

September 2009

# TROUBLED ASSET RELIEF PROGRAM

## Status of Government Assistance Provided to AIG





Highlights of [GAO-09-975](#), a report to congressional committees

## Why GAO Did This Study

GAO's seventh report on the Troubled Asset Relief Program (TARP) focuses on the initial assistance the government provided to American International Group, Inc. (AIG)—an organization with over 200 companies operating in over 130 countries and jurisdictions and \$830 billion in assets—in September 2008 and the restructuring of that assistance in November 2008 and March 2009. The unfolding crisis threatened the stability of the U.S. banking system and the solvency of a number of financial institutions, including AIG. In September 2008, downgrades of AIG's credit rating prompted collateral calls by counterparties and raised concerns that a rapid and disorderly failure of AIG would further destabilize the markets. As a result, the Board of Governors of the Federal Reserve System (Federal Reserve) authorized the Federal Reserve Bank of New York (FRBNY), in consultation with the Department of the Treasury (Treasury), to provide assistance to AIG. This report describes (1) the basis for the federal assistance, (2) the nature and type of assistance and steps intended to protect the government's interest, and (3) selected GAO-developed indicators of the status of federal assistance and AIG's financial condition.

To do this, GAO reviewed signed agreements and other relevant documentation from the Federal Reserve, FRBNY, Treasury, and AIG and interviewed their officials, among others. To develop the indicators, GAO reviewed rating agencies' reports, identified critical activities, and discussed them with the above named agencies and AIG.

Treasury had no substantive comments on the report. It provided technical comments along with the Federal Reserve, FRBNY, and AIG.

View [GAO-09-975](#) or [key components](#). For more information, contact Orice Williams Brown at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov).

# TROUBLED ASSET RELIEF PROGRAM

## Status of Government Assistance Provided to AIG

### What GAO Found

The Federal Reserve and Treasury provided assistance to AIG to limit further disruption to financial markets. These agencies determined that market events could have caused AIG to fail, which would have posed systemic risk to the financial system. According to the Federal Reserve, a disorderly failure of AIG would have contributed to higher borrowing costs and additional failures, further destabilizing fragile financial markets. The Federal Reserve and Treasury determined that an AIG default would place considerable pressure on AIG's counterparties and trigger serious disruptions to an already distressed commercial paper market. They concluded that because AIG was a large seller of credit default swaps—protection against losses from defaults—on collateralized debt obligations (CDO), had AIG failed, its counterparties would have been exposed to large losses if the values of the CDOs had continued to decline and AIG defaulted on its contracts. The Federal Reserve intended the initial September 2008 assistance to enable AIG to meet these added obligations with its counterparties and begin the process of selling business lines to raise monies to repay the government and resolve other liabilities. Subsequent assistance in November 2008 and March 2009 was intended to augment these goals, support liquidity needs, and repay FRBNY while mitigating disruptions in the broader financial markets.

To address systemic risk that could result if AIG were to fail, the Federal Reserve and Treasury made over \$182 billion available to assist AIG between September 2008 and April 2009. As of September 2, 2009, AIG's outstanding balance of assistance was \$120.7 billion. Some federal assistance was designated for specific purposes, such as a special purpose vehicle to provide liquidity for purchasing assets such as CDOs. Other assistance, such as that available through the Treasury's Equity Facility, is available to meet the general financial needs of the parent company and its subsidiaries. The table on the next page provides an overview of the total federal assistance to AIG and its related entities. Repayment of the \$120.7 billion outstanding government exposure is expected to come from various sources. As of September 2, 2009, \$6.8 billion was paid toward principal on the Maiden Lane facilities created by FRBNY to purchase certain AIG assets and provide AIG with liquidity. In providing the assistance, the Federal Reserve and Treasury have taken several steps intended to protect the government's interest. These include making loans that are secured with collateral, instituting certain controls over management, and obtaining compensation for risks such as charging interest, requiring dividend payments, and obtaining warrants. Moreover, Federal Reserve and Treasury staff routinely monitor AIG's operations and receive reports on AIG's condition and restructuring. While these efforts are being made, the government remains exposed to risks, including credit risk and investment risk, which could result in the Federal Reserve and Treasury not being repaid in full.

While federal assistance has helped stabilize AIG's financial condition, GAO-developed indicators suggest that AIG's ability to restructure its business and repay the government is unclear at this time. Indicators of AIG's financial risk suggest that since AIG reported significant losses in late 2008, AIG's operations, with federal assistance, have begun to show signs of stabilizing in mid 2009. Similarly, after a declining trend through 2008 and early 2009, indicators of AIG insurance companies' financial risk suggest improved financial conditions that were largely results of federal assistance. Indicators of AIG's repayment of federal

Overview of Federal Assistance Provided to AIG as of September 2, 2009

Dollar in millions		Amount of assistance authorized		Outstanding balance	Sources to repay the government
Description of the federal assistance	Debt	Equity			
<b>Implemented</b>					
<b>Federal Reserve</b>	FRBNY created a Revolving Credit Facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity. In exchange for the facility, for \$0.5 million, a Treasury trust received Series C preferred stock for the benefit of the Treasury, which gave Treasury a 77.9 percent voting interest in AIG.	\$60,000 <sup>a</sup>		\$38,792.5	Proceeds from dispositions of AIG businesses, internal cash flows, and restructuring part of the Revolving Credit Facility from debt into equity. The initial fee paid by AIG was reduced by \$0.5 million to pay for the Series C shares and will not be repaid.
	FRBNY created SPV—Maiden Lane II—to provide AIG liquidity by purchasing residential mortgage-backed securities from AIG life insurance companies. FRBNY provided a loan to the SPV for the purchases. It also terminated a previously established securities lending program with AIG.	22,500		16,899	Proceeds from the assets in Maiden Lane II will be used to repay the FRBNY loan to Maiden Lane II.
	FRBNY created a SPV called Maiden Lane III to provide AIG liquidity by purchasing CDOs from AIG Financial Products' counterparties in connection with termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30,000		20,196	Proceeds from the assets in Maiden Lane III will be used to repay the FRBNY loan.
<b>Treasury</b>	Treasury purchased Series D cumulative preferred stock from AIG. AIG used the proceeds to pay down the Revolving Credit Facility. These shares were later exchanged for Series E noncumulative preferred shares. Unpaid dividends on the series D shares were added to the Treasury's equity in the Series E shares.		40,000	41,605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Treasury purchased Series F noncumulative preferred shares of AIG and is allowing AIG to draw up to \$29,835 million through an equity facility to meet its liquidity and capital needs. Amounts drawn by AIG represent the cost of the federal equity interest in these shares.		29,835	3,206 <sup>b</sup>	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
<b>Subtotals</b>		<b>\$112,500</b>	<b>\$69,835</b>		
<b>Total authorized and outstanding assistance<sup>c</sup></b>			<b>\$182,335</b>	<b>\$120,698.5</b>	
<b>Pending</b>	AIG created two SPVs to hold the shares of two of its foreign life insurance businesses to enhance AIG's capital and liquidity, and to facilitate an orderly restructuring of AIG. The Revolving Credit Facility will be reduced by the amount of preferred equity interest in the SPVs to be received by FRBNY.	0	(25,000 <sup>d</sup> )	0	Proceeds from the public sale of the SPVs' common stock could be used to buy out the federal preferred equity and pay down part of the Revolving Credit Facility.
	AIG will create SPVs that will issue up to \$8,500 million in notes to FRBNY, which will be funded with a loan from FRBNY. AIG will use the proceeds to pay down part of the Revolving Credit Facility.	(8,500 <sup>d</sup> )		0	FRBNY's loan to the SPVs will be repaid from net cash flows of the life insurance policies.

Source: AIG SEC filings, Federal Reserve, and Treasury data.

<sup>a</sup>The facility was initially \$85 billion but was reduced to \$60 billion in November 2008.

<sup>b</sup>Amount as of September 8, 2009.

<sup>c</sup>Does not include AIG's participation in the Federal Reserve's Commercial Paper Funding Facility.

<sup>d</sup>These transactions have not been completed and are not included in the total assistance provided to AIG. The amount of the Revolving Credit Facility will be decreased by an equal amount upon completion.

assistance show some progress in AIG's ability to repay the federal assistance; however, improvement in the stability of AIG's business depends on the long-term health of the company, market conditions, and continued government support. Therefore, the ultimate success of AIG's restructuring and repayment efforts remains uncertain. GAO plans to continue to review the Federal Reserve's and Treasury's monitoring efforts and report on

these indicators to determine the likelihood of AIG repaying the government's assistance in full and the government recouping its investment.

---

# Contents

---

<b>Letter</b>		<b>1</b>
	Background	4
	The Federal Reserve and Treasury Provided Assistance to AIG to Limit Systemic Risk to the Financial Markets	10
	The Federal Reserve, FRBNY, and Treasury Have Taken a Variety of Steps to Stabilize AIG	27
	In Providing Assistance to AIG, the Federal Reserve and Treasury Have Taken Steps to Protect the Government’s Interest, but Risks Still Remain	36
	Federal Assistance Has Helped Stabilize AIG’s Financial Condition, but Indicators Suggest that It Is Too Soon to Evaluate AIG’s Ability to Restructure Its Business and Repay the Government	43
	Agency Comments and Our Evaluation	51
<b>Appendix I</b>	<b>Comments from the Department of the Treasury</b>	<b>55</b>
<b>Appendix II</b>	<b>Overview of the American International Assurance and American Life Insurance Company Transactions</b>	<b>56</b>
<b>Appendix III</b>	<b>Overview of the Executive Compensation Restrictions</b>	<b>59</b>
<b>Appendix IV</b>	<b>Summary of Rating Agencies’ Ratings</b>	<b>61</b>
<b>Appendix V</b>	<b>Overview of the AIG Risk and Repayment Indicators</b>	<b>62</b>
<b>Appendix VI</b>	<b>GAO Contact and Staff Acknowledgments</b>	<b>91</b>

---

---

**Related GAO Products**

92

---

**Tables**

Table 1: U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure, as of September 2, 2009	28
Table 2: Overview of Indicators of AIG's Financial Risk and Repayment of Federal Assistance	62
Table 3: Credit Ratings, as of March 31, 2009, and May 15, 2009	64
Table 4: Sources and Amounts of Available Corporate Liquidity at November 5, 2008; February 18, 2009; April 29, 2009; and July 29, 2009	67
Table 5: Composition of U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure, as of September 2, 2009 (dollars in millions)	84
Table 6: Dispositions Closed and Agreements Announced but not yet Closed, Second Quarter of 2008 through September 5, 2009 (dollars in millions)	89

---

**Figures**

Figure 1: AIG Organizational Structure, as of December 31, 2008	6
Figure 2: Timeline of AIG's Financial Difficulties and Government Actions in Response to Market Turmoil, Fall 2007 to September 30, 2008	14
Figure 3: Timeline of the Restructuring of AIG's Assistance, Market Events, and Related Government Actions, October 1, 2008, to April 30, 2009	24
Figure 4: AIG Restructuring and SPV Sale	57
Figure 5: AIG: Corporate Available Liquidity and Company-Wide Debt Projections (dollars in millions), Third Quarter of 2008 through Second Quarter of 2009	66
Figure 6: AIG: Trends in and Main Components of Consolidated Shareholders' Equity, Fourth Quarter of 2007 through Second Quarter of 2009	68
Figure 7: AIG's Operations by Major Segment: Operating Income/Loss Before Taxes, First Quarter of 2008 through Second Quarter of 2009	70

---

Figure 8: Status of the Winding Down of AIG's Financial Products Corporation, as of September 30, 2008; December 31, 2008; and March 31, 2009	71
Figure 9: AIGFP: Super Senior Credit Default Swap Portfolio Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Gains and Loss, Third Quarter of 2008 through Second Quarter of 2009	73
Figure 10: AIGFP: Gross Notional Value of Underlying Multi-Sector Collateralized Debt Obligations That Are Rated Less Than BBB, Third Quarter of 2008 through Second Quarter of 2009	75
Figure 11: AIG Credit Default Swap Premiums, January 2007 through July 2009	76
Figure 12: AIG Insurance Subsidiaries: Regulatory Capital at December 31, 2007, and December 31, 2008, and Primary Activities That Affected Regulatory Capital During 2008 (dollars in millions)	77
Figure 13: AIG Life and Retirement Services: Additions to and Withdrawals from Policyholder Contract Deposits Including Annuities, Guaranteed Investment Contracts, and Life Products, First Quarter of 2007 through Second Quarter of 2009	79
Figure 14: AIG Life Insurance and Retirement Services: Key Quarterly Revenues and Expenses, First Quarter of 2007 through Second Quarter of 2009	80
Figure 15: AIG General Insurance: Premiums Written by Division, First Quarter of 2007 through Second Quarter of 2009	81
Figure 16: AIG Property/Casualty Insurance: AIG Commercial Insurance Operating Ratios and AIG Foreign General Insurance Operating Ratios, Second Quarter of 2007 through Second Quarter of 2009	83
Figure 17: FRBNY Revolving Credit Facility Balance Owed and Total Amount Available, October 2008 through September 2009	86
Figure 18: Principal Owed and Portfolio Values of Maiden Lane Facilities	87
Figure 19: Proceeds from Dispositions by Quarter, Second Quarter of 2008 through September 5, 2009	88

---

---

## Abbreviations

AGF	American General Finance, Inc.
AIA	American International Assurance Company, Ltd.
AIG	American International Group, Inc.
AIGFP	AIG Financial Products Corporation
ALICO	American Life Insurance Company
ARRA	American Recovery and Reinvestment Act of 2009
CDO	collateralized debt obligation
CDS	credit default swaps
CPFF	Commercial Paper Funding Facility
FDIC	Federal Deposit Insurance Corporation
FRBNY	Federal Reserve Bank of New York
ILFC	International Lease Finance Corporation
NAIC	National Association of Insurance Commissioners
OFS	Office of Financial Stability
OTS	Office of Thrift Supervision
RBC	risk-based capital
RMBS	residential mortgage-backed security
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SPV	special purpose vehicle
SSFI	Systemically Significant Failing Institutions
TARP	Troubled Asset Relief Program
the act	Emergency Economic Stabilization Act of 2008
TLGP	Temporary Liquidity Guarantee Program

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office  
Washington, DC 20548

September 21, 2009

Congressional Committees:

The United States is experiencing a financial crisis that has threatened the stability of not only the U.S. banking system but also the U.S. and global economies and the solvency of a number of critical banks and nonbank institutions. Consequently, over the past year and a half, the U.S. government has taken extraordinary measures. The Emergency Economic Stabilization Act of 2008 (the act) created the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP) to address the crisis.<sup>1</sup> In addition, Treasury collaborated with the Board of Governors of the Federal Reserve System (Federal Reserve) to provide government assistance to institutions it deemed to be systemically significant to avoid further disruptions in the financial markets that could result from their failure.

American International Group, Inc. (AIG) is one of the largest recipients of government assistance. The Federal Reserve and the Federal Reserve Bank of New York (FRBNY), in consultation with Treasury, initially provided assistance to AIG in September 2008 following its rating downgrade, which had prompted collateral calls by its counterparties and raised concerns that a rapid failure of the company would further destabilize financial markets. However, AIG's condition continued to decline. In November 2008, the Federal Reserve and Treasury announced plans to restructure AIG's federal assistance to further strengthen its financial condition and, once again, avert the failure of the company. In March 2009, the Federal Reserve and Treasury provided additional assistance and further restructured the terms of the existing assistance. As a result of these actions, the federal government has an almost 80 percent interest in AIG.

---

<sup>1</sup>The Emergency Economic Stabilization Act of 2008 (the act), Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq. The act originally authorized Treasury to purchase or guarantee up to \$700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009), amended the act to reduce the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.741 billion.

---

The act requires GAO to provide oversight of actions taken under TARP. To fulfill our responsibilities, we have been monitoring and providing timely reporting on Treasury’s assistance to AIG—the largest participant in TARP and currently the sole participant in TARP’s Systemically Significant Failing Institutions (SSFI) Program.<sup>2</sup> We testified on the status of this government effort in March 2009.<sup>3</sup> Because the government assistance to AIG is a coordinated approach, we are also monitoring the efforts of the Federal Reserve. Our ability to review the Federal Reserve’s assistance was recently clarified by the Helping Families Save Their Homes Act of 2009, enacted on May 20, 2009, which provided GAO authority to audit Federal Reserve actions taken under section 13(3) of the Federal Reserve Act for “a single and specific partnership or corporation.”<sup>4</sup> Among other things, this amendment provides GAO with authority to audit Federal Reserve actions taken with respect to three entities also assisted under TARP—Citigroup, Inc.; AIG; and Bank of America Corporation. This amendment also gave GAO the authority to access information from entities participating in TARP programs, such as AIG, for purposes of reviewing the performance of TARP.

GAO is required to report at least every 60 days on the activities and performance of TARP.<sup>5</sup> This 60-day report provides an overview of (1) the

---

<sup>2</sup>Treasury created SSFI to provide capital to institutions on a case-by-case basis to provide stability and prevent disruption to financial markets caused by the failure of a systemically significant institution.

<sup>3</sup>See GAO, *Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG*, [GAO-09-490T](#) (Washington, D.C.: Mar. 18, 2009).

<sup>4</sup>Section 801 of The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632, 1662 (2009), amended the Federal Banking Agency Audit Act, §2, 31 U.S.C. § 714 (2006), which limits GAO’s authority to audit certain Federal Reserve activities. Specifically, GAO’s audits of the Federal Reserve generally may not include monetary policy matters, including discount window operations and open market operations.

<sup>5</sup>For our past 60-day reports, see GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008); *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-296](#) (Washington, D.C.: Jan. 30, 2009); *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-504](#) (Washington, D.C.: Mar. 31, 2009); *Auto Industry: Summary of Government Efforts and Automakers’ Restructuring to Date*, [GAO-09-553](#) (Washington, D.C.: Apr. 23, 2009); *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-658](#) (Washington, D.C.: June 17, 2009); and *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, [GAO-09-837](#) (Washington D.C.: July 23, 2009).

---

basis for the Federal Reserve's and Treasury's assistance to AIG, (2) the nature and type of assistance provided to AIG, (3) the steps taken by the Federal Reserve, FRBNY, and Treasury that are intended to protect the government's interest and remaining risks, and (4) the status of federal assistance and GAO-developed indicators of AIG's financial condition.

To address the first three objectives—describing both the basis for federal assistance to AIG and the nature and type of assistance provided to AIG—we reviewed relevant documents from the Federal Reserve and FRBNY; recent congressional testimonies on AIG; reports from the Federal Reserve, FRBNY, Treasury, and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP); and several GAO reports on AIG and TARP to obtain information on how the Federal Reserve and Treasury became involved with AIG, the general goals of the federal assistance, the nature of the assistance, and how the assistance was restructured. We also conducted numerous interviews with officials and staff from the Federal Reserve, FRBNY, Treasury, the National Association of Insurance Commissioners (NAIC), three state insurance regulators with major roles in regulating AIG's insurance companies, two industry observers, and three rating agencies to understand the government's involvement and the condition of the financial markets and the insurance industry at the time of AIG's request for assistance. In addition, we reviewed AIG's annual and quarterly accounting and financial filings (10Ks, 10Qs) with the Securities and Exchange Commission (SEC) to describe the evolving financial condition of AIG and factors affecting AIG's financial condition.<sup>6</sup> Furthermore, we reviewed federal laws for information about the legal framework of the assistance. We also reviewed studies from NAIC, academics, and rating agencies.

To assess AIG's financial condition, we developed a set of indicators of AIG's financial condition and the status of federal assistance to AIG. We reviewed reports by several credit rating agencies on how they rate long-term and short-term debt and financial strength. We also interviewed officials and staff from the Federal Reserve, Treasury, and AIG about

---

<sup>6</sup>Companies such as AIG that have publicly traded stock listed on the domestic stock exchanges are required to timely file reports with SEC under the Securities Exchange Act of 1934. The annual Form 10K gives a comprehensive overview of the company's business and financial condition and includes audited financial statements. The quarterly Form 10Q includes unaudited financial statements and provides a continuing view of the company's financial position during the year. The Form 8K is the current report companies use to report certain material corporate events as they occur.

---

possible indicators. No single indicator provides a definitive measure of AIG's progress, and indicators should be considered collectively. We selected indicators that appeared to track the most critical activities related to the goals for federal assistance to AIG. The resulting indicators address several dimensions of AIG's business, including its credit ratings, operating performance, capital, debt repayment, and liquidity. The data used to create the indicators came from several sources, but most are based on publicly available information, such as AIG's 10K and 10Q filings and NAIC reports. Specifically, AIG's SEC filings provided information on its credit ratings, liquidity, debt, shareholders' equity, operating income, credit default swap (CDS) portfolio, collateralized debt obligations (CDOs), additions to and withdrawals from AIG life and retirement policyholder contracts, and insurance premiums. In congressional testimony, AIG provided information about its planned restructuring, including its divestiture plans and the winding down of its CDS portfolio. We used Thomson Reuters Datastream to collect information about AIG's CDS premiums over time. In addition, NAIC sources provided information on regulatory capital and primary activities affecting stockholders' equity for AIG's insurance subsidiaries. AIG also provided information on credit ratings, revenues, and expenditures on AIG's life and retirement services, AIG's property/casualty operation ratios, and AIG business unit divestitures and asset sales. Rating agencies provided information on credit ratings. Finally, Federal Reserve reports provided information on the FRBNY Revolving Credit Facility and the Maiden Lane facilities. We assessed the reliability of the data and found that the data were sufficiently reliable for our purposes.

We conducted this performance audit from March 2009 to September 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

---

## Background

---

### AIG Operations

AIG is a holding company that, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad, including general insurance, life insurance and retirement services, financial services, and asset management. AIG

---

comprises at least 223 companies and has operations in over 130 countries and jurisdictions worldwide (see fig. 1). As of June 30, 2009, AIG had assets of approximately \$830 billion and \$50 billion in revenues for the 6 preceding months, and AIG and its subsidiaries had 106,000 employees. The AIG organization includes the largest domestic life insurer and the second-largest domestic and property/casualty insurer in the United States, and it has a large foreign general insurance business. Figure 1 illustrates the complexity of AIG and its subsidiaries.





---

AIG was a large issuer of commercial paper, a mortgage lender, and through AIG Financial Products Corporation (AIGFP)—a financial products subsidiary that engaged in a variety of financial transactions, including standard and customized financial products—a participant in the derivatives market.<sup>7</sup> AIGFP has been a key source of AIG’s financial difficulties. As of June 30, 2008, AIG’s business included an estimated \$15 billion of outstanding commercial paper and the company sold CDS with \$447 billion gross notional exposure on CDOs.<sup>8</sup> Additionally, AIG maintained a large securities lending program operated by its insurance subsidiaries. The securities lending program allowed insurance companies, primarily the life insurance companies, to lend securities in return for cash collateral that was invested in residential mortgage-backed securities (RMBS). This program was another major source of AIG’s liquidity problems in 2008.

Aspects of AIG and its subsidiaries are regulated by federal and state authorities. The Office of Thrift Supervision (OTS) is the consolidated supervisor of AIG, which is a thrift holding company by virtue of its ownership of AIG Federal Savings Bank. As the consolidated supervisor, OTS is charged with identifying systemic issues or weaknesses and ensuring compliance with regulations that govern permissible activities and transactions.<sup>9</sup> In recent testimony, OTS said that it supervised and assessed AIG as a conglomerate and communicated with other functional regulators and supervisors that share jurisdiction over portions of the conglomerate.<sup>10</sup> AIG’s domestic and life and property/casualty insurance companies are regulated by the state insurance regulators in which these companies are domiciled.<sup>11</sup> These state agencies regulate the financial solvency and market conduct of these companies within their states and

---

<sup>7</sup>Corporations primarily issue commercial paper, which are short-term promissory notes.

<sup>8</sup>CDS are bilateral contracts that are sold over the counter and transfer credit risks from one party to another. The seller, who is offering credit protection, agrees, in return for a periodic fee, to compensate the buyer if a specified credit event, such as default, occurs. CDOs are securities backed by a pool of bonds, loans, or other assets.

<sup>9</sup>GAO, *Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration*, [GAO-07-154](#) (Washington, D.C.: Mar. 15, 2007).

<sup>10</sup>See testimony of Scott M. Polakoff, Acting Director, Office of Thrift Supervision, before Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services, March 18, 2009.

<sup>11</sup>The primary state insurance regulators include New York, Pennsylvania, and Texas.

---

they have the authority to approve or disapprove certain transactions between an insurance company and its parent or its parent's subsidiaries. These agencies also coordinate the monitoring of companies' insurance lines among multiple state insurance regulators. For AIG in particular, these regulators have reviewed reports on liquidity, investment income, and surrender and renewal statistics; evaluated potential sales of AIG's domestic insurance companies; and investigated allegations of pricing disparities.

In addition, Treasury's purchase, management, and sale of assets under TARP, including those associated with AIG, are subject to oversight by SIGTARP. As part of its quarterly reports to Congress, SIGTARP has provided information on federal assistance and the restructuring of the federal assistance provided to AIG, as well as information on the unwinding of AIGFP and the sale of AIG's assets.<sup>12</sup> Recently, we and SIGTARP have initiated a coordinated review of the federal governance over institutions such as AIG where the government has provided extraordinary assistance and has a significant ownership interest. The key focus of this review includes the extent of government involvement in management of such companies and the extent to which effective risk management, internal controls, and monitoring are in place to protect and balance the government's interests in relation to corporate needs.

---

## Overview of the Federal Reserve's and Treasury's Authorities

The Federal Reserve and Treasury provided assistance to AIG under the following authorities:

- *Section 13(3) of the Federal Reserve Act.*<sup>13</sup> This provision allows the Federal Reserve, in "unusual and exigent circumstances," to authorize any Federal Reserve Bank to extend credit in the form of a discount to individuals, partnerships, or corporations when the credit is "indorsed or otherwise secured" to the satisfaction of the Federal Reserve Bank, after obtaining evidence that the individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. The Federal Reserve has used this emergency authority in

---

<sup>12</sup>SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, July 21, 2009; SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, April 21, 2009; SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, *Initial Report to the Congress*, February 6, 2009.

<sup>13</sup>Section 13(3) of the Federal Reserve Act, as amended, codified at 12 U.S.C. § 343 (2006).

---

support of the government's efforts to stabilize systemically significant financial institutions, including AIG, and this is the same authority used for various other Federal Reserve actions in the ongoing financial crisis.

