Brian Peters/NY/FRS
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To "Jon Greenlee" <Jon.D.Greenlee@frb.gov>
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Subject Fw: Update on AIG

Alejandro LaTorre

----- Original Message -----
From: Alejandro LaTorre
Sent: 09/12/2008 11:48 PM EDT
To: Christine Cumming; Timothy Geithner; William Dudley; William Rutledge; Arthur Angulo; Brian Peters; Meg McConnell; Dianne Dobbeck; Michael Nelson; Sandy Krieger; Michael Silva
Cc: Patricia Mosser; Catherine Voigts; Paul Whynott; Jim Mahoney
Subject: Update on AIG

We met with senior executives at AIG to discuss both their liquidity and risk exposure situation. These included the CEO, CFO, General Counsel, Treasurer and many others. Below are the important highlights ... Scott Alvarez, Deborah Bailey, Jim Clouse, Mike Gibson and Brian Madigan from the BoG also participated.

The key takeaway is that they are potentially facing a severe run on their liquidity over the course of the next several (approx. 10) days if they are downgraded by Moodys and S&P early next week. They anticipate downgrades could happen as early as Monday. Their risk exposures are concentrated among the 12 largest international banks (both U.S. and European) across a wide array of product types (bank lines, derivatives, securities lending, etc.) meaning their could be significant counterparty losses to those firms in the event of AIG's failure. They estimate that they might have to pay out $18.6B across the firm over the course of next week if they were downgraded.

I. Liquidity

Breakdown of the $18.6B is:
Failed rolls on ABCP: $4.7B
Collateral posting on Muni GICs: $6B
Collateral posting on Structured Lease GICs: $3B
Collateral posting in derivatives contracts: $5B

As of close of business today, they have $8B in cash at the holding company. They are experiencing significant difficulties in rolling their programs and have used some of their holding company cash to pay down the rolls. Their CP lines are backstopped by banks and if they were to draw down, this would mean banks have to fund $15B in credit. They expressed concern that banks might object to fund and take legal recourse to prevent from doing so; or more likely they would restrict credit on other exposures (e.g., trading lines). They also have $4.7B in ABCP programs which are not backstopped. They have enough liquidity to last until Sept. 26th.

Outside of the holding co., the insurance subs have about $68B in securities lending liabilities to the 12 largest firms. Program is managed by the holding company (AIG Financial Products). In principle they could use these assets for repo: in practice they do not believe that repo of assets is viable b/c the assets are mostly non-agency mortgages and not very desirable. They have lending facilities from the insurance subsidiary to the holding company of $4.9B. They discussed with NYSID Superintendent Dinallo whether they could free up liquidity in excess of the $4.9B to the holding co. Some of the subs have large muni and corporate portfolios that would have to be sold to free up liquidity, meaning not all have excess liquidity. They suggested that Dinallo was amenable to freeing up more liquidity.

They have so far made about $1B in collateral postings on derivatives over the past week; 1 bank has also cut down their overdraft lines limiting their ability to move funds across legal entities.

They have no concrete plans to generate near-term liquidity and longer-term plans in their early stages. These longer term plans include a private equity capital raise coupled with asset sales. Interested parties would be performing due diligence starting tomorrow and into sunday.

They are also large issuers of annuities and have $11B of contingent exposure in their domestic retirement services business. These are retail but run by large sponsors who could encourage accounts to put back the annuities in exchange for cash if they lose confidence in AIG. These sponsors are U.S. banks who have exposure elsewhere. This could be on top of the $18B payout above. They have similar exposures in Japan but could not quantify the size.

They also have a sterling-denominated money market account of $10B and an exchange traded fund in commodities with $3B (run by a sponsor) in liquidity that could also face a run if there is a loss of confidence

II. Risk Exposure

$2.7 trillion in notional derivatives exposure across all books across 12 major dealers.

Commodities: index book of $25B; swaps on futures contracts where they are long futures contracts to hedge; post variation margin of approx. $2B to NYMEX; also trade options on indices both plain vanilla and structured. Also have positions in precious and industrial metals.

CDS: Mostly ABS CDO (not pay as you go, but accelerate at default); $42B High Grade; $60B Mezz.; $20B in CMBS CDOs. Underlying consists mostly of RMBS 2005 vintage across ratings. Material net notionals of $305B in mortgage and corporate exposures combined. Investment Grade Corp. arbitrage another $55B; $1.5trillion of exposure to European banks through balance sheet CDOs.

IR derivatives: USD/EUR/Yen denominated. $3B-$4B in size. Very little negative convexity; long long-dated volatility, short short-dated volatility; Long american exercise, short european exercise.

FX: they have prime brokerage of $30B in volumes and they clear through CLS.

International Leasing Corp; commercial aircraft leasing to over 140 airlines of $50B; rolling CP has been difficult.

Also have smaller consumer finance companies and banks across the world ......

Jim, Trish, Paul, Cathy: if I've missed something or mischaracterized something, let us know.

Regards,

Alex

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