

FINANCIAL SERVICES

AIG HEARING LIVEBLOG,

PANEL 1

The hearing can be view on the committee stream or CSPAN3.

The witnesses in this panel are (Liddy, AIG's CEO, comes later):

Panel one

- Mr. Scott Polakoff, Acting Director, Office of Thrift Supervision
- The Honorable Joel Ario, Insurance Commissioner, Pennsylvania Insurance Department, on behalf of the National Association of Insurance Commissioners
- Ms. Orice M. Williams, Director, Financial Markets and Community Investment, Government Accountability Office
- Mr. Rodney Clark, Managing Director, Insurance Ratings, Standard & Poor's

Scott Polakoff: Rapid decline of AIG stemmed from liquidity problems in two business areas. CDS, typically based on mortgage loans. And securities lending. AIG stopped originating CDS in 2005. By that time, the company had \$50 B on its books. AIG halted these activities while the housing market was still going stong. AIG protecting against losses for the least risky credit vehicles. There have been no underlying losses. Crisis resulted from liquidity calls. Two important lessons learned. CDS continue to

be unregulated products. New regulations are essential. AIG story makes a compelling argument for a systemic risk regulator with authority to examine temporary liquidity problems.

Joel Ario: Hedge fund attached to large and stable insurance company. Financial products bet twice the value of AIG and failed to hedge the bets. It was to protect those leading financial institutions. We are doing this to protect our own financial system. AIG's competitors claim AIG is underpricing in an attempt to maintain volume. Such disputes reflect insurers trying to protect profit margins in soft economy. We have reviewed charges on both sides. We have not seen any evidence of undercharging on either side. Insurance companies have the value they do because state level regulation requires reserves. Securities lending would not have caused a systemic risk. This does not compare to the credit default risk. The lending problem is solved. Need to identify and manage systemic risk. Insurance companies more likely recipients than creators of risk.

Orice Williams: GAO prohibited by law from auditing the Fed. Assistance given to AIG has given AIG an unfair competitive advantage. Fed and Treasury told us goal was to avoid systemic risk. The Fed has been monitoring AIG since September and Treasury has begun to more actively monitor AIG. AIG has mixed success in progress on its restructuring. Has not sold off business units in this market. Declines in the values of its assets. Potential impact of AIG on commercial property casualty market. Some of AIG's competitors concerned that federal assistance has allowed AIG to offer coverage that is inadequate to the risk involved. While AIG may be pricing more aggressively, they have not seen indication that this pricing is out of line with prior practices. AIG insurance companies have received indirect benefit to the extent that AIG credit rating not downgraded.

Rodney Clark: Our ratings one tool to use in assessing the risk. Process by which we arrived

at rating for AIG. S&P had a triple A rating, began to change in 2004, lowered rating 4 times. In May 2008 AA-, following losses. In August S&P announced that its view of credit losses would be around \$8 billion, significantly more than M2M. In September put on negative credit watch. Lowered to A- in light of increasing credit losses. Since then AIG benefited from govt support, AIG has a six notch upgrade on rating—it would be B- without government support. Increased reputational risk for subsidiaries. AIG's difficulties resulted from convergence of many things. Some say S&P downgraded too slow, others too fast. Our ratings not driven by market sentiment.

Kanjorski: Any risk for insurance holders of AIG.

Ario: Reputational risk. Insurance companies are strong, these threats have not materialized. Policy holders would be fully protected.

Polakoff: There has been no realized credit losses on those underlying CDOs. The risk in that portfolio. The risk is in the collateral calls. We've been strongly looking at the FP portfolio. 306 billion, in UK which is subsidiary of French Bancaire. This book of business stopped in 2005.

Kanjorski: You're saying it's not your problem. What do you envision the change should be.

Polakoff: OTS should have stopped this in 2004, with the analysis that the real estate market could have gotten as bad as it got. We do believe this kind of company would have systemic risk oversight.

Garrett: I also dealt with framework in unwinding in July. 6 notch uptick. Is that due to amount of money, or implicit guarantee going forward?

Clark: We're not considering implicit guarantee, this is the money that has gone into it and the anticipation that more might go in. We've been saying for several months that AIG would be non-

investment grade.