- *Emergency Economic Stabilization Act of 2008*.<sup>14</sup> The act authorized Treasury to establish TARP and to implement the program through a new Office of Financial Stability within Treasury. Among other things, the act grants Treasury broad, flexible authorities to purchase and insure troubled assets from financial institutions. The act defines troubled assets to include residential or commercial mortgages and securities based on such mortgages. Troubled assets may also include any other financial instrument (e.g., equities) that the Secretary of the Treasury, after consultation with the Chairman of the Federal Reserve, determines is necessary to purchase to promote financial market stability.
- *The American Recovery and Reinvestment Act of 2009 (ARRA)*.<sup>15</sup> Provisions of this act amend and restate the executive compensation and corporate governance provisions of the act.

---

## The Federal Reserve and Treasury Provided Assistance to AIG to Limit Systemic Risk to the Financial Markets

The Federal Reserve and Treasury determined through analysis of information provided by AIG and insurance regulators, as well as publicly available information, that market events in September 2008 could cause AIG to fail, which would pose systemic risk to financial markets.<sup>16</sup> Consequently, the Federal Reserve and Treasury took steps to ensure that AIG obtained sufficient liquidity and could complete an orderly sale of its operating assets, continue to meet its obligations, and close its investment positions in its securities lending program and AIGFP. The Federal Reserve explained that a major concern was public confidence in the financial system and the economy. The Federal Reserve and Treasury said that financial markets and financial institutions were experiencing

---

<sup>14</sup>Pub. L. No. 110-343, 122 Stat. 3765 (2008).

<sup>15</sup>Pub. L. No. 111-5, Div. B, Title VII, 123 Stat. 115, 516 (2009).

<sup>16</sup>As we said in our March 2009 testimony on credit default swaps, there is no single definition for systemic risk. Traditionally, systemic risk was viewed as the risk that the failure of one large institution would cause other institutions to fail. This micro-level definition is one way to think about systemic risk. Recent events have illustrated a more macro-level definition: the risk that an event could broadly affect the financial system rather than just one or a few institutions. See, GAO, *Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps*, [GAO-09-397T](#) (Washington, D.C.: Mar. 5, 2009).

---

unprecedented strains resulting from the placing of Fannie Mae and Freddie Mac under conservatorship; the failure of financial institutions, including Lehman Brothers Holdings, Inc. (Lehman Brothers); and the collapse of the housing markets. The Federal Reserve said that in light of these events, a disorderly failure of AIG could have contributed to higher borrowing costs, diminished availability of credit, and additional failures. They concluded that a collapse of AIG would have been much more severe than that of Lehman Brothers because of its global operations, large and varied retail and institutional customer base, and different types of financial service offerings. The Federal Reserve and Treasury said that a default by AIG would have placed considerable pressure on numerous counterparties and triggered serious disruptions in the commercial paper market. Moreover, counterparties of AIGFP would no longer have protection or insurance against losses if AIGFP, a major seller of CDS contracts, defaulted on its obligations and CDO tranche values continued to decline. The Federal Reserve intended the initial September 2008 assistance to enable AIG to meet these obligations to its counterparties and begin the process of selling noncore business units in order to raise cash to repay the credit facility and other liabilities.<sup>17</sup> However, AIG's continuing financial deterioration and instability in the financial markets resulted in subsequent assistance by the Federal Reserve and Treasury in November 2008 and March 2009 to support AIG's liquidity and to avoid a disorderly failure and facilitate an orderly sale of assets and maximum repayment of federal financial assistance while mitigating disruptions in the broader financial markets.

---

## AIG's Financial Problems Mounted Rapidly in 2008

From July 2008 through early September 2008, AIG faced increasing pressure on its liquidity following a downgrade in its credit ratings in May 2008 due in part to losses from its securities lending program (see fig. 2). This deterioration followed liquidity strains earlier in the year, although AIG was able to raise capital in May 2008 to address its needs. Specifically, the declines in its securities lending reinvestment portfolio of RMBS assets and declining values of CDOs against which AIGFP had written CDS protection forced AIG to use an estimated \$9.3 billion of its cash reserves in July and August 2008 to repay securities lending counterparties that terminated existing agreements and to post additional collateral required

---

<sup>17</sup>The credit facility is a revolving loan created by FRBNY for the general corporate purposes of AIG and its subsidiaries, including functioning as a source of liquidity to pay obligations as they come due.

---

by the trading counterparties of AIGFP. AIG attempted to raise additional capital in the private market in September 2008, but was unsuccessful. On September 15, 2008, the rating agencies downgraded AIG's debt rating, which resulted in the need for an additional \$20 billion to fund its added collateral demands and transaction termination payments.<sup>18</sup> In addition, AIG's share price fell from \$22.76 on September 8 to \$4.76 per share on September 15.<sup>19</sup> Following the credit rating downgrade, an increasing number of counterparties refused to transact with AIG for fear that it would fail. Also around this time, the insurance regulators decided they would no longer allow AIG's insurance subsidiaries to lend funds to the parent company under a revolving credit facility that AIG maintained. Furthermore, the insurance regulators demanded that any outstanding loans be repaid and that the facility be terminated.

---

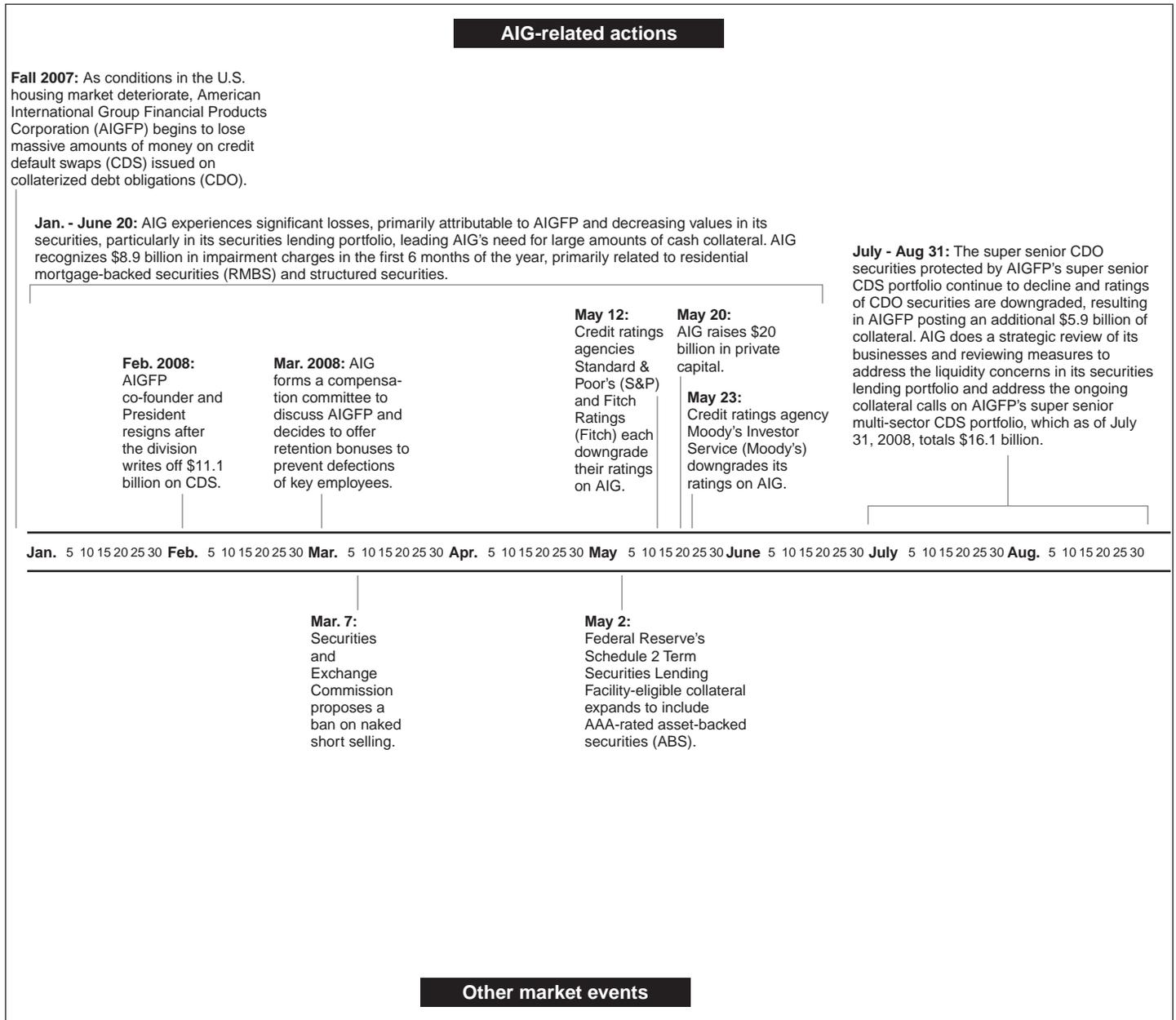
<sup>18</sup>Moody's Investors Service lowered AIG's rating to A2 from Aa3, or by 2 notches. Standard & Poor's Ratings Services lowered its rating of AIG to A- from AA-, or by 3 notches. Fitch Ratings reduced its rating of AIG to A from AA-, or 2 notches (see app. IV for ratings definition).

<sup>19</sup>AIG's share price was quoted at \$26.73 per share on the New York Stock Exchange on July 1, 2008. The shares closed at \$3.33 per share on September 30, 2008.

---

[This page left intentionally blank.]

**Figure 2: Timeline of AIG's Financial Difficulties and Government Actions in Response to Market Turmoil, Fall 2007 to September 30, 2008**





---

**AIG Contacted FRBNY as  
Its Liquidity Level  
Deteriorated, but Options  
for Government Assistance  
Were Limited**

Given the liquidity constraints and its inability to raise new funds, AIG contacted FRBNY on September 12, 2008, to seek assistance, fearing that low cash reserves could soon cause its failure. Federal Reserve and FRBNY officials with whom we spoke said that while FRBNY was the initial point of contact for AIG, Treasury officials and New York state insurance regulators were included in subsequent discussions about forms of assistance. Treasury officials—who were already in New York to deliberate on an appropriate policy response to the distress of Lehman Brothers—attended meetings at AIG with FRBNY officials during the week prior to the final decision to provide assistance. FRBNY and Treasury officials were joined by the New York state insurance regulators in discussions during the following weekend. Given the short time frame, Federal Reserve officials added that OTS, the consolidated regulator of AIG, was not consulted about the condition of AIG. FRBNY officials said that prior to these discussions, they had no nonpublic information on AIG operations because they did not supervise the company. FRBNY officials added that state insurance regulators provided information on the condition of AIG’s insurance subsidiaries, including the potential impact of RMBS portfolio losses on the subsidiaries’ capital base. In addition, during these meetings, AIG provided the Federal Reserve, FRBNY, and Treasury with financial and operational data, including updates on liquidity and counterparty information, to assist them with assessing AIG’s financial condition. Following these meetings, FRBNY and Federal Reserve officials presented their assessment of the situation to the Board of Governors of the Federal Reserve System, which authorized FRBNY to provide liquidity in the form of a Revolving Credit Facility to AIG on September 16. We discuss the basis for and the form of this assistance later in this report.

Federal Reserve officials told us that the potential failure of AIG was different from two other prominent failures in 2008—Bear Stearns and Lehman Brothers. A bankruptcy of Bear Stearns was averted through a sale process, and Lehman Brothers’ principal U.S. broker-dealer subsidiary was largely resolved through a sale process overseen by the bankruptcy court. Federal Reserve officials were skeptical that a sale process could be successfully completed for AIG, which was larger than Bear Stearns and Lehman Brothers. The Federal Reserve added that it also had more limited options in providing assistance to Lehman Brothers. The officials stated that Section 13(3) of the Federal Reserve Act requires that emergency loans extended by Federal Reserve Banks be adequately secured, and Lehman Brothers’ assets available as collateral fell short of the amount needed to secure a Federal Reserve loan of sufficient size to avert failure.

---

As the Federal Reserve, in consultation with Treasury, attempted to address the systemic risk that AIG's default could have posed, it noted that it faced regulatory and legal constraints. While the Federal Deposit Insurance Corporation (FDIC) has the authority to unwind banks, the Federal Reserve and Treasury noted that regulatory bodies involved with AIG did not have an effective mechanism for unwinding such a large nonbank financial institution in an orderly manner.<sup>20</sup> AIG's business units reported to hundreds of regulators, none of which maintained the authority to unwind AIG's various businesses. At the same time, AIG maintained financial relationships with a large number of banks, insurance companies, and other market participants across the globe, creating the possibility for system-wide disruption in the event of the failure of AIG.

According to Federal Reserve officials, this lack of a centralized and orderly resolution mechanism presented the Federal Reserve and Treasury with few alternatives in September 2008. Federal Reserve officials told us that the only other viable outcome besides the assistance package would have been bankruptcy. Without additional liquidity, AIG likely would have been forced to declare bankruptcy following any default on its contracts with counterparties. AIG's negotiations with counterparties and creditors to reduce the outstanding obligations through contract renegotiation had proven unsuccessful. Providing new liquidity to AIG and its affiliates would allow the company to satisfy its obligations. Thus, time was increasingly limited and the amount of assistance required continued to grow following the credit downgrade and the Lehman Brothers failure on September 15, 2008, as many AIG contracts required increased collateral and as market prices decreased.

The Federal Reserve described its actions in mid-September 2008 as an effort to avoid the effects that AIG's disorderly failure could have had on financial markets and the broader economy and allow AIG to conduct an orderly restructuring of its operations. As the Chairman of the Federal

---

<sup>20</sup>On March 25, 2009, Treasury announced a legislative proposal under which, after a systemic risk determination by the Secretary of the Treasury (in consultation with the President), FDIC would have the authority to provide financial assistance to and to put into receivership or conservatorship "systemically significant financial companies" that are not subject to FDIC's existing resolution authority. FDIC, with Treasury's approval, would be authorized to provide financial assistance through loans or equity investments, or by purchasing or guaranteeing assets. As a conservator or receiver, FDIC would have additional powers to sell or transfer assets or liabilities of the company, renegotiate or repudiate the company's contracts, and replace the board of directors and senior officers of the company.

---

Reserve Board stated, “[a]t best the consequences of AIG’s failure would have been a significant intensification of an already severe financial crisis and worsening of global economic conditions. Conceivably, its failure could have resulted in a 1930s-style global financial and economic meltdown, with catastrophic implications for production, income, and jobs.”<sup>21</sup> Avoiding the immediate threat of bankruptcy was the short-term goal of the federal agencies and state regulators who met to discuss the company’s situation prior to the establishment of the first form of assistance. The Federal Reserve and Treasury determined that AIG would be able to put up cash collateral and avoid imminent failure by receiving sufficient liquidity support. Counterparties would also avoid the possibility of holding defaulted contracts and needing to raise additional capital in adverse market conditions. In addition, Treasury noted in public documents the need to slow the spread of financial crisis and to allow for AIG to regroup and satisfy its obligations.

Critics of the government’s assistance have noted that by providing assistance to AIG for the purpose of providing or returning cash collateral to counterparties, the government was indirectly assisting the counterparties, and they questioned the efficiency of this approach. Some noted that banks that had bought CDS contracts from other failed insurers were paid 13 cents on the dollar in deals mediated by New York’s insurance regulator, whereas AIG’s counterparties were paid market value. They said that new capital to AIG in effect served as direct infusions to the counterparties, including foreign financial institutions. Conversely, Federal Reserve officials believed that if AIG had failed to pay the collateral amounts due, it would have been in default of its agreements, which could have resulted in AIG’s counterparties forcing it into bankruptcy. Moreover, they believed that the unfolding crisis warranted swift action to prevent a total collapse of the financial system given its fragile state at that time.

---

<sup>21</sup>See testimony of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the House Financial Services Committee, March 24, 2009.

---

## The Federal Reserve Determined That AIG and Its Insurance Subsidiaries Posed a Systemic Risk to the Financial System Amid Market Turmoil in September 2008

### Failure Would Have Undermined Business and Investor Confidence

The Federal Reserve concluded through internal discussions and dialogue with AIG's state insurance regulators that the failure of AIG would pose systemic risk for four primary reasons: (1) failure could have undermined already fragile business and investor confidence; (2) counterparty risk, through defaults and collateral requirements, could have negatively affected numerous financial institutions and the financial system; (3) default by AIG on its commercial paper could have negatively affected the money markets; and (4) failure could have disrupted the derivatives markets and caused liquidity problems for holders of AIG products.

First, given the nature of the ongoing crisis, the Federal Reserve was concerned that the disorderly failure of AIG would have undermined already fragile business and investor confidence that had been shaken by numerous events since the onset of the financial crisis in 2007, including the decision 2 weeks earlier to place Fannie Mae and Freddie Mac in conservatorship and the bankruptcy of Lehman Brothers on September 15, 2008. The Federal Reserve believed that the failure of AIG under the conditions then prevailing would have increased investor risk aversion and consequently contributed to higher borrowing costs and materially weaker economic performance. Additionally, the Chairman of the Federal Reserve noted that market confidence would have been hurt in other areas that would have been affected by AIG's failure, including the insurance industry, state and local governments that invested with AIG, 401(k) plans that purchased insurance with AIG, and banks that extended loans and credit lines to the company. He further stated that focusing on direct effects of a default on AIG's counterparties understates the risks to the financial system as a whole.<sup>22</sup>

The initial market stress that surrounded AIG's troubles can be traced to the tension in the broad-based decline in home prices and the cascading effect on mortgage-backed securities that began in 2007. The decline in home prices was a factor in the significant increase in delinquencies in the mortgage market. This was especially felt in the subprime markets.<sup>23</sup> Furthermore, these defaults and declines in underlying mortgages decreased the value of mortgage-backed securities and securitizations in

---

<sup>22</sup>See testimony of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the House Financial Services Committee, March 24, 2009.

<sup>23</sup>Subprime mortgages are loans that are traditionally riskier and extended to borrowers with lower credit standing, higher ratio of borrower debt to income, or higher ratio of the value of the loan to the collateral.

---

---

Counterparty Risk Would Have Negatively Affected Numerous Financial Institutions and the Financial System

general. These other securitized products declined subsequent to the decrease in mortgage-backed security valuations and included other asset-backed securities and CDOs. Essentially, with the collapse of underlying loans, the values of these instruments also suffered. The decline in value of these instruments and the collapse of Bear Stearns and Lehman Brothers led financial market participants to question about whether they would be able to collect on outstanding obligations.<sup>24</sup> Therefore, market confidence was further eroded in an environment already facing tightening of credit and interbank lending activities.

As another reason for systemic risk concern, the Federal Reserve stated that counterparty risk would have negatively affected the financial system because AIG's default on its obligations to trading counterparties could have seriously disrupted the ability of the financial system to operate effectively through its counterparty relationships with important market participants. The fluid operation of the payments and settlements system is critical to the U.S. financial markets, as market participants depend on this system to move funds between counterparties and to close transactions. Through the securities lending program and its AIGFP subsidiary, AIG maintained counterparty relationships that could have been negatively affected by the inability of AIG to fulfill terms under outstanding contracts. For example, there would have been harmful consequences to AIG's counterparties—including large banks such as Société Générale, Deutsche Bank, Goldman Sachs, and Merrill Lynch—and defaults directly related to AIG would then have rippled through the system and affected transactions between other counterparties.<sup>25</sup> This contagion would have been difficult to manage, as investor confidence would have plummeted with each market participant failure. The Federal Reserve Chairman stated in his March 2009 testimony that it would have been difficult to prevent additional failures in the wake of AIG's failure.<sup>26</sup>

---

<sup>24</sup>Counterparties reportedly were unwilling to do business with AIG because they did not want their assets tied up in bankruptcy, which could have taken years to resolve.

<sup>25</sup>The large banks were identified as counterparties in AIG's CDS contracts in the testimony of Edward M. Liddy, Chairman and Chief Executive Officer, American International Group, Inc. before the House Financial Services Committee, March 18, 2009.

<sup>26</sup>See testimony of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the House Financial Services Committee, March 24, 2009.

---

## Default on Commercial Paper Would Have Negatively Affected Money Markets

The Federal Reserve also noted that a default by AIG on its commercial paper would have negatively affected money market participants, led to higher lending rates, and reduced credit availability for borrowers as other commercial paper lenders and money market funds viewed the markets as riskier. The Federal Reserve anticipated that a default by AIG on its commercial paper could have triggered runs on money market mutual funds holding defaulted AIG commercial paper of an estimated \$20 billion. This run could have led to spreading pessimistic views of the money market as a whole and runs on related money market funds with no exposure to AIG as investors fled what had been considered a highly safe class of assets. Furthermore, these money funds' inability to invest and investor fears could have disrupted the commercial paper market, limiting the ability of financial and nonfinancial firms to access the short-term funding market to meet obligations. Federal Reserve officials with whom we spoke stated that this concern became increasingly important following disruptions in the money market in the wake of Lehman Brothers' failure. The Federal Reserve and other government agencies anticipated funding issues for many firms in the United States. These concerns ultimately contributed to the development of a number of other programs around this time to stem the crisis in the credit markets, such as the FDIC's Temporary Liquidity Guarantee Program and the Federal Reserve's own Commercial Paper Funding Facility; the latter program being one in which at least four AIG affiliates have participated.<sup>27</sup>

AIG had encountered such funding problems when it was unable to access the short-term funding market to obtain liquidity needed to meet its obligations. The collapse of large financial institutions and falling investor confidence had affected lending and trading conditions in the credit markets. In particular, short-term funding rates increased in response to perceived higher risk as the mortgage markets and related derivative markets effectively ceased to operate in the fall of 2008. This led to high spreads between lending rates and the target federal funds rate and illiquid trading conditions in the short-term money markets. As a result of these

---

<sup>27</sup>The Temporary Liquidity Guarantee Program was created in November 2008 by FDIC to encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest-bearing deposit transaction accounts. The Commercial Paper Funding Facility was created in October 2008 under Section 13(3) of the Federal Reserve Act by the Federal Reserve to help provide liquidity to term funding markets. The Commercial Paper Funding Facility involves the purchase, through a special purpose vehicle with financing from the Federal Reserve, of 3-month unsecured and asset-backed commercial paper directly from eligible issuers.

---

---

Failure Would Have Disrupted the Derivatives Markets and Caused Liquidity Issues for Holders of AIG Products

conditions, AIG was unable to raise additional liquidity. This inability became the greatest obstacle to AIG stabilizing its financial condition in mid-September, as it became evident that falling prices and the risk of counterparty failure would not be temporary. AIG publicly disclosed in its financial reports that declining asset prices had forced the posting of additional collateral in connection with its derivative positions.<sup>28</sup> A further downgrade in AIG's credit rating could have triggered a default because the downgrade would have resulted in AIG having to post additional collateral with counterparties.

Finally, the Federal Reserve and Treasury stated in separate reports and testimonies in the fall of 2008 and early 2009 that the failure of AIGFP could have led to billions of dollars of losses at bank counterparties that bought CDS contracts from AIG.<sup>29</sup> Because many banks used these contracts as credit protection, following losses to CDS contract holders, if any, AIG's failure could have led to mounting losses through sudden, unhedged, uncollateralized exposure as market conditions worsened and underlying assets continued to decline in value. Banks and other counterparties could have faced declining capital bases because of these unrealized losses. Moreover, counterparties with unfulfilled derivative contracts could have faced difficulties in offsetting balance sheet exposures through replacement derivatives, and they would have had to confront the possibility of entering into new contracts at a time when market participants had become increasingly risk averse and unwilling to execute new transactions.

---

After September 2008, Treasury and the Federal Reserve Determined That AIG Needed Further Assistance as Market Conditions Continued to Deteriorate

In the period following FRBNY's establishment of the Revolving Credit Facility for AIG in September 2008, market confidence continued to fall and lending rates continued to rise as financial institutions became increasingly reluctant to lend. Federal Reserve officials noted that the financial markets also experienced increased illiquidity in many asset classes where market participants were forced to trade assets at declining values. An effect of market illiquidity and borrowers' inability to access lending markets was a halt to the secondary market for asset sales.

---

<sup>28</sup>Disclosed in Third Quarter 2008 financial reports issued by AIG and restated in Addendum to Testimony by Mr. Edward M. Liddy on March 18, 2009, before the House Financial Services Committee.

<sup>29</sup>See testimony of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the House Financial Services Committee, March 24, 2009.

---

Treasury officials noted that ensuring financial stability was the most important goal, including the restoration of consumers' and businesses' access to funding and credit, and they viewed the troubles in the credit market as an inhibitor to success. Treasury and the Federal Reserve were also concerned that these troubles would hamper AIG's ability to dispose of operating assets to stabilize the business and repay outstanding debt to FRBNY according to the plan in place at the time AIG and FRBNY entered in the agreement establishing the Revolving Credit Facility.

