



# Ongoing Government Assistance for American International Group (AIG)

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## Summary

In the beginning of 2008, American International Group (AIG) was one of the world's largest insurers, generally considered to be financially sound with an AA credit rating. By the end of the year, it had undergone a near bankruptcy and had been forced to seek up to \$173.4 billion in financial assistance from the U.S. government. The CEO had been replaced at the government's behest, executive compensation was under limits, and shareholders in AIG had been nearly wiped out as their equity was diluted by a new 79.9% stake held by the government. The government assistance to AIG has been largely ad hoc. The overarching AIG holding company was regulated by the Office of Thrift Supervision (OTS), but because the company was primarily an insurer, it was largely outside of the normal Federal Reserve (Fed) facilities that lend to thrifts facing liquidity difficulties. AIG was also outside of the normal receivership provisions that apply to banking institutions. Had AIG not been effectively deemed "too big to fail" and given assistance by the government, bankruptcy seemed a near certainty in September 2008.

The losses that led to AIG's essential failure resulted largely from two sources: the state-regulated AIG insurance subsidiaries' securities lending program and the AIG Financial Products (AIGFP) subsidiary, a largely unregulated subsidiary that specialized in financial derivatives. The transactions that led to the immediate losses were dealt with relatively quickly in 2008, albeit with significant outlay of government funds. Although the securities lending program was relatively straightforward to discontinue, the AIGFP derivative operations extended well beyond the transactions that caused the immediate losses and are taking longer to wind down. The overall AIGFP derivative portfolio remains significant, as AIG reported approximately \$940.7 billion in notional net value of derivatives at the end of 2009.

The government assistance to AIG began with an \$85 billion loan from the Fed in September 2008. This loan was on relatively onerous terms with a high interest rate and required a handover of 79.9% of the equity in AIG to the government. As AIG's financial position weakened, several rounds of additional funding were provided to AIG and the terms were loosened to some degree. The current major restructuring of the assistance to AIG was announced in March 2009 and comprises (1) \$47.3 billion (of up to \$68.8 billion) in capital injections through preferred share purchases by the Treasury; (2) \$25.3 billion (of up to \$35 billion) in extraordinary loans from the Fed; (3) \$24.8 billion in Fed loans retired by equity interests provided to the government by AIG; (4) \$2.3 billion in Fed loans through the Commercial Paper Funding Facility; and (5) \$43.8 billion (of up to \$52.5 billion) in Fed loans for troubled asset purchases—assets that are now owned by the government.

Congress has held several hearings specifically focusing on the intervention in AIG. Congressional attention and anger has been focused on perceived corporate profligacy, particularly bonuses for AIG employees. Bills that would place specific taxes on or otherwise restrict such bonuses include H.R. 1586, passed by the House on March 19, 2009; S. 651, introduced on the same day; and H.R. 1664, passed by the House on April 1, 2009.

The future of AIG and the ultimate government cost of the intervention are unclear. Recently announced asset sales by AIG may repay all of the Fed loans, but this would leave the Troubled Asset Relief Program (TARP) preferred shares outstanding. Recent estimates of the losses on the TARP funding range from \$9 billion to \$49 billion.

This report will be updated as warranted by financial and legislative events.

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## Introduction

In 2007, American International Group (AIG) was the fifth-largest insurer in the world with \$110 billion overall revenues. In the United States, it ranked second in property/casualty insurance premiums (\$37.7 billion/7.5% market share) and first in life insurance premiums (\$53.0 billion/8.9%). For particular lines, AIG ranked first in surplus lines, ninth in private passenger auto, first in overall commercial lines (fifth in commercial auto), and fourth in mortgage guaranty. It was outside the top 10 in homeowners insurance.<sup>1</sup> According to the National Association of Insurance Commissioners, AIG had more than 70 state-regulated insurance subsidiaries in the United States, with more than 175 non-insurance or foreign entities under the general holding company.

Although AIG is generally identified as an insurance company, the parent entity of the various subsidiaries is a thrift holding company and thus falls under the general supervision of the Office of Thrift Supervision (OTS). The individual regulation of the subsidiaries is done according to the function of that subsidiary—for example, insurance subsidiaries are regulated by state insurance regulators, and bank subsidiaries are regulated by the appropriate banking regulator. This functional regulatory structure was enacted in the Gramm-Leach-Bliley Act of 1999.<sup>2</sup>

In the fall of 2008, facing losses on various operations, AIG experienced a significant decline in its stock price and downgrades from the major credit rating agencies.<sup>3</sup> These downgrades led to immediate demands for significant amounts of collateral (approximately \$14 billion to \$15 billion in collateral payments, according to contemporary press reports).<sup>4</sup> As financial demands on the company mounted, bankruptcy appeared a possibility, as occurred with Lehman Brothers. Fears about the spillover effects from such a failure brought calls for government action to avert such a failure. Many feared that AIG was “too big to fail”<sup>5</sup> due to the potential for widespread disruption to financial markets resulting from such a failure. The New York Insurance Superintendent, primary regulator of many of the AIG insurance subsidiaries, led an effort to allow access by the parent holding company and other subsidiaries of up to \$20 billion in cash from AIG’s insurance subsidiaries, which were perceived as solvent and relatively liquid. Ultimately, this transfer did not take place; instead, the Federal Reserve (Fed) approved an up to \$85 billion loan in September 2008, as detailed below.

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<sup>1</sup> Statistics from *The I.I.I. Insurance Fact Book 2009*, (New York: Insurance Information Institute, 2009).

<sup>2</sup> P.L. 106-102, 113 Stat. 1338.

