**July 8, 2013**

# Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc.

## Introduction

Pursuant to section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Financial Stability Oversight Council (Council) has made a final determination that material financial distress at American International Group, Inc. (AIG) could pose a threat to U.S. financial stability and that AIG should be subject to supervision by the Board of Governors of the Federal Reserve System (Board of Governors) and enhanced prudential standards.

In reaching this determination, the Council carefully considered a broad range of information in light of the statutory factors set forth in section 113(a)(2) of the Dodd-Frank Act, both separately and in conjunction with each other. The Council has considered information available through existing public and regulatory sources, as well as information provided by AIG. The Council also consulted with AIG's primary financial regulatory agency, the Board of Governors, as well as regulators of certain of AIG's insurance subsidiaries. Certain of AIG's subsidiaries are also regulated by other Council member agencies.

On June 3, 2013, the Council made a proposed determination under section 113 of the Dodd-Frank Act that material financial distress at AIG could pose a threat to U.S. financial stability and that AIG should be subject to Board of Governors supervision and enhanced prudential standards. The Council provided AIG with an explanation of the basis for the Council's proposed determination. On July 3, 2013, the Council received a letter from AIG stating that AIG had chosen not to contest the Council's proposed determination.

Based on the Council's evaluation of all the facts of record in light of the factors that the Council is required to consider under section 113 of the Dodd-Frank Act and the Council's interpretive guidance regarding nonbank financial company determinations (Interpretive Guidance),[1] the Council has voted to make a final determination that material financial distress at AIG could pose a threat to U.S. financial stability and that AIG will be supervised by the Board of Governors and subject to enhanced prudential standards.

The Council's final determination does not constitute a conclusion that AIG is experiencing material financial distress. Rather, consistent with the statutory standard for determinations by the Council under section 113 of the Dodd-Frank Act, the Council has determined that material financial distress at the company, if it were to occur, could pose a threat to U.S. financial stability.

[1] 12 C.F.R. part 1310, app. A (2013).

## Summary

Because of AIG's size and interconnectedness, certain characteristics of its liabilities and products, the potential effects of a rapid liquidation of its assets, potential challenges with resolvability, as well as other factors described herein, material financial distress at AIG could cause an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy.

Prior to the onset of the financial crisis, the company expanded its operations to include non-insurance businesses. During the intensification of the financial crisis in the fall of 2008, AIG became the recipient of considerable government support, which was deemed necessary to avoid an even larger financial disruption.[2] While the company's strategy, funding profile, and global footprint have changed greatly since the financial crisis, AIG remains a large and complex company with meaningful non-insurance-related exposures.

AIG is the third largest insurance company in the United States, and one of the largest insurers in the world, operating across many different markets. The company underwrites life insurance, annuity products, consumer property/casualty insurance, and a wide range of more specialized, commercial insurance products through subsidiaries in numerous jurisdictions around the world. AIG has approximately 63,000 employees, and its incorporated subsidiaries operate from over 400 offices in the United States and from approximately 600 offices outside the United States.[3]

AIG's core insurance operations create exposures and liabilities that could affect its policyholders and those of other insurers if material financial distress at AIG leads to a broader loss of confidence across the industry. AIG's life and retirement business has over 18 million customers and holds hundreds of billions of dollars in reserves to satisfy the obligations created by its operations. Many of AIG's life insurance and annuity products, while intended to be long-term liabilities, have features that could make them vulnerable to rapid and early withdrawals by policyholders.

If the company's financial distress were sufficiently severe, funds from products allowing for early withdrawals might be withdrawn regardless of the size of associated surrender charges or tax penalties. A rapid liquidation of AIG's life insurance and annuity liabilities could strain AIG's liquidity resources and compel the company to liquidate a substantial portion of its large portfolio of relatively illiquid corporate and foreign bonds, as well as asset-backed securities (ABS). This asset liquidation could have disruptive effects on the broader financial markets and impair financial market functioning.

