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Report to Congressional Committees

April 2010

TROUBLED ASSET RELIEF PROGRAM

Update of Government Assistance Provided to AIG

GAO-10-475

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Update of Government Assistance Provided to AIG

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Highlights

Highlights of GAO-10-475, 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)—a holding company that, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad—represents one of the federal government's largest investments in a private sector institution since the financial crisis began in 2008. Treasury and the Federal Reserve provided assistance to AIG in September 2008 that was restructured in November 2008 and March 2009. As part of GAO's statutorily mandated oversight of TARP, this report updates the risk and repayment indicators GAO originally reported in September 2009 (GAO-09-975). Specifically in this report, GAO discusses (1) trends in AIG's financial condition, (2) trends in the unwinding of AIG Financial Products (AIGFP), (3) the financial condition of AIG's insurance companies, and (4) the status of AIG's repayment of its federal assistance. To update the indicators, GAO primarily used data as of December 31, 2009, and more current publicly available information; reviewed rating agencies' reports; identified critical activities; and discussed them with officials from Treasury, Federal Reserve, and AIG.

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

View GAO-10-475 or key components.
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What GAO Found

Since our last report in September 2009, AIG's financial condition has remained relatively stable, as measured by several indicators, largely due to the federal assistance provided by the Federal Reserve and Treasury to assist AIG as a result of their determination that the company posed systemic risk to the financial system. Specifically, the Federal Reserve and Treasury have made more than $182 billion available to assist AIG since March 2008. As of December 31, 2009, the outstanding balance of the assistance provided to AIG was $129.1 billion, about $8.4 billion more than the balance on September 2, 2009 (see table). The federal assistance also appears to be facilitating a more orderly restructuring of the company. GAO's indicators show that, in general, the improvements in AIG's condition in the second quarter of 2009 continued into the third and fourth quarters due largely to ongoing federal assistance.

Several indicators show that AIGFP has continued to unwind its credit default swap positions. AIGFP also has shown progress in unwinding its Super Senior credit default swap portfolio but has made less progress in reducing the remaining multi-sector collateralized debt obligations (securities backed by a pool of bonds, loans, or other assets) portfolio. Several indicators on the status of AIG's insurance companies illustrate that AIG's insurance operations are showing signs of recovery, but federal assistance has been a critical factor. For the first time since the second quarter of 2008, additions to AIG life and retirement policyholder contract deposits have exceeded withdrawals. AIG's property/casualty companies also have shown some improvements.

AIG is continuing to repay its debt to the federal government, but much of the progress reflects the numerous exchanges of debt that AIG owed the Federal Reserve Bank of New York Revolving Credit Facility (facility) with various issues of preferred equity. As a result of this shift from debt to equity, which has occurred gradually, the authorized amount of the facility has decreased and the amount of preferred equity interests held in AIG and various special purpose vehicles for the government has increased. For example, as of December 30, 2009, the amount of assistance available to AIG through the facility had dropped to $35 billion and the amount AIG owed the facility had dropped to $23.4 billion, while the amount of equity or equity interest held by the government increased to almost $95 billion. Consequently, the government's exposure to AIG is increasingly tied to the future health of AIG, its restructuring efforts, and its ongoing performance. However, the sustainability of any positive trends in AIG's operations depends on how well it manages its business in this current economic environment. Similarly, the government's ability to fully recoup the federal assistance will be determined by the long-term health of AIG, the company's success in selling businesses as it restructures, and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government. We will continue to monitor these issues in our future work.

Overview of Federal Assistance Provided to AIG as of December 31, 2009

Dollar in billions

	Description of the federal assistance	Amount of assistance authorized: Debt	Amount of assistance authorized: Equity	Outstanding balance	Sources to repay the government
Implemented					
Federal Reserve	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 Treasury, which gave the trust a 77.9 percent voting interest in AIG.	$35[a]	N/A	$23.435	Proceeds from dispositions of AIG businesses, internal cash flows, and restructuring part of the Revolving Credit Facility from debt into equity. The initial commitment fee paid by AIG was reduced by $0.5 million to pay for the Series C shares. The trust must reimburse FRBNY for this amount when it disposes of the Series C shares.
	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	15.739[b]	Proceeds from asset sales in Maiden Lane II will be used to repay the FRBNY loan to Maiden Lane II.
	FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing collateralized debt obligations from AIG Financial Products' counterparties in connection with the termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30	N/A	18.159[b]	Proceeds from asset sales in Maiden Lane III will be used to repay the FRBNY loan.
	AIG created two SPVs, one for one for American International Assurance Company, Ltd (AIA) and one for American Life Insurance Company (ALICO), to hold the shares of certain of its foreign life insurance businesses to enhance AIG's capital and liquidity, and facilitate an orderly restructuring of AIG. FRBNY received on December 1, 2009, preferred equity interests in the SPVs of $16 billion and $9 billion, respectively, in exchange for reducing debt by 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.	N/A	25	25	On March 1, 2010, AIG announced agreement to sell AIA to Prudential PLC for approximately $35.5 billion (approximately $25 billion in cash plus $10.5 billion in equity linked securities and preferred stock). On March 8, 2010, AIG announced agreement to sell ALICO to Met Life for approximately $15.5 billion ($6.8 billion in cash plus $8.7 billion in Met Life equity and equity-linked securities).
Treasury	Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the Revolving Credit Facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends on the Series D shares were added to the principal amount of Series E stock that Treasury received.	N/A	40	41.605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to $29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares.	N/A	29.835	5.179	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Subtotals	**$87.5**	**$94.835**		
	Total authorized and outstanding assistance[c]		**$182.335**	**$129.117**	

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

Notes: Analysis does not include AIG's government debt under the FRBNY Commercial Paper Funding Facility of $4.739 billion as of December 31, 2009. This facility expired for new issuances on February 1, 2010, and will close upon maturity of all remaining commercial paper outstanding.

[a]The facility was initially $85 billion, was reduced to $60 billion in November 2008, and was reduced to $35 billion in December 2009. Balance shown includes accrued interest and fees of $5.535 billion.

[b]Government debt shown for Maiden Lane facilities as of December 31, 2009, are principal only and do not include accrued interest of $265 million for Maiden Lane II and $340 million for Maiden Lane III. Principal owed as of March 31, 2010, was $14.970 billion for Maiden Lane II and $16.929 billion for Maiden Lane III.

[c]Does not include AIG's participation in the Federal Reserve's Commercial Paper Funding Facility.

Contents

Tables

Figures

Abbreviations

AIA	American International Assurance Company, Ltd
AIG	American International Group, Inc.
AIGFP	AIG Financial Products
ALICO	American Life Insurance Company
CDO	collateralized debt obligations
CDS	credit default swaps
FRBNY	Federal Reserve Bank of New York
NAIC	National Association of Insurance Commissioners
NYSE	New York Stock Exchange
RMBS	residential mortgage-backed security
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SPV	special purpose vehicle
TARP	Troubled Asset Relief Program

GAO

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United States Government Accountability Office
Washington, DC 20548

April 27, 2010

Congressional Committees

Assistance provided to American International Group, Inc. (AIG) represents one of the federal government's largest investments in a private sector institution since the current financial crisis began in 2008. AIG is a holding company that, through its subsidiaries, engages in a broad range of insurance and insurance-related activities in the United States and abroad, including general insurance, life insurance and retirement services, financial services, and asset management. The potential demise of this company in 2008 threatened to further disrupt the already-troubled financial markets. To minimize the likelihood of such a scenario, the Board of Governors of the Federal Reserve System (Federal Reserve) and, subsequently, the Department of the Treasury (Treasury) deemed AIG to be systemically significant, opening the door for these entities to provide extraordinary assistance to AIG. The Federal Reserve, through its emergency powers under section 13(3) of the Federal Reserve Act, and Treasury, through the Emergency Economic Stabilization Act of 2008 (the act), 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 to avert a failure of the company and, in turn, further disruption of the financial markets. The ability of the government to recoup its assistance depends on the long-term health of AIG, its sales of certain businesses, and other factors.

[1]The Emergency Economic Stabilization Act of 2008 (the act), 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 the act 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.

Under our statutorily mandated responsibilities for providing timely oversight of TARP, we are 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 the federal assistance provided to AIG, we have developed indicators to monitor trends in AIG's operations and the status of repayments. Because the government assistance to AIG is a coordinated approach, in addition to providing timely reporting of Treasury's assistance to AIG, we are also monitoring the efforts of the Federal Reserve.[3] In September 2009 we issued a report on the status of government assistance to AIG in which we first reported on these indicators.[4] Since then, we have continued to monitor the financial risk posed by AIG, its financial condition, and the status of its repayment efforts.[5] This 60-day report provides an update on the AIG indicators primarily based on AIG's latest available public filings as of December 31, 2009, and other more current publicly available information where available. Specifically, the report discusses (1) trends in AIG's financial condition, (2) trends in the unwinding of AIG Financial Products (AIGFP), (3) the financial condition of AIG's insurance companies, and (4) the status of AIG's repayment of its federal assistance.

[2]GAO is required to report at least every 60 days on findings resulting from, among other things, oversight of TARP's performance in meeting the purposes of the act, 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, and TARP's compliance with applicable laws and regulations. 12 U.S.C. § 5226(a).

[3]Our ability to review the Federal Reserve's assistance was clarified by the Helping Families Save Their Homes Act of 2009, enacted on May 20, 2009, which provided GAO 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 GAO with authority to audit Federal Reserve actions taken with respect to three entities also assisted under TARP—Citigroup, Inc.; AIG; and Bank of America Corporation. This amendment also gave GAO the authority to access information from entities participating in TARP programs, such as AIG, for purposes of reviewing the performance of TARP.

[4]GAO, *Troubled Asset Relief Program: Status of Government Assistance to AIG*, GAO-09-975 (Washington, D.C.: Sept. 21, 2009). For our previous testimony on the assistance provided to AIG, see GAO, *Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG*, GAO-09-490T (Washington, D.C.: Mar. 18, 2009).

[5]GAO has recently been asked by Chairman Towns and Representative Cummings, House Committee on Oversight and Government Reform, and Ranking Member Bachus, House Committee on Financial Services, to undertake a review of the Federal Reserve's actions concerning its assistance to AIG. This report predates those requests and does not attempt to answer questions raised in either request.

To conduct this work, we updated previously published indicators that address several dimensions of AIG's business, including its credit ratings, operating performance, capital, debt repayment, and liquidity position. The data used to create the indicators are collected from several sources, but most are based on publicly available information, such as AIG's 10K and 10Q filings with the Securities and Exchange Commission (SEC) and National Association of Insurance Commissioners (NAIC) reports. We analyzed AIG's SEC filings through the fourth quarter of 2009 and supplements for those filings. We also analyzed information from Thomson Reuters and NAIC. We asked credit rating agencies for their most recent ratings of AIG. We also analyzed data from recent issues of the Federal Reserve weekly statistical releases H.4.1 and Treasury's Financial Position Paper 09-07. AIG also provided updated information on its asset dispositions. We assessed the reliability of the data and found that the data were sufficiently reliable for our purposes.

To assess AIG's financial condition, we updated indicators of key AIG credit ratings, its corporate debt and liquidity positions, trends in shareholder equity, operating income/losses, and its credit default swap (CDS) premiums. To assess the unwinding of AIGFP, we updated our indicators on AIGFP's trading positions and employee count, as well as its CDS portfolio.[6] To assess the financial condition of AIG's insurance companies, we reviewed the regulatory capital of AIG's largest domestic property/casualty and life insurance/retirement services companies, additions to and withdrawals from policyholder contract deposits, revenues and expenses for life insurance and retirement services, AIG general insurance premiums written, and combined ratios. To determine the status of AIG's repayment of its federal assistance, we updated the composition of the government's direct and indirect assistance to AIG, the Federal Reserve Bank of New York's (FRBNY) Revolving Credit Facility balance, balances on the Maiden Lane facilities, and AIG's divestitures and

[6]CDS are bilateral contracts that are sold over the counter and transfer credit risks from one party to another. The seller, who is offering credit protection, agrees, in return for a periodic fee, to compensate the buyer if a specified credit event, such as default, occurs.

asset dispositions.[7] We report the balances of the federal debt and equity assistance as of December 31, 2009, because our primary source for equity data, which is AIG's 10Q filing with the SEC, is only available quarterly, and the 10Q report containing more current data is not yet publicly available. No single indicator provides a definitive measure of AIG's progress, and the indicators in this report should be considered collectively. We selected indicators that appeared to track the most critical activities related to the goals for federal assistance to AIG. Since our last report, we have developed two new indicators of AIG's financial condition: one new indicator to track the performance of AIG's insurance companies and one new indicator to track federal assistance to AIG.

We conducted our work from November 2009 to April 2010 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions.

Background

AIG comprises approximately 400 companies and has operations in more than 130 countries and jurisdictions worldwide. As of December 31, 2009, AIG had assets of $847.6 billion and revenues of $96 billion for the 12 preceding months. The AIG companies are among the largest domestic life insurers and domestic property/casualty insurers in the United States, and they also comprise large foreign general insurance and life insurance businesses. Appendix I illustrates the breadth of AIG's operations and its subsidiaries.

AIG Operations

Historically, AIG has issued commercial paper to help finance its operations. For example, as of December 31, 2007, AIG reported having

[7]FRBNY created Maiden Lane II as a special purpose vehicle to provide AIG liquidity through its purchase of residential mortgage-backed securities from AIG life insurance companies. FRBNY provided a loan to the special purpose vehicle for the purchases. It also terminated a previously established securities lending program with AIG. FRBNY also created Maiden Lane III as a special purpose vehicle to provide AIG liquidity through its purchase of collateralized debt obligations from AIG Financial Products' counterparties in connection with termination of credit default swaps. FRBNY again provided a loan to the special purpose vehicle for the purchases. See GAO-09-975 (starting on page 30) for more discussion on FRBNY's creation of these special purpose vehicles.

$13.1 billion of commercial paper outstanding, and as of December 31, 2009, it continued to have $4.7 billion outstanding.[8] It is also a participant 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 December 31, 2009, AIG's total gross derivatives assets had a fair value of $34.5 billion, of which $32.0 billion pertained to AIGFP. 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, among other investments, residential mortgage-backed securities (RMBS). This program was another major source of AIG's liquidity problems in 2008.

AIG and its subsidiaries are regulated by federal, state, and international authorities. The Office of Thrift Supervision was the consolidated supervisor of AIG, which is a thrift holding company by virtue of its ownership of the AIG Federal Savings Bank. As the consolidated supervisor, the Office of Thrift Supervision was charged with identifying systemic issues or weaknesses and helping ensure compliance with regulations that govern permissible activities and transactions.[9] AIG's domestic, life, and property/casualty insurance companies are regulated by the state insurance regulators in the state in which these companies are domiciled.[10] These state agencies regulate the financial solvency and market conduct of these companies within their states, 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

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

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

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

business that are conducted in foreign countries are regulated by the supervisors in those jurisdictions to varying degree.

In addition, Treasury's purchase, management, and sale of assets under TARP, including those associated with AIG, are subject to oversight by the Special Inspector General for TARP (SIGTARP). As part of its quarterly reports to Congress, SIGTARP has provided information on federal assistance and the restructuring of the federal assistance provided to AIG, as well as information on the unwinding of AIGFP and the sale of certain AIG assets.[11] SIGTARP's reporting on AIG's activities has also included reports that focused on federal oversight of AIG compensation and efforts to limit AIG's payments to its counterparties.[12]

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

In September 2008, the Federal Reserve (and 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 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

[11]SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, January 30, 2010; Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, October 21, 2009; Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, July 21, 2009; Office of the Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, April 21, 2009; and Office of the Inspector General for the Troubled Asset Relief Program, *Initial Report to the Congress*, February 6, 2009.

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

[13]As we said in our March 2009 testimony on credit default swaps, there is no single definition for systemic risk. 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).

AIG in September 2008 and has taken subsequent steps to modify and amend that assistance.

AIG's Financial Problems Mounted Rapidly in 2008

From July through early September in 2008, AIG faced increasing liquidity pressure following a downgrade in its credit ratings in May 2008 due in part to losses from its securities lending program. The company was experiencing declines in its securities lending reinvestment portfolio of RMBS assets and declining values of collateralized debt obligations (CDO) against which AIGFP had written CDS protection.[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 to post additional collateral required by the trading counterparties of AIGFP. AIG attempted to raise additional capital in the private market in September 2008, but was unsuccessful. On September 15, 2008, the rating agencies downgraded AIG's debt rating, which resulted in the need for an additional $20 billion to fund its added collateral demands and transaction termination payments. Following the credit rating downgrade, an increasing number of counterparties refused to transact with AIG for fear that it would fail. Also around this time, the insurance regulators decided they would no longer allow AIG's insurance subsidiaries to lend funds to the parent company under a revolving credit facility that AIG maintained. Furthermore, the insurance regulators demanded that any outstanding loans be repaid and that the facility be terminated.

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

Because of increasing concerns that an AIG failure would have posed systemic risk to financial markets, in 2008 and 2009 the federal government agreed to make more than $182 billion of federal assistance available to AIG. First, in September 2008, the Federal Reserve, with the support of Treasury, authorized FRBNY to lend AIG up to $85 billion.[15] The secured loan was set up as a Revolving Credit Facility that AIG could use as a reserve to meet its obligations. This debt was subsequently restructured in November 2008 and March 2009.

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

[15]The Federal Reserve announced that, as a condition of establishing the initial $85 billion credit facility, a trust established for the sole benefit of the U.S. Treasury would become the majority equity investor in AIG. This was achieved through the establishment of an independent trust to manage Treasury's beneficial interest in preferred shares (Series C) of AIG. When the trust agreement was executed in January 2009, the Series C stock was convertible into approximately 77.9 percent of the issued and outstanding shares of common stock of AIG.

Specifically, AIG's mounting debt—the result of borrowing from the Revolving Credit Facility—led to concerns that its credit ratings would be lowered, which would have caused its condition to deteriorate further. In response, the Federal Reserve and Treasury restructured AIG's debt in November 2008. Under the restructured terms, Treasury purchased $40 billion in shares of AIG preferred stock (Series D), and the cash from the sale was used to pay down a portion of AIG's outstanding Revolving Credit Facility balance. The limit on the Revolving Credit Facility was also reduced to $60 billion, and other changes were made. This restructuring was critical to helping AIG maintain its credit ratings.

In March 2009, the Federal Reserve and Treasury announced plans to further restructure AIG's assistance. According to the Federal Reserve, debt owed by AIG on the Revolving Credit Facility would be reduced by $25 billion in exchange for FRBNY's receipt of preferred equity interests totaling $25 billion in two special purpose vehicles (SPV). Both SPVs were created by AIG to hold the outstanding common stock of two life insurance holding company subsidiaries of AIG—American Life Insurance Company (ALICO) and American International Assurance Company, Ltd (AIA). FRBNY's preferred equity interest, which was valued at $25 billion in December 2009, is an undisclosed percentage of the fair market value of ALICO and AIA as determined by FRBNY. On March 1, 2010, AIG announced that its board had approved the sale of AIA to Prudential PLC and the transaction is expected to close by the end of 2010 for approximately $35.5 billion in cash and equity securities, pending approval by regulators and stockholders.[16] And on March 8, 2010, AIG announced that its board had agreed to sell ALICO to MetLife and the transaction is expected to close by the end of 2010 for about $15.5 billion in cash and equity securities, pending approval by regulators.[17]

Federal assistance to AIG also included FRBNY's creation of two new facilities to purchase some of AIG's more troubled assets. AIG's securities lending program continued to be one of the greatest ongoing demands on its working capital, and on November 10, 2008, FRBNY announced plans

[16]According to AIG, cash proceeds from the sale will allow AIG to buy back all of FRBNY's preferred equity interest in AIA and repay part of the FRBNY Revolving Credit Facility.

[17]According to AIG, cash proceeds from the sale will allow AIG to reduce part of FRBNY's preferred equity interest in ALICO. Over time, the MetLife securities in the ALICO SPV will be sold and the funds will be used to FRBNY's remaining preferred interests in ALICO and, subsequently, repay AIG's debt on the FRBNY Revolving Credit Facility.

to create a RMBS facility—Maiden Lane II LLC—to purchase RMBS assets from AIG's U.S. securities lending collateral portfolio. The Federal Reserve authorized FRBNY to lend up to $22.5 billion to Maiden Lane II; AIG also acquired a subordinated, $1 billion interest in the facility, which will absorb the first $1 billion of any losses. On December 12, 2008, FRBNY extended a $19.5 billion loan to Maiden Lane II to fund its portion of the purchase price of the securities. The facility purchased $39.3 billion face value of the RMBS directly from AIG subsidiaries (domestic life insurance companies). As of December 30, 2009, Maiden Lane II owed $16 billion in principal and interest to FRBNY.

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

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

In March 2009, the Federal Reserve announced its intention to assist AIG in the form of credit made under section 13(3) of the Federal Reserve Act.

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

[19] AIGFP sold CDS on multi-sector 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.

FRBNY was authorized to make loans of up to an aggregate amount of approximately $8.5 billion to SPVs to be established by certain AIG domestic life insurance subsidiaries. As announced, the SPVs were to repay the loans from the net cash flows they were to receive from designated blocks of existing life insurance policies issued by the insurance companies. The proceeds of the FRBNY loans were to pay down an equivalent amount of outstanding debt under the Revolving Credit Facility. However, in February 2010, AIG announced that it is no longer pursuing this life insurance securitization transaction with FRBNY.

Treasury has also provided assistance to AIG. On November 10, 2008, Treasury's Office of Financial Stability announced plans under TARP to purchase $40 billion in AIG preferred shares. AIG entered into an agreement with Treasury on November 25, 2008, whereby Treasury agreed to purchase $40 billion of fixed-rate cumulative preferred stock of AIG (Series D) and received a warrant to purchase approximately 2 percent of the shares of AIG's common stock.[20] As previously discussed, the proceeds of this sale were used to pay down AIG's outstanding balance on the Revolving Credit Facility by the same amount.

On April 17, 2009, AIG and Treasury entered into an agreement in which Treasury agreed to exchange its $40 billion of Series D cumulative preferred stock for $41.6 billion of Series E fixed-rate noncumulative preferred stock of AIG, allowing for a reduction in leverage and dividend requirements. The $1.6 billion difference between the initial aggregate liquidation preference of the Series E stock and the Series D stock represents a compounding of accumulated but unpaid dividends owed by AIG to Treasury on the Series D stock. Because the Series E preferred stock more closely resembles common stock, principally because its dividends are noncumulative, rating agencies viewed the stock more positively when rating AIG's financial condition.

Finally, also on April 17, 2009, Treasury provided a $29.835 billion Equity Capital Facility to AIG whereby AIG issued to Treasury 300,000 shares of fixed-rate noncumulative perpetual preferred stock (Series F) and a warrant to purchase up to 3,000 shares of AIG common stock. The facility was intended to strengthen AIG's capital levels and improve its leverage.

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

As AIG draws on the Equity Capital Facility, the aggregate liquidation preference of the Series F stock is adjusted upward.[21] As of December 31, 2009, AIG had drawn down about $5.2 billion of the commitment. Table 1 provides an overview of the various forms of assistance, the purpose of each form of assistance, the amounts authorized, the amounts loaned or used for investments, and the outstanding balance as of December 31, 2009.

Table 1: U.S. Government Efforts to Assist AIG and the Government's Remaining Exposure as of December 31, 2009

Dollars in billions

		Amount of assistance authorized			
Implemented	Description of the federal assistance	Debt	Equity	Outstanding balance	Sources to repay the government
Federal Reserve	FRBNY created a Revolving Credit Facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity positions. In exchange for the facility and $0.5 million, a trust received Series C preferred stock for the benefit of the Treasury, which gave the trust a 77.9 percent voting interest in AIG.	$35[a]	N/A	$23.435	Proceeds from dispositions of AIG businesses, internal cash flows, and restructuring part of the Revolving Credit Facility from debt into equity. The initial commitment fee paid by AIG was reduced by $0.5 million to pay for the Series C shares. The trust must reimburse FRBNY for this amount when it disposes of the Series C shares.
	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	15.739[b]	Proceeds from asset sales in Maiden Lane II will be used to repay the FRBNY loan.

