S&P Global
Market Intelligence

American International Group, Inc. NYSE:AIG

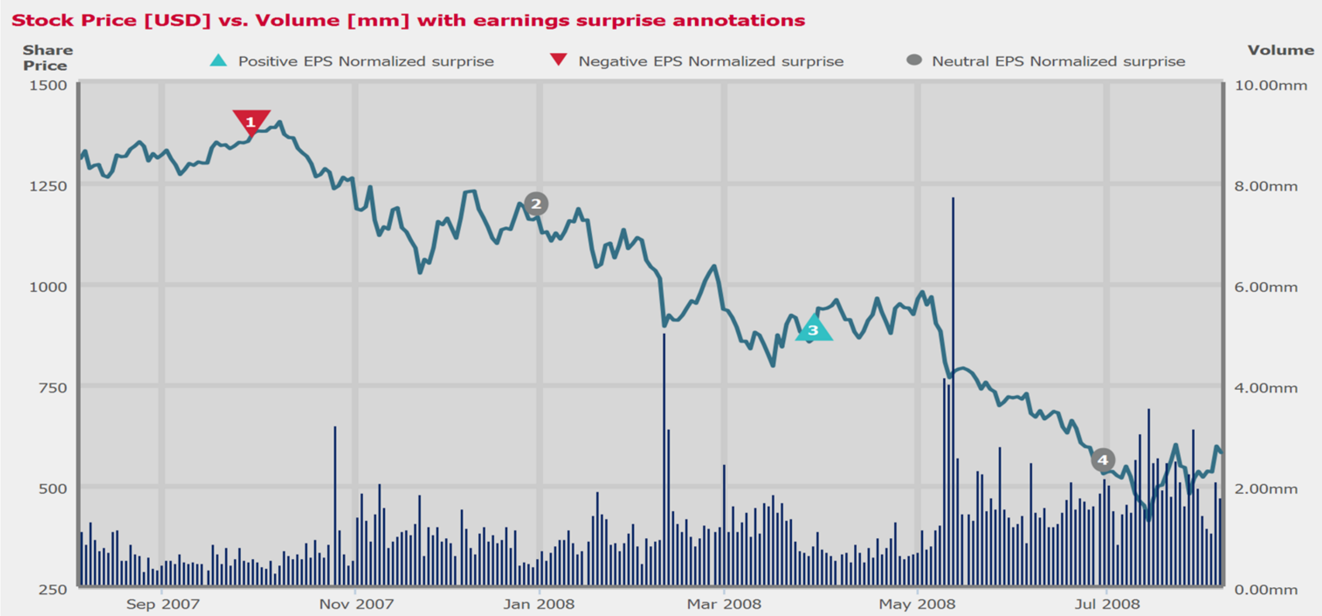
FQ3 2008 Earnings Call Transcripts

Monday, November 10, 2008 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(27.45)	(68.40)	NM	1.37	(46.73)	6.23
Revenue (mm)	-	-	-	-	71458.00	99900.00

Currency: USD
Consensus as of Nov-10-2008 11:37 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	32.46	28.80	1 (11.28 %)
FQ4 2007	(2.91)	(25.00)	NM
FQ1 2008	11.14	18.60	2 93.15 %
FQ2 2008	14.24	(10.20)	NM

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Call Participants

EXECUTIVES

Charlene M. Hamrah

Christopher J. Swift

David L. Herzog

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Edward M. Liddy

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ANALYSTS

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UBS

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Citadel Investment Group

Jimmy Bhullar
JPMorgan

John Levin
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Ron Bobman
Capital Returns

Scott Frost
HSBC

Thomas Gallagher
Credit Suisse

Unidentified Analyst

Presentation

Operator

Welcome and thank you for standing by. At this time, all participants are in a listen-only mode until the question-and-answer period. [Operator Instructions]. Today's conference is bring recorded, if you have any objections you may disconnect at this time.

Now, I would like to turn the meeting over to your host for today's call Director of Investor Relations, Ms. Charlene Hamrah. Ma'am you may begin.

Charlene M. Hamrah

Thank you. Good morning and thank you for joining us for this morning's conference call. Before we begin, it should be noted that the remarks made today may contain projections concerning certain financial information and statements concerning future economic performance and events, plans and objectives relating to special purpose vehicles formed with the Federal Reserve Bank of New York. As such dispositions, liquidity, collateral posting requirements, management operations, products and services and assumptions underlying these projections and statements. It is possible that AIG's actual results and financial condition may differ possibly materially, from the anticipated results and financial condition indicated in these projections and statements.

Factors that could cause AIG's actual results to differ, possibly materially from those in the specific projections and statements include developments in global credit markets and such factors as are discussed in Item 1A, Risk Factors, of AIG's Annual Report on Form 10-K for the year ended December 31, 2007, and in Item 1A, Risk Factors, and Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations of AIG's quarterly report on Form 10-Q for the period ended September 30, 2008.

AIG is not under any obligation and expressly disclaims any such obligation to update or alter its projections and other statements whether as a result of new information, future events, or otherwise.

Remarks made on the conference call may also contain certain non-GAAP financial measures. The reconciliation of such measures to the comparable GAAP figures will be included in the third quarter financial supplement available in the Investor section of AIG's corporate website.

And now, I would like to turn the call over to Ed Liddy, AIG's Chairman and CEO.

Edward M. Liddy

Thanks and good morning everyone. We have a really an awful lot to cover this morning so bear with us; we are going to try to do all this in about an hour. I think that will leave time for many of your questions if we don't get to them, I invite you to call Charlene at the conclusion of the meeting.

Sorry all for the play traffic, but if you turn off all Blackberries and things like that near your phones; it will make it possible for everyone else to hear.

On October 3rd, scant five weeks ago, sometimes, it seems like five years, I laid out an initial game plan to address AIG's immediate liquidity problems, to divest assets to repay the government loan, to refocus AIG on its historic strengths, and to restore the company to profitability.

At that point, there were a number of unresolved issues that still needed to be addressed. We've been hard at work since then and that work has resulted in the very comprehensive plan we announced this morning in conjunction with the U.S. Treasury, the Federal; Reserve Board, and the Federal Reserve Bank of New York.

We believe this plan is win - win. It sends a strong signal to our policyholders, to governments and the regulators around the world to our business party... partners and counterparties that AIG is in fact on the road to recovery. It gives us a durable capital structure both now and in the future. It addresses the liquidity issues that have threatened AIG. It gives us greater financial flexibility to complete our restructuring for the benefit of all our constituencies.

