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A.I.G. Secures $150 Billion Assistance Package

By MARY WILLIAMS WALSH

The American International Group said on Monday that it lost almost $25 billion in the third quarter and had secured a new $150 billion government assistance package intended to stem the bleeding from its complex financial contracts.

A central component of the new package will be to get the most tainted assets out of the company, in an effort to stop the collateral calls that have been rapidly draining A.I.G.'s cash. A.I.G.'s trading partners in these financial contracts will largely be made whole in the process.

Since mid-September, when A.I.G. suddenly came to the brink of collapse, its problems have become steadily bigger and costlier to fix. Originally, the Federal Reserve rushed in with an $85 billion line of credit. When that proved inadequate, the Fed added a $38 billion supplementary lending facility, and A.I.G. recently qualified to sell $21 billion of commercial paper to the Fed.

“These terms are not sustainable,” Edward M. Liddy, the insurance executive brought in to lead A.I.G. through the crisis, told securities analysts in a conference call Monday, referring to the high interest rates on the original loans.

The company has reported $38 billion in losses this year, wiping out the company's total reported earnings for the preceding three years.

The new assistance package reduces the original $85 billion loan to about $60 billion, lowers the interest rate and gives A.I.G. five years, instead of two, to pay it off. The government will also use money from its Troubled Asset Relief Program to buy $40 billion of preferred shares in A.I.G.

Another important feature will be government investments of about $50 billion to create special-purpose entities to relieve the company of its most tainted assets.

About $30 billion of the government money will be used to buy complex debt securities that were insured by A.I.G. and about $20 billion more will be used to buy securities backed by home loans.

A.I.G.'s counterparties — financial institutions in the United States and Europe — have not borne significant losses on the financial contracts that led A.I.G. to the brink, and the new program suggests they will not.

“We're funding somebody on the other side” of A.I.G.'s derivatives contracts, said Lynn E. Turner, a former chief accountant with the Securities and Exchange Commission who has been critical of the way the insurer's crisis has been handled. Even though a large amount of public money is being extended, neither A.I.G. nor the federal government has been willing to provide the names of the company's biggest counterparties, or their amount of exposure.

“We've had way too many things here that nobody knows anything about,” said Mr. Turner, who is on the Treasury's Advisory Committee on the Auditing Profession. “That's why no one has faith in the capital markets.”

Another critic said that A.I.G. would still have to contend with other financial contracts that were not addressed in the rescue but that might deteriorate in the future. “I think it will help, but I don't think it will solve the whole problem,” Donn Vickrey, founder of Gradient Analytics, an independent securities research firm, said of the latest plan.

Mr. Vickrey noted that A.I.G. had insured several different types of debt securities, and the type now being dealt with was the first to go bad because it was linked to subprime debt. “As the economy deteriorates, I would expect the other debt lines to incur more losses,” he said.

The Treasury official overseeing the government's financial relief said that revising the A.I.G. rescue plan was a one-shot deal that would be accompanied by stringent conditions to protect taxpayers.

Neel Kashkari, assistant secretary of the Treasury, said the move was "necessary to maintain the stability of the financial system."

At the heart of A.I.G.'s troubles are a type of derivative called credit-default swaps. They are essentially a kind of insurance that A.I.G. wrote on complex securities, known as collateralized debt obligations, sold in recent years to financial institutions. By issuing the swaps, A.I.G. was promising to pay these institutions — A.I.G.'s counterparties — if the debt securities defaulted.

A.I.G. wrote a large book of business on the thinking that such defaults were unlikely. As the economy has soured, though, some of the securities have weakened and shown signs of failure.

The insurance contracts have also proved crushingly expensive for A.I.G. because they included provisions requiring it to post collateral under certain circumstances, showing that it could afford to keep its promises. For instance, a downgrading of A.I.G.'s own creditworthiness could prompt a big collateral call.

That is what happened to A.I.G. in mid-September. It was suddenly required to come up with more than $10 billion in collateral, pushing the company to the brink. Much of the original $85 billion line of credit from the Fed has been spent fulfilling collateral calls.

Although A.I.G. wrote its insurance contracts on more than $400 billion of various types of complex debt securities, only about $70 billion worth of the securities are thought to be at imminent peril of default. A.I.G. refers to this batch of securities as multisector C.D.O.'s, because they combine a number of different types of debt.

Under the new plan, A.I.G. and the government will together create a new special-purpose entity to buy up the multisector C.D.O.'s. The C.D.O.'s will be quarantined in a place where it no longer matters much whether their value rises or falls, because A.I.G.'s own balance sheet will not be affected.

Also, because A.I.G.'s counterparties will no longer own the multisector C.D.O.'s, the company will not have to provide insurance coverage against default anymore. When the insurer cancels the troublesome insurance contracts, it will put an end to the collateral calls that have depleted its cash so severely.

The special-purpose entity will be financed with $5 billion from A.I.G. and $30 billion from the federal government. The entity will buy securities with a fair value of about $70 billion. The counterparties, which in aggregate had already pried about half that amount out of A.I.G., will be allowed to keep the collateral as well, people familiar with the planning said.

That will leave A.I.G. with losses of about $30 billion that it has already taken on its multisector C.D.O. insurance program, said Andrew Kligerman, a securities analyst at UBS.

"That's permanent," Mr. Kligerman said. "They're never going to get that $30 billion back," because the assets are being sent into quarantine.

But because A.I.G. and the government will be jointly holding the tainted assets in the special-purpose entity, he said, A.I.G. will share any income with the government. The government is the senior partner in the special purpose entity and will receive an interest rate of the three-month Libor plus 1 percentage point and will be entitled to be repaid for its investment first. A.I.G. will receive Libor plus 3 percentage points.

In exchange for the emergency loan, the Fed has received a warrant entitling it to a 79.9 percent stake in A.I.G. The new package does not change that.

Mr. Liddy said he believed that A.I.G. was "on the road to recovery," although the turnaround would still take time, he said. Even with the help of the government, he said, A.I.G.'s success would still depend on whether world financial markets came back to normal. He declined to say how long the process would take, or how long it would take the special-purpose entity to be formed and make its purchases.

While A.I.G. recovers, Mr. Liddy said, it will be paying market rates of interest on all loans from the federal government. “It is not exactly a bailout,” he said.

A.I.G.’s third-quarter report suggested that its core insurance business was also coming under pressure as the economy weakened. While about $7 billion of its quarterly losses, on a pretax basis, were connected with the insurance coverage A.I.G. sold on other institutions’ assets, a bigger share of the losses, about $18 billion, were incurred because the assets in A.I.G.’s investment portfolios had fallen in value.

Of that total amount, losses of a little less than $12 billion were on investments made under A.I.G.’s securities lending program, which is handled mostly by its life insurance subsidiaries. A.I.G. had previously been given a $38 billion credit facility from the Fed to support its securities lending activity, but said on Monday that that facility would be extinguished under the new program.

Instead, the government will invest $20 billion in A.I.G. to create a second special-purpose entity to hold other tainted investments, often backed by residential home loans, from its securities lending program. A.I.G. will invest $1 billion in that entity.

Mr. Liddy also said that A.I.G. had experienced a loss in its property and casualty business because of claims from Hurricanes Gustav and Ike, but said A.I.G.’s exposure was in line with that of the rest of the industry.

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