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Market Intelligence

American International Group, Inc. NYSE:AIG

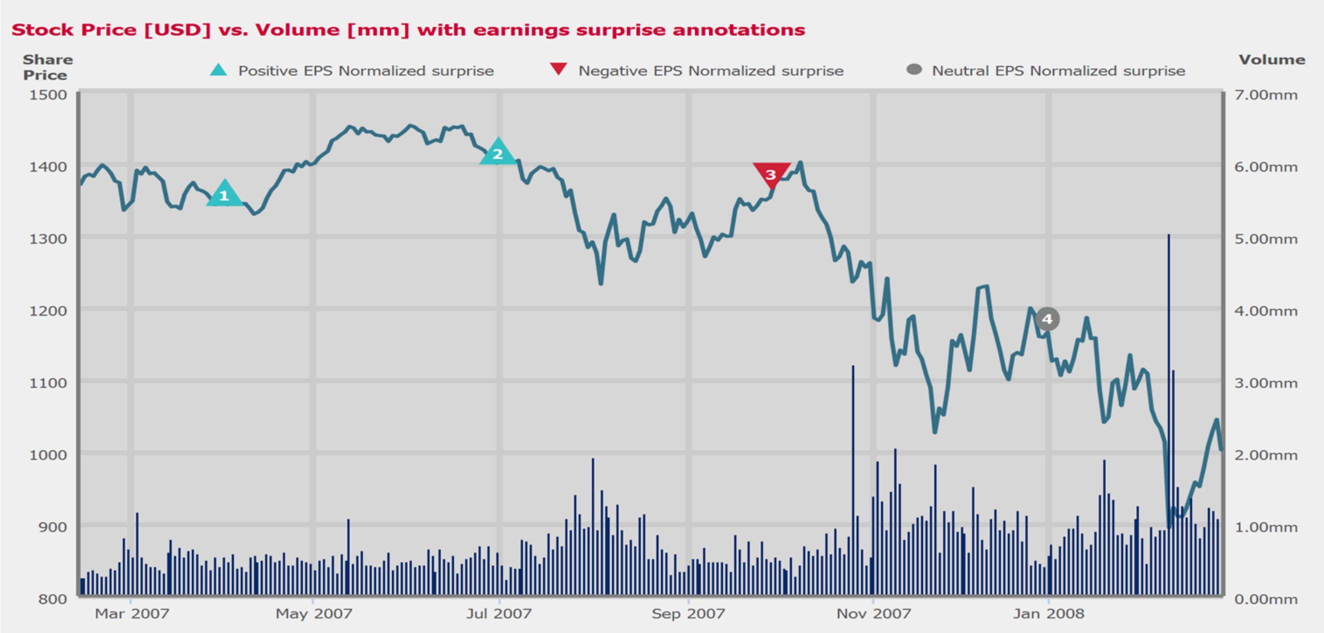
FQ1 2008 Earnings Call Transcripts

Friday, May 09, 2008 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2008-			-FQ2 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	11.14	18.60	▲93.15	29.27	108.13	130.48
Revenue	-	-	▲(8.43 %)	-	-	-
Revenue (mm)	31919.33	29227.00	-	31805.75	123762.25	140935.50

Currency: USD
Consensus as of May-09-2008 1:13 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2007	30.91	33.60	▲1 8.70 %
FQ2 2007	32.34	35.40	▲2 9.46 %
FQ3 2007	32.46	28.80	▼3 (11.28 %)
FQ4 2007	(2.91)	(25.00)	NM

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Presentation

Operator

Good morning and thank you for standing by. At this time all participants are on listen-only. After the presentation, we will conduct a question-and-answer session. [Operator Instructions]. I would like to inform participants that today's call is being recorded. If you have any objections, you may disconnect at this time. And I would also like to turn the call over to your conference host this morning to Ms. Charlene Hamrah, you may begin.

Charlene M. Hamrah

Thank you. Good morning. Thank you for joining us this morning to discuss AIG's first quarter 2008 earnings report. Before we begin, I would like to remind you again that the remarks made today may contain projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to 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 conditions indicated in these projections and statements. Factors that could cause AIG's actual results to differ possibly materially from those in this specific projections and statements are discussed in Item 1A, Risk Factors of AIG's Annual Report on Form 10-K for the year ended December 31, 2007, as well as in the outlook section of management's discussion and analysis of financial condition and results of operations in the quarterly report on Form 10-Q for the period-ended March 31, 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.

The information provided today may also contain certain non-GAAP financial measures. The reconciliation of such measures to the comparable GAAP figures are included in the first quarter 2008 financial supplement, which is available in the Investor Information section of AIG's corporate website.

And now, I would like to turn this conference call over to Martin Sullivan.

Martin Sullivan

Thank you very much, Charlene and good morning ladies and gentlemen. As usual, I'm joined this morning by a number of my senior management colleagues. As we anticipated in our fourth quarter earnings discussion, the US housing market has remained weak, and credit market disruption has persisted in the first quarter of 2008. These external factors cause AIG to report additional unrealized market valuation losses and impairment charges, which negatively affected reported results. Additionally, market conditions were not good for our alternative investment portfolio leading to a decline in partnership income from a record high in the first quarter of 2007 creating a significant unfavorable comparison. Excluding these external market issues, the underlying fundamentals of our core businesses remain solid, and several units performed quite well in the quarter. As we will discuss, top line production was strong in many of our businesses and operations facing... many of our operations facing competitive market challenges and maintaining their focus on profitable growth and underwriting discipline.

Additionally, as announced last evening, we have initiated a process to raise $12.5 billion of capital through the issuance of common stock, equity linked and high equity content fixed income securities. We are being asked why we raised the dividend, when we are also in a capital-raising mood. The answer is that the dividend increase is a reflection of both the Board's... of the Board and management's long-term view of the strength of that company's business, earnings, and capital generating power. The capital raised is a response to the events of the last two quarters and its effect on our capital position. It will fortify the fortress balance sheet you expect us to maintain and provide us with increased financial flexibility in these turbulent times. It will also position us well for the future. The two are simply reflections of a positive long-term view and a prudent response to the current environment.

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Last night, two of our major rating agencies, downgraded AIG's holding company rating by one notch to AA minus, and placed it somewhat pending the completion of our capital raising. A one-notch downgrade of the holding company is very manageable for us and we do not believe that it will have significant effect on our operations. Importantly, both agencies kept the financial strength ratings of our insurance company subsidiaries at the AA plus level, which is most important to us.

Now, let me provide a brief review of our results. As you have seen AIG reported a net loss of $7.81 billion in the first quarter of 2008, and an adjusted net loss of $3.56 billion. There were five principal factors that affected our performance in the quarter. First, we've reported a net unrealized market valuation loss of $9.11 billion pretax or $5.92 billion after-tax related to the AIG financial products, super senior credit default swap portfolio. Second, net income was affected by $3.965 billion in after-tax net realized capital losses. The pretax net realized capital losses of $6.09 billion, included $5.59 billion for other than temporary impairment charges, with the majority relating to severity losses. The impairment charges, resulted primarily from the significant rapid declines in market values of certain residential mortgage-backed securities and other structured securities in the first quarter for which AIG concluded it could not assert the recovery period would be temporary.

Though there is diversity in practice within the industry on determining impairments, we believe the judgments we have made are prudent. A third significant driver was net investment income performance, primarily the [inaudible] returns on our partnership and other alternative investments. We reported aggregate partnership income of $197 million in the first quarter of 2008, a $1 billion decline from the first quarter of 2007. Mutual Fund income also declined compared to a strong first quarter of 2007. In response to the market disruption, AIG has been increasing its liquidity position and investing in shorter duration investments. Our overall cash position has increased 9% from year-end 2007. While prudent in the current environment, such actions had a negative effect on overall investment yields, primarily in domestic life insurance and retirement services.

The fourth area affecting our results was a continued unfavorable results at United Guaranty and American General Finance. The operating results of these businesses have been and will likely continue to be affected into 2009 by continued credit quality deterioration of mortgages, a weak residential housing market and the overall US economy. Fifth, we saw a market volatility affect individual segments to a lesser degree. For example Foreign Life Insurance and Retirement Services results included $88 million in trading account losses related to certain UK variable annuity products and an $80 million increase incurred policyholder benefits related to a close block of Japan variable life business with guaranteed benefits.

