



STANDISH



American International Group

AIG Financial Products Corporation

RATING: Q3
Other Ratings as of: December 2008
Moody's: Aa3
S & P: A-

State of Domicile: Wilton, Connecticut
Holding Company: American International Group, Inc.
Type: Stock
Incorporated: 1987

AIG Financial Products Corporation (AIGFP) is a wholly-owned subsidiary of American International Group, Inc. (AIG), which is the largest United States-based international insurance and financial service organization, a leading underwriter of commercial and industrial insurance in the country and one of the largest U.S. life insurers. AIG's subsidiaries write a wide range of property and casualty insurance and life insurance products for commercial, institutional and individual customers. Product distribution is offered through a variety of channels in 130 countries throughout the world. AIG companies are also leading providers of retirement services, financial services and asset management around the world.

Through its operating groups, AIGFP engages as principal in standard and customized interest rate, currency, equity and credit products with top tier corporations, financial institutions, governments, agencies, institutional investors, and high net worth individuals throughout the world. The company assists clients with efficiently raising and managing capital and debt; hedging equity; foreign exchange, interest rate and credit exposures; and optimizing investments in global equity and credit markets. The firm facilitates corporate finance and capital markets transactions for clients, including transactions arising from domestic or foreign acquisitions and divestitures, expansions and joint ventures. AIGFP also raises funds through municipal reinvestment agreements and other private and public offerings, investing the proceeds in a diversified portfolio of high-grade fixed income securities. Although headquartered in Connecticut, the company also conducts business through its offices in Tokyo, London and Paris, where it operates through Banque AIG.

In the fall of 2004, AIG was involved in two separate regulatory investigations — one involving a Securities and Exchange Commission and Department of Justice investigation into transactions that allegedly smoothed earnings for two corporate clients and the second involving the New York Attorney General's investigation into commercial property and casualty insurance bid rigging. Late in the year the company agreed to pay \$126 million to settle the SEC and DOJ charges, without admitting or denying any wrongdoing. Two former AIG employees admitted to bid rigging commercial insurance quotes, while the company's legal troubles continued into the year 2005. At issue were reinsurance transactions that allegedly did not involve a true risk transfer, thus served to artificially inflate premium revenue and claim reserves. Also questioned was the legitimacy of certain offshore reinsurance agreements with affiliated entities. In the wake of these investigations, AIG endured senior management changes in the first quarter of 2005 as Martin Sullivan replaced legendary Hank Greenberg as CEO and Steven Bensinger became CFO. Members of the newly appointed management team are veterans of AIG and have long been considered strengths to AIG. During 2005, senior management performed extensive reviews on AIG's underwriting, financial reporting and internal control process, and restated five years of net income lower by a total of \$3.9 billion. The company also admitted that former executives "circumvented internal controls over financial reporting". As a result, AIG and its subsidiaries lost their AAA/Aaa credit ratings in 2005.

Collectively, the financial services division provides diversified financial products and services including aircraft leasing, financial products, commodities and foreign

exchange trading, consumer finance and insurance premium finance. Operating income for the financial services division plummeted in 2007 to a loss of \$9.5 billion. This came after several years of profitability of \$383 million, \$4.4 billion, and \$2.1 billion in 2006, 2005, and 2004, respectively. The deterioration in operating income was mainly caused by AIGFP having to recognize unrealized market valuation losses of \$11.4 billion on its super senior swaps portfolio.

AIGFP maintained publicly and privately throughout 2007 that its risk exposure in its super senior swap portfolio was minimal. This super senior swap portfolio mainly contained credit default swaps, where AIGFP sold insurance on billions of dollars of debt securities backed by everything from corporate loans to sub-prime mortgages to auto loans to credit-card receivables. AIGFP promised buyers of the swaps that if the debt securities defaulted, or in a number of cases were downgraded by a crediting agency, AIG would make good on the underlying asset. In August 2007, AIGFP's swap customers started to demand that AIGFP post collateral and in November 2007, AIGFP reported a \$352 million unrealized loss from its swap portfolio. The loss grew to \$1.5 billion the next month, but AIGFP executives publicly maintained that these losses would reverse themselves and there was minimal risk in its swap portfolio. In February 2008, AIG reported its year-end regulatory filing and disclosed that it had \$11.4 billion in unrealized losses in its swap portfolio and had posted \$5.3 billion in collateral for the same swap portfolio. For the first quarter of 2008, AIG reported an additional \$9.1 billion unrealized loss and that it had posted an additional \$4.4 billion in collateral for its swap portfolio. In May, AIG raised \$20 billion in private capital.

AIG reported in August a \$14.7 billion unrealized loss on its swap portfolio for the second quarter and also reported that it had posted an additional \$6.8 billion in collateral. In September, Standard & Poor's cut AIG credit rating to A- from AA-, which caused AIGFP to post an additional \$14.5 billion in collateral for its swap portfolio and AIG was on the verge of collapse. The Federal Reserve stepped in on September 16 to provide AIG with an \$85 billion loan in exchange for a 79.9% equity interest in AIG. On October 7, AIG posts an additional \$18.7 billion in collateral tied to its swap portfolio and the Federal Reserve extended AIG another \$37.8 billion loan the next day to keep the company afloat. AIG reported on November 10 that it had posted a total of \$37.3 billion in collateral on its swap portfolio so far and that it had a total unrealized loss on its swap portfolio of \$33.2 billion. On the same day, the Federal Reserve announced that it had reworked its loan to AIG by lowering the interest rate on the loan and extending the loan by three years. The loan was increased to \$150 billion and about \$50 billion of the loan would be used to buy mortgage-linked assets owned by AIG or guaranteed by the insurer through its credit-default swaps thus significantly reducing the risk in AIG's swap portfolio.

In 2008, we downgraded AIGFP to Q3 rating in our Credit Universe. The rationale behind this stems from the extensive losses stemming from its swap portfolio and the risk in AIG's ongoing prospect as a business entity. Given the backing the US Treasury has shown and promised to AIG, we feel that the current Q3 rating for AIGFP is justified.

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AIG Financial Products Corporation

Strengths:

- Financial backing provided by US Treasury
- Parent company has a strong asset base that it is liquidating to cover losses

Weaknesses:

- Extensive use of derivative securities and hedge positions can increase risk profile
 - Lost competitive advantage created by having highest quality debt ratings—opportunity for cheaper sources of funds
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