In addition to the direct effects of asset liquidation on financial markets, wide-ranging and rapid withdrawals by AIG policyholders and the associated deterioration of AIG's financial condition could cause financial contagion if the negative sentiment and uncertainty associated with

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[2] Many of the businesses into which AIG expanded created exposures to the U.S. housing market, which nearly bankrupted the organization during the financial crisis. Initiatives conducted by the Board of Governors, the Federal Reserve Bank of New York, and the U.S. Department of the Treasury ultimately stabilized AIG.
[3] AIG Annual Report on Form 10-K for the year ended December 31, 2012, pp. 29, 44.

material distress at AIG spreads to other insurers. In particular, if distress at AIG were to cause concern among policyholders at other insurers, those insurers could experience unanticipated increases in surrender activity that could strain liquidity resources, potentially impairing the financial condition of multiple insurers across the industry.

Numerous corporate and financial entities are exposed to AIG as counterparties and customers and could suffer significant losses in the event of material financial distress at AIG. Capital markets exposures to AIG arise through the company's outstanding securities, credit lines, derivatives liabilities, repurchase agreement transactions, and securities lending activities. While individual capital markets exposures to AIG may be relatively small, in the aggregate these exposures are potentially large enough that material financial distress at AIG could have a destabilizing effect on financial markets. These capital markets exposures could pose larger second-order and indirect risks to broader financial market functioning.

AIG is also the leading commercial insurance underwriter in the United States. It plays a major role in the provision of certain commercial insurance coverages that are highly capital intensive and difficult for policyholders to replace in a short timeframe.

The interstate and cross-border complexities involved in resolving a large organization such as AIG, particularly with insurer and non-insurer subsidiaries operating in multiple states and countries, increases the risk that such a resolution could be protracted or disorderly, increasing the possibility that material financial distress at AIG could pose a threat to the financial stability of the United States. These factors and others, in the context of AIG's size and complex structure, increase the obstacles to a rapid and orderly resolution of the company.

The Council has considered potential mitigants that could reduce the potential for material financial distress at AIG to be transmitted to other financial firms and markets, including the nature of certain insurance products and the significant efforts made by the company to simplify and restructure its core operations. However, based on the Council's evaluation of all the facts of record in light of the statutory factors that it is required to consider under the Dodd-Frank Act, the Council has concluded that material financial distress at AIG could cause an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy. Therefore, the Council has made a final determination that material financial distress at AIG could pose a threat to U.S. financial stability and that AIG should be subject to Board of Governors supervision and enhanced prudential standards.

## Determination that AIG is Predominantly Engaged in Financial Activities

The Council is authorized to determine that a "nonbank financial company" will be subject to supervision by the Board of Governors and enhanced prudential standards.[4] A company is a nonbank financial company, and thus eligible for a determination by the Council, if it is

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[4] See Dodd-Frank Act section 113, 12 U.S.C. § 5323.

predominantly engaged in financial activities, subject to certain exceptions.[5] For purposes of Title I of the Dodd-Frank Act, a company is "predominantly engaged in financial activities" if at least 85 percent of the company's and its subsidiaries' annual gross revenues are derived from, or at least 85 percent of the company's and its subsidiaries' consolidated assets are related to, "activities that are financial in nature" as defined in section 4(k) of the Bank Holding Company Act (BHC Act).[6]

AIG is a nonbank financial company and thus is eligible for a determination by the Council. Based on AIG's income statement for year-end 2012, more than 85 percent of AIG's revenues are derived from activities that are financial in nature. In addition, based on AIG's consolidated balance sheet as of year-end 2012, more than 85 percent of AIG's assets are related to activities that are financial in nature. These activities include insurance, lending, underwriting and dealing, investing and trading activities, and merchant banking activities.

**The Statutory Standard and the Legal Framework for a Final Determination**

Under section 113 of the Dodd-Frank Act, the Council may determine that a nonbank financial company will be supervised by the Board of Governors and be subject to enhanced prudential standards if the Council determines that (1) material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States (the First Determination Standard) or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to the financial stability of the United States (the Second Determination Standard).

The Council may subject a nonbank financial company to Board of Governors supervision and enhanced prudential standards if either the First or Second Determination Standard is met. The Council evaluated AIG under the First Determination Standard.