At March 31, 2008, shareholders equity stood at $79.7 billion, a $16.1 billion decline from year-end. The decline in shareholders equity was largely the result of the first quarter loss as well as a $6.8 billion in after-tax, unrealized depreciation of investments included in other comprehensive income, and a $1.1 billion decrease to 2008 opening shareholders equity due to the adoption of FAS 157 and FAS 159. Looking beyond the effects of market volatility, AIG's core insurance businesses are performing quite well. General Insurance operating income declined compared to first quarter of 2007, primarily due to lower partnership income and unfavorable loss development in certain segments. In particular, Foreign and General produced excellent premium growth then original currency, driven by strong accident and health production, commercial lines growth in Europe including the Wuba, the company we acquired in Germany and increases in all lines in Latin America. With a 51.78% loss ratio, selling and general continue to produce excellent underwriting results.

Net premiums written in the Commercial Insurance Group declined due to return premiums related to loss sensitive policies, declines in workers' compensation and increased competition. Workers' compensation remains under considerable pressures as statutory rates continue to decline. Rates in most lines have also declined due to competitive pressure particularly for aviation; excess casualty and D&O. Commercial property and other rights are also declining following relatively low catastrophe losses. In domestic personal lines, we achieved strong premium growth in the private client group, with virtually no growth in direct and Agency Auto.

First quarter loss experience however was unsatisfactory. The overall market has softened considerably. In response to the changing market conditions, we are filing rate increases and tightening underwriting

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guidelines to improve results. While UGC's results continue to be affected by the deterioration of the US housing market, the company is prudently pursuing opportunities of favorable terms and conditions through the increased use of mortgage insurance on domestic first-lien mortgages. Net investment income in certain products and life insurance and retirement services were negatively affected by the volatile markets in the first quarter. However, our ongoing focus on product innovation and multi-distribution led to strong premium and deposit growth in most lines and regions.

The Domestic Life Insurance business reported improved operating income in the quarter due to an increase in payout annuity business and growth in the life insurance in force. The US life insurance market remains competitive and we remain focused on achieving profitable growth while maintaining margins in this business. In Domestic Retirement services, the significant increase in individual fixed annuity deposits is due to the continued improvement in the yield curve environment and less competitive crediting rates from the bank and money market fund products. Despite pressures in the equity markets, individual and group retirement variable annuity sales improved slightly, while surrender rates and net flows improved to all three retirement services lines.

Overall, excluding the effective market volatility, AIG's Foreign Life Insurance and Retirement Services operations performed well with continued growth in premiums and reserves. Results also benefited from favorable foreign exchange. As we addressed in our recent investor conference, our global footprint, long-term presence in many growing and emerging markets and ability to maximize our broad product range and multiple distribution channels are key advantages that will continue to drive growth. For example, we were able to take advantage of our extensive bank insurance relationships in Japan to offer a single premium [inaudible] A&H product that generated substantial sales in the quarter following the full deregulation of bank channel in December. And while Financial Services results continued to be affected by the marks on the credit default swap portfolio, and lower operating income from AGF, there remain clear strengths and potential in each of the businesses.

ILFC continues to produce exceptional results. Despite recent headlines about the health of the US airline industry, ILFC remains well positioned given its emphasis on [inaudible] markets and its ability to the manage the placement of its fleet. Excluding the effects of the super senior CDS marks and the adoption of FAS 157, and FAS 159, AIGF enjoyed good performance from commodity index and currency products and energy and infrastructure investments. This performance reinforces the fact that credit derivatives are not AIGFP’s only line of business. Throughout its history, the majority of AIGFP's businesses have generated excellent returns to efficiently utilize capital and generated low volatility in its economic results. I should also reiterate that the super senior business is essentially in run-off with regulatory capital transactions ending as a result of Basel II and the fact that AIGFP substantially stop writing credit default swaps on multi-set to CDO's with sub prime collateral at the end of 2005. Despite the near-term pressures on its results, AGF's management of credit, mortgage credit risks through disciplined underwriting, conservative lending standards and emphasis on fixed rate loans has enabled the company to perform better than its peer group. The company prudently increased its finance receivables with the acquisition of the Equity One portfolio that added receivables due to credit quality, similar to AGF's portfolio as well as 130,000 new accounts in attractive regions.

Loan growth particularly in Poland and Latin America and recently acquired businesses in India and Thailand were the primary drivers of strong first quarter revenue growth in the Consumer Finance Group. This business continues to explore opportunities to expand its geographic presence in emerging and developing countries throughout the world. For example, during the quarter, we've reached an agreement to purchase the third largest consumer finance company in Colombia.

Asset management results reflect lower partnership income, lower carried interest and increased depreciation and amortization expense on real estate investments and operating losses on consolidated private equity investments in institutional asset management. Growth in client assets will provide ongoing base management fees as well as the opportunity to own future performance fees. Non-affiliated client assets under management increased 19% year-over-year to $91.4 billion. Our institutional asset management business generated $2 billion of gross new business wins from new and existing clients that could result in challenging market conditions.

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Before turning to your Q&A, Steve will now provide you with a brief update on our exposure to the credit, current credit market conditions. This presentation and additional supplemental materials are currently available on our website.

Now let me turn the call over to Steve.

Steven J. Bensinger

Thank you Martin and good morning. I will refer to the file entitled conference call credit presentation accessible on our Investor Relations website. First on capital markets. As itemized on page eight, the total net notional exposure in AIGFP Super Senior CDS portfolios was $469.5 billion as of March 31. The portfolio of credit defaults swaps is divided into three major categories; regulatory capital motivated transactions in respect of corporate debt and European residential mortgages, corporate debt arbitrage transactions and transactions in respect of multi-sector CDOs. The portfolio is essentially in run-off and during the quarter, the notional exposure in the portfolio declined by almost $58 billion resulting from amortization, maturities, and early terminations of regulatory capital transactions by counter parties. In the quarter, AIG recorded a further pretax unrealized market valuation loss on the AIGFP Super Senior CDS portfolio of $9.1 billion, bringing the total unrealized market valuation loss at March 31, to $20.6 billion.

The regulatory capital book is the largest by notional amount, representing $191.6 billion in corporate and $143.3 billion in European mortgages. These transactions were structured to provide counter parties with regulatory capital relief in their respective regulatory jurisdictions, rather than risk mitigation. Counter-parties achieved lower capital charges under the Basel I Accord by entering into credit derivatives on portfolios of corporate loans and residential mortgages with AIGFP. Typically, the transactions are subject to both regulatory and contractual call by the counter-parties as Basel II takes effect in Europe, as Martin noted. In fact, as of April 30, $55 billion in notional exposure has either been terminated or is in the process of being terminated. The expected maturity of the transactions based only on the contractual call dates is 1.3 years and 2.5 years respectively, but many of these trades may be terminated by the counter-parties earlier than that. These transactions are highly customized and are protected by significant subordination with high attachment points. AIG conducted a comprehensive analysis of information available at quarter-end including counter-party motivation, portfolio performance, marketplace indicators, and transaction specific considerations. This fundamental credit analysis does not indicate any significant risk of suffering realized losses.

Regarding valuation, the most compelling market observable data are these early terminations without any cost to AIGFP. Hence, AIG believes that it should not record a valuation adjustment on these trades for the first quarter of 2008, and we have not. We will continue however to monitor developments in the marketplace and are counter-party's behavior to assess the valuation of this portfolio and there can be no assurance that AIG will not recognize unrealized market valuation losses on this book in future periods. AIGFP's arbitrage motivated corporate book represented $57.1 billion in notional exposure as of March 31, down $13.3 billion from year-end. The underlying collateral in these deals has comprised of primarily investment grade corporate debt, and to a much lesser extent, collateralized loan obligations. AIGFP recorded an unrealized market valuation loss of $900 million in the first quarter as a result of general credit spread widening experienced in the market indices that are highly correlated to the exposures in the book. This mark brings our cumulative valuation loss on this category to $1.1 billion. Our fundamental analysis and stress testing does not indicate any significant risk of incurring realized losses in this portfolio.

