as the ceding of risk to reinsurers does not relieve AFG of its liability to insureds.

Variations from the actuarial assumptions used to establish certain assets and liabilities in AFG's annuity and supplemental insurance business could negatively impact AFG's reported financial results.

The earnings on certain products sold by AFG's annuity and supplemental insurance business depend significantly upon the extent to which actual experience is consistent with the assumptions used in setting reserves and establishing and amortizing deferred policy acquisition costs ("DPAC"). These assumptions relate to investment yields (and spreads over fixed annuity crediting rates), mortality, surrenders, annuitizations and, on some policies, morbidity. Developing such assumptions is complex and involves information obtained from company-specific and industry-wide data, as well as general economic information. These assumptions, and therefore AFG's results of operations, could be negatively impacted by changes in any of the factors listed above. For example, AFG recorded pretax charges in 2005 of (i) $15.8 million to DPAC and annuity liabilities due primarily to the negative effect of lower interest rates on expected future profits of its fixed annuity operations and (ii) $13.6 million related to an unexpected increase in mortality in its run-off life operations.

The continued threat of terrorism and ongoing military and other actions may adversely affect AFG's financial results.

The continued threat of terrorism, both within the United States and abroad, and the ongoing military and other actions and heightened security measures in response to these types of threats, may cause significant volatility and declines in the equity markets in the United States, Europe and elsewhere, loss of life, property damage, additional disruptions to commerce and reduced economic activity. Actual terrorist attacks could cause losses from insurance claims related to AFG's property and casualty and life insurance operations with adverse financial consequences. In addition, some of the assets in AFG's investment portfolios may be adversely affected by declines in the capital markets and economic activity caused by the continued threat of terrorism, ongoing military and other actions and heightened security measures.

Adverse securities market conditions can have significant negative effects on AFG's investment portfolio.

AFG's results of operations depend in part on the performance of its invested assets. As of December 31, 2006, 84% of AFG's investment portfolio was invested in fixed maturity securities and 4% in equity securities. Certain risks are inherent in connection with fixed maturity securities including loss upon default and price volatility in reaction to changes in interest rates and general market factors. See *Item 7A, "Quantitative and Qualitative Disclosures About Market Risk - Fixed Maturity Portfolio."*

AFG cannot predict whether and the extent to which industry sectors in which it maintains investments may suffer losses as a result of potential declines in

commercial and economic activity, or how any such decline might impact the ability of companies within the affected industry sectors to pay interest or principal on their securities, or how the value of any underlying collateral might be affected.

Investment returns are an important part of AFG's overall profitability. Accordingly, adverse fluctuations in the fixed income or equity markets could adversely impact AFG's profitability, financial condition or cash flows.

As a holding company, AFG is dependent on the operations of its insurance company subsidiaries to meet its obligations and pay future dividends.

AFG is a holding company and a legal entity separate and distinct from its insurance company subsidiaries. As a holding company without significant operations of its own, AFG's principal sources of funds are dividends and other distributions from its insurance company subsidiaries. As discussed under "Regulation," state insurance laws limit the ability of insurance companies to pay dividends or other distributions and require insurance companies to maintain specified levels of statutory capital and surplus. AFG's rights to participate in any distribution of assets of its insurance company subsidiaries are subject to prior claims of policyholders and creditors (except to the extent that its rights, if any, as a creditor are recognized). Consequently, AFG's ability to pay debts, expenses and cash dividends to its shareholders may be limited.

AFG may be adversely impacted by a downgrade in the ratings of its debt securities.

AFG's debt securities are rated by Standard & Poor's, Moody's and Fitch, independent corporate credit rating agencies. AFG's senior indebtedness is currently rated BBB by Standard & Poor's, Baa3 by Moody's and BBB+ by Fitch. Securities ratings are subject to revision or withdrawal at any time by the assigning rating organization. A security rating is not a recommendation to buy, sell or hold securities. An unfavorable change in either of these ratings could make it more expensive to access the capital markets and may increase the interest rate charged under AFG's current multi-bank credit line.