In considering whether to make a determination that a nonbank financial company shall be supervised by the Board of Governors and be subject to enhanced prudential standards, section 113 of the Dodd-Frank Act requires the Council to consider the following 10 statutory considerations:[7]

1. the extent of the leverage of the company;
2. the extent and nature of the off-balance-sheet exposures of the company;
3. the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
4. the importance of the company as a source of credit for households, businesses,

[5] Dodd-Frank Act section 102(a)(4), 12 U.S.C. § 5311(a)(4).
[6] Dodd-Frank Act section 102(a)(6), 12 U.S.C. § 5311(a)(6). The Board of Governors' Regulation PP describes activities that are financial in nature as defined in section 4(k) of the BHC Act and establishes the requirements for determining if a company is predominantly engaged in financial activities for purposes of Title I of the Dodd-Frank Act. See 78 Fed. Reg. 20756 (April 5, 2013) (to be codified at 12 C.F.R. part 242).
[7] The Council may also consider any other risk-related factors that it deems appropriate.

and State and local governments and as a source of liquidity for the United States financial system;

5. the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
6. the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
7. the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
8. the degree to which the company is already regulated by 1 or more primary financial regulatory agencies;
9. the amount and nature of the financial assets of the company; and
10. the amount and types of the liabilities of the company, including the degree of reliance on short-term funding.[8]

In considering whether material financial distress at AIG could pose a threat to U.S. financial stability, the Council considered each of the statutory considerations in section 113 of the Dodd-Frank Act, including the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of AIG. While the Council considered AIG's activities in evaluating AIG under the First Determination Standard, the Council did not consider whether the nature, scope, size, scale, concentration, interconnectedness, or mix of AIG's activities, absent material financial distress at AIG, could pose a threat to U.S. financial stability.

As noted in the Council's Interpretive Guidance, the Council will consider a "threat to the financial stability of the United States" to exist "if there would be an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy." The Interpretive Guidance also states that "material financial distress" exists "when a nonbank financial company is in imminent danger of insolvency or defaulting on its financial obligations."

In addition, the Interpretive Guidance states that for purposes of considering whether material financial distress at a nonbank financial company could pose a threat to U.S. financial stability, the Council intends to assess the impact of the company's material financial distress "in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment."

## Analysis of Potential Effects of Material Financial Distress at AIG

### *Consideration of Transmission Channels*

Consistent with the Dodd-Frank Act and the Interpretive Guidance, the Council evaluated the extent to which material financial distress at AIG could be transmitted to other financial firms

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[8] See Dodd-Frank Act section 113(a)(2), 12 U.S.C. § 5323(a)(2).

and markets and thereby pose a threat to U.S. financial stability through the following three transmission channels: (1) the exposures of creditors, counterparties, investors, and other market participants to AIG; (2) the liquidation of assets by AIG, which could trigger a fall in asset prices and thereby could significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings; and (3) the inability or unwillingness of AIG to provide a critical function or service relied upon by market participants and for which there are no ready substitutes. In evaluating whether material financial distress at AIG could be transmitted to other firms and markets through the transmission channels to a degree that could cause a broader impairment of financial intermediation or of financial market functioning, the Council has considered the statutory factors set forth in section 113 of the Dodd-Frank Act.

***Exposure Channel***

*A nonbank financial company's creditors, counterparties, investors, or other market participants have exposure to the nonbank financial company that is significant enough to materially impair those creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability.*

A large number of corporate and financial entities have significant exposures to AIG, in its capacity as a leading multi-line insurer, and could suffer losses in the event of material financial distress at AIG.[9] For example, AIG provides group annuities for private pension funds through its life insurance subsidiaries, and its institutional business lines offer stable value wrap products. If AIG were to experience material financial distress, the pension plan parties to these wrap contracts could be forced to write down their assets from book to market value, resulting in costs for the pension plan sponsors. AIG's retail policyholders, including over 18 million life insurance and retirement product customers in the United States,[10] could also suffer losses, which could lead them to withdraw the cash value of their policies in large numbers and create the potential for significant asset liquidation by AIG.

