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United States Government Accountability Office

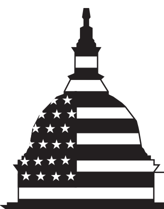
GAO

Report to Congressional Addressees

January 2011

TROUBLED ASSET RELIEF PROGRAM

Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan



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GAO-11-46

Highlights of GAO-11-46, a report to congressional addressees

January 2011

TROUBLED ASSET RELIEF PROGRAM

Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan

Why GAO Did This Study

Assistance provided by the Department of the Treasury (Treasury), under the Troubled Asset Relief Program (TARP), and the Board of Governors of the Federal Reserve System (Federal Reserve) to American International Group, Inc. (AIG) represents one of the federal government's largest investments in a private-sector institution since the financial crisis began in 2008. AIG is a holding company that, through its subsidiaries, engaged in a broad range of insurance and insurance-related activities in the United States and abroad.

As part of GAO's statutory oversight of TARP, this report updates a set of indicators GAO last reported in April 2010. Specifically, GAO discusses (1) trends in AIG's financial condition, (2) trends in the unwinding of AIG Financial Products (AIGFP) and the financial condition of AIG's insurance companies, and (3) the status of the government's exposure to AIG. To update the indicators, GAO primarily used available public filings as of September 30, 2010, and more current publicly available information; reviewed rating agencies' reports; and identified critical activities and discussed them with officials from Treasury, the Federal Reserve, and AIG.

Treasury, the Federal Reserve, and AIG provided technical comments that GAO incorporated, as appropriate.

View GAO-11-46 or key components.
For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov.

What GAO Found

Largely due to the federal assistance Treasury and the Federal Reserve provided to AIG, as measured by several indicators, AIG's financial condition has generally remained relatively stable or showed signs of improvement since GAO's last report in April 2010. As of September 30, 2010, the outstanding balance of the Federal Reserve and Treasury assistance to AIG was $123.7 billion, down from $129.1 billion in December 2009 (see table). Overall, federal assistance appears to be facilitating a more orderly restructuring of the company.

Several indicators show that AIGFP has continued to unwind its credit default swap positions and its portfolio of super senior credit default swaps. Several indicators on the status of AIG's insurance companies illustrate that its insurance operations are showing signs of recovery, but federal assistance has been a critical factor. In particular, in the first three quarters of 2010, additions to AIG life and retirement policyholder contract deposits exceeded withdrawals and the companies' pretax operating incomes, which increased slightly in 2009 remained positive. AIG's property/casualty companies have remained stabilized.

AIG repaid some of its debt to the federal government, but a larger volume of activity involved exchanging AIG's debt on the revolving credit facility (facility) with the Federal Reserve Bank of New York (FRBNY) for federally owned preferred interests in AIG ($40 billion) and AIA Group Limited (AIA) and American Life Insurance Company (ALICO) special purpose vehicles (SPV) ($25 billion). As a result of this shift from debt to equity, which has occurred gradually, the authorized amount of the facility has decreased and the amount of preferred equity interests held in AIG and various SPVs for the government has increased. For example, as of September 30, 2010, the amount of assistance available to AIG through the facility had been reduced to $29.2 billion and the amount AIG owed the facility was reduced to $20.5 billion. Also, FRBNY'S preferred interests in the SPVs created to hold the shares of certain foreign life insurance companies—AIA and ALICO—have increased nearly $1 billion and the Series F stock held by Treasury has increased more than $2 billion since December 31, 2009. Upon the execution of the recapitalization plan on January 14, 2011, all of the government's assistance to AIG is now in the form of common stock and preferred interests. Consequently, the government's, and thus the taxpayer's, exposure to AIG increasingly is expected to be tied to the success of AIG, its ongoing performance, and its value as seen by investors of AIG's common stock. The sustainability of any positive trends in AIG's operations depends on how well AIG manages its business, and the government's ability to fully recoup the federal assistance will be determined by the long-term health of AIG and subject to uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. GAO will continue to monitor these issues in its future work.

Overview of Federal Assistance Provided to AIG as of September 30, 2010

Dollar in billions

	Description of the federal assistance	Amount of assistance authorized: Debt	Amount of assistance authorized: Equity	Outstanding balance	Sources to repay the government
Implemented					
Federal Reserve	FRBNY created a revolving credit facility to provide a revolving loan that AIG and its subsidiaries could use to enhance their liquidity positions. In exchange for the facility and $0.5 million, a trust received Series C preferred stock for the benefit of Treasury, which gives the trust an approximately 79.75 percent voting interest in AIG.	$29.175[a]	n/a	$20.470	On January 14, 2011, AIG announced that it executed the signed recapitalization plan, which stated that AIG is using the net cash proceeds from the recent AIA IPO and the sale of ALICO to MetLife to repay the FRBNY revolving credit facility.
	FRBNY created a SPV—Maiden Lane II—to provide AIG liquidity by purchasing residential mortgage-backed securities 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.	22.5	n/a	13.656[b]	Proceeds from asset sales in Maiden Lane II will be used to repay the FRBNY loan.
	FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing collateralized debt obligations from AIGFP counterparties in connection with the termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30	n/a	14.638[b]	Proceeds from asset sales in Maiden Lane III will be used to repay the FRBNY loan.
	AIG created two SPVs, one for AIA and one for ALICO, to hold the shares of certain of its foreign life insurance businesses. On December 1, 2009, FRBNY received preferred interests in the SPVs of $16 billion and $9 billion, respectively, in exchange for reducing debt AIG owed on the revolving credit facility. The SPVs allowed AIG to strengthen its balance sheet by reducing debt and increasing equity and also were intended to facilitate dispositions to generate cash for repayment of the federal assistance.	n/a	25	25.955	On November 1, 2010, AIG announced the completion of an initial public offering of AIA on the Hong Kong Stock Exchange that generated gross proceeds of $20.51 billion. Also, on November 1, 2010, AIG announced that it had closed on the sale of ALICO to MetLife for approximately $16.2 billion, of which $7.2 billion is in cash. The cash proceeds will allow AIG to fully repay and close the revolving credit facility on closing of the recapitalization plan.
Treasury	Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the FRBNY revolving credit facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends on the Series D shares were added to the principal amount of Series E stock that Treasury received.	n/a	40	41.605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to $29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares.	n/a	29.835	7.378[c]	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
Subtotals		**$81.675**	**$94.835**		
Total authorized (debt and equity)			**$176.510[d]**		
Total outstanding assistance				**$123.702**	

Source: GAO analysis of AIG Securities and Exchange Commission filings, Federal Reserve, and Treasury data.

[a]The borrowing limit on the revolving credit facility was initially $85 billion, but was reduced to $60 billion in November 2008 and then reduced again to $35 billion in December 2009. The facility was reduced to $34.2 billion by March 31, 2010, to $33.728 billion by June 30, 2010, and to $29.175 billion by October 6, 2010; these reductions were attributed to repayments from proceeds obtained from the sale of various assets and businesses. The authorized and outstanding balances ast of September 30, 2010, shown above, include outstanding principal and exclude accrued interest and fees of $6.182 billion. The AIG loan balance reported in the H.4.1 reflects the outstanding principal balance, capitalized interest, unamortized deferred commitment fees, and the allowance for the loan restructuring, which was initially recorded in July 2009.

[b]Government debt shown for Maiden Lane facilities as of September 29, 2010, are principal only and do not include accrued interest of $408 million for Maiden Lane II and $499 million for Maiden Lane III.

[c]As of January 14, 2011, AIG had drawn down approximately $21 billion as part of the restructuring plan.

[d]The Federal Reserve and Treasury had made $182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to $176.5 billion.

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Abbreviations

AIA	AIA Group Limited
AIG	American International Group, Inc.
AIGFP	AIG Financial Products Corp.
ALICO	American Life Insurance Company
CDO	collateralized debt obligation
CDS	credit default swap
CPFF	commercial paper funding facility
DPW	direct premiums written
EESA	Emergency Economic Stabilization Act of 2008
Federal Reserve	Board of Governors of the Federal Reserve System
FRBNY	Federal Reserve Bank of New York
IPO	initial public offering
NAIC	National Association of Insurance Commissioners
NYSE	New York Stock Exchange
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
TARP	Troubled Asset Relief Program
Treasury	Department of the Treasury

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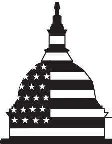


GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

January 20, 2011

Congressional Addressees

Assistance provided to American International Group, Inc. (AIG) represented one of the federal government's largest investments in a private-sector institution since the financial crisis began in 2008. AIG is a holding company that, through its subsidiaries, engages 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. The potential demise of this company in 2008 threatened to further disrupt the already troubled financial markets. To minimize the likelihood of such a scenario, the Board of Governors of the Federal Reserve System (Federal Reserve) and, subsequently, the Department of the Treasury (Treasury) deemed AIG to be systemically significant, opening the door for these entities to provide extraordinary assistance to AIG. The Federal Reserve, through its emergency powers under section 13(3) of the Federal Reserve Act, and Treasury, through the Emergency Economic Stabilization Act of 2008 (EESA), which authorized the Troubled Asset Relief Program (TARP), collaborated to make available more than $180 billion in assistance to AIG.[1] The assistance has been used to strengthen AIG's financial condition and avert a failure of the company and, in turn, further disruption of the financial markets. While Treasury, the Federal Reserve Bank of New York (FRBNY), the AIG Credit Facility Trust, AIG, and two special purpose vehicles (SPV)—ALICO Holdings LLC and AIA Aurora LLC—recently signed a restructuring agreement designed to enable AIG to more quickly

[1]EESA, 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 EESA 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. While the Secretary of the Treasury extended the authority provided under EESA through October 3, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010), enacted on July 21, 2010, (1) reduced Treasury's authority to purchase or insure troubled assets to $475 billion and (2) prohibited Treasury from using its authority, under EESA to incur any additional obligations for a program or initiative unless the program or initiative already had begun before June 25, 2010.

repay the assistance, Treasury's ability to recoup its investment depends on the long-term health of AIG and a number of other factors.[2]

Under our statutorily mandated responsibilities for providing timely oversight of TARP, we are continuing to report on the federal government's assistance to AIG.[3] To help Congress monitor the condition of AIG and the government's ability to recoup its assistance to AIG, we have developed indicators to monitor trends in AIG's operations and the status of repayments. Because government assistance to AIG is a coordinated approach, in addition to providing timely reporting of Treasury's assistance to AIG, we also are monitoring the efforts of the Federal Reserve.[4] In September 2009 we issued a report on the status of government assistance to AIG where we first reported on these indicators, which we updated that report in April 2010.[5] Since then, we have continued to monitor the financial risk posed by AIG, its financial condition, and the status of its repayment efforts.[6] This report provides an

[2]For the signed agreement, see AIG's 8K filing dated December 8, 2010.

[3]We must report at least every 60 days on findings resulting from oversight of TARP's performance in meeting the purposes of EESA, the financial condition and internal controls of TARP, the characteristics of both asset purchases and the disposition of assets acquired, TARP's efficiency in using the funds appropriated for the program's operation, TARP's compliance with applicable laws and regulations, and other matters. 12 U.S.C. § 5226(a).

[4]Our ability to review the Federal Reserve's assistance was clarified by the Helping Families Save Their Homes Act of 2009, enacted on May 20, 2009, which provided us authority to audit Federal Reserve actions taken under section 13(3) of the Federal Reserve Act "with respect to a single and specific partnership or corporation." Among other things, this amendment provides us with authority to audit Federal Reserve actions taken with respect to three entities also assisted under TARP—Citigroup, Inc.; AIG; and the Bank of America Corporation. It also gives us the authority to access information from entities participating in TARP programs, such as AIG, for purposes of reviewing the performance of TARP. Section 1109 of the Dodd-Frank Act provided us authority to review various aspects of Federal Reserve facilities initiated in response to the financial crisis. This related work is underway and we will issue a future report on the results.

[5]See GAO, *Troubled Asset Relief Program: Status of Government Assistance to AIG*, GAO-09-975 (Washington, D.C.: Sep. 21, 2009). For our previous testimony on the assistance provided to AIG, see *Troubled Asset Relief Program: Update of Government Assistance Provided to AIG*, GAO-10-475 (Washington, D.C.: Apr. 27, 2010) and *Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG*, GAO-09-490T (Washington, D.C.: Mar. 18, 2009).

[6]Representatives Towns and Cummings, House Committee on Oversight and Government Reform, and Representative Bachus, House Committee on Financial Services, asked us to review certain Federal Reserve actions relating to its assistance to AIG. We will address questions raised by these requests in a future report.

update on the AIG indicators primarily based on AIG's latest available public filings as of September 30, 2010, and other more current publicly available information where available. Specifically, the report discusses (1) trends in AIG's financial condition, (2) trends in the unwinding of AIG Financial Products (AIGFP), (3) the financial condition and performance of AIG's insurance companies, and (4) the status of the government's exposure to AIG.

To conduct this work, we updated previously published indicators that address several dimensions of AIG's business, including its credit ratings, operating performance, capital, debt repayment, and liquidity position. The data used to create the indicators are collected from several sources, but most are based on publicly available information, such as AIG's 10K and 10Q filings with the Securities and Exchange Commission (SEC) and National Association of Insurance Commissioners reports. We analyzed AIG's SEC filings, and any supplements for those filings, through the third quarter of 2010. We also analyzed information from Thomson Reuters Datastream and the National Association of Insurance Commissioners. We obtained the most recent ratings of AIG from credit rating agencies. We also analyzed data from recent issues of the Federal Reserve weekly statistical releases H.4.1 and Treasury's Financial Position Paper 09-07. AIG also provided updated information on its asset dispositions. We assessed the reliability of the data and found that the data were sufficiently reliable for our purposes.

To assess AIG's financial condition, we updated indicators of key AIG credit ratings, its corporate debt and liquidity positions, trends in shareholder equity, operating income and losses, and its credit default swap (CDS) premiums. We also included a new indicator of AIG's operating, investing, and financing cash flows. To assess the unwinding of AIGFP, we updated our indicators on AIGFP's trading positions and employee count and CDS portfolio.[7] To assess the financial condition of AIG's insurance companies, we reviewed the regulatory capital of AIG's largest domestic property/casualty and life insurance and retirement services companies, additions to and withdrawals from policyholder contract deposits, revenues and expenses for life insurance and retirement services, AIG general insurance premiums written, and combined ratios.

[7]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 to compensate the buyer in return for a periodic fee if a specified credit event, such as default, occurs.

To determine the status of AIG's repayment of its federal assistance, we updated the composition of the government's direct and indirect assistance to AIG, FRBNY's revolving credit facility balance, balances on the Maiden Lane facilities, and AIG's divestitures and asset dispositions.[8] We report the balances of the federal debt and equity assistance as of September 30, 2010, because our primary source for equity data—AIG's 10Q filing with SEC—is only available quarterly, and the 10Q report containing more current data is not yet publicly available. We also updated selected information to reflect the January 14, 2011, closing of AIG's recapitalization plan. No single indicator provides a definitive measure of AIG's progress, and the indicators in this report should be considered collectively. We selected indicators that appeared to track the most critical activities related to the goals for federal assistance to AIG. Since our last report, we have developed two new indicators of AIG's financial condition: one to track the performance of AIG's insurance companies and one to track federal assistance to AIG.

We conducted our work from May 2010 to January 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions.

Background

AIG comprises approximately 400 companies and has operations in more than 130 countries and jurisdictions worldwide. As of September 30, 2010, AIG had assets of $872 billion and revenues of $19.1 billion for the three preceding months. The AIG companies are among the largest domestic life insurers and domestic property/casualty insurers in the United States, and they also comprise large foreign general insurance and life insurance businesses. Appendix I illustrates the breadth of AIG's operations and its subsidiaries.

[8]FRBNY created Maiden Lane II as an SPV to provide AIG liquidity through its purchase of 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. FRBNY also created Maiden Lane III as an SPV to provide AIG liquidity through its purchase of collateralized debt obligations from AIGFP's counterparties in connection with termination of CDS. FRBNY again provided a loan to the SPV for the purchases. See GAO-09-975 (starting on page 30) for more discussion on FRBNY's creation of these SPVs.

AIG Operations

Historically, AIG has issued commercial paper to help finance its operations, but since the recent financial crisis, at the corporate level, AIG has had to draw on other short-term funding sources.[9] For example, as of December 31, 2007, AIG reported having $13.1 billion of commercial paper outstanding, and as of September 30, 2010, it had none outstanding. It also continues to be a participant (although at declining levels) in the derivatives market through AIGFP—a financial products subsidiary that engaged in a variety of financial transactions, including standard and customized financial products, which were a major source of AIG's liquidity problems. As of September 30, 2010, AIG's total gross derivatives assets had a fair value of $28.1 billion, of which $23.5 billion pertained to capital markets, down from $34.5 billion and $32 billion, respectively, at the end of 2009. Additionally, until 2008, AIG had maintained a large securities lending program operated by its insurance subsidiaries. The securities lending program allowed insurance companies, primarily AIG's life insurance companies, to lend securities in return for cash collateral that was invested in investments such as residential mortgage-backed securities (RMBS). This program was the initial source of AIG's liquidity problems in 2008.

Federal, state, and international authorities regulate AIG and its subsidiaries. Until recently, the Office of Thrift Supervision was the consolidated supervisor of AIG, which was a thrift holding company by virtue of its ownership of the AIG Federal Savings Bank. As the consolidated supervisor, the Office of Thrift Supervision was charged with identifying systemic issues or weaknesses and helping ensure compliance with regulations that govern permissible activities and transactions.[10] AIG's domestic, life, and property/casualty insurance companies are regulated by the state insurance regulators in the state in which these companies are domiciled.[11] These state agencies regulate the financial solvency and market conduct of these companies, and 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

[9]Commercial paper refers to short-term promissory notes that are issued primarily by corporations to finance their short-term credit needs.

[10]For more information on the role of consolidated supervisors, see GAO, Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration, GAO-07-154 (Washington, D.C.: Mar. 15, 2007).

[11]The primary state insurance regulators include New York, Pennsylvania, and Texas.

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. Finally, AIG's general insurance business and life insurance business that are conducted in foreign countries are regulated by the supervisors in those jurisdictions to varying degree.

In addition, Treasury's purchase, management, and sale of assets under TARP, including those associated with AIG, are subject to oversight by the Special Inspector General for TARP (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 certain AIG assets.[12] SIGTARP's reporting on AIG's activities also has included reports that focused on federal oversight of AIG compensation and efforts to limit AIG's payments to its counterparties.[13] The Congressional Oversight Panel, which helps provide oversight of TARP, also issued a report in June 2010, which reviewed the government's actions precipitating its assistance to AIG and identified several of its concerns with the rescue of AIG.[14] It concluded that while the government averted a financial collapse, it put billions of taxpayer dollars at risk, changed the marketplace, and adversely affected the confidence of the American people in the market.

[12]SIGTARP: Office of the Special Inspector General for the Troubled Asset Relief Program: *Quarterly Report to Congress* (Oct. 26, 2010); *Quarterly Report to Congress* (July 21, 2010); *Quarterly Report to Congress* (Apr. 20, 2010); *Quarterly Report to Congress* (Jan. 30, 2010); *Quarterly Report to Congress* (Oct. 21, 2009); *Quarterly Report to Congress* (July 21, 2009); *Quarterly Report to Congress* (Apr. 21, 2009); and *Initial Report to the Congress* (Feb. 6, 2009).

[13]SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, *Extent of Federal Agencies' Oversight of AIG Compensation Varied, and Important Challenges Remain* (Oct. 14, 2009); and *Factors Affecting Efforts to Limit Payments to AIG Counterparties* (Nov. 17, 2009).

[14]Congressional Oversight Panel, *June Oversight Report: The AIG Rescue, Its Impact on Markets, and the Government's Exit Strateg*y (Washington, D.C., June 10, 2010). Specifically, the panel was concerned that (1) the government did not exhaust its options before committing $85 billion in assistance to AIG; (2) the assistance distorted the marketplace; (3) some banks displayed a conflict in interest by acting at various times as advisors to, potential rescuers of, and counterparties with AIG; (4) AIG may not repay taxpayers for the assistance they provided; and (5) the AIG bailout may be seen as setting a precedent by implicitly guaranteeing "too big to fail" firms.

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

In September 2008, the Federal Reserve, FRBNY, 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 have posed systemic risk to financial markets.[15] Consequently, the Federal Reserve and Treasury took steps to help ensure that AIG obtained sufficient funds to continue to meet its obligations and could complete an orderly sale of its operating assets and close its investment positions in its securities lending program and AIGFP. The federal government first provided assistance to AIG in September 2008 and subsequently modified and amended that assistance.

AIG's Financial Problems Mounted Rapidly in 2008

From July through early September in 2008, AIG faced increasing liquidity pressure following a downgrade in its credit ratings in May 2008 due in part to losses from its securities lending program. The company was experiencing declines in the value and market liquidity of the RMBS assets that comprised to collateral for its securities lending operation and declining values of collateralized debt obligations (CDO) against which AIGFP had written CDS protection.[16] These losses 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 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. 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.

[15]In our March 2009 testimony on credit default swaps, we noted that no single definition for systemic risk exists. 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).

[16]CDOs are securities backed by a pool of bonds, loans, or other assets.

The Federal Reserve and Treasury Took a Variety of Steps to Assist AIG

Because of increasing concerns that an AIG failure would have posed systemic risk to financial markets, in 2008 and 2009 the federal government agreed to make more than $182 billion of federal assistance available to AIG. First, in September 2008, the Federal Reserve, with the support of Treasury, authorized FRBNY to lend AIG up to $85 billion.[17] The secured loan was set up as a revolving credit facility that AIG could use as a reserve to meet its obligations. This debt was subsequently restructured in November 2008 and March 2009. As of September 30, 2010, the amount of assistance to available AIG through the FRBNY facility had declined by about $5.8 billion from December 31, 2009 because of mandatory prepayments that reduced the amount available under the facility, lowering the amount of federal assistance available to AIG to $176.5 billion.

In late 2008, 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 in shares of AIG preferred stock (Series D) and the cash from the sale was used to pay down a portion of AIG's outstanding balance from the revolving credit facility. The limit on the facility also was reduced to $60 billion, and other changes were made. 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. According to the Federal Reserve, debt owed by AIG on the revolving credit facility would be reduced by $25 billion in exchange for FRBNY's receipt of preferred equity interests totaling $25 billion in two SPVs. AIG created both SPVs to hold the outstanding common stock of two life insurance company subsidiaries—American Life Insurance Company (ALICO) and AIA Group Limited (AIA). FRBNY's preferred interests, which were valued at $25 billion in June 2010, are an undisclosed percentage of the fair market value of ALICO and AIA as determined by FRBNY. On March 1, 2010, AIG announced that its

[17]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 U.S. Treasury would become the majority equity investor in AIG. The independent trust would manage the Treasury's beneficial interest in preferred shares (Series C) of AIG. The Series C stock is convertible into approximately 79.75 percent of the issued and outstanding shares of common stock of AIG.

board had approved the sale of AIA to Prudential PLC. The ultimate disposition is discussed later in the report.

Federal assistance to AIG also included FRBNY's creation of 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 working capital, and on November 10, 2008, FRBNY announced plans to create an RMBS facility—Maiden Lane II LLC—to purchase RMBS assets from AIG's U.S. securities lending portfolio. 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). As of September 29, 2010, Maiden Lane II owed $14.1 billion in principal and interest to FRBNY, down from $16 billion in December 2009.

In addition, on November 10, 2008, FRBNY announced plans to create a separate facility—Maiden Lane III LLC—to purchase multisector CDOs on which AIGFP had written CDS contracts.[18] This facility was aimed at facilitating the restructuring of AIG by addressing the greatest threat to AIG's liquidity position. In connection with the purchase of the CDOs, AIG's CDS counterparties agreed to terminate the CDS contracts.[19] The Federal Reserve authorized FRBNY to lend up to $30 billion to Maiden Lane III. On November 25, 2008, and December 18, 2008, FRBNY extended a total of $24.3 billion in loans to Maiden Lane III; AIG also paid $5 billion for an equity interest in Maiden Lane III and agreed to absorb the first $5 billion of any losses. As of September 29, 2010, Maiden Lane III owed $15.1 billion in principal and interest to FRBNY, down from $18.5 billion in December 2009.

[18]A multisector CDO is a CDO backed by a combination of corporate bonds, loans, asset-backed securities, or mortgage-backed securities.

[19]AIGFP sold CDS on multisector 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.

When the Maiden Lanes were created, FRBNY officials said that the FRBNY loans to Maiden Lane II and Maiden Lane III were both expected to be repaid with the proceeds from the interest and principal payments or liquidation of the assets in the facilities. The repayment is to occur through cash flows from the underlying securities as they were paid off. Accordingly, the Federal Reserve did not set a date for selling the assets; rather it has indicated that it is prepared to hold the assets to maturity if necessary.

In March 2009, the Federal Reserve announced its intention to assist AIG in the form of credit made under section 13(3) of the Federal Reserve Act. FRBNY was authorized to make loans of up to an aggregate amount of approximately $8.5 billion to SPVs to be established by certain AIG domestic life insurance subsidiaries. As announced, the SPVs were to repay the loans from the net cash flows they were to receive from designated blocks of existing life insurance policies issued by the insurance companies. The proceeds of the FRBNY loans were to pay down an equivalent amount of outstanding debt under the revolving credit facility. However, in February 2010, AIG announced that it was no longer pursuing this life insurance securitization transaction with FRBNY.

Treasury also has provided assistance to AIG. On November 10, 2008, Treasury's Office of Financial Stability announced plans 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.[20] As previously discussed, the proceeds of this sale were used to pay down AIG's outstanding balance on the revolving credit facility.

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 E stock and the Series D stock

[20]Cumulative preferred stock is a form of capital stock in which holders of preferred stock receive dividends before holders of common stock, and dividends that have been omitted in the past must be paid to preferred shareholders before common shareholders can receive dividends.

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.

Finally, 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. The facility was intended to strengthen AIG's capital levels and improve its leverage.

As AIG draws on the equity capital facility, the aggregate liquidation preference of the Series F stock is adjusted upward.[21] As of September 30, 2010, AIG had drawn down about $7.4 billion of the commitment, up from $5.2 billion in December 2009. 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 30, 2010.

Table 1: U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure, as of September 30, 2010

Dollars in billions

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
Federal Reserve				
FRBNY created a revolving credit facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity positions. In exchange for the facility and $0.5 million, a trust received Series C preferred stock for the benefit of the Treasury, which gives the trust an approximately 79.75 percent voting interest in AIG.	$29.175[a]	n/a	$20.470	On January 14, 2011, AIG announced that it executed the signed recapitalization plan, which stated that AIG is using the net cash proceeds from the recent AIA IPO and sale of ALICO to MetLife to repay the FRBNY credit facility.

[21]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.

Dollars in billions

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
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.	22.5	n/a	13.656[b]	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan.
FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing CDOs from AIGFP's counterparties in connection with the termination of CDS. FRBNY again provided a loan to the SPV for the purchases.	30	n/a	14.638[b]	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan.
AIG created two SPVs (AIA and ALICO) to hold the shares of certain of its foreign life insurance businesses. On December 1, 2009, FRBNY received preferred equity interests in the SPVs of $16 billion and $9 billion, respectively, in exchange for reducing debt that AIG owed on the revolving credit facility. The SPVs allowed AIG to strengthen its balance sheet by reducing debt and increasing equity and also were intended to facilitate dispositions to generate cash for repayment of the federal assistance.	n/a	$25	25.955	On November 1, 2010 AIG announced the completion of an initial public offering of AIA on the Hong Kong Stock Exchange that generated gross proceeds of $20.51 billion. Also, on November 1, 2010, AIG announced that it had closed on the sale of ALICO to MetLife for approximately $16.2 billion ($7.2 billion in cash, plus $9 billion in MetLife securities). Cash proceeds will allow AIG to fully repay and close the revolving credit facility on closing of the recapitalization plan.
Treasury				
Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the FRBNY revolving credit facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends ($1.605 billion) on the Series D shares were added to the principal amount of Series E stock that Treasury received.	n/a	40	41.605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.

Dollars in billions

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to $29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares.	n/a	29.835	7.378[c]	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
Subtotals	**$81.675**	**$94.835**		
Total authorized (debt and equity)		**$176.510**[d]		
Total outstanding assistance			**$123.702**	

Sources: GAO analysis of AIG SEC filings, Federal Reserve, and Treasury data.

[a]The borrowing limit on the revolving credit facility was initially $85 billion, reduced to $60 billion in November 2008, and reduced to $35 billion in December 2009. The facility was reduced to $34.2 billion by March 31, 2010, to $33.728 billion by June 30, 2010, and to $29.175 billion by October 6, 2010; these reductions were attributed to repayments from proceeds obtained from the sale of various assets and businesses. The authorized outstanding balances as of September 30, 2010 shown above include principal and exclude accrued interest and fees of $6.182 billion. The AIG loan balance reported in the H.4.1 reflects the outstanding principal balance, capitalized interest, unamortized deferred commitment fees, and the allowance for the loan restructuring, which was initially recorded in July 2009.

[b]Government debt shown for the Maiden Lane facilities as of September 29, 2010, are principal only and do not include accrued interest of $408 million for Maiden Lane II and $499 for Maiden Lane III.

[c]As of January 14, 2011, AIG had drawn down approximately $21 billion as part of the restructuring plan.

[d]The Federal Reserve and Treasury had made $182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to $176.5 billion.

Federal Assistance Remains Key to Improving AIG's Financial Condition

As of the third quarter of 2010, AIG's financial condition has remained relatively stable or slightly improved as measured by several indicators since we last reported on AIG's indicators in April 2010. These include the strength of AIG's credit ratings; trends and levels of available liquidity and sources for working capital; the level of shareholders' equity and trends in operating income; and CDS premiums on AIG, which is the going market price for credit protection on AIG. This improvement is largely attributable to the assistance AIG has received from the Federal Reserve and Treasury, not its ability to access private sources of capital. Specifically, AIG's credit ratings have remained fairly stable through the third quarter of 2010 in large part because government support has continued to fill AIG's short-term capital needs and allowed AIG to meet its payment obligations. Similarly, AIG's level of available corporate liquidity has remained fairly

stable, although the FRBNY revolving credit facility and Treasury's equity capital facility continue to be its primary sources of working capital. While the company's long-term goal is to rely on private sector sources of liquidity and its own operations instead of the government, AIG remains heavily reliant on federal assistance to meet its liquidity needs. Trends and the level of AIG's consolidated shareholders' equity—generally, a company's total assets minus total liabilities—improved in 2009 and remained fairly stable in the first nine months of 2010. While federal assistance largely drove the improvements, AIG's performance also has contributed to the improvements in its equity position. While our new indicator of AIG's cash flows shows that the company's net cash flows from operating, investing, and financing activities have been improving, AIG remains dependent on federal assistance for liquidity. 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. However, whether AIG will return to positive retained earnings, which should further increase shareholders' equity, remains unclear. Further, measures of AIG's operating income and losses illustrate that because of federal assistance, the large increasing losses AIG experienced through 2008 slowed in 2009. AIG generated a modest income in the second quarter of 2009 but experienced increasing losses in the third and fourth quarters. However, these losses were smaller than the operating losses experienced in 2008. During the first three quarters of 2010 AIG generated income from continuing operations that was more than offset by larger losses from discontinued operations. Finally, trends in CDS premiums on AIG showed that the downward-trending and stabilizing prices offered for credit protection on AIG that began in May 2009 has continued through November 2010.