Garrett: I got feeling no one overlooking AIG, but today Polakoff said OTS. Was there a regulator that looks over the entire holding company?

Williams: OTS is responsible for holding company. Questions we have is the focus of that regulation. Timing was off.

Garrett: There was a regulator.

Williams: There is a holding company regulator.

Garrett: Not able to audit Fed. That's under current statute. Should Congress look to do that?

Williams: We will do what you instruct us to do.

Garrett: What is the total amount at risk?

Polakoff: Post-September 15, no longer regulator for this company. \$80 billion is down to \$12 billion.

Garrett: Do you look at the other side to see if it's hedged?

Polakoff: As to how a counterparty would be hedging? No.

Frank: [Apologizes to Garrett—says official transcript is wrong] Rationale for intervention was to prevent total collapse. Was that appropriate?

Williams: Beyond the mandate.

Frank: Should have been some conditions. The Federal Reserve were being criticized bc they had not intervened to stop Lehman from going.

Polakoff: Systemic regulator.

Ario: Unwinding would go to competitors and a guarantee. There ought to be systemic approach to this.

Frank: Guarantee fund would come with limits which is a guide to prudent investment.

Williams: Framework for GAO has a provision to limit exposure to taxpayers.

Bachus: Any signs of recouping taxpayer dollars? Maiden Lane—those contracts may be performing at least at a higher level than when acquired?

Williams: Our work in this area is going on, we looked at where they are and the challenges. At this point, we're neutral in terms of the outlook.

Bachus: Polakoff, You acknowledge that you were aware of worsening situation at AIGFP.

Bachus: Did you understand the amount of risk.

Polakoff: We reviewed the models, understood the models. It was the liquidity that we failed to anticipate. In 2004 we failed to predict how bad things would get in 2008. This is not the only company that suffered liquidity crises.

[Why aren't these guys brought into clean this up, so we can fire the banksters getting the big bonuses??]

Ario: State insurance regulators are the success story here. There is nothing in systemic nature that we have to do. We deal primarily with insurance company level.

Ackerman: Eyes are starting to glaze over. Most members of Congress didn't know what CDS is. I want to make sure I understand it. Two guys on a life raft. A storm blows up and waves 10 feet high. First guy says, I'm scared, so the second guy sells him a policy. You're selling something with nothing to back you up, no money in wallet, if everything goes right, you're collecting a premium. It's like snake oil salesman, and they don't even have the oil. There's a great company called "I can't believe it's not butter." This is insurance without being insurance, bc if they called it insurance they'd have to have money to pay you off. How is this suddenly an industry? The biggest companies are buying this stuff thinking they are almost insured. And as long as they don't put in a claim, there's a lot of

people trying to cover their bare assets. How did we allow this to happen? You're playing "I can't believe we're not regulators." And we're playing "we can't believe we're not oversight." It's like if I have an 800 credit score, you can lend my kid money bc you think he has a great credit score.

Polakoff: \$50 billion went for securities issues. Lots of problems. It's a well-known, well-respected product.

Ackerman: If it were regulated.

Polakoff: The product should be regulated. CFTC asked Congress many years ago to ask that it be regulated.

Price: Pleased to hear Geithner will be here. Williams, one of the most pivotal roles is oversight. So it's a surprise that GAO is prohibited from auditing certain activities.

Williams: We have a prohibition in bank audit agency act. It articulates limits of authority. There are four, one is looking at Fed's monetary policy activities.

Price: Would it be helpful to do that?

Williams: In this current environment, yes. We are currently limited to information they give us publicly. We are not prohibited in their regulatory activities. It's to sustain its independence. That's an area where it makes sense for GAO to have more visibility.

Price: Exit strategy?

Williams: At this point plan is for restructuring. Work is ongoing.

Price: No exit strategy in place?

Williams: Not that we have seen.

Price: Polakoff, should have stopped in 2004. Any change in assessment before 04 and 08?

Polakoff: As we progressed our concerns became greater. Communicated about FP. We became more

aggressive in actions we took.

Price: Any attempts to address concerns?

Polakoff: Yes.

[we need to know what those were, because it'll impact how we go after Cassano]

Price: Were you aware of this?