[21]The securities purchase agreement indicates that the amount of $29.835 billion is equal to $30 billion minus $165 million in retention payments made by AIGFP; AIG Trading Group, Inc.; and their respective subsidiaries to their employees in March 2009.

Dollars in billions

Implemented	Description of the federal assistance	Amount of assistance authorized: Debt	Amount of assistance authorized: Equity	Outstanding balance	Sources to repay the government
	FRBNY created an SPV called Maiden Lane III to provide AIG liquidity by purchasing CDOs from AIG Financial Products' counterparties in connection with the termination of credit default swaps. FRBNY again provided a loan to the SPV for the purchases.	30	N/A	18.159[b]	Proceeds from asset sales in Maiden Lane III will be used to repay the FRBNY loan.
	AIG created two SPVs (AIA and ALICO) to hold the shares of certain of its foreign life insurance businesses. FRBNY received on December 1, 2009, preferred equity interests in the SPVs of $16 billion and $9 billion, respectively, in exchange for reducing debt by AIG owed on the Revolving Credit Facility. The SPVs allowed AIG to strengthen its balance sheet by reducing debt and increasing equity and also were intended to facilitate dispositions to generate cash for repayment of the federal assistance.	N/A	25	25	On March 1, 2010, AIG announced agreement to sell AIA to Prudential PLC for approximately $35.5 billion (approximately $25 billion in cash, plus $10.5 billion in equity linked securities and preferred stock). Cash proceeds will allow AIG to buy back all of FRBNY's preferred equity interest in AIA and repay part of the revolving credit facility. On March 8, 2010, AIG announced agreement to sell ALICO to Met Life for approximately $15.5 billion ($6.8 billion in cash, plus $8.7 billion in Met Life equity and equity-linked securities). Cash proceeds will allow AIG to buy back part of FRBNY's preferred equity interest in ALICO. Over time, AIG will convert equity securities it received to cash to buy back FRBNY's remaining preferred equity interest in ALICO and repay more of its debt on the revolving credit facility.
Treasury	Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the Revolving Credit Facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends on the Series D shares were added to the principal amount of Series E stock that Treasury received.	N/A	40	41.605	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.

Dollars in billions

Implemented	Description of the federal assistance	Amount of assistance authorized: Debt	Amount of assistance authorized: Equity	Outstanding balance	Sources to repay the government
	Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to $29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares.	N/A	29.835	5.179	Proceeds from dispositions of AIG businesses and internal cash flows of AIG.
	Subtotals	**$87.5**	**$94.835**		
	Total authorized and outstanding assistance[c]		**$182.335**	**$129.117**	

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

Notes: Analysis does not include AIG's government debt under the FRBNY Commercial Paper Funding Facility of $4.739 billion at December 31, 2009. This facility expired for new issuances on February 1, 2010, and will close upon maturity of all remaining commercial paper outstanding.

[a]The facility was initially $85 billion, was reduced to $60 billion in November 2008, and was reduced to $35 billion in December 2009. Balance shown as owed includes accrued interest and fees of $5.535 billion.

[b]Government debt shown for Maiden Lane facilities as of December 31, 2009, are principal only and do not include accrued interest of $265 million for Maiden Lane II and $340 million for Maiden Lane III. Principal owed as of March 31, 2010, was $14.970 billion for Maiden Lane II and $16.929 billion for Maiden Lane III.

[c]Does not include AIG's participation in the Federal Reserve's Commercial Paper Funding Facility.

Federal Assistance Remains Key to Stabilizing AIG's Financial Condition

Since our last report in September 2009, AIG's financial condition has remained relatively stable as measured by several indicators. These include the strength of AIG's credit ratings; trends and levels of available liquidity and sources for working capital; the level of shareholders' equity and trends in operating income; and CDS premiums on AIG, which is the going market price for credit protection on AIG. However, this stabilization remains largely attributable to the assistance AIG has received from the Federal Reserve and Treasury, not its ability to access private sources of capital. Specifically, AIG's credit ratings have remained stable over the fourth quarter in large part because government support has continued to fill AIG's short-term capital needs and allowed AIG to meet its payment obligations. Similarly, AIG's level of available corporate liquidity has stabilized, although the FRBNY Revolving Credit Facility and Treasury's Equity Capital Facility continue to be its primary sources of working capital. While the company's long-term goal is to rely on private sources of capital and its own operations instead of the government, AIG remains heavily reliant on federal assistance to meet its liquidity needs. Trends and level of AIG's consolidated shareholders' equity—generally a company's total assets minus total liabilities—showed improvements in 2009. While these trends were largely driven by the federal assistance, AIG's performance has contributed to the improvements in its equity position. Specifically, the efforts of AIG, FRBNY, and Treasury to restructure the composition of the federal assistance have reduced AIG's debt and boosted its shareholders' equity. However, whether AIG will return to positive retained earnings, which should further increase shareholder's equity, remains unclear. Finally, measures of AIG's operating income and losses illustrated that because of federal assistance, the large increasing losses AIG experienced through 2008 slowed in 2009. AIG generated a modest income in the second quarter of 2009 but experienced increasing losses in the following third and fourth quarters. However, these losses were only a fraction of the size of the operating losses in 2008. Finally, trends in CDS premiums on AIG showed that prices offered for credit protection on AIG have been stabilizing or trending down since May of 2009.

AIG's Credit Ratings Remained Stable Between May and December 2009

Ratings of AIG's debt and financial strength by various credit rating agencies have not changed from May 2009 through December 15, 2009, primarily because federal assistance has provided AIG with needed capital. Credit ratings measure a company's ability to repay its obligations and directly affect that company's cost of and ability to access unsecured financing. If a company's ratings are downgraded, its borrowing costs can increase, capital can be more difficult to raise, business partners may terminate contracts or transactions, counterparties can demand additional collateral, and operations can become more constrained generally. Rating agencies can downgrade the company's key credit ratings if they believe it is unable to meet its obligations. In AIG's case, this could affect its ability to raise funds and could increase the cost of financing its major insurance operations, and, in turn, impede AIG's restructuring efforts. A downgrade in AIG's credit ratings also could result in downgrades on insurer financial strength ratings for the AIG life and property/casualty companies, further declines in credit limits, and counterparties demanding that AIG post additional collateral. Collectively, these effects from a rating downgrade could impede AIG's restructuring efforts and hamper any plans to access traditional sources of private capital to replace the public investments. Conversely, an upgrade in AIG's credit ratings would indicate an improvement in its condition and possibly lead to lower borrowing costs and facilitate corporate restructuring.

AIG's key credit ratings have remained unchanged since May 2009.[22] For example, from March 31, 2009, to December 15, 2009, AM Best, Moody's, and Standard & Poor's (S&P) maintained the same credit ratings for AIG's long-term debt and the financial strength of its property/casualty and life insurance companies due in large part to the Federal Reserve and Treasury's support.[23] While contributing to stable ratings thus far, the scale of this assistance eventually may raise questions about AIG's future prospects if the company is not able to raise capital from private sources. For example, because of the importance of the federal funds to AIG's solvency, Fitch's ratings of AIG in several categories were lowered in May 2009. However, Fitch's ratings have not changed since May 2009. The general stability of AIG's long-term debt ratings has allowed the company to avoid collateral and termination payments that could result from a ratings downgrade because counterparties might demand such payments at the sign of weakening financial strength. Similarly, generally stable life-insurer financial strength ratings have helped keep down both the surrender rate of domestic retirement services and any pressure on the company to exit businesses that serve high net-worth clients or businesses governed by trust contracts. Further, generally stable property/casualty financial strength ratings have helped hold down any significant losses in net premiums written and operating losses. AIG's credit ratings remained unaffected with the December 2009 placement of AIA and ALICO into SPVs.

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

[23]AIG's long-term debt was rated at A-/Negative (S&P) and A3/Negative (Moody's), and its short-term debt was rated at A-1 (S&P) and P-1 (Moody's). While these ratings are described using slightly different terminology, they tend to show relative consistency in the strength of AIG's debt.

Federal Assistance Has Allowed AIG to Maintain a Steady Level of Liquid Assets, and Debt Projections Have Remained Stable

Since the fourth quarter of 2008, AIG's available corporate liquidity has remained stable due to federal assistance, and projections of debt have also remained fairly stable. Because a financially healthy business should have adequate holdings of liquid assets to cover maturing debt, we use three indicators to monitor AIG's corporate liquidity.[24] One indicator monitors the timing of potential future demand on AIG's corporate liquidity posed by its maturing debt and AIG's ability to meet its cash payment needs. If working and short-term capital become less accessible or if the level of maturing debt increases, AIG could face a higher risk of another liquidity crisis. The second indicator monitors the amount of corporate liquidity available from specific sources. Sources of available liquidity provide an indication of how AIG obtains the funds needed to meet its obligations. The third indicator, which we have added since our initial reporting on AIG in September 2009, monitors the extent to which AIG has used commercial paper to strengthen its liquidity position. The greater the portion of current available liquidity provided by AIG's own operations, the less reliant AIG will be on federal assistance.

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

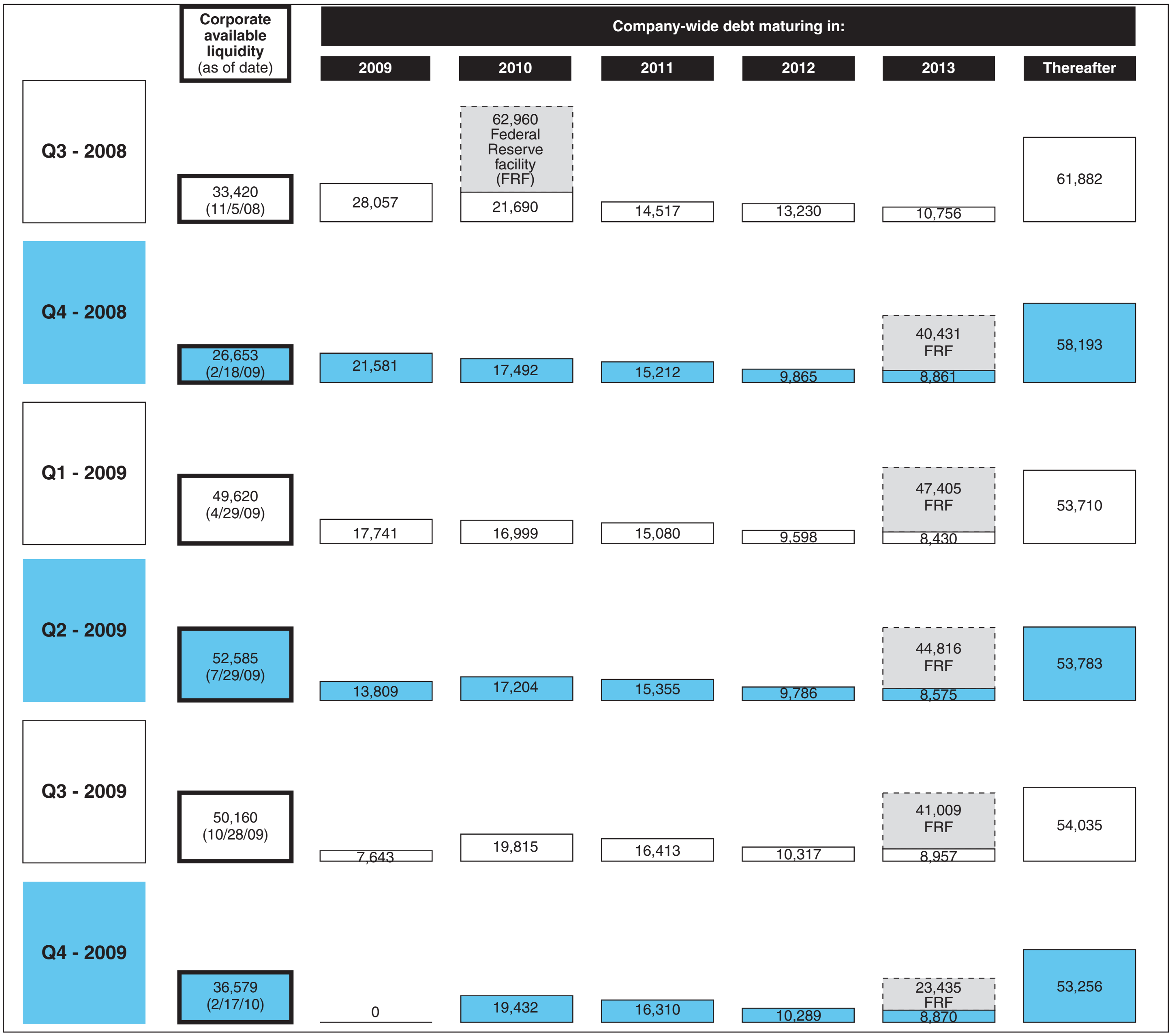
[24]Liquid assets—such as accounts receivable, cash on hand, Treasury Bills, and certificates of deposits—are assets that can be converted easily and quickly to cash.

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

As of February 2010, the amount of corporate liquidity available to AIG had fallen to $36.6 billion, largely because the ceiling on the Revolving Credit Facility was reduced again in December 2009 by $25 billion (from $60 billion to $35 billion) when AIG transferred AIA and ALICO into two SPVs in which FRBNY received a preferred equity interest.[26] Over this same period, the amount of company-wide debt stabilized as well, due to restructuring and deleveraging activity. These trends suggest that since late 2008, the Federal Reserve's actions were critical for AIG's solvency.

[26]In this transaction, FRBNY received preferred equity valued at $25 billion, and in exchange the debt AIG owed to the FRBNY Revolving Credit Facility was lowered by an equivalent amount.

Figure 1: AIG: Corporate Available Liquidity and Company-Wide Debt Projections, Third Quarter of 2008 through Fourth Quarter of 2009 (dollars in millions)



Source: GAO analysis of AIG SEC filings.

Notes: Available liquidity is at the corporate level, and debt maturing is at the corporate and operating-division levels. Much of the debt of the operating divisions is associated with assets serving as collateral or funding sources; thus repayment of this debt is not likely to rely on corporate liquidity. The figures exclude borrowings on consolidated investments that were less than 3.5 percent of total long-term borrowings.

Data disclosed by AIG indicate that since November 2008 the corporate liquidity available to AIG essentially has been the undrawn portions of three federally provided sources—the FRBNY Revolving Credit Facility, the CPFF, and Treasury's Equity Capital Facility. Over time, AIG's primary source of funds has shifted away from FRBNY's Revolving Credit Facility and CPFF to Treasury's Equity Capital Facility, which remained its primary source of funds through 2009. Since late 2008, less than $5 billion has been available from AIG's internal sources or from private sector sources. Thus, federal sources have allowed AIG to substantially improve its liquidity position relative to what it would have been able to achieve on its own. See appendix III for further discussion of AIG's available corporate liquidity.

Historically, AIG issued commercial paper to third parties to meet its liquidity needs, but since October 2008, the company has relied on FRBNY's CPFF to purchase its commercial paper. Because commercial paper is typically unsecured and issued by companies with high credit ratings, AIG's ability to access the traditional commercial paper market (independent of Federal Reserve programs) would be a positive signal regarding its financial condition. As shown in table 2, AIG's commercial paper programs, which reflect the amount of commercial paper AIG has issued to third parties, have steadily decreased from a high of about $13 billion in December 2007. Due to the general breakdown of the U.S. commercial paper market and reluctance from market participants to purchase or roll over AIG's commercial paper, by September 30, 2008, the balance had dropped to $5.6 billion. As of December 31, 2009, AIG had no outstanding commercial paper held by third parties. According to AIG, this is because all of AIG's third party commercial paper had matured and, currently, AIG's subsidiaries do not have access to third party commercial paper funding. This funding source had been replaced by commercial paper purchased by FRBNY's CPFF, which was utilized by AIG until the facility expired on February 1, 2010. As a result of the facility closing, AIG's CPFF amount outstanding had decreased to $4.7 billion from a high of $15 billion one year earlier. However, given AIG's ongoing reliance on federal assistance, it remains unclear when support provided by CPFF will be replaced with funds from AIG's own operations. Unlike many of the other large institutions that received government support as a result of the financial crisis, AIG has not yet been able to tap traditional sources of short-term capital, including commercial paper or other debt markets until recently. In particular, International Lease Finance Corp. (ILFC) and American General Finance (AGF) recently have been able to access the capital markets. In March 2010, ILFC sold $4.05 billion of secured debt and unsecured debt, and in April 2010, AGFS Funding Company—a wholly-owned indirect subsidiary of AGF—entered into and fully drew down a $3 billion, 5-year term loan.

Table 2: Amount of Outstanding Commercial Paper by Source, December 31, 2007, through December 31, 2009

Dollars in millions

	Dec. 31, 2007	Sept. 30, 2008	Dec. 31, 2008	Mar. 31, 2009	June 30, 2009	Sept. 30, 2009	Dec. 31, 2009
FRBNY CPFF program	$0	$0	$15,105	$12,242	$11,152	$9,607	$4,739
AIG's Commercial Paper programs	13,114	5,600	613	196	197	0	0
Total	**$13,114**	**$5,600**	**$15,718**	**$12,438**	**$11,349**	**$9,607**	**$4,739**

Sources: GAO analysis of AIG SEC filings.

Note: Does not include $1.1 billion outstanding by Nightingale.

Shareholders' Equity Continued to Improve in 2009

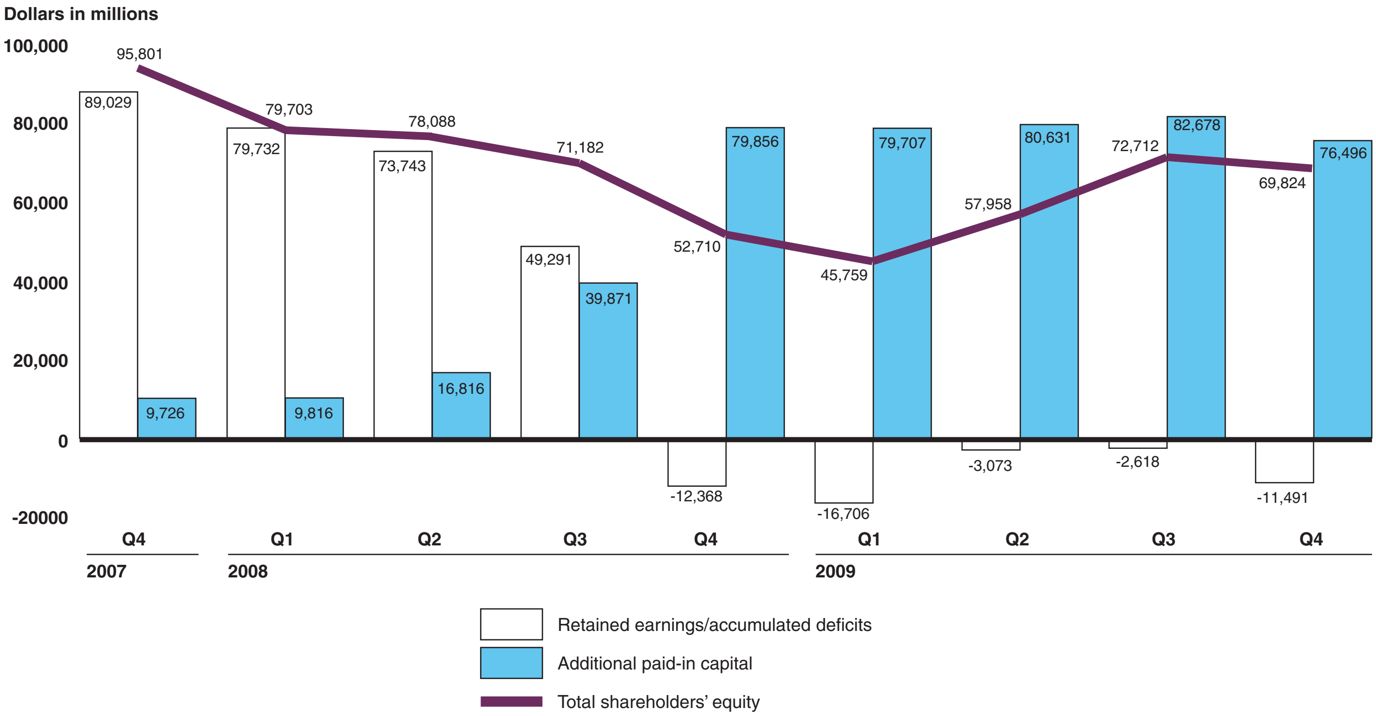
In contrast to the downward trends in 2008, AIG's shareholders' equity increased over the first three quarters of 2009 and its negative retained earnings, also known as accumulated deficits, decreased by nearly 85 percent. Rising accumulated deficits generally indicate mounting losses, while decreasing accumulated deficits could indicate a return to profitability. Shareholders' equity is generally calculated by subtracting a company's total assets from its total liabilities, and represents the company's ability to absorb negative shocks and prevent failure due to insolvency. One source of shareholders' equity is capital raised by issuing and selling common and preferred stock to investors, also referred to as paid-in capital. Another source is retained earnings, which the company accumulates over time through its operations.[27]

As figure 2 shows, AIG's shareholders' equity had 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

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

earnings in 2007 to completely paid-in capital by the end of 2009, reflecting the importance of federal assistance to its solvency. Specifically, AIG's shareholder's equity fell almost 48 percent, from $95.8 billion at the end of 2007 to $45.8 billion by the end of the first quarter of 2009, but rose the second and third quarter of 2009 and declined slightly to $69.7 billion in the fourth quarter of 2009. In the last quarter of 2007, retained earnings was the primary source of shareholders' equity, contributing $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 quarter 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. As shown in figure 2, starting in the fourth quarter of 2008, paid-in capital become the primary source of shareholders' equity because of the federal assistance.

Figure 2: AIG: Trends in and Main Components of Consolidated Shareholders' Equity, Fourth Quarter of 2007 through Fourth Quarter of 2009



Source: GAO analysis of AIG SEC filings.

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

There are several federal actions that caused these fluctuations and changes in 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 in order to obtain AIG's Revolving Credit Facility established by FRBNY.[28]
- In November 2008, Treasury purchased $40 billion of cumulative preferred shares (Series D) and received a warrant from AIG. AIG recorded the transaction as additional paid-in capital repaid.

The value of the federal government's common equity interests in AIG is tied to the market value of AIG's common stock, which has fluctuated over the last year. As a result, growth in value of the government's equity stake depends on further growth of the value of common shares. The values of the shares increased between March and September 2009 but fell slightly in the fourth quarter of 2009.[29] The market value of AIG's common shares outstanding peaked in December 2006 at $186.4 billion and by June 2008, as AIG's losses from its derivatives businesses continued to mount, the shares' market value declined to $71.1 billion (see appendix IV). During the last two quarters of 2008, when federal assistance was initially provided to AIG, AIG shares further declined in value, falling to $4.2 billion by the end of 2008. During the first quarter of 2009, AIG's common shares fell roughly 36 percent, underperforming the Thomson Reuters Insurance Index and the New York Stock Exchange (NYSE) Composite Index,

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

[29]As previously discussed, the federal equity investment includes federally owned Series C preferred shares that are convertible into 79.77 percent of total outstanding common shares. Under the terms of the Series C preferred stock issuance, the preferred stock is convertible into AIG's common stock. The conversion formula provides that the trust will receive 79.77 percent of AIG's common stock less the percentage of common stock that may be acquired by or for the benefit of Treasury as a result of warrants or other convertible preferred stock held by Treasury. Treasury received a warrant to purchase 2,690,088 shares of AIG Common Stock in connection with its purchase of Series D preferred stock, and an additional warrant to purchase AIG common stock in connection with its purchase of Series F preferred stock. Proceeds from the sale of the trust stock will be deposited in the U.S. Treasury General Fund.

pushing the value of its common stock below $3 billion. [30] Over the second and third quarter of 2009, AIG's stock price increased by 121 percent and outperformed both the NYSE Composite and the Insurance Index, resulting in a market capitalization of about $4.5 billion. However, since we last reported in September 2009, the value of the shares has fallen by more than 22 percent compared to gains of 13 and 8 percent respectively for the Insurance Index and NYSE Composite Index.

