

# SAUNDERSON HOUSE



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## **Independent Financial Advisers**

**Analysis into the Security of Investment into AIG Life Products**

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**Analysis into the Security of Investment into AIG Life Products**

**Background**

This note analyses the security of client assets placed in the AIG Standard Variable Rate (SVR) and Enhanced Variable Rate (EVR) funds which back AIG Life products, such as the Premier Access and International Premier Access Bonds. We consider three factors which, in our view, are key to assessing the security of investments into these products.

These factors, in declining order of importance, are:

1. Counterparty risk - the quality of the assets held in the two funds
2. Contamination risk - the security of the 'ring-fencing' between the funds and other parts of AIG Life's business
3. Parent company risk - the strength of American International Group Inc (AIG).

**Conclusions**

1. The assets are very conservatively invested in the SVR fund and somewhat less so in the EVR fund. A comparison of the underlying holdings of the funds leads us to conclude that the higher interest rate available on the latter is insufficient to justify the additional risk taken. The additional return (about 25bps) looks too low given the somewhat lower quality and higher duration of the assets and therefore the higher risk of capital loss. It appears likely that AIG Life enjoys a much higher profit margin on the EVR fund than the SVR fund.
2. The assets in the funds form part of AIG's long-term business fund (LTBF) and could therefore, in extreme circumstances, be used to meet claims incurred on other lines of life business. While it is unlikely that this would occur, it does make an investment into SVR or EVR riskier than one into a fund where the assets are entirely separate from the manager's other businesses.
3. The AIG balance sheet looks strong although, as the presentation slides on residential mortgage exposure show, the business is closely involved in the US housing market. It is also a large player in the collateralised debt market (CDO) and a substantial insurer of third party debt (credit default swaps). Analysing AIG's most recent report and accounts gives little insight into these exposures, however, the mortgage guarantee business did become loss making in the second quarter of this year.

**Recommendations**

We are satisfied that investments in the Standard Variable Rate funds are reasonably secure. The Enhanced Variable Rate funds are, however, less secure and take on sufficient additional risk to make a capital loss to investors a realistic possibility. Potential returns on the EVR funds are higher, but in our view, insufficiently so. We would, therefore, recommend the SVR funds in preference to the EVR funds unless the guaranteed rate on the latter improves markedly and the client indicates he is prepared to take some degree of capital risk.