AIGFP's exposure to multi-sector CDO's and its Super Senior credit derivative portfolio, the third category of exposure totaled $77.5 billion as of March 31, of which $60.6 billion had some level of exposure to sub-prime mortgages. As we said in previous presentations, during 2005, AIGFP observed deterioration in underwriting standards, structures and documentation and essentially ceased committing to new residential mortgage transactions in late 2005 into very early 2006. Therefore, the exposure to the 2006 and 2007 vintages in our collateral pool is limited to $2 billion and $1.9 billion respectively. The attachment points for these transactions are extremely important features to reduce risk in these deals. As shown on page A3 in the appendix, of the deals with some sub-prime exposure, the attachment

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points range from an average of 15.5% on the high grade deals to an average of 38% on the deals with mezzanine collateral. Other important risk mitigants in the Super Senior structures of AIGFP are the payment priorities reflected in the cash flow waterfalls that benefit the Super Senior layers.

While the Super Senior tranches we protect always sit at the top of the payment waterfall as it is applied to the capital structure. When it comes to being paid, this position is typically further enhanced by the existence of one or more over collateralization or interest coverage tests that if breached further direct available cash flows to amortize our position more rapidly. As shown on page 34, AIG recorded a further pretax unrealized market valuation loss in this category in the quarter of $8 billion, bringing the cumulative valuation loss to $19.3 billion. AIG follows a rigorous process to determine its best estimate of fair value for these credit derivatives on multi-sector CDO's. This process is required because there are no observable market prices for the actual credit derivatives AIGFP has written. Therefore, AIGFP utilizes a modified version of the binomial expansion technique or BET model to value these derivatives. On the earnings call in February, we explained our valuation methodology in great detail.

Today I will just refer you to pages 35 through 40 of our presentation slides for the detailed review. Although the fair value of the CDS under GAAP is our best estimate of the fair value of the underlying CDOs, the substantial risk that AIGFP covers for the CDO investors is the risk of suffering actual realized losses, not the variance in fair value of the CDOs. Therefore, AIG has undertaken fundamental credit stress test to analyze the risk of actually suffering realized losses. On page 21, we illustrate the static rating agency migration analysis we conducted as of year-end, which resulted in a modeled stress scenario realizable loss of approximately $900 million. Given the further rating agency downgrades in the underlying collateral securities occurring since year-end, and deploying the same static stress to the portfolio with new ratings, the number has increased to $1.25 billion.

During the first quarter of 2008, AIG developed a new methodology to estimate more precisely its potential realized losses from this portfolio. This methodology described on pages 27 through 29 combines the roll estimate of the losses emanating from the sub-prime and all day collateral securities in the CDOs plus an estimated losses arising from the CDOs inside the collateral pools known as inner CDOs. In the roll rate analysis, the rates on mortgages in various stages of delinquency are projected out at various rates to arrive at total expected defaults. Loss severities are then applied to the defaults to estimate realized losses. Finally, we apply loss estimates to the inner CDOs on the collateral pools using loss estimates that depend on the vintage of the CDO, its type and it's rating. On page 29, we show the results of this analysis, showing a range of loss between $1.2 billion and $2.4 billion. The estimate of potential realized loss is like the static rating stress far below the cumulative GAAP valuation loss posted of $19.3 billion for this book. AIG is aware that other market participants have used different assumptions and methodologies to estimate the potential losses on AIGFP Super Senior credit derivative portfolio.

For example, as described on page 30, our third-party market-based analysis provided to AIG in connection with the capital raising process estimates that potential realized losses are at between $9 billion and $11 billion. AIG has reviewed this third-party analysis, but because of the disruption in the marketplace, we continue to believe that our market-based analysis is not the best methodology to use as a predictor of AIG's potential realized losses. And we do not intend to update this analysis in future periods. So as page 29 shows the disparities between the $19.3 billion fair value estimates and the conservative stress scenario estimates of losses between approximately $1.2 billion and $2.4 billion have grown much wider in the first quarter. These disparities emphasize the effect of marking-to-market the portfolio in the current disrupted, illiquid and distressed CDO markets. We expect market conditions to remain under stress for some time in the residential mortgage markets. Market values will be difficult to discover and secondary market trading will remain thin. Furthermore, the end of a down cycle and credit quality is not over, with delinquencies in various segments still on the rise and house price appreciation in decline. However, through high attachment points and low exposure the later vintage mortgages, AIGFP has structured its Super Senior credit default swap portfolio to withstand considerable stress.

I will now move to AIG's insurance investment portfolios. Referring to page 58, our total holdings in residential mortgage-backed securities were $82.3 billion at the end of the first quarter. On the next slide, you will see that our RMBS portfolio continues to be of high quality with approximately 90% being agency paper or AAA rated and approximately 6% AA rated. As shown on page 58, $21.6 billion or 26% of the

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RMBS portfolio is sub-prime. This portfolio continues to be of high rating quality with 95% still rated AAA or AA. Alt-A holdings at March 31 amounted to $23.7 billion.

On page 64, we show that 98.3% of this portfolio is still rated AAA or AA. Despite the overall good credit quality of the insurance portfolio, as a consequence of the deterioration in market valuations of securities particularly in the structured product space we recorded a pretax net realized capital loss of $6.1 billion in the first quarter. However, as noted on page 55, over 90% or $5.6 billion relates to other than temporary impairment charges of which over $4 billion is attributable to severity losses. Severity losses represent rapid and severe market valuation declines, such as that experienced in current credit markets where AIG cannot reasonably assert that the recovery period will be temporary. We do have confidence however that a significant amount of these losses will be recovered over the remaining lives of the securities.

We've also recorded in the quarter $10.7 billion before tax of net unrealized depreciation of available for sale investments through accumulated other comprehensive income on the balance sheet. Although many risk assets were affected, over half were predominantly AAA rated RMBS. While AIG has marked these assets down to fair value in this severe housing downturn, we believe the strong credit enhancement levels described on page 57 another structural protections in our RMBS holdings will substantially protect us for recovery of our principles. In fact during the quarter, we received over $2 billion in principle pay down, the same level as in the fourth quarter.

As we have discussed in previous presentations, an important component in assessing the risk in our RMBS holdings is the level of credit enhancements or the degree to which a mortgage pool can suffer losses before we experience any permanent loss. On page 61, we've presented our original and current average credit enhancements for the sub-prime 2006 and 2007 vintages, the largest components of our sub-prime holdings and the ones most subject to market pressure. Although the market's loss expectations for these vintages have increased, the average credit enhancements have actually improved. For the 2006 vintage, we have average credit enhancements of 31.7% for our AAA holdings and 23.5% for all holdings below AAA. And for the 2007 vintage, the average credit enhancement is 25.5% for AAA and 21.8% for holdings below AAA. While lifetime loss estimates for 2006 and 2007 vintages have risen into the 20% to 30% range, the combination of excess spread and current credit enhancement provides cushion for our exposures.

On pages 69 through 90, we provide detailed information on our CMBS, CDO and monoline related exposures. These portfolios are currently performing well. In fact, the CMBS market, which has been under contagion stress with RMBS, has rallied over the past weeks.

In conclusion since August 2007, the broader capital markets have emphasized preservation of liquidity and diversion to risk. The US residential mortgage market has continued to deteriorate with limited financing opportunities for mortgage borrowers and substantial increases in lifetime loss expectations on '06 and '07, US subprime and ALT-A mortgages. This deterioration has increased our mark-to-market and downgrade risks. However, our historical preference for RMBS exposures, high in the capital structure continues to guide our current expectations that the risk of an ultimate loss to investment principal in these securities remains moderate. As we stated in February, we have opportunistically increased liquidity to be prepared for continued market disruption. While larger liquidity positions have cost us some yield in the first quarter, it has also positioned us well to take advantage of compelling market values when we see them and we have begun to do that slowly in the first quarter.

Moving to page 94, and AIG's mortgage insurance subsidiary, United Guaranty. The composition of UGC's portfolio has not changed significantly since year-end 2007. However actions taken by UGC including adjustments to underwriting and eligibility requirements and increased pricing combined with more rigorous underwriting standards by UGC's lender customers are targeted and improving the portfolio quality of new business. As shown on page 96, loans with FICO scores less than 620 have decreased to about 7.9% of UGC's domestic mortgage risk, while over 71% of their net risk in force has FICO scores greater than 660. Furthermore, higher risk products such as interest-only and option-adjustable rate mortgages have declined and remained less than 10% of the risk in force.