Income from AIG's Operations Has Begun to Stabilize with Federal Assistance

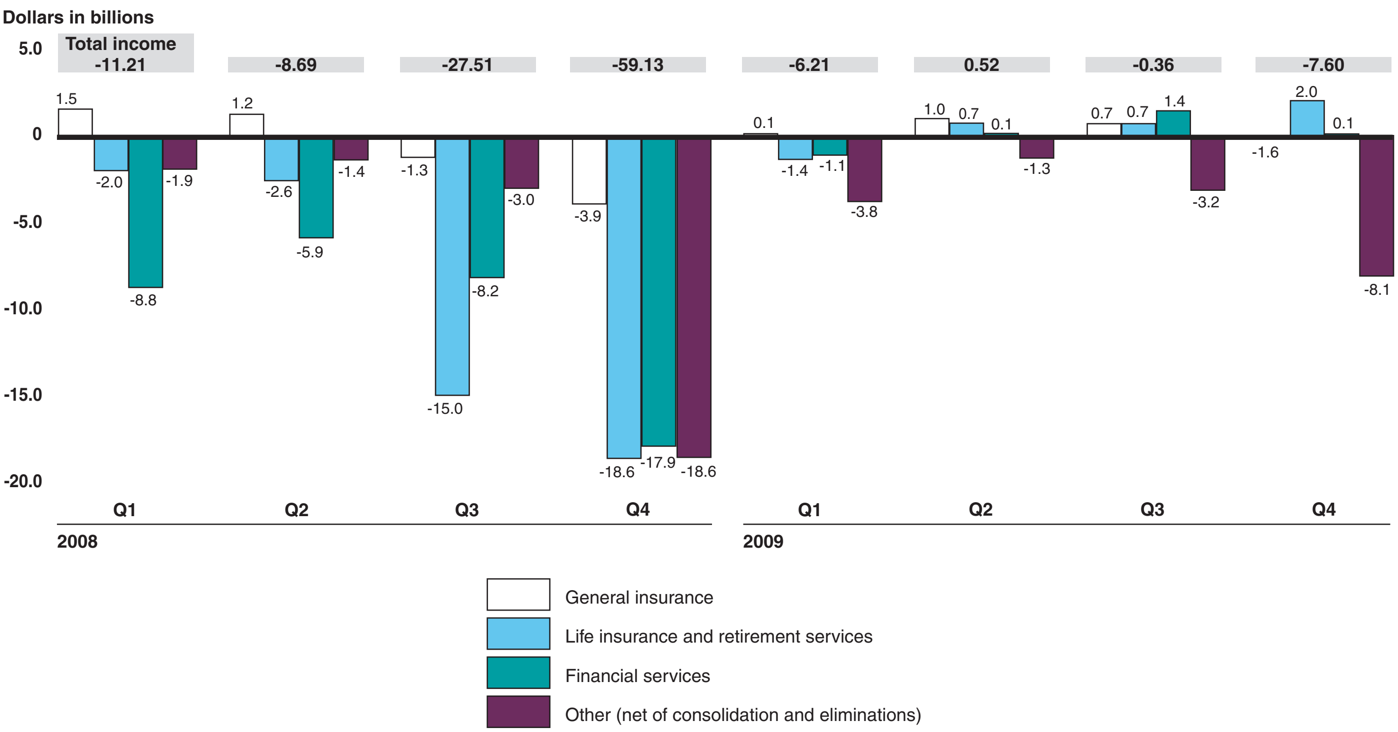
With the benefit of federal assistance, several of AIG's operating segments are beginning to stabilize, producing income instead of losses. To the extent that AIG's operating entities are profitable, they will generate income that could improve AIG's ability to sell certain businesses, retain others, and repay its federal assistance. If the businesses operate at a loss, AIG could face greater risks in its ability to repay the federal assistance and its ability to remain viable. The following indicator tracks the operating income and losses (before taxes) for AIG's insurance businesses and its major segments, including asset management, financial services, and other services that it expects to sell off as part of the restructuring.

As shown in figure 3, all of AIG's operating segments had operating losses in the last two quarters of 2008, but by the first quarter of 2009, some of the segments had considerably smaller operating losses, and other segments had operating income due in part to federal assistance such as Maiden Lane II and Maiden Lane III. AIG's general insurance segment (which includes AIG's domestic and foreign property/casualty businesses) reported an operating loss in 2008, largely due to operating losses from insurance underwriting, large net realized capital losses, and reduced investment income in the second half of the year. After three quarters with operating income in 2009 and operating losses in the fourth quarter, this segment ended the year with a relatively small operating profit for 2009. The improvement in 2009 relative to 2008 was largely due to reduced net realized capital losses and increased investment income that more than offset larger insurance underwriting losses. This is noteworthy, because historically, the general insurance segment has generated the largest operating income of all AIG segments. For example, operating income

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

from this segment accounted for more than half of AIG's total operating income for 2006 and 2007 combined. Tracking the operating performance of this segment is also important because AIG plans to retain its property/casualty insurance businesses among its core operations after the restructuring and divestitures of other businesses. As a result, AIG's ability to repurchase its preferred shares from Treasury will be partly contingent on the health of this segment.

Figure 3: Quarterly AIG Pretax Operating Income/Loss by Operating Segment, First Quarter of 2008 through Fourth Quarter of 2009



Source: GAO analysis of AIG SEC filings.

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

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

Figure 3 also shows that AIG's life insurance and retirement services segment incurred the largest operating losses of all of AIG's segments during the last half of 2008. Its losses could be largely attributed to net realized capital losses in the investment portfolios of domestic and foreign life insurance businesses due to severe market price declines in certain commercial mortgage-backed securities and other securities. In 2009 the life insurance and retirement services segment reported an operating profit compared to a loss in 2008, primarily because net realized capital losses declined and investment results improved. These improved investment results more than offset the decline in premium revenues, increase in claims and benefits, and related expenses.

The financial services segment reported losses in 2008 that were primarily attributed to unrealized market valuation losses from credit valuation adjustments in AIGFP's super senior credit default swap portfolio, and credit valuation adjustments on AIGFP assets and liabilities (see figure 3). In 2009 Financial Services reported an operating profit of $517 million, primarily because the combined operating profit for AIGFP and Aircraft Leasing were greater than the operating loss from consumer finance.

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

AIG Credit Default Swap Premiums Appear to Be Returning to Precrisis Levels

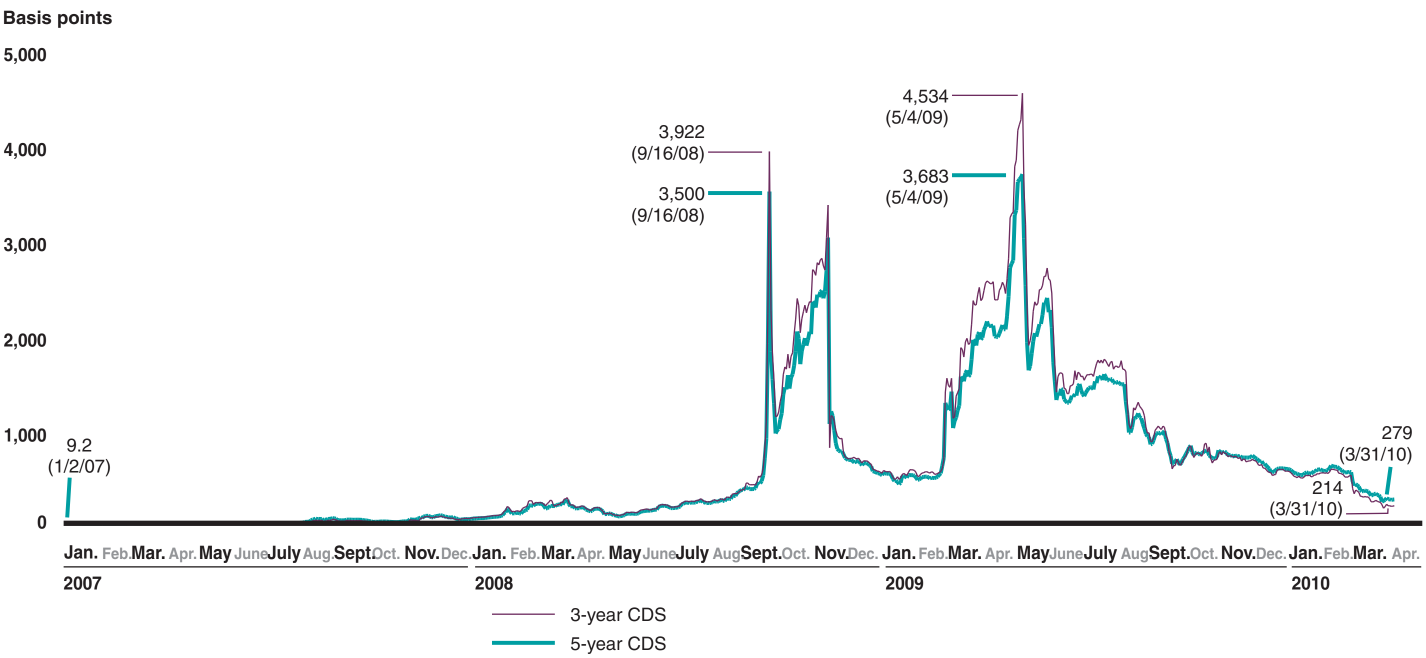
Dropping from their recent peak in May 2009, AIG CDS premiums have decreased and appear to be returning to precrisis levels. These premiums, which are the price insured parties pay to purchase CDS protection against AIG defaulting on senior unsecured debt, are another indicator of AIG's financial strength. 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.[31] 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

[31]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.

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 lower the market's expectation that AIG will default or the greater its confidence in AIG's financial strength.

AIG's CDS premiums have continued to decrease since May 2009, and as of January 2010 were similar to the level they were one year earlier, and generally have continued to decline through March 2010 (see figure 4). Over the same period—May 2009 through March 2010—the credit default swap index for the insurance sector declined, but not as much as the CDS premiums for AIG. While the trend is positive, it remains unclear whether this decline in the cost to protect against an AIG default reflects confidence in the standalone creditworthiness of AIG or whether the decline is due to the ongoing federal assistance to AIG. As the Federal Reserve has noted, the premium on AIG's CDS is based on both the market's assessment of the government's level of commitment to assist AIG and AIG's financial strength.

Figure 4: AIG Credit Default Swap Premiums, January 2007 through March 2010



Source: GAO analysis of Thomson Reuters Datastream.

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

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

A critical factor leading to AIG's financial crisis was the significant losses that AIGFP experienced from its derivatives trading business and the strains those losses put on AIG's corporate liquidity in 2008. A key part of AIG's reorganization and divestiture strategy is closing out or eliminating—also known as "unwinding"—these derivatives and closing AIGFP. Since the fall of 2008, AIGFP has attempted to unwind its derivatives portfolio by attempting to strike the most efficient balance between eliminating its positions quickly and mitigating portfolio losses. As discussed earlier, AIGFP had underwritten CDS protection on CDOs to a range of counterparties. Most of AIGFP's positions on its CDS contracts on multi-sector CDOs were eliminated when Maiden Lane III purchased CDOs from AIGFP's CDS counterparties late in 2008. With these purchases, the counterparties agreed to terminate the CDS contracts, which eliminated the need for AIG to post additional collateral as pricing continued to fall and eased its liquidity crisis. Since then, AIGFP has been in the process of closing out the remainder of its derivatives portfolio. To analyze AIGFP's progress, we monitored several groups of indicators dating back to at least September 2008. The following four indicators—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 is making progress. We also analyzed AIGFP's Super Senior CDS portfolio, where underlying collateral of CDOs are rated investment grade, and their remaining multi-sector CDO portfolio, where underlying collateral of CDOs are rated less than BBB. We found that AIGFP has made and continues to make progress in unwinding its super senior portfolio, but that it has made little progress since the fourth quarter of 2008 in closing out CDOs with lower rated underlying collateral.

AIGFP Continues to Unwind Its Operations

Our indicators show that from September 2008 through December 2009, AIGFP made significant progress in winding down its operations. A key reason for AIG's recent financial crisis was the strain on corporate 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 previously discussed, to help eliminate the financial strain arising from collateral payments, in the fall of 2008, the federal government created Maiden Lane III LLC, which purchased $29.3 billion worth of CDOs from AIGFP's CDS counterparties. In turn, these counterparties agreed to terminate the CDS contracts, because for the counterparties, the risk of possible downgrades or defaults on the CDOs had been eliminated by selling them to Maiden Lane III. Therefore, the counterparties no longer needed the protection that AIGFP's CDS contracts had provided them. The strains on corporate liquidity have decreased as AIGFP has continued to eliminate its positions in CDS contracts.

Figure 5 illustrates several dimensions along which AIGFP has reduced its size:

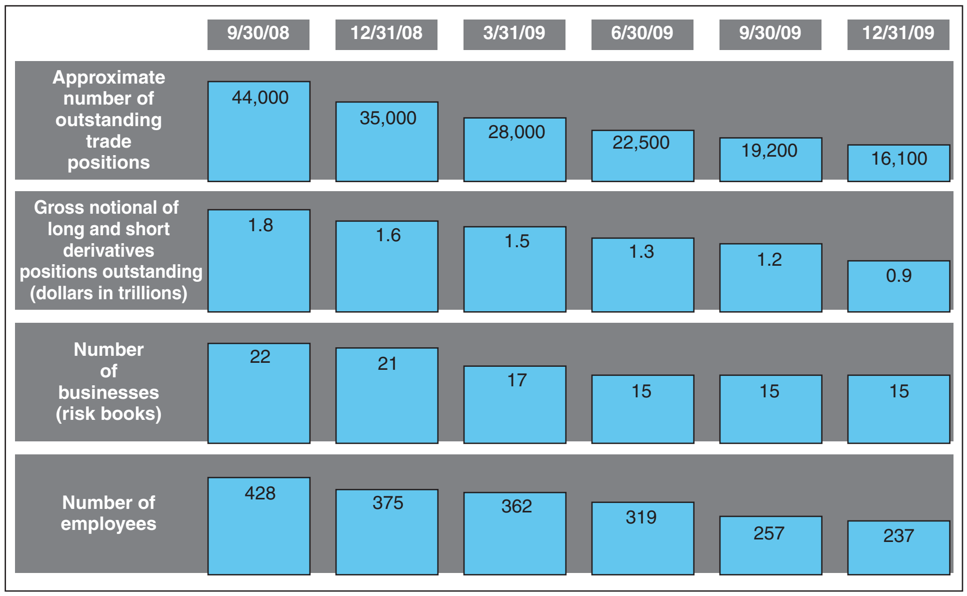
- First, since September 2008, AIGFP has closed out more of its outstanding trade positions, which refers to the number of AIGFP's outstanding long and short derivative contracts. At September 30, 2008, it had 44,000 positions, and at December 31, 2009, the number had declined to 16,100, down from 19,200 at the end of the previous quarter.

- Second, because of the positions that have been closed out, the gross notional value of derivatives positions outstanding—which is a measure of the size of AIGFP's inventory of derivatives outstanding—was reduced to $900 billion in December 2009, about half of the value 15 months earlier and $300 billion less than in the previous quarter.

- 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, which falls into 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 books and, according to AIGFP, this goal has been substantially accomplished. The number of books decreased from 22 to 15 from September 2008 to the end of the second quarter of 2009 and had not changed as of December 2009.

- Finally, since September 2008, the number of AIGFP employees had dropped by almost half to 237 as of the end of 2009. Staff may leave for several reasons, such as the sale of businesses, closing offices, or employee resignation, but the trend towards fewer staff is clear, and together with the above indicators, the evidence shows that AIGFP was much smaller at the end of 2009 than it was 15 months earlier.

Figure 5: Status of the Winding Down of AIG's Financial Products Corporation, Quarterly from September 30, 2008, through December 31, 2009



Source: Testimony by Mr. Edward M. Liddy, Chairman and Chief Executive Officer, AIG, before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, March 18, 2009; AIG Restructuring Update, May 7, 2009; and AIG.

Note: Due to Financial Accounting Standard 161, AIGFP changed its methodology for computing the gross notional for March 2009 leading to a slight increase of previously reported values. September and December notionals were estimated and restated numbers were 2.0 and 1.8, respectively. The March number was 1.5.

In September 2009 we reported that AIGFP officials believed that most of the unwinding could be completed by the end of 2009. In February 2010, Federal Reserve and Treasury officials confirmed that AIGFP is on track to close out its riskiest positions and that AIGPF will no longer be in business by the end of 2010, although the company's positions may not be entirely unwound by the end of the year. According to these officials, positions that cannot practicably be exited by year-end and trade positions for hedging AIG and subsidiary debt (that are currently managed by AIGFP) will likely be managed either centrally within AIG, by other AIG business units, or by third parties. However, AIG noted that the winding down of AIGFP and its portfolios remains linked to AIG's credit ratings and, as mentioned earlier, these efforts could be adversely affected if AIG's credit ratings were downgraded.

AIGFP Continues to Make Progress in Unwinding Its Investment Grade, Super Senior Credit Default Swaps Portfolio

Our indicators suggest that AIGFP continues to make progress in unwinding its portfolio of credit default swaps written on investment grade CDOs (those having a rating of BBB or higher from rating agencies). This super senior CDS 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.[32] 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 loss (or gain) 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 any effort to reduce its liabilities (i.e., the risk associated with the liabilities is viewed more favorably in the marketplace and reflects increased willingness to hold the liabilities). Therefore, such a decrease would be accompanied by comparable unrealized market valuation gains.

The indicators suggest that AIGFP is in the process of liquidating its CDS portfolio. The net notional amount of the portfolio and the fair value of derivative liability are both decreasing, and the portfolio has experienced modest unrealized gains as market conditions have improved. This progress is evident across several of AIGFP's risk books (see figure 6):

- *AIGFP's regulatory capital CDS book:* The regulatory capital book represented 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.[33] The net

[32]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.

[33]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.

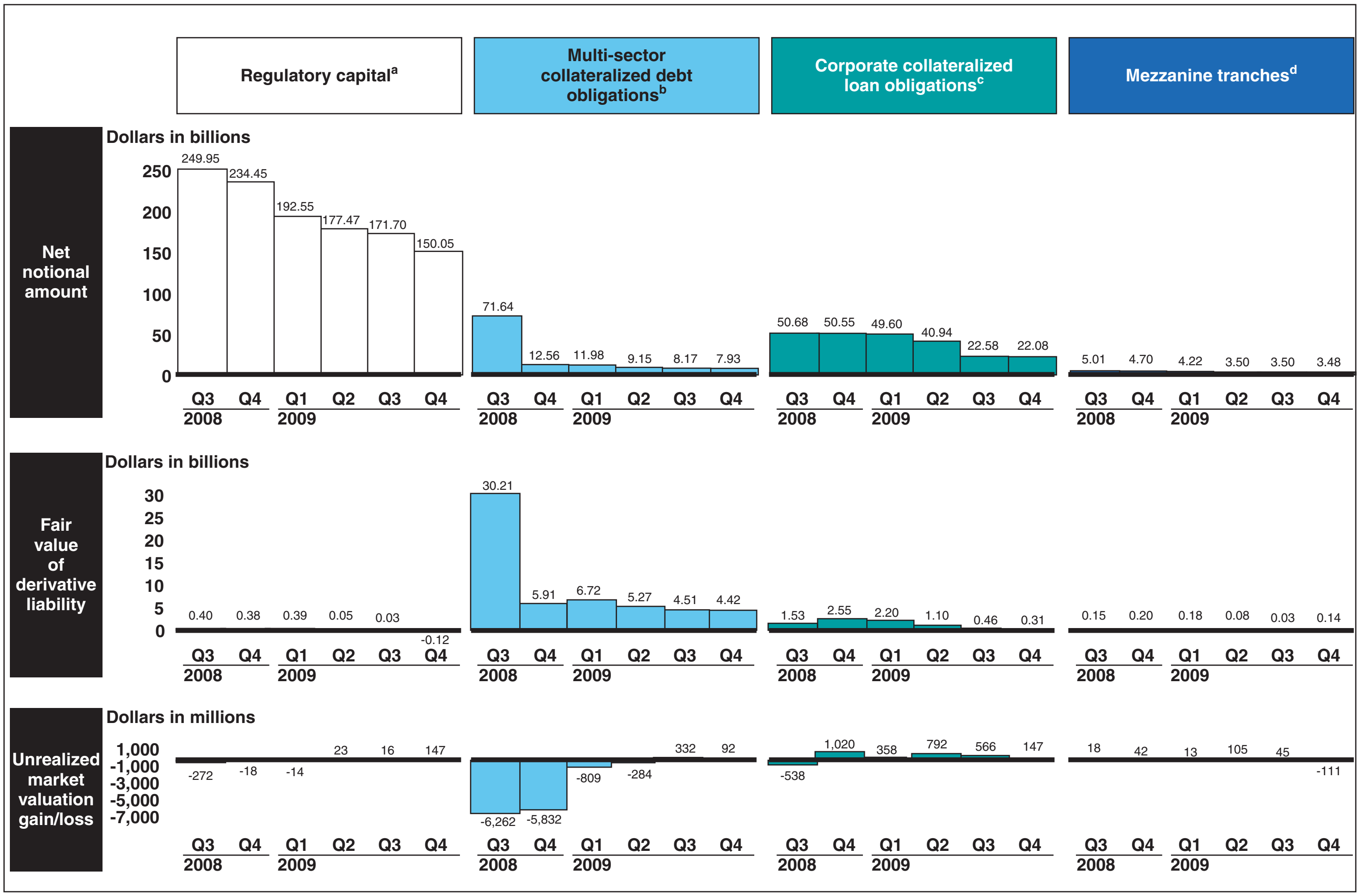
notional amount of this book dropped from about $250 billion in the fall of 2008 to about $150 billion in the fourth quarter of 2009, and the fair value of the liabilities fell over the same period from $397 million to negative $116 million. Though these CDS contracts continue to have a high net notional value relative to the other types of products, AIGFP continues to believe that these contracts will expire or be called by counterparties with little to no cost to AIG. AIGFP does not plan to sell these contracts but plans to let them expire because management believes that trying to sell them would not be cost effective.[34] This book also has experienced unrealized market gains in the last three quarters of 2009.

- *AIGFP's CDS on multi-sector CDO book:* These CDOs represent the CDS portfolio that, according to Federal Reserve officials, is a synthetic long credit position and written on CDO transactions that generally had underlying collateral of residential mortgage-backed securities, commercial mortgage-backed securities, and CDO tranche securities. There was a large drop in the net notional and fair values of the multi-sector CDOs from the third quarter to the fourth quarter of 2008. The decrease largely resulted from federal assistance provided through the purchase of the underlying assets in this category by Maiden Lane III and subsequent termination of the related CDS. In the fourth quarter of 2009, the net notional amount stood at about $7.9 billion and the fair value at $4.4 billion, both less than 15 percent of their values in the third quarter of 2008. Also in the fourth quarter of 2009, the book has seen unrealized gains for the second time in a year.

- *Corporate collateralized loan obligations and mezzanine tranches 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 that were rated less than investment grade (BBB or higher) at origination. AIGFP has also shown progress in reducing the CDS portfolio related to its corporate collateralized loan obligation portfolio. Unlike the previous two risk books, the corporate collateralized loan obligation book has had no unrealized market losses over the last year. The mezzanine tranche book had unrealized gains in the first three quarters of 2009 but a loss in the fourth quarter of 2009.

[34]According to AIG, the schedule by which they expected these positions to be called or terminated has slowed as the Basel Committee on Banking Supervision of the Bank for International Settlements has suggested a delay in the implementation of certain Basel II provisions, which could affect capital requirements and cause the banks to delay the termination of these transactions in the expected time frame.

