Minutes of meeting at AIGFP, Wilton

Meeting held on 10.11.07

AIGFP

	JC	Joe Cassano	CEO, AIGFP
	AF	Andy Forster	EVP, AIGFP, Head of Asset Desk
	PM	Pierre Micottis	Chief Risk Officer
	WK	William Kolbert	COO
	DC	Diane Cenci	CFO
	MB	Mark Balfan	Former CEO, FAS 157 coordinator
AIG			
	EH	Elias Habayeb	CFO, AIG FS Division
	AV	Anthony Valoroso	Head of Office of Accounting Policy, AIG
	KL	Ken Lau	Office of Accounting Policy
	JB	Jamie Bolton	AIG Market Risk Management
	KM	Kevin McGinn	Head of Credit Risk Management *(by phone)*
	PN	Paul Narayanan	AIG Credit Risk Management
PwC			
	Auditor 3 (A3)		Engagement Leader, AIG FP & FS Division
	Auditor 5 (A5)		Senior Manager, AIG FP & FS Division

Matters discussed:

Purpose of the meeting was to discuss the approach to be applied to address the valuation of the super senior transactions.

Overview for meeting

JC Consider the BET a gut check - have not fully validated the model at this stage, but have now run on approximately 40% of the portfolio

EH Confirm everyone is comfortable the B&C portfolios are fundamentally different and should be held at zero value, and that the focus is on the A, D&E portfolios.

Key to use this information as reference points, recognising the limitations in the model and validating the assumptions.

AV Agree focus should be on A, D&E

(A3) Process and rationale applied, and the documentation thereof is key to provide a basis for FP's valuation

Update on approach and market - JC

- Should note that across the AIGFP business where we rely on models the approach is always to build two independent models as a validation of the model - not yet completed for this book
- As far as the business is concerned, believe AIGFP's portfolio and construction is different from that of others on the street. Believe the fact the business is still here is evidence of the peculiarity of the business
- Super Senior in the wider markets means a range of things to different people
- Goal from the early days has been to focus on diversity, fundamental analysis, evaluation of the individual credits and the underlying count of reference obligations
- Different business from the investment banks and dealers who are in the warehouse and residual tranche space. Recent results by the banks reference super senior, but AIGFP stopped writing business with that counterparty (UBS) in 2005 due to different views on the level the trades should be done at. AIGFP view may be being borne out.

- Ambac also considered a different business, for example believe they may have a CDO^2 trade of 06 / 07 vintage with single A rated underlyers - not a business AIGFP would be in
- Firmly believe AIGFP has a fundamentally different business

BET model update - JC

- Impact of accruals across books D&E is approximately $22.5mn for the 3 months
- Note that BET model needs a number of estimates
- Consider a number of factors that are and are not in the model e.g. weighted average life ("WAL"), accruals, risk mitigants.
- Risk mitigants are very powerful on a qualitative basis but haven't been able to model these into the BET as yet so don't know how to quantify it. Impact of items such as waterfall changes, cash flow redirection, OC build.
- AIGFP doesn't do generic trades, deliberately structured to be risk protected
- June valuations - consider this to be a relatively stable market environment, value may be a fair representation of the unamortized EITF 02-3 value
- September - change due to P&L changes. Shows not a material change or diminution in value.
- Note the limitations of BET model, and the amount of work needed by New Products Group ("NPG") to build a validated model - compare this to the amount of time spent by AIGFP and PwC in validating the revised market valuation adjustments ("MVA") approach
- Note also that the market has been very dark over the last few months, to the level that repos broke down, one of the fundamentals of the market. Don't believe there is a value change, but if there is one it is small

