

July 2011

TROUBLED ASSET RELIEF PROGRAM

The Government's Exposure to AIG Following the Company's Recapitalization

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Highlights of [GAO-11-716](#), a report to congressional committees

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) represented one of the federal government's largest investments in a private sector institution. 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.

As part of GAO's statutory oversight of TARP, this report updates a set of indicators GAO last reported in January 2011. Specifically, GAO discusses (1) trends in the financial condition of AIG and its insurance companies, (2) the status of the government's exposure to AIG, and (3) trends in the unwinding of AIG Financial Products (AIGFP). To update the indicators, GAO primarily used available public filings as of March 31, 2011, 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-11-716](#) or key components. For more information, contact Tom McCool at (202) 512-2642 or mccoolt@gao.gov.

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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 generally has remained relatively stable or showed signs of improvement since GAO's last report in January 2011. However, the company recently recorded losses because of claims resulting from earthquakes and floods, in particular the ones that hit Japan in March 2011. As of March 31, 2011, the outstanding balance of the Federal Reserve and Treasury assistance to AIG was \$85 billion, down from \$123.1 billion in December 2010 (see table). Also, several indicators on the status of AIG's insurance companies illustrate that its insurance operations are showing signs of recovery. In particular, throughout 2010 and into the first quarter of 2011, additions to AIG life and retirement policyholder contract deposits exceeded withdrawals. In addition, AIG's property/casualty companies have remained stable.

Several indicators also show that the government's exposure to AIG has continued to decline with the execution of AIG's recapitalization in January 2011, but the return to the government on its investment continues to depend on AIG's long-term health, market conditions, and timing of Treasury's exit. With the recapitalization, AIG paid the Federal Reserve Bank of New York (FRBNY) about \$21 billion to completely repay its debt to the FRBNY revolving credit facility. Treasury also exchanged its Series C, Series E, and Series F preferred stocks for approximately 1.655 billion shares of AIG common stock that have a cost basis of about \$49.148 billion. Consequently, the government's remaining \$85 billion in assistance to AIG is composed of balances owed by Maiden Lanes II and III to FRBNY and Treasury's common stock in AIG and preferred interests in AIA Group Limited. As of March 31, 2011, the amount of assistance available to AIG also has been reduced to \$123.9 billion. As Treasury sells its stock in AIG to exit the company, several indicators show that the most likely investors will be institutions, many of whom already have holdings in insurance companies.

Several indicators show that AIGFP has continued to unwind its credit default swap (CDS) positions and its portfolio of super senior CDS. AIGFP has decreased its number of outstanding trade positions and its number of employees, and AIG has reported that it wants to complete the active unwind of AIGFP's portfolios by June 30, 2011. Also, AIGFP continues to see overall declines in its super senior CDS portfolio, including regulatory capital, multisector collateralized debt obligations, corporate collateralized loan obligations, and mezzanine tranches (the riskiest portions of related securities that are issued together). The government's ability to fully recoup its exposure to AIG continues to be determined by the long-term health of AIG; changes in market conditions; and how Treasury balances its interest in selling its shares in AIG as soon as practicable while striving to maximize taxpayers' return. GAO will continue to monitor these issues in its future work.

Highlights of GAO-11-716 (continued)

Overview of Federal Assistance Provided to AIG as of March 31, 2011

Dollar 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 Special Purpose Vehicle (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 ^a	n/a	\$12.353 ^b	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan. In March 2011, AIG offered to buy the Maiden Lane assets, but FRBNY rejected this offer.
	FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing collateralized debt obligations 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	12.346 ^b	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan.
Treasury	On January 14, 2011, as part of the closing of the recapitalization, Treasury provided up to \$2 billion in liquidation preference to AIG through a new AIG facility (Series G cumulative mandatory convertible preferred stock). AIG drew all but \$2 billion remaining under the Series F to purchase a portion of the SPV preferred interests that were exchanged with Treasury.	n/a	2	0	The facility was undrawn. ^c
	The preferred interests in the AIA and ALICO SPVs had an aggregate liquidation preference of approximately \$26.4 billion at December 31, 2010, which were purchased by AIG and transferred to Treasury as part of the closing of the recapitalization. The remaining preferred interests, which have an aggregate liquidation preference of approximately \$20.3 billion following a partial repayment on January 14, 2011, with proceeds from the sale of ALICO, were transferred from FRBNY to AIG and subsequently transferred to Treasury as part of the recapitalization.	n/a	20.3	11.164 ^d	Under the agreements, the SPVs generally may not distribute funds to AIG until the liquidation preferences and preferred returns on the preferred interests have been repaid in full and concurrent distributions have been made on certain participating returns attributable to the preferred interests.
	In total, Treasury received 1.655 billion shares of AIG common stock (approximately 92 percent of the company). ^d	n/a	49.148 ^d	49.148 ^d	Over time, Treasury will sell the shares, with the goal of recouping taxpayers’ funds.
Subtotal		\$52.5	\$71.448		
Total authorized (debt and equity)		\$123.948^e			
Total authorized and outstanding assistance				\$85.011	

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

^aGovernment debt shown for the Maiden Lane facilities is as of March 30, 2011, and reflects principal only and does not include accrued interest of \$492 million for Maiden Lane II and \$586 million for Maiden Lane III. As of May 25, 2011, principal owed was \$10.542 billion and \$11.985 billion and accrued interest was \$514 million and \$610 million for Maiden Lane II and Maiden Lane III, respectively.

^bOn May 27, 2011, the available amount of the Series G preferred stock was reduced to \$0 as a result of AIG’s primary offering of its common stock and the Series G preferred stock was cancelled.

^cIn February 2011 AIG used \$2.2 billion of proceeds from the sale of two life insurance companies to reduce the ALICO and AIA liquidation preferences. On March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury’s remaining \$1.4 billion of preferred interests in the ALICO SPV and reduce by \$5.5 billion Treasury’s remaining preferred interests in the AIA SPV. On March 15, 2011, Treasury received another payment of \$55.8 million, reducing the remaining preferred interest on the AIA SPV to \$11.164 billion.

^dTreasury’s cost basis in AIG common shares of \$49.148 billion comprises of liquidation preferences of \$40 billion for series E preferred shares, \$7.543 billion for series F preferred shares, and unpaid dividend and fees of \$1.605 billion. On May 24, 2011, Treasury sold 200 million shares of its common stock in AIG and on May 27, 2011, AIG issued and sold 100 million shares of common stock, reducing its holdings to approximately 1.5 billion shares, or approximately 77 percent of the equity interest in AIG, and increasing the total number of outstanding common shares to approximately 1.9 billion.

^eThe Federal Reserve and Treasury had made \$182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to \$123.9 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
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
OTS	Office of Thrift Supervision
RMBS	residential mortgage-backed security
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
SIGTARP	Special Inspector General for TARP
SPV	special purpose vehicle
TARP	Troubled Asset Relief Program
Treasury	Department of the Treasury

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G A O

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United States Government Accountability Office
Washington, DC 20548

July 18, 2011

Congressional Committees

Assistance provided to American International Group, Inc. (AIG) has represented one of the federal government's largest investments in a private-sector institution. 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 property/casualty insurance, life insurance and retirement services, financial services, and asset management. Its potential demise 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. Recently, AIG, the Federal Reserve, Treasury, and the AIG Credit Facility Trust took several steps to recapitalize the company and Treasury had begun to divest its AIG holding. However, the extent to which Treasury will further recoup its investment will continue to depend on the long-term health of AIG and a number of other factors. Under our statutorily mandated responsibilities for providing timely oversight of TARP, we are

¹EESA, 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.

continuing to report on the federal government's assistance to AIG.² 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 financial condition and the status of the government's exposure to AIG. Because government assistance to AIG is a coordinated approach, in addition to providing timely reporting of Treasury's assistance to AIG, we are monitoring the efforts of the Federal Reserve.³ In September 2009 we issued a report on the financial condition and the status of government's exposure to AIG in which we first reported on these indicators. Since then, we have continued to monitor the financial risk posed by AIG, its financial condition, and the status of its repayment efforts.⁴ This report provides an update on the AIG indicators primarily based on AIG's latest available public filings as of March 31, 2011, and other more current publicly available information where available. Specifically, the report discusses (1) trends in the financial condition of AIG and its insurance companies, (2) the status of the government's

²We 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).

³Our 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 for 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.

⁴See GAO, *Troubled Asset Relief Program: Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan*, [GAO-11-46](#) (Washington, D.C.: Jan. 20, 2011) and *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). 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.

exposure to AIG, and (3) trends in the unwinding of AIG Financial Products (AIGFP).

To conduct this work, we updated previously published indicators that address several dimensions of AIG's business. 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 supplements for those filings through the first quarter of 2011. We conducted analysis using data from Thomson Reuters Datastream, SNL Financial, and Yahoo Finance.com. We obtained the March 31, 2011, 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 transaction reports.

To assess AIG's financial condition, we updated indicators of key AIG credit ratings, trends in shareholders' equity, cash flows, operating income and losses, and its credit default swap (CDS) premiums. To assess the financial condition of AIG's insurance companies, we reviewed the additions to and withdrawals from policyholder contract deposits, and AIG general insurance premiums written, and underwriting ratios for AIG and several of its peers.

To monitor the status of the government's exposure to AIG, we updated some indicators, ceased reporting others, and developed several new ones. We updated our indicator of the composition of the government's direct and indirect assistance to AIG and the balances on the Maiden Lane facilities. We no longer include our indicator of the FRBNY's revolving credit facility balance because the credit facility has been terminated.⁵ We also ceased reporting on the indicator on AIG's divestitures and asset dispositions because the government's exposure is less driven by AIG's divestiture of assets and more by the return Treasury

⁵FRBNY 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.

will receive when it disposes of its shares in AIG. Conversely, we have added several new indicators. One shows the composition of the government's direct assistance to AIG before and upon announcement and execution of the recapitalization agreement. We reported the balances of the federal debt and equity assistance as of March 31, 2011, 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. A second new indicator shows the market value of AIG's common stock to estimate the profits and losses to Treasury if its shares in AIG are sold at various average prices. A third new indicator shows the month-end share prices of AIG common stock compared to the Standard and Poor's (S&P) 500 Index. A fourth new indicator compares Treasury-owned AIG shares to daily trading volume in AIG stock. A fifth compares the market capitalization and composition of shareholders for AIG with those for other large insurance companies. One other new indicator, developed under the premise that institutions with major insurance holdings might consider adding AIG as an insurance holding, presents data on total dollars of insurance holdings of nearly 2,000 institutions. As circumstances have evolved, we believe these new metrics provide useful information on AIG's financial condition, as well as the government's exposure and ability to recoup its investment.

To assess the unwinding of AIGFP, we updated our indicators on AIGFP's trading positions and employee count and CDS portfolio.⁶ In this section, as in other sections of the report, no single indicator provides a definitive measure of AIG's progress, but collectively the indicators appear to track the most critical activities related to the goals for federal assistance to AIG.

We determined that the data were sufficiently reliable for the purposes of our report. The data used to construct the indicators in this report came largely from AIG's public filings, Treasury, and Federal Reserve. We have reviewed these data and found them to be sufficiently reliable for our purposes. We also used data from SNL, Thomson Reuters, and Yahoo.com. We have relied on SNL and Thomson Reuters data for past reports, and we determined that these auxiliary data were sufficiently reliable for the purpose of presenting and analyzing trends in financial

⁶CDS 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.

markets. GAO reports also have relied on data from Yahoo.com, and in our limited review of these data we found them to be reliable for our purposes. We also reported data from four rating agencies. Although we have reported on actions needed to improve the oversight of rating agencies, we used these data because the ratings are used by AIG, Treasury, and the markets. We also relied on AIG's financial data, which we found reliable for our purposes.

We conducted our work from February to July 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 is an international insurance organization serving customers in more than 130 countries. As of March 31, 2011, AIG had assets of \$611.2 billion and revenues of \$17.4 billion for the 3 preceding months. AIG companies serve commercial, institutional, and individual customers through worldwide property/casualty networks. In addition, AIG companies provide life insurance and retirement services in the United States. Appendix I illustrates the breadth of AIG's operations and its subsidiaries.

AIG Operations

AIG 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 March 31, 2011, AIG's total gross derivatives assets had a fair value of \$11.9 billion, of which \$8.4 billion pertained to capital markets, down from \$28.1 billion and \$23.5 billion, respectively, at the end of September 2010. 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 (OTS) was the consolidated supervisor of AIG, which was a thrift holding company by virtue of its ownership of the AIG Federal Savings Bank.⁷ As the consolidated supervisor, the OTS was charged with identifying systemic issues or weaknesses and helping ensure compliance with regulations that govern permissible activities and transactions.⁸ AIG's domestic, life, and property/casualty insurance companies are regulated by the state insurance regulators in states in which these companies are domiciled.⁹ 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 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 degrees.

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

⁷In 1999, AIG became a savings and loan holding company when the Office of Thrift Supervision (OTS) granted AIG approval to organize AIG Federal Savings Bank. Until March 2010, AIG was subject to OTS regulation, examination, supervision and reporting requirements. As the consolidated supervisor, OTS was charged with identifying systemic issues or weaknesses and ensuring compliance with regulations that govern permissible activities and transactions. Since March 2010, AIG reports that it has been in discussions with the Autorité de Contrôle Prudentiel and the UK Financial Services Authority regarding the possibility of proposing another of AIG's existing regulators as its equivalent supervisor.

⁸For 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).

⁹The primary state insurance regulators include New York, Pennsylvania, and Texas.

the sale of certain AIG assets.¹⁰ 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.¹¹ The Congressional Oversight Panel, which helped provide oversight of TARP, also issued several reports that reviewed the government's actions precipitating its assistance to AIG and executive compensation, and identified several of its concerns with the rescue of AIG.¹² The panel's June 2010 report 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.

¹⁰Office of the Special Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress* (Jan. 26, 2011); *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).

¹¹Office 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).

¹²Congressional Oversight Panel, *June Oversight Report: The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy* (Washington, D.C.: Jun. 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 of interest by acting at various times as advisors to, potential rescuers of, and counterparties, with AIG; (4) AIG might not repay taxpayers for the assistance they provided; and (5) the AIG bailout might be seen as setting a precedent by implicitly guaranteeing "too big to fail" firms. Also see the panel's *February Oversight Report: Executive Compensation Restrictions in the Troubled Asset Relief Program* (Washington, D.C.: Feb. 10, 2011), and *March Oversight Report: The Final Report of the Congressional Oversight Panel* (Washington, D.C.: Mar. 16, 2011). Pursuant to EESA's requirements, the Congressional Oversight Panel terminated on April 3, 2011.

In Late 2008, the Federal Reserve and Treasury Provided Assistance to AIG to Limit Systemic Risk to the Financial Markets

AIG's Financial Problems Mounted Rapidly in 2008

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.¹³ 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.

From July through early September 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's RMBS assets, which were purchased with the cash collateral for its securities lending, declined in value and became less liquid. The values of the collateralized debt obligations (CDO) against which AIGFP had written CDS protection also declined.¹⁴ 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 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 further increased financial pressures on the company and the number of counterparties refusing 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 an AIG revolving credit facility and they demanded that any outstanding loans be repaid and the facility be terminated.

¹³In our March 2009 testimony on CDS, 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).

¹⁴CDOs are securities backed by a pool of bonds, loans, or other assets.

Concerns about an AIG Failure Led the Federal Reserve and Treasury to Assist the Company and Subsequently Restructure That Assistance

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 and twice restructured that assistance. In September 2008, the Federal Reserve, with the support of Treasury, authorized FRBNY to provide a secured loan to AIG of up to \$85 billion through a revolving credit facility.

As AIG borrowed from the facility, its mounting debt led to concerns that the company's credit ratings would be lowered, which would have caused its condition to deteriorate. In response, the Federal Reserve and Treasury restructured AIG's debt in November 2008. As part of the restructuring terms, 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.¹⁵ The proceeds of this sale were used to pay down a portion of AIG's outstanding balance on the revolving credit facility and the borrowing limit on the facility was reduced to \$60 billion.

To provide further relief, in late 2008, FRBNY created two new facilities—Maiden Lane II LLC and Maiden Lane III LLC—to purchase some of AIG's more troubled assets. Maiden Lane II LLC was created to purchase RMBS assets from AIG's U.S. securities lending portfolio, which placed significant demands on AIG's working capital. The Federal Reserve authorized FRBNY to lend up to \$22.5 billion to Maiden Lane II, and in December 2008 FRBNY loaned \$19.5 billion to Maiden Lane II.¹⁶ The facility purchased \$39.3 billion in face value of the RMBS directly from AIG domestic life insurance companies. Maiden Lane III LLC was created to purchase multisector CDOs on which AIGFP had written CDS contracts. These CDOs had become the greatest threat to AIG's liquidity position.¹⁷ In connection with the purchase of the CDOs, AIG's CDS

¹⁵Cumulative 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.

¹⁶AIG also acquired a subordinated \$1 billion interest in the facility to absorb the first \$1 billion of any losses.

¹⁷A multisector CDO is a CDO backed by a combination of corporate bonds, loans, asset-backed securities, or mortgage-backed securities.

counterparties agreed to terminate the CDS contracts.¹⁸ The Federal Reserve authorized FRBNY to lend up to \$30 billion to Maiden Lane III, and in November and December 2008 FRBNY loaned a total of \$24.3 billion to Maiden Lane III.¹⁹ FRBNY officials expected FRBNY's loans to Maiden Lane II and Maiden Lane III to be repaid with the proceeds from the interest and principal payments or liquidation of the assets in the facilities but were prepared to hold the assets to maturity if necessary.

In March 2009, the Federal Reserve and Treasury further restructured AIG's assistance by reducing the debt AIG owed on the revolving credit facility by \$25 billion. In exchange, FRBNY received preferred equity interests totaling \$25 billion in two special purpose vehicles (SPV) created by AIG 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 were an undisclosed percentage of the fair market value of ALICO and AIA as determined by FRBNY.

On April 17, 2009, to reduce AIG's leverage and dividend requirements, 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. The \$1.6 billion difference between the initial aggregate liquidation preference of the Series E and Series D stock represented 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 resembled common stock, principally because its dividends were noncumulative, rating agencies viewed the stock more positively when rating AIG's financial condition. In addition, to strengthen AIG's capital levels and further reduce AIG's leverage, 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

¹⁸AIGFP 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.

¹⁹AIG also paid \$5 billion for an equity interest in Maiden Lane III and agreed to absorb the first \$5 billion of any losses.

common stock. As AIG drew on the facility, the aggregate liquidation preference of the Series F stock increased.

In January 2011, the Recapitalization of AIG Changed the Composition of Federal Assistance to AIG

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, and the AIA and ALICO SPVs. Implementation of the recapitalization plan began on January 6, 2011, when AIG's board of directors 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 each party to the recapitalization plan determined as of January 12 that it expected the recapitalization would close on January 14. On January 14, 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 plan was executed on January 14, 2011.

The closing of AIG's recapitalization led to a restructuring of the government's assistance to AIG in a manner intended to facilitate the eventual sale of the government's stock. 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 AIA and ALICO SPVs that held the net cash proceeds from the initial public offering (IPO) of AIA and the sale of ALICO. As security for the loans from the SPVs, AIG pledged, among other collateral, its equity interests in Nan Shan Life Insurance Company, Ltd. and International Lease Finance Corporation and the assets held by the SPVs, including the ordinary shares of AIA held by the AIA SPV and the MetLife securities received from the sale of ALICO.²⁰ The net cash proceeds from the AIA

²⁰On 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. And on February 1, 2011, AIG reported that it completed the sale of AIG Star Life Insurance Co., Ltd. and AIG Edison Life Insurance Company, to Prudential Financial, Inc., for \$4.8 billion, consisting of \$4.2 billion in cash and \$0.6 billion in the assumption of third-party debt.

IPO were approximately \$20.1 billion and from the ALICO sale to MetLife were approximately \$7.2 billion.²¹

Second, Treasury, AIG, and the AIG Credit Facility Trust took several steps to exchange the various preferred interests in AIG for common stock.

- The trust exchanged its shares of AIG's Series C preferred stock (par value \$5.00 per share) for about 562.9 million shares of AIG common stock. The trust subsequently transferred these shares to Treasury.
- Treasury exchanged its shares of AIG's Series E preferred stock (par value \$5.00 per share) for about 924.5 million shares of AIG common stock.
- Treasury exchanged its shares of AIG's Series F preferred stock for the preferred interests in the AIA and ALICO SPVs, 20,000 shares of the Series G preferred stock, and about 167.6 million shares of AIG common stock. AIG and Treasury amended and restated the Series F securities purchase agreement to provide for AIG to issue 20,000 shares of Series G preferred stock to Treasury. AIG's right to draw on Treasury's equity capital facility tied to the Series F stock was then terminated with the closing of the recapitalization. AIG's right to draw on the Series G preferred stock was made 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. According to the agreement, dividends on the Series G preferred stock would be payable on a cumulative basis at a rate per annum of 5 percent, compounded quarterly. AIG drew down approximately \$20.3 billion remaining under Treasury's equity capital facility tied to the Series F preferred stock, less \$2 billion that AIG designated to be available after the closing for general corporate purposes under the Series G preferred stock, and used the amount it drew down on the equity facility to repurchase all of FRBNY's preferred interests in the AIA and ALICO SPVs. AIG then transferred the repurchased preferred

²¹In 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 continue to apply after the closing. Also, AIG agreed to provide Treasury and FRBNY with certain control and information rights.

interests to Treasury as part of the consideration for the drawdown on Treasury's equity capital facility. In addition, if AIG did not repay any draws on the equity facility tied to the Series G preferred stock by March 31, 2012, then Treasury's Series G preferred stock would be converted to common stock. The terms were that the price would be based on the lesser of \$29.29 and 80 percent of the average volume weighted average price over the 30 trading days commencing January 20, 2011.²²

At closing, Treasury held approximately 1.655 billion shares of AIG common stock, which represented approximately 92 percent of the outstanding AIG common stock.

