

July 2011

American International Group

SunAmerica Life Insurance Co. | AIG Financial Products (AIGFP)

Credit Summary Report

State of Domicile: Arizona
Holding Company: American International Group, Inc.
Type: Stock
Incorporated: 1897

Ratings as of July 2011:

	<u>SunAmerica</u>	<u>AIGFP</u>
Moody's:	A2	Baa3
S & P:	A+	A-
Fitch:	A	BBB

American International Group (AIG) is a leading international insurance organization with core operations in P&C insurance, U.S. life insurance, financial services, and mortgage guarantee services. AIG has traditionally been a leading underwriter of commercial and industrial insurance globally and one of the top U.S. life insurers. SunAmerica, the domestic life insurance operations, was previously the largest U.S. provider of GICs and funding agreements before placing its institutional products business into run-off in 2005. SunAmerica is still active in the fixed and variable annuities, term life, whole life, universal and variable life, and group and health insurance. Products are distributed through various captive and non-captive channels. In 2008, the U.S. government took an 80% preferred ownership in AIG in order to systematically unwind a large portfolio of CDS positions in the AIG Financial Products division which posed a devastating threat to the company's future as a going concern. American International Group Inc completed its recapitalization in January 2011, which included repayment of the Federal Reserve Credit Facility in full using the proceeds from the recent sale of foreign life company ALICO and initial public offering of AIA. The company also completed an exchange of preferred stock held by the U.S. Treasury for common stock, giving the government a 92% ownership stake in AIG, which will be sold over the next two years.

AIG principally operates three business segments; Chartis P&C insurance (65% of FY10 operating revenues), SunAmerica Life insurance (25%), and Financial Services (10%). During 2010, AIG reported consolidated pre-tax income from continuing operations of \$18b on total revenues of \$78b, compared to a pre-tax loss of \$14.3b on revenues of \$75b for FY09. Results in FY10 benefited from \$17.8b of gains from sales of divested businesses, a decline in interest expense on the FRBNY credit facility, improved asset management earnings, and a reduction in net realized losses, offsetting a \$4.2b underwriting loss at Chartis and lower pre-tax income at the Financial Services division. At 1Q11, AIG generated \$2.0b of operating earnings on revenues of \$17.4b, compared to operating income of \$637mm on revenues of \$18.6b during the same quarter last year. Net investment income increased 8% over prior year, driven by higher partnership income and gains related to higher valuation of assets in the Maiden Lane II SPV. The general insurance division Chartis reported an operating loss of \$463mm, reflecting \$1.3b of CAT losses from the Japanese earthquake and tsunami and, \$400mm of CAT losses related to an earthquake in New Zealand and floods in Australia. Overall CAT losses added 19.9 points to the combined ratio of 119% (+16.5pp y/y). Net written premiums for Q1 increased almost 20%, or 6.2% excluding the consolidation of Fuji Fire & Marine and FX impact, driven by increased retention in the U.S. and strong International organic growth. Life insurance division SunAmerica posted flat operating earnings compared to prior year at \$1.1b, highlighted by strong fixed and variable annuity sales due to product enhancements, higher investment income, and good group retirement, mutual fund, and life insurance sales growth, partially offset by unfavorable DAC experience and reserve strengthening for guarantees. The Financial Services division reported operating earnings of \$319mm, compared to a loss of \$171mm a year ago, driven by better results at ILFC and higher unrealized market valuation gains in the super senior CDS portfolio at the Capital Markets division.

Improvement in the financial markets and subsequent valuation gains on fixed income securities has led to fewer credit impairments, unrealized gains, and strengthened capital adequacy. AIG held \$410b in consolidated investments at YE10, with 62% allocated to FI securities; 89% of which are investment grade. Higher risk investment exposures include RMBS (9% of FI, 77% investment grade), CMBS (3%, 74% IG), and CDOs (3%, 67% IG), as well as direct commercial mortgage exposure (3.4% of total investments). Credit impairments of \$2.3b during FY10 were significantly lower than the \$5.4b in credit losses reported last year, attributed to fewer losses from RMBS and corporate bonds. AIG had a net unrealized gain position of \$7.6b on FI securities at YE10, up from only \$1.1b of unrealized gains at the end of last year. Spread tightening and valuation gains on RMBS, CMBS, and certain corporate bonds contributed to the y-o-y improvement.

Statutory capital and surplus at Chartis was \$40b (+3% y/y) and \$14b at SunAmerica (+14%), representing a strong life RBC ratio of 475%. Shareholders' equity improved 15% y/y to \$113b, driven by recent common and preferred share issuance, unrealized investment gains, and earnings growth during the past year. During Q4, AIG issued \$2.0b of senior unsecured debt for the first time since 2008, which is a positive indicator that the market positively views the company's restructuring efforts and progress toward achieving solid stand alone credit ratings in the absence of government ownership. Financial leverage as measured by adjusted debt-to-capital was much improved after the company's recent recapitalization at 25.3%, which is below the pro-forma estimate of 27%. Liquidity is provided by \$1.6b in cash, \$6.7b in short term investments, \$3.0b available under a syndicated LOC split between a 364 day and three year facilities, \$2.0b available under the U.S. Treasury Series G funding commitment, and \$500mm contingent liquidity facility, which adequately covers \$6.8b in upcoming debt maturities.

The company continues to face challenges in sustaining operating performance in a highly competitive market, as well as maintaining appropriate capitalization. Difficult economic conditions have dampened demand for insurance products and have led to competitive pricing, which could erode future profitability. The recent business divestitures of foreign life insurance units has diminished AIG's global reach which is now mostly concentrated in the domestic U.S. market. The recent robust performance in the variable annuity and life insurance product lines is indicative that the life insurance business is on the right track, as competitive product enhancements and efforts to re-engage distributors and improve productivity of the career agency force are starting to pay off. Investment income will likely continue to improve as SunAmerica reinvests cash and short term liquid assets into higher yielding investments as the financial markets continue to improve. AIG continues to unwind its CDS portfolio, which declined by 62% y/y to \$353b net notional amount and was one of the primary reasons for government intervention. The successful disposition of non-strategic subsidiaries enabled the company to repay government obligations, and it appears that the company has stabilized its life insurance operations, which bodes well for the long term viability of the company.

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Strengths:

- Well diversified revenues and cash flows from the P&C and life insurance operations
- Continued, albeit diminishing, support from the U.S. government at the holding company level
- Solid and improving capital base

Weaknesses:

- Operating performance at Chartis has been weaker than the peer average recently
- AIG still has sizable contingent liquidity exposure at its non-insurance subsidiaries
- Uncertainty regarding stand alone financial strength of the group after government support ends

Key Statistics – SunAmerica Life Insurance Co.

(\$ millions)	2010	2009	2008	2007	2006	CAGR/Avg
General Account Assets	17,131	17,355	24,667	39,094	46,537	-22.11%
Separate Account Assets	202	194	190	361	353	-13.03%
Total Assets	17,333	17,549	24,857	39,455	46,890	-22.03%
Capital & Surplus	3,898	4,024	4,659	4,721	4,463	-3.33%
NET GFO	89	459	503	747	498	-34.98%
Net Income	(138)	222	(2,232)	354	539	NM
Return on Assets (Stat.)	-0.80%	1.27%	-8.98%	0.90%	1.15%	-1.29%
Return on Capital (Stat.)	-3.54%	5.52%	-47.91%	7.50%	12.08%	-5.27%
RBC Ratio (ACL)	935.0%	773.4%	694.7%	714.5%	680.1%	759.5%

Sources: Company Reports and SEC filings

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