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AMERICAN INTERNATIONAL GROUP'S IMPACT ON THE GLOBAL ECONOMY: BEFORE, DURING, AND AFTER FEDERAL INTERVENTION

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MARCH 18, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–15

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AMERICAN INTERNATIONAL GROUP'S IMPACT ON THE GLOBAL ECONOMY: BEFORE, DURING, AND AFTER FEDERAL INTERVENTION

Wednesday, March 18, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Ackerman, Sherman, Capuano, Baca, Lynch, Miller of North Carolina, Scott, Maloney, Moore of Wisconsin, Hodes, Klein, Perlmutter, Donnelly, Carson, Speier, Childers, Wilson, Foster, Minnick, Adler, Kilroy, Kosmas, Grayson, Himes, Peters; Garrett, Price, Castle, King, Manzullo, Royce, Biggert, Capito, Hensarling, Putnam, Barrett, Gerlach, Campbell, Bachmann, McCotter, Neugebauer, McCarthy of California, Posey, and Jenkins.

Ex officio present: Representatives Frank and Bachus.

Also present: Representatives Waters, Watt, Moore of Kansas, Clay, Green, Ellison, Maffei, Lee, Crowley, Cummings, and Kaptur.

The CHAIRMAN. [presiding] To start the hearing, I want to make an announcement. I do appreciate the restraint shown and that nobody tried to blockade Mr. Ackerman this time. But this hearing, while it's going to be conducted by Mr. Kanjorski, will be conducted in an orderly fashion. There will be no disruptions. There will be no heckling.

If there is, I will ask the police officers to escort any disrupter out of here. And if it is unfortunately required, I will ask them to press charges if that is justified by the degree of disruption. We have an important subject. We are going to deal with it in a reasonable way, and I do want to instruct everyone that we will not accept interference with the process. The process will work best in the public interest if it is allowed to proceed in that manner. As I said, Mr. Kanjorski will be presiding. But as the chairman of the full committee, I just wanted to make that very clear.

On the other hand, this is not homeroom, and talking is permitted now among yourselves until the hearing is started.

[pause]

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. I ask unanimous consent that the following members have permission to participate in today's hearing: Mr. Crowley, Mr. Cummings, and Ms. Kaptur. Pursuant to an agreement with the ranking member, opening statements today will be limited to 20 minutes on each side. Without objection, all members' opening statements will be made a part of the record.

We meet today to scrutinize American International Group, a company that has so far gained access to more than $182 billion in taxpayer assistance. At this hearing, we will learn more about why we needed to save AIG. We will also examine how AIG is using the money it has received. Additionally, we will explore when AIG expects to repay the American taxpayer in full, and with interest.

Our committee has previously held hearings on the banks that have received assistance from the Troubled Assets Relief Program (TARP), but I wanted to address AIG's situation separately. AIG is unique from other TARP recipients in at least two respects. First, it is not a bank. Second, the Treasury Department and the Federal Reserve have provided AIG with extraordinary assistance, above and beyond any other financial institution participating in TARP.

Without question, today we will engage in a lively and energetic debate with our witnesses. Because of the scheduling concerns, however, the Treasury Department and the Federal Reserve could not accommodate our request to join us today. They are now the overseers of AIG, and we need to hear from them directly and publicly.

As a result, I have worked with Chairman Frank to convene a full committee hearing on March 24th. I am pleased that Treasury Secretary Geithner and Federal Reserve Chairman Bernanke will join us at that time to discuss AIG. They have much to explain not only to us but also to the American people. I look forward to their appearances.

During our first panel, we will hear from the Office of Thrift Supervision, AIG's holding company regulator. We will also hear from the Pennsylvania Insurance Commissioner on the regulation of AIG's insurance subsidiaries. I expect both of them to speak frankly about the failures of the current regulatory system in monitoring AIG's regulated and unregulated operations. Now is the time for them to accept responsibility, not to provide excuses.

Additionally, the Government Accountability Office is here to discuss its study, which Member Bachus and I requested, into how AIG is spending the government funds it has received, and whether the company might be using this money to undercut competition. Standard & Poor's will also discuss how it rates AIG and the need for providing ongoing Federal assistance to AIG. I look forward to hearing from both of them about these important matters.

Most significantly, we will hear from Mr. Edward Liddy, AIG's CEO. Immediately after the government intervened for the first time 6 months ago, Mr. Liddy took over the company's helm. He assumed a treacherous job, and he has traveled down a rocky road since then. This road became considerably more difficult to navigate this past weekend when the public learned the identity of

AIG's counterparties receiving billions of dollars of the taxpayers' money.

Even more troubling, the taxpayers also learned that their money helped to cover the million dollar plus retention bonuses of executives at the very unit that caused AIG to teeter on the brink of collapse. A million dollars is a sizable sum to the typical American family earning just $60,000 a year, and a million dollars is a lottery prize for anyone who has just lost a job.

Something is seriously out of whack, and AIG needs to fix it now. We face the most challenging economy since the Great Depression. Many have made personal sacrifices to survive these difficult times. AIG and its employees should do the same.

Moreover, it is regrettable that we have even reached this point. When the press first reported about the AIG Financial Products retention bonuses in late January, I called Mr. Liddy to express my concerns that paying out such sums to the very division that engaged in the risky behavior that warranted the government's bailout would rightly incite a public outcry.

My colleague, Joe Crowley, and I had previously worked cooperatively with Mr. Liddy to withhold $93.3 million in planned deferred compensation distributions. I had hoped that AIG might take similar actions again. Unfortunately, my sound advice went unheeded, the company hid behind legal technicalities, and the public outcry that I predicted happened: AIG has become the subject of considerable public scorn, and the public's interest in providing ongoing, sustainable support to repair our struggling financial system has plummeted.

We will undoubtedly spend much time today discussing these retention bonuses and counterparty payments, but I must urge my colleagues to focus on the bigger picture, too. We need to ask what happened, why it happened, what is happening now, and what we can do going forward to prevent similar situations. To protect the taxpayers, we must also ensure that AIG acts prudently and pays back its borrowed funds promptly. I am committing to doing just that.

We will now hear from the gentleman from New Jersey, Ranking Member Garrett.

Mr. GARRETT. And as I say, without my glasses, so. Thank you, Mr. Chairman. There has been much outrage expressed this week, and rightfully so, from almost all quarters regarding the bonuses for employees in AIG's Financial Products Unit.

But where was the outrage, at least from some quarters, 6 months ago, when AIG's bailout was hastily crafted and the American taxpayer became 80 percent owners of the company? And where was the outrage when $40 billion in TARP money was pumped into AIG for the benefit of its counterparties last November? But we didn't find out about the identities of those counterparties until this past weekend.

And why didn't the Fed, which I understand has known about these bonuses for at least a couple of months, raised this issue with us earlier? Did it raise this issue with Secretary Geithner, who has been called the architect of the AIG bailout, and from whom the Fed has been working so closely with the ongoing management of AIG's affairs? And why didn't Secretary Geithner raise this issue

just last week with the President when we knew that he was briefed in detail about the bonuses from the CEO of AIG? What about the fact that the Fed and the Administration still have not outlined an exit strategy from this whole situation?

You know, some of us were expressing concern from the original bailout of Bear Stearns which was conducted by the Fed over a year ago, when I and 16 of my colleagues even sent a letter to Chairman Frank demanding a hearing on how the Fed was putting American taxpayers at risk in such financial institutions. But it took him over 3 months to schedule one. I also sent a letter to the Fed in early December expressing concern about the Fed's lack of transparency and asking who it was had specific counterparties of AIG and who directly benefits from AIG's government assistance. Part of me wants to say some to some of the loudest critics, what did you expect? And why weren't you asking more questions before? I would argue that the real outrage now is the $170 billion of taxpayer monies that has been pumped into this company and to what effect.

So I realize that recent events have now, to some extent, overtaken this hearing, but there are some other issues to explore as well. We have heard repeatedly, for example, from a number of voices that AIG's Financial Products Division wasn't even regulated. But my understanding, and we have the OTS here to testify, is that the OTS was in fact looking at the activities in this unit. So I would like to explore that a little further.

Also, I wish that the Fed could have joined us here today, but they have an FMOC meeting here today, so they couldn't be with us, and so they have asked to be excused. But I think this basically highlights the tension, I think, between the Fed's duties relating to monetary policies and their regulatory policies.

Furthermore, we have a representative from S&P here today. And I hope they can shed some light on issues relating to credit downgrades, and what role they may have played with regard to AIG to come up with additional funds at the current time, and which led to the government interference in the first place, and most recently, to the restructuring. And secondly, on this point, should Congress and the American taxpayers be bracing for further downgrades, and will that affect our responsibilities or liabilities going forward?

Well, I'm sure we will spend a lot of time this morning talking about the bonus issues. As important as that is, I also hope—as I assume the chairman does—that we can get into the weeds a little bit more and talk about the current state of the company, efforts to wind down the company, and the counterparty obligations, and the progress that has been made in selling off the company's assets and divisions as well.

And with that, I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Garrett. And we will now hear from our full committee chairman, Mr. Frank of Massachusetts, for 5 minutes.

The CHAIRMAN. Thank you, Mr. Chairman. I had hoped we could focus on the subject at hand, but I do have to respond to Mr. Garrett's complaint that he didn't get a hearing quickly enough. Yes, Mr. Garrett did ask for a hearing on the role of the Fed. We had

a number of other things going on legislatively at the time. We did have the hearing in July of 2008. And because I was concerned about the gentleman from New Jersey's views here, I did check. At that hearing, he asked no questions about this program. He did ask a question about covered bonds. So the gentleman was asking could we have the hearing. We had the hearing on specifically this general subject, and he declined to ask any questions about it. I suppose—I understand he's disturbed that we didn't give him a chance not to ask any questions a month earlier, but I am unconvinced that would have made any difference. We did have a hearing about the role of the Federal Reserve well in advance of the decision by the Federal Reserve to—

Mr. GARRETT. Will the gentleman yield?

The CHAIRMAN. I will yield.

Mr. GARRETT. My understanding is that I began on the issue of covered bonds but then went into other issues as well.

The CHAIRMAN. Well, that wasn't my reading of the transcript, which I thought might come up. But the fact is that we did have the hearing, and in 5 minutes I would have to say maybe at the end the gentleman touched on it. I didn't recall that. But covered bonds hardly seem to me to be the major topic that the gentleman insisted on having the hearing about, and we did have the hearing, and I would have thought he would have used all of his time on this topic. Five minutes is, as we know, often too little for us to deal with it.

But the point is that the committee did have a hearing on this well before the decision to go into the AIG. The Federal Reserve came to us in September and told us they were doing AIG. We have had subsequent hearings, and I do believe it is important for us to amend that statute under which the Federal Reserve operates, although I think doing it in the midst of this current financial uncertainty would be a mistake. But the point is, we did have a hearing well in advance of the AIG situation, and I guess we will just release the whole transcript and people can decide how vigorously these questions were pursued. It is not my recollection. I think a number of people left their fight in the gym when it came to the actual confrontation with Mr. Bernanke.

Now as to AIG, and the subject of the hearing, I do believe that it is time for us to assert our ownership rights under this arrangement. The bonuses are wholly unjustified, and they are an example of the problem with the financial incentives that the compensation gives in general. This is an issue that many of us raised in 2006 when we were in the Minority. We brought it up again in 2007 in the Majority. We brought to the Floor a bill on executive compensation. It was just the beginning. It was very strongly opposed by most on the other side.

The problem is not the dollar amount but the incentive structure. It's a head they win, tails they break even. I look at the contract that is being invoked as unassailable, and here's what it says: "The bonus pool for any compensation year, beginning with the 2008 compensation year, will be affected by the incurrence of any realized losses arising from any source subject to the limitations set forth in Section 3.07." And Section 3.07 says, "Not withstanding any other provision of the plan, for any compensation year begin-

ning with 2008, there shall be a $67.5 million limit per year on the extent to which the pool can be reduced."

So that it means that if in fact they have a net loss for the year, they still get the bonuses. This is the problem. This is the problem with those contracts, and I think whoever signed these contracts ought to be called to account on the part of the company. It's a problem with compensation structure going forward. What it says is here, given the 70/30 split of distribution income, if the losses in the year exceed $225 million, then that loss above $225 million is irrelevant to reducing the bonus pool; $225 million turned out to be a rounding error in their losses.

So they give themselves contracts which effectively insulate them from losses. That's one of the things we have to look at, this situation in which you get a bonus when it goes up. So what they do is they count any gain, and that goes into the bonus pool. If those gains are offset by huge losses, there's a very limited effect to which they go into the bonus pool.

What I think we should be doing is exercising our rights as the owners of this company and bring lawsuits. It is one thing for the Federal Government to say because the Federal Reserve lent the money and then Treasury followed up, we are going to invalidate these contracts where both parties to the contract say they want to go forward. That causes some problems in people's minds. The question of the Federal Government abrogating a contract is not something we should do statutorily. But we're the effective owners of this company.

What we ought to be doing is exercising our rights as the owners to bring lawsuits to say these people performed so badly, the magnitude of the losses was so great, that we are justified in rescinding the bonuses. That may be a controversial lawsuit, but it is a better one than trying to interfere under our regulatory authority. And I think it is worth trying, and I think that there could be a good case made that the bonuses granted by people who in fact incurred great net losses by their work, ought not to be granted.

We will also be asking Mr. Liddy to give us the names of the recipients. They have sent us some information under the confidentiality rules. I have spoken to Chairman Kanjorski about this. We will be asking for the names. If Mr. Liddy declines to give us the names, then I will convene the committee to vote a subpoena for the names. So we do intend to use our power to get the names of the people here.

Let me say that if you read this contract, it appears to me to have been signed in contemplation of serious losses, because it has this limitation on the amount to which—again, it's an incentive bonus. The final—what it says is, if you make money, you get money. But if you make money which is outweighed by losing money, you still get the bonus. As I said, I think those are bad incentives.

And as to retention, no, I do not think these are the people you want to retain. The argument is, you need to have the people who made the mistakes so they know how to undo them. Human nature being what it is, I think there's a lot to be said about having people who were not the ones who made the mistakes undo them. The natural tendency to protect your own mistakes comes into play. So,

as I said, I will be urging the Secretary of the Treasury—I have written him a letter—that we exercise our ownership rights, and let's bring a lawsuit as the owners against people who in fact did damage to the company.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Frank. And now we will hear from Mr. Bachus for 2 minutes.

Mr. BACHUS. Thank you, Chairman Kanjorski. As Chairman Kanjorski said, he and I requested the GAO to do an investigation on the motivations behind the government intervention and bailout of AIG and who it was actually intended to help. And I'll be very interested to find out the results of that study.

For several weeks now, and even today, we continue to play kind of a game that children used to play, pin the tail on the donkey. Trying to put the blame somewhere else. And in truth, there's plenty of blame to go around. AIG, their company engaged in very reckless, risky behavior, and I think we all have a right to be angered that such a fine company at one time is in the mess that it is in and the effect that it has had on our economy. That's justified anger, so we could certainly pin the donkey on AIG and those within that company, most all of them long gone, who caused that. Washington, the regulators, they failed to do their job. We ought to blame them. That's justified. This Congress, some of our policies have contributed to some of that behavior, the failure to regulate, the failure of oversight by this Congress. We're to blame.

The one faction who probably aren't to blame but seem to be paying the tab is the American people. They're paying for it. All this bad behavior by the company, all this bad behavior by our failure to regulate, all the failure of us to take action in numerous different areas, we all should bear the blame. But I think at this point that anger shouldn't distract us from really the true issue and our goal today, and that's to try to recover as much of the taxpayers' money as we possibly can. That ought to be our motive. And the blame game needs to be secondary, because we're all to blame.

Now the only possible successful outcome to this is to manage our way out of the current problems. Now how do we do that? Do you think Congress can manage AIG? I don't think so. Take a walk through the Capitol Visitor's Center—3 times over budget, 5 years late. We can't manage AIG. How about the regulators? There are a lot of empty desks at Treasury. I don't think that the Fed or the Treasury has done a very good job. How about a poll on TV? Should we just take some poll results and act from there? I don't think so.

As unpopular as it may be, I think the best opportunity that we have is to let that new team at AIG—we're all upset over the bonuses. The bonuses were awarded and signed as contracts in 2007, long before Mr. Liddy and the new team was in place. And we're justifiably angry at him for maybe not doing a better job of getting out of it. But he came in after the collapse of AIG with a $1 salary and you can vilify this new management team if it makes you feel better, but resolving a company as large and as complex as AIG is no easy task. It was in a mess, and it will require a lot of good fortune. It will require an economic recovery, and that's what they're

doing now. They're unraveling the deals. They're shutting down this Financial Products Division that has caused all of us heartbreak and harm, and that's going to take time. The people who set the policies that brought AIG to the brink of total collapse are gone. We need to give this new management team the time it needs to get the job done. They were assigned that job in September, and when we did it, and when the Fed did it, they said it would take 2 years or 3 years to do it. The government trying to get more involved than it is, is just going to be a sad experience. We need to let, as I say, we need to—and I'll close by again saying it. The solution here is not the government running this company. It's a private team. And they're going to need all the help they can get.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. Bachus. And now we will hear from the gentleman from New York, Mr. Ackerman, for 1 minute.

Mr. ACKERMAN. I'll try to observe the time. Mr. Chairman, there's a tidal wave of rage throughout America right now, and it's building up, and it's expressing itself at this latest outrage, which is really just the tip of the iceberg. And that rage is because the taxpayer knows that they are the ultimate sucker on the list of who pays for all of the greed that has been going on in the marketplace for years and years.

And the real question that we're going to have to face here is not just these bonuses, which are minuscule compared to the outrageous sums that we really have to be talking about, but how a previously venerable company that was an icon in the industry selling legitimate insurance products on the financial market succumbed to this greed and figured out how to package smoke and sell it on the marketplace for billions of dollars without any bit of supervision by any agency, regulation, and without the watchful eye of the Congress.

Chairman KANJORSKI. And now the gentleman from Georgia, Mr. Price, for 2 minutes.

Mr. PRICE. Thank you, Mr. Chairman. I was remarkably disappointed to learn that Secretary Geithner declined to testify at today's hearing, considering the primary role that he played in the governmental intervention into AIG. Make no mistake, everyone is up in arms over the bonuses provided to AIG executives. It seems to me, however, that the outrage should more appropriately be directed at the fact the taxpayers were put in this position in the first place.

This is exactly why the Federal Government should not be in the business of bailing out private companies. This is what a political economy looks like. And it's a very dangerous place to be. Misguided past governmental intervention has put us in precisely this position. The bonus money distributed by AIG is indefensible, but the taxpayer bailout afforded to AIG by the government is remarkably more egregious. The government has already poured over $170 billion taxpayer dollars into AIG, over 1,000 times the amount paid out in bonuses.

President Obama has said he's going to "pursue every legal avenue to block these bonuses and make the American taxpayer

whole." Well, I wish the President demonstrated the same level of outrage over the repeated taxpayer-funded bailouts that we have seen in recent months. I wish he demonstrated the same commitment to making sure that the taxpayers were made completely whole. I wish he demonstrated the same commitment to fundamental American principles.

What we desperately need is an exit strategy that will get back the $170 billion that the taxpayers have already sacrificed to keep AIG running. To that end, we need a comprehensive strategy that is going to recoup all taxpayer subsidies, get the government out of the business of running private companies, picking winners and losers, and taking us further into a political economy.

AIG should be held accountable for every bad decision it has made. We simply must, however, restore accountability and the market discipline in the system so that our economy will be able to grow again. We need to make it recognize that to those who still believe it ought to be the most vibrant and robust economy in the world, and the best way to accomplish that is to embrace and restore fundamental American principles that made this country great.

Chairman KANJORSKI. Thank you very much, Mr. Price. As a matter of fact, it was excellent. It was exactly 2 minutes. Now we will recognize the gentleman from California, Mr. Sherman, for 1 minute.

Mr. SHERMAN. Mr. Chairman, at the appropriate time, I'll ask that Mr. Liddy be sworn. We should impose a high surtax on those executives who choose to retain excessive compensation, and that should apply to all the big bailed-out firms. Securities laws require timely disclosure of material information to shareholders and impose criminal penalties on those who conspire to withhold that information. If the 300 million shareholders of AIG, namely the American people, had been fully informed on a timely basis about these bonuses, we would not have invested $170 billion. We certainly would not have invested the additional $30 billion that was put in just 2 weeks ago. We would have insisted on receivership. This would have saved us tens of billions of dollars, prevented billions of dollars from being disbursed to foreign banks, prevented the bonuses from being paid, and voided the bonus contracts.

I have urged receivership. Some can argue against receivership. But no one can argue in favor of a criminal conspiracy to withhold information from the American people so as to deprive them of the right to decide whether we should have receivership.

I yield back.

Chairman KANJORSKI. Thank you, Mr. Sherman. And now we will hear from the gentleman from Delaware, Mr. Castle, for 1½ minutes.

Mr. CASTLE. Thank you, Mr. Chairman. While we seem to all agree that AIG employee bonuses are a poor use of taxpayer dollars at this critical point in time, I am concerned we aren't getting the full story here. The Fed and the Treasury are stewards of the American taxpayer investment in AIG, an amount approaching an 80 percent ownership share of that company since September of 2008.

It is my understanding that the Treasury, the Fed, and AIG executives have been discussing these bonus payments amongst themselves for the last 3 months. I would like to know what was said between these agencies, what options were weighed, and how the bonus decisions were ultimately made. Any details on this matter that can be provided are of utmost concern to me and the American public. I realize Mr. Liddy is relatively new to his position. I'm sure he can describe AIG's role in these decisions. However, I am disappointed, Mr. Chairman, that we will not be hearing today from the Fed and Treasury to discuss their role during today's hearing. And I heard you state earlier we will hear from them in a week or so, but I think they should have been here today.

The American taxpayer is being asked to trust government now more than ever. The Treasury and the Fed are overseeing the expenditure of billions, if not trillions of dollars to stabilize our financial infrastructure and get our economy on solid ground. We understand that this role is difficult, but transparency and honesty is paramount as we work to regain fiscal stability. I look forward to hearing from our witnesses today, and I look forward to hearing from Treasury and the Fed when they arrive here.

I yield back the balance of my time, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Castle. Now, we will hear from Mr. Capuano of Massachusetts for 1 minute.

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Chairman, this first panel is made up of thrift regulators, insurance regulators, and credit rating agencies. I want to know where were you or your agency, or more importantly some of your sister agencies at a different level? Where were they when AIG was getting ready to do this? Not today. I want to know how we got where we are. I want to know, do you believe that what we have done so far, the path we have taken, is it better or worse than simply declaring bankruptcy for this company and getting it over with? I want to know whether you believe that AIG, whether they will ever return to profitability, whether the taxpayers will ever see their money back, and if so, when?

Thank you, Mr. Chairman. I return my time.

Chairman KANJORSKI. Thank you, Mr. Capuano. Now we will hear from Mr. Manzullo of Illinois for 1 minute.

Mr. MANZULLO. Mr. Chairman, I examined Mr. Kashkari from TARP on December 10th and asked him if he was going to ask for a $3 million bonus back from one individual. He said it could be deferred compensation and ostensibly not returnable. Deferred compensation for what? I represent Rockford, Illinois, the largest city with 14 percent unemployment. People are losing their jobs. Factories are closing.

They're taking cutbacks, working odd shifts, and taking late night shifts. They aren't being paid to destroy the economy. They're being paid to invigorate it. They're sitting in this seat today, all 740,000 of them, wondering how could government do something so stupid as to allow these people to make that kind of money and then sit back and everybody point fingers at each other. We want some answers today.

Chairman KANJORSKI. Thank you very much, Mr. Manzullo. Now we will hear from Mrs. Maloney of New York for 1 minute.

Mrs. MALONEY. Thank you. American taxpayers are justifiably outraged. AIG will be remembered as one of the worst financial disasters in American corporate history. Six months into the crisis, AIG executives still have not read the memo from the American taxpayer. It is morally reprehensible and fiscally irresponsible to expect bonus money for bringing a corporate giant to its knees and paralyzing a national economy.

There are many proposals before Congress now to address this outrage. I have authored legislation which would tax at 100 percent any bonus compensation where the U.S. taxpayer has majority ownership of the company. This would bring back the $125 million in bonus money. Bonuses should be based on creating value, not destroying it and a formerly great company, AIG.

Chairman KANJORSKI. Now we will hear from Mr. Royce of California for 1 minute.

Mr. ROYCE. Thank you, Mr. Chairman. I voted against the bailout of AIG, and I wrote an editorial at the time, "Bailout Plan Could Mutate into a Gravy Train of Tax Money." Well, it has. And rewarded in this are the counterparties around the world that made poor investments with AIG. Rewarded with bonuses are the members of the very Financial Products Division that contributed to AIG's demise. Rewarded is AIG, that now appears to be using their new systemically significant label issued by the Federal Government to charge artificially lower rates in the commercial lines and undercut responsible small private insurance companies in this country.

Central to this discussion on AIG is what Chairman Bernanke told us. He said 54 various State insurance regulators didn't have the capacity to deal with a global insurance company. I have been warning about the systemic risk here since 2006. Congresswoman Melissa Bean and I have been pushing a bill that will close that gap. And until we establish a world class regulatory alternative that is able to deal with a global insurance company like this, that gap will remain. Now in the meantime, we should strike these bonuses.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. Royce. And now we will hear from Mr. Hodes of New Hampshire.

Mr. HODES. Thank you, Mr. Chairman. You know, as far as the American people are concerned, I think AIG now stands for Arrogance, Incompetence, and Greed. It is unacceptable that TARP funds are being pocketed by AIG executives, and it must not be allowed to stand.

I agree with Chairman Frank. I think his approach is a good one. It is ridiculous to stand on these contracts as justification for paying the bonuses, given the circumstances that AIG found itself in. As representatives of the taxpayers, I believe that the contract provisions which allow bonuses for failure are unconscionable and should be held to be invalid or unenforceable on the grounds of public policy. I think it's a good thing that we explore that tack, and I look forward to supporting any way we get this money back for the American taxpayers.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you. Now we will hear for 1 minute from Mrs. Biggert of Illinois. Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman, and thank you for holding this hearing. Let me be clear. We want the money back. It should never have gone to the recipients in the first place. Today I want to know, did taxpayers who own 80 percent of this company get to vote on these bonuses? Did anyone represent the U.S. taxpayer?

While preaching transparency and accountability, did the Administration and the leaders in Congress drop the ball? Did the regulators drop the ball? I would also like to know how much would the recipients have received in bonuses if the Federal Government had not stepped in in September and October and November and now in March. I don't think that there would have been any bonuses. So I think that AIG should either return the bailout money with or without the bonuses.

We need to reverse this travesty. Perhaps we need to take legal action. This is not the direction that my hardworking, tax paying citizens want us to go. We can do better, and we must do better.

With that, I would yield back.

Chairman KANJORSKI. Thank you, Mrs. Biggert. And now for 1 minute, Mr. Klein of Florida.

Mr. KLEIN. Thank you, Chairman Kanjorski, for holding this important hearing. As most Americans are, we're pretty disgusted by the deplorable saga of AIG, and I certainly join my constituents in their outrage about the millions of dollars in bonuses that are being awarded to AIG employees. The American people understand that we are going through a difficult time and are prepared to sacrifice and work together to get our country back on track. But they will not stand for taxpayer dollars being wasted on bonuses for people who bear responsibility for this crisis in part, and neither will I.

When I'm back in my district in South Florida, I talk to people who have lost their jobs, their health care, their homes, or the value of their pension investments. And here we are sitting today, or we will be sitting before the Chairman and CEO of AIG who distributed million dollar bonuses to those who drove the company and possibly our economy into the ground.

There's a tremendous disconnect between the American people and the executive officers of AIG. And I certainly want to know what were they thinking when they allowed these bonuses to go forward. I look forward to the testimony and a frank discussion about how to resolve this.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Klein. And now we will hear from Mrs. Capito of West Virginia for 1 minute.

Mrs. CAPITO. Thank you. Mr. Chairman, I would like to thank you for convening this hearing this morning. As I was on my way to work this morning into the office, the first person I encountered looked at me and said, "something isn't right here," in reference to the recent news of the AIG bonuses. And to be honest, I couldn't agree more.

When this body first considered the proposal that would become the TARP program, I and others expressed significant concerns

that we were moving too quickly, there was too much risk for the taxpayer, and too little oversight. News accounts from this week only reconfirm what many of us said from the beginning. There was not adequate understanding or transparency surrounding these dollars.

All across the Nation, American families and small businesses are tightening budgets, cutting back on costs, and making tough decisions. And the recent news of these bonuses has just added an insult to the prudence of these small businesses and families who are making difficult decisions every day.

