

HANK'S DOG AND PONY SHOW

Hank Greenberg will testify before the House Oversight Committee about the AIG collapse today at 10 AM.

I'm uncertain that it'll be useful in unpacking what happened with AIG at all. If Greenberg's planned testimony from last fall is any indication (he called in sick for an October 7 AIG hearing, but had already submitted his testimony), he will say that the CDS before he left were hedged properly, not in subprime mortgages, and watched closely by management (that is, by him); but all that changed after he was forced out.

AIG's strategy, accordingly, was to look for opportunities in businesses that benefitted from its AAA rating, strong capital base, risk management skills, as well as the intellectual capital needed to manage such diversification.

That led to the creation of AIGFP in 1987. At that time, the derivative market was small and growing. From the beginning, AIG's policy was that AIGFP conduct its business on a "hedged" basis – that is, its net profit should stem from the differences between the profit earned from the client and the cost of offsetting or hedging the risk in the market. AIGFP would therefore not be exposed to directional changes in the fixed income, foreign exchange or equity markets.

AIGFP, at that time, reported directly to me and Ed Matthews, Senior Vice Chairman, and later to William Dooley, Senior Vice President, supported by AIG's credit risk and market risk departments. When I was AIG's CEO, AIG management closely monitored AIGFP and

its risk portfolio. AIGFP was subject to numerous internal risk controls, including credit risk monitoring by several independent units of AIG, review of AIGFP transactions by outside auditors and consultants, and scrutiny by AIGFP's and AIG's Boards of Directors. Every new type of transaction or any transaction of size, including most credit default swaps, had to pass review by AIG's Chief Credit Officer.

[snip]

AIGFP reportedly wrote as many credit default swaps on collateralized debt obligations, or CDOs, in the nine months following my departure as it had written in the entire previous seven years combined.

Moreover, unlike what had been true during my tenure, the majority of the credit default swaps that AIGFP wrote in the nine months after I retired were reportedly exposed to sub-prime mortgages. By contrast, only a handful of the credit default swaps written over the entire prior seven years had any sub-prime exposure at all.

What I am interested in the hearing for is the squabble it has elicited both between Greengerg and AIG, and between Ed Towns (the Chair of the Committee) and Ranking member Darrell Issa.

AIG has already released a statement rebutting some of Greenberg's claims—notably about whether or not the CDS were hedged properly before he left.

In a statement, AIG said that when Mr. Greenberg left in March 2005, the unit had already sold about half of the swaps that caused the biggest problems. AIG added that AIG's exposure under the contracts wasn't hedged.

To which Greenberg seems to backing off his earlier statement that everything was hedged properly.

Mr. Greenberg said the amount of exposure AIG faced under the contracts when he left was beside the point. When AIG lost its triple-A credit rating, which came after his departure as CEO, he would have hedged the exposure and tried to modify the collateral requirements, he said in the interview.

Which has led Darrell Issa to try to get Towns to cancel the hearing—or challenge Greenberg's statement ahead of time.

The committee's ranking minority member, Rep. Darrell Issa (R-Calif.), urged Rep. Towns in a letter late Wednesday to "reconsider" allowing Mr. Greenberg to testify, "or at the very least, join me in publicly acknowledging the veracity of his testimony is questionable."

Though Issa may be just as anxious to prevent Towns' questions about why AIG got multiple deferred prosecution agreements rather than real criminal investigations.

In November 2004, the Bush Justice Department and the Securities and Exchange Commission agreed not to prosecute AIG for allegedly helping companies fudge their books. In exchange, AIG agreed to host a government-appointed auditor in company meetings. At the time, Greenberg said it brought "finality to the claims raised by the SEC and the Department of Justice."

Towns said that Greenberg should be able to identify Bush administration officials involved in the decision-making around the settlement. Towns added the committee wants to know what

Bush administration regulators knew about AIG's credit default swaps and other highly risky positions that brought the company down.

Asked if he would be directly pursuing Bush administration officials, Towns said: "No doubt about it. That's the reason I want to talk to Greenberg first. He might even point some folks out. That's of great interest to us."

I always get kind of woozy when I sort of agree with Issa. But it sure seems like Greenberg plans to use his appearance today to pitch schemes that will increase the value of AIG stock (he remains a big stock-holder) by going after the CDS counterparties.