

**Report Pursuant to Section 129 of the
Emergency Economic Stabilization Act of 2008:
Secured Credit Facility Authorized for American International Group, Inc.
on September 16, 2008**

Overview

On September 16, 2008, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of its five members and with the full support of the Secretary of the Treasury, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) the establishment by the Federal Reserve Bank of New York (FRBNY) of a revolving credit facility for American International Group, Inc. (AIG) in an aggregate amount not to exceed \$85 billion dollars outstanding at any time. As discussed further below, the credit facility has several important terms designed to protect the Federal Reserve and the taxpayer.

Background

AIG is a large, diversified financial services company that, as of June 30, 2008, reported consolidated total assets of slightly more than \$1 trillion, stockholders' equity of \$78 billion, and total consolidated borrowings of \$178.6 billion. Commercial paper and extendible commercial notes represented approximately \$15 billion of these consolidated borrowings.

AIG operates in four general business lines through a number of subsidiaries: (i) general insurance, (ii) life insurance and retirement services, (iii) financial services, and (iv) asset management. In 2007, AIG's U.S. life and health insurance businesses ranked first in the United States in terms of net premiums written (\$51.3 billion) and third in terms of total assets at year-end (\$364 billion). For the same period, AIG's U.S. property and casualty insurance businesses ranked second in the United States in terms of net premiums written (\$35.2 billion) and third in terms of total assets at year-end (\$124.5 billion). Certain of AIG's regulated insurance subsidiaries also operate a securities lending program under which the subsidiaries, with the approval of their appropriate state insurance authority, pool together and lend out high-quality, fixed-income securities owned by the insurance companies to third parties in exchange for cash collateral. As of October 6, 2008, approximately \$37.2 billion of securities were subject to loans under AIG's securities lending program.

Through a wholly-owned subsidiary, United Guaranty Corporation (UGC), AIG also provides private mortgage insurance for high loan-to-value first- and second-lien residential mortgages. As of June 30, 2008, UGC's domestic mortgage risk in force aggregated \$31.8 billion, approximately 83 percent of which was secured by first-lien, owner-occupied properties.

In addition to its on-balance-sheet positions, AIG is a major participant in a wide range of derivatives markets through its Financial Services division, and particularly through its AIG Financial Products business unit (AIGFP), and is a significant counterparty to a number of major national and international financial institutions. For example, as of June 30, 2008, AIGFP had sold credit default swaps (CDS) with a gross notional exposure of \$441 billion on super-senior tranches of collateralized debt obligations (CDOs). Approximately \$307 billion of that exposure represented transactions between AIG and banking organizations that are designed to assist the financial institutions in managing their regulatory capital requirements. As of June 30, 2008, AIGFP had \$53 billion in borrowings outstanding, including \$18.2 billion through guaranteed investment agreements. A significant portion of the guaranteed investment agreements and financial derivative transactions entered into by AIGFP include provisions that require AIGFP, upon a downgrade of AIG's long-term debt ratings, to post additional collateral or, with the consent of the counterparties, assign or repay its positions or arrange a substitute guarantee of its obligations by an obligor with higher debt ratings.

Board's Authorization

On September 16, 2008, the Board authorized FRBNY, pursuant to section 13(3) of the Federal Reserve Act, to establish a revolving credit facility for AIG under which FRBNY may lend up to an aggregate amount of \$85 billion outstanding at any time. As noted above, the Board acted with the full support of the Secretary of the Treasury. At the time the Board acted, the financial and credit markets were experiencing severe stress. This severe stress can be traced back to, among other things, the sharp and broad-based decline in home prices. That decline was the primary factor behind a substantial rise in mortgage delinquencies and defaults, especially on subprime mortgages, and the resulting substantial drop in values of mortgages as well as mortgage-backed securities and other instruments based on such assets. As a result of these and other factors, short-term funding markets had come under severe stress during the months prior to September 2008, with very high spreads between lending rates and the target federal funds rate and very illiquid trading conditions in term money markets. Those stresses intensified

in late August and early September 2008, and these developments had led to a considerable impairment of a broad range of other financial markets.

These events placed significant liquidity pressures on AIG in the period leading up to September 16, 2008, as declines in the prices of mortgage-related assets required AIG to post additional collateral in connection with its CDO and other mortgage-related derivative exposures and as AIG experienced difficulty in raising additional funding in the markets. Given AIG's inability to obtain adequate credit accommodations from banking institutions or in the market, a downgrade of AIG's credit rating, which was then under review by the major credit rating agencies, threatened to prompt a default by the firm, partly by increasing the collateral calls on the institution.