Whether we like it or not, or whether they like it or not, the companies that have received TARP are under intense scrutiny understandably. The light is shining brightly on their actions, and it is my hope we can resolve the current economic challenges so the taxpayers are no longer on the hook for this type of excess.

I would like to thank the witnesses for being here today and I look forward to the testimony. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mrs. Capito. And now we will hear from Mr. Peters of Michigan for 1 minute.

Mr. PETERS. Thank you, Mr. Chairman, and I want to thank you for holding this hearing here today. I'm one of the many members of the subcommittee who are outraged by news that employees of AIG were paid $165 million in bonuses. AIG has received over $170 billion from taxpayers, and my constituents are finding it harder and harder to believe that such support is justified.

In my congressional district in Michigan, there are thousands of UAW employees who have employment contracts, and they have been told that they need to re-negotiate those contracts and make concessions to justify taxpayer investments. There are thousands of white collar employees with employment contracts who have foregone promised bonuses and benefits and have taken pay cuts in order to save the companies that they work for.

People are sick of this double standard where working class and middle class workers are treated differently than the financial industry executives. What people are looking for is a sense of shared sacrifice. Wall Street does not seem to understand that yet, but they need to understand it immediately. I know that Mr. Liddy has outlined some reductions, but I look forward to hearing more from Mr. Liddy.

And, again, thank you, Mr. Chairman, for this opportunity.

Chairman KANJORSKI. Thank you very much, Mr. Peters. And now we will hear from the gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. With respect to the TARP program, this AIG bonus scandal is simply the outrage of the week, and the week is not yet half over. The greater outrage should be the almost $180 billion and growing of taxpayer exposure. The greater outrage ought to be four bailouts later, no end in sight, and no plan of sustainability or exit strategy that has been explained to this committee, the greater outrage ought to be taxpayer money used to sustain counterparties to make them whole, counterparties who undertook a risk versus taxpayers who did not take the risk.

And finally, the greater outrage ought to be over a Congress and a President who could have prevented all of this. With respect to

comments out of the Administration, I am reminded of that famous scene in the Humphrey Bogart movie, Casablanca, "I'm shocked to find gambling going on here," as the character stuffs the gambling winnings in his pockets.

I have two suggestions: No more taxpayer funds without the ability to place these firms in receivership; and no more bonuses until the taxpayer is made whole.

Chairman KANJORSKI. Thank you very much. Next, Mr. Scott of Georgia for 1 minute.

Mr. SCOTT. Thank you very much, Mr. Chairman. I just want to say how very important it is for us to quickly restore the confidence of the American people in what we're doing. In order to do that, we have to get to the bottom of how we got into this situation in the first place.

I think it's very important, Mr. Chairman, to get to the bottom of this, to look at the fraud elements of this case. We have to remember that this started in March of 2008. How in the world could they justify putting out contracts of $450 million for a Financial Products Department in AIG that had only 367 employees? Also it's very important that this $165 million at the outset is only the tip of the iceberg. What they have put forward here comes to a total of $1.2 billion in bonuses that have been given throughout the firms for this year.

The other point I want to make, Mr. Chairman, is, in order for us to really get the confidence of the people back, we have to put a pause button on these bailouts and get to the bottom of it. And we in Congress have that responsibility to do as well, and we have a role to play. So as we point fingers here in Congress, we have to recall that there are three fingers pointing right back at us. We have to make sure we're doing our job in order to have the confidence of the American people.

Chairman KANJORSKI. The gentleman from South Carolina for 1 minute.

Mr. BARRETT. Thank you, Mr. Chairman.

Last fall, President Bush asked for my help to avoid a total collapse of the economy, a collapse which would have pushed our country into great economic peril. Back home, small business owners and major corporations called me to let me know that if we didn't take extraordinary steps in those extraordinary times, many of the employers my constituents rely on would be forced to close their doors for good.

Now it disappoints me to see that some of these very companies which requested taxpayer assistance have failed to change their pattern of irresponsible decisionmaking, which undoubtedly contributed to the current economic crisis. The Bush Administration and then-chairman of the New York Fed, Timothy Geithner, mismanaged the implementation of this program, and the Obama Administration, while assuring us they knew exactly what was going on and how the monies were being spent, have failed to bring about the necessary reforms and safeguards to protect the American taxpayer.

Panel, we need to figure out our exit strategy, how taxpayers are going to be paid back, and when we can end this toxic relationship with AIG.

Chairman KANJORSKI. Thank you very much, Mr. Barrett.

For 1 minute, the gentleman from Idaho, Mr. Minnick.

Mr. MINNICK. I opposed the TARP bill and I opposed the bailout of AIG. I'm a businessman who, when I bought companies, took due diligence seriously. We taxpayers shouldn't buy companies or socialize businesses. Having made the mistake with AIG, we should not now throw good money after bad. Instead, we should now withdraw taxpayer support and let AIG go bankrupt. Let a Federal bankruptcy judge void these ill-advised bonus contracts, sort out the losses and bring in new qualified management to properly manage AIG before you get one more nickel of taxpayer support. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Minnick.

Next, Mr. Campbell of California for 1 minute.

Mr. CAMPBELL. Thank you, Mr. Chairman.

There will be lots of discussion about how we got here, but we also need to spend some time on what we are going to do next. I have a lot of concerns about whether there will be any business left from which the taxpayers can recoup any money.

A question I would like to know the answer to is that in September, AIG had $450 billion of exposure on credit default swaps. What is that number today? AIG's commercial property and casualty business was down 22 percent in the fourth quarter and there is evidence that it retained the remainder of its business by substantially reducing prices.

What is happening to that property and casualty business? It would appear it is in some kind of a death spiral. Have there been some, even in the money market fund that AIG had, some puts and other riskier assets put into that which should not have been put into that and if the systemic risk is in the life insurance business, where does that stand right now?

Thank you, Mr. Chairman. I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Campbell.

And now, the last opening statement, the gentleman from Texas, Mr. Neugebauer, for 1 minute.

Mr. NEUGEBAUER. Well, thank you, Mr. Chairman.

I was going to go ahead and say that I am outraged as well, but what I would like to be is enlightened. What we really need to know is what the plan is. The whole problem with the TARP plan from the very beginning is nobody has ever had a plan, other than to throw taxpayers' money at a problem that nobody is able to actually define. As the previous speaker said, what is the position in some of the CDS's today as opposed to what they were on the day that we took over, or I guess—I think we took over. I'm not sure what we did with AIG.

What the American taxpayers want to know is what we are doing to mitigate their exposure, when are they going to get their money back, and what is defined. And what we need, this committee needs, if we are going to actually do oversight, is a plan that has measurable results. In other words, here is where we are today. Here is where we think we are going to be. Then we want you to come back in 30 days or 60 days or 90 days and show us whether or not you are going to make any progress.

You couldn't borrow money anywhere in the world on the basis that we are throwing money at some of these entities without a plan. So I hope we will be enlightened today, as well as hopefully get a little bit less enraged and more engaged in getting our money back for the American taxpayers.

Chairman KANJORSKI. Thank you very much, Mr. Neugebauer.

And now in response to requests in consultation with the ranking member, our witnesses today will take an oath. Will the witnesses please stand and raise their right hands and respond "I do" after I read the oath.

[witnesses sworn]

Chairman KANJORSKI. Thank you very much. You are now sworn in. Please be seated.

I will now introduce the panel and first thank them for appearing today. We had to make changes to the panel because of the recent news. In light of that, I may say, because I heard some comments in the opening remarks, initially this subcommittee hearing was scheduled 6 weeks ago and at that time, there was no hullabaloo in the land about the bonuses. It was a standard process we were going through to find out what is happening with AIG. But Mr. Scott Garrett and I are so attuned to what may happen in the future, we anticipated this occurrence and therefore, we are here at the right moment asking. I am trying to be humorous, but I am not very humorous.

In reality, the purpose of this hearing, really, is to find out what happened, how did AIG get here, what is the plan for AIG to perform, and what can we expect in the future, particularly toward when the taxpayers can expect to receive their funds back? And Mr. Castle specifically stated some disappointment that the Secretary of the Treasury and the Chairman of the Federal Reserve are not here today. They are scheduled to be here on the 24th of March. That will be the follow-up for that. I am sure there will be a lot of concentration on the bonuses.

I would just caution my panel members on both sides of the aisle that bonuses are important, the bonuses are shocking, but the bonuses are not the only element here. The most important element is what the plan is for the future and are we going to be—

The CHAIRMAN. Will the gentleman yield?

Chairman KANJORSKI. Yes.

The CHAIRMAN. On the procedural issues, we could also note that the Secretary of the Treasury has also been scheduled to be here on the 26th to talk about the board of regulatory issue, the subject of our previous hearing. And I did want to note both of those hearings, just procedurally, will be full committee hearings, although the subcommittee has been doing an excellent job of handling this.

But the protocol has been, for as long as I have been here, that cabinet officers will only testify at full committees, so the hearings with Mr. Geithner and Chairman Bernanke, not because there is any reason, other than that is the only way you can get them to come. This will continue to be a matter in which the subcommittee is taking the lead for us.

Chairman KANJORSKI. Thank you very much, Mr. Chairman. We will take that into consideration and understand that.

Now our witnesses are asked to summarize their testimony in 5 minutes and all of your written statements will be made a part of the record without objection. Hearing no objection, that is so ordered.

First, we will hear from Mr. Scott Polakoff, Acting Director of the Office of Thrift Supervision.

Mr. Polakoff.

STATEMENT OF SCOTT M. POLAKOFF, ACTING DIRECTOR, OFFICE OF THRIFT SUPERVISION (OTS)

Mr. POLAKOFF. Good morning, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. Thank you for inviting me here to testify about the supervision of AIG by the OTS.

The scope of government intervention on behalf of AIG has created enormous public interest and acute attention by policymakers. I welcome the opportunity to present the facts available and to answer the important questions surrounding AIG.

The OTS granted a Federal savings bank charter to AIG in 1999 and the bank opened for business in 2000. The OTS is the primary Federal regulator for the $1 billion FDIC insured depository institution and the OTS was the consolidated regulator for the savings and loan holding company.

In January 2007, the OTS was informed that its holding company supervision was deemed equivalent to that required by the coordinator under the European Union's financial conglomerate's directive. OTS continued in its role as consolidated supervisor until September 16, 2008, when by operation of law, AIG was no longer a savings and loan holding company.

My written testimony goes into detail about OTS' oversight of AIG, including our annual examinations of the company, targeted reviews of its subsidiaries, including the AIG Financial Products operating business, our reports on the findings of those supervisory activities and follow-up communications with AIG's management and board of directors to address our concerns.

In my statement today, I would like to highlight just a few points. The rapid decline of AIG stemmed from liquidity problems and two important business lines:

Number one, credit default swaps. A credit default swap is a derivative instrument that provides insurance-like protection to investors against credit losses from the underlying obligations which were typically mortgage loans. Number two, securities lending, a business strategy implemented by a handful of AIG's State insurance subsidiaries.

It is important to note that AIG stopped originating credit default swaps that were linked to subprime borrowers in 2005. By that time, however, the company already had $50 billion of such instruments on its books. AIG halted these activities while the housing market was still going strong, but the company's model forecasted trouble ahead.

Another important point is that AIG's credit default swaps were protecting against credit losses on the highest rated, super senior, triple A plus rated tranche of the collateralized debt obligations. This segment of the securitization poses the least risk of credit loss.

In fact, as of December 31, 2008, there have been no actual realized credit losses from the underlying CDO's.

AIG's crisis resulted from the enormous sums of liquidity required to meet collateral calls triggered by one of the following three events: A rating agency downgrade of the company; a rating agency downgrade of the underlying CDO; or a reduction in the market value of the underlying CDO. AIG's security lending program, which began prior to 2000, lent securities from the State insurance companies to third parties who provided cash collateral in return.

As a general theme, the cash collateral was invested in residential mortgage-backed securities. With the turmoil in the housing and mortgage markets over the past 2 years, these residential mortgage-backed securities experienced sharp declines in value. When the trades expired or were unwound, the cash collateral had to be returned to the counterparty.

This created unprecedented liquidity pressure for the company. The cash requirements of the program significantly contributed to AIG's crisis. I think these are the keys to understanding how we got to where we are today.

And as to where we go from here, I see two important lessons learned.

Number one, the credit default swaps at the center of AIG's problems continue to be unregulated products. New regulations governing these complex derivative products are essential. The announcement by the President's Working Group on Financial Markets in November of last year to implement essential counterparty service for credit default swaps is a good beginning. And number two, the AIG story makes a compelling argument for establishing a systemic risk regulator with the authority to examine the resources to address temporary liquidity crises and the legal authority to perform receivership activities if a failure is unavoidable.

Thank you, Mr. Chairman, for allowing me to testify. I look forward to answering questions.

[The prepared statement of Mr. Polakoff can be found on page 210 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Polakoff.

Now we will hear from the Honorable Joel Ario, Insurance Commissioner of the Commonwealth of Pennsylvania Insurance Department, on behalf of the National Association of Insurance Commissioners.

Welcome, Mr. Ario.

TESTIMONY OF THE HONORABLE JOEL ARIO, INSURANCE COMMISSIONER, PENNSYLVANIA INSURANCE DEPARTMENT, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. ARIO. Thank you, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. I appreciate the opportunity to provide an insurance regulator's perspective on what has happened at AIG.

Ben Bernanke, Chairman of the Federal Reserve, recently described AIG as, "A hedge fund attached to a large and stable insurance company." He was right on both counts. The hedge fund is

AIG Financial Products, which, according to Chairman Bernanke, made, "Irresponsible bets and took huge losses." The large and stable insurance company is, of course, 71 State regulated insurance subsidiaries, including 11 companies in my State of Pennsylvania.

The reason the Federal Government decided to rescue AIG was because of the systemic risk created by Financial Products. That risk materialized last September when it became apparent that Financial Products had bet twice the value of AIG on risky credit default swaps and failed to hedge its own bets. To make matters worse, the counterparties to those swaps included many of the world's leading financial institutions. It was to protect those institutions that the Federal Government acted.

In Chairman Bernanke's words, "We are not doing this to bail out AIG or their shareholders certainly. We are doing this to protect our financial system and to avoid a much more severe crises in our global economy. We know that the failure of major financial firms can be disastrous for the economy. We really had no choice."

To put it bluntly, AIG Financial Products, the hedge fund that failed to hedge its own bets, has become the poster child for systemic risk. Although the September crisis at Financial Products produced collateral damage within the AIG insurance companies, the fact is that these companies do perform well—they are not in a death spiral—well enough that competitors accuse AIG of using its Federal assistance to unfair advantage in the marketplace.

The allegations are most prominent in commercial insurance where the Nation's largest insurers routinely bid against each other on multi-million dollar accounts. AIG's competitors claim that AIG is deliberately underpricing in a desperate attempt to maintain premium value. AIG has fired back that its competitors are selectively underpricing to exploit a vulnerable company.

Such disputes typically reflect insurers trying to protect profit margins in a soft market, but there is a point at which low pricing can threaten long-term stability. So we have carefully reviewed, we being State insurance regulators, carefully reviewed charges on both sides and to date, have not seen any clear evidence of underpricing on either side.

What have we learned from the AIG ordeal? First, we have seen stable insurance companies that demonstrate the efficacy of State insurance regulation. Indeed, the Federal rescue of AIG would have been an even tougher call were it not for the well-capitalized insurance companies providing the possibility that the AIG loans will be paid back. That was true in September. It is true today.

The insurance companies have the value they do because State regulation requires healthy reserves backed by conservative investments all dedicated to protecting policyholders and other claimants. This is not to say that regulation is perfect, to the chairman's introductory comment, which brings me to securities lending.

Securities lending did not pose systemic risk and would have been resolved without any Federal assistance, but for the Financial Products debacle, which caused the run on the bank that took a net of $20 billion in Federal funds to fully resolve. It is more than $40 billion out, but $20 billion held by the Federal Government today. This was unfortunate and it is a problem for State regulation, but

it does not compare to the $440 billion credit default swap mess that continues to pose systemic risk.

The securities lending problem: solved today. Completely solved. My written testimony contains more details about securities lending, but let me conclude with a few thoughts on the most important lesson we can learn from the abuses at Financial Products: the need to identify and manage systemic risk.

As AIG illustrates, insurance companies are more likely to be the recipients rather than the creators of systemic risk, but as AIG also illustrates, the systemic risk that is received can have significant repercussions. In this case, a manageable securities lending problem turned into a run on the bank back in September.

State insurance regulators recognize that Federal action is needed to address systemic risk, but the solution should be a collaborative one that builds on the strength of State regulation (multiple eyes on any problem) by adding the eyes of other functional regulators in a transparent structure that holds all functional regulators accountable and does not compromise one company within the enterprise for the benefit of another. Such a structure would give us, as State regulators, the ability to do what we do best, protect the insurance buying public. Thank you.

[The prepared statement of Mr. Ario can be found on page 136 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Ario.

And now our next witness will be Ms. Orice Williams, Director of Financial Markets and Community Investment at the Government Accountability Office.

Ms. Williams.

TESTIMONY OF ORICE M. WILLIAMS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Ms. WILLIAMS. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to participate in this morning's hearing on AIG and issues related to its Federal assistance. I will be providing an update on the status of our ongoing work on issues surrounding the Federal Reserve's and Treasury's assistance to AIG and potential competitive implications for commercial property/casualty markets where AIG insurance companies are major players.

When you and Ranking Member Bachus asked GAO to initiate this work in January, we pulled together a multi-disciplinary team that includes staff knowledgeable about insurance and economics, including our Chief Actuary and Chief Economist. Our work is divided primarily into two areas:

In the first area, we are exploring the goals of the assistance, progress in achieving these goals, and challenges AIG faces in repaying the Federal assistance as well as how the Federal Reserve and Treasury are monitoring AIG's restructuring efforts; however, it is important to note that GAO is prohibited by law from auditing the Federal Reserve's monetary policy activities, which includes the emergency authority the Federal Reserve is using to address the current financial crisis. Therefore, our review is based on publicly available information.

Second, we are examining allegations that the assistance provided to AIG has afforded its property and casualty insurers an unfair advantage in certain markets and that they are pricing in a way that is not consistent with their risks.

Now I will share a few of our preliminary findings. The Federal Reserve and Treasury officials told us that the goal of the continued assistance has been to avoid systemic risk from a rating downgrade or rapid failure of the company that would further destabilize financial markets. The Federal Reserve has been monitoring AIG's operations since September and Treasury is beginning to more actively monitor AIG's operations as its role has expanded.

Although the ongoing Federal assistance has generally prevented further downgrades in AIG's credit rating, AIG has had mixed success in fulfilling its other restructuring plans. For example, while AIG has terminated its securities lending program, its efforts to sell certain business units has been more challenging in the current economic environment.

GAO also faces ongoing challenges from the continued overall economic deterioration and tight credit markets. AIG's ability to repay its obligations to the Federal Government has also been impaired by its falling revenue and ability to sell its assets, as well as further declines in the value of its assets.

Now I will briefly discuss our ongoing work on the potential impact of AIG's Federal assistance on the commercial property and casualty market. Specifically, we are reviewing potential effects on AIG's pricing practices. As you know, some of AIG's competitors have expressed concerns that Federal assistance to AIG has allowed AIG's commercial property and casualty insurance companies to offer coverage at rates that are inadequate for the risk involved.

To date, we have spoken with numerous State insurance regulators, insurance brokers, and insurance buyers. The general consensus thus far is that while AIG may be pricing somewhat more aggressively in order to retain business in light of damage to the parent company's reputation, they have not seen indications that this pricing was inadequate or out of line with previous AIG pricing practices. However, we have found no evidence to date that Federal assistance has been provided directly to AIG's property/casualty insurers.

To the extent that the property and casualty insurers would have been adversely affected by a credit downgrade or failure of the parent, AIG's insurance companies have likely received some indirect benefit.

In closing, I would note that the extent to which the assistance provided by the government will achieve its goal of preventing systemic risk continues to unfold and will largely be influenced by AIG's success in meeting its ongoing challenges to try to restructure its operations and maintain goodwill. Our work is ongoing at this time. We have not drawn any final conclusions about whether or how the assistance has impacted the overall competitiveness of the commercial property and casualty market and will face a number of challenges in doing so.

Mr. Chairman, this completes my oral statement. I would be pleased to answer any questions that you or members of the subcommittee may have at the appropriate time.

[The prepared statement of Ms. Williams can be found on page 231 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Williams.

And last, we will hear from Mr. Rodney Clark, managing director of insurance ratings at Standard & Poor's.

Mr. Clark.

TESTIMONY OF RODNEY CLARK, MANAGING DIRECTOR, INSURANCE RATINGS, STANDARD & POOR'S RATINGS SERVICES (S&P)

Mr. CLARK. Thank you, Mr. Chairman, Ranking Member Garrett, and members of the subcommittee. Good morning. My name is Rodney Clark. I serve as a managing director in Standard & Poor's rating services business and from 2005 until very recently, I served as S&P's lead rating analyst covering AIG. I am pleased to appear before you today.

Let me begin by speaking generally about our ratings process and the nature of our credit ratings. S&P's credit ratings are current opinions on the future credit risk of an entity or debt obligation. Our ratings do not speak to the market value of a security or the volatility of its price and they are not recommendations to buy, sell or hold a security. They are one tool for investors to use as they assess risk and differentiate credit quality of issuers and the debt that they issue.

S&P analysts gather information about a particular issuer or debt issue, analyze the information according to our published criteria, form opinions and then present their findings to a committee of experienced analysts that votes on what ratings to assign. S&P publishes its ratings opinion in real time and for free on our Web site and we also generally publish a narrative that provides additional information about our opinion.

This is the process by which S&P arrived at its ratings on AIG, which I will now discuss in more detail. Attached to my written submission is a table listing our global ratings history of AIG since 1990, as well as a more detailed description of our rationale for our rating changes. For many years, S&P had a triple A rating on AIG. Our opinion began to change in 2004 and since March 2005, we have lowered our ratings on AIG 4 times.

In February of last year, S&P announced a negative outlook on the company's ratings related to the way AIG was determining the fair value of credit default swap contracts or CDS. AIG's CDS guaranteed an array of structured finance securities. Several months later, in May 2008, we lowered AIG's rating to double A minus following the company's announcement of further losses in their CDS portfolio and we maintained a negative outlook on AIG throughout the summer of 2008.

In August, S&P announced that its view of the actual expected credit losses in the CDS area would likely amount to around $8 billion, significantly higher than the mark-to-market losses. AIG's financial condition continued to deteriorate sharply amid the substantial market turbulence in September 2008 leading to a sudden

drop in the market value of AIG's investments and its CDS portfolio.

In light of these events, on September 12, 2008, S&P placed its ratings on AIG and its subsidiaries on credit watch with negative implications. On September 15, 2008, as AIG's condition continued to deteriorate, S&P lowered its rating further to A minus in light of the increase in CDS related losses and AIG's reduced flexibility in meeting its collateral needs. Since then, AIG has benefitted from government support.

Our rating on AIG remains at A minus, but includes a six notch uplift for the government support. Thus, without government support, our rating on AIG today would be double B minus. S&P recently affirmed its A minus rating on AIG; however, we maintain a negative outlook on the company's rating going forward.

I have also been asked to address the effect of AIG's troubles on creditworthiness of its insurance subsidiaries. We believe those subsidiaries are, to some extent, protected by insurance regulations from AIG's financial problems. Nevertheless, we believe there is increased reputational risk for the subsidiaries at this time, which may eventually affect their earnings. Moreover, they may have reduced access to capital in the event AIG's condition should worsen.

I have also been asked to address whether S&P's ratings may have contributed to the decline of AIG. We believe that AIG's difficulties resulted from the convergence of many factors, including the unprecedented and substantial deterioration in the market value of AIG's CDS portfolio. While some have argued that S&P's downgrade was too slow, others have said that we acted too aggressively and that our downgrades contributed to AIG's decline.

We would not refrain from taking any rating actions simply out of deference to a particular issuer or at the request of a market participant. Our ratings are not driven by market sentiment; rather, our role to act as an independent observer offering our views on creditworthiness.

Finally, you have asked me to describe any involvement S&P may have had in connection with the structuring or restructuring of the government support packages to AIG. Although S&P has been informed by government officials about the actions that have been taken, we have had no participation in the structuring or restructuring of these packages, nor has S&P provided or been asked to provide any advice or consultation to the government in connection with its support of AIG. I think you for the opportunity to participate in this hearing and I would be happy to answer any questions you have.

[The prepared statement of Mr. Clark can be found on page 148 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Clark.

To the whole panel, we thank you for coming today. We did not anticipate that this hearing would have as much attention as it does. It is just a standard old country type hearing up here and suddenly has gotten a life of its own for totally other purposes. But maybe we can use our time in questioning you to find out some important questions, other than bonuses.

And that is first maybe directed to our Pennsylvania insurance commissioner because a good part of AIG's insurance is inspected

by your department. And I know you are here for the National Insurance Commissioners, but could you give us an idea whether there is any real negative impact or risk to the insurance policyholders of AIG, specifically in Pennsylvania, but then as you may know, countrywide.

Mr. ARIO. As was just said by the gentleman from Standard and Poor's, there are some threats on the horizon in terms of reputational risk and in terms of access to capital, but today I can tell you that the 11 companies in Pennsylvania are strong. They continue to be roughly as strong today as they were in September.

And so far, these threats have not materialized, and the insurance companies continue to be strong. Even if there were more threats, of course, the policyholders under these insurance companies would be fully protected, but today I think the franchise value is still there across the set of AIG companies, both in the property and casualty business and in the life business, and we continue to watch it carefully.

Chairman KANJORSKI. So as I understand that, trying to be fair, if I were a policyholder, I would not fear the fact that my policy will be honored, can be honored, and the funds are there protecting me. So it will be honored; is that correct?

Mr. ARIO. That is absolutely correct.

Chairman KANJORSKI. Very good.

As to the thrift regulator, I guess I am just going to ask a simple question that I get asked every day when I am home talking to people. Most people are astounded that the problems of AIG and their involvement in the derivative markets were not picked up by the regulator and dealt with by the regulator. It seems that there was no whistleblower either. Can you give us some evidence of what happened and why the regulator did not pick that up?

Mr. POLAKOFF. Yes, sir. I'll start with the notion that indeed the Office of Thrift Supervision reviewed the performance of the $80 billion in credit default swaps that are really at issue with the government bailout that occurred last year. Of that $80 billion in credit default swaps that are primarily supporting CDO's, the underlying CDO's, I want to restate what I said earlier, sir, which is that there has been no credit, realized credit losses, on those underlying CDO's.

Credit default swaps were written on the triple A senior, super senior, tranche of the CDO's. The risk in that portfolio, especially that $80 billion, the risk is from collateral calls associated with either the rating downgrade of AIG, the company, the rating downgrade of the CDO's, or the market value deterioration in the CDO's.

We have been strongly looking at the FP performance since 2004. We had regular, what we call colleges, with all the international supervisors each year. In 2007 and 2008, we very aggressively discussed the risk within FP and the credit default swap portfolio. About $306 billion of the $430 billion of the credit swaps reside in a subsidiary in the U.K., but is actually a subsidiary of a French bank that is part of FP. So Commission Bancaire looks at that portion of the credit default swaps.

But indeed, I do want to clarify, from our perspective, we reviewed and clearly understood and worked with FP with this risk.

I also want to state that it is important to understand that this book of business, that the subprime credit default swap book of business stopped in 2005.

Chairman KANJORSKI. On that point, though, it seems to me that it was not our problem? We are not responsible for it so we would have to look somewhere else. So it is sort of a pointing game. The problem is, we are going to have to find somebody ultimately who is responsible for the whole thing, and what do you envision the change should be so that this problem will never happen again?

Mr. POLAKOFF. Well, thank you, sir. Congressman, I want to go on record as saying OTS should have, in 2004, stopped this book of business with an understanding, with an anticipation, with an analysis that suggested that the real estate market might get as bad as it has gotten in the last 2 years. At the 2004 assessment, we should have done it; we didn't do it. There are a lot of people walking around who failed to understand how bad the real estate market was going to get.

I, in no way, want to suggest that there is a pointing game going on here or we are looking at others. We do believe that this kind of company deserves the oversight of what we will call a systemic risk regulator and that systemic risk regulator would have three parts to it: The ability to examine; the ability to provide liquidity if there is a liquidity crisis; and the ability to place an institution into receivership if that is a necessary outcome.

Chairman KANJORSKI. Thank you very much, Mr. Polakoff.

And now my time has expired. My ranking member from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you. And I seek unanimous consent, just to clarify the record, as to my comments in July that actually besides covered bonds, it was also dealing with the framework of the unwinding process, the potential for future troubled institutions, such as this, and future activity of the Fed in the reserve, if no objection.

