AIG's rescue has a long way to go

When will the government's costly bailout of the deeply distressed insurance giant be over? Don't expect it to be anytime soon.

By Carol J. Loomis, senior editor at large, Fortune

NEW YORK (Fortune) -- Within insurance giant American International Group, but known to only a few people, is something irreverently called the "kill list."

It was created by AIG's controller, David Herzog, on Tuesday, Sept. 16, the wild day when the company plunged toward bankruptcy only to be bailed out instead by the U.S. government. Very late that night, Herzog, then 48, sat in the company's New York City headquarters, brooding about the day's events.

Robert Willumstad, CEO for only three months, had learned from the Federal Reserve that he was out, on the theory no doubt that the government can't extend an $85 billion credit line to a company and leave things in the hands of existing management.

The AIG board had been told that the new CEO was to be Edward Liddy, who had decades before overseen a Sears Roebuck restructuring and then become head of a Sears spin-off, Allstate Insurance. More important to the crisis at hand, Liddy's career had made him a business friend of Secretary of the Treasury Henry Paulson and a member of the Goldman Sachs board.

Minutes before midnight, at 11:54 p.m., Herzog - called by one former AIG officer "a prince, a straight shooter" - wrote a short e-mail to the deposed Willumstad, first thanking him for having stepped up months earlier to the "difficult challenge" of running the company.

Then Herzog flung his e-mail grenade: "Before you leave, I ask only one thing. Please clean the slate for Mr. Liddy. I urge the following dismissals immediately." Herzog next listed the names of one vice chairman, two executive vice presidents, five senior vice presidents, and one vice president. AIG's general counsel was in the pack, and so were the heads of finance, investments, strategic planning, risk, credit, and human resources.

These executives, according to Herzog, "have shown ... a clear pattern of ineptness that contributed to the destruction of one of America's greatest companies. Please, don't make Mr. Liddy figure this out on his own." Herzog thought AIG's 120,000 employees deserved better than that and also "some sense of accountability" for what had happened. "We need leadership," he said, "and these individuals are simply not leaders."

In the one day before Liddy took over, the authority-shorn Willumstad did not fire any of Herzog's designees. In Liddy's regime, two have left. One was Richard Scott, a senior vice president, and the other - the highest-ranking executive on the list - was vice chairman and chief financial officer Steven Bensinger, to whose CFO job Liddy promoted Herzog. The remaining seven executives on his list still work for AIG, as five of them did in fact for longtime chairman Maurice "Hank" Greenberg (who was forced out by the board in early 2005) and his successor, Martin Sullivan (ousted last June).

Asked in mid-December about the midnight blast of David Herzog, new CEO Liddy says

Autos and homes were Liddy's insurance beat at Allstate. The vastly more complex world of AIG has left him dealing with problems of enormous depth.

it was "one of many information points" he had looked at on his way to making his own decisions about people. Herzog himself recants. "At midnight," he tells Fortune, "after watching a great company crumble, and along with it nine years of my life's work, I sent an emotional and rash e-mail that I deeply regret. It was a product of frustration and fatigue. I disavow it completely, and I have apologized to my colleagues."

That e-mail was given to Fortune by someone who knows AIG well and thought that any article about its present and future should take note of management's long-running contribution to its extraordinary problems.

Deciding to publish the e-mail, we sought reactions from the nine people Herzog named. One person, Brian Schreiber, head of strategic planning, accepted our invitation to comment. He says angrily that after learning of the e-mail, he asked

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Herzog to give an example of anything Schreiber had done that had harmed AIG. "He thought a long time and he could not think of a single example," Schreiber says. "He then emphasized that he views me as important to the success of AIG's restructuring effort."

Wounded gladiator

At the least, the e-mail episode is a vivid illustration of the extreme stress racking the company. Vastly global, spread out indeed over 130 countries, AIG is today a sorely wounded gladiator, with a market value that has crashed from $180 billion in 2007 to $5 billion. Competitors sensing a kill are attacking the company however they can, trying to poach its best people and customers.

These aren't just AIG's problems, they're ours. September's $85 billion from the government - Plan A, let's call it - proved to be too little, and the terms of the deal were more than AIG could handle.