AIG's Credit Ratings Remained Fairly Stable from December 2009 through September 2010

Ratings of AIG's debt and financial strength by various credit rating agencies have either remained unchanged or improved slightly from December 2009 through September 2010, primarily because federal assistance has provided AIG with needed capital. Credit ratings measure a company's ability to repay its obligations and directly affect that company's cost of and ability to access unsecured financing. If a company's ratings are downgraded, its borrowing costs can increase, capital can be more difficult to raise, business partners may terminate contracts or transactions, counterparties can demand additional collateral, and operations can become more constrained generally. Rating agencies can downgrade the company's key credit ratings if they believe it is unable to meet its obligations. In AIG's case, this could affect its ability to raise funds and could increase the cost of financing its major insurance

operations, and, in turn, impede its restructuring efforts. A downgrade in AIG's credit ratings also could result in downgrades on insurer financial strength ratings for the AIG life and property/casualty companies, further declines in credit limits, and counterparties demanding that AIG post additional collateral. Collectively, these effects from a rating downgrade could impede AIG's restructuring efforts and hamper any plans to access traditional sources of private capital to replace the public investments. Conversely, an upgrade in AIG's credit ratings would indicate an improvement in its condition and possibly lead to lower borrowing costs and facilitate corporate restructuring.

While some of AIG's key credit ratings declined in 2009 and early 2010, overall, they have remained unchanged or improved slightly since December 2009.[22] For example, from December 2009 to March 31, 2010, all four of the major rating agencies maintained the same credit ratings for AIG's long-term and short-term debt due in large part to Federal Reserve and Treasury support.[23] Over this same period, AM Best and Standard and Poor's (S&P) also maintained their same ratings for the financial strength of AIG's property/casualty and life insurance companies, while Moody's lowered their life insurer ratings from "A1/developing" to "A1/negative." Also, Fitch placed AIG's U.S. property/casualty companies on "rating watch negative." This occurred in February 2010 because of its concerns about AIG's reserve adequacy and the underlying profitability of its casualty businesses. The downgrade followed AIG's disclosure of the company's fourth quarter 2009 results, which included a $2.3 billion pretax increase in reserves in its domestic property/casualty companies for prior accident years. However, in early July 2010, Fitch reviewed all of AIG's ratings, affirmed those ratings; revised the rating outlook to "stable" from "evolving," removed the property/casualty companies from "rating watch negative;" and reassigned them as "stable outlook." Fitch's ratings of AIG have remained unchanged since then. In April 2010, S&P affirmed its ratings of AIG and maintained their negative outlook, reflecting its view of the challenges AIG faces in sustaining the performance of its insurance operations and capitalizing its life insurance businesses. S&P's ratings also

[22]See appendix II for a detailed listing of AIG's historical and current credit ratings and an explanation of the meaning of the various credit ratings.

[23]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). While these ratings are described using slightly different terminology, they tend to show relative consistency in the strength of AIG's debt.

have remained unchanged. Moody's, however, as of September 2010, placed AIG's short-term ratings on review for possible downgrade. While contributing to stable ratings thus far, the level of the federal assistance eventually may raise questions about AIG's future prospects if the company is not able to raise capital from private sources. The importance of AIG's forthcoming credit ratings is underscored by the recent recapitalization and restructuring plan; one of the conditions for recapitalization is that the financial condition of AIG; the primary insurance companies of Chartis, Inc.; and the primary insurance companies of SunAmerica Financial Group, taking into account the recapitalization and the ratings profile of these companies, are to be reasonably acceptable to FRBNY, Treasury, the AIG Credit Facility Trust, and AIG. But there are no assurances that AIG and its subsidiaries will meet this condition.

The general stability of AIG's long-term debt ratings has allowed the company to avoid collateral and termination payments that could result from a ratings downgrade because counterparties might demand such payments at the sign of weakening financial strength. Similarly, generally stable life-insurer financial strength ratings have helped keep down both the surrender rate of domestic retirement services and any pressure on the company to exit businesses that serve high net-worth clients or businesses governed by trust contracts. Further, generally stable financial strength ratings for property/casualty have helped hold down any significant losses in net premiums written and operating losses.

Federal Assistance Continues to Allow AIG to Maintain a Steady Level of Liquid Assets and Debt Projections Remain Stable

Since the fourth quarter of 2008, federal assistance has provided AIG with a stable source of liquidity, and projections of debt also remained fairly stable. Because a financially healthy business should have adequate holdings of liquid assets to cover maturing debt, we use three indicators to monitor AIG's corporate liquidity.[24] One indicator monitors the timing of potential future demand on AIG's corporate liquidity posed by its maturing debt and AIG's ability to meet its cash payment needs. If working and short-term capital become less accessible or if the level of maturing debt increases, AIG could face a higher risk of another liquidity crisis. The second indicator monitors the amount of corporate liquidity available from specific sources. Sources of available liquidity provide an indication of

[24]Liquid assets—such as accounts receivable, cash on hand, treasury bills, and certificates of deposits—are assets that can be converted easily and quickly to cash.

how AIG obtains the funds needed to meet its obligations. The third indicator monitors the extent to which AIG has used commercial paper to strengthen its liquidity position. The greater the portion of current available liquidity provided by AIG's own operations, the less reliant AIG will be on federal assistance.

As indicated in figure 1, by the third quarter of 2008, AIG's corporate-level liquid assets (corporate liquidity) were becoming insufficient to meet its companywide debt obligations, with much of that debt—attributable to the Federal Reserve's revolving credit facility—maturing in 2010. In the fourth quarter of 2008, AIG's remaining available corporate liquidity reached a low of $26.7 billion, as AIG began utilizing its access to the commercial paper funding facility (CPFF) by issuing commercial paper.[25] In that same quarter the Federal Reserve restructured the original payment date for the credit facility. This restructuring reduced the amount of maturing debt in the facility from $62.9 billion in the third quarter of 2008 to $40.4 billion in the fourth quarter of 2008, which occurred when proceeds from the issuance of the new Series D preferred stock (new with the restructuring) to Treasury were used to pay down a portion of the balance owed on the facility. The restructuring also gave AIG more time to repay its debt to the facility, moving the due date from 2010 to 2013.[26] From the fourth quarter of 2008 to the third quarter of 2009, AIG nearly doubled its available corporate liquidity to about $50 billion because of its access to the restructured FRBNY revolving credit facility and CPFF.

[25]CPFF, a Federal Reserve emergency facility that became operational in October 2008 and closed in February 2010, provided a liquidity backstop to U.S. issuers of commercial paper through an SPV that purchased eligible 3-month unsecured and asset-backed commercial paper from eligible issuers using financing provided by FRBNY. Its purpose was to enhance the liquidity of the commercial paper market.

[26]The amount of maturing debt was reduced when the amount authorized on the facility was reduced from the original $85 billion to $60 billion.

Figure 1: AIG Corporate Available Liquidity and Companywide Debt Projections, Third Quarter of 2008 through Third Quarter of 2010

Dollars in millions

	Corporate available liquidity (as of date)	Companywide debt maturing in:						
		2009	2010	2011	2012	2013	2014	Thereafter
Q3 - 2008	$33,420 (11/5/08)	$28,057	$62,960 Federal Reserve facility (FRF); 21,690	$14,517	$13,230	$10,756		$61,882
Q4 - 2008	26,653 (2/18/09)	21,581	17,492	15,212	9,865	40,431 FRF; 8,861		58,193
Q1 - 2009	49,620 (4/29/09)	17,741	16,999	15,080	9,598	47,405 FRF; 8,430	$3,151	50,559
Q2 - 2009	52,585 (7/29/09)	13,809	17,204	15,355	9,786	44,816 FRF; 8,575	3,264	50,519
Q3 - 2009	50,160 (10/28/09)	7,643	19,815	16,413	10,317	41,009 FRF; 8,957	3,461	50,574
Q4 - 2009	36,679 (2/17/10)	0	19,432	16,310	10,289	23,435 FRF; 8,870	3,370	49,886
Q1 - 2010	33,674 (4/28/10)	0	13,495	15,910	10,029	27,400 FRF; 9,089	3,464	53,442
Q2 - 2010	37,081 (7/28/10)	0	8,720	13,180	12,029	26,457 FRF; 8,881	3,379	57,378
Q3 - 2010	37,394 (10/27/10)	0	4,283	10,336	9,808	20,470 FRF; 6,446	4,208	53,899

Source: GAO analysis of 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.

By February 2010, the amount of corporate liquidity available to AIG had fallen to $36.6 billion, largely because the borrowing limit on the revolving credit facility was reduced in December 2009 by $25 billion (from $60 billion to $35 billion) as part of the transfer of AIA and ALICO into two SPVs in which FRBNY received preferred interests.[27] Over this same period, the amount of company-wide debt stabilized as well, due to restructuring and deleveraging activity. From February to October 2010, the amount of corporate available liquidity has remained relatively constant. These trends suggest that since late 2008, the Federal Reserve's actions have been critical for AIG's solvency. The amount of AIG debt to mature in 2014—about $4.2 billion—will be about 35 percent lower than the $6.4 billion of debt to mature in 2013, the year in which the FRBNY revolving credit facility expires.[28]

Data disclosed by AIG indicate that since November 2008 the corporate liquidity available to AIG essentially has been the undrawn portions of three federally provided sources—the FRBNY revolving credit facility, the CPFF, and Treasury's equity capital facility.[29] Beginning in October 2008, AIG's primary source of funds shifted from private sector sources to the FRBNY revolving credit facility and the CPFF. This changed beginning in 2009 when the CPFF and AIG's bilateral facilities and cash and short-term investments became secondary sources of liquidity and Treasury's equity capital facility became a primary source of funds for AIG. From February 2010 through the third quarter of 2010, the only nonfederal sources of corporate liquidity available to AIG have been cash and short-term investments, and as of October 27, 2010, that amount was $515 million, a

[27]In this transaction, FRBNY received preferred interests valued at $25 billion, and in exchange the debt AIG owed to the FRBNY revolving credit facility was lowered by an equivalent amount.

[28]On September 30, 2010, AIG, Treasury, FRBNY, and the AIG Credit Facility Trust agreed in principle to a plan that would recapitalize AIG and in the process require that AIG repay the FRBNY revolving credit facility.

[29]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. The facility was intended to strengthen AIG's capital levels and improve its leverage.

fraction of the $36.9 billion available through the FRBNY and Treasury facilities. However, the need for corporate level liquidity has lessened as key AIG subsidiaries have stabilized or improved and accessed the capital markets. And on November 30, 2010, AIG re-entered the long-term debt market, issuing $2 billion in notes, the proceeds of which, according to AIG, will be used for general corporate purposes and to build liquidity for the AIG parent company in anticipation of the termination of the FRBNY revolving credit facility, which was terminated on January 14, 2011. Thus, federal sources have substantially improved AIG's liquidity position relative to what it would have been able to achieve on its own. See appendix III for further discussion of AIG's available corporate liquidity.

Historically, AIG issued commercial paper to third parties to meet its liquidity needs, but between October 2008 and March 2010 the company relied on FRBNY's CPFF to purchase its commercial paper. Because commercial paper typically is unsecured and issued by companies with high credit ratings, AIG's ability to access the traditional commercial paper market (independent of Federal Reserve programs) would be a positive sign of its financial condition. As shown in table 2, AIG's commercial paper programs, which reflect the amount of commercial paper AIG issued to third parties, were at a high of about $13 billion in December 2007. By September 30, 2008, the balance had dropped to $5.6 billion because of a general breakdown of the U.S. commercial paper market and reluctance from market participants to purchase or roll over AIG's commercial paper. Since September 2009, these programs have not issued any new commercial paper and after June 30, 2010, no third parties held AIG's outstanding commercial paper. According to AIG, all of its third-party commercial paper has matured, and currently, neither the AIG parent company nor its subsidiaries have access to third-party commercial paper funding. This funding source had been replaced by commercial paper purchased by FRBNY's CPFF, which AIG utilized until the facility expired on February 1, 2010. As a result of the facility closing, AIG's amount outstanding with CPFF had decreased to $4.7 billion from a high of $15 billion one year earlier, and as of September 30, 2010, AIG had no commercial paper outstanding with CPFF. In September 2010, the AIG parent company reported that it did not intend to access the commercial paper market. Instead, AIG told us that upon the closing of its planned recapitalization, it has access to at least $9.5 billion in liquidity, which includes a bank facility, the right to drawdown approximately $2 billion on the Series G preferred stock, and other factors.[30] However, through the

[30]Series G preferred stock is discussed in more detail later in this report.

third quarter of 2010, AIG continued to depend on the FRBNY revolving credit facility and the Treasury equity facility as its primary sources of liquidity.

Table 2: Amount of Outstanding Commercial Paper by Source, December 31, 2007, through September 30, 2010

Dollars in millions

	Dec. 31, 2007	Sept. 30, 2008	Dec. 31, 2008	Mar. 31, 2009	June 30, 2009	Sept. 30, 2009	Dec. 31, 2009	Mar. 31, 2010	June 30, 2010	Sept. 30, 2010
FRBNY CPFF program	$0	$0	$15,105	$12,242	$11,152	$9,607	$4,739	$1,185	$0	$0
AIG's commercial paper programs	13,114	5,600	613	196	197	0	0	0	0	0
Nightingale Finance LLC	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1,100	0	0
Total	**$13,114**	**$5,600**	**$15,718**	**$12,438**	**$11,349**	**$9,607**	**$4,739**	**$2,285**	**$0**	**$0**

Source: GAO analysis of AIG SEC filings.

Note: According to AIG, Nightingale Finance LLC is a structured investment vehicle sponsored but not consolidated by AIGFP. Before March 31, 2010, AIG had not consolidated the $1.1 billion of outstanding commercial paper issued by its affiliate Nightingale Finance LLC. AIG repaid CPFF on April 26, 2010, and repaid commercial paper of Nightingale Finance LLC during the second quarter of 2010 through an increase in borrowings under the FRBNY revolving credit facility.

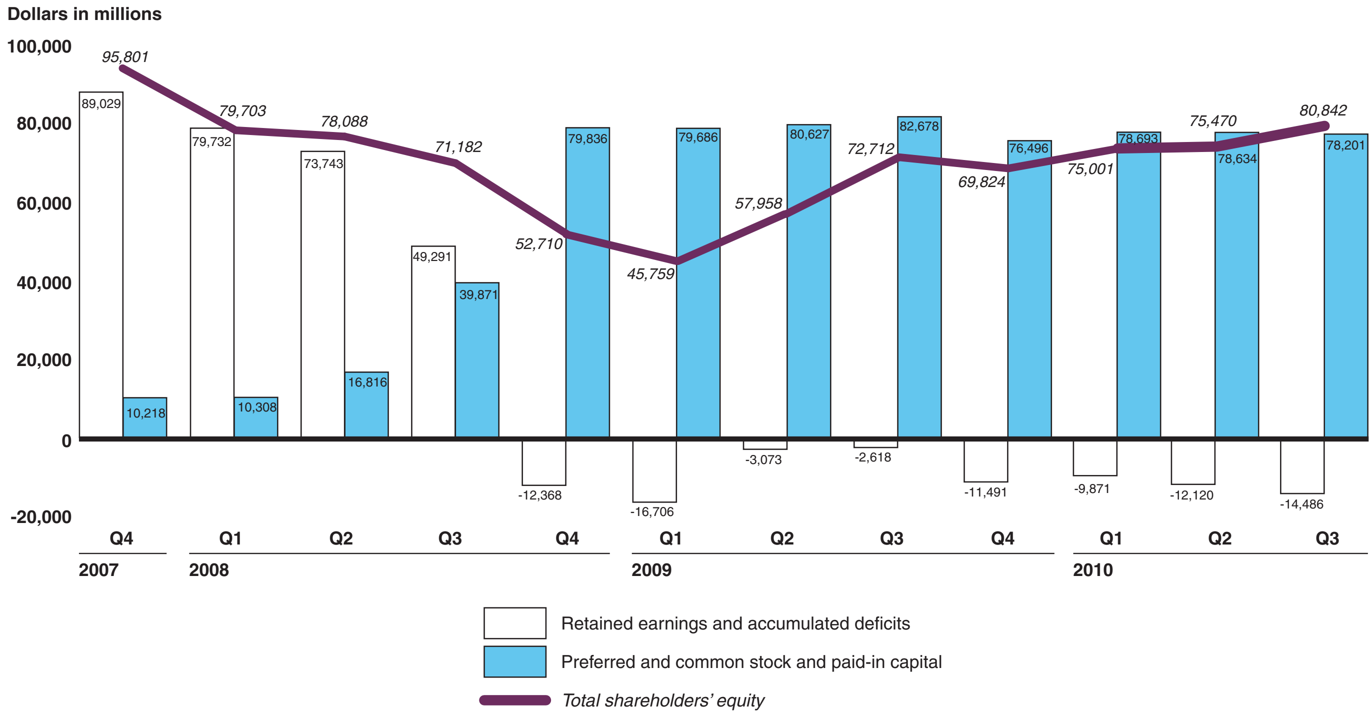
Shareholders' Equity Improved in 2009 and Stabilized in the First Nine Months of 2010

In contrast to the downward trends in 2008, AIG's shareholders' equity increased over the first three quarters of 2009 and its negative retained earnings, also known as accumulated deficits, decreased by nearly 85 percent. But since September 2009, AIG's shareholders' equity has increased at a much slower rate and accumulated deficits have increased. Rising accumulated deficits generally indicate mounting losses, while decreasing accumulated deficits could indicate a return to profitability. Shareholders' equity generally is calculated by subtracting a company's total liabilities from its total assets, and represents the company's ability to absorb negative shocks and prevent failure due to insolvency. Capital raised by issuing and selling common and preferred stock to investors, also known as paid-in capital, is one source of shareholders' equity. Retained earnings, which the company accumulates over time through its operations, are another source.[31]

[31]Other capital included payments advanced to purchase shares, the cost of Treasury stock, and accumulated other comprehensive income or loss as originally reported. Our computations adjusted the value of AIG's common stock and paid-in capital for the retroactive effect of the July 2009 reverse stock split.

As figure 2 shows, AIG's shareholders' equity declined from the fourth quarter of 2007 through the first quarter of 2009, and more significantly, the composition of its shareholders' equity changed from mostly retained earnings in 2007 to completely paid-in capital by the end of 2008, reflecting the importance of federal assistance to its solvency. Over this period, AIG's shareholders' equity fell almost 52 percent, from $95.8 billion at the end of 2007 to $45.8 billion by the end of the first quarter of 2009. However, shareholders' equity rose in the second and third quarter of 2009 and increased to nearly $81 billion at the end of the third quarter of 2010. From the last quarter of 2007 through the last quarter of 2008, retained earnings were the primary source of shareholders' equity ($89 billion of AIG's $95.8 billion in shareholders' equity). However, retained earnings declined throughout 2008, becoming cumulative deficits by the end of 2008 because of a net loss for the year of about $99.3 billion. At its lowest point, in the first quarter of 2009, AIG reported a negative balance of $16.7 billion in accumulated deficits, and shareholders' equity fell to $45.8 billion. AIG's accumulated deficit improved to a negative balance of $3.1 billion and $2.6 billion in the second and third quarters of 2009, respectively, contributing to the increase in shareholders' equity. However, in the fourth quarter of 2009, the accumulated deficit increased to $11.5 billion, lowering shareholders' equity. AIG's accumulated deficits continued to grow throughout the first three quarters of 2010, amounting to negative $14.5 billion by the end of the third quarter, primarily because of losses from discontinued operations of $4.4 billion that more than offset $1.1 billion of income from continuing operations. Also as shown in figure 2, starting in the fourth quarter of 2008, paid-in capital became and has remained the primary source of shareholders' equity because of the federal assistance.

Figure 2: AIG Trends in and Main Components of Consolidated Shareholders' Equity, Fourth Quarter of 2007 through Third Quarter of 2010



Source: GAO analysis of AIG SEC filings.

Note: Other components of total shareholders' equity are preferred stock (Series C preferred stock and Series D cumulative preferred stock), with the Series D preferred stock exchanged in April 2009 for Series E noncumulative preferred stock, accumulated other comprehensive losses, and Treasury stock. Drawdowns from the approximately $30 billion committed under the Series F equity capital facility will increase paid-in capital in the future by an equal amount.

Several federal actions caused fluctuations and changes in shareholders' equity in 2008 and 2009. Federal government actions significantly increased AIG's shareholders' equity. Between the third and fourth quarters of 2008, the adjusted value of common and preferred stock and paid-in capital increased from $39.9 billion to $79.9 billion, of which almost $73 billion was paid-in capital that could be attributed to two government actions:

- In September 2008, AIG, through a noncash transaction, added $23 billion to shareholders' equity as additional paid-in capital to record the fair value of preferred shares (Series C) that were later issued to obtain AIG's revolving credit facility established by FRBNY.[32]

- In November 2008, Treasury purchased $40 billion of cumulative preferred shares (Series D) and received a warrant from AIG. AIG recorded the transaction as additional paid-in capital repaid.

The value of the federal government's common equity interests in AIG upon closing of the recapitalization and restructuring plan is tied to the market value of AIG's common stock, and growth in value of the government's equity stake depends on growth of the value of common shares. The market value of AIG's common shares outstanding peaked in December 2006 at $186.4 billion and by June 2008, as AIG's losses from its derivatives businesses continued to mount, the shares' market value declined to $71.1 billion (see app. IV). During the last two quarters of 2008, when the federal government initially provided assistance to AIG, AIG shares further declined in value, falling to $4.2 billion by the end of 2008. Since March 1, 2009, when the AIG credit facility trust and AIG entered into the purchase agreement for Series C preferred stock, AIG's common shares outstanding have fluctuated between $2.7 billion and $5.9 billion, and as of September 2010 were valued at $5.3 billion. Over that same period, the values of the government's preferred shares increased from $10.6 billion in March 2009 to a peak of $23.5 billion in September 2009,

[32]This amount was based on the fair value of common shares into which the preferred Series C would be convertible on September 16, 2008; the date 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 to AIG for issuing the Series C preferred shares by reducing the commitment fee FRBNY charged AIG for the facility by an equivalent amount. Through June 30, 2009, $10.2 billion of this asset was amortized through the accumulated deficit and thus reduced shareholders equity. For more information on Series C preferred shares, see GAO-09-975.

and as of September 2010 were valued at $20.8 billion.[33] During the first quarter of 2009, AIG's common shares fell roughly 36 percent, underperforming the Thomson Reuters Insurance Index and the New York Stock Exchange (NYSE) Composite Index, pushing the value of its common stock below $3 billion.[34] However, from the first quarter to the end of the fourth quarter of 2009, AIG's stock price increased by roughly 50 percent and outperformed both the NYSE Composite Index and the Insurance Index, resulting in a market capitalization of about $4.0 billion. AIG's common shares appreciated another 15 percent during first two quarters of 2010, compared with gains of 7 percent and losses of 10 percent for the Insurance Index and NYSE Composite Index, respectively. As of the end of the second quarter of 2010 the market capitalization of AIG's publicly traded common shares was $4.7 billion, and by the end of the third quarter of 2010 was roughly $5 billion. When the recapitalization plan closed on January 14, 2011, the market capitalization of AIG's publicly traded common shares was approximately $7.3 billion.

[33] As previously discussed, the federal equity investment includes Series C preferred shares that are convertible into approximately 79.75 percent of total outstanding common shares. Under the terms of the Series C preferred stock issuance, AIG agreed to issue preferred stock convertible into AIG's common stock to a trust created on behalf of the U.S. Treasury (the AIG Credit Facility Trust). This independent trust was established to manage the U.S. Treasury's beneficial interest in Series C preferred shares. The conversion formula provides that the trust will receive approximately 79.75 percent of AIG's common stock 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 2,690,088 shares of AIG 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.

[34] Thomson Reuters maintains the Insurance Index, a stock price index comprising of insurance companies that conduct a variety of insurance activities. As a result the index is a good proxy for the stock market performance for the insurance sector. The NYSE Composite Index is designed to measure the performance of all common stocks listed on NYSE and, therefore, provides a measure of overall stock market performance.

Net Cash Flows from AIG's Operating, Investing, and Financing Activities Appear to be Stabilizing, but AIG Still Is Dependent on Federal Assistance for Liquidity

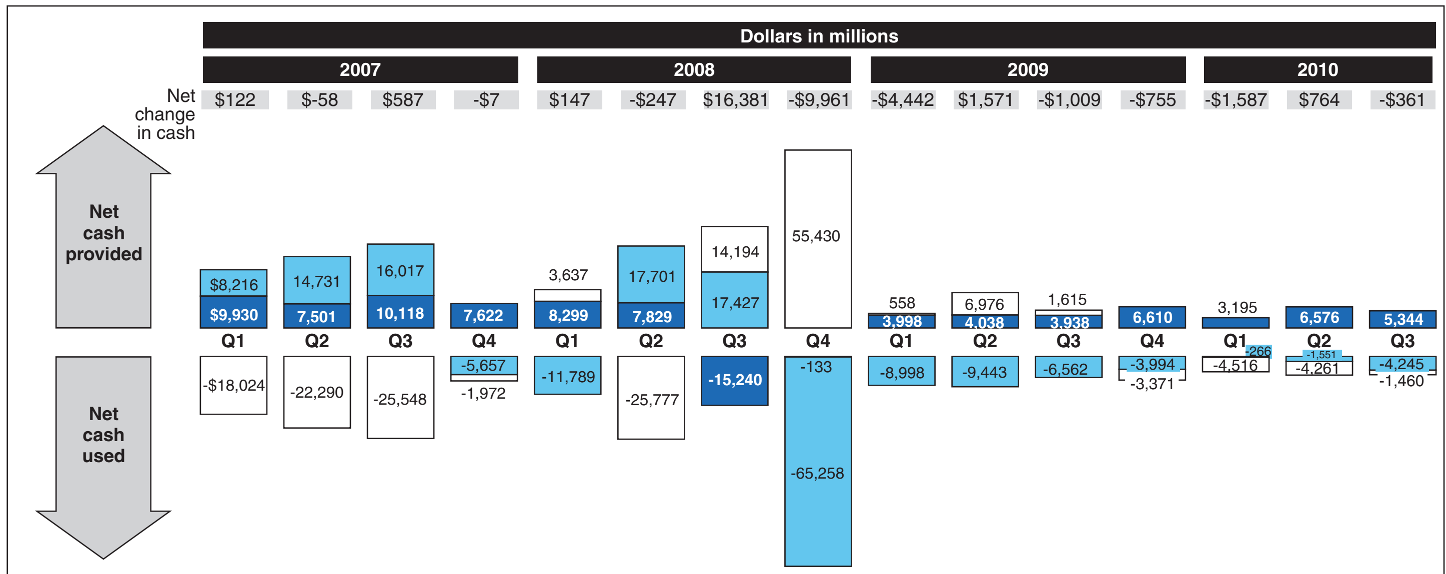
We have added a new indicator of cash flows and net changes in cash using data from AIG's quarterly Consolidated Statements of Cash Flows. This indicator tracks the cash flows and net changes in cash for AIG's operating, financing, and investing activities.

- Operating activity cash flows indicate whether the company's core businesses are profitable.
- Financing activity cash flows indicate the extent to which a company uses the capital markets for equity and debt financing such as issuing its stock, bonds, and commercial paper to investors and obtaining bank loans and other forms of bank credit.
- Investing activity cash flows indicate the extent to which a company invests in its production capacity and efficiency (capital expenditures), acquires and divests businesses, and has financial investments such as stocks and bonds.

Generally, a healthy and growing company can generate cash internally from operations, generate cash externally from financing activities, and use this cash for growth in its operations or investments in financial assets. This indicator shows that with the benefit of federal assistance, AIG has resumed positive operating cash flows and cash flows from investing and financing activities have improved, though not quite at pre crisis levels of 2007.

As shown in figure 3, during the first three quarters of 2007, before receiving federal assistance, AIG generated cash from its operating activities indicating that it was profitable and generated cash through its financing activities, which in turn indicated that it had access to the capital markets. It also used cash in its investing activities; however, during the latter part of 2008, AIG's operating and financing cash flows deteriorated rapidly because of severe operating and investment losses and reduced access to the capital markets. Cash flows from investing activities moved from negative to positive as AIG shifted to selling investment assets and businesses to generate liquidity. However, cash generated from these activities was insufficient for AIG to meet near-term liquidity needs that spiked when rapidly deteriorating credit and capital markets and company credit ratings triggered certain obligations on which creditors demanded immediate payment. AIG obtained federal assistance to meet these creditor demands.

Figure 3: Net Cash Flows and Changes in Cash from Operating, Investing, and Financing Activities, from First Quarter of 2007 through Third Quarter of 2010



Source: GAO analysis of AIG SEC filings.

Throughout 2009, AIG's cash flows began to stabilize. In particular, quarterly operating cash flows returned to net positive. Net cash flows from operating activities were around $4 billion for the first three quarters of 2009 and rose to $6.6 billion in the fourth quarter. Since the third quarter of 2008, quarterly financing cash flows have been negative, reflecting the company's still limited access to the private capital markets. Although the negative amounts have increased over the first three quarters of 2010, they are much smaller than the negative amounts recorded in the first three quarters of 2009. Throughout 2009 and the first three quarters of 2010 the company has had net cash inflows from operating activities and since the fourth quarter of 2009, has returned to a precrisis condition of net cash outflows from investing activities—the latter indicating that the company is once again purchasing or expanding its base of income to produce assets rather than selling them to raise cash. AIG reported in its second quarter 2010 10Q that it primarily used its cash flows to meet its debt obligations and the liquidity needs of its subsidiaries. Because of the improving operating and financing cash flows and access to federal

assistance, AIG has not had to sell assets aggressively to generate cash. Taken collectively, while the three cash flows show signs of some stability through the third quarter of 2010, AIG continues to rely on federal assistance to ensure that it can meet its liquidity needs.