Chairman KANJORSKI. No objection. It is so ordered. Do you have a copy?

Mr. GARRETT. Sure.

Thank you all. Just to run down the aisle, Mr. Clark, with regard to the comments regarding the six notch uptick with regard to the grading, is that due to the fact—simply to the amount of money that the Federal Government puts into this or is there an implicit now guarantee that we are there going forward?

Mr. CLARK. We are not considering, in our analysis, that there is an implicit guarantee going forward. We are reflecting the support that has been provided and the potential that there could be future support, which would include some of the things that AIG and the Fed have announced, but have not yet been put into place.

Mr. GARRETT. Because just recently, a few months—a short time ago, it was restructured from the Fed and the Treasury as to what their relationship was and I guess that was in light of the fact that had they not done that, then you would have gotten that six notch or some deviation.

Mr. CLARK. Right. And conditions wouldn't have been exactly the same at the time. So the answer might not have been exactly six notches, but it would have been in the range. But we have been

saying for several months in our publications that we believe AIG's ratings would be non-investment grade had it not been for the support that had been provided.

Mr. GARRETT. I appreciate that.

Ms. Williams, the last time you were here, whenever that was—a few weeks back—I got the impression—maybe I heard wrong from our exchange—that there was no one really responsible for or looking over the AIG and the holding company with regard to all this stuff going on here, black box/black hole, I think you referred it to, as far as the derivatives and what have you, but today, and also at the meeting previously, Mr. Polakoff, in reading his testimony, I get the idea that there was and that it was the OTS.

And if you go into his whole testimony, he had a whole bunch of review back in March and what they said should be done and it comes back to them, AIG coming back with their recommendations. So if I understand it correctly, was there a regulator that looks over all the holding companies and the banks and the CDS out there?

Ms. WILLIAMS. The OTS, in this situation, is the holding company regulator. They are responsible for regulating the holding company. And that is what I mentioned before, that there is a holding company regulator. The questions that we have about holding company regulation is the focus of that regulation; in this situation we have heard today, they were looking at AIG FP. There is a question of timing. And I think I may have indicated the timing was off in terms of when they actually started going ahead.

Mr. GARRETT. Bottom line, there was a regulator. Mr. Polakoff says that maybe they were just looking in the wrong—had the wrong modeling, the wrong analysis. In retrospect, they can see what they should have done, but—

Ms. WILLIAMS. Yes. There is a holding company regulator.

Mr. GARRETT. Very good. And just very quickly, on a side note, your comment that you are not able to audit the Fed with regard to the monetary policy, that is under current statute.

Ms. WILLIAMS. Correct.

Mr. GARRETT. And perhaps, this is something—I know Chairman Frank has said at some point in time to look at the policy, and what have you, our control over that. I assume—do you want to make a comment whether that is something that Congress should look to do?

Ms. WILLIAMS. This is an issue. GAO has said before that we will do what you instruct us to do and we—you know, if you want us to do it, we will definitely do it.

Mr. GARRETT. I appreciate that.

Mr. Polakoff, $80 billion left out there; $50 billion of that is on the subprime situation, right?

[no verbal response]

Mr. GARRETT. Okay. Going on Mr. Campbell's original question, what is the—how did you phrase that, Mr. Campbell? What is the total amount that is at risk, actually there, exposure for the taxpayer at this—or for actually AIG and potentially for the company and the taxpayer?

Mr. POLAKOFF. Congressman, I may not be the best person to answer that question since post-September 15th—

Mr. GARRETT. That is fair enough.

Mr. POLAKOFF. —we are no longer a savings and loan holding company regulator for this company. But I would submit to you, sir, that the $80 billion is down to $12 billion as a book of business of AIG FP.

Mr. GARRETT. One other question while you are here. Do you take a look to see on the other side on these CDS's whether these CDS's are actually hedged in this situation because we know that some of the folks out there who looked at AIG earlier than you folks and saw the problems said, "We are going to hedge this business with AIG and protect ourselves."

So even though the fact we bailed out AIG and some of these parties were basically—got tax dollars through that, they were actually protected on the other side for their own hedging on the downgrade on this. Do you look at that? Do you have that information?

Mr. POLAKOFF. We do not have that information. As to how a counterparty would be hedging, that relationship with AIG, no, sir.

Mr. GARRETT. Does anybody look at that?

Mr. POLAKOFF. It is going to depend who the counterparty is and who the regulator is for that counterparty.

Mr. GARRETT. I understand. Thanks so very much.

Chairman KANJORSKI. Thank you very much, Mr. Garrett.

And now the gentleman from Massachusetts, the chairman of the full committee, Mr. Frank.

The CHAIRMAN. Thank you, Mr. Chairman.

And let me say to the gentleman from New Jersey, I apologize. I was looking at the transcripts of our previous hearing and the transcript, the official transcript, is probably incorrect. Looking at the official transcript, it cuts off the questioning. I should have wondered because, according to this transcript, the gentleman used far less than 5 minutes and most of us find 5 minutes too constraining.

So I will have to correct the transcript. It began with covered bonds and I will have to check and see why transcripts were not better done. So we did have the hearing on July 10th well before they got involved again. The gentleman did ask if they planned to do it again and I guess he got his answer. They may not have planned to do it again, but they did it again.

Mr. GARRETT. They didn't want to do it again. They said—yes.

The CHAIRMAN. This may be beyond the scope of what the GAO got involved in, but you know, Ms. Williams, that the rationale for the intervention by the Federal Reserve was to prevent systemic risk if there was a total collapse. Does the GAO have any opinion on whether or not that was a valid fear or was that beyond the scope of your mandate?

Ms. WILLIAMS. It really is beyond the scope of our study. We were attempting to identify what the goal was.

The CHAIRMAN. That's fine. There is no question, you know, it is correct. I would just note, and it is clear that there should have been some conditions, but I was re-reading the transcripts, probably to remind myself of what had happened. We should note that the Federal Reserve and the Secretary of the Treasury at that time, Secretary Paulson and Mr. Bernanke, were being criticized

because they had not intervened to stop Lehman Brothers from falling apart and not paying off.

So they were, to a certain extent, dammed, but they didn't dam when they didn't because there was a consensus forming—well, first Bear Stearns, there was intervention for Bear Stearns and there was a lot of criticism. People said this is capitalism. You have to let people go belly-up.

And then Lehman Brothers went belly up and it turned out bellies didn't look so good to people. So when the next one came up, which was AIG, they intervened. Now that doesn't mean they did it right or wrong, but we ought to give that context. And there was a significant consensus that letting Lehman Brothers fail with no intervention was a problem.

But this is a question I want to ask our various witnesses and it is not exactly what they were asked about, but we do—in addition to doing everything we can to get the money back, an important part of our job is to minimize this kind of damage and, in particular, not to have either the Bush Administration, the Obama Administration, or any Administration forced with the choice of either you let Lehman Brothers go completely under and have a problem or you bail out AIG's counterparties and have a problem.

We have, under the law, reasonable means for reacting when a bank is going bad. It is called "resolve" it. One of those antiseptic words. We can "resolve" banks. Wachovia went under during this period, Washington Mutual. Neither of those or other banks caused the kind of disruption, one way or the other, that we saw from Bear Stearns or Merrill Lynch being bought by Bank of America, etc.

What Secretary Geithner has asked for, and recently the Speaker and Mr. Paulson were for this, and he has testified about it and Mr. Bernanke has, an argument is that I think, very strong that there should be a statutory framework so that regulators can step in and unwind an institution and not be faced with the O and nothing choice that they had with regard to, I think, people would find both the Lehman Brothers outcome and the AIG outcome somewhat unsatisfactory.

I'm wondering again—it wasn't on your agenda, maybe, beyond the scope for some, but on the other hand, from OTS and others, do you have opinions as to whether or not we ought to be moving towards some statutory framework so that you can unwind these troubled institutions without the kind of choices we have had?

Mr. POLAKOFF. Yes, sir. We do believe that there should be that statutory process. We do believe that if there is sufficient discussion and debate within Congress and a decision to move forward with a systemic regulator that the power should fall within the systemic regulator to examine, and if necessary for receivership activities. Yes, sir.

The CHAIRMAN. Anyone else? Yes, Commissioner.

Mr. ARIO. Yes, within the insurance subsidiaries there's a clear process too for unwinding, just like there is with the banks.

The CHAIRMAN. Right.

Mr. ARIO. Two things would happen with AIG in this kind of situation. One, most of the business would go to competitors, so there would be a smooth transition for policyholders; and, to the extent

that didn't happen, there would be a guaranteed fund protection behind it. So we agree with OTS that there ought to be a systemic approach to this, and we would think.

The CHAIRMAN. And let me just say one of the things with a guaranteed fund is it could come with limits so people are not rewarded with open-ended funds, but in the guaranteed funds there are usually limits, which is a guide to prudent investing.

My time has expired, Mr. Chairman. If either one of you has a brief comment, but I think it's probably not a GAO issue.

Ms. WILLIAMS. Well, actually I would just like to comment. The framework the GAO rolled out in January of this year for the financial regulatory system has an element that directly goes to that.

The CHAIRMAN. Thank you.

Ms. WILLIAMS. And that's a provision to make sure that the exposure to taxpayers is limited in any framework going forward. So this would fall into that category.

The CHAIRMAN. I thank you. That's something this committee will have to focus on.

Chairman KANJORSKI. Thank you very much, Mr. Chairman.

Now, the gentleman from Alabama, Mr. Bachus, for 5 minutes.

Mr. BACHUS. Thank you.

Ms. Williams, Chairman Kanjorski and I, part of our request to you is to determine whether there had been any measurable progress in recouping the taxpayer dollars. Have you seen anything, any optimistic signs or positive signs; and, one of the things I'll ask you in that question or even choose to use this or not, but in the Fed's special purpose vehicle, "Maiden Lane," I notice that those contracts and credit default swaps may be performing at least apparently at a higher level than when they were acquired. But would you comment on the broader question than maybe that detailed question?

Ms. WILLIAMS. Our work in this area is going on, on an ongoing basis. In terms of the status, we looked at where they are and we noted the challenges. And at this point we see a number of challenges that AIG continues to face in terms of restructuring itself. So, I would say at this point we are kind of neutral until we continue to do some more work in terms of the outlook.

Mr. BACHUS. Okay. Thank you.

And Mr. Polakoff you acknowledged, I believe, that you were somewhat aware of the worsening situation at the Financial Products Subsidiary, but you, I think, admit that OTS didn't foresee the extent of the risk to AIG. Is that correct?

Mr. POLAKOFF. Yes, sir. We did not foresee the extent that the mortgage market would deteriorate and the impact on the liquidity of AIG FP.

Mr. BACHUS. Did you understand the complicated use of the credit default swaps? Did you end the exposure they were creating for the company, the amount of risk? Was there an appreciation of that?

Mr. POLAKOFF. Yes, sir. Absolutely. We reviewed the models. We understood the models. We worked with the external auditors. We worked with senior management of the company. Again, the models were accurate in predicting that the actual realized credit loss on

the underlying CDOs was minimal, and it remains minimal as of today. It was the liquidity aspect that the models failed and we failed to identify that aspect.

Mr. BACHUS. Did you lack qualified examiners, or is that an impossible task?

Mr. POLAKOFF. No, it's quite possible. I'm very proud of the work our examiners did. Again, in 2004, we failed to predict how bad things would get in 2008.

Mr. BACHUS. Have you revised your examinations? Of course, a lot of that liquidity has been unwound now. So I guess it's accurate.

Mr. POLAKOFF. Yes, sir. And this is not the only company that suffered liquidity crises. And from the Basel committee on down, all of the regulators have focused on the proper review of liquidity.

Mr. BACHUS. Thank you. Okay.

Mr. "Ario," is that how you pronounce it?

Mr. ARIO. That's correct.

Mr. BACHUS. There has been, you know, some call to create an optional Federal charter. But at least as I have seen it, I am not seeing much failure of State regulation of the insurance industry.

Would you comment on what native reform, maybe the insurance reform ought to be and where that ought to come from?

Is there a gap in the regulatory structure? Is there a failure of Federal regulation or is it a State regulation?

Mr. ARIO. Thank you for that question.

I certainly agree with you that there hasn't been a failure of the State system here. In fact, we are the success story within this overall story and that the insurance companies continue to remain strong, stable, well-capitalized companies. And they are the most likely route that the taxpayer will get paid back here is the value in those insurance companies. There are on an ongoing basis many modernization initiatives that we're involved in. The world changes fast these days, and so we're updating our financial regulation, taking into account some of the issues on securities lending.

I do agree with my colleague here, Mr. Polakoff, that it's the same thing on securities lending. It was liquidity issues that caused the problem, not losses in the underlying value. But we're looking at that issue. We're looking at modernizing our product approval and market conduct systems, our producer licensing systems, and so forth.

But there is nothing in a systemic nature, I think, that we have to do other than be partners as part of a national systemic risk system that protects the functional regulators within an overall collaborative system.

Mr. BACHUS. Have you looked at the overall holding company at AIG in doing your assessments of the insurance company? Or, do you deal solely with the insurance operations?

Mr. ARIO. We deal primarily with the insurance companies. Certainly, when we have questions we kick them up to the holding company level, since securities lending was actually handled at the holding company level. When we have those kind of questions then about how is it being handled there, because it's using money from the life insurance companies, we generally get answers to those questions.

But there is a well there where if we are pressed real hard on some sensitive topics, we don't have clear authority to go into the holding company level. And so I do think you need somebody that has clear authority at that holding company level as well.

Mr. BACHUS. Thank you.

Chairman KANJORSKI. Thank you very much.

And now we will hear from the gentleman from New York, Mr. Ackerman, for 5 minutes.

Mr. ACKERMAN. Thank you, Mr. Chairman.

I think a lot of people listening to us, their eyes are starting to glaze over because they don't know what the heck we're talking about. And when they hear a term "credit default swaps," it sounds very intimidating to begin with. Most of the American people don't know what that is, and I daresay that most Members of Congress didn't know what it was as long ago as a year ago, because it's a relatively new thing.

I just want to make sure that I understand it. And I'll try to explain my understanding in what my mother would call by giving you a "for instance." So there are two guys out on a life raft, and they're adrift at sea, and a storm blows up. And the raft is surrounded by sharks and the waves are 10 feet high. And the first guy says, "I'm scared." So the second guy sells him the policy.

That's a credit default swap. You're selling something with absolutely nothing to back you up. You have no money, possibly, in your pocket or your wallet, and, if everything goes right, you're collecting a premium. And if everything goes wrong, so what. It makes no sense. It's like snake oil salesmen selling you jars of snake oil, and they don't even have the oil in the jars.

I mean there's a great company called, "I Can't Believe It's Not Butter." You know, at least they have the decency to tell you it's not butter. I mean, this is insurance without being insurance, because if they called it insurance they would have to have money to pay you off. But they don't have the money to pay you off and they're calling it credit default swaps, because if they called it, "I Can't Believe It's Not Insurance," maybe nobody would buy it.

I mean, it's a funny joke I made up but this is exactly what's happening, and it's not funny, because all of us who are laughing are crying, and getting angry and getting enraged. How is this suddenly an industry? I mean these brilliant people figured this out. It's really very simple. Call yourself something else and sell something that you're saying isn't insurance that people think is, and the biggest companies, the most sophisticated investment minds on Wall Street and all over the world are buying this stuff thinking that they are "almost insured," almost.

And as long as they don't put in a claim, they're fine, but as soon as the tide goes out, there are a lot of people trying to cover their bare assets and they don't have the wherewithal to do it. How did we allow this to happen? I mean, some people think that we're the regulators and the Congress are the watchdogs. We're not that agency. We make the laws. We have oversight, and we rely on the regulators. We rely on the rating agencies and you at the table to sound the bells, whistles, and alarms and tell us hey, there's something going on out there that we can't regulate, that we can't observe, that we can't figure out, but it's going on.

There are billions of dollars. AIG is the biggest, I suppose. How large is this? How many other people are involved in this? What is the risk to the American people? I mean, otherwise, you're playing, "I can't believe we're not regulators," and we're pretending to be, "I can't believe we're doing oversight."

Take a shot.

Mr. ARIO. I'll give you an answer from an insurance perspective as a downstream recipient of the risk that was created here. Financial Products is essentially on top of the pyramid. Financial Products is the one that everybody else looks at this stuff and says, "We're not quite sure if this is going to perform or not. We had better hedge on it."

You buy the policy from AIG, and then people, as Mr. Garrett said, even people who bought policies from AIG hedge, in case AIG couldn't pay.

Mr. ACKERMAN. They went to AIG because these guys rated AIG triple A, and so everybody assumes that their subsidiary is triple A, which you haven't rated. It's like if I have an 800 credit score, are you going to lend my kid money because you think he has an 800 credit score?

Mr. POLAKOFF. Congressman, if I could offer a couple of points for your consideration of the bailout that has occurred. And AIG recently did a press release breaking down the money—$52 billion went for credit default swap-related issues, and $40 billion went for security lending issues. So there were multiple issues associated with AIG.

There are many large financial institutions in the United States today that underwrite credit default swaps. The issue is not the product.

Mr. ACKERMAN. They're underwriting the underwriters that are doing the underwriting?

Mr. POLAKOFF. No. They're issuing, selling credit default swaps on various products. It's a well-known, well-respected product if done properly, if it were regulated.

Mr. ARIO. Well, I do agree with you, sir, that the product itself should be a regulated product.

Mr. ACKERMAN. Well, bingo! That's the whole problem. Why don't we say that it has to be regulated? Otherwise, it can't be insurance.

Mr. ARIO. Well, we agree on that.

Mr. POLAKOFF. Yes, the CFTC Commissioner a number of years ago came before Congress to ask that indeed credit default swaps become regulated; and, I think many members at this table would endorse that it should be a regulated product.

Mr. ACKERMAN. The New York State Insurance Supervisor, Eric Dinallo, came before a different committee of Congress back in October and said that. I mean, where is the guy on television who does the bells and whistles and gongs? We need all of these things going off here.

Otherwise, there's nobody getting our attention. The thing that we have to be doing, Mr. Chairman, I think, is taking a look at how we regulate a completely runaway financial giant that's going on so that when people buy—I think I'm buying insurance—are buying insurance, and not something else.

I yield back the balance of my time.

Chairman KANJORSKI. Thank you very much, Mr. Ackerman.

Gentlemen, as you know, we have some votes. We have probably 8 minutes left, 7 minutes left, 7½ minutes left. Are you a fast talker, Mr. Price?

Mr. PRICE. I think 5 minutes.

Chairman KANJORSKI. In 2½, you can do 5 minutes?

We will recognize Mr. Price for his 5 minutes reduced to 2½ minutes.

Mr. PRICE. The first vote will go for a while, so I will appreciate them as chairman. I am pleased to hear the chairman of the committee announce that Mr. Geithner will be here before our committee within a couple of weeks. I think that there are a lot of questions that we would like to ask him today. I want to thank the panel for their perspective.

Ms. Williams, one of the most pivotal roles that we can play is oversight, and so I think it comes as a surprise to some members of our committee that the GAO is prohibited by law from certain reviews of certain Federal financial activities.

Would you elaborate on that? And, I know you responded to Mr. Garrett on that, but what is it specifically the GAO cannot do?

Ms. WILLIAMS. This is an area that we actually have a prohibition, and it's quite unusual. It is in the Bank Audit Agency Act, and it articulates the limits of our authority in this area. And there are specific areas prohibited and I think there are four. One of the four articulated in the Act is we are prohibited from looking at the Federal Reserve's monetary policy activities.

Mr. PRICE. You mentioned that you would be happy to do that if we gave you the authority to do so. Would it be helpful for you to be able to do that?

Ms. WILLIAMS. In this current environment, I would say yes.

Mr. PRICE. So you would be able to give us and the American people a better sense of what has happened and what is going on if you were able to look at that.

Ms. WILLIAMS. We currently, in our conversations with the Fed, are limited to the information they provide publicly. We don't have the same prohibition, for example, with their supervisory and regulatory activities. We can actually go in and look at what they are doing.

GAO does appreciate the fact that, you know, the reason the Fed has the protections that it has is to ensure its independence.

Mr. PRICE. Sure.

Ms. WILLIAMS. But I think we are in an extraordinary time, so when the Fed has evoked activities under their emergency powers, that's an area that perhaps would make sense for GAO to have more visibility.

Mr. PRICE. Thank you.

I want to address your report, and I just got it this morning, so I am trying to digest it all. But I didn't see any sense of an exit strategy that AIG has reported by GAO in your report. Is that an accurate assessment of what's going on over there?

Ms. WILLIAMS. I mean, at this point, the plan is for restructuring. I think given the assistance that the government has provided so far and kind of the ongoing restructuring that has hap-

pened, there are real questions about what the exit strategy is. But our work in this area is ongoing.

Mr. PRICE. But the American people can't look at it and say there's an exit strategy that's in place. Is that an accurate statement?

Ms. WILLIAMS. Not that we have seen.

Mr. PRICE. Okay. Thank you.

Mr. Polakoff, you mentioned that OTS should have stopped a whole book of business back in 2004; and, I think you respond to a couple members saying OTS didn't appreciate how bad liquidity was going to get in 2008.

Was there any change in the assessment between 2004 and 2008?

Mr. POLAKOFF. Yes, sir. What we didn't understand or appreciate significantly with our analysis was how bad the real estate market was going to get from 2004 to 2008 and the corresponding impact to liquidity on the CDS contracts.

Mr. PRICE. And in 2006 or 2005?

Mr. POLAKOFF. Oh, absolutely, as we progress through the years, and these were continuous examinations. As we progressed through the years, our concerns became greater. We communicated more with the board. We communicated more with management.

Mr. PRICE. With the board of AIG?

Mr. POLAKOFF. Yes, sir, but about FP. And we became more aggressive in the actions that we took as a regulator.

Mr. PRICE. And were there any structural changes within AIG to address the concerns that you had?

Mr. POLAKOFF. Yes, especially with regards to the modeling and the valuation of the credit default swaps.

Mr. PRICE. Mr. Clark, were you aware of any of this going on as you were going through your ratings over the 2005, 2006, 2007 period, the changes that AIG was making in response to OTS?

Mr. CLARK. We were generally aware of that. We were certainly aware of their decision to cease writing the new credit default swaps on that asset class when they did; and, therefore, the nature of the portfolio was relatively low-risk compared to if they had continued to protect against mortgages in 2006 and 2007 when the assets clearly were worse.

Mr. PRICE. And the moneys that they have received at this point, have they been used to the best advantage of shoring up the company?

Do you believe in terms of your rating your rating remains at an A-minus, negative?

Mr. CLARK. The moneys relating to those credit default swaps on the assets that covered subprime mortgages were used essentially to fund this "Maiden Lane III" vehicle.

Mr. PRICE. Could they have been used more wisely?

Mr. CLARK. I won't comment as to whether they have been used wisely or not. I will say the way that they have been used limits further loss to AIG, and so contributes to stabilizing them.

Mr. PRICE. I thank the Chair.

Chairman KANJORSKI. Thank you, Mr. Price.

The committee will stand in recess.

[recess]

Chairman KANJORSKI. The subcommittee will come to order.

We have had some discussions. Two members of the panel are due to testify in the Senate around 1:00 and have delayed their testimony even up until this point. In order to accommodate them, and also to accommodate the rest of the subcommittee members, particularly with the second panel, Mr. Liddy, we have decided to go until 1:15, and then excuse this panel and bring in the second panel.

So all members who wish to have their time, I think we have more than enough requests right now, but anyone else who has a request for time, please get it into the respective side so that we can put you down, and, to the best of my knowledge the last examiner was Mr. Price. And so we are now into California and Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

Without objection, I would like to enter into the record an article by economist Dean Baker, explaining how even if it might have been a mistake to let Lehman go under, that certainly does not mean it is a mistake for AIG to go into bankruptcy or receivership.

Mr. SHERMAN. Mr. Ario, do you have any bright member of your staff who understands credit default swaps?

Mr. ARIO. They understand it better than me, and I think they understand them pretty well.

Mr. SHERMAN. Okay. In order to have somebody on your staff who understands credit default swaps, how many million dollars of retention bonus did your agency give him last year?

Mr. ARIO. As you might guess, the answer to that would be zero.

Mr. SHERMAN. And one would expect that this individual would make what kind of general salary? Don't reveal anything all that.

Mr. ARIO. It may be into 6 figures, if that.

Mr. SHERMAN. Okay. I'll ask our Acting Director of the Office of Thrift Supervision.

Do you have anybody on your staff that understands credit default swaps? I mean, they may not have understood in 2004 that the real estate market would tank in 2008. Anybody who understood that is a genius and a multi-millionaire right now. But in terms of just understanding how they work, do you have people on your staff who understand it?

Mr. POLAKOFF. Yes, sir. We do.

Mr. SHERMAN. Retention bonuses of over a million in order to keep them on staff?

Mr. POLAKOFF. No retention bonuses, sir.

Mr. SHERMAN. Salaries below $125,000 a year?

Mr. POLAKOFF. I would say $125- to $150,000 for some of these specialists.

Mr. SHERMAN. I don't know how it is that the private sector has to pay millions of dollars for that kind of expertise. And, I might add that the members of your staff, they haven't destroyed your agency or the international economy in any case, which is additional reason to think that they might be goodbye.

I want to thank the panel for exposing one more fraud perpetrated on behalf of AIG, its counterparties, its general creditors, and of course its executives. And that fraud is this image that has been perpetrated, that the savings bank and its depositors, and the

insurance company and its consumers would be destroyed if we put AIG into receivership.

I think you gentlemen and lady have illustrated that these operating agencies, the savings bank, the insurance companies, have some representational relationship, some reputation tie. But, if anything, putting them into receivership would ameliorate a little bit of taint that they have had by being associated with their parent company. After all, if AIG was in receivership a month ago, we wouldn't have all these cameras here. And being associated with AIG as the savings bank and the insurance companies are wouldn't be near the problem that it is for them today.

So let me just clarify Mr. Ario, if AIG, the parent company, were bankrupt and the bankruptcy judge or receiver were to spin-off the independent insurance companies, would they still be relatively health insurance companies, at least as to the 11 companies that your agency is familiar with?

Mr. ARIO. The general answer to that is yes. The longer out in time we go, the more the insurance companies get separated from the holding company issues, the more the answer is going to be yes.

Back in September, though, I would say that a bankruptcy at that point, because of the way the ratings are tied together between the holding company and the insurance companies, the disentanglement and the potential for the problems at the insurance level were greater then. But your general point, the longer we go, the easier to separate.

Mr. SHERMAN. Also, the longer we go we know the executives at AIG are greedy and now desperate, and they're trying to think of ways to squeeze money out of the savings bank and the insurance companies and bring it into the parent company in the Financial Products unit.

You have done a very good job in preventing them from doing that, but every day that they are in control of those subsidiaries is a day that worries me.

Mr. Polakoff, what about the savings bank? If it was a separate company unaffiliated with AIG, would it be relatively healthy?

Mr. POLAKOFF. Yes, sir. In fact, if any holding company goes into bankruptcy, the underlying insured financial institution remains an open institution. I want to underscore the importance of the FDIC deposit insurance in that approach. So, yes sir.

Mr. SHERMAN. I think this illustrates the fact that $170 billion has gone not just to pay the bonuses, but it's going to take care of the counterparties. These are the richest entities in the world, the most powerful entities in the world. And they have insisted that the American taxpayer make sure that the AIG casino pays them off the full amount called for by their bet, notwithstanding they have broken the bank. And, it is said that AIG was too big to fail, that it was explained AIG is too interconnected to fail.

I would put forward that AIG is too well-connected to fail and it is about time that they are put into receivership and the insurance companies and savings bank you regulate are no longer held hostage by and perhaps squeezed by a relatively malignant parent company. I yield back.

Chairman KANJORSKI. Thank you very much.

Next, we will hear from the gentleman from Delaware, Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman. And let me just start with a question for Commissioner Ario. In your opinion, are the various entities that make up AIG's insurance portfolio of sufficient strength and in a position to be able to be sold to develop assets as part of the return of the loan from the United States?

Mr. ARIO. Yes, but for the deterioration of the economy generally. Relative to other insurers they continue to hold good value, but of course anybody who was in the market today trying to sell, and somebody has to raise the capital to buy, it's a problem for everybody. But if the markets recover so that there are actually opportunities to sell any insurance companies to anybody else, the AIG companies are going to be as good as anybody's.

Mr. CASTLE. Yes, I wasn't trying to ask you to market them, but just from your point of view, from a regulatory legal point of view, they are sellable as assets?

Mr. ARIO. Yes.

Mr. CASTLE. Thank you.

I guess this question could go to Ms. Williams and Mr. Polakoff, but I am concerned about the management of AIG since the Federal Government has been involved. I think that was in October of 2008 under the previous Administration when the stock was assigned to the Federal Government as part of, I think, the first initial bailout, close to 80 percent of the stock of AIG.

