AIG Mending, But Still Dependent, GAO Says

By Editor Test *Wed, Apr 28, 2010*

"The sustainability of any positive trends in AIG's operations depends on how well it manages its business in this current economic environment," said a new GAO report.

The Government Accounting Office (GAO) has issued an 89-page report, “Trouble Asset Relief Program: Update of Government Assistance Provided to AIG,” that offers a portrait of the global insurance giant’s financial health two years after its near-fatal losses in the subprime mortgage crisis.

While AIG is healthier than it was 18 months ago, as indicated by the price of credit default swaps on its debt, its share price, and reductions in its debt to the Federal Reserve, the GAO says the company has mainly exchanged government debt for equity, turning U.S. taxpayers from creditors to shareholders, and it is not ready to function without outside assistance.

The report says in part:

AIG’s commercial paper programs, which reflect the amount of commercial paper AIG has issued to third parties, have steadily decreased from a high of about $13 billion in December 2007. Due to the general breakdown of the U.S. commercial paper market and reluctance from market participants to purchase or roll over AIG’s commercial paper, by September 30, 2008, the balance had dropped to $5.6 billion.

As of December 31, 2009, AIG had no outstanding commercial paper held by third parties. According to AIG, this is because all of AIG’s third party commercial paper had matured and, currently, AIG’s subsidiaries do not have access to third party commercial paper funding. This funding source had been replaced by commercial paper purchased by FRBNY’s CPFF, which was utilized by AIG until the facility expired on February 1, 2010.

As a result of the facility closing, AIG’s CPFF amount outstanding had decreased to $4.7 billion from a high of $15 billion one year earlier. However, given AIG’s ongoing reliance on federal assistance, it remains unclear when support provided by CPFF will be replaced with funds from AIG’s own operations. Unlike many of the other large institutions that received government support as a result of the financial crisis, AIG has not yet been able to tap traditional sources of short-term capital, including commercial paper or other debt markets until recently.

In particular, International Lease Finance Corp. (ILFC) and American General Finance (AGF) recently have been able to access the capital markets. In March 2010, ILFC sold $4.05 billion of secured debt and unsecured debt, and in April 2010, AGFS Funding Company-a wholly- owned indirect subsidiary of AGF-entered into and fully drew down a $3 billion, 5-year term loan.

In closing, the report says:

Federal assistance provided to AIG has gradually shifted from debt to equity, with a reduction in the authorized amount of the FRBNY Revolving Credit Facility and an increase in the amount of preferred equity interests held in AIG and various special purpose vehicles for the government. Consequently, the government's, and thus taxpayer's, exposure to AIG is increasingly tied to the success of AIG, its restructuring efforts, and its ongoing performance.

However, the sustainability of any positive trends in AIG's operations depends on how well it manages its business in this current economic environment. Similarly, the government's ability to fully recoup the federal assistance will be determined by the long-term health of AIG, the company's success in selling businesses as it restructures, and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government.

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