

The Rise and Fall of AIG

John Becker

Monica Pringle

Peter Swiatek

Enterprise Risk Management

Professor Chris Weir

December 1, 2010

Abstract

For many decades, American International Group has been a global insurer and the holder of a great many insurance and financial service providers. However, the events of the past few years stand in stark contrast to the careful fiscal guidance and risk management that made the firm so successful. How is it that a multi-billion-dollar firm, a firm with influence in almost every major financial and consumer insurance market, could be brought down so quickly in such a ruthless fashion?

In this paper, we explore the firm as it stood when the financial meltdown developed. We detail the key players, key factors, and key choices instrumental in the firm's disastrous collapse. We survey the economic landscape which presented AIG with a unique opportunity and investigate how the effort to exploit this opportunity spiraled out of control. We delve into the means whereby a very small business unit, AIGFP, nearly drove the vast enterprise into bankruptcy. We identify several early warning signs along the way. Finally, we explore the drastic government action necessary to save the firm and what has developed in the aftermath of these pivotal events. Throughout this analysis, our goal is to show that the vital role of risk management - more precisely the lack thereof - was the determining factor in one of the most iconic corporate catastrophes in modern history.

AIG's Background

Who is AIG?

American International Group is a truly massive enterprise. Not only is AIG the largest insurance firm in the USA, but the enterprise encompasses scores of subsidiaries and holdings all over the USA and the world. Most of these business units provide general insurance, life insurance, retirement services, or financial services (Reuters, 2010). However, the holdings do include a flight training academy in China, a telecommunications firm in Bulgaria, and a ski resort in Vermont, for example. Most of these businesses were operating reasonably well going into 2008, but all of this was made irrelevant by a relatively small specialty products division in London. The autonomous group sold a large amount of specialized financial insurance in the form of credit default swaps that would later bring the entire enterprise to its knees (The Economist, 2008).

This was the underlying activity that made so much noise going into the fall of 2008. AIGFP (American International Group, Financial Products division) was given the power to leverage the firm's outstanding credit rating by selling this insurance on many different securities. The portfolio of insured securities grew to unsafe levels; AIGFP's books remained opaque; corporate internal control was weak; and risk control in the group itself was very lax. These factors would combine into one of the most perfect storms on record, augmented by a deep recession and great risk management failings throughout the rest of AIG. This is explored in great detail later on.

The Key Players

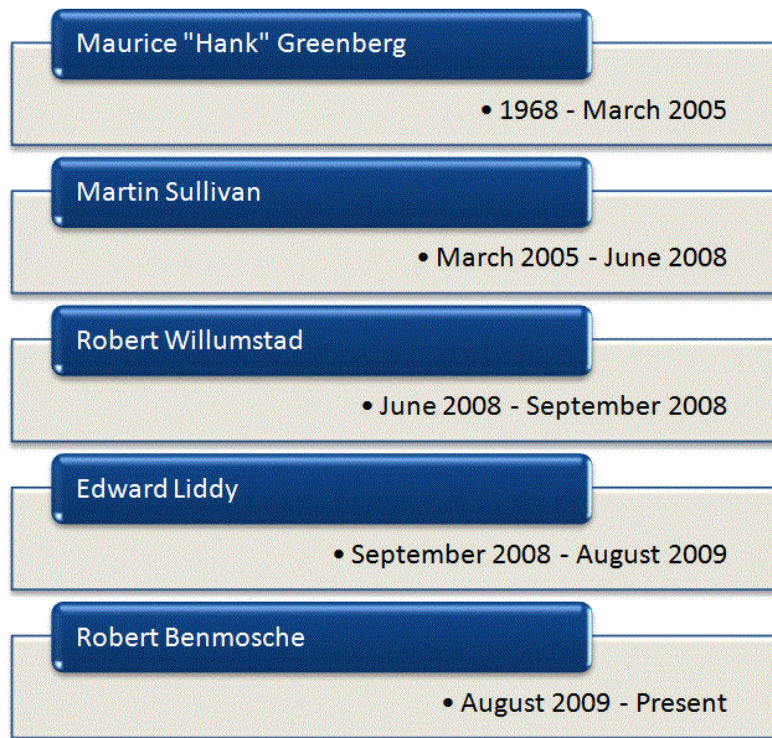
AIG has long been known as a major player in the insurance industry. In 2005, there were major changes in the leadership structure. When shareholders became concerned and began to question the company's performance, then-CEO Maurice "Hank" Greenberg was asked to leave. Greenberg, who had served as CEO for nearly 40 years, was accused of less-than-full cooperation with federal investigations regarding AIG's involvement in the subprime mortgage market. Some believe that Greenberg refused to comply with the investigations because he would have incriminated himself.

Greenberg was replaced in March, 2005 by Martin Sullivan, who helped AIG rework its reputation. However, after a double quarter loss in the mortgage sector in 2008, Sullivan was ousted as well. This was the second sudden shift in management related to the U.S. subprime mortgage market - not a good message to shareholders. Robert Willumstad became the new CEO, despite concerns that he may have lacked the proper credentials and background. Although Willumstad led the firm for only 91 days, he did help AIG avoid major bankruptcy. Edward Liddy replaced Willumstad in September, 2008.

Although initially critical of AIG's past bonus payments, Liddy later approved the same types of compensation even as the firm was bailed out by the federal government. After his resignation in August, 2009, Liddy was replaced by the fifth chief executive in only 54 months, current-CEO Robert Benmosche. Benmosche was initially loath to accept the post, given the legal and business troubles of his predecessors. He has been criticized for living a lavished life even as AIG was rescued by taxpayers and accused of conflicts of interest with his personal business ventures. Nonetheless, Benmosche has actively defended himself against such allegations, claiming innocence. In October, 2010, AIG announced that Benmosche was

diagnosed with cancer. If this situation forces him to step down, AIG may again have to fill the CEO position.

AIG CEO Timeline



AIG is also managed by a Board of Directors that creates and oversees activities to promote the interests of AIG's stakeholders. According to the company's website, "The size and composition of the Board is to be determined from time to time by the Board itself in an effort to balance the following goals:

- The size of the Board should facilitate substantive discussions by the whole Board in which each director can participate meaningfully. Given the size and complexity of the businesses in which AIG is engaged, as well as the value of diversity of experience and views among Board members, the Board currently believes that it will be desirable over time to have a Board of between 8 and 12 members (allowing that a larger or smaller

number may be necessary or advisable in periods of transition or other particular circumstances).

- In order to provide oversight to management, given AIG’s complex businesses, the composition of the Board should encompass a broad range of skills, expertise, industry knowledge and diversity of opinion.