We have had a series of problems and transgressions since then, and I don't know if in your work in terms of dealing with them on a regulatory matter, looking into their circumstances of functioning, if you made a determination of how the management aspect of this is working, has the Federal Government in the form of the Federal Reserve or in the form of Treasury asserted itself in terms of board membership or anything of that nature; or, have they been present during these board meetings that have taken place in which these decisions have been made?

I mean, I have been told that I think the Federal Reserve at least was present during some of the discussion of bonuses, for instance, and, I don't know what you know about that. And perhaps there's an answer you will have to get to us at a later time, but I am very interested in what that Federal Government role is concerned.

We have a lot of money on the line. We have a lot of ownership at this point, and I would hope that our involvement is greater than what we have been hearing on the television and newspapers in the last few days as a matter of fact.

Either one of you or both of you.

Ms. WILLIAMS. As part of our ongoing oversight of the TARP program, one of the things we recommended in our very first report was for Treasury to make sure it created a process to oversee the agreements the agreements they have with institutions. And Treasury did have an agreement with AIG in November and they are still in the process of standing up that process to oversee the terms of their agreement. And in terms of the Fed, based on what they have disclosed to us, our understanding is that they are present at certain board meetings at least as a silent observer, if you will.

Mr. CASTLE. Okay. I may come back to you.

Mr. Polakoff, do you have anything to add?

Mr. POLAKOFF. Congressman, once the United States Government took ownership of AIG, the company, back in September of 2008, we in essence ceased to be the regulator of the holding company. So I don't have that information.

Mr. CASTLE. Gotcha.

Ms. Williams, can you tell us anything about that Treasury plan in terms of what their involvement in the management would be in more detail?

You have indicated there was a plan and you believe they executed it, but what did it consist of?

Ms. WILLIAMS. No, actually. Let me clarify that. Our recommendation was for Treasury to develop a plan.

Mr. CASTLE. Right.

Ms. WILLIAMS. And in our second report that we issued in January, we found that they still hadn't developed that plan yet and it was still in process.

Mr. CASTLE. Okay.

Ms. WILLIAMS. And this is an area we continue to monitor the status of that recommendation.

Mr. CASTLE. And you can't update us today as to whether or not they have done any thing since then. Is that correct?

Ms. WILLIAMS. What we found when we spoke to them specific to AIG is they are continuing to stand up oversight of AIG as their role has increased in the assistance that's being provided to AIG, but they haven't done that yet.

Mr. CASTLE. Okay.

Mr. Clark, I am a little concerned in your testimony in terms of some of the credit ratings, etc. Was this done with a rearview mirror? It seems to me if you look at your chart of when downgrades were done, it sort of reflects things that have happened in the world of AIG.

Do you feel that you and other agencies that do this are doing it in such a way that you are giving fair warning as opposed to looking at it after the fact? And I am asking that, maybe in general, but specifically as to AIG.

Mr. CLARK. It certainly is the case that we sought to give fair warning in our ratings announcements, and that includes back in February 2008, long before this rescue became necessary when we placed the ratings on negative outlook, a subsequent downgrade to the ratings in May. And, in fact, we indicated at that time that potential downgrades could occur after that if the company did not successfully raise capital.

In June, they did successfully raise $20 billion of capital. After that fact, the events started to change very dramatically, particularly the first part of September, where in a very quick time the takeovers of Freddie Mac and Fannie Mae, the failure of Lehman, and just a massive loss of confidence in the markets that occurred over a very short period of time, and really greatly changed the assumptions that we had about the potential market value losses on those credit default swap securities.

So the rating actions we made earlier in the year did reflect the facts as we knew them at that time and what we felt were appro-

priate assumptions for the future, but we didn't fully anticipate this extremely rapid, really unprecedented deterioration in the markets in early September, which affected the company's liquidity and collateral needs. And as soon as we were in a position to recognize that and see that it was going to have a lasting and important impact, we took the rating changes that we felt were appropriate.

Mr. CASTLE. Thank you.

Thank you, Mr. Chairman. I yield back.

Chairman KANJORSKI. Thank you very much.

Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Ladies and gentlemen, I think I heard most of you say that you didn't have oversight over CDS, but I didn't hear any disagreement with Mr. Ackerman's general description or the general belief that credit default swaps are all some sort of insurance. And I take that to be an accurate assessment of what they are. They're just insurance with nothing backing it up.

If that's what they were, I would then argue that you did have the authority to oversee these. If we were a part of the holding company, it was your responsibility at the OTS to include any activity that might have impacted the holding company. If it was part of the insurance company, the State regulators had a responsibility to oversee some sort of insurance; and, certainly, the credit rating agencies had some responsibility to see that this game wasn't going to undermine investors' confidence.

So I know nobody wants to take fault for it, and again, I don't think it's actually anybody's fault. It's everybody's fault. Credit default swaps were simply a way to get around any sort of regulation, any sort of oversight, and everybody here allowed it to happen. Everybody allowed it to happen. To say you didn't have any authority to me is simply an easy way out and a wrong way out.

But I do want to know now. I mean, okay, it's done. We are where we are. I presume that everybody, you're here today, because you know a lot about AIG, and AIG to me is just one of the many problems, but it's the one that we're talking about today. I presume that even though the OTS isn't technically the regulator, I presume you are still keeping an eye on it, because in theory there will come a time when you will be the regulator again unless we change everything.

So I don't think you probably just dropped the ball. I hope you have. And that being the case, I would like to know when do you think that the path that we are on now should, has a reasonable expectation, of leading AIG back to profitability at some point of stability; and, if so, when. And I'm not saying when, tomorrow, but within a year, 2 years, 10 years, 100 years, never.

Mr. Polakoff?

Mr. POLAKOFF. Congressman, thank you.

If I could just go back to one of your earlier points to clarify from my perspective while credit default swaps may be an unregulated product, they absolutely, positively fell within a company that OTS regulated and we indeed very much understood the risks of the profile of the credit default portfolio as we were looking at it.

Mr. CAPUANO. Well, hopefully that cannot be true, because if you did, and then didn't do anything about it, that's even worse than

not doing anything about it in the first place. If you understood the risk and took no action and said nothing about it, that's 10 times worse to me than simply saying not our bailiwick.

Mr. POLAKOFF. Well, we did take action, and the risk in the portfolio was not a risk of credit loss because they have had no credit loss in the underlying CDOs. It was a liquidity risk.

Mr. CAPUANO. I understand that, but a risk is a risk, and the truth is that may be important to you, but it is not important to the American public as to why we are putting billions of dollars in there. It doesn't matter.

The risk, I think, was part of your responsibility to oversee, and the fact that you let them take so much risk, credit risk, liability risk, counterparty risk, I don't care what you call it or where you put it in a box, it's still too much risk for the American people. And you and your agency was one—not the only one. I'm not trying to single you out. You were one of the ones who allowed it to happen, but I would like to know when are we going to see some profitability at AIG.

Mr. POLAKOFF. Congressman, I don't know when we are going to see the company returned to a profitable scenario. My understanding of everything that the government has done are the right actions to put it down the path to get where the American public wants it to be.

Mr. CAPUANO. Are you reasonably satisfied—not the details, but in general—with the approach we have taken or has been taken is an acceptable approach?

Mr. POLAKOFF. It seems very supportable and logical to me.

Mr. Ario, on the States' side?

Mr. ARIO. Forward looking at credit default swaps, clearly, they should be regulated. I think you could get agreement across the panel on that. As to your question of when AIG will come out of this situation, basically, it depends on the markets.

When this was done in September, there was enough value in the insurance subsidiaries to sell a number of them and pay back the Federal Government. Then, as we all know, it was October and the markets deteriorated across-the-board, and there just hasn't been an environment in which to sell.

Mr. CAPUANO. So you would agree that the basic approach is in your group's estimation a reasonably correct approach?

Mr. ARIO. The question of whether the counterparties needed to be paid-off in order to stabilize the financial market, I think, that's a question for the Federal Reserve and Treasury. I don't have the expertise to answer that one. But the question of whether that money can be paid back, whether the insurance companies have the value in them to pay back, I think they do.

Mr. CAPUANO. But it's insurance companies subject to State regulation, so therefore the State regulators in my estimation have to be on top of this issue. They must have an opinion as to whether this has been reasonably well-handled or not. I mean, it's a very simple question.

Mr. ARIO. From the insurance perspective, the answer is yes.

Mr. CAPUANO. Ms. Williams, I am going to skip you, because I don't think that's your end of the world.

Mr. Clark, the credit rating agencies must have an answer on this. You must now be absolutely certain, because I know that's what you get paid to do is to give us your opinion. When is AIG going to become profitable again?

Mr. CLARK. I would have to have quite the crystal ball to be absolutely certain on that. No. We are not certain when AIG is going to be profitable again. I can tell you from the company's financial reports in 2008 if it hadn't been for significant investment losses caused by the markets, the life insurance business would have been profitable.

The property and casualty insurance excluding mortgage guarantee would have been profitable, excluding those investment losses. So there are still core profitable businesses that are a part of this group, but I agree with Commissioner Ario. Until the financial markets stabilize or even begin to show recovery, it will be difficult for AIG to show profitability.

Mr. CAPUANO. And do the credit rating agencies believe in general that the general approach taken on this is reasonably good or horrendously bad?

Mr. CLARK. Which general approach? I'm sorry.

Mr. CAPUANO. On AIG, what we have done so far, what has been done.

Mr. CLARK. The government's approach; we don't have a view on whether it was appropriate or not, only that it has to some degree stabilized the condition of the company.

Chairman KANJORSKI. Thank you very much, Mr. Clark.

Thank you, Mr. Capuano.

Our next questioner is Mr. Royce of California for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

I want to ask Ms. Williams of the Government Accountability Office a question. Yesterday, "ABC News" reported during late closed-door talks last month negotiators for the House, Senate, and White House stripped out a measure to the stimulus bill that could have restricted the AIG bonuses. And "ABC News" goes on to say, "Last month the Senate unanimously approved an amendment to the stimulus bill aimed at restricting bonuses over $100,000 at any company receiving Federal bailout funds. The measure, which was drafted by Senator Olympia Snowe, Republican-Maine, and Senator Ron Wyden, Democrat-Oregon, applied these restrictions retroactively to bonuses received or promised in 2008 and onward. But, then, the provision was stripped-out during the closed-door conference negotiations involving the House and Senate leaders and the White House."

A measure by Senator Chris Dodd, Democrat-Connecticut, to limit executive compensation, replaced it. But Dodd's measure explicitly exempted bonuses agreed to prior to the passage of the stimulus bill. Here's the exact language, says "ABC News," from Dodd's measure in the stimulus:

"The prohibition required under clause I shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009."

Now, I didn't vote for the stimulus for this particular bill, but the point is that some Democratic members, those who controlled the

conference committee, were aware of the potential for taxpayer dollars to be used for bonuses and went out of their way to protect those bonuses by a reading of the provision in the conference report here that says exactly that. So I am going to ask the GAO, Ms. Williams, to comment. I don't know if inside the Government Accountability Office there has been discussion about the consequences of that language. But, if there has been, I would like to hear your commentary on it.

Ms. WILLIAMS. Based on what we were doing specific to AIG, I am not in a position to provide a specific response to that issue. But I would be more than happy, if this is something we have looked at, to provide an agency response for the record.

Mr. ROYCE. Well, as we pull up the language of the bill and, as I said, this isn't in the House version or the Senate version. This comes out of the conference committee report after Senator Olympia Snowe and Senator Ron Wyden attempted to put in on the Senate side. They added the language aimed at restricting bonuses over $100,000, those retroactive and prospective bonuses. And then to go through the provision again, this is the language that was put in behind the closed-door conference committee. It says: "The prohibition required under clause I shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009."

Now, that measure came back to the House and back to the Senate with that new provision in it. And my second question would be, why couldn't we pass legislation? And I believe the House Republicans prepared legislation to do this. Why can't we pass legislation that would remove that provision in the stimulus package? And, if we did, would that put us on firmer ground as we tried to knock-out these bonuses on AIG.

Ms. WILLIAMS. Once again, this is really outside of the scope of what we are specifically looking at in terms of AIG.

Mr. ROYCE. But you are looking at the bonus issue, and I am looking at the law that attempts to prescribe us or attempts to prevent us from knocking down those bonuses—attempts to prevent regulators and other authorities from halting the payment of those bonuses. And I am just saying, why don't we go back and reverse what was done in that closed-door session? And, if we did that, clarify the law, maybe go back to Senator Olympia Snowe's original language before it was taken out in the conference committee, I would think that would put us on firmer ground then to prevent these bonuses from being paid.

Chairman KANJORSKI. The gentleman from Massachusetts, Mr. Lynch.

Mr. Lynch, because of the limitation of time until 1:15, do you have an objection if we allow 2 minutes, because we are intending to try and get in many members as possible.

Mr. LYNCH. I am happy to cooperate, Mr. Chairman, sure.

Chairman KANJORSKI. The gentleman is recognized.

Mr. LYNCH. Thank you, Mr. Chairman, and Ranking Member Garrett.

I am tempted to follow up on the gentleman from California's point. I do know that in terms of contract, we have heard objections that we can't go back and interfere with a pre-existing contract.

However, I know that Congress, in our raw power, has the ability to do just that. We do it all the time in bankruptcy where Congress has provided a forum where we just basically tear up every contract in a bankruptcy. And I know that Article 1, Section 10 of the Constitution prevents States from doing that, but Congress has that power.

But I understand, Ms. Williams, you are saying it is outside the scope of your authority, and I am not going to badger on that. But I'm mystified why my autoworkers were badgered and badgered publicly on these financial shows because they are making $40 an hour and you don't hear one word about the—it is just a sense of entitlement by the folks of these companies that are losing billions of dollars—billions of dollars—in taxpayer money, and yet they still feel the sense of entitlement that they are due these bonuses. It just blows my mind.

Let me ask you: AIG originally received $85 billion back in September of 2008—actually, it was September of 2007, I believe, when we originally gave them $85 billion and we took an 80 percent share of AIG. Then following that, there was $70 billion in cash given to them by the Fed, $40 billion in loans from the Fed, $34 billion in—from this sheet, it looks like the Capital Purchase Program, we took some equities and securities back from AIG. And then finally there was $52.5 billion in TARP, which I want to note that I voted against, but they got it anyway.

Going all the way back to the beginning of this, we have received zero in terms of information on AIG. We got a lot this week. We got nothing on counterparties, who they were, where the money went, what kind of compensation deals going on out there, if there were bonuses being paid, whether the money was going to foreign banks. So going back to the original $85 billion that they got, we had 6 months of silence basically.

And you folks are supposed to be out there helping us get information back here because we have a whole bunch of people lined up who want another bailout, which—forget it. As far as I am concerned, forget it. We got so little cooperation from these people and we have such abuse here, don't even think about coming up here looking for a bailout. That is a disgrace.

But why did we have to wait for 6 months, until this week, until finally we got a little bit of information? Chairman Frank is still waiting for information on some of these counterparties, they haven't told us the identities of all these people. We are going to try to get it from Mr. Liddy when he comes up here in a little bit.

But where is the bottleneck? What is the problem with getting information about where the taxpayers' money is going? Can you help me with this?

Mr. POLAKOFF. Congressman, I would only offer that from an OTS perspective, we are not involved in that role and we are not involved with the communication requests from Members of Congress.

Mr. LYNCH. I am not going to let you off the hook that easily. You know, you looked at these CDOs. I know that, by virtue of an Act of Congress back in 2000, CDOs are not regulated, but you did look at the condition of this company on the holding company end. What about information on what these instruments were valued

at? I know you are saying we had no credit losses on the super senior tranch, but you have a mezzanine tranch and an equity tranch that were just deteriorating, and that has an impact on the margin for those senior tranches. I mean what about the information on that stuff that we would be looking for?

Mr. POLAKOFF. Any information, Congressman, that you have been looking for hasn't come to the OTS in a request. To the extent we have information that is not part of the examination process that we can share with you, we would do so in a timely manner.

Chairman KANJORSKI. Thank you very much, Mr. Lynch. And now, Mr. Hensarling of Texas.

Mr. HENSARLING. Thank you Mr. Chairman, and as I said in my opening remarks, as outrageous as this bonus scandal is, the greater outrage continues to be the almost $180 billion of taxpayer exposure for bailouts with no end in sight, taxpayer money used to help make counterparties whole, including foreign entities.

Mr. Chairman, there was an excellent editorial in the Wall Street Journal yesterday entitled, "The Real AIG Outrage" that is on point. I would ask unanimous consent that it be entered into the record. Mr. Chairman?

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. HENSARLING. Thank you, Mr. Chairman.

In addition to serving on this committee, I also have the opportunity to serve on the Congressional Oversight Panel for the TARP program, and with my time on that panel, I have concluded that when I look at the causes at the economic turmoil we have, certainly there are the crooked, there are the greedy, there are the foolish, but there are also smart people, good people, well-meaning people who simply made mistakes. And with the hindsight of 20/20 vision, it is able to bring these mistakes to the fore.

So, Mr. Polakoff, I don't frankly know enough about you or completely studied OTS's actions, so I am not here to vilify you, but I am here to understand the limits of your power, your authority, and what actions were taken.

In an earlier answer to one of the questions, I believe I heard you say that OTS in 2004 should have stopped the book of business that I think you were alluding to, the CDS, and the AIG securities lending commitments. Did I understand you correctly?

Mr. POLAKOFF. Yes, sir.

Mr. HENSARLING. So if you said you should have stopped it in 2004, that implies you could have stopped it in 2004. Is that correct?

Mr. POLAKOFF. Yes, sir.

Mr. HENSARLING. So there were not limits on your power. Perhaps there were limits on your knowledge or insight, but there was not limits on your power to stop what you cite, as I believe—I'm reading from your testimony—"AIG's liquidity was the result of two IGs business lines." So you did have the power to stop those business lines, is that correct?

Mr. POLAKOFF. Yes, sir.

Mr. HENSARLING. I read on your Web site that, "OTS has supervisory and enforcement authority over the entire corporate structure. The scope of this authority includes the savings association, its holding company, and other affiliates and subsidiaries of the

savings association." I continue to quote, "These supervisory tools allow OTS to obtain a complete picture of the interrelationships and risk throughout the savings and loan holding company enterprise regardless of its size and complexity."

Again, it appears, if this is correct, it was not a lack of supervisory authority that caused you not to take action with respect to these two lines, is that correct?

Mr. POLAKOFF. Yes, sir.

Mr. HENSARLING. And I think I also heard you say in your testimony that you did have sufficient manpower and expertise, is that correct?

Mr. POLAKOFF. Yes sir.

Mr. HENSARLING. So again, in retrospect, it wasn't the lack of authority, it wasn't the lack of resources, it wasn't the lack of expertise, you just flat out made a mistake. Is that a correct assessment?

Mr. POLAKOFF. In 2004, we failed to assess how bad the mortgage economy, the real estate economy would become in 2008, yes, sir.

Mr. HENSARLING. I see my time has expired. Thank you.

Chairman KANJORSKI. Thank you very much Mr. Hensarling. Now the gentleman from North Carolina, Mr. Miller, for 2 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Until just the last few days, I have assumed that we had really smart, really aggressive, mean lawyers looking at every possible legal theory upon which we could sue directors or officers or employees who caused all of this.

So I was surprised to hear that we were actually worried about them suing us, that we were getting legal advice, that we had to pay these contracts, these bonuses, no questions asked. They were based upon the contracts. Contracts are sacred. We could end up, under Connecticut law, having to pay double damages if we paused to ask any questions.

Mr. Frank has already mentioned the failure of performance, the negligence, the incompetence as an issue, but that argument also assumes that this was an arms length transaction involving a solvent corporation, a corporation that had been continuously solvent at the time that it made the contracts and at the time that it paid the bonuses.

And there is a great deal of evidence that AIG is not solvent, has not been solvent for a long time, much longer than a year, and that at least their top executives knew that. They were cooking their books.

The Oversight and Government Reform Committee last fall had a hearing, and in lieu of deposition, Joseph W. St. Dennis provided written answers. He was the vice president of accounting policy at AIG Financial Products from June 2006 until October 2007. His duties were documenting the accounting for proposed transactions, etc.

And his statement is that he resigned because he was consistently excluded from valuing the assets, from performing his job, by Mr. Cassano, that Mr. Cassano didn't want him to be part of him valuing their super senior credit default swap portfolio, and he believed because he would bring transparency to it as the accounting rules required.

Have we looked at the liability, if in fact they were insolvent, they knew they were insolvent, and they were cooking their books? Ms. Williams?

Ms. WILLIAMS. GAO has not looked at that issue.

Mr. MILLER OF NORTH CAROLINA. Is anybody else familiar? Do you know if we are looking at any liability by any officer, director, or employee of AIG Financial Products, the AIG parent?

Mr. POLAKOFF. At this point, OTS is not, Congressman.

Mr. MILLER OF NORTH CAROLINA. My 2 minutes has expired.

Chairman KANJORSKI. Thank you, Mr. Miller. The gentleman from Georgia, Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Polakoff, I want to ask you some direct questions and I want you to give me some direct answers because I want to speed up to get to Mr. Liddy. When were you aware that AIG was going into the business of credit default swaps?

Mr. POLAKOFF. Sir, I would say 2004 or earlier.

Mr. SCOTT. At that time, did you know that that was an unregulated market?

Mr. POLAKOFF. Yes.

Mr. SCOTT. Were you concerned about that?

Mr. POLAKOFF. Our focus was on the modeling and on the risk associated with the product, sir.

Mr. SCOTT. When were you aware of the contracts for the bonuses?

Mr. POLAKOFF. I was not aware of those contracts, sir.

Mr. SCOTT. Not aware of the contracts? The contracts began, as we are aware now, on March 15th of last year.

Are you aware that on March 15th, that particular unit, the Financial Products division, was losing buckets of money, by the trainloads that accumulated in $40.5 billion of losses at the very time that they were preparing these contracts? Were you aware of that?

Mr. POLAKOFF. I was aware of the financial condition of FP, yes sir.

Mr. SCOTT. I mean, wouldn't that raise a major concern, that here is a division, a company that is awarding a division with $450 million in contracts for a unit of 467 people at a time when that very unit was bleeding money to the company at the tune of $40.5 billion.

I mean, it seems to me that somebody was saying, how can we even think of bonuses to be given to a division and rated at $450 million at the very time that division is losing buckets of money. And that 5 months later, here we come, they are asking, and out of the Federal Reserve rescue fund we give them $85 billion? It seems to me that somebody was asleep at the switch.

This is a profound issue that borders on fraud and criminality with the timeline. And I am anxious to put these lines of questioning to Mr. Liddy, but you, as the oversight agency over AIG, should have known all of this.

We didn't know. We were rushed into a panicking situation by then-Secretary Paulson to save this AIG or the whole world economy is coming down.

Mr. POLAKOFF. Congressman—

Chairman KANJORSKI. Mr. Scott, I am going to interpose here. Allow the answer. We have to move this along. We have several members waiting.

Yes, respond.

Mr. POLAKOFF. The timeline that you offered revealed that these contracts were initiated when this company was an operating—still well-rated company before any government funds. And we would have looked at the financial condition of the company as still a well-rated company with no taxpayer dollars in looking at those payments and the intent of those payments to keep employees at FP to unwind the transactions that originated in 2005 or earlier.

Chairman KANJORSKI. Okay, the gentlelady from New York, Mrs. Maloney, for 2 minutes.

Mrs. MALONEY. Thank you. I would like to ask insurance commissioner Joel Ario, have you seen this document, produced by AIG, on systemic risk of AIG? Did you ever see this document?

Mr. ARIO. Yes, I have, ma'am.

Mrs. MALONEY. This document really talks about the dire consequences if AIG were allowed to fail, and I am wondering if a similar document was ever reviewed by the executives of AIG when they decided to go into derivatives and other highly risky products that have brought down the company. Do you think they ever looked at anything that assessed that risk? I would like to put this in the record, please.

Mr. ARIO. Not to my knowledge.

Mrs. MALONEY. I would like to ask you a question. How are the insurance businesses of AIG segregated from the AIG Financial Products?

Mr. ARIO. Within insurance regulation, there is the strong principle that the assets that are there for the benefit of policyholders are walled off from all other creditors of the company, including the holding company upstream. So we believe that the assets of the insurance companies are there for the policyholders and they are protected against all other creditors, including the holding company upstream.

Mrs. MALONEY. So in other words, the risk of default in the life insurance business of AIG is separate from the cross-linked risk of being associated with and dragged down by AIG Financial Products, is that correct?

Mr. ARIO. It is a slightly different question. If there are problems at the holding company level, particularly in terms of the rating of the companies, that can create rating issues for the downstream insurance companies, and that is a particularly important issue in the property and casualty side. If we are going below the A minus level that we are at now into the Bs, it would have very negative impacts on the insurance company. So there is that linkage.

Mrs. MALONEY. But the linkage is only with the rating companies. In other words, they are walled off, they are separate. So what would happen if AIG Financial Products was allowed to fail? Would that have an impact on the insurance properties and the insurance assets of AIG?

Mr. ARIO. Not directly on the assets. That is more a question for how the rating agencies would look at that issue for the insurance companies.

Mrs. MALONEY. The rating agencies do not have a lot of credibility at this point, so I would rather ask the insurance commissioner. It is my question. So if Financial Products was walled off and allowed to fail, the insurance portion would be safe and sound, and going forward, is that correct?

Mr. ARIO. Yes, the assets would be there and would be protected.

Mrs. MALONEY. Thank you.

Chairman KANJORSKI. The gentleman from Florida, Mr. Klein.

Mr. KLEIN. Thank you, Mr. Chairman. I would like to direct my questions to Mr. Clark.

Mr. Clark, there have been a lot of questions about the role that the rating agencies have played, not just in AIG, but in the entire meltdown, and who pays the fees where there are conflicts of interest, the systems that are being used? I have heard the comments that say that—I think in your statement today you said it is just one factor, which of course it is. There are the sophisticated buyers of instruments who look at a rating agency valuation one way and there is the general public who also, to some degree, looks at the rating agencies and sees a triple A rate or an A minus, or any number of things.

And it seems to me that there is a failure here—and I am not just picking on Standard & Poor's or you. But the system that really depends on transparency, making intelligent investment decisions at the highest level and the average investor who is buying a bond, needs to know that the information is real and it is objective in terms of making that decision. In my opinion—I am not a professional, but as someone who has done some securities work in the past—the system is not working properly with the role of the rating agencies in their current form.

And I would like to just gauge from you whether you think mistakes were made, and how are you changing your models as you move forward in your valuation techniques to help, if you are going to continue to do what you are doing, and the role that you have in our system to make sure that we really do get information that is objective and useful for investors to make their decisions.

Mr. CLARK. The first part of your question, were mistakes made, I think hindsight being 20/20, we might have formed different judgments than we did if we knew then what we know now about how the financial markets would perform in the late summer, because that really is the biggest thing that changed in our analysis of AIG over this period.

We believe based on the models that we used, the assumptions we were making, the information we had, that our ratings were correct and appropriate until the beginning of September until the huge decline in those market values and the effect that would have on the collateral that the company would have to post really changed those conclusions very rapidly with the extreme rapidity of the movement in those markets.

Mr. KLEIN. Wouldn't you agree, though, that the projection of the market has some value in terms of where things are going, the value of an investment vehicle?

Mr. CLARK. The market values are important. They are an important guideline, but what we could not have understood at that time, what many people in the market did not know at that time,

was how quickly the value of mortgage-related securities and other structured securities would decline over the late summer into September. It was something unprecedented in terms of the rapidity of the decline.

Chairman KANJORSKI. Mr. Perlmutter, for 1 minute.

Mr. PERLMUTTER. Thank you all for testifying today. Just a statement.

Mr. Ario, I appreciate the fact you say there are good parts to AIG that still either have been profitable or are solid. What we had was a rogue or a subsidiary that made outrageous profits and it created outrageous losses that took this company down and has cost the United States a lot of money. So hopefully those solid parts of the company will ultimately pay us back $160 billion, which is where I want to see this thing go.

But I would ask all of you, just taking a look at this retention plan, it almost contemplates the losses that that subsidiary suffered. They are almost pointing to everybody, "We are going to lose money, but you guys are still going to get a bonus."

And so I would look at that closely. I think Mr. Miller was on to something. When a company is insolvent, there is a concept called fraud against creditors, that you can't just be making bonuses to people if you are out of money. So I don't know why we paid these bonuses, especially to that division, when they talk about realized losses in this thing. They are already contemplating their own demise.

That is just a statement. Can somebody tell me what guaranteed investment agreements are as we are repaid as part of the TARP money?

