AIG's fire sale is sparsely attended

As insurer's assets lose value, cost of U.S. loan looks high—and its strings are tightening

By Beth Braverman

WHEN THE FEDERAL RESERVE bailed out American International Group last month, the support—in the form of an $85 billion loan—came with some major strings attached.

With the credit markets frozen and the stock market taking roller-coaster dives, those strings are now strangling AIG.

AIG has since arranged for a second line of credit for $37.8 bilion. As of Thursday, the insurer had drawn down $82.9 billion, or two-thirds of the $123 billion available. Meanwhile, the company's plan to pay off the onerous debt through asset sales—its only feasible means of raising capital—has not yielded a single deal.

Under the terms of the original two-year loan, the Federal Reserve received a 79.9% stake in the insurer, and AIG will pay 8.5 percentage points over three-month Libor, an initial gross commitment fee of 2% of the total loan facility and a fee on undrawn amounts of 8.5% a year.

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"Time is not on their side," said John Ward, chief executive of Cincinnatus Partners, a private equity firm specializing in the insurance industry. "They've got to move quickly. It's very expensive to keep that loan."

The company continues to hemorrhage money on credit default swaps tied to billions in bad mortgage bets. The bulk of the loan money has gone into meeting collateral calls and unwinding the securities lending program that put the company on the brink of bankruptcy.

Changes in the financial markets over the last few weeks have made it impossible to find viable buyers for AIG's assets.

"The underlying businesses that comprise the AIG franchise are good businesses, and they're valuable well in excess

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AIG's lack of takers

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of the $85 billion loan," Mr. Ward said. "The challenge is getting the right suitors to the table in a market where everyone's been wounded in the last couple of weeks."

Although most other big insurers have some exposure to collateralized debt through their investments, their balance sheets a few weeks ago appeared much stronger than AIG's, since they did not originate deals like AIG did.

But insurers' stocks have been pummeled in the broad sell-off that has been ongoing since CEO Edward Liddy's announcement on Oct. 3 that AIG would sell assets. In the week immediately following the announcement, the stock prices of likely buyers Ace, Travelers and MetLife all fell by more than 20%. At the same time, debt availability, already tight, virtually disappeared.

MetLife raised $2 billion with an Oct. 8 stock issuance, but it sold shares at a discounted $26.50 each, just days after they had been selling for more than $40. MetLife said it would use the proceeds for general corporate purposes and potential "strategic initiatives."

"Given the credit markets right now, it's difficult for insurance companies to get financing to do these deals," said Andrew Colannino, vice president of property and casualty at A.M. Best.

Even as the credit markets eased slightly last week, equity markets remained volatile, recording their biggest plunge in decades Wednesday.

On Thursday, Fitch Ratings revised its ratings outlook to negative from stable for 12 insurance and reinsurance sectors globally, and confirmed its negative outlook on six other sectors, including the U.S. life insurance sector. Ratings downgrades in September sparked the liquidity crisis that almost bankrupted AIG.

"Some of the potential suitors [for AIG businesses] may have stumbled into some unexpected turbulence in the markets themselves," Mr. Ward said.

Even though none of AIG's rivals have acquired any of the company's subsidiaries, they may still benefit by stealing market share or personnel, analysts said.

"Anytime you have a situation like this, there's going to be a strain on employees and policyholders," Mr. Colannino said. "But AIG is doing everything it can to hold on to employees at this point. I haven't heard of any mass defections yet. I am sure policyholders may be looking for alternatives" when their renewals come up.

AIG has not publicly put forth a timetable for the sales, but Mr. Liddy has said the company may sell more or fewer assets depending upon the prices they draw, its ability to "monetize" the value of securities in its financial products division and, possibly, its participation in the Treasury's Troubled Assets Relief Program.

"GIVEN THE CREDIT MARKETS RIGHT NOW, IT'S DIFFICULT FOR INSURERS TO GET FINANCING."

On Thursday, AIG appointed a new chief financial officer, David Herzog, to help oversee AIG's plan to address its capital structure and pay down the credit facility. Mr. Herzog, 48, had been AIG's controller since 2005. He replaced Steven Bensinger, who had served since May as AIG's vice chairman of financial services and acting CFO.

The management change followed a public uproar and threatened legal action by New York attorney general Andrew Cuomo over alleged improper bonuses and other payments to former executives.

Under the second lending agreement with the New York Fed, the Fed would borrow up to $37.8 billion worth of investment-grade, fixed-income securities from AIG's domestic life subsidiaries in exchange for cash collateral.

"It's designed to provide liquidity to our securities lending program but give protection to the Fed," said AIG spokesman Joseph Norton.

Another wild card: former chief executive Maurice "Hank" Greenberg, who has himself been rumored to be interested in purchasing some of AIG's subsidiaries. Mr. Greenberg, also a major AIG shareholder, sent a letter to Mr. Liddy and AIG's board last Monday proposing an alternative to the onerous terms of the original $85 billion AIG loan.

"AIG cannot pay off this loan from the proceeds of selling assets in this market, nor can it pay the annual interest rate from earnings," he wrote in the letter, filed with the Securities and Exchange Commission. "As a result, thousands of jobs will be lost, pensioners will lose their savings and millions of shareholders will be disenfranchised. It is a lose/lose plan."

Instead, Mr. Greenberg wants to give the Fed non-voting preferred stock with a dividend of about 5.5% and a 10-year right of redemption at a 10% premium

Mr. Ward doesn't expect the Fed or AIG will "take the proposal seriously."

"The proposal is not nearly as good for the federal government, which reached the agreement with AIG when it was on the brink of bankruptcy," he said. "You can't come in after the pressure is off and get the Fed to reconsider the terms." FW