- At least two-thirds of the Board will consist of directors who are, under the New York Stock Exchange, Inc. (“NYSE”) listing standards, “independent” in the business judgment of the Board (“Independent Directors”).” (2010)

The current board consists of the following members:

Robert S. Miller Non-Executive Chairman of the Board, AIG	Laurette T. Koellner Fmr. President, Boeing International
Robert H. Benmosche President and CEO, AIG	Donald H. Layton Fmr. Chairman and CEO, E*Trade Financial
Suzanne Nora Johnson Fmr. Vice Chairman, Goldman Sachs	Christopher S. Lynch Fmr. Partner, KPMG LLP
Morris W. Offit Chairman, Offit Capital Advisors	Arthur C. Martinez Fmr. President, Chair, and CEO, Sears Roebuck
Ronald A. Rittenmeyer Fmr. President, Chair, and CEO, Electronic Data Systems	George L. Miles President and CEO, WQED Multimedia
Douglas M. Steenland Fmr. President and CEO, Northwest Airlines	Henry S. Miller Chairman and Managing Director, Miller Buckfire

The Board of Directors also has a number of standing committees that oversee and make recommendations based on certain operations of the company. The following is a list of current standing committees and their members.

Audit Committee <ul style="list-style-type: none"> • Christopher S. Lynch, Chairman • Donald H. Layton • George L. Miles, Jr. • Ronald A. Rittenmeyer 	Nominating and Corporate Governance Committee <ul style="list-style-type: none"> • George L. Miles, Jr., Chairman • Donald H. Layton • Arthur C. Martinez • Suzanne Nora Johnson
Compensation and Management Resources Committee <ul style="list-style-type: none"> • Arthur C. Martinez, Chairman • Laurette T. Koellner • Suzanne Nora Johnson • Ronald A. Rittenmeyer 	Regulatory, Compliance and Public Policy Committee <ul style="list-style-type: none"> • Laurette T. Koellner, Chairman • Henry S. Miller • Morris W. Offit • Douglas M. Steenland
Finance and Risk Management Committee <ul style="list-style-type: none"> • Morris W. Offit, Chairman • Christopher S. Lynch • Henry S. Miller • Douglas M. Steenland 	

AIG's Finances

Between 2007 and 2009, AIG seems to have gone from standing on top of the world to falling off the face of the earth. Its financial picture for those 3 years took a wild roller coaster ride.

Below is a copy of AIG's Income Statement provided by Thomson Reuters, taken from MSN.com. A few noticeable items help to put into perspective the amount of loss that was accumulated in 2008.

Looking at Revenue alone, we can see that AIG had gone from \$103.7 billion to \$6.9 billion in revenue between 2007 and 2008. The main component here is the Realized Losses that AIG began incurring. In 2007, AIG saw \$15.0 billion in investment losses; one year later the figure was \$81 billion. This resulted in a gross loss of \$78 billion, an operating loss of \$106.5 billion, and a net loss of \$99.3 billion. With this data we can see that AIG had gone from extreme success to the brink of ruin.

	2009	2008	2007
Period End Date	12/31/2009	12/31/2008	12/31/2007
Period Length	12 Months	12 Months	12 Months
Stmt Source	10-K	10-K	10-K
Stmt Source Date	02/26/2010	02/26/2010	02/26/2010
<hr/>			
Total Premiums Earned	64,702.0	78,564.0	74,753.0
Net Investment Income	25,239.0	11,433.0	30,051.0
Realized Gains (Losses)	-5,436.0	-81,307.0	-14,973.0
Other Revenue, Total	11,499.0	-1,794.0	13,801.0
Total Revenue	96,004.0	6,896.0	103,632.0
<hr/>			
Losses, Benefits, and Adjustments, Total	61,436.0	58,839.0	62,452.0
Amort. Of Policy Acquisition Costs	20,674.0	26,284.0	19,819.0
Gross Profit	13,894.0	-78,227.0	21,361.0

Unusual Expense (Income)	2,657.0	804.0	0.0
Other Operating Expenses, Total	9,516.0	10,490.0	8,476.0
Operating Income	-13,648.0	-106,528.0	8,134.0
Interest Income (Expense), Net Non-Operating	0.0	0.0	0.0
Gain (Loss) on Sale of Assets	0.0	0.0	0.0
Other, Net	0.0	0.0	0.0
Income Before Tax	-13,648.0	-106,528.0	8,134.0
Income Tax - Total	-1,878.0	-8,894.0	1,267.0
Income After Tax	-11,770.0	-97,634.0	6,867.0
Minority Interest	1,364.0	1,098.0	-1,288.0
Net Income Before Extra. Items	-10,406.0	-96,536.0	5,579.0
▶ Total Extraordinary Items	-543.0	-2,753.0	621.0
Net Income	-10,949.0	-99,289.0	6,200.0

Losses like this caused the extreme debt that brought AIG to its knees. Below is a copy of AIG's Balance Sheet for those 3 critical years. In 2007, AIG's liabilities reached over \$952 billion. Although generating income that year, AIG was not prepared to handle the massive debt of its souring investments. In 2008, AIG's short term debt and notes due jumped from \$13.1 billion to over \$56 billion. Retained Earnings went negative from \$89 billion to -\$12.3 billion. This mounting debt and low income was a recipe for disaster.

	2009	2008	2007
Period End Date	12/31/2009	12/31/2008	12/31/2007
Stmnt Source	10-K	10-K	10-K
Stmnt Source Date	02/26/2010	02/26/2010	03/02/2009
Assets			
▶ Cash and Short Term Investments	4,400.0	8,642.0	2,284.0
▶ Total Receivables, Net	20,327.0	30,949.0	31,906.0
Prepaid Expenses	0.0	0.0	0.0

Property/Plant/Equipment, Total - Net	48,233.0	48,961.0	47,502.0
Goodwill, Net	6,195.0	6,952.0	9,414.0
Intangibles, Net	0.0	0.0	0.0
Long Term Investments	545,600.0	572,497.0	694,692.0
Insurance Receivables	16,549.0	21,088.0	18,395.0
Note Receivable - Long Term	0.0	0.0	0.0
Other Long Term Assets, Total	4,108.0	11,734.0	0.0
Deferred Policy Acquisition Costs	40,814.0	45,782.0	43,914.0
Other Assets, Total	161,359.0	113,813.0	200,254.0
Total Assets	847,585.0	860,418.0	1,048,361.0