Further to page 97, UGC recorded an operating loss of $354 million in the first quarter, as the benefits from tighter eligibility in underwriting requirements will not be incurred until future periods. The

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deterioration of the US housing market has affected all segments of the mortgage business but the high LTV second lien product is particularly sensitive and accounts for 43% of UGC's first quarter 2008 domestic mortgage net losses incurred. First lien net losses incurred however are also having a significant effect on operating results and further deterioration is expected in 2008. In summary, UGC expects that the downward market cycle will continue to adversely affect its operating results for the foreseeable future and is likely to result in another significant full-year 2008 operating loss. American General Finance is AIG's domestic consumer finance division. The residential mortgage market deterioration has also affected AGF's results, as operating income fell to $11.4 million from $50 million in the first quarter of 2007, as AGF increased its allowance for finance receivables losses by over $78 million during the quarter.

Turning to page 109, during the first quarter of 2008, AGF acquired $1.5 billion in outstanding balances of branch-based consumer loans of Equity One including $1 billion of real estate mortgages. Since the acquisition was completed at the end of February, there is approximately one month of earnings effect in AGF's first quarter results. As shown on page 111, the company's credit quality measurements continue to perform favorably, relatively favorably I should say, despite the current upheaval in the US housing market. AGF's real estate 60 plus day delinquency rate of 2.99% and it's real estate net charge-off ratio of 0.68% are still both below their target ranges which were set by AGF management to denote sound credit quality parameters. This is largely because well over 90% of AGF's mortgages are full documentation fixed-rate mortgages.

AGF maintained it's disciplined underwriting approach throughout the rise and subsequent deterioration of the residential real estate markets by continually reevaluating guidelines and adjusting as appropriate. This has resulted in delinquency and charge-off rates that continue to be better than industry experienced rates albeit at the expense of growth. AGF believes that the housing market will likely continue to deteriorate for the reminder of 2008. But, the company's business model and underwriting approach are sound, and will allow the company to continue to pursue opportunities as they arise.

Now I'll turn it back to Mark.

Martin Sullivan

Thanks very much, Steve. On our fourth quarter call, I made the point that we are obviously witnessing and living through extraordinary market conditions. We have now [ph] illusions about the challenges ahead in the remainder of 2008, and recognize that many of our businesses while largely affected by external factors fell short of our own high expectations. We have plans to address the issues we face and are confident that we have the right strategies and resources to succeed and generate long-term shareholder value.

Now, before we take your questions, you have seen from our release yesterday of Steve's appointment as Vice Chairman, Financial Services. I just want to recognize that Steve has made a significant contribution to AIG over the past three years, as our CFO and has developed a topnotch financial team, which his successor will be fortunate to inherit. The Board and I felt that this was the right time to utilize Steve’s talents and expertise in a segment of our business that is operating in a challenging environment. So, congratulations to Steve.

Ladies and gentlemen, we'd be very happy to respond to any of your questions. Thank you.
Question and Answer

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Question and Answer

Operator

Thank you. At this time, we're ready to begin the question-and-answer session. [Operator Instructions]. Our first question does come from Nigel Dally of Morgan Stanley. You may ask your question.

Nigel Dally
Morgan Stanley

Great. Thank you, and good morning. First question, I know you downplayed in your opening statements, but the one-notch ratings down grade. Can you discuss the fundamental impact across your various businesses, especially aircraft leasing. Second, I was just wondering, whether you have an estimate on the CS mark through the end of April, given we have seen some improvement in credit spreads, and then just lastly timing, on the raising of the remaining $5 billion of capital rates. Thanks.

Martin Sullivan

Make sure we've got all your question there Nigel. Okay. Obviously we've given a lot of detailed analysis to the impact of the one-notch down grade of AIG and as I mentioned in my opening remarks, we don't believe that is significant to the operations. The key takeaway there is the ratings of our insurance subsidiaries which were maintained and that's as I said very important areas of possibility obviously of increased funding cost to subsidiary like ILFC, but other than that Steve, I don't think we've identified anything that the challenges, I think we did disclose the collateral.

Steven J. Bensinger

We did, yes. The result in about $1.6 billion of additional collateral posting, but from an operational perspective, we were prepared as an organization in the event that any downgrade occurred given that we were on both watch and negative outlook from the various rating agencies and these actions should not have any significant effect at all on the operations. As Martin said, we could have a nominal increase in borrowing costs, but we'll see how that turns out. In terms of your second question on the April 30 mark, we do not have an updated mark through April 30. When you look at various portfolios of our business, we can say the following, if you look at what has happened in the credit markets since March 31, clearly you've seen a rally in corporate credit spreads which if it sustains itself, and we can't certainly be certain of that, should have somewhat of a positive effect on that part of our book. If you look at the commercial mortgage- backed securities market that has certainly done somewhat better in the second quarter so far than in the previous few quarters. However, in the highly structured credit market with residential mortgage, sub prime and Alt-A securities, we don't see any precise evidence to date that those markets have rebounded. People point to the ABX Index, we've said pretty consistently that we don't think the ABX is very well correlated to our books, and therefore the volatility both up and down associated with that index is not a good measure of what's happening in our portfolios. The process of coming up with a valuation of those types of securities and CDOs and CDS at this point in time is a long process. It requires significant data input from collateral managers and other market participants that are not available within a short period of time after the end of the month. And so to develop the type of mark that we use for valuation purposes, unfortunately is… as a requirement to obtain the information that we can get on a timely basis in these market conditions. With regard to the, your last question was --

Martin Sullivan

Timing of the fixed, I think the last question Nigel, you had was the timing of the high-equity content fixed income.

Nigel Dally
Morgan Stanley

That's right.

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Steven J. Bensinger

We've said that we will launch that shortly after we launch the first two tranches of the capital rates, which are the common equity and the mandatory convertible securities. So we'll... that will be based on our judgment of the market.

Nigel Dally
Morgan Stanley

Very good, thanks.

Martin Sullivan

Thank you.

Operator

Jimmy Bhullar of JP Morgan. You may ask your question.

Jimmy Bhullar
JP Morgan

Hi, Thank you. I have a few question, the first one is on your capital. I saw you updated the economic capital model, how much progress have you made in convincing the rating agencies of your output from that model and convincing on the capital position that you're taking 2.5 to 7.5, or just convincing them with that. And then secondly, if you could give us an idea on the sub-prime CDS that you have, the $77 billion notional amount, an idea on the maturity schedule of that, how much of it rolls off over the next year or two years, or over the next three or four years, any metrics that you could give on that? And then finally on loss trends in the P&C business, you had consistent positive development for the last few periods, and this quarter outside of the law sensitive business I think you had adverse development of approximately $175 million. If you could talk to what caused that, is that the total environment or anything else, if you can just talk about, what caused the adverse development in the P&C line?

Martin Sullivan

Okay. I think we've got all three there, Jimmy. I think Steve is going to respond to the first point.

Steven J. Bensinger

Okay, Jimmy. As far as the excess capital position, first let me... before I get to your rating agency point, let me also clarify because I'm sure we'll get the question why did our excess capital range reduce from what was pretty consistently close to 15 to 20 down to 2.5 to 7.5. Using best practice market consistent approaches now towards economic capital modeling the full extent of Level 2 asset changes comes through as a reduction of available economic capital. So this quarter, because we had a significant decline in value of the investment portfolio for the reasons that I cited in my presentation earlier, we had a significant reduction in available economic capital. And despite our views of ultimate realized losses, that comes through at full fair value without adjustments. And so, that that's why the range of excess capital and this is before the capital raise has decreased from 2.5 to 7.5. With regard to your question on rating agencies, the fact is that I don't think there has been significant progress so far with regard to the rating agencies embracing our economic capital modeling, and I think that is a more general issue not just related to AIG. I also think that the credit market events of the last few quarters have certainly been keeping the rating agencies quite busy on other fronts and I'm not sure that this has really gotten their first line attention at this point in time. So, I think a lot of these events were set back and making progress on that. So, the short answer is, our views of our capital and the rating agency's views are different and each of the rating agencies have differences on how they view it as well. So really no progress on that front.