Although some policyholder losses would be mitigated by the state-based guaranty and security fund association system (GA System), the failure of AIG's insurance subsidiaries could put unprecedented strain on the system, particularly in the context of broader financial market stress, potentially exhausting its capacity to cover policyholders at other firms and undermining confidence in other insurers, particularly in the context of broader financial stress across the insurance industry.

[9] For this transmission channel, the Council has considered statutory considerations including the extent of AIG's leverage (Dodd-Frank Act section 113(a)(2)(A), 12 U.S.C. § 5323(a)(2)(A)); the extent and nature of its off-balance sheet exposures (Dodd-Frank Act section 113(a)(2)(B), 12 U.S.C. § 5323(a)(2)(B)); the extent and nature of AIG's transactions and relationships with other significant nonbank financial companies and significant bank holding companies (Dodd-Frank Act section 113(a)(2)(C), 12 U.S.C. § 5323(a)(2)(C)); the amount and nature of the financial assets of AIG (Dodd-Frank Act section 113(a)(2)(I), 12 U.S.C. § 5323(a)(2)(I)); the amount and types of AIG's liabilities, including the degree of AIG's reliance on short-term funding (Dodd-Frank Act section 113(a)(2)(J), 12 U.S.C. § 5323(a)(2)(J)); and the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of AIG (Dodd-Frank Act section 113(a)(2)(G), 12 U.S.C. § 5323(a)(2)(G)).

[10] AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 3.

AIG also has the potential to transmit material financial distress to the broader economy through direct and indirect capital markets exposures. These exposures include holders of AIG securities as well as derivatives, repurchase agreements, and securities lending counterparties. Individual exposures to AIG may be relatively small, but in the aggregate, the exposures are large enough that material financial distress at AIG, if it were to occur, could have a destabilizing effect on the financial markets. AIG also ranks as a significant reference entity for single-name and index credit default swaps (CDS) based on gross notional amount outstanding.

***Asset Liquidation Channel***

*A nonbank financial company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings.*

A key determinant of the potential for transmission of financial distress of an insurer is the liquidity characteristics of its liabilities.[11] Although AIG's life insurance and annuity product reserves for claim and benefit payments are generally considered to be long-term liabilities, a substantial portion of these liabilities are available for discretionary withdrawal with little or no penalty and therefore can effectively become short-term liabilities. A large number of withdrawals and surrenders within a short period of time could strain AIG's liquidity resources and compel the company to sell assets in order to meet its obligations to policyholders. The risk of a rapid liquidation of these liabilities would increase in the event that AIG experiences material financial distress, as concerns about the company's ability to meet future obligations could induce large numbers of policyholders and contract holders to accelerate the withdrawal of available cash.

In addition, AIG policyholders are entitled to take out loans against the cash values of certain life insurance and annuity policies. Many of these products are subject to tax, contractual, or other disincentives for early withdrawals, but these disincentives may not deter early withdrawals in the event of material financial distress at AIG. To meet the demand for greater than expected withdrawals, AIG would need to come up with a significant amount of cash in excess of current reserves. Because the value of highly liquid assets in AIG Life and Retirement subsidiaries is a small fraction of the value of AIG's potentially liquid liabilities, a severe and sudden liquidity stress could force AIG to sell assets in such significant volume that these asset sales would place downward pressure on prices in certain markets, and under more severe conditions, cause markets to seize up.

The effect of a liquidation of any significant portion of AIG's assets on the financial markets is likely to be even greater during a period of overall stress in the financial services industry and in a weak macroeconomic environment, when liquidity dries up and price swings can be magnified.

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[11] For this transmission channel, the Council has considered statutory considerations including the extent of AIG's leverage (Dodd-Frank Act section 113(a)(2)(A), 12 U.S.C. § 5323(a)(2)(A)); the amount and nature of the financial assets of AIG (Dodd-Frank Act section 113(a)(2)(I), 12 U.S.C. § 5323(a)(2)(I)); the amount and types of AIG's liabilities, including the degree of AIG's reliance on short-term funding (Dodd-Frank Act section 113(a)(2)(J), 12 U.S.C. § 5323(a)(2)(J)); and the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of AIG (Dodd-Frank Act section 113(a)(2)(G), 12 U.S.C. § 5323(a)(2)(G)).