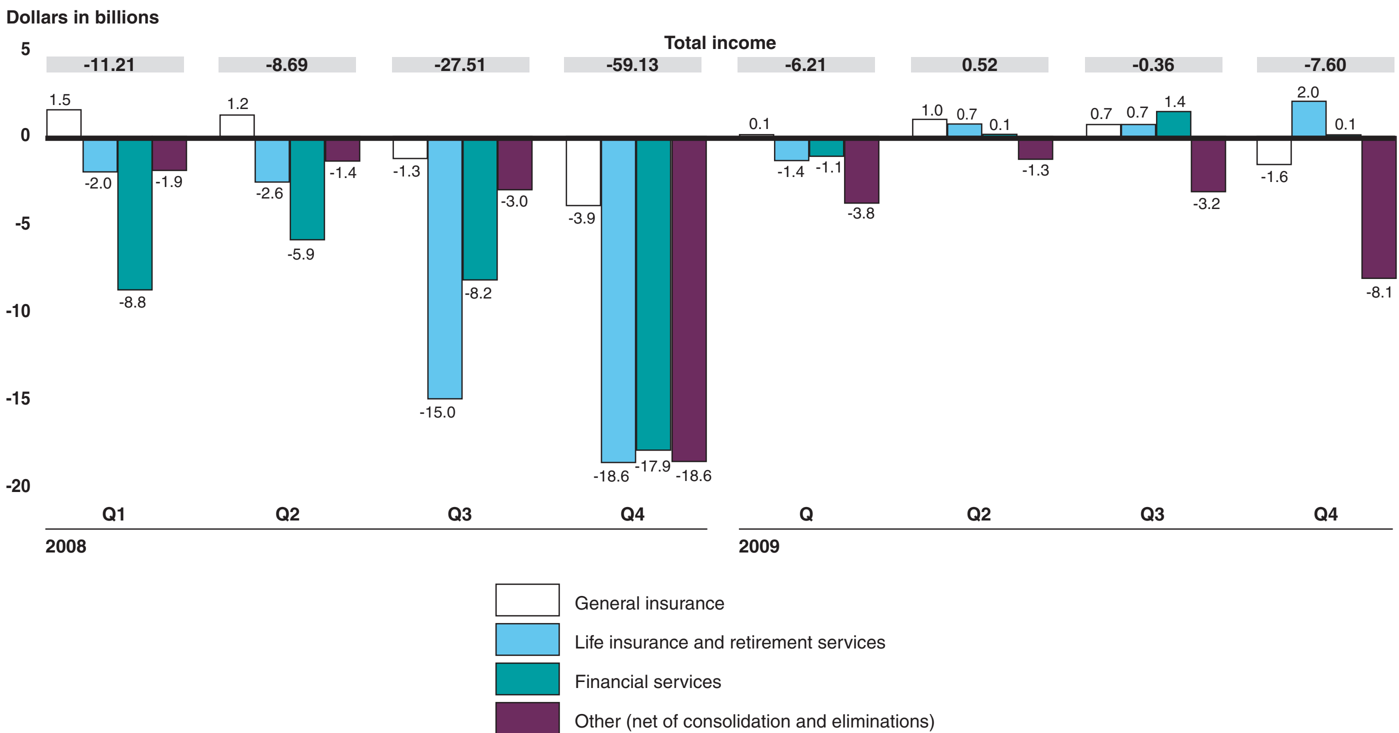
Income from AIG's Operations Began to Stabilize in 2009 with Federal Assistance

With the benefit of federal assistance, several of AIG's operating segments continued to stabilize, producing income instead of losses. To the extent that AIG's operating entities are profitable, they will generate income that could improve AIG's ability to sell certain businesses, retain others, and repay its federal assistance. If the businesses operate at a loss, AIG could face greater risks in its ability to repay the federal assistance and its ability to remain viable. The following indicator tracks the operating income and losses (before taxes) for AIG's insurance businesses and its major segments, including asset management, financial services, and other services that it expects to sell as part of the restructuring. Because AIG realigned its operating segments in the first and second quarters of 2010 but has not publicly issued restated segment information for all prior quarters covered in our indicator, we cannot update this indicator beyond the fourth quarter of 2009. Thus our reporting on this indicator will be limited.

As shown in figure 4, all of AIG's operating segments had operating losses in the last two quarters of 2008, but by the first quarter of 2009 some of the segments had considerably smaller operating losses, and other segments had operating income due in part to federal assistance such as Maiden Lane II and Maiden Lane III. AIG's general insurance segment (which includes AIG's domestic and foreign property/casualty businesses) reported an operating loss in 2008, largely due to operating losses from insurance underwriting, large net realized capital losses, and reduced investment income in the second half of the year. After three quarters with operating income in 2009 and operating losses in the fourth quarter, this segment ended the year with a relatively small operating profit for 2009. The improvement in 2009 relative to 2008 largely was due to reduced net realized capital losses and increased investment income that more than offset larger insurance underwriting losses. This is noteworthy because historically the general insurance segment has generated the largest operating income of all AIG segments. For example, operating income from this segment accounted for more than half of AIG's total operating income for 2006 and 2007 combined. Tracking the operating performance of this segment also is important because AIG plans to retain its property/casualty insurance businesses among its core operations after the restructuring and divestitures of other businesses. As a result, AIG's ability

to redeem its preferred shares held by Treasury partly will be contingent on the health of this segment.

Figure 4: Quarterly AIG Pretax Operating Income and Loss by Operating Segment, First Quarter of 2008 through Fourth Quarter of 2009



Source: GAO analysis of AIG SEC filings.

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

The "other operations and consolidating adjustments" include consolidations and eliminations, interest expense on the FRBNY facility, restructuring costs, expenses of corporate staff not attributable to specific reportable segments, corporate-level net realized capital gains and losses, net gains and losses on sale of divested businesses, results from noncore businesses that include certain mortgage guaranty and asset-management operations, and equity earnings in partly owned companies.

Because AIG restated its operating segments in each quarter of 2010 but has not publicly issued restated segment information for all prior quarters covered in our indicator, we cannot further update this indicator for analysis of levels and trends across multiple quarters and years.

Figure 4 also shows that AIG's life insurance and retirement services segment incurred the largest operating losses of all of AIG's segments during the last half of 2008. Its losses largely could be attributed to net realized capital losses in the investment portfolios of domestic and foreign life insurance businesses due to severe market price declines in certain

commercial mortgage-backed and other securities. In 2009 the life insurance and retirement services segment reported an operating profit compared to a loss in 2008, primarily because net realized capital losses declined and investment results improved. These improved investment results more than offset the decline in premium revenues, the increase in claims and benefits, and related expenses.

The financial services segment reported losses in 2008 that primarily were attributed to unrealized market valuation losses from credit valuation adjustments in AIGFP's portfolio of super senior credit default swaps, and credit valuation adjustments on AIGFP assets and liabilities (see figure 4). In 2009 financial services reported an operating profit of $517 million, primarily because the combined operating profit for AIGFP and Aircraft Leasing were greater than the operating loss from consumer finance.

Finally, AIG's other operations reported losses in the fourth quarter of 2008 that generally resulted from fees and interest expenses associated with the FRBNY revolving credit facility, net realized capital losses, and operating losses of asset management and mortgage guaranty activities that are in this category as noncore businesses, and the decline in the value of AIG's equity interest in Maiden Lane III. In 2009, most of these factors also contributed to the operating losses reported from AIG's other operations.

AIG Credit Default Swap Premiums Appear to Be Trending Toward Precrisis Levels

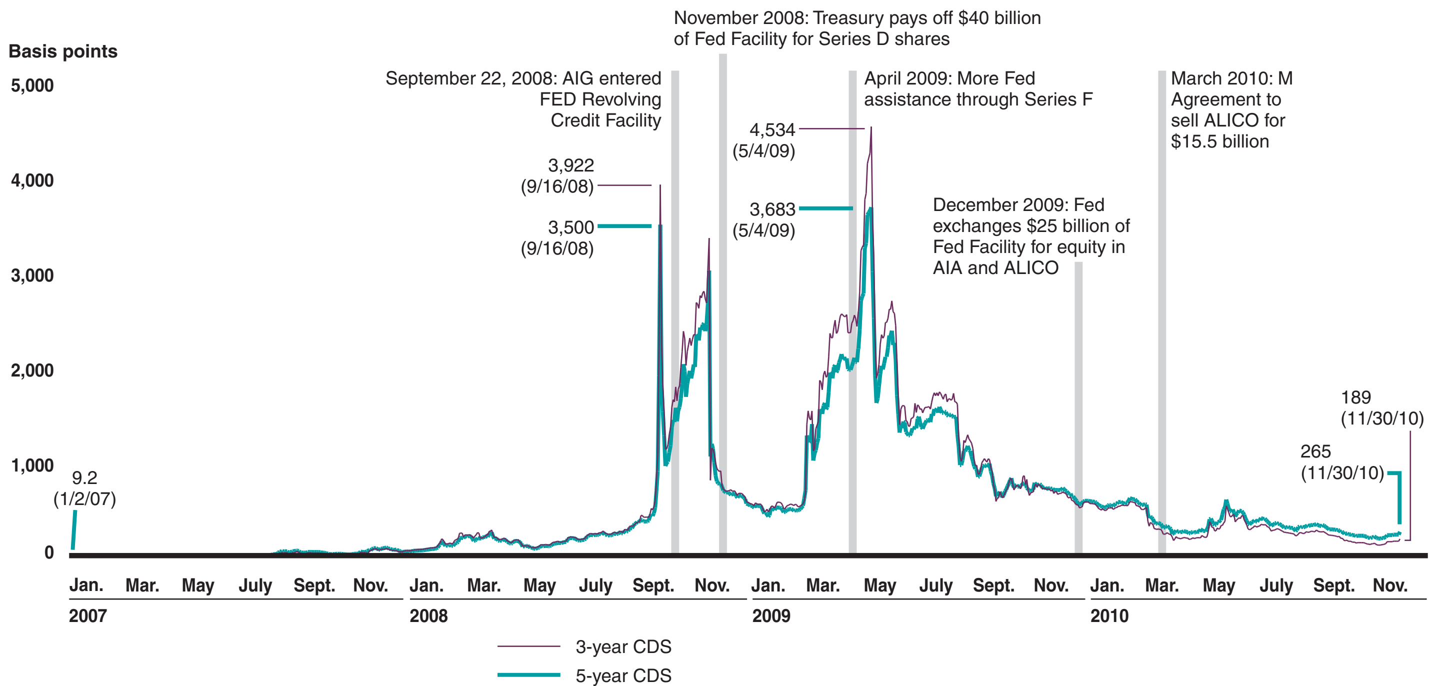
Dropping from their recent peak in May 2009, AIG CDS premiums have decreased and appear to be trending toward precrisis levels. These premiums, which are the price insured parties pay to purchase CDS protection against AIG defaulting on senior unsecured debt, are another indicator of AIG's financial strength. This indicator measures what the market believes to be AIG's probability of default by tracking prices (premiums, expressed in basis points) paid by an insured party against a possible default on a senior unsecured bond and the spreads between the 3-year and 5-year premiums.[35] This measure pertains to CDS prices on AIG and not AIGFP's CDS inventory that the company is winding down; it is a composite of what dealers would charge customers for CDS on AIG. Higher basis point levels indicate a higher premium for a CDS contract. The higher the CDS premiums, the greater the market's perception of

[35]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.

credit risk associated with AIG. Conversely, the lower the CDS premiums, the greater its confidence in AIG's financial strength (the lower the market's expectation that AIG will default).

AIG's CDS premiums have continued to decrease since May 2009 and as of November 30, 2010, were similar to their level in June and August 2008 for the 3-year and 5-year CDS premiums (see figure 5). From May 2009 through March 2010, the CDS index for the insurance sector declined, but not as much as the CDS premiums for AIG. From May through November 2010, AIG's CDS premiums moderated slightly. While the overall trend is positive, whether this decline in the cost to protect against an AIG default reflects confidence in the standalone creditworthiness of AIG or whether the decline is due to the ongoing federal assistance to AIG is unclear. As the Federal Reserve has noted, the premium on AIG's CDS is based both on the market's assessment of the government's level of commitment to assist AIG and AIG's financial strength.

Figure 5: AIG Credit Default Swap Premiums on AIG, January 2007 through November 30, 2010



Source: GAO analysis of Thomson Reuters Datastream.

Note: CDS provide protection to the buyer of the CDS contract if the assets covered by the contract go into default.

AIGFP Has Continued to Unwind Its CDS Portfolio Positions and Reduce Its Number of Full-Time Equivalent Employees

The significant losses that AIGFP experienced from its derivatives trading business and the strains these losses put on AIG's liquidity in 2008 were critical factors contributing to AIG's financial crisis. A key part of AIG's reorganization and divestiture strategy is closing out or eliminating—also known as "unwinding"—these derivatives and closing AIGFP, which according to AIG will not be done for a significant amount of time. Since the fall of 2008, AIGFP has been unwinding its derivatives portfolio by attempting to strike the most efficient balance between eliminating its positions quickly and mitigating portfolio losses. As discussed earlier, AIGFP had underwritten CDS protection on CDOs to a range of counterparties. Most of AIGFP's positions on its CDS contracts on multisector CDOs were eliminated when Maiden Lane III purchased CDOs from AIGFP's CDS counterparties late in 2008. With these purchases, the counterparties agreed to terminate the CDS contracts, which eliminated the need for AIG to post additional collateral as values of the CDOs continued to fall and eased the stress on its financial condition. Since then,

AIGFP has been closing out the remainder of its derivatives portfolio. To analyze AIGFP's progress, we monitored several groups of indicators dating to at least September 2008. The four indicators we monitored—number of outstanding derivatives trade positions, gross notional amount of outstanding derivatives contracts, number of risk books, and number of AIGFP employees—show different dimensions of the unwinding process. Their trends suggest AIGFP has continued to make progress. We also analyzed AIGFP's super senior CDS portfolio, in which the underlying collateral of CDOs was rated investment-grade, and their remaining multisector CDO portfolio, in which the underlying collateral of CDOs was rated less than BBB. We found that while AIGFP continues to make progress in unwinding its super senior portfolio, it has made less progress since the fourth quarter of 2008 in closing out CDOs with lower-rated underlying collateral. AIGFP asserts that this result is consistent with its strategy of maintaining positions that have potentially significant upside profit opportunity and very limited potential liquidity risk. The multisector CDO portfolio represents one such set of positions. This strategy, with respect to the multisector CDO portfolio, has resulted in market valuation gains of $940 million over the past five quarters.

AIGFP Has Continued to Unwind Its Operations

Our indicators show that from September 2008 through September 2010, AIGFP made significant progress in winding down its operations. A key reason for AIG's financial problems was the strain on liquidity that resulted from the performance of AIGFP's derivatives portfolios. The values of the investment-grade CDOs protected by CDS contracts written by AIG declined in the summer of 2008. In response to the declining values, AIGFP had to make collateral payments to the CDS counterparties. As we previously discussed, the federal government created Maiden Lane III LLC to help eliminate the financial strain arising from collateral payments. Maiden Lane III purchased $29.3 billion in CDOs from AIGFP's CDS counterparties. In turn, these counterparties agreed to terminate the CDS contracts, because for the counterparties, the risk of possible downgrades or defaults on the CDOs had been eliminated by selling them to Maiden Lane III. Therefore, the counterparties no longer needed the protection that AIGFP's CDS contracts had provided. The strains on liquidity have decreased as AIGFP has continued to eliminate its positions in CDS contracts. Figure 6 illustrates several dimensions along which AIGFP has reduced its size:

- First, since September 2008, AIGFP has closed out 87 percent of its outstanding trade positions, which refers to 38,300 of AIGFP's outstanding long and short derivative contracts. At September 30, 2008, it had 44,000

positions; by December 31, 2009, the number had declined to 16,100; and as of September 30, 2010, the number had declined to 10,200. The 10,200 trade positions include approximately 4,500 nonderivative asset and liability positions whose management was transferred to AIG's asset management group and AIG's treasury. According to AIG, from September 2008 through September 2010, the number of counterparties has been reduced by about 74 percent, and the number of trades dated more than 50 years has been reduced by 96 percent from 67 to 3.

- Second, because of the positions that have been closed out, the gross notional value of derivatives positions outstanding—which is a measure of the size of AIGFP's inventory of derivatives outstanding—was reduced, to $506 billion as of September 30, 2010, down from $940 billion in December 2009, $1.2 trillion in the previous quarter, and $2 trillion in September 2008.

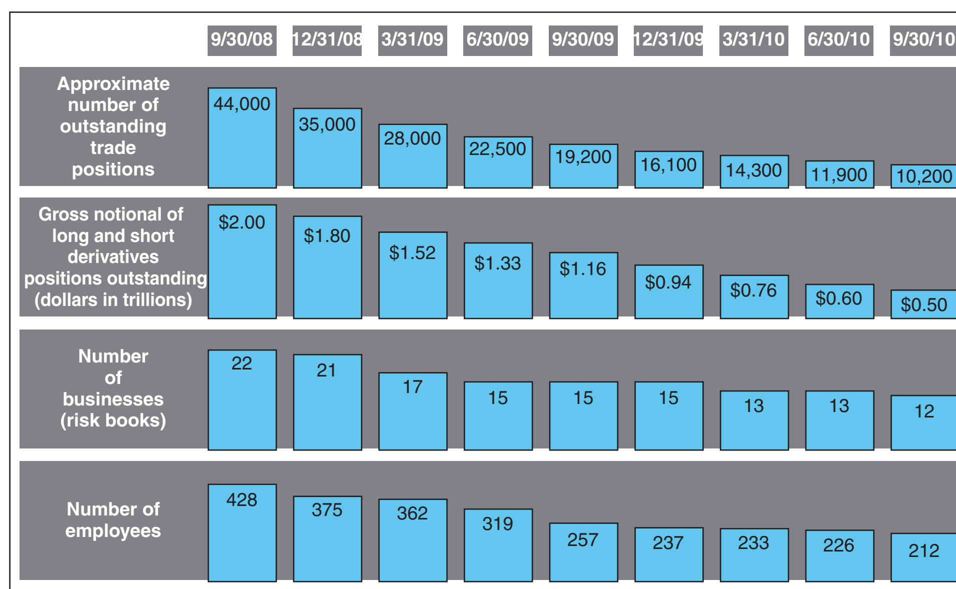
- Third, the reduction in positions also has resulted in a marked decrease in the number of AIGFP's businesses or risk books. In its switch from a strategy of growth and profit maximization to risk mitigation and unwinding, AIGFP reorganized its business into 22 separate risk books determined in part by the type of risk and placed them in 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. Initially, AIGFP focused on closing out its riskiest positions across all risk books. AIG officials said that in certain cases, some books were dominated by risky positions, so these entire books were targeted. According to AIGFP and Federal Reserve officials, this goal has been substantially accomplished. The number of books decreased from 22 in September 2008 to 15 at the end of the second quarter of 2009; to 13 by March 31, 2010; and to 12 as of September 30, 2010. The 12 books include 5 risk books related to the transfer of the nonderivative asset and liability positions described above. AIG reports that AIGFP's priority in 2010 has been to unwind complete books.

- Finally, the number of AIGFP employees dropped most significantly—from 428 to 257—between September 2008 and September 2009. Since that time the pace has slowed and as of September 30, 2010, the number was 212.[36] The 212 positions include 17 employees responsible for managing AIGFP's cash assets that AIGFP transferred to AIG and 46 employees who report to both AIG and AIGFP. According to AIG, AIGFP has closed its

[36]AIGFP staff may leave for several reasons, such as the sale of businesses, closure of offices, or resignation.

Tokyo and Hong Kong offices and its Banque AIG office in London is expected to be taken over by AIG Asset Management in the first quarter of 2011.

Figure 6: Status of the Winding Down of AIG Financial Products Corp., Quarterly from September 30, 2008, through September 30, 2010



Source: GAO presentation of AIG corporate information.

Notes: 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 2008 notionals were estimated and restated numbers were 2 and 1.8, respectively. The March 2009 number was 1.5.

AIGFP officials believed that most of the unwinding could be completed by the end of 2009, but they later indicated that the vast majority of the remaining positions would be unwound by the end of 2010. In February 2010, Federal Reserve and Treasury officials said that AIGFP was on track to close out its riskiest positions and that AIGFP no longer would be in business by the end of 2010, although the company's positions might not be entirely unwound by the end of the year. In August 2010, Federal Reserve and AIG officials confirmed that, according to the measures established by AIG, AIGFP had met their targets to date and generally expected AIGFP to meet or exceed its targets if current market conditions persisted. AIG reported in the third quarter of 2010 that of AIGFP's remaining approximately 10,200 trade positions, the management of approximately 4,500 nonderivative asset and liability positions was transferred to AIG's direct investment business. AIG anticipates that the

remaining derivatives positions will continue to be reported as AIGFP under capital markets, a component of AIG's financial services reporting segment.[37] However, Federal Reserve and AIG noted that the winding down of AIGFP and its portfolios remains linked to AIG's credit ratings and, as mentioned earlier, these efforts could be affected adversely if AIG's credit ratings were downgraded. In August 2010, the Federal Reserve noted that the successful execution of AIG's plan to reduce the size of its portfolios was subject to market conditions and counterparties' willingness to transact with AIGFP. AIG reported in September 2010, that it will take substantial time to wind-down AIGFP because of the long-term duration of AIGFP's derivative contracts and the complexity of AIGFP's portfolio.

AIGFP Has Continued to Make Progress in Unwinding Its Portfolio of Investment-Grade, Super Senior Credit Default Swaps

Our indicators suggest that AIGFP continued to make progress in unwinding its portfolio of credit default swaps written on investment-grade CDOs (those having a rating of BBB or higher from rating agencies). This portfolio was written on the super senior tranche of CDOs and had a net notional amount of approximately $375 billion in the third quarter of 2008.[38] The notional amount denotes the size of the portfolio on which AIGFP wrote credit protection. This is the maximum dollar-level exposure for the portfolio, taking into account offsetting positions, and it measures an underlying quantity upon which payment obligations are computed. A decrease in the net notional amount could indicate progress in unwinding AIGFP's obligations. To measure this progress, we analyzed the net notional amounts of AIGFP's super senior CDS portfolio, the fair value of AIGFP's derivative liability, and the unrealized market valuation loss or gain. The fair value of its derivative liability represents the fair market valuation of AIGFP's liabilities in each asset portfolio. The unrealized market valuation gain (or loss) tracks the increase (or decrease) in this valuation from quarter to quarter. As with the overall portfolio, a decrease in the net notional amount could indicate progress in unwinding AIGFP's obligations. A decrease in the fair value of derivative liability could result in a decrease in the cost to AIGFP to transfer the respective derivatives to

[37]Through the third quarter of 2010, AIG has reported on its operations through four reporting segments—general insurance, domestic life insurance and retirement services, foreign life insurance and retirement services, and financial services. The financial services segment includes commercial aircraft and equipment leasing, capital markets operations, consumer finance and insurance premium financing, both in the United States and abroad.

[38]A tranche is a portion or class of a security. A security may have several tranches, each with different risks and rates of return, among other differences.

other counterparties in an 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 indicators suggest that AIGFP has continued to liquidate its CDS portfolio. The net notional amount of the portfolio is being reduced; however, the portfolio has experienced a combination of unrealized gains and losses. According to Federal Reserve officials, AIGFP management has recognized that the size and risks of the remaining CDS portfolios need to be further reduced and that AIG and AIGFP have been developing an action plan to efficiently reduce these risks. AIG's progress is evident across several of its risk books (see fig. 7):

- *AIGFP's regulatory capital CDS book.* The regulatory capital book represents derivatives written for European banks that allowed them to reduce the amount of capital they needed to set aside to cover potential losses on certain asset portfolios of residential mortgages and corporate loans by buying protection against losses on underlying assets.[39] The net notional amount of this book dropped from about $250 billion in the fall of 2008 to about $65.5 billion in the third quarter of 2010, and the fair value of the CDS liability fell over the same period from $397 million and shifted to an asset with a fair value of $186 million. These CDS contracts continue to have a high net notional amount relative to the other AIGFP products, and the company continues to believe that these contracts will expire or be called by counterparties with little to no cost to AIG. According to the Federal Reserve, this portfolio has been downsized significantly due to counterparties' willingness to exit trades at no cost to AIGFP. AIGFP does not plan to sell these contracts but plans to let them expire because management believes that, based on stress tests, trying to sell them would

[39]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.

not be cost-effective.[40] This book also has experienced minimal but mixed unrealized market gains and losses in the first three quarters of 2010.

- *AIGFP's CDS on multisector CDO book.* These CDOs represent the CDS portfolio that, according to Federal Reserve officials, is a synthetic credit position and written on CDO transactions that generally had underlying collateral of residential mortgage-backed securities, commercial mortgage-backed securities, and CDO super senior tranche securities.[41] Federal assistance provided through the purchase of the underlying assets in this category by Maiden Lane III and subsequent termination of the related CDS led to a drop of more than 80 percent in the net notional and fair values of the multisector CDOs from the third quarter of 2008 in the fourth quarter of 2008—$12.6 billion and $5.9 billion, respectively. As of the third quarter of 2010, the net notional amount continued to show declines and had dropped to $6.9 billion and, similarly, the fair value of the derivative liability declined to $3.6 billion. Also, in the first three quarters of 2010, multisector CDOs continued to show unrealized market valuation gains.

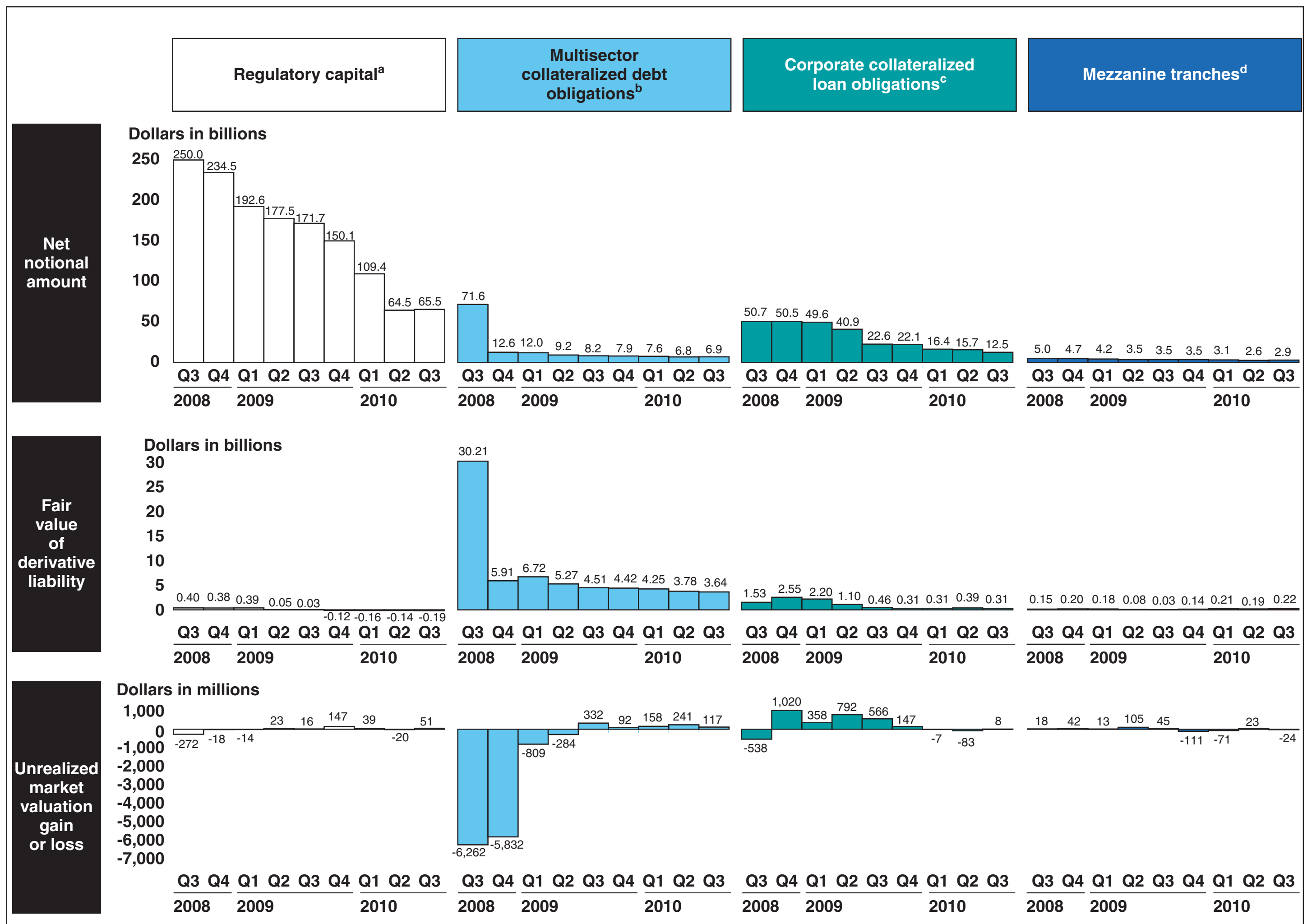
- *Corporate collateralized loan obligations and mezzanine tranche books.* This portfolio consists of CDS transactions primarily written on portfolios of senior unsecured loans and mezzanine tranches, a portfolio of CDS transactions written on obligations rated less than investment-grade (investment-grade is rated BBB or higher) at origination. The net notional amount of the corporate portfolio continued to drop throughout the first three quarters of 2010, while the amount for the mezzanine portfolio dropped in the first two quarters but increased slightly in the most recent quarter. The fair value of derivative liability for the corporate collateralized loan obligation book portfolio, which fell significantly from the fourth quarter of 2008 through the first quarter of 2010, has changed

[40]According to AIG, AIGFP has not been required to make any payments as part of terminations initiated by counterparties. The regulatory benefit of these transactions for the counterparties is generally derived from the terms of Basel I that existed through the end of 2007, which was replaced by Basel II. As financial institution counterparties transitioned to Basel II, AIG expects them to receive little or no additional regulatory benefit from these CDS transactions, except in a small number of specific instances. According to AIG, the schedule by which these positions are called or terminated has slowed. This development likely has been impacted by changes in capital standards that have been recently proposed by the Basel Committee, which when implemented are expected to have various degrees of impact on global financial institutions, including the AIGFP counterparties.

[41]According to AIG, the outstanding multisector CDO portfolio at June 30, 2010, was written on CDO transactions, including synthetic CDOs. Synthetic CDOs are backed by credit derivatives such as CDS or options contracts instead of assets such as bonds or mortgage backed securities.

little since then. Also, this corporate collateralized loan book had unrealized market gains throughout 2009, followed by relatively small losses over the first two quarters of 2010, and a small gain in the third quarter of 2010. By comparison, the fair value of derivative liability and the unrealized market valuations of the mezzanine tranche book have changed little in 2010. AIG officials commented that the smaller movement is consistent with a decrease in the size of the portfolio (see fig. 7).

Figure 7: Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Losses and Gains for AIGFP's Super Senior (rated BBB or better) CDS Portfolio, Third Quarter of 2008 through Third Quarter of 2010



Source: GAO analysis of AIG SEC filings.

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

[a]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.

[b]Multisector CDO 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.

[c]The corporate collateralized loan obligations portfolio consists of CDS transactions primarily written on portfolios of senior unsecured loans.

[d]A tranche is a piece or portion of a structured deal, or one of several related securities that are issued together but offer different risk-reward characteristics. The mezzanine tranche is subordinated to the senior tranche, but is senior to the equity tranche. The senior tranche is the least-risky tranche, whereas the equity tranche is the first loss and riskiest tranche.