Third, 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.²³ The AIG Credit Facility Trust, Treasury, and FRBNY did not receive any of these warrants. According to Treasury officials, the warrants were issued to address the AIG board of directors' desire to compensate existing shareholders for the dilutive effect of the recapitalization plan.

Fourth, AIG used proceeds from the sale of ALICO to reduce Treasury's preferred interests (aggregate liquidation preference) in the ALICO and AIA SPVs to approximately \$20.3 billion. This occurred on January 14, 2011. (Subsequent to the recapitalization, on March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury's remaining \$1.4 billion of preferred interests in the ALICO SPV and reduce by \$5.5 billion Treasury's remaining preferred interests in the AIA SPV to \$11.3 billion.)

As of January 14, 2011, when the restructuring closed, Treasury owned about \$20.3 billion in preferred equity in AIA and ALICO SPVs and at then current stock prices, about \$49.1 billion in common equity in AIG, giving

²²AIG was not to directly redeem the Series F preferred stock while FRBNY held preferred interests in the AIA and ALICO SPVs, but AIG had the right to use cash to repurchase a corresponding amount of the preferred interests in the SPVs from FRBNY, which would then be transferred to Treasury to reduce the aggregate liquidation preference of the Series F preferred stock.

²³Exercise price is the price at which the option holder may buy or sell the underlying asset.

Treasury an increased total exposure to AIG of about \$69.4 billion (see app. II for additional detail). As shown in table 1, with the completion of the restructuring, as of the end of the first quarter of 2011, the government's exposure has been reduced to \$85 billion, and most of this exposure was in the form of Treasury's ownership of AIG common stock.

Table 1: Outstanding U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure, as of March 31, 2011

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 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	\$12.353 ^a	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan. In March 2011, AIG offered to buy the Maiden Lane assets, but FRBNY rejected this offer.
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	12.346 ^a	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan.
Treasury				
On January 14, 2011, as part of the closing of the recapitalization, Treasury provided up to \$2 billion in liquidation preference to AIG through a new AIG facility (Series G cumulative mandatory convertible preferred stock). AIG drew all but \$2 billion remaining under the Series F to purchase a portion of the SPV preferred interests that were exchanged with Treasury.	n/a	\$2	0	The facility was undrawn. ^b
The preferred interests in the AIA and ALICO SPVs had an aggregate liquidation preference of approximately \$26.4 billion at December 31, 2010, which were purchased by AIG and transferred to Treasury as part of the closing of the recapitalization. The remaining preferred interests, which have an aggregate liquidation preference of approximately \$20.3 billion following a partial repayment on January 14, 2011, with proceeds from the sale of ALICO, were transferred from FRBNY to AIG and subsequently transferred to Treasury as part of the recapitalization.	n/a	20.3	11.164 ^c	Under the agreements, the SPVs generally may not distribute funds to AIG until the liquidation preferences and preferred returns on the preferred interests have been repaid in full and concurrent distributions have been made on certain participating returns attributable to the preferred interests.

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
In total, Treasury received 1.655 billion shares of AIG common stock (approximately 92 percent of the company). ^d	n/a	49.148 ^d	49.148 ^d	Over time, Treasury will sell the shares, with the goal of recouping taxpayers' funds.
Subtotal	\$52.5	\$71.448		
Total authorized (debt and equity)	\$123.948^e			
Total outstanding assistance			\$85.011	

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

^aGovernment debt shown for the Maiden Lane facilities is as of March 30, 2011, and reflects principal only and does not include accrued interest of \$492 million for Maiden Lane II and \$586 million for Maiden Lane III. As of May 25, 2011, principal owed was \$10.542 billion and \$11.985 billion and accrued interest was \$514 million and \$610 million for Maiden Lane II and Maiden Lane III, respectively.

^bOn May 27, 2011, the available amount of the Series G preferred stock was reduced to \$0 as a result of AIG's primary offering of its common stock and the Series G preferred stock was cancelled.

^cIn February 2011 AIG used \$2.2 billion of proceeds from the sale of two life insurance companies to reduce the ALICO and AIA liquidation preferences. On March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury's remaining \$1.4 billion of preferred interests in the ALICO SPV and reduce by \$5.5 billion Treasury's remaining preferred interests in the AIA SPV. On March 15, 2011, Treasury received another payment of \$55.8 million, reducing the remaining preferred interest on the AIA SPV to \$11.164 billion.

^dTreasury's cost basis in AIG common shares of \$49.148 billion comprises liquidation preferences of \$40 billion for series E preferred shares, \$7.543 billion for series F preferred shares, and unpaid dividend and fees of \$1.605 billion. On May 24, 2011, Treasury sold 200 million shares of its common stock in AIG and on May 27, 2011, AIG issued and sold 100 million shares of common stock, reducing its holdings to approximately 1.5 billion shares, or approximately 77 percent of the equity interest in AIG, and increasing the total number of outstanding common shares to approximately 1.9 billion.

^eThe Federal Reserve and Treasury had made 182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to \$123.9 billion.

AIG's Financial Condition and Insurance Operations Remained Stable after AIG's Recapitalization and the Restructuring of Federal Assistance

Since we last reported on AIG's indicators in January 2011, AIG's financial condition and operating results generally have remained relatively stable or showed signs of improvement.²⁴ Our indicators for tracking AIG's financial condition include credit ratings; the level of shareholders' equity; the market value of AIG's common stock; AIG's cash flows; CDS premiums on AIG; and insurance contract deposits, premiums written, and underwriting profitability.²⁵ AIG's credit ratings remained fairly stable through 2010 but showed mixed trends in the first quarter of 2011. 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 throughout 2010 and into 2011. The company's net cash flows from operating, investing, and financing activities improved or became more stable in 2010 and were affected by the recapitalization of AIG in the first quarter of 2011. The downward-trending and stabilizing prices offered for CDS premiums on AIG that began in May 2009 continued through May 2011. Overall trends in indicators related to the performance of AIG's insurance companies stabilized or improved, with the exception of underwriting profitability for AIG's property/casualty companies.

While AIG's Credit Ratings Remained Fairly Stable in 2010, They Showed Mixed Trends in the First Quarter of 2011

Ratings of AIG's debt and financial strength by various credit rating agencies either remained largely unchanged from May 2009 through 2010, primarily because federal assistance has provided AIG with needed capital, but in the first quarter of 2011 the ratings have shown mixed trends. Credit ratings measure a company's ability to repay its obligations and directly affect that company's cost of and ability to access unsecured

²⁴However, as discussed later in this section, according to AIG, the earthquake and tsunami that hit Japan in March 2011 caused the company to record catastrophe losses of \$864 million in Chartis International.

²⁵Since our previous update in January 2011, we have ceased coverage of several indicators that track AIG's financial condition. We discontinued the indicator on corporate available liquidity and companywide debt maturity timetable and the associated discussion and table on available corporate liquidity because AIG no longer has direct federal assistance outstanding in the form of debt or any remaining untapped federal assistance available for future borrowing. We also did not include the indicator on outstanding commercial paper because the FRBNY Commercial Paper Funding Facility is terminated and AIG has no outstanding commercial paper. We excluded the indicator on the operating income and losses of AIG's operating segments. We could not update this indicator because AIG has been realigning segments as part of the restructuring and as a result of divestitures but has not published realigned data for all prior quarters since the federal assistance.

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. Downgrades 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.

Several of AIG's key credit ratings were unchanged in 2009, remained fairly stable over the remainder of 2010, and became mixed in the first quarter of 2011.²⁶ In April 2010, S&P affirmed its ratings of AIG and maintained its negative outlook, reflecting its view of the challenges AIG faces in sustaining the performance of its insurance operations and capitalizing its life insurance businesses. In early July 2010, Fitch reviewed all of AIG's ratings and affirmed them. AIG's short-term debt ratings also have been generally stable, but two rating agencies downgraded their ratings slightly in the most recent quarter (Fitch, a third rating agency, withdrew its ratings of AIG's short-term debt in November 2010). Since December 2010, S&P has increased its rating on AIG long-term debt to "A-/stable," while decreasing its ratings on short-term debt to "A-2, because the recapitalization was executed." As of January 2011, Moody's had lowered its ratings on AIG long-term debt to "Baa1/stable" and short-term debt to "P-2/stable."

The company's life insurer financial strength ratings overall have received mixed ratings from three rating agencies with mixed changes by two agencies, reflecting views of the financial strength of these companies. The ratings have helped keep down both the surrender rate of domestic

²⁶See appendix III for a detailed listing of AIG's historical and current credit ratings and an explanation of the meaning of the various credit ratings.

retirement services and any pressure on the company to exit businesses that serve high net-worth clients or businesses governed by trust contracts. Since December 2010, A.M. Best has withdrawn its life insurer rating on one AIG legal entity as it was merged into an existing life company. In the first quarter of 2011, S&P raised its ratings on the financial strength of AIG's life insurers to "A+/stable." Conversely, Moody's lowered its ratings of these insurers to "A2/stable." The lower ratings by Moody's reflect its view that while AIG's core insurance operations stabilized in 2010, AIG has not yet improved enough to justify higher ratings in the absence of continued government support. And in April 2011, Fitch upgraded AIG's life insurer ratings to "A/stable." AIG's financial strength ratings for property/casualty, which had been generally stable, were downgraded in the first quarter of 2011, but the movement in the rating has not been large, which has helped limit any significant losses in net premiums written and operating losses. In early July 2010, Fitch revised the rating outlook to "stable" from "evolving," removed the property/casualty companies from "rating watch negative," and reassigned them as "stable outlook." In January 2011, Fitch lowered its ratings on these companies to A/stable and Moody's lowered its ratings to "A1/stable," again reflecting its view that AIG's core insurance operations stabilized in 2010, but they have concerns about how AIG would perform without continued government support. Similarly, in February 2011, S&P lowered its ratings on AIG's property/casualty insurers to "A/stable" because the Chartis companies' operating performance was lower than S&P's expectations." While federal assistance helped stabilize AIG's ratings, rating agencies' views of AIG's insurance companies' performance and the recapitalization have led to some volatility in these ratings and the level of federal assistance eventually may raise questions about AIG's future prospects to the degree the company has limited success in raising capital from private sources.

Shareholders' Equity Improved in the Three Quarters of 2009 and 2010 and Has Remained Stable in the First 3 Months of 2011

In contrast to the decreases in 2008, AIG's shareholders' equity increased over the first three quarters of 2009 primarily due to unrealized appreciation on investments. But since September 2009, AIG's shareholders' equity has increased at a much slower rate as accumulated deficits have increased. Rising accumulated deficits generally indicate operating losses, while decreasing accumulated deficits generally indicate a return to operating profitability. Shareholders' equity generally is the amount by which a company's total assets exceed total liabilities, and represents the extent to which a company could absorb losses before imminent risk of failure or insolvency. The primary components of a company's shareholders' equity are capital raised by issuing and selling

common and preferred stock to investors, also known as paid-in capital, unrealized appreciation on investments, and retained earnings that a company accumulates over time from operating profits.²⁷

AIG's shareholders' equity declined from the fourth quarter of 2007 through the first quarter of 2009 and 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 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 seven of eight quarters throughout 2009 and 2010, amounting to \$85 billion in the first quarter of 2011. From the last quarter of 2007 through the last quarter of 2008, retained earnings were the primary source of shareholders' equity. However, retained earnings declined throughout 2008, becoming cumulative deficits by the end of 2008. 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. While AIG's accumulated deficits fluctuated from the second quarter of 2009 through the third quarter of 2010, by the end of 2010 such deficits had been reduced to about \$3.5 billion and by the end of the first quarter of 2011 were \$3.2 billion. Also, since the fourth quarter of 2008, paid-in capital has remained the primary source of shareholders' equity because of the federal assistance (see app. IV).

Net Cash Flows from AIG's Operating, Investing, and Financing Activities Stabilized in 2010 because of Federal Assistance but Adjusted in 2011 due to the Recapitalization

AIG's cash flows stabilized throughout 2010 and are much improved over 2008, but are not at the precrisis levels the company achieved during the first three quarters of 2007. During that period in 2007, AIG generated cash from its operating activities indicating that it was profitable and generated cash through its financing activities, which further showed that it had access to the capital markets. The indicator of cash flows and net changes in cash tracks cash flows from and overall net changes in cash. It uses data from AIG's quarterly Consolidated Statements of Cash Flows.

²⁷Other 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.

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- 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.

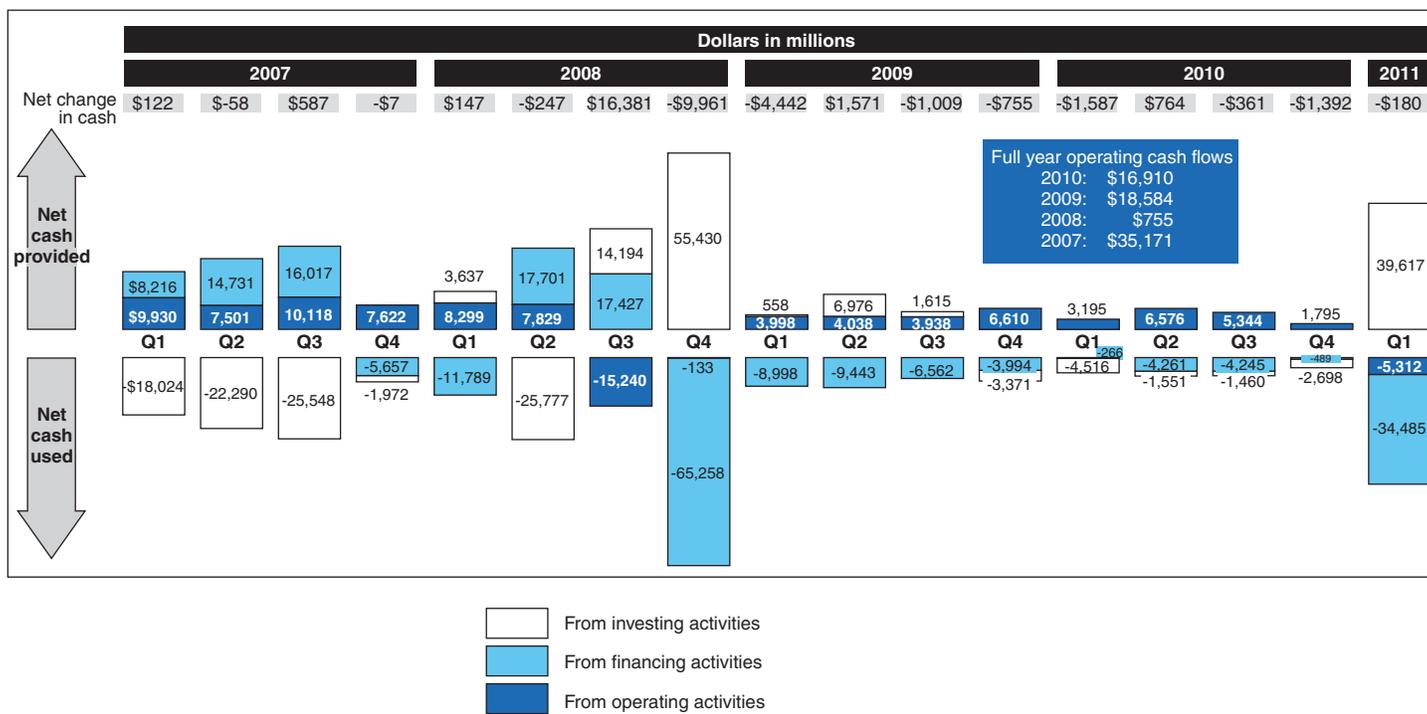
Generally, a healthy and growing company can generate cash internally from operations, generate cash externally from financing activities, and use this cash for growth in its operations or investments in financial assets.

As shown in figure 1, throughout 2009 and 2010 AIG's cash flows began to stabilize, but in the first quarter of 2011, the company reported large cash in flows and cash out flows that were mainly due to its recapitalization. AIG's full-year operating cash flows (see inset box in figure 1) decreased from \$35.2 billion in 2007 to \$755 million in 2008, primarily because of negative cash flows of \$15.2 billion in the third quarter of 2008. However, in 2009 and 2010, these cash flows were \$18.6 billion and \$16.9 billion, respectively. In 2009 this was because of quarterly cash flows of around \$4 billion in each of the first three quarters of 2009 and \$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. The negative amounts increased over the first three quarters of 2010, but they were much smaller than the negative amounts recorded in the first three quarters of 2009 and decreased significantly in the fourth quarter of 2010.

Throughout 2009 and 2010, the company had net cash inflows from operating activities and had 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-producing 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. In the first quarter of 2011, AIG's net cash flows diminished primarily due to payments the company made to FRBNY. The company's net cash flows decreased to \$5.3 billion

for its operating activities, mostly because of a \$6.4 billion payment to the FRBNY revolving credit facility and \$2 billion in unrealized losses on earnings. However, the company's operating activities benefited from \$1.2 billion in net cash flows provided by discontinued operations. AIG's net cash flows also decreased for its financing activities, by nearly \$34.5 billion, largely because of \$26.4 billion in repayment of the FRBNY SPV preferred interests, \$14.6 billion in FRBNY credit facility payments, and \$9.1 billion in repayment of Treasury SPV preferred interests, offset in part by \$20.3 billion in proceeds drawn on a Treasury's Series F equity facility. In addition, instead of investing in operations or acquiring businesses, the company had \$39.6 billion in net cash in flows from investment activities due largely to \$30.5 billion that included activities related to AIG's recapitalization and \$4.2 billion from sales of short-term investments.

Figure 1: Net Cash Flows and Changes in Cash from Operating, Investing, and Financing Activities, from First Quarter 2007 through First Quarter 2011



Source: GAO analysis of AIG SEC filings.

Note: Operating cash flows of \$755 million for 2008 and \$35.171 billion for 2007 include both continuing and discontinued operations as of year end 2010. Operating cash flows from continuing operations was net cash used of \$122 million for 2008 and net cash provided of \$32.792 billion for 2007.

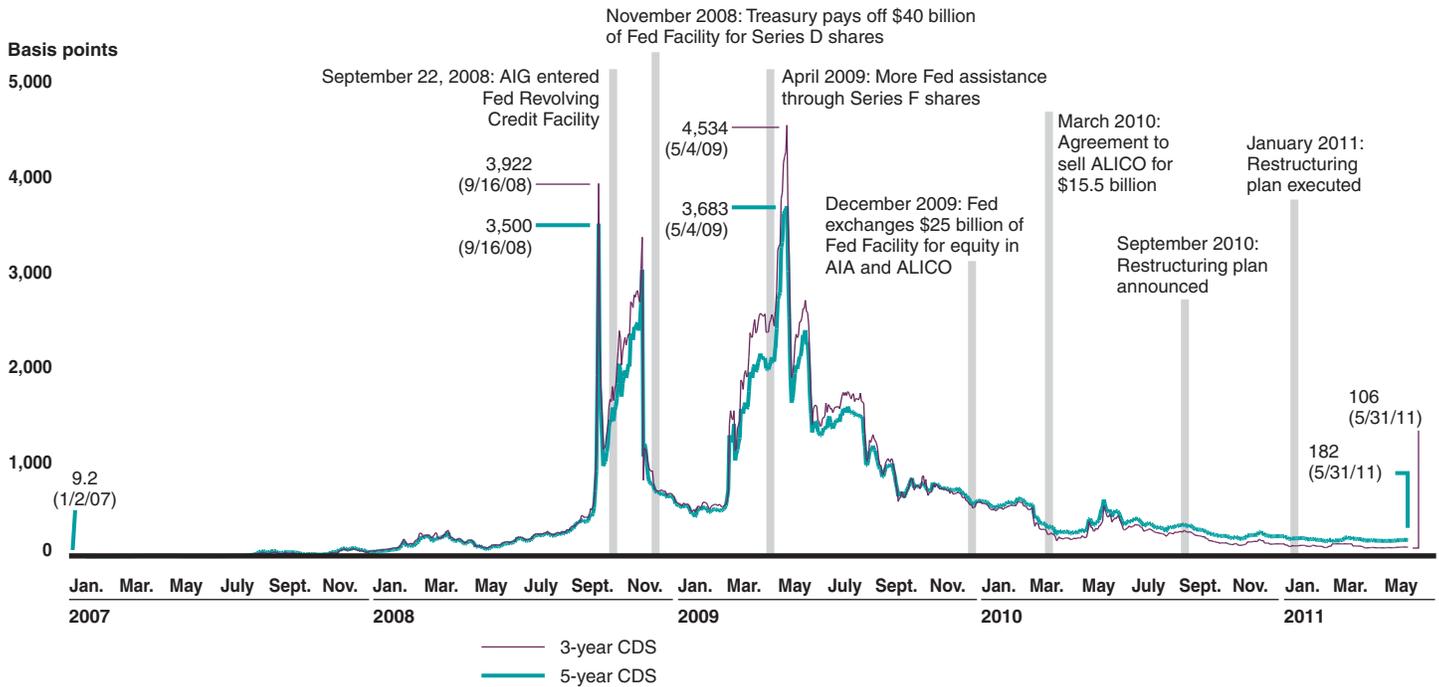
AIG CDS Premiums Appear to Be Continuing to Trend Downward Toward Precrisis Levels

Dropping from their 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.²⁸ 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 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 May 31, 2011, were similar to their March 2008 level for the 3-year and 5-year CDS premiums (see fig. 2). 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 March 2010 through May 2011, AIG's CDS premiums have moderated slightly. While the overall trend is positive, whether this decline in the cost to protect against an AIG default reflects confidence in the stand-alone 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.