AFG is a party to litigation which, if decided adversely, could impact its financial results.

AFG and its subsidiaries are named as defendants in a number of lawsuits. See *Item 1 - "Property and Casualty Insurance Operations - Asbestos and Environmental Reserves ("A&E")," Item 3 - "Legal Proceedings,"* and *Item 7 - "Management's Discussion and Analysis - Uncertainties."* Litigation, by its very nature, is unpredictable and the outcome of these cases is uncertain. AFG is unable to predict the precise nature of the relief that may be sought or granted in any lawsuits or the effect that pending or future cases may have on AFG's business, operations, profitability or financial condition.

Certain shareholders exercise substantial control over AFG's affairs, which may impede a change of control transaction.

Carl H. Lindner is Chairman of the Board of Directors of AFG, and his sons, Carl H. Lindner III and S. Craig Lindner, are each Co-Chief Executive Officers and Directors of AFG. Carl H. Lindner, Carl H. Lindner III and S. Craig Lindner beneficially own 11.2%, 6.9% and 6.8% of AFG's outstanding Common Stock as of February 1, 2007. Another son, Keith E. Lindner, reported in April 2006 that he beneficially owned shares representing 7.7% of AFG's outstanding Common Stock. As a result, certain members of the Lindner family have the ability to exercise significant influence over AFG's management, including over matters requiring shareholder approval.

The price of AFG common stock may fluctuate significantly, which may make it difficult for holders to resell common stock when they want or at a price they find attractive.

The price of AFG's common stock as listed on the NYSE and Nasdaq Global Select Market constantly changes. During 2005 and 2006, AFG's common stock traded at prices ranging between $18.64 and $36.71. AFG's common stock price can fluctuate

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as a result of a variety of factors, many of which are beyond its control. These factors include but are not limited to:

- actual or anticipated variations in quarterly operating results;
- actual or anticipated changes in the dividends paid on AFG common stock;
- rating agency actions;
- recommendations by securities analysts;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving AFG or its competitors;
- operating and stock price performance of other companies that investors deem comparable to AFG;
- news reports relating to trends, concerns and other issues in AFG's lines of business; and
- geopolitical conditions such as acts or threats of terrorism or military conflicts.

ITEM 2

Properties

Subsidiaries of AFG own several buildings in downtown Cincinnati. AFG and its affiliates occupy about half of the aggregate 650,000 square feet of commercial and office space in these buildings.

AFG's insurance subsidiaries lease the majority of their office and storage facilities in numerous cities throughout the United States, including Great American's and GAFRI's home offices in Cincinnati. A property and casualty insurance subsidiary owns approximately 179,000 square feet of office space on 17.5 acres of land in Richfield, Ohio, approximately half of which it occupies; the remaining space is leased to unaffiliated tenants. GAFRI subsidiaries own a 40,000 square foot office building in Austin, Texas and a 45,000 square foot office building in Mission, Kansas. Most of this space is used by the companies for their operations.

ITEM 3

Legal Proceedings

Please refer to "Forward-Looking Statements" following the Index in front of this Form 10-K.

AFG and its subsidiaries are involved in various litigation, most of which arose in the ordinary course of business, including litigation alleging bad faith in dealing with policyholders and challenging certain business practices of insurance subsidiaries. Except for the following, management believes that none of the litigation meets the threshold for disclosure under this Item.

AFG's insurance company subsidiaries and its 100%-owned subsidiary, American Premier Underwriters (including its subsidiaries, "American Premier"), are parties to litigation and receive claims asserting alleged injuries and damages from asbestos, environmental and other substances and workplace hazards and have established loss accruals for such potential liabilities. The ultimate loss for these claims may vary materially from amounts currently recorded as the conditions surrounding resolution of these claims continue to change.