It gives U.S. tax payers a very attractive return on preferred stock, and debt investments in AIG as well as the potential for gains on asset purchases and the future appreciation in AIG common shares which they own. This plan represents a substantial progress over the past six weeks its part of a multi-year journey of which today is really is the second milestone. The third milestone will be the business divestitures and I will talk a little bit more about those in a moment.

The subsequent phases of our plan will include appropriately recapitalizing the company after the federal credit facility is paid down. So all investors should recognize that this would be a several year process tied in no small part to the recovery of financial markets around the world. But importantly, following the restructuring transactions we are announcing today, we will have the stability to restore confidence in our global franchise. Business partners and customers can confidently continue to place business with us.

Before I go into the details of the restructuring plan and AIG's third quarter results, I want to take this opportunity to clarify certain facts that may have been inaccurately characterized or may have been quite simply misunderstood. I know that many of you have tried to piece together information from different sources to understand the big picture. Our goal on this call is to give you the information you need to clearly understand the plan announced today in its totality as well as each of its components. There is also a substantial amount of detail in our 10-Q which was released this morning.

Now, in particular I'd like to focus on just a couple of key points.

First, our indebtedness to the Federal Reserve Bank of New York under the original bridge loan currently stands at $61 billion. There have been reports citing indebtedness as high as $123 billion. To get to this number commentators are adding together the $85 billion of total capacity available under the bridge loan and the $37.8 billion available will not currently borrowed under the securities lending facility.

We do have 19.9 billion outstanding under that facility but the Federal Reserve Bank of New York holds collateral in the form of third party investment grade securities from our portfolio. So it's apples and oranges that are being compared here. As evidence of why the two amounts should not be added together, the Federal Reserve is now providing an alternate mechanism that will completely extinguish the $37.8 billion facility.

Second, the terms of the restructuring are commercial in nature. All of the facilities being provided by the U.S. government are at market rates.

Third, as we anticipated to undertake such a dramatic restructuring of the company's businesses, our quarterly earnings are showing, and may continue to exhibit substantial volatility reflecting the unprecedented conditions in global financial markets. Nevertheless, there is stability in our underlying insurance business not withstanding catastrophe losses in competitive market conditions. Our insurance companies remain disciplined in their underwriting, they are well capitalized and they continue to meet or exceed all regulatory requirements.

Last, because these businesses remain strong, disciplined, well sequenced process of divestitures has been undertaken. The interest of the tax payers as well as the shareholders and bondholders of AIG will be best served by our ability to offer our remarkable assets for sale as market conditions permit.

We expect to announce several key dispositions this year, proving that good deals can get done in this marketplace. But while we will report our progress and announce deals, we will not share a specific schedule for divestitures.

Now, let me turn to our discussion of the plan. This plan is designed to accomplish a number of objectives. It creates a durable capital structure for AIG with new equity capital and substantially reduced debt. These are good things.

The terms of the debt are restructured to give AIG a lower cost of capital as well as some financing breathing room. The plan directly addresses our securities lending and multi-sector CDO issues. It puts

AIG in a much better position to successfully execute our divestiture plan and to emerge as a global insurance company.

The plan addresses all of these issues while giving tax payers both an attractive current return on their investment in AIG and the potential for upside from the assets purchased from AIG and in AIG common stock. It is not exactly a bailout.

Let me walk you through the current funding sources and how they will change as a result of the restructuring.

I think you know when I just hinted at or mentioned there are three components of the current structure. First, we presently have an $85 billion, two-year bridge loan facility from the Federal Reserve Bank in New York against which $61 billion is currently outstanding. That $61 billion carries a LIBOR plus 8.5 and the commitment fee of 2% and the fee on the undrawn portion of 8.5%. Clearly, these terms are not sustainable.

Second, we have $37.8 billion securities lending facility from the Federal Reserve of New York, with $19.9 billion currently outstanding and as noted earlier this amount is fully collateralized, it's a liquidity facility not a loan.

Third, we are participating in the government's commercial paper funding facility, that's a temporary facility designed to restore liquidity in the commercial paper market. We have an approved line of $20.9 billion, with $8 billion currently outstanding. Note that this is a broadly available program, not a program specific to AIG. Many of America's largest companies are also participating in this program because the commercial paper market simply is not working.

The next slide provides a schematic of the comprehensive plan we've announced today. What I think about this plan is as a combination of ongoing financing, which is shown on the top part of the page; and one-time transactions, which are shown on the bottom half.

Let's start with the ongoing financing that has several components. First, the U.S. Treasury will purchase $40 billion of newly issued AIG preferred stock. The preferred has a 10% coupon. All the proceeds will be used to pay down a portion of the Federal Reserve credit facility that is currently outstanding.

Second, the size of the current credit facility will be amended to reduce the capacity from 85 billion to 60 billion. Its terms will be extended from two years to five years and the interest rate and fee on undrawn portions will be reduced to LIBOR plus 3% on the drawn portion, which will be approximately $21 billion at the outset, and the fee on the undrawn portion will be reduced to 0.75%.

Third, AIG will continue to participate in the commercial paper funding facility. That's the ongoing portion. On the bottom of the slide, are diagrams of two one-time transactions we will undertake in partnership with the Federal Reserve. These transactions are designed to address our liquidity issues related to securities lending in multi-sector CDSs.

And the last is the securities lending solution, and first just let me remind you how the problem developed and then discuss the solution.

In our securities lending program AIG, like most institutional investors lends securities from our portfolios to third parties who will give us cash collateral in return. We invest the cash collateral for the term of the loan. Much of the collateral was invested in residential mortgage-backed securities. With the turmoil in the housing and mortgage markets, these RMBSs have declined sharply in price to levels well below those implied by the underlying cash flows they are producing.

When securities lending trades expire or are unwound, we have to return cash to our counterparties, in this case the combination of an ill-liquid market for RMBSs and the attended market value pressures resulted in unprecedented liquidity pressures. This has been a major source of our liquidity short falls.

To address this issue, we and the Federal Reserve Bank of New York are creating a new financing entity that will be capitalized with $1 billion of funding from AIG and up to $22.5 billion of funding from the

Federal Reserve. This entity will acquire substantially all of the RMBSs from AIG's securities lending program.

It's really important that you note, as a result of this transaction, AIG's remaining exposure to losses from its U.S. securities lending program will be limited to declines in market value prior to the closing of this entity and our $1 billion of funding.

Similarly, on the bottom right hand portion of slide 3, there is a diagram of our solution to the multi-sector credit default swap issue.