So in November the feds moved to Plan B , whose complex parts add up to a mind-bending bailout of about $150 billion (which, to supply some perspective, is more than the assets of Procter & Gamble). This deal includes a $60 billion credit line from the Federal Reserve; $40 billion of preferred stock that makes the Treasury a 79.9% owner of AIG; and two Fed-sponsored financing vehicles that magically rid AIG's financial statements of about $50 billion of trouble. The aim of the package, as management sees it anyway, is to keep AIG afloat while it works toward reemerging as a standalone private company and getting Washington out of its life.

The theoretical cost here - $150 billion - may be reduced by amounts the government derives from owning AIG. Most of all the feds are set to be the beneficiary of a big plan, mapped out originally by Willumstad and unfolded by Liddy, for AIG to sell major assets. These are to include the bulk of both AIG's noninsurance properties and life insurance companies, for a total of perhaps 20 to 25 different sales. Completion of the plan, says CEO Liddy, would reduce AIG's annual revenues from around $100 billion to perhaps $40 billion and return the company to its roots, property-and-casualty insurance. Some estimates say the proposed sales could bring in $60 billion, an amount equal to the loan portion of the bailout.

Both AIG and the government are burning to make these sales. But unfortunately, prospective buyers for AIG's properties - which Liddy calls "our incredibly world -class assets" - are scarce right now. Many insurance companies that might normally bid have been crippled by investment losses, and acquirers in general can't rustle up financing. Were it forced to unload quickly, says Liddy, AIG would be looking at fire-sale prices that would benefit no one on the selling side. So AIG needs breathing room, and Plan B accommodated, extending the term of the government's main credit line to AIG from two years to five. Two side parts of the deal even have a term of six years and are "subject to extension."

Alas, even five years in close quarters with AIG is way beyond what the government envisioned. The ties that bind these two parties, in fact, bring to mind the 1942 movie classic "The Man Who Came to Dinner," in which Monty Woolley, playing the insufferable Sheridan Whiteside, arrives to dine, injures his hip on the front steps, and stays on for the duration, driving his hosts batty. In today's reality show, AIG is The Company That Came to Dinner, and the trapped, restless host is the government. Don't ask when these two will be parting ways, because there's no date set.

The endpoint, in fact, could be stretched way out by one special AIG troublemaker: a complex noninsurance operation that nobody thinks can be sold but that instead needs to be wound down, a process apt to be both lengthy and expensive. This albatross is AIG Financial Products - FP for short - which is housed in a division called Capital Markets. FP was formed 21 years ago to trade over-the-counter derivatives, and it proceeded to ride the great boom in that business. For most of its history, FP gave longtime CEO Hank Greenberg profits on cue, helping him build a great record of earnings growth - until this streak was rudely smashed several years ago by earnings restatements that involved practically every corner of the company, FP included.

Worse, even as those humiliations were surfacing (and leading as well

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to Greenberg's departure), AIG got deeply involved with mortgage securities that all too soon were identified as toxic. A nutty investment policy at the company's insurers helped create this problem. But the true agent of doom was FP, which wrote close to $80 billion of credit default swaps - contracts that insure investors against losing principal and interest - on super-senior tranches of collateralized debt obligations (CDOs) that were loaded with mortgage securities, some of them subprime. A financial tsunami then engulfed AIG, which is structurally a holding company - the parent of a webwork of operating insurers. The CDOs fell in value, and credit ratings for the parent company went down with them. This drop in AIG's creditworthiness triggered clauses in the credit default swaps (CDS) that allowed AIG's counterparties to demand collateral, and those calls for cash put the parent in a vise. There you have the *internal* situation that, in time, shoved AIG into the arms of the government.

The *external* situation is that AIG may have landed in that house of refuge because Lehman Brothers didn't. In the crisis-ridden week leading up to Monday, Sept. 15, the government decided it could not or would not rescue Lehman but instead would let it go bust. Bankruptcy court records have since shown that Lehman had 900,000 derivatives and financial contracts with other parties, and each creditor holding these realized on Monday morning that its check wasn't going to be in the mail. The hazy financial concept called "systemic risk" immediately became hard reality. Credit markets froze worldwide and stayed frozen on Tuesday, which is the day when AIG was headed toward bankruptcy but didn't get there. The theory around, which all of financialdom seems to accept as received truth, is that the government realized by Tuesday that it had erred grievously in letting Lehman go down and knew that it could not compound the error by allowing AIG to fail a day later.

