AIG Rating AA

Insurance Company

Rating AA

10% fee

Insurance

Pension Fund

Needs to invest

Money in case of defaults

But AIG

Rating AA

1. Rating
   AIG Corp

   To AIG Corp
   (capital)
   or
   Money in case of defaults
   Hedge Fund

2. AIG buys CD$ from ABC Corp.
   Loans no money

Rating DB

Good

Ratings

Moody's

Agency Ratings

Can't lend unless AIG is fine; but without regulation, they are cash

Credit Default Swaps (CDS)
pension funds

1. We give money to pension fund
2. They hold our money until we retire
3. Pension fund invests money & earns return
4. They keep some of return
5. They give us some of return
6. When we retire we get our money back plus extra.

Default: company can't pay money back

Interest: Rent on money
Mortgage

1. Payment check
2. Broker sells mortgage to someone else
3. Broker sells loan to Home Buyer
4. Good job with high income
5. Home Buyer

Fannie Mae or other financial firms

Collateralized Debt Obligation

Does M.B. care if loan defaults if he has already been paid?