Mr. ARIO. That is going to be where a government agency is issued a bond, they have a certain amount of money, say $100 million to build a bridge or something, and they don't need all the money right now, so they go out and get a contract with a company like AIG to guarantee the payment of the money back when they need it. That is what a guaranteed investment contract would be.

Mr. PERLMUTTER. Thank you, because a substantial amount of the money from the TARP went back to States, as I can see it from this. Thank you.

Chairman KANJORSKI. Thank you very much. We will have 1 minute for the gentleman from Indiana, Mr. Donnelly.

Mr. DONNELLY. Thank you very much.

Mr. Polakoff, I have a question. For naked credit default swaps, how are those anything other than gambling? There is nothing really there. Back home in Indiana, if a fellow goes and places a bet on a Bears game, he can go to jail. On Wall Street, he is considered a master of the universe. How does this work and why is it allowed?

And then the last question, and it may be the most important, why should we be paying for just a gambling casino, just bets, there is no real product there? And you know what, the casino is closed, you go home.

Mr. POLAKOFF. Congressman, I agree with you from the perspective that these products need to be regulated and there are certain parts of these products, whether it is a naked credit default swap

or in some cases whether it is naked short selling, which is an entirely different vehicle—

Mr. DONNELLY. Well, there is nothing even there, is there, other than a bet? And if it is a bet, how come you go to jail for betting on a Bears game and not for one of these?

Mr. POLAKOFF. Naked credit default swaps are not the subject of the AIG FP though, sir.

Mr. DONNELLY. Well, if you are a waitress or a truck driver or a hardworking person, why should you pay the other side of a bad bet?

Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentlelady from California for 2 minutes.

Ms. SPEIER. Thank you, Mr. Chairman.

I think that it is very important for us today to realize that Congress has a lot of finger pointing to do at itself. When the Commodities and Futures Trading Commission Chairman said, "Credit default swaps should be regulated," came up here, testified to that fact, she lost her job, and subsequently, credit default swaps were unregulated specifically by legislation that passed the Congress.

We had the Glass-Steagall Act that was on the books for over 60 years, it worked, and then the financial services industry wanted the Gramm-Leach-Bliley Act, which allowed for this financial supermarket to happen, and what did Congress do? It passed it. So I believe that part of the responsibility falls with us.

One last question to Mr. Clark. You rated AIG at an A or A minus through most of 2008, is that not correct?

Mr. CLARK. We lowered the rating on AIG to A minus on September 15, 2008, and it—

Ms. SPEIER. So before that, it was a double A?

Mr. CLARK. Before that it was double A until May, and then it was double A minus from—

Ms. SPEIER. Well, growing up, an A means good. A double A means really good. So through all of 2008, it was a double A until September 15 when we already knew in March of 2008 that it had lost $12 billion.

So I believe that you need to go back to the drawing board and come up with different ways of rating these agencies.

Chairman KANJORSKI. Thank you very much, Ms. Speier. Mr. Foster, did you want to exercise your minute to 2 minutes?

Mr. FOSTER. One minute.

Chairman KANJORSKI. One minute? Very good. That is it then.

Mr. FOSTER. I have been struck by the complexity of AIG from a corporate point of view, and I was wondering if you could give me an impression of what fraction of these difficulties could have been avoided if AIG was simply simpler or a series of independent companies accomplishing the same thing. You know, if they were a bunch of independent insurance companies, and if the thing called the holding company basically didn't exist, and that you had a credit default swap trading house that was regulated so that the regulator only had to look at that.

Mr. ARIO. AIG started as an insurance company, and in my view, if they had stuck to that, they would still be the number one insurance company in the world on the property and casualty side.

Mr. POLAKOFF. Congressman, I think your question goes well beyond AIG to whether we need a systemic regulator, because what you described is not limited to an AIG structure. When you get to be a trillion dollar company, when you operate internationally, it is a very complex unit.

And I think your point, as I understand it, sir, is if it is going to be complex and arrogated like an AIG is or other companies are, there really needs to be someone from the top down who has all the powers necessary as a systemic regulator.

Mr. FOSTER. No, my point was more should we allow this level of complexity?

Ms. Williams, did you have any comments on this?

[no response]

Mr. FOSTER. Thank you. I yield back.

Chairman KANJORSKI. I thank you very much, Mr. Foster. That completes the examinations.

I want to thank this panel for appearing.

Mr. Clark, you have an opportunity to correct the record. You had some problem that—

Mr. CLARK. Yes, Mr. Chairman, thank you, if I could.

In my remarks, I believe I may have made one statement in error with regard to the credit default swaps. S&P announced in August that AIG's actual credit losses in these areas would amount to around $8 billion with significantly higher mark-to-market losses. I may have said that incorrectly earlier, so I would ask that to be submitted to the record.

Chairman KANJORSKI. Put that in the record.

Thank you all very much for appearing, and now this panel will be excused and we will have the seating of the second panel.

[pause]

Chairman KANJORSKI. Will the Capitol Police restore order, and particularly the signs of demonstration are to remain down or be removed from the room. I am a very patient person, but do not try my patience.

Now the Pink Ladies back there, respond properly or please exit the room.

Signs down!

And in consultation with the ranking member, our witness today will take an oath. Will the witness please stand and raise his right hand, and I will ask the witness to respond "I do" after I read the oath.

[witness sworn]

Chairman KANJORSKI. Thank you very much, Mr. Liddy, if you will kindly be seated.

Mr. Liddy, you and I are not strangers to one another. We have had the occasion to visit personally some 2 or 3 months ago in my office for what I thought was a great conversation. And then subsequently, maybe 4 to 6 weeks ago, a telephone conversation that was not as great, as I recall. And I want to just have the record reflect that.

So that the public knows and the record reflects, Mr. Liddy is not a person who is being paid anything for the CEO position he occupies at AIG. He has been pressed into Federal service by officers

and public officials of the United States Government, and he responded to their call.

He is a former CEO of one of our largest insurance companies, now presently retired before he took on this command.

I wanted to make that clear, Mr. Liddy, because I am sure that you and your family have had a great deal of abuse, particularly in these last few days. We do not intend to harass you here in this committee, nor should we.

On the other hand, I think it is only fair that we set the record straight. When we discovered that there were potential bonus payments about 2 months ago, we talked with each other and I urged you to do everything within your power to see if you could suppress the payment of those bonus payments, or deny them in their entirety.

At that time, it was my understanding and the understanding of my staff, that both AIG people and my staff on the committee would cooperate, would have a transfer of information and some documents to indicate whether or not there was any assistance we could lend in interpreting what positions AIG could take in regard to these bonuses.

I think specifically, to make it simple, we wanted to see whether or not we could vitiate that contract. And when I say "we," Members of Congress and for the benefit of this committee.

The disappointment and why you are here under these circumstances, Mr. Liddy, is that I warned you at that time that if these bonuses were paid and no mitigation was made to the general public of the United States or to this Congress, the action by AIG in doing that would jeopardize the second rescue plan that is anticipated and potentially needed to save the American economy.

As of Saturday last, we had received no communication regarding the documents, papers, and faxes that we had expected from AIG prior to payment. The only thing we received was a letter indicating that payment was made and that it was done on the basis of an attorney's or attorneys' positions, that a contract was involved, and apparently they advised that no way around the contract could be found.

Not to get argumentative about it, but I do want to render this opinion. In my prior life, I was an attorney, and I dealt with your prior insurance company where you were CEO. And I will not mention the company, because it is of no concern to anyone else. But I am sure everybody knows what a large company that was.

In cases that I had with your company, there were clear cases of the need for recovery or payment. And yet defenses were rendered and time was taken, and very often those cases had to go to trial. And that practice exists all over the United States.

So this is not a thing of first impression, that sometimes insurance companies delay payment or take a position they will not pay until they were sued.

In this case, there is an opinion in the land, and in this committee, reflected today that this was a rush to payment, that there were other alternatives at hand.

One of the last alternatives would have been a denial of the right to pay on the contract. And a simple word to these folks: Sue us.

Now that is not a bad remedy, in my estimation, and I hope you will address it in your statement today. I have read your prepared statement. Insofar as if you had taken that position, these bonus recipients would have been in the same position as the taxpayers of the United States. They would have had to sue and wait until the resolve of whether AIG succeeds or not, or go the distance of the suit, which would be 2 or 3 years.

The worst that could have happened would be a penalty feature under the laws of the State involved. But, if in the meantime, an election were made to take AIG into bankruptcy or some other relief, those funds would not have been paid.

Now I indicated to you I thought that you were missing the gravity of this situation in terms of what the American people were responding to: They had enough. This was an unreasonable action on the part of AIG to pay these funds.

So in your testimony today, I hope you address some of these ideas. And with no further assertion on my part, and looking forward to the question, Mr. Liddy, if you summarize your testimony, we will allow you some leeway because of your involvement in the situation, so provide it all, and you may proceed.

Mr. BACHUS. Mr. Chairman, I don't know how long Mr. Liddy's statement is, but I would because of the gravity of this matter, even if it's 10 minutes, I would—

Chairman KANJORSKI. Absolutely. I will be very lenient. Mr. Liddy can take all the time he wishes to respond to the committee, I hope. But I am going to be heavy on the gavel, because there is a lot of criticism at the lower levels of the committee that we have not gotten down to, and I assume there is nobody at this hearing today who is not going to want their 5 minutes with Mr. Liddy. So I am going to hold everybody to their 5 minutes, and probably be annoying by slapping the gavel.

Mr. Liddy, proceed.

STATEMENT OF EDWARD M. LIDDY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN INTERNATIONAL GROUP (AIG)

Mr. LIDDY. Thank you, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. I appreciate the opportunity to appear before you as the representatives of the largest shareholder we have, the American people.

My name is Edward Liddy. Six months ago, I came out of retirement to help my country. At the government's request, I have had the duty and the extraordinary challenge of serving as Chairman and Chief Executive Officer of American International Group or AIG.

I speak to you today on behalf of the 116,000 AIG employees around the world, who are remarkably united around one simple belief. When you owe someone money, you pay that money back.

I'm sure we all share that belief. I believe that you and I also share a common agenda today to clean up the mess at AIG and in the process, help get the American economy moving again.

Let me speak directly to the situation at AIG that has sparked the Nation's outrage over the past several days. No one knows better than I that AIG has been the recipient of generous amounts of

government aid. We are acutely aware, not only that we must be good stewards of the public funds we have received, but that the patience of America's taxpayers is indeed wearing thin.

Where that patience is especially thin is on the question of compensation. I am personally mindful both of the environment in which we are operating, and the President's call for a more restrained compensation system.

At the same time, we are essentially operating AIG on behalf of the American taxpayer, so that we can maximize the amount we pay back to the government as quickly as possible.

We weigh every decision we make with one priority in mind: Will this action help our ability to pay monies back to the government or hurt it?

Although we have wound down more than $1 trillion, roughly a third from its peak, in the portfolio of AIG Financial Products, the unit that is at the root of our financial problems, that portfolio remains very large, $1.6 trillion. And it continues to contain substantial risk.

The financial downside for taxpayers is potentially very large, and it's very real, and that's why we're winding down that business as quickly as possible.

To prevent undue risk exposure in the meantime, AIG has made a set of retention payments to employees, based upon a compensation system that prior management put in place at the end of 2007 and the beginning of 2008.

Payments were made to employees in the Financial Products Unit that caused many of AIG's problems. And Americans are asking quite simply, "Why pay these people anything at all?"

Here is why: I'm trying desperately to prevent an uncontrolled collapse of that business. This is the only way to improve AIG's ability to pay taxpayers back quickly and completely, and the only way to avoid a systemic shock to the economy that the U.S. Government help was meant to relieve.

Make no mistake, had I been CEO at the time, I would never have approved the retention contracts that were put in place over a year ago. It was distasteful to have to make these payments, but we concluded that the risk to the company and therefore the financial system and the economy were unacceptably high, and if not paid, we ran the risk that we would have happen what everyone has worked so hard thus far not to have happen.

That said, we have heard the American people loudly and clearly these past few days. The payment of large bonuses to people in the very unit that caused so much of AIG's financial trouble does not sit well with the American taxpayer in any way, shape, or form. And for a good reason.

Accordingly, this morning, I have asked the employees of AIG Financial Products to step up and do the right thing. Specifically, I have asked those who received retention payments in excess of $100,000 or more to return at least half of those payments. Some have already stepped forward and offered to give up 100 percent of their payments.

The action we are taking today is a result of discussions with numerous parties, many of you, including Attorney General Cuomo of New York.

We will work to ensure the highest level of employee participation in this effort in the days ahead, and will keep the Congress and the American people informed of our progress.

Now obviously we are meeting today at a high point of public anger. And I share that anger. As a businessman of some 37 years, I have seen the good side of capitalism. But over the last few months, in reviewing how AIG has been run in prior years, I have also seen evidence of its bad side.

Mistakes were made at AIG on a scale few could have ever imagined possible. The most critical of those was the creation of a credit default swap portfolio, which eventually became subject to massive collateral calls, that created a liquidity crisis for AIG.

I agreed to take the reins at AIG last September after the company had turned to the U.S. Government for financial support.

On behalf of my colleagues, I want to thank the Federal Reserve and the U.S. Treasury and the American taxpayer for making the extraordinarily tough call to provide that support. It has meant that together we have been able to preserve jobs and businesses, and most importantly protect policyholders who rely on a promise of insurance to secure their wellbeing.

We are moving urgently on a business plan designed to maximize the value of our core businesses, so that in turn we can maximize the amount that we repay to the American taxpayer.

We at AIG want to believe that we are all in this together. I have led AIG for 6 months, and I want to assure you that the people there today are working as hard as we can to solve this problem for the benefit of America's taxpayer. And quite frankly, we need your help.

We need the support of the Congress to do this, and if we do it together, I'm confident we can achieve two hugely important things: First, repayment of AIG's debt to the government to the maximum extent possible; and second, and perhaps equally important, a solution to AIG's condition that is a giant stepping stone to the economic recovery we all desire.

With that, Mr. Chairman, I would request that my remarks and several additional comments be included in the hearing record and I'm happy to respond to your questions or those of the members.

[The prepared statement of Mr. Liddy can be found on page 157 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Liddy. I guess my first question is, you have just announced that some of your employees who received those bonuses after Saturday of this week have agreed to return them. Why could that not have been negotiated for the last 2 months? And why couldn't that information have been made available to this committee, to the Secretary of the Treasury, and to the Chairman of the Federal Reserve?

Mr. LIDDY. I think there are two parts to that question, sir. Let me see if I can address them in turn. We have been working on this issue of what to do with these retention payments. We have made the information publicly available in our various 10–K filings and 8–Ks and 10–Qs.

The decision we made, I made, was as much one of risk assessment as it was blindly following legal advice. The risk assessment was: We have made great progress in winding down this business,

but there is still $1.6 trillion of stuff in that portfolio. There is risk that it could blow up. And if it were to explode, it can cause irreparable damage to that progress that we have already made.

Chairman KANJORSKI. Necessitating, Mr. Liddy, a further investment of the American taxpayers in AIG with equity, if we are to keep you solvent?

Mr. LIDDY. Would you repeat that, sir?

Chairman KANJORSKI. The risk is, if those assets deteriorate or blow up, you would either go into total—

Mr. LIDDY. Yes—

Chairman KANJORSKI. —destruction, or have to come back to the United States Government and this Congress for additional funds.

Mr. LIDDY. Yes. I think that's exactly correct, sir.

Chairman KANJORSKI. Right.

Mr. LIDDY. So the judgment that we made in cooperation with the Federal Reserve—we treat the Federal Reserve as our very important partner in this—the decision we made was that we could preserve that unit and continue to wind it down in a very orderly fashion and not expose the taxpayer and the company to the risks that heretofore they had been exposed to.

I know $165 million is a very large number; it's a very large number. In the context of $1.6 trillion and the money that has already been invested in us, we thought that was a good trade.

Chairman KANJORSKI. Am I to understand that you are saying that Chairman Bernanke or his designated person at the Federal Reserve was informed that you were going to make these payments and acquiesced in that decision?

Mr. LIDDY. Yes. Everything we do, we do in partnership with the Federal Reserve. The Federal Reserve is at our board meetings, at our compensation committee meetings, at our various meetings on strategy. And they have the ability to weigh in either yea or nay on anything that we decide.

Chairman KANJORSKI. Why was this committee not informed, as you had previously indicated that you would put a plan together and you would immediately after that plan was submitted to Treasury and to the Federal Reserve make us aware of what that plan was? Why did you hold us, in the absence of that information, and make the payments on a Saturday night?

Mr. LIDDY. Sir, there was no intent to deceive or hide anything. These payments were due to be paid on March 15th. We have been discussing this issue at large with the staff of many of the members who are represented here today, and with the Federal Reserve since—

Chairman KANJORSKI. You publicly did not discuss this with my staff?

Mr. LIDDY. I don't remember, sir, whether we discussed all of the particulars of this with your staff or not. I would just like to make the point that there's no attempt to do anything under the stealth of darkness or under cover. We wanted to do what was right in these contracts. The contracts called for a payment on March 15th.

And we have done that. We have been talking about this within the board and with our representatives of the Federal Reserve literally for 3 months.

Chairman KANJORSKI. And with the Secretary of the Treasury?

Mr. LIDDY. No. The way our relationship generally works is we review things with the Federal Reserve, and the Federal Reserve—as they think is appropriate—discusses it with the Secretary of the Treasury or with representatives of Treasury.

I have asked if the Federal Reserve would like us to have a separate line of communication with Treasury or not, and I have asked Treasury. I think they're trying to get as efficient a process as possible.

Chairman KANJORSKI. Are you aware of the fact that probably the funds available, the TARP funds, will run out shortly, and the likelihood of additional funds will have to be secured by action and authority of Congress?

Mr. LIDDY. I am.

Chairman KANJORSKI. And do you realize that the actions that you take at AIG and took in this precise case not only impact AIG and the potentials of that reality occurring that you described, but it may have jeopardized our ability to get a majority of this Congress to support further largess to provide funds to prevent a recession, depression, or meltdown.

Are you aware that is the process of your decision and how important it was?

Mr. LIDDY. I am sir, although I think there's also a question of another element. And that is if something happens to AIG, and it goes bankrupt or goes belly-up and puts at risk all the money that has already been put into it, that also can have dire consequences.

So it's an issue of: Can we stabilize the AIG FP situation, run it down so nothing untoward happens there and reach the promise of paying back the taxpayer?

Chairman KANJORSKI. Well, not to argue that point further, but you are going to serve further. Are we to assume that you are going to continue this process of decisionmaking and disclosure of talking only to the Federal Reserve and not informing the Congress or the American people or the Executive Branch of this government?

Mr. LIDDY. I will do it in any way that you and the Federal Reserve ask AIG to do it. Heretofore, what we have assumed is that our discussions with the Federal Reserve were being properly communicated to others. It appears that we need to improve upon that process. We will do everything we can to do that.

Chairman KANJORSKI. My time has expired. Mr. Garrett?

Mr. GARRETT. Thank you.

First, I appreciate your service and recognize the fact that you have to step up to this situation. The chairman didn't make mention of the fact; I guess it's in the press as far as apparently physical threats or what have you, to yourself or to your family, which of course are condemnable, and no one should be going through that.

Secondly, along this line, we realize how difficult it is to get people to fill spots like this, and also we recognize right now the Treasury Secretary has had his dilemma in filling spots as well. It may be because the government is engaged in an activity that it has never engaged in before, basically crossing the line between public and private, and the conflicts then are inherent there that we have to have a public discussion of what otherwise would be private activity.

So that is something Congress needs to consider, going forward.

Much of the discussion will be on the bonuses. I'll just raise one question with regard to that, and it goes along the line as far as who knew what when, and what have you. I appreciate your comment with regard to the discussions that you have had with the Fed on this.

I would presume that even though the Treasury was not sitting in at those meetings, the information should still be hopefully flowing back from the Fed to the Treasury. You probably don't have any personal knowledge of that.

Mr. LIDDY. I don't. I'm pretty sure that it did, but I would be hard-pressed to prove it to you.

Mr. GARRETT. Yes. And the reason is this, because there are stories in the papers today and yesterday saying that the White House has now instructed the Treasury to try to engage in some clawback provisions in past legislation to engage in trying to get some or all of this money back.

And I'm reading that, and I'm wondering, is the White House basically then second-guessing what the Treasury Secretary must have known—or at least I will assume that your Treasury Secretary must have known—for a period of time: (a) through these discussions with the Fed; and (b) just by the fact that the Treasury Secretary is from Wall Street and we sort of know that this type of employment contract and contingency contract is not unique to top-level management.

I presume you would agree.

Mr. LIDDY. I'm sorry, Mr. Garrett. The Treasury Secretary is—

Mr. GARRETT. Well, the Treasury Secretary obviously comes from a financial background. He comes from having been involved with the AIG situation in the past Administrations as well.

Mr. LIDDY. I understand.

Mr. GARRETT. And whether you had that conversation with him or not, some of this is sort of obvious on the face that these types of employment contracts would have been there.

So it's just puzzling to me that the White House now seems to be second-guessing the decision that the Treasury Secretary made, if he allowed this to go forward.

Mr. LIDDY. Yes, I don't have a comment on that. I talked to the Treasury Secretary last week, and he indicated to me that the first he had heard of this whole situation was about a week before that. So I don't know where the—

Mr. GARRETT. Okay—

Mr. LIDDY. —rubber meets the road, so to speak.

Mr. GARRETT. A final question is on the bigger picture, and that is: How do we get the taxpayer off the hook, going forward? Is there basically in a word an exit strategy here for the government to get out from under this?

Mr. LIDDY. There is.

Mr. GARRETT. Is that exit strategy basically in part to sell off some of the assets, and if that is the case, do you see—I know you haven't been able to do it now, because of the global economic climate—is there anything that you would see in the near future, that any of this exit strategy is really going to engage itself?

Mr. LIDDY. The exit strategy, I think, is a solid one. It has been in place for a while now. And it is: Sell whatever assets we can, use that money to pay back the Federal Reserve and the TARP money. To the extent we can't sell an asset, we're going to ring-fence it, put it in a separate trust, and actually give that asset to the Federal Reserve as satisfaction of the debt.

And when that asset can be taken public or it can be sold, then the Federal Reserve would decide to sell it.

Mr. GARRETT. Okay.

Mr. LIDDY. So there is an exit strategy. I think it will work. But it's very market-dependent.

Mr. GARRETT. And the final question here is this: The number you gave was $1.6 trillion?

Mr. LIDDY. $1.6 trillion. The testimony on an earlier panel was about the derivative aspect, and you originally said it was 360 or 370 on the foreign derivatives overseas, and around 80 or 90 billion here, adds up to 400-something. So why is that number different than what you see as being outstanding?

Mr. LIDDY. I believe the prior testimony, which I was watching, had more to do with credit default swaps.

Mr. GARRETT. Right.

Mr. LIDDY. But in addition to that, there are all kinds of derivative contracts. There are currency contracts, interest rate contracts, oil contracts, a whole series of contracts.

So there are three measures. Let me see if I can clarify that for you. There's a measure of how many dollars of notional exposure is it? At the beginning of 2008, that was $2.7 trillion, it's now $1.6 trillion. We have made great progress winding it down.

With respect to the credit default swaps that have caused us all the difficulty, that number started out at about $80 billion, it's now about $10 billion.

Mr. GARRETT. Right.

Mr. LIDDY. And then there's another category called regulatory capital trades. And that started out at about $360 billion, it's now down to $230 billion, and we will get it down to considerably less than that by the end of the first quarter in 2010.

So there are different metrics designed to measure different things.

Mr. GARRETT. I appreciate your answers. Thank you.

Chairman KANJORSKI. Pink Ladies, I think you have tried my patience. Now the signs are either going to be removed from the room, or you are going to be removed from the room, before I recognize another speaker.

Do you wish to remain in the room? And those of you who are in pink with the signs, are you going to surrender those signs so that they can be held for you later on, or do you want to be removed from the room?

VOICE IN AUDIENCE. We won't—

Chairman KANJORSKI. Officers, take the signs. If I see any more signs on camera, you are going to be physically removed from this room.

The Chair will now recognize the chairman of the full committee, Mr. Frank of Massachusetts.

The CHAIRMAN. I thank you, Mr. Chairman. Given your method of dealing with this, I assume it's a good thing no one was wearing a tee-shirt with a slogan.

[laughter]

Let me begin by repeating what Mr. Geithner has said and others. Mr. Liddy is in no way responsible for these bonuses having been agreed to. He, as a public service, agreed to come in, and inherited a situation.

I disagree with some of the ways in which he has handled it, but there ought to be a clear distinction between people who had a responsibility for creating this situation and those given the responsibility for handling it, who may differ with us.

And frankly, on some of those signs talking about jail with regard to imbecility, they were entirely inappropriate and not, it seems to me, seemly for people who believe in civil liberties and fairness to incorrectly suggest that there was any criminality on the part of this witness.

Now having said that, I do want to say, as I have said several times, that I think the time has come to make some changes, and indeed I think the time has come for the Federal Government to assert greater ownership rights.

That is in part motivated by what I would think was a stronger legal position. If we sued against these bonuses as the owner, charging that there had not been adequate performance to justify the bonuses, as opposed to as a regulator, I think many, myself included, would have more comfort with the Federal Government as a party in interest as the actual owner, saying, "We are exercising ownership rights not to have paid out bonuses," when there was a poor performance, than for the Federal Government to interfere with an existing third-party contract.

I also have said that I thought there should be some people removed, and I was not talking about Mr. Liddy, and I may not have been as clear about that.

I am very critical of the people who put these contracts in place. As I read earlier from the contract, there is a pool of money to be distributed, and then it says: But losses are to be subtracted from that, but the losses that could be subtracted toward a cap by $65 million.

Let me just ask you, Mr. Liddy, is it possible under the way these contracts were written, that you inherited, that the company as a whole could have lost money but there still would have been a bonus pool to distribute to the employees?

Mr. LIDDY. Congressman, I think the contracts here that you were reading from have to do with performance bonuses. No performance bonuses at FP, zero. It's a different issue than the retention bonuses, where we basically said to people, "You have a job, that job's going to go away, after you wind down the book of business that you manage. If you'll stay—

The CHAIRMAN. So are you saying that the only bonuses that were paid recently were the retention bonuses?

Mr. LIDDY. Yes.

The CHAIRMAN. There were no other bonuses paid?

Mr. LIDDY. Not at AIG FP. No, I don't believe so.

The CHAIRMAN. All right. And as to the retention bonuses, we are told some people who got retention bonuses have since left. Is that correct?

Mr. LIDDY. Yes, sir. The arrangement—

The CHAIRMAN. Did they give back their retention bonuses?

Mr. LIDDY. No. The arrangement is if you stay, wind down your particular business, do a good job of it, and we are comfortable with the job you have done, you will get that retention bonus. So—

The CHAIRMAN. So—the people who got a retention bonus and then they left, what would be the average period of time after which people got a retention bonus that they left? I don't expect you to know that off the top of your head. I would ask you to submit to us.

Mr. LIDDY. Okay.

The CHAIRMAN. One other issue before I get to—well, two others. You are optimistic in here about paying down the Federal Reserve debt. You don't mention the debt to the Treasury. Is that next after the Federal Reserve debt?

Mr. LIDDY. Yes. It's really important for us, sir, to pay the debt down first so the rating agencies remain—

The CHAIRMAN. As opposed to the TARP, which is considered a different category? Is that the—

Mr. LIDDY. Yes. Although, could I clarify? I think there's some confusion. Right now, the Federal Government has invested two major tranches of money in AIG. One is $40 billion of TARP and the other is just under $38 billion of a loan from the Federal Reserve. That's it. It's $78 billion.

There's another $30 billion of TARP, which is available to us if we have to draw—

The CHAIRMAN. And you are talking about paying off the Federal Reserve debt, the $38 billion?

Mr. LIDDY. The order in which we would do things is, first, the Federal Reserve debt, and then the TARP dollars.

The CHAIRMAN. Next question before I ask you my final one: I'm running of time. I would be interested in your submitting in writing, given your experience, whether we should be dealing with this question of an orderly resolution procedure. You were put in place where there wasn't any.

The Secretary of the Treasury previously and currently has said: "We need an orderly way to wind down a troubled non-bank."

But let me ask you this now; you have said some people are giving the bonuses back. I'm now asking you to send us the names of those who received bonuses, who have not given them back. Can you do that?

Mr. LIDDY. Sir, I will if I can be absolutely assured that they will remain confidential.

The CHAIRMAN. Well, I won't give you that assurance, sir. And so if that's the condition, it would be my intention to ask this committee to subpoena them. This is a situation where there is a lot of public activity.