²⁸ 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.

Figure 2: AIG CDS Premiums on AIG, January 2007 through May 31, 2011



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.

Deposits Continued to Exceed Withdrawals in AIG’s Life Insurance and Retirement Services Companies

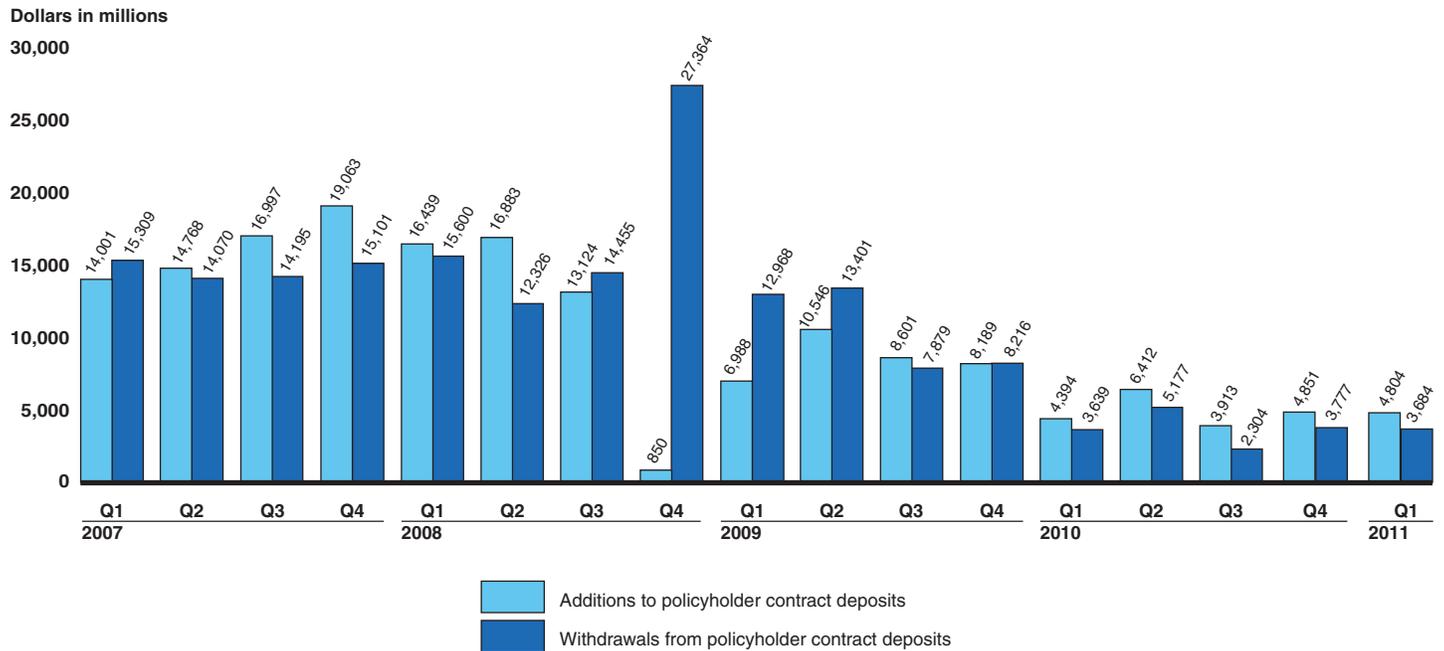
Deposits at AIG’s life and retirement service companies have been improving compared with withdrawals. Specifically, deposits exceeded withdrawals in each quarter of 2010 and in the first quarter of 2011. We use one indicator to monitor AIG’s life insurance and retirement services companies. It tracks the additions to AIG life and retirement policyholder contract deposits and is intended to monitor for potential redemption “runs” by AIG annuitants and policyholders.²⁹ 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

²⁹In this case, a run would be a considerable rise in the volume of customers seeking to close or redeem their annuity or insurance contracts for cash to levels that could strain an insurer’s liquidity.

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 an insurance company's liquidity.

As shown in figure 3, additions to policyholders' contract deposits have exceeded withdrawals for AIG's life and retirement services since the first quarter of 2010. Beginning in the fourth quarter of 2008, these services saw a sharp decline in additions to deposits and a large spike in withdrawals, resulting in a gap of more than \$26 billion. Without more granular data, determining 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. 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 were lower because businesses slated for sale were shifted from continuing operations, contract deposits continued to exceed withdrawals. In each of the last three quarters of 2010 and the first quarter of 2011, deposits exceeded withdrawals by more than \$1 billion.

Figure 3: AIG Life and Retirement Services Additions and Withdrawals from Policyholder Contract Deposits (Including Annuities, Guaranteed Investment Contracts, and Life Products), First Quarter 2007 through First Quarter 2011



Source: GAO analysis of AIG SEC filings.

Note: Contract deposit additions and withdrawals were calculated from data on continuing operations as reflected in the AIG's Consolidated Statement of Cash Flows. Data for similar calculations on discontinued operations were not available.

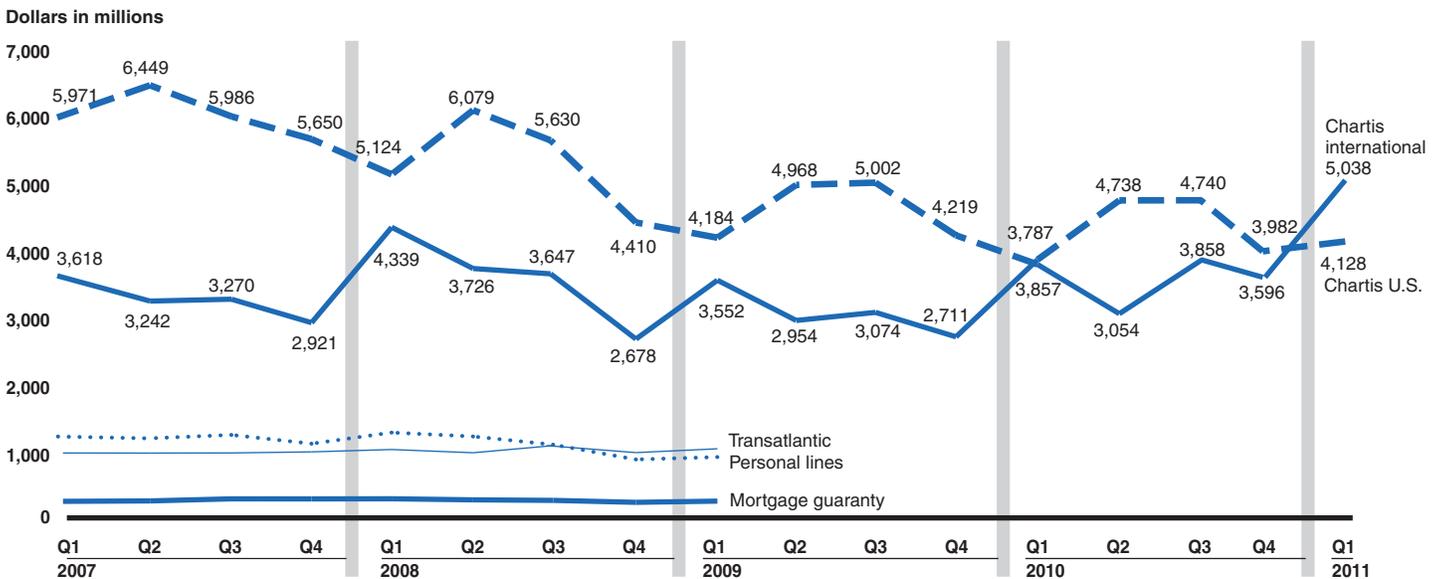
Chartis' Premiums Written Appear to Have Remained Stable

Dollar volumes of premiums written for Chartis, which includes Chartis U.S. (AIG's property/casualty insurance businesses in the United States and Canada) and Chartis International (AIG's property/casualty insurance businesses in other parts of the world), trended downward in 2007 to 2008, but started to stabilize in 2009 and 2010 and improve in the first quarter of 2011. 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 Chartis, we developed an indicator that tracks the trends in quarterly premiums written by Chartis since the beginning of 2007. "Premiums written" is the dollar volume of business in a particular period. This indicator is important because Chartis is 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. However, the indicator on volume of premiums written is limited

because it 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 industrywide cycle characterized by hardening and softening markets.

As illustrated in figure 4, quarterly dollar volumes of premiums written by Chartis U.S. have followed an annual recurring pattern with highest volumes generally occurring in the second and third quarters, and overall, the trends appear to have stabilized. For Chartis U.S., 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 each quarter of 2010 were below levels in the same quarters of 2009, but the rates at which they were declining moderated and premium volumes for the first quarter of 2011 increased slightly, indicating that the trends may have stabilized. As for Chartis International, the 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. 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 two quarters were higher than the same two quarters of 2009. Gains were stronger in the last two quarters of 2010, and even stronger in the first quarter of 2011. However, according to AIG, Chartis U.S. and Chartis International recorded catastrophic losses of \$139 million in the fourth quarter of 2010 and expect additional significant claims in 2011 due to flooding in Australia in 2010 and 2011. Also according to AIG, the earthquake and tsunami that hit Japan in March 2011 materially affected AIG's consolidated financial position and results of operations, with the company recording catastrophe losses of \$864 million in Chartis International.

Figure 4: Chartis Insurance Premiums Written by Division, First Quarter 2007 through First Quarter 2011



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 sold. The personal lines companies were sold to a third party on July 1, 2009. Commercial insurance retained the private client business historically written by the personal lines segment.

The Underwriting of AIG's Property/Casualty Companies Has Not Been Profitable, but Net Income Was Positive because of Investment Income

In nearly every quarter since the first quarter of 2008, underwriting in AIG's property/casualty companies has not been profitable, but net income generally has been positive because investment income more than offset underwriting losses. 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. 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. 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. 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 (combining the loss ratio and the expense

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.

Our indicator tracks AIG's underwriting ratios quarterly compared with the average underwriting ratios of its 15 property/casualty insurance peers or competitors and AIG's investment income and net income as percentages of premiums earned. To identify the 15 property/casualty insurance peers of AIG, 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 2009.³⁰ 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 5 compares AIG ratios to those of its peers. AIG's combined ratios were usually higher than the average of its peers. Also, since the first quarter of 2008, the combined ratio for these AIG companies exceeded 100 in all but one quarter (with the highest ratio in the fourth quarter of 2010) indicating AIG's underwriting usually was not profitable. In contrast, the ratios for its peers averaged less than 100 in all but four quarters, indicating that their underwriting usually was profitable. The top panel of the figure also shows that while AIG's expense ratios have been lower than the average of its peers in every quarter, its loss

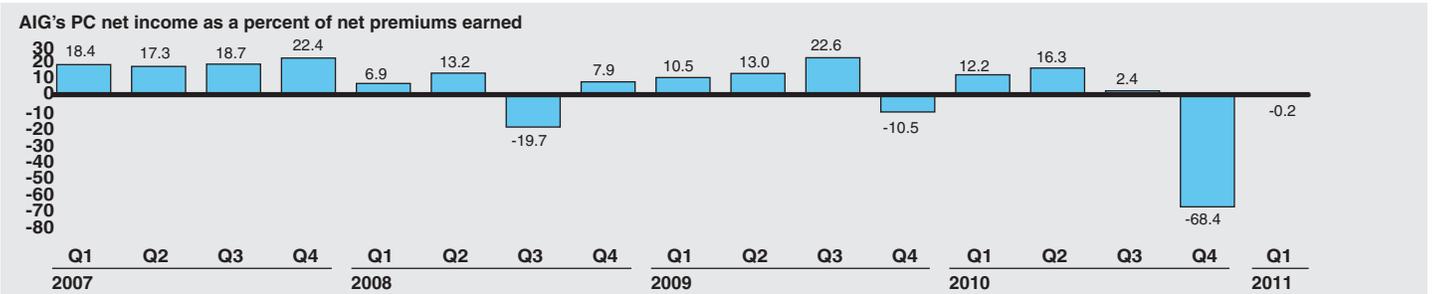
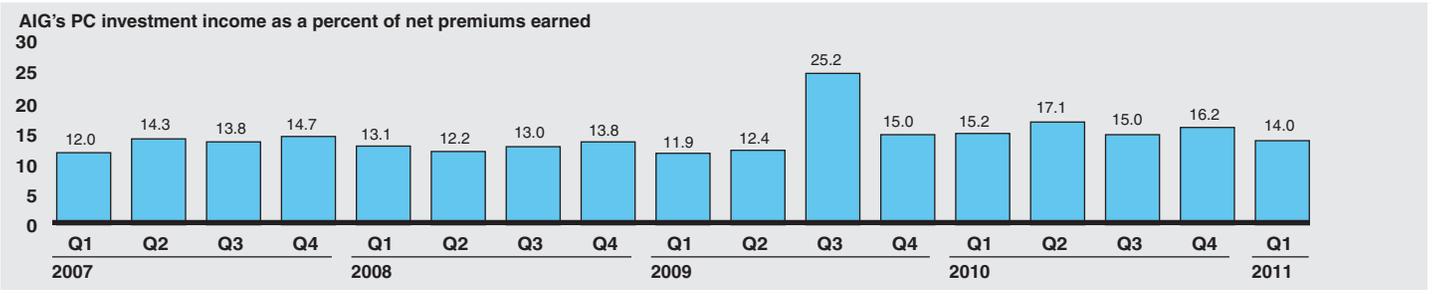
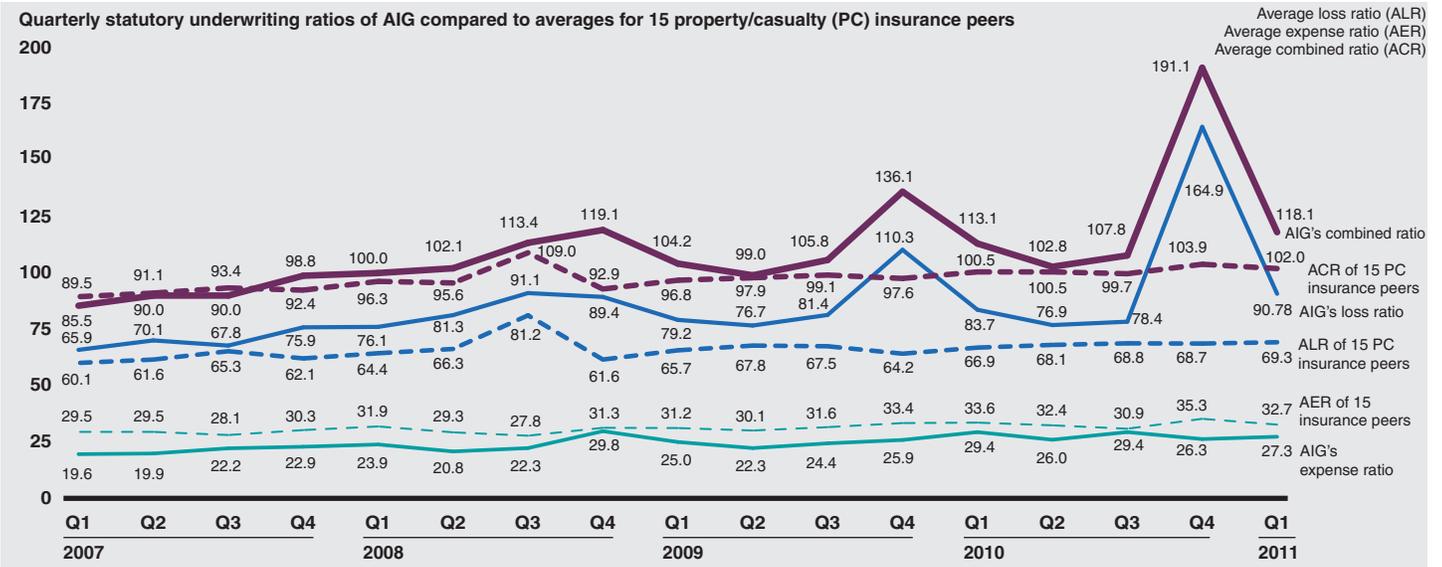
³⁰We reviewed 30 property/casualty companies and identified 15 as AIG's property/casualty insurance peers based on the similarities in the distributions of their premiums written in 2009 by lines of business. As did AIG, these companies wrote premiums in several property/casualty lines of insurance. 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.

ratios have been higher than the average of its peers in every quarter.³¹ The lower panels of the figure show that despite a combined ratio usually over 100 and the higher-than-peer average underwriting costs, AIG's property/casualty companies had positive net income in 13 of the 16 quarters because investment income more than offset the underwriting losses.³²

³¹Historical 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.

³²Investment returns are not considered part of underwriting and thus are not included in the ratios.

Figure 5: Quarterly Statutory Underwriting Ratios of AIG (Chartis 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 First Quarter of 2011



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 were concentrated either in 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.

While our data cover only 4 full calendar years, they suggest a pattern of loss and expense ratios rising in the latter part of three of those years. However, investment returns were high enough for the peers combined to be profitable in 13 of 17 quarters. The capital losses in the fourth quarter of 2010 (68.4 percent) largely reflect a \$3.7 billion fourth quarter loss in AIG's property/casualty net income. Moreover, in the fourth quarter of 2010, AIG's combined ratio increased sharply to 191.1, while the average ratio of its peers rose modestly to 103.9. The sharp increase for AIG resulted primarily from domestic property/casualty insurance in which claims and claims adjustment expenses rose 105 percent and underwriting expenses rose 31 percent, while premiums earned declined 4 percent. Second, the 4 percent rise in premiums earned by foreign property/casualty insurance was more than offset by increases of 30 percent in claims and claims adjustment expenses and 19 percent in underwriting expenses. Claims and claims adjustment expenses increased mostly from actual losses exceeding estimated losses (adverse loss development) that was recognized and recorded in 2010 for asbestos and excess casualty and workers' compensation coverage in years prior to 2010. Increased underwriting expenses reflect increased costs in areas such as brokers' commissions, employee incentive programs, marketing, financial systems, impairments of intangible assets, divestitures, and workforce reductions. However, in the first quarter of 2011, the loss ratio and combined ratio declined considerably from the fourth quarter of 2010 due to declines in claims and claims adjustment expenses.³³

³³ An impairment to an intangible asset is a decline in its fair value or expected future cash flows that is recognized by reducing the asset's value that is carried on the books.

The Federal Government's Exposure to AIG Has Been Reduced and Return on Investment Will Depend on AIG's Long-Term Health, Market Conditions, and Timing of Exit

As of March 31, 2011, total authorized federal assistance to AIG had been reduced to \$122.3 billion, and federal exposure decreased to \$86.1 billion. Factors contributing to the reductions include ongoing repayment of the debt related to Maiden Lanes II and III and the recapitalization of AIG, including the repayment of the FRBNY revolving credit facility, the sale of ALICO to MetLife and repayment of Treasury's preferred liquidation preference in ALICO and partial repayment of Treasury's liquidation preference in AIA, and Treasury's exchange of its various preferred shares in AIG for 1.655 billion shares of AIG common stock. After recapitalization, all remaining direct assistance to AIG was in the form of equity. In relation to exposure, since AIG has repaid the FRBNY revolving credit facility, it no longer has outstanding debt directly owed to the government. Consequently, we changed some of our indicators, with new indicators focusing on the market value of AIG common stock, trading volume in AIG stock, and shareholders in insurance companies. The government has considerable common equity exposure to AIG as a result of the recapitalization (92 percent of AIG's common stock, which in May 2011, was reduced to approximately 77 percent after Treasury sold 200 million shares of its common stock in AIG).³⁴ This stock is now a government asset that is to be sold to repay the \$49.148 billion in equity assistance to AIG. The extent of recovery of this assistance to AIG is tied to Treasury's prospects for selling the stock. Moreover, the extent to which the government can recoup the assistance to AIG depends on AIG's long-term health and the timing of Treasury's offerings to sell its stock and is subject to uncertainty associated with future economic and financial market conditions.