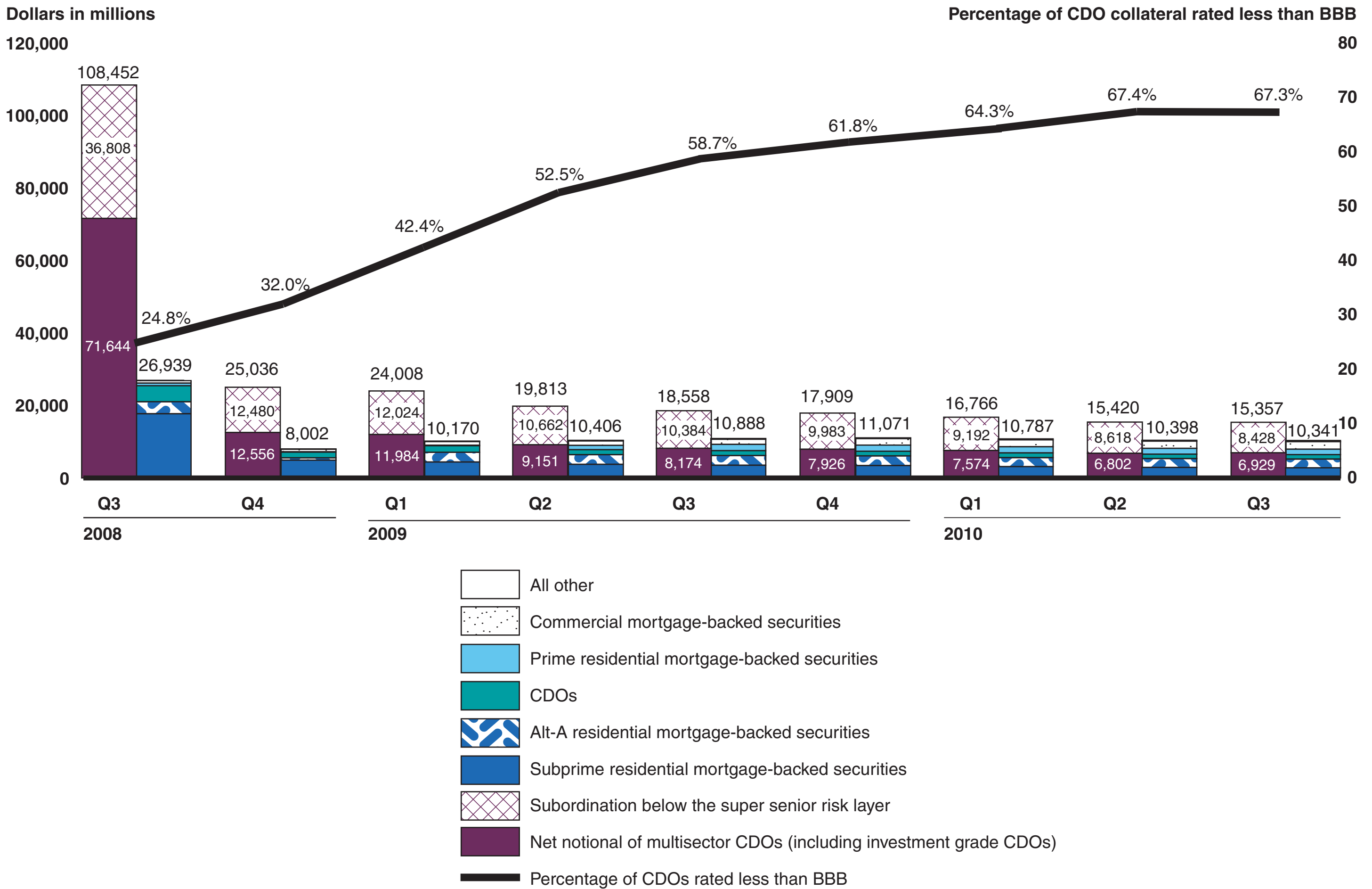
AIG's Multisector CDO Portfolio has Changed Significantly Since the First Quarter 2009

The gross notional amount of AIGFP's multisector CDO portfolio was reduced significantly in the fourth quarter of 2008 with the purchase of CDOs by Maiden Lane III, and since then, AIG has continued slowly to reduce the gross notional amount. Our indicator uses the gross notional amount to track the size of AIGFP's multisector CDO portfolio and its composition with respect to the credit quality of the underlying assets. However, as the portfolio has been unwinding, its underlying credit rating has not improved while the longer-term trend is not yet clear. According to AIG officials, the SEC filings about the composition of the multisector CDOs on which it has written credit default protection summarizes the gross transaction notional amount, percentage of the total CDO collateral pools, ratings, and vintage breakdown of collateral securities in the multisector CDOs, by asset-backed securities category. However, the gross notional data does not account for the attachment points of the specific transactions. When taken into account, the gross notional of the underlying CDOs of $15.4 billion is reduced to a net notional exposure of $6.9 billion.

As shown in figure 8, the total gross notional amount of AIGFP's multisector CDOs and of CDOs that had underlying assets rated less than BBB were reduced considerably in the fourth quarter of 2008, but reductions since then have been much smaller. The total gross notional amount for the multisector CDOs was reduced from $108.5 billion to $25 billion during the fourth quarter of 2008, primarily due to Maiden Lane III purchasing the CDOs underlying AIGFP's CDS contracts. The gross notional for these CDOs has continued to be reduced each quarter and as of the third quarter of 2010, had been reduced to about $15.4 billion as

AIGFP has continued to unwind this portfolio. In contrast, while the gross notional amount with underlying assets rated less than BBB decreased from $26.9 billion at the end of the third quarter of 2008 to $8 billion in the following quarter, the amount increased about $3 billion throughout 2009 to just more than $11 billion by the end of 2009. However, in the first three quarters of 2010 the trend reversed, and the gross notional for this portion of the portfolio was reduced to $10.3 billion. Despite this drop, as of the end of the third quarter of 2010, the underlying credit rating of the portfolio has not improved, with more than 67 percent of the remaining CDO portfolio comprising CDOs with underlying assets rated lower than BBB. This change in portfolio composition largely resulted from the successful unwinding of portfolio holdings that have underlying assets rated at least BBB. According to AIG officials, the amount of future collateral posting requirements of this portfolio is a function of AIG's credit ratings, the ratings of the reference obligations, and any further decline in the market value of the relevant reference obligations, with the latter being the most significant factor. In addition, the amount of collateral posting requirements is a function of the collateral provisions in the specific credit support annexes, which are legal documents that detail the terms of collateral for derivative transactions. In the case of the multisector CDO portfolio, a significant portion of the remaining positions are not subject to additional collateral postings. AIGFP currently posts $3.1 billion against the $6.9 billion of net notional exposure in the multisector CDO portfolio.

Figure 8: Total Gross and Net Notional Amounts of Multisector CDOs Compared to Portions of Gross National Portfolio That Have Underlying Assets That Were Rated Less than BBB, Third Quarter of 2008 through Third Quarter of 2010



Source: GAO analysis of AIG SEC filings.

Note: Gross notional is equal to the net notional plus the subordination amounts.

AIG's Insurance Operations Have Continued to Show Signs of Recovery, but Federal Aid to Life Insurance Companies Has Been Critical to Their Progress

Given the importance of AIG's insurance operations to its long-term financial health, we analyzed AIG's insurance operations by tracking several indicators of both its property/casualty and life insurance companies. We tracked the annual regulatory capital of AIG's insurance subsidiaries. The most recent data show that from 2008 through the first half of 2010, AIG's insurers maintained capital above regulatory minimums, but the recent federal assistance was critical to the health of domestic life and retirement companies. In particular, our indicators show that for AIG's life and retirement services, additions to policyholder contracts exceeded withdrawals and operating income for the domestic and foreign life insurance and retirement services businesses declined in the first two quarters of 2010 compared to the fourth quarter of 2009, but remained positive. We also analyzed AIG's property/casualty companies by tracking their insurance premiums written. While the pattern has been somewhat cyclical, overall trends in volume of premiums written appear to have stabilized though not fully recovered to the levels of 2007. Finally, while the insurance companies generally showed some growth, our indicators show that the property/casualty companies' underwriting was not profitable in the first two quarters of 2010 although underwriting costs relative to premiums earned in the first two quarters 2010 declined considerably from the fourth quarter 2009. Underwriting costs relative to net premiums earned for the international companies declined in the second quarter of 2010 to the point where their underwriting again became profitable.

AIG's Insurers Maintained Capital Levels Higher Than the Regulatory Minimum, but the Domestic Life and Retirement Companies Needed Federal Assistance to Maintain Capital Ratio

The most recent data show that capital maintained by AIG's insurers has exceeded National Association of Insurance Commissioners (NAIC) minimums, and several of AIG's life and retirement companies have benefited from federal assistance. This indicator of AIG's capital—which we will update annually as newer NAIC data become available—is intended to monitor the capital of AIG insurers that, if depleted by losses, could require additional capital contributions through federal assistance (for instance, by AIG drawing on FRBNY's revolving credit facility or Treasury's equity capital facility). NAIC requires that insurance companies hold a minimum amount of capital, known as risk-based capital. According to NAIC, "a company reporting total adjusted capital of 200 percent or more of minimum risk-based capital is a 'no action' level company; nothing needs to be done by regulators."[42] On the other hand, NAIC states that

[42]"Total adjusted capital" is a company's actual amount of capital and surplus; it refers to a company's capital base.

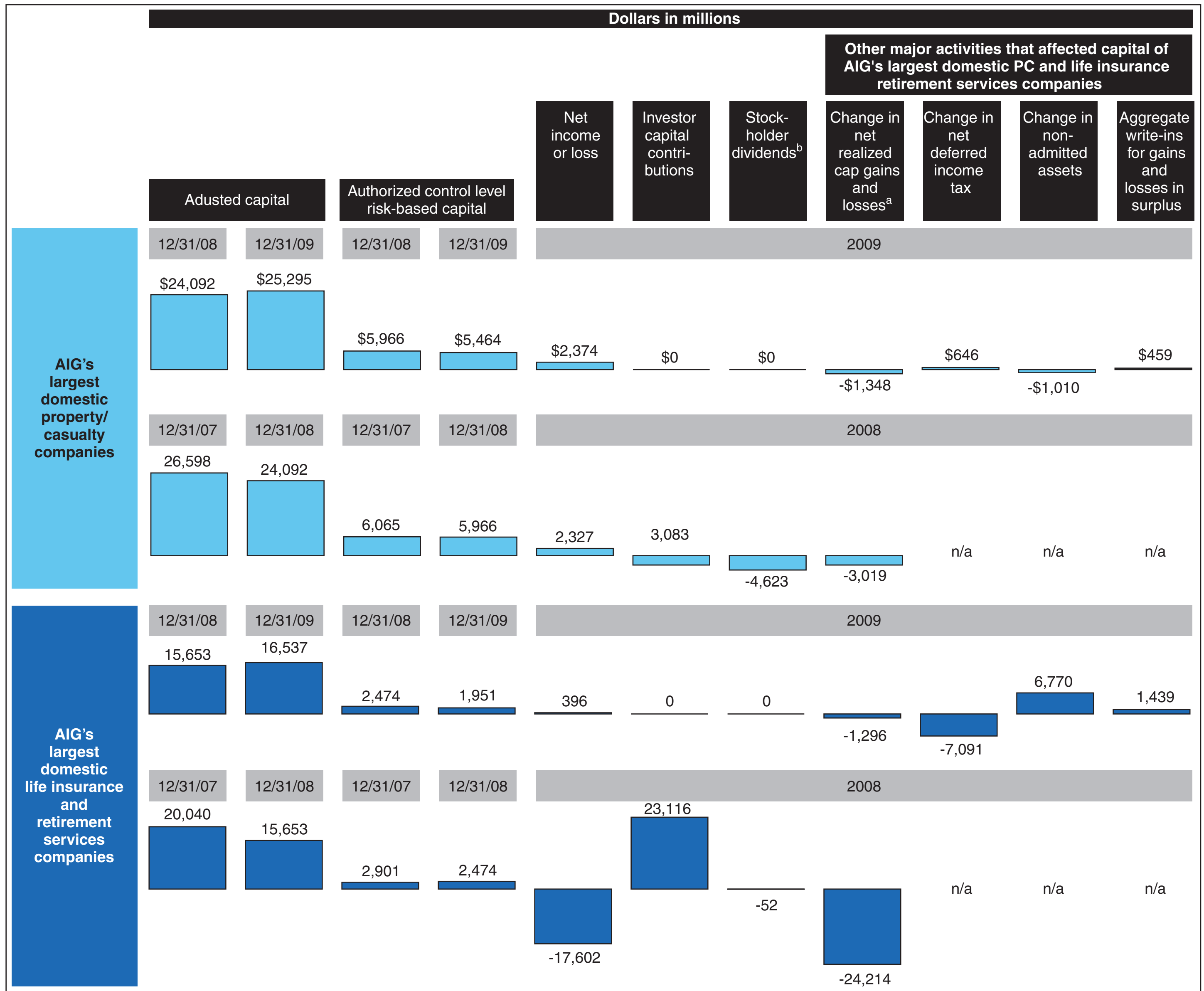
"total adjusted capital of less than 70 percent triggers a mandatory control that requires the regulator to take steps to place the insurer under control." Moreover, a company's credit ratings are influenced by, among other things, its ratio of total adjusted capital to its authorized control level risk-based capital.[43] Adverse movements in the primary components of capital and shareholders' equity may indicate weak performance by the company.

As previously reported, AIG's property/casualty insurers and domestic life insurance and retirement services companies have maintained levels of capital higher than the minimum requirement set by NAIC, as shown in figure 9. The property/casualty companies and domestic life companies had adjusted capital of at least 400 percent and 600 percent, respectively, of risk-based capital at year end 2007, 2008, and 2009. However, the domestic life companies only were able to maintain their capital ratios with federal assistance. Specifically, according to Federal Reserve officials, Maiden Lane II's direct purchase of $39.3 billion of RMBS at fair value helped these companies reduce the risks that were created by their securities lending activities in 2008. Further, AIG used funds from the FRBNY revolving credit facility to contribute capital to these companies, primarily to make up for the losses in the securities lending portfolio.[44] In contrast, AIG's domestic property/casualty companies have maintained levels of adjusted capital in excess of requirements with virtually no direct federal assistance. Because AIG companies report adjusted capital no more than once annually in their year-end filings with NAIC, this indicator can be updated only once a year after the calendar year-end data become available. We determined that the capital and surplus that AIG reports in its quarterly filings with NAIC are proxy for quarterly tracking of the adjusted capital because the same activities would affect both measures. More information about this indicator and the results of a proxy indicator that we developed for the first nine months of 2010 are included in appendix V.

[43]The authorized control level risk-based capital is the level at which an insurance commissioner can seize or first take control of an insurance company.

[44]As discussed earlier, FRBNY created Maiden Lane II, an SPV, to provide AIG liquidity through its purchase of RMBS 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.

Figure 9: Regulatory Capital for AIG Domestic Insurance Subsidiaries and Primary Activities That Affected Regulatory Capital during 2009



Source: AIG and GAO analysis of AIG financial statements filed with NAIC.

[a]NAIC financial statements show unrealized capital losses separately from net income.

[b]Includes dividends paid within AIG.

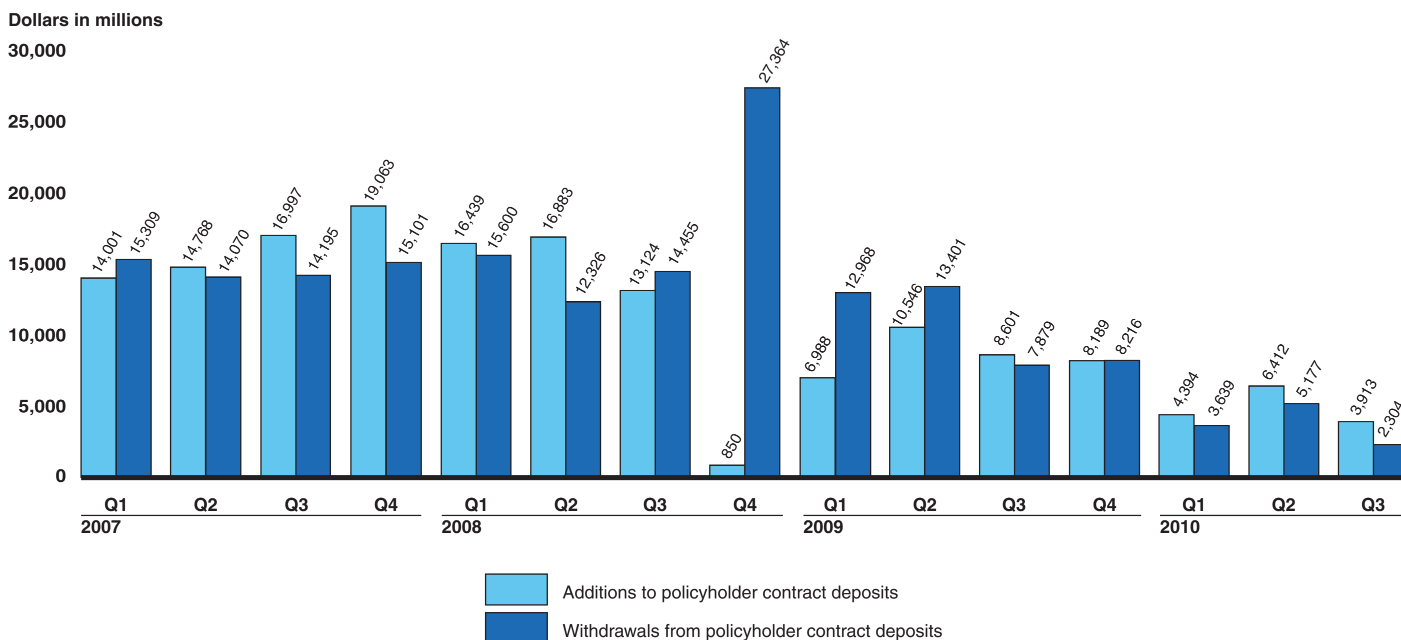
Business at AIG's Life Insurance and Retirement Services Companies Has Shown Deposits Recently Exceeding Withdrawals and Their Operating Income Has Remained Positive

Deposits at AIG's life and retirement service companies have been improving compared with withdrawals, and their operating income has remained positive. We use two indicators to monitor AIG's life insurance and retirement services companies. The first indicator tracks the additions to AIG life and retirement policyholder contract deposits and is intended to monitor for potential redemption "runs" by AIG annuitants and policyholders. 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 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 position. The second indicator tracks the capital gains and operating income of these companies and is intended to monitor the profitability of AIG's life insurance and retirement services companies. 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 and not directly 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 in figure 10, 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 more than $26 billion. Without more granular data, it is unclear 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 financial reasons. The excess of withdrawals over deposits adversely affected the liquidity position of certain entities in this segment of AIG in late 2008. Conditions started to improve in the first quarter of 2009, with a 77 percent reduction in the gap between additions and withdrawals to about $6 billion, and that improvement continued through the third and fourth quarters of 2009. The third quarter of 2009 was the first time since the second quarter of 2008 that additions to AIG life and retirement policyholder contract deposits exceeded withdrawals—by more than $700 million—but withdrawals again exceeded deposits in the fourth quarter of 2009. In 2010, while the dollar volume of contract deposits and withdrawals reported are lower because

of businesses slated for sale were shifted from continuing operations, contract deposits continued to exceed withdrawals, by $755 million, $1.2 billion, and $1.6 billion in the first, second, and third quarters, respectively.

Figure 10: AIG Life and Retirement Services Additions and Withdrawals from Policyholder Contract Deposits for AIG Life and Retirement Services Including Annuities, Guaranteed Investment Contracts, and Life Products, First Quarter of 2007 through Third Quarter of 2010



Source: GAO analysis of AIG SEC filings.

A closer look at the revenues and expenses of these companies shows that the companies suffered large operating losses in 2008 not because of their underwriting activities but because of losses from their investment activities (capital losses). Yet beginning in early 2009 and continuing into the first three quarters of 2010, their investment losses have become smaller and thus their operating incomes have become positive. For example, in the fourth quarter of 2008, net realized capital losses of AIG's domestic life and retirement services business accounted for $14.4 billion of its $15.2 billion in operating losses. Similarly, in that same quarter, AIG's foreign life insurance companies had net realized capital losses of $4.6 billion, which more than offset their operating income of $1.2 billion,

resulting in an operating loss of $3.4 billion.[45] For the full year 2009, net realized capital losses were $3.2 billion for the domestic companies and $0.6 billion for the foreign companies, much lower than they were for 2008—$32.6 billion for the domestic companies and $11.8 billion for foreign companies. In turn, in 2009 the reported operating income was $3.5 billion for domestic companies and $4.2 billion for foreign companies, compared with operating losses of $31.1 billion for domestic companies and $6.3 billion for the foreign companies in 2008. The reported net realized capital losses for the domestic companies were nearly $800 million in the first quarter of 2010 but the losses gave way to a reported $20 million gain in the third quarter 2010. The pretax operating net income increased over that same period, from $327 million to $998 million. Foreign companies reported realized capital losses in the first quarter of 2010 of $61 million, but these were followed by gains the next two quarters. Pretax operating income for these companies in the first three quarters of 2010 fluctuated at about $700 million and in the third quarter of 2010 was about half of the amount of income in the last quarter of 2009 (see app. VI).

AIG's Property/Casualty Companies Premiums Written Appear to Have Remained Stable

For the property/casualty commercial companies, dollar volumes of premiums written trended downward throughout 2007 and 2008, but started to stabilize in the first quarter in 2009 and this trend has continued through the first three quarters of 2010. To monitor trends in business volume in a way that includes the impact of AIG's financial troubles on its ongoing ability to retain existing business and attract new business activity to AIG's property/casualty companies, we developed an indicator that tracks the trends in quarterly premiums written by these companies since the beginning of 2007. "Premiums written" is the dollar volume of business in a particular period. This indicator is important because AIG's property/casualty insurance businesses are expected to remain among AIG's core businesses following its restructuring. Trends in premiums written also can provide some indication of the success of AIG's efforts to maintain business volume. For example, to retain and attract business, AIG formed Chartis, Inc. from several of AIG's property/casualty

[45]The life insurance and retirement services segment losses associated with investment activity through the segment's securities lending program accounted for a significant portion of AIG's losses in the fourth quarter of 2008. Appendix VI describes the revenues and expenses of AIG's life and retirement services programs in more detail.

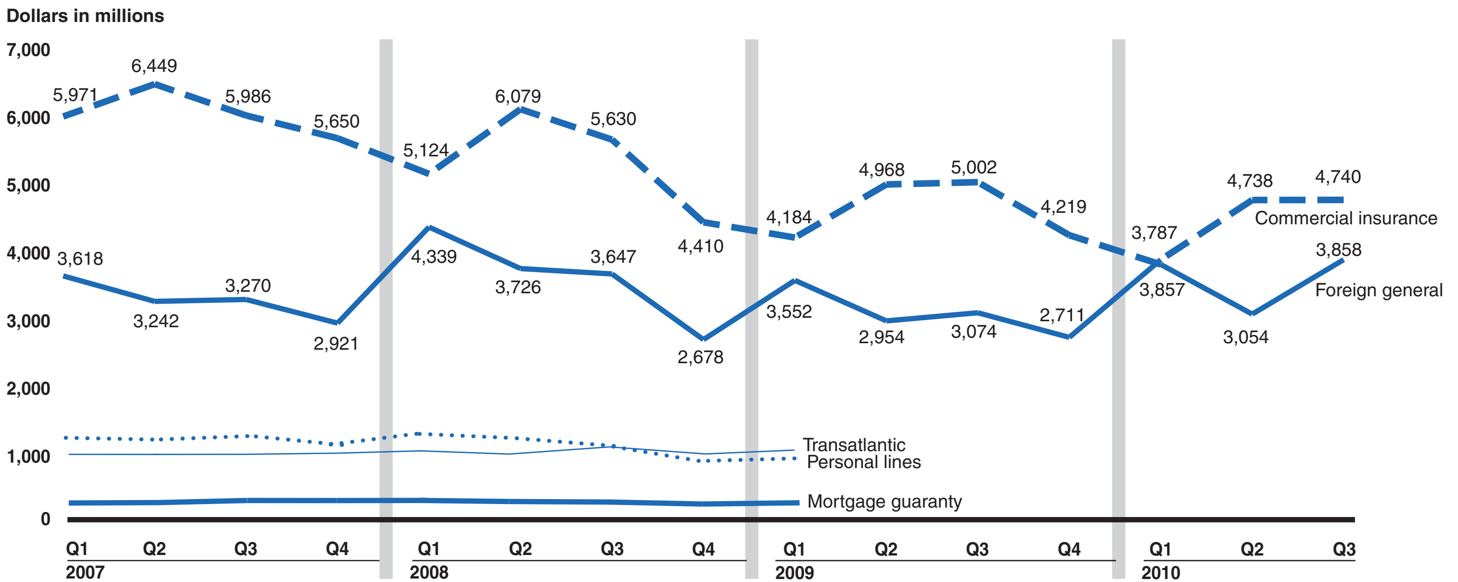
companies and rebranded (renamed) several other AIG companies.[46] However, the indicator on volume of premiums written is limited because it only measures a business's dollar volume and does not break out dollar volume by new and existing business. Therefore, the indicator cannot capture unit volume or the mix of products that comprise the volume. Also, the indicator tracks only AIG's business and does not compare AIG's business with that of its peers in the property/casualty insurance industry. Such a comparison would be important because property/casualty insurers as a group are subject to market pressures that drive premium prices up and down according to an industry-wide cycle characterized by hardening and softening markets. For example, according to a fourth quarter 2009 survey of the Council of Independent Agents and Brokers, commercial property/casualty premium rates were falling in the fourth quarter 2009 at about the same rate as in the third quarter.[47] According to the survey, low demand continued to put pressure on the rates.

As illustrated in figure 11, quarterly dollar volumes of premiums written by AIG's general insurance companies followed an annual recurring pattern with highest volumes generally occurring in the second and third quarters. For these companies, this pattern recurred at declining levels in 2009 as premium volumes in each quarter were lower than levels in same quarters of 2008, which were lower than levels in the same quarters of 2007. Also, premium volumes in the first three quarters of 2010 were below levels in the same quarters of 2009, but the rates at which they were declining moderated, indicating that the trends may have stabilized. As for foreign general insurance, such an annual recurring pattern and declines in premium volumes were not as consistent or pronounced. Premium volumes in the first three quarters of 2008 were higher than in the corresponding quarters of 2007. Then from the fourth quarter of 2008 through the third quarter of 2009 premium volumes were lower than in the corresponding prior year quarters before rebounding in the fourth quarter of 2009 to slightly exceed the premium volume in the fourth quarter of 2008. This trend continued into 2010 as premium volumes in the first three quarters were higher than the same three quarters of 2009.

[46]In July 2009, AIG announced that it had formed an SPV into which it would contribute the equity of AIU Holdings—which included AIG's commercial insurance, foreign general insurance, and private client group operations—and would be called Chartis, Inc.

[47]*The Council of Insurance Agents and Brokers' Quarterly Commercial P/C Market Index Survey, fourth quarter 2009* (Jan. 22, 2010).

Figure 11: AIG General Insurance Premiums Written by Division, First Quarter of 2007 through Third Quarter of 2010



Source: GAO analysis of AIG quarterly financial supplements.

Note: Common shares of Transatlantic were sold during the second quarter of 2009, reducing the aggregate ownership interest in Transatlantic to 14 percent, and additional shares were sold in the first quarter of 2010, leaving AIG owning 1 percent of the shares outstanding, which AIG also expects to sell. 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.

The health of AIG's insurance companies also can be viewed from the perspective of their underwriting profitability. For property/casualty insurers, underwriting profitability can be measured using the combined ratio, which is the sum of the loss and the expense ratios. The loss ratio measures claims costs plus claims adjustment expenses relative to net earned premiums. A rising loss ratio indicates rising claims costs relative to the premiums earned, which may be due to increased claims losses, decreased premiums earned, or a combination of the two. For example, a loss ratio of 77.3 percent indicates that 77.3 cents of every dollar in premiums earned are used for claims and claims-related costs. The expense ratio measures the level of underwriting administrative expenses relative to net premiums earned and is a measure of underwriting efficiency. For example, an expense ratio of 22.4 percent indicates that 22.4 cents of every dollar in premiums earned are used for underwriting expenses. The combined ratio is an overall measure of a property-casualty insurer's underwriting profitability. Thus, a combined ratio of less than 100 percent would indicate that an insurer's underwriting is profitable and a ratio of more than 100 percent would indicate an underwriting loss.

AIG's combined ratios in both commercial and foreign general property/casualty insurance businesses were below 100 throughout 2007 and the first half of 2008. These ratios rose and exceeded 100 in the second half of 2008 and repeated a similar pattern in 2009. However, the loss ratios for AIG's commercial insurance rose significantly in the third and fourth quarters of 2008. The combined ratio spiked in the fourth quarter of 2008, largely due to an administrative charge (that also spiked the expense ratio) to recognize permanent impairment of goodwill of previously acquired businesses.[48] The higher combined ratio also was partly due to a higher loss ratio because of increased claims costs associated with Hurricane Ike and other major catastrophes in 2008. The combined ratio also rose in the fourth quarter of 2009, largely due to increased claims costs related to a reserve strengthening charge. The commercial insurance combined ratios dropped significantly in the first quarter of 2010 and since then have remained at just more than 100, indicating that its commercial insurance underwriting was not profitable during these quarters. The combined ratio for AIG's foreign general insurance fell in the second quarter of 2010 to its lowest level in a year to 95.6, indicating that for this segment of business, underwriting again became profitable. AIG officials said the foreign general loss ratio increased during 2009 primarily because of higher claims generally related to directors and officers insurance as well as professional liability insurance (errors and omissions coverage) for financial institutions at the time of the worldwide credit crisis, particularly in Europe.[49] They also said that the foreign general expense ratio increased because AIG sold its Brazil operations, which resulted in decreased net premiums earned in 2008, more competitive pricing in the insurance markets in 2009, and higher levels of general operating expenses primarily

[48]A company records goodwill on its books when it buys another entity and pays more than the market value of all assets on the entity's books. A company will pay more because of intangibles such trademarks and copyrights on the books at historical cost and other factors—such as human capital, brand name, and client base—that accounting conventions do not capture on the books. If the company later determines that the entity has lost value and recovery is not a realistic expectation it might write-down that lost value as an impairment.