I ask you to submit the names of the people who have received the bonuses, noting that they paid them back, or not, and I would accept them under a confidentiality personally. In fact, you have submitted some confidential information, and I frankly threw it

away after reading it, because I was afraid I would inadvertently breach the confidentiality.

But I do ask that you submit those names with restriction, and if you feel unable to do that, then I will ask the committee to subpoena them.

Mr. LIDDY. Congressman, if you'll let me explain. I very much want to comply with your request. I would hope it doesn't take a subpoena. If it does, then we will obviously comply with the law.

I'm just really concerned about the safety of our people. So let me just read two things to you: "All the executives and their families should be executed with piano wire around their necks. My greatest hope." "If the government can't do this properly, we the people will take it in our hands and see that justice is done. I'm looking for all the CEOs' names, kids, where they live, etc."

You have a legitimate request—

The CHAIRMAN. Well—

Mr. LIDDY. But I won't affect the wellbeing of our employees.

The CHAIRMAN. Could I get an additional minute by unanimous consent? Because this is a subject to be addressed?

[Off microphone discussion]

The CHAIRMAN. I understand that. Many of us get these kind of threats. Clearly, those threats are despicable, people who engage in this kind of threat.

And I would say to my colleagues, the rhetoric can get overheated, so we ought to be very careful. That's why I want to be very clear, Mr. Liddy, that I disagree with the way you have handled this, but I understand that you inherited it. I disagree with the people who wrote those contracts, but it did not appear to me to be criminal.

I will be willing to be guided to some extent by what the security officials may say, but this is an important public subject, and my guess is that there are probably threats aimed without too much specificity about people who work there.

So I am going to keep that request on the table. I will consult with the law enforcement people, including the Federal law enforcement people, and if they tell us they think there is a serious threat, we will have to take that into consideration.

But I do want to keep that request on the table, and it is subject to our being persuaded, if I ask for a subpoena there would be a committee mark-up, it's not a unilateral decision, and yes it's legitimate to take into account.

I have to say that if we gave in to these kind of threats, we would never get information made public about a lot of things, and I would certainly ask that the State and local and Federal law enforcement officials give full cooperation, and I would urge that any threat that anybody even comes close to carrying out or even threats which themselves can, by law, be prosecuted.

At this point, I am not persuaded, but it is—I will ask before we act that we get information from the security people and that will be before the committee when we vote.

Thank you, Mr. Chairman.

Mr. LIDDY. Thank you, sir. We will wait to have more discussion with you.

Chairman KANJORSKI. Thank you very much, Mr. Frank.

The gentleman from Alabama, Mr. Bachus?

Mr. BACHUS. Thank you. Mr. Liddy, mark-to-market, I think, is good in concept, but insurance and banking CEOs are telling me that it is not working well in a distressed market. I would like your comments on modifications others have proposed, and general modifications, and how it might help AIG to increase the likelihood of the taxpayers being fully reimbursed.

Mr. LIDDY. Yes, sir. I think mark-to-market is a good concept, run amok. On balance, knowing what something is worth every day is a good thing, but it presumes that there's a market. It presumes that there's a willing buyer and a willing seller.

When liquidity completely dries up, there's not a willing buyer, so you have to keep marking the value of the assets down to an unwilling buyer level.

In insurance companies, we have a long liability. We will insure your life. And we will match it with a long dated asset. Those long dated assets, like commercial mortgage-backed securities and residential mortgage-backed securities, because they're long-dated, they are not liquid right now, and they have been buffeted in value, unlike anything most of us have ever seen.

So as a result of that, AIG and many other insurance companies have had to write the value of those assets down, and it has caused great stress on the liquidity.

So I'm a believer in mark-to-market, but I think it's not a one-size-fits-all, and I think it's not a one-size-fits-all with respect to all the various assets to which it applies.

I think it is important that some adjustment be made. To be honest with you, much of the damage is already done, but that's not an argument for not closing the door. We should still close the door, and perhaps be more prudent about how we apply it, starting with this quarter, the first quarter of 2009, going forward.

Mr. BACHUS. And maybe be critical to get that guidance out before those first quarter reports.

Mr. LIDDY. Yes. I know this topic has been discussed before, and it made sense to me to not do anything in 2008. You can't do it in the fourth quarter of the year.

But to start afresh with the new quarter of 2009, to the extent it's possible, that makes sense to me.

Mr. BACHUS. Thank you.

You said that you have unwound all but about $10,000 worth of credit default swaps. That's very good news. That's $70 billion. What about the balance sheet rental? When you were talking about regulatory capital, was that the same thing or a different thing?

Mr. LIDDY. No. That is the balance sheet rental. The regulatory capital trades are really of a substantially different nature. They don't require—for the most part, they don't require the collateral postings that the credit default swaps did. It's pay-as-you go. If a company actually doesn't get a payment, then you have to make them whole.

What has happened—and a couple of the individuals on the previous panel did a great job I think of explaining that—with the AIG credit default swaps, what we did was we insured the value. So when the value went down, we had to post collateral.

In most cases, what you are doing is you are insuring the payment. So the regulatory capital works in an entirely different way.

Mr. BACHUS. Sure. What—on the balance sheet rental, have you had progress in that regard?

Mr. LIDDY. Yes. That number was at its height. I'm going to give you boxcar numbers. I don't remember precisely, it was $350- or $370 billion. It is now down to $230 billion.

And because of some things that are happening in the regulatory environment in Europe, that will be reduced by 95 percent by the end of the first quarter next year.

Mr. BACHUS. All right. You know, I have had some problems, we use that figure $170 billion, bail-out money that the taxpayers are owed?

Mr. LIDDY. Yes.

Mr. BACHUS. Now I'm aware of the Federal loan, which is $37.8 billion. The $40 billion TARP, now that's $77-, $78 billion. Is that what is actually owed? Or is it $170 billion?

Mr. LIDDY. No, it's $78 billion that is actually owed. If you would let me break down the pieces. $40 billion of TARP money, you're 100 percent correct. $37.8 billion at the end of 2008, it might have gone up a "skooch." So it's in the range of $80 billion is what we actually owe.

Mr. BACHUS. Right.

Mr. LIDDY. Now the Federal Reserve invested in some of our distressed assets, they bought into financing vehicles that have RMBSs in them.

Mr. BACHUS. Those are the Maiden Lane?

Mr. LIDDY. Yes, Maiden Lane II and III. They were able to acquire those assets at a discount at 40 or 50 or 60 cents on the dollar. They are currently performing. There have been no credit losses on them. And the Fed is a patient investor. They and the American public will do very well on that investment.

So I believe what frequently happens is people take the $40 billion and we can have as much as $60 billion in the Federal Reserve. We have only tapped into, let's call it $40 billion. But analysts, writers will take $40- plus $60- plus the $50 billion of assets that the Federal Reserve has invested in, and a few other things, and they get to that $170 billion number.

It's an important distinction, because for us to pay off what we owe the Federal Government, it's roughly an $80 billion target right now, and we can do that. But we need some help from the markets to be able to do it.

Mr. BACHUS. Thank you. And let me say this, Mr. Chairman, as I close. It's my understanding most of those assets, like you say, they were 45 cents, 50 cents on the dollar. Now in the markets generally, they're trading about 90 cents on the dollar. Is that—

Mr. LIDDY. No, that is too high, sir. That's too high. They are down—it depends upon the specific asset, but they are probably anywhere from 30 to 75 cents; it depends upon the asset.

But the really important thing is: They are current pay. You know, for every dollar that's owed on those, 96 or 97 or 98 cents is being paid.

Mr. BACHUS. That's performing? So they're performing?

Mr. LIDDY. Yes, they're performing.

Mr. BACHUS. And you know, when you talk about $1.6 trillion under management, and you're having to have people to manage that, I would say to the committee, we're talking about—this is a big number—but a million and six hundred thousand million.

Mr. LIDDY. Right.

Mr. BACHUS. That's a pretty big figure.

Mr. LIDDY. And sir, that really is the risk trade-off that we made. I don't want that book to blow up and cause to come undone all that we have achieved, all that you all have achieved thus far.

You know, do other reasonable people see it in an entirely different way? Yes. Is the American public mad as a hornet about it? Yes. Would I have liked not to have made those payments? Yes.

But I don't want that business to erupt on us and cause the difficulties we have tried so hard to avoid.

Mr. BACHUS. I think that is the definition of the risk, if those aren't properly managed, is a million six hundred thousand million. So we ought to all keep that in mind when we talk about you having the skill to manage those.

Mr. ACKERMAN. [presiding] Mr. Liddy, you have basically been parachuted into the helm of a ship that has already hit the rocks. And you get no pay, you get a buck a year, you have no stock options is my understanding. You have no financial upside, no matter how good a job you might do.

And on behalf of a lot of people, I want to thank you for rising to the occasion to take on the task of setting this thing straight to the best of your ability.

Mr. LIDDY. Thank you, sir.

Mr. ACKERMAN. You're going to hit some bumps in the road. But you have no right and neither do the good people who work for your company to be subjected to the kinds of things that you have been subjected to and the threats to yourself or your family by anybody.

And I just want to apologize on behalf of the millions and millions of decent Americans who understand really what is going on, but are nonetheless frustrated.

We are here to help you over those bumps in the road, because you're not going to make perfect decisions all the time, and you have just hit one of those bumps in the road.

So I want to try to help you. So maybe you can—

Mr. LIDDY. Thank you. I need all the help I can get.

Mr. ACKERMAN. All right. This old school teacher is going to give you a little bit of advice: Pay the $165 million back. That bonus money that has been given out, circumstances understood very clearly. You have a legal question here. But you have received or have access to $197.3 billion of U.S. taxpayer money. $165 million adds up to this old math teacher as less than one-tenth of 1 percent. That's not worth the aggravation, the angst, that you have suffered and that this country is going through.

Give that back. Cut your losses in financial terms. It just isn't worth it. Do you think you could consider doing that? And then pursue the legal options if you wish, of litigation against the people who do not want to give it back or haven't given it back?

Mr. LIDDY. Sir, that is what I have attempted to set in motion this morning; I have asked the folks at AIG FP to, in fact, return

that money, give it back, at least 50 percent of it, and for the leadership group, 100 percent of it.

The issue I have, I never got a chance a moment ago to fully explain the legal side of it. And I'm not one who hides behind the legal aspect of this.

What we can't do is have a group of individuals or have an event which causes AIG FP to get into a situation of cross-default. If it does that, it will be bankruptcy and it won't be a very good picture.

Mr. ACKERMAN. Take it out of your profits down the road. Eat it now. It's a lot sweeter now than it's going to be later. Because you have legislation coming down the pike that they're going to call it, "I can't believe it's not waterboarding."

Mr. LIDDY. What I would like to do, sir, is see how much leadership comes from the AIG FP people in terms of returning those bonuses. My fear is the damage is done, that we will get the bulk of that money back. They will return it, but they will return it with their resignations.

And we do in fact run the risk of that business being much more difficult to wind down than we ever anticipated. That is not a concession to defeat. We will do everything we can to make sure that business gets wound down professionally, quickly, and efficiently.

Mr. ACKERMAN. You're talking about the business of credit default swaps?

Mr. LIDDY. No. I'm really talking about the $1.6 trillion. We're pretty much done with credit default swaps.

Mr. ACKERMAN. Is credit default swaps a bad idea?

Mr. LIDDY. No, a credit default swap is I think a very legitimate product. It just needs much more visibility and you can't use the language—

Mr. ACKERMAN. Can I edit one of your words, "visibility?"

Mr. LIDDY. Yes.

Mr. ACKERMAN. And say "transparency." The reason this country is great and our system works better than any other, is because of transparency, and our capital markets work great, better than any others, because of transparency.

And the fact that Mr. Madoff said, "I can't tell you the secrets of my business, because they're secret, that's why I'm successful," that is what has everybody all screwed up, because nobody knew what he was doing and he's just too big to fail.

The credit default industry is Madoff Lodge. People are buying into what they don't understand, they can't see through, it is completely unregulated by any agency that we know of or have been told today by the regulators; has no finances to back it up, and can't pay off on a bad debt, on a bad bet.

It's people sitting around, shooting craps without a wallet. And I don't think that's a good financial investment, do you?

Mr. LIDDY. Well, I wholeheartedly accept your edit. Transparency is a better word. With transparency and the right contract, a credit default swap can serve a purpose. That is not what we had. We did not have transparency, and we did not have a good contract.

Mr. ACKERMAN. My time has expired. Mr. Price? No? In that case, Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman. And thank you, Mr. Liddy for being here today. I am very interested in the events that

have occurred about the time that you came to AIG, and in terms of the Federal Government role in all of this, going back to the first tranche, which I understand was issued by the Federal Bank of New York, as a matter of fact, which I think Mr. Geithner was heading at that time.

Can you tell us—and it was at that point that the Federal Government became the owner of 89-point-some percent of AIG stock, and so we became a majority stockholder at that time. Can you tell us what the Federal Government participation has been since that time in terms of meetings that have occurred either with the Fed of New York or the greater Federal Reserve here in Washington and the Treasury Department?

Mr. LIDDY. I can. Our interaction is primarily with the Federal Reserve Bank of New York. They have observer or overseer powers over us. They have assigned an excellent cadre of people to understanding our business. That cadre of people have brought in experts from Morgan Stanley, and from Ernst & Young to supplement them since the Federal Reserve primarily is a regulator of banks, not of insurance companies.

As I said earlier, I very much view the relationship as a partnership. We do not do a single thing of strategic import without making certain that we have talked to the Federal Reserve about it and we have given them an opportunity to weigh in on it.

The Federal Reserve attempts—

Mr. CASTLE. I don't mean to interrupt you, but you said in your testimony, "working with our partners in the Federal Reserve and the U.S. Treasury." You have only been talking about the Federal Reserve so far.

Mr. LIDDY. Well, no, really I'm just talking about the Federal Reserve. As I have talked to the Federal Reserve, and I have talked to the U.S. Treasury, they have encouraged us to primarily deal with one regulator or one overseer, and that has been the Federal Reserve, and that is exactly what we have done.

Mr. CASTLE. And the Federal Reserve has been a participant at your board meetings. I'm not sure they have a vote, but they have been a participant at your board meetings and in other significant meetings in terms of reviewing policy since that time in October?

Mr. LIDDY. Yes. Absolutely yes. And it goes well beyond that. It goes to participation in all the things that lead up to board meetings or committee meetings.

Mr. CASTLE. And it has been a variety of people? Either outsiders they have brought in, or people from the Federal Reserve who participated in these meetings. Is that correct?

Mr. LIDDY. Yes, sir.

Mr. CASTLE. And you indicated that you assumed that they had shared that information earlier in testimony today. You assumed they had shared that information with Treasury and with Congress, for all that matters. Is that correct?

Mr. LIDDY. Yes. As I mentioned—

Mr. CASTLE. I'm correct and have been correct in saying that was an assumption you made?:

Mr. LIDDY. Yes. I had a conversation with Treasury Secretary Geithner about a week ago, and he indicated to me that he had only become aware of the situation about a week prior to that, and

we have tried to keep the staffs of various Members of Congress apprised of all of the situation and to be very responsive to whatever queries you may have. I think we have done a good job of that. Very good—you'll be the judge of that.

Mr. CASTLE. If Treasury Secretary Geithner was the head of the New York Federal Reserve and his people were participating in the meetings that you had thereafter, would he not have known from them? Or was even a participant in the meetings at least until he became Secretary of the Treasury?

Mr. LIDDY. I don't know. You really have to ask the Federal Reserve that as to how much was there in the chain of command that would have gone all the way up to Mr. Geithner. I don't know the answer to that.

Mr. CASTLE. Did he participate in any of the meetings when he was still at the Federal Reserve in New York?

Mr. LIDDY. In several yes, although once he was nominated as a potential Secretary of the U.S. Treasury, he recused himself from any of those situations.

Mr. CASTLE. Now you indicated that the Federal Reserve could say yea or nay at these various meetings, and I assume these are probably board meetings or some subset of the board executive committee meetings or whatever.

Mr. LIDDY. Correct.

Mr. CASTLE. Did they actually have the right to say yea or nay on decisions such as bonuses, or whatever? Or did you just assume that they were there and they could have said something if they wanted to. How do you interpret their powers?

Mr. LIDDY. I generally ask them, I ask them if they're okay or if they have a comment on it, which is my way of making certain that if there's a different point of view that should be heard or should be voiced, that there's an opportunity for it to be heard.

Mr. CASTLE. And they did not say nay as far as these bonuses were concerned?

Mr. LIDDY. No. There was great angst over the payment of these bonuses, believe me, on all of our parts, including the Federal Reserve's. And the judgment, as I said—I'm sorry to be repetitive—the judgment we made was the risk was too great that we would lose all the progress we made if we didn't pay these bonuses.

Mr. CASTLE. I request, Mr. Chairman, as I close here—and would it be possible to ask if Mr. Liddy or those working with him could submit a list and the chronology of the meetings that occurred at which the Fed was available there and who was there and the basic outline of what was discussed at that meeting?

Mr. ACKERMAN. Would you submit that in writing?

Mr. CASTLE. Could you submit that in writing? I'm not asking you to do it now.

Mr. LIDDY. We don't have it available to us right now. I—

Mr. CASTLE. No, would you submit it in writing? Could you go back and after several days be able to submit something of that nature, looking at your minutes or whatever?

Mr. LIDDY. Yes.

Mr. ACKERMAN. Thank you.

Mr. CASTLE. Yes, from your board minutes or whatever other writing you might have. Thank you.

Mr. ACKERMAN. The answer was yes.

Before moving to Mr. Sherman, if the committee would indulge a quick clarification? If you could give us a yes or no? During the exchange with Chairman Frank, requesting a list of those people who have accepted the bonuses or to whom bonuses were given, you also referenced the fact that you were going to cooperate with Attorney General Cuomo in New York.

He has indeed already subpoenaed those names. Does that mean you will be cooperating with that subpoena?

Mr. LIDDY. We have not provided those names to the Attorney General.

Mr. ACKERMAN. The question was: Will you cooperate with the Attorney General's subpoena?

Mr. LIDDY. I'll talk to my general counsel about it, and we will do the right thing.

Mr. ACKERMAN. Does the right thing include complying with legal requests from attorneys general?

Mr. LIDDY. We always comply, we do everything we are required to do and more with respect to obeying the law.

Mr. ACKERMAN. So that will be a yes? You will supply the names subpoenaed?

Mr. LIDDY. I'm sorry to be so evasive. I just want to protect our employees—

Mr. ACKERMAN. No, it's easy. You don't have to be evasive. It's really yes or no.

Mr. LIDDY. I just want to protect our employees. So if someone can just assure me that what is not going to happen is a list of names, addresses, dollars, and pictures are released and therefore they are even more at risk than they are right now.

Mr. ACKERMAN. You are not giving it to a bunch of Congressmen, now. You're giving it to an attorney general of a big State—

Mr. LIDDY. No. Believe me, I understand that, and it would our intent to comply with the subpoena.

Mr. ACKERMAN. Thank you. Mr. Sherman?

Mr. SHERMAN. Thank you. Mr. Liddy, you missed the first panel. We learned in the first panel that the insurance companies and savings banks will be just fine and that U.S. consumers would be just fine if the parent company went into receivership. We heard that from the regulators of those entities.

They said that there would be a slight reputational risk if the parent company went into receivership, but it would be maybe a thousandth of the bad press that they have gotten over the last week, because you didn't go into receivership.

The second thing they told us is that they had on their staffs experts in credit default swaps, who were making between $100- and $150,000 per year with no retention bonuses at all.

But of course none of those individuals, although they have the expertise, none of them have the experience in bringing down an entire company or a world economy.

Now I support Chairman Frank's plan to launch a shareholder derivative suit or similar action against the overpaid executives.

But I don't want to go home and tell my constituents, "We may have some chance of getting some of the money back." The American people are skeptical.

And so as a tax attorney, I can assure my constituents that if we pass the tax bill, we're sure to get virtually all of the excess compensation back for the American taxpayers.

Now if the Federal Reserve Board knew about the particulars of these bonuses and didn't tell us, then they should be called to account. Because that calls into question not only their competence, but their dedication to democracy. Because they may have deliberately prevented the American people from weighing in on the decision as to whether AIG should have been put into receivership.

Mr. Liddy, can I count on you to provide the members of this committee with every document that you gave the Fed, excluding those documents that have the names or other identifying information of your employees?

Mr. LIDDY. I would like the opportunity to talk to my general counsel about that and make sure that, in fact, is the right thing to do.

Mr. SHERMAN. Well, if you're going to keep your shareholders informed, you have to keep the members of this committee informed, and not just give it to a Fed that seems to have let us down.

I would ask you provide for the record a chart, focused on future bonuses and future high compensation, which we could stop if we pushed you into receivership. At least we can stop future payments.

And in that chart, show us how many employees are getting more than $100,000 a month in salary and how many stand, under current compensation plans, to get over $500,000, $1 million, or $2 million during 2009 in bonuses?

Can you furnish that for the record?

Mr. LIDDY. I believe we can.

Mr. SHERMAN. Thank you.

Now are the employees of the company able to consult at AIG expense criminal defense lawyers, especially the high-paid $500-an-hour or $1,000-an-hour criminal defense attorneys? Is that allowed under your policies?

Mr. LIDDY. Only if there's an assertion of criminal wrongdoing.

Mr. SHERMAN. I think anybody listening to this committee would say that there is an assertion of criminal wrongdoing, at least being made by the America people.

You have an obligation to keep your shareholders informed. The shareholders are the 300 million American people. You can't just tell one or two shareholders. You have to tell all the shareholders.

You knew a month ago that if we put this company into receivership, we not only would save the $30 billion that was provided to the company, or the risk that was taken by the Federal taxpayer, in providing an additional $30 billion credit line, but that we would invalidate these bonus contracts.

You seem to have informed one or two people of that. You did not inform all of the shareholders.

The other issue is the contracts themselves seemed to have been entered into in contemplation of huge losses, and whether there was a criminal conspiracy to conceal these losses from the shareholders that AIG had about a year ago, and enter into these contracts, both of issues raise issues of whether there is criminal liability.

Under those circumstances, will AIG spend the money to provide criminal defense counsel to its employees and officers?

Mr. LIDDY. I really need to look at the facts, sir. And in much more detail than what you just indicated.

Mr. SHERMAN. I would ask that you would provide for the record what your policies are, because as of, you know—the Miranda rights don't entitle you to a $1,000-an-hour criminal defense attorneys, they entitle you only to what is called, the rights that Miranda was given.

I believe my time has expired.

Mr. ACKERMAN. The gentleman from illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you, Mr. Chairman.

Mr. Liddy, when did you first know about the retention contracts?

Mr. LIDDY. In October or November of 2008.

Mr. MANZULLO. Did you attempt to change any of those contracts as you did when you were at Allstate?

Mr. LIDDY. I asked that a complete analysis be done of whether there were ways to effectively alter those contracts. Could we change them? Did we have to honor them? I did do that.

Mr. MANZULLO. And so you came to the conclusion that even though the taxpayers owned 80 percent of the company, and the company couldn't pay any bonuses at all unless the taxpayers had put up the money, that the contracts could not be altered. Is that what you were told?

Mr. LIDDY. It was what I was told, sir, but I really started from a different place. As I mentioned earlier, I started from the basic issue of risk analysis.

Mr. MANZULLO. No, I understand that.

The top 7 people at the organization received more than $4 million in retention bonuses, and the top individual got $6.4 million, and 73 employees got a total of $1 million each. Were these being considered to be key players, key figures in the corporation?

Mr. LIDDY. Not within the corporation, but within the unit known as AIG FP, so just to be clear, the top people in the corporation are getting no bonuses.

Mr. MANZULLO. But that's the group that went sour, isn't it, the Financial Services Division?

Mr. LIDDY. Yes. And they would be some of the top people in AIG—

Mr. MANZULLO. When Mr. Kashkari, who is the head of TARP, testified before this committee on December 10th, he said that the top people who were involved in AIG going sour had been removed. Would he have been mistaken when he said that?

Mr. LIDDY. I think he was really referring—I haven't seen the testimony—I think he was referring to the corporate level, the holding company, versus AIG FP.

But with—

Mr. MANZULLO. He said, "We have removed those people."

Mr. LIDDY. I understand that Mr. Cassano is gone.

Mr. MANZULLO. But I had asked him that question, because I was questioning a $3 million bonus, which turned out to be $4 million, and his statement was that the key people who had made AIG

go sour had been removed, and that this was evidently somebody else.

And my question too is that these people who got the $4 million and the $6.4 million, those are the people who were in charge of the Financial Services Division at the time that division collapsed? Isn't that correct?

Mr. LIDDY. Not entirely, sir. The architects and builders of the AIG FP strategy, they are gone, primarily Mr. Cassano and a few other names. And we are not paying them anything, despite what the contracts say and everything else, we are not paying them—

Mr. MANZULLO. So you could not pay contracts? Go ahead.

Mr. LIDDY. Not when we have our people who are more executers and traders, derivatives—

Mr. MANZULLO. Would you say an executor would get $6.4 million in bonus and 7 get more than $4 million? These are not perfunctory people, these are first-class people making first-class decisions that determined the destiny of the Financial Services Division.

Isn't that correct?

Mr. LIDDY. Yes—

Mr. MANZULLO. So they have to bear responsibility, do they not?

Mr. LIDDY. They are very talented people who are—

Mr. MANZULLO. I understand that, but they have to bear the responsibility, do they not, Mr. Liddy, that they were there at the time that these financial investments went south and they have to bear responsibility that they perhaps were at fault also in addition to the gentleman that you removed, who is on the holding company? Isn't that correct?

Mr. LIDDY. Yes. Although sir, most of the people who were directly responsible for the credit default swaps at AIG FP, those people are gone.

Mr. MANZULLO. Well, then, who are these people? I mean did the credit swaps come out of the Financial Services Division?

Mr. LIDDY. They did, but think of it as boxes. You had credit default swaps, you had regulatory capital, you have other derivatives trades. Many of these people are working the other derivative trades at $1.6 billion. The regulatory capital book, we have that under control, and the credit default swap book, that's pretty much gone.

These are people who for the most part worked in the derivatives, the currency hedges—

Mr. MANZULLO. Okay. I understand that. But my question is the fact that your testimony is inconsistent with that of Mr. Kashkari, because he led the American people to believe—and perhaps he was correct—that the people who are responsible for the mess at AIG had been removed from their areas of responsibility and all new people had been put into that position.

That is why the Americans are really upset over people who are at fault getting these types of outrageous bonuses.

Mr. LIDDY. Sir, I think we are in agreement. The people who were primarily responsible for the credit default swaps that had brought us to our knees, they are gone. The people who were responsible for regulatory capital trades that had some exposure, they are gone.

But the people who still operate a $1.6 trillion trading book of business, we aren't losing the kinds of dollars on that we have lost on credit default swaps, they are still there.

Mr. MANZULLO. Those are the ones—

Mr. LIDDY. They are the ones who are winding that book of business down.

Mr. MANZULLO. And they got the retention bonuses?

Mr. LIDDY. Yes, they did.

Mr. MANZULLO. Even though seven of them left after they got the retention bonuses?

Mr. LIDDY. Well, again, they did exactly what we asked them to do. They had a book of business of several—

Mr. MANZULLO. But they got paid on March 15th and this is March 18th. So they didn't retain very long, did they?

Mr. LIDDY. No. Remember, these went into effect on January 1, 2008, so those people may have taken until October to November of 2008 to get rid of that book of business in a way that we felt comfortable with—

Mr. MANZULLO. Okay—

Mr. LIDDY. If they did that and then their job was eliminated, they earned their retention bonuses.

Mr. MANZULLO. Thank you. My time is up. Thank you.

[Off microphone discussion]

Mr. ACKERMAN. Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Liddy, I'm just curious. First of all, thank you for working for a dollar a year. Apparently Diogenes found his one good man and you're it.

I think you're about to get some more thanks.

I'm just curious. When you were doing these bonuses, did you expect that it would touch a nerve with the American people, as it has?

Mr. LIDDY. Absolutely.

Mr. CAPUANO. All right. So you knew this was coming?

Mr. LIDDY. Yes.

Mr. CAPUANO. All right.

Mr. LIDDY. But perhaps not as severe as it is, but absolutely.

Mr. CAPUANO. Fair enough.

I understand that these people who got these bonuses—and I want to be clear—I'm not against bonuses per se. What I'm against is bonuses to people who helped cause the problem and particularly bonuses that come out of taxpayer's dollars, etc., etc.

I'm not against bonuses. We're not talking about anybody who got a $1,000 bonus, we're talking about people who got hundreds of thousands of millions of dollars.

And do you believe honestly in your heart, with all of the unemployment that has gone on in the financial services sector right now, right this very minute, do you really believe that these are the only people who are capable of doing this job?

Mr. LIDDY. No, I don't.