Clark: Generally aware of that. Aware of decision to cease writing CDS.

Clark: Maiden Lane limits loss to AIG.

Kanjorski: We will go until 1:15, then go onto the second panel (Liddy).

Sherman: Enter article by Dean Baker, explaining how even if it was a mistake to let Lehman go under, not necessarily a mistake to let AIG go into receivership. Ario, anyone who understand CDS?

Sherman: How many dollars in bonus did he get last year?

Ario: Maybe in 6 figures.

Sherman: Polakoff? Anyone who understands swaps? Bonuses?

Polakoff: No retention bonuses? \$125,000 to \$150,000 for these specialists.

Sherman: These people haven't destroyed your agency of the international economy. I want to thank panel for exposing another lie, that the savings banks would be destroyed if we put into receivership. If AIG was in receivership a month ago, we wouldn't have these cameras here. Ario, if AIG the parent company, and BK judge were to spin off insurance companies, still healthy insurance companies?

Ario: General answer yes, longer out the more the answer is going to be yes. Bank in September, bc of the ratings, the problems at the insurance level were greater.

[Note, the AIG powerpoint recently threatened

the insurance holders when asking for more money.]

Sherman: The savings bank. Would it be healthy?

Polakoff: Yes, it remains a viable entity.

Sherman: 100-some bonuses has gone to take care of counter-parties. Richest entities in the world make sure AIG casino pays them off full amount for their debt. AIG too well-connected to fail.

Castle: Sufficient strength to be sold to develop assets?

Polakoff: But for the general economy, but anyone trying to sell now it's a problem for everyone.

Castle: Has govt been present at board meetings?
I've been told Federal Reserve was present during discussions of bonuses. I would hope our involvement is greater than what we've been hearing.

Williams: we recommended Treas to put together an agreement—did have it in November, still in process of standing up that process. In terms of Fed, based on what they've disclosed, they're present at least as a silent observer.

Polakoff: We ceased to be regulator, so I don't have that information.

[Of course that means we've gotten LESS oversight since we took over the company.]

Williams: We issued report in January and they're still developing the plan on oversight.

Castle: You can't update on whether they've done anything since then.

Williams: Continuing to stand up oversight. They haven't done that yet.

Castle: Clark, concerned whether this was done with a rear view mirror. Do you feel that you're getting fair warning?

Clark: We sought to give fair warning, including

back in February 2008, when we placed ratings on negative outlook. We indicated in May that potential downgrades could occur after that. In June, they raised \$20 billion. First part of September, very quick time, takeovers of Freddie and Fannie and Lehman, massive loss of confidence, greatly changed assumptions we had. The ratings actions did reflect the facts as we knew them. We didn't fully anticipate this extremely rapid deterioration in September.

Capuano: Didn't have oversight over CDS. No disagreement that CDS are some sort of insurance. They're just insurance with nothing backing them. If it was part of the insurance company. Certainly the credit rating agencies to see that this game wasn't going to undermine investor confidence. CDS just a way to get around any sort of oversight and regulation. You're here today bc you know a lot about AIG. OTS is not the regulator. In theory there will come a time when you will be the regulator again. Do you think that the path we are on now should bring it back to stability?

Polakoff: While CDS may be unregulated, they fell within a company that OTS regulated and we understood the profile of the risk.

Capuano: If you did and didn't do anything about it that's 10 times worse.

Polakoff: We did take action. Not a risk of credit loss, liquidity risk.

Capuano: That may not be important to you, important to American people. Still too much risk.

Polakoff: Did not see extent mortgage market would deteriorate.

Clark: Until financial markets stabilize, difficult for AIG to be profitable.

Capuano: Approach good?

Clark: We don't have a view on whether it was appropriate or not.

Royce: Yesterday ABC reported stripped out measure to stim bill aimed at restricting bonuses. The measure applied restrictions retroactively. Provision stripped out during closed door conference negotiations. A measure by Dodd replaced but Dodd's language stripped out retroactive. Some Democratic members were aware of potential to protect bonuses.

Williams: Outside scope, I'd be happy to look at it.

[Note that Williams offered to investigate this and Royce specifically did not ask her to do that. He must know that ABC got what happened wrong, but he wants to go after Dodd anyway.]