Figure 6: AIGFP: Net Notional Amount, Fair Value of Derivative Liability, and Unrealized Market Valuation Losses and Gains for AIGFP's Super Senior (rated BBB or better) Credit Default Swap Portfolio, Third Quarter of 2008 through Fourth Quarter of 2009



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. Also, clarifications have been made to the presentation of this data in the prior report (GAO-09-975) in which some losses were shown without brackets and gains with brackets.

[a]Regulatory capital represents the CDS portfolio sold to provide regulatory capital relief to primarily European financial institutions. In exchange for a periodic fee, these institutions received credit protection for a portfolio of diversified loans, thus reducing minimum capital requirements set by their regulators.

[b]Multi-sector collateralized debt obligations (CDOs) represent the CDS portfolio sold primarily for arbitrage purposes and written on CDO transactions that generally had underlying collateral of residential mortgage-backed securities, commercial mortgage-backed securities, and CDO tranche securities.

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

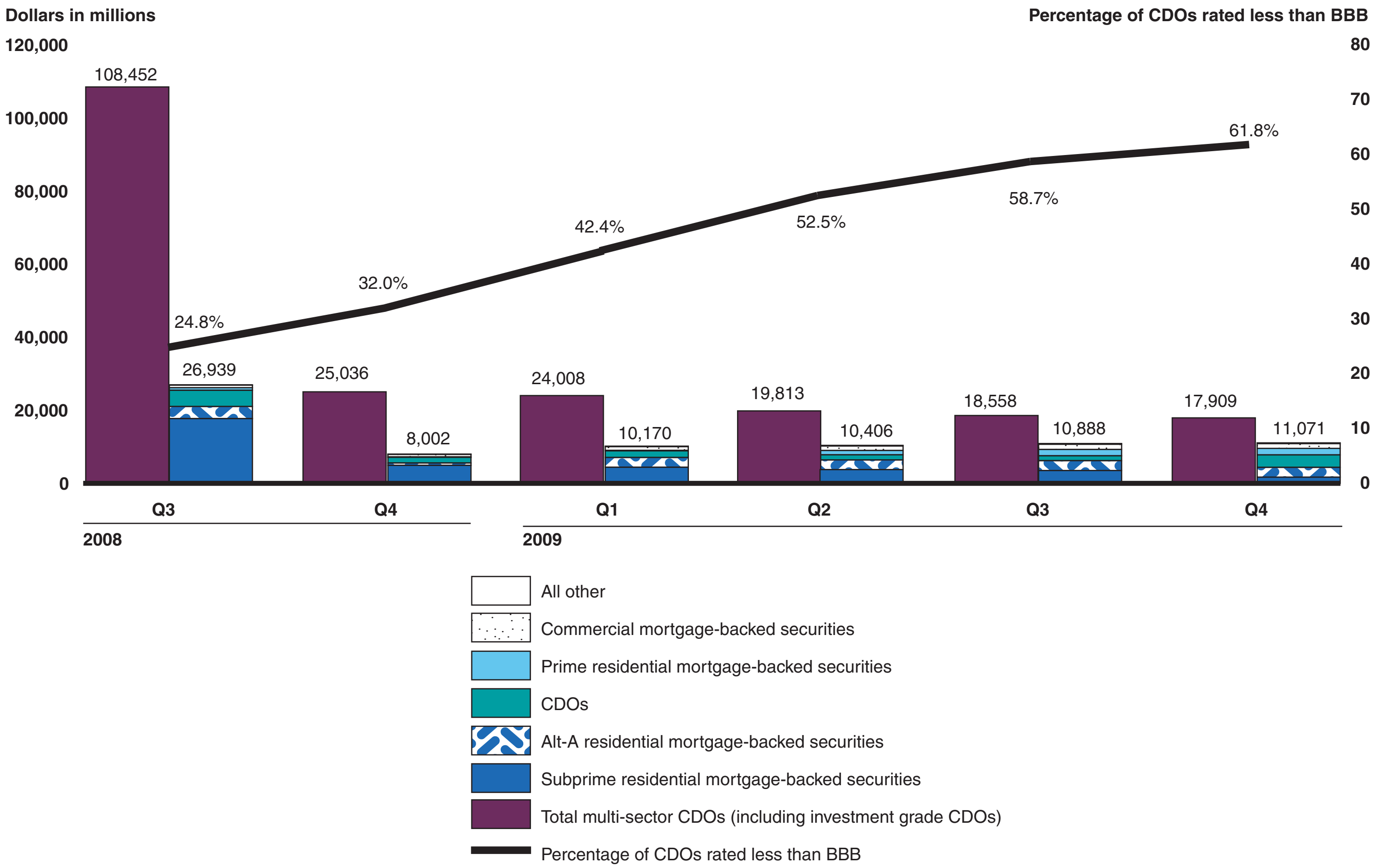
[d]A tranche is a piece or portion of a structured deal, or one of several related securities that are issued together but offer different risk-reward characteristics. The mezzanine tranche is subordinated to the senior tranche, but is senior to the equity tranche. The senior tranche is the least risky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

AIG Has Made Less Progress in Reducing the Noninvestment Grade Multi-Sector CDO Portfolio than the Total Portfolio, with Little Change in the Value of the Underlying Assets Since the First Quarter 2009

Our indicator uses the gross notional amount to track the size of AIGFP's multi-sector CDO portfolio and its composition with respect to the credit quality of the underlying assets. Our indicator shows that the gross notional amount of AIGFP's multi-sector CDO portfolio was reduced significantly in the fourth quarter of 2008 with the purchase of CDOs by Maiden Lane III and that since then AIG has continued to reduce the gross notional amount. However, as the portfolio has been unwinding, its underlying credit rating has declined but the longer term trend is not yet clear. Tracking the credit rating of the underlying assets (collateral) of the remaining holdings in AIGFP's multi-sector CDO portfolio is an important indicator of whether AIG might be required to post additional collateral in the future. If the credit rating of these assets declines, AIG may be required to post additional collateral. According to AIG, in most cases the underlying assets for AIGFP's multi-sector CDS portfolio at inception were rated at least BBB (by S&P) or Baa (by Moody's). As AIGFP unwinds, if considerable portions of underlying assets of the remaining holdings in the multi-sector CDO portfolio are downgraded below BBB ratings, counterparties could require AIG to post additional collateral, which would increase demands on AIG's operating cash flows and liquid assets and slow the completion of the unwinding of AIGFP.

As shown in figure 7, the gross notional amount of AIGFP's multi-sector CDOs and CDOs that had underlying assets rated less than BBB decreased significantly. However, while the notional amount of the CDO portfolio has continued to decrease, the amount with lower rated underlying assets has increased slightly. The total gross notional amount dropped from $108.5 billion to $25 billion in the fourth quarter of 2008, primarily due to Maiden Lane III purchasing the CDOs underlying AIGFP's CDS contracts. At the end of the fourth quarter of 2009, the overall notional amount of the CDOs had been reduced to about $17.9 billion, illustrating that AIGFP has continued to unwind this portfolio. The gross notional amount with underlying assets rated less than BBB also decreased from $26.9 billion at the end of third quarter of 2008 to $8 billion by the end of the fourth quarter of 2008 but has increased steadily since that time from about $10 billion to just more than $11 billion by the end of 2009. Consequently, of the remaining portfolio, the percentage with underlying assets rated less than BBB has grown to 61.8 percent of the total portfolio as of the end of the fourth quarter of 2009 as the notional amount of the multi-sector CDOs has continued to be reduced. This change in portfolio composition is largely because of the successful unwinding of portfolio holdings that have underlying assets rated BBB or above even though credit rating of the remaining portfolio has deteriorated since the end of 2008.

Figure 7: AIGFP: Total Gross Notional Amounts of Multi-Sector Collateralized Debt Obligations Compared to Portions of Portfolio That Has Underlying Assets that are Rated Less Than BBB, Third Quarter of 2008 through Fourth Quarter of 2009



Source: GAO analysis of AIG SEC filings.

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

Given the importance of AIG's insurance operations to its long-term financial health, we analyzed AIG's insurance operations by tracking several indicators of both its property/casualty and life insurance companies. We tracked the annual regulatory capital of AIG's insurance subsidiaries. The most recent data show that in 2008 and 2009, AIG's insurers maintained capital above regulatory minimums, but the recent federal assistance was critical to the health of domestic life and retirement companies. In particular, for AIG's life and retirement services, our indicators of additions to and withdrawals from policyholder contracts show that deposits are growing, and our analysis of their revenues shows that for the year 2009 operating income from these companies increased slightly, although dipping somewhat in the third quarter. We analyzed AIG's property/casualty companies by tracking their insurance premiums written, and the trends also show slight increases. While the insurance companies generally showed some growth, our last set of insurance indicators shows that in the third quarter of 2009 these companies' costs of doing business also increased.

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

The most recent data show that capital maintained by AIG's insurers has exceeded NAIC minimums, and several of AIG's life and retirement companies have benefited from federal assistance. This indicator of AIG's capital—which will be updated annually as newer NAIC data become available—is intended to monitor the capital of AIG insurers that, if depleted by losses, could require additional capital contributions through federal assistance (e.g., by AIG drawing on FRBNY's Revolving Credit Facility or Treasury's Equity Facility). NAIC requires that insurance companies hold a minimum amount of capital, known as risk-based capital. According to NAIC, "a company reporting total adjusted capital of 200 percent or more of minimum risk-based capital (RBC) is a 'no action' level company; nothing needs to be done by regulators."[35] On the other hand, NAIC states that "total adjusted capital of less than 70 percent triggers a mandatory control that requires the regulator to take steps to place the insurer under control." Moreover, a company's credit ratings are influenced by, among other things, its ratio of total adjusted capital to its authorized control level risk-based capital.[36] Adverse movements in the

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

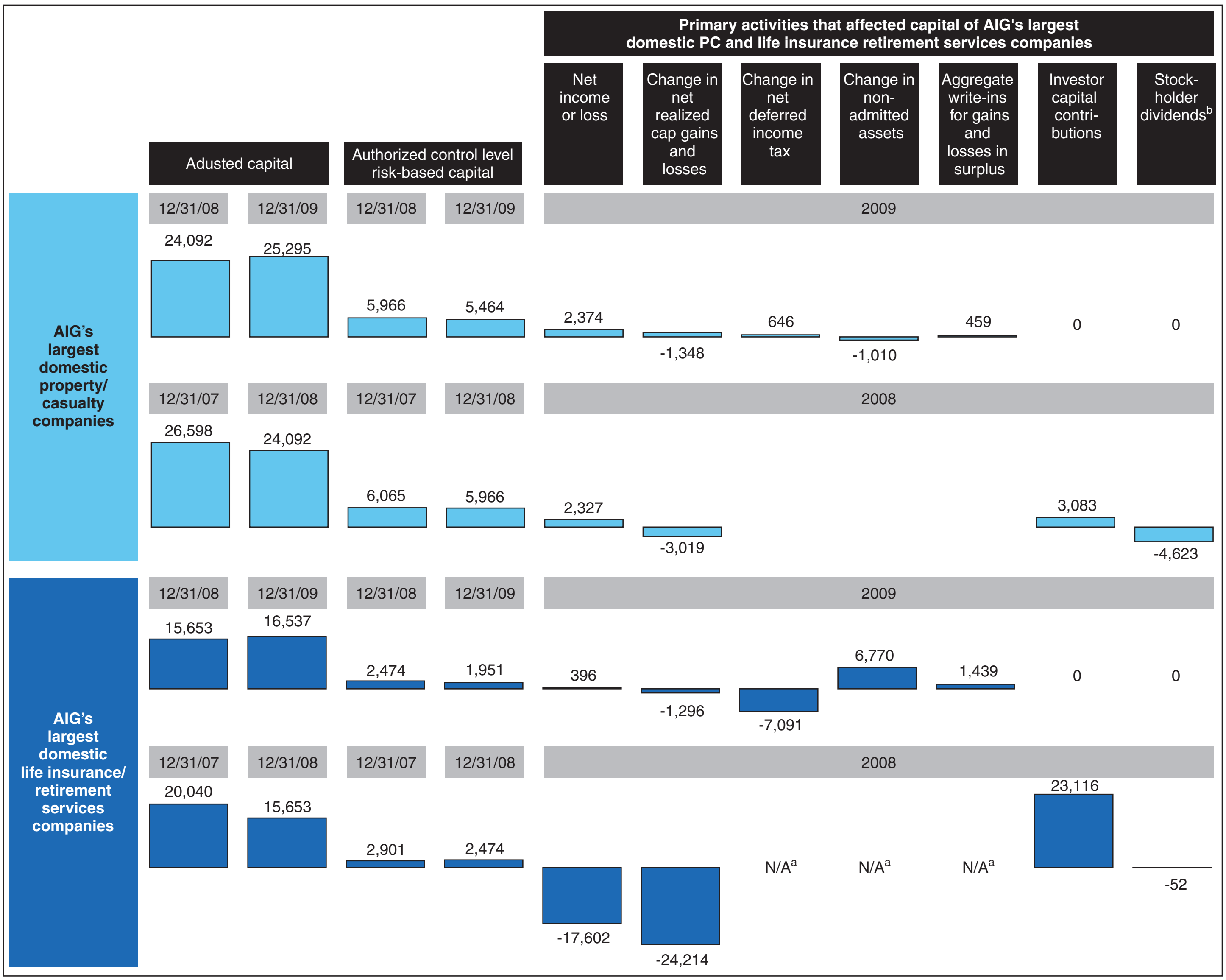
[36]The authorized control level risk-based capital is the level at which an insurance commissioner can seize or first take control of an insurance company.

primary components of capital and shareholders' equity may indicate weak performance by the company.

AIG's property/casualty insurers and domestic life insurance and retirement services companies have maintained levels of capital higher than the minimum requirement set by NAIC, as shown in figure 8. The property/casualty companies and domestic life companies had adjusted capital of at least 400 percent and 600 percent, respectively, of risk-based capital at year end 2007, 2008, and 2009. However, the domestic life companies were only able to maintain their capital ratios with federal assistance. Specifically, according to Federal Reserve officials, Maiden Lane II's direct purchase of $39.3 billion of RMBS at fair value helped these companies reduce the risks that were created by their securities lending activities in 2008. Further, AIG used funds from the FRBNY Revolving Credit Facility to contribute capital to these companies, primarily to make up for the losses in the securities lending portfolio.[37] In contrast, AIG's domestic property/casualty companies have maintained levels of adjusted capital in excess of requirements with virtually no direct federal assistance. Because AIG companies report adjusted capital no more than once annually in their year-end filings with NAIC, this indicator can be updated only once a year after the calendar year-end data become available. We determined that a proxy for quarterly tracking of the adjusted capital is the capital and surplus that AIG reports in its quarterly filings with NAIC because the same activities would affect both measures. More information about this indicator and the results for the first 9 months of 2009 is included in appendix V.

[37]As discussed earlier, FRBNY created Maiden Lane II, 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.

Figure 8: AIG Insurance Subsidiaries: Regulatory Capital at December 31, 2007; December 31, 2008; and December 31, 2009, and Primary Activities That Affected Regulatory Capital During 2009 (dollars in millions)



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

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

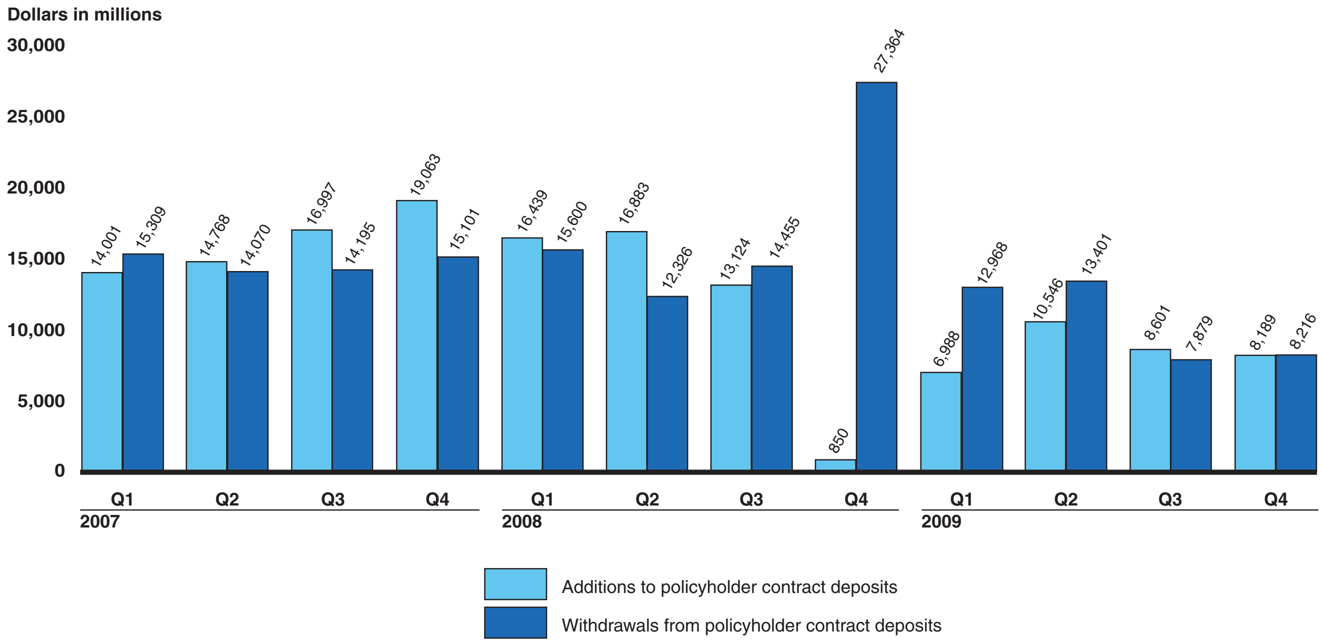
[b]Includes dividends paid within AIG.

Business at AIG's Life Insurance and Retirement Services Companies Shows Deposits Improving in Relation to Withdrawals and Slight Increases in Operating Income

Deposits at AIG's life and retirement service companies have been improving compared to withdrawals, and their operating income has increased. We have identified two indicators to monitor AIG's life insurance and retirement services companies. The first indicator tracks the additions to AIG life and retirement policyholder contract deposits and is intended to monitor for potential redemption "runs" by AIG annuitants and policyholders. Additions to policyholder contract deposits are amounts customers have paid to AIG to purchase a policy or contract. Withdrawals represent redemptions or cancellations of these instruments. Sharp increases in contract withdrawals or reductions in contract deposits could indicate sharply increased redemptions due to customer anxiety about AIG in particular or insurance companies more broadly. Sharp increases in redemptions could strain a company's liquidity position. The second indicator tracks the capital gains and operating income of these companies and is intended to monitor the profitability of AIG's life insurance and retirement services companies. Operating income before capital gains or losses provides an indication of the profitability of the company's underwriting operations, while capital gains and losses relate to investment activities and not directly to insurance underwriting. Increases in operating income or reductions in net realized capital losses could indicate improvements in the operations of AIG's life and retirement services companies, including improvement in market conditions, lower other-than-temporary impairments, and dissipating effects of lower credit ratings and negative publicity related to the AIG brand since September 2008.

As shown in figure 9, in the fourth quarter of 2008 AIG life and retirement services saw a sharp decline in additions to policyholders' contract deposits and a large spike in withdrawals, resulting in a gap of more than $26 billion. Without more granular data, it is unclear whether the withdrawals were driven by concerns about the condition of AIG or by the overall economic downturn, which may have resulted in policyholders cashing in policies for financial reasons. The excess of withdrawals over deposits adversely impacted the liquidity position of certain entities within this segment of AIG in late 2008. Conditions started to improve in the first quarter of 2009, with a 77 percent reduction in the gap between additions and withdrawals to about $6 billion, and that improvement continued through the third and fourth quarters of 2009. The third quarter of 2009 was the first time since the second quarter of 2008 that additions to AIG life and retirement policyholder contract deposits have exceeded withdrawals, by just more than $700 million. In the fourth quarter of 2009, withdrawals were $27 million more than deposits.

Figure 9: AIG Life and Retirement Services: Additions to and Withdrawals from Policyholder Contract Deposits Including Annuities, Guaranteed Investment Contracts, and Life Products, First Quarter of 2007 through Fourth Quarter of 2009



Source: GAO analysis of AIG SEC filings.

A closer look at the revenues and expenses of these companies shows that AIG's large operating losses in 2008 were not the result of their underwriting activities but instead were primarily caused by losses from their investment activities. For example, in the fourth quarter of 2008, net realized capital losses of AIG's domestic life and retirement services business accounted for $14.4 billion of its $15.2 billion in operating losses. Similarly, in that same quarter, AIG's foreign life insurance companies had net realized capital losses of $4.6 billion, which more than offset its operating income of $1.2 billion, resulting in an operating loss of $3.4 billion.[38] For the full year 2009, net realized capital losses were much less than they were for 2008—$3.5 billion for the domestic companies and $1.3 billion for foreign companies. Thus, the domestic companies reported a

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

smaller operating loss of $670 million and the foreign companies reported operating income of about $1.3 billion (see appendix VI).

AIG's Property/Casualty Companies Premiums Written Appear to Be Stabilizing

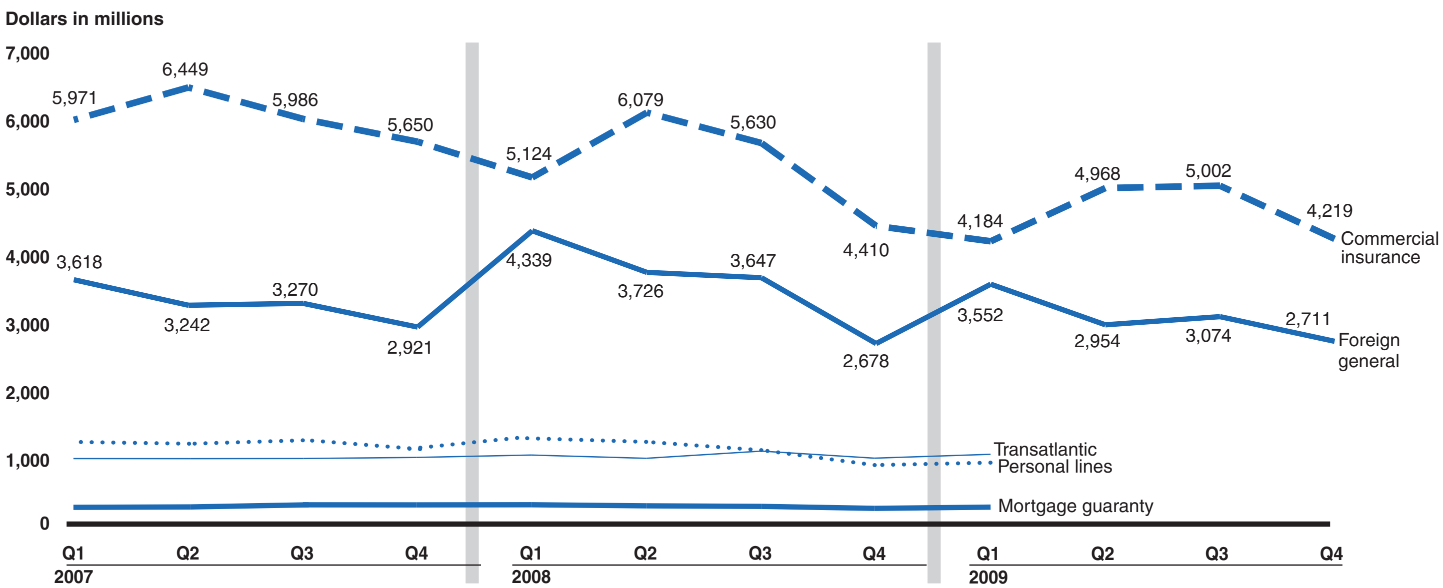
For the property/casualty commercial companies, dollar volumes of premiums written trended downward throughout 2007 and 2008, but beginning with the first quarter in 2009, they appeared to be stabilizing. To monitor trends in business volume in a way that includes the impact of AIG's financial troubles on its ongoing ability to retain existing business and attract new business activity of AIG's property/casualty companies, we developed the following indicator that tracks the trends in quarterly premiums written by these companies since the beginning of 2007. "Premiums written" is the dollar volume of business in a particular period. This indicator is important because AIG's property/casualty insurance businesses are expected to remain among AIG's core businesses following its restructuring. Trends in premiums written can also provide some indication of the success of AIG's efforts to maintain business volume. For example, to retain and attract business, AIG formed Chartis, Inc. from several of AIG's property/casualty companies and rebranded (renamed) several other AIG companies.[39] However, the volume of premiums written indicator is limited because it only measures a business's dollar volume and does not break out dollar volume by new and existing business. Therefore, the indicator cannot capture unit volume or the mix of products that comprise the volume. Also, the indicator tracks only AIG's business and does not compare AIG's business with that of its peers in the property/casualty insurance industry. Such a comparison would be important because property/casualty insurers as a group are subject to market pressures that drive premium prices up and down according to an industry-wide cycle characterized by hardening and softening markets. For example, according to a fourth quarter 2009 survey of the Council of Independent Agents and Brokers, commercial property/casualty premium rates were falling in the fourth quarter 2009 at about the same rate as in the third quarter.[40] According to the survey, low demand continued to put pressure on the rates.