AIG's Recapitalization Has Changed the Composition of Government's Direct Assistance to AIG and Sources for Repayment

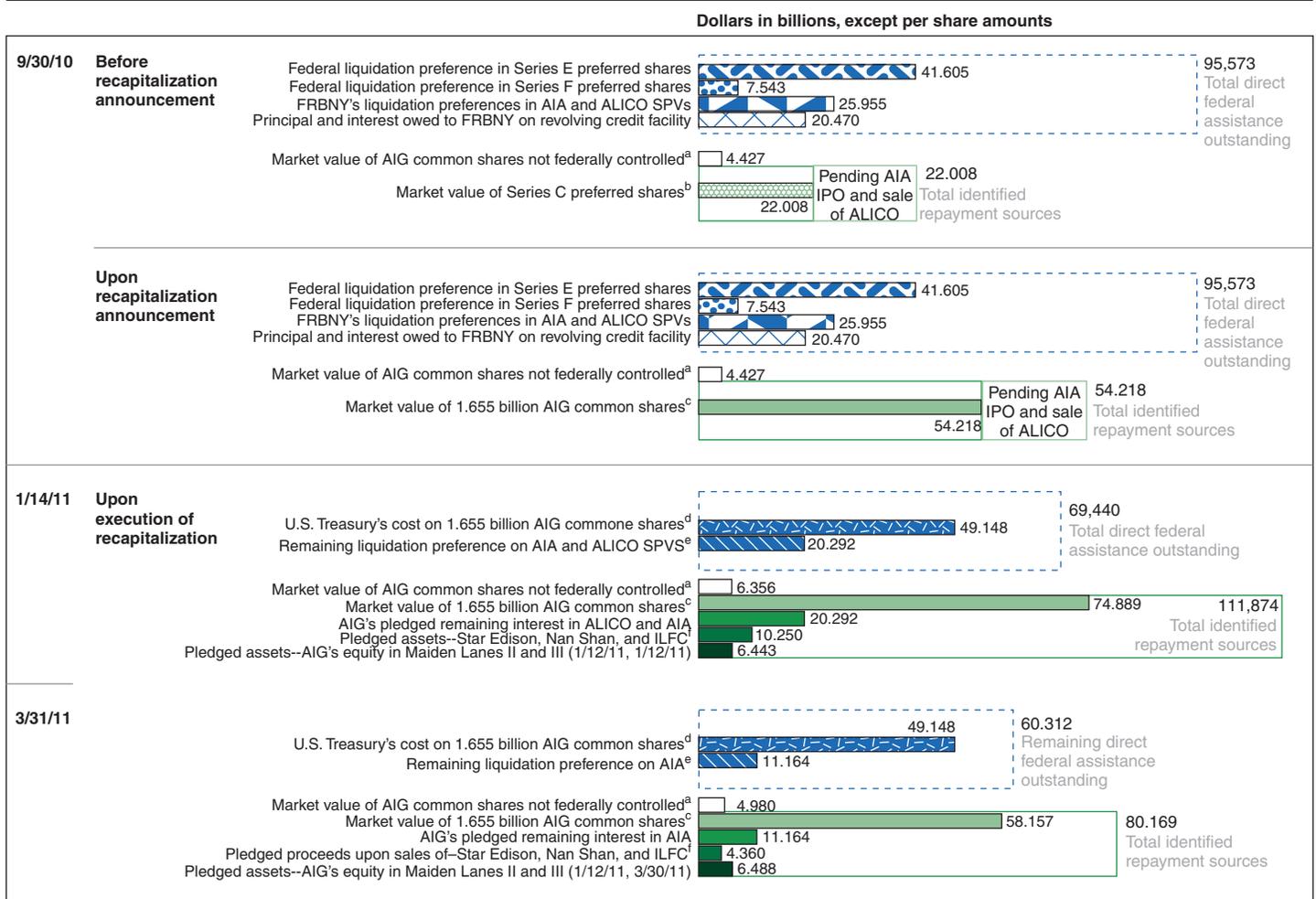
The recent recapitalization of AIG reduced the level and changed the composition of direct federal assistance. It also increased the resources available for the federal government to recoup its assistance to AIG. To capture these changes, we updated our indicators. We discontinued our indicator that compared the debt and equity federal assistance provided to AIG with AIG's book value and replaced it with a new indicator on the composition of debt and equity federal assistance to AIG before and upon

³⁴On May 24, 2011, AIG sold 100 million shares of common stock, which were issued on May 27, 2011, increasing the total number of common shares to approximately 1.9 billion. On May 24, 2011, Treasury sold 200 million shares of its common stock in AIG, reducing its holdings to approximately 1.5 billion shares, or approximately 77 percent of the equity interest in AIG as of May 27, 2011.

announcement and execution of AIG's recapitalization. The indicator shows the changing composition and level of the federal assistance and the composition and value of identified resources for repaying that assistance at several points in time. Tracking both is critical to understanding the nature of the government's ongoing assistance to AIG and the prospects for full recovery of that assistance.

Figure 6 shows that prior to and upon the announcement of AIG's recapitalization plan on September 30, 2010, AIG's direct federal assistance amounted to about \$95.6 billion, including approximately \$20.5 billion from FRBNY's revolving credit facility, \$26 billion liquidation preference in AIA and ALICO, and \$41.6 billion and \$7.5 billion liquidation preference in Series E and Series F preferred shares, respectively. Prior to the announcement, resources available to repay the federal government consisted of all of AIG's assets, generally, plus other specified repayment resources with an estimable market value—namely Treasury's convertible preferred Series C shares in AIG, as shown in the figure. These preferred shares had an estimated market value of \$22 billion that was derived from applying the September 30, 2010, share price of publicly traded AIG common shares to the 562.9 million AIG common shares that could be exchanged for the Series C preferred shares. Upon the recapitalization announcement, other specified repayment resources increased by more than \$33 billion in market value because of provisions in the plan to exchange Series C, E, and F preferred shares for 1.655 billion shares of AIG common stock. In addition, as indicated by the dashed lines in figure 6, proceeds of undetermined amounts were expected to be generated from the AIA IPO and sale of ALICO to MetLife, as both transactions were pending as of September 30, 2010.

Figure 6: Composition of Direct Debt and Equity Federal Assistance to AIG before and upon Announcement and Execution of Recapitalization Agreement



Source: Treasury, AIG, and AIG press releases and SEC filings.

^aNot part of repayment sources.

^bConvertible into 79.77 percent of AIG common shares.

^c\$32.76 as of September 30, 2010, \$45.25 as of January 14, 2011, \$37.35 as of March 11, 2011.

^d\$40 billion plus \$7.543 billion for Series E and F preferred plus \$1.605 billion of unpaid dividends.

^eObtained for Treasury by AIG drawdown on Series F.

^fEstimated or expected pledged disposition proceeds consists of \$2.2 billion from the February 1, 2011, sale of Star and Edison, and \$2.16 billion from the January 12, 2011, sale of Nan Shan Life Insurance Company. Amounts for International Lease Finance Corporation (ILFC) are not available.

As further illustrated in figure 6, upon the execution of the recapitalization in January 2011, the amount of direct federal assistance was reduced to just over \$69.4 billion, which included \$49.148 billion for the cost of Treasury's 1.655 billion in AIG common shares and about \$20.3 billion in Treasury's remaining liquidation preference in the AIA and ALICO SPVs. Thus all remaining direct assistance was in the form of equity. Identified sources for repayment increased to more than \$111 billion from the increased value of AIG's common stock and the inclusion of AIG's pledged remaining interest in AIA, pledged estimated proceeds from several AIG expected dispositions, and AIG's equity in Maiden Lanes II and III.

By the end of the first quarter 2011, direct federal assistance to AIG was further reduced by about \$9 billion. In February 2011, AIG used \$2.2 billion of proceeds from the sale of two life insurance companies to reduce the ALICO and AIA liquidation preferences. On March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury's remaining \$1.4 billion of preferred interests in the ALICO SPV and reduce by \$5.5 billion Treasury's remaining preferred interests in the AIA SPV. On March 15, 2011, Treasury received another payment of \$55.8 million, reducing the remaining preferred interest on the AIA SPV to \$11.164 billion. However, the value of the available sources for repayment also decreased with the decline in the value of AIG's common stock. With AIG's recapitalization, Treasury is the only federal entity with remaining direct assistance to AIG and the amount of that assistance has been reduced. Several sources have been designated for recovering that assistance, with the bulk of the repayment expected to come from proceeds to Treasury on future sales of its AIG stock.

Total Government Exposure Has Decreased through the First Quarter of 2011

The government's exposure to AIG, which was \$120.7 billion in September 2009 and increased to \$129.1 billion in December 2009, decreased to \$86.1 billion as of March 31, 2011.³⁵ As discussed, the federal government has provided various forms of direct and indirect assistance to AIG, but with the recapitalization of AIG, the amount and scope of that assistance has been reduced. Since AIG has repaid the FRBNY revolving credit facility, it no longer has outstanding debt directly

³⁵We reported the amounts for 2009 and 2010 in [GAO-09-975](#), [GAO-10-475](#), and [GAO-11-46](#). The amounts for January 2011 are reported in app. II.

owed to the government. The only debt owed to the government that relates to AIG are the loans to be repaid by Maiden Lane II and Maiden Lane III—the SPVs established by FRBNY—to provide indirect assistance to AIG by purchasing RMBS assets from AIG’s life insurance companies and CDOs from AIGFP’s CDS counterparties, respectively. As of March 31, 2011, the government’s exposure to the Maiden Lanes had been reduced to \$25.8 billion. Also, the government’s remaining equity interests had been reduced to its preferred interests in the AIA SPV of approximately \$11.2 billion and its ownership of over 92 percent of AIG through Treasury’s 1.655 billion shares of AIG common stock. As of March 31, 2011, the government’s exposure was about \$49.1 billion, but on May 24, 2011, Treasury sold 200 million shares of AIG stock, reducing its holdings to approximately 1.5 billion shares, or approximately 77 percent of the equity interest in AIG.³⁶ Table 2 illustrates our indicator on the composition of the assistance and the government’s remaining exposure as of March 31, 2011.

³⁶Treasury sold a total of 200 million AIG common shares at \$29 per share, consisting of approximately 132 million TARP shares and 68 million non-TARP shares (shares received from the trust created by the FRBNY). Receipts for non-TARP common stock totaled \$1.97 billion and are not included in TARP collections.

Table 2: Composition of Government Efforts to Assist AIG and the Government’s Approximate Remaining Exposures, as of March 31, 2011

Dollars in billions

	Direct AIG assistance			Indirect AIG assistance		Accrued interest dividends and fees	Total government exposure
	Amount authorized	AIG debt owed to government	Government equity	Other debt owed to government	Government equity		
Federal Reserve							
Maiden Lane II	\$22.5	n/a	n/a	\$12.353 ^a	n/a	\$0.492	\$12.845 ^a
Maiden Lane III	30	n/a	n/a	12.346 ^a	n/a	0.586	12.932 ^a
Treasury							
Series G	2						
AIA	20.3 ^b	n/a	\$11.164 ^b	n/a	n/a	n/a	11.164 ^b
1.655 billion shares of AIG common stock	47.543 ^c	n/a	47.543 ^c	n/a	n/a	1.605	49.148 ^c
Total							
Total direct assistance		\$0	\$58.707			\$1.605	\$60.312
Total indirect assistance				\$24.699		\$1.078	\$25.777
Total direct and indirect assistance to benefit AIG	\$122.343	\$0	\$58.707	\$24.699		\$2.683	\$86.089

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

^aFRBNY 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. Government assistance shown for the Maiden Lane facilities is as of March 30, 2011. As of May 25, 2011, principal owed was \$10.524 billion and \$11.985 billion and accrued interest was \$514 million and \$610 million for Maiden Lane II and Maiden Lane III, respectively.

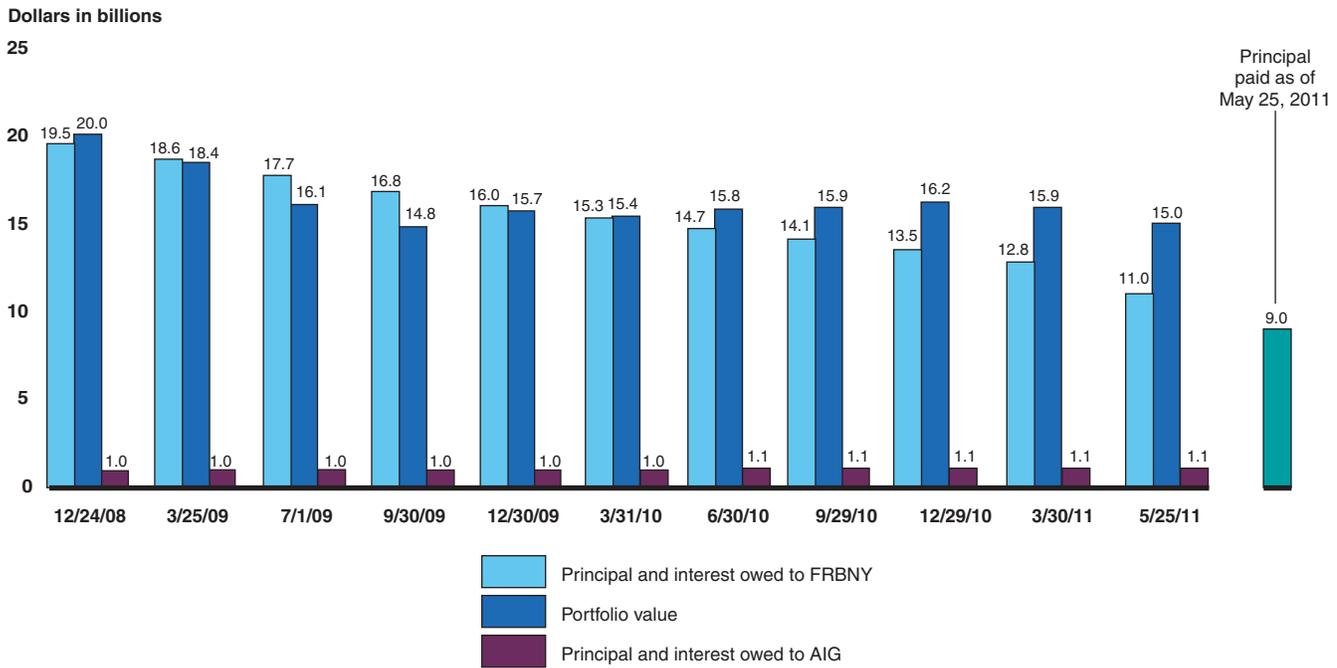
^bAIG created two SPVs to hold the shares of certain of its foreign life insurance businesses (AIA and ALICO). In November 2010, the company announced that it sold ALICO to MetLife for approximately \$16.2 billion (including approximately \$7.2 billion in cash and the remainder in MetLife securities) 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. In February 2011, AIG used \$2.2 billion of proceeds from the sale of two life insurance companies to reduce the ALICO and AIA liquidation preferences. On March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury’s remaining \$1.4 billion of preferred interests in the ALICO SPV and reduce by \$5.5 billion Treasury’s remaining preferred interests in the AIA SPV. On March 15, 2011, Treasury received another payment of \$55.8 million, reducing the remaining preferred interest on the AIA SPV to \$11.164 billion.

^cOn May 24, 2011, Treasury sold 200 million shares of its common stock in AIG, reducing its holdings to approximately 1.5 billion shares, or approximately 77 percent of the equity interest in AIG, and on May 27, 2011, AIG announced that it issued 100 million shares of common stock, increasing the total number of outstanding common shares to approximately 1.9 billion.

We also are monitoring the status of the government's indirect assistance to AIG through the Maiden Lane II and Maiden Lane III facilities. As discussed earlier, 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. By monitoring the principal and interest owed on these facilities, we can track FRBNY's ongoing exposure related to financial assistance it provided to AIG. The Maiden Lane II and Maiden Lane III portfolios were funded primarily by loans from FRBNY, which are not debt on AIG's books. At the time of implementation, the Federal Reserve had said that it planned to keep the Maiden Lane assets until they matured or increased in value to maximize the amount of money recovered through their sale, but that it had the authority to change its portfolio strategy at any time. 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, according to specific percentages for each LLC. In addition to the FRBNY investments in the facilities, AIG invested \$1 billion in Maiden Lane II and \$5 billion in Maiden Lane III.

As shown in figure 7, 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 May 25, 2011, the portfolio value was \$15 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 \$11 billion on May 25, 2011, which is about \$4 billion less than the facility's portfolio value as of that same date. Overall, \$9 billion of the principal on the FRBNY loan has been repaid.

Figure 7: Amounts Owed and Portfolio Value of Maiden Lane II, December 24, 2008–May 25, 2011



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

Note: When Maiden Lane II was established in 2008 the par value of total securities purchased was \$39.3 billion. Since January 2010, FRBNY has published the current principal balance for each security held by Maiden Lane II as of the end of the quarter.

Following an offer by AIG to repurchase the assets it had sold to Maiden Lane II, FRBNY announced on March 30, 2011, that it had declined AIG's offer. FRBNY and the Board of Governors of the Federal Reserve System said this was done to serve the public interest of maximizing returns from any sale and promoting financial stability. In light of improved conditions in the RMBS market and a high level of interest, FRBNY stated that it would begin more extensive asset sales through a competitive sales process. In early April 2011, FRBNY began offering segments of the Maiden Lane II RMBS portfolio for sale to a group of dealers on more or less a weekly basis through the middle of May 2011, a strategy that it hopes will avoid market disruption. FRBNY's investment manager, BlackRock Solutions, is disposing of the Maiden Lane II securities through a competitive sales process. To maximize returns to the public, FRBNY has not stipulated a time frame for disposing of these assets, but as shown in Table 3, through May 19, 2011, Maiden Lane II has held several auctions, selling more than \$8 billion from its portfolio.

Table 3: Dates and Values of Maiden Lane II Asset Auctions, April 6, 2011–May 19, 2011

Date of auction	Face value of assets sold^a	Cumulative assets sold (face value)	Number of CUSIPs sold^b
April 6, 2011	\$1,326,856,873	\$1,326,856,873	42
April 13, 2011	626,080,072	1,952,936,945	37
April 14, 2011	534,127,946	2,487,064,891	8
April 28, 2011	1,122,794,209	3,609,859,100	8
May 4, 2011	1,773,371,055	5,383,230,155	38
May 10, 2011	427,486,898	5,810,717,053	74
May 12, 2011	1,373,506,029	7,184,223,082	34
May 19, 2011	878,641,682	8,062,864,764	29
Total	\$8,062,864,764		270

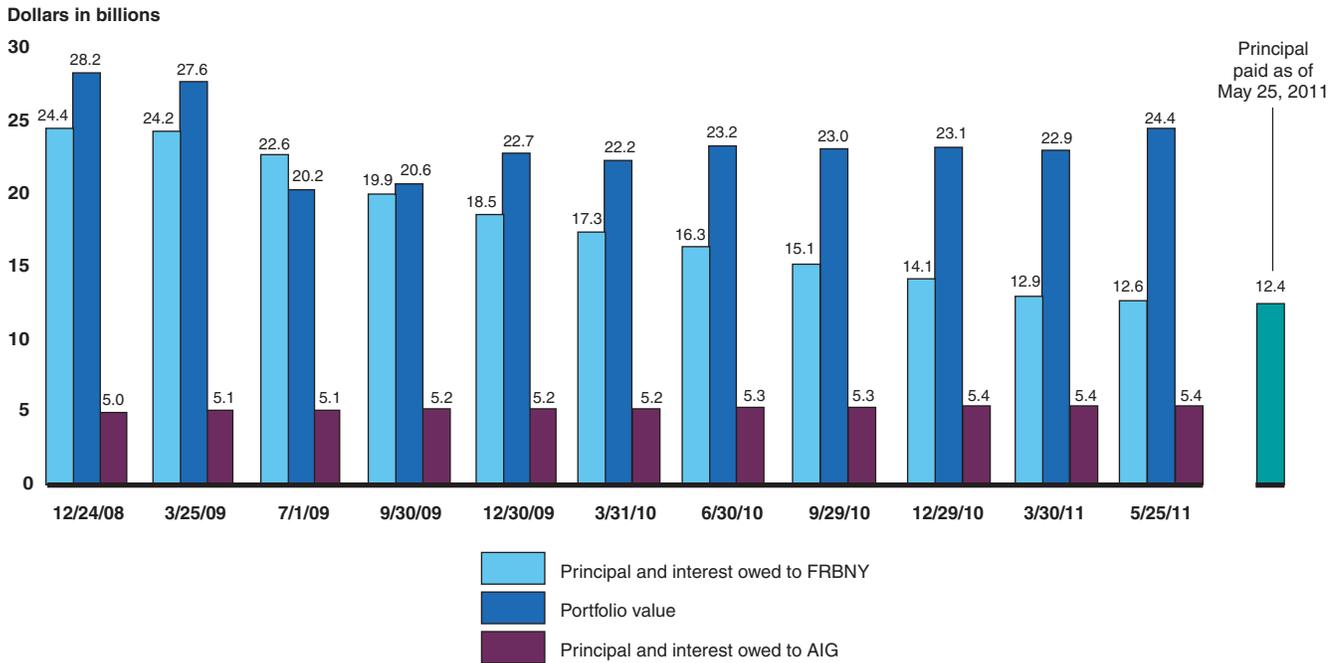
Source: FRBNY.

^aValue is the face amount of the most recent balance of principal outstanding.

^bCUSIP stands for the Committee on Uniform Securities and Identification. A CUSIP number consists of nine characters that uniquely identify a company or issuer and the type of security.

As shown in figure 8, 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 \$24.4 billion as of May 25, 2011. By contrast, the level of debt has continued to be reduced since December 2008, and as of May 25, 2011, stood at \$12.6 billion. 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 \$11.8 billion. Maiden Lane III's assets are continuing to amortize and the long-term plan is for this SPV to sell the portfolio's assets to repay the debt. Federal Reserve officials said that they constantly evaluate opportunities to sell assets—while still meeting their objective of maximizing long-term cash flows—and have been able to sell a handful of assets across this portfolio. 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. Federal Reserve officials said that there has been no change in the approach to the disposition of Maiden Lane III assets.