<sup>3</sup> In 2005, amid accounting irregularities that ultimately led to the resignation of then-CEO Maurice Greenberg, AIG was downgraded by S&P from AAA to AA+. Further downgrades followed in June 2005 and May 2008. In September 2008, S&P downgraded AIG to A-.

<sup>4</sup> See, for example, “U.S. to Take Over AIG in \$85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up,” *Wall Street Journal*, September 17, 2008, pp. A1-A6.

<sup>5</sup> Institutions that are too big to fail are ones that are deemed to be big enough that their failure could create systemic risk, the risk that the financial system as a whole would cease to function smoothly. See CRS Report R40877, *Financial Regulatory Reform: Systemic Risk and the Federal Reserve*, by Marc Labonte and CRS Report R40417, *Macroprudential Oversight: Monitoring Systemic Risk in the Financial System*, by Darryl E. Getter for more information on systemic risk and “too big to fail.”

## Current Status of Government Assistance to AIG

As AIG's financial position weakened after September, several rounds of additional funding were provided to AIG and the terms were loosened to some degree (see "Forms of Assistance for AIG" below for more complete discussion of the changes to AIG's assistance). The latest major restructuring of the assistance to AIG was announced in March 2009. As currently structured, the assistance to AIG comprises

- \$47.5 billion (of up to \$68.8 billion) in capital injections through preferred share purchases by the Treasury's Troubled Asset Relief Program (TARP);<sup>6</sup>
- \$24.8 billion (of up to \$35 billion) in extraordinary loans from the Fed;<sup>7</sup>
- \$25 billion in Fed loans retired by equity interests in AIG subsidiaries AIA Group Limited (AIA) and American Life Insurance Company (ALICO);<sup>8</sup>
- \$2.3 billion in Fed loans through the Commercial Paper Funding Facility (CPFF);<sup>9</sup> and
- \$43.8 billion (of up to \$52.5 billion) in Fed loans for troubled asset purchases—assets that are now owned by the government.<sup>10</sup>

On March 1, 2010, AIG announced that an agreement had been reached to sell AIA to the Prudential PLC<sup>11</sup> for approximately \$35.5 billion, which includes \$25 billion in cash and \$10.5 billion in securities. Assuming completion of this sale, the Fed would receive approximately \$16 billion immediately because of its previous equity stake in AIA. AIG indicated that the remaining \$9 billion in cash and the ultimate proceeds of the securities would be used to pay down some of the outstanding loan from the Fed.<sup>12</sup>

On March 8, 2010, AIG announced that an agreement had been reached to sell ALICO to MetLife for approximately \$15.5 billion, including \$6.8 billion in cash and \$8.7 billion in securities. Assuming completion of this sale, the Fed would likely receive all of the cash as well as an additional \$2.2 billion in securities because of its previous \$9 billion equity stake in ALICO. The

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<sup>6</sup> U.S. Treasury, *TARP Monthly 105(a) Report—February 2010*, March 10, 2010, pp.12-13, available at <http://financialstability.gov/latest/reportsanddocs.html>.

<sup>7</sup> Federal Reserve H.4.1 data release, *Factors Affecting Reserve Balances of Depository Institutions*, March 11, 2010, Table 1, available at <http://www.federalreserve.gov/releases/h41/>.

<sup>8</sup> Federal Reserve H.4.1 data release, *Factors Affecting Reserve Balances of Depository Institutions*, March 11, 2010, Table 9, available at <http://www.federalreserve.gov/releases/h41/>.

<sup>9</sup> American International Group, Inc., "Aig Reports Fourth Quarter and Full Year 2009 Results", press release, February 26, 2010, p. 5, available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzMjR8Q2hpbGRJRDR0tMXxUeXB1PTM=&t=1>. The CPFF was closed to further borrowing on February 1, 2010.

<sup>10</sup> Federal Reserve H.4.1 data release, *Factors Affecting Reserve Balances of Depository Institutions*, March 11, 2010, Tables 5 and 6, available at <http://www.federalreserve.gov/releases/h41/>.

<sup>11</sup> Prudential PLC is a British insurer and not related to the large U.S. insurer Prudential Financial.

<sup>12</sup> AIG, "AIG to Sell AIA to Prudential for Approximately \$35.5 Billion," press release, March 1, 2010, <http://www.aigcorporate.com/newsroom/index.html>.

remaining securities would be sold over time with the proceeds being used to pay down a portion of the outstanding loan from the Fed.<sup>13</sup>

These announced asset sales will likely take several months to complete and will not be reflected in the announced totals from government assistance to AIG until completion. A summary of current amounts outstanding is presented in **Table 1**.

**Table 1. Summary of Assistance to AIG**

<b>Program</b>	<b>Maximum Amount of Current Government Assistance</b>	<b>Latest Reported Amount Outstanding</b>	<b>Recompense to the Government/Value of Current Holdings</b>
TARP Share Purchase	\$69.8 billion	\$47.5 billion (Feb. 28, 2010)	10% dividend; warrants for 2% of AIG equity
Federal Reserve Loan	\$35 billion	\$24.8 billion (Mar. 10, 2010)	3 month LIBOR+3%; 77.9% of AIG equity
Retired Federal Reserve Loan	\$25 billion	\$25.3 billion (Mar. 10, 2010)	\$25.3 billion
Commercial Paper Funding Facility	\$2.3 billion	\$2.3 billion (Feb. 17, 2010)	three-month overnight index swap (OIS) rate+1%; OIS+3%
Maiden Lane II	\$19.5 billion	\$15.3 billion (Mar. 10, 2010)	\$15.6 billion (Dec. 31, 2009)
Maiden Lane III	\$24.3 billion	\$17.3 billion (Mar. 10, 2010)	\$22.4 billion (Dec. 31, 2009)

**Source:** Federal Reserve, U.S. Treasury, AIG 10-Q and 10-K Statements.

**Notes:** Dividend paid on shares under TARP is subject to the AIG board approval. Outstanding amounts for Federal Reserve loans and LLCs include interest and dividends due. The loan amounts to Maiden Lane II and III are from these entities to the Fed, and are not to be repaid by AIG.

