



Speech by Edward Liddy

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**The American Chamber of Commerce &
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Good afternoon and thank you for inviting me to address the American Chamber of Commerce in Hong Kong and the Hong Kong General Chamber of Commerce. I appreciate your hospitality and the attendance of so many of our partners and colleagues who are here today.

As many of you know, AIG traces its roots to China, and so it is fitting that on my first trip outside the United States as AIG's Chairman and CEO, I am here. Next year marks the 90th anniversary of the organization's founding in Shanghai. I confess that, at this point, less than three months into my tenure, I am still coming up to speed on our Asian businesses. But I am fortunate that we have Edmund Tse and the leaders of AIA, among others, to help guide me. And even at this early juncture, what I can do today is to assure you that AIG remains fully committed to our business in this region of the world, especially here in Hong Kong, which stands at the crossroads of global commerce.

If you think about AIG's history over the last 89 years, you will quickly recognize that we grew as Asia grew, intermittently suffering the stresses of world wars and regional conflicts, as well as the vagaries of economic conditions. However, as I will discuss more fully in a few minutes, there is no doubt that what we confront today is the most difficult confluence of circumstances in our storied history. The term one increasingly sees used in talking about current economic circumstances is the word,

“unprecedented.” You will hear me use this word more than once or twice in the course of my remarks. In my 37 years in business, I have never seen business conditions like those in the last weeks and months. There is a saying on Wall Street that, “They never ring the bell at the bottom.” And so, we really don’t know how deep, how pervasive or how long lasting the current financial crisis will be.

WHAT I WOULD LIKE TO TALK ABOUT TODAY

First, I’ll talk about how AIG found itself in the center of the current financial crisis. Second, I’ll describe some of the extraordinary measures undertaken by the U.S. government to assure AIG’s continued viability. Third, I will use this topic as a springboard to share some of the thinking that is ongoing in the financial and policymaking arenas in the United States right now. Fourth, I will try to close by answering the question “Where do we go from here?” for AIG – but again use AIG as a point of departure for a more national, if not international, perspective. For, if anyone doubted that the world’s economies are interdependent; those doubts should be put to rest now. AIG, with its global franchise, is a metaphor for the interconnectedness of the global financial system.

HOW DID AIG ARRIVE IN THE MIDDLE OF THE MAELSTROM?

By way of background, AIG is one of the largest insurance organizations in the world, with unique underwriting capabilities. We have over 74 million customers and 116,000 employees in 130 countries and jurisdictions worldwide. AIG has the most extensive property-casualty and life insurance networks of any insurer. We have over \$1 trillion in assets. AIG underwrites a vast majority of the Fortune 500 companies. And, here in Hong Kong and throughout Asia, we have long been a major part of the local economy. In the last quarter, our worldwide revenues were \$21 billion – up seven percent over the previous year.

Not only do we have insurance companies, but we have the most valuable aircraft leasing operation in the world and one of the more extensive financial services organizations around the globe that includes trading in foreign exchange, commodities and interest rates. Through our asset management

businesses, we manage a nearly \$700 billion portfolio with investments across all asset classes, including global real estate. So, with all of the wisdom of hindsight, any dislocation in the global economy would inevitably affect AIG.

However, there was one particular condition that precipitated the financial crisis for AIG. That is the condition of the residential housing market in the United States. The present crisis, which has been widely reported, has been brewing in the U.S. for some time, as cheap credit created an overheated housing market. The situation was complicated, if not enabled, by the creation of complex financial instruments called collateralized debt obligations, or CDOs, which bundled mortgages together for resale and sliced them into tranches based on credit quality, payment terms and default histories. AIG, with its premier credit rating, was one of the entities which sold credit default swaps to buyers of these CDOs, to protect them against the possibility that the CDOs would default. The buyers of the CDOs and the credit default swaps were some of the largest banks and investment organizations in the world.

In 2005, AIG became concerned that the quality of the underlying securities going into the CDOs was diminishing. We made the decision at that point not to write any further credit default swaps on newly issued CDOs. However, we did not exit the business for the credit default swaps that we had written to that point. In 2007, the CDO market began to unravel as the U.S. housing bubble burst. By early 2008, the price of the CDOs had fallen markedly – not because of high default rates, but because no one wanted the exposure to these and similar instruments.

By mid-2008, our counterparties to a variety of multi-sector securities began to demand collateral from AIG as assurance that, in fact, if there were events of default, AIG would be able to pay. Essentially, no one could sell their portfolio of CDOs at prices that were commensurate with the payment performance of the securities. That included AIG, which had an investment portfolio that included such securities. The result is that there was the proverbial “run on the bank.” Counterparties were demanding increasing amounts of cash collateral from AIG, more than we could reasonably be expected to raise, given market conditions. Thus, we were caught up in the liquidity shortfall – even

though the actual risk of default of underlying securities had not implicated AIG's original underwriting decisions.