Liabilities and Shareholders' Equity

Accounts Payable	0.0	0.0	6,445.0
Payable/Accrued	0.0	0.0	0.0
Accrued Expenses	0.0	0.0	0.0
Policy Liabilities	518,673.0	552,077.0	604,210.0
Notes Payable/Short Term Debt	28,174.0	56,149.0	13,114.0
Current Port. of LT Debt/Capital Leases	0.0	0.0	0.0
Other Current Liabilities, Total	256.0	2,879.0	85,788.0
▶ Total Long Term Debt	113,298.0	137,054.0	162,935.0
Deferred Income Tax	0.0	0.0	0.0
Minority Interest	29,211.0	10,016.0	10,522.0
Other Liabilities, Total	88,149.0	49,533.0	69,546.0
Total Liabilities	777,761.0	807,708.0	952,560.0
Redeemable Preferred Stock	0.0	0.0	0.0
Preferred Stock - Non Redeemable, Net	69,784.0	40,000.0	0.0
Common Stock	354.0	368.0	6,878.0
Additional Paid-In Capital	6,358.0	39,488.0	2,848.0
Retained Earnings (Accumulated Deficit)	-11,491.0	-12,368.0	89,029.0
Treasury Stock - Common	-874.0	-8,450.0	-6,685.0
Other Equity, Total	5,693.0	-6,328.0	3,731.0
Total Equity	69,824.0	52,710.0	95,801.0
Total Liabilities & Shareholders' Equity	847,585.0	860,418.0	1,048,361.0

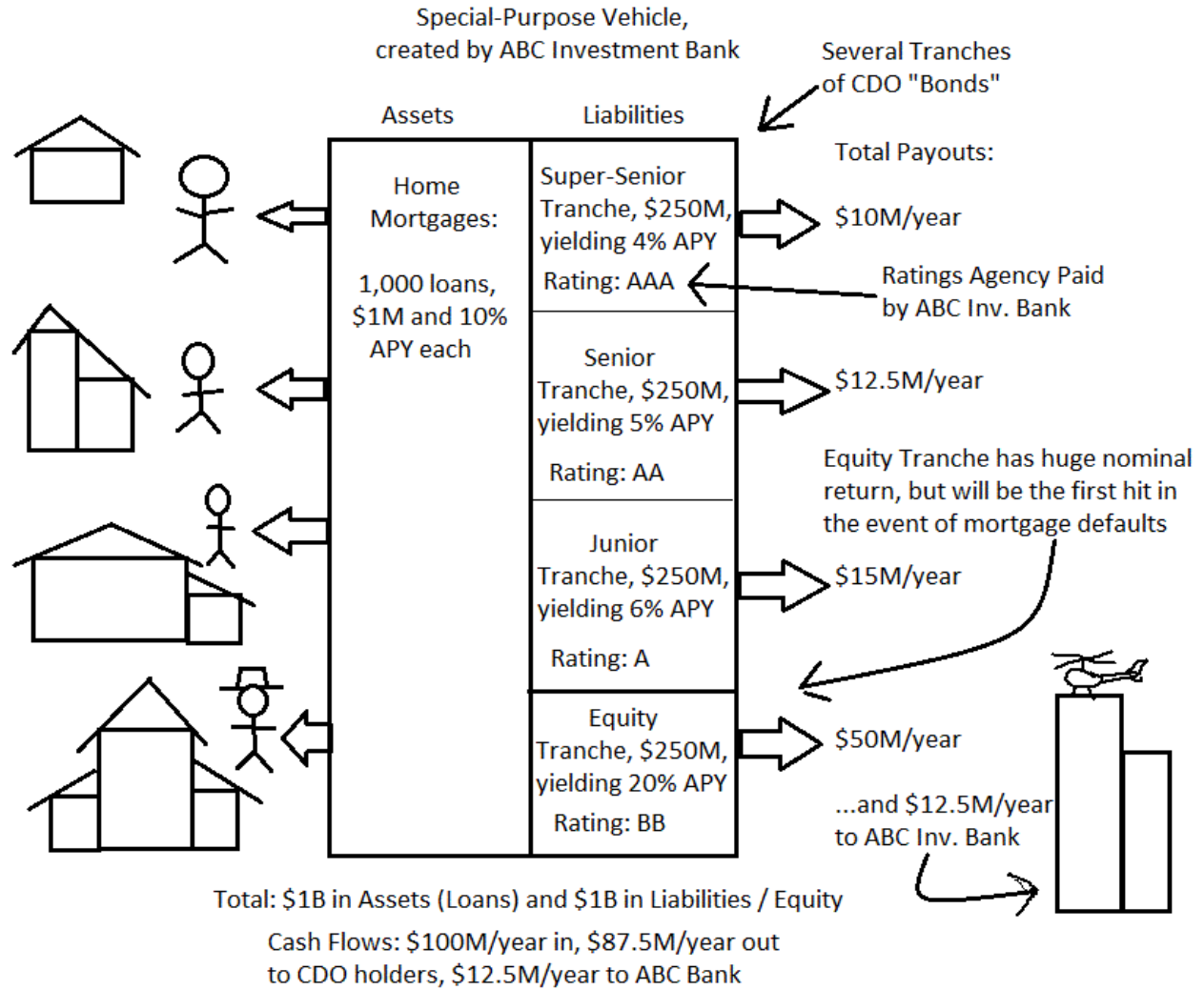
AIG's Crisis

A Company of its Time

AIG had been a leading insurance company, taking pride in its AAA credit rating. According to TPM.com (2009), “three Drexel Burnham Lambert traders, led by finance scholar Howard Sosin, convinced AIG CEO Hank Greenberg to branch out from his core insurance business by creating a division focused on complex derivatives trades that took advantage of AIG's AAA credit rating.” This rating was a powerful asset for the company, and it's only natural to try to utilize such an asset to generate as much revenue as possible. It is likely that nobody in 1987 knew what an Achilles' heel this new exploit would become for the company.



It is important to remember the historical uniqueness of the years leading up to the financial collapse. When monetary policy remained loose even as the economy recovered from the tech bubble and bust, real estate prices, along with many other asset valuations, rose quickly. New forms of securitization were embraced as means for interested parties to more efficiently exchange capital and risk specific to real estate. Many SPV's (special purpose vehicles) were created for the purpose of issuing MBS's (mortgage-backed securities) and CDO's (consolidated debt obligations). See the illustration on the next page for a brief CDO example. Note that the specific numbers are for illustration only.