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

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

As illustrated in figure 10, the dollar volumes of premiums written by AIG's property/casualty commercial companies was trending down in 2007 and 2008 and stabilized somewhat in 2009. In the third quarter of 2009, these companies' commercial insurance premiums written exceeded $5 billion for the first time since the third quarter of 2008 and were higher than in the second quarter of 2009, a pattern not found when comparing the third and second quarters of 2008 and 2007. However, by the end of the fourth quarter of 2009 commercial premiums were just above the level earned in the first quarter of 2009. Foreign general insurance premiums written were also higher in the third quarter of 2009 than the second quarter, which did not occur in 2008. However, by the end of the fourth quarter of 2009 foreign general insurance premiums written had reached their lowest level since the fourth quarter of 2008. AIG officials had noted that in the fourth quarter of 2008 and the first quarter of 2009, general insurance net premiums written were also adversely affected by negative publicity surrounding AIG's financial challenges in other areas. When commenting on the fourth quarter 2009 financial results, AIG's president and chief executive officer noted that AIG expects continued volatility in first quarter of 2010, partly due to restructuring activities.

Figure 10: AIG General Insurance: Premiums Written by Division, First Quarter of 2007 through Fourth Quarter of 2009



Source: GAO analysis of AIG quarterly financial supplements.

Note: AIG intends to buy United Guaranty Corporation, AIG's mortgage guaranty operations, from the recently established AIU Holdings (Chartis, Inc.). Common shares of Transatlantic were sold during the second quarter of 2009, reducing the aggregate ownership interest in Transatlantic to 14 percent, and additional shares were sold in the first quarter of 2010, leaving AIG owning 1 percent of the shares outstanding, which AIG also expects to sell. The personal lines companies were sold to a third party on July 1, 2009. Commercial insurance will retain the private client business historically written by the personal lines segment.

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

The combined ratio is an overall measure of a property-casualty insurer's underwriting profitability. Thus, a combined ratio of less than 100 percent would indicate that an insurer's underwriting is profitable and a ratio of more than 100 percent would reflect a loss. AIG's combined ratios in both commercial and foreign general property-casualty insurance businesses rose above 100 percent in the third quarter of 2009 for the first time since the fourth quarter of 2008 and continued to rise in the fourth quarter of 2009, indicating that claims and administrative costs were higher and rising faster than premium earned and thus their insurance underwriting was not profitable in these two most recent quarters (see appendix VII). However, as discussed earlier, AIG's property/casualty insurance segment was profitable in the third quarter of 2009 despite a combined ratio above 100 percent because positive investment returns more than offset underwriting losses.[41] While our data cover only a 3-year period, they suggest a pattern of loss and expense ratios rising in the latter part of calendar years 2007, 2008, and 2009 for both commercial and foreign general insurance. For commercial insurance the combined ratio spiked in the fourth quarter of 2008, largely due to an administrative charge (that

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

also spiked the expense ratio) to recognize permanent impairment of goodwill of previously acquired businesses.[42] The higher combined ratio was also partly due to a higher loss ratio because of increased claims costs associated with Hurricane Ike and other major catastrophes in 2008. The combined ratio also rose in the fourth quarter of 2009, and this was largely due to increased claims costs related to a reserve strengthening charge. Ratios for foreign general insurance also were higher in the first three quarters of 2009 than in the comparable quarters of 2008 and 2007. AIG officials said the foreign general loss ratio increased during 2009 primarily because of higher claims generally related to Directors and Officers insurance as well as professional liability insurance (Errors and Omissions coverage) for financial institutions at the time of the worldwide credit crisis, particularly in Europe. They also said that the foreign general expense ratio increased because AIG sold its Brazil operations, which resulted in decreased net premiums earned in 2008, more competitive pricing in the insurance markets in 2009, and higher levels of general operating expenses primarily related to remediation/audit of general insurance (Chartis, Inc.), pension costs, and post retirement liability costs.[43]

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

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

While AIG Continues to Make Progress in Repaying Some of Its Federal Assistance, the Government's Ability to Fully Recoup the Assistance Will be Determined by AIG's Restructuring and Long-term Health

We analyzed AIG's progress in repaying its federal assistance using several indicators. We developed an analysis of the composition of the federal assistance to show the amount of direct and indirect assistance and the sources of that assistance. It shows that AIG is continuing to repay its debt to the federal government, but much of the recent progress reflects the several exchanges of debt that AIG owed the FRBNY Revolving Credit Facility with various issues of preferred equity. For example, we tracked the amount of assistance available to AIG through the FRBNY Revolving Credit Facility and the balance of the facility, and found that both were reduced in December 2009, largely due to a transaction in which the government received $25 billion in preferred equity in the SPVs created to hold AIA and ALICO equity in exchange for decreasing the balance in the Revolving Credit Facility by an equal amount, as previously discussed. We also tracked the Maiden Lane II and Maiden Lane III portfolios and found that their values increased slightly in the fourth quarter of 2009 while the principal and interest owed to FRBNY continued to decline throughout 2009. We also tracked AIG's book value (shareholders' equity) and found that it has been increasing, but this occurred because of the unprecedented steps taken by the Federal Reserve and Treasury to assist AIG. In addition, we tracked AIG's divestiture of businesses and found that in 2009 the company divested several of its businesses, but that activity slowed significantly in the fourth quarter of 2009.

While the Amount of Debt Owed to the Federal Government Has Continued to Decline, the Amount of Preferred Equity Held by the Government Has Increased

AIG's debt to the federal government has been reduced, and a main reason for this is the restructuring of the composition of government assistance. This indicator identifies the various components of federal assistance to AIG as of December 31, 2009, or the latest available data. The U.S. government remains committed to making available around $182 billion in assistance to AIG.[44] Changes in the amount and composition of the federal assistance may provide insights about the overall condition of AIG and the extent of its reliance on federal assistance.

Based on the information provided in table 3, as of December 31, 2009, the government had authorized $182 billion in government assistance to AIG. Although the government's current exposure of $129 billion is less than the authorized amount, the exposure has increased by $8.4 billion since

[44]This amount does not include AIG's use of the Federal Reserve's Commercial Paper Funding Facility.

September 2009.[45] As discussed earlier, the federal government has provided various forms of assistance to AIG.

- First, in the form of debt owed by AIG to the government, the government has loaned money to AIG directly through the FRBNY Revolving Credit Facility. As of year-end 2009, $23.4 billion of assistance was being provided directly to AIG via a secured loan through the FRBNY Revolving Credit Facility.

- Second, in the form of equity shares owned by the government, the government has a balance of $71.8 billion of AIG shares through a combination of (1) Treasury's Series E noncumulative preferred stock, (2) Treasury's Equity Capital Facility that is associated with the fixed-rate Series F noncumulative perpetual preferred stock, and (3) the preferred equity interest in the AIA and ALICO SPVs. This direct government investment, which is now the primary form of federal assistance to AIG, was the result of the November 2008 and March and April 2009 restructurings, and most recently, the December 2009 transaction in which the Federal Reserve exchanged $25 billion of its debt for $25 billion in preferred equity interest in AIA and ALICO SPVs.[46]

- Third, in the form of debt owed to the government on behalf of AIG, the government has provided loans to Maiden Lane II and III—the SPVs established by FRBNY—for the purpose of purchasing RMBS assets from AIG's life insurance companies and AIGFP's CDS counterparties. Currently, the government's exposure on those loans is $33.9 billion.

As a result of these restructurings, the government has increased its preferred equity interest in AIG by acquiring preferred stock in exchange for reducing a substantial portion of AIG's debt on the FRBNY Revolving

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

[46]In March 2010, AIG announced the pending sale of AIA for about $35.5 billion. AIG expects to use approximately $16 billion in proceeds to redeem FRBNY's preferred interests in AIA and use approximately $9 billion to repay the FRBNY Revolving Credit Facility. In addition, AIG announced that its board had approved the sale of AIA to Prudential PLC by the end of 2010 for approximately $25 billion in cash and $10.5 billion in equity securities, pending approval by regulators and stockholders. AIG intends to sell for cash the $10.5 billion in face value of Prudential securities over time. According to AIG, all net cash proceeds from the monetization of these securities will be used to repay any outstanding debt under the FRBNY Credit Facility. More recently, on April 1, 2010, AIG announced that per the terms of the Series E and F preferred stock agreements, since AIG did not pay dividends on those series of preferred stock for four quarterly periods, Treasury appointed two directors to the AIG board of directors.

Credit Facility. Moreover, in February 2010 AIG said that it was not going to pursue the life insurance securitization transaction—originally AIG and FRBNY announced in March 2009, when the federal assistance to AIG was restructured for a second time, that FRBNY would loan SPVs up to $8.5 billion to acquire insurance policies of certain AIG domestic life insurance subsidiaries. AIG had planned to use proceeds from the sale of insurance policies to the SPV, which would have repaid its FRBNY debt from the net cash flows they received from the life insurance policies.

Table 3: Composition of U.S. Government Efforts to Assist AIG and the Government's Approximate Remaining Exposures, as of December 31, 2009, or latest available date as noted

Dollars in billions

		Direct AIG assistance		Indirect AIG assistance		
	Amount authorized	AIG debt owed to government	Government equity	Other debt owed to government	Government equity	Total government exposure
Federal Reserve						
Revolving Credit Facility	$35	$23.435[a]	N/A	N/A	N/A	$23.435[a]
Maiden Lane II	22.5	N/A	N/A	$15.739[b]	N/A	15.739
Maiden Lane III	30	N/A	N/A	18.159[b]	N/A	18.159
AIA and ALICO	25	N/A	$25[c]	N/A	N/A	25.000
Treasury						
Series D and E	40	N/A	41.605[d]	N/A	N/A	41.605[d]
Series F	29.835	N/A	5.179	N/A	N/A	5.179
Total direct assistance		**$23.435**	**$71.784**			**$95.219**
Total indirect assistance				**$33.898**		**$33.898**
Total direct and indirect assistance to benefit AIG	**$182.335**	**$23.435**	**$71.784**	**$33.898**		**$129.117**

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

Note: Analysis does not include AIG's government debt under the FRBNY Commercial Paper Funding Facility of $4.739 billion at December 31, 2009. This facility expired for new issuances on February 1, 2010, and will close upon maturity of all remaining commercial paper outstanding.

[a]FRBNY reduced the amount of the commitment fee on the revolving credit facility by $500,000 to pay for the Series C stock.

[b]Values for the Maiden Lanes are as of December 30, 2009. Government debt shown for Maiden Lane facilities do not include accrued interest of $265 million for Maiden Lane II and $340 million for Maiden Lane III.

[c]In March 2010 AIG reached agreements to sell AIA to Prudential PLC and ALICO to Met Life. Combined proceeds are to be $31.5 billion in cash plus $19.2 billion in equity securities. Cash proceeds and equity securities when converted to cash are to be used to buy back the $25 billion in federal preferred equity interests and repay debt on the revolving credit facility.

[d]When the Series E preferred shares were exchanged for Series D preferred shares, $1.605 billion of accrued but unpaid dividends were included in the liquidation preference of the federal government.

As of December 30, 2009, the amount of direct assistance available to AIG through the FRBNY Revolving Credit Facility had dropped to $35 billion, and the amount AIG owed the facility had dropped to $23.4 billion (see appendix VIII). Key reasons for the drop in available assistance and outstanding balance were the November 2008 and March 2009 restructurings of the government's assistance to the company from debt to preferred equity. On November 25, 2008, AIG entered into an agreement with Treasury whereby Treasury agreed to purchase $40 billion of fixed-rate cumulative preferred stock of AIG (Series D) and received a warrant to purchase approximately 2 percent of the shares of AIG's common stock.[47] The proceeds of this sale were used to pay down AIG's outstanding balance on the Revolving Credit Facility by the same amount. This transaction left the government's overall exposure unchanged, allowed AIG to reduce its debt outstanding and increase the federal equity position by $40 billion, and also involved a reduction of the borrowing limit on the credit facility from $85 billion to $60 billion. More recently, in December 2009 the outstanding balance and borrowing limit were further reduced when FRBNY received preferred interests in the SPVs holding AIA and ALICO, which was part of the March 2009 restructuring. In this transaction the amount AIG owed on the facility was reduced by $25 billion and in exchange, FRBNY acquired preferred equity interest in the SPVs of the same amount, which, in effect, was an exchange of debt for equity. Also, the borrowing limit was reduced from $60 billion to $35 billion. In March 2010, AIG announced agreements to sell the AIA and ALICO SPVs for total proceeds of $51 billion consisting of $31.5 billion in cash and $19.2 billion in equity securities issued to AIG by the buyers. According to AIG, it expects to close both sales later in 2010 and plans to use the proceeds to repay federal assistance by redeeming the preferred

[47]As discussed in the background section of this report, on April 17, 2009, AIG and Treasury entered into an agreement in which Treasury agreed to exchange its $40 billion of Series D cumulative preferred stock for $41.6 billion of Series E fixed-rate noncumulative preferred stock in AIG. The $1.6 billion difference between the initial aggregate liquidation preference of the Series D stock and the aggregate liquidation preference of the Series E stock represents a compounding of accumulated but unpaid dividends owed by AIG to Treasury on the Series D stock.

equity interests in the SPVs and paying down the Revolving Credit Facility. Equity securities will be converted to cash as conditions allow, which will be used to repay the federal assistance. Changes in amounts owed on the facility fluctuate weekly and could increase or decrease depending on liquidity needs related to ongoing operations and restructuring activities, such as more conversions of debt to preferred equity.[48]

We are also monitoring the status of the government's indirect assistance to AIG through the Maiden Lane II and Maiden Lane III facilities (see appendix VIII). FRBNY provided loans to the facilities, giving Maiden Lane II capital to purchase residential mortgage-backed securities from AIG's domestic life insurance companies and Maiden Lane III capital to purchase multi-sector CDOs from AIGFP's CDS counterparties. The Maiden Lane II and Maiden Lane III portfolios were funded primarily by loans from FRBNY, which are not debt on AIG's books. The loans and related expenses are to be repaid from cash generated by investment yields, maturing assets, and sales of assets in the facilities. Such cash is to be used to pay, in this order, operating expenses of the LLC, principal due to FRBNY, interest due to FRBNY, principal due to AIG, and interest due to AIG. Any remaining funds are to be shared between FRBNY and AIG. In addition to the FRBNY investments in the facilities, AIG invested $1 billion in Maiden Lane II and $5 billion in Maiden Lane III. The portfolio values of the Maiden Lanes peaked in December 2008, with Maiden Lane II declining through September 2009 but increasing in December 2009. Similarly, the portfolio value of Maiden Lane III declined in July 2009 and values fluctuated in September 2009 but had increased by the end of the year.

The Federal Reserve said that it plans to hold on to the Maiden Lane assets until they mature or increase in value to a point where the Federal Reserve can maximize the amount of money recovered through their sale. Our analysis shows that the assets have declined in value since December 2008. Federal Reserve officials explained that the Maiden Lane assets are amortizing and that the long term plan is for the Maiden Lanes to sell off the portfolios' assets, which will be used to fully repay the debt. The Federal Reserve officials noted that the value of these assets as a percent of the outstanding loan balance have improved between December 2008 and December 2009 and they believe that the Maiden Lanes will continue to receive payments of principal and interest on their portfolios before

[48]See appendix VIII for additional details about amounts owed under FRBNY's Revolving Credit Facility.

maturity or sale. As assets mature, are sold, or pay interest, any portion remaining after paying operating expenses of the Maiden Lanes goes toward the loan balance. These payments will reduce the amount of principal owed by the Maiden Lanes to FRBNY. As of December 30, 2009, proceeds from the Maiden Lanes had been used to pay down $9.9 billion of the outstanding principal.[49]

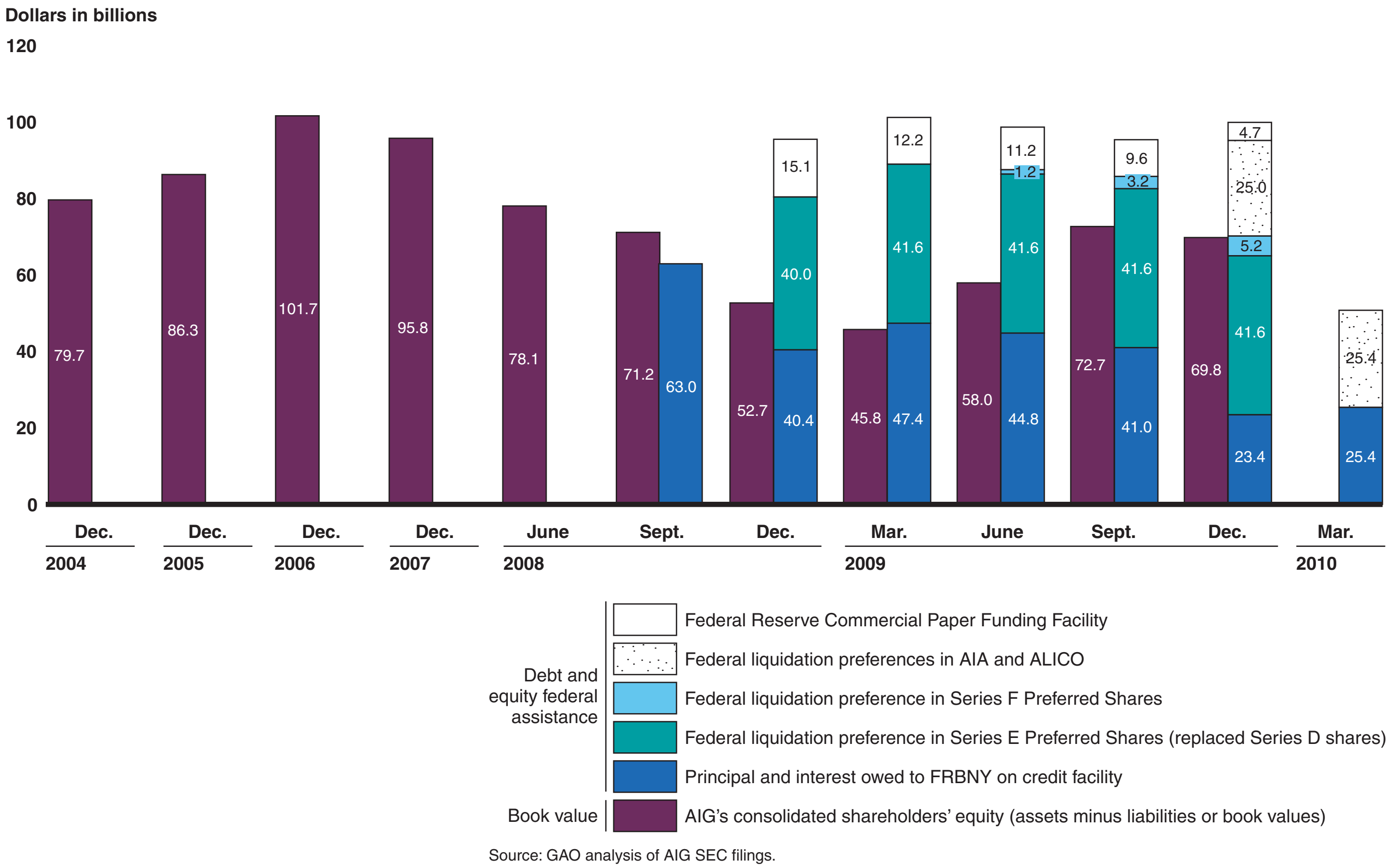
AIG's Book Value (Shareholders' Equity) Is Increasing, Supported by the Unprecedented Federal Assistance Provided to AIG in the Form of Both Debt and Equity

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

Figure 11 shows that AIG's shareholders' equity peaked in December 2006 at $101.7 billion and decreased to a low of $45.8 billion in March 2009. Since then it has increased, and as of the end of December 2009, shareholders' equity had climbed to $69.8 billion, which is about $30.1 billion less than the total federal assistance on AIG's books either as debt owed or as preferred equity. However, as discussed earlier, AIG's positive shareholders' equity currently is entirely the result of federal assistance.

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

Figure 11: Debt and Equity Federal Assistance Provided to AIG Compared to AIG's Book Value (Shareholder's Equity), December 2004 through December 2009 and Partial Data as of March 31, 2010



Source: GAO analysis of AIG SEC filings.

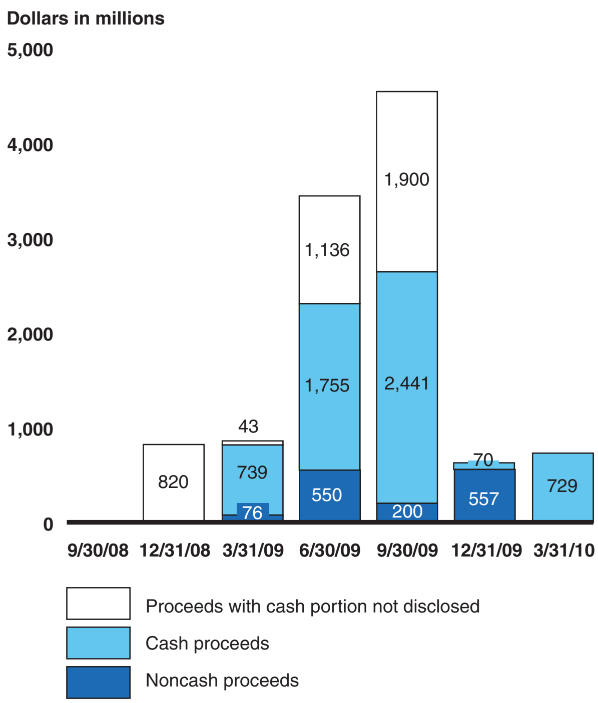
Note: March 31, 2010, data was not yet available for all of the factors in figure.

AIG Divested Several Business Units in 2009 and Announced Two Major Agreements in March 2010

Part of AIG's restructuring plan is for the company to sell some of its businesses. In 2009 the company divested several of its businesses and in March 2010 announced agreements to sell AIA and ALICO. As AIG's restructuring unfolds, the cash proceeds from such sales are available to fund operations, reduce AIG's balance on the FRBNY Revolving Credit Facility, and redeem preferred equity interests. In order to track the progress of this activity, we have developed an indicator to chronologically track divestitures (or dispositions) by AIG and the terms of such transactions, including cash proceeds. Our indicator groups the divestitures and the related proceeds by the quarters in which the transactions closed.

Figure 12 shows aggregate proceeds from dispositions closed by quarter from the quarter ending in December 31, 2008, through the quarter ending in March 31, 2010, broken out by cash proceeds, noncash proceeds, and proceeds with the cash portion not disclosed. AIG said that it has used the cash proceeds from these sales to meet its obligations, including the FRBNY Revolving Credit Facility; to cover capital needs; and to provide loans to its subsidiaries. AIG also reported that from January 2009 through March 31, 2010, it has entered into other agreements that have not yet closed. These include agreements announced in March 2010 to sell AIA and ALICO for combined total proceeds of $51 billion that will be comprised of $31.8 billion cash and $19.2 billion in equity securities. As noted above, and according to Treasury officials, proceeds are expected to be used to redeem federal preferred equity interests in AIA and ALICO and reduce the outstanding balance in the Revolving Credit Facility.