[49]Errors and omissions insurance is a liability insurance that protects professionals and companies against claims by clients for actual or alleged negligent actions and other errors and omissions in the performance of contracted services. Directors and officers insurance protects a company's directors and officers from liability arising from actions relating to the duties they perform as it relates to the company.

related to the remediation and audit of general insurance (Chartis, Inc.), pension costs, and post-retirement liability costs.[50]

We also developed a new indicator to quarterly track AIG's underwriting ratios compared with the average underwriting ratios of its property/casualty insurance peers or competitors and AIG's investment income and net income as percentages of premiums earned. The indicator shows that in nearly every quarter since the first quarter of 2008, AIG's property/casualty companies have not had profitable underwriting but generally they have had positive net income, largely because of their investment income. We analyzed the distributions of 2009 direct premiums written (DPW) by lines of business of 30 property/casualty companies that each had more than $1 billion in DPW for 2009.[51] From these companies we defined a "peer" of AIG as a company that generated more than 90 percent of its DPW in lines that accounted for more than 60 percent of AIG's DPW. We defined a nonpeer of AIG as a company that generated more than 80 percent of its DPW in lines that accounted for less than 40 percent of AIG's DPW or more than 50 percent of its DPW in a single line that was less than 20 percent of AIG's DPW.

The top panel of figure 12 compares AIG ratios to those of its peers. Its combined ratios were usually higher than the average of its peers. However, since the first quarter of 2008, the combined ratio for these AIG companies exceeded 100 in all but two quarters (indicating AIG's underwriting usually was not profitable), whereas the ratios for its peers averaged less than 100 in all but three quarters, indicating that their underwriting usually was profitable. The top panel of the figure also indicates that while AIG's expense ratios (which measure the level of

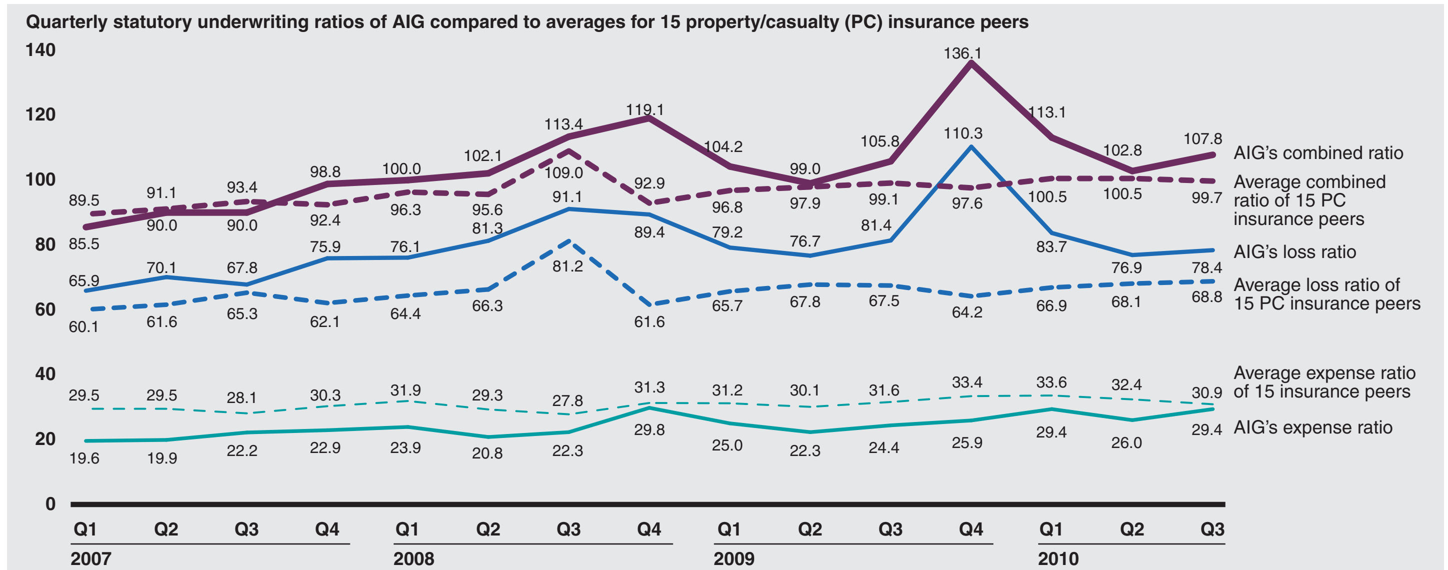
[50]For a more detailed discussion of the condition of AIG's insurance operations, see appendix VII.

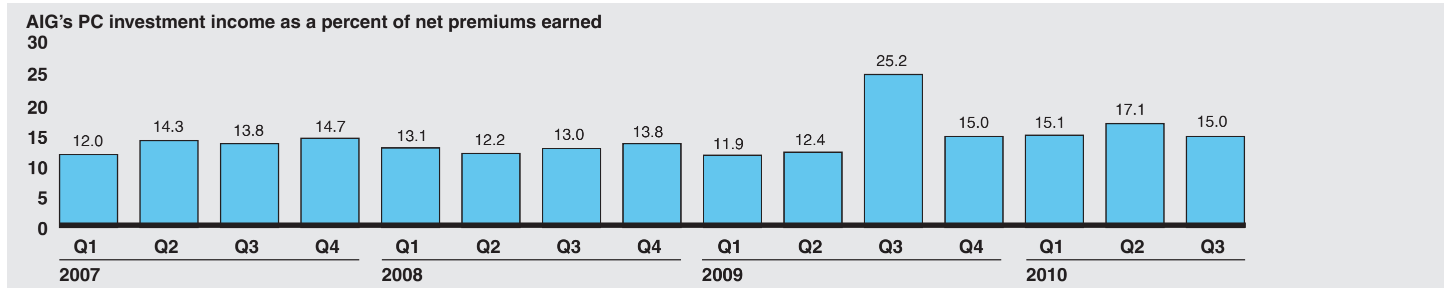
[51]We reviewed 30 property/casualty companies and identified 15 of these companies as AIG's property/casualty insurance peers based on the similarities we found in the distributions of their premiums written in 2009 by lines of business. As did AIG, these companies wrote premiums in several property/casualty lines of insurance. The companies are ACE, Alleghany, Allianz SE, American Financial, Arch Capital, Argo Group, Chubb, C.N.A., Fairfax Financial, Hartford Financial Services, Liberty Mutual, Markel, Old Republic, Travelers, and WR Berkley. Other property/casualty insurers not identified as peers were mostly companies concentrated in private auto insurance or home or farm owners insurance and other lines of insurance that were not major lines for AIG. These companies are Allstate; Assurant, Inc.; Bank of America; Berkshire Hathaway (GEICO); Erie Insurance Group; FM Global; Nationwide Mutual; Progressive; QBE Insurance Group; State Farm Fire and Casualty; State Farm Mutual Auto Insurance; Tokio Marine; United Services Automobile Association; White Mountains; and Zurich Financial Services.

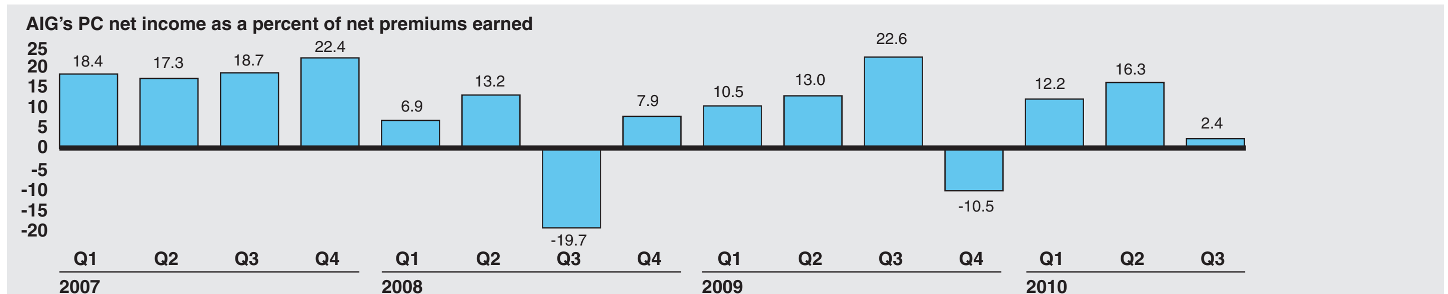
underwriting administrative expenses relative to net premiums earned) have been lower than the average of its peers in every quarter, its loss ratios (which measure the level of claims costs and loss adjustment expenses relative to net premiums earned) have been higher than the average of its peers in every quarter.[52] The lower panels of the figure show that despite the higher-than-peer average underwriting costs, AIG's property/casualty companies had positive net income in all but 2 of the 15 quarters presented and that the companies' investment income was a major factor.

[52]Historical operating ratios for commercial insurance have been revised to include Private Client Group and exclude HSB Group, Inc. The loss ratio for the fourth quarter of 2009 includes a $2.3 billion increase in the reserve for prior years' adverse loss development. The underwriting expense for the fourth quarter of 2008 includes a $1.2 billion charge for impairment to goodwill, increasing the expense ratio by 22.5 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.

Figure 12: Quarterly Statutory Underwriting Ratios of AIG (Domestic and Foreign Property/Casualty Insurance Companies) Compared to Averages for 15 Peers and AIG's Property/Casualty Investment Income and Net Income as Percents of Premiums Earned, First Quarter 2007 through Third Quarter of 2010







Sources: GAO analysis of AIG and peers data per SNL Financial.

Note: We determined AIG's property/casualty peers for our analysis by comparing various property/casualty companies' distribution of premiums written in 2009 by their lines of business. Similar to AIG, its peers have several lines of business. The 15 peers are ACE, Alleghany, Allianz SE, American Financial, Arch Capital, Argo Group, Chubb, C.N.A., Fairfax Financial, Hartford, Liberty Mutual, Markel, Old Republic, Travelers, and WR Berkley. Other property/casualty companies were not included in the peer group for this analysis. Most of these companies either concentrated on the private auto insurance business or home/farm owners insurance, neither of which is among AIG's largest lines of business. These companies are Allstate; Assurant, Inc.; Bank of America; Berkshire Hathaway (GEICO); Erie Insurance Group; FM Global; Nationwide Mutual; Progressive; QBE Insurance Group; State Farm Fire and Casualty; State Farm Mutual Auto Insurance; Tokio Marine; United Services Automobile Association; White Mountains; and Zurich Financial Services.

The panels of figure 12 also show that for AIG's domestic and foreign property/casualty insurance combined, underwriting for the segment was not profitable in 10 of the 15 quarters spanning 2007 through the third quarter of 2010, but returns from investments for these companies more than offset the underwriting losses, making the segment profitable overall.[53] While our data cover just under 4 years, they suggest a pattern of loss and expense ratios rising in the latter part of calendar years 2007, 2008, and 2009 for both commercial and foreign general insurance. However, investment returns were high enough for these general insurance divisions combined to remain profitable in 2007, 2009, and the first three quarters of 2010, but were not large enough to outweigh the nearly $4.4 billion in general insurance investment losses in 2008.

The Federal Government's Exposure to AIG Has Declined and Its Ability to Fully Recoup Its Assistance Will Be Determined by AIG's Long-term Health and Market Conditions

Our analysis of the composition of the federal assistance, including the amount of direct and indirect assistance and the sources of that assistance, shows that the federal exposure to AIG has declined since we last reported, and while AIG, Treasury, FRBNY, the AIG Credit Facility Trust, and the AIA and ALICO SPVs have executed a plan to recapitalize AIG and restructure the federal assistance to AIG in the hope of repaying the government's assistance, whether the federal government, in particular Treasury, will fully recoup its assistance may not be known for some time. As of September 30, 2010, total authorized federal assistance was reduced from $182.3 billion as of December 2009 to $176.5 billion, primarily because of a reduction in the credit limit of the FRBNY revolving credit facility. For the same time period, largely due to fluctuations in asset values, outstanding federal assistance was reduced from $129.1 billion to $124.6 billion. Specifically, the debt related to Maiden Lanes II and III owed to FRBNY on behalf of AIG decreased from $33.9 billion to $28.3 billion as of September 30, 2010. The values of the Maiden Lane II and

[53]Investment returns are not considered part of underwriting and thus are not included in the ratios.

Maiden Lane III portfolios have continued to increase slightly from September 2009 through September 30, 2010, while the principal and interest owed to FRBNY has declined. We also tracked AIG's book value (shareholders' equity) as an indicator on the prospect of AIG's repayment and found that it largely has stabilized through September 2010, due to the unprecedented actions the Federal Reserve and Treasury have taken to assist AIG. In addition, we tracked AIG's divestiture of businesses as another indicator on the prospect of AIG's repayment. AIG is using the net cash proceeds from the recent AIA initial public offering (IPO) and the sale of ALICO to MetLife to repay the FRBNY revolving credit facility. On January 14, 2011, AIG and relevant parties executed a recapitalization and restructuring plan through which AIG repaid the outstanding balance in FRBNY's revolving credit facility. Nevertheless, the extent to which the government can recoup the assistance to AIG depends on AIG's long-term health and is subject to uncertainty arising from the likelihood of future changes in general economic and market conditions.

Over the First Three Quarters of 2010, Total Government Exposure Has Declined

The government's exposure has decreased by about $4.5 billion since December 2009 to $124.6 billion as of September 30, 2010 (see table 3).[54] As discussed, the federal government has provided various forms of direct and indirect assistance to AIG.

- First, in the form of debt owed by AIG to the government, the government has loaned money to AIG directly through the FRBNY revolving credit facility. As of September 30, 2010, about $20.5 billion of assistance was being provided directly to AIG via a secured loan through the facility. This is less than 30 percent of the peak balance of $72.3 billion reached in October 2008. According to AIG, the company has drawn on the facility to address its short-term liquidity needs as it has not been able to issue commercial paper at the corporate level (see table 2) and because certain of its regulated subsidiaries are restricted from making dividend payments, or advancing funds, to AIG. However, as discussed earlier, an IPO for AIA occurred in late October 2010 and ALICO was sold in November 2010 to MetLife, generating cash proceeds to repay the facility, on closing of the announced recapitalization plan, as discussed later.

- Second, in the form of equity shares owned by the government, the government had a September 30, 2010, balance of $73.3 billion of AIG shares through (1) Treasury's Series E noncumulative preferred stock,

[54] See table 5 in GAO-09-975.

(2) Treasury's equity capital facility that is associated with the fixed-rate Series F noncumulative perpetual preferred stock, and (3) FRBNY's preferred interests in the AIA and ALICO SPVs. This direct government investment, which as of September 30, 2010, has grown by more than $1.5 billion from $71.8 billion in December 2009, is the primary form of federal assistance to AIG. It resulted from the November 2008 and March and April 2009 restructurings and the December 2009 transaction in which the Federal Reserve exchanged $25 billion of its debt for $25 billion in preferred interests in the AIA and ALICO SPVs. On April 1, 2010, AIG announced that pursuant to the terms of the Series E and F preferred stock agreements, which provide that Treasury has the right to elect directors to AIG's board in the event that AIG does not pay dividends on those series of preferred stock for a total of four quarterly periods, Treasury elected two directors to the AIG board of directors.

- Third, in the form of debt owed to the government on behalf of AIG, FRBNY has provided loans to Maiden Lane II and III—the SPVs established by FRBNY—for the purpose of purchasing RMBS assets from AIG's life insurance companies and CDOs from AIGFP's CDS counterparties, respectively. As of September 30, 2010, the government's exposure (not including interest dividends and fees) on those loans was $28.3 billion, down from $33.9 billion as of December 2009.

FRBNY acquired its preferred interests in the AIA and ALICO SPVs in exchange for reducing a substantial portion of AIG's debt under the FRBNY revolving credit facility. Moreover, in February 2010 AIG said that it was not going to pursue a previously announced life insurance securitization transaction. Specifically, AIG and FRBNY announced in March 2009, when federal assistance to AIG was restructured for a second time, that FRBNY would loan SPVs up to $8.5 billion to acquire the rights to cash flows from insurance policies issued by certain AIG domestic life insurance subsidiaries. AIG had planned to use proceeds from the sale of insurance policy cash flows to the SPV to repay FRBNY debt.

Table 3: Composition of U.S. Government Efforts to Assist AIG and the Government's Approximate Remaining Exposures, as of September 30, 2010

Dollars in billions

		Direct AIG assistance		Indirect AIG assistance			
	Amount authorized	AIG debt owed to government	Government equity	Other debt owed to government	Government equity	Accrued interest dividends and fees	Total government exposure
Federal Reserve							
Revolving Credit Facility	$29.175	$14.288[a]	n/a	n/a	n/a	$6.182	$20.47[a]
Maiden Lane II	22.5	n/a	n/a	$13.656[b]	n/a	0.408	14.064
Maiden Lane III	30	n/a	n/a	14.638[b]	n/a	0.499	15.137
AIA and ALICO	25	n/a	$25.955[c]	n/a	n/a	n/a	25.955
Treasury							
Series D and E	40	n/a	40[d]	n/a	n/a	1.605	41.605[d]
Series F	29.835	n/a	7.378[e]	n/a	n/a	n/a	7.378[e]
Totals							
Total direct assistance	**n/a**	**$14.288**	**$73.333**	**n/a**	**n/a**	**$7.787**	**$95.408**
Total indirect assistance	**n/a**	**n/a**	**n/a**	**$28.294**	**n/a**	**$0.907**	**$29.201**
Total direct and indirect assistance to benefit AIG	**$176.51**	**$14.288**	**$73.333**	**$28.294**	**n/a**	**$8.694**	**$124.609**

Sources: GAO analysis of AIG SEC filings, and Federal Reserve Statistical Release H.4.1.

Note: Data are as of September 30, 2010, or latest available.

[a]FRBNY created a revolving credit facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity positions. In exchange for the facility and $0.5 million, a trust received Series C preferred stock for the benefit of the Treasury, which gives the trust an approximately 79.75 percent voting interest in AIG. FRBNY reduced the amount of the commitment fee on the revolving credit facility by $500,000 to pay for the Series C stock. The AIG loan balance reported in the H.4.1 reflects the outstanding principal balance, capitalized interest, unamortized deferred commitment fees, and the allowance for the loan restructuring, which was initially recorded in July 2009. On January 14, 2011, AIG announced that it executed the recapitalization action plan, which stated that AIG is using the net cash proceeds from the recent AIA IPO and sale of the ALICO to Metlife to repay the FRBNY revolving credit facility.

[b]FRBNY created an SPV—Maiden Lane II LLC—to alleviate liquidity and capital pressures on AIG by purchasing RMBS from AIG U.S. insurance subsidiaries, and another SPV called Maiden Lane III LLC to alleviate liquidity and capital pressures on AIG by purchasing CDOs from AIGFP's counterparties in connection with the termination of CDS. Principal owed as of September 29, 2010, was $13.656 billion for Maiden Lane II LLC and $14.638 billion for Maiden Lane III LLC.

[c]AIG created two SPVs to hold the shares of certain of its foreign life insurance businesses (AIA and ALICO). In November 2010, the company announced that it sold ALICO to MetLife for approximately $16.2 billion (including approximately $7.2 billion in cash and the remainder in MetLife securities) and in October 2010 it announced that it had raised more than $20.5 billion in gross proceeds in the initial public offering of two-thirds of the shares of AIA. On January 14, 2011, AIG announced that it executed the signed recapitalization plan, which stated that the funds for repaying the FRBNY revolving credit facility were to come from the net cash proceeds from the IPO of 67 percent of AIA and the sale of ALICO.

[d]Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the revolving credit facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends on the Series D shares were added to the liquidation preference amount of Series E stock that Treasury received. When the Series D preferred shares were exchanged for Series E preferred shares, $1.605 billion of accrued but unpaid dividends were included in the liquidation preference of the Series E preferred stock. On January 14, 2011, AIG announced that it executed the signed recapitalization plan, which stated that Treasury's shares of AIG's Series E preferred stock were to be exchanged for approximately 924.5 million shares of AIG common stock.

[e]Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to $29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares. On January 14, 2011, AIG announced that it executed the signed recapitalization plan, which stated that AIG was to draw down amounts remaining on the Series F preferred stock and use them to repurchase all or a portion of FRBNY's preferred interests in the AIA and ALICO SPVs. According to this plan, AIG and Treasury were to amend and restate the Series F securities purchase agreement to provide for the issuance of Series G preferred stock by AIG to Treasury. According to the plan, AIG's right to draw on Treasury's equity capital facility was to terminate with the closing of the recapitalization. Treasury's shares of the Series F preferred stock have been exchanged for (1) preferred interests in the AIA and ALICO SPVs transferred to Treasury, (2) newly issued shares of Series G preferred stock, and (3) approximately 167.6 million shares of AIG common stock.

Due to restructuring and mandatory repayments from the sale of assets, the borrowing limit on the amount of direct assistance available to AIG through the FRBNY revolving credit facility has been lowered several times since the facility was created, and the amount AIG owes the facility also has been reduced (see app. VIII). Initially, FRBNY made $85 billion in assistance available to AIG. Both the available assistance and, in turn, the outstanding balance were reduced in November 2008 when the government first restructured its assistance to the company from debt to preferred equity. On November 25, 2008, AIG entered into an agreement with Treasury 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.[55] The proceeds of this sale were used to pay down AIG's

[55]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 in AIG. 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.

outstanding balance on the revolving credit facility by the same amount. This transaction left the government's overall exposure unchanged, allowed AIG to reduce its outstanding debt, and increased the federal equity position by $40 billion. It also involved a reduction of the borrowing limit on the credit facility from $85 billion to $60 billion.

The borrowing limit and outstanding balance were again reduced in December 2009 when FRBNY received preferred interests in the AIA and ALICO SPVs, which was part of the March 2009 restructuring. In this transaction, the amount AIG owed on the facility was reduced by $25 billion and, in exchange, FRBNY acquired preferred interests in the SPVs of the same amount. In effect, the transactions exchanged debt for equity. Also, the borrowing limit on the credit facility was reduced from $60 billion to $35 billion. To accelerate its efforts to repay the revolving credit facility AIG announced in March 2009 that it would generate proceeds of about $51 billion once pending agreements to sell AIA and ALICO to Prudential PLC and MetLife, respectively, were finalized. Later, AIG announced that it had terminated its pending agreement to sell AIA to Prudential PLC. In late October 2010 an IPO of two-thirds of the shares of AIA generated $20.5 billion in cash, and in November 2010 ALICO was sold to MetLife for $16.2 billion, including approximately $7.2 billion in cash and the remainder in MetLife securities. According to the executed recapitalization plan, the net cash proceeds from both transactions were to be loaned by the SPVs to AIG to repay the revolving credit facility.

The borrowing limit on the facility was reduced several more times in 2010 because of mandatory repayments from proceeds from sales of assets and businesses. In addition, in August 2010 International Lease Finance Corporation raised $3.9 billion by issuing senior secured debt in the private market. Like an asset sale, this activity triggered a mandatory prepayment under the FRBNY credit agreement with AIG. The outstanding balance includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring.[56] Changes in amounts owed on the facility fluctuate weekly and could increase or decrease depending on liquidity needs related to

[56]Balance includes accrued interest and fees of $6.182 billion as of September 30, 2010.

ongoing operations and restructuring activities, such as more conversions of debt to preferred equity.[57]

We also are monitoring the status of the government's indirect assistance to AIG through the Maiden Lane II and Maiden Lane III facilities (see app. VIII). FRBNY provided loans to the facilities, giving Maiden Lane II capital to purchase RMBS from AIG's domestic life insurance companies and Maiden Lane III capital to purchase multisector CDOs from AIGFP's CDS counterparties. The Maiden Lane II and Maiden Lane III portfolios were funded primarily by loans from FRBNY, which are not debt on AIG's books. The loans and related expenses are to be repaid from cash generated by investment yields, maturing assets, and sales of assets in the facilities. Such cash is to be used to pay, in this 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 between FRBNY and AIG. In addition to the FRBNY investments in the facilities, AIG invested $1 billion in Maiden Lane II and $5 billion in Maiden Lane III. For Maiden Lanes II and III, FRBNY debt and portfolio values peaked at $43.9 billion and $48.2 billion, respectively, in December 2008. At that time, the combined portfolio value was $4.3 billion higher than the combined FRBNY debt. Since then, and through September 29, 2010, the debt was reduced by $14.7 billion and the portfolio value, which has fluctuated over time, by $9.3 billion. This indicated that during that 21-month period, market prices of portfolio assets overall had not deteriorated while the debt was being reduced by cash flows generated by the portfolio from investment yields and asset maturities. Thus, as of September 29, 2010, Maiden Lane II had a portfolio value of $15.9 billion and Maiden Lane III had a portfolio value of $23 billion against unpaid FRBNY debt of $14.1 billion and $15.1 billion, respectively.

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 their sale but added that it has the authority to change its portfolio strategy at any time. Federal Reserve officials explained that the Maiden Lane assets are amortizing and that the long-term plan is for the Maiden Lanes to sell off the portfolios' assets, which will be used to repay the debt. Federal Reserve officials also said that they constantly evaluate opportunities to

[57]See appendix VIII for additional details about amounts owed under FRBNY's revolving credit facility.

sell assets—while still meeting their objective of maximizing long-term cash flows—and have been able to sell a handful of assets across the two Maiden Lanes. They clarified that their decision to sell an asset depends on an asset's discounted expected future cash flows and weighting those cash flows across scenarios by how likely they are to occur. The value of these assets relative to the outstanding loan balance had improved since the latter part of 2008 and the Maiden Lanes have continued to receive payments of principal and interest on their portfolios. The officials added that the assets in the Maiden Lanes are high-quality bonds and thus they expect to continue receiving timely payments of interest and principal on most bonds in the portfolio regardless of the holding period. In their view, the risk is that these payments cease as the underlying portfolio has substantially matured or defaulted prior to the full repayment of outstanding principal.[58] As assets mature, are sold, or pay interest, any portion remaining after paying operating expenses of the Maiden Lanes will go toward reducing the loan balance. These payments will reduce the amount of principal owed by the Maiden Lanes to FRBNY. As of September 30, 2010, proceeds from the Maiden Lanes had been used to pay down $15.5 billion of the outstanding principal.[59]

AIG and Relevant Parties Executed the Five Transactions Provided in the Master Transaction Agreement in the Closing of the Recapitalization Plan

In September 2010, AIG reached an agreement in principle for a recapitalization to begin to repay its federal assistance. Most of the plan hinged on the success of several transactions that involved a restructuring of the government's assistance to AIG. On December 8, 2010, this agreement was superseded by a master transaction agreement signed by AIG, FRBNY, Treasury, the AIG Credit Facility Trust (the Trust), as well as the AIA and ALICO SPVs, and this plan was executed on January 14, 2011. First, AIG repaid FRBNY in cash all the amounts owed under the FRBNY revolving credit facility, which as of September 30, 2010, was approximately $20.5 billion, and the credit facility was terminated. The funds for repayment came from loans to AIG from the SPVs that held the net cash proceeds from the IPO of AIA and the sale of ALICO. The net cash

[58]Federal Reserve officials added that BlackRock, its investment manager for the Maiden Lanes, currently produces moderate and extreme stress case scenarios to evaluate the potential risk to their outstanding loans if either significant downside shock were to occur. As of June 30, 2010, they said that BlackRock projected full repayment of interest and principal on the FRBNY loans to Maiden Lane II and III under the moderate and extreme stress scenarios.

[59]For additional trends information on Maiden Lane II, see appendix VIII.

proceeds from the AIA IPO were approximately $20.1 billion and from the ALICO sale to MetLife were approximately $7.2 billion.

Second, AIG drew down an amount available under Treasury's equity capital facility established pursuant to the Series F preferred stock securities purchase, less an amount up to $2 billion. AIG used the amount drawn down to repurchase all or a portion of FRBNY's preferred interests in the AIA and ALICO SPVs and then transferred the repurchased preferred interests to Treasury in partial consideration for the Series F shares.[60] In addition to the value provided by the remaining equity stake in AIA and equity interests in MetLife received as part of the ALICO sale, AIG used the proceeds from the sales or dispositions of its interests in its Nan Shan Life Insurance Company, Ltd.; AIG Star Life Insurance Co. Ltd.; AIG Edison Life Insurance Company; International Lease Finance Corporation; and Maiden Lane II LLC and Maiden Lane III LLC to repay the proceeds loaned to AIG from the AIA and ALICO SPVs, providing funds that the SPVs used to redeem any of the preferred interests in the SPVs that remained outstanding after the closing.[61] Any preferred interests in the SPVs not transferred to Treasury at closing continue to be held by FRBNY and would be senior to the preferred interests in the SPVs transferred to Treasury. AIG has the right to designate up to $2 billion of the remaining Series F preferred stock to a new Series G cumulative mandatory convertible preferred stock for general corporate purposes (this is discussed in more detail below).

Third, AIG and Treasury amended and restated the securities purchase agreement related to the Series F preferred stock so that AIG could issue to Treasury Series G preferred stock at closing, and AIG's right to draw on the Series F preferred stock was terminated. AIG's right to draw on the Series G preferred stock is subject to terms and conditions substantially similar to those in the agreement. According to Treasury officials, the terms of the Series G stock would make it punitive for AIG to draw on the stock for financing. Indeed, according to the agreement, dividends on the

[60]In connection with the issuance of the Series E and F preferred stocks and as a participant in TARP, AIG had agreed to a number of covenants with Treasury related to corporate governance, executive compensation, political activity, and other matters. These covenants will continue to apply after the closing. Also, AIG will agree to provide Treasury and FRBNY with certain control and information rights.

[61]On January 12, 2011, AIG announced an agreement to sell its 97.57 percent interest in Nan Shan Life Insurance Company, Ltd. to Ruen Chen Investment Co., Ltd. of Taiwan for $2.16 billion in cash.

Series G preferred stock would be payable on a cumulative basis at a rate per annum of 5 percent, compounded quarterly. In addition, Treasury and AIG officials said that if AIG did not repay its draw on this facility within a year, then Treasury's Series G preferred stock would be converted to common stock at the lesser of 29.29 percent and 80 percent of the average volume weighted average price over the 30 trading days commencing immediately after the date the common stock trades without the right to receive warrants in connection with the recapitalization.[62]

Fourth, the various preferred stock held by the Trust and Treasury were exchanged for common stock. The exchanges included the following:

1. The Trust's shares of AIG's Series C perpetual, convertible, participating preferred stock were exchanged for approximately 562.9 million shares of AIG common stock, which are now held by Treasury;

2. Treasury's shares of AIG's Series E fixed rate noncumulative preferred stock were exchanged for approximately 924.5 million shares of AIG common stock; and

3. Treasury's shares of the Series F preferred stock were exchanged for preferred interests in the AIA and ALICO SPVs transferred to Treasury, newly issued shares of Series G preferred stock, and approximately 167.6 million shares of AIG common stock.

Treasury now holds approximately 1.655 billion shares of AIG common stock, representing approximately 92.1 percent of the AIG common stock that would be outstanding as of the closing.

Fifth, AIG issued to holders of AIG common stock, by means of a dividend, 10-year warrants to purchase up to 75 million shares of AIG common stock at an exercise price of $45 per share.[63] According to Treasury officials, the warrants were issued to address the AIG board of directors' desire to

[62]AIG may not directly redeem the Series G preferred stock while FRBNY continues to hold any preferred interests in the AIA and ALICO SPVs, but AIG will have the right to use cash to repurchase a corresponding amount of the preferred interests in the SPVs from FRBNY, which will then be transferred to Treasury to reduce the aggregate liquidation preference of the Series G preferred stock. If FRBNY no longer holds preferred interests in the AIA and ALICO SPVs, AIG may redeem in cash the Series G preferred stock, at the liquidation preference plus accrued and unpaid dividends.