Many of the same factors that created substantial stress for AIG also contributed to the failure of Lehman Brothers Holdings, Inc. on September 15, 2008. The markets, which were already fragile, were absorbing and adjusting to the failure of Lehman Brothers as these stresses bore down on AIG.

Under these circumstances, the potential failure of AIG posed significant systemic risks. A default by AIG on its commercial paper would likely have caused a number of money market mutual funds to "break the buck," potentially triggering runs on those and other money funds. Such a development could have significantly disrupted the market for commercial paper, undermining the ability of major financial and nonfinancial firms to obtain funding. The difficulties also could have spread to other important money markets, which were already under considerable stress. A default by AIG would have imposed a significant burden on its securities lending counterparties, who would have had to either fund or liquidate the securities they had borrowed from AIG in exchange for cash collateral. Large global banks had significant exposure to AIG on various credit facilities. In addition, many banks have purchased credit protection from AIG on CDS contracts that AIG had written to protect the banks against losses on super-senior asset-backed security (ABS) CDOs. While AIG had posted collateral to cover most of its counterparties' exposures on these CDS contracts, some uncollateralized exposure remained and a failure of AIG would have left the banks bearing the risk of losses if the value of the ABS CDOs declined further. Moreover, a failure of AIG would cause the closeout of derivatives contracts in which it is a counterparty, and many firms would have found the contracts difficult to replace.

More broadly, the disorderly failure of AIG would have undermined business and household confidence and increased investor risk aversion. These

effects would have contributed to substantially higher borrowing costs, reduced wealth, and materially weaker economic performance.

In light of these and all other facts, the Board determined that, under the circumstances at the time, a disorderly failure of AIG could add to already significant levels of financial market fragility and lead to, among other things, substantially higher borrowing costs, reduced household wealth, and materially weaker economic performance. The authorized credit facility is intended to assist AIG in meeting its obligations as they come due and facilitate a process under which AIG will sell certain of its businesses in an orderly manner, with the least possible disruption to the overall economy.

Terms of the Revolving Credit Facility and Related Agreements

Pursuant to the Board's authorization and pending execution of a credit agreement, FRBNY initially provided advances to AIG in exchange for promissory notes payable on the demand of FRBNY. These advances against the demand notes of AIG were entered into between September 16, 2008, and September 19, 2008, in an aggregate amount of \$37 billion. The advances bore an interest rate of 14 percent and were secured by a wide range of assets of AIG, including its ownership interest in certain subsidiaries. On September 22, 2008, FRBNY and AIG entered into a Credit Agreement and Guarantee and Pledge Agreement. A copy of the Credit Agreement and the Guarantee and Pledge Agreement as filed by AIG with the Securities and Exchange Commission on September 22, 2008, is enclosed with this report. (The Guarantee and Pledge Agreement is included as Exhibit B to the Credit Agreement). Upon execution of the Credit Agreement, the existing demand notes between FRBNY and AIG were cancelled and amounts due under such notes effectively were transferred to the revolving credit facility (Credit Facility) established under the Credit Agreement.

Terms, Rates and Fees

The Credit Facility has a term of two years and will mature on September 22, 2010. Under the terms of the Credit Agreement, AIG has paid FRBNY an initial gross commitment fee equal to 2 percent of the aggregate amount available under the Credit Facility, or \$1.7 billion. Outstanding advances made to AIG under the Credit Facility bear interest at a rate equal to 3-month LIBOR plus 8.5 percent, payable quarterly. Amounts that are not paid when due are subject to a default interest rate equivalent to the normal rate plus 2 percent, and are due in immediately available funds.

The Credit Agreement also obligates AIG to pay an ongoing commitment fee each quarter equal to 8.5 percent of the average undrawn amount available under the Credit Facility during the preceding quarter. Interest and the initial and ongoing commitment fees generally are payable through an increase in the outstanding balance of the Credit Facility, with interest thereafter accruing on such balances at the rate of 3-month LIBOR plus 8.5 percent. AIG may, however, elect to pay all or any portion of the interest or ongoing commitment fee payable on a quarterly payment date in cash by giving notice to FRBNY.

AIG may use the proceeds of advances made under the Credit Facility solely for the general corporate purposes of AIG and its subsidiaries, including as a source of liquidity to pay obligations as and when they become due. In addition, FRBNY's agreement to lend is conditioned on FRBNY being reasonably satisfied in all respects with the corporate governance of AIG after giving effect to the transactions provided for in the Credit Agreement.¹ FRBNY is in regular contact with AIG's senior management and FRBNY representatives attend all AIG board of directors meetings, including committee meetings, as an observer. FRBNY also has staff on-site at AIG to monitor the company's funding, cash flows, use of proceeds and progress in pursuing its global divestiture plan. Control and management of the daily business and operations of AIG and its subsidiaries continue to be vested in the new chairman and chief executive officer of AIG and his management team.