WHAT WAS THE U.S. GOVERNMENT RESPONSE?

As you know, by mid-2008, AIG was not the only entity which had liquidity issues. Bear Sterns was sold to JP Morgan, and Lehman Brothers declared bankruptcy. By late summer, Congress had passed legislation granting the U.S. Treasury authority to undertake steps to infuse capital into U.S. financial institutions. In AIG's case, the government elected to intervene. In mid-September, the Federal Reserve Bank of New York provided AIG with an \$85 billion bridge loan in the form of a credit facility that allowed us to continue to meet the cash collateral calls from our counterparties.

But the underlying problem – that there is no market for various CDOs – persisted. On November 10, the NY Fed and the US Treasury announced a more durable approach for AIG that featured an infusion of \$40 billion of equity, revisions to the credit facility, and the establishment of a vehicle that would remove a significant portion of the credit default swap liability from our books.

I can't underscore enough the significance of the November 10 action. It reflects the ability of our government to act quickly – and commercially – before further damage was wrought to the financial infrastructure. It should also be noted that, except for our problem with credit default swaps, AIG has healthy, vibrant businesses around the globe. Nothing was to be gained – and there was much to lose – if AIG were not allowed to develop a global restructuring plan to resolve our financial difficulties.

WHERE DO WE GO FROM HERE?

The very phrasing of this question goes to the heart of who “we” are, in a globally interconnected world. Who is going to address not just AIG's problems, but the consequences of such problems on economies around the world”? Will it be “we” of a restructured AIG? Will it be “we” Americans with

the world's largest economy? Will it be "we," who are leaders of industry, such as all of you in the audience today? Will it be "we" public policymakers of the various nations?

I personally believe – and profoundly hope – that "we" who are charged with the joint responsibility of ensuring that the global financial system operates properly is the cooperative effort of private and public sector leaders from all over the globe.

But let me talk for a moment about where AIG goes from here. In this period of uncertainty around the world, it is inevitable that there will be rumors – sometimes spread by those with a vested interest in making certain outcomes a reality. There is no doubt that AIG has been a centerpiece of many rumors of late. Some of the rumors are rather remarkable. My advice is simply this: Be wary. When we have developments to report or if our plans change, we intend to report them. But if a report emerges that does not originate with AIG, I would ask you to maintain a healthy skepticism. In the meantime, let me give you some facts.

Our strategy is to divest assets and become a more focused enterprise. Our focus in the future will be on our worldwide property casualty businesses with a continuing interest in our Asia life business. These are challenging times to undertake divestitures and it's quite possible that the pace or order of our divestitures will change. Nevertheless, I have made the very public commitment that we will pay down the entirety of the amounts we have borrowed from the U.S. taxpayers.

We have previously announced our intention to maintain a majority ownership in AIA but to sell a minority stake of up to 49%. AIA is the leading life insurer in Southeast Asia. Anyone who takes the ferry across Victoria Harbor can't help but notice the AIA signs on Stubbs Road and in Quarry Bay. Other key Asian properties we will be seeking to divest in their entirety include ALICO, AIG Star and AIG Edison.

Assets like AIA and ALICO are businesses that are available only once in an executive's lifetime. They simply could not be re-created today. We expect leaders who want to transform their businesses in Asia will be most eager to bid on these assets.

The U.S. government has put a five-year timeframe on our arrangements. Thus, we don't need to hold a "fire sale." We are committed to identifying buyers that will honor our values and recognize the contributions of our people. At the same time, we want buyers for these businesses who can provide the capital and leadership necessary to exploit the remarkable opportunities that the Asian economy promises for the businesses. We expect to entertain fully valued offers for our Asian businesses – and indeed, for many premier businesses around the globe.

Paula Reynolds, who recently joined AIG as Vice Chairman, is here today with me and is leading our divestiture and restructuring process. Now that we have made progress on the structure of our support from the Treasury and Federal Reserve, we are beginning to execute transactions. We recently announced several divestitures, including sales of our private banking business, a stake in AIG's Brazilian joint venture, and a divestment in a U.S. energy company. We expect more announcements in the weeks ahead. Given the size and complexity of our businesses, however, please recognize that announcements on these businesses are a couple of months or more into the future.

Meanwhile, I'm working to ensure that AIG continues as a viable, competitive business that provides value to our stakeholders. Like all businesses around the globe, we are being extremely cautious with expenses and major new investment commitments, but will continue to support our worldwide enterprises. In addition, AIG is engaged in improving transparency - not as a penalty, but as a necessity for the good of all stakeholders - working with regulators regarding issues of capital adequacy, appropriate accounting treatment during times of market disruption, and risk management metrics. This is the recipe for a holistic approach for reigniting confidence in us and contributing to the restoration of well-functioning markets.