So AIG lived to become a government ward, and in that guise it is unique. True, it is an infamous match for Fannie Mae and Freddie Mac, which are also owned 79.9% by the government. But the world always knew these fraternal twins to be the unacknowledged children of the feds. Until September, conversely, AIG never had the slightest look - at least publicly - of a company that would need government help, much less emergency rescue. Visualize, in fact, a "too big to fail" list, or as the term often goes in these days of derivatives, a "too interconnected to fail" list. Had several smart, informed, worldly businesspeople been asked in 2007 to name the five top contenders for that list, probably no one would have placed AIG on it. Among onlookers, therefore, AIG's sudden collapse - and its need, my God, for $150 billion! - tends to be one of the great bafflements of the credit crisis. In statements about why it bailed out AIG, the government has simply muttered "systemic risk." But it has never explained why it took this threat so seriously, and the New York Fed, the government's foster parent for AIG, wouldn't discuss the company at all with Fortune.

Our reporting suggests, though, that fears of systemic risk certainly weren't crazy. FP, in particular, is a breeding ground for this dreaded contagion, because of the derivatives links it has to counterparties around the world. Catch the horrified reaction of a New York currency trader when she heard in September that AIG might go bankrupt: "No!" she said. "AIG would be lots worse than Lehman. AIG is *everywhere*."

Today FP has around $2 trillion of derivatives, not a big book in this world (J.P. Morgan Chase has more than $80 trillion) but one known to be loaded with particularly complex and long-dated contracts. The most infamous among these derivatives are the $80 billion of credit default swaps described above, for which the counterparties were around 25 financial institutions in the U.S. and at least seven other countries. All of the counterparties, of course, were wrung out by the credit crisis and vulnerable to a domino effect if AIG went under. Liddy proves himself a master at understatement in describing the threat to the counterparties: "That would have backed up into their capital adequacy and could have caused a problem."

The remaining $1.9 trillion of FP's derivatives, many of them commonplace items like interest-rate swaps and currency futures, got little attention as AIG was swooning. But the fact is that these derivatives linked AIG to countless financial and industrial counterparties around the world - among them the one in which that

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alarmed currency trader works, for example - and could have hung at least some of these institutions out to dry. Another operation in FP had guaranteed $20 billion of municipal investment agreements, in which FP was in effect holding the funds of U.S. states and cities. An AIG bankruptcy would have made these municipalities general creditors of AIG and probably stung them with losses. Money market funds were also big holders of AIG debt.

Then there is the uncertainty of what a bankruptcy would have done to AIG's insurance companies. Making his own list of AIG systemic risks one day, the superintendent of the New York State insurance department, Eric Dinallo, wrote down the thought that the failure of a company once seen as impregnable might cause a general loss of confidence in the insurance industry. That danger indeed acquired a certain substance on AIG's fateful day of Sept. 16, when news spread globally that the company's operating insurers were set to send $20 billion of rescue money to parent AIG. In Singapore, some customers promptly rushed to AIG offices and sought to cash out their policies. AIG's public relations people panicked at this insurance version of a run, putting out a weird press release that assured the world - and specifically Asia - that the company's operating insurers would husband their cash for themselves.

In the end, says Dinallo, "it was incalculable as to what the ramifications of a bankruptcy were going to be." The matter, in any case, became moot on Sept. 16. By saving AIG, the federal government preempted the question of what would have happened had it gone down, and moved the argument to what happens now.

'A little less intense life'

Ed Liddy, 62, the man charged with the Herculean task of making AIG valuable again, retired in April as chairman of Allstate, a Chicago company, and became a partner in the private equity firm of Clayton Dubilier & Rice, a job he thought might provide him "a little less intense life." Then Henry Paulson called on September 16th to ask him to take over AIG, assuring him he had just the right combo of insurance and restructuring experience - and besides, "Your country needs you." Well, says Liddy, "you can sit on the sidelines, or you can get in the game and try to help."

