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8-14-2008

**Federal Reserve Bank Email from Kevin Coffey to Terrence Checki  
William Rutledge Arthur Angulo Brian Peters and Meg McConnell  
Re AIG Meeting with OTS**

Kevin Coffey

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**Kevin Coffey/NY/FRS**

08/14/2008 10:47 PM

To

Terrence Checki/NY/FRS@FRS, William Rutledge/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS

cc

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Subject

AIG - Meeting with OTS

Elise and I met with the OTS's AIG team on August 11 for a long sought meeting to open a dialogue with them about AIG and its operations as well as to discuss some of the insurance related issues we have seen w/r/t the monoline financial guarantors that may similarly impact firms such as AIG. Overall, the meeting was successful and we agreed to meet again in the near future to continue to exchange views etc.. The OTS team was very open, sharing their views on AIG's operations, OTS's oversight program etc.. They also seemed genuinely appreciative to hear our thoughts on issues relating to CDS counterparties, the monolines and various other issues that have come up at banks over the past year (e.g., GIC triggers, liquidity puts, secured funding rollover risk) that could affect similar firm's liquidity and capital etc..and how we assess some of the potential impact (e.g., waterfalls).

As it was an introductory meeting, we did not want to push the team too specifically or deep in some area but we hope to gain more information in our future discussions so I apologize upfront if details are missing or contradictions are evident.

Capital Raise & Liquidity Management

- OTS confirmed that the primary reason for the \$20 billion capital raise in May was for liquidity purposes. Since that time, approximately \$6-7 billion has been used to support AIGFP (via repos) and another \$1 billion was infused directly into AIG SunAmerica to support its growth. Given the remaining \$12-13 billion, they seemed generally comfortable with the firm's current liquidity. They were also confident that the firm could

access the capital markets with no problem if it had to. From a capital standpoint, AIG now has \$3-5 billion in "excess capital" down from \$15-20 billion.

- Until six or seven months ago, liquidity management was not a holding company activity and things were managed in "fiefdoms" (i.e., AIGFP, Domestic Life, ILFC etc). The firm is now implementing common stress testing across major businesses and is also starting to require the businesses to run liquidity scenario analysis where there is no external financing for 1 year. (We tried to clarify if this meant no unsecured borrowings and/or no secured borrowings and they seemed to indicate it covered both but this will need to be clarified in the future).

- From a securities lending standpoint, things are currently better and they indicated that cash and short-term investments had risen to about \$20 billion recently. They also indicated that tenors on these deals ranged from overnight out to six months but were not sure whether there had been any change/shortening in the maturity profile of the book, although they had the numbers (and may discuss further). Finally, they viewed the securities being lent as scarce, in demand by borrowers and therefore less likely to have funding rollover issues.

(Note: CSG's CPC team indicated today that in its relationship with AIG, CSG does not need the securities it borrows but instead AIG is using the deals to raise cash. As such, CSG is looking to take a haircut on AIG's securities as opposed to posting cash to AIG in excess of the securities value which is the market standard).

- In order to expand liquidity capacity, the firm's insurance companies were setting up repo lines which they had never done before (it was unclear if this had already been implemented or if it is on the to do list). They are also setting up another \$2 billion inter-company LOC.

#### Recent Rating Agency Statements

- The team had not yet had an opportunity to review the Moodys or the S&P statements on AIG so they had not yet factored this into their analysis (or earlier comments on liquidity and capital). However, they seemed to focus particular attention when we mentioned the S&P statement regarding AIG's need to achieve earnings stability in the third quarter. As they noted a quite a few times, this gave AIG only 45 days.

#### AIGFP specific issues

- CEO Bob Willumstad is under significant pressure to exit this business (given the CDS losses).

- The firm has about a \$100 b balance sheet and is assigned proxy/rating agency capital of about \$2 billion in the OTS's capital regime. As such, capital requirements for this business (as well as ILFC) may be subject to changing rating agency capital standards.

- The Commission Bancaire may be pressuring Banque AIG (AIG's main European derivatives company facing clients who then enters into an offsetting deal with AIGFP) to reduce exposure with AIGFP given its size. OTS is looking to do more work on the European operations of AIG in the near future.

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Please let Elise or I know if you have any question etc. w/r/t the above.

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