

Flash Comment

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USA: AIG gets loan from the Fed

Overview: Yesterday night the Federal Reserve announced a USD85bn lending facility to AIG. At the same time the US Government is set to take a 79.9% equity stake in AIG. AIG has experienced deep trouble following losses on its holdings of various structured credit with mortgage exposure, sale of CDS protection and holdings of RMBS (see [Research: The financial crisis - what's next?](#)). The intervention removes a major uncertainty for the financial markets and is thus positive for credit and equities while bearish for bonds. However, the financial system is still under severe stress and we believe US authorities will be hesitant to bail out more institutions unless they are of a similar magnitude to AIG.

Details:

With the full support of the US Treasury, the Federal Reserve Bank of New York has been authorised to lend up to USD85bn to American International Group (AIG). The secured loan has terms and conditions designed to protect the interests of the US government and taxpayers.

The reason was that a failure of AIG could add to already significant levels of financial market fragility and have systemic consequences, which could spill over into the real economy.

The liquidity facility is in place for two years and will therefore assist AIG in meeting its obligations as they come due (AIG was facing substantial collateral calls due to the negative rating actions on Monday). Moreover, the loan will facilitate a process under which AIG will sell certain of its businesses in an orderly manner, with the least possible disruption to the overall economy. The facility is revolving and interest will accrue on the outstanding balance at a rate of three-month Libor plus 850 basis points.

The interests of the US taxpayers are protected by key terms of the loan. The loan is collateralised by all the assets of AIG, and of its primary non-regulated subsidiaries (i.e. primarily non-life businesses). The loan is expected to be repaid from the proceeds of the sale of the firm's assets.

Also, the US government will receive a 79.9% equity interest in AIG through warrants and has the right to veto the payment of dividends to common and preferred shareholders. In connection with the bailout, the current CEO Robert Willumstad, will be replaced by Edward Libby who is a former head of the insurer Allstate Corp.

Assessment and outlook:

For the credit market the rescue of AIG is very positive – mainly because the alternative (a failure of AIG) would have been unbearable. AIG is one of the largest insurers in the world – if not the largest. At the same time, it is one of the world's largest counterparts in credit derivatives. Contrary to Lehman, which mainly acted as a broker and therefore had relatively small gross exposures, AIG holds enormous gross credit ex-

posures and the spill-over effects would therefore have been much bigger. After the announcement, the investment grade CDS index, iTraxx Europe, tightened by about 15% and opened around 120bp. With the rescue of AIG some relief is brought to the credit market on a short-term basis as fears of a systemic melt-down have been reduced. Nevertheless, credit is likely to be in for a continuing rough ride as financial institutions, particularly in the US, are under distress. We believe the US government will be hesitant to bail out more institutions unless they are of a similar, or even greater, importance as AIG.

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