Liddy's home base remains Chicago, to which he says he tries to get back every second or third week. Talking to Fortune, he stressed that he flies commercial, booking coach and hoping for an upgrade. This declaration is clearly the result of biting criticism that AIG has received, notably from Congress, for holding expensive junkets for agents and financial planners. Liddy defends the general idea of those as being good for business, but he's grown acutely conscious of AIG's need, in its taxpayer-owned status, to be frugal. About one customer event, a partridge shoot that certain high-placed AIG executives staged in England, Liddy expresses real disgust: "That was wrong. And those people have been severely taken to task. We've reprimanded them, we've shorted their pay."

The hold on costs extends to Liddy's compensation. In salary he's a $1-a-year-man, and he'll get no bonus for 2008, though one might come in 2009. The same pay arrangements apply to Liddy's biggest hire, his new vice chairman for restructuring, Paula Reynolds, 52, who had been CEO of insurer Safeco until she closed its sale to Liberty Mutual last September. Her next plan was to spend several months cleaning her closets. Then Liddy, whom she had known for years, called, and she signed up. Like Liddy, she's kept a distant home-base - hers is Seattle - to which she tries to get back every so often, flying commercial, of course.

But the work around AIG is consuming these days and, more often than not, darkened by the prospect that this struggling company, with its uncertain future, will lose its best people and customers. Liddy has tried to make light of losses on both fronts. Still, news of employees defecting from AIG continues to surface, and sometimes the departures are consequential. In December, Liddy lost both the CEO, Kevin Kelley, and the COO, Shaun Kelly, of Lexington Insurance, one of AIG's biggest property and casualty companies; both went to Bermuda insurer Ironshore. AIG has also lost people to another Bermuda company, Ace Ltd., which is run by Hank Greenberg's son, Evan Greenberg.

Many of the people remaining at AIG, most of whom of course had

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nothing to do with its financial sins, are surely demoralized, both by emotional and financial blows. Over the years, valued employees have been paid in part in AIG stock and encouraged by moral suasion or directive to keep it. Reynolds tells the story of a meeting recently at which one person broke down, choking out an explanation that it was hard to focus on work "because we have been wiped out."

The customer story is at this moment uncertain: This article went to press just as AIG was confronting the key date for policy renewals, Jan. 1, at which big-deal moment many commercial buyers of insurance were going to be casting an economic yes or- yes or-no vote about this insurer. The risk manager at one Fortune 500 company said recently that he'd be keeping AIG in his picture but reducing its participation in his coverage. That's a result, Liddy says, he can live with: "What's important is that we keep the relationship." Another AIG customer, a New York broker who places commercial policies, said he'd found certain risk managers and their bosses - treasurers and the like - split over AIG. The risk managers, he said, favored hanging tight to AIG's insurance expertise, while their superiors were leaning toward "Get me out of here."

Short term, the Jan. 1 results will be critical for AIG. Longer term, the main question before the house is Reynolds's restructuring sales, which essentially leave her cleaning out AIG's closets instead of her own. Reynolds, who is nothing if not frank, describes a sales process that sounds on the verge of lunatic - and, yes, expensive: "Everybody's feeding on the company like it was a bankruptcy carcass. Everybody's meter is running. We've got too many bankers, too many consultants. You can't get any work done because there's so much noise - so many people running around." For the record, Blackstone is AIG's primary global advisor. Another consultant, BlackRock, is helping AIG Financial Products value its assets, and McKinsey & Co. is also a consultant to FP.

Through it all, the specter of Hank Greenberg, CEO of AIG for 37 years, haunts the job of redoing the immensely complex company he built (see "Hank's Last Stand," on Fortune.com). A special sales obstacle, says Reynolds, is that AIG has 4,000 subsidiaries and other legal entities, with all manner of cross-ownership among them. "With all due respect to our former chairman," she says, "a lot of things were done around the 1986 tax act." This is a U.S. law that tightened up tax rules applying to financial services income earned overseas. Reynolds says that while the law's provisions were later effectively repealed, a lot of ownership structures that AIG had built weren't taken down. So simplification is today badly needed, she says, and a big team of lawyers is on the case.