BET model - PM

- Believe the Gorton model is still the best model for underwriting the business
- Wanted a different view, Peter [Robinson] suggested the BET model, a "simple" model with market based inputs
- Model needs spreads (inferred off the underlying collateral), diversity scores, recovery rates - all of these then drive the expectation of losses, and the income stream derived off the open notional
- Gives you an alternative model with some sense of market factors
- Simple model at this stage - can't factor in credit mitigants. Given time constraints, needed a short cut - with longer lead time, will build these in.
- Current version is a very long way from a production model
- *AV: Gorton says zero value, BET says something else? Yes - but Gorton is not a pricing model, simply determines where you need to attach to be Super Senior under AIGFP definition*
- Analogy - FX is run at the money, but skew is dealt with in a local vol model outside the system. Use the BET as a check to flag items
- Danger in relying on the model until fully validated is that there becomes a tendency to over-rely on it, e.g. for hedges, and don't believe it is robust enough for that

BET inputs - AF

- Needed spreads for the BET model - initially sought to go to dealers to get data points. However, ranges were huge, and no-one was really giving spreads, only prices. Also unable to get good views on WAL, and spread is dependent on WAL
- Have some prices on cash assets, and see prices on same reference portfolios under lower tranches well below the super senior. Impacting on some of the prices in the asset book
- Realistically can't get inputs on the whole portfolio - considering June and September was able to get about 3 yards of 150 [yards=$1bn of notional]

- *PN raised question on CDX and whether can use this to validate the pricing on off the BET model - discussion noted that this was the minor issue since making minor modifications to a well established model, challenge is more around inputs*
- WAL is a key input and not readily observable
- Note also continue to run the Gorton model, and all existing deals remain Super Senior as defined by AIGFP. Continue to also stress the Gorton results e.g. pre-emptively downgrade certain credits.

Qualitative factors - JC

- Need to consider the mitigants that have not been built into the model and can't quantify at this time
- Need to adjust for the impact of accruals (i.e. in the absence of changes in the value of the protection leg, the NPV of the premium decreases over time). Change in BET values from June to September is $90mn decrease net of accruals
- JPMC data is based on generic current assets, not vintage defined. Ran values using raw data and then adjusted to reflect vintage - simple assumption is use 80% of the spreads for 2005 and earlier vintages
- Also tried to scale based on information from ABX indices. Earliest index is the ABX 06-1 which is predominantly late 2005 and early 2006 collateral, latest is ABX 07-2 which is taken as a proxy to the current information. Ratio of ABX 06-1 to ABX 07-2 is compared by asset class and applied to the generic data for that collateral class for the collateral in the AIGFP portfolio of 2005 and earlier vintages. The unadjusted data is used for the 2006 and 2007 vintage collateral
- Had previously sought to get asset specific prices for the underlying collateral, and had been able to for some for June, but the market continued to dry up and would have required more management judgement in applying the data. The use of the JPMC data provides an objective data point and provides consistencies rather than being subject to vagaries of different brokers
- Continue to use cash prices and infer spreads off those, which should imply a degree of conservatism as the cash prices are also affected by liquidity considerations.

Meeting broke, JB and PN spoke with Peter Robinson and James Bridgwater (NPG) via HALO conference to discuss the model. AIG personnel reconvened to propose an approach, to be booked, and presented their conclusion to PwC and AIGFP personnel.

Conclusion - EH & AV

- 2 key data points to consider - Gorton and BET models
- Recognise Gorton model is not a pricing model, however continues to show never expect a loss in severe scenarios
- BET model as adapted for spread and pricing information provides another data point showing $90mn decrease in fair value for the D&E portfolios.
- Note A portfolio shows no MTM losses, and B&C (regulatory) portfolios are fundamentally different and should continue to be held at fair value.
- Conservative assumptions in the BET model, including use of cash spreads and the fact that structural protections have not been built in yet, but nor have they been quantified
- Based on the above information, management's best estimate is that the fair value is somewhere in the range of $0-$90mn, and as an objective approach, should book the midpoint of the range (i.e. charge of $45mn) as a best estimate of the Day 2 change in fair value.
- AIGFP and PwC personnel concurred as reasonable, and AIGFP noted would continue to work on validating and refining the model and inputs.
- All agreed to revert internally to confirm views, including EH and JC meeting with Steve Bensinger the next morning