Martin Sullivan

Do you want anything Steve or…on the second point, that you've raised, Jimmy, Andy Foster is with us from AIGFP, and he's going to give us some color on that.

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Unidentified Company Representative

Okay. On the multi-sector CDO's with sub-prime, calculating what the expected average life or expected maturity is that a fairly difficult process to do. We outlined in our presentation that looking at the underlying collateral; we came up the value of around 6 years, 6.5 years for the average life of it. But, the reason it's complicated obviously is the different collateral deteriorates and as Martin and Steve alluded to, we have lots of different cash flow triggers in the different deals and is the actually is the quality of collateral is deteriorating, we're triggering a lot of those over collateralization triggers which is actually diverting cash towards us. So, we would hope that the, that our portfolios will pay down faster than what is outlined in the presentation. I think we're in the process of trying to do a better assessment of what those cash flows will be, given these different triggers and, we're sort of almost at the end of that process. So, I would hope that, certainly by the next call, we'd be able to give you a more accurate assessment of what that average life would be.

Jimmy Bhullar
JP Morgan

Okay.

Martin Sullivan

All right. On the third point there Jimmy, I think obviously there was some adverse development in one particular area in excess causality, and I think I'll ask Frank just to give you some additional background there, because that's not necessarily reflective of a trend going forward.

Unidentified Company Representative

That's right, Martin. As you mentioned in the question Jimmy, there was about $175 million of adverse development if you exclude the favorable development from more sensitive business that was driven almost entirely by excess casualty from maximum years primarily in the late 1990's through 2000. It was largely related to one specific exposure MTBE, gasoline additive certain policies during that time period. I can't quote you a number on those exposures exactly since it's litigation at this time. But, if you took excess casualty out of the mix as a whole, or if you just assigned at a normal quarter development, the overall development would have been favorable even including... even excluding the loss sensitive business. So we regard this as largely non-recurring, what happened this quarter relating to MTBE is still going to be out there, excess casualty is always, as you know a long tale line is always the risk of more developments of many latent types. But, this quarter obviously had an outside development, which we don't expect to recur, it hasn't happened in the last couple of years and we don't think it 's a trend of what you should expect to see going forward.

Jimmy Bhullar
JP Morgan

And you don't believe that the MTBE reserves will develop adversely going forward from here.

Unidentified Company Representative

No, we establish, what we think as the appropriate reserve overall, I mean excess casualty you don't have exact reserves… type of exposure what happened this quarter as we learned about certain additional exposures, then we adjusted our overall reserves accordingly, so there is certainly a risk at any particular type of claim could developed further, excess causality that's a risk, we're just always going to have, but this quarter is certainly unique in the magnitude of the adjustment that we made because of information that developed this quarter.

Jimmy Bhullar
JP Morgan

Thank you.

Martin Sullivan

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Thanks Jimmy.

Operator

Alain Karaoglan of Banc Of America Securities. You may ask your question.

Alain Karaoglan
Banc of America Securities

Good morning.

Martin Sullivan

Good morning Alain.

Alain Karaoglan
Banc of America Securities

I have three questions. The first one with respect to the capital that you're raising of $12.5 billion, what are the use of proceeds in terms of, what are the businesses that you plan do you think you need them, or you plan to deploy them in? The second question with respect to Taiwan, do you have any new thoughts on rather than assuming that interest rates are going to go up and may be taking more risk on the investment portfolio, to clean up the slate, may be take a charge and if interest rates do go up, then we will have a lot better earnings going forward given all the mark-to-markets and the capital that you've raised and third you had a comment in the 10-Q about personalized underwriting results to worsen in further going forward. Were you referring to worsen further from where they were in the first quarter or further from where they were last year?

Martin Sullivan

Well, on the capital our plan obviously is to use it for general purposes, what we have said clearly is that we want fortify, the fortress balance that we have, obviously from our standpoint, we want the ability to continue to grow, while maintaining the strength to withstand potential market volatility that will obviously the financial services sector is facing at the present moment. So, at the present time, it's for general purposes, fortify the fortress balance sheet and to give us the ability to grow in certain areas and obliviously withstand any potential short-term market volatility. Steve, anything.

Steven J. Bensinger

I'll just add that, holding the proceeds in the holding company at the parent company level will give us the optimum financial flexibility to respond to any capital needs that might arise within all the various operating companies that we have and that's our current intention as Martin said.

Martin Sullivan

I think, Alain in response to your question on Taiwan, I'm going to ask Chris and Edmund to give you some additional background on that

Edmund S. W. Tse

Alain, good morning, Edmund here.

Alain Karaoglan
Banc of America Securities

Good morning.

Edmund S. W. Tse

On the Taiwan investment, we are not betting on really any increase on the investment or interest trend in the near future. So, our plan there is to really diversify more to take a little bit more higher risk in other investments, including the equities and the [inaudible] change of administration that the local

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markets will be strong going there in the near future. So, we'd put probably more, a little bit more in those higher risk investments. And in addition, that we're now applying to directly it has to increase our foreign investments from the 35% to 40%. Hopefully, we get approval that we could, also put more to the foreign investment that that include in higher long duration, high return upon and also probably put some in the Asian market, in equities and to increase our, hopefully increase, enhance our returns. On your plan about weather we should take a one-time charge and that to take that, we've studied this for quite a while. And we believe our Taiwan operation still quite profitable, and over the years that we've kept on having a good profit increase and we're able to maintain our high profit. So, for the time being no plan to take a one-time charge, but if situations change, we may reconsider that. I may refer to back that to, also to Chris that to add some color.

Kristian P. Moor

Our gross premium valuation analysis does show that our DAC is fully recoverable, and the pay reserves right now, Alain as we talked at our Investor Conference. So, no real news in and again from a US GAAP accounting side, we just can't take a charge unless the facts warranted, and right now our best estimate of the facts is based on what Edmond said in some of our philosophy, we just can't take a charge. We did consider the fair value option for the Taiwan, but did reject it just given the ongoing volatility and then beyond the other update as we disclosed in the 10-Q, we did commit to move approximately $400 million in, roughly in either June or July of this year once we get full regulatory approval.

Martin Sullivan

On the third point you raised, I think the key area where we've seen loss ratios deteriorate year-on-year is primarily in our Agency Auto portfolio to a lesser degree in the direct portfolio. The little uptick we got in our private client group which has an excellent loss ratio was increased frequency in the homeowners sector. Kevin Kelly is on the line and Kevin, I don’t know what trends you're seeing from the fourth quarter, I think which was Alain's specific question, quarter-on quarter, sequentially.

Kristian P. Moor

Yes. What I can say is that none of us are happy with the performance. In the first quarter 5.5 points came from prior policy year developments. So what we're seeing in the current result are approximately 3 points in the current accident year driven principally by auto severity, as Martin has pointed out in most pointedly in our Agency Auto business. We continue to work on that business and we continue to... I think to make improvements in that business going forward.

Alain Karaoglan
Banc of America Securities

Thank you very much.

Martin Sullivan

Thanks.

Operator

Tom Cholnoky of Goldman Sachs you may ask your question.

Thomas Cholnoky
Goldman Sachs

Good morning. I guess Martin, to go back to the capital raise, can we look at this because I guess what I'm struggling with is whether this is really a dilutive event, which is certainly appears to be on the surface. Or whether you can make the K sort of it's going to be accretive. And if so, when would this be accretive?

Steven J. Bensinger

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Tom, it’s Steve. I think certainly the initial raise of common equity will be dilutive to EPS and earnings per share by definition. The mandatory has somewhat of a delayed dilutive effect, but that’s dilutive as well when it's converted. I think the dilution is something that we hope we will be able to offset by the use of that capital in very productive ways as the opportunities manifest themselves over the course of the... over the next few quarters. So certainly initial dilution and our... you know that we are active capital managers now, we have a situation now where the markets are very turbulent and volatile. We felt this was the... absolutely right thing to do to fortify the balance sheet as Martin said and preserve our financial flexibility that we've always enjoyed and also of course the rating agency considerations as you've read for the capital raising. This was not driven by the rating agencies. I'll tell you that we went to the rating agencies and told them of our plans to raise capital. They didn't direct us to raise capital. Nonetheless all of those features factored into the development of our capital plan, we think it's absolutely the right thing to do at this point in time at the sacrifice some near term dilution.