So whether you are a regulator wondering about our commitment to surplus adequacy... or a lender wondering about loan status... or a customer wondering about whether we will pay a claim, please know that we are very much in business today with the future in mind. We are not going to make short-sighted decisions or ignore the very real obligations we have around the globe. In this same vein - and this may disappoint customers who are hoping for lower prices for insurance - AIG is committed to maintaining the underwriting discipline that has always been essential to our success. It will do us no good to overcome today's financial problems only to find a few years down the road that we are sitting on a pile of unprofitable insurance policies. We are fully dedicated to protecting, serving and providing value to our policyholders, our agents and the other business partners who are central to our success. Insurance is a people business, and we need to maintain solid relationships with our clients that are based on integrity and respect.

In summary, you can expect us to run the business responsibly.

WHERE DO WE GO FROM HERE, AS LEADERS?

In my current role, I have the opportunity to talk to my counterparts around the globe, as well as an occasional policymaker, particularly in the United States. If I had to summarize the collective thinking of leaders – with an admittedly American slant – I would offer the following observations.

1. **This situation is more than a sectoral crisis.** It started in the U.S. housing market, but has erupted into a financial crisis. This occurred as the banking system found itself having to deleverage rapidly after a prolonged period of somewhat reckless financing activities. There was excessive risk-taking because risk was not properly assessed and priced. Even as the risk became more apparent, most of us, including AIG, did not take the necessary steps to staunch the risk. As a result, the problem is now systemic.
2. **The notion that nations can selectively decouple themselves from the consequences of a financial crisis that is this deep and pervasive is not realistic.** We are all in the crisis

together. Thus, we must now resist the temptation to correct this state of affairs by building walls that separate us or creating barriers to international trade in goods and finance. Winston Churchill said, “Minds are like parachutes; they work best when they are open.” Thus, we should improve the conduct of economic diplomacy and together build the beneficial policies and risk management practices that have been so sorely lacking.

3. **We are interdependent, but we should not be “co-dependent.”** We must not be enablers of each other’s transgresses. As America tries to revert to a more prudent savings rate, other countries will now have to take action as well to reset expectations. But an uncoordinated response would threaten to disrupt global markets and should be avoided at all costs. We must all recognize that a systemic problem requires systemic, holistic solutions. Thus, coordinated regulatory reform of financial markets across the globe is imperative.

4. **At the core of what we must address is the crisis of confidence.** No single company, not even AIG, can fully resolve its challenges unless international policymakers come together to address systemic risk. We have seen a succession of actions in the U.S. where monetary authorities have dropped rates and infused capital, but meanwhile the interbank market – the lubricant of well-functioning financial markets – persistently refused to cooperate. This occurred because there is a fundamental lack of confidence across the board. The actions that will count the most with all of us as individuals, as consumers, as business leaders, is to see that the policy leadership of the world is working harmoniously. Nothing will ignite confidence more than the knowledge that pilots of the economic systems are in coordinated flight paths.

I know that many of you are wondering how this coordination can take place when the U.S. leadership is in transition. We can only have one President at a time, so the question of how America can move forward before mid-January is on the minds of many. In my opinion, President-elect Barack Obama has been totally immersed in economic matters and has assembled around him a team that is being

universally praised as highly capable. This team is earnestly engaged and is asking all the right questions. We are very hopeful.

Those of you who are long-time residents of Hong Kong have recently commemorated the 10th anniversary of the Asian economic crisis, in which Hong Kong suffered so much. So I don't have to tell you when flying through a stormy environment, you can't necessarily only navigate those storms of your own making. But in the end, you find ways to fly through. I believe that economic history has shown that Hong Kong addressed the Asian economic crisis in a very decisive way, and its recovery spurred growth across the wider region. At the core of that recovery was the confidence on the part of all the economic players that the direction was correct and that the necessary steps would be taken. With concerted and coordinated action, we can all navigate through this storm as well.

Insurance is the oxygen of the free enterprise system. It makes all other economic activity possible. As policymakers around the globe undertake coordinated actions, AIG will proceed with its restructuring, and in doing so, hope to contribute positively to a recovering world economy.

We will certainly be a different company in the future, but some core values will remain the same. We are committed to our customers. We are committed to our employees, our agents and our business partners. We are committed to Asia. We are committed to being a responsible enterprise. We will carry forth with a culture of productivity and transparency, rooted in our Asian heritage.

We thank all of you who have been our partners and our clients for the trust you have placed in us. We are working every day to restore and enhance your confidence in our businesses around the world.

Thank you for being here today.

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