Figure 12: Proceeds from Dispositions by Quarter, Second Quarter of 2008 through March 31, 2010



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

As of December 31, 2009, AIG disclosed that it had received $10.3 billion in total proceeds from sales, $5 billion of which was cash. It also showed that proceeds were increasing each quarter through the third quarter of 2009.

In the last quarter of 2009, AIG closed on only one sale, AIG Finance—Hong Kong, for $627 million. AIG officials told us that in addition to this sale, AIG signed agreements on several other transactions during this time period that had not yet closed. The slow down in sales also may reflect the asset disposition strategy of AIG's current president and chief executive officer, which has been to hold assets in hopes for a higher return rather than to sell them quickly.[50]

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

Federal assistance provided to AIG has gradually shifted from debt to equity, with a reduction in the authorized amount of the FRBNY Revolving Credit Facility and an increase in the amount of preferred equity interests held in AIG and various special purpose vehicles for the government. Consequently, the government's, and thus taxpayer's, exposure to AIG is increasingly tied to the success of AIG, its restructuring efforts, and its ongoing performance. However, the sustainability of any positive trends in AIG's operations depends on how well it manages its business in this current economic environment. Similarly, the government's ability to fully recoup the federal assistance will be determined by the long-term health of AIG, the company's success in selling businesses as it restructures, and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government. We will continue to monitor these issues in our future work.

Agency Comments and Our Evaluation

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

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

We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at http:www.gao.gov.

If you or your staffs have any questions concerning this report please contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix X.

Gene L. Dodaro
Acting Comptroller General
of the U.S. Government Accountability Office

List of Congressional Committees

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

The Honorable Christopher J. Dodd
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 Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
Chairman
The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
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Committee on the Budget
House of Representatives

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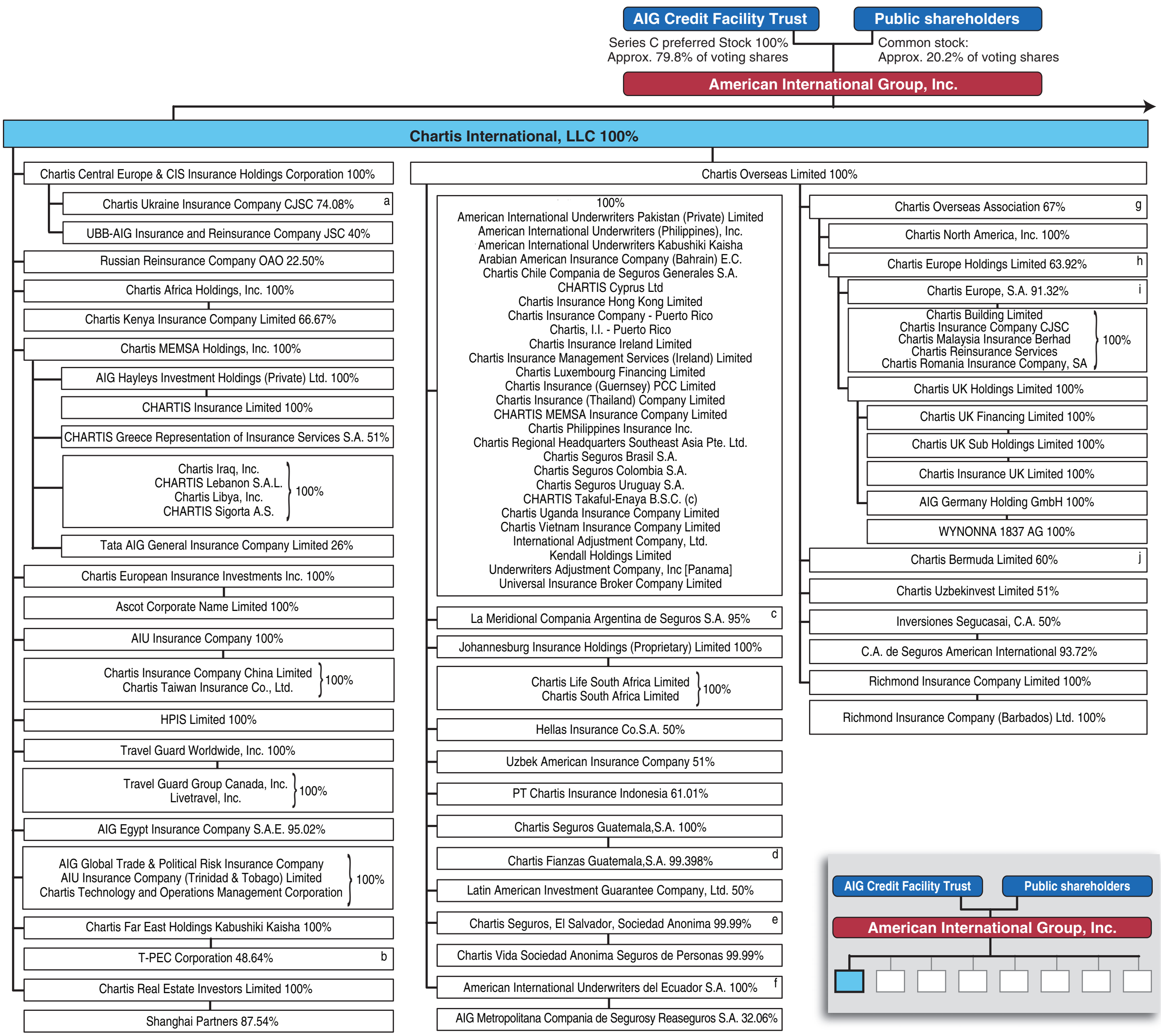
Committee on Financial Services
House of Representatives

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

Appendix I: AIG Operations

American International Group, Inc. (AIG) is a holding company that, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad. These activities include general insurance, life insurance and retirement services, financial services, and asset management. Figure 13, which illustrates the AIG parent company and its subsidiaries that it directly owns, conveys the complexity of the AIG organization. AIG's subsidiaries are Chartis International, LLC; AIG Life Holdings International, LLC; ALICO Holdings, LLC; Chartis Inc.; AIG Life Holdings (United States), Inc.; AIG Capital Corporation; AIG Financial Products Corp; and 10 other companies. AIG comprises approximately 400 companies and has operations in more than 130 countries and jurisdictions worldwide. As of December 31, 2009, AIG had assets of $847.6 billion and revenues of $96 billion for the 12 preceding months. The AIG companies are among the largest domestic life insurers and domestic property/casualty insurers in the United States, and include large foreign general insurance and life insurance businesses.

Figure 13: AIG, Its Subsidiaries, and Percentage Ownership by Parent Company as of February 28, 2010



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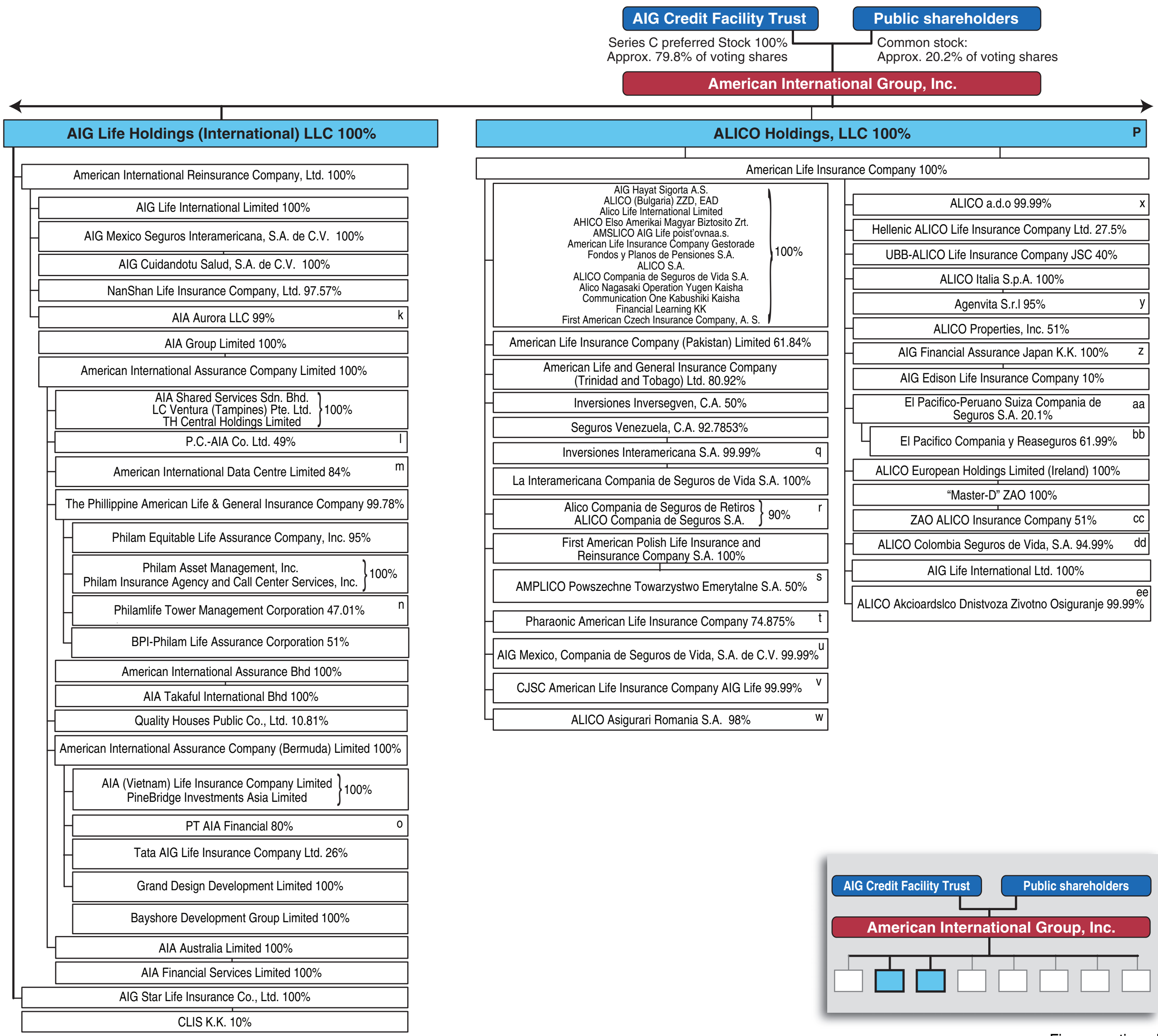

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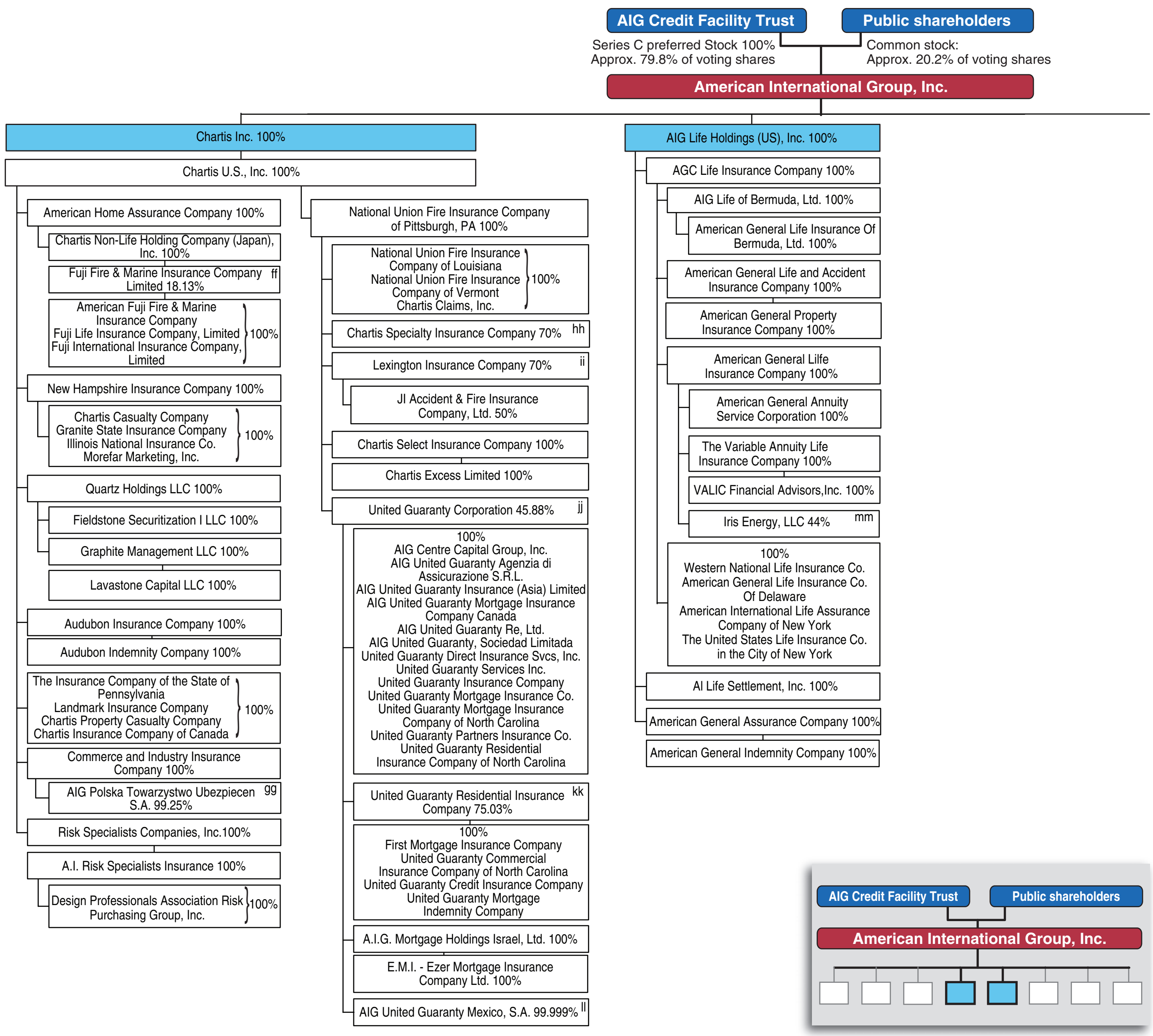

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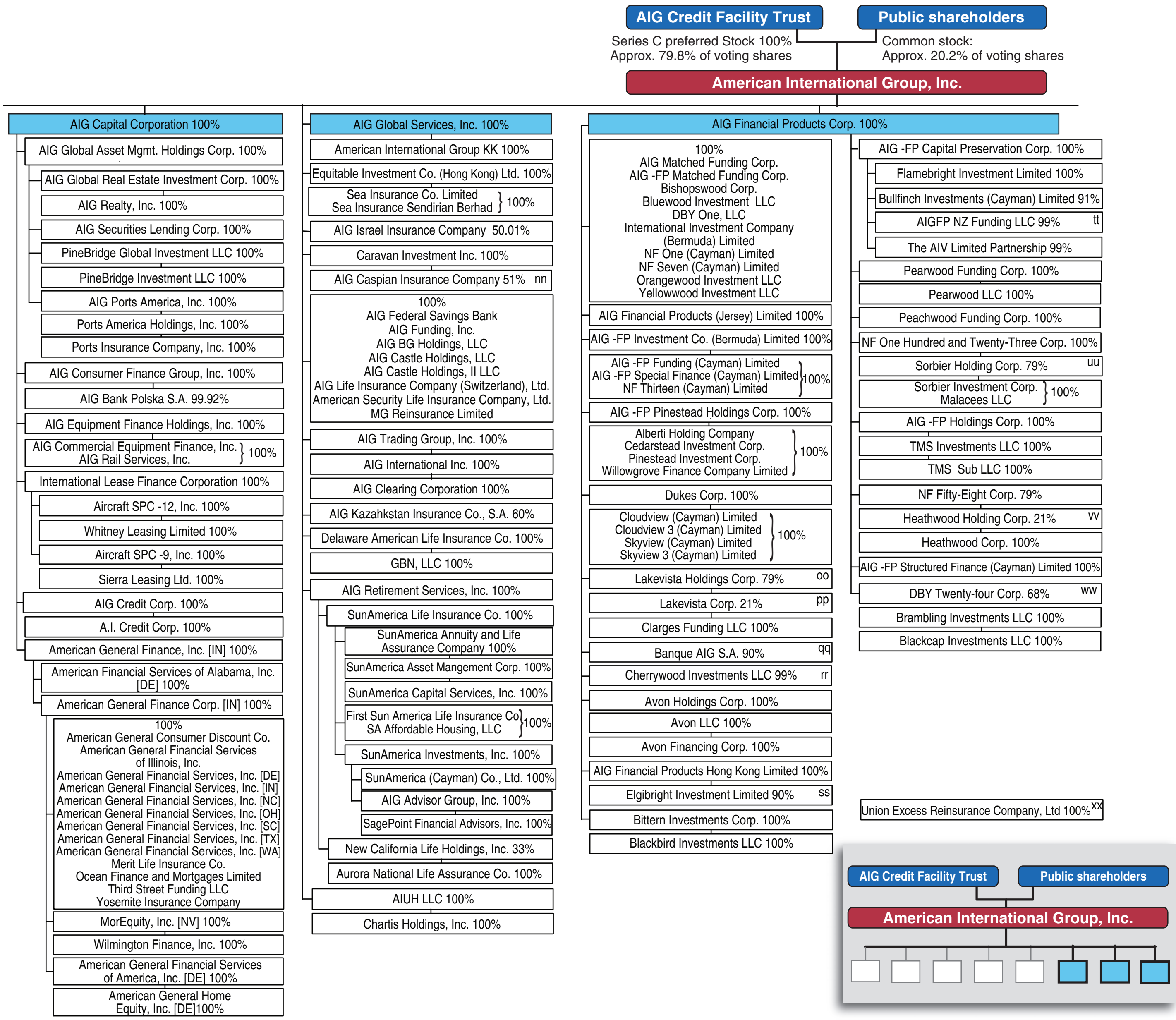

AIG Credit Facility Trust
Public shareholders
Series C preferred Stock 100%
Approx. 79.8% of voting shares
Common stock:
Approx. 20.2% of voting shares
American International Group, Inc.
AIG Capital Corporation 100%
AIG Global Asset Mgmt. Holdings Corp. 100%
AIG Global Real Estate Investment Corp. 100%
AIG Realty, Inc. 100%
AIG Securities Lending Corp. 100%
PineBridge Global Investment LLC 100%
PineBridge Investment LLC 100%
AIG Ports America, Inc. 100%
Ports America Holdings, Inc. 100%
Ports Insurance Company, Inc. 100%
AIG Consumer Finance Group, Inc. 100%
AIG Bank Polska S.A. 99.92%
AIG Equipment Finance Holdings, Inc. 100%
AIG Commercial Equipment Finance, Inc.
AIG Rail Services, Inc.
100%
International Lease Finance Corporation 100%
Aircraft SPC -12, Inc. 100%
Whitney Leasing Limited 100%
Aircraft SPC -9, Inc. 100%
Sierra Leasing Ltd. 100%
AIG Credit Corp. 100%
A.I. Credit Corp. 100%
American General Finance, Inc. [IN] 100%
American Financial Services of Alabama, Inc. [DE] 100%
American General Finance Corp. [IN] 100%
100%
American General Consumer Discount Co.
American General Financial Services of Illinois, Inc.
American General Financial Services, Inc. [DE]
American General Financial Services, Inc. [IN]
American General Financial Services, Inc. [NC]
American General Financial Services, Inc. [OH]
American General Financial Services, Inc. [SC]
American General Financial Services, Inc. [TX]
American General Financial Services, Inc. [WA]
Merit Life Insurance Co.
Ocean Finance and Mortgages Limited
Third Street Funding LLC
Yosemite Insurance Company
MorEquity, Inc. [NV] 100%
Wilmington Finance, Inc. 100%
American General Financial Services of America, Inc. [DE] 100%
American General Home Equity, Inc. [DE]100%
AIG Global Services, Inc. 100%
American International Group KK 100%
Equitable Investment Co. (Hong Kong) Ltd. 100%
Sea Insurance Co. Limited
Sea Insurance Sendirian Berhad
100%
AIG Israel Insurance Company 50.01%
Caravan Investment Inc. 100%
AIG Caspian Insurance Company 51% nn
100%
AIG Federal Savings Bank
AIG Funding, Inc.
AIG BG Holdings, LLC
AIG Castle Holdings, LLC
AIG Castle Holdings, II LLC
AIG Life Insurance Company (Switzerland), Ltd.
American Security Life Insurance Company, Ltd.
MG Reinsurance Limited
AIG Trading Group, Inc. 100%
AIG International Inc. 100%
AIG Clearing Corporation 100%
AIG Kazakhstan Insurance Co., S.A. 60%
Delaware American Life Insurance Co. 100%
GBN, LLC 100%
AIG Retirement Services, Inc. 100%
SunAmerica Life Insurance Co. 100%
SunAmerica Annuity and Life Assurance Company 100%
SunAmerica Asset Mangement Corp. 100%
SunAmerica Capital Services, Inc. 100%
First Sun America Life Insurance Co
SA Affordable Housing, LLC
100%
SunAmerica Investments, Inc. 100%
SunAmerica (Cayman) Co., Ltd. 100%
AIG Advisor Group, Inc. 100%
SagePoint Financial Advisors, Inc. 100%
New California Life Holdings, Inc. 33%
Aurora National Life Assurance Co. 100%
AIUH LLC 100%
Chartis Holdings, Inc. 100%
AIG Financial Products Corp. 100%
100%
AIG Matched Funding Corp.
AIG -FP Matched Funding Corp.
Bishopswood Corp.
Bluewood Investment LLC
DBY One, LLC
International Investment Company (Bermuda) Limited
NF One (Cayman) Limited
NF Seven (Cayman) Limited
Orangewood Investment LLC
Yellowwood Investment LLC
AIG Financial Products (Jersey) Limited 100%
AIG -FP Investment Co. (Bermuda) Limited 100%
AIG -FP Funding (Cayman) Limited
AIG -FP Special Finance (Cayman) Limited
NF Thirteen (Cayman) Limited
100%
AIG -FP Pinestead Holdings Corp. 100%
Alberti Holding Company
Cedarstead Investment Corp.
Pinestead Investment Corp.
Willowgrove Finance Company Limited
100%
Dukes Corp. 100%
Cloudview (Cayman) Limited
Cloudview 3 (Cayman) Limited
Skyview (Cayman) Limited
Skyview 3 (Cayman) Limited
100%
Lakevista Holdings Corp. 79% oo
Lakevista Corp. 21% pp
Clarges Funding LLC 100%
Banque AIG S.A. 90% qq
Cherrywood Investments LLC 99% rr
Avon Holdings Corp. 100%
Avon LLC 100%
Avon Financing Corp. 100%
AIG Financial Products Hong Kong Limited 100%
Elgibright Investment Limited 90% ss
Bittern Investments Corp. 100%
Blackbird Investments LLC 100%
AIG -FP Capital Preservation Corp. 100%
Flamebright Investment Limited 100%
Bullfinch Investments (Cayman) Limited 91%
AIGFP NZ Funding LLC 99% tt
The AIV Limited Partnership 99%
Pearwood Funding Corp. 100%
Pearwood LLC 100%
Peachwood Funding Corp. 100%
NF One Hundred and Twenty-Three Corp. 100%
Sorbier Holding Corp. 79% uu
Sorbier Investment Corp.
Malacees LLC
100%
AIG -FP Holdings Corp. 100%
TMS Investments LLC 100%
TMS Sub LLC 100%
NF Fifty-Eight Corp. 79%
Heathwood Holding Corp. 21% vv
Heathwood Corp. 100%
AIG -FP Structured Finance (Cayman) Limited 100%
DBY Twenty-four Corp. 68% ww
Brambling Investments LLC 100%
Blackcap Investments LLC 100%
Union Excess Reinsurance Company, Ltd 100% xx
AIG Credit Facility Trust
Public shareholders
American International Group, Inc.