Thomas Cholnoky
Goldman Sachs

So you would characterize this [inaudible], but clearly as offensive or much more offensive than defensive.

Steven J. Bensinger

Proactive.

Thomas Cholnoky
Goldman Sachs

Proactive, okay, and just the second question, I realize there had been a lot of people in the queue. I just on the alternative portfolios, investment portfolios, there is clearly a lag in here and how should we think about that given what’s transpired in the previous quarters, are we likely still to face some real headwinds in here for the next couple of quarters on the alternative portfolios?

Martin Sullivan

Well, I think I will have Win add some color, but the first thing I'd point out Tom is obviously in the first half of 2007, we had record contributions from partnership income, way excess I think if I'm not correct, in $2 billion I think contributed to earnings in the first half of 2007. Obviously, Win has articulated I think for at least 2.5 but not longer years, that the average expected run rate of that portfolio is in the area of 10% to 15%, but specifically on the lag, I'll ask Win to add some color there.

Win J. Neuger

All right. Tom, I think the way the accounting goes today, the lag is much less significant than it was 2 years or 3 years ago because of the markets that go to take place in the underlying funds in which we invest. So, that's compressed from what it historically has been. If we look at the first quarter, the total for the company return on the portfolio was a little under 3%. We've said, as Martin had said, consistently we think that portfolio will generate 10% to 15% returns over a longer periods of time. And it was running significantly above that for a couple of years with last year's first quarter being a peak in the excess of 20% return on the portfolio. So, we've come down now below what we expect to be our normal range, but we've no reason to expect that to be different. Hedge funds where they real laggard in the first quarter, given the market turbulence but, again not in anyway alarming to us in terms of the results.

Thomas Cholnoky
Goldman Sachs

So, would you take on a sequential basis, this could hopefully mark a low point in terms of alternative of investment returns? Or could it they get worse in the second quarter?

Win J. Neuger

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Well, I think that's largely going to be a function of what happens in the capital market, if equity markets are turnaround and do extremely well then, I would expect to that we would catch up with that, if equity markets are down, it's going to be continued tough sliding, I think for the partnership returns.

Thomas Cholnoky
Goldman Sachs

Right, Okay, great, thank you.

Martin Sullivan

Thank you, John.

Operator

Dan Johnson, Citadel Investment, you may ask a question.

Dan Johnson
Citadel Investment

All right, thanks. Got a couple, just following up on Tom's question, you've noted that you list private equity returns have been... I know that it is, I am sorry partnership I should say returns. Can you just say the high level, just to put that between something that looks like private equity and something that looks like hedge fund? You were talking something like $29 billion in assets.

Steven J. Bensinger

Sorry, I'm just trying to find… why don't you go to one another question.

Dan Johnson
Citadel Investment

Yes, perfect. If we look into the life businesses, you do a nice job of breaking out the earnings in a couple of different views, one of them is earnings before DAC benefit generated from realized capital losses and one of them is earnings afterwards, they give somewhat of a different picture to the performance in the quarter and somewhat last quarter too. What is the better way to look at the operating performance of the life businesses? Should we include or exclude the roughly $270 million of benefit in the quarter that was generated from capital losses, realized or unrealized capital losses?

Martin Sullivan

Chris is with us. So he is going to respond to that. Chris?

Kristian P. Moor

Dan, I think most of our management metrics are excluding the DAC benefit. Again the capital markets are what they are. We've repositioned portfolios from time to time, we generate OTD. Again it is somewhat timing, so that is really why we excluded and that is our internal matrix.

Martin Sullivan

Certainly from a management perspective, the team has managed without the benefit of the DAC contribution.

Dan Johnson
Citadel Investment

Understood. On the 1.8 billion of benefit from FAS 157 implementation due to widening of your credit spreads. Does that somehow just benefit the balance sheet or did that flow through a particular segment on the earnings statement.

Steven J. Bensinger

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I'll let David Herzog, our Controller to give you the intricacies of FAS 157.

David Herzog

Good morning Dan. The $1.8 billion is a... I think is what you are referring to, that is a benefit that runs through the current period but it's also in the books of business that we elected, the fair value option FAS 159. For example at AIG Financial Products, any effect of our credit spreads on AIG are largely offset by effective credit spreads on the underlying assets as well, and that was one of the considerations that we took under review, when we elected the fair value option where there was a reasonable correlation between the effects of the credit spreads on the underlying assets versus AIG. So, we're buying large offset, and I think we've disclosed that in the Q… in our 10-Q, that both the effects that were largely offset in the period.

Dan Johnson
Citadel Investment

In AIGFP they were, but maybe I'm misreading the table on page 11, of the Q, even adjusting for that, don't we still end up with what looks like a $2.8 billion pre-tax benefit from basically, credit spread widening of AIG in the quarter?

Steven J. Bensinger

Well, you'll see that the effects of the total again, you've got $2.6 billion offset in AIGFP, there was a reduction in earnings that ran through the current period earnings on the counter-party spread widening as well. So, you've got $2.7 billion benefits versus $2.6 billion expense.

Dan Johnson
Citadel Investment

So, the $1.8 billion after-tax overall includes or does not include the offset item from other counter party's credit spreads?

Steven J. Bensinger

Well, can you just clarify where you're seeing in the $1.8 billion?

Dan Johnson
Citadel Investment

Sure, I'm sorry I keep flipping between pre-tax and post-tax, page 11 of the Q says that the...

Steven J. Bensinger

Well, you are just tax affecting that number.

Dan Johnson
Citadel Investment

Yes, yes so I'm trying to figure out where are their two benefits?

Steven J. Bensinger

No, no that's one benefit, and the net effect of all of this was relatively small on a pre-tax and after-tax basis, because what you've going through as David said on the... on income and on expense relating to credit spread widening of our own credits and also credits of counter-party financial institutions, in which we have investments and transactions largely offset that. So, the net effect on the financials was very small.

Dan Johnson
Citadel Investment

Okay, probably we'll want to circle back, any look on the private equity question?

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Martin Sullivan

Yes, I think Win has some information, it may not be exactly what you want, Dan, but if it's not then we'll have to revert back to you.

Win J. Neuger

If you break down the NII, during the quarter between partnerships, our hedge funds versus partnerships that are private equity. Private equity actually generated a positive return during the quarter, of close to 7% and hedge funds are slight decline of 2% or 3%. Couple of things, I'd note on that. Number one, I don't have the exact size of the two portfolios, but the private equity portfolio is slightly larger than the hedge fund portfolio, and although they're not that far off of even. The second thing is that in hedge funds in particular, we have not insignificant part of our portfolio that is still on the cross method and therefore the returns on that portfolio only reflect realizations or equity method partnerships, so over this significant embedded profitability still in the cost method partnerships in hedge funds that don't get reflected in those numbers.

Dan Johnson
Citadel Investment

Do you feel like you've got good visibility on the private equity piece for this year?

Win J. Neuger

Well. I mean, as you know, I mean most of the holdings in the private equity sector are private companies, so you have to look at the underlying investments and how those companies are doing what their results are, what valuations are. We spend a lot of time working with obliviously our portfolios, but also with our managed, our funds that are managed by others understanding the valuations. And I think that most of managers are being very rigorous in terms of how they do the marks within their portfolio but, if there's always a certain lack of visibility in private equity by definition.

Dan Johnson
Citadel Investment

Last question related to financing [ph], does these marks include first quarter performance, or are they only updated to be at fourth quarter or February if that's the case?

Win J. Neuger

Right. It varies by the two asset classes, so hedge funds do reflect most of the first quarter the way we do hedge partnership is with the one-month lag, so it’s performance through, still primarily performance through February whereas private equity reflects the most recent evaluation, which typically would be year-end valuations.

Dan Johnson
Citadel Investment

Thank you very much for the questions.