## Ultimate Cost of Assistance to AIG?

Because the assistance to AIG has come in the form of asset purchases and loans, which have resulted in equity stakes in AIG, the ultimate cost to the government of the AIG rescue will depend critically on the future value of these assets. The Federal Reserve assistance to AIG appears to be on track to be repaid without loss to the Fed. If the sales of ALICO and AIA go through as currently reported, the proceeds of these sales would be approximately enough to repay the extraordinary loans made by the Fed. The current estimated values of the Maiden Lane II and III LLCs are also approximately sufficient to repay the loans to the Fed, and the CPFF amount has been dropping and will be repaid shortly, as the program's term has expired.

If the Fed loans are indeed repaid, the ultimate cost of the intervention in AIG would largely be determined by the outcome of the outstanding assistance under TARP, currently approximately \$45.3 billion, and the value of the approximately 80% equity interest in the company held by the government. Current estimates of the value of the TARP preferred shares are for significant losses

<sup>13</sup> AIG, "AIG to Sell ALICO to MetLife for Approximately \$15.5 Billion," press release, March 8, 2010, <http://www.aigcorporate.com/newsroom/index.html>.

on these instruments, although precise values vary significantly. As of September 30, 2009, the Treasury estimated that the value of its holdings of TARP preferred shares was only \$13.2 billion on the then-outstanding balance of \$43.2 billion. In January 2010, the Congressional Budget Office estimated a net cost of \$9 billion for the TARP assistance to AIG, whereas the Office of Management and Budget estimated a net cost of \$49.9 billion.

The value of the government common equity interests in AIG is equally uncertain. As of March 5, 2009, the market value of the shares being traded on the open market was approximately \$3.8 billion. If the approximately 80% of the company held by the government is valued equally to the 20% that is trading, the government's common equity interests would be worth approximately \$15 billion. It should be noted that a government move to sell its equity interest would likely have a significant impact on AIG's share price.

## **Legal Authority for Assistance to AIG**

According to the Fed, its assistance to AIG is authorized under Section 13(3) of the Federal Reserve Act,<sup>14</sup> the same emergency authorization used for numerous other Fed actions in the ongoing financial crisis. This emergency authorization was needed because the Federal Reserve cannot normally lend to a financial firm that is neither a depository institution nor a primary dealer. Following amendments passed in 2008, the Fed is required to report on emergency loans under Section 13(3).<sup>15</sup>

Treasury assistance to AIG has occurred under Section 101 of the Emergency Economic Stabilization Act (EESA),<sup>16</sup> which authorizes the purchase of "troubled assets" by the Treasury. Part (B) of the act's definition of "troubled assets" defines such assets as "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability." Treasury is required to report on its transactions under the EESA.<sup>17</sup>

## **Sources of AIG Losses**

AIG, as most financial institutions, suffered losses on a wide variety of financial instruments because of the widespread market downturn. The exceptional losses resulting in essential failure of AIG arose primarily from two sources: the derivative activities of the AIG Financial Products (AIGFP) subsidiary and the securities lending activities managed by AIG Investments with securities largely from the AIG insurance subsidiaries.

### **AIG Financial Products**

The AIGFP subsidiary is headquartered in Connecticut with major operations in London. According to AIG's website, it was "founded in 1987 as one of the first companies in the United

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<sup>14</sup> 12 U.S.C. 343.

<sup>15</sup> Section 13(3) reports can be found at [http://www.federalreserve.gov/monetarypolicy/bst\\_reportsresources.htm](http://www.federalreserve.gov/monetarypolicy/bst_reportsresources.htm).

<sup>16</sup> 12 U.S.C. 5211.

<sup>17</sup> TARP reports can be found at <http://financialstability.gov/latest/reportsanddocs.html>.

States focused principally on OTC [over the counter] derivatives markets.”<sup>18</sup> In recent years, AIGFP began writing credit default swaps (CDS), particularly on mortgage-related securities. CDS can act essentially as insurance policies on securities, typically requiring the company selling the CDS to pay off the claims on these CDS if there is a default or specified credit event involving the security.<sup>19</sup> AIGFP’s portfolio of CDS at the end of 2007 had a notional value of approximately \$500 billion, including around \$60 billion in CDS on securities linked to subprime loans. By August of 2008, approximately 64% of the subprime-linked securities backed by AIG had been downgraded and six were in default.<sup>20</sup>

As over-the-counter derivatives, CDS can take any form desired by the two parties writing the contracts in question. In typical CDS contracts, collateral requirements are placed on CDS sellers such that, even before default occurs, the seller may be required to post cash collateral as either the seller’s financial condition weakens or the likelihood of default increases. AIG was forced to post increasing collateral on the CDS written by AIGFP. These collateral calls were an important factor driving the need for a rescue in September 2008, and a primary motivation for the Fed’s creation of the Maiden Lane III Limited Liability Corporation (LLC) in the November 2008 restructuring of the AIG intervention (see “Collateralized Debt Obligations/Maiden Lane III” below for more details on these interventions).

## **AIG Securities Lending Program**

Securities lending is a not uncommon practice where the holder of a security agrees to lend a security to another party.<sup>21</sup> Such transactions are, like CDS, done over the counter rather than on exchanges, and thus can take almost any form desired by the two parties. Typically, the borrower of the security provides some form of collateral, often cash, which the lender invests to further profit from the transaction. The timing aspects of the transactions, such as when and how loaned securities are returned, are up to the contract specifics negotiated by the two parties.