Given the large size of AIG's investment portfolio, actions taken by the company to liquidate assets could have potentially large effects on the prices of those assets for other market participants and could disrupt the availability of funding in those markets.

Beyond the direct effect of AIG's asset liquidation on the financial markets, other insurance companies are also exposed to indirect effects if asset liquidation at AIG sparks a loss of confidence in the broader insurance industry, potentially leading to runs at other major insurers. The imposition of a stay on discretionary withdrawals could cause a similar loss of confidence, particularly if other insurers are also simultaneously experiencing financial distress.

***Critical Function or Service Channel***

*A nonbank financial company is no longer able or willing to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes.*

In evaluating the potential threat that material financial distress at AIG could pose to U.S. financial stability through the critical function or service channel, the Council has considered the extent to which AIG provides a critical function or service that is relied upon by market participants and for which there are no ready substitutes.[12]

AIG is the leading commercial insurance underwriter in the United States. While many large corporate clients have insurance programs that include coverage from multiple insurance providers, AIG's commercial insurance policies cover many of the largest U.S. corporations, including 98 percent of the Fortune 500.[13] The company has a significant presence in several lines of the commercial insurance business where competitors may not be able to promptly replace AIG coverages, particularly during a period of broader financial market stress. In particular, the specialized policies underwritten by AIG's excess and surplus lines insurers, and the associated balance sheet capacity, could be difficult for competitors to rapidly replace should AIG exit the market. The resulting decline in capital in the property/casualty insurance sector could reduce the availability and affordability of certain insurance products until the market's capital levels and broader capacity are able to readjust. AIG's exit from certain significant markets could aggravate the negative effects of material financial distress at AIG on the broader economy.

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[12] For this transmission channel, the Council has considered statutory considerations including the importance of AIG as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system (Dodd-Frank Act section 113(a)(2)(D), 12 U.S.C. § 5323(a)(2)(D); the importance of AIG as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities (Dodd-Frank Act section 113(a)(2)(E), 12 U.S.C. § 5323(a)(2)(E)); and the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of AIG (Dodd-Frank Act section 113(a)(2)(G), 12 U.S.C. § 5323(a)(2)(G)).

[13] "AIG Property Casualty Commercial Insurance" Investor Presentation, April 1, 2013, p. 4, http://www.aig.com/Chartis/internet/US/en/AIG%20Property%20Casualty%20Commercial%20Insurance%2004.01.2013_tcm3171-482966.pdf

## Existing Supervision and Regulation

In considering whether to make a final determination that material financial distress at AIG could pose a threat to U.S. financial stability and that AIG should be subject to Board of Governors supervision and enhanced prudential standards, the Council has considered the degree to which AIG is already regulated by one or more primary financial regulatory agencies.[14]

Incorporated in Delaware, AIG is currently a grandfathered unitary savings and loan holding company (SLHC) subject to consolidated supervision by the Board of Governors, and is permitted to engage in commercial activities under the governing statute for SLHCs, the Home Owners' Loan Act (HOLA). The Board of Governors became the appropriate federal banking agency for AIG on July 21, 2011, when authority over SLHCs was transferred to the Board of Governors from the Office of Thrift Supervision.

AIG's diverse subsidiaries are subject to supervision by dozens of U.S. and international regulators. For its insurance subsidiaries, the primary U.S. insurance regulators are the Texas Department of Insurance for its life insurance and annuity products businesses, the North Carolina Department of Insurance for its private mortgage insurance businesses, and the Pennsylvania Insurance Department and the New York Department of Financial Services for its property/casualty insurance businesses. AIG's non-insurance subsidiaries include a federal savings bank (regulated by the Office of the Comptroller of the Currency), broker-dealers (regulated by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority), and registered investment advisers (regulated by the SEC).