Source: AIG.

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

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

[c]4.99 percent Chartis Global Management Company Limited.

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

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

[f]19.72 percent Chartis Overseas Association.

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

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

[i]8.68 percent Chartis Overseas Limited.

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

[k]1 percent American International Group, Inc., Federal Reserve Bank of New York 100 percent interest with certain rights not customary of preferred holders.

[l]51 percent Rich Development Limited.

[m]16 percent Chartis Insurance Hong Kong Limited.

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

[o]20 percent PT Asta Indah Abadi.

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

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

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

[s]50 percent American Life Insurance Company.

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

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

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

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

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

[y]5 percent American Life Insurance Company.

[z]2.77 percent Chartis Overseas Limited.

[aa]90 American International Reinsurance Company, Limited.

[bb]38.01 percent American Life Insurance Company.

[cc]49 percent American Life Insurance Company.

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

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

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

[gg]75 percent American Life Insurance Company.

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

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

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

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

[ll]0.001 percent United Guaranty Services, Inc.

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

[nn]49 percent American International Group, Inc.

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

[pp]79 percent AIG Financial Products Corp.

[qq]10 percent AIG Matched Funding Corp.

[rr]1 percent AIGFP Capital Preservation Corp.

[ss]10 percent AIG Financial Products Corp.

[tt]1 percent AIG Financial Products Corp.

[uu]21 percent NF Thirty-nine Corp.

[vv]79 percent AIG Financial Products Corp.

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

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

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

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

As shown in table 4, AIG's key credit ratings have remained unchanged since May 2009, primarily because federal assistance has provided AIG with needed liquidity. For example, from March 31, 2009, to December 15, 2009, AM Best, Moody's, and Standard & Poor's (S&P) maintained the same credit ratings for AIG's long-term debt and the financial strength of its property/casualty and life insurance companies due in large part to the Board of Governors of the Federal Reserve System and the Department of the Treasury's support.[1] While contributing to stable ratings thus far, the scale of this assistance eventually may raise questions about AIG's future prospects if the company is not able to raise capital from private sources. For example, because of the importance of the federal funds to AIG's solvency, Fitch's lowered its ratings of AIG in several categories in May 2009. However, Fitch's ratings have not changed since May 2009.

[1]AIG's long-term debt was rated at A-/Negative (S&P) and A3/Negative (Moody's), and its short-term debt was rated at A-1 (S&P) and P-1 (Moody's). While these ratings are described using slightly different terminology, they tend to show relative consistency in the strength of AIG's debt.

Table 4: Credit Ratings, as of March 31, 2009; May 15, 2009; and December 15, 2009

	Credit rating[a]			
Rating agency	**Mar. 31, 2009**	**May 15, 2009**	**Dec. 15, 2009**	**Potential consequences of a ratings downgrade**
Debt				
Long-term				
				AIG Financial Products Corporation (AIGFP) 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: • By close of business on May 22, 2009, a 1-notch, 2-notch, or 3-notch downgrade from S&P and Moody's would have cost AIGFP $3.8 billion, $6.8 billion, or $7.7 billion, respectively. • By close of business on February 17, 2010, a 1-notch, 2-notch, or 3-notch downgrade from S&P and Moody's would have cost AIG $1.8 billion, $1.4 billion, or $0.3 billion, respectively.
S&P	A-/negative[b]	no change	no change	
Moody's	A3/negative[b]	no change	no change	
Fitch	A	BBB/evolving	no change	
Short-term				
S&P	A-1 for AIG Funding, Curzon, and Nightingale[b]	no change	no change	AIG affiliates in commercial paper programs (AIG Funding, Curzon Funding LLC, and Nightingale LLC) could be ineligible for participation in the Federal Reserve's Commercial Paper Funding Facility (CPFF). AIG's International Lease Finance Corporation lost access to CPFF funds after an S&P downgrade on January 21, 2009. The CPFF expired for new issuances on February 1, 2010, and will close upon maturity of all remaining commercial paper outstanding.
Moody's	P-1 for AIG Funding[b]	no change	no change	
Fitch	F1	no change	no change	
Financial strength				Further downgrades of these ratings may prevent AIG's insurance companies from offering products and services or result in increased policy cancellations or termination of assumed reinsurance contracts. A downgrade in AIG's credit ratings may result in a downgrade of the financial strength ratings of AIG's insurance subsidiaries.
Life insurer				
AM Best	A/negative[b]	no change	no change	Domestic retirement services would be severely affected by a high surrender rate and further suspension of sales in some firms, and would suffer a significant loss of wholesalers.

Rating agency	Credit rating[a] Mar. 31, 2009	May 15, 2009	Dec. 15, 2009	Potential consequences of a ratings downgrade
S&P	A+/negative	no change	no change	New domestic life business would be severely affected, in several instances forcing the company to exit businesses that serve either the high-net-worth marketplace or businesses that are governed by trust contracts. The company would need to continue to dedicate key resources to retention and management of existing relationships.
Moody's	A1/developing	no change	no change	
Fitch	AA-	A-/evolving	no change	
P&C insurer				
AM Best	A/negative[a]	no change	no change	AIG commercial property/casualty businesses expect that a financial strength rating downgrade would result in a loss of approximately 50 percent of the net premiums written and operating losses for the domestic business. For the foreign businesses, a downgrade could cause regulators to further strengthen operational and capital requirements. Staff retention could become a key issue, and premiums would deteriorate significantly.
S&P	A+/negative	no change	no change	
Moody's	Aa3/negative	no change	no change	
Fitch	AA-	A+/evolving	no change	

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

[a]Credit ratings are explained in the appendix II.

[b]These are key ratings.

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

Table 5: Summary of Rating Agencies' Ratings

Grade and Quality	Definitions	Moody's[a]	S&P[b]	Fitch[b]
Highest grade and quality	There is an extremely strong capacity to meet financial commitments on the obligation and bonds have little investment risk.	Aaa	AAA	AAA
High grade and quality	There is a very strong capacity to meet financial commitment on the obligation and bonds have very little investment risk, but margins of protection may be lower than with the highest grade bonds.	Aa	AA	AA
Upper medium grade and quality	There is a strong capacity to meet financial commitment on the obligation and the principal and interest are adequately secured, but the bonds are more vulnerable to a changing economy.	A	A	A
Medium and lower medium grade	There are adequate protections for these obligations, but the bonds have investment and speculative characteristics. This group comprises the lowest level of investment grade bonds.	Baa	BBB	BBB
Noninvestment and speculative grades	There is little protection on these obligations and the interest and principle may be in danger, where default may be likely.	Ba1 and below	BB+ and below	BB+ and below

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

[a]Moody's has numerical modifiers of 1, 2, and 3 in each rating classification from Aa to B: "1" indicates that the issue ranks in the higher end of the category, "2" indicates a mid-range ranking, and "3" indicates that the issue ranks in the lower end of the category.

[b]S&P's Ratings Services and Fitch Ratings: Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Appendix III: Corporate Liquidity Available to AIG

This indicator monitors the timing of potential future demand on American International Group, Inc.'s (AIG) liquidity posed by its debt obligations. These liquidity measures reflect AIG's ability to meet its cash payment needs. A decrease in available liquidity, or an increase in debt, could increase the risk of insolvency. Sources of available liquidity provide an indication of how AIG obtains the funds needed to meet its obligations. The greater the portion of current available liquidity provided by AIG's own operations, the less reliant they are on federal assistance.

As shown in table 6, in November 2008, the major source of AIG's corporate available liquidity was the Federal Reserve Bank of New York's (FRBNY) Revolving Credit Facility, with lesser amounts available through the FRBNY Commercial Paper Funding Facility (CPFF) and AIG's bilateral facilities. Overtime, AIG's primary source of liquidity has shifted away from CPFF and AIG's bilateral facilities. Starting in April 2009, AIG was obtaining the funds needed to meet its obligations primarily from the Department of the Treasury's Equity Facility, which remains its primary source of liquidity into 2010, as well as from FRBNY's Revolving Credit Facility.

Table 6: Amounts of Available Corporate Liquidity at November 5, 2008; February 18, 2009; April 29, 2009; July 29, 2009; October 28, 2009; and February 17, 2010

Dollars in millions

	Nov. 5, 2008	Feb. 18, 2009	Apr. 29, 2009	July 29, 2009	Oct. 28, 2009	Feb. 17, 2010
FRBNY Revolving Credit Facility	$24,000	$24,800	$17,400	20,000	$18,300	$14,000
Commercial paper under CPFF and syndicated and bilateral facilities	5,600	753	1,940	3,493	4,872	0
Unused bank syndicated and bilateral facilities	3,820	0	0	0	0	0
AIG Cash and short term investments	0	1,100	445	407	359	287
Treasury Equity Facility	0	0	29,835	28,685	26,629	22,292
Total	**$33,420**	**$26,653**	**$49,620**	**$52,585**	**$50,160**	**$36,579**

Source: GAO analysis of AIG SEC filings.

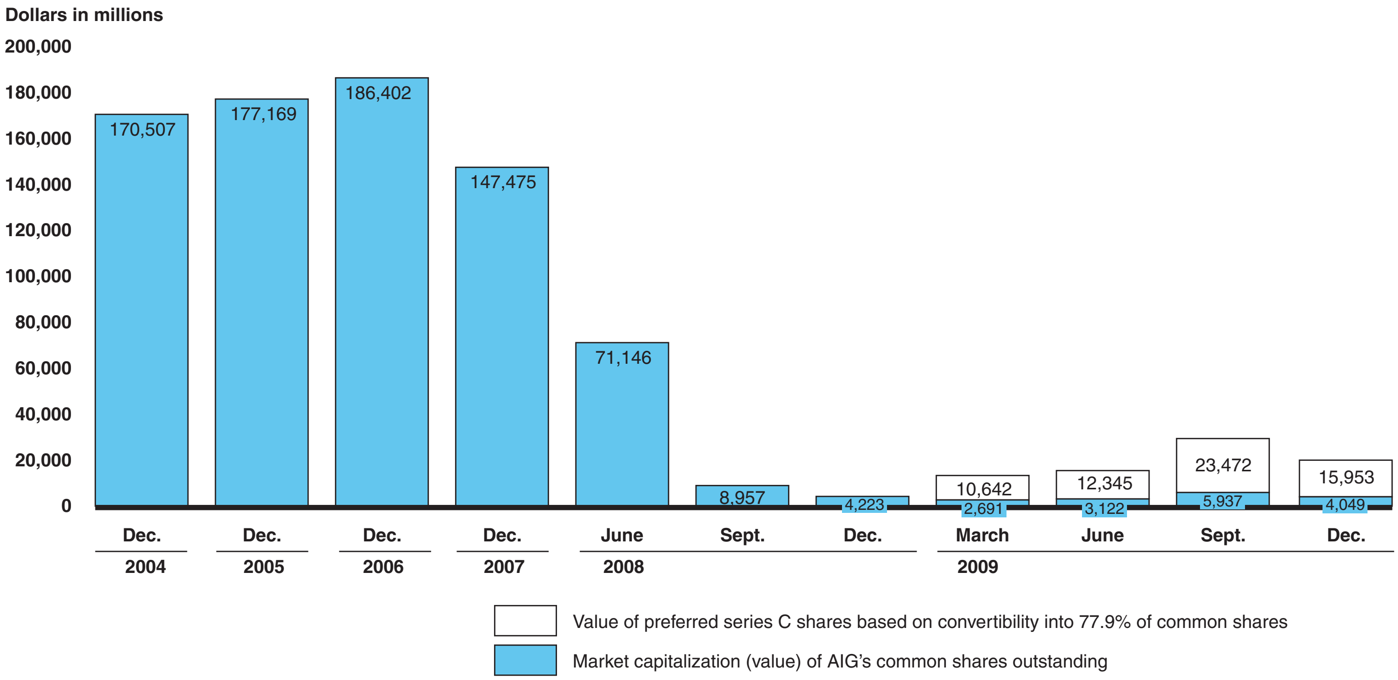
Note: The CPFF, which became operational in October 2008, provides a liquidity backstop to U.S. issuers of commercial paper through an SPV that purchases eligible three-month unsecured and asset-backed commercial paper from eligible issuers using financing provided by FRBNY. Its purpose is to enhance the liquidity of the commercial paper market.

Appendix IV: Value of Preferred and Common Shares of AIG

The value of the federal government's common equity investment in American International Group, Inc. (AIG) is tied to the market value of AIG's common shares. As a result, growth in value of the government's preferred equity stake depends on further growth of the value of common shares. As shown in figure 14, the market value of AIG's common shares outstanding peaked in December 2006 at $186.4 billion and by June 2008, their market value had declined to $71.1 billion. During the last two quarters of 2008, when federal assistance was initially provided to AIG, AIG shares further declined in value, falling to $4.2 billion by the end of 2008. On March 1, 2009, the AIG Credit Facility Trust and AIG entered into the Series C Preferred Stock Purchase Agreement. The values of the Series C preferred shares increased between March and September 2009 but fell in the fourth quarter.[1]

[1]The federal equity investment includes federally-owned Series C preferred shares that are convertible into 79.77 percent of total outstanding common shares. Under the terms of the Series C preferred stock issuance, the preferred stock is convertible into AIG's common stock. The conversion formula provides that the trust will receive 79.77 percent of AIG's common stock less the percentage of common stock that may be acquired by or for the benefit of Treasury as a result of warrants or other convertible preferred stock held by Treasury. Treasury received a warrant to purchase 2,690,088 shares of AIG Common Stock in connection with its purchase of Series D preferred stock, and an additional warrant to purchase AIG common stock in connection with its purchase of Series F preferred stock. Proceeds from the sale of the trust stock will be deposited in the U.S. Treasury General Fund.

Figure 14: Market Capitalization (Value) of AIG Outstanding Common Shares, Including Federally Owned Preferred C Shares That Are Convertible Into 79.77 Percent AIG's Outstanding Common Shares, December 2004 through December 2009



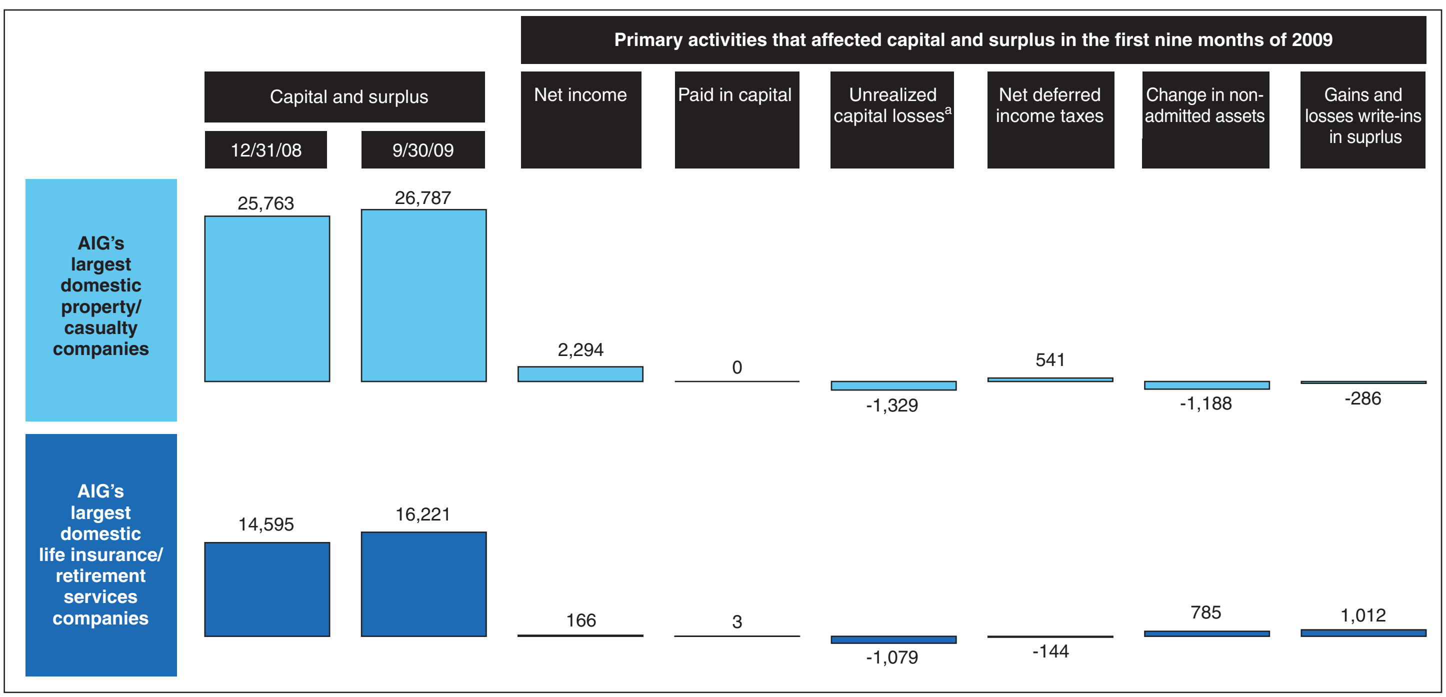
Source: GAO analysis of AIG's SEC filings and Treasury Financial Reporting Position Paper 09-07.

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

Appendix V: AIG Insurance Subsidiaries' Capital and Surplus

Because information on adjusted capital and related activities is only available annually in the year-end financial statements that American International Group, Inc. (AIG) companies file with the National Association of Insurance Commissioners (NAIC), we can only track it once a year. To track adjusted capital more frequently, we developed an indicator as a proxy that tracks capital and surplus as reported in AIG's quarterly filings with NAIC and major activities that could deplete capital and surplus, as well as adjusted capital. As illustrated in figure 15, capital and surplus for the first 9 months of 2009 increased for AIG's largest domestic property/casualty companies and largest domestic life and retirement services companies, and no major activities had an adverse effect large enough to deplete capital and surplus. Similar to the results of the adjusted capital indicator discussed in the report, these proxy results showed that AIG's domestic property/casualty companies did not need additional federal assistance during the first 9 months of 2009 to boost their regulatory capital.

Figure 15: AIG Insurance Subsidiaries: Capital and Surplus at December 31, 2008, and September 30, 2009, and Primary Activities That Affected Them In the First Nine Months of 2009 (dollars in millions)



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

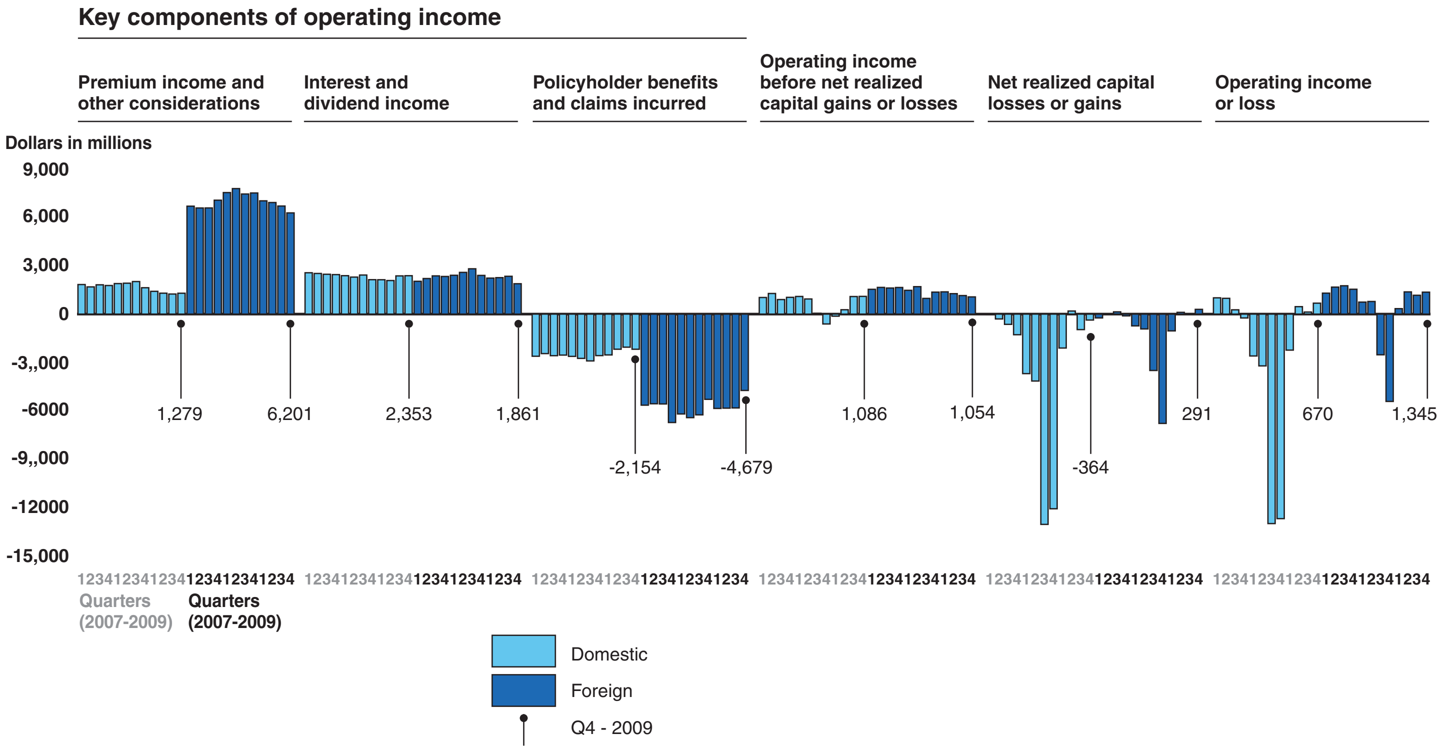
[a]NAIC financial statements show unrealized capital losses separately from net income.

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

The losses or gains of life insurance and retirement services may occur for several reasons. For example, operating income before capital gains or losses provides an indication of the profitability of a company's underwriting operations, while capital gains and losses relate to investment activities not directly related to insurance underwriting. Increases in operating income or reductions in net realized capital losses could indicate improvements in the operations of American International Group, Inc.'s (AIG) life and retirement services companies, including improvement in market conditions, lower other-than-temporary impairments, and dissipating effects of lower credit ratings and negative publicity related to the AIG brand since September 2008.

Figure 16 provides an indicator that can be used to examine the reasons for the profitability or losses of AIG's life insurance and retirement services. In 2008 the vast majority of losses incurred by AIG were not the result of their underwriting activities but instead were caused by losses in the investment portfolios of domestic and foreign life insurance businesses due to severe market price declines in certain commercial mortgage-backed securities and other securities. In subsequent quarters in 2009, AIG's domestic life and retirement services business realized income gains from operations partly because of Maiden Lane II's purchase of residential mortgage-backed securities from these companies, which helped prevent continued liquidity strains on AIG.