Figure 8: Amounts Owed and Portfolio Value of Maiden Lane III, December 24, 2008–May 25, 2011



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

Note: When Maiden Lane III was established in 2008 the par value of total securities purchased was \$62.1 billion. Since January 2010, FRBNY has published the current principal balance for each security held by Maiden Lane III as of the end of the quarter.

The values of the assets in the Maiden Lane II and III portfolios have continued to increase relative to the outstanding loan balances since the latter part of 2008 and the assets in the portfolios have continued to generate payments of interest and returns of principal at maturity. According to FRBNY officials, 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 could cease

before the underlying portfolio has substantially matured or defaults could occur prior to the full repayment of outstanding principal.³⁷

Treasury Would Have to Sell Its AIG Common Stock for at Least an Average Share Price of \$29.70 to Fully Recover Its Assistance

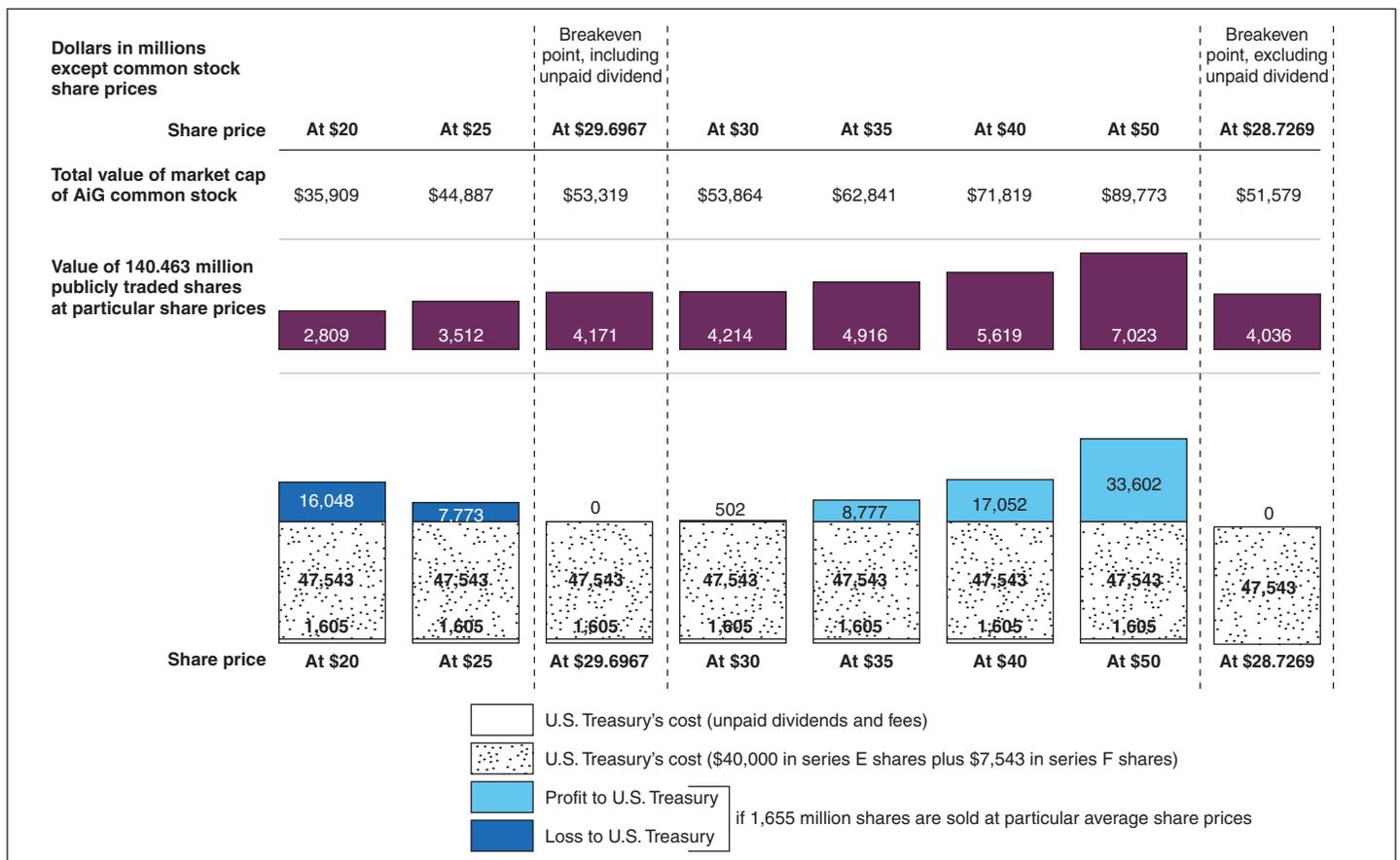
The extent of the \$49.148 billion in equity assistance to AIG that Treasury will recoup depends on the prices at which it sells its 1.655 billion shares. As a shareholder, selling AIG stock with the goal of maximizing taxpayers' returns is a reasonable goal for Treasury. However, we have previously reported that as a government agency providing temporary emergency assistance, it needs to balance this goal with exiting its assistance as soon as practicable. Treasury has retained Greenhill & Co., LLC to advise it on selling and disposing of its AIG common shares. One way to measure potential return to the taxpayer is to track the performance of the company in the stock market.

We developed an indicator to show the market value of AIG's stock at various share prices and the profits or losses that Treasury would realize if it could sell all of its stock at those share prices. A related indicator also compares month-end share prices of AIG common stock with S&P's 500 index since the federal government began providing assistance to AIG in 2008. Treasury's cost basis of \$49.148 billion for those shares was established as part of AIG's recapitalization plan, announced on September 30, 2010, and executed on January 14, 2011, when Treasury received 1.655 billion shares of AIG common stock to be the repayment source for the \$49.148 billion. This cost basis comprises \$47.543 billion of liquidation preferences in Series E and Series F preferred shares plus \$1.605 billion of unpaid dividends and fees. Treasury said that its primary goal is to recoup taxpayers' cash. As such, using the cash in/cash out approach, Treasury included only the cost of the liquidation preferences in the Series E and Series F preferred shares—\$47.543 billion—to calculate a breakeven share price to be \$28.73. Under a different approach that captures the entire amount of \$49.148 billion, the calculation of the breakeven share price would include the \$1.605 billion

³⁷Federal 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. And as discussed above, FRBNY has begun to more extensively sell its Maiden Lane II asset (see table 3), while Federal Reserve officials said that there has been no change in the approach to disposition Maiden Lane III assets.

of unpaid dividends and fees, and the breakeven share price would increase to approximately \$29.70. This represents the minimum average price at which Treasury would need to sell all of its shares to fully recover the \$49.148 billion. As shown in figure 9, the amount of the \$49.148 billion Treasury will recover depends on the prices at which it sells its 1.655 billion shares of AIG common stock. The figure shows several higher and lower share prices at which Treasury could recover more or less than the full amount of assistance. For example, at \$40 a share Treasury would recover an additional \$17.1 billion while at \$25 a share Treasury would recover \$7.8 billion less than the amount of assistance.

Figure 9: Market Value of AIG Common Stock at Various Share Prices—140.463 Million Publicly Held Shares and 1.655 Billion Shares Owned by Treasury upon Execution of Recapitalization

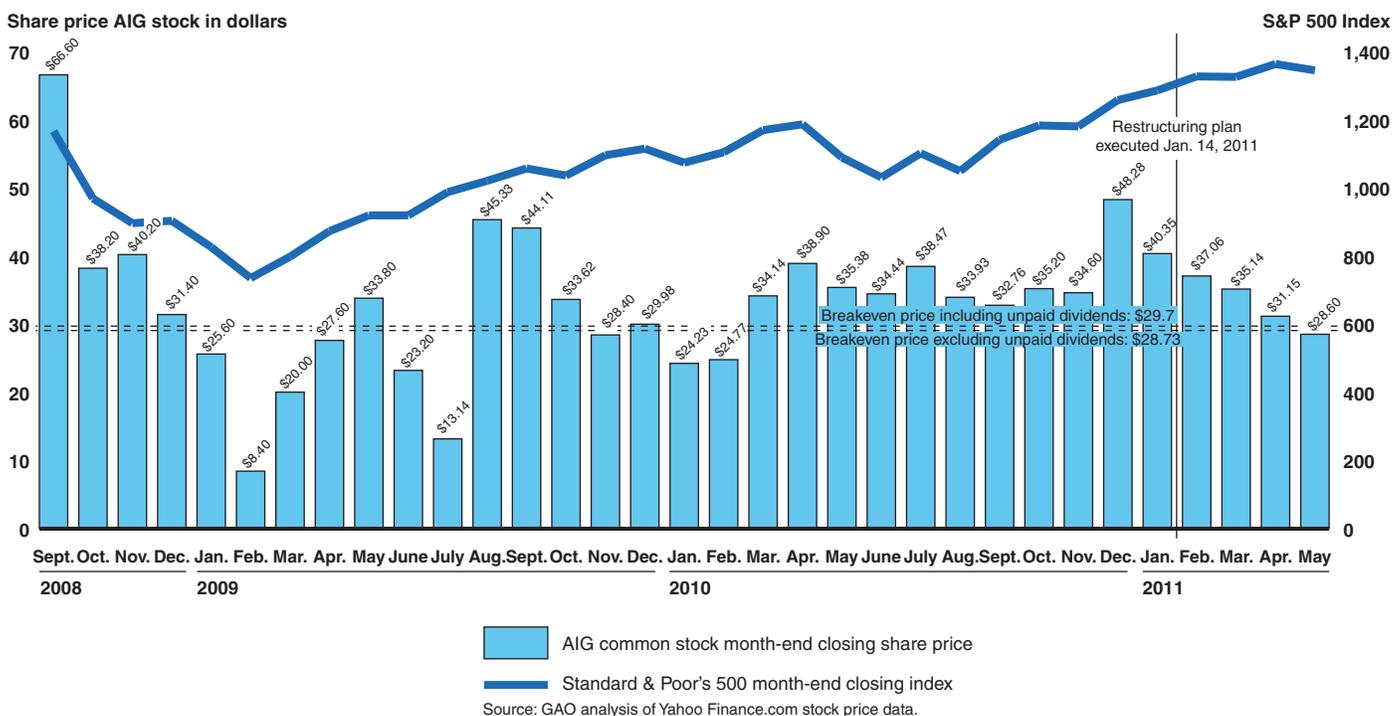


Source: GAO analysis of AIG financial and share price data.

Note: Treasury's cost comprises \$40 billion plus \$7.543 billion on Series E and F preferred shares, respectively, plus \$1.605 billion of unpaid dividends and fees on Series D preferred shares.

Since January 2011 when AIG was recapitalized, the daily closing share price of AIG stock has trended downward but remained above our \$29.70 breakeven price until May 24 when it closed at \$29.46 (see fig. 10). More specifically, the price trended down from \$45.25 per share on January 14, 2011, to \$28.28 per share on May 25, 2011—its lowest price since early March 2010. This 37.5 percent downtrend has reduced the value of Treasury owned shares by \$28.1 billion. In contrast, the S&P 500 index increased over this same period. The downward trend and underperformance of AIG common stock suggests that conditions for Treasury to sell its AIG shares have deteriorated since the recapitalization was executed.

Figure 10: Month-End Closing Share Prices of AIG Common Stock Compared to the S&P 500 Index and Breakeven Share Price for Treasury’s 1.655 Billion Shares, September 2008 through May 2011



Notes: GAO retroactively adjusted AIG’s share price prior to July 2009 for the 1 for 20 reverse stock split that took effect on July 1, 2009. In January 2011, AIG issued 10-year warrants to AIG common shareholders as a 16.331455 percent dividend, as part of the Recapitalization Plan. None of the warrants were issued to the Treasury or the FRBNY. The warrants, that expire January 19, 2021, allow AIG shareholders of record on January 13, 2011 to purchase up to 74,997,778 shares of AIG Common Stock at an exercise price of \$45.00 per share. AIG share prices prior to January 2011 (back to July 2009) are actual closing prices and not adjusted for this dividend.

Treasury Is Likely to Seek Large Institutional Buyers as Important Purchasers of Its 1.655 Billion Shares of Common Stock That It Holds in AIG

The government has considerable common equity exposure to AIG as a result of the recapitalization plan that resulted in Treasury acquiring 92 percent of AIG's common stock. This AIG stock is now a government asset that is to be sold to repay the \$49.148 billion in equity assistance to AIG. The government's full recovery of this portion of assistance to AIG is tied to Treasury's prospects for selling AIG stock. Those prospects depend on the share price discussed earlier, investor interest, and the period over which Treasury sells its stock. Treasury officials told us that, depending on market conditions, their goal is to sell the AIG stock in blocks within 2 years and they will consider offers by institutions, sovereign funds, retail investors, and others. Based on AIG common stock's average daily trading volume of 6.5 million shares over the 12 month period from June 1, 2010, to May 31, 2011, selling shares every day it could take Treasury about 224 trading days to sell its remaining 1.455 billion shares of AIG common stock in the open market if it decided to pursue this approach.³⁸ To accommodate such sales by Treasury, and thus limit downward pressure such sales might have on AIG's stock price, existing and new buyers would need to collectively double the current daily buying volume. Whether such increased buying of AIG stock could occur is unknown. Our analysis suggests that it would not be feasible to expect Treasury to be able to sell its shares in AIG in an orderly manner in the open market, and supports the agency's consideration of selling its blocks of stock to institutional investors.³⁹ This strategy of selling to institutional investors also may help Treasury balance its competing goals of maximizing returns as a shareholder and exiting the investment as government agency.

We developed two indicators that help illustrate the prospects for institutional ownership of AIG. One indicator compares the market capitalization of AIG with nine other large insurance companies and compares the amount of stock the federal government holds in AIG to the amount of stock institutional investors hold in the nine other large insurance companies. Institutional ownership in the nine other large

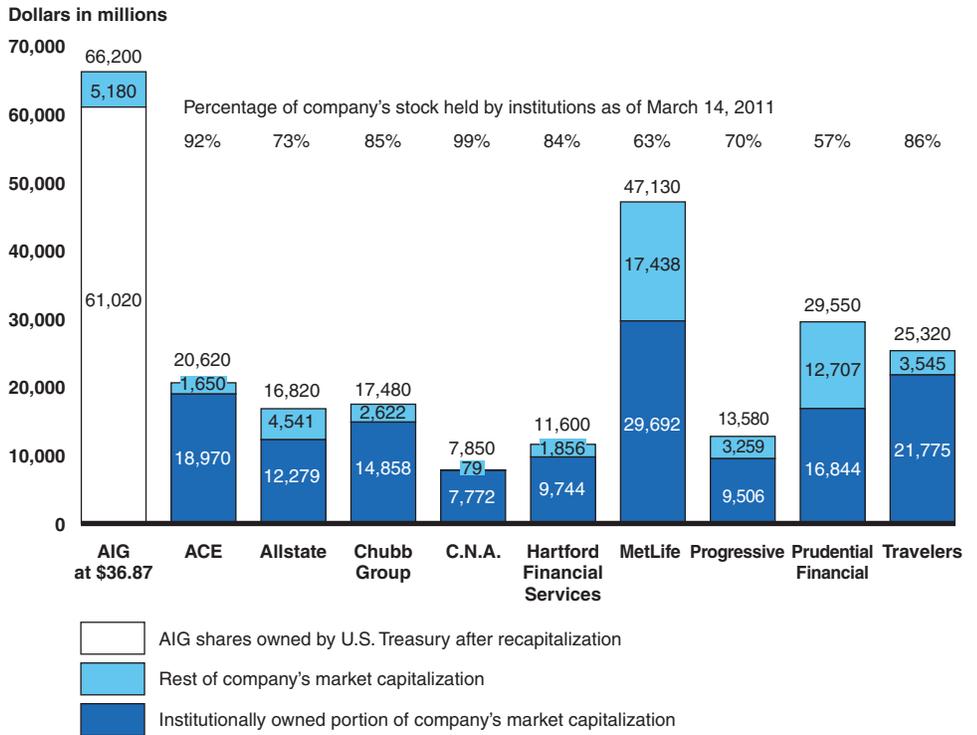
³⁸The estimated 224 days was computed by dividing 1.455 billion shares by an average daily trading volume of AIG common shares during the 12 month period, which was 6,501,438 shares.

³⁹Institutional investors include mutual funds, pension funds, trust funds, foundations, endowments, investment banks, and other non-individual organization investors that hold large volumes of securities and qualify for fewer investor protection regulations because they are assumed to be knowledgeable investors.

insurance companies could be indicative of potential institutional interest in AIG. While this indicator is helpful in demonstrating that AIG eventually could have majority institutional ownership like other large insurance companies, it likely understates that potential because it is limited to institutional holdings in nine insurance companies. Thus we developed a second indicator to more broadly look at institutional ownership of insurance companies.

Figure 11 shows that institutional investors collectively have majority common stock ownership of each of nine large insurance companies and this finding is consistent with comments by Treasury officials that insurance companies tend to be largely held by institutional investors. This suggests that Treasury may look to institutional investors to purchase most of the stock that it holds in AIG. The data in figure 11, obtained on March 14, 2011, show that institutional investors own on average 79 percent of the companies, ranging from a low of 57 percent for Prudential Financial to a high of 99 percent for C.N.A. The market value of institutional holdings ranged from \$7.8 billion (of C.N.A.) to \$29.7 billion (of MetLife). Thus institutional holdings in each of the nine insurers are smaller than Treasury's holdings in AIG of \$61 billion. If institutions were to purchase AIG shares held by Treasury proportional to their 79 percent average ownership in the nine companies, the amount would be \$47.6 billion or 78 percent of \$61 billion. This would be considerably larger than institutional ownership in each of the other nine institutions and raises questions about whether institutions collectively might desire or have the capacity to acquire \$47.6 billion of AIG stock.

Figure 11: Market Values of Institutional and Other Holdings of Common Stock in AIG and Nine Other Insurers Based on Share Prices, on March 14, 2011



Source: GAO analysis of market capitalization and percentages of institutional holdings data from Yahoo.Finance.com.

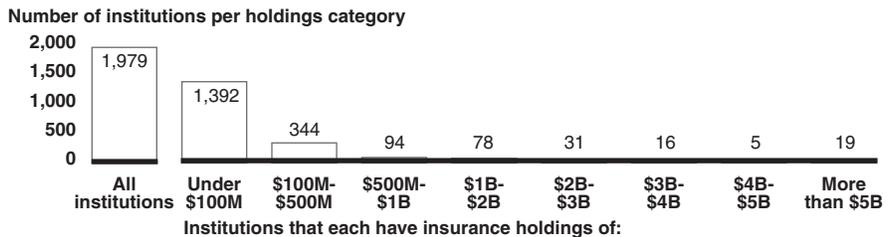
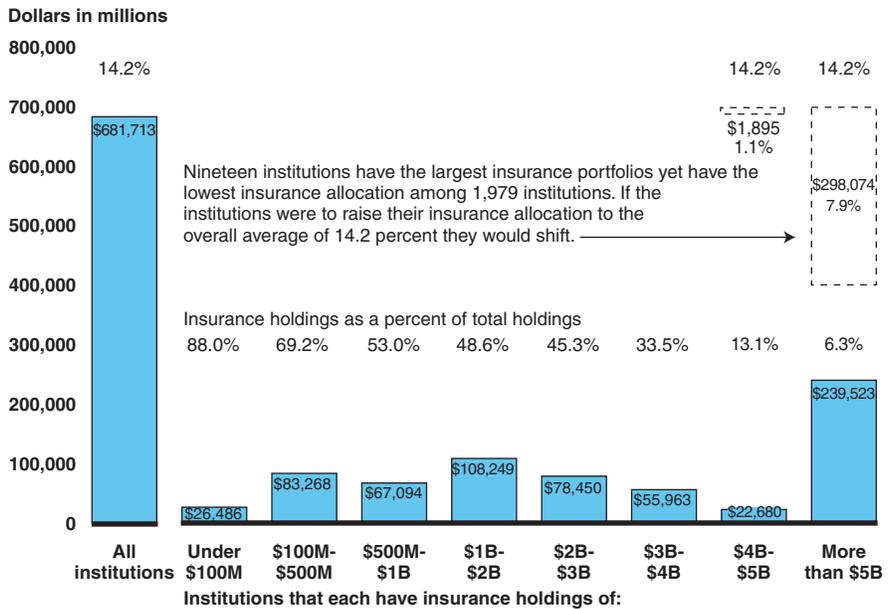
Note: GAO identified, but did not include in the above analysis, 25 other insurers, each with a market capitalization larger than \$8 billion as of March 8, 2011. The combined market capitalization of the 25 insurers was \$866 billion.

Institutions with major insurance holdings may consider acquiring stock in AIG and such institutions may have the most capacity to buy Treasury's AIG stock. To analyze whether institutions collectively might have the capacity to acquire most of Treasury's AIG stock, we developed an indicator on the aggregate insurance holdings of 1,979 institutions we identified as shareholders in one or more of the nine insurance companies analyzed in figure 11. This indicator is broader than that shown in figure 11 because it identifies and quantifies all insurance holdings of the 1,979 institutions. The premise behind the indicator is that institutions that have existing insurance holdings also might consider holding stock in AIG. The indicator provides the aggregate insurance holdings of the institutions that invest in AIG and nine other large insurers. As such, it may be useful for determining whether these institutions could have the capacity to purchase Treasury's AIG stock. The indicator is not

intended as a device for speculating about whether the institutions should or will purchase AIG stock. Also, it is not known whether other institutions with considerable insurance holdings exist that would make total institutional insurance holdings considerably larger than aggregate amounts shown in the indicator.