The Board of Governors has asserted its intention, to the greatest extent possible taking into account any unique characteristics of SLHCs and the requirements of the HOLA, to assess the condition, performance, and activities of SLHCs on a consolidated risk-based basis in a manner that is consistent with the Board of Governors' established risk-based approach regarding bank holding company supervision. Absent a determination by the Council regarding AIG, however, AIG would not be subject to the enhanced prudential standards required under sections 165 and 166 of the Dodd-Frank Act because these standards do not apply to SLHCs unless the Board of Governors separately applies these requirements to SLHCs. Furthermore, it is possible that in the future, certain companies may no longer be subject to the Board of Governors' authority if they successfully deregister as SLHCs. For example, if AIG were to deregister as an SLHC, even though its subsidiaries would remain subject to other regulatory regimes, the Board of Governors would no longer act as its consolidated supervisor.

A final determination by the Council under section 113 of the Dodd-Frank Act will allow the Board of Governors to apply a number of new requirements to AIG. These include the enhanced prudential standards required by sections 165 and 166 of the Dodd-Frank Act, which, among other things, will require the company to: (1) meet enhanced liquidity and capital standards; (2) undergo and report periodic stress tests; (3) adopt enhanced risk-management processes; (4) submit a resolution plan providing for its rapid and orderly resolution in the event of its material

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[14] See Dodd-Frank Act section 113(a)(2)(H), 12 U.S.C. § 5323(a)(2)(H).

financial distress or failure; and (5) provide for the early remediation of financial distress at the company on a consolidated basis. The enhanced prudential standards required by section 165 of the Dodd-Frank Act are in addition to the authority that the Board of Governors now has to supervise and regulate SLHCs under the HOLA and for the purpose of "prevent[ing] or mitigat[ing] risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions." In addition, the Board of Governors would have additional authorities with respect to the review of any proposals by AIG to expand its size or scope.

**Resolvability**

In considering whether to make a final determination that material financial distress at AIG could pose a threat to U.S. financial stability and that the company should be subject to Board of Governors supervision and enhanced prudential standards, the Council has considered whether the threat that material financial distress at AIG could pose to U.S. financial stability could be mitigated or aggravated by its complexity, the opacity of its operations, or its difficulty to resolve, consistent with the Interpretive Guidance. The Council has evaluated AIG's resolvability in light of all the facts of record. "Resolvability" refers to the ease or difficulty of successfully separating and liquidating, or otherwise disposing of, the company if it should fail.

AIG is a highly complex and interconnected diversified financial services organization operating in 130 countries.[15] The company's complicated organizational structure significantly increases the obstacles to a rapid and orderly resolution.[16] AIG's complexity increases the risk that material financial distress at AIG, if it occurred, could pose a threat to the financial stability of the United States and significantly decreases the likelihood of preserving its franchise value in a resolution scenario.

The interstate and cross-border complexities involved in liquidating a large organization with insurer and non-insurer subsidiaries operating in multiple states and countries include the coordination of numerous receivers and bankruptcy courts across multiple jurisdictions. In the event of an insolvency at one or more of AIG's insurance subsidiaries, various state-level receivers would have to disentangle a complex web of intercompany transactions, including loans and guarantees, reinsurance agreements, and pooled liquidity arrangements in a complicated process that would likely require significant time. A prolonged receivership process would increase the likelihood that customers of the failed insurer would suffer losses and experience delays in payment. These factors could increase uncertainty and generally erode the public's confidence in the insurance industry and potentially aggravate the threat posed to financial stability by material financial distress at AIG. An effort to achieve a coordinated resolution of AIG would require accommodations with each of its local supervisory authorities, as well as cooperation among a number of home and host jurisdiction supervisory authorities and

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[15] AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 2.

[16] It should be noted that some assets and businesses by their nature will take longer to wind down. "Rapid" as applied to these assets and businesses refers to the ability to timely implement a plan for resolving the company that calms markets and participants. By design, the winding down of a failed insurer's estate may take several years to accomplish while policyholder liabilities are paid off as they come due.

courts. There is currently no global regulatory framework for the resolution of cross-border financial conglomerates. The absence of such a global framework poses a significant obstacle to an orderly resolution of AIG, and could aggravate the risk that its material financial distress could pose a threat to U.S. financial stability.