Again let me summarize how the problem developed, then explain how the solution addresses the problem. AIG has written credit default swaps against collateralized debt obligations or CDOs which our securities backed by pools of debt.

Our credit default swap is essentially an insurance policy which reimburses the holder of the CDO for specified covered events. There are two problems that have developed with our CDSs. First, even though defaults on the securities and loans in the underlying pools haven't risen to levels that have required us to incur significant credit losses, the market prices of the underlying CDOs have declined sharply. As a result, we've been required to write-down our CDS positions. This write-down has caused hits to AIG's equity, which in turn contributed to credit ratings downgrades.

Second, our credit default swap contracts also specify that under certain conditions, we have to post cash collateral to our counterparties. This confluence of events has been particularly acute in our multi-sector credit default swaps, which account for less than 25% of our total swap portfolio, but about 95% of our write-downs.

So to address this issue, we and the Federal Reserve Board will create a second financing entity that will purchase up to approximately $70 billion face amount of multi-sector CDOs on which AIG has written credit default swaps. As I mentioned approximately 95% of the write-downs AIG financial products has taken to-date is in its CDS portfolio, these were the ones related to the multi-sector CDO. AIG will provide up to $5 billion in subordinated funding, and the Federal Reserve will provide up to $30 billion in senior funding to the financing entities.

The CDS contracts will be terminated on multi-sector CDOs that are purchased, and again importantly as a result of this transaction AIG's remaining exposure to losses will be limited to declines in market values of multi-sector CDOs prior to the pricing date of establishing this entity and to our... up to $5 billion funding.

Now, AIG will continue to have exposure to CDS contracts on multi-sector CDOs that are not terminated, and as AIG winds down its financial products division, it will also have exposure to other types of remaining CDS contracts, but these have generated substantially smaller total collateral demands than the CDSs in our multi-sector CDOs.

So to sum up, the plan we announced today represents a significant step forward for AIG. We still have a lot of work to do to execute this plan. And ultimately, transition to a restructured and recapitalized AIG. But, today's agreements put us in an improved position to succeed and emerge as a focused profitable global insurance company.

Before moving on to earnings, let me briefly turn you to slide 4. I will dwell on this slide, but I will merely offer this perspective. The American tax payer has and will be offered considerable returns as a result of the restructuring of AIG.

Now, let's turn to a review of third quarter results. Dave Herzog is going to take you through the numbers in a minute but first, I want to give you some perspective on the quarter. The loss we've reported reflects a confluence of really unprecedented events, rather than the core earnings power of AIG's insurance businesses.

The strengths of our global franchise allowed us to continue to write significant amounts of new business this quarter. Despite financial market turmoil, continuing price competition in property casualty and all of negative publicity about AIG, our consolidated premiums and other considerations were still $21 billion, up almost 7% from last year. Foreign General had a strong quarter with net premiums written up 11.5%. In Domestic Life, premiums, deposits and other considerations were up nearly 14%.

We did see some top-line pressure in the domestic commercial insurance business and Chris will have a couple of comments on that in a few moments. This reflected market concerns following the September 6th announcement as well as our decision, which we communicated to our brokers that we would maintain underwriting discipline and markets, where rates were not adequate to generate appropriate returns.

There are now indications that the situation in commercial insurance begin to stabilize in October and our prices are gaining traction in the market. All of our insurance businesses are making a concerted effort to get in front of customers and brokers to address their concerns.

Today's announcement should alleviate many of those concerns and put our businesses in a much better position going forward. Nevertheless, AIG's exposure to the U.S. housing market and associated financial instruments has materially undermined our financial performance.

And now let me turn it over to Dave Herzog, who will take you through the significant items affecting reported earnings in the quarter. Dave?

David L. Herzog

Thanks Ed and good morning, everyone. AIG reported the third quarter loss of over $24 billion after making the usual adjustments for net realized capital gains or losses and FAS 133, our adjusted net loss for the quarter was $9.2 billion. This is the largest quarterly loss we've ever reported and it reflects the extreme dislocations and volatility in the capital markets and significant charges related to restructuring activities that I will comment on more in a minute as well as catastrophe losses.

First, with respect to realized capital losses which totaled $18.3 billion before tax. The primary driver was other than temporary impairment charges of about 19.9 billion before tax. Securities lending related OTTI amounted to roughly 11.7 billion of which almost 7 billion stems from our decision to change our intent to hold such securities in light of the solutions that are announced this morning. More detailed discussion of the OTTI charges is included in our Form 10-Q that we filed this morning.

There is a table on page 2 of the earnings release which is also included as an appendix to the earnings presentation. This table details the major items affected both reported and adjusted earnings for the quarter. These items are also discussed in more detail in our Form 10-Q. In the interest of time I am not going to describe each of the items in the table. If you would like more information, once you've had a chance to review our 10-Q, again, please feel free to contact our Investor Relations.

I think it's helpful to think about these charges in three broad categories. The first category relates to capital markets disruption. The biggest item in this category is the $7.5 billion charge related to AIGFP, mostly due to the marks on the credit default swap portfolio. The restructuring plan we announced this morning will limit losses on this portion of the AIGFP portfolio and Ed described that earlier.

The second category is charges related to restructuring activities. The largest item in this category is a provision for deferred income taxes related to certain of our foreign businesses for sale, but we can no longer assert for tax purposes that we will reinvest profits and definitely in tax jurisdictions outside the U.S. As a result we've recorded a charge of about $3.6 billion.

The third category includes other noteworthy items the largest of which is our catastrophe losses related to hurricanes Gustav and Ike, totaling about $1.4 billion. Given the industries Cat loss this season this loss is inline with the industry.

And finally, I wanted to mention the $23 billion increase to additional paying capital, this represents the fair value of consideration received for preferred stock but not yet issued in conjunction with the entering of the Fed credit facility.

And with that I will turn it back over to Ed.

Edward M. Liddy

As you know back in... on October 3rd we announced what we would look like when we emerge from this crisis and we will emerge from it. And that is we would have a Foreign Gen business or commercial insurance and a continuing ownership interest in AIA. I thought what I would do is ask Chris Moore [ph] and Nick Walsh to talk about the commercial insurance and foreign gen. The only reason we are not talking about AIA or any of the other businesses is that all of those businesses are either in total or in part for sale and I thought it wise to simply not go into those conservations.

So first let me turn it over to Chris [ph] for couple of comments on the commercial insurance business.