[63]Exercise price is the price at which the option holder may buy or sell the underlying asset.

compensate existing shareholders for the dilutive effect of the recapitalization plan.

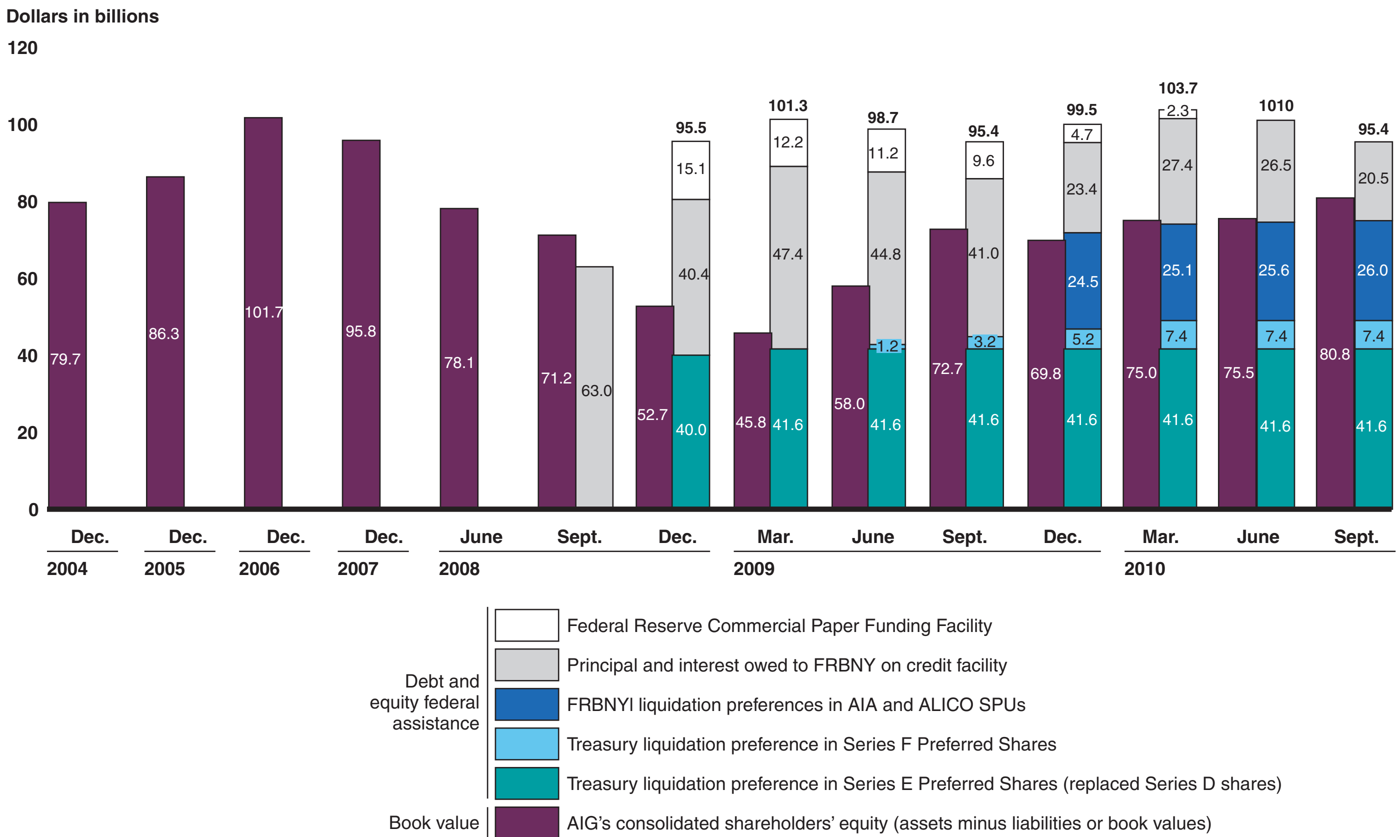
Implementation of the recapitalization plan began on January 6, 2011, when AIG's Board of Directors conditionally declared a dividend in the form of warrants to purchase shares of AIG's common stock to the holders of AIG common stock subject to the condition that the parties to the recapitalization plan determined as of January 12 and closed on January 14. On January 12, AIG announced that this condition had been satisfied. It proceeded with the distribution of the warrants, which were 10-year warrants to purchase up to 75 million shares of AIG common stock. The warrants were issued on January 19, 2011, to AIG's common shareholders of record as of January 13, 2011. Each warrant entitles the holder to purchase one share of AIG common stock, par value $2.50 per share (AIG common stock), at $45 per share. With these exchanges completed, Treasury now owns approximately 92 percent of the common stock of AIG. Treasury also owns new Series G preferred shares, which AIG may draw for general corporate purposes, and preferred interests in the AIA and ALICO SPVs. AIG expects that over time, Treasury will sell its shares of AIG common stock.

With Continued Federal Debt and Equity Assistance, AIG's Book Value Remained Generally Stable over the First Nine Months of 2010

To assess AIG's prospects of repaying federal assistance, we developed an indicator to track AIG's book value (shareholders' equity). A rise in book value could indicate improved prospects for repayment. Conversely, a decrease could indicate worsening prospects for repayment. The indicator monitors the amount of federal assistance provided in the form of debt and equity to AIG relative to AIG's book value. It tracks AIG's book value annually over several years before the financial deterioration that resulted in federal assistance, and from that point forward compares the book value with the level of federal debt and equity assistance provided but not yet repaid on a quarterly basis.

Figure 13 shows that AIG's shareholders' equity peaked in December 2006 at $101.7 billion and bottomed at $45.8 billion in March 2009. It climbed to $72.7 billion in September 2009, and has fluctuated more modestly since then. As of September 30, 2010, shareholders' equity was at $80.8 billion, compared to $95.4 billion of total federal assistance on AIG's books either as debt owed or as preferred equity. However, as discussed earlier, as of the third quarter 2010, AIG's shareholders' equity currently is positive, which is entirely the result of federal assistance.

Figure 13: Debt and Equity Federal Assistance Provided to AIG Compared with AIG's Book Value, December 2004 through September 30, 2010



Source: GAO analysis of AIG SEC filings.

AIG Has Implemented Major Divestitures

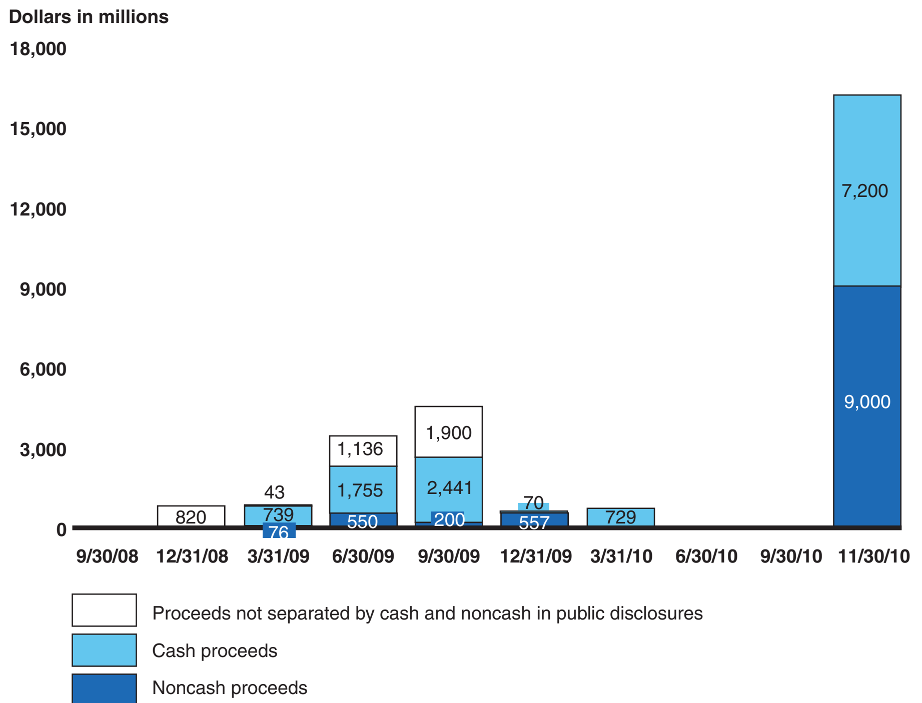
Part of AIG's plan has been for the company to restructure itself into a smaller company by selling some of its businesses, and that has included major recent divestitures. In 2009 the company divested several of its businesses and in the Fall of 2010, AIG sold ALICO and completed an IPO of AIA, two insurance companies that were major subsidiaries of AIG. According to Federal Reserve officials, the proceeds from the AIA and ALICO transactions were to be held in an escrow-type account and would not be used to pay either the FRBNY credit facility or the preferred interests in the AIA and ALICO SPVs until all of the closing conditions of the restructuring plan were met. Cash proceeds from certain other asset sales will be available to fund operations and redeem preferred interests. To track the progress of this activity, we developed an indicator to chronologically track divestitures (or dispositions) by AIG and the terms

of such transactions, including cash proceeds. Our indicator groups the divestitures and the related proceeds by the quarters in which the transactions closed.

Figure 14 shows aggregate proceeds from dispositions closed by quarter from the third quarter of 2008 through the third quarter of 2010, and as of November 30, 2010, broken out by cash proceeds, noncash proceeds, and proceeds with the cash portion not disclosed (figure does not include the AIA IPO, which is not a disposition). AIG said that it has used the cash proceeds from these sales to meet its obligations, including the credit facility; to cover capital needs; and to provide loans to its subsidiaries. As of November 30, 2010, AIG disclosed that it had received about $27.2 billion in total proceeds from sales, $12.9 billion of which was cash. Figure 14 shows that proceeds were increasing each quarter through the third quarter of 2009. In the last quarter of 2009, AIG closed on the sale of AIG Finance-Hong Kong for $627 million. AIG officials told us that in addition to this sale, AIG signed agreements on several other transactions during this period that had not yet closed. The slowdown in sales also may have reflected the asset-disposition strategy of AIG's current president and chief executive officer, which has been to hold assets in hopes for better terms at a later date rather than to sell them quickly.[64]

[64]For a list of dispositions, see appendix IX.

Figure 14: Proceeds from Dispositions by Quarter, September 30, 2008, through November 30, 2010



Sources: AIG and GAO analysis of AIG press releases and SEC filings.

Most recently, AIG has reported significant progress in disposing of two of its major assets. On March 8, 2010, AIG announced that its board had agreed to sell ALICO to MetLife, and the sale subsequently was closed in November 2010 for $16.2 billion, which is reflected in the figure above. In March 2010, AIG also announced that its board had approved the sale of AIA to Prudential PLC, but subsequently this sale was terminated and AIA was positioned for an IPO. The IPO occurred in late October 2010 and generated $20.5 billion, which is not reflected in the figure above since the transaction was not a sale. On the closing of the recapitalization plan, the net cash proceeds from the sale of ALICO and the AIA IPO were used to repay the FRBNY revolving credit facility.[65] AIG, Treasury, FRBNY, and the

[65]The cash proceeds will be lent by the SPVs to the parent company in the form of secured nonrecourse loans and the loan proceeds will then be used to repay the facility. Also, at the time of repayment and termination of the credit agreement, any remaining unamortized prepaid commitment fee asset, which approximated $4.3 billion at September 30, 2010, will be written off through a charge to earnings.

AIG Credit Facility Trust see these transactions as critical for AIG to repay its federal assistance.

The unprecedented steps the Federal Reserve and Treasury have taken to assist AIG as a result of their determination that the company posed systemic risk to the financial system have helped stabilize AIG's operations. The federal assistance, including the most recent recapitalization and restructuring plan, also appears to be facilitating a more orderly restructuring of the company. Our panel of indicators shows that, in general, the improvements AIG made in 2009 continued into the first three quarters of 2010. However, the indicators also show that AIG has continued to rely heavily on federal assistance for its liquidity needs and equity capital structure.

Since the beginning of our monitoring effort, federal assistance provided to AIG gradually has shifted from debt to equity, with a reduction in the authorized amount of the FRBNY revolving credit facility and an increase in the amount of preferred equity interests held in AIG and various SPVs for the government. With the January 14, 2011, completion of the restructuring plan, all of the government's assistance to AIG is now in the form of common stock and preferred interests. Consequently, the government's, and thus the taxpayer's, exposure to AIG increasingly is expected to be tied to the success of AIG, its ongoing performance, and its value as seen by investors in AIG's stock. The sustainability of any positive trends in AIG's operations will depend on how well it manages its business in the current economic environment. Similarly, the government's ability to fully recoup its assistance will be determined by the long-term health of AIG and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government. We will continue to monitor these issues in our future work.

Agency Comments and Our Evaluation

We shared a copy of the draft of this report with the Federal Reserve, Treasury, and AIG. They provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to interested congressional committees and members, the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, 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.

If you or your staffs have any questions concerning this report please contact Orice Williams Brown at (202) 512-8678 or 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 X.

Orice Williams Brown
Director, Financial Markets
and Community Investment

List of Congressional Addressees

The Honorable Max Baucus
The Honorable Thad Cochran
The Honorable Kent Conrad
The Honorable Orrin Hatch
The Honorable Daniel K. Inouye
The Honorable Tim Johnson
The Honorable Jeff Sessions
The Honorable Richard C. Shelby
United States Senate

The Honorable Hal Rogers
Chairman
The Honorable Norm Dicks
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable Paul Ryan
Chairman
The Honorable Chris Van Hollen
Ranking Member
Committee on the Budget
House of Representatives

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

The Honorable Dave Camp
Chairman
The Honorable Sander M. Levin
Ranking Member
Committee on Ways and Means
House of Representative

Appendix I: AIG Operations

American International Group, Inc. (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. These activities include general insurance, life insurance and retirement services, financial services, and asset management. Figure 15, which illustrates the AIG parent company and subsidiaries that it directly owns, conveys the complexity of the AIG organization. AIG's subsidiaries are Chartis International, LLC; AIG Life Holdings International, LLC; ALICO Holdings, LLC; Chartis Inc.; AIG Life Holdings (United States), Inc.; AIG Capital Corporation; AIG Financial Products Corp; and 10 other companies. AIG comprises approximately 400 companies and has operations in more than 130 countries and jurisdictions worldwide. As of September 30, 2010, AIG had assets of $872 billion and revenues of $19.1 billion for the 3 preceding months. The AIG companies are among the largest domestic life insurers and domestic property/casualty insurers in the United States, and include large foreign general insurance and life insurance businesses. According to AIG, there have been no material changes in their organization chart as of September 1, 2010.

Figure 15: AIG, Its Subsidiaries, and Percentage Ownership by Parent Company as of September 1, 2010

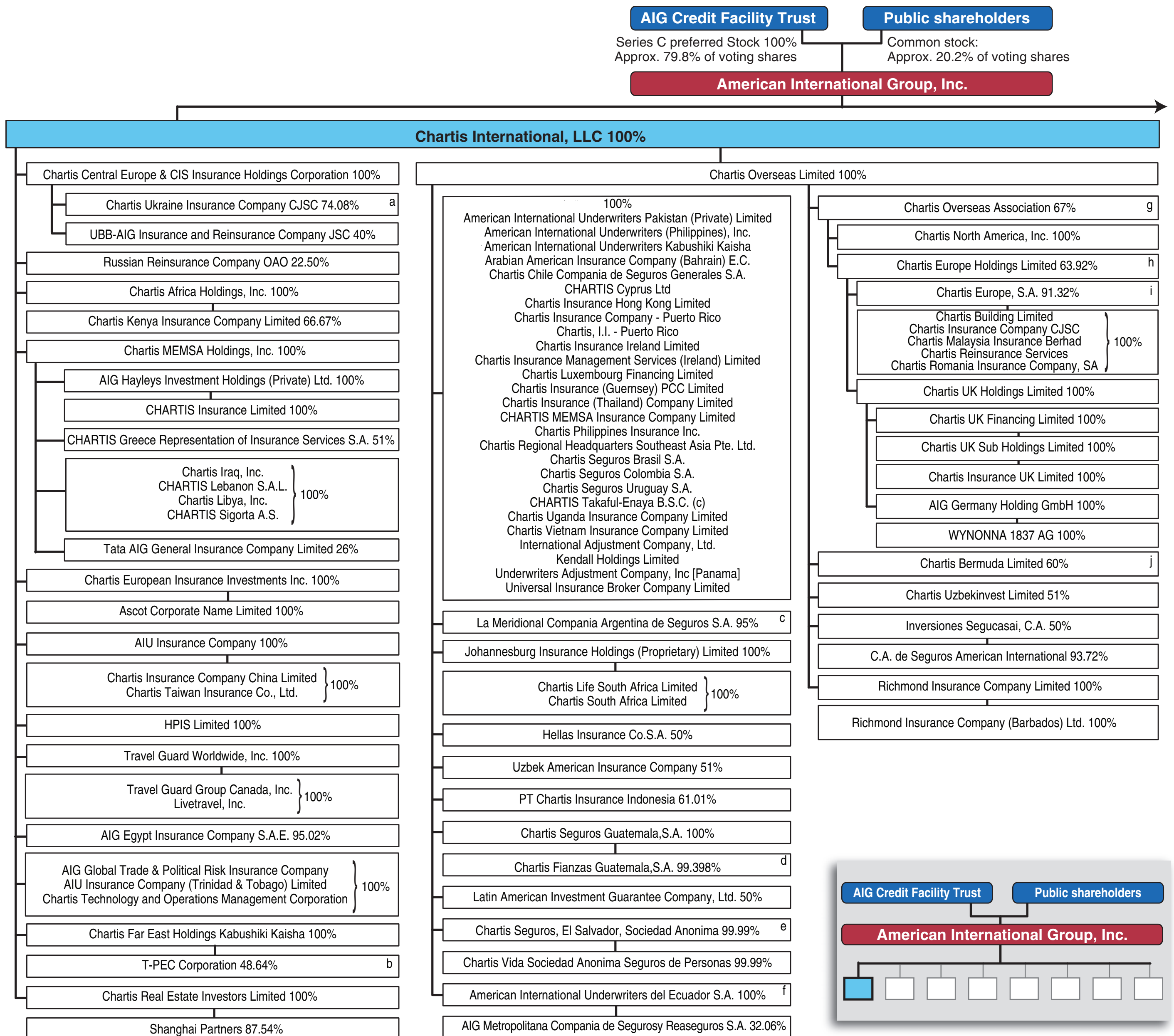


Figure continued

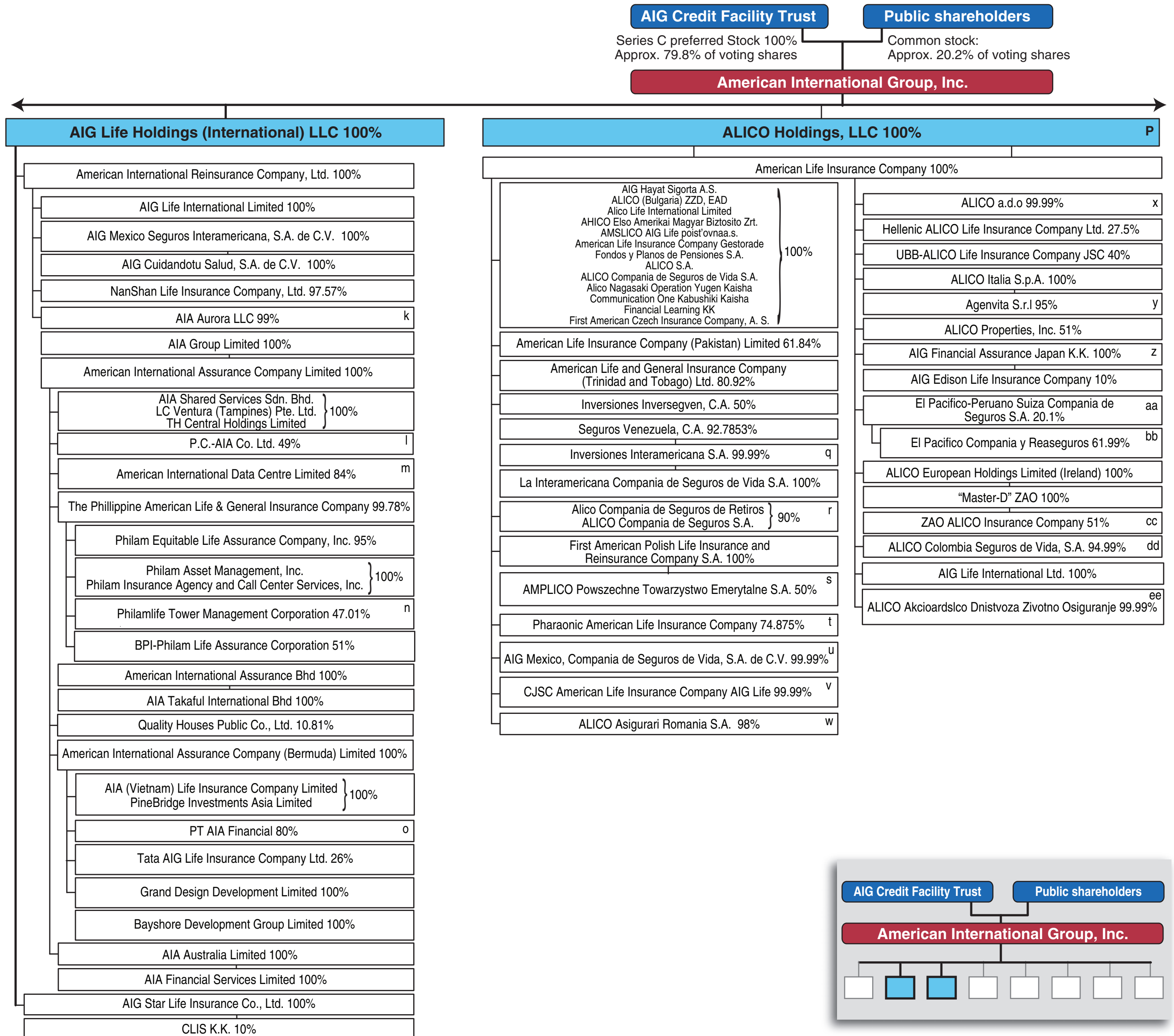


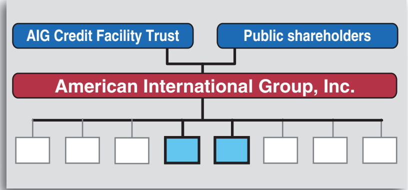
Figure continued

AIG Credit Facility Trust — Series C preferred Stock 100%, Approx. 79.8% of voting shares

Public shareholders — Common stock: Approx. 20.2% of voting shares

American International Group, Inc.

- Chartis Inc. 100%
  - Chartis U.S., Inc. 100%
    - American Home Assurance Company 100%
      - Chartis Non-Life Holding Company (Japan), Inc. 100%
        - Fuji Fire & Marine Insurance Company Limited 18.13% ff
        - 100%: American Fuji Fire & Marine Insurance Company; Fuji Life Insurance Company, Limited; Fuji International Insurance Company, Limited
    - New Hampshire Insurance Company 100%
      - 100%: Chartis Casualty Company; Granite State Insurance Company; Illinois National Insurance Co.; Morefar Marketing, Inc.
    - Quartz Holdings LLC 100%
      - Fieldstone Securitization I LLC 100%
      - Graphite Management LLC 100%
      - Lavastone Capital LLC 100%
    - Audubon Insurance Company 100%
    - Audubon Indemnity Company 100%
    - 100%: The Insurance Company of the State of Pennsylvania; Landmark Insurance Company; Chartis Property Casualty Company; Chartis Insurance Company of Canada
    - Commerce and Industry Insurance Company 100%
      - AIG Polska Towarzystwo Ubezpiecen S.A. 99.25% gg
    - Risk Specialists Companies, Inc.100%
      - A.I. Risk Specialists Insurance 100%
        - 100%: Design Professionals Association Risk Purchasing Group, Inc.
    - National Union Fire Insurance Company of Pittsburgh, PA 100%
      - 100%: National Union Fire Insurance Company of Louisiana; National Union Fire Insurance Company of Vermont; Chartis Claims, Inc.
      - Chartis Specialty Insurance Company 70% hh
      - Lexington Insurance Company 70% ii
        - JI Accident & Fire Insurance Company, Ltd. 50%
      - Chartis Select Insurance Company 100%
        - Chartis Excess Limited 100%
      - United Guaranty Corporation 45.88% jj
        - 100%: AIG Centre Capital Group, Inc.; AIG United Guaranty Agenzia di Assicurazione S.R.L.; AIG United Guaranty Insurance (Asia) Limited; AIG United Guaranty Mortgage Insurance Company Canada; AIG United Guaranty Re, Ltd.; AIG United Guaranty, Sociedad Limitada; United Guaranty Direct Insurance Svcs, Inc.; United Guaranty Services Inc.; United Guaranty Insurance Company; United Guaranty Mortgage Insurance Co.; United Guaranty Mortgage Insurance Company of North Carolina; United Guaranty Partners Insurance Co.; United Guaranty Residential Insurance Company of North Carolina
        - United Guaranty Residential Insurance Company 75.03% kk
          - 100%: First Mortgage Insurance Company; United Guaranty Commercial Insurance Company of North Carolina; United Guaranty Credit Insurance Company; United Guaranty Mortgage Indemnity Company
        - A.I.G. Mortgage Holdings Israel, Ltd. 100%
          - E.M.I. - Ezer Mortgage Insurance Company Ltd. 100%
        - AIG United Guaranty Mexico, S.A. 99.999% ll
- AIG Life Holdings (US), Inc. 100%
  - AGC Life Insurance Company 100%
    - AIG Life of Bermuda, Ltd. 100%
      - American General Life Insurance Of Bermuda, Ltd. 100%
    - American General Life and Accident Insurance Company 100%
    - American General Property Insurance Company 100%
    - American General Lilfe Insurance Company 100%
      - American General Annuity Service Corporation 100%
      - The Variable Annuity Life Insurance Company 100%
      - VALIC Financial Advisors,Inc. 100%
      - Iris Energy, LLC 44% mm
    - 100%: Western National Life Insurance Co.; American General Life Insurance Co. Of Delaware; American International Life Assurance Company of New York; The United States Life Insurance Co. in the City of New York
  - AI Life Settlement, Inc. 100%
  - American General Assurance Company 100%
  - American General Indemnity Company 100%



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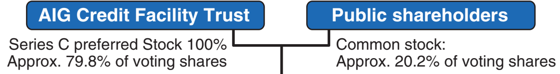


Series C preferred Stock 100%
Approx. 79.8% of voting shares

Common stock:
Approx. 20.2% of voting shares

American International Group, Inc.

- **AIG Capital Corporation 100%**
  - AIG Global Asset Mgmt. Holdings Corp. 100%
    - AIG Global Real Estate Investment Corp. 100%
    - AIG Realty, Inc. 100%
    - AIG Securities Lending Corp. 100%
    - PineBridge Global Investment LLC 100%
    - PineBridge Investment LLC 100%
    - AIG Ports America, Inc. 100%
      - Ports America Holdings, Inc. 100%
      - Ports Insurance Company, Inc. 100%
  - AIG Consumer Finance Group, Inc. 100%
    - AIG Bank Polska S.A. 99.92%
  - AIG Equipment Finance Holdings, Inc. 100%
    - AIG Commercial Equipment Finance, Inc.; AIG Rail Services, Inc. } 100%
  - International Lease Finance Corporation 100%
    - Aircraft SPC -12, Inc. 100%
    - Whitney Leasing Limited 100%
    - Aircraft SPC -9, Inc. 100%
    - Sierra Leasing Ltd. 100%
  - AIG Credit Corp. 100%
    - A.I. Credit Corp. 100%
  - American General Finance, Inc. [IN] 100%
    - American Financial Services of Alabama, Inc. [DE] 100%
    - American General Finance Corp. [IN] 100%
      - 100%: American General Consumer Discount Co.; American General Financial Services of Illinois, Inc.; American General Financial Services, Inc. [DE]; American General Financial Services, Inc. [IN]; American General Financial Services, Inc. [NC]; American General Financial Services, Inc. [OH]; American General Financial Services, Inc. [SC]; American General Financial Services, Inc. [TX]; American General Financial Services, Inc. [WA]; Merit Life Insurance Co.; Ocean Finance and Mortgages Limited; Third Street Funding LLC; Yosemite Insurance Company
      - MorEquity, Inc. [NV] 100%
      - Wilmington Finance, Inc. 100%
      - American General Financial Services of America, Inc. [DE] 100%
      - American General Home Equity, Inc. [DE]100%
- **AIG Global Services, Inc. 100%**
  - American International Group KK 100%
  - Equitable Investment Co. (Hong Kong) Ltd. 100%
  - Sea Insurance Co. Limited; Sea Insurance Sendirian Berhad } 100%
  - AIG Israel Insurance Company 50.01%
  - Caravan Investment Inc. 100%
  - AIG Caspian Insurance Company 51% nn
  - 100%: AIG Federal Savings Bank; AIG Funding, Inc.; AIG BG Holdings, LLC; AIG Castle Holdings, LLC; AIG Castle Holdings, II LLC; AIG Life Insurance Company (Switzerland), Ltd.; American Security Life Insurance Company, Ltd.; MG Reinsurance Limited
  - AIG Trading Group, Inc. 100%
  - AIG International Inc. 100%
  - AIG Clearing Corporation 100%
  - AIG Kazakhstan Insurance Co., S.A. 60%
  - Delaware American Life Insurance Co. 100%
  - GBN, LLC 100%
  - AIG Retirement Services, Inc. 100%
    - SunAmerica Life Insurance Co. 100%
      - SunAmerica Annuity and Life Assurance Company 100%
      - SunAmerica Asset Mangement Corp. 100%
      - SunAmerica Capital Services, Inc. 100%
      - First Sun America Life Insurance Co; SA Affordable Housing, LLC } 100%
      - SunAmerica Investments, Inc. 100%
        - SunAmerica (Cayman) Co., Ltd. 100%
        - AIG Advisor Group, Inc. 100%
        - SagePoint Financial Advisors, Inc. 100%
    - New California Life Holdings, Inc. 33%
    - Aurora National Life Assurance Co. 100%
  - AIUH LLC 100%
  - Chartis Holdings, Inc. 100%
- **AIG Financial Products Corp. 100%**
  - 100%: AIG Matched Funding Corp.; AIG -FP Matched Funding Corp.; Bishopswood Corp.; Bluewood Investment LLC; DBY One, LLC; International Investment Company (Bermuda) Limited; NF One (Cayman) Limited; NF Seven (Cayman) Limited; Orangewood Investment LLC; Yellowwood Investment LLC
  - AIG Financial Products (Jersey) Limited 100%
  - AIG -FP Investment Co. (Bermuda) Limited 100%
  - AIG -FP Funding (Cayman) Limited; AIG -FP Special Finance (Cayman) Limited; NF Thirteen (Cayman) Limited } 100%
  - AIG -FP Pinestead Holdings Corp. 100%
  - Alberti Holding Company; Cedarstead Investment Corp.; Pinestead Investment Corp.; Willowgrove Finance Company Limited } 100%
  - Dukes Corp. 100%
  - Cloudview (Cayman) Limited; Cloudview 3 (Cayman) Limited; Skyview (Cayman) Limited; Skyview 3 (Cayman) Limited } 100%
  - Lakevista Holdings Corp. 79% oo
  - Lakevista Corp. 21% pp
  - Clarges Funding LLC 100%
  - Banque AIG S.A. 90% qq
  - Cherrywood Investments LLC 99% rr
  - Avon Holdings Corp. 100%
  - Avon LLC 100%
  - Avon Financing Corp. 100%
  - AIG Financial Products Hong Kong Limited 100%
  - Elgibright Investment Limited 90% ss
  - Bittern Investments Corp. 100%
  - Blackbird Investments LLC 100%
  - AIG -FP Capital Preservation Corp. 100%
    - Flamebright Investment Limited 100%
    - Bullfinch Investments (Cayman) Limited 91%
    - AIGFP NZ Funding LLC 99% tt
    - The AIV Limited Partnership 99%
  - Pearwood Funding Corp. 100%
  - Pearwood LLC 100%
  - Peachwood Funding Corp. 100%
  - NF One Hundred and Twenty-Three Corp. 100%
  - Sorbier Holding Corp. 79% uu
  - Sorbier Investment Corp.; Malacees LLC } 100%
  - AIG -FP Holdings Corp. 100%
  - TMS Investments LLC 100%
  - TMS Sub LLC 100%
  - NF Fifty-Eight Corp. 79%
  - Heathwood Holding Corp. 21% vv
  - Heathwood Corp. 100%
  - AIG -FP Structured Finance (Cayman) Limited 100%
  - DBY Twenty-four Corp. 68% ww
  - Brambling Investments LLC 100%
  - Blackcap Investments LLC 100%

Union Excess Reinsurance Company, Ltd 100% xx

AIG Credit Facility Trust | Public shareholders

American International Group, Inc.