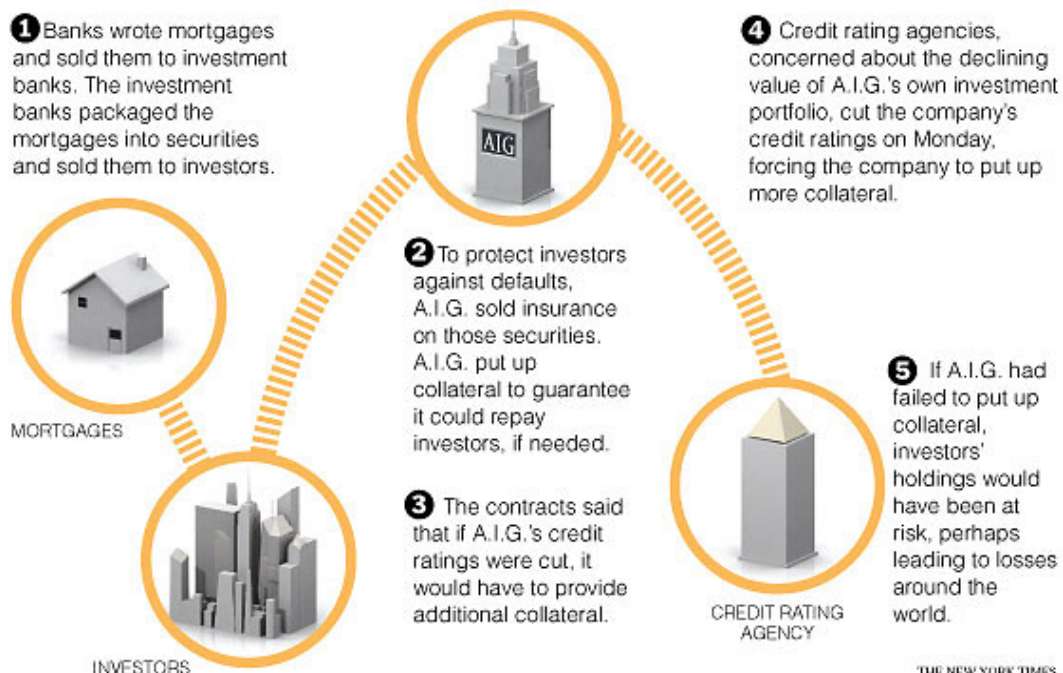


The Brilliant New Venture

The new division at AIG was given the name AIGFP (AIG Financial Products). The venture envisioned by Sosin and Greenberg was meant to create mutually beneficial agreements of a sort which no other company offered at the time, but one initial problem was the way the profits were recognized. “The agreement called for AIGFP to receive its profits up front, even though its deals generally took years to play out. AIG itself, not AIGFP, would be on the hook down the road if things went wrong” (Roth & Buchwalter, 2009).

“Buying and selling credit default swaps is a process that allows the owner of risky credit to transfer the risk to someone else who is willing to assume the credit and get paid a premium for doing so” (Newcomb, 2008). AIG got into the business of selling “insurance” on all sorts of bonds and securities, including the various tranches of CDO structures (Morgenson, 2008). These insurance contracts became known as credit default swaps (CDS’s). For a recurring fee, usually a portion of the security’s yield, AIG would agree to pay all or a large portion of the face value of an insured security if the original issuer defaulted on their obligation. The graphic below gives some detail on these transactions.

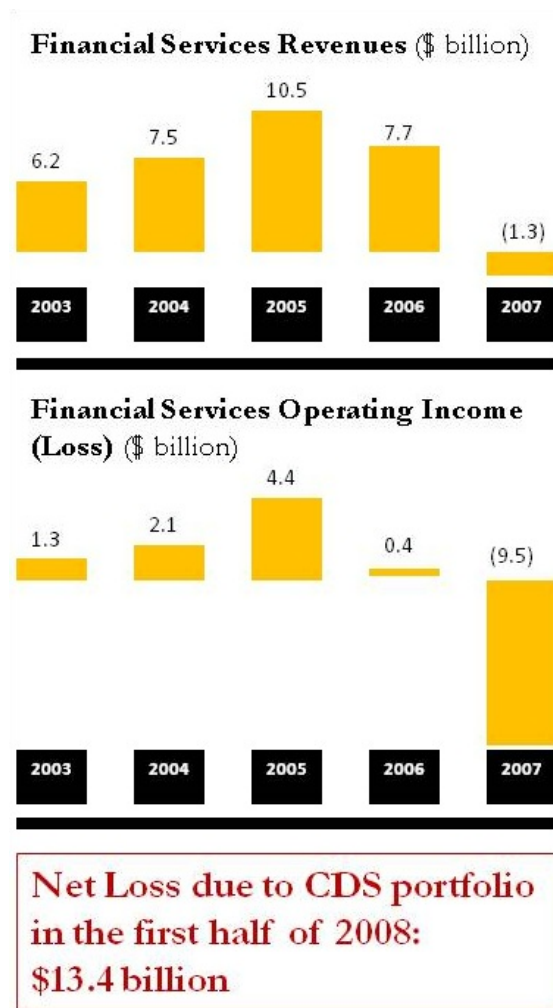
A.I.G.’s Troubles and Why They Matter American International Group is a giant insurance company that provided \$440 billion of insurance to investors who bought securities backed by mortgages.



Because AIG itself had a stellar bond rating, CDS's allowed all sorts of more conservative investment firms to purchase securities that would normally be too risky. Also because of AIG's rating, it was often not required to post any collateral with the counterparty to a CDS deal. It was taken on faith that AIG was "good for the money," and so there was no logistical limit to the sheer volume of CDS arrangements. Naturally, if the economy remained healthy, AIG stood to gain a great deal from recurring fees. "According to computer models devised by Gary Gorton, a Yale Business Professor and consultant to the unit, there was a 99.85 percent chance that AIGFP would never have to pay out on these deals (Roth & Buchwalter, 2009). Essentially, this would happen only if the economy went into a full-blown depression, in which case, the firm believed, the counter-parties would be wiped out, and therefore would hardly be in a position to demand payment anyway" (Roth & Buchwalter, 2009).

The Beginning of the End

In 2005, Greenberg stepped down “amid an investigation by New York Attorney General Eliot Spitzer into questionable accounting practices at the firm” (Roth & Buchwalter, 2009). It turns out that AIG had not conducted any official audit of the financial products unit or communicated proper disclosures to investors. AIG’s rating soon fell from AAA to AA, which made it necessary for AIGFP to come up with collateral on some of their credit default swaps. It soon became clear that most of the insured CDO’s involved sub-prime mortgages. If the housing market ever turned sour, this would be disastrous. But in 2005, the odds of such a collapse were widely regarded as negligible.



Source: AIG Annual Reports

In 2007, the negligible began to happen. The housing market collapsed and sub-prime assets dropped in value. Counterparties began to demand collateral that was due pursuant to the CDS agreements. AIG’s rating continued to fall, triggering yet more collateral payouts. The downward spiral had begun. In late November, “AIGFP reported that its swaps portfolio had lost \$352 million” (Roth & Buchwalter, 2009). That figure rose to \$1.1 billion a month later.

At the time of these developments, Joe Cassano was leading AIGFP. “The man in charge of AIG’s doomed Financial Products division in London has defiantly denied taking reckless risks on

hefty derivatives contracts that were widely blamed for pushing the huge US insurer to the brink of bankruptcy” (Clark, 2010). Both Cassano and Greenberg have faced criminal charges but have denied any wrongdoing. The risk officer, Robert Lewis, has verbally admitted that AIG underestimated the potential risks associated with these swaps (Hwang, Leising, & Son, 2010).

