

Memo

To: / Location: AIGFP 2007 2Q Review files
From: / Location: Justin Keane
Date: August 8, 2007
Subject: Notes from conference call with AIGFP regarding collateral calls on Super Senior

Background

On August 7, 2007, a conference call was held between certain PwC and AIGFP personnel regarding proposed changes to the market valuation adjustments approach. As preamble to this call, a brief discussion was held regarding collateral calls that had been received by AIGFP from a counterparty.

Notes from conference call

PwC attendees: Henry Daubeney ("HJD", Partner), J Douglas Summa (Partner, Risk & Reg), Justin Keane (Senior Manager)

AIGFP attendees: Joe Cassano ("JC", CEO), Pierre Micottis (CRO), Alex Kolesnikov (Market Risk), Mark Balfan (CFO)

Timeline of events

HJD commented that there had been market gossip that collateral calls on derivatives related to sub-prime and related exposures were being made and subject to dispute.

JC noted that AIGFP was actually in the process on one of these transactions. The timeline related to this was (dates are approximate):

- GS approached AIGFP, calling collateral of \$1.8bn in relation to certain super senior protection written by AIGFP to GS. AIGFP initially disputed the collateral call, noting would expect zero, having done some limited analysis.
- GS then reverted during the week of July 30th having refreshed their analysis in response to AIGFP's comments, with a revised call for \$1.2bn. AIGFP continued to assert that no collateral call was required.

- AIGFP refreshed their analysis and given that during this time the month end (July 31) had been crossed, AIGFP had received counterparty quotes as contractually required on other transactions and noted the values were zero (Merrill Lynch).
- AIGFP communicated this to GS, who later came back with a revised request for \$600mn collateral call.
- JC had subsequently spoken with Mike Sherwood, Head of GS Fixed Income in London, and noted that AIGFP was angry at the errors that GS appeared to have made in moving from \$1.8bn to \$600mn. In addition, there appears to be some confusion over whether the basis for collateral calls should be on "actionable bids" per GS versus mids per AIGFP, and the contractual information may need to be clarified.
- Although AIGFP continues to believe no collateral was required, \$300mn has been offered to GS for relationship purposes as "a gesture of goodwill to calm people down".

Assessment of fact pattern

JC noted that this appeared to be indicative of the fact that there is little or no price transparency around such complex and senior products. Given the market conditions, for risk management purposes protection buyers will clearly be looking to obtain collateral to protect themselves should actual events trigger.

In addition, it was difficult to determine whether such examples were indicative of true market levels moving, or simply temporary dislocations due to positions being closed. The issue is compounded by the fact that liquidity typically scales back during the summer months as traders take vacation, so the market liquidity crisis has been exacerbated by this fact.

Finally, due to the movements in asset allocations, there is a belief that across the industry there are significant amounts of un-invested cash on the sidelines awaiting the right opportunity to reinvest.

Conclusion¹

Based on the information above, the rapid decreases in the amount of collateral called by GS, and the zero level noted at month end by Merrill Lynch, management does not consider the need to revalue the portfolio, and "do not consider these [collateral calls] as harbingers of value", which the engagement team considers reasonable.

In addition, it is noted that even if the value changed as a result of the market developments, these would be considered a 3Q07 event since the positions are derivatives held at fair value, marked through income.

No further action required in respect of the 2Q07 Review.

¹ Note to file: Conclusion was noted on the call and agreed on with HJD. Due to issues around access to the database, this memorandum has been marked completed and reviewed by Justin Keane, Senior Manager.