AIG – Summary of Drivers of Potential Earnings, Capital and Liquidity Issues¹
August 14, 2008

Despite raising $20 billion of capital in May 2008, AIG is under increasing capital and liquidity pressure. The firm appears to need to raise substantial longer term funds to address the impact of deteriorating asset values on its capital and available liquidity as well as to address certain asset/liability funding mismatches. This could require the firm to issue additional debt and equity; re-position assets on its balance sheet via asset sales to increase its liquidity; and/or to further access secured funding markets via repurchase agreements, to the extent permissible.

Moodys and S&P highlighted earning, capital and/or liquidity concerns following AIG’s Q2 earnings announcement last week.

- Moody’s reiterated its negative outlook for AIG and expressed its expectation that the firm will actively address its capital and liquidity needs. Moody’s also stated that the failure of AIG to address these concerns in the near term could lead to a downgrade of AIG and/or some of its operating units.

- S&P, while expressing concerns about certain of AIG’s asset/liability mismatches, warned that a downgrade of one notch would be likely if earnings at AIG did not stabilize in the current quarter.

Given the current environment, it appears the firm needs to move aggressively to address these challenges or face additional ratings downgrades, further liquidity drains, and potentially increasing investor/counterparty uncertainty that could further exacerbate its situation.

Based on internal analysis, there are six areas driving the current earnings, capital and/or liquidity issues for AIG:

1. Fixed Income and equity investments of the firm (primarily in AIG’s domestic life insurance cos.) are heavily weighted to structured credit products (20%) that have experienced significant valuation losses and have reduced earnings and capital as impairments have been recognized. These and other asset can be further impacted as/if conditions continue to deteriorate.

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2. Unfunded synthetic credit assets – predominantly $80 billion of multi-sector super-senior CDO credit protection sold by AIGFP– are also experiencing significant mark-to-market losses. Because many of these CDS contracts provide for margin calls to cover losses, significant cash outflows have occurred since the beginning of the year and the firm is subject to ongoing margin calls as if conditions continue to deteriorate.

- To date, the firm’s multi-sector CDOs have recorded losses of $26.5 billion. Against these positions, the firm has posted $16.5 billion of collateral with counterparties (of which an estimated $13 billion has been posted since the beginning of this year).

3. The firm has significant amounts of near term liabilities including GICs maturing in less than one year ($11 billion), funding obtained via short term securities lending agreements ($75 billion) and current portions of the firm’s long-term debt that may impact its liquidity needs.

- Through its securities lending agreements, AIG has borrowed $75 billion. These funds have generally been invested in longer term credit assets – RMBS/ABS/ CDOs ($36b), corporate bonds (13b), cash (10b) – that have lost approximately $16 billion. Because the maturities of the securities lending contracts range from 1 day (approximately $7 billion) out to 6 months, the firm is subject to significant rollover risk on these liabilities to the extent redemptions exceed available cash and proceeds from asset sales. In addition, the assets (and the firm’s insurance entities) can be further impacted as if conditions continue to deteriorate.

4. The firm has other commitments to purchase CDOs that could require funding.

- The firm has $10.5 billion of commitments to purchase super-senior CDOs via Liquidity Puts (i.e., 2(a)7 puts) and to purchase super-senior CDOs if certain event of default triggers are hit in CDOs. As of July 31, $1.6 billion of these transactions have already experienced event of default triggers, with only $100 million funded. The firm has committed liquidity lines of $3 billion available to support purchases of specific (but not all) deals within this portfolio.

- In addition, the firm has various additional commitments of $17 billion (e.g., private equity, hedge funds and limited partnership calls).

5. The firm has ratings-based triggers in various GIC and derivatives contracts that could result in significant collateral calls if it is downgraded a single notch by either Moody’s or S&P.

- A one notch downgrade by Moody’s or S&P could expose the firm to collateral calls of $15 billion. If both rating agencies were to lower their ratings one notch, this outflow would potentially increase to $18 billion.

6. The firm has limited standby credit facilities available to manage sudden cash needs.

- Although the firm has third party revolving credit facilities of $18 billion, approximately $14 billion is currently utilized. The remaining $4 billion of facilities are meant to support the firm’s commercial paper programs but are also available for broader corporate purposes.

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2 These assets are not included as part of the firm’s fixed income and equity investments cited in point 1.
3 AIG has an additional $5 billion of undrawn facility where subsidiaries of the company are the lenders.
4 It is unclear from the firm’s disclosures if the $3 billion of committed liquidity lines related to the Liquidity Puts are included in this amount.