Another beautiful part of the story was that a counterparty did not have to actually prove ownership of the underlying security to purchase a CDS from AIG, or any other institution. Thus, CDS’s became a means for savvy and aggressive investors to take a bearish position on the bonds, CDO’s, etc. of a firm or special entity. For many smart fund managers, this was like scouring the neighborhood for ill-maintained houses and buying fire insurance on those properties, betting that they would burn down at some point. As the economy weakened more and more, the list of potential tinderboxes grew significantly. So this small group within AIG managed to get the firm into over-leveraged, bullish positions on housing, real estate, and even other firms. AIG resembled a rookie options trader in a losing position when the margin calls and counterparty demands rolled in. Many CDS’s came due, and a ratings downgrade forced the posting of collateral on many of the outstanding contracts (Merced & Dash, 2008). Murphy’s Law had struck again.

The graphic below, published by the New York Times, shows the interaction of many of these factors.

An Insurance Giant, Brought Down

A tiny unit at American International Group ...

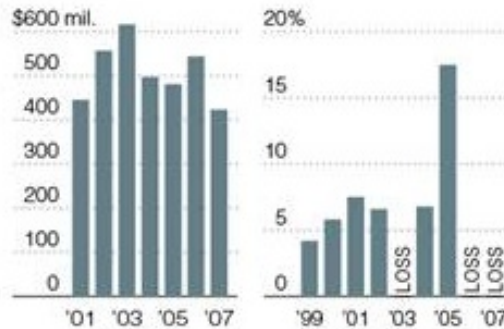


The world's largest insurer was brought to the edge of bankruptcy by its small London unit A.I.G. Financial Products, which sold complex financial contracts, called credit derivatives.

Source: A.I.G. company reports

... was well compensated ...

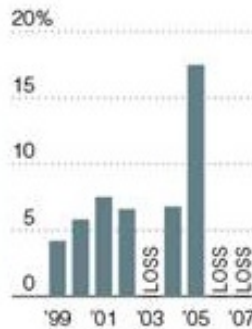
A.I.G.F.P. EMPLOYEE COMPENSATION



Those derivatives had been a big source of revenue for A.I.G., which paid the roughly 400 people in that office an average of more than \$1 million a year.

... for generating a significant share of revenue ...

SHARE OF ALL A.I.G. OPERATING INCOME FROM A.I.G.F.P.



... from selling contracts that protected clients from losses on debt.



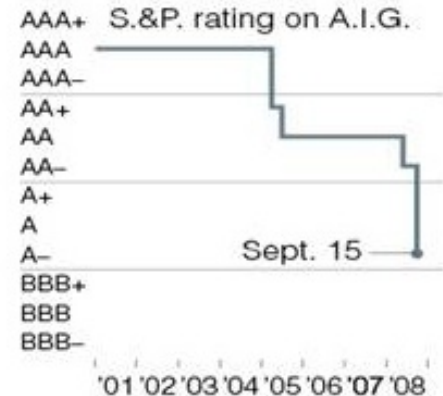
A.I.G.F.P. insured \$513 billion of debt against default using credit-default swaps. \$78 billion worth of insured debt was affected by the decline in the U.S. housing market.

But as certain debt losses mounted, A.I.G. was forced to increase its own financial cushion and write down the value of some of its own holdings ...



Initially, A.I.G.'s high credit rating meant no collateral was required to sell the insurance. Because of the way the derivatives contracts were written, A.I.G. was forced to increase the amount of money on hand as the value of the debt declined.

... ratings agencies punished the company, ultimately forcing it into a downward spiral.



When A.I.G.'s credit ratings were downgraded Sept. 15, the need for more money on hand increased beyond what it could borrow, and it asked the Federal Reserve for help.

THE NEW YORK TIMES

AIG's Risk Management Decisions

The Early Warning Signs

Once just a small part of AIG, AIGFP had grown to over 400 employees and almost \$1 billion in revenue by 2005. By that time credit default swaps were becoming famous stars on Wall Street. According to the Washington Post, “investment banks were snapping [CDS's] up to insure all kinds of deals in case of default, fueling one of the great financial booms in U.S. history” (O'Harrow Jr. & Dennis, 2008).

But early warning signs began to surface in late 2005. Eugene Park, an executive with AIGFP started to examine the CDS portfolio and became alarmed. “Many of the CDO's that were being insured contained too large a proportion of sub-prime mortgages, meaning the risk of default was high if the housing market collapsed” (Roth, Buchwalter, 2009). Park had brought this to the attention of then-CEO Joseph Cassano, who decided to stop selling CDS deals, but AIGFP had already amassed over \$80 billion of insured CDO's on its books.

Things had been great throughout the next year. The economy was soaring; housing was reaching all time highs; and AIG's Financial Products division looked as though it was the best thing that ever happened to the financial industry. When things are going so well, it is tough to ask the difficult questions.

Despite AIG's mounting exposure, Cassano was telling investors in August of 2007 that “it is hard for us, without being flippant, to even see a scenario within any kind of realm of reason that would see us losing \$1 in any of those transactions” (Roth, Buchwalter, 2009). The housing market soon had a different story to tell. Late in 2007, the collapse began and sub-prime assets plummeted. This was the start of what many considered unimaginable.

The Crisis Stage

Although AIGFP halted CDS deals with heavy residential and sub-prime exposure in early 2006, the confidence of Cassano and others close to these deals remained high. No substantial effort was made to hedge or otherwise reduce exposure to the housing market. Concerns about this concentrated risk and implications for the ERM picture were raised by a few in the company, but these were generally ignored. As of December 21, 2007, the nominal value of the Super-Senior CDS portfolio exposure was \$78 billion (FCIC 2010).

To make matters worse, by 2007 another department of AIG had amassed substantial investments in residential mortgage-backed securities and other asset-backed securities funded by a complex bond-lending operation. In effect, AIG Investments was short low-yield bonds and long high-yield RMBS and ABS to the tune of \$88 billion in September of 2007. Some departments were trying to avoid further exposure to sub-prime housing, while other groups saw things differently. Clearly, there was no coherent approach toward ERM as disaster drew nearer. CEO Martin Sullivan, CFO Steven Bensinger, CRO Robert Lewis, CCO Kevin McGinn, and others danced around the issue at the time and played the blame game later on.

Many sources later confirmed that AIG's FP division, among others, was not forthcoming to risk control officers with its true market position as the crisis unfolded (Roth 2009). It was around this time that many regulators and auditors began smelling trouble at the firm. The Office of Thrift Supervision issued several recommendations regarding the firm's risk structure as early as 2006 and gave specific direction related to AIG's thrift activities in March of 2008 (Lee 2010).