Mr. CAPUANO. So that there are people out there who would have taken this job, who maybe wouldn't have gotten this far. So you could have fired these people to replace them with equally capable, professional people that are currently unemployed on Wall Street right this minute?

Mr. LIDDY. If you'll let me explain. Each of these contracts is a complicated contract unto itself. It's not you have seen one, you have seen them all. They're really all unique.

And they need to be properly hedged and balanced at the end of each day, because there's so much volatility in the—

Mr. CAPUANO. Yes—

Mr. LIDDY. If they're not, you get burned.

Mr. CAPUANO. Let me ask a question. In your former life with Allstate—I'm a policyholder of lots of insurance, that's basically a legal contract between me and my insurer, so when you were at Allstate, every person that you sold an insurance policy to had a basic contract with Allstate. Would you agree with that?

Mr. LIDDY. Yes.

Mr. CAPUANO. Did you honor every single one of those contracts as those clients saw them as they should have been on it, as they think? Every single one of them. You just paid it out when somebody asked.

Mr. LIDDY. No, we—

Mr. CAPUANO. You had a difference of opinion on a legal contract. You went to court, based on judgment.

Mr. LIDDY. Yes.

Mr. CAPUANO. And let the courts decide. I'm a lawyer. I'm all for courts making decisions on legal matters, not necessarily lawyers for private companies. Our job, your job, is to make decisions on the basis of what you think is best but at the same time, in this case, you have an obligation to the general public.

I can't imagine why you couldn't have followed the same policy here. Simply—

Let me ask you one more question I asked the previous panel. Do you believe that the current course that AIG is on, that this course will lead to stability and profitability of AIG within a reasonable period of time?

Mr. LIDDY. I do.

Mr. CAPUANO. Do you have any idea how long it will take? A year, 2 years, 5, 10, or 100 years?

Mr. LIDDY. You know, the plan is about a 2- to 3-year period of time—

Mr. CAPUANO. A 2- to 3-year period.

Mr. LIDDY. But it's very dependent upon what happens to market conditions around the globe.

Mr. CAPUANO. I respect that.

Mr. LIDDY. Very dependent.

Mr. CAPUANO. As we all are dependent on that.

So did you consider at all—you didn't consider replacing these people because you thought the contracts were too complicated. I respect that.

Did you consider at all saying, "Look, we're not going to do this. We read it differently, we think the circumstances have changed, we think these contracts are null and void because the circumstances have changed. If you disagree with us, we will see you in court," knowing, or at least believing that within 2 to 3 years, AIG will either be back to profitability or bankrupt and gone. Either way, by the time those lawsuits were settled, these people would be then in a court that either was a private company with

no taxpayer dollars left, or a company that went bankrupt, with a bankruptcy judge to decide who got what money. Did that cross your mind at all?

Mr. LIDDY. It crossed our minds; it got very serious consideration.

Mr. CAPUANO. Serious consideration. Why didn't you do it?

Mr. LIDDY. Back to the risk assessment. Had we done that, more than likely those people would have walked out the door tomorrow or whenever, and we would have had this $1.6 trillion book of business which needs to be managed every day with no one to manage it.

To the extent something happens in one of those trades, and it triggers a cross default, we get into a spiral that undoes all of what the government has—

Mr. CAPUANO. So do you have any plans for the people who haven't left yet? Do you have any plans for firing them now? Because they have proven to me that they don't have the best interest of their employer, mainly the American taxpayer, at heart.

Since that's the case, I understand you don't want to be without them. You don't have to tell me names, but is there anybody you are going to fire next week or next month or 3 months from now and replace them quietly in a thoughtful manner?

Mr. LIDDY. No. Let me tell you what we have tried to do. Each person has a book of business. There are 22 or 24 separate books of business. Their job, either individually or in tandem, is to wind that book of business down.

It could happen by the end of April, it could happen by the end of December.

What we have also done is we have brought in some additional people to understand those books of business—it's hard to get all the right expertise at the right time—to understand those books of business as backstops or insurance.

Mr. CAPUANO. Mr. Liddy, I think you have made a series of judgments that I obviously disagree with, that you could have made other decisions and let the chips fall where they may.

It amazes me that these are the only people. Apparently you are the only good person left on Wall Street to do this because you know the American people need it, and I appreciate your effort, and I don't mean to berate you on a personal basis. I really do appreciate what you have done.

Nonetheless, it would be nice if we had a couple more people working for AIG at top-level salaries who felt the same way or anywhere near the same way.

And for those who don't, the truth is, as one taxpayer, I don't want them working for me. I would just as soon you get rid of them and take the risk with that.

Mr. LIDDY. You know, sir, there is a cadre of people working at AIG very hard for the American taxpayer, trying to do everything we can to repay every single dollar.

You would be proud of them.

Mr. CAPUANO. Not right now, I'm not.

Mr. LIDDY. Okay.

Mr. ACKERMAN. The gentlelady from Illinois, Ms. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

If the taxpayers hadn't loaned AIG any money, would the executives who received the bonuses have received them?

Mr. LIDDY. Probably not. But if you'll let me explain, I think it's a matter of what would have happened. I think the company would have spiraled into bankruptcy, and in bankruptcy, a bankruptcy court judge makes the decision of: "Are you important, or are you important, and what do we have to do in order to keep you?"

So if they were determined by a bankruptcy judge to be important, they may have gotten a payment. But the basic contracts would have been voided.

Mrs. BIGGERT. But because the money came from the Treasury and from the Fed, they were able to get the bonuses?

Mr. LIDDY. There was no bankruptcy.

Mrs. BIGGERT. Okay.

In my opening statement, I was concerned whether the taxpayers who own 80 percent of the company got to vote on these bonuses. Was there any notification or anything that—the reason I'm asking that is because as part of the bailout, the New York Fed appointed 3 trustees to represent the government's nearly 80 percent ownership interest in the company. Did you ever see or hear from these trustees? Were they at the board meetings? Were they there?

Mr. LIDDY. You know, I have met with the trustees on a number of occasions. They were just appointed approximately the middle of February or so. I don't remember the exact date.

Again, we have reviewed these with the Federal Reserve, and the Federal Reserve is the repository gatekeeper, if you will, of the relationship with AIG.

Mrs. BIGGERT. So they were appointed after the decision—well no, the decision was in March.

Mr. LIDDY. No. Before.

Mrs. BIGGERT. So did they notify anybody? Or did you talk to them about the bonuses?

Mr. LIDDY. I do not know if they were reviewed or not.

Mrs. BIGGERT. Okay. Who are the trustees?

Mr. LIDDY. There are three trustees. To be honest with you—Doug Fuge. I can get you that list, if you will—

Mrs. BIGGERT. I would appreciate it.

Mr. LIDDY. Bill Considine. I can get you that list.

Mrs. BIGGERT. All right.

So did you or your staff make the Treasury aware of the bonuses, other than talking to the trustees, or—

Mr. LIDDY. I'm sorry, did we make the Treasury—

Mrs. BIGGERT. Yes. Did you make the Treasury aware?

Mr. LIDDY. No, as I said earlier, we began discussing this at our board meeting starting in the middle of November, a full disclosure with the Federal Reserve. And I don't know, I'm not privy to what happens from the Federal Reserve up into the Treasury.

Mrs. BIGGERT. Okay. You know, my constituents and the American taxpayers are really upset with this. As you well know, as we all know.

And they don't want to see one more dime go to AIG. Can you give me three good reasons why you should have received that money, and why, if you are going to need it in the future, that the taxpayers should give you support?

Mr. LIDDY. I think the payment of the bonus, the thought process was that it would prevent a very disorderly event within the Financial Products business, which could have brought down the whole corporation.

And then the roughly $80 billion that the taxpayers have already invested in AIG would have been for naught.

So we did not think that the $165 million relative to putting at risk the $80 billion that has already been invested—we thought it was wiser to err on the side of caution and see if we could do everything we could to keep those individuals in place at AIG FP.

Mrs. BIGGERT. And do you think that it would happen that the company would need more money?

Mr. LIDDY. I believe we are adequately capitalized, particularly with the ability to draw down on the additional $30 billion of TARP.

It goes back to my answer to somebody's question over here. It is very much a function of what happens with the capital markets around the globe, if investment values, if asset values continue to go down, it will be a problem for everybody in the life insurance industry.

Mrs. BIGGERT. All right. Thank you.

Mr. ACKERMAN. Thank you very much, Ms. Biggert.

And now, Mr. Baca of California?

Mr. BACA. Thank you very much, Mr. Chairman, and thank you very much, Mr. Liddy, for being here and trying to find a solution to a major problem that the American people are outraged in reference to what happened to these particular bonuses.

I want to start out by asking a couple of the questions. You indicated you started in September, but I believe in part of your testimony you indicated that it was during the last Administration they came up with these contracts that were in place, is that correct?

Mr. LIDDY. When you say last Administration, do you mean my predecessors?

Mr. BACA. Yes.

Mr. LIDDY. Yes.

Mr. BACA. And that was before President Obama took office, is that correct?

Mr. LIDDY. Yes. That goes back to the end of 2007, beginning of 2008.

Mr. BACA. So it was basically under this last Administration. And part of the problem that we have and people are so much upset with this, retention bonuses that were given out right now—isn't retention, doesn't that mean that you stay, and a bonus means that you're getting paid for something you performed that is positive and is turning our economy around and our crisis around?

Mr. LIDDY. Yes. In this case it meant you stayed and you made progress on a specific assignment to wind down a portion of your responsibility within AIG FP.

Mr. BACA. And some of these retention bonuses individuals you indicated in your testimony, that some of them have left, is that correct?

Mr. LIDDY. Yes. If they completed their work and their responsibility was wound down to our satisfaction, they would have left probably closer to the end of the year, and they have would have

waited until March 15th, but they would eligible for the retention arrangement.

Mr. BACA. You know, it is appalling to me that we are giving out these bonuses, and to the American people and the taxpayer—we have teachers right now across the Nation who are receiving pink slips, especially in the State of California. They are doing excellent jobs, and yet they are not getting bonuses. I wish we would have given those teachers bonuses, because they're getting the pink slips, and yet, these individuals out here, when you look at the crisis that we're in, they haven't gotten us out of the crisis, they received the bonuses. Isn't that a shame?

Mr. LIDDY. I have teachers in my family, sir. I know that pain.

Mr. BACA. And you indicated during your testimony that you asked a lot of these AIG executives who received these bonuses to return the money. What has been the result of that survey that you conducted earlier?

Mr. LIDDY. I just asked them this morning. And in response to the public outrage, in response to the suggestions of many folks that I met with yesterday, just listening to the President of the United States say, we need to do something, we have attempted to amend this situation, and we have asked the people at AIG FP to demonstrate their leadership and give it back.

Mr. BACA. Isn't there any remorse or feeling by these people who are getting these bonuses, when people are losing their jobs, losing their homes, the economy is where it's at right now? I mean, what has been there expression and their feelings? We are talking about human beings who have lost their jobs, have lost their homes. And yet we're giving out the $165 million that was given.

And I'm glad that the last question was asked, you know, "Was it done because of the bailout?" Because it was this last Administration that asked us to vote for this bailout that a lot of us didn't want to, did they know in fact that we were going to have a crisis and that they were going to gain from this?

Mr. LIDDY. You know—

Mr. BACA. It could have been, yes.

Mr. LIDDY. Yes, that's a hard one to answer, sir. I understand the intent of the question. The people at FP, it is easy to paint with one brush and capture everybody. In fact, there are a lot of really good people up there. They are basic Americans, they want to do a good job for us.

The trades that were done that brought us to our knees, that was a very small number of people—

Mr. BACA. Somebody asked us to do a bailout, we gave them the bailout. They knew it, they took it, they ran, they took the American people's money.

Mr. LIDDY. No, but I was really trying to be sensitive to and respond to your point. You know, don't these people have a conscience, which is basically what you asked me.

You bet they do. What we asked them to do was to stay, do a specific amount of work, and if you do that, at the end of that period of time and you have done that work, we will give you a retention bonus. That is what those payments were.

So they did the work, they reduced the risk from that $2.7 trillion down to $1.6 trillion, and the American taxpayer is better off because we have less risk.

But we have to keep shrinking this business quickly so it doesn't get away from us.

Mr. BACA. And I hope that in part of the comment, that we hope that from now on, that we modify those kind of contracts, and we never ever have these kind of contracts if the American people will have to pay for something that someone else has created, something that they didn't do, that we now are paying for that.

Mr. LIDDY. Duly noted.

Mr. BACA. Thank you very much. I yield back the balance of my time.

Mr. ACKERMAN. Thank you very much, Mr. Baca.

Mr. Hensarling from Texas.

Mr HENSARLING. Thank you, Mr. Chairman. Mr. Liddy, I have disagreed with certain things that you have said, and I have disagreed with some of your conclusions. But I do want to add my voice to others who state that you are one of the good guys. You were asked to come into this position, take on a very, very tough job, and clearly you are doing this out of a feeling of service to your country, and I thank you for that.

On page 4 of your testimony, you talk about Federal regulators making the decision not to allow AIG to fail. With all due respect, Mr. Liddy, AIG has failed. Any company requiring $170 billion-plus of taxpayer viability exposure has failed. It has failed in my mind, and it certainly has failed in the public opinion's mind.

I mean AIG, notwithstanding the fact—I know you have many good men and women, I know that you have profitable divisions. But it appears to many of us it is now a conduit for counterparty transfers of taxpayer money.

My first question is: Did I hear you correctly? And please, I had to step out of the room on occasion. You speak of a plan in your testimony, a business plan designed to maximize the value of the core of businesses, so that we can maximize the amount to repay the American taxpayer.

Is it your belief that this plan will make the American taxpayer whole?

Mr. LIDDY. It is, sir, with the caveat, if you will, that the markets have to behave. In order to sell assets, there have to be buyers who have equity or cash or capital in order to be able to buy them.

Since October, that has proven not to be the case. We have set in motion a plan that despite that fact, we think we can still pay back the Federal Government.

Mr HENSARLING. Mr. Liddy, I spent about 12 years in the private sector before coming to Congress, and I know we have talked about the bonuses ad nauseam. But when I was in the private sector, two things had to happen to qualify for a bonus. You had to perform exceedingly well and the company had to perform exceedingly well.

Clearly, you are bullish on the future of AIG. I'm curious whether the recipients of these bonuses share your enthusiasm. And if so, let me offer a suggestion to you, sir. What AIG does with their money is their business. What they do with taxpayer money is our business. If these people who receive the bonuses share your bull-

ish thoughts on AIG, why don't you do double or nothing on these bonuses? Let's let the taxpayer be made whole, and if the taxpayer is made whole on his debt, if the taxpayer makes a decent return on his equity position, and AIG is indeed returned to profitability, Mr. Liddy, why don't you just double those bonuses. Instead if these people have skin in the game and if they believe they can work it out of trouble, then we don't have to worry about these other options.

Mr. LIDDY. Interesting idea.

I would say it's probably not in the taxpayer's best interest to go there. I have much confidence that we can in fact rescue AIG. It's not a failed company; it is a failing company unless we do something about it. And we in fact have a plan to do something about it.

It basically is a disaggregation of AIG.

Mr HENSARLING. Well, Mr. Liddy—

Mr. LIDDY. And the sale of those businesses to pay back—

Mr HENSARLING. Here's the challenge for many of us here. And that is—and I voted against TARP once, I voted against it twice, I'll vote against it 3 or 4 times, if necessary. So I didn't support the underlying legislation.

But if the taxpayer is being asked to yet again prop up this company, you know, where is the skin in the game for the individuals who were supposed to turn this around? How can I look taxpayers in the eye in the Fifth District of Texas and say, "Yes, invest your fifth tranche of hard-earned money into this company," notwithstanding the fact that the people who receive the bonuses don't ultimately have enough confidence that you're going to get paid back?

How do we do that? How do we have any confidence? And in addition, I know you talk about failure, but failure isn't necessarily chaos. I mean, that is why they have chapter 11, that is why they have reorganization, that is why they have receivership.

Mr. LIDDY. I think you find—I did listen to the previous panel—I think you would find that AIG is regulated by 430 regulators around the globe, and if the company failed, those good insurance companies would be grabbed by whatever regulators could possibly get their hands on them, to make sure that they were protected.

I don't know that the world has ever seen anything like that. My risk assessment is that winding down the AIG FP business as quickly as possible is essential because it's the biggest exposure that we have. If we are successful in doing that, when we are successful in doing that, then we can in fact sell all the good insurance businesses, take those proceeds, and pay back the Federal Government. That is what we are desperately trying to do.

Chairman KANJORSKI. The gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. Thank you for testifying, Mr. Liddy. I appreciate your being here. I want to get right to the employee retention plan. Do you have a copy of this in front of you?

Mr. LIDDY. I do not.

Mr. LYNCH. Can some of the staff drop off a copy here to—can you hold my time till we get this down there? Mr. Liddy, I'm going to explain a couple of sections here. One has already been mentioned by Chairman Frank, and that was the—at page 10 of this

compensation agreement, it holds that the bonus pool that's available for employees will be basically capped at $67.5 million and that regardless of what happens with the company, and investments, the bonuses will be given out. So it basically anticipates losses on the part of the company but protects the employee's bonuses from that dire circumstance. Do you think that's consistent with your fiduciary responsibility to your shareholders and to people who rely on your performance for their own benefit?

Mr. LIDDY. Congressman, you'll have to forgive me. I just am not familiar with that contract. I believe that contract is the annual performance bonus arrangement.

Mr. LYNCH. Right. It is.

Mr. LIDDY. No performance bonuses were paid in AIG FP, I don't believe, for 2007.

Mr. LYNCH. I'm sorry. This is for retention. These are retention bonuses. And while you're looking at it, the paragraph above that, Section 306, subparagraph A, this really gets me.

Mr. LIDDY. I'm sorry, sir. What page are you on?

Mr. LYNCH. Page 10 of the agreement. It says, "The effect"—the subheading is, "The effect of mark-to-market losses on the bonus pool." This is again a protection for the bonus pool for the employees.

It says: "The bonus pool of any compensation year beginning with 2008 compensation year will not be effected by the incurrence of any mark-to-market losses or gains or impairment changes arising from the CDO portfolio." This is the credit default swaps. This is the underlying—these are the underlying assets.

So what you have done here is basically you have reserved the bonus pool for the employees, and not only have you done that in this agreement, but you have basically protected yourself, immunized yourself from the stupidest decisions made by AIG, which earlier in the testimony has been admitted to that it was the credit default swaps that were really—you know, by the Financial Products Division—that really brought this company down to where it is right now.

And what you have done here in this agreement is basically you have immunized your own bonuses from that stupid decision. In other words, the bonus pool will not be affected by the CDOs and the credit default swaps that you were all worried about. And this agreement was written in 2007. This is similar—this is like the captain and the crew of the ship reserving the lifeboats saying, "To hell with the passengers. We're going to take the lifeboats for ourselves." That is what happened here.

This is a violation of fiduciary duty. When you cordon yourself off and protect yourself, as the managers of this company and as the people running the ship, and you say, well, we're going down, so we're going to make an agreement where we're not affected by the bad decisions we make. We're going to pass that all on to the investor and the shareholder.

That amounts to malfeasance. Not just nonfeasance, but that's a complete violation of trust in the people who invested in your company. This should not have happened, and I honestly believe this is reversible. This is so outrageous that you would say we're not going to be victims of our own stupid decisions. We're not going to

take the heat for this on the CDOs and the credit default swaps. That is simply unbelievable. It's arrogance. And I think it's probably illegal. And I agree with Chairman Frank that we should probably try to challenge this as shareholders on behalf of the American people as well.

Do you have anything to say for yourself?

Mr. LIDDY. Yes, sir, I do.

Mr. LYNCH. Please.

Mr. LIDDY. You have generously used the word "you" in that construct. As I mentioned, these contracts were all put together before I was at AIG. I would not have done these contracts this way, and this whole arrangement would have looked, if it existed, would have looked a whole lot different. So I really do—I take offense, sir, at the use of the word—

Mr. LYNCH. Well, offense was intended. So you take it rightfully, sir.

Mr. LIDDY. No. I take it—

Mr. LYNCH. What I see happened to the American people here and what is happening to 200 billion innocent taxpayers. I have people in my district who don't have a 401(k). They're out there working every day for, you know, a fixed wage. And yet they and their sons and daughters and grandchildren and great grandchildren are going to have to pay the freight here. They don't have anything to do with Wall Street. They're lucky if they can live from day to day. A lot of them are out of work right now. Think about those people, how they feel in having to pick up the tab for this.

Mr. LIDDY. I understand everything you have said, sir. I do. It's just important for me that you appreciate these were put in place before I was there.

Mr. LYNCH. But the decision to allocate these was made in December, sir.

Mr. LIDDY. No. No. That decision—the decision to put this plan in place goes back to 2007.

Mr. LYNCH. No, no, no. The actual payment of the bonuses.

Mr. LIDDY. Okay. There were no payments then. If you'll just give me a chance to explain. The arrangement you're reading from continues to be—it's an omnibus plan that covers retention payments and an annual performance plan.

Mr. LYNCH. It says here retention bonuses.

Mr. LIDDY. Right. And if you—I think if you read through it, I would be glad to spend time with you offline and make sure that I understand your point of view, and maybe I can help you understand—

Mr. LYNCH. Well, look. I understand if there's ambiguity, we can talk about it. But this says, in large letters, "Employee Retention Plan."

Mr. LIDDY. Right.

Mr. LYNCH. Look, I am a contract attorney. You might want to try that with somebody else, but this is the plain language within the four corners of this contract that we're talking about here, sir.

Mr. LIDDY. Right. And it applies to the payment of annual performance bonuses, not to the pay of the retention plan itself. So there were no performance bonuses. You're absolutely correct. The clauses that are on here should not be in here. I would not have

put them in there. We did not pay anything in accordance with those clauses.

Mr. LYNCH. Okay. My time has expired, Mr. Chairman. I yield back.

Chairman KANJORSKI. Thank you. We will now hear from Mr. Campbell of California.

Mr. CAMPBELL. Thank you, Mr. Chairman, and thank you, Mr. Liddy, for your rather thankless service. I would like to focus on the future of this company which is now nationalized. You talked about reducing the exposure in the Financial Products Division from $2.7 trillion to $1.6 trillion. And I understand what you have said about it depends very much, the future, on what the markets are like.

If markets were as they are today, in other words, they don't get any better, they don't get any worse, and you run down that $1.6 trillion, what kind of loss would AIG expect out of the Financial Products Division once you have wound it all out?

Mr. LIDDY. Mr. Campbell, if I could, my comment about markets getting worse has more to do with selling assets. It's selling our really good life insurance company in Asia or what have you. The rundown of the book of business can happen in an orderly way. On some trades we make money, on some trades we lose money. The goal would be not to lose any money on that business so we don't have to put more money into it from the Federal Reserve. That's entirely possible in almost any market condition as long as there's someone there monitoring the book of business. If there's no one there, you have a problem.

Mr. CAMPBELL. I understand. So do you think it's likely that could be run down without any further loss?

Mr. LIDDY. No. I think it will probably cost, I don't know, maybe a couple of billion dollars, which is a large number, but that's anticipated in the borrowings that we already have from the Federal Reserve.

Mr. CAMPBELL. Okay. Let me talk about—you talked about the good businesses, and I wanted to discuss just how good perhaps they are. My understanding—correct me if I'm wrong on this—is that the commercial property and casualty business was down 22 percent, I believe, in the fourth quarter. There is that anecdotal evidence out there that there is a lot of price cutting on the part of AIG, and so therefore the profitability of that business—that the business may be shrinking, and it's both in volume and in margins. And obviously, a business that has shrinking volume and margins has problems for the future. Is that what's going on in the—

Mr. LIDDY. No. I don't believe it is. And I think as I listened to the individual from the GAO, I think what she said was as of her testimony today, they had seen—and Joel Ario said the same thing—they had seen no evidence of irresponsible price cutting on the part of AIG.

I will tell you what is happening. What AIG does is we write really big risks for oil rigs and large apartment buildings and new hotels and tunnels and things of that nature. That has all ground to a halt. So there is no new business that you can write insurance on. So to the extent you lose an account, there's not fertile ground

that you can apply to replace that account. That is happening in spades.

The point you make is a good one. Over time, people just get AIG fatigue. A buyer of insurance just doesn't want to deal with, "Is AIG bankrupt? Are they solvent? Are they going to be around? Why did they pay those bonuses?" You just get AIG fatigue. And if I can't turn this situation around, we run the risk that the business does atrophy. We're trying very hard not to do that.

We have a plan. We're going to sell a minority interest in that business, maybe take it public, maybe get it out entirely from underneath the AIG umbrella. We brand it and give it a chance so we can realize some value and pay it back to the Federal Government.

Mr. CAMPBELL. Will that business be profitable in the first quarter of 2009?

Mr. LIDDY. I just haven't seen the numbers. I'm sorry. I just don't remember what they are.

Mr. CAMPBELL. Was it profitable in the last quarter of 2008?

Mr. LIDDY. If you exclude investment losses, I believe it was, yes. It was profitable and generated cash.

Mr. CAMPBELL. Talk about the life insurance subsidiary for a second. I know that in your—I believe it was the company's evaluation of systemic risk, that is where you believe there is a great deal of systemic risk, but there is a lot of counterparty liabilities to other life insurance companies. Is that true?

Mr. LIDDY. It is in both. You know, we insure, on the property casualty side, we insure 94 percent of the Fortune 500 companies. So the systemic risk idea is very real in both the property casualty and the life side.

Mr. CAMPBELL. Okay. But in the property casualty, I mean, they could replace that insurance with another carrier.

Mr. LIDDY. If there is enough capacity.

Mr. CAMPBELL. Right.

Mr. LIDDY. It is a really good point, and if you would just give a minute. You know, we are so large. We have more capital than any other insurance company in the United States in the property casualty area. If that business went away, I'm not so sure that it could all be immediately replaced. And because the market is so treacherously low right now, companies that wanted to replace it couldn't go out and raise the capital to be able to do it.

Mr. CAMPBELL. Okay. Because I'm running low on time, what is the status then of the life insurance—that is a separate division from property casualty, correct?

Mr. LIDDY. It is. Multiple life divisions.

Mr. CAMPBELL. Correct. And is that business profitable? Is it shrinking in margins and business, or what is its status?

Mr. LIDDY. It is profitable. Pieces of it are stable. If you sell variable annuities or fixed annuities right now, nobody in the industry is selling those. Industry sales are down maybe 40 to 50 percent on balance. So we are down the same as the industry is. But the persistency has more or less stabilized since September. That business is profitable. That's part of what we want to either take public or give to the Federal Reserve to satisfy our debt.

Mr. CAMPBELL. Why can't we sell that? That is my final question.

Mr. LIDDY. No buyers. The people who would buy that business don't have any money, and their stocks are down 70 percent since October 1st. So they can't use equity to buy it. They can't go out to the capital markets and raise cash to buy it. There is no way. We could sell it for a fraction of what it is worth. That is not a good idea; it would not enable us to pay back the money that we owe to the government.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman from North Carolina, Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. Mr. Liddy, I am sympathetic to your concerns about the safety of your employees, but the lack of transparency at AIG has been a great frustration to me personally, to the Congress, and to the American people. Neel Kashkari sat right there on December 10th, and I asked him whether we were ever going to find out who the counterparties were, and if not, why not, and he said he did not understand my question.

You said that you first learned of these performance—rather these retention benefits—in October or November, and you talked to lawyers, and they said there is no way out of this, you have to pay it. You would have to pay twice this under Connecticut law if you don't pay it, no questions asked. Did your lawyers assume that AIG, the Financial Products Unit, was solvent at the time of the contract, that this was an arm's length transaction with a solvent corporation? Or did they ask you if it was possible that this was a sweetheart deal to loot an insolvent company by insiders to leave the company without sufficient—or leave the company with even less to pay its honest debts?

Mr. LIDDY. As I mentioned, I was not there. I simply do not know the answer to that question.

Mr. MILLER OF NORTH CAROLINA. You were there. This was in October/November of last year.

Mr. LIDDY. Yes. Let me explain. The work that I asked to be done in October/November of last year was, are these valid contracts? Are we required to pay them? Can we break these contracts?

Mr. MILLER OF NORTH CAROLINA. And that is what I am asking.

Mr. LIDDY. What will happen if we do?

Mr. MILLER OF NORTH CAROLINA. There is an important factual question here: Was AIG solvent? Were these arm's length transactions or were these sweetheart contracts?

Mr. LIDDY. Yes. I'm not a lawyer, sir, but I would say at the end of 2007, 2008, when they were entered into, AIG was solvent. It was before the very substantial credit crunch of the third and fourth quarter.

