Timothy Geithner/NY/FRS
09/16/2008 10:00 AM

To Calvin Mitchell/NY/FRS
cc
bcc Michael Silva/NY/FRS@FRS, Tanshel Pointer/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS
Subject Fw: Proposal to Insulate Retail Impact of AIGFP Failure

----- Forwarded by Timothy Geithner/NY/FRS on 09/16/2008 09:56 AM -----

Alejandro LaTorre/NY/FRS
09/16/2008 01:44 AM

To Timothy Geithner/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, William Rutledge/NY/FRS@FRS, Patricia Mosser/NY/FRS@FRS
cc Tanshel Pointer/NY/FRS@FRS
Subject Proposal to Insulate Retail Impact of AIGFP Failure

Attached is a proposal to allow the parent to fail while insuring against the negative retail dyanmics. The text is below. The document has some numbers.

Proposal to Reinsure Stable Value Fund Business for AIG.doc

Issue

AIG Financial Products (AIGFP) has approximately $38 billion of stable value wrap contracts written to trustees and investment managers of defined contribution assets.
The wrap allows the plans to manage the asset-liability mismatch that arises when funds are withdrawn from participants. Should AIGFP fail, these funds would have to rebalance by selling assets, potentially generating realized losses for these plans. In the extreme, it could lead to several defined contribution plans to "break the buck". The losses, if large and/or unexpected in magnitude, could lead to a crisis of confidence in the eyes of the public more generally about the security of their retirement benefits.

Dilemma

The dilemma is how to allow AIGFP fail in a manner that contains some of the negative and unpredictable spillover effects that could arise if the failure causes the public to lose confidence in benefit plans more generally.

Proposal

The proposal is to have the federal government reinsure AIGFP's stable value wraps so that AIGFP can be unwound in a manner that contains the negative economic and psychological impact on plan participants. The reinsurance could be temporary until such time a buyer can be found for this segment of AIG. This would require an act of Congress.

Pros

1. Removes a significant argument in favor of preserving AIGFP; allows AIGFP to fail so as not to reward the company's poor risk management practices.

2. Relatively inexpensive to implement; funds would be dispensed over time as plan participants draw down over the life of the plan.

3. Would prevent certain money defined contribution plans from "breaking the buck" and impairing confidence in them (i.e., prevents a "run").

4. Would attract political support from Congress as it would protect individuals from the effects of financial market dislocations.

Cons

1. Sets a precedent involving tax payer funds.

2. May not be necessary.

3. Congress may not be able to act quickly enough.

Next Steps

The Federal Reserve should approach Treasury on providing reinsurance. If Treasury is convinced, it could liaise with the administration and Congress.

Background

AIG-FP has approximately $38 billion of stable value wrap contracts written to trustees and investment managers of defined contribution assets. These are written directly to individual corporate 401(k) and public 457 plans, as well as to institutional trust company collective trusts (collectively "Plans"). There are over 200 counterparties, including pension plans for AT&T, Bank of America, Boeing, Chrysler, Citibank, DuPont, JPM Chase and Wal-Mart. See tables below for additional information on the top investment managers and Plans in respect of these agreements.

FASB provides accounting guidance (FSP AAG INV-1 and SOP 94-4-1) to these Plans that allow them to account for the value of a portfolio of underlying bond investments at a stable value (without daily mark to markets) if these Plans enter into stable value wrap contracts from a third party. The third party must be able and willing to make payment on the difference between where the market value of the underlying assets and the book value of these assets (essentially the amounts reported to the Plan participants).

The bankruptcy of AIGFP will constitute an event of default under all stable wrap contracts entered into with these Plans. Because participants are allowed to trade on a daily basis, if a bankruptcy were to affect AIG-FP, the investment managers and trustees (Fidelity, Vanguard, BlackRock and JPM Investment Management among others) would be required to replace AIG-FP with another stable value wrap provider on the same day as AIG's (and AIG-FP's) filing or risk having their fund assets "break the buck" on the $38 billion exposure. This is because AIG-FP would no longer be viewed as a strong, financially viable counterparty for these contracts. Replacement may be difficult due to the limited number of possible wrap providers, nearly all of which have capacity constraints for additional business in the current environment.

The stable value industry is approximately $400 billion in size among the $2 trillion Defined Contribution market. Set forth below are the Investment Managers and Individual Plans, ranked by notional amount under the relevant stable value wrap contract.

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Top Investment Managers	AIG-FP Notional Exposure
Fidelity	$9.9 bln
Dwight Asset Mgmt	6.3 bln
Galliard (Wells Fargo)	3.4 bln
JPMorgan Inv Mgmt	2.7 bln
Vanguard	2.7 bln
BlackRock	2.6 bln
Morley Asset Mgmt	2.3 bln
Standish (BoNY)	1.7 bln
Deutsche Asset Mgmt	1.7 bln
DuPont Asset Mgmt	.9 bln

Top Individual Plans	AIG-FP Notional Exposure
*Fidelity Managed Income Portfolio II	$3.4 bln
*BlackRock Retirement Preservation Trust	2.1 bln
*Vanguard Retirement Savings Trust	1.8 bln
*Fidelity Managed Income Portfolio	1.7 bln
Boeing Company	1.6 bln
*Wells Fargo Stable Return Fund	1.4 bln
AT&T	1.0 bln
*ICMA Vantage Plus Fund	.9 bln
DuPont	.8 bln
* SEI Trust	.7 bln
JPM Chase Bank	.7 bln
3M	.7 bln
LA County	.5 bln
Raytheon	.5 bln
Lucent	.4 bln
Chrysler	.3 bln
International Paper	.3 bln

* represents institutional collective trusts offered for trust companies, intended for use by thousands of smaller 401(k) and 457 plans.

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