Although managed centrally by AIG Investments, the securities used in AIG’s securities lending originated primarily from its state-regulated insurance subsidiaries. As of June 30, 2008, 71% of the loaned securities came from AIG’s U.S. life insurers and retirement services and 4% came from AIG’s U.S. property/casualty insurers. In return for lending securities, AIG typically received cash collateral worth between 100% and 102% of the loaned securities and then invested this cash until the loaned securities were returned, at which point the cash collateral was to be returned. In mid-2008, AIG’s total liability for the return of securities lending collateral equaled \$75.1 billion. The market value of the investments made by AIG with this collateral (largely in mortgage-backed securities) totaled only \$59.5 billion.<sup>22</sup> As AIG suffered downgrades and increased market skepticism during the fall of 2008, increasing numbers of AIG’s counterparties

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<sup>18</sup> See [http://www.aig.com/AIG-Financial-Products-Corp\\_20\\_20258.html](http://www.aig.com/AIG-Financial-Products-Corp_20_20258.html).

<sup>19</sup> For more information on CDS see CRS Report RS22932, *Credit Default Swaps: Frequently Asked Questions*, by Edward V. Murphy and Rena S. Miller.

<sup>20</sup> For examples, see “Goldman, Merrill Collect Billions after Fed’s AIG Bailout Loans,” Bloomberg, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aTzTYtLNHSG8> and “Behind Insurer’s Crisis, Blind Eye to a Web of Risk,” New York Times, September 27, p. A1.

<sup>21</sup> The International Securities Lending Association estimates that the global amount of loaned securities is greater than 1 trillion pounds (approximately \$1.4 trillion).

<sup>22</sup> Statistics from American International Group, Inc., *Form 10-Q*, for the quarterly period ending June 30, 2008, pp. 111-112, available at [http://media.corporate-ir.net/media\\_files/irol/76/76115/reports/Q210Q.pdf](http://media.corporate-ir.net/media_files/irol/76/76115/reports/Q210Q.pdf).



in securities lending agreements returned the original securities and expected the return of their cash collateral. This demand for cash led to the Securities Borrowing Facility, announced by the Fed on October 8, 2008, and the creation of the Maiden Lane II LLC in November 2008, as detailed below in “Residential Mortgage-Backed Securities/Maiden Lane II.”

## **Forms of Assistance for AIG**

### **Initial Loan**

On September 16, 2008, the Fed announced, after consultation with the Treasury Department, that it would lend up to \$85 billion to AIG over the next two years. Drawing from the loan facility would only occur at the discretion of the Fed. A new CEO was installed after the initial intervention and Fed staff was put on site with the company to oversee operations. The interest rate on the funds drawn from the Fed was 8.5 percentage points above the London Interbank Offered Rate (LIBOR), a rate that banks charge to lend to each other. AIG also had to pay a flat 8.5% interest rate on any funds that it does not draw from the facility. The government received warrants that, if exercised, would give the government a 79.9% ownership stake in AIG. Three independent trustees were to be named by the Fed to oversee the firm for the duration of the loan. The trustees for the AIG Credit Trust were announced on January 16, 2009.<sup>23</sup>

This lending facility (and its successors) is secured by the assets of AIG’s holding company and non-regulated subsidiaries.<sup>24</sup> In other words, the Fed could seize AIG’s assets if AIG fails to honor the terms of the loan. This reduces the risk that the Fed and the taxpayers would suffer a loss. The risk still remains that if AIG turns out to be insolvent, its assets may be insufficient to cover the amount it had borrowed from the Fed.<sup>25</sup>

On September 18, the Fed announced that it had initially lent \$28 billion of the \$85 billion possible. This amount grew to approximately \$61 billion on November 5, shortly before the restructuring of the loan discussed below in “Loan Restructuring.”<sup>26</sup>

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<sup>23</sup> See <http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.html>.

<sup>24</sup> The regulated subsidiaries are primarily the state-chartered insurance subsidiaries. Thus, if AIG were to default on the loan, the Fed could seize the insurance subsidiary stock held by the holding company, but not the actual assets held by the insurance companies.

<sup>25</sup> If AIG is indeed too big to fail, however, it is unclear whether its assets could be seized in the event of non-payment without precipitating system-wide problems.

<sup>26</sup> Federal Reserve, “Factors Affecting Reserve Balances,” Statistical Release H.4.1, September 18, 2008. See <http://www.federalreserve.gov/releases/h41/20080918/>; and “Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Restructuring of the Government’s Financial Support to the American International Group, Inc. on November 10, 2008, p. 4. See <http://www.federalreserve.gov/monetarypolicy/files/129aigrestructure.pdf>.

## **Securities Borrowing Facility<sup>27</sup>**

On October 8, the Fed announced that it was expanding its assistance to AIG by swapping cash for up to \$37.8 billion of AIG's investment-grade, fixed-income securities. These securities stemmed from the AIG securities lending program (described above). As some counterparties stopped participating in the lending program, AIG was forced to incur losses on its securities lending investments.<sup>28</sup> AIG needed liquidity from the Fed to cover these losses and counterparty withdrawals. This lending facility was to extend for nearly two years, until September 16, 2010, and advances from the securities borrowing facility to AIG paid an interest rate of 1% over the average overnight repo rate. As of November 5, 2008, \$19.9 billion of the \$37.8 billion remained outstanding.

