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Eric Dinallo

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Conference Call with Eric Dinallo, Superintendent
New York State Insurance Department (NYSID)
Regarding the Financial Condition of American International Group, Inc. (AIG)
September 14, 2008

I. Immediate Liquidity Needs and Pieces of the Proposed Liquidity Plan

- There is an immediate need for a capital injection as there would be a $5 billion hole in liquidity with an $18 billion collateral call on a 1-step downgrade on GICs and CDOs.
  - AIG has a bank line that could be pulled down but may result in an automatic 3-4 notch downgrade beyond the expected 1-step downgrade.
  - AIG's GICs have 10 days in which to post collateral.

- New piece of information from regulator discussions of liquidity plan with AIG:
  - Warren Buffet's insurance lieutenant, Ajit Jain, is evaluating if Berkshire Hathaway Assurance Corporation could provide additional liquidity by wrapping GICs to avoid GIC collateral calls if AIG is downgraded 1 notch.

- AIG may potentially be able to raise $40-$45 billion in capital.
  - Private equity firms want the capital amount to be on the higher side, while AIG wants it to be on the lower side.
  - NYSID wants as much as possible in a one-shot deal so that AIG does not have to attempt to repeat capital-raising efforts.
  - There is $10-15 billion in private equity bids currently:
    - One potential investor is Chris Flowers of J.C. Flowers & Co. LLC, an investment firm that serves as advisor to two private equity funds focused solely on the financial services sector. This firm has not been selected as the lead private equity provider as yet.
      - Flowers is clearly "on the hedge" regarding how much equity is needed and is concerned because of legacy reporting systems and how AIG is still recovering from Greenberg "running everything in his head." Systems for rolling up risk and revenues are not perfectly cognizable.
    - It is expected that there will be an immediate infusion of capital into AIG tonight before the Asian markets open on September 15.

- $16.4 billion of capital in the form of par value municipal bonds is to be released from two of AIG's largest property/casualty companies to the parent company:
  - American Home Assurance Company (American Home, domiciled in New York; total assets of $27.9 billion), and
  - National Union Fire Insurance Company of Pittsburgh (National Union, domiciled in Pennsylvania; total assets of $34.2 billion).
  - In return for the munis, American Home and National Union will receive equity in an intermediate holding company of twelve life insurers, AGC Life

Insurance Company, domiciled in Missouri (AGC; total assets of $13.5 billion).
- NYSID feels that this transaction would not disadvantage American Home and National Union policyholders.
- State regulators from Pennsylvania have been involved in the discussions for National Union and join New York in encouraging the transactions planned for the property/casualty companies.
- The life insurance companies would be sold in the next several months.

➢ Asset sales are also contemplated:
- Personal lines assets of $5 billion, representing a big chunk of an automobile insurer's book of business, are of interest to Travelers, represented in discussions by Greenhill.
- Variable Annuity Life Insurance Company (VALIC) of Texas, an annuity underwriter, is being bid on by Axa Equitable for $8 billion.
- Additional asset sales are expected throughout the next year, but the amounts expected are not part of the $40-45 billion in capital needed; rather, proceeds from these asset sales will be used to pay back the property/casualty companies for purchasing the life insurance company stock when the munis are upstreamed to AIG as capital.

➢ AIG will run out of liquidity by Tuesday if the company is downgraded Monday and none of the immediate measures noted above take place. If the corporation cannot roll its commercial paper, it will have to use its bank lines which will result in it being downgraded 3-4 notches, and "then it'll all be over."

➢ The private sector is desperately worried about the domino effect of the issues related to both Lehman and AIG in one week --
- Berkshire Hathaway and J.C. Flowers are invested across the financial services sectors, so they are "willing to go in quite a bit" to protect their investments.

II. <u>Health of Major AIG Insurance Subsidiaries</u>

➢ Dinallo said there is no doubt that the two property/casualty companies domiciled in New York and Pennsylvania that will become owners of the twelve life insurance subsidiaries are in good shape and have adequate capital cushions.

➢ It is more difficult to judge the condition of the aggregate $26 billion of assets (on a GAAP basis) in life insurance companies, which are not domiciled in New York. JPMorgan Chase is valuing the companies. $16.4 billion in par value of munis (on a statutory accounting basis) will be transferred as consideration for the equity in these insurance companies.

- New York Life and MetLife are seen as prospective buyers for these life insurance companies, the market value and salability of which are considered quite high.

➢ By broad line of business, AIG's revenues break down as follows:
- Property casualty operations: 42%
- Life insurance operations: 46%
- Financial products: 8%
- Asset management: 4%

➢ AIG's property/casualty businesses have nearly $27 billion of capital on a combined basis, and the risk-based capital ratio for the group is well above the regulatory minimum of 200% at 458%.

➢ These property/casualty companies wrote $12.7 billion in insurance premiums during 1H08, which is down a bit year-over-year but shows underwriting discipline in a softening market. Combined ratios are less than 100%, meaning the underwriting of the businesses is profitable. Based on ratios of net premiums written to capital, leverage is very low.

➢ State insurance regulators do not have the regulatory jurisdiction to put an insurance holding company in conservatorship. However, under the insurance holding company statutes, certain transactions with affiliates are subject to regulator approval.

- Mention was made of the case of an insurance company holding company, Conseco, Inc. which in December 2002 filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. (It emerged from bankruptcy in late 2003.) In this case, state insurance regulators ring-fenced the insurance subsidiaries of the parent company.

➢ AIG's securities lending business is guaranteed by the parent holding company for $5 billion. This business has seen a $7 billion unrealized loss so far.

➢ Residential mortgage-backed securities portfolios that have taken write-downs are mainly in the life insurance companies – they would not be in the property/casualty companies because of the tails. The write-downs taken on these portfolios are not by any means solvency threatening.

➢ Portfolios of the life companies have not been evaluated as yet; investment banks are conducting due diligence on this with the aim of getting a perspective on the consolidated portfolio under AGC.

➢ Holding company multi-sector collateralized debt obligation (CDO) exposure is subject to $20 billion in collateral calls. $20-odd billion in collateral is coming from AIG's thrift, AIGFP.

- Insurance law prevents the transfer of assets between affiliates.
  - AIG's asset swap with involving the munis and life insurance companies requires regulatory forbearance as it involves the movement of assets from two property/casualty subsidiaries to the parent company.
  - Risk-based capital has dropped but is between 275% - 350% for each of the 3 companies involved – AGC, American Home, and National Union.
  - Rating agencies could be a bit concerned with these arrangements, as they evaluate the effect of capital levels on the financial strength rating of each subsidiary, which then could impact an insurer's ability to write new business.

- What is the process for moving excess capital to an affiliate or a parent?
  - In general, state insurance statutes allow commercial insurance underwriters to pay out a maximum dividend amount of the greater of (1) the prior year-end net income, or (2) 10% of the surplus as regards policyholders, without the approval of the state's insurance regulatory authority. State insurance regulatory authorities have the power to approve extraordinary dividends on a case-by-case basis.
  - Insurers may apply for approval for extraordinary dividends, and the process can be fairly quick, but there is no timeframe prescribed by law.
  - Dividending assets might not get AIG where it needs to go - it needs much more liquidity than could be upstreamed from ordinary dividends from its subsidiaries.
  - State insurance regulators do not favor proposals for subsidiaries to act as a source of strength at the expense of the subsidiaries' solvency and would be unlikely to allow very large dividends in these circumstances.

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