Royce: Why can't we pass leg that would remove exemption for revoking bonuses?

Williams: Outside scope.

Royce: But you're looking at bonus issue. Why don't we go back and reverse what was done in that closed door session?

Lynch: In terms of contract we have heard objections about interfering with contracts. BK, we tear up every contract. Prevents states from doing that. But Congress has that power. I'm mystified why my auto workers were badgered bc they were making \$40 an hour, but we don't hear one word, the sense of entitlement that they're due these bonuses. It just blows my mind. AIG originally received \$85 billion. Then following that \$70 billion in cash, -it looks like capital purchase program. Finally \$53.5 billion in TARP. We have received zero in terms of information on AIG. Nothing on counterparties, where the money went, if there were bonuses, whether the money was going to foreign banks. Six months of silence. You folks are supposed to be helping us get information. "Forgeddaboudit." What's the problem with getting information about where the taxpayer's money is going?

Polakoff: We're not involved.

Hensarling: Four bailouts with no end in sight,

making foreign entities whole. I also serve on Congressional oversight for TARP, I've concluded that when I look at causes, there are the crooked, there are the greedy, the foolish, but also well-meaning people who simply made mistakes. With hindsight of 20/20 vision. I'm here to understand limits of your power. I believe I heard you say OTS should have stopped CDS and AIG securities lending commitments?

Polakoff: Yessir.

Hensarling; You could have stopped it?

Polakoff: Yessir.

Hensarling: You had the power to stop those business lines.

Miller: Have we looked at liability if they were cooking their books, if they knew they were insolvent?

Williams: We have not.

Scott: When aware that AIG going into CDS? Did you know unregulated market?

Polakoff: Focus on modeling.

Scott: When were you aware of contracts for bonuses. Began March 15 of last year. Are you aware during March 15, that unit was losing buckets of money? At the very time preparing these contracts? Would not that raise a major concern? Borders on fraud and criminality. As oversight agency should have known all of this. We were rushed into panicky situation by Paulson.

Polakoff: Timeline revealed that these were initiated when still operating well-rated company. Intent of those payments to keep employees.

[This guy needs to be hammered for that--there were already public announcements that AIG had lost control at that point.]

Maloney: Systemic risk--ever reviewed by AIG?

Ario: Not to my knowledge.

Maloney: How is insurance segregated from FP?

Ario: Assets there walled off from all other creditors. We believe that assets are there for policy holders. Downstream ratings is important. Linkage with ratings companies.

Maloney: What would happen if AIG FP was allowed to fail.

Ario: More a question for ratings agencies.

Maloney: Ratings agencies do not have a lot of credibility so I'd rather ask someone else.

Ario: Assets would be there and be protected.

Klein: There's a failure here, system depends on transparency, at highest level and average investor. Needs to know that info is real. IMO, the system's not working properly with rating agencies in current form. Whether mistakes were made, how to change the models?

Clark: Were mistakes made? Hindsight 20/20. Financial markets late summer, we believed based on models, assumptions, that ratings were correct until beginning of September. and effect to have on collateral. Changed conclusions rapidly.

Klein: Wouldn't you agree that projection of market has some value.

[Is this Pearlmutter?] Fraud against creditors. I don't know why we paid these bonuses. They talked about realized losses in this thing. Can somebody tell me what guaranteed investment agreements are?

Ario: Govt contract doesn't need the money right now, that's where money want back to states.

[is this Carson or Donnelly?] Naked credit default swaps.

Polakoff: Not what AIGFP does.

Speier: Congress hasn't been doing its job. CDS passed Congres. We took Grass Steagall off the

books. Clark You rated AIG A or A- through most of 2008.

Clark: Yes:

Speier: It was a AA. We already knew in March it had lost 12 billion.

Foster: [asks about whether the holding company was the problem]

Ario: If it was just insurance, AIG would still be top ranked insurance company in the world.

Polakoff: Need systemic regulator.

Foster: My point was whether we should allow that level of complexity.

Clark correct record: one statement in error, S&P announced in August, \$8 billion in losses, I may have said that incorrectly before.

[We'll start a new thread]