Although this assistance resembles a typical collateralized loan (the Fed receives assets as collateral, and the borrower receives cash), the Fed characterized the agreement as a loan of securities from AIG to the Fed in exchange for cash collateral. It appears the arrangement was structured this way because New York insurance law prevents AIG from using the securities as collateral in a loan.<sup>29</sup>

## **Commercial Paper Funding Facility**

The Commercial Paper Funding Facility (CPFF) was initially announced by the Fed on October 7, 2008, as a measure to restore liquidity in the commercial paper market. Through the CPFF, the Fed purchases both asset-backed and unsecured commercial paper. Rather than charging an interest rate, the Fed purchases the paper at a discount based on the three-month overnight index swap rate. Unsecured paper is discounted by 3%, whereas secured paper is discounted by 1%. Individual participants in this facility and the amounts accessed are not announced by the Fed.

AIG itself announced that, as of November 5, 2008, it had been authorized to issue up to \$20.9 billion of commercial paper to the CPFF and had actually issued approximately \$15.3 billion of this amount. Subsequent downgrades of AIG's airline leasing subsidiary (ILFC) reduced the maximum amount AIG could access from the CPFF to \$15.2 billion in early January 2009. ILFC had approximately \$1.7 billion outstanding to the CPFF when it was downgraded; this amount was repaid by January 28, 2009. As of February 17, 2010, the reported total outstanding was \$2.3 billion.<sup>30</sup> CPFF purchase of commercial paper expired February 1, 2010, with maximum maturities extending 90 days from this point. Thus, all AIG borrowing from the CPFF must be repaid by April 30, 2010.

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<sup>27</sup> Terms detailed by the Federal Reserve in "Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Securities Borrowing Facility for American International Group, Inc.," available at <http://www.federalreserve.gov/monetarypolicy/files/129aigsecborrowfacility.pdf>.

<sup>28</sup> Liam Pleven et al., "AIG Bailout Hit By New Cash Woes," *Wall Street Journal*, October 9, 2008, p. A1.

<sup>29</sup> N.Y. Ins. Law, Sec. 1410.

<sup>30</sup> American International Group, Inc., "Aig Reports Fourth Quarter and Full Year 2009 Results", press release, February 26, 2010, p. 5, available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzZ3MjR8Q2hpbGRJRDR0tMXxUeXBIPtM=&t=1>.

## **November 10, 2008, Revision of Assistance to AIG**

On November 10, 2008, the Federal Reserve and the U.S. Treasury announced a restructuring of the federal intervention to support AIG. Following the initial loan, some, notably AIG's former CEO Maurice Greenberg, criticized the terms as overly harsh, arguing that the loan itself might be contributing to AIG's eventual failure as a company. As evidenced by the additional borrowing after the September 16 loan, AIG had continued to see cash flow out of the company. The revised agreement points to a fundamental trade-off between making the terms of the assistance undesirable enough to deter other firms from seeking government assistance and making the terms of assistance so punitive that they exacerbate the financial problems of the recipient firm. It also points to the risk that once a firm has been identified as too big to fail, government assistance to the firm can become open-ended, as the original amounts offered were quickly revised upward.

The revised agreement eased the payment terms for AIG and had three primary parts: (1) restructuring of the initial \$85 billion loan, (2) a \$40 billion direct capital injection, and (3) up to \$52.5 billion purchases of troubled assets. Specific details follow. Separately, AIG continued to access the Fed commercial paper funding facility as described above.

### **Loan Restructuring**

The Fed reduced the \$85 billion loan facility to \$60 billion, extended the time period to five years, and eased the financial terms considerably. Specifically, the interest rate on the amount outstanding was reduced by 5.5 percentage points (to LIBOR plus 3%), and the fee on undrawn funds was reduced by 7.75 percentage points (to 0.75%).

### **Troubled Asset Relief Program Direct Capital Injection**

Through the Troubled Asset Relief Program (TARP), the Treasury purchased \$40 billion in preferred shares of AIG. In addition to the preferred shares, the Treasury also received warrants for common shares equal to 2% of the outstanding AIG shares. AIG was the first announced non-bank to receive TARP funds. The \$40 billion in preferred AIG shares held by the Treasury were slated to pay a 10% dividend per annum, accrued quarterly.<sup>31</sup> The amount of shares held in trust for the benefit of the U.S. Treasury under the previous Fed loan was also reduced to 77.9% so that the total government equity interest in AIG (trust shares plus warrants) remained 79.9% after the TARP intervention.

### ***Executive Compensation Restrictions under TARP***

By accepting TARP assistance, AIG is subject to the executive compensation standards for their senior executive officers (SEOs, generally the chief executive officer, the chief financial, and the three next most highly compensated officials) generally required under Section 111 of EESA. In addition to these general restrictions, Treasury imposed additional executive compensation

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<sup>31</sup> Full details of the preferred shares can be found on the Treasury website at <http://ustreas.gov/press/releases/reports/111008aigtermsheet.pdf>.

restrictions on AIG that are more stringent than for other participants in TARP in recognition of the special assistance received by AIG.<sup>32</sup>

The TARP executive compensation restrictions were amended and strengthened by the 111<sup>th</sup> Congress in the American Recovery and Reinvestment Act of 2009,<sup>33</sup> which amended Section 111 of EESA to further limit executive compensation for financial institutions receiving assistance under that act, including AIG. Among other things, for applicable companies, the new language requires the adoption of standards by Treasury that

1. prohibit paying certain executives any bonus, retention or incentive compensation other than certain long-term restricted stock that has a value not greater than one-third of the total annual compensation of the employee receiving the stock (the determination of how many executives will be subject to these limitations depends on the amount of funds received by the TARP recipient);
2. require the recovery of any bonus, retention award or incentive compensation paid to CEOs and the next 20 most highly compensated employees based on earnings, revenues, gains or other criteria that are later found to be materially inaccurate;
3. prohibit any compensation plan that would encourage manipulation of the reported earnings of the firm to enhance the compensation of any of its employees;
4. prohibit the provision of “golden parachute” payment to an CEO and the next five most highly compensated employees for departure from a company for any reason, except for payments for services performed or benefits accrued; and
5. prohibit any compensation plan that would encourage manipulation of the reported earnings of the firm to enhance the compensation of any of its employees.