Unidentified Company Representative

Thank you, Ed. I appreciate this opportunity to discuss with you the state of our commercial insurance operations. There has been misinformation about the performance of these businesses in the marketplace, but I am happy to report the facts to you today.

There is no doubt that the days surrounding September 16th were difficult, but thanks to the extraordinary efforts of commercial insurance employees, our businesses have performed well. The tremendous support from the insurance brokerage community and our many customers has been gratifying.

In the two weeks after September 16th, we were able to speak to tens of thousands of brokers and customers to address their most immediate concerns with the following facts. First, commercial insurance maintains an exceptionally strong financial position, distinguished by its highest statutory policyholder surplus among its U.S. peers.

Second, our investment portfolio is conservative. Third, no part of commercial insurance is for sale. And fourth, policyholder interests are protected by state regulators, who have made strong public statements supporting our financial strength.

These efforts have helped us retain a vast majority of accounts. In September, account retention was down approximately 6.5% compared to September 2007. October's retention was down modestly from the previous October and that variance improved from September.

New business writings year-to-date through August has been declining approximately 20% from our delivered decision to maintain underwriting discipline in competitive market conditions. In September, new business was down an additional 10%. October was consistent with September.

That said, we continue to write a substantial amount of new business in both months.

While it's true that our counsel market as they have always been, it is also true that our franchise is intact and we continue to retain and win business, which speaks volumes about the extent of our offerings and depth of our customer relationships.

I want to make an additional point very clear; commercial insurance is not sacrificing underwriting integrities to retain market share. In fact, our actuarial report shows that year-to-date rate change through September was a negative 10%, while key indicators for October confirmed several points of rate improvement compared to September.

Terms and conditions continue to remain stable. I believe that allegations of excessive price cutting are coming from certain carriers frustrated of their inability to win significant market share from us.

Thankfully, customers continue to choose to do business with commercial insurance, because of our unique market strengths, which are not easily replicated and include a strong balance sheet, the broadest product selection with over 450 products and services and innovative culture, its worth noting that we launched 40 new products and services since September 16th. Commitment of these... 40 years of experience in most complex lines such as property, D&O and excess casualty, a large and experienced in-house claim staff, and AIG service infrastructure that regularly engages customers around the globe.

But perhaps the greatest of advantage is our over 12,000 dedicated professionals. It is not surprising that this seasoned staff is highly sought after by competitors. Of the more than 700 employees in the senior manager ranks, recent turnover is less than 6 %. Any open positions have been quickly and suitably filled. It is our top priority to ensure a bright future for all employees, and we have a number of initiatives in place to just to do just that.

We know full well that our business and people are highly valued by competitors. This is not new given our decades long leadership in the industry. However, I truly believe that out team continues to prove itself they are fighters. Our results and key performance indicators support the fact that out business is strong and we maintain a leading market position though we will not relax, we will continue to earn our customers business every single day.

Finally, with the changes announced today by AIG I believe that our greatest remaining challenge the uncertainty of our parent's financial situation will be behind us, and we will be free to compete on the merits of this great franchise. Nick?

Nicholas C. Walsh

As revenue where markets it's important point to remember that the Foreign Gen portfolio is well balanced with approximately half of our business coming from commercial, and half from consumer alliance. There is obviously a different pricing dynamic between these two segments with much of consumer lines being much less sensitive to rate movements and market volatility.

Turning specifically to the third quarter results Foreign Gen delivered an underwriting profit of $99 million or the 96.7 combined, excluding the impact of the unusually high level of catastrophe losses, the underwriting profit was 232 million at a 92 - 97% combined. This compares with combined ratio of 88.78 in the third quarter of '07.

With regard to rate movements, we've always been known and are still known for our superior technical underwriting discipline and capability. We have maintained our discipline over the years, and have not changed this in the current environment. For Commercial Alliance business, the market remains broadly soft, and in most regions rate reductions average around 10%.

We will continue to service our customers and deliver world-class underwriting results with the desirable combined ratio. Our business retention remains strong, even exceeding 90% in some areas. We are achieving this by the support and loyalty of our long-term partners, customers, intermediaries and sponsors. Not by cutting rates despite the claims of certain competitors and despite competitor attempts to restrict our access to business and deprive customers of choice.

We are maintaining the right technical pricing as we have always done. At the same time our new business is down in some areas, we are winning new business and growing our base in a number of regions.

For example, we had two record weeks for sales in AIG and AIG direct consumer lines business in October and despite the attacks on our D&O book, we also managed to close a new trophy D&O accounts in Germany. With strategy and competition is price, there are examples of companies offering the assumption of portfolios blind at a big rate discount. This is flattering to our underwriting process.

Price appears to be their only differentiator as we are not beatable on service, breadth of product or professional claims response. Our stock turnover is close to normal levels due to our bench strength, we have instantly been able to replace the few senior people who left, with very experienced and capable business leaders, despite the recent events we are still hiring new people to support our global franchise, retention and growth strategies.

We have had a continuous dialogue with our regulators around the world who have been very supportive. They are doing their job and making sure the policyholders are protected and we are fully cooperating with their requests.

In summary, the core Foreign Gen insurance operations once again produced good top-line growth and an underwriting profit, despite the unusually high level of catastrophe losses. Unprecedented conditions in the financial markets impacted our results, nevertheless we remain committed to our growth strategies and look forward to continuing to serve our customers and producers around the world. Thanks.

David L. Herzog

Nick, this is David, I just want to amplify on a point I made earlier. The borrowings under the commercial paper funding facility as of November 5th splitted 15.2 billion. Ed?

Edward M. Liddy

Okay. We are ready to take your questions. It will make great sense if we kind of divide the Q&A into two sessions. Let's first take any questions you might have about the announcement we had with the U.S. Treasury and the Federal Reserve and then we will save time for any questions and answers that you might have with respect to our results for the third quarter. Charlene I am not quite sure how to do that. I don't want to lose their place in line. We'll try not to make that happen, but let's again, let's start with first any questions you might have regarding the relationships with the U.S. government entities. So first question.
Question And Answer

Question and Answer

Operator

Thank you, sir. [Operator Instructions]. Our first question is from John Levin, with Levin Capital. Your line is open.

John Levin
Levin Capital

Hi, Mr. Liddy, John Levin. Thank you very much for recognizing me. I think that Dave's announcement is absolutely a step in the right direction for which I absolutely congratulate you for. That is not had any comment about all the other aspects of the process that have occurred, but the conceptual question would be this, with the many change in this process, from the beginning. It seems to me that the outcome is uncertain because the financial markets and the marks, not just losses but so much could change depending on mortgages, that it will be desirable to have the federal government looks like this transfer of 25 or 30 or $35 billion to the federal government. So that their outcome would also be tiered such that they would get 10 or 15 billion back, maybe the first 10 or 15 but if the equity turned to be out hugely valuable, it will be scaled since the government interest came down a 60% or 40% or 30%. My point is some scaling, which seem to be appropriate given the variables?

