12-7-2007

AIG Email from William Shirley to Joe Cassano regarding Deferred Comp Write-Up for Compensation Committee

William Shirley

Joseph Cassano

From: Shirley, William
Sent: Friday, December 07, 2007 3:31 PM
To: Cassano, Joseph
Subject: RE: Deferred Comp -- Write-Up for Compensation Committee

Joe,

Elias called back with two further comments from Bill. The comments were minor, and I went ahead and made them.

- They wanted to add a statement indicating that installment payments of amounts deferred in prior years will be made under the existing Plan. Here's the sentence I added: "Installment payments of amounts deferred in prior years under the existing Deferred Compensation Plan will be made in accordance with the Plan's terms as described above."
- They wanted to state expressly that allocations of compensation among employees for this year have not been completed. Thus, what was a bullet point with a single sentence now has two sentences: "The total amount of 2007 special deferred compensation will depend on the specific allocations of compensation among employees. These allocations have not been completed."

I attach the revised version of the write-up.

Bill

mws054.doc

From: Cassano, Joseph
Sent: Friday, December 07, 2007 11:43 AM
To: Shirley, William
Subject: RE: Deferred Comp -- Write-Up for Compensation Committee

the comments are silly but this is fine .

From: Shirley, William
Sent: Friday, December 07, 2007 4:17 PM
To: Cassano, Joseph
Subject: Deferred Comp -- Write-Up for Compensation Committee

Joe,

Elias called to say that Bill had two comments on the write-up for the Compensation Committee:

- Bill wants the annex to indicate how the FP compensation pool would have changed if the valuation loss had been taken into account. Elias suggested adding a second sentence to the footnote, so that the footnote reads: "Does not reflect valuation adjustment related to subprime super senior portfolio, estimated to be $1.5 billion as of November 30, 2007. If the estimated valuation adjustment had been taken into account in the calculations, the 2007 Available Compensation Pool would have been reduced by $450 to $7 million." (I've checked the numbers with Kathy.)
- In the paragraph that sets out the percentage changes that would have resulted in 2006 if the 2007 proposal had applied then, Bill wanted to add the dollar amounts. If we do this, the paragraph would read (base on Kathy's numbers): "If the special deferred compensation arrangements proposed for 2007 had applied in 2006, the aggregate amount of the available compensation pool paid out in cash to employees would have been reduced by approximately 54% (from $247,653,527 to $113,060,761), and the aggregate amount deferred (under the existing Deferred Compensation Arrangements and these special arrangements) would have

increased by approximately 107% (from $125,522,107 to $260,114,873)."

I attach a revised version of the write-up reflecting these changes, but I haven't sent it to Elias yet. Please let me know if this is ok or if you want to handle Bill's requests differently.

Thanks.

Bill
<< File: mws054.doc >>

AIG Financial Products: 2007 Incentive Compensation Proposal
DRAFT

Objective

- AIG Financial Products (AIG-FP) would like approval for special incentive compensation arrangements for 2007. The purpose of the proposal is to provide motivation to the AIG-FP team to continue forward in developing, promoting and executing AIG-FP's business while recognizing the serious effect of the unrecognized losses associated with the valuation adjustment related to AIG-FP's super senior credit derivative portfolio.

Background

- As reported in AIG's third quarter results, AIG incurred a charge of $229 million net of tax ($352 million pre-tax) for a net unrealized market valuation loss related to AIG-FP's super senior credit derivative portfolio. The current estimate of the aggregate unrealized market valuation loss as of November 30, 2007 is $1.5 billion pre-tax.

- In this context, AIG-FP proposes to reduce regular incentive compensation paid to the AIG-FP team for 2007 by reducing the amount of distributable income that is allocated in the regular manner between AIG (70%) and the AIG-FP compensation pool (30%) and to put in place the additional special deferred compensation arrangements for 2007 described below.

Current Incentive Compensation Arrangements

- Under current AIG-FP incentive compensation arrangements, AIG-FP and AIG share annual distributable income generated by AIG-FP (revenues less expenses and reserves as determined by AIG-FP's board) 30% for AIG-FP and 70% for AIG.

- The AIG-FP share, less payroll expenses and other adjustments, is allocated among AIG-FP employees at the discretion of AIG-FP management.

    - In addition to being paid as incentive compensation, a portion of the available compensation pool is paid as an additional return on deferred compensation balances under AIG-FP's existing Deferred Compensation Plan (referred to as the "equity kicker").