Although the new Section 111 (b)(1) of the amended EESA indicates that these standards are to apply to all TARP recipients until they repay TARP funding, later language (Section 111(b)(3)(iii)) specifically allows bonuses required to be paid under employment contracts executed before February 11, 2009, to go forward notwithstanding the new requirements. Treasury published an interim final rule implementing these requirements in June 2009 and the Special Master for TARP Executive Compensation released several specific determinations for AIG compensation.<sup>34</sup>

## **Purchase of Troubled Assets**

Although P.L. 110-343 provided for Treasury purchase of troubled assets under TARP, the troubled asset purchases related to AIG were done by LLCs created and controlled by the Federal Reserve. This structure is similar to that created by the Fed to facilitate the purchase of Bear

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<sup>32</sup> U.S. Treasury, “Treasury to Invest in AIG Restructuring under the Emergency Economic Stabilization Act,” hp-1261, November 10, 2008, available at <http://www.ustreas.gov/press/releases/hp1261.htm>.

<sup>33</sup> Section 7001 of P.L. 111-5.

<sup>34</sup> See “Executive Compensation” on the Treasury Financialstability.gov website available at <http://www.financialstability.gov/about/executivecompensation.html>.

Stearns by JPMorgan Chase in March 2008. There are two LLCs set up for AIG—Maiden Lane II for residential mortgage-backed securities (RMBS) and Maiden Lane III for collateralized debt obligations (CDO).<sup>35</sup>

### ***Residential Mortgage-Backed Securities/Maiden Lane II***

Under the November 2008 restructuring, the RMBS LLC/Maiden Lane II could receive loans up to \$22.5 billion by the Fed and \$1 billion from AIG to purchase RMBS from AIG's securities lending portfolio. The previous \$37.8 billion securities lending loan facility was repaid and terminated following the creation of this LLC. The Fed is credited with interest from its loan at a rate of LIBOR plus 1% for a term of six years, extendable by the Fed. The \$1 billion loan from AIG is credited with interest at a rate of LIBOR plus 3%. The AIG loan, however, is subordinate to the Fed's. Any proceeds from Maiden Lane II are to be distributed in the following order: (1) operating expenses of the LLC, (2) principal due to the Fed, (3) interest due to the Fed, and (4) deferred payment and interest due to AIG. Should additional funds remain at the liquidation of the LLC, these remaining funds are to be shared by the Fed and AIG with AIG's insurance subsidiaries receiving one-sixth of the value.

The actual amount of Fed loan made to Maiden Lane II was \$19.5 billion of the \$22.5 billion maximum. Maiden Lane II purchased RMBS with this amount along with the \$1 billion loan from AIG. The securities purchased had a face value of nearly double the purchase price (\$39.3 billion).<sup>36</sup> As of February 24, 2010, outstanding loan principal plus interest owed to the Fed was \$15.5 billion; the reported market value of the RMBS portfolio holdings was \$15.5 billion as of December 31, 2009.<sup>37</sup>

### ***Collateralized Debt Obligations/Maiden Lane III***

Under the November 2008 restructuring, the CDO LLC/Maiden Lane III could receive loans up to \$30 billion from the Fed and \$5 billion from AIG to purchase CDOs on which AIG has written credit default swaps. The Fed and AIG are to be credited with interest from the loans at a rate of LIBOR plus 3% until the LLC is ultimately liquidated. The proceeds from Maiden Lane III are to be distributed in the following order: (1) operating expenses of the LLC, (2) principal due to the Fed, (3) interest due to the Fed, and (4) deferred payment and interest due to AIG. Should any funds remain after this distribution, they are to go two-thirds to the Fed and one-third to AIG.

The actual amount of the Fed loan to Maiden Lane III was \$24.3 billion of the \$30 billion maximum, while AIG loaned the LLC \$5 billion. In addition to these loans, Maiden Lane III purchase of CDOs was also funded by approximately \$35 billion in cash collateral previously posted to holders of CDS by AIGFP. In return for the use of this collateral, AIGFP received approximately \$2.5 billion from the LLC. The total par value of CDOs purchased by Maiden Lane III was approximately \$62.1 billion. At the same time that the CDOs were purchased, the CDS written on these CDOs were terminated, relieving financial pressure on AIG. The

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<sup>35</sup> The headquarters of the Federal Reserve Bank of New York sits between Maiden Lane and Liberty Street in downtown New York City.

<sup>36</sup> "Maiden Lane Transactions" on the webpage of the Federal Reserve Bank of New York, available at <http://www.newyorkfed.org/markets/maidenlane2.html>.

<sup>37</sup> Information on Maiden Lane II from the Federal Reserve, "Factors Affecting Reserve Balances," Statistical Release H.4.1, February 25, 2010, available at <http://www.federalreserve.gov/releases/h41/Current/>.

outstanding loan principal plus interest owed to the Fed was \$17.7 billion as of February 24, 2010, whereas the reported market value of the CDO portfolio holdings was \$22.4 billion as of December 31, 2009.<sup>38</sup>

## **March 2, 2009, Revision of Assistance to AIG**

On March 2, 2009, the Treasury and Fed announced another revision of the financial assistance to AIG. On the same day, AIG announced a loss of more than \$60 billion in the fourth quarter of 2008. In response to the poor results and ongoing financial turmoil, the ratings agencies were reportedly considering further downgrading AIG, which would most likely have resulted in further significant cash demands due to collateral calls.<sup>39</sup> According to the Treasury, AIG “continues to face significant challenges, driven by the rapid deterioration in certain financial markets in the last two months of the year and continued turbulence in the markets generally.” The revised assistance is intended to “enhance the company’s capital and liquidity in order to facilitate the orderly completion of the company’s global divestiture program.”<sup>40</sup>