A number of other factors could further complicate the resolution of AIG, including the company's intercompany guarantees and support agreements. In addition, the system of separate state insurance guaranty funds has never been tested by the insolvency of a life insurance company with the combined size and scope of AIG's subsidiaries. Based on all the facts of record, including information provided by AIG, the Council has determined that AIG's resolvability could aggravate the potential for its material financial distress to pose a threat to U.S. financial stability.

As noted above, a Council determination regarding AIG under section 113 of the Dodd-Frank Act will allow the Board of Governors to apply a number of new requirements to AIG, including a requirement that AIG submit a resolution plan providing for its rapid and orderly resolution in the event of its material financial distress or failure. While a company's resolution can be complicated by its complexity, the opacity of its operations, or other exacerbating factors, the Council believes that no firm should be protected from its own failure, and these statutory tools enable regulators to facilitate the orderly liquidation of a company.

**Evaluation of Statutory Considerations**

The following discussion describes and summarizes the Council's consideration of each of the statutory considerations in evaluating whether material financial distress at AIG could be transmitted through one or more of the transmission channels to other financial firms and markets to such a degree that there would be an impairment of financial intermediation or of financial market functioning sufficiently severe to inflict significant damage on the broader economy.

The Council considered ***the extent of AIG's leverage***. AIG's current leverage is lower than its leverage during the financial crisis. However, AIG's significant amount of debt in the context of this leverage creates meaningful exposures to counterparties and customers, potentially exacerbating the effects of fire sales. AIG's consolidated debt of approximately $48.5 billion represents the second-largest amount of consolidated debt among U.S. insurance company peers reviewed.[17]

The Council considered the ***extent and nature of AIG's off-balance-sheet exposures***. Derivatives are a source of off-balance-sheet exposure for AIG. AIG has approximately $215 billion of gross notional derivatives outstanding (as of year-end 2012).[18] AIG is a derivatives counterparty to large global banks. The banks exposed to AIG are also significant participants in

[17] AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 288. AIG's total debt figure of $48.5 billion is exclusive of International Lease Finance Corporation's (ILFC) debt, which AIG does not report in its year-end 2012 filings in light of the announced divestiture of this subsidiary.
[18] Id. at p. 277.

the global debt and derivatives markets and are some of the largest issuers of commercial paper and long-term debt. The off-balance-sheet exposures of those large global banks to AIG expose those banks to AIG in ways that could transmit material financial distress at AIG to them as well as to financial markets more broadly.

The Council considered ***the extent and nature of AIG's transactions and relationships with other significant nonbank financial companies and significant bank holding companies***. As described above, AIG has exposure to other financial firms and the financial system more broadly, and its interconnectedness in the financial system is a conduit for the transmission of the effects of its material financial distress. Specifically, AIG has a number of exposures to global systemically important banks.

The Council considered ***the importance of AIG as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system***. AIG's large balance sheet and reliance on long-term liabilities allow it to provide a substantial amount of credit to the U.S. economy. Specifically, as of December 31, 2012, AIG held approximately $152 billion in corporate debt and $36 billion in state and municipal debt.[19] The company also runs a commercial mortgage lending program, with exposures of $13.8 billion.[20]

The Council also considered ***the importance of AIG as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of AIG would have on the availability of credit in such communities***. While AIG is involved in the provision of credit to low-income, minority, or underserved communities, it does not appear to play an important role as a source of credit in these markets, and therefore, it appears that material financial distress at AIG would not have an appreciable impact on the availability of credit in such communities. However, in the event of material financial distress at AIG, the funding and building of low-income housing may be affected because AIG is the market leader in certain private mortgage insurance products and a major investor in affordable housing.

The Council also considered ***the extent to which assets are managed rather than owned by AIG, and the extent to which ownership of assets under management is diffuse***. The relevance of this factor to AIG is limited. If AIG were to experience material financial distress, its asset management business likely could be transferred to other asset managers, and therefore it is unlikely that AIG provides a critical function as a third-party asset manager.