Edward M. Liddy

John, I guess I have two comments. First, you are correct. I very much view this as a journey and this is kind of the second or third stop on that journey and it's a good stop.

John Levin
Levin Capital

I agree.

Edward M. Liddy

The journey is going to go through some uncharted waters called what happens to the liquidity in the financial marketplace. It is really a confused place right now. We have not given up all the upside on the credit default swap or on the RMBSs. With respect to the securities lending program, we have about a sixth of the upside and with respect to the credit default swaps, we retain about a third of the upside, so that, as things get better, which I would project at some point in time they will, the government will do well and we will do well.

If we were... if on this phone call, we were all wealthy men and wealthy women, we would buy these RMBSs. The government can afford to hold these things for a long time. So if they buy them at $0.60 or $0.50 or $0.40 on the $1, these are for the most part performing loans. If you just hold them to duration, you are going to do very, very well. If the marketplace recovers, you are going to do very, very well. So the government I think is very, very smart in what it's doing. We have not... we are not totally precluded from participating in that upside.

John Levin
Levin Capital

But the 79% ownership is the huge equity transfer value here that I would hope could possibly be scaled with the kind of look back depending on results?

Edward M. Liddy

Yes, John right now, the deal is... what the deal is, not fixed in concrete forever. As you can see the movement we made from the first transaction to the second one, is a rather quantum improvement. We'll continue to do everything we can to put AIG in the best possible position. What these two arrangements do is they stop the cash out flows for the most part.

John Levin
Levin Capital

I agree with you and congratulate you on that.

Edward M. Liddy

Thank you. Next.

Operator

Our next question is from Andrew Kligerman with UBS. Your line is open.

Andrew Kligerman
UBS

Yes, great couple of quick questions. First what assets are still not on the table for sale? Could you just reconfirm... reaffirm that?

Edward M. Liddy

Yes, our commercial insurance let's say primarily in the U.S. are fine general insurance, and we'd like to maintain a majority ownership interest in AIA.

Andrew Kligerman
UBS

Okay so that still stands.

Edward M. Liddy

I am sorry Andrew let me just be very clear on that. We have no new announcement today on what this company will look like when we emerge from this crisis or what assets are for sale. We are absolutely spot on consistent with the way we were back in the beginning of October.

Andrew Kligerman
UBS

And then with regard to the CDS you said that your losses on CDS would be limited to the amount that you have taken already. Now, should the government buy in the underling CDOs... and it seems like they [ph] will on most of these multi-sector CDOs. It seems there is a good chance that overtime you could reverse those charges. Is that correct?

Edward M. Liddy

David?

David L. Herzog

Andrew, good morning, it's David. The way that the structure will work as I had described we will earn a return on the equity that we've invested in the vehicle will then share as I had described in the upside of that. So you are correct in that we will participate in the upside.

Andrew Kligerman
UBS

I know but David, what I meant is on the insurance company's balance sheet or the holding company's balance sheet you these CDS in AIG financial product. Overtime, those marks that you've taken, I think its 30 billion in the aggregates to date could be reversed. Is that correct?

David L. Herzog

Yes, that is not correct. We will settle the credit default swap liability by this transaction. Our upside participation will be in through the subordinated funding vehicle that we are providing to the new structure.

Andrew Kligerman
UBS

Got it. In terms of employee retention I think I heard that retention was pretty good in the Foreign General, P&C operation... excuse me if I missed it but how is retention in the U.S. operations and domestic general and P&C?

Edward M. Liddy

Andrew, you missed it because it's such an important point.

Andrew Kligerman
UBS

Sorry about that.

Edward M. Liddy

I will have ask Chris [ph] to repeat it.

Andrew Kligerman
UBS

Okay.

Unidentified Company Representative

Yes, Andrew, as I said it before, over 700 senior management ranks, turnover is less than 6% and we have about 12,000 counted and sort after professionals in our organization domestically.

Andrew Kligerman
UBS

Okay. And then, just the last question on the life and, the life insurance operations, I saw that, that you said premiums and deposits were up 14% last quarter. How about October, are we looking up or down or in sideways?

Edward M. Liddy

We're not going there, Andrew, We're not talking about October, we're just talking about third quarter results.

Andrew Kligerman
UBS

All right. Thank you.

Operator

Our next question is from Michael Bearing [ph] with Banc of America. Your line is open.

Unidentified Analyst

Thank you, gentlemen. First, a point of clarification, when we start to talk about CDO LLC, this is not a direct commutation of the CDS, but instead it's a purchase of the underlying CDO upon which the CDS would be terminated?

The second question is who is going to be driving the negotiations with the CDO counterparties in CDO LLC, and who is the ultimate decision maker in terms of price point?

And then one other point to clarification, I'm looking at slide 5 here, is that $35 billion available to go and buy the CDOs or is this 70 billion, the 70 billion being the difference between 35 of equity fund... of funding and the 35 of collateral postings? Thanks.

Edward M. Liddy

Michael, I'm going to do the middle of those two, and Dave will do the other two. The Federal Reserve, and its rather substantial influence will be the driver of the negotiations with the counterparties, and we would expect that they will have substantially more success with those discussion than we had.

With respect to your first and third point, Dave, you want to go through that?

David L. Herzog

Sure, the funding, we're in fact, the vehicle is in fact purchasing the CDO and the and the CDS will be... if you will torn up as a result.

Unidentified Analyst

Okay.

David L. Herzog

And then with respect to the amount of funds available it would be sufficient to purchase the CDO with the negotiated price that I had just referred to?

Unidentified Analyst

And again is there 35 billion available to purchase CDOs or 70?

David L. Herzog

It's 35, but there is again part of the proceeds from the collateral that we have already posted will likewise help fund that.

Unidentified Analyst

Okay. And I guess the reason for the confusion here is that it doesn't seem at least to us that these things are worth anywhere near par. So if you had to purchase 70 billion worth of underlying CDOs with 70 billion that would suggest that you are looking to pay close to par on some of these underlying CDOs. Is that the situation?

David L. Herzog

Ed?

