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By Lilla Zuill (https://www.insurancejournal.com/author/lilla-zuill/) and Mark Felsenthal (https://www.insurancejournal.com/author/mark-felsenthal/) | November 9, 2008

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The U.S. government dramatically boosted its bailout of insurer American International Group Inc. and eased the terms of its loans to the company on Monday after an initial rescue plan failed to stabilize the company.

Under the new plan, the U.S. Treasury will take a $40 billion equity stake in AIG as part of a package of credits to to prevent the collapse of what it called a "systemically important company." The Federal Reserve is providing up to $112.5 billion in loans and funds for asset purchases.

The new package, the largest bailout of a single company, provides AIG with about $27 billion more than previously extended and will leave the government exposed to billions of dollars of additional potential losses.

"This is a one-off, created solely for AIG," a U.S. Treasury official said of the transaction hammered out over the weekend.

"This wasn't done to help AIG shareholders. It gives the company the room it needs in its capital structure to execute its asset disposition plan," the official told reporters in a background briefing.

AIG shares rose 29 percent to $2.72 in early trade after the new rescue plan was disclosed.

MASSIVE LOSSES

The restructured bailout was announced as AIG posted a $24.47 billion third-quarter loss, the largest in the company's 89-year history. In addition to massive losses on investments, there were billions of dollars of insurance claims from hurricanes that battered the U.S. Gulf Coast this year.

The U.S. Treasury will buy $40 billion of AIG preferred shares with money from its $700 billion financial rescue fund, the Troubled Asset Relief Program (TARP), a tool that did not exist at the time of AIG's initial bailout in mid-September.

This will allow AIG to pay down its loan from the Federal Reserve to $60 billion from $85 billion. The Fed also will provide more than $50 billion to buy distressed securities and backstop the firm's lending portfolio.

The new plan is nearly double the government's initial $85 billion rescue of AIG, forged on Sept. 16, weeks before the Treasury launched its plan to inject capital directly into American financial institutions.

The government said its equity stake in the insurer would still be about 80 percent, making it the biggest beneficiary of the revised bailout.

The preferred shares will carry a dividend of about 10 percent. The Fed will slash the interest rate on its remaining loan by 5.5 percentage points to three percentage points above three-month LIBOR. AIG will only pay 0.75 percent interest on undrawn funds from the facility, which is extended to five years from two years.

The AIG capital injection will reduce to just $40 billion the amount of bailout funds that the Treasury could now to dole out to non-bank companies before it must ask Congress for a second $350 billion. Struggling automakers General Motors Corp. , Ford Motor Co > and Chrysler LLC have requested tens of billions of dollars in Treasury aid.

The Treasury has separately committed $250 billion for banks and thrifts, but officials are studying other uses for the remaining funds.

A Fed official said the government, after an outside analysis, concluded that cutting AIG's loan rate and taking on its mortgage-backed securities and credit default swap contracts was the best way to stabilize the firm. The government is confident the loans will be repaid and there is a chance it could return to profits, the official said.

AIG, once the world's largest insurer by market value, initially got a government bailout in September after counterparties and rating downgrades forced the company to post large amounts of collateral for credit derivatives positions. Last month, $37.8 billion in additional federal funds were put at its disposal under a securities lending agreement.

The new plan replaces both of those facilities.

AIG Chief Executive Edward Liddy said the terms of the new bailout "create a durable capital structure that will make possible an orderly disposition of certain of AIG's assets" and assure taxpayers are repaid in full with interest.

Credit default swap agreements have led AIG to record $18 billion in losses over the past three quarters.

The U.S. Treasury said its $40 billion investment would subject AIG to more stringent curbs on executive pay and bonuses than those imposed on banks and thrifts receiving government capital injections. These include limits on golden parachutes and a freeze on the bonus pool for the firm's top 70 executives, along with the most stringent curbs on pay for the top five executives.

AIG reported a third-quarter net loss of $24.47 billion, or $9.05 a share, compared with a year-earlier profit of $3.09 billion, or $1.19 a share.

AIG's revenue in the third quarter fell sharply to $898 million from $29.8 billion in the year-ago quarter. The company also recorded $1.39 billion in catastrophe losses, primarily from hurricanes Gustav and Ike.

A year ago, AIG's stock was about $57. It closed at $2.11 on Friday, off an all-time low of $1.25 in the hours before the government stepped in with the initial $85 billion loan.

(Reporting by Mark Felsenthal and David Lawder in Washington and Lilla Zuill in New York; Editing by Chizu Nomiyama)

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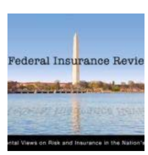

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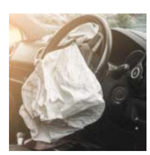

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