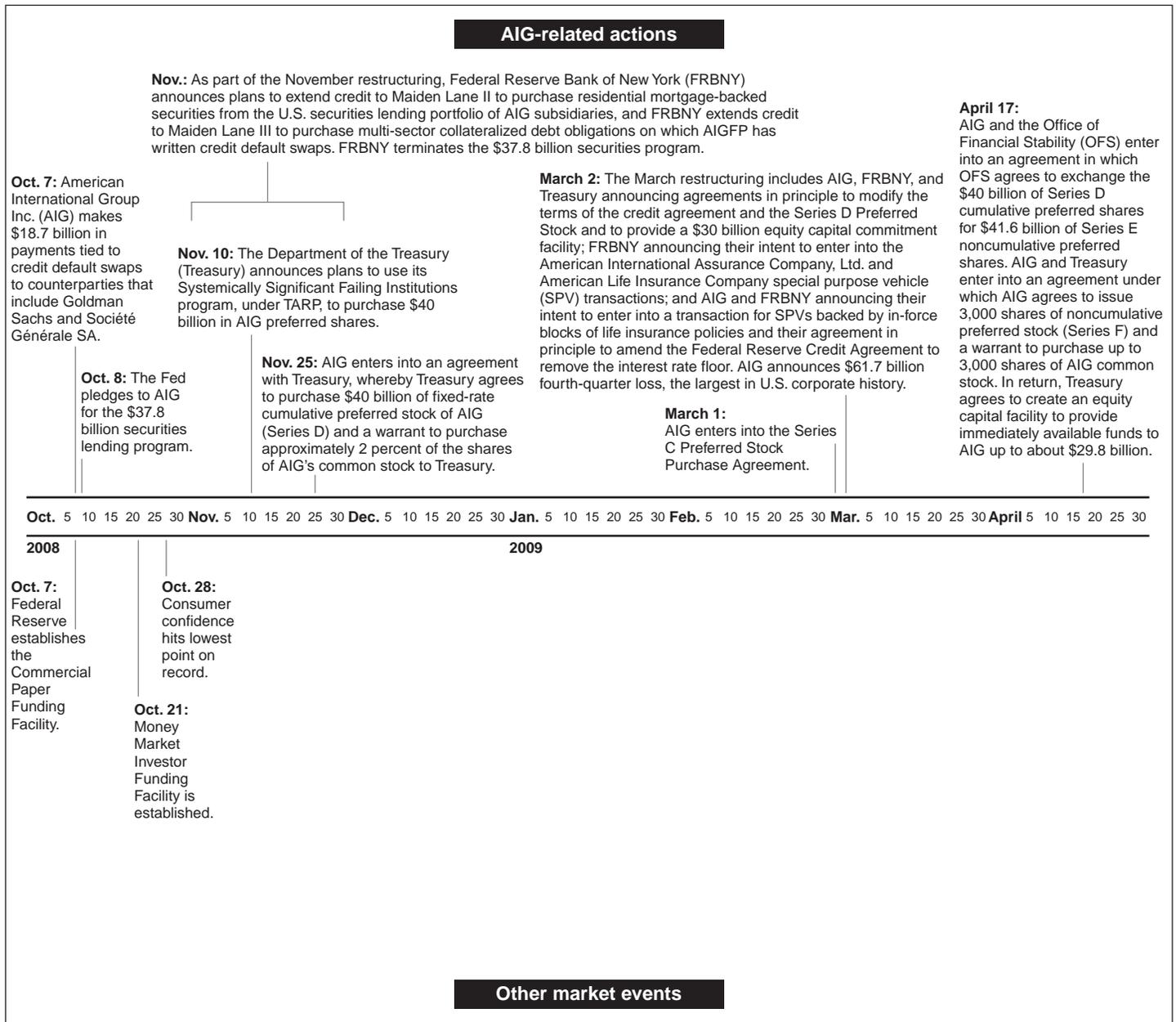
To facilitate AIG's efforts to restructure and prevent further degradation to AIG's balance sheet and further credit downgrades, in November 2008 Treasury joined the Federal Reserve in the efforts to assist AIG (see fig. 3). Treasury's assistance was organized as a preferred equity investment under the SSFI program of TARP rather than as debt. Treasury formed its investment in this manner in consideration of the effect of the Revolving Credit Facility on AIG's balance sheet, which had increased the company's debt levels, or leverage, and lowered the company's interest coverage ratio.<sup>30</sup> These are two of the metrics used by credit rating agencies in assessing the financial strength of an issuer. Maintaining AIG's credit rating continued to be an important goal of Treasury and FRBNY. Treasury's use of an equity infusion, a tool unavailable to it until the Emergency Economic Stabilization Act of 2008 became law, allowed AIG to obtain new capital without putting further strain on its financial position through additional leverage. According to Treasury's press release, improving AIG's ability to dispose of its assets in an orderly manner was a primary goal of the restructuring and of the additional capital provided to the company.<sup>31</sup>

---

<sup>30</sup>Interest coverage ratio is a ratio used to determine how a company can pay interest on outstanding debt and is calculated by dividing a company's operating income by the company's interest expenses over a period. The higher the ratio, the better positioned the company is to service its debt expense. A ratio below 1 indicates the company is not generating sufficient operating income to pay its interest.

<sup>31</sup>See March 2, 2009 Treasury press release at <http://www.treas.gov/press/releases/tg44.htm>.

**Figure 3: Timeline of the Restructuring of AIG's Assistance, Market Events, and Related Government Actions, October 1, 2008, to April 30, 2009**



---

By November 2008, it was evident that the Revolving Credit Facility had not sufficiently halted the withdrawal of counterparties from transactions with AIGFP or claims for additional collateral in connection with AIG's securities lending business. As counterparty withdrawals and claims for collateral continued, AIG faced additional liquidity shortfalls in an effort to meet its obligations. AIG estimates that between September 16, 2008, and December 31, 2008, \$22.4 billion in cash was paid directly by AIG to AIGFP counterparties as collateral, while FRBNY provided another \$46.6 billion in assistance for this purpose. The restructuring and other assistance the Federal Reserve and Treasury announced in November 2008 were intended to allow AIG to concentrate on using remaining liquidity available from the Revolving Credit Facility for purposes other than posting collateral for outstanding transactions contracted prior to the establishment of the Revolving Credit Facility. As discussed more fully later in this report, to address this situation, the Federal Reserve committed in November to provide additional assistance to AIG through the establishment of special purpose vehicles that would allow AIG to close out most of AIGFP's super senior CDS portfolio as well as to liquidate the portfolio of RMBS assets that was purchased through the securities lending reinvestment program of its insurance subsidiaries.<sup>32</sup> The Federal Reserve noted that this RMBS portfolio and the CDS protection underwritten by AIGFP accounted for the majority of the liquidity shortfall and \$19 billion of the \$24.5 billion in losses reported by AIG for the third quarter of 2008.<sup>33</sup>

---

**In Early 2009 the Federal Reserve and Treasury Determined That Assistance Needed to Be Restructured to Allow Time for AIG to Dispose of Its Assets**

In March 2009, continuing market stress and the difficult business conditions affecting AIG and would-be buyers of AIG's business units forced the Federal Reserve and Treasury to again restructure the various forms of assistance provided to AIG. AIG continued to work on the divestiture and repayment plan created with the establishment of the Revolving Credit Facility in September 2008. Nevertheless, the continuing difficult market conditions compelled AIG to restructure existing forms of assistance with FRBNY and Treasury in order to decrease leverage and create additional time and flexibility to dispose of key business assets.

---

<sup>32</sup>Special purpose vehicles are legal entities, such as limited liability companies, created to carry out some specific financial purpose or activity.

<sup>33</sup>See Federal Reserve, *Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Restructuring of the Government's Financial Support to the American International Group, Inc.* (Washington, D.C., Nov. 10, 2008).

---

According to AIG's financial reports and testimony by the AIG Chairman, the company faced persistent difficult market conditions as it entered 2009.<sup>34</sup> In particular, the deteriorating state of the financial markets created large losses for AIG in the fourth quarter of 2008. Furthermore, AIG had difficulties finding buyers for operating businesses that it had put up for sale in the last half of 2008 because many potential buyers were facing financial challenges of their own. However, ongoing federal assistance prevented further downgrades in AIG's credit rating through the first half of 2009. This allowed AIG to conserve critical cash in its drive to maintain sufficient liquidity and unwind its AIGFP portfolio. The AIGFP officials with whom we spoke said that a downgrade of the parent company's credit rating and staff retention remained the most pressing issues, rather than portfolio volatility. In March 2009, the President of FRBNY continued to believe that derivative positions of substantial magnitude still remained in force at AIGFP that could lead to billions of dollars of losses and a corresponding loss of taxpayer dollars invested in the company in the form of equity and debt. Subsequently, AIGFP officials stated that AIGFP had succeeded in exiting many of its riskiest positions, including many of the CDS positions related to corporate CDOs, foreign exchange positions, commodities positions, and private equity-related businesses as of June 2009.

In March 2009, the Federal Reserve and Treasury approved several changes to their existing debt and equity relationships with AIG to lower leverage and create additional time and flexibility for AIG to divest businesses and repay federal assistance. For example, the Federal Reserve authorized FRBNY to extend credit to securitize life insurance policies underwritten by certain AIG life insurance subsidiaries and, in addition, to receive a nonvoting, preferred equity stake in AIG subsidiaries American International Assurance Company, Ltd. (AIA) and American Life Insurance Company (ALICO) in exchange for a reduction in the outstanding balance under the Revolving Credit Facility, with a corresponding reduction in FRBNY's commitment to lend under the facility. FRBNY believed that, considering the market difficulties, the exchange offer would help to protect the government's investment in AIG by not forcing the company to make decisions that would harm its ability to repay its obligations to FRBNY. In another example, Treasury exchanged its equity interest purchased through the SSFI. These, and other actions, are discussed in

---

<sup>34</sup>See Testimony of Edward M. Liddy, Chairman and Chief Executive Officer, American International Group, Inc. before the House Financial Services Committee, March 18, 2009.

---

detail in the next section of this report. Treasury viewed inaction as a potentially costlier and riskier option because of the risk of a credit rating downgrade, which would have led to a disorderly failure of the firm. Creating a more durable capital structure for AIG that allows the company time and flexibility to dispose of its noncore assets continues to be a main goal of the restructuring process. The Federal Reserve noted that it expects the disposition of assets to be the principal way by which AIG will repay government funds lent by FRBNY, recoup equity investments made by Treasury, and pay other expenses associated with the government's efforts. AIG noted in public reports that through the third quarter of 2009, it had completed dispositions and asset sales of an estimated \$5.9 billion in total proceeds, which we discuss later in the report.

---

## The Federal Reserve, FRBNY, and Treasury Have Taken a Variety of Steps to Stabilize AIG

To address concerns about the systemic risk posed by AIG's potential disorderly failure, the Federal Reserve and Treasury have agreed to make over \$182 billion of federal assistance available to AIG since September 2008. This assistance was intended to stabilize AIG by providing it with a reliable source of liquidity to allow for an orderly restructuring of its operations. While some of the assistance was designated for specific purposes—such as reducing the debt outstanding to the Federal Reserve or establishing SPVs created by FRBNY to purchase specific assets such as CDOs and RMBS—other assistance was provided to enable AIG to meet the general corporate needs of the parent company and its subsidiaries. Finally, the government made investments in AIG to stabilize its capital position. Table 1 provides an overview of the various forms of assistance, the purpose of each form of assistance, the amounts authorized, the amounts loaned or used for investments, and the outstanding balance as of September 2, 2009.

**Table 1: U.S. Government Efforts to Assist AIG and the Government’s Remaining Exposure, as of September 2, 2009**

Dollars in millions

	Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
		Debt	Equity		
<b>Implemented</b>					
<b>Federal Reserve</b>	FRBNY created a Revolving Credit Facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity. In exchange for the facility and \$0.5 million, a trust received Series C preferred stock for the benefit of the Treasury, which gave Treasury a 77.9 percent voting interest in AIG.	\$60,000 <sup>a</sup>		\$38,792.5	Proceeds from dispositions of AIG businesses, internal cash flows, and restructuring part of the Revolving Credit Facility from debt into equity. The initial fee paid by AIG was reduced by \$0.5 million to pay for the Series C shares and will not be repaid.
	FRBNY created an SPV—Maiden Lane II—to provide AIG liquidity by purchasing RMBS from AIG life insurance companies. FRBNY provided a loan to Maiden Lane II for the purchases. FRBNY also terminated its securities lending program with AIG, which had provided additional liquidity associated with AIG’s securities lending program when it created Maiden Lane II.	22,500		16,899	Proceeds from asset sales in Maiden Lane II will be used to repay the FRBNY loan.
	FRBNY created a SPV called Maiden Lane III to provide AIG liquidity by purchasing CDO’s from AIG Financial Products’ counterparties in connection with the termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30,000		20,196	Proceeds from asset sales in Maiden Lane III will be used to repay the FRBNY loan.

Dollars in millions

	Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
		Debt	Equity		
<b>Treasury</b>	Treasury purchased Series D cumulative preferred stock from AIG. AIG used the proceeds to pay down part of the Revolving Credit Facility. Series D shares were later exchanged for Series E noncumulative preferred shares. Unpaid dividends on the Series D shares were added to the Treasury's equity in the Series E shares.		40,000	41,605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Treasury purchased Series F noncumulative preferred shares of AIG and is allowing AIG to draw up to \$29,835 million through an equity facility to meet its liquidity and capital needs. Amounts drawn by AIG represent the cost of the federal equity interest in these shares.		29,835	3,206 <sup>b</sup>	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	<b>Subtotals</b>	<b>\$112,500</b>	<b>\$69,835</b>		
	<b>Total authorized and outstanding assistance<sup>c</sup></b>		<b>\$182,335</b>	<b>\$120,698.5</b>	
<b>Pending</b>	AIG created two SPVs to hold the shares of two of its foreign life insurance businesses to enhance AIG's capital and liquidity, and facilitate an orderly restructuring of AIG. The Revolving Credit Facility will be reduced by the amount of preferred equity interest in the SPVs to be received by FRBNY.	0	25,000 <sup>d</sup>	0	Proceeds from the public sale of the common stock in the SPV could be used to buy out the federal preferred equity and/or pay down part of the Revolving Credit Facility.
	AIG will create SPVs that will issue up to \$8,500 million in notes to FRBNY which will be funded with a loan from FRBNY. AIG will use the proceeds to pay down part of the Revolving Credit Facility.	8,500 <sup>d</sup>		0	FRBNY's loan to the SPVs will be repaid from cash flows of the life insurance policies.

Source: AIG SEC filings, Federal Reserve, and Treasury data.

<sup>a</sup>The facility was initially \$85 billion but was reduced to \$60 billion in November 2008.

---

<sup>b</sup>Amount as of September 8, 2009.

<sup>c</sup>Does not include AIG's participation in the Federal Reserve's Commercial Paper Funding Facility.

<sup>d</sup>This transaction has not been completed and is not included in the total assistance provided to AIG because the amount of the Revolving Credit Facility will be decreased by an equal amount.

---

## FRBNY's Revolving Credit Facility Provided AIG with a Source of Liquidity but Increased Its Debt, which Is Being Restructured through Several Subsequent Actions

In September 2008 the Federal Reserve announced that, with the support of Treasury, it had authorized FRBNY to lend AIG up to \$85 billion under the emergency provisions of Section 13(3) of the Federal Reserve Act. The amount was subsequently reduced to \$60 billion as discussed below. This secured loan was structured as a revolving credit facility—a secured revolving loan or line of credit that AIG could use to meet its obligations as they came due.<sup>35</sup> However, in light of ongoing concerns about AIG's condition and the continued threat it posed to the stability of financial markets, this debt was subsequently restructured in November 2008 and again in March 2009. The term of the loan was initially 2 years but was subsequently extended to 5 years to allow AIG additional time to restructure its operations and repay the debt.

AIG's mounting debt—the result of borrowing from the Revolving Credit Facility—led to concerns that its credit ratings would be lowered, which would have caused its condition to deteriorate further. In response, the Federal Reserve and Treasury restructured AIG's debt in November 2008. Under the restructured terms, Treasury purchased \$40 billion shares of AIG preferred stock (the Series D securities purchase agreement discussed later in this report), and the cash from the sale was used to pay down a portion of AIG's outstanding balance. The limit on the Revolving Credit Facility was also reduced from \$85 billion to \$60 billion. This restructuring was critical to helping AIG maintain its credit ratings.

In March 2009, the Federal Reserve and Treasury announced plans to further restructure AIG's assistance. Consistent with earlier assistance, this restructuring also was designed to enhance AIG's capital and liquidity to facilitate orderly restructuring of the company. According to the Federal Reserve, the facility is to be reduced in exchange for the FRBNY's receipt of preferred interests in two special purpose vehicles created by AIG to hold the outstanding common stock of two life insurance holding company subsidiaries of AIG—ALICO valued at about \$9 billion and AIA

---

<sup>35</sup>As a condition of providing the loan, FRBNY took a number of steps aimed at protecting the government's interest, including the creation of a trust to hold the Series C preferred shares, which we discuss later.

---

valued at about \$16 billion. The valuation for FRBNY's preferred stock interests, which was set at \$25 billion in June 2009 when the agreements were finalized, is a percentage of the fair market value of ALICO and AIA as determined by FRBNY. AIG expects to close these transactions by early 2010 pending the appropriate regulatory approvals and desirable market conditions. While this transaction will lower the amount of AIG's debt to FRBNY, it shifts the debt to equity interest in AIG subsidiaries and does not decrease the government's overall risk exposure. For the details of the terms of the AIA and ALICO agreement, see appendix II.

---

### FRBNY Creates Two New Lending Facilities, Maiden Lane II and III, to Relieve Liquidity Pressures Related to Two Portfolios of Mortgage-Related Assets

To help resolve AIG's ongoing liquidity issues, the Federal Reserve authorized FRBNY to create two new facilities to purchase some of AIG's more troubled assets. AIG's securities lending program continued to be one of the greatest ongoing demands on its liquidity, and on November 10, 2008, FRBNY announced plans to create a RMBS facility—Maiden Lane II LLC—to purchase RMBS assets from AIG's U.S. securities lending collateral portfolio. According to FRBNY, this facility was established to prevent continuing liquidity strains on AIG. The Federal Reserve authorized FRBNY to lend up to \$22.5 billion to Maiden Lane II; AIG also acquired a subordinated, \$1 billion interest in the facility, which will absorb the first \$1 billion of any losses. On December 12, 2008, FRBNY extended a \$19.5 billion loan to Maiden Lane II to fund its portion of the purchase price of the securities. The facility purchased \$39.3 billion face value of the RMBS directly from AIG subsidiaries (domestic life insurance companies).<sup>36</sup> As of September 18, 2009, the amount owed was \$17.1 billion.

By October 2008, AIG had used \$72 billion of the \$85 billion available under the Revolving Credit Facility. To provide it with additional liquidity, the Federal Reserve authorized FRBNY to borrow securities from certain regulated U.S. life insurance subsidiaries of AIG. Under this program, FRBNY was authorized to borrow up to \$37.8 billion in investment-grade, fixed-income securities from AIG in return for cash collateral. These securities had previously been lent by AIG's life insurance company subsidiaries to third parties. This program provided AIG with another source of liquidity to pay its obligations associated with its securities

---

<sup>36</sup>In response to questions about the purchase prices paid for these securities SIGTARP is reviewing how the purchase prices of the securities were determined.

---

lending program, one of its major sources of liquidity problems.<sup>37</sup> It also enabled AIG to use the remainder of the Revolving Credit Facility for other liquidity needs. This agreement was terminated in December 2008 simultaneously with the closing of the Maiden Lane II transaction.

The FRBNY loan to Maiden Lane II is expected to be repaid with the proceeds from the interest and principal payments or proceeds from the liquidation of the assets held by the facility. Accordingly, the Federal Reserve has not set a date for selling the assets; rather it has indicated that it is prepared to hold the assets to maturity if necessary. Until this time, the government's investment remains exposed to risk of loss. Payments are to be made in the following order, and each category must be fully paid before proceeding to the next category:

1. necessary costs and expenses of Maiden Lane II, plus a cash reserve for future expenses;
2. all principal on the FRBNY loan;
3. all interest on the FRBNY loan;
4. up to \$1 billion of deferred consideration to AIG's Life Insurance Companies; and
5. interest due on the deferred consideration to AIG's life insurance companies.

If Maiden Lane II has paid in full its obligations to FRBNY and AIG's life insurance companies, any remaining proceeds will be distributed between FRBNY and the life insurance companies. FRBNY is to receive approximately 83 percent of the remaining proceeds, while the AIG life insurance subsidiaries are to receive 17 percent of any remaining proceeds.

Also on November 10, 2008, FRBNY announced plans to create a separate facility—Maiden Lane III LLC—to purchase multi-sector CDOs on which

---

<sup>37</sup> AIG's domestic life insurance companies participated in a securities lending program through which they would loan securities to investors for cash collateral. In turn, AIG invested the cash collateral in RMBS. When these investors returned the borrowed securities and demanded their cash collateral, AIG was unable to sell the securities at prices needed to meet their obligations under current market conditions.

---

AIGFP had written CDS contracts. This facility was aimed at facilitating the restructuring of AIG by addressing the greatest threat to AIG's liquidity. In connection with the purchase of the CDOs, AIG's CDS counterparties agreed to terminate the CDS contracts.<sup>38</sup> The Federal Reserve authorized FRBNY to lend up to \$30 billion to Maiden Lane III. On November 25, and December 18, 2008, FRBNY extended a total of \$24.3 billion in loans to Maiden Lane III; AIG also paid \$5 billion equity interest in Maiden Lane III and would absorb the first \$5 billion of any losses.

The FRBNY loan to Maiden Lane III is expected to be repaid with the proceeds from the maturity or liquidation of the assets in the facility. As with Maiden Lane II, the repayment will occur through cash flows from the underlying securities as they are paid off. Similarly, the Federal Reserve may hold the assets to maturity. Until this time, the government's investment remains exposed to risk of loss. Payments from the portfolio holdings of Maiden Lane III will be made in the following order and each category must be fully paid before proceeding to the next category:

1. necessary costs and operating expenses of Maiden Lane III;
2. amounts due under certain currency hedging transactions;
3. amounts to fund a reserve for necessary expenses payable by Maiden Lane III between monthly payment dates;
4. amounts to fund a reserve for payments that may be incurred by Maiden Lane III in connection with management of CDO defaults;
5. all principal due on the FRBNY loan;
6. all interest due on the FRBNY loan;
7. a release to Maiden Lane III, to repay AIG's \$5 billion equity contribution;

---

<sup>38</sup>AIGFP sold CDS on multi-sector CDOs. As a result, to unwind these contracts, Maiden Lane III was created to purchase the CDOs from AIG's CDS counterparties. In exchange for purchasing the underlying assets, the counterparties agreed to terminate the CDS contracts thereby eliminating the need for AIG to post additional collateral as the value of the CDOs fell.

- 
8. a release to Maiden Lane III, to pay distributions accruing to AIG on its equity contribution; and
  9. amounts due under certain currency hedging transactions to the extent the counterparty to the hedge is in default.

After Maiden Lane III has paid in full FRBNY and all other outstanding secured obligations, any remaining proceeds will be distributed between FRBNY's and AIG's subsidiaries. FRBNY will receive 67 percent of the remaining proceeds, while the AIG subsidiaries will receive 33 percent of any remaining proceeds.

FRBNY Also Can Provide Credit to AIG Subsidiaries but Intends to Reduce the Revolving Credit Facility by an Equivalent Amount

Also in March 2009, FRBNY was authorized to make new loans under section 13(3) of the Federal Reserve Act of up to an aggregate amount of approximately \$8.5 billion by acquiring notes issued by the special purpose vehicles that will be established by certain AIG domestic life insurance subsidiaries. As announced, the special purpose vehicles are to repay the notes from the net cash flows they receive from designated blocks of existing life insurance policies issued by the insurance companies. Effectively, these net cash flows are a portion of the operating profits of the life insurance companies. The proceeds of the notes would pay down an equivalent amount of outstanding debt under the Revolving Credit Facility. Therefore, this amount has no effect on the total government exposure. The amounts lent, the size of the haircuts taken by FRBNY, and other terms of the notes are to be determined based on valuations FRBNY deems acceptable.<sup>39</sup> Federal Reserve officials said that they are working to complete the transactions with AIG.

---

Treasury's OFS Is Using TARP's SSFI Program to Invest in AIG

On November 10, 2008, Treasury's OFS announced plans to use its SSFI program, under TARP, to purchase \$40 billion in AIG preferred shares. AIG entered into an agreement with Treasury on November 25, 2008, whereby Treasury agreed to purchase \$40 billion of fixed-rate cumulative preferred stock of AIG (Series D) and received a warrant to purchase approximately 2 percent of the shares of AIG's common stock.<sup>40</sup> As

---

<sup>39</sup>The haircut is the difference between the value of the collateral and the value of the loan. This haircut is calculated based on a percentage of the collateral value and varies by asset class.

<sup>40</sup>Treasury also took a number of additional steps to protect the government's interests, which we discuss later.

---

previously discussed, the proceeds of this sale were used to pay down AIG's outstanding balance on the Revolving Credit Facility by the same amount.<sup>41</sup> This transaction left the government's overall exposure unchanged but allowed AIG to reduce its debt outstanding and increase its equity position by \$40 billion. The rating agencies viewed this structure as more favorable. And as noted previously, AIG and FRBNY also agreed to reduce the amount available to borrow under the Revolving Credit Facility from \$85 billion to \$60 billion.

On April 17, 2009, AIG and Treasury entered into an agreement in which Treasury agreed to exchange its \$40 billion of Series D cumulative preferred stock for \$41.6 billion of Series E fixed-rate noncumulative preferred stock of AIG, allowing for a reduction in leverage and dividend requirements. The \$1.6 billion difference between the initial aggregate liquidation preference of the Series D stock and the aggregate liquidation preference of the Series E stock represents a compounding of accumulated but unpaid dividends owed by AIG to Treasury on the Series D stock. Because the Series E preferred stock more closely resembles common stock, principally because its dividends are noncumulative, rating agencies viewed the stock more positively when rating AIG's financial condition.

Also on April 17, 2009, Treasury provided a \$29.835 billion Equity Capital Facility to AIG whereby AIG issued to Treasury 300,000 shares of fixed-rate noncumulative perpetual preferred stock (Series F) and a warrant to purchase up to 3,000 shares of AIG common stock. As AIG draws on the Equity Capital Facility, the aggregate liquidation preference of the Series F stock is adjusted upward.<sup>42</sup> As of September 8, 2009, AIG had drawn down \$3.2 billion of the commitment.

---

<sup>41</sup>Cumulative preferred stock is a form of capital stock in which holders of preferred stock receive dividends before holders of common stock receive dividends, and dividends that have been omitted in the past must be paid to preferred shareholders before common shareholders can receive dividends.

<sup>42</sup>The securities purchase agreement indicates that the amount of \$29.835 billion is equal to \$30 billion minus \$165 million in retention payments made by AIGFP, AIG Trading Group, Inc., and their respective subsidiaries to their employees in March 2009.

---

## In Providing Assistance to AIG, the Federal Reserve and Treasury Have Taken Steps to Protect the Government's Interest, but Risks Still Remain

Federal assistance to the private sector includes accountability measures to help ensure that Congress and the public can have confidence that the assistance is used in a manner consistent with the identified objectives and that the government's interests are being protected. In previous work we have identified fundamental principles that can serve as a framework for considering federal government financial assistance to large firms.<sup>43</sup> One of the key principles of this framework is to protect the government's interests. Given the significant financial exposure the government may assume, any federal assistance to the private sector should include appropriate mechanisms to protect taxpayers from excessive or unnecessary risks.

In crafting the government's loans to and investments in AIG, the Federal Reserve and Treasury have taken a number of actions aimed at protecting the government's interests, including (1) making loans that are secured with collateral; (2) instituting certain controls over management, including loan covenants and restrictions on executive compensation; and (3) obtaining compensation for risks, including dividends, interest, and fees. The Federal Reserve and Treasury have also appointed staff and hired advisors to monitor the operations of AIG and routinely receive periodic reports about the status of its condition and restructuring. However, while these actions may serve to help protect the government's interests, risks remain.