Edward M. Liddy

Well, the way the transaction is going to work is we are going to have to tear up the credit default swap its valuation. And you would adjust the collateral of course with against what the value of this CDS that was agreed to. Then this CDO, LLC will purchase the underlying bond that's held by our counterparty at its market value. And they are still about 35 billion available to execute this trade.

Unidentified Analyst

Understand, understand. Thank you very much.

Edward M. Liddy

Okay next.

Operator

Our next question is from Jimmy Bhullar with JPMorgan. Your line is open.

Jimmy Bhullar
JPMorgan

Hi, thank you. I had a few questions. First on you mentioned this briefly in your comments, but if you could talk about pricing trends in the P&C market and if you have seen some hardening recently, what's your view as to if it will sustain?

And then secondly on your sales in domestic and in foreign life, they were down across many of the products, but down maybe less than we would have expected if you could talk about sales progression during the quarter and if you saw a noticeable downward trend after the second week of September?

And then last one I have is just on the environmental selling assets, if you could just... to whatever extent you can discuss given that market prices or public companies are down a lot, how much interest are you seeing and how much are the valuations that you are seeing down because of that?

Edward M. Liddy

Yes, Jimmy, Ed Liddy. We'll do those in reverse order. We have smart, disciplined, competitive process for selling assets. The announcement of today gives us more flexibility and more time. We have great confidence in our ability to sell these remarkable assets. Beyond that, we won't have any comments.

When we enter in new transactions that are announceable, we will absolutely let the marketplace know that. I can't underscore enough, we have great demand for these various properties. We are probably dealing with I don't know north of 75 or a 100 different people, complex - complicated transactions, assets that have a presence in worldwide markets. It's just not something that someone comes to you on Friday and says here is my price. It requires great diligence and great thought and that's exactly what we are doing. It's a smart disciplined thoughtful process.

Jimmy Bhullar
JPMorgan

And just on that with the change in the terms on the loan, are you, its been, if environment stays the way it is right now would you be willing to wait a little bit to get better prices? Or would you want to announce stuff based on your internal schedule?

Edward M. Liddy

It's a smart disciplined process. We will do the right thing at the right time in the right way. Chris, [ph] do you want... recognizing there is always the difficulty of pricing conversation. Would you like to give a little color to that but not too much.

Unidentified Company Representative

Sure. Year-to-date on our overall pricing is down about at the end of September, is down about a little over 10%... around 10% from middle of September to the end October, it was down a little bit less than that. So there was a slight improvement.

Jimmy Bhullar
JPMorgan

Right.

Edward M. Liddy

Jimmy, Rod Martin will speak briefly to your question concerning our domestic life and retirement services, as you noted it had frankly a very strong quarter.

In the areas it was down, it was down consistent with the industry, example of that would be universal life, but our term sales were up in the third quarter 9%, our variable universal life sales albeit on a smaller basis up 16% and payout annuities in sales and deposits were up 22%. So a very solid quarter.

Clearly and consistent with what we've discussed and reported previously, tied to the events and the announcements, there was a dampening in the September and October third piece and it is, reflected in the quarter accordingly.

Jimmy Bhullar
JPMorgan

And similarly on the foreign business?

Edmund Tse

Jimmy, Edmund here. I will add a little bit color on the foreign business in that. Now, our foreign business on the regular premium basis it has been continuing to do quite well and they are even dealing those economy situation, the foreign life all together for a quarter you have the 9.6% growth in regular premium basis and for AIA territories and there we have 7.2% growth.

The only slowing down is in the single premium investment linked type products because of the equity market volatility and the fact that we have been slowing down in selling the investment linked type product that because of the very weak equity markets almost throughout the world particularly in Asia. Otherwise there we continue to do quite well.

Jimmy Bhullar
JPMorgan

Okay, thank you.

Edward M. Liddy

Next question.

Operator

Our next question, it's from Ron Bobman with Capital Returns. Your line is open.

Ron Bobman
Capital Returns

Hi, good morning, thanks. I was curious to know what portion of the securities lending balances are from front securities at the insurance subs?

And then I also wanted to know what the key middle group [ph] that's been responsible for managing the securities lending program, if continuing to do so?

David L. Herzog

This is David Herzog. I will cover the first part of that. It is entirely related to the insurance companies. There is a... and that's all the domestic programs, this is a U.S. domestic solution, the foreign approval continued to perform in orderly way. And so we will unwind the U.S. domestic, the solution focus is on the RMBS related portion of the portfolio and then there is a second leg of this transaction or the solution that will be executed with the available funds from our insurance companies.

Edward M. Liddy

And we have changed the leadership of that, the group that manages the... that particular segment of our investment portfolio.

Ron Bobman
Capital Returns

Thanks. And then just one little small follow-up. Was that group part of AIG Investments or its separate and apart from that?

Edward M. Liddy

No, it's part of AIG Investments.

Ron Bobman
Capital Returns

Okay, thanks a lot and best of luck.

Edward M. Liddy

Next.

Operator

Our next question is from Tom Gallagher with Credit Suisse. Your line is open.

Thomas Gallagher
Credit Suisse

Good morning, few questions. Let's see, first, I just want to understand the logistics around the transfer of the CDS and CDOs and their securities lending. What we... I guess what we are looking at. What kind of timing are we looking at the transfer of this? And is there potentially a substantial loss ahead when that transfer takes place or has the pricing been predetermined? One, and I will just stop that and then I will follow-up.

Edward M. Liddy

Yes, that was really my comment earlier, Tom. We are going to put these entities in place as soon as we can. It's not going to happen tomorrow, but it will happen as soon as we can. So any further erosion between now and when that entity gets put in place is for our account. So that's going to be, what it's going to be. Second, whatever money we put into these transactions, we are also potentially at risk force. So that's roughly a 1 billion into the securities lending and roughly $5 billion into the credit default swap. So we'll endeavor to put these in place just as quickly as we can.

Thomas Gallagher
Credit Suisse

Okay. And so the pricing on this is, what we should think about is, both of these portfolios remarked as at the end of 3Q any erosion that has occurred in 4Q, plus any that may occur, whenever this transaction closes, would be a absorbed by AIG?

Edward M. Liddy

Yes, I would say any movement.

Thomas Gallagher
Credit Suisse

Yes. Okay.

Edward M. Liddy

Up or down.

Thomas Gallagher
Credit Suisse

Okay. Is there any realized things, things have been all over the place in terms of market, but I presume given how big of an issue this is for AIG, you've looked at some kind of estimate ballpark, has... will this result in a very large loss, in a 10 - 15% hit to shareholders equity, something more modest or larger. Can you give us some scope or based on the way you think this plays out, what the impact maybe?