PricewaterhouseCoopers LLP, AIG's long-time independent auditor, held numerous meetings with high-level executives leading up to 2008, with a special focus on the highly-

suspect CDS valuation process. By February 2008, PwC had compiled several “material weaknesses with risk management and internal controls” (FCIC 2010). They included the following assessments:

Martin Sullivan did not show commitment to change the way AIG was run.

Neither Bensinger nor Sullivan was good at holding personnel accountable for internal control matters.

The corporate heads lacked the leadership, experience, and willingness to make "difficult decisions" regarding the FP division.

Bob Lewis was believed to be unable to implement an effective ERM program at a company like AIG.

AIG's Investments and Financial Products groups, among others, were not open to the risk control efforts of Lewis and his team.

Bensinger and Sullivan had too much control and too many responsibilities.

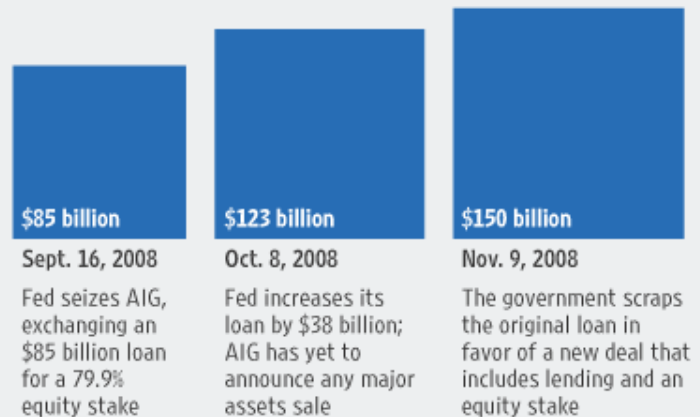
Compensation plans were very dependent upon "mark-to-market" valuations and did not consider internal risk control.

No senior risk committee was present at the company.

None of these recommendations were acted upon. After steady losses in AIG's investments, stock price, credit rating, and CDS holdings, the firm was unable to meet current obligations or find assistance from another party. On September 16, 2008, an initial loan of \$85 billion was made by the Federal

A Bigger Bite

Since the Federal Reserve first bailed out AIG in September, government aid to the ailing insurer has nearly doubled.



Reserve, acting as a lender of last resort, in exchange for a 79.9% equity stake. The amount soon grew to \$123 billion, and then \$150 billion - at the time the largest nominal-value bailout in American history.

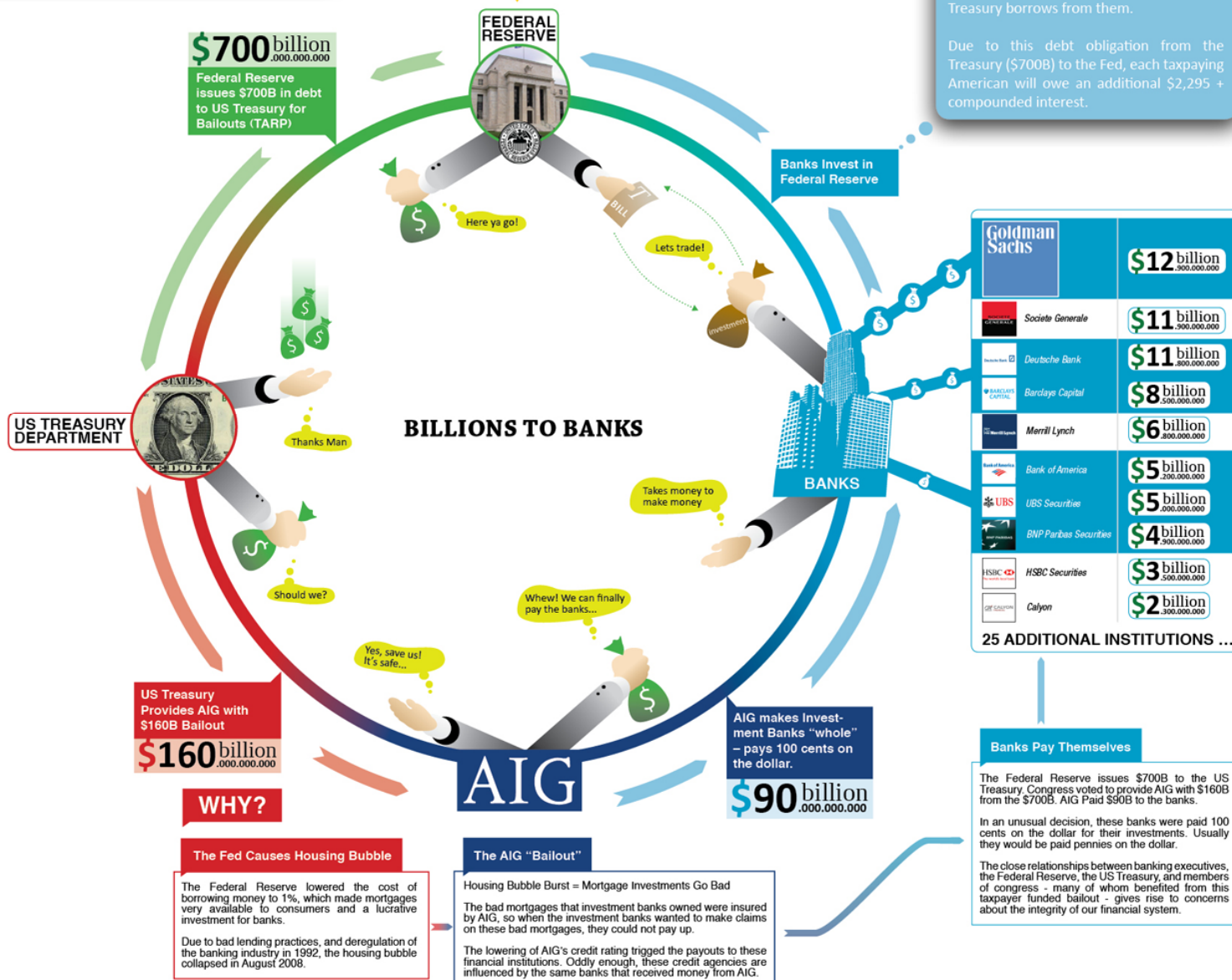
What followed was a vicious cycle of financial desperation eventually halted only by the Fed's efforts to make more capital available to AIG and others, largely through the TARP program. Much of this activity is illustrated in the following graphic:

You knew that the U.S. just gave AIG \$160B dollars, but did you know that \$90B of it went to the same banks who created the housing bubble? The same banks that are putting the U.S. further in debt are loaning money to the Treasury in order to pay themselves back. Here's how it works...