---

## All FRBNY Loans Are Secured by AIG Assets

In lending to AIG, FRBNY has drafted credit agreements that contain provisions for securing the loans. FRBNY took AIG's pledge of a portion of its assets, including its ownership interests in its domestic and foreign insurance subsidiaries, as collateral on the Revolving Credit Facility. Moreover, when the facility was reduced from \$85 billion to \$60 billion at the November 2008 restructuring, the posted collateral remained unchanged. While FRBNY believes that the pledged collateral is generally sufficient to repay the debt AIG owes to FRBNY, AIG's ability to divest its assets to make repayment relies heavily on conditions in financial markets. Moreover, as discussed above, the Federal Reserve expects to reduce AIG's outstanding debt by accepting a preferred ownership interest in certain AIG life insurance holding companies in lieu of a cash payment.

---

<sup>43</sup>GAO, *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-242T](#) (Washington, D.C.: Dec. 4, 2008); *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-247T](#) (Washington, D.C.: Dec. 5, 2008); and [GAO-09-553](#).

---

While the amount of debt would be reduced, FRBNY will assume investment risk that FRBNY may lose on the amount of the investment.

---

### While AIG Continues to Manage the Company, the Federal Reserve and Treasury Have Instituted Certain Controls over Management

While the government has not taken over management of AIG, it has taken a number of steps to create certain controls over AIG's management of the company. For example, FRBNY has used its rights as a creditor to work with AIG's new management team to help wind down AIGFP and to oversee AIG's restructuring and divestiture strategy. Due to the government's large loans to and investments in AIG, FRBNY has observer status at board of director meetings and Treasury has certain rights to elect directors. The Federal Reserve noted in its September 2008 report that following the implementation of the Revolving Credit Facility, FRBNY had regular contact with AIG senior management, and FRBNY representatives attended all AIG Board of Directors meetings as observers. According to the Federal Reserve, FRBNY, and Treasury, the Federal Reserve and FRBNY have 20-25 staff assigned to monitor AIG. FRBNY has also hired professional advisors to assist in monitoring AIG. FRBNY officials said they receive reports on a daily and weekly basis, in FRBNY's role as a creditor, to track the ongoing performance of AIG. For example, reports include cash forecasts, liquidity updates, and regulatory developments. In addition, as Treasury's investment in AIG has grown, the staff responsible for monitoring its condition and restructuring efforts have grown from 1 to 4. Like the Federal Reserve, Treasury also receives periodic reports as required by its securities purchase agreements. AIG told us, and the Federal Reserve and Treasury officials confirmed, that any substantial cash outlays are disclosed to the government before they occur. These measures were taken to help ensure that government staff are available to monitor the government's large investment in the company.

In addition, the Federal Reserve announced that, as a condition of establishing the initial \$85 billion credit facility, a trust established for the sole benefit of the United States Treasury would become the majority equity investor in AIG.<sup>44</sup> This was achieved through the establishment of an independent trust to manage Treasury's equity interest in preferred

---

<sup>44</sup>The Treasury's equity interest is managed by three trustees. The trust agreement provides that the trust is for the sole benefit of the Treasury, which means that any property distributable to the Treasury as a beneficiary shall be paid to the Treasury for deposit into the U.S. Treasury General Fund as miscellaneous receipts. See AIG Credit Facility Trust Agreement, Section 1.01, January 16, 2009.

---

shares (Series C) of AIG.<sup>45</sup> When the trust agreement was executed in January 2009, the Series C stock was convertible into approximately 77.9 percent of the issued and outstanding shares of common stock of AIG.<sup>46</sup> Proceeds from the Credit Facility Trust are to go directly to the Treasury for the benefit of taxpayers. The Credit Facility Trust is intended to prevent inherent conflicts of interest that could arise from direct government or Federal Reserve control of AIG.

The three trustees who manage the trust are required to be independent of the Federal Reserve and FRBNY, and all have corporate management experience. According to the terms of the Credit Facility Trust agreement, the trustees are responsible for managing the AIG equity stake in matters such as voting and rights associated with shareholders, but they are to leave day-to-day management of AIG to its officers. For example, according to Treasury officials with whom we spoke, the trustees used their voting power to vote in a majority of new board members who subsequently hired a new chief executive officer in August 2009. However, FRBNY and Treasury continue to have their own relationship and conduct their own monitoring of AIG operations. The trustees are also accountable for developing a plan to dispose of the shares over time. FRBNY is also working with Treasury and the trustees to ensure that AIG reviews and updates its corporate governance. While the Credit Facility Trust was intended to protect the taxpayers' interests, the agreement clearly holds AIG responsible for the day-to-day operations and management of the company and makes the trustees autonomous from outside influence. Some in Congress have questioned the trust structure and whether it should be used as a model for providing government assistance to other big companies. We are conducting a joint review with SIGTARP of the government's management and governance of its ownership interests and plan to address these issues as part of that ongoing work.

---

<sup>45</sup>See FRBNY press release announcing the establishment of the AIG Credit Facility Trust, <http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.html>.

<sup>46</sup>Under the terms of the Series C preferred stock issuance, the preferred stock is convertible into AIG's common stock. The conversion formula provides that the trust will receive 79.9 percent of AIG's common stock on, less the percentage of common stock that may be acquired by or for the benefit of Treasury as a result of warrants or other convertible preferred stock held by Treasury. Treasury received a warrant to purchase a number of shares equal to 2 percent of AIG's common stock in connection with its purchase of Series D preferred stock, and an additional warrant to purchase AIG common stock in connection with its purchase of Series F preferred stock. Proceeds from the sale of the trust stock will be deposited in the U.S. Treasury General Fund.

---

As another protective measure, the FRBNY loan agreement includes covenants to prevent AIG from engaging in actions that would be detrimental to the loans provided and ultimately the government's interests. For example, the loan agreement precludes AIG from incurring additional debt, paying dividends, and making capital expenditures without the approval of FRBNY. Moreover, Treasury's securities purchase agreements further restrict AIG's ability to declare dividends, lobby, and repurchase stock as long as Treasury has equity in the company. Also as part of its equity investments, Treasury required that if AIG does not pay dividends due for four dividend periods, consecutive or not, Treasury will be able to directly elect the greater of two directors or a number of directors equal to 20 percent of the total number of directors to the AIG Board of Directors. As of September 2009, AIG had not declared and paid the three scheduled dividend payments since the inception of the preferred equity investments.<sup>47</sup> According to Treasury, if AIG fails to make its next dividend payment due on November 1, Treasury will be able to directly elect at least two board members.

Finally, Congress, the Federal Reserve, and Treasury have taken steps to limit executive compensation.<sup>48</sup> According to the Federal Reserve Chairman, the Federal Reserve has pressed AIG to ensure that all compensation decisions are covered by robust corporate governance, including internal review, review by AIG's Compensation Committee of the Board of Directors, and consultations with outside experts. Under this framework, and in agreement with Treasury, AIG has limited the salary, bonuses, and other types of compensation for senior management for 2008 and 2009. Moreover, Congress, Treasury, and the New York Attorney General have also imposed restrictions on compensation at AIG. Following the \$165 million payout of retention bonuses to AIGFP staff in March 2009, AIG now vets payouts of bonuses with Treasury. AIG has yet to make its scheduled July 2009 retention bonus payment pending feedback from Treasury. See appendix III for a complete discussion of Treasury's executive compensation requirements.

---

<sup>47</sup> AIG only has to make dividend payments when it declares dividends.

<sup>48</sup> SIGTARP has an ongoing audit that will provide an in-depth assessment of AIG's executive compensation programs and the adequacy of federal oversight of these programs.

---

## The Federal Reserve and Treasury Have Taken a Number of Steps to Help Ensure That They Will Be Compensated for the Risks Involved in the Assistance

The Federal Reserve and Treasury have taken a number of steps to ensure they will be compensated for the risks they are assuming on behalf of AIG. First, FRBNY required an initial gross commitment fee of 2 percent totaling an estimated \$1.7 billion.<sup>49</sup> In addition, FRBNY is charging interest on the outstanding balance of the Revolving Credit Facility as well as any unused commitment. Initially, the rate on outstanding balances was the 3-month London Interbank Offered Rate, with a 3.5 percent minimum. As part of the November 2008 restructuring, the interest rate on the loan was reduced to the London Interbank Offered Rate plus 3 percent, and the unused commitment fee was reduced to an annualized rate of .75 percent from 8.5 percent.<sup>50</sup> In March 2009 the 3.5 percent minimum rate requirement was removed. While the Federal Reserve viewed the restructured terms of the assistance as necessary to address AIG's continued challenges following the initial assistance, some critics questioned whether they eroded the government's interests. FRBNY will receive less compensation for its risk exposure, but in light of AIG's continued reliance on the facility to pay its continuing obligations, including interest and commitment fees on the facility, the Federal Reserve concluded that restructuring the debt was in the government's interest.

Second, the Federal Reserve negotiated that upon repayment of outstanding loans made by FRBNY to Maiden Lanes II and III, and AIG's subordinated interest in the SPVs, approximately 83 percent and 67 percent, respectively, of any residual income will be apportioned to FRBNY, with the remainder going to AIG. In addition, according to the Federal Reserve, AIG also cannot receive any return on its stakes in these vehicles until the FRBNY loans have been repaid in full. Thus, AIG is also required to take the first loss up to a predetermined amount should there be any losses.<sup>51</sup>

Third, AIG is also required to pay dividends of 10 percent per annum on Treasury's cumulative preferred share investment.<sup>52</sup> While the March 2009

---

<sup>49</sup>A gross commitment fee normally is paid at the initiation of a credit facility agreement and is a percentage of the total amount committed by a lender to the borrower.

<sup>50</sup>An unused commitment fee is a percentage of the unused, or undrawn, portion of a revolving credit facility or loan commitment.

<sup>51</sup>Under the agreements, AIG is to incur the first \$1 billion in losses under Maiden Lane II and the first \$5 billion under Maiden Lane III.

<sup>52</sup>See Securities Purchase Agreement, Nov. 25, 2008.

---

restructuring authorized AIG to convert the shares from cumulative preferred shares to noncumulative preferred shares, thereby providing AIG relief from paying dividends on the preferred shares when dividends are not declared, it did not decrease the 10 percent requirement.<sup>53</sup> Additionally, the accrued but unpaid dividends from the initial capital investment were added to the amount outstanding for purposes of the stock conversion. Treasury viewed the conversion as necessary to further stabilize AIG and protect financial markets and protect its investment. AIG is scheduled to make a dividend payment in November 2009; however, there is no indication as to whether AIG will declare and make this payment.

Fourth, as part of the various purchases of equity from AIG, Treasury obtained warrants in connection with each capital commitment.<sup>54</sup> The initial \$40 billion capital injection under the SSFI program specified that Treasury would receive a warrant to purchase 2 percent of the then issued and outstanding shares of common stock with an exercise, or purchase, price of \$2.50 per share. Similar to other TARP investments, this warrant has a term of 10 years. These terms remained when the Series D shares were exchanged for the Series E shares in April 2009. As noted above, the agreement establishing the Equity Capital Facility also provided that Treasury would receive a warrant to purchase common stock equal to 3,000 shares of the then issued and outstanding shares of common stock with an exercise price of \$2.50 per share.

Finally, FRBNY has agreed to obtain an equity interest in certain AIG life insurance subsidiaries by accepting preferred ownership interests in AIG life insurance holding companies to facilitate an alternative means to recoup a portion of FRBNY's loan to AIG. While the equity interest will give the government an opportunity for upside gain, it also will continue to expose the government to risk that its investment may not be recouped.

---

<sup>53</sup>See Securities Exchange Act, April 17, 2009.

<sup>54</sup>If the Secretary of the Treasury purchases troubled assets under the act from a publicly traded financial institution, section 113(d)(1)(A) of the act, 12 U.S.C. § 5223(d), requires that it receive a warrant giving the Secretary the right to receive nonvoting common stock or preferred stock, or voting stock for which Treasury agrees not to exercise voting power. The act requires that the warrant or senior debt instrument be designed to provide for the reasonable participation by the Secretary, for the benefit of taxpayers, in equity appreciation (in the case of a warrant) or a reasonable interest rate (in the case of a debt instrument). The warrant is also to provide additional protection for the taxpayers against losses from the sale of assets by the Secretary under the act and the administrative expenses of TARP.

---

The long-term value of stakes in the companies to be held by FRBNY will also depend on the companies' performance and eventual valuation by the market or prospective buyer.

---

### Despite Efforts to Protect the Government, Some Risks Remain

Despite these efforts, the Federal Reserve and Treasury continue to carry significant exposure as a result of the assistance to AIG. Until the debt is repaid and the equity interests are repurchased or sold, the Federal Reserve and Treasury remain exposed to credit and investment risks. The ongoing potential of systemic risk remains a concern until AIG is restructured and market conditions improve. According to Treasury, "an orderly restructuring is essential to AIG's repayment of the support it has received from U.S. taxpayers and to preserving financial stability." However, an orderly restructuring depends heavily on AIG's ability to successfully divest assets. According to AIG's former chief executive officer, AIG's plan is to sell businesses that constitute almost 65 percent of the company and employ approximately 70,000 people. According to Treasury officials, the current chief executive officer is re-evaluating this plan.

In March 2009, the Federal Reserve and Treasury most recently noted their commitment to AIG in order to avoid future market disruptions and have acknowledged that AIG's ability to sell its assets depends on financial markets continuing to stabilize and its assets maintaining their market value. While this level of government commitment has helped AIG maintain its key credit ratings, which are important for AIG's ongoing financial stability and restructuring efforts, it also exposes the government to risks that must continue to be monitored and managed. In addition, the Federal Reserve's interest as a creditor must be appropriately balanced with those of Treasury as an investor. We have ongoing work with SIGTARP that will more fully address how the government is managing its investments in AIG and other institutions that have received extraordinary assistance.

---

## Federal Assistance Has Helped Stabilize AIG's Financial Condition, but Indicators Suggest that It Is Too Soon to Evaluate AIG's Ability to Restructure Its Business and Repay the Government

While the federal assistance provided to AIG has helped stabilize its operations, a number of variables will continue to affect the company's ability to restructure its business and repay the government. AIG's recovery depends not only on the long-term health of the company but also on market conditions, and other factors. Consistent with our mandated responsibilities to assess the effectiveness of TARP programs and our development of macroeconomic indicators of TARP's overall effectiveness, we have developed a number of microeconomic indicators to help Congress and the public monitor the level of financial risk posed by AIG and the status of AIG's restructuring and repayment efforts. Our indicators track the following elements:

- status of AIG's financial condition,
- status of the wind down of AIGFP,
- financial condition AIG's insurance subsidiaries, and
- amount of repayment of federal assistance.

The indicators, which are discussed in detail in appendix V, are designed to help guide Congress and the public in their oversight efforts and raise questions for AIG, Treasury, and Federal Reserve officials about observed trends and the status of progress toward achieving desired goals. Because no single indicator provides a definitive measure of AIG's progress, they should be considered collectively and evaluated in the context of the ongoing situation. Moreover, these indicators should not be viewed as exhaustive, and there may be other indicators, such as those that track the market value of AIG's assets, that also would provide insights into the status of AIG's operations and ability to repay. We plan to continue to refine these indicators and to provide periodic updates as part of our ongoing oversight of TARP.

---

## Federal Assistance Has Been Key to Helping Stabilize AIG's Financial Condition

While AIG's financial condition stabilized or improved in the second quarter of 2009 by several measures—including liquidity, credit ratings, shareholders' equity, and operating income—most of this improvement was attributable to the assistance it received from the Federal Reserve and Treasury.

- **Liquidity.** AIG's primary sources of liquidity continue to be the FRBNY Revolving Credit Facility and Treasury's equity facility. While the long-term goal is for the company to be able to acquire its liquidity from private

---

sources and its own operations instead of the government, AIG remains heavily reliant on federal assistance to meet its liquidity needs.

- **Credit ratings.** Overall, AIG's credit ratings have remained stable since May 2009, due in part to the support of the government. Although Fitch's credit ratings of AIG in the long-term debt, property/casualty insurer, and life insurer categories were lower in May 2009 than in March 2009, AM Best, Moody's, and Standard & Poor's (S&P) maintained the same ratings in those categories.<sup>55</sup> Fitch's downgrades did not have a major effect on AIG's insurance business. However, if AIG becomes unable to meet its obligations, rating agencies could downgrade the company's key credit ratings, which could impede its restructuring efforts. Conversely, an upgrade in AIG's credit ratings would indicate an improvement in its condition.
- **Shareholders' equity.** Trends, level, and composition of AIG's consolidated shareholders' equity—generally a company's total assets minus total liabilities—are also indicators of solvency. The efforts of AIG, FRBNY, and Treasury to restructure the composition of the federal assistance have reduced AIG's debt and boosted its shareholders' equity. Moreover, the largest contributor to leveling off shareholders' equity has been paid-in capital primarily associated with the federal assistance and investment.<sup>56</sup> In the second quarter of 2009, AIG's accumulated deficits were cut to \$3.1 billion from of \$16.7 billion in the previous quarter.
- **Operating income and losses.** Operating income and losses include the profits or losses generated by AIG's operating companies and provide a measure of AIG's financial condition. A large portion of AIG's losses in the second half of 2008 were associated with investment losses in its life insurance and retirement services subsidiaries. Another significant portion of AIG's operating losses in the fourth quarter of 2008 resulted from interest expense and fees on the FRBNY Revolving Credit Facility, which totaled over \$10 billion. In the first quarter of 2009, these losses were cut dramatically due to the sale of certain assets to the Maiden Lane facilities created by FRBNY, the unwinding of portions of AIGFP's portfolio of assets, and the restructuring of the assistance provided to AIG, which reduced its debt and the interest and fees paid on the debt. In the second

---

<sup>55</sup>AIG's long-term debt was rated at A-/Negative (S&P) and A3/Negative (Moody's), and its short-term debt was rated at A-1 (S&P) and P-1 (Moody's).

<sup>56</sup>Paid-in capital is equity capital provided by investors in exchange for common or preferred stock.

---

quarter of 2009, AIG reported an operating income before taxes of \$1.3 billion, compared to an operating loss of \$8.8 billion in the same quarter of the previous year. Increased profitability in its various operating segments could improve AIG's ability to sell its noncore assets, restructure its operations, and repay federal assistance, while increased losses could pose an ongoing threat to its viability.

---

### Maiden Lane III Enabled AIGFP to Unwind Most of Its Riskiest Positions and, with Other Unwinding Actions, Contributed to Progress in AIG's Financial Strength

FRBNY's creation of Maiden Lane III enabled AIGFP to unwind its book of CDS that protects multi-sector CDOs, a major source of the liquidity strain.<sup>57</sup> In the fall of 2008, AIGFP developed a strategy to unwind its derivatives portfolio in which it attempted to strike the most efficient balance between loss mitigation and the rapid unwinding of this portfolio. Initially, AIGFP focused on unwinding the riskiest books in its portfolio, and according to AIGFP, this goal has been substantially accomplished. Overall, AIGFP has fewer outstanding trade positions and fewer books of business. In addition, two areas that should be monitored closely—the amount of underlying CDOs rated below BBB and AIG CDS premiums—only started to show signs of stabilizing in the second quarter of 2009. While AIGFP officials originally estimated that the unwinding of positions would take from approximately 2 to 4 years, they now believe that the majority of the unwinding can be completed by the end of 2009, provided the markets remain stable and AIG maintains its credit rating.

AIGFP monitors the status of four indicators, which have all declined, indicating progress in winding down AIGFP's operations (see app. V). First, the number of outstanding trade positions—the number of AIGFP's outstanding long and short derivative contracts—has continued to decline. Second, the gross notional amount of derivatives outstanding, which is a measure of the size of AIGFP's derivatives portfolio (not actual risk), has also continued to fall slightly. Third, 5 of the 22 businesses or risk books that AIGFP is winding down have “decreased.”<sup>58</sup> Finally, the number of employees or the staff size of AIGFP, which may change for several

---

<sup>57</sup>A multi-sector CDO is a CDO is backed by a combination of corporate bonds, loans, asset-backed securities, or mortgage-backed securities.

<sup>58</sup>In its switch from growth and profit maximization to risk mitigation and unwinding, AIGFP reorganized its business into 22 separate risk books determined in part by type of risk, which fall into the following five groupings: (1) credit books, (2) investment securities and liabilities books, (3) capital markets books, (4) principal guaranty products, and (5) private equity and strategic investment books. According to AIG, decreased means a book of business that has reduced in size by at least 75 percent.

---

reasons, such as the sale of businesses, closing offices, or employee resignations, has continued to decrease.

We also found that AIGFP's unwinding of its super senior CDS portfolio appears to be progressing, as indicated by the following measures:<sup>59</sup>

- The net notional amount has decreased over the past year, potentially indicating progress in unwinding AIGFP's obligations.<sup>60</sup>
- The fair value of derivative liability has also decreased, indicating that the market views AIG's liabilities as being less risky.<sup>61</sup> This should enable AIGFP to eliminate these liabilities at less expense.
- The unrealized market valuation gain or loss tracks the change in the fair value of AIGFP's derivative liabilities from quarter to quarter. This value has fluctuated over the past year but trended upward in the second quarter of 2009, indicating a positive change in fair values.

Activity in selected aspects in AIGFP's portfolio also provides information about the status of AIGFP's unwinding efforts.

- AIGFP's book of regulatory capital CDS that provide protection to European banks against default from certain loans on their balance sheets has seen a steady decline in the net notional amount since the fall of 2008 and achieved a reduction in the fair value of the liabilities in the second quarter of 2009. Though these CDS contracts continue to have a high net notional value relative to the other types of products, AIGFP continues to believe that these contracts will expire or be called by counterparties with little to no cost to AIG. AIGFP does not plan to sell these contracts but plans to let them expire because management believes that trying to sell them would not be cost effective.

---

<sup>59</sup>The super senior CDS portfolio was written on the super senior tranche of CDO. The super senior layer comprises assets that typically receive a rating between BBB and AAA from rating agencies. For additional information, see AIG 2008 10K p.132.

<sup>60</sup>The net notional amount represents the maximum dollar level exposure for the portfolio.

<sup>61</sup>The fair value of derivative liability represents the fair market valuation of AIGFP's liabilities in each portfolio and provides an indicator of the dollar amount the market thinks AIGFP would need to pay to eliminate its liabilities.

- 
- The net notional and fair values of AIGFP's CDS on multisector CDOs dropped in the fourth quarter of 2008 when most of the assets in this category were sold to Maiden Lane III. Moreover, the amount of asset-backed securities rated below BBB has been significantly lower following the sale of most of these assets to Maiden Lane III, which helped stabilize the multi-sector CDOs portfolio since the third quarter of 2008.<sup>62</sup> However, with the exception of subprime mortgage-backed securities, from the fourth quarter of 2008 to the first quarter of 2009, the amount of underlying asset-backed securities rated below BBB rose in every category. By the second quarter some had begun to fall, but some remained elevated over 2008 levels. This indicates deteriorating credit quality of its other holdings including prime, commercial, and Alt-A mortgage-backed securities.
  - Finally, AIGFP has also shown some modest progress in reducing its CDS portfolios relating to corporate collateralized loan obligation portfolio and mezzanine tranches.

Another indicator of AIG's financial strength is the price of purchasing CDS protection against AIG defaulting on senior unsecured debt. This indicator measures what the market believes is AIG's probability of default. The higher the CDS premiums, the greater the market's expectation that AIG will default. Conversely, the lower the CDS premiums, the lower the market's expectation that AIG will default or the greater its confidence in AIG's financial strength. AIG's CDS premiums as of September 8, 2009, are lower than they were in the fourth quarter of 2008, but it is too soon to say whether they are stabilizing. As the Federal Reserve noted, the premium on AIG's CDS is based on both the market's assessment of the government's level of commitment to assist AIG as well as AIG's financial strength.

---

### AIG's Insurance Operations Show Some Signs of Recovery with the Life Insurance Companies Largely Aided by the Federal Assistance

The success of AIG's insurance operations is important to its restructuring plans. Indicators of their financial health have started to show signs of stabilizing and their long-term financial stability is vital to AIG's restructuring plans and the ultimate repayment of assistance. However, it will take several quarters of data to be able to determine more meaningful trends.

- **Levels of capital.** AIG's property/casualty insurers and domestic life insurance and retirement services companies have maintained levels of

---

<sup>62</sup>A rating of BBB indicates a lower medium grade investment. See appendix IV.

---

capital higher than the minimum requirement set by NAIC. However, without the federal assistance provided to AIG's domestic life and retirement companies associated with Maiden Lane II, the capital balance would not have been adequate to cover losses in 2008. Conversely, AIG's property/casualty companies have maintained levels of adjusted capital in excess of requirements with virtually no direct federal assistance.

- **Income gains and losses.** The life insurance and retirement services segment losses associated with investment activity through its securities lending program accounted for a significant portion of AIG's losses in the fourth quarter of 2008. The federal assistance provided through Maiden Lane II helped enable this segment to realize income gains from operations and post a moderate income gain in the second quarter of 2009.
- **Withdrawals and deposits.** In the fourth quarter of 2008, the life and retirement services segment saw a sharp decline in policyholders' contract deposits and a large spike in withdrawals. However, without more granular data, we cannot determine whether the withdrawals were driven by concerns about the condition of AIG specifically or by the overall economic downturn, which may have resulted in policyholders cashing in policies for economic reasons. The almost \$26 billion disparity between the withdrawals and deposits adversely affected the liquidity position of this segment in late 2008. However, the segment started to rebound in the first quarter of 2009 and by the second quarter of 2009, the gap had closed significantly to \$3 billion, bringing the amounts closer to historical levels. However, withdrawals continue to outstrip deposits and should be monitored.
- **Premiums written.** AIG's property/casualty insurance businesses are expected to be AIG's core business once it is restructured and divests other operations. Therefore, in monitoring the status of AIG's restructuring efforts, premiums written in this segment provide an indicator of AIG's ability to retain business and attract new business. However, this is not a perfect measure because multiple factors, including industry-wide factors such as softening or hardening markets, can affect premiums written. Nevertheless, changes in premiums written can also provide some indication of the success of AIG's efforts to retain and attract business, such as the formation of Chartis, Inc. and effectively rebranding the company. Through 2007, 2008, and the first quarter of 2009, premiums written by AIG's property and casualty subsidiaries trended downward, which closely followed the general industry trend. The current data are not clear as to whether this trend is leveling off.