Figure 12 shows that institutions with holdings in AIG and the nine large insurers may have the resources to consider buying stock in AIG. The figure shows that, using data from late April and early May 2011, the 1,979 institutions have an average of 14.2 percent of their holdings in insurance companies. Of these institutions, 1,392 each had insurance holdings of less than \$100 million (totaling \$26.5 billion), and 587 each had insurance holdings of more than \$100 million. Among these institutions as the size of an institution's insurance holdings increases, the percent of their holdings in insurance companies decreases. For example, investors with less than \$100 million invested in insurance companies have 88 percent of their aggregate investments in these companies, but the largest two groups of investors—those with between \$4 billion and \$5 billion and those with more than \$5 billion invested in insurance companies—have 13.1 percent and 6.3 percent, respectively, of their aggregate investments in insurance companies. Consequently, larger institutional investors might have a greater capacity to invest in Treasury's AIG stock. If the 19 institutions with the largest insurance portfolios increased their insurance holdings to the 14.2 percent aggregate average for all 1,979 institutions, their insurance investments would increase by \$300 billion, considerably larger than the \$47.5 billion of Treasury's AIG stock. For these 19 institutions a percentage point increase in their insurance holdings would amount to \$38 billion, as these institutions have combined total portfolio holdings of \$3.8 trillion (\$239.5 billion divided by 6.3 percent). Thus, \$47.5 billion of AIG stock would raise their insurance holdings from 6.3 percent to 7.6 percent. This suggests that these institutions, as a group, have the capacity to purchase \$47.5 billion of AIG stock, should they choose to do so, without concentrating their holdings in insurance or considerably changing the distribution of their holdings by industry. This would suggest that institutional investors, especially larger institutions, collectively might have the capacity to add AIG stock to their existing insurance holdings.

Figure 12: Approximate Number and Aggregate Market Values of Insurance Holdings for 1,979 Institutions, from Data Obtained in Late April and Early May 2011



Source: GAO analysis of institutional insurance holdings data per SNL Financial.

Notes: The 1,979 institutions were identified as shareholders in the nine larger insurers analyzed in figure 11. The large insurers are ACE, Allstate, Chubb, C.N.A., Hartford Financial Services, MetLife, Progressive, Prudential Financial, and Travelers. Data on total insurance holdings of the 1,979 institutions were collected in late April and early May 2011. The 1,979 institutions were identified as shareholders in the nine larger insurers analyzed in figure 12. The large insurers are ACE, Allstate, Chubb, C.N.A., Hartford Financial Services, MetLife, Progressive, Prudential Financial, and Travelers. Data on total insurance holdings of the 1,979 institutions were collected in late April and early May 2011. SNL Financial data on institutional stock holdings are from each institution's latest available Quarterly Form 13F filing with SEC. The latest available quarterly Form 13F filings differed among the 1,979 institutions at the time of our analysis. SNL daily updates the market values of these holdings using daily stock prices. Because of the volume of data used in this analysis, GAO could not obtain market values of holdings for all 1,979 institutions as of a single day but over several days from late April to early May 2011. Thus, the above aggregates for institutional holdings reflect quarterly 13F filings and market value dates that differ among the 1,979 institutions.

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

A key part of AIG's reorganization and divestiture strategy is "unwinding" derivative positions (which drove its losses in 2008) and closing AIGFP. 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. Since then, AIGFP has been closing out the remainder of its derivatives portfolio. 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. For example, since September 2008, AIGFP has closed out about 94 percent of its outstanding trade positions. We also analyzed AIGFP's super senior CDS portfolio, on which AIGFP continues to make progress. And, although AIGFP has reduced the total gross notional amount of multisector CDOs, other portions of the CDO portfolio have changed. As of the first quarter of 2011, more than 69 percent of the remaining CDO portfolio comprised CDOs with underlying assets rated lower than BBB.

AIGFP Has Continued to Unwind Its Operations

Our indicators show that from September 2008 through March 2011, 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. 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 provided. Following Maiden Lane III's purchase of CDOs from AIGFP's CDS counterparties late in 2008, AIGFP became a smaller entity. As this smaller AIGFP has continued to eliminate its positions in CDS contracts, the strains on AIG's liquidity also have decreased. Figure 13 illustrates several dimensions along which AIGFP has reduced its size:

- First, since September 2008, AIGFP has closed out about 94 percent of its outstanding trade positions, which refers to 41,200 of AIGFP's

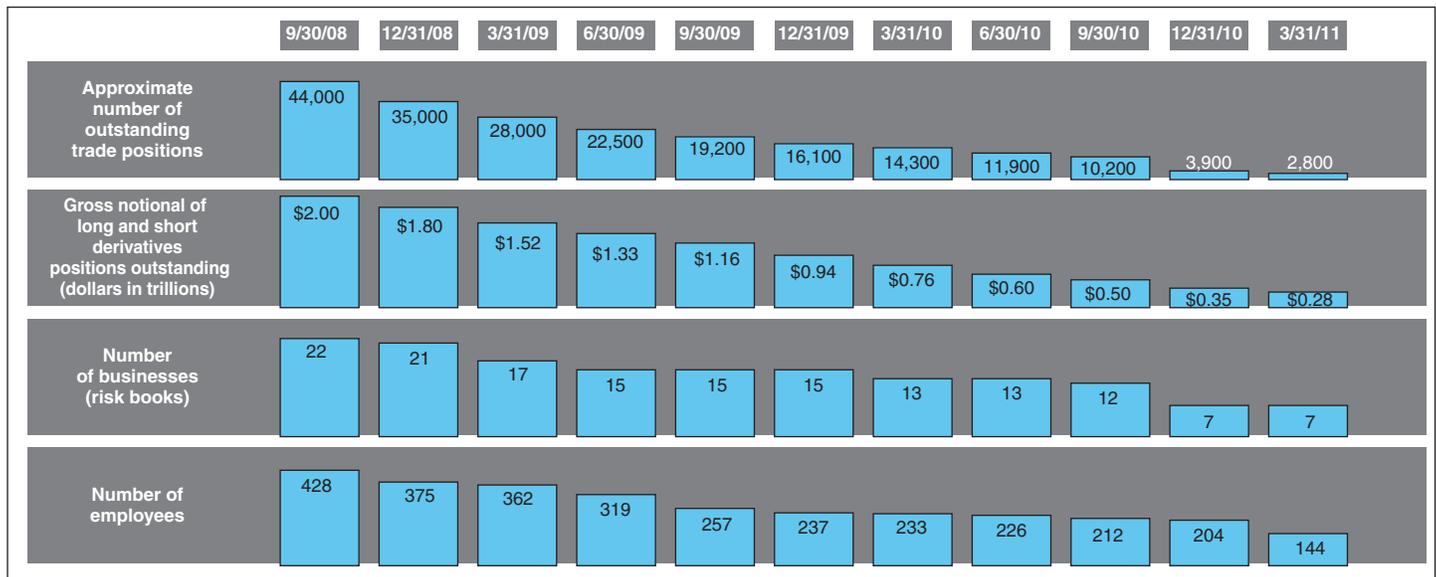
outstanding long and short derivative contracts. At September 30, 2008, it had 44,000 positions and as of March 31, 2011, the number had declined to 2,800. According to AIG, from September 2008 through March 2011, the number of counterparties has been reduced by about 74 percent, and the number of trades dated more than 50 years has been reduced by 99 percent from 67 to 1. The company reports that as a consequence of its wind-down strategy, AIGFP is entering into new derivative transactions only to hedge its current portfolio, reduce risk, and hedge the currency, interest rate, and other market risks associated with its affiliated businesses.

- 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 86 percent, to about \$280 billion as of March 31, 2011, down from \$940 billion in December 2009, 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 7 as of March 31, 2011.
- Finally, the number of AIGFP employees, which dropped most significantly (from 428 to 257) between September 2008 and September 2009, since has dropped to 144 as of March 31, 2011.⁴⁰ The 144 includes 13 employees who were transferred elsewhere within AIG in April 2011. According to AIG, AIGFP has closed its

⁴⁰AIGFP staff may leave for several reasons, such as the sale of businesses, closure of offices, or resignation.

Tokyo and Hong Kong offices and is in the process of winding down much of its London branch.

Figure 13: Status of the Winding Down of AIGFP, Quarterly from September 30, 2008, through March 31, 2011



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. The September and December 2008 notional values were estimated and the restated numbers were 2 and 1.8, respectively. The March 2009 number was 1.5.

The Federal Reserve and AIG noted that the winding down of AIGFP and its portfolios remains linked to AIG's credit ratings and these efforts could be affected adversely if AIG's credit ratings were downgraded. Previously, 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 previously reported 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. More recently, AIG has reported that it wants to complete the active unwinding of AIGFP's portfolios by June 30, 2011.⁴¹

⁴¹AIG said that it will publicly report the unwinding status of AIGFP in its quarterly financial report forthcoming in August 2011.

According to AIG, the remaining AIGFP derivatives portfolio will consist predominantly of transactions AIG believes will be of low complexity, low risk, supportive of AIG's risk-management objectives, or not economically appropriate to unwind when comparing costs to benefits. AIG reports that it may have to recognize unrealized market valuation losses if credit markets deteriorate, which could adversely affect their financial condition. Moreover, the time frame for unwinding AIGFP could be affected by how and when the Basel I regulatory requirements are phased out.⁴²

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

Our indicators suggest that AIGFP continued to make progress in unwinding its portfolio of CDS written on investment-grade CDOs (those having a rating of BBB or higher from rating agencies).⁴³ 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 2008.⁴⁴ 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 other counterparties in an effort to reduce its liabilities (that is, the risk

⁴²According to AIG, the regulatory benefit of the CDS transactions for AIGFP's financial institution counterparties was generally derived from the capital regulations known as Basel I. When a new framework for international capital and liquidity standards, known as Basel III, is fully implemented, AIG has stated that it may reduce or eliminate the regulatory benefits to certain counterparties from these transactions, and may thus impact the period of time that such counterparties are expected to hold the positions.

⁴³AIG refers to this as its Capital Markets super senior CDS portfolio.

⁴⁴A 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.

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. 14):

- **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.⁴⁵ The net notional amount of this book dropped from about \$250 billion in the fall of 2008 to about \$35.1 billion in the first quarter of 2011, and the fair value of the CDS liability fell over the same period from about \$400 million and shifted to an asset with a fair value of about \$190 million. These CDS contracts continue to have a high net notional amount relative to the other AIGFP products. According to AIG, during 2010, of this book, \$84.1 billion in net notional amount was terminated or matured at no cost to AIGFP, and through February 16, 2011, AIGFP received notices regarding an additional \$1.4 billion in net notional amount to be terminated in 2011. As of December 31, 2010, AIGFP estimated that the weighted average expected maturity of the portfolio was just over 3 years. AIG reports that this average increased by about 1.8 years from a year earlier because some counterparties did not terminate their transactions. Further, AIGFP expects that counterparties will, to the extent possible, continue to

⁴⁵In 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.

terminate these transactions prior to their maturity.⁴⁶ This book also has experienced minimal but mixed unrealized market gains and losses in 2010 and the first quarter of 2011.

- **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 RMBS, commercial mortgage-backed securities, and CDO super senior tranche securities.⁴⁷ 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 to the fourth quarter of 2008—\$12.6 billion and \$5.9 billion, respectively. As of the first quarter of 2011, the net notional amount continued to show declines and had dropped to \$6.2 billion. Similarly, the fair value of the derivative liability declined to about \$3.1 billion. Also, throughout 2010 and into 2011, multisector CDOs continued to show unrealized market valuation gains. According to the company, AIGFP has reduced the size of its portfolio through ongoing terminations of transactions in its regulatory capital portfolio, selling its commodity index business, terminating and selling its foreign exchange prime brokerage activities, and disposing of its energy/infrastructure investment portfolio.

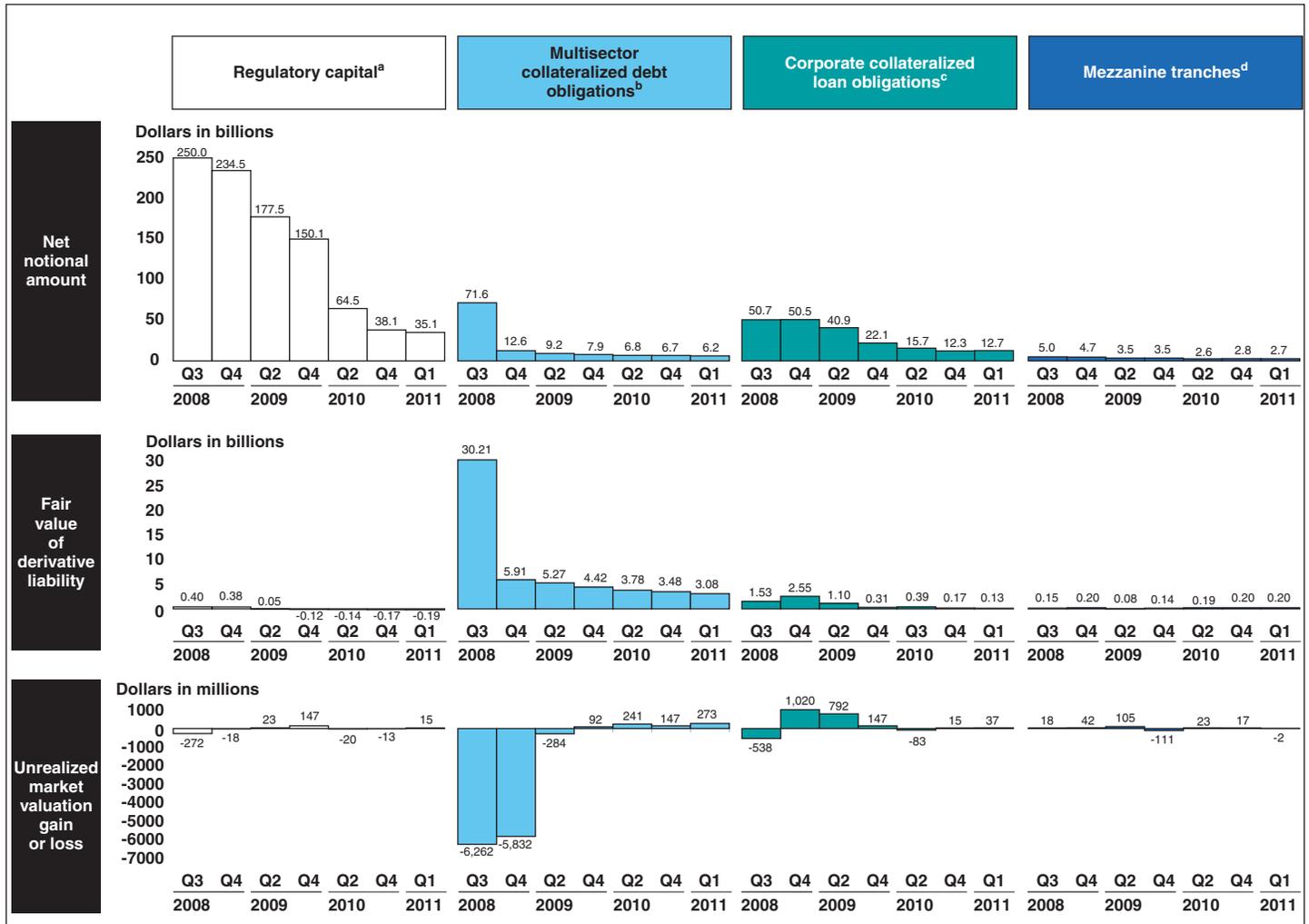
⁴⁶According to AIG, AIGFP has not been required to make any payments as part of terminations initiated by counterparties. The regulatory benefit of these transactions for the counterparties is generally derived from the terms of Basel I that existed through the end of 2007, which was replaced by Basel 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.

⁴⁷According 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. 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.

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- **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.⁴⁸ The net notional amount of the corporate portfolio continued to drop through 2010 and rose slightly in the first quarter of 2011, while the amount for the mezzanine portfolio dropped slightly in this 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 continued to fall, albeit slightly. 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 through the first quarter of 2011. By comparison, the fair value of derivative liability and the unrealized market valuations of the mezzanine tranche book have changed little since 2008. AIG officials commented that the smaller movement is consistent with a decrease in the size of the portfolio (see fig. 14).

⁴⁸The 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.

Figure 14: 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 2008 through First Quarter 2011



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.

^aRegulatory 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.

^bMultisector CDO represent the CDS portfolio sold primarily for arbitrage purposes and written on CDO transactions that generally had underlying collateral of RMBS, commercial mortgage-backed securities, and CDO tranche securities.

^cThe corporate collateralized loan obligations portfolio consists of CDS transactions primarily written on portfolios of senior unsecured loans.

^dA 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.

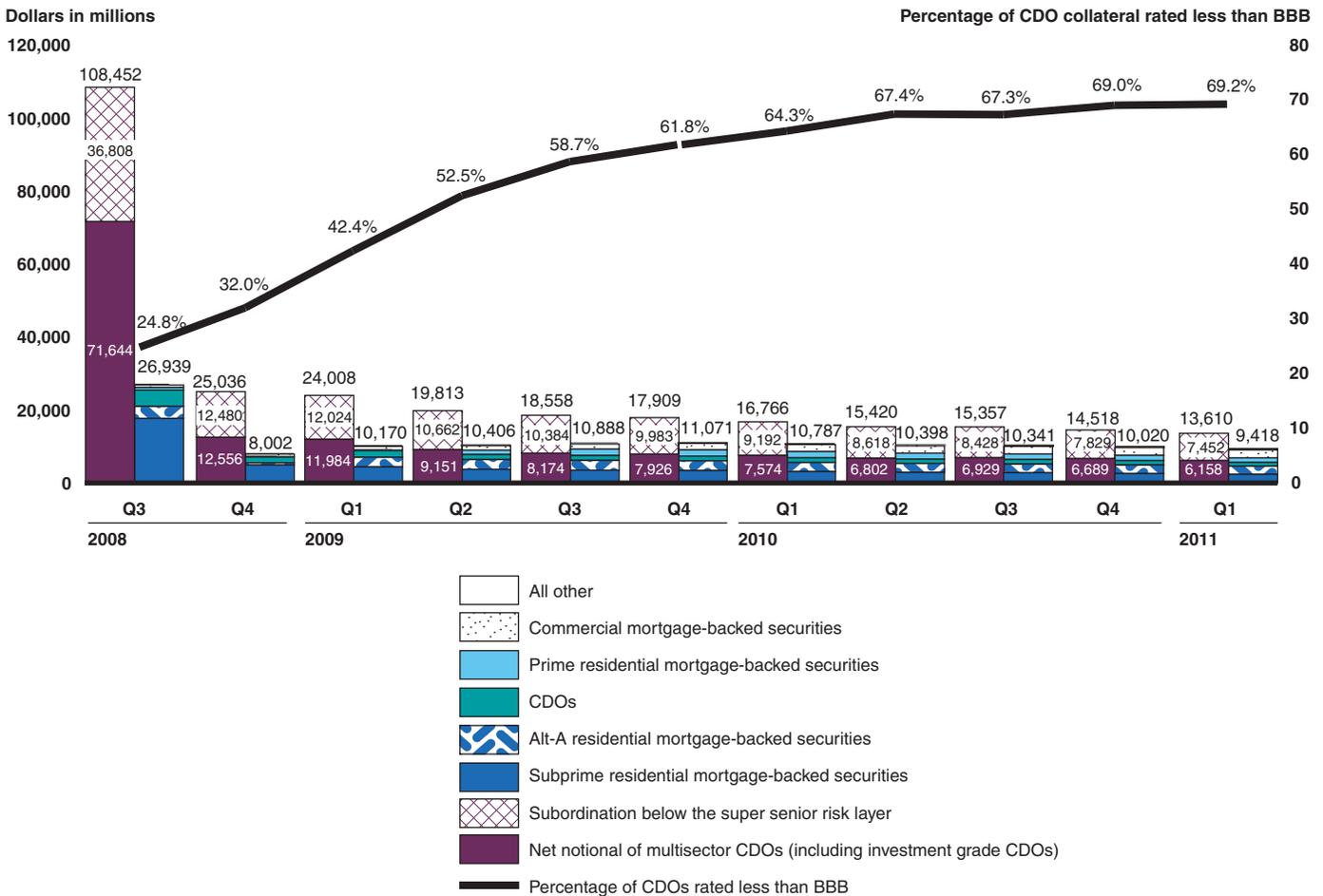
AIG's Multisector CDO Portfolio Has Changed Significantly Since the First Quarter 2009

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 slowly has continued 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 and the longer-term trend remains unclear. According to AIG officials, the SEC filings about the composition of the multisector CDOs on which it has written credit default protection summarize 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 \$13.6 billion is reduced to a net notional exposure of approximately \$6.2 billion.

As shown in figure 15, the total gross notional amount of AIGFP's multisector CDOs and of CDOs with underlying assets rated less than BBB was 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 many of the CDOs underlying AIGFP's CDS contracts. The gross notional for these CDOs has continued to be reduced each quarter and as of the first quarter of 2011, reached about \$13.6 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. In 2010 the trend reversed, and as of the first quarter of 2011 the gross notional amount for this portion of the portfolio was reduced to \$9.4 billion. Despite this drop, as of the first quarter of 2011, the underlying credit rating of the portfolio has not improved, with more than 69 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 \$2.6 billion against the \$6.2 billion of net notional exposure in the multisector CDO portfolio.