START HERE

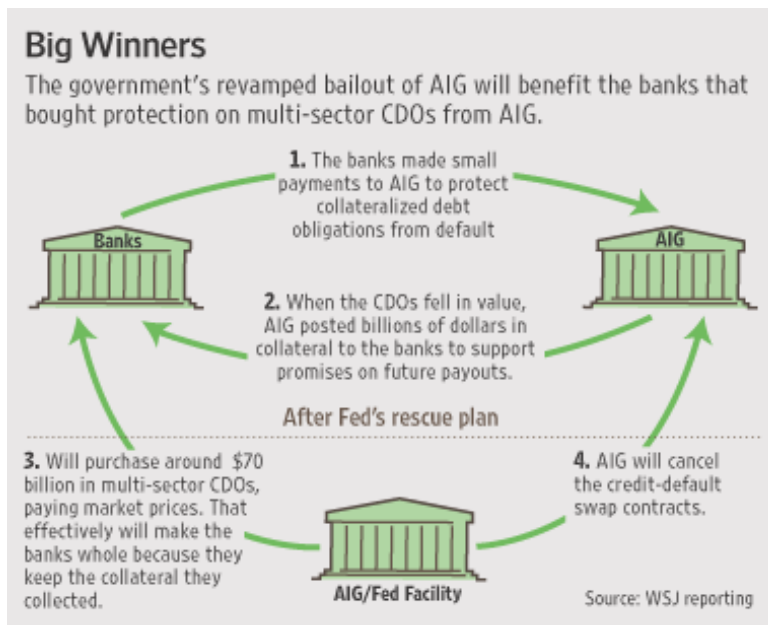
These banks are Primary Dealers (investors) in the Federal Reserve. This means these banks make interest on the money that the Treasury borrows from them.

Due to this debt obligation from the Treasury (\$700B) to the Fed, each taxpaying American will owe an additional \$2,295 + compounded interest.



The Fallout

“AIG, once the world’s largest insurer, received a 2008 bailout designed to protect banks that bought \$62.1 billion in swaps from the firm (Hwang, Leising, & Son, 2010). The bailout of AIG had the effect of providing monetary relief to AIG’s many counterparties, firms such as Bank of America, Goldman Sachs, Merrill Lynch and Morgan Stanley. All four companies participated in derivatives with AIG, which led to increased losses for each player (Greider,



2010). It should be noted that this bailout was initially separate from the TARP program, which was enacted 17 days later. However, the two later became managed in similar ways and are now closely related in the minds of most observers. AIG later received additional capital under the TARP program.

As head of the New York Federal Reserve Bank, Tim Geithner tried to keep the details of the AIG bailout a secret, due to the possible hailstorm of mainstream criticism (Blodget, 2010). Many were understandably critical of the entire effort, noting that it was taxpayer money used for the bailout, that the action represented a dangerous moral hazard situation, and that AIG’s position was a result of its own bad decisions – all very valid objections.

But the other argument was compelling. Not only was AIG a top insurer globally, but it was also one of the largest counterparties to all sorts of risk control transactions undertaken by a host of global banks, including the now infamous CDS deals (Hilsenrath, Karnitschnig, Plevan,

& Solomon, 2008). It was believed that the insolvency of AIG would be devastating for the global economy. The U.S. government intervened and took over AIG, keeping the firm afloat.

According to Hugh Son, “AIG’s first rescue was a credit line of \$85 billion from the New York Fed in September of 2008. The bailout was expanded three times and is valued at \$182.3 billion. That includes a \$60-billion Fed credit line, an investment of as much as \$69.8 billion from the Treasury, and up to \$52.5 billion for Maiden Lane facilities to buy mortgage-linked assets owned or backed by the company” (Son, 2010).

To raise capital, AIG has since been selling many of its investments and subsidiaries around the globe. Currently, AIG still owes the Federal Reserve about \$20 billion. The firm is working to manage this debt, considering additional credit lines with commercial banks among other options (Benoit & Holm, 2010).

There has been a great amount of outrage from taxpayers regarding this whole affair, in connection with the bailout of other firms. This has resulted in much public scrutiny and political theater based around AIG’s corporate meetings, personnel changes, compensation policies, counterparty contracts, and the like. Graphics such as the following have emerged to connect several of these elements chronologically, some items bearing a clear causal relationship to the crisis and other items much less so. While much of the public criticism is surely understandable and deserved, it is regrettable that much of it has surrounded issues unrelated to the actual collapse.

Risky business

Key events in the fall of the giant insurer:



Conclusion

AIG will always be remembered for a dominant role in the disastrous narrative of 2007-2009. Though the company has been trying to rebuild its reputation, it is not clear that numerous staffing changes and huge financial loss have brought about a risk management culture capable of averting this sort of disaster in the future. AIGFP, as it existed before the crisis, is no more, and several other culpable units within the firm have either disbanded or been sold off. However, many of the recommendations of PricewaterhouseCoopers and others reflect serious enterprise-level risk management failings. It is not clear that these have been rectified as of yet.

The AIG downfall, along with the larger financial collapse, has led the U.S. government to establish new regulations within the sector. Several pieces of legislation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, have taken aim at some perceived root causes of the meltdown. Examples include regulating derivatives, addressing excessive reliance on commercial rating agencies, requiring more robust credit risk modeling, and enumeration of explicit taxpayer guarantees before a crisis (Lee 2010). Many believe this whole situation could have been alleviated with stricter securities laws, and that this should start with reform inside the Federal Reserve itself (Greider, 2010).

So changes in AIG's risk management culture need to be implemented, and several regulatory reforms are in process. But there is a third factor, more subtle yet significant nonetheless. "In the run up to AIG's crisis, nearly every instrument of national policy was directed at enhancing the value of a single asset: housing. AIG was not alone in attempting to capitalize on what was, by near consensus, an important national goal. The unintended consequences of this policy have been profound and prolonged" (Lee 2010).

You can say that again. Only the future will tell if AIG, or the United States, will have learned and applied valuable lessons from this very expensive crisis.