- Under the existing Deferred Compensation Plan:

    - If incentive compensation for an employee exceeds $250,000, it is subject in part to mandatory deferral under the Plan.
    - Deferred amounts for a given year are paid out in equal annual installments over a period equal to the average life of AIG-FP's swap book for that year (4-6 years depending on the year).
    - During the deferral period, the principal balance earns a LIBOR flat coupon paid quarterly. In addition, as noted above, an equity kicker is paid annually to current employees participating in the Plan.
    - Rights to deferred amounts are not forfeited when employment ends (although, as noted above, receipt of the annual equity kicker is conditioned on continued employment).
    - Deferred amounts constitute unsecured subordinated debt of AIG-FP and thus form part of its capital base and are at risk to AIG-FP's business.

- In 2006 AIG-FP paid incentive compensation and equity kicker aggregating $373 million (including deferrals under its existing Deferred Compensation Plan). If the valuation adjustment were not considered, in 2007 AIG-FP would pay incentive compensation and equity kicker aggregating $457 million (including deferrals). A calculation of these amounts is set out in Annex 1.

- AIG-FP employees do not participate in any AIG compensation plans.

<u>AIG-FP Special Deferred Compensation Proposal for 2007</u>

- No individual will receive regular incentive compensation greater than $1.25 million this year, and there will be no payment of a cash equity kicker under the existing Deferred Compensation Plan.

    - To the extent that 2007 incentive compensation for any employee exceeds $250,000, it will be subject to partial mandatory deferral under the existing Deferred Compensation Plan in accordance with the Plan's terms as described above.
    - Installment payments of amounts deferred in prior years under the existing Deferred Compensation Plan will be made in accordance with the Plan's terms as described above.

- Employees who, in the absence of the super senior valuation loss, would have received incentive compensation in excess of $1.25 million, and/or would have received payment of an equity kicker, will be eligible for future payment of special 2007 deferred compensation (outside of the existing Deferred Compensation Plan).

- Each such employee will receive special deferred compensation equal to the amount by which the employee's incentive compensation would have exceeded $1.25 million in the absence of the super senior valuation loss, plus the amount of the equity kicker that the employee would have received.

- The total amount of 2007 special deferred compensation will depend on the specific allocations of compensation among employees. These allocations have not been completed.

    - If the special deferred compensation arrangements proposed for 2007 had applied in 2006, the aggregate amount of the available compensation pool paid out in cash to employees would have been reduced by approximately 54% (from $247,653,527 to $113,060,761), and the aggregate amount deferred (under the existing Deferred Compensation Arrangements and these special arrangements) would have increased by approximately 107% (from $125,522,107 to $260,114,873).

- The special deferred compensation will be at risk to AIG-FP's business to the same extent as deferred compensation under the existing Deferred Compensation Plan. Thus the special deferred compensation will also form part of AIG-FP's capital base.

- The vesting of the special deferred compensation will be 1/3rd at the end of 2008 and 2/3rd at the end of 2009, subject to vested amounts continuing to be subordinated to the rights of senior creditors and thus remaining at risk to the business.

- The vested, deferred amount will be paid in a lump sum at the end of 2010. Employees who leave the company before 2010 will forego all (if they depart in 2008) or two-thirds (if they depart in 2009) of the special deferral.

- During the three-year deferral term, the deferral will earn interest at LIBOR (paid quarterly) and will share pro rata with the existing Deferred Compensation Plan in any annual equity kicker.

- An amount that will give AIG a 70/30 participation in the economics of this arrangement will be set aside and will also be paid to AIG at the end of 2010, subject to its also being at risk to the business on a subordinated basis.

ANNEX 1

Distribution For Comp YTD November 2007/2006

($ millions)

	Comp YTD 2007*	Comp YTD 2006	% Increase /Decrease
Revenues	**1,974**	**1,703**	**16%**
Expenses	**(265)**	**(207)**	**28%**
Net Revenue	**1,709**	**1,496**	**14%**
AIG Fees at 70%	**1,200**	**1,063**	**13%**
AIG FP Fees at 30%	**509**	**433**	**18%**
Less: Payroll Expenses	**(52)**	**(60)**	**-13%**
Add: Undistributed Balance from Prior Year	**0**	**0**	
Available Compensation Pool	**457**	**373**	**23%**

*Does not reflect valuation adjustment related to subprime super senior portfolio, estimated to be $1.5 billion as of November 30, 2007. If the estimated valuation adjustment had been taken into account in the calculations, the 2007 Available Compensation Pool would have been reduced by $450 million to $7 million.