The announced revised assistance includes the following:

- Exchange of the previous \$40 billion in preferred shares purchased through the TARP program for \$41.6 billion in preferred shares that more closely resemble common equity, thus improving AIG’s financial position. Dividends paid on these new shares remain at 10%, but will be non-cumulative and only be paid as declared by AIG’s Board of Directors. Should dividends not be paid for four consecutive quarters, the government would have the right to appoint at least two new directors to the board.
- Commitment of up to \$29.8 billion<sup>41</sup> in additional preferred share purchases from TARP. When these share purchases may occur are at the discretion of AIG.
- Reduction of interest rate on the existing Fed loan facility by removing the current floor of 3.5% over the LIBOR portion of the rate. The rate will now simply be three-month LIBOR plus 3%, which was approximately 4.25% at the time.
- Limit on Fed revolving credit facility is to be reduced from \$60 billion to as low as \$25 billion.
- Up to \$34.5 billion of the approximately \$38 billion outstanding on the Fed credit facility is to be repaid by asset transfers from AIG to the Fed. Specifically, (1) \$8.5 billion in ongoing life insurance cash flows will be securitized by AIG and

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<sup>38</sup> Information on Maiden Lane III from the Federal Reserve, “Factors Affecting Reserve Balances,” Statistical Release H.4.1, February 25, 2010, available at <http://www.federalreserve.gov/releases/h41/Current/>, and “Factors Affecting Efforts to Limit Payments to AIG Counterparties” Testimony of Thomas C. Baxter Jr. of the Federal Reserve Bank of New York, January 27, 2010, available at <http://www.newyorkfed.org/newsevents/speeches/2010/bax100127.html>.

<sup>39</sup> See, for example, “A.I.G. Reports Loss of \$61.7 Billion as U.S. Gives More Aid,” *New York Times*, March 2, 2009, p. A1.

<sup>40</sup> U.S. Treasury, “U.S. Treasury and Federal Reserve Board Announce Participation in AIG Restructuring Plan,” Press Release dated March 2, 2009.

<sup>41</sup> The amount was reduced from \$30 billion following controversy over \$165 million in employee bonuses paid to AIGFP employees in March 2009.

transferred to the Fed; and (2) approximately \$26 billion in equity interests in two of AIG's large foreign life insurance subsidiaries (ALICO and AIA) will be issued to the Fed. This effectively transfers a majority stake in these companies to the Fed, but the companies will still be managed by AIG.

A \$25 billion repayment of the Fed loan through the transfer of equity interest worth \$16 billion in AIA and \$9 billion in ALICO was completed on December 1, 2009, with a corresponding reduction in the Fed loan maximum to \$35 billion. According to AIG's 2009 annual 10-K filing with the SEC, the repayment through securitization of life insurance cash flows is no longer expected to occur.

## **Who Has Benefited from Assistance to AIG?**

Although billions of dollars in government assistance have gone to the AIG, in many cases, it can be argued that AIG has essentially acted as an intermediary for this assistance. In short order after drawing on government assistance, substantial funds flowed out of AIG to entities on the other side of AIG's financial transactions, such as securities lending or credit default swaps. If AIG had been allowed to fail and had entered bankruptcy, as was the case with Lehman Brothers, then these counterparties in many cases would have been treated as unsecured creditors and may have received relatively little for their claims.

Seen from this view, the true beneficiary of many of the federal funds that flowed to AIG was not AIG itself, but these counterparties. In the interest of transparency, many argued that these counterparties need to be identified, so that both Congress and taxpayers can judge the efficacy and fairness of the assistance to AIG. Until March 15, 2009, no such list of counterparties had been published by the Fed or AIG. Several Senators pressed Donald Kohn, the vice chairman of the Board of Governors of the Federal Reserve, on this point in a March 5, 2009, Senate hearing on AIG. Vice Chairman Kohn, however, expressed his judgment that "giving the names would undermine the stability of the company and could have serious knock-on effects to the rest of the financial markets and the government's efforts to stabilize them."<sup>42</sup> Ten days following the Senate hearing, on March 15, 2009, AIG released information detailing \$52.0 billion of direct support to AIG that went to AIGFP related transactions, \$27.1 billion in Maiden Lane III CDS-related transactions, and \$43.7 billion in payments to securities lending counterparties.<sup>43</sup>

Questions about transparency and disclosure were brought forward again late in 2009 and early in 2010, particularly regarding the actions of the Federal Reserve Bank of New York, whose president was then Timothy Geithner, who is now the U.S. Treasury Secretary, relating to AIG SEC filings regarding the creation of the Maiden Lane entities. According to reports, staff at the Fed discouraged AIG from including details such as 100% payments to counterparties and the identification of counterparties in SEC filings in late 2008. During the subsequent months, AIG amended its SEC filings several times in response to the agency's request for more disclosure. Later, AIG asked the SEC to grant confidential treatment to the filings that would exclude them

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<sup>42</sup> Donald Kohn, answering a question by Senator Christopher Dodd, reported in Federal News Service's transcript of the March 5, 2008 hearing of the Senate Committee On Banking, Housing, And Urban Affairs on "American International Group: Examining What Went Wrong, Government Intervention, and Implications For Future Regulation."