As of October 1, AIG had drawn down approximately \$62 billion of the Credit Facility, and as of October 29, 2008, AIG had \$89.6 billion in borrowings from FRBNY under both the Credit Facility and the separate securities borrowing facility established on October 6, 2008.

Collateral and Repayment

AIG is unconditionally obligated to repay the unpaid principal amount of all advances, together with accrued and unpaid interest thereon and any unpaid fees, under the Credit Agreement on the maturity date. In addition, as provided in the Guarantee and Pledge Agreement, all outstanding balances under the Credit Agreement are secured by the pledge of a substantial portion of the assets of AIG

¹ The composition of AIG's board of directors also must be satisfactory to the trustees of the trust that will hold the preferred shares described below.

and its primary non-regulated subsidiaries,² including AIG's ownership interest in its regulated U.S. and foreign subsidiaries.³ Upon the receipt of shareholder approval, additional collateral will be pledged by AIG to secure the Credit Facility. Importantly, under the terms of the Credit Agreement, FRBNY's agreement to provide advances under the Credit Facility is specifically conditioned on FRBNY being satisfied in its sole discretion with the nature and value of the collateral securing AIG's obligations at the time of the advance.

The Guarantee and Pledge Agreement also provides for AIG's obligations under the Credit Facility to be guaranteed by each of the company's domestic, non-regulated subsidiaries that have more than \$50 million in assets.⁴ These guarantees separately are secured by assets pledged to FRBNY by the relevant guarantor. Pursuant to the Guarantee and Pledge Agreement, additional subsidiaries of AIG may be added as guarantors (and become subject to all the terms of the Guarantee and Pledge Agreement) over time by signing a short supplemental agreement.

Consistent with the objective of the Board's authorization and to generate sufficient liquidity to repay any advances under the facility, AIG's new Chairman and Chief Executive Officer, Edward M. Liddy, announced on October 3, 2008, a comprehensive and global divestiture program through which AIG will sell all of its existing businesses and subsidiaries other than its U.S. property and casualty business, its foreign general insurance business, and a portion of its foreign life insurance operations. AIG has hired The Blackstone Group and J.P. Morgan Chase to serve as global coordinators of the company's divestiture program. The Credit Agreement includes provisions designed to ensure that the proceeds of the asset sales to be conducted by AIG are used to permanently repay any outstanding balances under the Credit Facility.

² For example, the Guarantee and Pledge Agreement does not cover collateral, such as real estate, motor vehicles and aircraft, the perfection of security interests in which is dealt with outside the Uniform Commercial Code. The Credit Agreement, however, requires that AIG and certain subsidiaries mortgage real property they own in favor of FRBNY.

³ In the case of foreign subsidiaries, the Guarantee and Pledge Agreement limits the equity interest FRBNY will accept as collateral to 66 percent ownership to avoid adverse tax consequences for AIG or its subsidiaries.

⁴ Regulated subsidiaries, such as insurance companies, typically are not permitted to provide such guarantees.

In light of the complexities involved in valuing the extremely broad range of collateral and guarantees securing all advances under the Credit Facility, the Board believes any estimate at this time of the aggregate value that ultimately will or may be received from the sale of collateral or the enforcement of the guarantees in the future would be speculative and could interfere with the goal of maximizing value through the company's global divestiture program and, consequently, the proceeds available to repay the Credit Facility. Given the substantial assets and operations supporting repayment of the loan, as well as the equity interest (described below) in AIG that the U.S. Treasury Department will receive, the Board does not believe that authorization of the Credit Facility will result in any net cost to taxpayers.

Convertible Preferred Stock Issued for the Benefit of the U.S. Treasury

As additional compensation to the U.S. government for the Credit Facility, AIG will issue 100,000 shares of a new series of perpetual, non-redeemable convertible participating serial preferred stock (the Preferred Stock) to a trust that will hold the Preferred Stock for the benefit of the U.S. Treasury Department. The Preferred Stock will be convertible into 79.9 percent of AIG's outstanding common stock at the time of issuance and is protected by standard anti-dilution provisions. Because AIG currently does not have a sufficient amount of authorized but unissued common stock to permit the conversion of the Preferred Stock, AIG will hold a special meeting of its shareholders to amend the company's certificate of incorporation in order to increase the amount and lower the par value of the company's authorized common stock.⁵ Once this amendment is effective, the Preferred Stock will be convertible at any time into 79.9 percent of the shares of AIG's common stock.

⁵ FRBNY also has the right to require that AIG bring any other matter to a vote of the shareholders that FRBNY determines to be necessary for the conversion of the Preferred Stock or the operation of the Credit Facility, including the pledging of additional collateral.