To get warm bodies for that team, Reynolds pulled in help from AIG's operating companies. These are a spread-out collection of silos linked to a holding-company center that is staffed with relatively few people - too few for the job at hand now, say both Reynolds and Liddy. Of course, Greenberg never clustered people at his side. He ran AIG out of his head, seemingly unfazed by an accounting system so inefficient that AIG is notorious among ex-executives for always getting just under the wire when making its SEC filings. The accounting systems plagued the CEOs who followed Greenberg - Sullivan and Willumstad - and remain a trial today. Says Reynolds: "The best businesses are run by people who kick their tires every day. We don't even know where the tires are, much less get to kick them. If we can get back to the size of a company where we can intelligently kick our tires every day, that would be a wonderful outcome."

The misadventures that AIG's silo architecture can create are sharply illustrated by the company's disasters in mortgage securities. These problems certainly were spawned in AIG Financial Products. But the fact is that FP had a moment of enlightenment in late 2005, when it began to believe that the housing boom was nearing an unfortunate end and decided to stop selling credit default swaps on super-senior tranches of CDOs. It had a few deals in the pipeline, however, so total "multisector" CDS - AIG's name for these spiffy items - climbed a bit further in early 2006, to a total of nearly $80 billion. Later, as 2006- and 2007-vintage mortgages turned toxic, AIG talked proudly to analysts about its wise decision to pull out before trouble hit. The company proved to be excruciatingly wrong in thinking it was safe, of course, since earlier vintages have been creamed

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too. But the point is that by August 2007 - the start of the credit crisis - CEO Martin Sullivan and FP's boss, Joseph Cassano, were saying to everybody who'd listen that FP had ducked the mortgage bullet by avoiding the 2006 and 2007 securities that were by that time viewed as poisonous.

Various other AIG silos, unfortunately, *weren't* listening. The regulatory statements filed by AIG's operating subsidiaries show that a raft of these companies, and particularly the life insurers among them, were still loading up on late-vintage residential mortgage-backed securities (RMBS) in December 2007 - months after AIG had begun congratulating itself on ducking the mortgage bullet. Why, Liddy is asked, would one arm of AIG be buying mortgage securities while another is pronouncing them dangerous? As if there might be someone in AIG's empire he didn't care to offend, Liddy states his answer carefully: "You know, the company is a highly decentralized, far-flung enterprise. And different pieces of the company took different risks. Let me just leave it at that."

We won't leave it entirely, though, because the RMBS turned out to be connected by tunnel to the netherworld called securities lending. For many years, the AIG operating companies, like many other large holders of fixed-income securities, have lent these to banks and brokers that have reasons for needing them - maybe clients wanting to sell short. For this service, the lenders had received cash collateral that slightly exceeded the value of the bonds. Over the years, AIG's companies had invested this short-term money in conservative, liquid investments and thus been always ready to repatriate the collateral if their customers wanted it back.

But this strategy didn't make much money. So in the middle of this decade, the AIG companies began both to greatly increase the amount of securities lending they were doing - the total hit about $90 billion in the third quarter of 2007 - and to invest the collateral in longer-term, seemingly safe AAA securities that offered good yields. The main choice for investment was, you guessed it, RMBS. That bit of elegant selection left AIG's operating companies not only using short-term money to invest long, which is known folly, but also putting this money into impenetrable securities poised to both tumble in value and establish new records for illiquidity. When news of AIG's problems spread in 2008, the banks and brokers came tearing back to redeem their cash collateral, and the AIG companies couldn't hand it over, because it was tied up in unsalable RMBS. This was a second vise that tightened around AIG. One company insider calls this whole investment plot "just one of the dumbest things I've ever seen." (Fortune was refused an interview with AIG's head of investments, Win Neuger, who was one of the executives on Herzog's kill list. A Neuger lieutenant also on the list, Richard Scott, has left, as noted earlier.)