American Premier is a party or named as a potentially responsible party in a number of proceedings and claims by regulatory agencies and private parties under various environmental protection laws, including the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), seeking to impose responsibility on American Premier for hazardous waste or discharge remediation costs at certain railroad sites formerly owned by its predecessor, Penn Central Transportation Company ("PCTC"), and at certain other sites where hazardous waste or discharge allegedly generated by PCTC's railroad operations and American Premier's former manufacturing operations is present. It is difficult to estimate American

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Premier's liability for remediation costs at these sites for a number of reasons, including the number and financial resources of other potentially responsible parties involved at a given site, the varying availability of evidence by which to allocate responsibility among such parties, the wide range of costs for possible remediation alternatives, changing technology and the period of time over which these matters develop. Nevertheless, American Premier believes that its accruals for potential environmental liabilities are adequate to cover the probable amount of such liabilities, based on American Premier's estimates of remediation costs and related expenses and its estimates of the portions of such costs that will be borne

by other parties. Such estimates are based on information currently available to American Premier and are subject to future change as additional information becomes available. In 2004, American Premier reached an agreement on the allocation of environmental clean-up costs at its former railroad site in Paoli, Pennsylvania. The settlement became final and agreed upon amounts were paid in early 2005. American Premier has filed suit seeking reimbursement from others for portions of remediation costs incurred.

As previously reported, Great American Insurance Company and certain other insurers were parties to asbestos-related coverage litigation under insurance policies issued during the 1970's and 1980's to Bigelow-Liptak Corporation and related companies, subsequently known as A.P. Green Industries, Inc. ("A.P. Green"). These claims alleged that the refractory materials manufactured, sold or installed by A.P. Green contained asbestos and resulted in bodily injury from exposure to asbestos. A.P. Green sought to recover defense and indemnity expenses related to those claims from a number of insurers, including Great American, and in an effort to maximize coverage asserted that Great American's policies were not subject to aggregate limits on liability, and that each insurer was liable for all sums that A.P. Green became legally obliged to pay.

In February 2002, A.P. Green filed petitions for bankruptcy under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of Pennsylvania (In Re Global Industrial Technologies, Inc., et al, filed February 14, 2002).

In 2003, Great American Insurance Company entered into an agreement, which was approved by the bankruptcy court, for the settlement of coverage litigation related to A.P. Green asbestos claims. The settlement is for $123.5 million (Great American has the option to pay in cash or over time with 5.25% interest). The agreement allows up to 10% of the settlement to be paid in AFG Common Stock. The settlement agreement is conditioned upon confirmation of a plan of reorganization that includes an injunction prohibiting the assertion against Great American of any present or future asbestos personal injury claims under policies issued to A.P. Green and related companies. No assurance can be made that all conditions will be met; no payments are required until completion of the process.

The Bankruptcy Court has ruled that the Debtors' plan of reorganization will require a resolicitation of votes from silica claimants as a condition of the Court's approval of the plan. The Court has set a further hearing on plan confirmation for March 2007.

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PART II

ITEM 5

Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Please refer to "Forward-Looking Statements" following the Index in front of this Form 10-K.

AFG Common Stock has been listed and traded on the New York Stock Exchange and the Nasdaq Global Select Market under the symbol AFG. In November 2006, AFG's Board of Directors approved a three-for-two common stock split. On December 15, 2006, one additional common share was issued for every two common shares held by shareholders of record on November 30, 2006. A total of 39,724,479 new shares were issued. All share and per share amounts (except the number of shares authorized and the stated value of $1.00 per share) presented in this Annual Report on Form 10-K have been adjusted to reflect the effect of the split for all periods presented. The information presented in the table below represents the high and low sales prices per share reported on the NYSE Composite Tape.