Steven J. Bensinger

And can I just finally... let me just go back to your page 11 question, that's hopefully put it to bed. I have it in front of me now. The table shows the $2.781 billion pre-tax increase, the footnote talks about the amount for AIGFP, which is the predominant component of that $2.78 billion. If you add up the $2.58 million and the $65 million in the table, you get to the $2.648 million for AIGFP, which is largely in the footnote under it shows that it's offset by the counter-party credit spreads for assets. So, the net effect on the income statement for FP was $28 million and then, the only the rest of that you've taken to account of the first two items on the table $288 million minus the $155 million. So, that brings you down to a very small number.

Dan Johnson

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Citadel Investment

Very good. Thank you.

Steven J. Bensinger

All right.

Operator

Andrew Kligerman of UBS. You may ask your question.

Martin Sullivan

Good morning Andrew.

Operator

Andrew your line is open; Please check your mute button. We can go to the next question if you like?

Andrew Kligerman
UBS

Yes, I am here.

Martin Sullivan

Okay.

Andrew Kligerman
UBS

Sorry about that. Question around the property casualty business. It looks to me like the expense ratio has really trended up a fair amount. You've got 23.6 in '06, 24.7 in '07. This quarter it came in at 26.4. It looks like domestic brokerage spike up a fair amount, while the other main areas came down. Could you talk to or discuss the outlook for that expense ratio and what might be driving it?

Martin Sullivan

Well, obviously one of the key factors was obviously the return premiums that were discussed earlier in the loss sensitive business. Obviously that reduced the premiums and therefore obviously the expense ratio would obviously by definition go up. And obviously we experienced something like $0.5 billion I think, Chris MPW reduction, which accounted for a couple of points of expense there. I think the actual increase in expense in the Commercial Insurance Group was probably around one point true underlying growth in the expense ratio. Obviously we are very focused on expense discipline area in AIG. That's been a hallmark of the organization. Now that's certainly not going to change. Obviously, we've invested where we needed to invest in remediation efforts but the focus on expense discipline is there. I think there was also and Rob Schmidt [ph] is with us, the CFO of the General Insurance sector. And I think there were some increases in acquisition costs as well.

Unidentified Company Representative

Yes. Andrew, it is Rob Schmidt, just two other points I might add to what Martin was just saying. One is that there are a couple of quota-share agreements that we had on the property side of the house where there is no longer a ceding commission or profit share coming in that is reflected in the prior year as a reduction to acquisition costs as well as the fact that as we work on the mix of our business, you'll see us shift to lines of business that might have a lower loss ratio and a higher expense ratio. So those were a couple of key points.

Andrew Kligerman
UBS

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What areas will have the... that new metric or what would be more prominent with the lower... the higher expense ratio?

Unidentified Company Representative

This is Chris, there's a change in the mix of business issue there, but overall the gross commissions on our book are only up slightly and that is almost mainly due to change of the mix.

Andrew Kligerman
UBS

And the areas that have the higher commissions or --?

Unidentified Company Representative

Yes. It's usually the smaller business and accident... businesses like accident and health.

Andrew Kligerman
UBS

I guess just finally, where might you see the expense ratio overall leveling out, I mean is there any sense of where that's going or...

Unidentified Company Representative

I think you probably see an improvement, I don't know the exact number; you will see an improvement probably in the second quarter.

Andrew Kligerman
UBS

Okay. Then just lastly, on the capital initiatives again just, it sounds like yields are not part of the equation at all. Is that right?

Martin Sullivan

Well, your question, our deals part of the...

Andrew Kligerman
UBS

Yes, in acquisitions. It sounds like you really is... as Martin said several times it's fortress... fortifying the balance sheet is really the key. It doesn't sounds to me like M&A is part of this equation in raising the $12.5 billion, am I reading into it properly?

Martin Sullivan

Yes, you're reading into it properly. That's not a driving factor in this capital rates.

Andrew Kligerman
UBS

Great. Thanks a lot.

Martin Sullivan

Yes. Thank you. Ladies and gentlemen, we are about timing obviously. We can stay on line to around 10 o'clock. So, given the fulsome disclosure we've made, if you could limit your questions may be to one or possibly two, then we have a chance of trying to get to everybody who is in the queue at the moment.

Operator

Tom Gallagher of Credit Suisse, you may ask your question.

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Thomas Gallagher

Good morning. I'll just have one and then I will turn it over to Charlie Gates on the P&C side. On page 103 of your 10-Q, it says that as if April 30th AIGFP post a collateral of $9.7 billion. Just curious if you could talk a little bit about how that's funded, are you funding that with debt, is it equity and also if the March come down in AIGFP will the collateral come down in proportion?

William Dooley

All right. This is Bill Dooley. Just to talk about the liquidity per shift position in FP, first of all, we've been managing that extremely carefully for quite some time. We started to build cash in FP last summer when we saw the markets starting to deteriorate. So, right now we do have adequate cash, also FP continues to have normalized business in their book and they generate cash every day from their book. The third thing is the capital markets, we can raise money in the capital markets, and as far as any other liquidity needs that we have, we do have assets that can be monetized. So, overall I am very comfortable with the liquidity position and for the most part that's where the cash has, so that's nothing the most part for the point, that's where the cash has come from over the last few quarters. As far as the marks are concerned, if the marks do change and the marks start to move up, then the collateral will be returned to us.

Thomas Gallagher

And Bill is it fairly straightforward in terms of the 9.7 sort of rising and falling in direct proportion with the marks, or is it not that straightforward?

William Dooley

It is related to the mark. Yes.

Thomas Gallagher

Okay. So in other words, if credit spreads keep widening it would continue to consume more collateral.

William Dooley

Yes, if the marks that we get from the collateral agents and those marks are compared to our own marks, and we debate the difference between the two marks. Those debates have really quieted down recently and we really have very, very little disagreement between the various parties. So it's true from what you just said.

Thomas Gallagher

Okay. Thanks. And then Charlie Gates, I think had something on the P&C side.

Unidentified Analyst

My one question, could you elaborate in as much detail as possible, on the commercial lines, property casualty insurance, competitive environment in United States, do you see into both pricing and changes in terms and conditions?

Martin Sullivan

Happy to do so, Charlie if you want a good level of detail, I'm going to give Chris the microphone and may be I'll add some color as well.

Kristian P. Moor

Yes, hi Charlie. It's a competitive market with rates, pressures in most of our lines, particularly workers compensation, aviation. Terms and conditions remain stable overall. If you will go in to the rates, I'll give you a year-to-date this year so far overall rates are down a little bit over 10%. In the property area, rates are down averaging about 18% with CAT rates averaging a little higher than that, non-CAT rates averaging a little lower. Probably our biggest concern right now in our lines of business are workers' comp and aviation. So besides that we see opportunities throughout most of our other lines. Our account retentions

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are very strong in our new business; we are not seeing as much opportunity as before because of this environment, new business year-over-year is down about 13%.

Martin Sullivan

I would just add, Charlie, I've been in this business nearly 40 years and seen many cycles. I think the one thing that is holding up reasonably well is terms and conditions globally. I think we're still seeing... there is always exceptions, but we're still seeing reasonable discipline on the deductibles and certainly reasonable discipline on policy wordings. And that is a component part of the overall profitability of underwriting a risk. So I think that's one change that's a little bit different from maybe power cycles that I've certainly, personally experienced.

Unidentified Analyst

Thank you.

Martin Sullivan

Thank you.

Operator

Paul Newsome of Sandler O'Neill & Partners, you may ask your question.

Martin Sullivan

Hi Paul.

Paul Newsome
Sandler O'Neill & Partners

Good morning and thank you for the call. How should I think about or how should we think about the excess capital numbers that is in your capital adequacy model versus the capital raise. I mean, isn't there a bit of a conflict and that you on the one hand saying that the capital is in excess and then raising more capital. Or should we be thinking it's sort of a... AIG is having some sort of cushion that they need?

Steven J. Bensinger

Yes. I just said earlier on the call Paul, but I'm not sure you are on yet then that our… the level of excess capital at March 31 has decreased from the 15 to 20 range where we've been, since we've been publishing that statistic a year ago to $2.5 billion to $7.5 billion largely because of a decline in the investment portfolio. That is an excess capital cushion that is simply too low for comfort for us in this kind of a volatile period within the capital market. So among many other reasons, the capital raise restores the excess capital position to something much more comfortable during this kind of a turbulent period and we think it's the right thing to do.