Unfortunately for AIG's restructuring plan, the RMBS - greatly marked down during 2008 - sat at crisis time on the balance sheets of life insurance companies that AIG has since determined to sell. But what buyer wants to take on billions of tainted, impossible- to-value mortgage securities? Enter the government's troops: RMBS having a face value of $39 billion, marked down to $19.8 billion by AIG, have just been helicoptered out of the war zone into a new off-balance-sheet financing vehicle. This vehicle has received a six-year, extendable $19.5 billion Fed loan and $5.1 billion in equity from AIG. If the loan is paid back and the RMBS meanwhile gain in value, the Fed and AIG will share in the gains, with the Fed getting the lion's share.

A similar split of eventual gains, if there are any, will apply to another special-purpose vehicle set up to sweep most of AIG's multisector CDS risks off the company's financial statements. The Fed has made a $30 billion loan to this vehicle, and AIG has contributed $5 billion in equity. To cut through the details of this labyrinthine transaction, the $35 billion total, plus collateral that AIG's counterparties held, is intended to make these parties whole on about $65 billion par value of CDOs. Meanwhile, AIG will be freed of its swap obligations on these securities. That will not rid AIG of direct risk on multisector CDS. It will continue to wrestle with $9.5 billion of swaps that were sheer speculations, rather than insurance-like contracts, and that the government's rescue program is not taking over.

The two new entities will test the theory - widely admired by people who own mortgage securities - that there is good value in these if they are held to

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maturity. This opinion is indeed endorsed by Rodney Clark, the lead AIG analyst at Standard & Poor's, who thinks that the recoveries on AIG's mortgage securities could be "potentially significant" and that it is regrettable that AIG has given up so much of the upside to the government. Clark's opinion in effect frames a can't-win proposition for the feds: If they make money on the RMBS, that's good for the taxpayer. But because AIG will share so little in the gains, these won't do much to get the company off the government's hands.

Let's sum up the components of the government's largesse: There are three elements that lean on Fed loans: a $60 billion credit line, and two financing vehicles, one providing a $19.5 billion loan, the other $30 billion. Alongside is the Treasury's holding of $40 billion of AIG preferred stock, paying a 10% dividend. Grand total: $149.5 billion, which through history will be rounded off to $150 billion. And that does not take into account the possibility that down the road Plan B will be revealed as inadequate and a Plan C will have to be announced, which will make harakiri swords mandatory at the press conference.

The CEO who put AIG financial products into the ill-fated multisector CDS, Joe Cassano, 53, is no longer with AIG. He "stepped down" with AIG's "concurrence" last February, just as the company reported more than $11 billion of 2007 unrealized losses on the $80 billion of multisector CDS then outstanding. These losses (not to mention another $23 billion that came later) trashed the confident statements that Cassano had been making about the CDS. A famous one, from an analysts' meeting in August 2007: "It is hard for us, without being flippant, to even see a scenario ... within any kind of realm of reason that would see us losing $1 in any of those transactions."). One remarkable fact: A retired AIG director says that a few years ago Cassano was on the short list of candidates to succeed Hank Greenberg as boss of AIG in its entirety.

Today FP has a brand-new interim head, Gerry Pasciucco (pa-SHOE-co), 48, who came in November from Morgan Stanley, which is an advisor to the New York Fed and is more or less lending Pasciucco, a capital markets expert, to FP. Pasciucco knows his mission as if it had been engraved on the inside of his glasses: He is to "de-risk" FP and wind it down with all due speed. Says Liddy: "We are not going to be in that business. I've made that declaration. I want to get us out."

The overriding question is just how fast that can happen. Liddy himself, speaking to analysts in early October, said it would take a while. And for an "instructive prior situation," he referred the analysts to Warren Buffett's experience in extricating Berkshire Hathaway from General Re Securities, a derivatives operation originally modeled after AIG FP. The notional value of Gen Re's derivatives, however, was only about $1 trillion at the peak, vs. AIG's $2 trillion.

Buffett's experience is indeed instructive - "Even to me," the Berkshire CEO cracks. After buying Gen Re in 1998, he tried unsuccessfully to sell the derivatives business and then, in 2001, began to wind it down. Buffett says he told Gen Re's management to be patient at getting the job done, because he knew its difficulties. Derivatives, he presciently told Berkshire's stockholders then, are a little like hell: "easy to enter and almost impossible to exit." That's because if the aim is to terminate all your contracts - tear up the tickets, as they say - you must conduct negotiations with all your counterparties, most of whom will be interested in exacting a pound of flesh.