<sup>43</sup> See [http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809\\_tcm385-155645.pdf](http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf) for a full listing of counterparties.

from public disclosure. On May 22, 2008, after a staff ruling that the filings met the necessary standard of “commercially sensitive information”—the SEC granted the AIG filings confidential treatment through November 25, 2018.<sup>44</sup> Several Members of Congress have raised questions about the Fed’s intervention in the AIG disclosures and the House Committee on Government Reform and Oversight focused on this question in a hearing on January 27, 2010. Following this hearing, the information that had been granted confidential treatment was released publicly by Representative Darryl Issa.<sup>45</sup>

## Congressional Action

### Hearings

Congressional committees, including the House Oversight and Reform Committee, the House Financial Services Committee, and the Senate Banking, Housing, and Urban Affairs Committee, have held several hearings on AIG. Congressional attention (and anger) toward AIG has been focused on concerns regarding possible waste of taxpayer money through corporate profligacy and payment of employee bonuses. Transparency regarding the intervention and the ultimate future of AIG have also been of significant concern.

**Table 2. Congressional Hearings Focusing on AIG**

Date	Title	Committee
October 7, 2008	The Causes and Effects of the AIG Bailout	House Oversight and Government Reform
March 5, 2009	American International Group: Examining what went wrong, government intervention, and implications for future regulation	Senate Banking, Housing & Urban Affairs
March 18, 2009	American International Group’s Impact on the Global Economy: Before, During, and After Federal Intervention	House Financial Services
March 24, 2009	Oversight of the Federal Government’s Intervention at American International Group	House Financial Services
April 2, 2009	The Collapse and Federal Rescue of AIG and What it Means for the U.S. Economy	House Oversight and Government Reform
May 15, 2009	AIG: Where is the Taxpayer Money Going?	House Oversight and Government Reform
October 14, 2009	AIG Bonuses: Report of the Special Inspector General for the Troubled Asset Relief Program	House Oversight and Government Reform
January 27, 2010	The Federal Bailout of AIG	House Oversight and Government Reform

**Source:** CRS.

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<sup>44</sup> For example, see “SEC May Keep Potentially Controversial AIG Actions Secret for a Decade,” *Best’s Insurance News*, January 12, 2010.

<sup>45</sup> See “Issa: AIG Investigation Just Getting Started,” January 27, 2010, available at [http://republicans.oversight.house.gov/index.php?option=com\\_content&view=article&id=518%3Aissa-aig-investigation-just-getting-started&catid=22&Itemid=1](http://republicans.oversight.house.gov/index.php?option=com_content&view=article&id=518%3Aissa-aig-investigation-just-getting-started&catid=22&Itemid=1).



## **Legislation**

Legislation regarding AIG has focused on issues surrounding executive compensation including the following:

### **H.R. 1586**

This bill, “[t]o impose an additional tax on bonuses received from certain TARP recipients,” was introduced by Representative Charles Rangel on March 18, 2009. It has been widely portrayed as responding to an outpouring of anger over the AIG bonuses. The House passed H.R. 1586 under suspension of the rules by a vote of 328-93 on March 19, 2009.

The bill would institute a tax of 90% on bonuses given by companies who have more than \$5 billion in outstanding funding from TARP. In addition to AIG, several other companies would fall under this definition, including Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, Wells Fargo, U.S. Bancorp, and General Motors. The bill also specifically included Fannie Mae and Freddie Mac by name. The 90% tax rate would only apply to bonus recipients with a household income greater than \$250,000 for singles or married couples filing jointly or \$125,000 for a married person filing separately.

### **H.Con.Res. 76**

This Sense of the Congress resolution regarding “executive and employee bonuses paid by AIG and other companies assisted with taxpayer funds” was introduced March 19, 2009. It was brought up the same day under suspension of the rules, but failed to gain a two-thirds majority on a vote of 255-140.

### **S. 651**

The Compensation Fairness Act of 2009 was introduced on March 19, 2009. It was placed on the legislative calendar but has not been acted on by the full Senate.

This bill would impose an excise tax of 35% on both the employee and the employer should “excessive” bonuses be paid out by recipients of federal economic assistance. Any retention bonus would be considered excessive, while non-retention bonuses would be excessive if they exceeded \$50,000 with an exception for equity-based bonuses with a vesting period of at least three years. It would also apply a \$1 million limit on nonqualified deferred compensation. These provisions would apply to Fannie Mae and Freddie Mac specifically, as well as to any recipient of federal assistance with more than \$100 million of assistance outstanding.

### **H.R. 1664**

This bill “[t]o amend the executive compensation provisions of the Emergency Economic Stabilization Act of 2008 to prohibit unreasonable and excessive compensation and compensation not based on performance standards,” was introduced on March 23, 2009. It was amended and passed by the House on April 1, 2009, on a vote of 241-171.

As passed, it would prohibit institutions with outstanding capital obligations from TARP, as well as Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, from making a compensation payment (other than a longevity bonus or a payment in the form of restricted stock) to any employee under an existing or new compensation arrangement, if (1) it provides for compensation that is “unreasonable or excessive,” or (2) it results in any bonus or supplemental payment that is not directly based on performance. Defining both “unreasonable and excessive” and allowable performance-based measures would be done by the Treasury Secretary, with the approval of the agencies that make up the Federal Financial Institutions Examination Council, and in consultation with the chairperson of the Congressional Oversight Panel.

### **H.Res. 251**

This resolution would direct the Secretary of the Treasury to transmit specified information regarding AIG to the House. It was introduced on March 17, 2009, and marked up on March 25, 2009, by the House Financial Services Committee. Although placed on the House Calendar when reported on April 23, 2009, it has not been considered by the full House.

H.Res. 251 would direct the Secretary to transmit information regarding (1) negotiations on possible break-up of AIG, (2) negotiations regarding additional TARP assistance, or (3) communications or authorization for payment of executive bonuses by AIG.

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