Figure 15: 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 2008 through First Quarter 2011



Source: GAO analysis of AIG SEC filings.

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

Since 2009, federal assistance provided to AIG gradually has shifted from debt to equity, and as of March 31, 2011, following the January 14, 2011, recapitalization of AIG, the assistance consists of about 13 percent in preferred interests in AIA, 57 percent in common interests in AIG, 30 percent in debt assistance to Maiden Lanes II and III, and the remaining in accrued interest dividends and fees. Consequently, the government's, and thus the taxpayers', 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. Since Treasury still has approximately 77

percent equity interest in AIG, monitoring the markets to identify divestment strategies that will strike the right balance between Treasury's competing goals of maximizing taxpayers' returns and exiting its investments as soon as practicable remains important. 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, the credit derivatives markets, and investors'—including large institutional investors—support for the company that are beyond the control of AIG or the government. We will continue to monitor these issues in our future work.

Agency Comments

We provided a draft of this report to Treasury for review and comment. Treasury did not provide written comments. We also shared a draft of this report with the Federal Reserve and AIG. We received technical comments from Treasury, the Federal Reserve, and AIG, which we have incorporated in the report as appropriate.

We are sending copies of this report to appropriate congressional committees, the Financial Stability Oversight Board, the Special Inspector General for TARP, the Department of the Treasury, the federal banking regulators, and other interested parties. 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 Thomas J. McCool at (202) 512-2642 or mccoolt@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 V.



Thomas J. McCool
Director
Center for Economics,
Applied Research and Methods

List of Congressional Committees

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

The Honorable Tim Johnson
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing,
And Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Jeff Sessions
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
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 Levin
Ranking Member
Committee on Ways and Means
House of Representative

Appendix I: AIG Operations

American International Group, Inc. (AIG) is an international insurance organization comprising approximately 230 companies and serving customers in more than 130 countries. AIG companies serve commercial, institutional, and individual customers through worldwide property/casualty networks. In addition, AIG companies provide life insurance and retirement services in the United States. Figure 16, which illustrates the AIG parent company and subsidiaries that it directly owns, conveys the complexity of the AIG organization. AIG's subsidiaries are AIG Life Holdings International, LLC; SunAmerica Financial Group, Inc.; AIG Capital Corporation; AIG Financial Products Corp; AIUH, LLC (which includes Chartis Inc.); United Guaranty Corporation; and several other companies.¹ As of March 31 2011, AIG had assets of \$611.2 billion and revenues of \$17.4 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 businesses.

¹Ownership of United Guaranty Corporation was transferred to AIG as a result of a transaction involving Chartis U.S., Inc. that closed on February 24, 2011, but was effective December 31, 2010.

Figure 16: AIG, Its Subsidiaries, and Percentage Ownership by Parent Company as of December 31, 2010

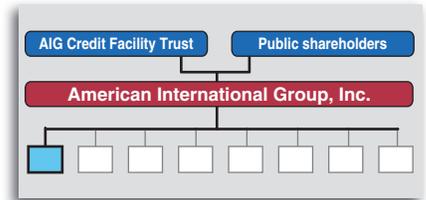
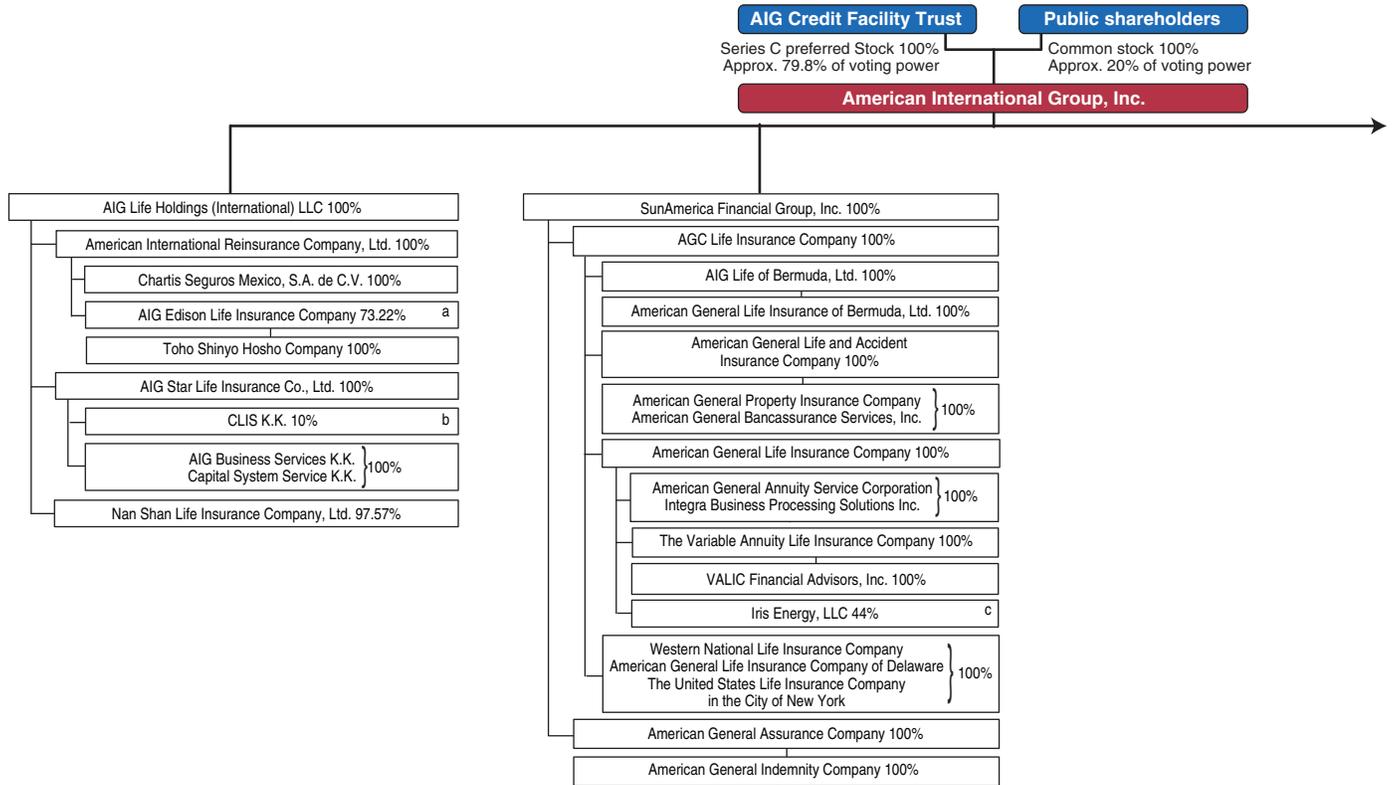


Figure continued

Appendix I: AIG Operations

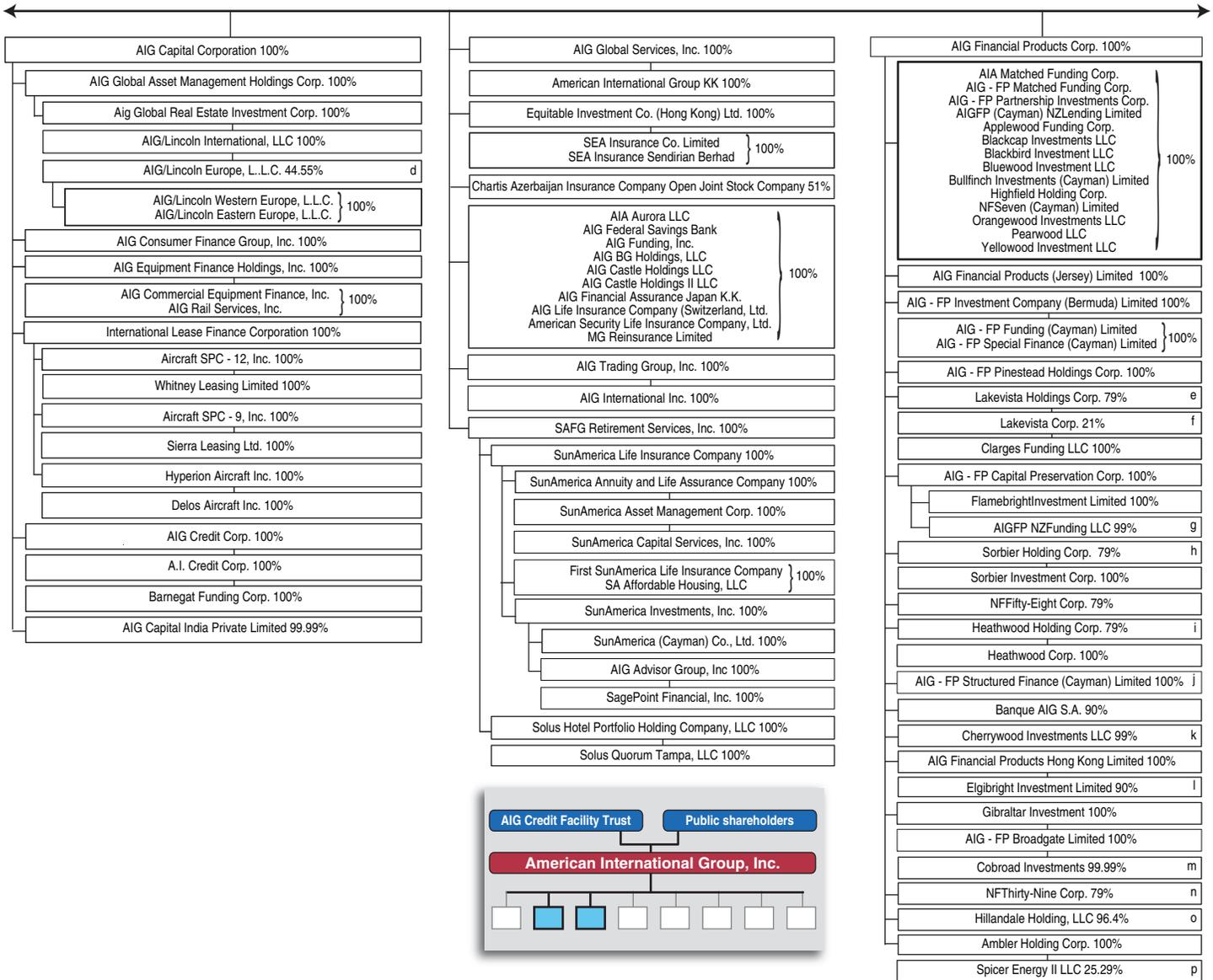


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Appendix I: AIG Operations

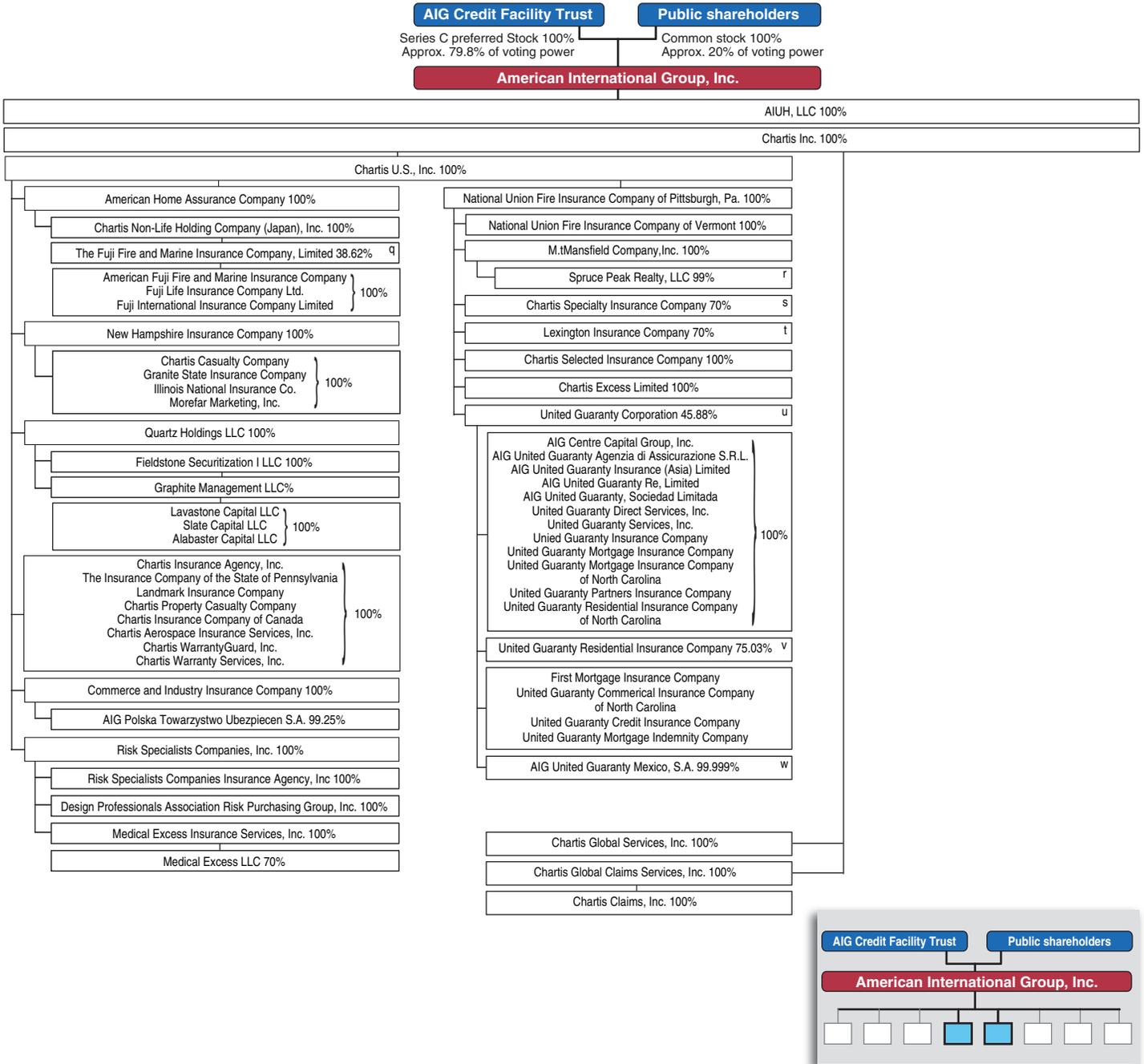


Figure continued

Appendix I: AIG Operations

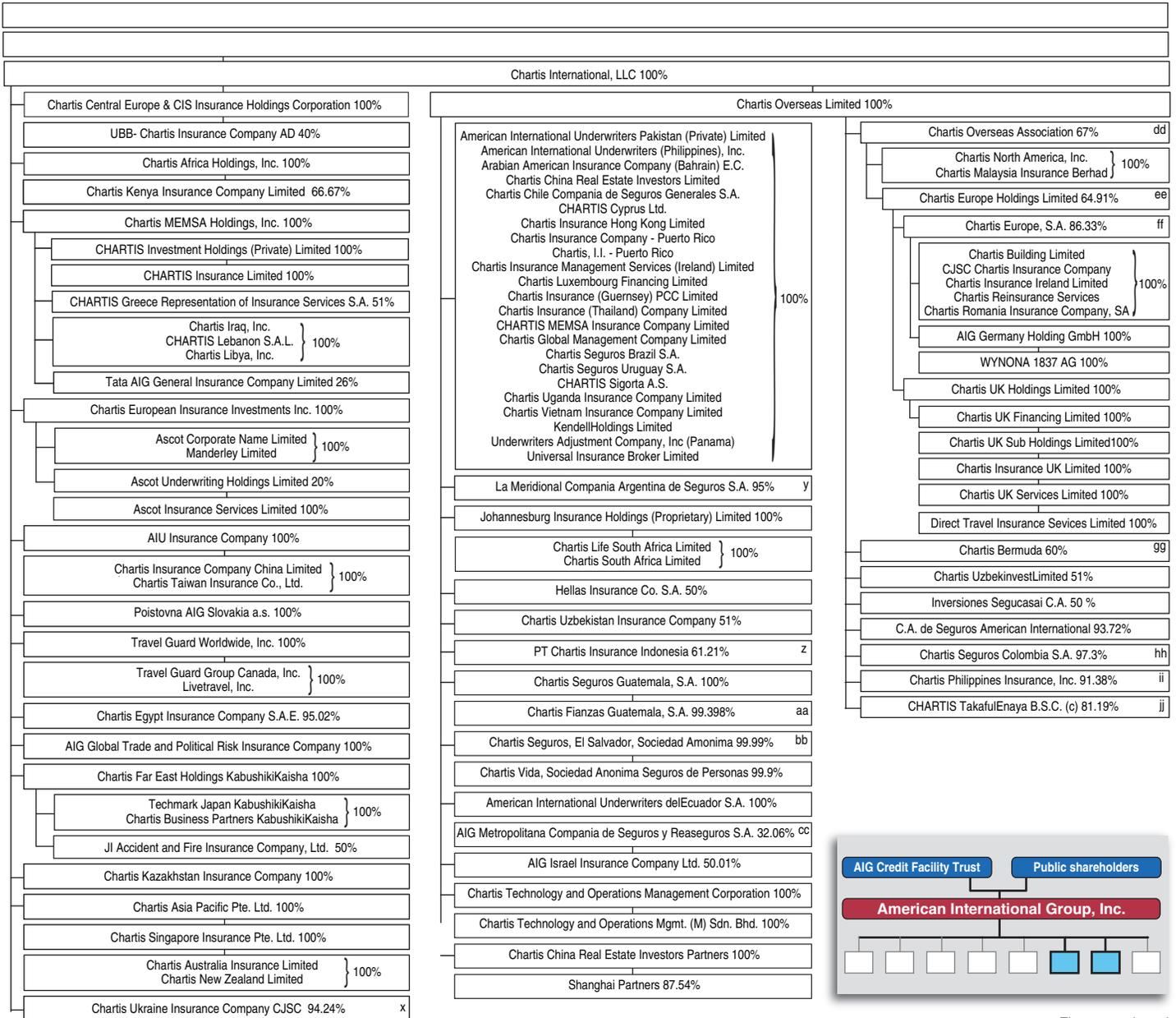
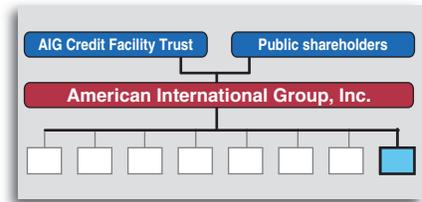
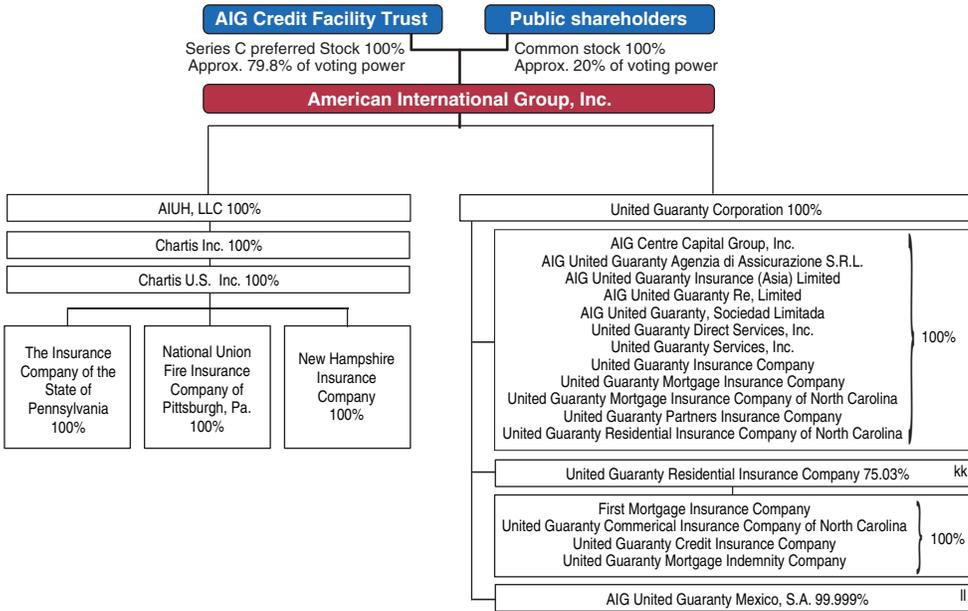


Figure continued

Appendix I: AIG Operations



Source: AIG.

^a8.14 percent AIG Financial Assurance Japan K.K. and 18.64 percent American International Group, Inc.

^b45 percent AIG Business Service K.K. and 10 percent Capital System Service K.K..

^c29 percent American General Life and Accident Insurance Company and 1 percent Iris Energy Holding L.P.

^d30.45 percent AIGGRE Lincoln Chelsea I LLC.

^e21 percent NF Fifty-One (Cayman) Limited.

^f79 percent AIG Financial Products Corporation.

^g1 percent AIG Financial Products Corporation.

^h21 percent NF Thirty-nine Corporation.

ⁱ21 percent NF Fifty-eight Corporation.

^j10 percent AIG Matched Funding Corporation.

^k1 percent AIG-FP Capital Preservation Corporation.

^l10 percent AIG Financial Products Corporation.

^m0.01 percent NF Ten (Cayman) Limited.