The Council also considered ***the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of AIG***. AIG is a diversified financial conglomerate, a leading multi-line insurer, and one of the largest insurance companies in the world by equity capital.[21] It had a market capitalization of $52 billion and GAAP equity capital outstanding of $99 billion as of

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[19] Id. at p. 240.
[20] Id. at p. 149.
[21] Based on data aggregated by Bloomberg as of December 31, 2012, AIG is the largest insurer in the world by total equity after Berkshire Hathaway.

year-end 2012.[22] It also reported $48.5 billion in long-term debt outstanding, creating sizable exposure for bondholders.[23] Its activities in the capital markets entail exposures to a host of counterparties including financial entities, sovereigns, nonfinancial companies, special-purpose entities, municipalities, universities, pensions, and exchanges. Furthermore, other insurance industry participants are exposed to AIG through the assessment processes associated with state guaranty funds for life and health insurance companies and the security funds for property/casualty companies. Other insurance underwriters could be responsible for guaranteeing a portion of any unpaid insurance liabilities in the event that any of AIG's insurance companies becomes insolvent and assets are insufficient to meet policyholder obligations. In addition, AIG and its subsidiary ILFC are the reference entities for a combined $70 billion in notional single-name CDS, which is significant and comparable to several of the largest money-center banks, investment banks, bond insurers, and prime brokers.[24]

The Council also considered ***the degree to which AIG is already regulated by one or more primary financial regulatory agencies***. As discussed above, AIG's worldwide operations are subject to regulation by various regulatory authorities, including banking, insurance, securities, and investment advisory regulators in the United States and abroad. AIG is subject to consolidated supervision by the Board of Governors as a grandfathered unitary SLHC that is permitted to continue to engage in commercial activities. The Board of Governors has asserted its intention of taking into account, to the greatest extent possible, any unique characteristics of SLHCs and the requirements of the HOLA, to assess the condition, performance, and activities of SLHCs on a consolidated risk-based basis in a manner that is consistent with the Board of Governors' established risk-based approach regarding bank holding company supervision.[25]

The Council also considered ***the amount and nature of the financial assets of AIG***. In AIG's case, this involves not only the composition and size of its asset portfolio, but also available sources of liquidity at AIG's life insurance subsidiaries. Only assets within AIG Life and Retirement subsidiaries and the parent holding company would be available to meet liquidity needs arising from a run on AIG Life and Retirement products because assets on the books of other insurance company affiliates generally may not be transferred without regulatory approval. The value of highly liquid assets in AIG Life and Retirement subsidiaries is a small fraction of the value of AIG's potentially liquid liabilities. In times of severe stress, policyholders could surrender products at a higher-than-anticipated rate, creating liquidity challenges resulting in the potential need to sell large volumes of relatively illiquid assets over a short period of time. The sale of these assets could place downward pressure on prices in certain markets.

The Council also considered ***the amount and types of AIG's liabilities, including the degree of AIG's reliance on short-term funding***. As noted above, AIG has consolidated debt of

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[22] AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 204. Market capitalization per SNL Financial; as of December 31, 2012.
[23] AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 288. This figure excludes ILFC debt.
[24] Based on information provided by the Trade Information Warehouse
[25] See "Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies," 76 Fed. Reg. 22662 (April 22, 2011).

approximately $48.5 billion.[26] AIG is a leading multi-line insurer with exposures to policyholders and contract holders.[27] AIG's net liability for unpaid claims and claim adjustment expenses is approximately $88 billion and deposit contract obligations are approximately $127 billion.[28] AIG also accesses the short-term funding markets through repurchase agreements and securities lending. Although AIG's life insurance and annuity products reserves for claim and benefit payments are generally considered to be long-term liabilities, a substantial portion of these liabilities are available for discretionary withdrawal with little or no penalty and therefore can effectively become short-term liabilities.

## Conclusion

The Council has made a final determination that material financial distress at AIG could pose a threat to the financial stability of the United States and that AIG should be supervised by the Board of Governors and be subject to enhanced prudential standards.

[26] Excludes ILFC's debt, which AIG does not report in its year-end 2012 filings in light of the pending divestiture of this subsidiary. Inclusive of ILFC debt, this figure is approximately $73 billion. AIG Annual Report on Form 10-K for the year ended December 31, 2012, p. 288.
[27] Id. at p. 2.
[28] Id. at p. 204.