Edward M. Liddy

No, I have to tell you we really have not thought about it in those terms. We thought about it from the context for us to emerge successfully from these crises. We cannot continue to hemorrhage cash into two areas of securities lending and the credit default swaps.

We need to stop that. We need to stop it now. That's what we want to do, but neither do we want to walk away from any upside at all. So we try to thread that needle as best we can, so that we are protected on the downside and have some opportunity on the upside.

Once those two, if you think about the $61 billion that we have drawn down from the Fed facility, I am close on this number, please accept it as a box car, something in the range of $53 billion is related to 53 to 55 maybe, is related to the posting of collateral and the credit default swaps and issues surrounding the securities lending.

We need to stop that. And that's what this is designed to do.

Thomas Gallagher
Credit Suisse

Okay. I guess, just not to be the dead horse, but I guess I just want to get some clarification or comfort that what we see today from a capital structure standpoint. We're not looking in an enormous change in the loss content looking ahead to 4Q because this is such a transformational transaction for the company. Is there any further detail you can give us on this, because in my mind until we get a sense for how big the problem maybe, if in fact it even is a problem in terms of the... what the loss would be on this transaction its very hard to get a sense for what does this mean for AIG if you know what I mean?

Edward M. Liddy

Yes, Tom I do, but I don't know how anybody can answer that question. The condition at present to answer that question is what you think is going to happen to the capital markets either equities or credit default spreads or what have you. So I think it's just... I think it's impossible to answer.

Our market is going to continue move south, I just do not know we have the risk until this thing is put to bed. The issues you are poking at to a certain extent the rating agencies have considered and they have looked at this and I think if you have not had the opportunity; we've shared this... the whole structure with them. They have made certain judgments about what their view is on this transaction and on balance it's been well received.

Thomas Gallagher
Credit Suisse

Okay. And then I guess just on a related note since the... I believe the valuation approach you are using is more looking at sort of a trading approach, just broadly speaking because you are planning on transferring these assets. So is it fair to say then the valuation methodology used at the end of 3Q would be similar to the one that we would see when the assets are transferred if that makes sense?

Edward M. Liddy

Yes, I think that's a good assumption on your part.

Thomas Gallagher
Credit Suisse

Okay. Then just a couple of other quick follow-ups.

Edward M. Liddy

Tom I'm going to give you one more and that's it.

Thomas Gallagher
Credit Suisse

All right.

Edward M. Liddy

Make it the one that's important to you.

Thomas Gallagher
Credit Suisse

All right I'll go for the big one then, $48 billion deferred acquisition cost that was up little over 1 billion from last quarter. How should we think about AIG's methodologies for valuing that as you think about selling assets, should we expect there will be major adjustments to this and maybe just tell us in a little bit about how they think about that prospect? Thanks.

David L. Herzog

This is David and I'll make some initial comments and ask Chris Swift, the CFO for life retirement service segment. Our methodology is around DAC and the sales inducement assets that we have on the books it hasn't changed. We did as you saw on the table on page, on the earnings release we did in fact have a DAC unlocking which is reflective of ongoing market disruption we had reversion to the mean and we made some modifications to some near term lapse assumptions in parts of our business. So again our methodologies controls around it haven't changed. Chris, you want to comment on that further.

Christopher J. Swift

Sure, David. That is true what we did in the third quarter for the domestic, looked hard at our assumptions and did need to unlock for reversion for the mean and for higher anticipated lapses. We are in the midst of our fourth quarter review process for the foreign life and I can't predict how it's going to come out at this point in time.

David L. Herzog

Thank you.

Edward M. Liddy

Next question. And we have... sorry, to do this to you all, we have time for probably two more.

Operator

Our next question is from Scott Frost with HSBC. Your line is open.

Scott Frost
HSBC

I just want to make sure I understand, I wanted to go back to the facilities here, this is dealing with the multi-sector CDOs, you are showing about 71.6 billion of notional outstanding is the idea you are going to take part, I guess the holders of the super senior CDOs effectively either through, is that... if that was an avenue you are going to pay 70 billion to holders of these CDOs in exchange you are going to acquire the underlying collateral that's marked at 35 billion?

You are going to give 5 billion, the Fed is going to give 30, the CDO holders made whole and then, you think that overtime this collateral will mature or eventually be worth par again?

Is that, first of all, is that how this is working and are you actually acquiring the collateral or is the holder of the CDO expected to take this as a settlement then they would liquidate the collateral themselves and hold it?

And the second is on the SEC lending line, you had 22 billion of... you're the Fed, I guess about roughly 37.8 billion, that's the line, you have 19.9 that you have drawn and exchanged for securities, is the Fed now again taking those issues... those securities and putting in a special purpose vehicle. And that effectively removes all the securities lending payables from your balance sheet as well as the assets associated with it. Is that what we are kind of looking at on a pro forma basis that how it's going to work?

David L. Herzog

Yes, this is David, I want... let me take those in the order you offered them. First of all on the credit default swap, the facility or the entity will purchase the underlying CDOs.

Scott Frost
HSBC

And the assets with them, right?

David L. Herzog

Correct. They are buying the CDO, it's essentially at whatever the negotiated prices, but they are the underlying CDOs. The credit default swap that we will be turned up--

Scott Frost
HSBC

The yield in the assets, therefore and you have the swaps, so you chair it up?

David L. Herzog

We don't own the assets. We never did own the assets, we rolled the credit default swap on the assets.

Scott Frost
HSBC

Right.

David L. Herzog

So the structure is working that the vehicle that is being created, that we are contributing the junior funding, the subordinated funding to we'll own those underlying CDOs that are purchased. That vehicle will not be consolidated on AIG's books.

We will participate in the returns on the underlying CDOs in the form of our equity clauses mentioned earlier, a sharing of the upside.

Scott Frost
HSBC

So let me back-up a second, so the CDO holders not being made hold here. Is that correct? You are buying... you are essentially buying this, you are buying the CDO for $0.50 on the dollar? Is that what you expect to happen here?

David L. Herzog

No, Scott let's be clear. The CDO is being purchased at a negotiated rate. And I think I had commented that the Fed is involved, heavily involved in that negotiation.

Scott Frost
HSBC

Well I mean are you suggesting that well, I mean if I am the counterparty, why wouldn't I accept less... why would I accept less than par unless you are saying that Fed is going... I mean I am not you are saying that Fed is going to be strong on holders right?