---

## With Restructured Federal Assistance, AIG Has Begun to Repay Its Debt to the Government but the Success of These Repayment Efforts Is Unclear

The U.S. government has committed around \$182 billion in its efforts to prevent the failure of AIG.<sup>63</sup> As of September 2, 2009, \$120.9 billion had been used and, as discussed earlier in this report, the assistance has taken a variety of forms. Changes in the amount and composition of the federal assistance may provide insights about the overall condition of AIG and the extent of its reliance on federal assistance. The assistance falls into four broad categories: (1) debt owed by AIG to the government, (2) equity shares in AIG owned by the government, (3) other debt owe to the government on behalf of AIG, and (4) equity shares in AIG-related entities owned by the government. While most of the \$120.9 billion in assistance provided as of September 2, 2008, has been a \$38.8 billion secured loan balance to AIG via the FRBNY Revolving Credit Facility and Treasury's approximately \$45 billion purchase of preferred shares and outstanding balance on the equity facility, the government has also provided about \$37 billion in more indirect assistance by creating and making loans to Maiden Lanes II and III for the purchase of CDOs from AIG's counterparties and residential mortgage-backed securities from AIG. The other forms of indirect assistance have not been completed as of September 2, 2009.<sup>64</sup> For more detailed information, see appendix V.

The outstanding amount AIG owes as of September 2, 2009, on the FRBNY Revolving Credit Facility is almost \$39 billion, which includes loan principal, all capitalized interest and fees, and the amortized portion of FRBNY's initial commitment fee.<sup>65</sup> Since December 2008, the outstanding balance on the facility has remained fairly steady at around \$40 billion.

---

<sup>63</sup>This amount does not include AIG's use of the Federal Reserve's Commercial Paper Funding Facility.

<sup>64</sup>As discussed earlier in the report, the Federal Reserve plans to further modify the assistance provided to AIG. For example, on March 2, 2009, the Federal Reserve and AIG announced their intent to enter into a transaction in which FRBNY will purchase up to \$8.5 billion of securitization notes issued by newly formed special purpose vehicles that will receive the net cash flows from a block of life insurance policies held by AIG's domestic life insurance subsidiaries. When this transaction closes, AIG's outstanding balance and maximum available amount to borrow on the facility is expected to be reduced by up to \$8.5 billion. In addition, on June 25, 2009, the Federal Reserve and AIG entered into agreements in which AIG will transfer to FRBNY preferred equity interest in special purpose vehicles formed to hold AIA and ALICO. When this transaction is completed, the amount outstanding and the maximum amount available to borrow on the facility will be reduced by \$25 billion. The maximum amount available under the FRBNY facility will be \$25 billion as a result of a reduction from the AIA, ALICO, and securitization notes transactions.

<sup>65</sup>Outstanding loans are the average weekly balance of credit extended to AIG under the Revolving Credit Facility, as reported by FRBNY.

---

Changes in amounts owed on the facility fluctuate weekly and could indicate increased liquidity needs related to restructuring decisions or decreased liquidity needs, resulting in payments to the facility. Similar to the liquidity measure discussed earlier, the balance of the facility provides some indication of AIG's ongoing reliance on federal assistance to fund its obligations.

The Maiden Lane II and Maiden Lane III portfolios are funded primarily by loans from FRBNY, which are not debt owed by AIG but rather are to be repaid from the maturity or liquidation of assets held in each facility.<sup>66</sup> The amount owed on the loans and their portfolio values peaked in December 2008 and subsequently have trended downward.<sup>67</sup> The Federal Reserve said it plans to hold on to the Maiden Lane assets until they mature or increase in value to a point where the Federal Reserve can maximize the amount of money recovered through a sale of assets. While the portfolio value has declined slightly, the Federal Reserve continues to believe that the assets held in the Maiden Lanes will appreciate over time and the Maiden Lanes will continue to receive payments of principal and interest on their portfolios before maturity or sale. As assets mature, are sold, or pay interest, any portion remaining after paying operating expenses of the Maiden Lanes goes toward the loan balance. These payments will reduce the amount of principal owed to the FRBNY. By monitoring these balances, we can track the status of AIG's repayment of the assistance. As of September 2, 2009, proceeds from the Maiden Lanes had been used to pay down \$6.8 billion of the outstanding principal.

Finally, as part of AIG's restructuring plan, the company is selling some of its businesses. Tracking the sales of AIG entities and net cash proceeds from these sales provides an additional indicator of the status of AIG's restructuring efforts. AIG has realized \$8.6 billion in total proceeds from sales as of September 30, 2009, \$5 billion of which was cash. AIG plans to use the cash proceeds from these sales to meet its obligations, including the FRBNY Revolving Credit Facility, to cover capital needs, and to provide loans to its subsidiaries. As of May 1, 2009, AIG said that it had paid down \$1.4 billion on the FRBNY Revolving Credit Facility from the proceeds of sales. AIG stated that it expects to have \$4.6 billion available

---

<sup>66</sup>The order in which payments will be made from the net portfolio holdings of these facilities is described in section two of this report.

<sup>67</sup>The portfolio value is based on the market value of the underlying assets and will mirror the change in value of those assets.

---

to pay toward the facility from the proceeds of sales that it has recently closed. Sales in 2009 have far surpassed those in 2008.

As a result of the determination that AIG posed systemic risk to the financial system in light of the unfolding events of the last year, the Federal Reserve and Treasury have taken unprecedented steps to help stabilize AIG's operations and allow for an orderly divestiture of its operations. While the second quarter of 2009 provided some signs of improvement over the first quarter, the company continues to rely heavily on the federal government as its source of liquidity and capital. AIG's insurance companies have started to show some positive signs in the second quarter of 2009, but it is too early to determine a trend. Likewise, AIGFP has stated it has unwound a substantial amount of its riskiest books with expectations of unwinding the majority of its books by the end of 2009. AIG is continuing to sell some of its businesses, the Maiden Lanes have begun to make payments on their facilities, and Federal Reserve officials remain positive about future repayment from the Maiden Lanes.

The sustainability of any positive trends of AIG's operations and repayment efforts is not yet clear. The government's ability to recoup the federal assistance money depends on the long-term health of AIG, its sales of certain businesses, and the maturation or sale of assets in the Maiden Lanes, among other factors. Although the Federal Reserve and Treasury have yet to develop specific milestones and targets for AIG's progress, the Federal Reserve's secured loan, which has a 5-year term, carries an implicit timeline. Treasury has publicly stated that it wants to sell its investments back to the companies in which it has invested under TARP as soon as possible. We will continue to monitor these issues in our future work.

---

## Agency Comments and Our Evaluation

We provided a draft of this report to the Federal Reserve, FRBNY, and Treasury for comment. We also provided an informational copy to AIG for its review. We received written comments from Treasury that are reprinted in appendix I. The Federal Reserve and FRBNY did not provide written comments. We received technical comments from Treasury, the Federal Reserve, FRBNY, and AIG that are incorporated, as appropriate.

In its written comments Treasury noted that it had no substantive comments on the report.

---

We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, SIGTARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

Orice Williams Brown is our point of contact on this report. She can be reached at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix VI.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Gene L. Dodaro  
Acting Comptroller General  
of the United States

---

*List of Congressional Committees*

The Honorable Daniel K. Inouye  
Chairman  
The Honorable Thad Cochran  
Vice Chairman  
Committee on Appropriations  
United States Senate

The Honorable Christopher J. Dodd  
Chairman  
The Honorable Richard C. Shelby  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Kent Conrad  
Chairman  
The Honorable Judd Gregg  
Ranking Member  
Committee on the Budget  
United States Senate

The Honorable Max Baucus  
Chairman  
The Honorable Charles E. Grassley  
Ranking Member  
Committee on Finance  
United States Senate

The Honorable David R. Obey  
Chairman  
The Honorable Jerry Lewis  
Ranking Member  
Committee on Appropriations  
House of Representatives

The Honorable John M. Spratt, Jr.  
Chairman  
The Honorable Paul Ryan  
Ranking Member  
Committee on the Budget  
House of Representatives

---

The Honorable Barney Frank  
Chairman  
The Honorable Spencer Bachus  
Ranking Member  
Committee on Financial Services  
House of Representatives

The Honorable Charles B. Rangel  
Chairman  
The Honorable Dave Camp  
Ranking Member  
Committee on Ways and Means  
House of Representatives

---

# Appendix I: Comments from the Department of the Treasury

---



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 17, 2009

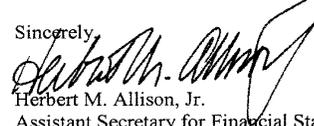
Thomas J. McCool  
Director, Center for Economics  
Applied Research and Methods  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. McCool:

Thank you for providing the Department of the Treasury (Treasury) the opportunity to review and comment on your draft audit report regarding government assistance to American International Group (AIG). Treasury appreciates the Government Accountability Office's (GAO) comprehensive review of actions taken by Treasury and the Federal Reserve to assist AIG in order to stabilize the financial system. This letter provides Treasury's official response to the GAO's study.

Treasury has reviewed the report for factual accuracy and provided technical corrections to GAO staff. We have no substantive comments as to the content of the report. We thank you again for your continuing work in reviewing Treasury's actions to stabilize the financial system.

Sincerely,

  
Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

Enclosure

---

# Appendix II: Overview of the American International Assurance and American Life Insurance Company Transactions

---

In March 2009, the Board of Governors of the Federal Reserve System (Federal Reserve) and American International Group, Inc. (AIG) announced that two special purpose vehicles would be formed to hold all of the common stock in American International Assurance (AIA) and American Life Insurance Company (ALICO)—two life insurance companies—on behalf of the Federal Reserve Bank of New York (FRBNY). Upon closing of this transaction, AIG's debt outstanding on the \$60 billion Revolving Credit Facility created by FRBNY in September 2008 would be reduced by \$25 billion (\$16 billion from AIA and \$9 billion from ALICO).<sup>1</sup> AIG and FRBNY reached a final agreement on June 25, 2009, on the terms of the agreement, which is expected to close in 2009. Under the terms of the agreements, AIG will retain 100 percent of the common interests of the AIA and ALICO special purpose vehicles (SPV) but FRBNY will have a substantial ownership interest in the form of preferred interests in the SPVs. AIG will retain 100 percent of the voting power of the SPVs, including the right to appoint the boards of managers of both SPVs, but FRBNY will have certain governance rights. After the common stock of ALICO and AIA is transferred to the SPVs, the SPVs are expected to be sold or entered into an initial public offering. The proceeds from the sale or offering of AIA's SPV will be divided in the following order and each category must be fully paid before proceeding to the next lower category (see fig. 4):

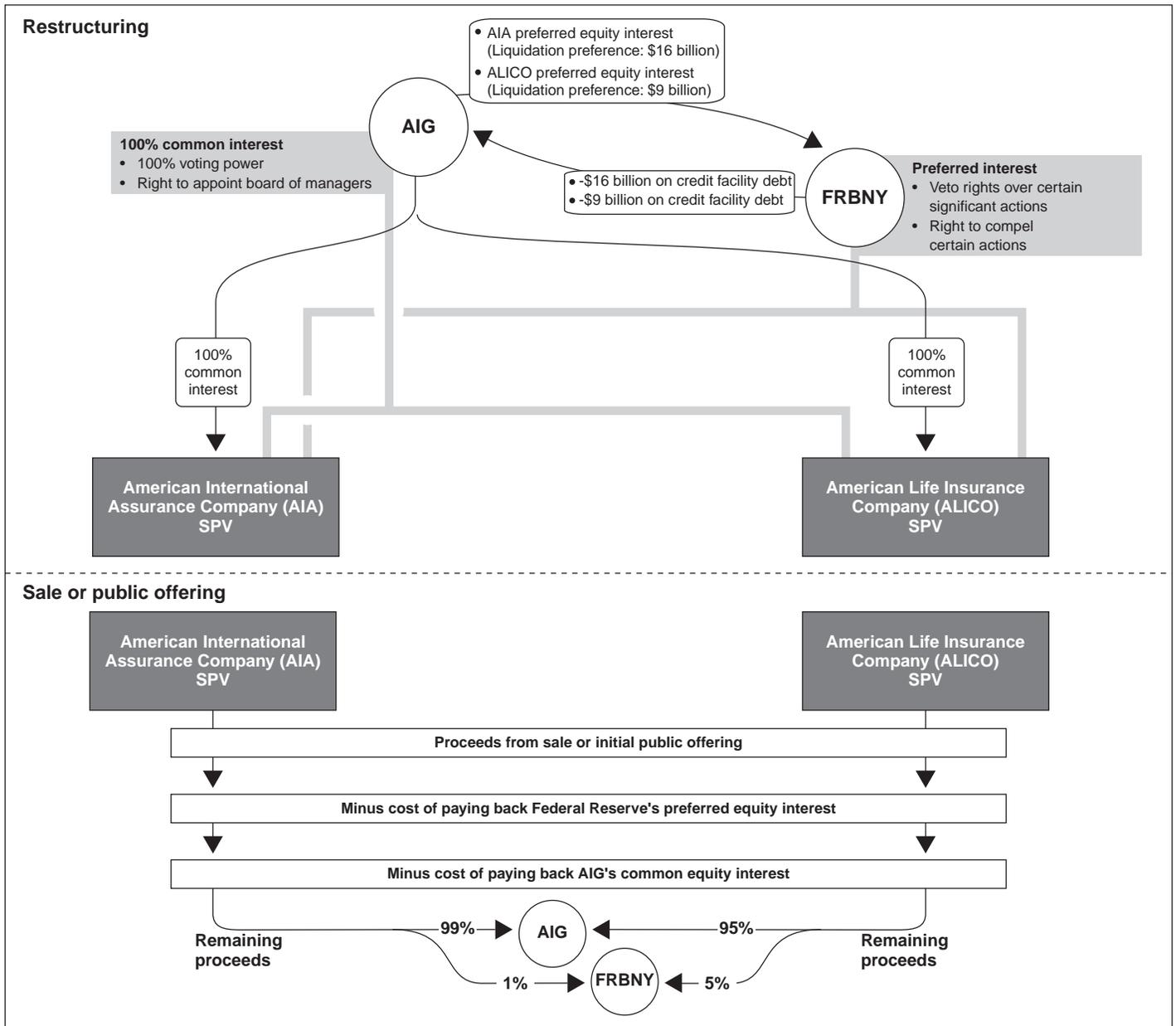
1. pay the current quarter return on equity owed to FRBNY;
2. pay 1 percent of net income for all previous years to FRBNY;
3. pay the liquidation preference of \$16 billion to FRBNY;
4. pay \$9 billion to the common members of the SPV, plus 99 times the amount paid in clause 2 above, plus the amount of any additional capital contributions made by the common members; and
5. pay 99 percent of any remaining proceeds from the sale to the common members of the SPV. FRBNY is entitled to 1 percent of any remaining proceeds from the sale of the SPV.

---

<sup>1</sup>The ceiling on the Revolving Credit Facility was initially \$85 billion but was subsequently lowered as part of the November 2008 restructuring.

**Appendix II: Overview of the American International Assurance and American Life Insurance Company Transactions**

**Figure 4: AIG Restructuring and SPV Sale**



Source: GAO.

The proceeds from the sale of ALICO SPV will be divided in the following order and each category must be fully paid before proceeding to the next lower category (see fig. 4):

1. pay the current quarter return on equity owed to FRBNY;
2. pay the liquidation preference of \$9 billion to FRBNY;
3. pay \$6 billion to the common members of the SPV, plus the amount of any additional capital contributions made by the common members;  
and
4. pay 95 percent of any remaining proceeds from the sale to the common members of the SPV. FRBNY is entitled to 5 percent of any remaining proceeds from the sale of the SPV.

According to Federal Reserve officials, the transfer of the preferred interest in the AIA and ALICO SPVs is expected to occur before the end of 2009. FRBNY's preferred interests will entitle it to limited veto rights over certain significant actions and the right, subject to certain restrictions, to compel the SPVs to take certain actions, including issuing an initial public offering or selling the SPVs.

---

# Appendix III: Overview of the Executive Compensation Restrictions

---

The Emergency Economic Stabilization Act of 2008 (the act) included limitations on executive compensation for firms participating in the Troubled Asset Relief Program (TARP). Accordingly, the November 25, 2008, agreement between American International Group, Inc. (AIG) and the Department of the Treasury (Treasury) concerning the purchase of Series D preferred shares included a requirement that AIG comply with the act's executive compensation requirements. Also on November 25, AIG announced its agreement to executive compensation restrictions that went beyond the act's requirements. In addition to eliminating 2008 annual bonuses and salary increases through 2009 for AIG's top management, and eliminating salary increases through 2009 for a group of senior executives, AIG also announced plans to develop a funding structure to ensure that no taxpayer dollars were used for annual bonuses or future cash performance awards to the top 60 members of management. The American Recovery and Reinvestment Act of 2009 (ARRA) restated and amended the act's executive compensation provisions; the terms of Treasury's subsequent investments in AIG require the firm to be in compliance with the act's executive compensation and corporate governance requirements, as amended by ARRA, as well as any related guidance or regulations.

On June 10, 2009, Treasury announced an interim final rule to implement the executive compensation and corporate governance provisions of the act, as amended by ARRA, as well as to adopt certain additional standards deemed necessary by the Secretary to carry out the purposes of the act.<sup>1</sup> The interim final rule requires that recipients of TARP financial assistance meet standards for executive compensation and corporate governance. The requirements generally include

- limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of TARP recipients;<sup>2</sup>

---

<sup>1</sup>TARP Standards for Compensation and Corporate Governance, 74Fed. Reg. 28, 394 (June 15, 2009) (to be codified at 31 C.F.R. Part 30). Pursuant to section 101(c) of the act, the Secretary is authorized to issue regulations and other guidance that the Secretary deems necessary and appropriate to carry out the purposes of the act. The interim final rule became effective on June 15, 2009, and the public comment period ended on August 14, 2009.

<sup>2</sup>The senior executive officers are generally the principal executive officer, the principal financial officer, and the three most highly compensated executive officers (other than the principal executive officer and the principal financial officer).

- provision for the recovery of any bonus, retention award, or incentive compensation paid to a senior executive officer or the next 20 most highly compensated employees based on materially inaccurate statements of earnings, revenues, gains, or other criteria;
- prohibition on making any large severance payments, or “golden parachute” payments, to a senior executive officer or any of the next 5 most highly compensated employees;
- prohibition on the payment or accrual of bonuses, retention awards, or incentive compensation to senior executive officers or certain highly compensated employees, subject to certain exceptions for payments made in the form of restricted stock; and
- prohibition on employee compensation plans that would encourage manipulation of earnings reported by TARP recipients to enhance employees’ compensation.

The new interim regulations also require the establishment of the Office of the Special Master for TARP Executive Compensation (Special Master) to address the application of the rules to TARP recipients and their employees. The duties and responsibilities of the Special Master with respect to TARP recipients of “exceptional assistance,” such as AIG, include reviewing and approving compensation payments and compensation structures applicable to the senior executive officers and certain highly compensated employees.<sup>3</sup> The Special Master will also have responsibility for administering the review of bonuses, retention awards, and other compensation paid to employees of TARP recipients before February 17, 2009, and the negotiation of appropriate reimbursements to the federal government. Finally, the interim final rule also establishes compliance reporting and record-keeping requirements regarding the rule’s executive compensation and corporate governance standards. While certain scheduled bonus payments are not subject to the interim final rule’s requirements or the jurisdiction of the Special Master, AIG has solicited Treasury’s input. As of September 15, 2009, Treasury had not provided an opinion.

---

<sup>3</sup>Under TARP, firms needing more assistance than is allowed under a widely available standard program are said to need “exceptional assistance;” firms falling under this standard have firm-specific negotiated agreements with Treasury.

# Appendix IV: Summary of Rating Agencies' Ratings

Grade and Quality	Definitions	Moody's <sup>a</sup>	Standard & Poor's <sup>b</sup>	Fitch <sup>b</sup>
Highest grade and quality	There is an extremely strong capacity to meet financial commitments on the obligation and bonds have little investment risk.	Aaa	AAA	AAA
High grade and quality	There is a very strong capacity to meet financial commitment on the obligation and bonds have very little investment risk, but margins of protection may be lower than with the highest grade bonds.	Aa	AA	AA
Upper medium grade and quality	There is a strong capacity to meet financial commitment on the obligation and the principal and interest are adequately secured, but the bonds are more vulnerable to a changing economy.	A	A	A
Medium and lower medium grade	There are adequate protections for these obligations but the bonds have investment and speculative characteristics. This group comprises the lowest level of investment grade bonds.	Baa	BBB	BBB
Noninvestment and speculative grades	There is little protection on these obligations and the interest and principle may be in danger, where default may be likely.	Ba1 and below	BB+ and below	BB+ and below

Sources: Moody's Investors Service, Standard & Poor's Ratings Services, and Fitch Ratings.

Notes:

<sup>a</sup>Moody's Investors Service has numerical modifiers of 1, 2, and 3 in each rating classification from Aa to B: '1' indicates that the issue ranks in the higher end of the category, '2' indicates a mid-range ranking, and '3' indicates that the issue ranks in the lower end of the category.

<sup>b</sup>Standard & Poor's Ratings Services and Fitch Ratings: Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

# Appendix V: Overview of the AIG Risk and Repayment Indicators

We have developed several indicators intended to help monitor the financial risk posed by American International Group, Inc. (AIG) and the status of AIG repayment efforts. These indicators are identified and summarized below.

**Table 2: Overview of Indicators of AIG’s Financial Risk and Repayment of Federal Assistance**

Figure/ Table	Indicator	Purpose—to monitor:
<b>AIG</b>		
Table 3	Credit Ratings	Changes in key credit ratings
Figure 5	AIG Inc.: Corporate Available Liquidity and Company-Wide Debt Projections	The timing of potential future demand on AIG’s liquidity posed by its debt obligations
Table 4	Sources and Amount of Available Corporate Liquidity	The timing of potential future demand on AIG’s liquidity posed by its debt obligations
Figure 6	AIG Inc.: Trends in and Main Components of Consolidated Shareholders’ Equity	The trends, level, and composition of AIG’s equity capital as an indicator of solvency and capital adequacy
Figure 7	AIG Inc.’s Operations by Major Segment: Operating Income/Losses Before Taxes	The contribution of AIG’s operating segments to overall operating earnings or losses
<b>AIG Financial Products Corporation</b>		
Figure 8	Status of the Winding Down of AIG’s Financial Products Business	The status of the winding down of AIG Financial Product’s business
Figure 9	AIGFP: Super Senior Credit Default Swap Portfolio Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Gains and Loss	The wind down of the AIG Financial Products’ Super Senior Credit Default Swap portfolio and value of corresponding liabilities
Figure 10	AIGFP: Gross Notional Value of the Multi-Sector Collateralized Debt Obligations that Are Rated Less than BBB	The credit quality of the underlying assets of AIGFP’s remaining Multi-Sector Collateralized Debt Obligation portfolio
Figure 11	AIG Credit Default Swap Premiums	What the market believes is AIG’s probability of default by tracking prices of 3-year and 5-year Credit Default Swaps insuring against AIG’s default
<b>AIG Insurance Companies</b>		
Figure 12	AIG Insurance Subsidiaries: Regulatory (Adjusted) Capital and Primary Activities Affecting Stockholders’ Equity in 2008	The capital of AIG insurers for adequacy and additional losses that could further deplete capital and require additional capital contributions by the federal government
Figure 13	AIG Life and Retirement Services: Additions to and Withdrawals from Policyholder Contract Deposits Including Annuities, Guaranteed Investment Contracts, and Life Products	For potential redemption “runs” by AIG annuitants and policyholders
Figure 14	AIG Life Insurance and Retirement Services: Key Quarterly Revenues and Expenses	The profitability of AIG’s life insurance and retirement services companies as AIG arranges their disposition
Figure 15	AIG General Insurance: Premiums Written by Division	Business retention and new business activity of AIG property/casualty insurance businesses

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

<b>Figure/ Table</b>	<b>Indicator</b>	<b>Purpose—to monitor:</b>
Figure 16	AIG Property/Casualty Insurance: AIG Commercial Insurance Operating Ratios and AIG Foreign General Insurance Operating Ratios	Operating performance of major domestic and foreign AIG property/casualty insurance businesses
<b>Repayment of Federal Assistance</b>		
Table 5	Composition of U.S. Government Efforts to Assist AIG and the Government’s Remaining Exposure	The changes to the composition of assistance and amount that AIG is obligated to repay the government
Figure 17	FRBNY Revolving Credit Facility Balance Owed and Total Amount Available	AIG’s outstanding balance owed to the Revolving Credit Facility established by the Federal Reserve Bank of New York
Figure 18	Principal Owed and Portfolio Values of Maiden Lane Facilities	Repayment of Federal Reserve Bank of New York loans to purchase AIG assets and the portfolio values of these assets
Figure 19	Proceeds from Dispositions by Quarter	To monitor proceeds including cash from dispositions, which is part of AIG’s strategy to repay federal assistance.
Table 6	Dispositions Closed and Agreements Announced but not yet Closed	To monitor the status of dispositions, which part of AIG’s strategy to repay federal assistance.

Source: GAO.

**Indicators of AIG’s Financial Condition**

**Credit Ratings.** This indicator monitors key changes in AIG’s credit ratings (see table 3). Credit ratings measure a company’s ability to repay its obligations and directly affect the cost and availability to that company of unsecured financing. Downgrades in the ratings can affect AIG’s major insurance operations as well as AIG’s liquidity and ability to restructure. AIG noted that a downgrade on its credit ratings could likely result in downgrades on insurer financial strength ratings for the AIG life and property/casualty companies. AIG also noted that a downgrade could result in further declines in credit limits and in counterparties’ willingness to transact with AIG (to hedge their portfolios, for example).

Overall, the government’s assistance has helped keep AIG’s credit ratings relatively stable since May 2009. Although Fitch Ratings (Fitch) downgraded AIG in the long-term debt, property and casualty insurer, and life insurer categories on May 15, 2009, Moody’s Investors Service (Moody’s) and Standard & Poor’s Ratings Services (S&P) maintained the same rating in those categories. Therefore, Fitch’s downgrade did not have a major effect on AIG’s access to capital or its counterparty relationships.

