AIG's slow climb back

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The insurer has finally taken real steps towards recovery, and its stock has rallied. But taxpayer returns look a long way off.

Almost a year after it nearly collapsed, American International Group has only just found a chief executive who might stick around for a while. It has been a slow start to a marathon that began when Lehman Brothers went bust in September last year.

The arrival of tough-talking Robert Benmosche has accompanied a rally in the company's languishing stock. But real progress is sluggish. A return to health looks a long way off -- and any investment return to taxpayers is even more distant.

Lehman's collapse had unexpectedly dire and rapid repercussions, prompting politicians and officials to inject $85 billion of taxpayer money into AIG (AIG, Fortune 500) just days later. As time went on, AIG's financial positioned worsened as it began winding down its $500 billion portfolio of credit default swaps in awful market conditions. A series of further bailout moves followed.

In total, taxpayers committed about $180 billion to bail out AIG and buy some of its dodgiest assets. The hurriedly installed stopgap chief executive, Edward Liddy, proposed a plan to sell assets to pay back the government.

But buyers for the big ones haven't bitten. So far, AIG has managed to sell only a few billion dollars worth of assets. There have been other challenges too. AIG was hit with a public relations disaster over bonuses it had agreed to pay members of its financial products unit, the source of its woes. Along the way, the dollar-a-year Liddy became fed up with taking flak from Congress and the media.

Finally, in early August new chief Benmosche, formerly the boss at MetLife, took the helm. He has helped boost AIG's stock by saying he will take a more patient approach to selling assets. The company's shares have tripled since he replaced Liddy -- although they are still trading at less than 5% of their level six months before Lehman's collapse.

But Benmosche's tough talk -- including criticisms of officials, a risky game given AIG's precarious position -- can't on its own help U.S. taxpayers get their money back. So far the government's investment has merely been reshuffled, reducing AIG's debt to taxpayers but increasing their exposure to equity in the company's business units. In June, the government agreed to swap $25 billion of its bailout loans to AIG for stakes in key insurance business units that AIG plans to spin off, but which are yet to prove their standalone value.

Even assuming the spin-offs conclude successfully, AIG will still owe the government $20 billion in debt. The US Treasury also made a $40 billion equity-like investment, while the Federal Reserve's original bailout has given it an effective 79.9% interest in AIG itself.

The odds that taxpayers will even get their money back, let alone a return, still look long. The two spin-offs need to be accorded enough value by investors that the government's stakes are together worth at least the $25 billion implicitly paid. The bad assets the U.S. government took off AIG's hands for $45 billion-odd have to perform the unlikely feat of turning out to be worth that much. And AIG needs to get back on its feet so that the government's $20 billion in debt can be repaid or refinanced.

Then the government's remaining equity interest still has to be worth $40 billion for taxpayers to break even. Right now, AIG's publicly traded common shares are worth about $5.5 billion. If

the government becomes the holder of a true 79.9% stake, the implicit market capitalization would be around $27 billion -- half what it needs to be, even though the stock has risen four-fold in the past two months. In other words, an awful lot has to go right.

There are some brighter spots. Benmosche, with his $7 million a year package, seems motivated to get AIG on track. He is already revving up the troops with colorful language, including criticism of New York Attorney General Andrew Cuomo.

A certain amount of aggression may be warranted, but Benmosche has already had to back off some of his rhetoric. He will have earned the right to be more publicly belligerent if, in a few years, AIG is genuinely on track towards making taxpayers whole.

LAUGHLIN, Lauren Silva. AIG's slow climb back. **Fortune**, Amsterdam, Sept. 8th 2009. Disponível em: <www.money.cnn.com>. Acesso em: 9 set. 2009.