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TESTIMONY OF RODNEY CLARK
MANAGING DIRECTOR, RATINGS SERVICES,
STANDARD & POOR'S FINANCIAL SERVICES LLC
BEFORE

THE CONGRESSIONAL OVERSIGHT PANEL
CONGRESS OF THE UNITED STATES

MAY 26, 2010

Chairwoman Warren, members of the panel, good morning. My name is Rodney Clark. I serve as a managing director in Standard & Poor's Ratings Services ("S&P") and, from 2005 through 2008, I served as S&P's lead ratings analyst covering American International Group ("AIG"). I am pleased to appear before you today, and I intend to address three broad topics: (i) the history of S&P's ratings on AIG; (ii) our reasoning in arriving at those rating opinions, particularly those that we published in the period immediately before the government rescue of AIG in the fall of 2008; and (iii) our views with respect to the effect of AIG's troubles on the creditworthiness of its subsidiaries.

At the outset, I would like to take a moment to speak generally about our ratings process and to explain what ratings are and are not intended to convey.

S&P's Credit Ratings

S&P's credit ratings are our current opinions on the future credit risk of an entity or a debt obligation. They express our opinion about the capacity and willingness of an entity to meet all of its contractual and financial obligations as they come due. S&P's ratings do not speak to the market value of a security or the volatility of its price and they are not recommendations to buy, sell or hold a security; they simply provide one of the tools investors can use as they assess risk and differentiate credit quality of obligors and the debt they issue.

S&P forms its rating opinions through quantitative and qualitative analysis performed by rating analysts. These analysts gather information about a particular obligor or debt issue, analyze the information according to our published criteria, form opinions about the information

and then present their findings to a committee of analysts that votes on what ratings to assign. After a rating opinion is formed, S&P publishes the opinion in real-time and for free on its Web site, www.standardandpoors.com. We also generally publish a narrative along with our ratings that provides detailed information about our opinion.

This is the process by which S&P arrived at its ratings on AIG, which I will now address in some detail.

S&P's AIG Rating History

Attached to my written submission is a table listing our global ratings history on AIG since 1990. As the table shows, as of June 1990 S&P's rating on AIG was 'AAA.' This is our highest rating, and it reflected our view at the time that AIG's capacity to meet its financial commitments was extremely strong. Our view took into consideration AIG's internationally diversified business mix, historically superior earnings performance, conservative balance sheet management, and exceptional liquidity characteristics. Our opinion began to change, however, starting in March 2005. Since then, S&P has lowered its rating of the company four times.

Recent Ratings Actions on AIG

S&P downgraded AIG on March 30, 2005, when it lowered AIG's rating from 'AAA' to 'AA+'. Our opinion of AIG had changed in large part due to the company's involvement in a number of questionable financial transactions, and reflected our revised assessment of AIG's management, internal controls, corporate governance and culture. In publishing this rating change, we expressed our view that AIG's globally diversified financial services group was still expected to generate very strong earnings and profits. We also reported that the company had told us that its new management had initiated a rigorous review of internal controls.

In June 2005, we again lowered our rating on AIG — this time to 'AA' — reflecting our revised credit assessment based on significant accounting adjustments that had just been announced by the company. Despite strong overall earnings, we believed that AIG's adjusted financial statements indicated greater volatility and lower profitability than had been previously reported. At that time, we considered AIG's capitalization — that is, its ability to absorb losses — good.

In February 2008, S&P placed a negative outlook on the company based on concerns about the way AIG was determining the fair value of credit default swaps — or "CDS" —it had entered into. As has been widely reported, CDS are essentially guarantees of credit risk on securities or entities. AIG's CDS guaranteed an array of structured finance securities, including securities backed by subprime residential mortgages.

Three months later, in May 2008, we lowered our rating on AIG further to 'AA-'. This rating action was based in large part on our reaction to the company's announcement of an after-tax loss of $7.8 billion, including $5.9 billion in losses related to its CDS portfolio. S&P maintained a negative outlook on AIG throughout the summer of 2008.

In August, following a deal-by-deal credit analysis of AIG's investment and CDS portfolios, S&P reached its view — and stated publicly — that AIG's actual credit-related losses in these areas would likely amount to around $8 billion with significantly higher mark-to-market losses.

As has been well-publicized, AIG's financial condition deteriorated sharply in September 2008 following substantial market disruptions, including government takeovers of Freddie Mac and Fannie Mae, the bankruptcy of Lehman Brothers, and the sale of Merrill Lynch, among other

things. These events led to a sudden drop in the market value of AIG's investments and, more importantly, the investments of third parties that had purchased CDS guarantees from AIG.

In light of these events, on September 12, 2008, S&P placed its ratings of AIG and all AIG subsidiaries on CreditWatch with negative implications. Three days later, on September 15, 2008, as AIG's condition continued to deteriorate, S&P lowered its rating further to 'A-'. As stated in our published reports at the time, our decision to downgrade AIG was based primarily on a combination of AIG's reduced flexibility in meeting collateral needs and its increasing CDS-related losses.

The next day, on September 16, 2008, the Federal Reserve Bank of New York announced that it would extend an $85 billion borrowing facility to AIG. Were it not for this government assistance, we believe that AIG's creditworthiness would have continued to deteriorate. Indeed, our current rating on AIG, which remains at 'A-', includes a five-notch "uplift" to account for federal government support. Thus, without government support, our rating on AIG today would be 'BB'.