David L. Herzog

I am just telling you there is a negotiated price Scott. So it's a negotiated price between the owner of the CDO in this newly formed structure.

Scott Frost
HSBC

And again, if I am on the holder of the CDO, why do I accept less than par now?

David L. Herzog

Yes, it's a get a negotiated price.

Scott Frost
HSBC

Okay. Again, if you are saying that... what is motivation of the CDO holder to accept less than... because you're saying, look, I am going to offer this to you, take or leave it and if the CDO holder says, I'll leave it, what do you about it?

David L. Herzog

Yes, they can also the tear the credit default swap upside, I think they're... again, I think there the structure has been designed in a way that's balanced in terms of the various stakeholders motivations and incentives. So we believe this structure will be successful in accomplishing the restructuring and the de-risking of the AIG portfolio --

Scott Frost
HSBC

Okay.

David L. Herzog

In this regard.

Scott Frost
HSBC

Also, I see it is fair to say that there is going to be some kind of, a little bit of execution risk here in your ability to get the holders of the CDOs to accept what you are offering them? That's a fair, is that accurate?

David L. Herzog

We are optimistic that we think that the structure --

Scott Frost
HSBC

Okay.

David L. Herzog

Will be successful.

Scott Frost
HSBC

Okay. Great.

David L. Herzog

And then second of all on the securities lending, there is again... this is the U.S. domestic securities lending portfolio, the solution is focused on that. There will be RMBS securities that will be purchased by the vehicle. Again, we are providing the junior or the subordinated funding for that vehicle like the credit default swap solution. This vehicle will not be not consolidated on AIG's books and the underlying RMBS will be owned by the new vehicle and again we will participate in the economics of that through the returns on our subordinated investment as well as the sharing of the upside that Ed spoke to.

Scott Frost
HSBC

Okay.

Edward M. Liddy

Next and last question.

Operator

Next question is from Dan Johnson with Citadel Investment Group. Your line is open.

Daniel Johnson
Citadel Investment Group

Thank you, Ed. Just a couple. I will make it quick. Statutory capital in the U.S. life and retirement business, where was it at the end of the second quarter and were is it at the end of third please?

Christopher J. Swift

Dan it's Chris Swift. In the aggregate fourth quarter's ended right around 300%. How we got there, lot of pluses and minuses.

Christopher J. Swift

I don't have the exact number in front of me Dan.

Daniel Johnson
Citadel Investment Group

So it was I think, something in the mid teens, billions excluding ALICO, if you were just looking at the real domestic business?

Edward M. Liddy

Dan, why don't you follow-up with Charlene, we'll get you the number.

Daniel Johnson
Citadel Investment Group

Okay. Then I'll just skip to the other ones. So hopefully the multi-sector CDO issues are mainly behind us. The remaining regulatory and capital arbitrage portfolios looked like they came down a bit in the quarter as well. I wanted to compare what looked like on slide 8 of the credit presentation shows about 30 billion of maturities and early terminations.

How does that compare to the 80 billion that was referenced in the second quarter 10-Q as of the end of July, there is a comment that said 80 billion were in the process of being terminated early and then I do have one final question.

David L. Herzog

Okay, this is a David. The 30 on page 8, I believe is for the quarter. During the quarter and that again... that portfolio continues to perform and terminate very much inline with our expectations.

Daniel Johnson
Citadel Investment Group

Does that... harder again, was that did I have... am I comparing apples-to-oranges, the comment in the Q that said about 80 billion was in process of being up... terminated?

David L. Herzog

Yes, that's right. Some of the 80s is included here.

Daniel Johnson
Citadel Investment Group

And the remainder is still in process of being terminated early?

David L. Herzog

Yes, remember the 80 was in inception to-date through Dan.

Daniel Johnson
Citadel Investment Group

Very good apples and oranges. Then finally, last question was on the capital contribution in the shareholders equity the $23 billion. Is there actual any capital or say even cash being transacted here and how is that number determined?

David L. Herzog

I am sorry again the 23?

Daniel Johnson
Citadel Investment Group

There is a $23 billion--

David L. Herzog

The 23 yes okay thank you. What that represents is the... is the fair value at that point of time, that's the consideration. So there is no cash that changes in with that... in that regard. That's a fair value ascribed to the... the value of the credit facility. It represents the 79.9% at that date and time.

Daniel Johnson
Citadel Investment Group

The line is going around at call it 80%... 80% fair value of what?

David L. Herzog

Of AIG at the date of... at the date of that transaction, so again we gave a promise if you will to... an obligation, to issue preferred stock at the date of the credit, the day we entered into the credit facility. The fair value of that obligation was approximately $23 billion at that day.

Daniel Johnson
Citadel Investment Group

It is sort of looks like an option valuation model or --?

David L. Herzog

No, it was it was based upon the market value of the, what the outstanding common stock at the date of that transaction.

Daniel Johnson
Citadel Investment Group

What was the share price at that date?

David L. Herzog

It was around $2 a share.

Daniel Johnson
Citadel Investment Group

Okay, $2 a share. And as that $23 billion does that play any role in any statutory calculations, capital calculations?

David L. Herzog

It does not Dan what it we'll do, we'll amortize of through interest expense in proportion to the outstanding capacity on the credit line.

Daniel Johnson
Citadel Investment Group

Yes, okay, I get so its 23 now, it will decline overtime... over the five-year time period.

David L. Herzog

That's correct.

Daniel Johnson
Citadel Investment Group

Through the income statement--?

David L. Herzog

That's correct through interest expense.

Daniel Johnson
Citadel Investment Group

Got it understood. I will follow-up on the state capital question thank you.

Edward M. Liddy

We're going to bring our session to a conclusion, thanks for your time. I'd make two remarks as we end. First, our insurance companies remain very strong we continue to do well. Remind you this is the largest insurance company in the U.S. and the largest insurance company in the world.

Second, we have worked hard to fashion a very compressive plan in order to put AIG in a much more solid footing. I think the plan we have represented, we have put forward if you think about what the Dutch government has done for ING or AEGON or what have you I think it's just a recognition on the part of the Federal Reserve and the U.S. Treasury that, this really is a systemic issue that's going on and to try to address on a company-by-company basis simply wasn't the right way to do it. So what the government has really done is they have stepped up and they have... we have fashioned a much more holistic and comprehensive solution.
What we got probably would not have been possible back in September because some of the tools that we are availing ourselves are just simply weren't there. So we're... we very much like to change it we think that they are good for all of our constituents. We look forward to making progress on our asset divestiture plan and we will keep you posted as we go. Thank you all. .