References

- American International Group. (2008). 2008 Annual Report Data. Retrieved November 17, 2010, from <http://www.market-melange.com/wp-content/uploads/2010/07/AIG-FP-info.jpg>
- American International Group. (2010). Corporate governance. Retrieved November 11, 2010, from <http://www.aigcorporate.com/corpgovernance/index.html>
- Beattie, R. I. (2008, May 20). Ex-AIG CEO: Don't blame me for bonuses. *www.cbsnews.com*. Retrieved November 12, 2010, from <http://www.cbsnews.com/stories/2009/03/20/earlyshow/main4878528.shtml>
- Benoit, D., Holm, E. (2010, November 23). AIG, Treasury prepare for life after bailout. *www.foxbusiness.com*. Retrieved November 26, 2010, from <http://www.foxbusiness.com/markets/2010/11/23/aig-treasury-prepare-life-bailout/>
- Blodget, H. (2010, January 7). Tim Geithner's Fed ordered AIG to keep bailout details secret, emails show. *www.businessinsider.com*. Retrieved November 26, 2010, from <http://www.businessinsider.com/henry-blodget-tim-geithners-fed-ordered-aig-to-keep-bailout-details-secret-2010-1>
- Chicago Tribune (2009, March 18). Risky business. Retrieved November 16, 2010, from http://media.mcclatchydc.com/smedia/2009/03/18/17/219-20090318-AIG-downfall.large.prod_affiliate.91.jpg
- Clark, A. (2010, June 30). AIG crisis wasn't my fault, says Joseph Cassano. *www.guardian.co.uk*. Retrieved November 19, 2010, from <http://www.guardian.co.uk/business/2010/jun/30/aig-joseph-cassano-fault>

Financial Crisis Inquiry Commission (2010, June 30). [AIG's] Risk management. Retrieved November 25, 2010, from <http://www.fcic.gov/hearings/pdfs/2010-0630-AIG-Risk-Management.pdf>

Greider, W. (2010, August 6). The AIG bailout scandal. *www.thenation.com*. Retrieved November 26, 2010, from <http://www.thenation.com/article/153929/aig-bailout-scandal>

Hilsenrath, J. E., Karnitschnig, M., Plevin, L., & Solomon, D. (2008, September 16). U.S. to take over AIG in \$85 billion bailout; central banks inject cash as credit dries up. *www.wsj.com* Retrieved November 26, 2010, from <http://online.wsj.com/article/SB122156561931242905.html>

Hwang, I., Leising, M., & Son, H. (2010, June 30). Cassano defends AIG swaps, Lewis says 'We were wrong.' *www.businessweek.com*. Retrieved November 19, 2010, from <http://www.businessweek.com/news/2010-06-30/cassano-defends-aig-swaps-lewis-says-we-were-wrong-.html>

Lee, C. (2010, July 1). Testimony of C.K. Lee before the Financial Crisis Inquiry Commission. Retrieved November 26, 2010, from <http://www.fcic.gov/hearings/pdfs/2010-0701-Lee.pdf>

Merced, M., Dash, E. (2008, September 16). Industry efforts to rescue AIG said to falter. *New York Times*. Retrieved November 10, 2010, from <http://dealbook.blogs.nytimes.com/2008/09/16/industry-efforts-to-rescue-of-aig-said-to-falter/>

Morgenson, G. (2008, September 27). Behind insurer's crisis, blind eye to a web of risk. *New York Times*. Retrieved November 10, 2010, from <http://www.nytimes.com/2008/09/28/business/28melt.html>

- MSN.com. (2010). American International Group: Financial Statement. Retrieved November 11, 2010, from <http://moneycentral.msn.com/investor/invsub/results/statemnt.aspx?Symbol=AIG>
- Newcomb, P. (2008, March 24). Derivatives for dummies. *www.vanityfair.com*. Retrieved November 19, 2010, from <http://www.vanityfair.com/online/daily/2008/03/derivatives-for.html>
- O'Harrow Jr., R, Dennis, B. (2008, December 31). Downgrades and downfalls. *washingtonpost.com*. Retrieved November 24, 2010, from http://www.washingtonpost.com/wp-dyn/content/article/2008/12/30/AR2008123003431_pf.html
- Reuters. (2010). Profile: American International Group, Inc. (AIG.N). Retrieved November 10, 2010, from <http://www.reuters.com/finance/stocks/companyProfile?symbol=AIG.N&rpc=66>
- Roth, Z., Buchwalter, B. (2009, March 20). The rise and fall of AIG's financial products unit. *TPM.com*. Retrieved November 18, 2010, from http://tpmmuckraker.talkingpointsmemo.com/2009/03/the_rise_and_fall_of_aigs_financial_products_unit.php
- Roth, Z. (2009, March 27). Did Cassano shut out AIG risk officers? *TPM.com* Retrieved November 25, 2010, from http://tpmmuckraker.talkingpointsmemo.com/2009/03/did_cassano_shut_out_aig_risk_of_ficers.php
- Roth, Z. (2009, April 3). In letter to Liddy, lawmaker probes AIG risk practices. *TPM.com* Retrieved November 25, 2010, from

[http://tpmmuckraker.talkingpointsmemo.com/2009/04/in_letter_to_liddy_lawmaker_prob
es_aig_risk_practices.php](http://tpmmuckraker.talkingpointsmemo.com/2009/04/in_letter_to_liddy_lawmaker_prob
es_aig_risk_practices.php)

Son, H. (2009, August 21). Benmosche accepts AIG job after friend chides U.S. *Bloomberg*.

Retrieved November 12, 2010, from

http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aZ3xs_HDanKU

Son, H. (2010, January 7). Geithner's Fed told AIG to limit swaps disclosure (Update3).

www.bloomberg.com. Retrieved November 26, 2010, from

<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXIvW4igKV38>

Son, H. (2010, October 28). AIG Names miller to serve as interim CEO if needed. *Bloomberg*.

Retrieved November 12, 2010, from <http://www.bloomberg.com/news/2010-10-27/aig-designates-miller-to-serve-as-interim-ceo-if-benmosche-needs-to-leave.html>

The Economist. (2008, November 13). How AIG got Uncle Sam over a barrel. Retrieved

November 10, 2010, from

http://www.economist.com/finance/displaystory.cfm?story_id=12607251

The Financial Times Lexicon. (2010). TARP. *www.ft.com*. Retrieved November 26, 2010, from

<http://lexicon.ft.com/term.asp?t=TARP>

The New York Times. (2008, September 17). AIG's troubles and why they matter. *New York*

Times. Retrieved November 17, 2010, from

<http://www.nytimes.com/imagepages/2008/09/17/business/17aig.a1graphic.ready.html>

The New York Times. (2008). An insurance giant, brought down. *New York Times*. Retrieved

November 17, 2010, from <http://www.market-melange.com/wp-content/uploads/2010/07/AIG-FP-info.jpg>

The Wall Street Journal (2009, February 23). A bigger bite. *wsj.net* Retrieved November 16, 2010, from [http://s.wsj.net/public/resources/images/P1-](http://s.wsj.net/public/resources/images/P1-AO842_AIGjum_NS_20090223184418.gif)

[AO842_AIGjum_NS_20090223184418.gif](http://s.wsj.net/public/resources/images/P1-AO842_AIGjum_NS_20090223184418.gif)

The Wall Street Journal (2008, November 11). Big winners. *wsj.net* Retrieved November 16, 2010, from [http://s.wsj.net/public/resources/images/MI-](http://s.wsj.net/public/resources/images/MI-AT440B_COUNT_NS_20081111190136.gif)

[AT440B_COUNT_NS_20081111190136.gif](http://s.wsj.net/public/resources/images/MI-AT440B_COUNT_NS_20081111190136.gif)