Figure 16: AIG Life Insurance and Retirement Services: Key Quarterly Revenues and Expenses, First Quarter of 2007 through Fourth Quarter of 2009



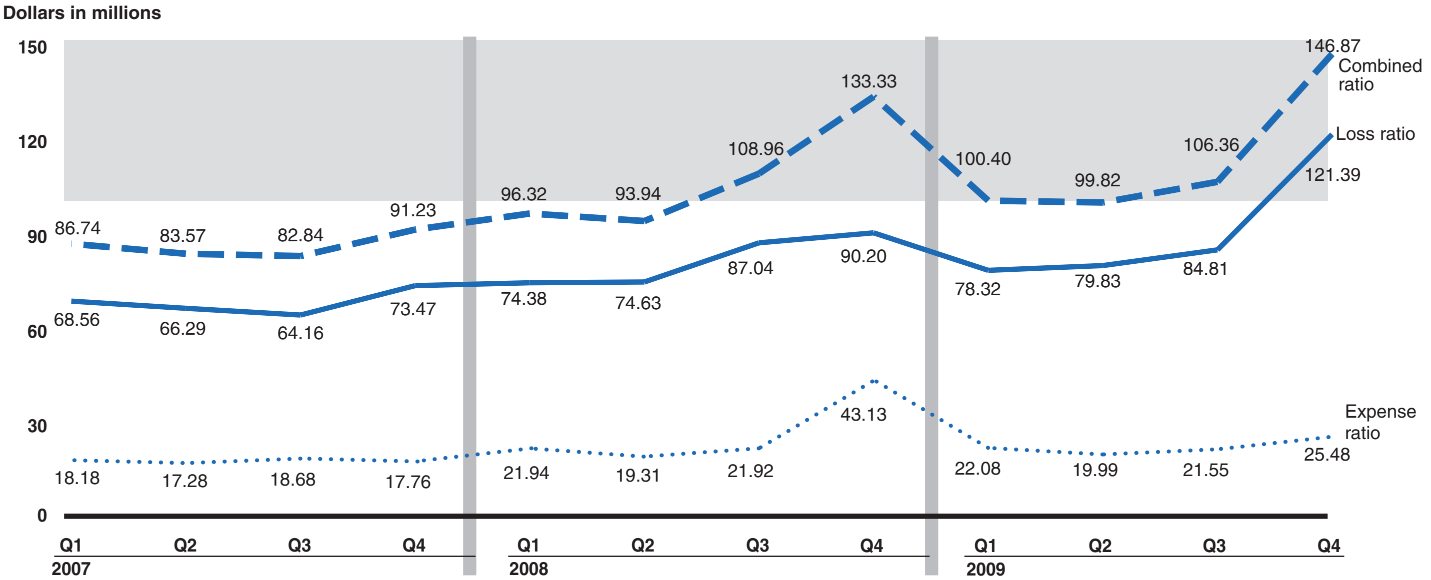
Source: GAO analysis of AIG's quarterly financial supplements.

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

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

As shown in figure 17, the combined ratio for American International Group, Inc.'s (AIG) commercial property-casualty insurance business spiked in the fourth quarter of 2008, largely due to an administrative charge to recognize impairment of goodwill of previously acquired businesses. The higher combined ratio was also partly due to a higher loss ratio because of increased claims costs associated with Hurricane Ike and other major catastrophes in 2008. The combined ratio rose above 100 percent in the last two quarters of 2009, indicating that claims and administrative costs were higher and rising faster than premium revenues and thus their insurance underwriting was not profitable. The combined ratio's rise in the fourth quarter of 2009 was also largely due to increased claims costs that arose because of a reserve strengthening charge AIG made to address unexpected losses in excess casualty and excess workers' compensation, two long-tail lines of business

Figure 17: AIG Property/Casualty Insurance: AIG Commercial Insurance Operating Ratios, First Quarter of 2007 through Fourth Quarter of 2009

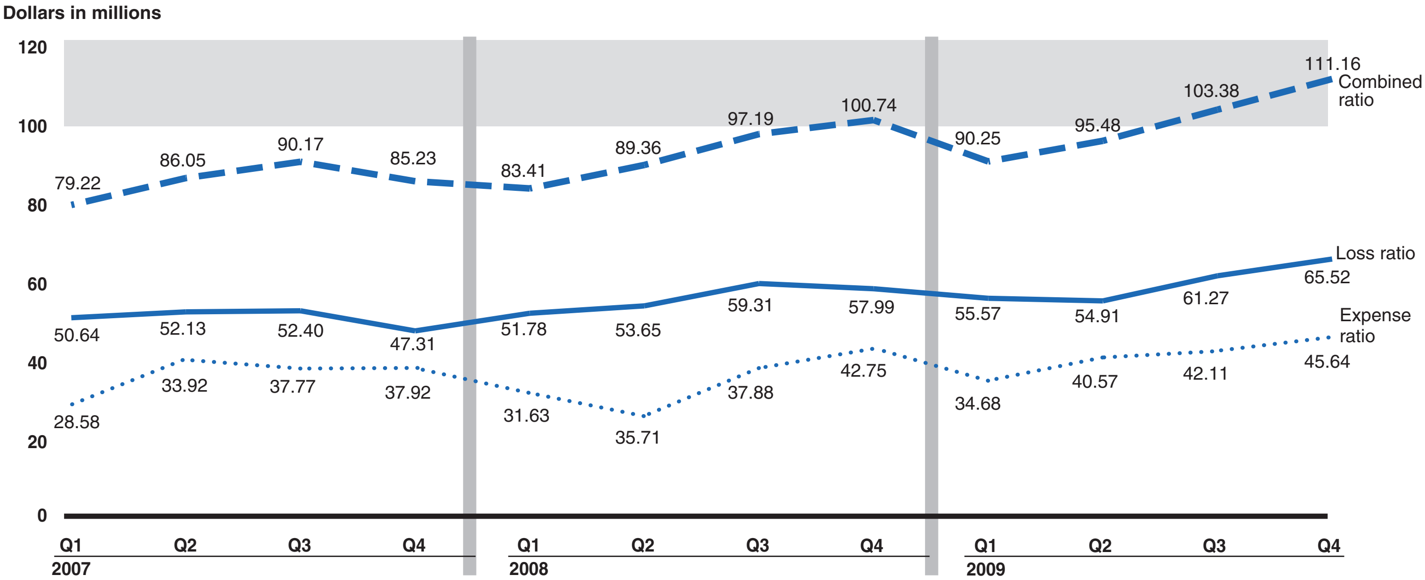


Source: GAO analysis of AIG's financial statements filed with SEC and quarterly financial supplements.

Note: Historical operating ratios for commercial insurance have been revised to include Private Client Group and exclude HSB Group, Inc. The underwriting expense for the fourth quarter of 2008 includes a $1.2 billion charge for impairment to goodwill, increasing the expense ratio by 22.50 points. Claims related to major catastrophes were $1.4 billion in 2008, including hurricane claims of $1.1 billion in the third quarter of 2008. Conversely, claims related to major catastrophes were $100 million in 2007.

Combined ratios for foreign general insurance were lower in the first three quarters of 2007 and 2008 than in comparable quarters of 2009 (see fig. 18). AIG officials attributed the higher 2009 numbers to several factors, including increased loss ratios due to higher claim losses, particularly in Europe, and increased expense ratios because of lower net premiums earned that resulted from the sale of its Brazilian operations. In addition, insurance markets becoming more competitive, and higher levels of general operating expenses primarily related to remediation/audit of general insurance (Chartis, Inc.), pension costs, and post retirement liability costs contributed to the higher combined ratios in 2009. As with AIG's commercial insurance, the combined ratio in its foreign general property-casualty insurance business also rose above 100 percent in the last two quarters of 2009.

Figure 18: AIG Property/Casualty Insurance: AIG Foreign General Insurance Operating Ratios, First Quarter of 2007 through Fourth Quarter of 2009

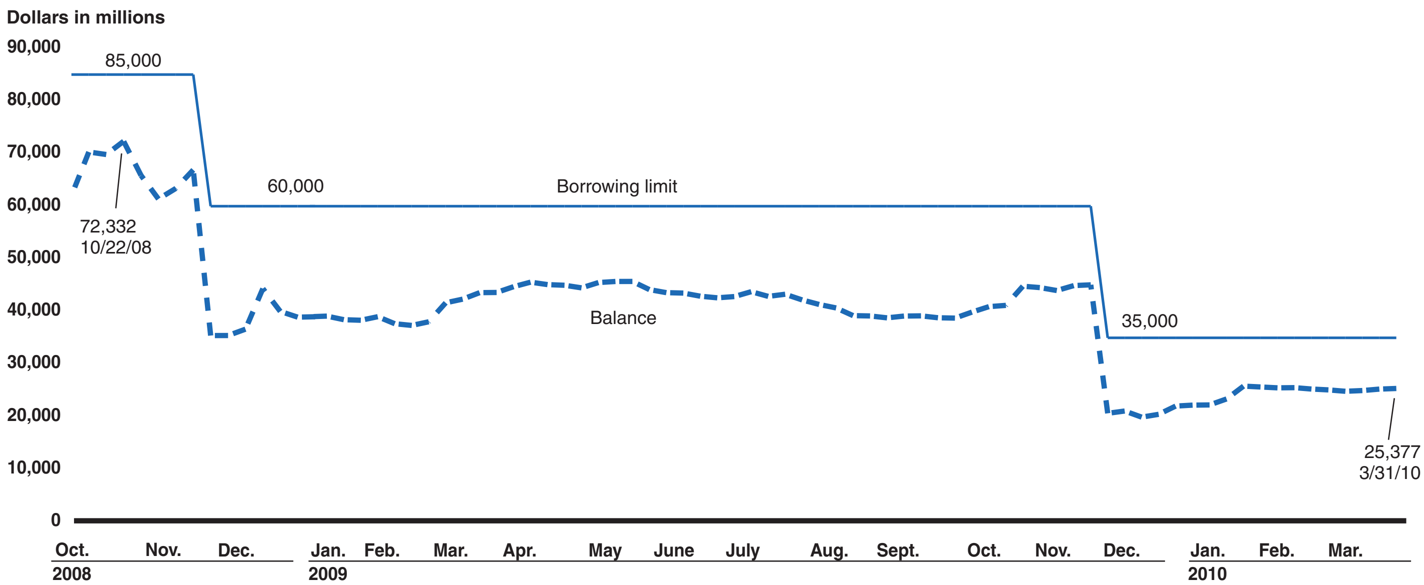


Source: GAO analysis of AIG's financial statements filed with SEC and quarterly financial supplements.

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

The initial federal assistance to American International Group, Inc. (AIG) was provided through the Federal Reserve Bank of New York's (FRBNY) Revolving Credit Facility. This indicator tracks the borrowing limit and the amount owed on the facility since it was implemented. As shown in figure 19, as of December 30, 2009, the amount of direct assistance available to AIG through the facility dropped to $35 billion, and the amount AIG owed the facility dropped to $23.4 billion. The decreases in available assistance and outstanding balance were attributable to the November 2008 and December 2009 restructuring of the government's assistance to the company from debt to preferred equity. Changes in amounts owed on the facility fluctuate weekly and could indicate increased liquidity needs related to restructuring decisions. Lower balances could indicate decreased liquidity needs, payments to the facility, and conversions to preferred equity stakes in AIG.

Figure 19: FRBNY Revolving Credit Facility Balance Owed and Total Amount Available, October 2008 through March 2010

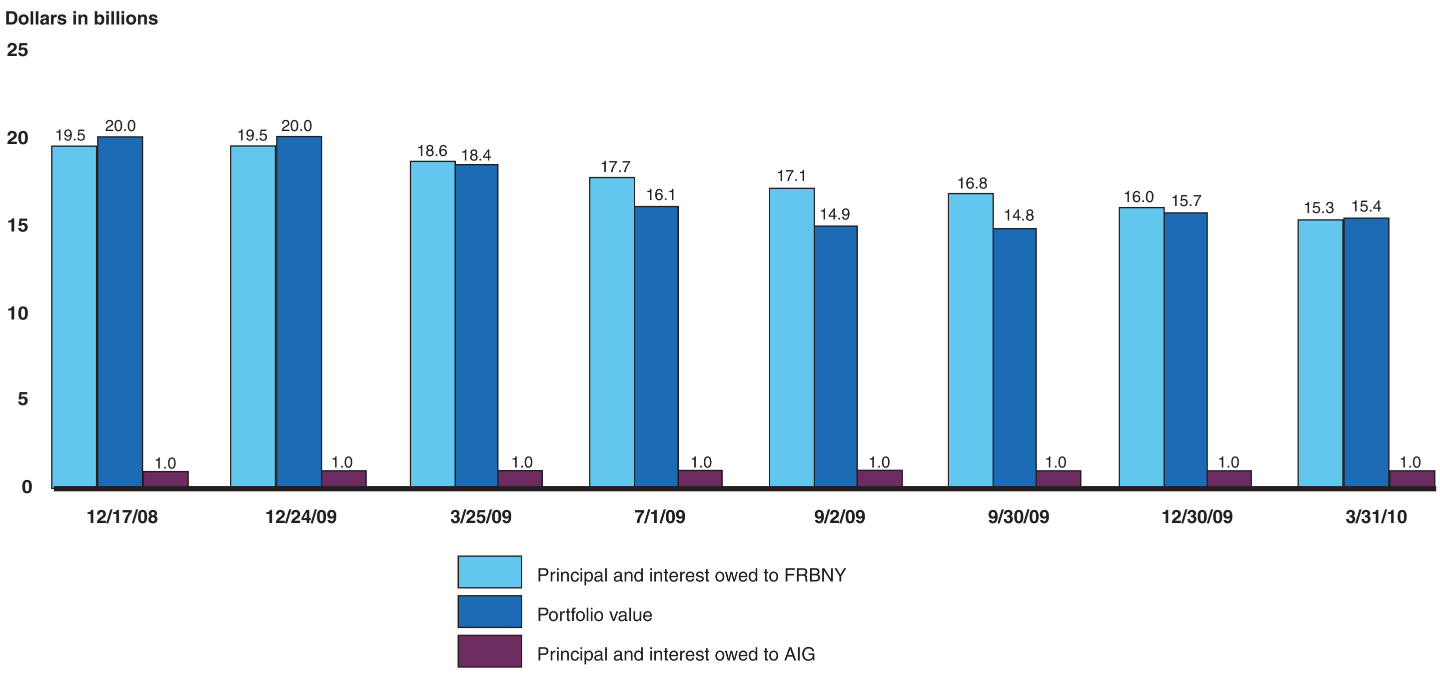


Sources: GAO analysis of Federal Reserve Statistical Release H.4.1 and Federal Reserve.

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

FRBNY provided a loan to Maiden Lane II to purchase residential mortgage-backed securities from AIG's domestic life insurance companies. As shown in figure 20, the portfolio value of Maiden Lane II peaked at $20 billion in December 2008 and was $14.8 billion at the end of September 2009. The level of debt (principal and interest) for the facility has been reduced from a maximum of $19.5 billion to its level in December 2009 of $16 billion.

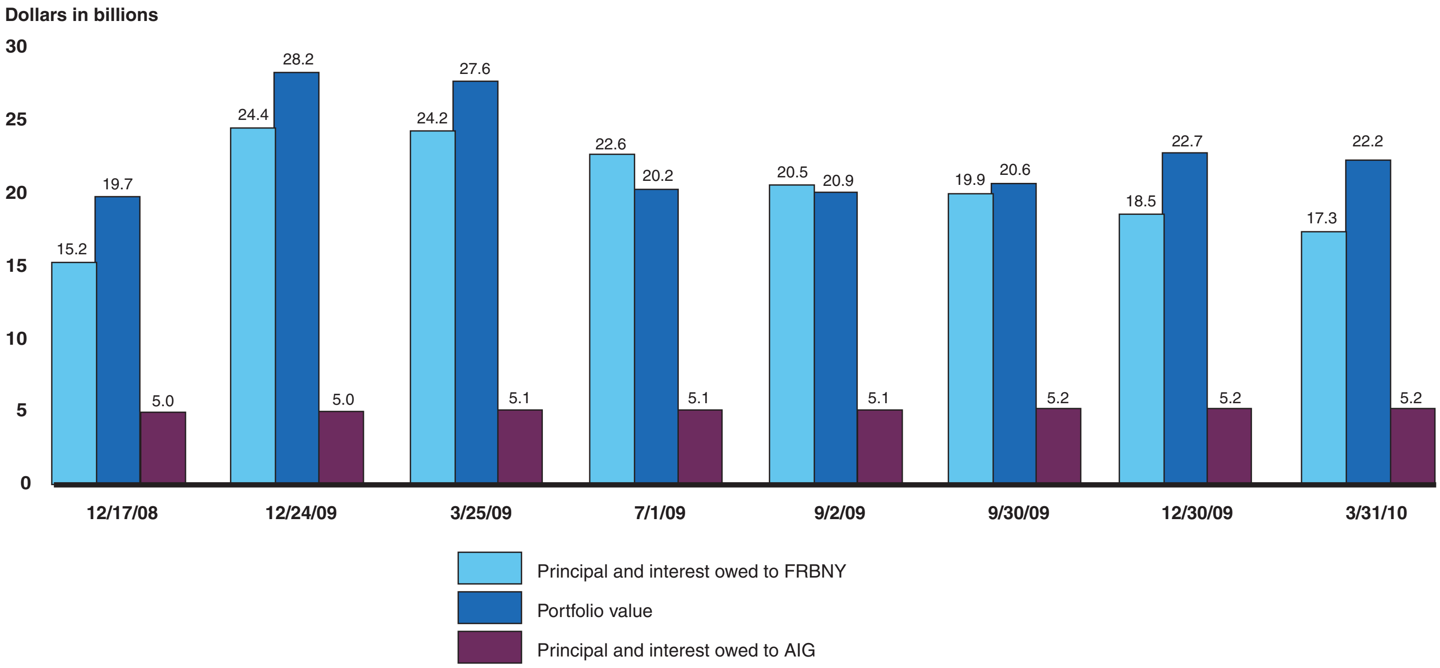
Figure 20: Amounts Owed and Portfolio Value of Maiden Lane II



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

FRBNY also provided loans to Maiden Lane III so it could purchase multi-sector collateralized debt obligations from AIGFP's credit default swaps counterparties. As shown in figure 21, the portfolio value of Maiden Lane III peaked at $28.2 billion in December 2008 and declined to $20.2 billion just more than 6 months later in July 2009. The level of debt has continued to be reduced since December 2008, and as of March 31, 2010, it stood at $17.3 billion, which is 29 percent less than the amount owed at December 24, 2008.

Figure 21: Amounts Owed and Portfolio Value of Maiden Lane III



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

Appendix IX: Disposition of AIG Assets

Part of American International Group, Inc.'s (AIG) strategy to raise money for repaying the federal government is to sell several of its assets. This indicator tracks sales or dispositions that have been closed and agreements of pending dispositions that have been publicly announced but have not yet closed. As table 5 shows, AIG sold increasingly more of its assets each quarter, from the last quarter of 2008 when it sold one asset for $820 billion, to the third quarter of 2009 when it sold 12 of its assets for a disclosed value of more than $4.5 billion (the proceeds for most of the sales that quarter were not publicly disclosed). In the last quarter of 2009, AIG sold only one asset—AIG Finance-Hong Kong—for $627 million. AIG officials told us that in addition to the sale of this asset, AIG signed sales agreements for several other transactions during this time period that had not yet closed. As of December 31, 2009, AIG disclosed that it had received $10.3 billion in total proceeds from sales, $5 billion of which was cash. Most recently, AIG has announced that it has entered into agreements to sell American International Assurance Company, Ltd (AIA) and American Life Insurance Company (ALICO) for a combined $51 billion.

Table 7: Dispositions Closed and Agreements Announced but not yet Closed, Second Quarter of 2008 through March 31, 2010

Dollars in millions

Dispositions closed in quarter ending	**Total proceeds**
September 30, 2008	
N/A	N/A
December 31, 2008	
Unibanco JV	$820
March 31, 2009	
AIG Financial Products Energy Commodity Hedges (all cash) (part of investment assets disposition below)	
Philam Savings Bank	43
Hartford Steam Boiler ($739 million cash)	815
Spanish Solar Park (part of investment assets disposition below)	
June 30, 2009	
AIG Life Insurance Company of Canada (all cash)	263
Commodity Business (all cash)	15
AIG Retail Bank and AIG Card (Thailand) ($45 million cash)	540
AIG Private Bank ($253 million cash)	308
Darag	N/D
Real estate in Tokyo (all cash)	1,179
Transatlantic Holdings	1,136

Dollars in millions

Dispositions closed in quarter ending	Total proceeds
September 30, 2009	
21st Century Insurance Group ($1.7 billion cash)	1,900
CFG China	N/D
Consumer finance operations in Mexico	N/D
A.I. Credit Life (all cash)	741
Investment assets—energy and infrastructure	1,900
AIG Credit Card Co (Taiwan)	N/D
CFG Thailand	N/D
AIG Systems Solution	N/D
Philam Plans	N/D
Philam Care	N/D
72 Wall Street (Manhattan office tower)	N/D
Consumer finance operations in Russia	N/D
December 31, 2009	
AIG Finance-Hong Kong ($70 million cash)	627
March 31, 2010	
Transatlantic Holdings, Inc.	452
portion of its asset management business	277
Total proceeds on dispositions closed	**$11,016**
Total known cash proceeds on closed dispositions with terms disclosed	**$5,734**
Disposition agreements announced but not yet closed at March 31, 2010	
Consumer finance operations in Argentina	N/D
Consumer finance operations in Colombia	N/D
Consumer finance business in Poland	N/D
Nan Shan	2,150
UGC International Canada	N/D
UGC International Israel	N/D
AIA ($25 billion cash, $8.5 billion equity linked securities $2.0 billion preferred stock in Prudential PLC)	35,500
ALICO ($6.8 billion cash, $8.7 billion stock in Met Life)	15,500

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

Note: N/D means not disclosed.

Appendix X: GAO Contact and Staff Acknowledgments

GAO Contact

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

Staff Acknowledgments

In addition to the contacts named above, Karen Tremba (Assistant Director); Farah Angersola, Tania Calhoun, Rachel DeMarcus, Lawrance Evans, John Forrester, Marc Molino, Jennifer Schwartz, 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 loss on that asset or security. It is calculated by starting with the original cost of an asset or security, then adding the value of any improvements, legal fees, and assessments and subtracting the value of any accumulated depreciation, amortization, and other losses.
Asset	An item owned by an individual, corporation, or government that provides a benefit, has economic value, and could be converted into cash. For businesses, an asset generates cash flow and may include, for example, accounts receivable and inventory. Assets are listed on a company's balance sheet.
Book	A trader's record or inventory of long (buy) and short (sell) positions on securities it is holding and on orders that have been 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 used by a business 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 where 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 Obligations (CDO)	Securities backed by a pool of bonds, loans, or other assets. In a basic CDO, a pool of bonds, loans, or other assets are pooled and securities are then issued in different tranches (or slices) that vary in risk and return.
Combined Ratio	A common measure of the performance of the daily operations of an insurance company. The ratio 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 below 100 percent generally indicates that the company is making underwriting profit while a ratio above 100 percent generally means that it is paying out more money in claims that it is receiving from premiums.
Commercial Paper	An unsecured obligation with maturities ranging from 2 to 270 days issued by banks, corporations, and other borrowers with high credit ratings to finance short-term credit needs, such as operating expenses and account receivables. Commercial paper is a low-cost alternative to bank loans. Issuing commercial paper allows a company to raise large amounts of funds quickly without the need to register with the Securities and Exchange Commission by either 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 (CDS)	CDS are bilateral contracts that are sold over the counter and transfer credit risks from one party to another. The seller, who is offering credit protection, agrees, in return for a periodic fee, 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, where 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. The fair value of derivative liability, for example, represents the fair market valuation of the liabilities in a portfolio of derivatives. In this example, the fair value provides an indicator of the dollar amount the market thinks the trader of the portfolio would need to pay to eliminate its liabilities.
Goodwill (and Goodwill Impairment)	Goodwill occurs when a company buys another entity and pays more than the market value of all assets on the entity's books. A company will pay more because of intangibles—such trademarks and copyrights—on the books at historical cost and other factors—such as human capital, brand name, and client base—that accounting conventions do not capture on the books. If the company later determines that the entity has lost value and recovery is not a realistic expectation it might decide record the lost value as an impairment.
Liability	A business's financial obligation that must be made to satisfy the contractual terms of such an obligation. A current liability, such as accounts payable or wages, is a debt that is payable within 1 year, while a long-term liability, 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 is also 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
Paid-in capital is 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/Unsecured Debt

Secured debt is debt backed or secured by a pledge of collateral. Unsecured debt is not backed by any such 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 where 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 was originally 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. This is commonly referred to as a buyer's market as buyers hold much of the power in negotiating prices.

Solvency

Minimum standard of financial health for an insurance company, where 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 a variety of purposes such as to securitize loans in order 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 purchased back 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 which is still owned by the holder is higher or lower than the price the holder paid for it.

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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