	2006		2005	
	High	Low	High	Low
First Quarter	$28.30	$24.70	$21.25	$19.93
Second Quarter	29.70	27.08	22.64	18.64
Third Quarter	32.13	27.15	23.42	21.50
Fourth Quarter	36.71	31.13	26.33	21.38

There were approximately 8,900 shareholders of record of AFG Common Stock at February 1, 2007. In 2006 and 2005, AFG declared and paid quarterly dividends of $.092 and $.083 per share, respectively. In November 2006, AFG announced its intent to increase its annual dividend to $.40 per share of Common Stock, or $.10 per share quarterly. AFG paid its first dividend at that rate in January 2007. The ability of AFG to pay dividends will be dependent upon, among other things, the availability of dividends and payments under intercompany tax allocation agreements from its insurance company subsidiaries.

Under AFG's shareholder-approved Stock Option Plan, 297,274 shares of AFG Common Stock (251,610 at an average price of $34.83 per share in November and 45,664 at an average price of $36.29 per share in December) were tendered in connection with the exercise of stock options for a total of 417,918 shares in the fourth quarter of 2006.

ITEM 6

Selected Financial Data

The following table sets forth certain data for the periods indicated (dollars in millions, except per share data).

	2006	2005	2004	2003	2002

Earnings Statement Data

:

Total Revenues	$4,250	$3,984	$3,868	$3,323	$3,709
Operating Earnings Before Income Taxes	698	335	585	296	171
Earnings from Continuing Operations	428	196	366	319	121
Discontinued Operations	25	11	-	(31)	4
Cumulative Effect of Accounting Changes (a)	-	-	(6)	6	(40)
Net Earnings	453	207	360	294	85
Basic Earnings (Loss) Per Common Share:					
Earnings from Continuing Operations	$ 3.63	$1.69	$3.31	$3.00	$1.17
Discontinued Operations	.21	.09	-	(.30)	.04
Cumulative Effect of Accounting Change	-	-	(.05)	.06	(.39)
Net Earnings Available to Common Shares	3.84	1.78	3.26	2.76	.82
Diluted Earnings (Loss) Per Common Share:					
Earnings from Continuing Operations	$ 3.54	$1.66	$3.26	$2.99	$1.17
Discontinued Operations	.21	.09	-	(.30)	.04
Cumulative Effect of Accounting Change	-	-	(.05)	.06	(.39)
Net Earnings Available to Common Shares	3.75	1.75	3.21	2.75	.82
Cash Dividends Paid Per Share of Common Stock	$ .37	$.33	$.33	$.33	$.33
Ratio of Earnings to Fixed Charges Including					
Annuity Benefits (b)	2.62	1.77	2.42	1.68	1.35

Balance Sheet Data

:

Total Assets	$25,101	$22,816	$22,560	$20,312	$19,628
Long-term Debt	921	1,000	1,106	1,102	945
Minority Interest	284	261	220	188	471
Shareholders' Equity	2,929	2,458	2,431	2,076	1,726

(a) Reflects the implementation of required accounting changes.

(b)

Fixed charges are computed on a "total enterprise" basis. For purposes of calculating the ratios, "earnings" have been computed by adding to pretax earnings the fixed charges and the minority interest in earnings of subsidiaries having fixed charges and the undistributed equity in losses of investees. Fixed charges include interest (including interest credited to annuity policyholders' accounts as indicated), amortization of debt premium/discount and expense, preferred dividend and distribution requirements of subsidiaries and a portion of rental expense deemed to be representative of the interest factor.

The ratio of earnings to fixed charges *excluding* interest credited to annuity policyholders' accounts was 9.15, 4.58, 7.02, 3.66 and 2.35 for 2006, 2005, 2004, 2003 and 2002, respectively. Although the ratio of earnings to fixed charges *excluding* interest on annuities is not required or encouraged to be disclosed under Securities and Exchange Commission rules, some investors and lenders may not consider interest credited to annuity policyholders' accounts a borrowing cost for an insurance company, and accordingly, believe this ratio is meaningful.

ITEM 7

Management's Discussion and Analysis

of Financial Condition and Results of Operations

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