ⁿ21 percent NF Thirty-nine Holding (Cayman) Limited.

^o3.6 percent AIG-FP Capital Preservation Corporation.

^p25.27 percent American General Life Insurance Company.

^q10.04 percent Chartis Far East Holdings K.K. and 6 percent Chartis Europe, S.A.

^r1 percent National Union Fire Insurance Company of Pittsburgh, Pennsylvania.

^s10 percent Chartis Property Casualty Company and 20 percent The Insurance Company of the State of Pennsylvania.

^t10 percent Chartis Property Casualty Company and 20 percent The Insurance Company of the State of Pennsylvania.

^u35.12 percent New Hampshire Insurance Company and 19 percent The Insurance Company of the State of Pennsylvania.

^v24.97 percent United Guaranty Residential Insurance Company of North Carolina.

^w0.001 percent United Guaranty Services, Inc.

^x0.02 percent Chartis Central Europe & CIS Insurance Holdings Corporation and 5.7 percent Steppe Securities, LLC.

^y4.97 percent Chartis Global Management Consulting Limited.

^z39.79 percent PT. Tiara Citra Cemerlang.

^{aa}0.06 percent American International Underwriters (Guatemala), S.A.

^{bb}0.01 percent Chartis Latin America Investments, LLC.

^{cc}19.72 percent Chartis Overseas Association.

^{dd}10 percent American Home Assurance Company, 11 percent National Union Fire Insurance Company of Pittsburgh, Pennsylvania, and 12 percent New Hampshire Insurance Company.

^{ee}2.22 percent Chartis Bermuda Limited, 31.41 percent Chartis Overseas Limited, and 1.46 percent Chartis Luxembourg Financing Limited.

^{ff}8.21 percent Chartis Overseas Limited and 5.46 percent Chartis UK Holdings Limited.

^{gg}40 percent American International Reinsurance Company, Limited.

^{hh}2.7 percent Chartis Insurance Company-Puerto Rico.

ⁱⁱ8.62 percent Chartis International, LLC.

^{jj}18.81 percent Chartis International, LLC.

^{kk}24.97 percent United Guaranty Residential Insurance Company of North Carolina.

^{ll}0.001 percent United Guaranty Services, Inc.

Appendix II: Federal Assistance to AIG and the Government's Remaining Exposure as of AIG's Recapitalization

In January 2011, the government's remaining exposure to AIG was adjusted by the recapitalization of AIG and the continued paydown of the Federal Reserve Bank of New York (FRBNY) loan to Maiden Lane II and Maiden Lane III special purpose vehicles (SPV). The plan to recapitalize AIG was implemented when AIG's board of directors declared a dividend in the form of warrants to purchase shares of AIG's common stock to the holders of AIG common stock.

The closing of AIG's recapitalization led to a restructuring of the assistance provided by the Board of Governors of the Federal Reserve System (Federal Reserve) to AIG, as shown in table 4. First, AIG repaid FRBNY in cash all the amounts owed under the FRBNY revolving credit facility and the credit facility was terminated. The funds for repayment came from loans to AIG from the AIA Group Limited (AIA) and the American Life Insurance Company (ALICO) SPVs that held the net cash proceeds from the initial public offering (IPO) of AIA and the sale of ALICO. As security for the repayment of the loans extended to it by the SPVs, AIG pledged, among other collateral, its equity interests in Nan Shan Life Insurance Company, Ltd. and International Lease Finance Corporation and the assets held by the SPVs, including the ordinary shares of AIA held by the AIA SPV and certain of the MetLife securities received from the sale of ALICO.¹ The net cash proceeds from the AIA IPO were approximately \$20.1 billion and from the ALICO sale to MetLife were approximately \$7.2 billion.² In addition, repayments on the FRBNY loans to Maiden Lane II and Maiden Lane III continued, reducing their balances to approximately \$12.8 billion and \$13.5 billion, respectively.

¹On 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. And on February 1, 2011, AIG reported that it completed the sale of AIG Star Life Insurance Co., Ltd. and AIG Edison Life Insurance Company, to Prudential Financial, Inc., for \$4.8 billion, consisting of \$4.2 billion in cash and \$0.6 billion in the assumption of third-party debt.

²In connection with the issuance of the Series E and F preferred stocks and as a participant in the Troubled Asset Relief Program (TARP), AIG had agreed to a number of covenants with the Department of the Treasury (Treasury) related to corporate governance, executive compensation, political activity, and other matters. These covenants continue to apply after the closing. Also, AIG agreed to provide Treasury and FRBNY with certain control and information rights.

**Appendix II: Federal Assistance to AIG and the
Government's Remaining Exposure as of AIG's
Recapitalization**

Table 4: U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure, as of January 14, 2011

Dollars in billions

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
Federal Reserve				
Federal Reserve Bank of New York (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 Department of the Treasury (Treasury), which gave the trust an approximately 79.75 percent voting interest in AIG.	\$0 ^a	n/a	\$0	On January 14, 2011, FRBNY announced the termination of its assistance to AIG with the full repayment of its loans to AIG, including interest and fees, as a result of the closing of the recapitalization plan. AIG used cash proceeds from the recent AIA Group Limited (AIA) initial public offering and sale of American Life Insurance Company (ALICO) to MetLife to repay the FRBNY credit facility. With the closing, the trust exchanged its Series C preferred stock in AIG for approximately 562.9 million shares of AIG common stock and subsequently delivered to Treasury. With the closing of AIG's recapitalization, the trust was also terminated.
FRBNY created a special purpose vehicle (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	12.777 ^b	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan. In March 2011, AIG offered to buy the Maiden Lane assets, but FRBNY rejected this offer.
FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing collateralized debt obligations from AIGFP's counterparties in connection with the termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30	n/a	13.526 ^b	Proceeds from asset sales, asset maturities, and interest will be used to repay the FRBNY loan.

**Appendix II: Federal Assistance to AIG and the
Government's Remaining Exposure as of AIG's
Recapitalization**

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
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	\$0	0	On January 14, 2011, the credit extended to AIG by FRBNY was repaid with cash proceeds from the public offering of 67 percent of AIA and the sale of ALICO. FRBNY's remaining preferred interests in the AIA and ALICO, SPVs of about \$20 billion, were purchased by AIG, which drew on Treasury's Series F preferred stock and then transferred by AIG to Treasury as partial consideration for the Series F draw.
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	0	0	With the closing of AIG's recapitalization, Treasury exchanged its Series E preferred stock in AIG for approximately 924.5 million shares of AIG common stock.
Treasury purchased Series F noncumulative preferred stock of AIG. Treasury was 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	0	0	With the closing, Treasury's shares of Series F preferred stock in AIG were exchanged for preferred interests in the AIA and ALICO SPVs that were transferred to Treasury, newly issued shares of Series G preferred stock, and approximately 167.6 million shares of AIG common stock.
On January 14, 2011, as part of the closing of the recapitalization, Treasury provided up to \$2 billion in liquidation preference to AIG through a new AIG facility (Series G cumulative mandatory convertible preferred stock). AIG drew all but \$2 billion remaining under the Series F to purchase a portion of the SPV preferred interests that were exchanged with Treasury.	n/a	2	0	The Series G facility had not been used.

Appendix II: Federal Assistance to AIG and the Government's Remaining Exposure as of AIG's Recapitalization

Description of the federal assistance	Amount of assistance authorized		Outstanding balance	Sources to repay the government
	Debt	Equity		
The preferred interests in the AIA and ALICO SPVs had an aggregate liquidation preference of approximately \$26.4 billion at December 31, 2010, which were purchased by AIG and transferred to Treasury as part of the closing of the recapitalization. The remaining preferred interests, which have an aggregate liquidation preference of approximately \$20.3 billion following a partial repayment on January 14, 2011 with proceeds from the sale of ALICO, were transferred from FRBNY to AIG and subsequently transferred to Treasury as part of the recapitalization.	n/a	20.3	20.3	Under the agreements, the SPVs generally may not distribute funds to AIG until the liquidation preferences and preferred returns on the preferred interests have been repaid in full and concurrent distributions have been made on certain participating returns attributable to the preferred interests. In February AIG used \$2.2 billion of proceeds from the sale of two life insurance companies to reduce the liquidation preferences of the AIA and ALICO SPV preferred interests. On March 8, 2011, AIG used \$6.9 billion from the sale of MetLife equity securities to repay Treasury's remaining \$1.4 billion of preferred interests in ALICO SPV and reduce by \$5.5 billion Treasury's remaining preferred interests in AIA SPV to \$11.3 billion.
In total, Treasury received 1.655 billion shares of AIG common stock (approximately 92 percent of the company).	n/a	49.148 ^c	49.148 ^c	Over time, Treasury will sell the shares, with the goal of recouping taxpayers' funds.
Subtotal	\$52.5	\$71.448		
Total authorized (debt and equity)		\$123.948^d		
Total outstanding assistance			\$95.751	

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

^aThe 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, to \$29.175 billion by October 6, 2010, and to \$0 on January 14, 2011. The reductions were attributed to mandatory repayments from proceeds obtained from the sale of various assets and businesses.

^bGovernment debt shown for the Maiden Lane facilities is as of January 12, 2011, and represents principal only and does not include accrued interest of \$457 million for Maiden Lane II and \$551 for Maiden Lane III. As of March 2, 2011, principal owed was \$12.353 billion and \$12.434 billion and accrued interest was \$479 million and \$574 million for Maiden Lane II and Maiden Lane III, respectively.

^cTreasury's cost basis in AIG common shares of \$49.148 billion comprises liquidation preferences of \$40 billion for Series E preferred shares, \$7.543 billion for Series F preferred shares, and unpaid dividend and fees of \$1.605 billion. Also, the Federal Reserve and Treasury had made 182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to \$123.9 billion.

^dThe Federal Reserve and Treasury had made \$182.3 billion in assistance available as of December 31, 2009. This amount was subsequently reduced to \$123.9 billion. As of January 14, 2011, Treasury's total cash commitment in AIG was \$68 billion

AIG's recapitalization also affected the assistance provided by the Department of the Treasury (Treasury) to AIG. Treasury, AIG, and the AIG Credit Facility Trust exchanged the various preferred interests in AIG for common stock, giving Treasury 1.655 billion shares of AIG common stock, or approximately 92.2 percent of the outstanding AIG common stock. First, the trust exchanged its shares of AIG's Series C preferred stock (par value \$5.00 per share) for about 562.9 million shares of AIG common stock, which it subsequently transferred to Treasury. Second, Treasury exchanged its shares of AIG's Series E preferred stock (par value \$5.00 per share) for about 924.5 million shares of AIG common stock. Third, Treasury exchanged its shares of AIG's Series F preferred stock for the preferred interests in the AIA and ALICO SPVs, 20,000 shares of the Series G preferred stock, and about 167.6 million shares of AIG common stock. As of January 14, 2011, Treasury owned about \$20.3 billion in preferred equity in the AIA and ALICO SPVs and at then current stock prices, about \$49.1 billion in common equity in AIG, giving it a total exposure to AIG of about \$69.4 billion. AIG and Treasury amended and restated the Series F securities purchase agreement to provide for AIG to issue 20,000 shares of Series G preferred stock to Treasury. AIG's right to draw on Treasury's equity capital facility tied to the Series F stock was then terminated with the closing of the recapitalization. AIG's right to draw on the Series G preferred stock was made subject to terms and conditions substantially similar to those in the agreement, including that dividends on the Series G preferred stock would be payable on a cumulative basis at a rate per annum of 5 percent, compounded quarterly. AIG drew down approximately \$20.3 billion remaining under Treasury's equity capital facility, less \$2 billion that AIG designated to be available after the closing for general corporate purposes under the Series G preferred stock, and used the amount it drew down on the equity facility to repurchase all of FRBNY's preferred interests in the AIA and ALICO SPVs.³

³AIG was not to directly redeem the Series F 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 F preferred stock.

Appendix III: Overview of Definitions of Credit Ratings and AIG's 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 AIG's 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.

Moody's, Standard and Poor'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 principal 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.

^aMoody'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.

^bS&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.

As shown in table 6, AIG's key credit ratings remained largely unchanged from May 2009 through 2010, primarily because federal assistance provided AIG with needed liquidity, but in the first quarter of 2011 the ratings have shown mixed trends. From March 31, 2009, to December 15, 2009, A.M. Best, Moody's, and 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 Federal Reserve and Treasury provided.¹ While the government's assistance has helped stabilize AIG's ratings, 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 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." In the first quarter of 2011, AIG's ratings have become more mixed, with long-term debt and life insurer ratings changing little but short-term debt and property/casualty ratings dropping slightly, because of the withdrawal of government support.

¹AIG'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.

Appendix III: Overview of Definitions of Credit Ratings and AIG's Credit Ratings

Table 6: AIG's Key Credit Ratings, March 31, 2009, through March 31, 2011

Rating agency	Mar. 31, 2009	May 15, 2009	Dec. 15, 2009	Mar. 31, 2010	July 31, 2010	Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011
Debt								
<i>Long-term</i>								
Potential consequences of a future downgrade	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 December 31, 2010, a one-notch downgrade from S&P would have cost AIG up to \$0.7 billion in cumulative additional collateral postings and termination payments, while a one-notch downgrade from Moody's and a two-notch from S&P would increase that cost to \$1.1 billion. Another notch downgrade would have increased that cost to \$1.3 billion. By comparison, 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.							
S&P	A-/negative ^a	no change	no change	no change	no change	no change	no change	A-/stable
Moody's	A3/negative ^a	no change	no change	no change	no change	no change	no change	Baa1/stable
Fitch	A	BBB/evolving	no change	no change	BBB/stable	no change	no change	no change
<i>Short-term</i>								
Potential consequences of a future downgrade	Further downgrades in these ratings may reflect a loss of liquidity provided by government funding facilities.							
S&P	A-1 for AIG Funding, Curzon, and Nightingale ^a	no change	no change	no change	no change	no change	no change	A-2
Moody's	P-1 for AIG Funding ^a	no change	no change	no change	no change	on review for possible downgrade	no change	P-2/stable
Fitch	F1	no change	no change	no change	no change	no change	affirmed and withdrawn Nov. 19, 2010	not rated
Financial strength								
Potential consequences of a future downgrade	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.							

Appendix III: Overview of Definitions of Credit Ratings and AIG's Credit Ratings

Rating agency	Mar. 31, 2009	May 15, 2009	Dec. 15, 2009	Mar. 31, 2010	July 31, 2010	Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011
<i>Life insurer</i>								
Potential consequences of a future downgrade	Domestic retirement services could 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 could 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.							
A.M. Best	A/negative ^a	no change	no change	no change	no change	no change	no change	no change
S&P	A+/negative	no change	no change	no change	no change	no change	no change	A+/stable
Moody's	A1/developing	no change	no change	A1/negative	no change	no change	no change	A2/stable
Fitch	AA-	A-/evolving	no change	no change	A-/stable	no change	no change	no change ^b
<i>Property/casualty insurer</i>								
Potential consequences of a future downgrade	AIG commercial property/casualty businesses expect that a financial strength rating downgrade could 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.							
A.M. Best	A/negative ^a	no change	no change	no change	no change	no change	no change	no change ^b
S&P	A+/negative	no change	no change	no change	no change	no change	no change	A/stable
Moody's	Aa3/negative	no change	no change	no change	no change	no change	no change	A1/stable
Fitch	AA-	A+/evolving	no change	placed rating on rating watch - negative	A+/stable	no change	no change	A/stable ^b

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

^aThese are key ratings.

^bA.M. Best commented on February 9, 2011, that the ratings of the Chartis companies were unchanged following the announcement of an expected \$4.1 billion strengthening of reserves for prior years' losses. Fitch commented that regarding the financial strength ratings, it upgraded AIG's life insurer ratings to A/stable on April 25, 2011, and downgraded AIG's property/casualty insurer ratings to A on February 10, 2011.

Appendix IV: Trends in and Changes in the Composition of Consolidated Shareholders' Equity

Since September 2009, AIG's shareholders' equity has increased at a much slower rate than earlier in the year 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 extent to which a company could absorb losses before risk of imminent failure or insolvency. One component of shareholders' equity is capital raised by issuing and selling common and preferred stock to investors, also known as paid-in capital. Another component is retained earnings, which the company accumulates over time from operating profits.¹

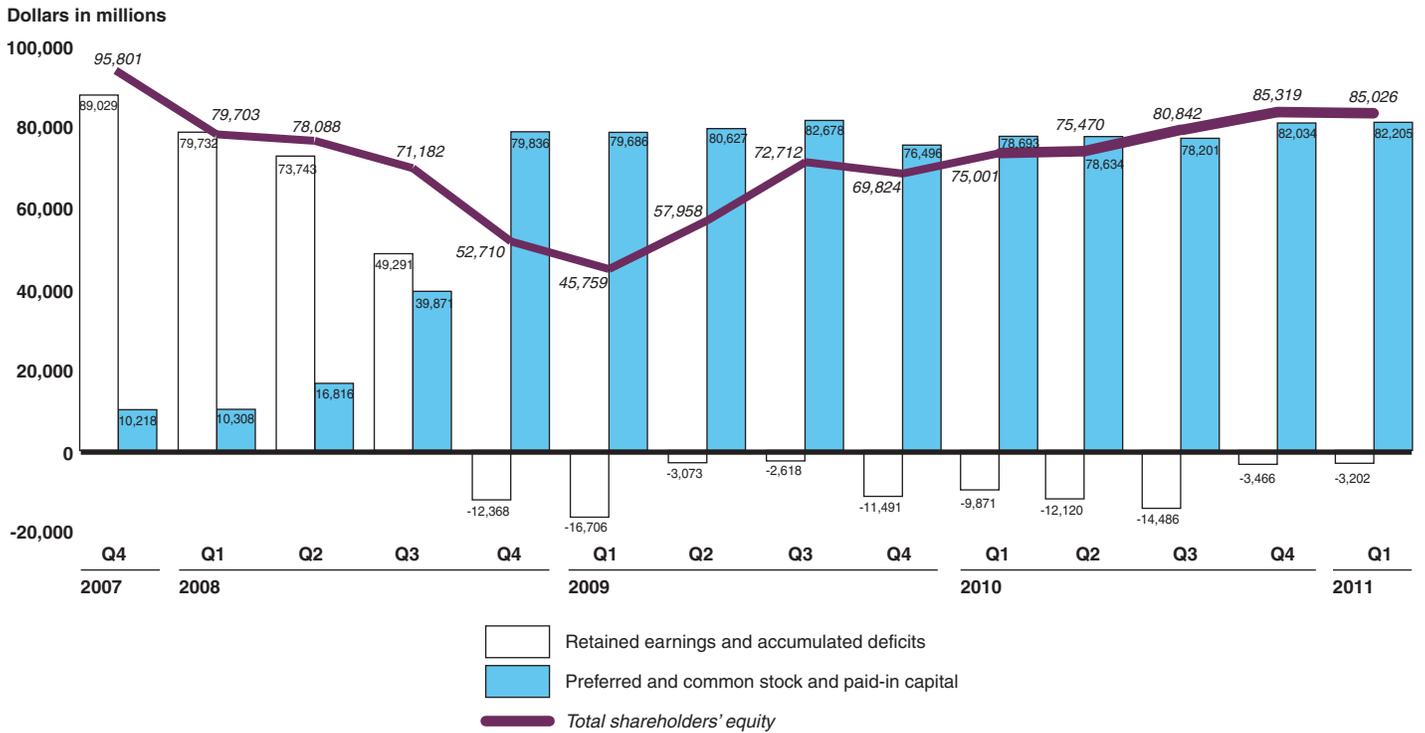
As figure 17 shows, AIG's shareholders' equity declined from the fourth quarter of 2007 through the first quarter of 2009, and more significantly, the composition of its shareholders' equity changed from mostly retained earnings in 2007 to completely paid-in capital by the end of 2008, reflecting the 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. Since that period, shareholders' equity has risen in all but one quarter in 2009 and 2010 and increased to approximately \$85 billion at the end of 2010 and the first quarter of 2011. 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

¹Other capital included payments advanced to purchase shares, the cost of Department of Treasury (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.

Appendix IV: Trends in and Changes in the Composition of Consolidated Shareholders' Equity

from discontinued operations of \$4.4 billion that more than offset \$1.1 billion of income from continuing operations. This trend reversed in the first quarter of 2011 when such deficits were reduced to about \$3.2 billion. Also as shown in figure 17, 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 17: AIG Trends in and Main Components of Consolidated Shareholders' Equity, Fourth Quarter 2007 through First Quarter 2011



Source: GAO analysis of AIG SEC filings.

Note: Prior to AIG's recapitalization on January 14, 2011, the other components of total shareholders' equity included 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. As part of AIG's recapitalization, the company drew down approximately \$20.3 billion under the Series F equity capital facility to purchase an equivalent amount of FRBNY's preferred interests in the AIA and ALICO special purpose vehicles, which was then provided to Treasury. The drawdown also increased the paid-in capital in the first quarter of 2011 by an equal amount. As part of the restructuring that closed on January 14, 2011, the remaining amount available under the Series F equity capital facility was drawn—approximately \$22.3 billion—and repaid.

Several federal actions in 2008 and 2009 caused the changes in size and composition of AIG shareholders' equity. 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.²
- 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.

²This 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, \$10.9 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](#).

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

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

Glossary of Terms

Adjusted Basis	The net cost of an asset or security that is used to compute the gains or losses 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 than 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 to 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.

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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