S&P's Current Outlook For AIG

On April 1, 2010, S&P affirmed its 'A-' rating on AIG. This rating, as noted, is adjusted to account for the extraordinary government support currently provided to AIG. Our most recent ratings affirmation also reflects an increase in AIG's stand-alone credit profile to 'BB', from 'BB-'. This revised stand-alone rating reflects our view of AIG's continued momentum in reestablishing its multi-line insurance market presence through its Chartis and SunAmerica operations, of good progress in the unwinding of AIG Financial Products Corp., and of the

improved liquidity position of its noninsurance operations. We also believe that AIG's recently announced transactions reflect solid progress in its challenging restructuring plan.

Although we do not expect any increase in government support at this time, in our view, the government's continuing actions with respect to AIG have significantly reduced the risk of further rapid deterioration in the company's creditworthiness. However, while our outlook on the company's stand-alone credit profile is positive, we maintain our negative outlook on the company going forward. This is based in part on our belief that AIG is particularly susceptible to the broad insurance market trends, given its somewhat weakened position, and that pressure on the operating performance of its subsidiaries may build, due to market factors such as aggressive pricing and competitive pressures. Furthermore, the negative outlook reflects uncertainty with regard to legislative risk and its potential impact on the government's ability to continue to provide extraordinary support to AIG, if needed.

If, in our view, AIG's operating performance does not improve to a level approaching historical performance, factoring in the strong but diminished competitive position, we could lower the company's rating one notch. However, if operating performance comes close to historical levels and capitalization remains consistent or improves, we could revise the outlook to stable.

The Relationship Between AIG and its Subsidiaries

With respect to the effect of AIG's current financial situation on the creditworthiness of its subsidiaries, we believe those subsidiaries are to some extent insulated. For example, if AIG had been forced into bankruptcy, the bankruptcy would have likely included a relatively small number of AIG's non insurance subsidiaries — such as AIG Financial Products Corp. — with

only a marginal impact on AIG's insurance subsidiaries. That is because the insurance subsidiaries' capital is generally insulated by state insurance laws and regulations.

Nevertheless, when S&P lowered its credit rating on AIG to 'A-' on September 15, we also lowered the ratings on most of AIG's insurance subsidiaries to 'A+' from 'AA+', where they remain today. While AIG's financial problems have no direct effect on the solvency of its insurance subsidiaries, we believe the creditworthiness of those subsidiaries is nevertheless indirectly affected in two primary respects. First, in our opinion financial pressures at AIG generally make it less likely that AIG will be in a position to provide additional capital to its subsidiaries in the event the subsidiaries suffer investment losses of their own or otherwise require recapitalization. This concern is somewhat muted by AIG's receipt of government support, and because of improved capitalization. For example, we believe the recent announcements of two major divestitures — AIA and ALICO — will, if successfully completed, improve AIG's financial profile, and the overall improvement in the company's full-year 2009 GAAP earnings reflects favorable trends in financial markets that contributed to lower investment losses and the general improvement in mark-to-market results across all segment operations.

The second issue we see affecting the creditworthiness of AIG's insurance subsidiaries relates more generally to overall reputational risk resulting from the parent company's financial problems. For example, it may be more difficult for the subsidiaries to retain and attract new customers where there is uncertainty surrounding the parent company — particularly in light of a dampened demand for insurance and, more significantly, marginal pricing.

As a general matter, S&P believes that AIG's insurance subsidiaries are currently well capitalized to meet their policy obligations. The strength of its subsidiaries is a positive factor in our view of AIG's overall creditworthiness. Our ratings on any particular subsidiary could change in the event of a sale of the subsidiary by AIG. The nature of the change would likely depend on the buyer and the impact of the sale on the subsidiary's competitive position, capital structure, and earnings. It is quite possible that the ratings on some subsidiaries could move in a different direction than others.

Ratings Treatment of a Distressed Exchange

In the invitation to appear today you also asked that I explain S&P's ratings treatment of distressed exchanges, where a company that is in distress settles its obligations at a significant discount so as to avoid insolvency or bankruptcy. Such efforts are usually motivated, at least partially, by the desire to avoid the alternative of a potential conventional default.

As a general matter, the impact on ratings of such exchange offers depends on the facts of a particular situation and how a reviewing rating committee assesses them. Our criteria call for the consideration of various factors in assessing whether a distressed exchange would be viewed as a selective default, including whether default, insolvency, or bankruptcy in the near or medium term would be likely without the exchange offer. To consider an exchange offer as tantamount to default, we generally consider whether: 1) the offer, in our view, implies the investor will receive less value than the promise of the original securities; and 2) the offer, in our view, is distressed, rather than purely opportunistic. Thus, although every situation is different, any discount other than one for the time value of money could potentially constitute a default pursuant to our published ratings criteria.

In the event that we do consider a distressed exchange as a default, we may lower the issuer credit rating and the affected issue ratings to ‘CC’, and, upon completion of the exchange, ratings may be lowered to ‘D’ and the issuer credit rating may be lowered to ‘SD’ (selective default), assuming the issuer continues to honor its other obligations. This is the case even though the investors, technically, may accept the offer voluntarily and no legal default occurs. After that, our practice is to adjust the rating going forward to again focus on conventional default risk.

Conclusion

I thank you for the opportunity to participate in this hearing, and I would be happy to answer any questions you may have.

Table of S&P ratings history for American International Group Inc. since June 1990

Date	Rating/Outlook
26-Jun-1990	AAA/Stable
29-Oct-2004	AAA/Negative
15-Mar-2005	AAA/Watch Neg
30-Mar-2005	AA+/Watch Neg
03-Jun-2005	AA/Negative
10-Nov-2006	AA/Stable
12-Feb-2008	AA/Negative
08-May-2008	AA-/Watch Neg
21-May-2008	AA-/Negative
12-Sep-2008	AA-/Watch Neg
15-Sep-2008	A-/Watch Neg
17-Sep-2008	A-/Watch Dev
03-Oct-2008	A-/Watch Neg
02-Mar-2009	A-/Negative