Source: AIG.

[a]5.73 percent Steppe Securities, L.L.C. and 20.18 percent American International Group, Inc.

[b]10 percent American Life Insurance Company, and 9.40 percent American Home Assurance Company.

[c]4.99 percent Chartis Global Management Company Limited.

[d]0.602 percent American International Underwriters (Guatemala), S.A.

[e]0.01 percent Chartis Latin America Investments, LLC.

[f]19.72 percent Chartis Overseas Association.

[g]10 percent American Home Assurance Company; 11 percent National Union Fire Insurance Company of Pittsburgh, PA.; and 12 percent New Hampshire Insurance Company.

[h]1.42 percent Chartis Luxembourg Financing Limited, 32.39 percent Chartis Overseas Limited, and 2.28 percent Chartis Bermuda Limited.

[i]8.68 percent Chartis Overseas Limited.

[j]40 percent American International Reinsurance Company, Ltd.

[k]1 percent AIG and the Federal Reserve Bank of New York has 100 percent interest with certain rights not customary of preferred holders.

[l]51 percent Rich Development Limited.

[m]16 percent Chartis Insurance Hong Kong Limited.

[n]3.45 percent Kapatiran Realty Corporation, 11.24 percent Perf Realty Corporation, and 6.83 percent Philam Properties Corporation.

[o]20 percent PT Asta Indah Abadi.

[p]Federal Reserve Bank of New York has 100 percent interest with certain rights not customary of preferred holders.

[q]0.01 percent International Technical and Advisory Services Limited.

[r]10 percent International Technical and Advisory Services Limited.

[s]50 percent American Life Insurance Company.

[t]7.50 percent AIG Egypt Insurance Company S.A.E.

[u]0.00001 percent International Technical and Advisory Services Limited.

[v]0.0005 percent International Technical and Advisory Services Limited and 0.0005 percent Borderland Investments Limited.

[w]1 percent Societatea de Asigurari AIG Romania SA and 1 percent International Technical and Advisory Services Limited.

[x]0.01 percent International Technical and Advisory Services Limited.

[y]5 percent American Life Insurance Company.

[z]2.77 percent Chartis Overseas Limited.

[aa]90 American International Reinsurance Company, Limited.

[bb]38.01 percent American Life Insurance Company.

[cc]49 percent American Life Insurance Company.

[dd]5.01 percent International Technical and Advisory Services Limited.

[ee]0.01 percent International Technical and Advisory Services Limited.

[ff]10.36 percent AIU Insurance Company; 2.58 percent Chartis Overseas Limited; 7.73 percent Chartis Europe, S.A.; and 2.76 percent American Home Assurance Company.

[gg]75 percent American Life Insurance Company.

[hh]10 percent Chartis Property Casualty Company and 20 percent The Insurance Company of the State of Pennsylvania.

[ii]10 percent Chartis Property Casualty Company and 20 percent The Insurance Company of the State of Pennsylvania.

[jj]35.12 percent New Hampshire Insurance Company; and 19 percent The Insurance Company of the State of Pennsylvania.

[kk]24.97 percent United Guaranty Residential Insurance Company of North Carolina.

[ll]0.001 percent United Guaranty Services, Inc.

[mm]29 percent American General Life and Accident Insurance Company and 1 percent Iris Energy Holding, L.P.

[nn]49 percent American International Group, Inc.

[oo]21 percent NF Fifty-One (Cayman) Limited.

[pp]79 percent AIG Financial Products Corp.

[qq]10 percent AIG Matched Funding Corp.

[rr]1 percent AIGFP Capital Preservation Corp.

[ss]10 percent AIG Financial Products Corp.

[tt]1 percent AIG Financial Products Corp.

[uu]21 percent NF Thirty-nine Corp.

[vv]79 percent AIG Financial Products Corp.

[ww]17 percent AIGFP Pinestead Holdings Corp. and 15 percent NF Seven (Cayman) Limited.

[xx]Although no AIG company owns an equity interest in Union Excess, control over Union Excess may be implied through the timing and nature of certain reinsurance commutations.

Appendix II: AIG's Credit Ratings and an Overview of Definitions of Credit Ratings

Credit ratings measure a company's ability to repay its obligations and directly affect that company's cost of and ability to access unsecured financing. If a company's ratings are downgraded, its borrowing costs can increase, capital can be more difficult to raise, business partners may terminate contracts or transactions, counterparties can demand additional collateral, and operations can become more constrained generally. Rating agencies can downgrade the company's key credit ratings if they believe the company is unable to meet its obligations. In American International Group, Inc.'s (AIG) case, this could affect its ability to raise funds and increase the cost of financing its major insurance operations, and, in turn, impede AIG's restructuring efforts. Conversely, an upgrade in AIG's credit ratings would indicate an improvement in its condition and possibly lead to lower borrowing costs and facilitate corporate restructuring.

As shown in table 4, AIG's key credit ratings remained largely unchanged since May 2009, primarily because federal assistance has provided AIG with needed liquidity. For example, from March 31, 2009, to December 15, 2009, AM Best, Moody's, and Standard & Poor's (S&P) maintained the same credit ratings for AIG's long-term debt and the financial strength of its property/casualty and life insurance companies due in large part to support that the Board of Governors of the Federal Reserve System (Federal Reserve) and the Department of the Treasury provided.[1] While contributing to stable ratings thus far, the scale of this assistance eventually may raise questions about AIG's future prospects if the company is not able to raise capital from private sources. For example, because of the importance of the federal funds to AIG's solvency, Fitch's lowered its ratings of AIG in several categories in May 2009. Months later, in February 2010, Fitch placed AIG's U.S. property/casualty companies on "rating watch negative," but in early July 2010, Fitch reviewed all of AIG's ratings, affirmed those ratings, and revised the rating outlook to "stable" from "evolving." It removed the property/casualty companies from "rating watch negative" and reassigned them as "stable outlook." Fitch's ratings of AIG have remained unchanged since then. And in April 2010, S&P reported that AIG made solid progress in its overall restructuring plan and in stabilizing its insurance operations. S&P affirmed its ratings of AIG and maintained their negative outlook, reflecting S&P's view of the challenges AIG faces in sustaining performance of its insurance operations and

[1]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). While these ratings are described using slightly different terminology, they tend to show relative consistency in the strength of AIG's debt.

capitalizing its life insurance businesses. S&P's ratings too have remained unchanged.

Table 4: AIG's Key Credit Ratings, March 31, 2009, through September 30, 2010

Rating agency	Mar. 31, 2009	May 15, 2009	Dec. 15, 2009	Mar. 31, 2010	July 31, 2010	Sep. 30, 2010	Potential consequences of future downgrade
Debt							
Long-term							
S&P	A-/ negative[a]	no change	no change	no change	no change	no change	AIG Financial Products Corp. 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: • At September 30, 2010, a one-notch, two-notch, or three-notch downgrade from S&P and Moody's would have cost AIG up to $1.2 billion, $2.4 billion, and $2.6 billion, respectively, in cumulative additional collateral postings and termination payments. • At June 30, 2010, a one-notch, two-notch, or three-notch downgrade from S&P and Moody's would have cost AIG up to $1.7 billion, $3 billion, and $3.2 billion, respectively, in cumulative additional collateral postings and termination payments.
Moody's	A3/ negative[a]	no change	no change	no change	no change	no change	
Fitch	A	BBB/ evolving	no change	no change	BBB/ stable	no change	
Short-term							
S&P	A-1 for AIG Funding, Curzon, and Nightingale[a]	no change	no change	no change	no change	no change	AIG affiliates in commercial paper programs (AIG Funding, Curzon Funding LLC, and Nightingale LLC) could have been ineligible for participation in the Federal Reserve's Commercial Paper Funding Facility (CPFF).[b]
Moody's	P-1 for AIG funding[a]	no change	no change	no change	no change	on review for possible downgrade	
Fitch	F1	no change	no change	no change	no change	no change	
Financial strength							Further downgrades of these ratings may prevent AIG's insurance companies from offering products and services or result in increased policy cancellations or termination of assumed reinsurance contracts. A downgrade in AIG's credit ratings may result in a downgrade of the financial strength ratings of AIG's insurance subsidiaries.

Rating agency	Mar. 31, 2009	May 15, 2009	Dec. 15, 2009	Mar. 31, 2010	July 31, 2010	Sep. 30, 2010	Potential consequences of future downgrade
Life insurer							
AM Best	A/ negative[a]	no change	no change	no change	no change	no change	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. 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. A.M. Best commented on September 30, 2010, that its ratings of the AIG holding company and its subsidiaries were not changed by the announcement of a plan for AIG to exit government ownership.
S&P	A+/ negative	no change	no change	no change	no change	no change	
Moody's	A1/ developing	no change	no change	A1/ negative	no change	no change	
Fitch	AA-	A-/ evolving	no change	No change	A-/ stable	no change	
Property/casualty insurer							
AM Best	A/ negative[a]	no change	no change	no change	no change	no change	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. A.M. Best commented on September 30, 2010, that its ratings of the AIG holding company and its subsidiaries were not changed by the announcement of a plan for AIG to exit government ownership.
S&P	A+/ negative	no change	no change	no change	no change	no change	
Moody's	Aa3/ negative	no change	no change	no change	no change	no change	
Fitch	AA-	A+/ evolving	no change	placed rating on rating watch - negative	A+/ stable	no change	

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

[a]These are key ratings.

[b]AIG's International Lease Finance Corporation lost access to CPFF funds after an S&P downgrade on Jan. 21, 2009. CPFF expired for new issuances on February 1, 2010, and as of June 30, 2010, AIG had no commercial paper outstanding with the CPFF.

Moody's, S&P, and Fitch are three of the credit rating agencies that assess the creditworthiness of AIG. Each of the rating agencies uses a unique rating to denote the grade and quality of the bonds being rated. Table 5 provides an overview of the ratings for Moody's, S&P, and Fitch.

Table 5: Summary of Rating Agencies' Ratings

Grade and quality	Definitions	Moody's[a]	S&P[b]	Fitch[b]
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, in cases in which default may be likely.	Ba1 and below	BB+ and below	BB+ and below

Sources: Moody's Investors Service, S&P's Ratings Services, and Fitch Ratings.

[a]Moody's 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 midrange ranking, and "3" indicates that the issue ranks in the lower end of the category.

[b]S&P'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 III: Corporate Liquidity Available to AIG

This indicator monitors the timing of potential future demand on American International Group, Inc.'s (AIG) liquidity posed by its debt obligations. These liquidity measures reflect 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 it is on federal assistance.

As shown in table 6, in November 2008, the major source of AIG's corporate available liquidity was the Federal Reserve Bank of New York's (FRBNY) revolving credit facility, with lesser amounts available through the FRBNY commercial paper funding facility (CPFF) and AIG's bilateral facilities. Prior to October 2008, AIG's corporate liquidity was available through the private sector, but that month, AIG looked to other sources for its corporate liquidity, namely FRBNY's credit facility and the new CPFF. In November 2008, these two sources became AIG's primary sources of liquidity. Throughout 2009 and into 2010, FRBNY's credit facility remained a primary source of liquidity, but CPFF and AIG's bilateral facilities and cash and short-term investments became secondary sources of liquidity. Starting in April 2009, AIG was obtaining the funds needed to meet its obligations primarily from the Department of the Treasury's equity capital facility, which remains its primary source of liquidity into 2010, as well as from FRBNY's credit facility.

Table 6: Amounts of Available Corporate Liquidity, November 5, 2008, through and October 27, 2010

Dollars in millions

	Nov. 5, 2008	Feb. 18, 2009	Apr. 29, 2009	Jul. 29, 2009	Oct. 28, 2009	Feb. 17, 2010	Apr. 28, 2010	Jul. 28, 2010	Oct. 27, 2010
FRBNY revolving credit facility	$24,000	$24,800	$17,400	20,000	$18,300	$14,000	$11,007	$14,380	$14,587
Commercial paper under CPFF and syndicated and bilateral facilities	5,600	753	1,940	3,493	4,872	0	0	0	0
Unused bank syndicated and bilateral facilities	3,820	0	0	0	0	0	0	0	0
AIG cash and short-term investments	0	1,100	445	407	359	287	375	409	515
Treasury equity capital facility	n/a	n/a	29,835	28,685	26,629	22,292	22,292	22,292	22,292
Total	**$33,420**	**$26,653**	**$49,620**	**$52,585**	**$50,160**	**$36,579**	**$33,674**	**$37,081**	**$37,394**

Source: GAO analysis of AIG Security and Exchange Commission filings.

Note: CPFF, a Federal Reserve emergency facility that became operational in October 2008 and closed in February 2010, provided a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicles that purchased eligible 3-month unsecured and asset-backed commercial paper from eligible issuers using financing provided by FRBNY. Its purpose was to enhance the liquidity of the commercial paper market.

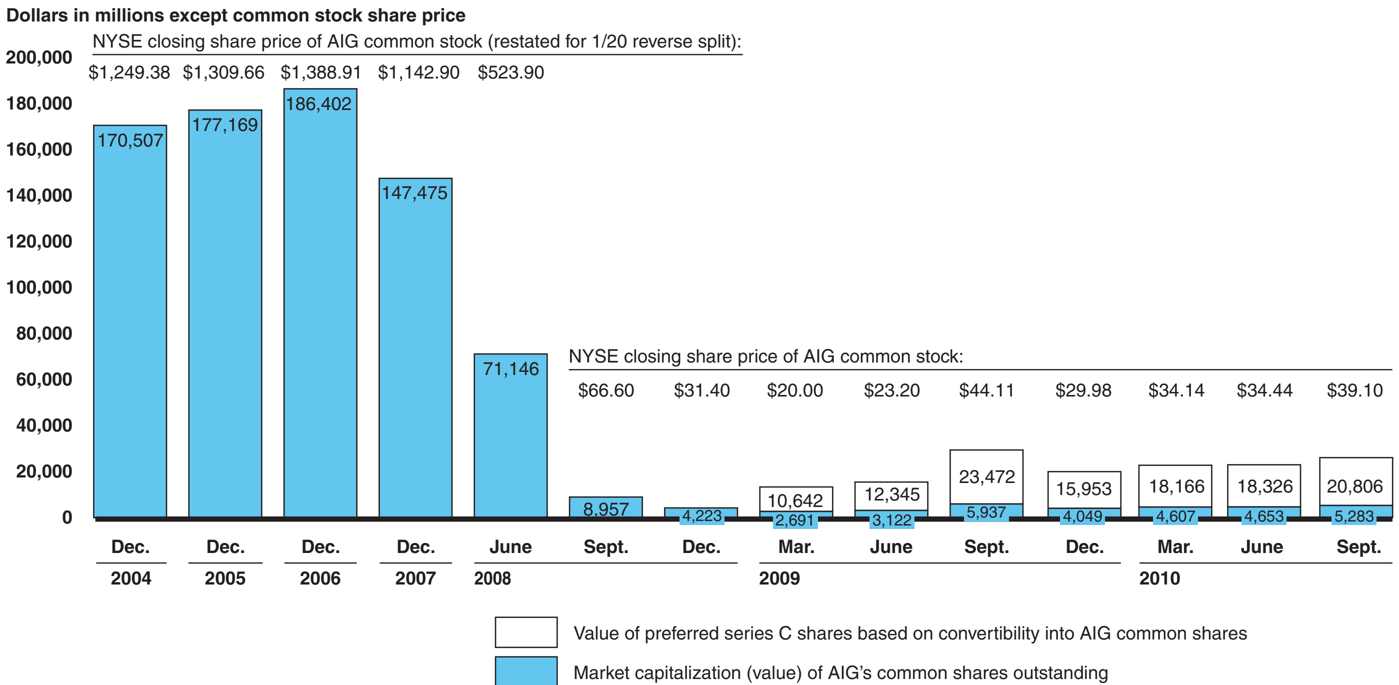
Appendix IV: Value of Preferred and Common Shares of AIG

The value of the federal government's equity investments in American International Group, Inc. (AIG) is tied to the market value of AIG's common shares. As a result, growth in value of the government's common and preferred equity stakes depends on growth in the value of common shares. As shown in figure 16, the market value of AIG's common shares outstanding peaked in December 2006 at $186.4 billion and by June 2008, the market value had declined to $71.1 billion. During the last two quarters of 2008, when federal assistance was initially provided to AIG, AIG shares further declined in value, to $4.2 billion by the end of 2008.

From March 1, 2009, when the AIG credit facility trust and AIG entered into a purchase agreement for Series C preferred stock, through September 30, 2010, the value of AIG's common shares outstanding have fluctuated between $2.7 billion and $5.9 billion, and as of September 2010 were valued at $5.3 billion. The value of the Series C preferred shares is part of the federal government's equity investment in AIG, and under the terms of the Series C preferred stock issuance, the preferred stock is convertible into AIG's common stock. The value of the federal government's Series C preferred shares is based on the value of common shares outstanding. The value of both increased between March and September 2009 when the share price of AIG common stock rose but fell in the fourth quarter of that year when the share price declined.[1] Since the fourth quarter of 2009, the government's equity interest has increased from just under $16 billion to almost $20.8 billion.

[1]While not currently convertible because of the pending implementation of the AIG recapitalization plan, the federal equity investment includes Series C preferred shares owned by the Trust that are convertible into approximately 79.75 percent of total outstanding common shares. The conversion formula provides that the trust will receive 79.9 percent of AIG's common stock less the percentage of common stock that may be acquired by or for the benefit of the Treasury as a result of warrants or other convertible preferred stock held by Treasury. Treasury received a warrant to purchase 2,690,088 shares of AIG Common Stock in connection with its purchase of Series D preferred stock (now Series E), 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.

Figure 16: Market Capitalization of AIG Outstanding Common Shares, Including Trust-Owned Preferred C Shares That Are Convertible into Approximately 79.75 Percent of AIG's Outstanding Common Shares, December 2004 through September 2010



Source: GAO analysis of AIG's SEC filings and Treasury Financial Reporting Position Paper 09-07.

Note: The preferred Series C shares are in a trust for the benefit of the Treasury and in this figure do not include a warrant held by Treasury that is convertible into 2 percent of common shares. See GAO-09-975 for more details on the trust.

Appendix V: AIG Insurance Subsidiaries' Capital and Surplus

Because information on adjusted capital and related activities is only available annually in the year-end financial statements that American International Group, Inc. (AIG) companies file with the National Association of Insurance Commissioners (NAIC), we can only track it once a year. To track adjusted capital more frequently, we developed a proxy indicator that tracks capital and surplus as reported in AIG's quarterly filings with NAIC and major activities that could deplete capital and surplus, as well as adjusted capital. As illustrated in figure 17, capital and surplus for the first nine months of 2010 has changed little for AIG's largest domestic property/casualty companies and increased more than 12 percent for AIG's largest domestic life and retirement services companies, and no major activities had an adverse effect large enough to deplete capital and surplus. Similar to the findings in our previous update and in the results of the adjusted capital indicator discussed in the report, these proxy results showed that AIG's largest domestic property/casualty companies and largest domestic life and retirement services companies did not need federal assistance during the first nine months of 2010 to boost their regulatory capital.

Figure 17: AIG Domestic Insurance Subsidiaries: Capital and Surplus at December 31, 2009, and September 30, 2010, and Primary Activities That Affected It During the First 9 Months of 2010

Dollars in millions

	Capital and surplus		Primary activities that affected capital and surplus in the first nine months of 2010					
	12/31/09	9/30/10	Net income	Change in unrealized capital gains[a]	Deferred income taxes	Change in nonadmitted assets	Change in asset valuation reserve	Stockholder dividends
AIG's largest domestic property/casualty companies	$26,973	$27,209	$1,398	$118	-$73	$687	n/a[b]	n/a[b]
AIG's largest domestic life insurance and retirement services companies	15,595	17,520	83	1,490	-1,660	2,581	-480	-75

Sources: AIG and GAO analysis of AIG financial statements filed with NAIC.

[a]NAIC financial statements show unrealized capital gains separately from net income.

[b]Dollar amount is either zero or too small to constitute a major activity. Also other categories were excluded that had larger, but minor dollars of activity.

Appendix VI: Revenues and Expense of AIG Life Insurance and Retirement Services

The losses or gains of life insurance and retirement services may occur for several reasons. For example, operating income before capital gains or losses provides an indication of the profitability of a 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 American International Group, Inc.'s (AIG) 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.

Figures 18 and 19 provide an indicator that can be used to track the profitability of AIG's life insurance and retirement services. In 2008, the vast majority of losses incurred by AIG were not the result of their underwriting activities, but instead were caused by losses in the investment portfolios of domestic and foreign life insurance businesses. As we have previously discussed, this was due to severe market price declines in certain commercial mortgage-backed securities and other securities. In subsequent quarters in 2009, AIG's domestic life and retirement services business realized income gains from operations. This was partly because of Maiden Lane II's purchase of residential mortgage-backed securities from these companies, which helped prevent continued liquidity strains on AIG. Most recently, as shown in figure 18, the reported net realized capital losses for the domestic companies were nearly $800 million in the first quarter of 2010 but AIG reported a $20 million gain in the third quarter 2010. Pretax operating net income increased over that same period, from $327 million to $998 million.

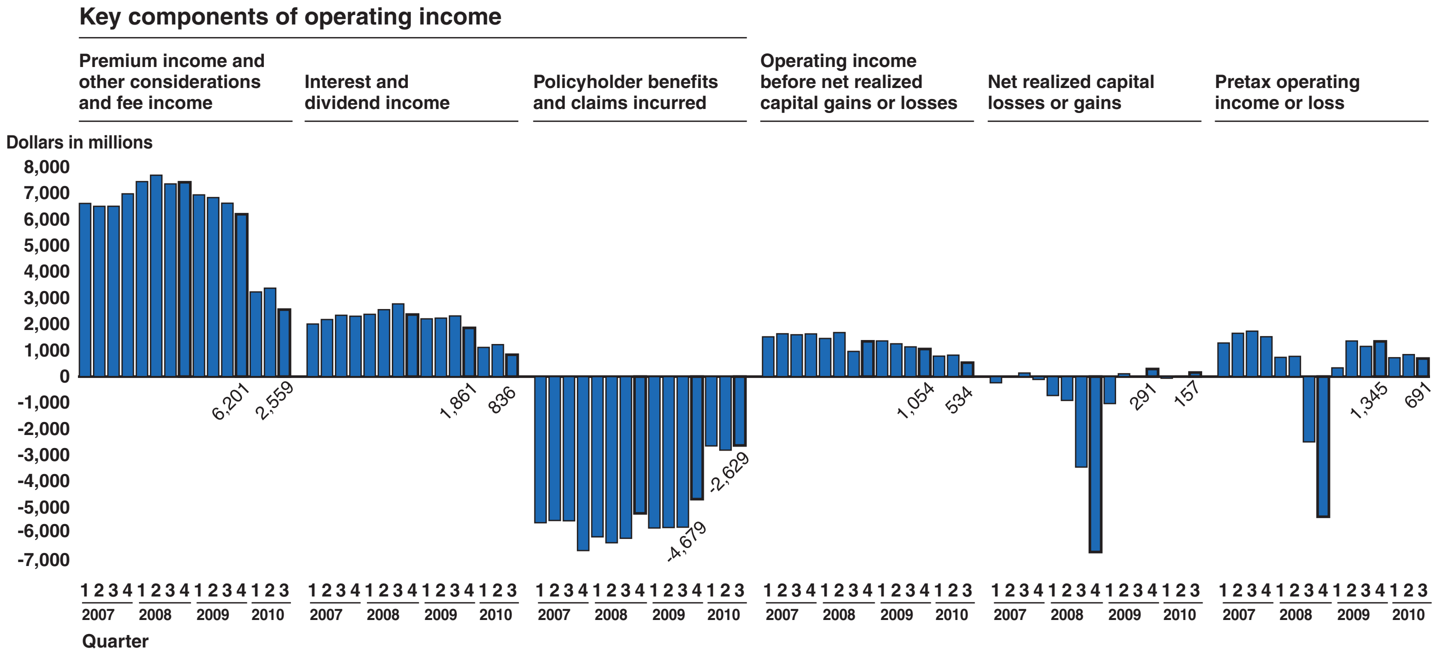
Figure 18: Key Quarterly Revenues and Expenses for AIG Domestic Life Insurance and Retirement Services Companies for First Quarter of 2007 through Third Quarter of 2010

Source: GAO analysis of AIG's quarterly financial supplements.

Note: As reported, the data do not reflect prior period restatements after December 31, 2009.

As shown in figure 19, foreign companies reported realized capital losses in the first quarter of 2010 of $61 million, but these were followed by gains the next two quarters. Pretax operating income for these companies in the first three quarters of 2010, while fluctuating, at about $700 million is about half of what it was at the end of 2009. Overall, after accounting for policyholder operating income and a mix of realized capital gains and losses both the domestic and foreign life companies reported positive pretax operating income for the first three quarters of 2010. Whether these positive results can continue is unclear.

Figure 19: Key Quarterly Revenues and Expenses for AIG, Life Insurance and Retirement Services Companies for AIG Foreign Life Insurance and Retirement Services Companies First Quarter of 2007 through Third Quarter of 2010



Source: GAO analysis of AIG's quarterly financial supplements.

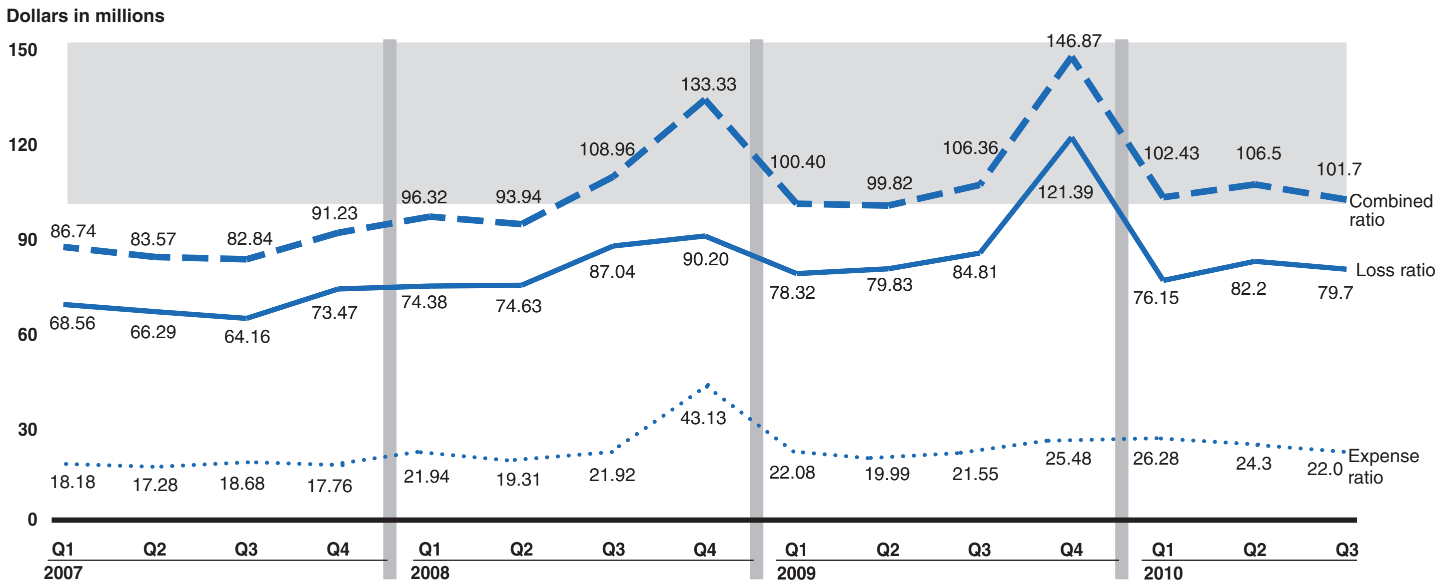
Note: As reported, the data do not reflect prior period restatements after December 31, 2009.

Appendix VII: Underwriting Ratios for AIG's Property/Casualty Companies

The underwriting profitability of property/casualty insurers can be measured using the combined ratio, which is the sum of the loss and the expense ratios. The loss ratio measures claims costs plus claims adjustment expenses relative to net earned premiums. A rising loss ratio indicates rising claims costs relative to the premiums, which may be due to increased claims losses, decreased premiums revenue, or a combination of the two. The expense ratio measures the level of underwriting administrative expenses relative to net premiums earned and is a measure of underwriting efficiency. The combined ratio is an overall measure of a property/casualty insurer's underwriting profitability. Thus, a combined ratio of less than 100 percent would indicate that an insurer's underwriting is profitable, and a ratio of more than 100 percent would reflect an underwriting loss.