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

**Table 3: Credit Ratings, as of March 31, 2009, and May 15, 2009**

Rating agency	Credit rating		Potential consequences of future downgrade
	Mar. 31, 2009	May 15, 2009	
<b>Debt</b>			
<i>Long-term</i>			
S&P	A-/Negative <sup>a</sup>	A-/Negative <sup>a</sup>	<p>AIG Financial Products Corporation (AIGFP) would have to post collateral and termination payments. The total obligations depend on the market and other factors at the time of the downgrade. For example:</p> <ul style="list-style-type: none"> <li>• By close of business on Feb. 18, 2009, a 1-notch, 2-notch, or 3-notch downgrade from S&amp;P and Moody's would have cost AIGFP \$8 billion, \$10 billion, or \$11 billion, respectively.</li> <li>• By close of business on Mar. 31, 2009, a 1-notch, 2-notch, or 3-notch downgrade from S&amp;P and Moody's would have cost AIGFP \$4.2 billion, \$8.2 billion, or \$9.2 billion, respectively.</li> <li>• By close of business on May 22, 2009, a 1-notch, 2-notch, or 3-notch downgrade from S&amp;P and Moody's would have cost AIGFP \$3.8 billion, \$6.8 billion, or \$7.7 billion, respectively.</li> </ul>
Moody's	A3/Negative <sup>a</sup>	A3/Negative <sup>a</sup>	
Fitch	A	BBB/Evolving	
<i>Short-term</i>			
S&P	A-1 for AIG Funding, Curzon, and Nightingale <sup>a</sup>	A-1 for AIG Funding, Curzon, and Nightingale <sup>a</sup>	<p>AIG affiliates in commercial paper programs (AIG Funding, Curzon Funding LLC, and Nightingale LLC) could be ineligible for participation in the Commercial Paper Funding Facility (CPFF).</p> <p>Note: AIG's International Lease Finance Corporation lost access to CPFF funds after an S&amp;P downgrade on Jan. 21, 2009.</p>
Moody's	P-1 for AIG Funding <sup>a</sup>	P-1 for AIG Funding <sup>a</sup>	
Fitch	F1	F1	
<b>Financial strength</b>			
<i>Life insurer</i>			
AM Best	A/Negative <sup>a</sup>	A/Negative <sup>a</sup>	Domestic retirement services would be severely affected by a high surrender rate and further suspension of sales in some firms, and would suffer a significant loss of wholesalers.
S&P	A+/Negative	A+/Negative	Domestic life new business would be severely affected, in several instances forcing the company to exit businesses that serve either the high-net-worth marketplace or businesses that are governed by trust contracts. The company would need to continue to dedicate key resources to retention and management of existing relationships.
Moody's	A1/developing	A1/developing	
Fitch	AA-	A-/Evolving	

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

Rating agency	Credit rating		Potential consequences of future downgrade
	Mar. 31, 2009	May 15, 2009	
<i>P&amp;C insurer</i>			
AM Best	A/Negative <sup>a</sup>	A/Negative <sup>a</sup>	AIG commercial property/casualty businesses expect that a financial strength rating downgrade would result in a loss of approximately 50 percent of the net premiums written and operating losses for the domestic business. For the foreign businesses, a downgrade could cause regulators to further strengthen operational and capital requirements. Staff retention could become a key issue, and premiums would deteriorate significantly.
S&P	A+/Negative	A+/Negative	
Moody's	Aa3/Negative	Aa3/Negative	
Fitch	AA-	A+/Evolving	

Sources: AIG Securities and Exchange Commission (SEC) filings; S&P, Fitch, Moody's, and AM Best press releases; and AIG.

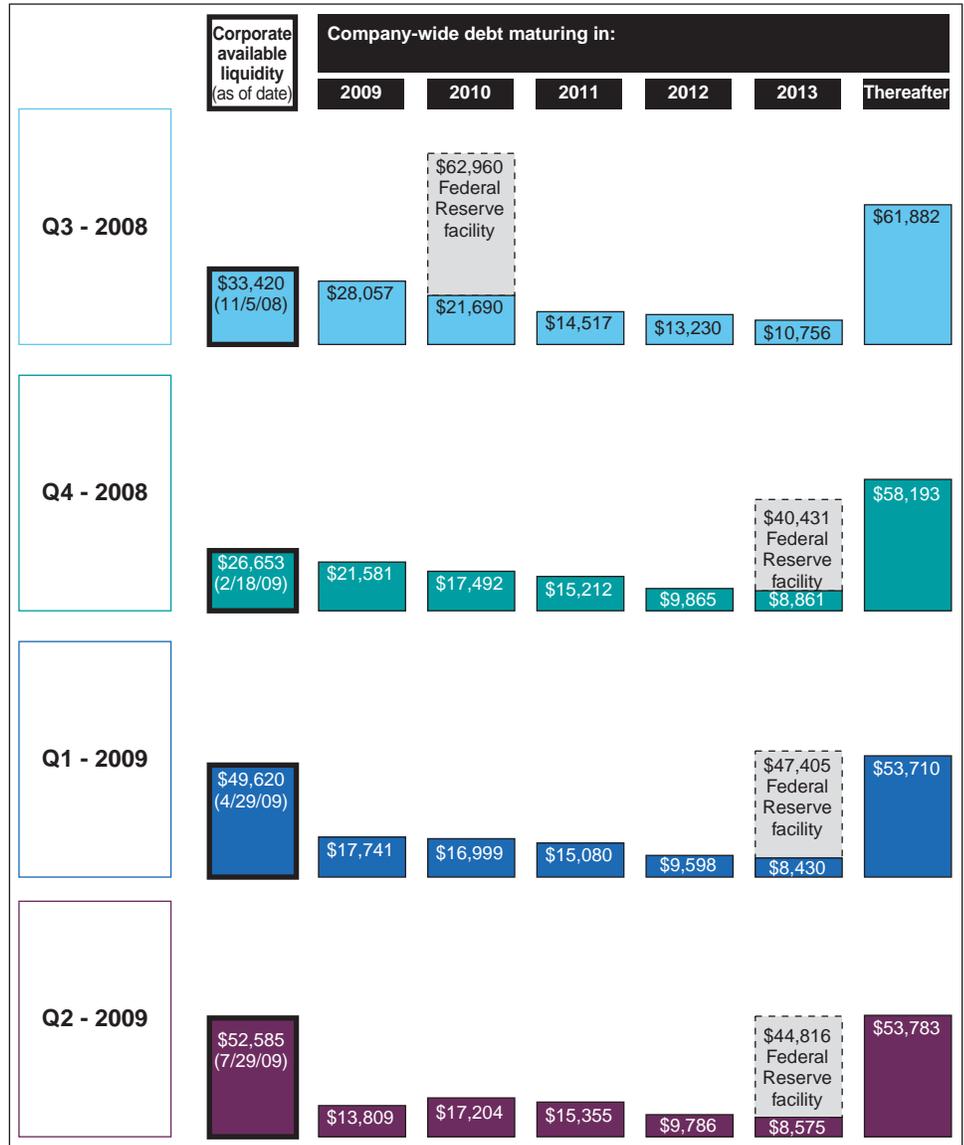
<sup>a</sup>These are key ratings.

**AIG: Corporate Available Liquidity and Company-Wide Debt Projections.** This indicator monitors the timing of potential future demand on AIG's liquidity posed by its debt obligations (see fig. 5 and table 4). These liquidity measures reflects AIG's ability to meet its cash payment needs. A decrease in available liquidity, or an increase in debt, could increase the risk of insolvency. Sources of available liquidity provide an indication of how AIG obtains the funds needed to meet its obligations. The greater the portion of current available liquidity provided by AIG's own operations, the less reliant they are on federal assistance.

AIG's liquidity has increased primarily because of federal assistance. As illustrated in figure 5, in order to assist AIG with its liquidity needs, the Federal Reserve Bank of New York (FRBNY) modified the original repayment date for the Revolving Credit Facility from 2010 to 2013. The amount owed on the facility also decreased as a result of AIG using the proceeds of its sales of preferred stock to the Department of the Treasury (Treasury) to pay down the outstanding balance on the facility. As discussed earlier in this report, AIG is expected to have similar decreases in the future as assets are sold and/or its debt is restructured.

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

**Figure 5: AIG: Corporate Available Liquidity and Company-Wide Debt Projections (dollars in millions), Third Quarter of 2008 through Second Quarter of 2009**



Source: AIG SEC filings.

Notes: Available liquidity is at the corporate level and debt maturing is at the corporate and operating division levels. Much of the debt of the operating divisions is associated with assets serving as collateral or funding sources; thus repayment of this debt is not likely to rely on corporate liquidity. The figures exclude borrowings on consolidated investments that were less than 3.5 percent of total long-term borrowings.

**Table 4: Sources and Amounts of Available Corporate Liquidity at November 5, 2008; February 18, 2009; April 29, 2009; and July 29, 2009**

Dollars in millions				
	Nov. 5, 2008	Feb. 18, 2009	Apr. 29, 2009	July 29, 2009
FRBNY Revolving Credit Facility	\$24,000	\$24,800	\$17,400	\$20,000
Commercial paper under CPFF and syndicated & bilateral facilities	5,600	753	1,940	3,493
Unused bank syndicated & bilateral facilities	3,820			
AIG Cash and short-term investments		1,100	445	407
Treasury Equity Facility			29,835	28,685
<b>Total</b>	<b>\$33,420</b>	<b>\$26,653</b>	<b>\$49,620</b>	<b>\$52,585</b>

Sources: Sept. 30, 2008 10Q, Dec. 31, 2008 10K, Mar. 31, 2009 10Q, and June 30, 2009 10Q.

**AIG: Trends in and Main Components of Consolidated**

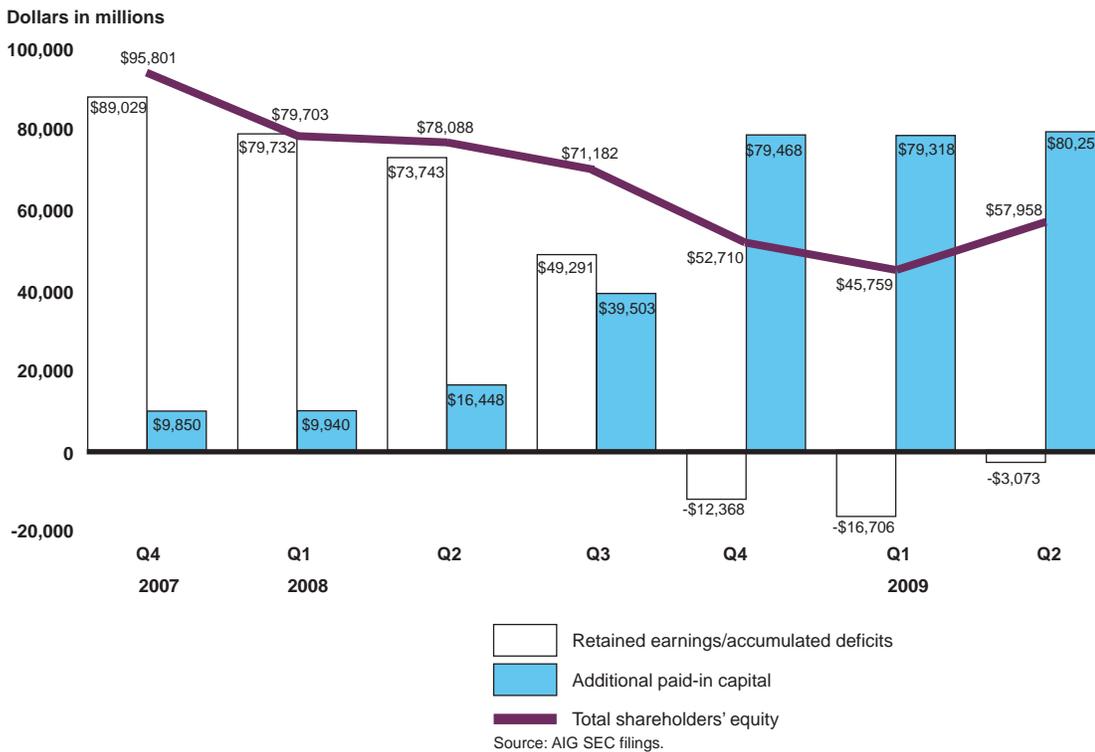
**Shareholders' Equity.** This indicator is intended to monitor the trends, level, and composition of AIG's Consolidated Shareholders' Equity as an indicator of solvency (see fig. 6). Shareholders' equity is generally a company's total assets minus total liabilities. Paid-in capital is equity capital provided by investors in exchange for common or preferred stock. Stabilizing or decreasing deficits could indicate AIG's operating profitability is recovering.

As figure 6 shows, AIG's shareholders' equity fell throughout 2008 and the first quarter of 2009. In the second quarter of 2009, this trend reversed as the company saw an increase in shareholders' equity. However, paid-in capital, primarily from government assistance, was the largest contributor to this change in shareholders' equity.<sup>1</sup> AIG's accumulated deficit for the second quarter of 2009 improved to \$3.1 billion from \$16.7 billion in the previous quarter. In September 2008, AIG, through a non-cash transaction, added \$23 billion to shareholders' equity as additional paid-in capital to record the fair value of Series C preferred shares that was later issued in

<sup>1</sup>Paid-in capital is equity capital provided by investors in exchange for common or preferred stock.

order to obtain AIG's Revolving Credit Facility established by FRBNY.<sup>2</sup> On December 31, 2008, AIG added \$40 billion to shareholders' equity as additional paid-in capital to record the issuance of AIG Series D preferred shares and a warrant to Treasury. As mentioned previously, the \$40 billion in proceeds were used to pay a portion of AIG's debt owed on the FRBNY credit facility. To the extent that AIG improves its profitability, accumulated deficits should shrink and become retained earnings.

Figure 6: AIG: Trends in and Main Components of Consolidated Shareholders' Equity, Fourth Quarter of 2007 through Second Quarter of 2009



<sup>2</sup>This amount was based on the fair value of common shares into which the Preferred Series C would be convertible on September 16, 2008, which was the date on which AIG received FRBNY's commitment. AIG also recorded this amount as a prepaid commitment fee for the \$85 billion credit facility to be treated as an asset to be amortized as interest expense over the 5-year term of the FRBNY facility. The only cash involved in this transaction was \$500,000 that FRBNY paid for the Series C preferred shares. Through June 30, 2009, \$10.2 billion of this asset was amortized through the accumulated deficit and thus reduced shareholders equity.

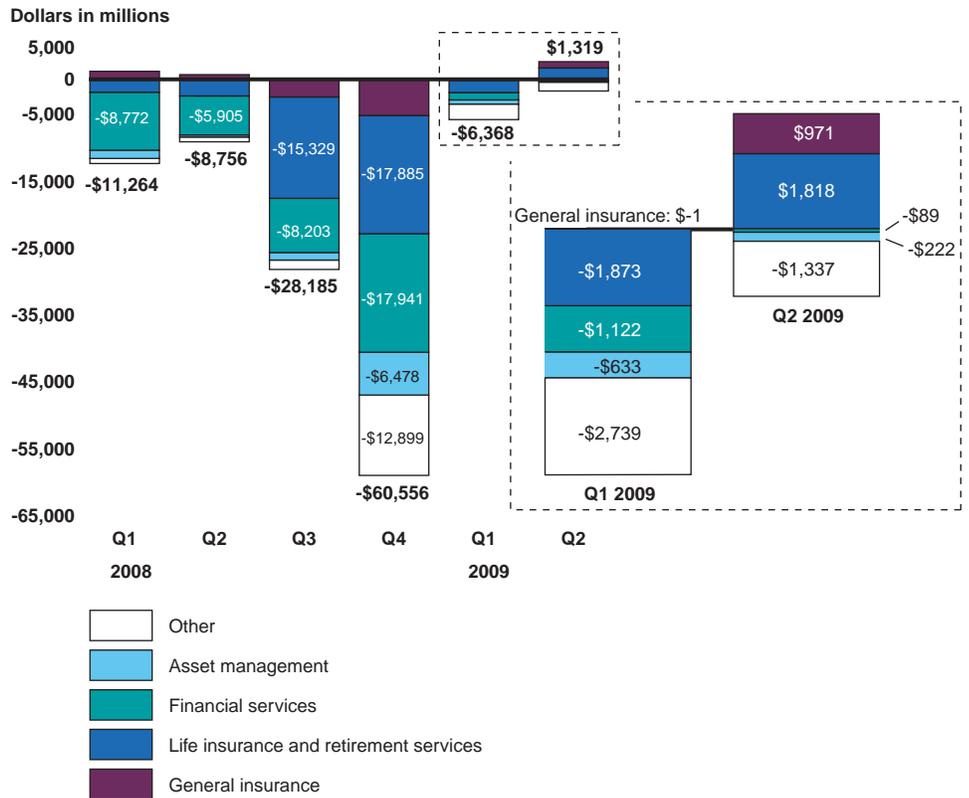
---

Note: Other components of total shareholders' equity are preferred stock (Series C preferred stock), Series D (preferred stock, which was exchanged in April 2009 for Series E preferred shares), accumulated other comprehensive losses, and Treasury stock. Drawdowns from the approximately \$29 billion authorized under the Series F preferred stock transaction will increase paid-in capital in the future by an equal amount.

**AIG's Operations by Major Segment: Operating Income/Loss Before Taxes.** This indicator is intended to monitor the contribution of AIG's operating segments to overall operating earnings or losses (see fig. 7). Operating income/losses include the profits or losses generated by the operating companies. Increased profitability in these segments could improve AIG's ability to sell its noncore assets, restructure its operations, and repay federal assistance, while increased losses could create a greater risk of insolvency. The insurance data include both investment and underwriting performance.

Federal assistance allowed AIG to stay in business and cut its losses in late 2008 and early 2009. In the second quarter of 2009, AIG achieved moderate income gains from its operations. As shown in figure 5, over half of the losses in the fourth quarter of 2008 and over 82 percent of the losses in the third quarter of 2008 were associated with the financial services and life insurance and retirement services segments. AIG's general insurance business continued to earn a profit in the first half of 2008 and had the lowest losses among the major segments thereafter. In the first quarter of 2009, losses were cut by nearly 90 percent largely due to the creation of the Maiden Lane facilities and the unwinding of portions of AIGFP's portfolio of assets. The "Other" segment in figure 7 was also a major factor in the fourth quarter 2008 losses. Specifically, 82 percent of the losses in this segment resulted from interest expense and fees on the FRBNY Revolving Credit Facility. In the second quarter of 2009, AIG reported an operating income before taxes of \$1.3 billion compared to an operating loss of \$8.8 billion in the same quarter of the previous year.

Figure 7: AIG's Operations by Major Segment: Operating Income/Loss Before Taxes, First Quarter of 2008 through Second Quarter of 2009



Source: AIG SEC filings.

Notes: The insurance data include both investment and underwriting performance.

The "Other" category includes consolidations and eliminations, equity earnings in partly owned companies, interest expense on the FRBNY facility, other interest expenses, unallocated corporate expenses, net realized capital gains/losses, and other miscellaneous expenses (net). Compounding interests and fees of the FRBNY facility were \$10.6 billion and \$1.5 billion in 2008-q4 and 2009-q1, respectively.

## Indicators of the Status of Winding Down AIG Financial Products

### Status of the Winding Down of AIG's Financial Products' Business.

This indicator is intended to monitor the wind-down status of AIG Financial Products Corporation (AIGFP). The status of winding down of AIGFP's business is illustrated by four indicators (see fig. 8). First, the number of outstanding trade positions is the number of AIGFP's outstanding long and short (positions) derivative contracts. This number has continued to decline, and AIGFP continues to unwind its books of business. Second, the notional of derivatives outstanding is the maximum

dollar level exposure of AIGFP’s derivatives outstanding, which has also continued to fall slightly. Third, the number of businesses is the number of risk books that AIGFP is winding down. In its switch from growth and profit maximization to risk mitigation and unwinding, AIGFP reorganized its business into 22 separate risk books determined in part by type of risk, which fall into the following five groupings: (1) credit books, (2) investment securities and liabilities books, (3) capital markets books, (4) principal guaranty products, and (5) private equity and strategic investment books. The number of books has decreased from 22 to 17. Finally, the number of employees is the staff size of AIGFP, which may change for several reasons, such as the sale of businesses, closing offices, or employee resignation.

**Figure 8: Status of the Winding Down of AIG’s Financial Products Corporation, as of September 30, 2008; December 31, 2008; and March 31, 2009**

	September 30, 2008	December 31, 2008	March 31, 2009
Approximate number of outstanding trade positions	44,000	35,000	28,000
Gross notional of long and short derivatives positions outstanding (dollars in trillions)	\$1.8	\$1.6	\$1.5
Number of businesses (risk books)	22	21	17
Number of employees	428	375	362

Source: Testimony by Mr. Edward M. Liddy, Chairman and Chief Executive Officer, AIG, before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, March 18, 2009, and AIG Restructuring Update, May 7, 2009.

Note: These figures have not been publicly updated by AIG since they were released in the May 7, 2009 Restructuring Update. Due to Financial Accounting Standard 161, AIGFP changed its methodology for computing the gross notional for March 2009 leading to a slight increase of previously reported values. September and December notionals were estimated and restated numbers were 2.0 and 1.8, respectively. The March number was 1.5.

**AIG Financial Products: Super Senior Credit Default Swap Portfolio Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Gains and Losses.** This indicator is

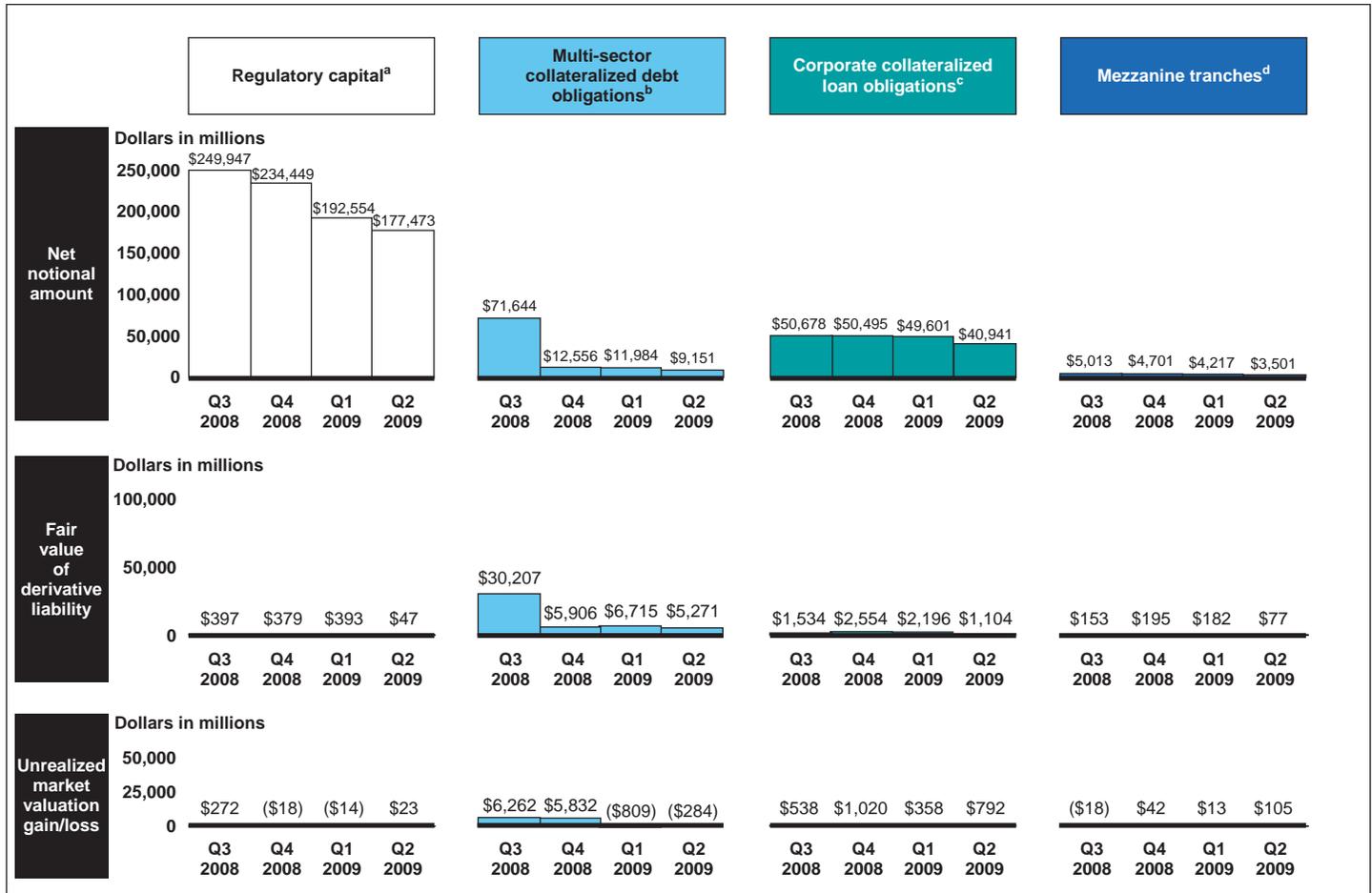
intended to monitor the wind-down of the AIGFP Super Senior Credit Default Swaps (CDS) portfolio and value of corresponding liabilities (see fig. 9). Notional denotes the size on which AIGFP wrote credit protection. This is the maximum dollar-level exposure for the portfolio and represents an underlying quantity upon which payment obligations are computed. A decrease in the net notional amount could indicate progress in unwinding AIGFP's obligations. The fair value of derivative liability represents the fair market valuation of AIGFP's liabilities in each asset portfolio. The unrealized market valuation loss (gain) tracks the increase (decrease) in this valuation from quarter to quarter. A decrease in the fair value of derivative liability represents a decrease in the cost to AIGFP to transfer the respective derivatives to other counterparties in any effort to reduce its liabilities (i.e., the risk associated with the liabilities is viewed more favorably in the marketplace and reflects increased willingness to hold the liabilities). Therefore, such a decrease would be accompanied by comparable unrealized market valuation gains.

The unwinding of this portfolio appears to be progressing, with a decrease in the net notional amount of Super Senior CDS portfolio, a decrease in the fair value of derivative liability, and increases in unrealized market valuation. The net notional amount represents the maximum dollar level exposure for the portfolio taking into account offsetting positions, and measures an underlying quantity upon which payment obligations are computed. As with the overall portfolio, a decrease in the net notional amount could indicate progress in unwinding AIGFP's obligations.