Paul Newsome
Sandler O'Neill & Partners

So there's a level of cushion that you're going to want perceptively?

Steven J. Bensinger

Yes, I don't think a company like AIG should be running at a capital position that is too close to the line. You want to have excess capital cushions to take into account a lot of uncertainty out there in the capital markets and what mother nature might have in store, what man-made events might be. I mean there are issues; you have to be prepared for in terms of unexpected liquidity and capital demand. That's what we are here for.

Paul Newsome
Sandler O'Neill & Partners

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Great, thank you very much.

Steven J. Bensinger

Thank you.

Operator

Jay Cohen of Merrill Lynch, you may ask your question.

Jay Cohen
Merrill Lynch

Yes, thank you. A couple of questions, two topics. First is on the capital raise, on the equity and equity link component. Can you talk about how much straight equity you will be issuing roughly, and if you can talk about what the actual dilution to EPS would be from the cap, from the equity portion of the capital raise?

Martin Sullivan

Jay, as you can well appreciate, now the offering has been made, there are legal restrictions as you will well appreciate, and I can't really make any additional comments on the offerings at this time.

Jay Cohen
Merrill Lynch

Okay, fair enough.

Steven J. Bensinger

Jay, we really can't comment on dilution because that depends on the composition of the raise and the final pricing. So, there's really no way to do that yet.

Jay Cohen
Merrill Lynch

Let's wait for that then. Second topic on page 100 of the slide presentation, it shows that the delinquency rate at UGC, based on that graph it looks like it may have peeked and is beginning now to come down. I don't want to read too much into two quarters with the data, but should we look at that and say and hey, it looks like things are peeked or you just can't tell?

Martin Sullivan

Yes. Certainly reading that right and I'll ask Billy to give you some color on that?

William Dooley

Sure Jay. Good morning to you. I would not read too much into that at this point. That is a seasonal downturn that we normally experience in the early part of the year, as you are very much aware, the housing market continues to deteriorate and we're likely to see further increases in our delinquency. What is noted there though is the widening spread between UGC and the rest of our competitors. But, in response to your question, that's a seasonal downturn.

Jay Cohen
Merrill Lynch

Fair enough, thanks for that clarification.

Martin Sullivan

Thanks Jay.

Operator

Jonathan Adams of Oppenheimer Capital. You may ask your question.

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Jonathan Adams
Oppenheimer Capital

Good morning.

Martin Sullivan

Good morning Jonathan.

Jonathan Adams
Oppenheimer Capital

The message the board is trying to send with the increase of the dividend, but given the fairly sophisticated capital deployment models that you use is this pretty clearly an inefficient way of using capital?

Martin Sullivan

Well, all I can tell you Jonathan is that obviously, when the subject of the raise in dividend was discussed with the Board, we believe clearly that it reflects the long-term prospects, the positive long-term prospects of the organization and that's really what the decision was based on.

Jonathan Adams
Oppenheimer Capital

But I guess, what did they say about your capability or your Boards' capability of allocating capital efficiently. Right since, you've got to generate capital and then make decisions about how you deploy it?

Martin Sullivan

When we put this in perspective Jonathan, a 10% increase in our dividend is about $200 million annually.

Jonathan Adams
Oppenheimer Capital

I understand, it’s a small amount, but again if partly they're making a symbolic statement to show the strength of the company. I would think you would also be equally concerned about the symbolism of efficient versus inefficient capital deployment?

Martin Sullivan

Yes, I don't think we've said it symbolic .I think we said there was a judgment that was made, all things considered about the long-term future of the organization and its capability. Our shareholders have told us and one of the reasons we established the dividend policy, they've told us the yield is also important to them. Our yields are relatively lower and we've been trying to get them to a higher level over the course of time. Reasonably, this is just one step in that direction and we felt that was prudent even in the current circumstances.

Jonathan Adams
Oppenheimer Capital

Okay. Thank you.

Martin Sullivan

Thank you.

Operator

Scott Frost of HSBC, you may ask your question.

Scott Frost
HSBC

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Yes, I want to make sure, I just understand the loss figures. You have got $6 billion of realized losses that's mostly other than temporary impair that's... those are the securities that have been downgraded or defaulted then mark down. The unrealized mark-to-market of $9.1 billion plus the $10.6 billion, are you saying that that's the market ... the market valuation loss, mark-to-market valuation. But what's your... are you saying that there is a much smaller... the actual losses only give me a small portion of that according to you and the rest will revert and go back into, I guess shareholders equity, is that how you see it?

Martin Sullivan

I think you are very close. Let me just clarify. What goes through income is predominantly this quarter related to... even though it comes through the realized capital loss line, these are not realized. In fact net realized capital... net realized sales for the quarter were a small net gain.

Scott Frost
HSBC

Are these just write-downs?

Martin Sullivan

These are principally other than temporary impairments. The way we judge what goes through the income statement versus what stays on the balance sheet through other comprehensive income is based on our judgment of whether the decline in value is other than temporary. And if we can't make the assertion and which we can't in many cases in today's market conditions, that some of these prices which are 50% or 40% or more down from our carrying value will recover in the course of the next few quarters. We've taken the position that they are candidates for impairment and write-down through the income statement at this point in time. That contrast of the other $10.7 billion that you'd refer to, that's going through the balance sheet as a reduction on unrealized depreciation of securities. Those securities have not reached a level of decline where we felt they were candidates for impairment and permanent write-down through the income statement. But rather simply reflect those through the balance sheet. The differential is really a degree of severity of price reduction at this point in time and not necessarily a differential between our expectations of ultimate value recovery. If you look in the 10-Q, you'll see a table and the number associated with actual credit impairments in the table... my colleague would get to it now, is a small number compared to the overall other than temporary impairment charge for the quarter.

Scott Frost
HSBC

All right. But just to reiterate of that $19.7 billion of unrealized losses through P&L and AOCI, what amount of that is going to actually be in your view paid losses? Is that the right way to think about that versus marks?

Martin Sullivan

Yes, I can't give you an exact number of what is going to come in. If you look at page 96 in the Q, there is a table on other than temporary impairment charges. Issuers specific credit events is a $171 million out of the $5.6 billion, market severity is $4.1 billion. So our credit experts have actually determined that we think there will be a permanent impairment in value, there is a $171 million out of that whole lot. And how, is it possible? Of course that, the rest of it won't come back and transform into some further impairments. I think that depends on the economy, on unemployment, on the credit markets, on the housing markets, a lot of variables that unfortunately our crystal ball isn't clear enough to accurately predict right now.

Scott Frost
HSBC

Okay. But the severity number, this is after tax, right? And this includes AOCI and the $9.1 billion on the P&L. You are saying that the vast majority of that is mark-to-market severity, not what you consider to be issuer specific credit, is that accurate?

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Martin Sullivan

The vast majority is related to the price issues in the market right now and not necessarily what we believe to be permanent impairments of value.

Scott Frost
HSBC

Okay. Thank you.

Steven J. Bensinger

And I just wanted to add something to what you said, Scott, at the outset you talked about the fact that it was tied to defaults and downgrades?

Scott Frost
HSBC

Let's make sure, other than temporarily impaired. That's in realized losses as you mark those down, right?

Martin Sullivan

As Steve said, number one, it's not realized in terms of having sold them, but I... furthermore virtually none of these securities except for the ones that Steve talked about is some of those perhaps. The rest is not in default. It's still paying currently and the vast majority of it is still rated AAA.

Scott Frost
HSBC

Okay.

Martin Sullivan

So it's not even that it's not performing. It's simply that the price decline in the market for RMBS has been so significant that it has put us in this other than temporary impairment position.

Scott Frost
HSBC

Okay. All right. I understand. Okay. Thank you.

Martin Sullivan
Thank you. Unfortunately ladies and gentlemen, we have to close the call around 10’o clock this morning. I'm sorry if we didn't get to all of your questions. Anybody that has any specific questions, I'd encourage you to go to Charlene Hamrah, and we will try and respond as soon as we can. So, thank you very much indeed.

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