As shown in figure 20, the combined ratio for American International Group, Inc.'s (AIG) commercial property/casualty insurance business spiked in the fourth quarter of 2008, largely due to an administrative charge to recognize impairment of goodwill of previously acquired businesses. The higher combined ratio also was partly due to a higher loss ratio because of increased claims costs associated with Hurricane Ike and other major catastrophes in 2008. The combined ratio rose to more than 100 percent in the last two quarters of 2009, indicating that claims and administrative costs were higher and rising faster than premium revenues and thus AIG's insurance underwriting was not profitable. The combined ratio's rise in the fourth quarter of 2009 also largely was due to increased claims costs that arose because of a reserve strengthening charge AIG made to address unexpected losses in excess casualty and excess workers' compensation, two "long-tail" lines of business (that is, claims arose years after premiums were collected and were higher than reserve estimates). In the first quarter of 2010 the ratio dropped significantly to just more than 102, and has changed little in the two subsequent quarters.

Figure 20: AIG Commercial Insurance Operating Ratios, First Quarter of 2007 through Third Quarter of 2010

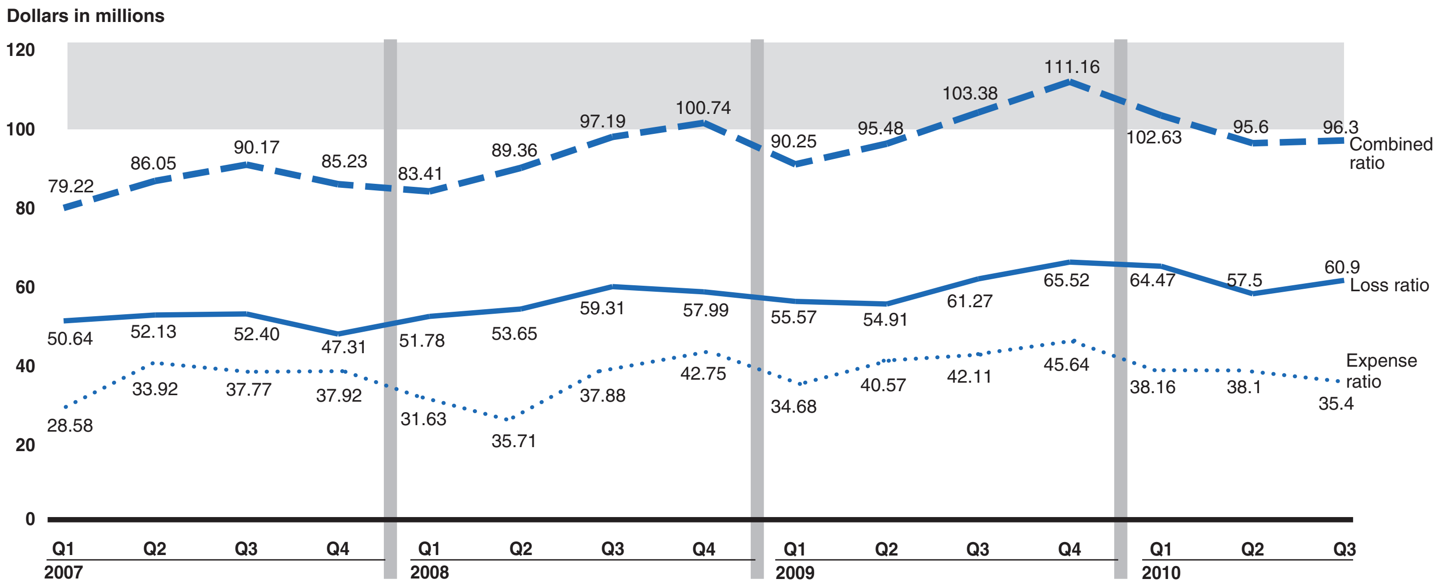


Sources: GAO analysis of AIG's financial statements filed with SEC and quarterly financial supplements.

Note: Historical operating ratios for commercial insurance have been revised to include Private Client Group and exclude HSB Group, Inc. The loss ratio for the fourth quarter of 2009 includes a $2.3 billion increase in the reserve for prior years' adverse loss development. The underwriting expense for the fourth quarter of 2008 includes a $1.2 billion charge for impairment to goodwill, increasing the expense ratio by 22.5 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.

Combined ratios for foreign general insurance were lower in the first three quarters of 2007 and 2008 than in comparable quarters of 2009, and the ratios dropped to less than 100 in the second and third quarters of 2010 (see fig. 21). AIG officials attributed the higher 2009 numbers to several factors, including increased loss ratios due to higher claim losses, particularly in Europe, and increased expense ratios because of lower net premiums earned that resulted from the sale of their Brazilian operations. In addition, insurance markets becoming more competitive, and higher levels of general operating expenses primarily related to remediation/audit of general insurance (Chartis, Inc.), pension costs, and postretirement liability costs contributed to the higher combined ratios in 2009. As with AIG's commercial insurance, the combined ratio in its foreign general property/casualty insurance business rose to more than 100 percent in the last two quarters of 2009. In the first quarter of 2010 the ratio dropped to 102.6, and as of the second quarter 2010, the ratio had fallen to its lowest level in a year to 95.6, indicating that for this line of business, underwriting again became profitable, and changed little in the third quarter of 2010.

Figure 21: AIG Foreign General Insurance Operating Ratios, First Quarter of 2007 through Third Quarter of 2010



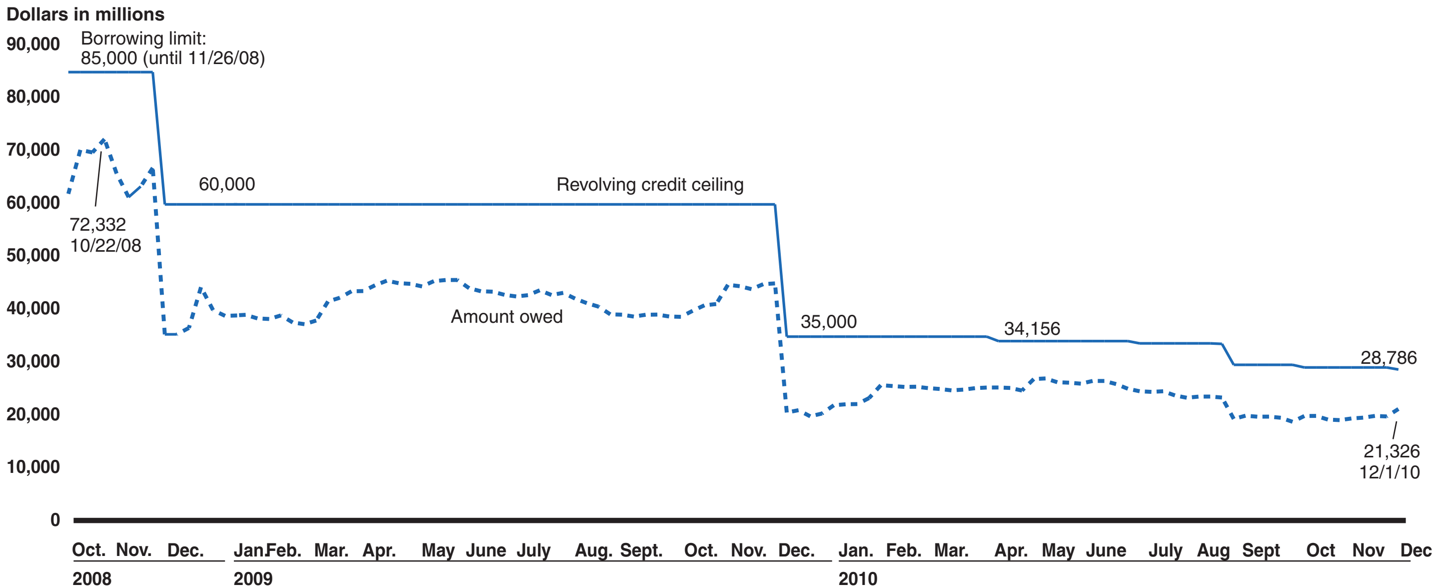
Sources: GAO analysis of AIG's financial statements filed with SEC and quarterly financial supplements.

Appendix VIII: Detail on AIG's Federal Assistance and the Repayment of That Assistance

The initial federal assistance to American International Group, Inc. (AIG) was provided in October 2008 through the Federal Reserve Bank of New York's (FRBNY) revolving credit facility. This facility was fully repaid and closed as part of the recapitalization plan that was executed on January 14, 2011, as discussed above. This indicator tracks the borrowing limit and the amount owed on the facility since the initial borrowing. As shown in figure 22, as of December 30, 2009, the amount of direct assistance available to AIG through the facility was reduced to $35 billion and the amount AIG owed the facility was reduced to $23.4 billion. The decreases in available assistance and outstanding balance were attributable to the November 2008 and December 2009 restructuring of the government's assistance to the company from debt to preferred equity. The amount available again was reduced in March 2010 to $34.2 billion and several times thereafter because of AIG repayments from proceeds obtained from sales of various assets. By December 1, 2010, the amount available had been reduced to $28.8 billion, because of mandatory repayments that reduced the amount available under the facility. The amount available was determined by reference to principal outstanding, excluding capitalized interest and fees.[1] As of December 1, 2010, the amount of assistance to AIG through the FRBNY credit facility had been reduced to $21.3 billion. Changes in amounts owed on the facility fluctuated weekly and could have been related to increased or decreased liquidity needs of AIG's operations or payments by AIG on the facility, or could have resulted from restructuring decisions such as the conversion of a portion of the facility to preferred equity stakes in AIG.

[1]Balance outstanding includes accrued interest and fees of $6.182 billion through September 30, 2010.

Figure 22: FRBNY Revolving Credit Facility Balance Owed and Total Amount Available, October 2008 through December 1, 2010



Sources: GAO analysis of Federal Reserve Statistical Release H.4.1 and Federal Reserve data.

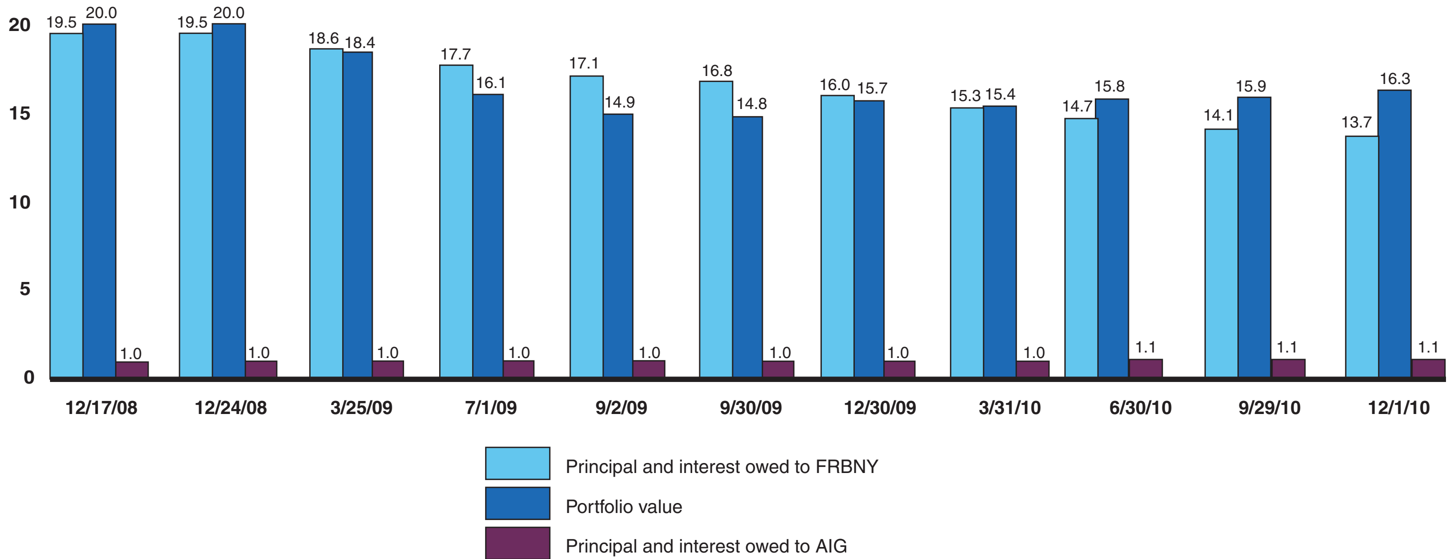
Note: The Federal Reserve H.4.1 data that we used does not breakout principal from accrued interest and fees. Thus the available credit is actually larger by the amount of accrued interest and fees. Interest and fee data are found in AIG's 10Q and 10K reports.

We also developed two indicators to monitor the status of the government's indirect assistance to AIG through Maiden Lane II and Maiden Lane III. By monitoring the principal and interest owed on these facilities, we can track FRBNY's ongoing exposure that is related to financial assistance provided to AIG. The Maiden Lane II and Maiden Lane III portfolios are funded primarily by loans from FRBNY, which are not debt on AIG's books. The loans and related expenses are to be repaid from cash generated by investment yields, maturing assets, and sales of assets in the facilities. In addition to the FRBNY investments in the facilities, AIG invested $1 billion in Maiden Lane II and $5 billion in Maiden Lane III.

FRBNY provided a loan to Maiden Lane II to purchase residential mortgage-backed securities from AIG's domestic life insurance companies. As shown in figure 23, the portfolio value of Maiden Lane II peaked at $20 billion in December 2008 and was $14.8 billion at its lowest point at the end of September 2009. As of December 1, 2010, the portfolio value had risen to $16.3 billion. As the assets of Maiden Lane II have matured, proceeds have been used to reduce debt (principal and interest) of the facility from a maximum of $19.5 billion in December 2008 to $13.7 billion

on December 1, 2010, which is about $2.6 billion less than the facility's portfolio value as of that same date.

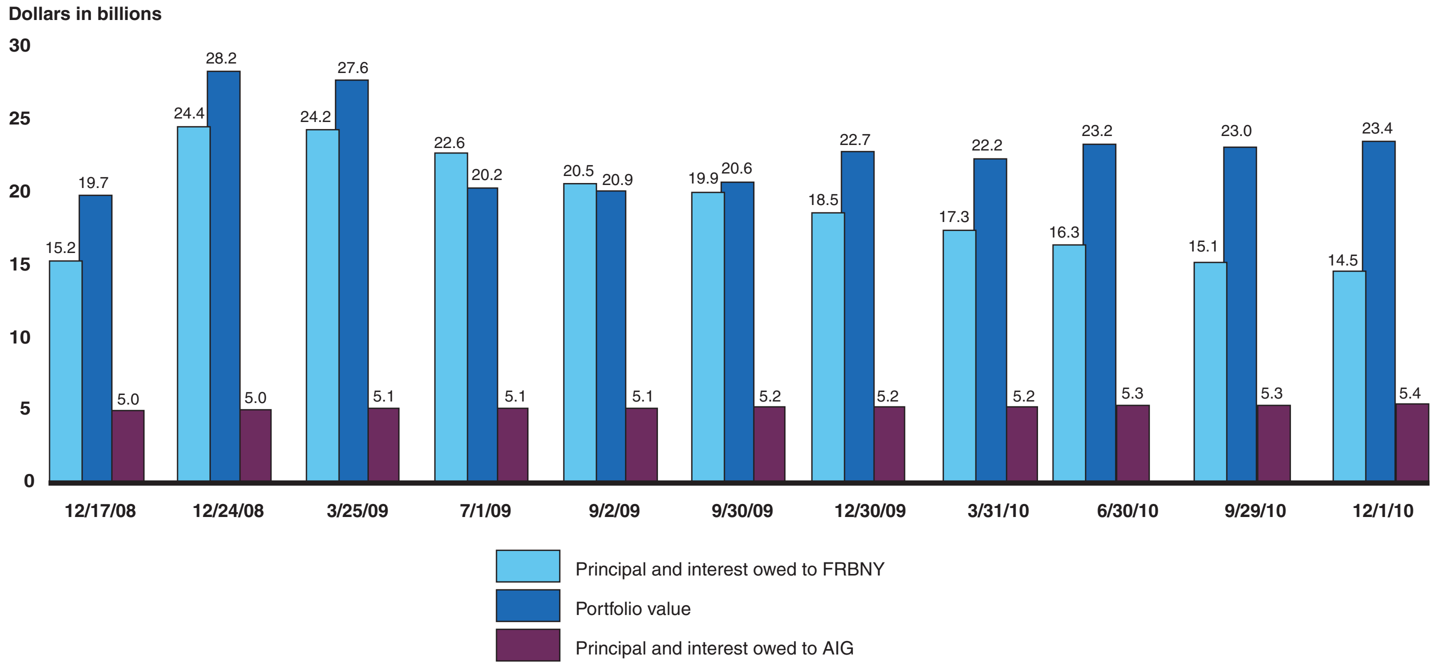
Figure 23: Amounts Owed and Portfolio Value of Maiden Lane II through December 1, 2010



Source: GAO analysis of weekly Federal Reserve Statistical Release H.4.1.

FRBNY also provided loans to Maiden Lane III so it could purchase multisector collateralized debt obligations from counterparties to AIG Financial Product Corporation's credit default swaps. As shown in figure 24, the portfolio value of Maiden Lane III was $28.2 billion in December 2008, dropped to $22.7 billion one year later, and has remained fairly stable since, amounting to $23.4 billion as of December 1, 2010. By contrast, the level of debt has continued to be reduced since December 2008, and as of December 1, 2010, stood at $14.5 billion, an average quarterly reduction of about $1.1 billion dollars since September 30, 2009. Also since September 30, 2009, the excess in value of the remaining portfolio over the remaining FRBNY debt increased from about $0.7 billion to about $8.9 billion.

Figure 24: Amounts Owed and Portfolio Value of Maiden Lane III through December 1, 2010



Source: GAO analysis of weekly Federal Reserve Statistical Release H.4.1.

Appendix IX: Disposition of AIG Assets

Part of American International Group, Inc.'s (AIG) strategy to raise money for repaying the federal government has been to sell some of its assets. This indicator tracks sales or dispositions that have been closed and agreements of pending dispositions that have been publicly announced but not yet closed. As table 7 shows, AIG sold increasingly more of its assets each quarter, from the last quarter of 2008 when it sold one asset for $820 million, to the third quarter of 2009 when it sold 12 assets for a disclosed value of more than $4.5 billion (the proceeds for most of the sales that quarter were not publicly disclosed). In the last quarter of 2009, AIG sold only one asset—AIG Finance-Hong Kong—for $627 million. As of November 30, 2010, AIG disclosed that it had received $27.2 billion in total proceeds from sales, $16.2 billion of which was from the sale of American Life Insurance Company (ALICO) to MetLife. Also, of the total proceeds, $12.9 billion was cash, including $7.2 billion from the sale of ALICO. In the first quarter of 2010, AIG announced that it sold three assets, two of which had combined reported cash proceeds of $729 million, and one had proceeds that were not disclosed. The company also announced two new sales in the second quarter of 2010 of undisclosed amounts and no new sales the following quarter. However, in November 2010 AIG reported selling a portion of its American General Finance business. It also sold ALICO to MetLife. In addition, in October 2010, there was an initial public offering for AIA that generated $20.5 billion (this transaction is not listed in the following table since it is not an asset sale). On closing of the recapitalization plan, AIG expected the net cash proceeds from the ALICO sale and the AIA IPO to be sufficient to repay the FRBNY revolving credit facility.

Table 7: Dispositions Closed and Agreements Announced but Not Yet Closed, September 30, 2008, through November 30, 2010

Dollars in millions

Dispositions closed in quarter ending	Total proceeds
September 30, 2008	
n/a	n/a
December 31, 2008	
Unibanco JV	$820
March 31, 2009	
AIG Financial Products Energy Commodity Hedges (all cash) (part of investment assets disposition below)	--
Philam Savings Bank	43
Hartford Steam Boiler ($739 million cash)	815

Dollars in millions

Dispositions closed in quarter ending	Total proceeds
Spanish Solar Park (part of investment assets disposition below)	--
June 30, 2009	
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 ($253 million cash)	308
Darag	n/d
Real estate in Tokyo (all cash)	1,179
Transatlantic Holdings	1,136
September 30, 2009	
21st Century Insurance Group ($1.7 billion cash)	1,900
CFG China	n/d
Consumer finance operations in Mexico	n/d
A.I. Credit Life (all cash)	741
Investment assets—energy and infrastructure	1,900
AIG Credit Card Co (Taiwan)	n/d
CFG Thailand	n/d
AIG Systems Solution	n/d
Philam Plans	n/d
Philam Care	n/d
72 Wall Street (Manhattan office tower)	n/d
Consumer finance operations in Russia	n/d
December 31, 2009	
AIG Finance-Hong Kong ($70 million cash)	627
March 31, 2010	
Transatlantic Holdings, Inc. (secondary stock offering for cash)	452
Portion of its asset management business (all cash)	277
Consumer finance operations in Colombia	n/d
June 30, 2010	
Consumer finance operations in Argentina	n/d
Consumer finance business in Poland	n/d
September 30, 2010	
No dispositions closed	--
October 1–November 30, 2010	
ALICO ($7.2 billion cash, $9 billion stock in MetLife)	16,200

Dollars in millions	
Dispositions closed in quarter ending	**Total proceeds**
80 percent of American General Finance Inc.	n/d
Total proceeds on dispositions closed	**$27,216**
Total dislosed cash proceeds terms disclosed	**$12,934**
Disposition agreements announced but not yet closed as of November 30, 2010	
UGC International Canada	n/d
UGC International Israel	n/d
ILFC portfolio of 53 aircraft	1,987
AIG Star and AIG Edison Life Insurance Companies ($4.2 billion cash)	4,800

Sources: AIG and GAO analysis of AIG press releases and Securities and Exchange Commission filings.

Notes: N/d means not disclosed.

On January 12, 2011, AIG announced an agreement to sell its 97.57 percent interest in Nan Shan Life Insurance Company, Ltd. to Ruen Chen Investment Co., Ltd. of Taiwan for $2.16 billion in cash.

Appendix X: GAO Contact and Staff Acknowledgments

GAO Contact

Orice Williams Brown, (202) 512-8678 or williamso@gao.gov

Staff Acknowledgments

In addition to the contacts named above, Karen Tremba (Assistant Director); Tania Calhoun, Rachel DeMarcus, Lawrance Evans, John Forrester, Marc Molino, Barbara Roesmann, Jennifer Schwartz, and Melvin Thomas made important contributions to this report.

Glossary of Terms

Term	Definition
Adjusted Basis	The net cost of an asset or security that is used to compute the gains or loss on that asset or security. It is calculated by starting with the original cost of an asset or security, then adding the value of any improvements, legal fees, and assessments and subtracting the value of any accumulated depreciation, amortization, and other losses.
Asset	An item owned by an individual, corporation, or government that provides a benefit, has economic value, and could be converted into cash. For businesses, an asset generates cash flow and may include, for example, accounts receivable and inventory. Assets are listed on a company's balance sheet.
Book	A trader's record or inventory of long (buy) and short (sell) positions on securities it holds and orders placed. A book may hold few or several positions and a trader may have several books, which are variously organized, such as by types of product or risk.
Capital	The value of cash, goods, and other financial resources a business uses to generate income or make an investment. Companies can raise capital from investors by selling stocks and bonds. Capital is often used to measure the financial strength of a company.
Capital Market	The market for long-term funds in which securities such as common stock, preferred stock, and bonds are traded. Both the primary market for new issues and the secondary market for existing securities are part of the capital market.
Claims (Adjustment) Expenses	Costs of adjusting a claim that include attorneys' fees and investigation expenses.
Collateral	Properties or other assets pledged by a borrower to secure credit from a lender. If the borrower does not pay back or defaults on the loan, the lender may seize the collateral.

Collateralized Debt Obligation

Securities backed by a pool of bonds, loans, or other assets. In a basic collateralized debt obligation, a pool of bonds, loans, or other assets are pooled and securities then are issued in different tranches (see "tranche" and "mezzanine tranche") that vary in risk and return.

Combined Ratio

This ratio is a common measure of the performance of the daily operations of an insurance company. It is calculated by adding the amount of incurred losses and the amount of expenses incurred by the company and dividing that combined amount by the earned premium generated during the same period. The ratio describes the related cost of losses and expenses for every $100 of earned premiums. A ratio of less than 100 percent generally indicates that the company is making underwriting profit while a ratio of more than 100 percent generally means that it is paying out more money in claims that it is receiving from premiums.

Commercial Paper

An unsecured obligation with maturities ranging from 2 to 270 days issued by banks, corporations, and other borrowers with high credit ratings to finance short-term credit needs, such as operating expenses and account receivables. Commercial paper is a low-cost alternative to bank loans. Issuing commercial paper allows a company to raise large amounts of funds quickly without the need to register with the Securities and Exchange Commission, either by selling them directly to an investor or to a dealer who then sells them to a large and varied pool of institutional buyers.

Credit Default Swap

Bilateral contracts that are sold over the counter and transfer credit risks from one party to another. In return for a periodic fee, the seller (who is offering credit protection) agrees to compensate the buyer (who is buying credit protection) if a specified credit event, such as default, occurs.

Derivative

A financial instrument, traded on- or off-exchange, the price of which directly depends on the value of one or more underlying commodities. Derivatives involve the trading of rights or obligations on the basis of the underlying product, but they do not directly transfer property.

Directors and Officer Liability Insurance

Provides coverage when a director or officer of a company commits a negligent act or misleading statement that results in the company being sued.

Equity

Ownership interest in a business in the form of common stock or preferred stock.

Errors and Omissions Liability Insurance (or Coverage)

Insurance protection to various professions for negligent acts or omissions resulting in bodily injury, property damage, or liability to a client.

Expense Ratio

The ratio of underwriting expenses to net premiums earned. It is a measure of underwriting efficiency, in which an increase in the ratio represents increased expenses relative to premiums. The underwriting expenses include the amortization of deferred policy acquisition costs (commissions, taxes, licenses and fees, and other underwriting expenses amortized over the policy term), and insurance operating costs and expenses. For example, a 22.4 expense ratio indicates that 22.4 cents out of every dollar in premiums earned are used for underwriting expenses.

Fair Value

An estimated value of an asset or liability that is reasonable to all willing parties involved in a transaction taking into account market conditions other than liquidation. For example, the fair value of derivative liability represents the fair market valuation of the liabilities in a portfolio of derivatives. In this example, the fair value provides an indicator of the dollar amount the market thinks the trader of the portfolio would need to pay to eliminate its liabilities.

Goodwill (and Goodwill Impairment)

Goodwill occurs when a company buys another entity and pays more than the market value of all assets on the entity's books. A company will pay more because of intangibles—such trademarks and copyrights—on the books at historical cost and other factors—such as human capital, brand name, and client base—that accounting conventions do not capture on the books. If the company later determines that the entity has lost value and recovery is not a realistic expectation it might decide record the lost value as an impairment.

Liability

A business's financial obligation that must be made to satisfy the contractual terms of such an obligation. Current liabilities, such as accounts payable or wages, are debts payable within 1 year, while long-term liabilities, such as leases and bond repayments, are payable over a longer period.

Liquidity

Measure of the extent to which a business has cash to meet its immediate and short-term obligations. Liquidity also is measured in terms of a company's ability to borrow money to meet short-term demands for funds.

Loss Ratio

The ratio of claims and claims adjustment expenses incurred to net earned premiums. For example, a 77.3 loss ratio indicates that 77.3 cents out of every dollar in premiums earned are used to adjust and pay claims.

Mezzanine Tranche

A tranche is a piece or portion of a structured deal, or one of several related securities that are issued together but offer different risk-reward characteristics. The mezzanine tranche is subordinated to the senior tranche, but is senior to the equity tranche. The senior tranche is the least-risky tranche whereas the equity tranche is the first loss and riskiest tranche.

Mortgage-Backed Securities

Securities or debt obligations that represent claims to the cash flows from pools of mortgage loans, such as mortgages on residential property. These securities are issued by Ginnie Mae, Fannie Mae, and Freddie Mac, as well as private institutions, such as brokerage firms and banks.

Notional Amount (Gross and Net)

The amount upon which payments between parties to certain types of derivatives contracts are based. The gross notional amount is not exchanged between the parties, but instead represents the underlying quantity upon which payment obligations are computed. The net notional amount represents the maximum dollar level exposure for the portfolio.

Paid-in Capital

Funds provided by investors in exchange for common or preferred stock. Paid-in capital represents the funds raised by the business from equity, and not from ongoing operations.

Preferred Stock (Cumulative, Noncumulative, etc.)

A class of ownership in a corporation or stock that has characteristics of both common stock and debt. Preferred shareholders receive their dividends before common stockholders, but they generally do not have the voting rights available to common stockholders.

Retained Earnings
A calculation of the accumulated earnings of a corporation minus cash dividends since inception.

Reverse Stock Split
A proportionate decrease in the number of shares held by stockholders that a company generally institutes to increase the market price per share of its stock. In a 1-for-10 stock split stockholders would own 1 share for every 10 shares that they owned before the reverse split.

Risk-based Capital (Insurance)
The amount of required capital that an insurance company must maintain based on the inherent risks in the insurer's operations. Authorized control level risk-based capital is the level at which an insurance commissioner can first take control of an insurance company.

Secured
Secured debt is backed or secured by a pledge of collateral.

Securitization
The process of pooling debt obligations and dividing that pool into portions (called tranches) that can be sold as securities in the secondary market—a market in which investors purchase securities or assets from other investors. Financial institutions use securitization to transfer the credit risk of the assets they originate from their balance sheets to those of the investors who purchased the securities.

Shareholders' Equity
Total assets minus total liabilities of a company, as found on a company's balance sheet. Shareholders' equity is also known as owner's equity, net worth, or book value. The two sources for shareholders' equity are money that originally was invested in the company, along with additional investments made thereafter, and retained earnings.

Soft Market
A market in which supply exceeds demand resulting in a lowering of prices in that market. Also refers to a buyer's market, as buyers hold much of the power in negotiating prices.

Solvency
Minimum standard of financial health for an insurance company, in which assets exceed liabilities. In general, a solvent company is able to pay its debt obligations as they come due.

Term	Definition
Special Purpose Vehicle	A legal entity, such as a limited partnership that a company creates to carry out some specific financial purpose or activity. Special purpose vehicles can be used for purposes such as securitizing loans to help spread the credit and interest rate risk of their portfolios over a number of investors.
Trading Position	The amount of a security or commodity owned by an investor or a dealer.
Tranche	A tranche is a portion or class of a security. A security may have several tranches, each with different risks and rates of return, among other differences.
Treasury Stock	Previously issued shares of a company that the company has repurchased from investors.
Unrealized Gains and Losses	A profit or loss on an investment that has not been sold. That is, an unrealized profit or loss occurs when the current price of a security that still is owned by the holder is higher or lower than the price the holder paid for it.
Unsecured Debt	Unsecured debt is not backed by any pledge of collateral.
Warrant	An options contract on an underlying asset that is in the form of a transferable security. A warrant gives the holder the right to purchase a specified amount of the issuer's securities in the future at a specific price.

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