The regulatory capital book of positions was written for European banks and allows the banks to keep lower reserves by buying protection against losses on the underlying assets. This book provides protection to the banks against default from their clients. AIGFP continues to believe that these positions will unwind at little to no cost, even though these positions continue to have a high net notional value relative to the other types of products. Figure 9 shows a large drop in the net notional and fair values of the multi-sector collateralized debt obligations from the third quarter to the fourth quarter of 2008. This decrease largely resulted from federal assistance through the sale of most of the underlying assets in this category to Maiden Lane III and the termination of the related CDS. Finally, figure 9 shows that AIGFP has also shown some modest progress in reducing the CDS portfolio relating to its corporate collateralized loan obligation portfolio and mezzanine tranches.

Appendix V: Overview of the AIG Risk and Repayment Indicators

Figure 9: AIGFP: Super Senior Credit Default Swap Portfolio Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Gains and Loss, Third Quarter of 2008 through Second Quarter of 2009



Source: AIG SEC filings and AIG.

Notes: The data for unrealized market valuation gain/loss correspond to the indicated 3-month quarter. The unrealized market valuation loss (gain) tracks the increase (decrease) in this valuation from quarter to quarter.

<sup>a</sup>Regulatory capital represents the CDS portfolio sold to provide regulatory capital relief to primarily European financial institutions. In exchange for a periodic fee, these institutions received credit protection for a portfolio of diversified loans, thus reducing minimum capital requirements set by their regulators.

<sup>b</sup>Multi-sector collateralized debt obligations (CDOs) represent the CDS portfolio sold primarily for arbitrage purposes and written on CDO transactions that generally had underlying collateral of residential mortgage-backed securities, commercial mortgage-backed securities, and CDO tranche securities.

---

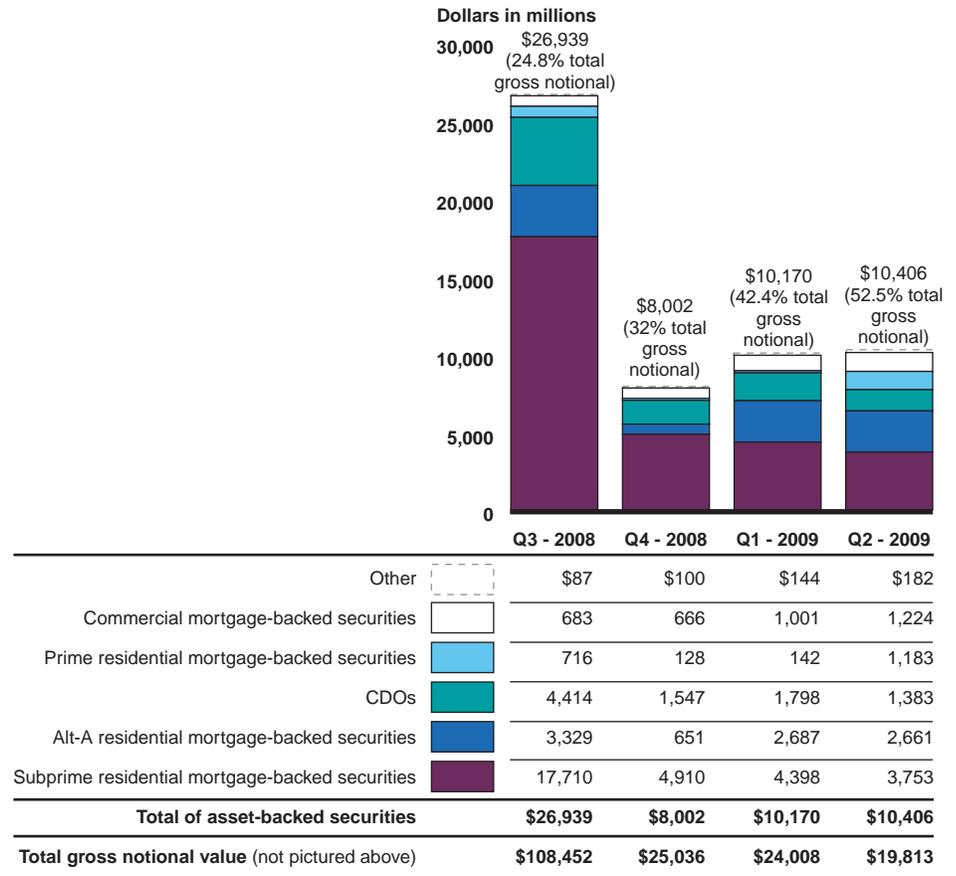
<sup>o</sup>The corporate collateralized loan obligations portfolio consists of CDS transactions primarily written on portfolios of senior unsecured loans.

<sup>q</sup>Mezzanine tranches are a portfolio of CDS transactions written on obligations that were rated less than investment grade “A or lower” at origination.

**AIGFP: Gross Notional Value of Multi-Sector Collateralized Debt Obligations That Are Rated Less than BBB.** This indicator is intended to monitor the credit quality of the underlying assets of AIGFP’s remaining multi-sector CDO portfolio, since the amount of future collateral postings is most significantly affected by declines in the market value of these underlying assets (see fig. 10). AIG has indicated that in most cases, the assets in AIGFP’s multi-sector CDS portfolio were rated at least BBB (by S&P) or Baa (by Moody’s) at inception. An increase in the percentage of the gross notional amount of the portfolio rated less than BBB represents deterioration in the credit quality of the underlying assets, and could increase demands on liquidity.

The amount of asset-backed securities rated below BBB experienced a \$19 billion drop in the fourth quarter of 2008, primarily due to federal assistance through Maiden Lane III. However, from the fourth quarter of 2008 to the first quarter of 2009, the amount of asset-backed securities rated below BBB rose in every category except subprime mortgage-backed securities, indicating deteriorating credit quality of these holdings. The categories contributing to the largest amount of increase were commercial mortgage-backed securities and Alt-A residential mortgages. In the second quarter of 2009, these amounts started to level off, but prime residential mortgage-backed securities continued to increase.

**Figure 10: AIGFP: Gross Notional Value of Underlying Multi-Sector Collateralized Debt Obligations That Are Rated Less Than BBB, Third Quarter of 2008 through Second Quarter of 2009**

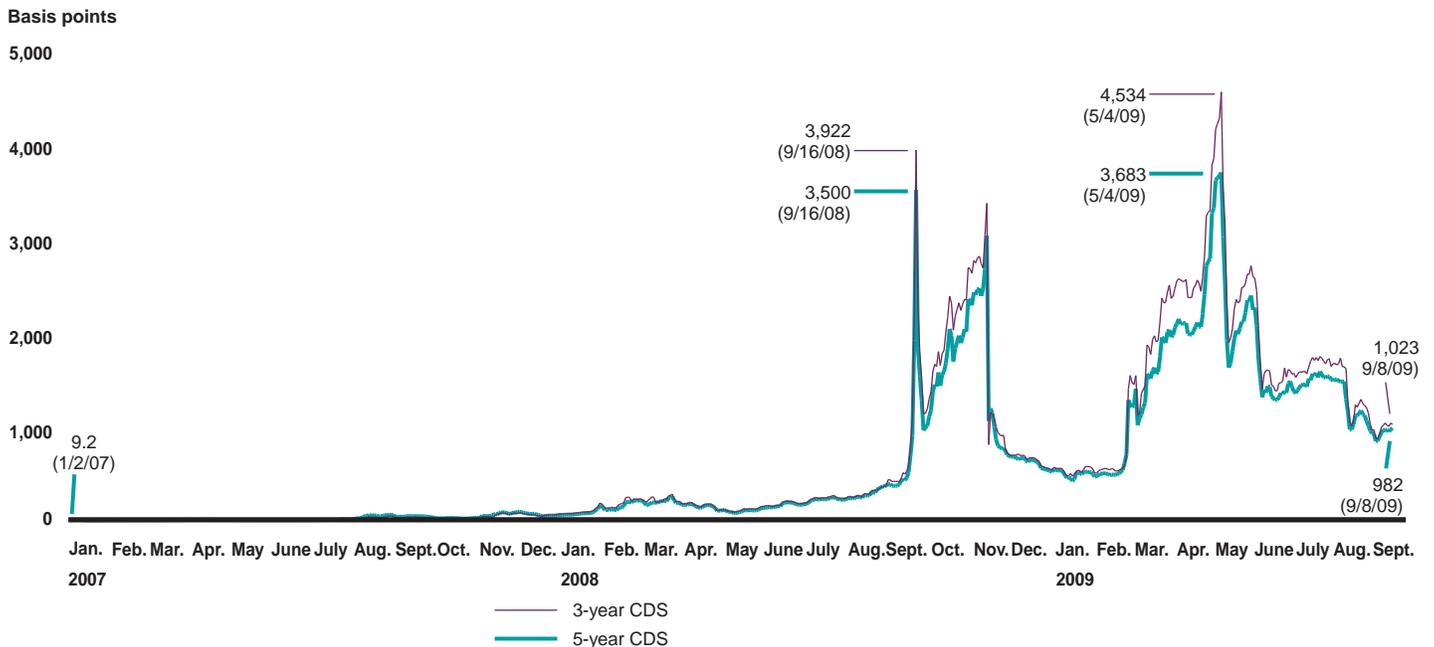


Source: AIG SEC filings.

**AIG Credit Default Swap Premiums.** This indicator is intended to monitor what the market believes is AIG’s probability of default by tracking prices of 3-year and 5-year CDS insuring against AIG’s default (see fig. 11). This graphic tracks the premiums, expressed in basis points, paid by an insured party against a possible AIG default on a senior unsecured bond and the spreads between the 3-year and 5-year premiums. A basis point is a common measure used in quoting yield on bills, notes, and bonds and represents 1/100 of a percent of yield. Higher basis point levels indicate a higher premium for a CDS contract. The higher the CDS premium rises, the greater the market’s expectation that AIG will default. Decreases in CDS premiums could indicate increased confidence in AIG’s financial strength.

AIG's CDS premiums are lower in the second quarter of 2009 than they were in the fourth quarter of 2008, but it is too soon to say whether they are stabilizing. As the Federal Reserve noted, the market is trying to judge the government's level of commitment because the government's backing is driving perceptions about the prospect of default by AIG, as opposed to simply judging AIG's financial strength.

Figure 11: AIG Credit Default Swap Premiums, January 2007 through July 2009



Source: GAO analysis of Thomson Reuters Datastream.

Note: A basis point is a common measure used in quoting yield on bills, notes, and bonds and represents 1/100 of a percent of yield. CDS provide protection to the buyer of the CDS contract if the assets covered by the contract go into default.

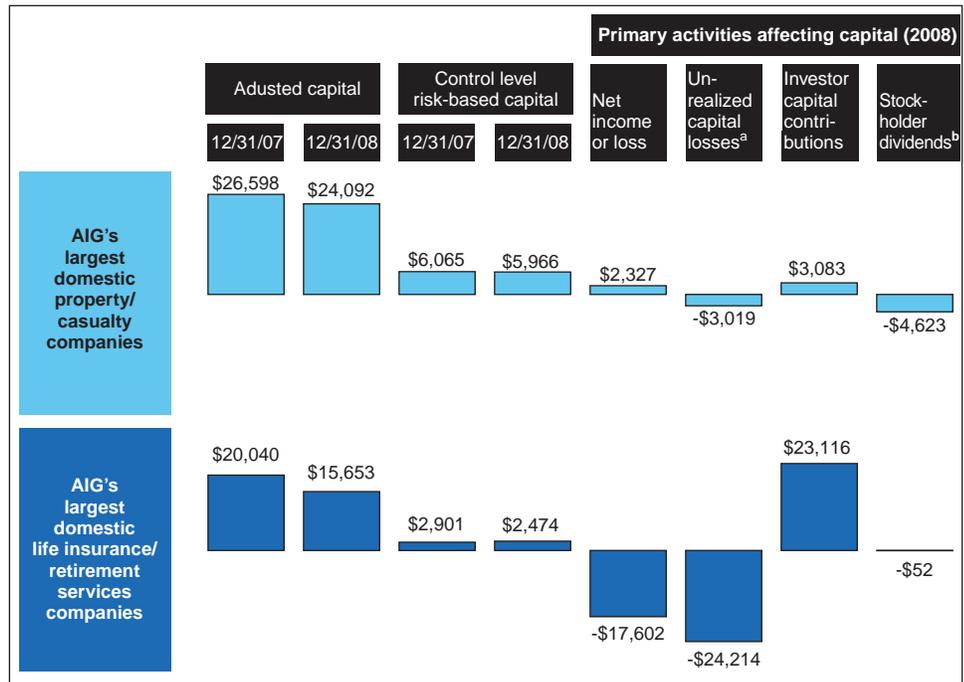
## Indicators of the Health of AIG's Domestic Insurance Companies

**AIG Insurance Subsidiaries: Regulatory Capital and Primary Activities Affecting Stockholders' Equity.** This indicator is intended to monitor the capital of AIG insurers for losses that could deplete capital and require additional capital contributions through federal assistance (see fig. 12). The National Association of Insurance Commissioners (NAIC) requires that insurance companies hold a minimum amount of capital as computed by a risk-based capital formula. According to NAIC, "a company reporting total adjusted capital of 200 percent or more of minimum risk-based capital (RBC) is a 'no action' level company; nothing

needs to be done by regulators.” On the other hand, NAIC states that “Total Adjusted Capital of < 70 percent triggers a Mandatory Control Level that requires the regulator to take steps to place the insurer under control.” Moreover, a company’s credit ratings are influenced by, among other things, its ratio of Total Adjusted Capital to its control level RBC. Figure 12 shows that, as AIG stated, the property/casualty companies and life companies had adjusted capital of 400 percent and 600 percent, respectively of RBC at year end for both 2007 and 2008. Adverse movements in the primary components of capital and stockholders’ equity may indicate weak performance by the companies, which could be offset by capital contributions from the federal government lines of credit in order to maintain the desired capital ratios.

However, figure 12 also shows without capital contributions, adjusted capital would not have been adequate to cover losses in 2008. The capital contributions were part of the federal assistance and losses were from securities lending activities.

**Figure 12: AIG Insurance Subsidiaries: Regulatory Capital at December 31, 2007, and December 31, 2008, and Primary Activities That Affected Regulatory Capital During 2008 (dollars in millions)**



Source: Financial statements filed with the National Association of Insurance Commissioners.

---

Notes:

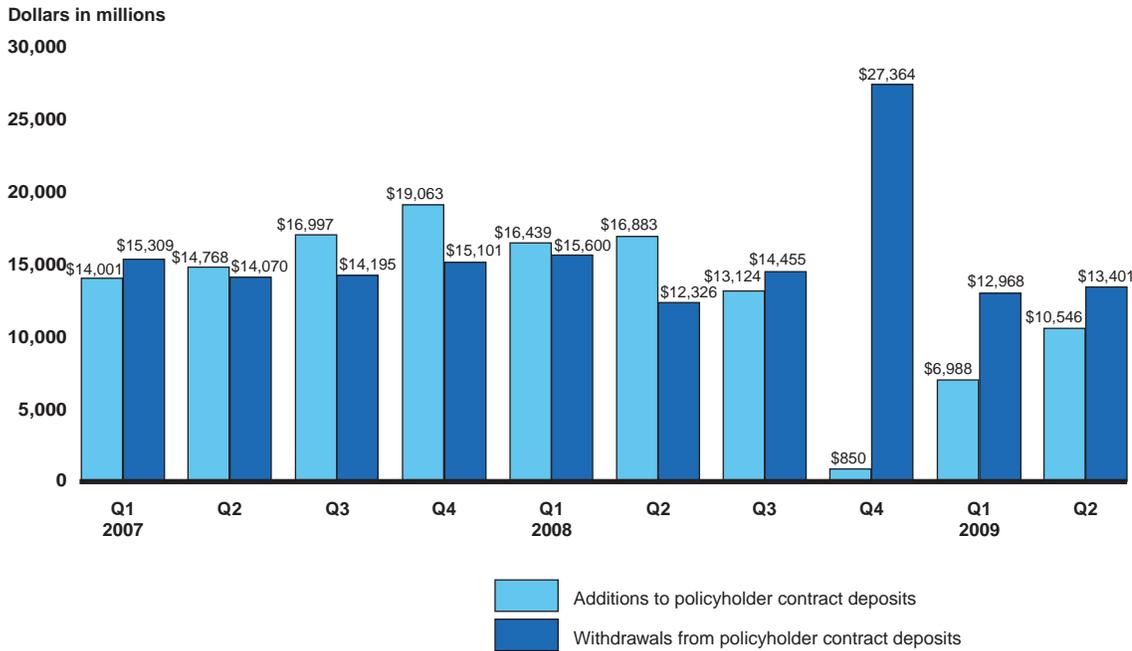
<sup>a</sup>Includes dividends paid within AIG.

<sup>b</sup>NAIC financial statements show unrealized capital losses separately.

**AIG Life and Retirement Services: Additions to and Withdrawals from Policyholder Contract Deposits Including Annuities, Guaranteed Investment Contracts, and Life Products.** This indicator is intended to monitor for potential redemption “runs” by AIG annuitants and policyholders (see fig. 13). Additions to policyholder contract deposits are amounts customers have paid to AIG to purchase a policy or contract. Withdrawals represent redemptions or cancellations of these instruments. Sharp increases in contract withdrawals and/or reductions in contract deposits could indicate sharply increased redemptions due to customer anxiety about AIG in particular or insurance companies more broadly. Sharp increases in redemptions could strain a company’s liquidity.

As reflected in figure 13, in the fourth quarter of 2008 AIG life and retirement services saw a sharp decline in additions to policyholders’ contract deposits and a large spike in withdrawals resulting in a gap of over \$26 billion. Without more granular data, we cannot determine whether the withdrawals were driven by concerns about the condition of AIG or by the overall economic downturn, which may have resulted in policyholders cashing in policies for economic reasons. The large disparity between the withdrawals and deposits adversely impacted the liquidity position of this segment of AIG. However, AIG rebounded in the first quarter of 2009 with a 77 percent reduction in the gap between additions and withdrawals to about \$6 billion. In the second quarter of 2009, the disparity between additions to and withdrawals from deposits shrank even further to \$2.9 billion, bringing the amounts closer to historical levels. However, withdrawals continue to outstrip deposits.

**Figure 13: AIG Life and Retirement Services: Additions to and Withdrawals from Policyholder Contract Deposits Including Annuities, Guaranteed Investment Contracts, and Life Products, First Quarter of 2007 through Second Quarter of 2009**



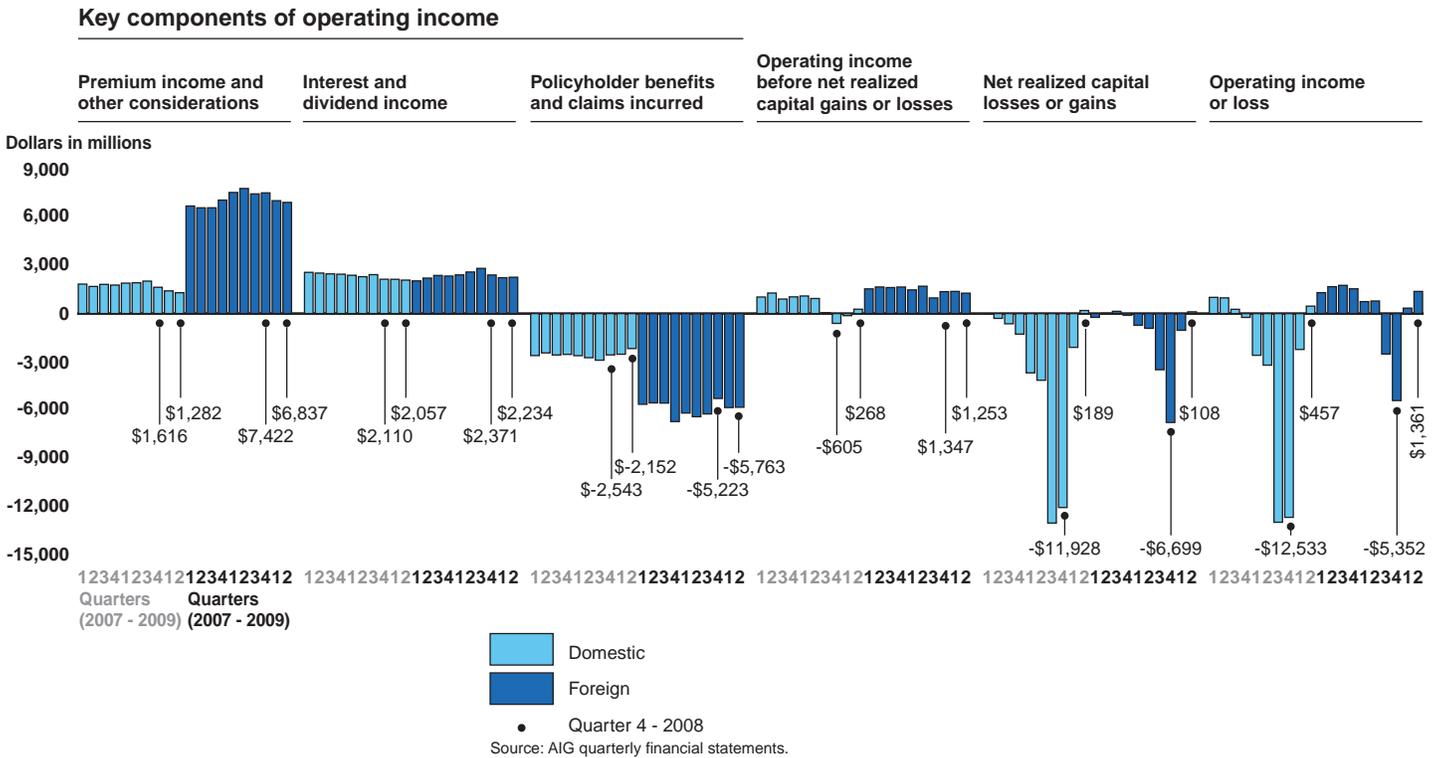
Source: AIG SEC filings.

**AIG Life Insurance and Retirement Services: Key Quarterly Revenues and Expenses.** This indicator is intended to monitor the profitability of AIG’s life insurance and retirement services companies as AIG arranges their disposition (see fig. 14). Operating income before capital gains or losses provides an indication of the profitability of the company’s underwriting operations, while capital gains and losses relate to investment activities not directly related to insurance underwriting. Increases in operating income or reductions in net realized capital losses could indicate improvements in the operations of AIG’s life and retirement services companies, including improvement in market conditions, lower other-than-temporary impairments, and dissipating effects of lower credit ratings and negative publicity related to the AIG brand since September 2008.

As shown previously in figure 7, a large portion of the losses incurred by AIG in the fourth quarter of 2008 came from the life insurance and retirement services segment. Figure 14 provides a closer look at the operating gains and losses sustained by the Life and Retirement segment of AIG. The core underwriting activity of the companies has remained

fairly constant since 2007, with only slight reductions in premiums and little change in claims and member benefits. The vast majority of the losses incurred by AIG in 2008 were the result of losses associated with its investment activity. For example, investment losses associated with AIG's domestic life and retirement services business accounted for \$11.9 billion of its \$12.5 billion in operating losses (95 percent) in the fourth quarter of 2008. Similarly, for its foreign companies, losses from AIG's investment activity of almost \$6.7 billion accounted for all of the fourth quarter 2008 losses and totally wiped out operating income of \$1.3 billion, resulting in a loss of almost \$5.4 billion. In the second quarter of 2009, AIG's life insurance subsidiaries achieved an operating income of over \$1.8 billion.

Figure 14: AIG Life Insurance and Retirement Services: Key Quarterly Revenues and Expenses, First Quarter of 2007 through Second Quarter of 2009

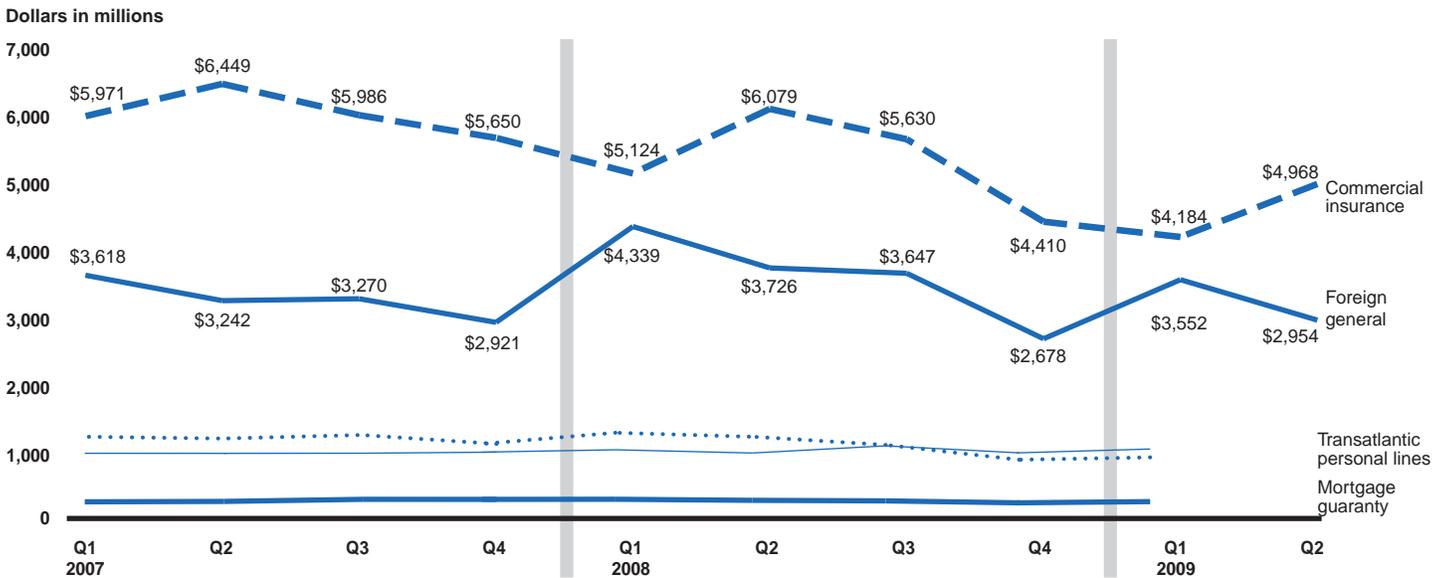


**AIG General Insurance: Premiums Written by Division.** The purpose of this indicator is to monitor business retention and new business activity of AIG's property/casualty businesses (see fig. 15). "Premiums written" is the dollar volume of business in a particular period. Multiple factors, including industry-wide factors such as softening or hardening markets,

can affect premiums written. Changes in premiums written can also provide some indication of the success of AIG's efforts to retain and attract business, such as the formation of Chartis, Inc. and rebranding. According to the Fourth Quarter 2008 Survey of the Council of Independent Agents and Brokers, the approximately five-year continued decline in average premium rates for accounts of all sizes is leveling off, perhaps signaling the end of the current soft market.