Four years later, in early 2005, Buffett gave his shareholders an update: Gen Re Securities had started with 23,218 contracts and had worked those down to 2,890. The aggregate losses on this endeavor, he said, had been $404 million. The settled contract that stood out, he added, was one that had "a term of 100 years!"

Gerry Pasciucco says FP has between 40,000 and 50,000 contracts. The preponderance of those are swaps, and a small part are options. The options are a particular problem in today's volatile markets because they require "dynamic hedging," which means they must be repeatedly hedged as prices swing. Some of Pasciucco's 380 employees are wrestling with that bear, and a raft of others are trying to settle contracts. Many of these stretch out for years, because from its start FP knew that contracts beyond, say, 20 years in length attracted the least competition and therefore were odds on

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to be moneymakers. Pasciucco doesn't know of any 100-year contracts in the shop. But there is one, he says, that runs to 2080.

Pasciucco has divided FP business into 23 segments - for instance, commodities is a segment - and says he is intent on winding these down in a very organized way. At his office in Wilton, Conn. (the other of FP's big offices is in London), he sometimes gets thoughts about the creditworthiness of counterparties from Fed officials who are based on the premises. He says those observers recognize the need to balance the competing objectives of speed, careful use of cash, and getting maximum value out of FP's business.

Pasciucco will not say how long he's slated to stay around FP, but it is clear he's thinking more like one year than five. The business, he says, will gradually get wound down, and then AIG will be left with a relatively small number of contracts (which is in fact Buffett's situation) and what insurers call a "tail" that extends residual risk into future years.

It's not easy to believe it's going to be that simple. Nothing about derivatives is, and FP is hardly a routine player. Another party sensing there may be a lasting issue here is Moody's, which in December said of FP's wind-down: "The costs and duration of this process are difficult to estimate and could be substantial."

Liddy, however, presents himself as an optimist about AIG. He sees the company selling its properties and regaining strength to the point that it can talk to the government about ways to cut down that 79.9% ownership. All that he says on this point is very vague: "There's just more thinking that needs to be applied to that." Meantime, he says AIG has a good "partnership" with the government. He treats this partner like the gorilla it is: "Whenever you want to do anything that requires shareholder approval," he says, "you have to go spend some time with them."

Not all parts of the world are as cheerful about AIG's future, partly because the company's stock price - under $2 a share - suggests a waif hanging on by its fingernails. In December, a financial Web site, 24/7 Wall Street, actually listed the company as one that wouldn't be around at the end of 2009. That seems extreme, if only because it is not easy to imagine the government walking away from the $150 billion it already has on the table. On the other hand, appearing on Meet the Press right after AIG was saved from bankruptcy, Hank Paulson dared to use the L-word, saying the government had put up its funding facility (then $85 billion) "to allow the government to liquidate this company...." And then he left the thought unfinished, as he referred to avoiding "a real catastrophe in our financial system."

Among the less sanguine AIG experts around is Hank Greenberg, who hangs on every move the company makes. Speaking recently in the quiet Park Avenue offices of C.V. Starr & Co., which he heads and which is AIG's largest shareholder after the government, he talked about the people who call to tell him they are leaving AIG and about the poor insurance results it reported in the third quarter. The unspoken subtext in everything he says is that things would be different if he were there.

Meanwhile, he clearly does not approve of the way Uncle Sam is treating its guest. "The government," he says, "should realize that its purpose is to get paid back, not wring every dollar of income it can out of the company today." He doubts that AIG is viable unless there's a Plan C - some lightening of the burden that interest and dividends place on the company and some move by the government to be more generous in sharing gains it extracts. Whether or not Greenberg is right about the need for the government to alter its approach, it seems clear that AIG will be dining at the taxpayer table for years to come.

Other AIG news:

AIG is having to sell off, at deeply discounted prices, various assets so it can repay the $60 billion loan it got from US taxpayers.

Despite continued fancy corporate retreats and executive perks, the US government okayed a total of $150 billion to AIG.

Given the prices fetched by the sale of AIG assets thus far, including an entire insurance unit, experts say AIG won't be able to pay back the federal loans.