Through 2007, 2008 and the first quarter of 2009, premiums written by AIG's property/casualty subsidiaries trended downward, which closely followed the general industry trend. AIG noted that in the fourth quarter of 2008 and the first quarter of 2009 general insurance net premiums written were also adversely affected by negative AIG publicity. The current data are not clear as to whether this trend is leveling off.

Figure 15: AIG General Insurance: Premiums Written by Division, First Quarter of 2007 through Second Quarter of 2009



Source: AIG SEC filings.

Note: AIG intends to buy United Guaranty Corporation, AIG's mortgage guaranty operations, from the recently established AIU Holdings (Chartis, Inc.). Common shares of Transatlantic were sold during the second quarter of 2009, reducing the aggregate ownership interest in Transatlantic to 14 percent; the remaining shares are expected to be sold before the end of 2009. The personal lines companies were sold to a third party on July 1, 2009. Commercial Insurance will retain the Private Client business historically written by the personal lines segment.

**AIG Property/Casualty Insurance: AIG Commercial Insurance Operating Ratios and AIG Foreign General Insurance Operating Ratios.** The purpose of this indicator is to monitor operating performance of major domestic and foreign AIG property/casualty businesses (see fig. 16). The indicator includes three ratios that provide information on an insurer's operating profitability. Increased loss ratios indicate higher losses relative to premiums, due to either increased losses or decreased premiums. Expense ratios are a measure of underwriting efficiency, and increases represent increased expenses relative to premiums. For example,

Loss ratio = $\frac{\text{claims} + \text{claims adjustment expenses incurred}}{\text{net earned premiums}}$	A 77.3 loss ratio indicates that 77.3 cents out of every dollar in premiums earned are used to adjust and pay claims.
Expense ratio = $\frac{\text{underwriting expenses}}{\text{net premiums earned}}$	A 22.4 expense ratio indicates that 22.4 cents out of every dollar in premiums earned are used for underwriting expenses.
Combined ratio = loss ratio + expense ratio	A combined ratio of less/more than 100 indicates underwriting profitability/loss.

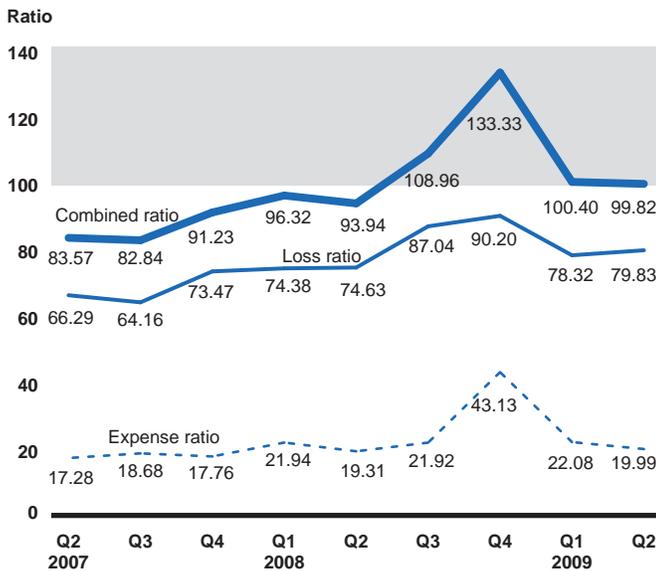
As shown in figure 16, AIG's expense ratio for AIG commercial insurance spiked in the fourth quarter of 2008. This spike was largely due to an accounting charge associated with an impairment to goodwill resulting from the acquisitions.<sup>3</sup> The increased loss ratio for AIG commercial insurance can largely be attributed to increased claims associated with Hurricane Ike and other major catastrophes in 2008. The loss ratio and the combined ratio dropped back down to levels similar to the third quarter of 2008. The combined ratio is still high at around 100.

---

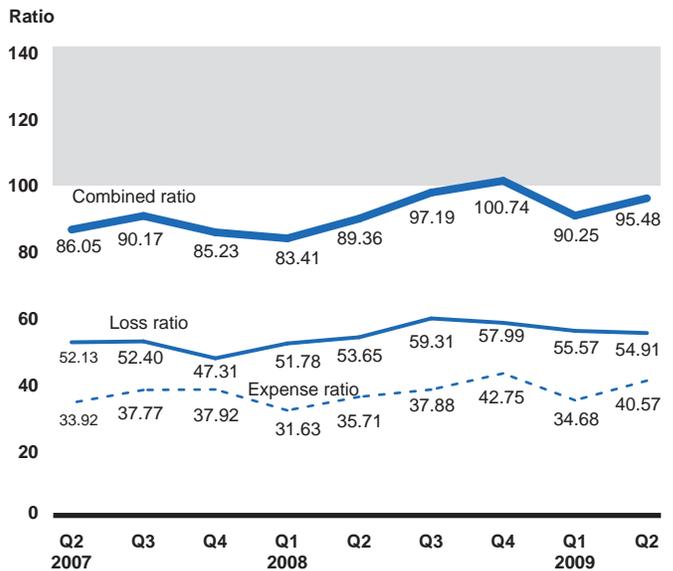
<sup>3</sup>Goodwill is generally the value of a business that is not directly attributable to the fair value of the assets and liabilities of the business. If the fair value of the assets (present value of future cash flows) is less than the carrying value (booked value of assets plus goodwill less liabilities) then the impairment loss must be recognized on the income statement. In the case of AIG an increase in expenses was necessary to account for the impairment loss.

Figure 16: AIG Property/Casualty Insurance: AIG Commercial Insurance Operating Ratios and AIG Foreign General Insurance Operating Ratios, Second Quarter of 2007 through Second Quarter of 2009

AIG commercial insurance operating ratios



AIG foreign general insurance operating ratios



Source: AIG quarterly financial supplements.

Note: The underwriting expense for the fourth quarter of 2008 includes a \$1.2 billion charge for impairment to goodwill, increasing the expense ratio by 22.50 points. Claims related to major catastrophes were \$1.4 billion in 2008, including hurricane claims of \$1.1 billion in the third quarter of 2008. Conversely, claims related to major catastrophes were \$100 million in 2007.

Indicators of the Status of the Government's Exposure to AIG

**Composition of U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure.** This indicator identifies the various components of federal assistance to AIG (see table 5). Included are (1) the assistance provided directly by the federal government, either as debt to the government or as government equity; (2) other federal efforts to assist AIG, including debt that the government has incurred or as government equity; and (3) remaining government exposures to AIG, whether financial or legal. The table also shows that while most of the \$120.9 billion in assistance provided has been the \$83.8 billion in direct assistance to AIG in the form of FRBNY's Revolving Credit Facility and Treasury's purchase of preferred shares and creation of the Equity Facility, the government has also provided about \$37 billion in indirect assistance by creating and making loans to Maiden Lanes II and III for the purchase of mortgage-backed securities from AIG's insurance subsidiaries and for the purchase of CDOs from AIG's counterparties.

Also reflected in table 5 are plans to further modify the assistance provided to AIG. For example, on March 2, 2009, the Federal Reserve and AIG announced their intent to enter into a transaction in which FRBNY will purchase securitization notes in the amount of up to \$8.5 billion issued by special purpose vehicles (SPV) that will be established by certain AIG domestic life insurance subsidiaries. The SPVs are to repay the notes from the net cash flows they received from the designated blocks of existing life insurance policies issued by the insurance companies. AIG is to use the proceeds of the FRBNY loan to pay down an equivalent amount of outstanding debt under the Revolving Credit Facility. In addition, on June 25, 2009, the Federal Reserve and AIG entered into agreements under which AIG will transfer its preferred equity interest in two SPVs created by AIG to hold the common stock of two foreign life insurance subsidiaries, American International Assurance (AIA) and American Life Insurance Company (ALICO), to FRBNY, as previously discussed. When this transaction is completed, the amount outstanding and the maximum available to borrow on the facility is to be reduced by \$25 billion.<sup>4</sup>

**Table 5: Composition of U.S. Government Efforts to Assist AIG and the Government’s Remaining Exposure, as of September 2, 2009 (dollars in millions)**

	Amount authorized	Direct AIG assistance		Indirect AIG Assistance		Total
		AIG debt owed to government	Government equity	Other debt owed to government	Government equity	
<b>Federal Reserve</b>						
Revolving Credit Facility	\$60,000	\$38,792.5 <sup>a</sup>				\$38,792.5 <sup>a</sup>
Maiden Lane II	\$22,500			\$16,899		\$16,899
Maiden Lane III	\$30,000			\$20,196		\$20,196
Securitization Note	[\$8,500] <sup>p</sup>			0		0
American International Assurance/ American Life Insurance Company	[\$25,000] <sup>p</sup>					

<sup>4</sup>The maximum amount available under the FRBNY facility will not be less than \$25 billion as a result of a reduction from the AIA, ALICO, or securitization notes transactions.

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

	Amount authorized	Direct AIG assistance		Indirect AIG Assistance		Total
		AIG debt owed to government	Government equity	Other debt owed to government	Government equity	
<b>Treasury</b>						
Series D/E	\$40,000		\$41,605 <sup>c</sup>			\$41,605 <sup>c</sup>
Series F	\$29,835		\$3,206 <sup>d</sup>			\$3,206 <sup>d</sup>
<b>Total</b>						
<b>Total direct assistance</b>		<b>\$38,792.5</b>	<b>\$44,811</b>			<b>\$83,603.5</b>
<b>Total indirect assistance</b>				<b>\$37,095</b>		<b>\$37,095</b>
<b>Total direct and indirect assistance to benefit AIG</b>	<b>\$182,335</b>	<b>\$38,792.5</b>	<b>\$44,811</b>	<b>\$37,095</b>		<b>120,698.5</b>

Source: AIG SEC filings, Federal Reserve Statistical Release H.4.1, and Treasury transactions reports.

Note: When all transactions regarding the placement of AIA, ALICO, and domestic life insurance companies into SPVs are completed, they will again change the composition of the federal assistance. The debt owed by AIG-related entities will increase by \$8.5 billion, government equity in AIG-related entities will increase by \$25 billion, and debt owed by AIG will decrease by \$33.5 billion.

<sup>a</sup>FRBNY reduced the amount of the commitment fee on the revolving credit facility by \$500,000 to pay for the Series C stock.

<sup>b</sup>These transactions are still pending and therefore, were not included in the total government equity exposure.

<sup>c</sup>When the Series E preferred shares were exchanged for Series D preferred shares, \$1.605 billion of accrued but unpaid dividends was included in the liquidation preference the government received.

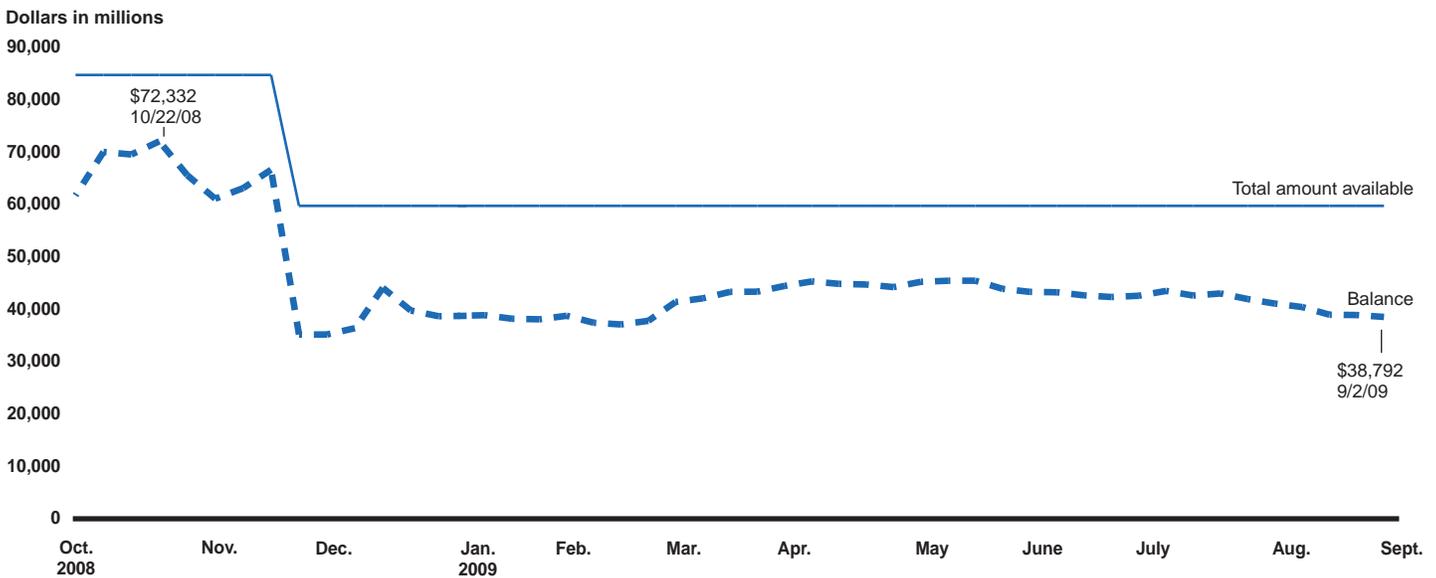
<sup>d</sup>\$3.2 billion represents the amount that AIG has drawn on the authorized \$29.8 billion facility.

**FRBNY Revolving Credit Facility Balance Owed and Total Amount Available.** This indicator is intended to monitor AIG's outstanding balance owed to the Revolving Credit Facility established by the FRBNY (see fig. 17). Outstanding loans are the weekly balance of credit extended to AIG under the Revolving Credit Facility, as reported by the FRBNY. Amounts reported include loan principal, all capitalized interest and fees, and the amortized portion of the initial commitment fee. AIG is able to borrow up to \$60 billion from this facility, excluding interest and fees.

As shown in figure 17, in November 2008 the outstanding balance on the credit facility was reduced when the proceeds from the issuance of Series D preferred stock to Treasury were used to pay down the balance owed and the ceiling on the credit facility was reduced from \$85 billion to \$60

billion. Since December 2008 the outstanding balance on the facility has remained fairly steady at around \$40 billion. Changes in amounts owed on the facility fluctuate weekly and could indicate increased liquidity needs related to restructuring decisions. Lower balances could indicate decreased liquidity needs and payments to the facility including payments in the form of preferred equity stakes in AIG assets.

Figure 17: FRBNY Revolving Credit Facility Balance Owed and Total Amount Available, October 2008 through September 2009



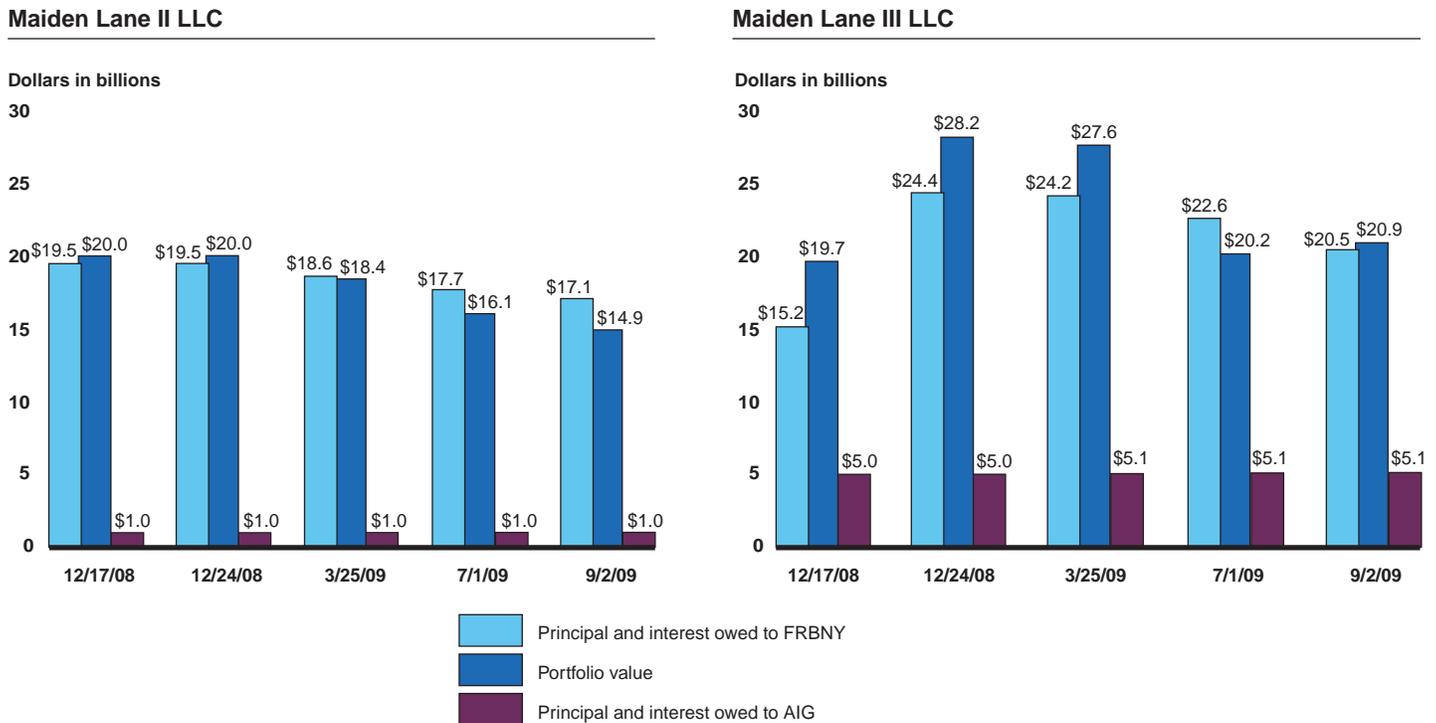
Source: Federal Reserve Statistical Release H.4.1 and Federal Reserve.

**Principal Owed and Portfolio Values of Maiden Lane Facilities.** The purpose of this indicator is to monitor Maiden Lane II and Maiden Lane III repayment of FRBNY loans to purchase AIG and the counterparty assets and the portfolio values of these assets (see fig. 18). FRBNY extended credit to each Maiden Lane facility, which then purchased assets from AIG domestic life insurance companies and, in the case of Maiden Lane II, its counterparties. The Maiden Lane II LLC portfolio includes residential mortgage-backed securities and the Maiden Lane III LLC portfolio includes multi-sector collateralized debt obligations. The FRBNY loans are to be repaid from the maturity or liquidation of assets from each facility. Payments from the net portfolio holdings of these facilities are to be made in the following order: operating expenses of the LLC, principal due to FRBNY, interest due to FRBNY, principal due to AIG and interest due to AIG. Any remaining funds are to be shared by FRBNY and AIG. AIG made

investments of \$1 billion to Maiden Lane II and \$5 billion to Maiden Lane III.

As shown in figure 18, the principal balance of the loans to Maiden Lanes and the value of their portfolios peaked in December 2008 and have subsequently trended downward.<sup>5</sup> The Federal Reserve said that it plans to hold on to the Maiden Lane assets until they mature or increase in value to a point where the Federal Reserve can maximize the amount of money recovered through a sale of assets. While the portfolio value has declined slightly, the Federal Reserve continues to believe that the assets held in the Maiden Lanes will appreciate over time.

**Figure 18: Principal Owed and Portfolio Values of Maiden Lane Facilities**

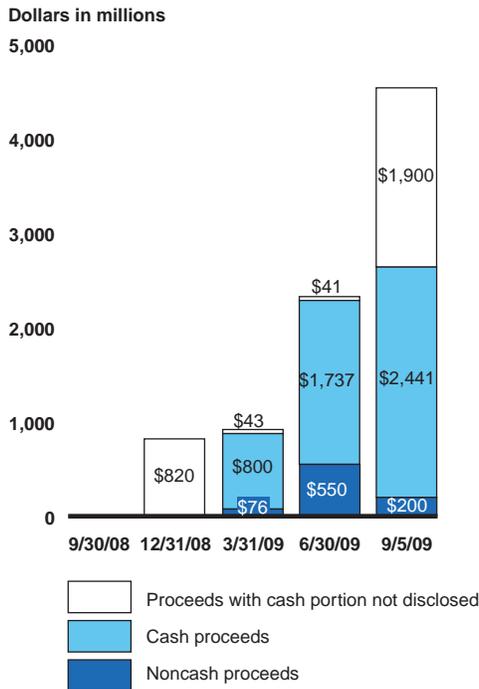


Source: Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet, June 2009.

<sup>5</sup>The portfolio value is based on the market value of the underlying assets and will mirror the change in value of those assets.

**AIG Business Unit Divestitures by Quarter.** The purpose of this indicator is to monitor sales of AIG entities and net cash proceeds from these sales (see fig. 19 and table 6). Total sales amount includes amount applied to repay AIG intercompany loan facilities. Estimated net cash proceeds is the amount available to apply to the Revolving Credit Facility balance. Asset sales are listed according to the quarter in which the transaction closed. Sales in 2009 have far surpassed those closed in 2008.

**Figure 19: Proceeds from Dispositions by Quarter, Second Quarter of 2008 through September 5, 2009**



Source: AIG SEC filings.

**Table 6: Dispositions Closed and Agreements Announced but not yet Closed, Second Quarter of 2008 through September 5, 2009 (dollars in millions)**

<b>Dispositions closed in quarter ending</b>	<b>Total Proceeds</b>
<b>September 30, 2008</b>	
not applicable	not applicable
<b>December 31, 2008</b>	
Unibanco JV	\$820
Taiwan Finance	N/D
<b>March 31, 2009</b>	
AIGFP Energy Commodity Hedges (all cash)	61
Philam Savings Bank	43
HSB (\$739 million cash)	815
<b>June 30, 2009</b>	
AIG Life Insurance Company of Canada (all cash)	263
Commodity Business (all cash)	15
AIG Retail Bank and AIG Card (Thailand) (\$45 million cash)	540
AIG Private Bank (\$250 million cash)	305
Darag	26
Real estate in Tokyo (all cash)	1,179
<b>September 5, 2009</b>	
21st Century Insurance Group (\$1,700 million cash)	\$1,900
CFG China	N/D
Consumer finance operations in Mexico	N/D
A.I. Credit Life (all cash)	741
Investment assets—energy & infrastructure	1,900
<b>Total proceeds on dispositions closed</b>	<b>\$8,608</b>
<b>Total cash proceeds on closed dispositions with terms disclosed</b>	<b>\$4,993</b>

---

**Appendix V: Overview of the AIG Risk and Repayment Indicators**

---

<b>Dispositions closed in quarter ending</b>	<b>Total Proceeds</b>
<b>Disposition agreements announced but not yet closed</b>	
AIG Finance- Hong Kong	627
Consumer finance operations in Russia	9
AIG Credit Card Co (Taiwan)	117
Consumer finance operations in Argentina	69
Consumer finance operations in Colombia	N/D
CFG Thailand: CFGS	N/D
UGC-Campus Partners	N/D
Consumer finance business in Poland	N/D
Portion of investment management advisory business	500
Transatlantic Holdings	1,096

---

Source: AIG.

Note: N/D means not disclosed

---

# Appendix VI: GAO Contact and Staff Acknowledgments

---

## GAO Contact

Orice Williams Brown, (202) 512-8678 or [williamsso@gao.gov](mailto:williamsso@gao.gov)

---

## Staff Acknowledgments

In addition to the contact named above, Karen Tremba and Patrick Ward (Assistant Directors); Silvia Arbelaez-Ellis, Tania Calhoun, Rachel DeMarcus, John Forrester, Dana Hopings, Matthew McDonald, Marc Molino, Barbara Roesmann, Christopher Ross, Jennifer Schwartz, Ellery C. Scott, Cynthia S. Taylor, and Melvin Thomas made important contributions to this report.

---

# Related GAO Products

---

*Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable.* [GAO-09-837](#). Washington, D.C.: July 23, 2009.

*Troubled Asset Relief Program: Capital Purchase Program Transactions for October 28, 2008, through May 29, 2009, and Information on Financial Agency Agreements, Contracts, Blanket Purchase Agreements, and Interagency Agreements Awarded as of June 1, 2009.* [GAO-09-707SP](#), an e-supplement to [GAO-09-837](#). Washington, D.C.: June 17, 2009.

*Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-658](#). Washington, D.C.: June 17, 2009.

*Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date.* [GAO-09-553](#). Washington, D.C.: April 23, 2009.

*Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act.* [GAO-09-507R](#). Washington, D.C.: April 16, 2009.

*Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-504](#). Washington, D.C.: March 31, 2009.

*Troubled Asset Relief Program: Capital Purchase Program Transactions for the Period October 28, 2008 through March 20, 2009 and Information on Financial Agency Agreements, Contracts, and Blanket Purchase Agreements Awarded as of March 13, 2009.* [GAO-09-522SP](#). Washington, D.C.: March 31, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-539T](#). Washington, D.C.: March 31, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-484T](#). Washington, D.C.: March 19, 2009.

*Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG.* [GAO-09-490T](#). Washington, D.C.: March 18, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-474T](#). Washington, D.C.: March 11, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-417T](#). Washington, D.C.: February 24, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-359T](#). Washington, D.C.: February 5, 2009.

*Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues.* [GAO-09-296](#). Washington, D.C.: January 30, 2009.

*High-Risk Series: An Update.* [GAO-09-271](#). Washington, D.C.: January 22, 2009.

*Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency.* [GAO-09-266T](#). Washington, D.C.: December 10, 2008.

*Auto Industry: A Framework for Considering Federal Financial Assistance.* [GAO-09-247T](#). Washington, D.C.: December 5, 2008.

*Auto Industry: A Framework for Considering Federal Financial Assistance.* [GAO-09-242T](#). Washington, D.C.: December 4, 2008.

*Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages.* [GAO-09-231T](#). Washington, D.C.: December 4, 2008.

*Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency.* [GAO-09-161](#). Washington, D.C.: December 2, 2008.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to [www.gao.gov](http://www.gao.gov) and select "E-mail Updates."

---

## Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Ralph Dawn, Managing Director, [dawnr@gao.gov](mailto:dawnr@gao.gov), (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, DC 20548

---

## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, DC 20548