Mr. MILLER OF NORTH CAROLINA. Have you seen the written questions and written answers from Joseph W. St. Dennis provided in October of last year to the Government Reform and Oversight Committee as part of their investigation of AIG? He was the vice president of accounting policy at AIG Financial Products from June 2006 to October 1, 2007. He said that he left, he resigned because on multiple instances, beginning in the late summer of 2007, "Mr.

Cassano took actions that I believe were intended to prevent me from performing the job duties for which I was hired."

He gave several instances, one of which was evaluation of credit default swap portfolio, and said that Mr. Cassano pretty clearly admitted that he had intentionally cut or excluded Mr. St. Dennis from those discussions. Have you reviewed this?

Mr. LIDDY. I have not.

Mr. MILLER OF NORTH CAROLINA. Are you familiar with it?

Mr. LIDDY. I am familiar with it, yes.

Mr. MILLER OF NORTH CAROLINA. Okay. Have you looked at whether Mr. Cassano or anyone else has any liability to your corporation for—on any basis?

Mr. LIDDY. You know, as I said, I'm not a lawyer, but there was no evidence of wrongdoing in any of this.

Mr. MILLER OF NORTH CAROLINA. This isn't evidence of wrongdoing?

Mr. LIDDY. No, sir. I—

Mr. MILLER OF NORTH CAROLINA. Isn't this evidence of cooking the books?

Mr. LIDDY. I have not read it, so I can't comment on it.

Mr. MILLER OF NORTH CAROLINA. You said in your testimony, and I agree with this, that when you owe somebody money, you pay that money back. The United States Government and the American people don't owe anyone for the debts of AIG. It is not our debt. Do you agree with that?

Mr. LIDDY. I'm not sure I understand, Mr. Miller. AIG owes the government—

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. LIDDY. —the American people $80 billion—

Mr. MILLER OF NORTH CAROLINA. Yes. But what you owe your counterparties, that is not a debt of the United States Government.

Mr. LIDDY. No, it is a debt of AIG.

Mr. MILLER OF NORTH CAROLINA. Okay. There has been a study by economists on what works and what doesn't when a nation's banking system collapses, its financial system collapses, and one of the characteristics is transparency. The second is maintaining market discipline. And that means that shareholders bear the loss, but it also means that unsecured creditors bear the loss. Anyone who is in a position to determine the ability of the corporation they are doing business with to pay their debts should bear the loss, not presumably taxpayers. Are we maintaining market discipline by continuing to give money to AIG to pay unsecured creditors, to pay the counterparties to your credit default swaps?

Mr. LIDDY. Well, that whole process is over. We are not doing any of that any longer. We have walled off those liabilities, if you will. But to your basic point, we owe those people that money. I mean, it's just a fact of life. AIG owes those counterparties that money. If you don't pay them, the result—

Mr. MILLER OF NORTH CAROLINA. You did. We didn't.

Mr. LIDDY. Right. But the result of not paying them is an event of default and it forces the company into bankruptcy.

Mr. MILLER OF NORTH CAROLINA. Okay. Are you going to examine ever whether there is any liability by any officer, director, or employee of the Financial Products Unit?

Mr. LIDDY. Yes. There are ongoing investigations by the Justice Department and the SEC and the FBI and a regulatory agency in the U.K. We are cooperating fully with those investigations.

Mr. MILLER OF NORTH CAROLINA. I'm talking about civil liability to the corporation, for breach of fiduciary duty or whatever else. Are you examining whether you can sue them? You seem to be terrified they might sue you. Are you going to sue them?

Mr. LIDDY. No. We did examine that. And, again, the judgment was on a risk basis: if we don't have those people, we increase the risk that something happens at AIG FP, and we undo everything we have done to get to this point.

Chairman KANJORSKI. Okay, gentlemen. We have eight votes on the Floor. It will be approximately 1 hour. We would appreciate your indulgence, Mr. Liddy. We have arrangements for where you are to stay, and we will take a recess for 1 hour.

[recess]

Mr. SCOTT. [presiding] The subcommittee will come to order.

We will now hear from Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. Liddy, I have a conversation I want to have with you and it has to do with the issue of any discussions which AIG might have had with members of the Senate over the provision that was put in the Senate bill in order to guarantee the payment of the bonuses.

The explicit provision that went in in conference said: "The prohibition required under this clause shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009." But the wider discussion I was interested in was whether AIG had contacted any members of the United States Senate about this particular problem of the bonuses. And, so, I would just like your response to that.

Mr. LIDDY. I believe the answer is no, at least not to my knowledge. We have a strict prohibition against lobbying. We will respond if called, but we do not make outbound calls, if you will. So as far as I know that is not anything we had any engagement in whatsoever.

Mr. ROYCE. Let me ask this, then. Could you check and see if there are any e-mails or any written communication around this issue that would have attempted to bring this to the attention of members of the United States Senate, or the House for that matter. But I understand the provision went on in the Senate.

Mr. LIDDY. I will answer. At your request, we will check. I feel quite certain the answer is no.

Mr. ROYCE. And then let me ask you about discussions that you may have had with members of the Administration and get into a little more detail in terms of who had those discussions and the basic thrust of them.

Mr. LIDDY. The only discussion I would have had with members of the Administration would have been with Secretary Geithner. The first of those conversations would have been about a week ago. I'm sorry not to be more precise. I don't have the exact date. And there probably would have been two of those: one on a Tuesday and one on a Friday; or one on a Wednesday and one on a Friday;

something like that. And the purpose of the discussions was for Secretary Geithner to hear from me—my view of the bonuses and what we were going to do.

As I indicated earlier, he indicated to me that he had become aware of those only maybe a week or 10 days beforehand, and we shared a healthy exchange on this is going to be rough for the American public. He understood the risk issues, I believe, understood the legal issues, asked for me to make some changes to them, which we did. I sent him a note, which was vetted with his staff beforehand, and that has pretty much been the extent of it.

Mr. ROYCE. I understand.

Mr. LIDDY. When you said Administration, I didn't include in any of that the Federal Reserve.

Mr. ROYCE. Sure. Well, let me ask this question then. Would there be any talking points or e-mails or communication from the company that you could provide this committee as to the nature of that conversation? We would appreciate it if that could be supplied to the chairman and ranking member.

Mr. LIDDY. We can do that, and that basically would be the letter which I sent to Secretary Geithner, and I think has an attachment to it in his public record.

Mr. ROYCE. The issue to us is of course the fact that Senator Snowe was concerned about this very provision, and so when the stimulus bill came before the Senate, she attached to that an amendment aimed at restricting bonuses over $100,000 to any company that received Federal bailout money. And that measure drafted by Olympia Snowe in the Senate and by Ron Wyden applied these restrictions retroactively to those bonuses received or promised in 2008 and onward. And, of course, the issue was at some point that provision was stripped out during the closed-door conference negotiation involving the House and Senate leaders and involving the White House.

And a measure reportedly originally reported by "ABC News," that it was Senator Chris Dodd who put that provision in it, but at any rate, a provision that the Democratic leadership on both the House and Senate side were aware of replaced the provision voted out of the Senate by 100 members of the Senate. And so, instead, we had a final bill come back to the House with a new provision in it, a provision that explicitly exempted bonuses agreed to prior to the passage of the stimulus bill.

So, you know, for us on the House side, you can see the surprise. Republicans all voted against that bill, but in that bill, then, we find a provision that nobody voted on in the Senate or House on the Floor, but instead is put in during a closed conference and expressly prohibits us from attempting to prevent the use of taxpayer money for bailouts of firms for payment of bonuses to firms which the taxpayers have themselves bailed out, and, so, hence our concern over the line of communication.

So, if there's any company communication or lobbyist retained by the company that did have any communication on this, the request from this committee is for that to be produced.

And, again, thank you very much, Mr. Chairman.

Mr. LIDDY. I understand your point. I have no involvement and no perspective on it, but we will comply with your request.

Mr. ROYCE. Thank you.

Chairman KANJORSKI. The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much. Mr. Liddy, over here. How are you? Welcome.

First of all, I want to say you're in a tough spot. We understand that and I share your concern that whatever we do, it is very important for us to understand that the American taxpayers now have $173 billion invested at AIG. We have another $30 billion on its way.

That's over $200 billion. And if we are going to get a return on that and get our money paid back and be able to restructure this company, it is going to take talented, hard-working, good people at AIG to do this. So we are aware of this and we are all very sensitive to it.

But, Mr. Liddy, we are in effect at war. Our economy is almost in the tank. We get a ray of hope with the stock market here and there. We had a new Administration coming in. We had hopes soaring, but this happened. And what we have here with the action with AIG and these bonuses is sort of like a stone in America's shoe, a stone that makes it difficult for us to walk this journey, let alone run it where we have to go.

And the American people are demanding that we get this stone out of this shoe, so we need to hurry up and get this bonus issue off the table. And so I applaud you in coming forward in your initial statement of saying what you're doing for that, but getting half of the money back is not the answer. The answer is getting all this money back, because there is strong evidence as you have seen from the testimony here that we are coming at that money, because the American people want us to come at it.

We should not have to fight this through the courts. We should not have to harangue the Tax Code in such a way. There's also thoughts of fraudulent and criminal activity. We don't need to go down that road, so I hope that you will amend your efforts to demand, as to now see the person who is now in charge to say on my watch I don't need this hanging over us.

We have too much to do to be sidetracked by this, and with the Senate offering bills along that line, with the House coming forward with efforts, and you heard the chairman of the committee and the different concerns. The American people need this. We need to win this round and get this money back.

I want to ask you a couple of points along this line. The first point I want to ask you is would you do that, first of all. Would you amend and ask for all of this money to come back?

Mr. LIDDY. If you let me think about that, sir, it is one of many, many requests that I have had: Are there different ways to do that. I hear your request.

Mr. SCOTT. Okay. Now, the other point is, I asked the thrift person, and I want to ask you. And I know you came on the scene in September, but many of us believe that this was a fraudulent effort here.

What do you think when they put forward the effort 1 year ago exactly this month to give $450 million in bonuses to this Financial Products division, which has only 367 people in it, to deal with this area when they were bleeding money at the time?

And 4 or 5 months later, they had bled enough money to the tune of $40.5 billion, this very unit that drove AIG into the arms of the taxpayers. Somewhere down the line, it seems to me the question should be asked: Where were they thinking they were going to get this money? And was there any thought too, since there's such a close proximity here and they're bleeding money that somebody down the line might have thought down the road if we do this, the government will come to our rescue. And, thereby, that's where we could get our bonuses from, from the taxpayers.

Had that thought occurred to you?

Mr. LIDDY. Sir, I was not there. I just do not know. I think the timeline would be important there and I think there are some differences in the timeline that maybe we can share with you that would perhaps persuade you that is not the case.

Mr. SCOTT. Okay. Let me get to my other point, because I only have a few minutes.

Now, we know it's $165 million that is going out the door. But, in fact, the true amount of the money is a little over $1 billion in bonuses that have been agreed-to. Now, you are in the seat now. First of all, of the $450 million, $165 million of that has gone out the door. That leaves $285 million. Where are you on that? Where is that in the process of being distributed? Can we not stop that?

And then, there is another $600 million that is being committed to spread over 4,700 employees. What are you going to do about the remaining, what amounts to about $835 million, that has been committed in bonuses that are yet to be given.

Mr. LIDDY. Let me break your question down into components, if I can.

There is a retention bonus that could be paid in March of 2010, additional retention bonus to AIG FB employees that could total as much as $200 million. As I have said in my conversation in my letter to Secretary Geithner, that's for work not yet done. It's one thing to evaluate a bonus for work already done; quite another one to evaluate for work yet to be done.

That size bonus, there is no way that that would be paid. I unfortunately suspect that most of those people will be gone. I think they will, in fact. The people at FP will in fact return the bulk of the money that has been given to them, and it will come with their resignations. So I don't think that size payment is going to happen at all.

We may not like the outcome of that, sir, when those people are no longer there. I am worried about the $1.6 trillion of exposure, and keeping that business under control. Do not hear in that a concession. We are going to do everything we can to wind that business down well and wisely. It just got harder by many, many multiples, because I think what people will do is stay for a short period of time, but they will return that money along with their resignation.

Sir, could I, if you would?

Chairman KANJORSKI. Yes, sir.

Mr. LIDDY. There are so many numbers bandied about with respect to AIG and I think the facts should be out.

The amount of money that we need to return to the American taxpayer is right now—at the end of December—$78 billion. We

have not drawn the additional $30 billion. Other elements of it we simply haven't drawn. There is still money available at the Federal Reserve.

We haven't drawn that, but if I could just make sure that you have one really important fact as you walk out the door towards the end of this hearing, the dollars we owe the American taxpayer right now, it totals $78 billion.

That is a big number, but it is substantially more manageable than $200 billion. And I only raised that because keeping that in the context of the assets that we have to sell so we can raise that number, it is much more reasonable if the number is $78 billion than if it is $178 billion or $200 billion.

Mr. SCOTT. Thank you, sir.

Chairman KANJORSKI. Mr. McCarthy of California is not here. We will go to Mr. Posey of Florida.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Liddy, we wouldn't care anything about the bonuses if it wasn't for the bailout money. You know, if private industry pays people what they are worth and they do not ask our constituents to pay the bill for it, it really doesn't matter. You know why we care so much about this.

Mr. LIDDY. I do.

Mr. POSEY. And I am still not clear how these people earn these retention bonuses in the past or the future. I heard your answers, but I am not sure that I really understood them. And I would think a big bonus for the people who put us in this position would be that they're not in jail, number one, and number two, that they still have jobs.

I can't imagine there are a lot of other employers frothing at the mouth to hire the people who put AIG in that position. I mean, I just can't imagine that the job market is that great for somebody who exhibits such a tremendous ability to fail and screw up the whole country, basically, or help do it.

Have you in your analysis of the way AIG operates now, have you seen any signs of what somebody might normally consider to be criminal activity?

Mr. LIDDY. I have not, sir. I would not condone it. I have seen absolutely none.

We have had a number of investigative authorities looking at our practices and our books and records, and nothing has come to light that I am aware of. Could I go back to one other point?

Mr. POSEY. Certainly, you may.

Mr. LIDDY. It is important to remember at FP, as I said earlier, it really is easy to paint with one brush and color everyone with the same brush. There are people who worked on one piece of FP called credit default swaps. There were people who worked on another area of FP called regulatory capital. There were people who worked on the derivatives book, the $1.6 trillion.

For the most part, those are separate people. I am simplifying, but for the most part they are separate groups of people. It is the credit default swap people who, really, and that was a very small number of folks and a very small number of trades. They are the ones who brought our company to its knees.

The folks out here in the derivatives book, you know, they are getting tarred and feathered along with everyone else, and they are the ones that we're asking to please, please, wind this book of business down, orderly, economically, and efficiently, so it doesn't cause problems for us. They are the ones who got the retention bonus.

Mr. POSEY. I hear what you are saying. Somebody gave me a button on November 5th that said, "Every now and then an innocent man gets sent to Congress." So we understand that.

Is there an obligation on your part if you see activities that might be considered unethical or perhaps illegal that you would have a duty to report that? And, if so, who would you report it to?

Mr. LIDDY. Oh, sure. You know, I would report it first to our general counsel and to our board and audit committee, and our partners at the Federal Reserve, absolutely.

We are trying to establish a new AIG, one that is transparent, one that shares information. It's hard to do. That has not been our practice in the past, but that would be reported and I wouldn't be shy about taking the lead on that.

Mr. POSEY. Well, let's spur some of these questions. We have good reason to believe, obviously, there is plenty of evidence that, you know, back in the days when Enron was inventing cap and trade or cap and tax, whatever we want to call it, that they were also pulling down some pretty good bonuses based on cooking the books to make it look like they had performed better than they had actually performed.

And the question that begged for an answer is whether there was any sign of that here. You know, people would do a lot of things to get a million-dollar bonus, and obviously it has been demonstrated that is one of the things they would do.

Mr. LIDDY. Yes, I would say there are no signs of this here. What we had at AIG is too much appetite for risk, too much appetite for businesses outside of our core competencies, contractual commitments, which, when left in place and the market melted down, exposed their weaknesses. So we could and should be roundly criticized for aggressive business practices, but nothing like an Enron or a WorldCom or the things that you just referred to.

Mr. POSEY. Okay. And one final one, Mr. Chairman, if I have time.

You know, we understand that 73 people got bonuses that exceeded $1 million and they are called retention bonuses. And 11 of those people are no longer with the company.

Mr. LIDDY. Yes.

Mr. POSEY. Why did we even consider giving a retention bonus to somebody who is no longer with the company?

Mr. LIDDY. We specifically asked those people on a book of business to wind it down, get it to go away, and get it within certain parameters. If you can do that by the end of October, that's fine. We will pay you the retention bonus. If it takes you until March to do it, we will pay you the retention bonus then.

Those people achieved the objective. That is how we got the book from $2.7 trillion down to $1.6.

Mr. POSEY. Thank you.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much.

Next, we will have Mrs. Maloney of New York.

Mrs. MALONEY. Thank you, Mr. Liddy, for your public service. I understand you are a retired CEO of one of America's great companies and you were asked to come back and serve. And we appreciate it. Thank you.

I have so many questions I am going to have to submit them to you in writing and trust that you will respond to the committee because we have very limited time.

On the question of bonuses, you mentioned that a number of people said that they would give back their bonuses. Well, I have been told by Chairman Rangel that on the Floor tomorrow will be a version of my bill that will tax the bonuses at 90 percent, so the money will be coming back to the Treasury.

How many people have said they will give money back to the Treasury? And, after this bill passes, maybe more will give back. Wouldn't you agree?

How many people tell you they would give back the money?

Mr. LIDDY. I don't have the information, Congresswoman. I have just made that request this morning and I have been in this hearing.

Mrs. MALONEY. If you could get back to us on that, we would really appreciate it. Also, I requested from Treasury and the Federal Reserve for many, many months now to get information on who is receiving the money. The taxpayers own AIG now, 80 percent, yet they were saying it is proprietary. We own it. We should see the books.

Just on Sunday night, they released this information, and why were you fighting giving us this information when it belongs to the American taxpayer?

Mr. LIDDY. I wasn't fighting anything. The Federal Reserve has a policy against disclosure of counterparties, and, when we saw the testimony of Chairman Bernanke and Vice Chairman Kohn, I had a conversation with the people at the Federal Reserve and said we should figure out a way to disclose this.

We made the various telephone calls to make sure that the counterparties would be okay with that, and so we disclosed on the credit default swaps, and the RMBSes, the securities lending and municipalities. We disclosed all of it, so it really wasn't on the part of AIG that we were attempting to husband any information or not disclose.

Mrs. MALONEY. Really? So you were willing to disclose and the Federal Reserve would not disclose. Is that correct?

Mr. LIDDY. Well, we were never asked. The Federal Reserve had a policy of not disclosing counterparty associations. With respect to "Maiden Lane III," they are the ones who own that structure, and they are the ones who negotiated with the counterparties.

Mrs. MALONEY. Are there any other disclosures that you have attempted to make, but have been blocked by the Federal Reserve or the Treasury? Any other request that has been blocked that you would have been willing to give the information?

Mr. LIDDY. Not that I can think of. No.

Mrs. MALONEY. Now, really, the Federal Government is not required or obligated to bail out AIG. Isn't that correct? Bailing out AIG was never a government obligation?

Mr. LIDDY. It was never an obligation; again, it was a decision made before I was there. But as I understand it, the representatives of the Federal Reserve and the Treasury believed that AIG's failure would cause a shock to the system, on a worldwide basis, that would be unpalatable.

Mrs. MALONEY. Yes. AIG prepared a document that I would like to put in the record that said if AIG failed, it would be a tremendous shock to our American economy. I would venture to say that if every company said and prepared a document like that, our Treasury would be bankrupt.

So I looked at the counterparties. We were told that this was systemic risk. Now, some of the counterparties were municipalities. I'm a former city council member. I love cities, but if we bailed out every municipality that made a bad decision, we would be bankrupt in this country. So I would venture to say that that was not a systemic risk.

Also in the document that I haven't thoroughly studied, because we just got it, there were two foreign banks. Certainly, bailing out foreign banks is not a systemic risk to the American economy. I would say we were basically bailing out the governments of Germany and France. If the bank was so important to their economy, they would have bailed it out. So, indirectly, we bailed out two different countries, and, I would venture to say that it was not a systemic risk to our own economy.

So I would venture, were there any guidelines that said what would be systemic risk? Anyway, I just find that very, very disturbing. But, the main point is we could have saved the insurance arm, but let the derivatives business go, and possibly be in better economic condition.

In the prior hearing, I questioned the insurance regulator, one of them, of AIG. He said the insurance arm was very healthy.

Would you agree with that?

Mr. LIDDY. Yes, they were and are very healthy.

Mrs. MALONEY. And I would venture to say that probably not many Americans are buying insurance from AIG right now. It would probably be better for the company to divide, to have the insurance go for it and be healthy, and divide up the derivatives that is pulling down the risky products division. It is pulling down the company. Would you agree?

The insurance regulator told me after the hearing that he thought it should be divided. It should go that way, that we should come in, possibly take control and a bank holiday for a day, and divide the company. Would you agree?

Mr. LIDDY. That's exactly what we're doing.

Mrs. MALONEY. That's exactly what you're doing?

Mr. LIDDY. Yes.

Mrs. MALONEY. So are you going to have a bank holiday?

Mr. LIDDY. No.

Mrs. MALONEY. How were you going to do it?

Mr. LIDDY. The dividing of AIG.

Mrs. MALONEY. Pardon me?

Mr. LIDDY. The dividing of AIG is exactly what we are doing. So the entity that has existed for 90 years as AIG, it will over time cease to exist. We are selling assets wherever people can afford to

buy those assets. We are taking assets and putting them in trust, and giving them to the Federal Reserve, big assets that can be taken public at a later time or sold when the market recovers. So those assets will move out from AIG. We are going to seek the minority interest in our property casualty business, possibly take it public and spin it off, so that is exactly what we need to do in order to repay the taxpayer.

Mrs. MALONEY. Last question: Would you say it is a serious mistake to have allowed a risky product to be attached to one of the great insurance companies in the world? Was that a bad regulatory decision?

Mr. LIDDY. Yes. I would say two things to you, Congresswoman. One, any time you see a business stray from what it is really good at, watch out. And, two, and Chairman Bernanke uses this vernacular, and I think it is very appropriate, what we had at AIG was a series of well-regarded, well-run, well-capitalized insurance companies, and to it we attached an internal hedge fund.

That internal hedge fund worked fine for a while, but we became too aggressive in terms of the risks that we were prepared to take, and when the capital markets stopped functioning, it exposed that aggressiveness for what it was and that is what caused the liquidity problem.

Mrs. MALONEY. My time has expired.

Thank you.

Chairman KANJORSKI. Next, we have Mr. McCotter.

Mr. MCCOTTER. Thank you, and thank you for coming, Mr. Liddy. I know you are not doing this for the money. You make a dollar a year. You are trying to help your country in a very difficult time and you relied on people, both at the Fed and the Treasury, to try to help you succeed in that job, which is why I'm going to try to reconcile much of what we are seeing today with how my constituents view this.

I come from Michigan. It has the highest unemployment rate in the country. They quite simply think it is thoroughly insane to pay people to stay in a job when they can't find one. They think it is insane for the people who helped cause the problem to be paid for causing the problem and then have them turn around and have to be paid to clean it up. They think that is not only insane, it is unfair.

They think it is insane for people to say that we need the best and the brightest to fix this problem when it was the best and the brightest who caused the problem in the first place. As I have said before, if these individuals are the best and the brightest, we live in benighted times and God help us all.

I think one of the things that we have to remember is these individuals have jobs for one reason: The taxpayers decided to bail them out. Well, not the taxpayers, but their representatives in government when they voted for the Wall Street bailout and the individuals at the Federal Reserve Board when they decided to start the process.

So when they look at this, they say to themselves, we would really like the money back that is given out in bonuses. And credit to you, you have already started that process. You have talked about 50 percent coming back. I personally don't know that the 50 per-

cent is going to be enough for them. I know it isn't for me. They would like full restitution, in their mind, of money that was given to people who caused the problem and don't deserve another penny for cleaning up their mess.

You said that you have not asked for the access to the $30 billion that the Treasury has committed to AIG; am I correct?

Mr. LIDDY. Yes.

Mr. MCCOTTER. I would like to see Secretary Geithner repeal that commitment to that $30 billion and then precondition any allowing of that money to go to AIG on first recouping the bonuses from the individuals who have done it. And I do think it would be in their best interest, not only the taxpayers in terms of equity, but as has been pointed out before, there will be transparency in the process. The request and potential subpoena of the list of individuals who have received and kept that money will come to this Congress because the taxpayers will need to know.

I do think and appreciate the threats that may be made against them and have been made, but there is a very good way to get one's name off the list. It is to give back the bonus to the taxpayers of the United States. I think that when you made this decision, I can't believe that you made it alone. I think you would have consulted with both Treasury and/or the Federal Reserve Board.

We talk about how losing these people would have caused AIG potentially to go under, right? Enormous damage to AIG towards the attempt at a soft landing, which to me, in and of itself, shows the very weakness of AIG and why we can't continue to try to effectuate a soft landing because you have said that market conditions are going to dictate over the next year or two as to how soft that landing will be.

It will also require a whole bunch more of Federal money, I would think, in that 1 to 2 years until the market "corrects" because I think what you have done—not you specifically, but you generally, both you and the government, is you mistake why the public has no confidence right now in the economy. We think that if consumers just woke up and decided that we are seeing signs of light, that potentially I could go out and spend some of my hard-earned nest egg, that we would stimulate consumer demand and everything would be fine.

But the reason that we are having this discussion today is Americans believe that we have seen institutional failures, both in our economic sphere and right now in the government sphere, because of a failure to be good stewards of their money. And until that institutional confidence is restored in the minds of the American people, there will be no recovery in the next 1 to 2 years.

If we continue down the path that institutions that were once deemed too big to fail continue to prove too big to fix and cost taxpayers billions of dollars at a time when they are struggling to keep their homes, their jobs, and their hopes for their children, they will have no institutional confidence in anything and we will continue on the path that we are on.

So my question to you is, if we can recover, hypothetically, within the next 1- to 2-year timeframe that you talk about, how much would it potentially cost the taxpayers to keep injecting into AIG during the next 1 to 2 years to have that soft landing because as

we found out on March 2nd, I think AIG reported the largest quarterly lost in corporate history, what $61.7 billion, and then promptly received an offer of $30 billion, which you have not drawn upon. If we continue on the path we are on for the next 1 to 2 years, how much money are the taxpayers going to be asked to continue to put into AIG?

Mr. LIDDY. Let me see if I can respond to your question, sir. As I mentioned earlier, we have roughly $80 billion invested from the taxpayer through Treasury and the Federal Reserve into AIG with a call on another $30 billion if we need it. The comment about soft landing really applies to the book of business at AIG FP, its own little—not so little—unique world of derivatives trading and hedges, etc., etc. And to a certain extent, it works, I'm going to say independently, of what is going on in the capital markets. That is a simplification. It's clearly aligned to them, but it works differently.

The comment about the markets having to help us is we have good businesses to sell, really good businesses to sell, but people have no money to buy them, so the price mechanism is that which equates. So we have a great business in Southeast Asia, but there is no—the companies that want to buy that business don't have equity. Their equities are down 70 percent. They don't have access to the capital markets, to liquidity markets. So as a result of that, the values are depressed. What we don't want to do is sell good assets at fire sale prices and then not have enough proceeds to be able to repay the Federal Reserve and the Treasury.

I do not anticipate asking the Federal Government for more money. I would like it very much if we didn't have to draw on the $30 billion and I would like to give you a guarantee that is exactly what will happen. I can't do that because my crystal ball is not that good and I do not know what is going to happen with the value of assets.

You are 100 percent correct, we reported a very large loss, the largest in corporate history in the fourth quarter, and three things drove it. When the value of assets goes down, we have to write those assets down and we have to recognize that loss in our P&L. That is $30 billion of that $60 billion.

Because we are restructuring the company, we write off things like deferred tax assets because we think they are valueless. It wasn't a cash loss. It was a loss that had to do with the restructuring of the company. I don't believe that it will occur again. I certainly hope not, but it will very much be dependent upon what happens to the value of assets going forward.

Mr. MCCOTTER. Forgive the indulgence, Mr. Chairman.

If the loss was as you say, and I'm not disputing that, why did Treasury then make available another $30 billion, which you have not drawn down upon?

Mr. LIDDY. When you lose that money, it reduces the equity that the company has. Think of a home; you need so much equity to support the debt. We have all the debt, but the equity shrunk because of the loss. So as a result of that, the Treasury restructured the TARP arrangement, the original TARP arrangement, in such a way that accounted for more equity and made the $30 billion available to us if we needed it. That kept the rating agencies calm so

they don't downgrade the company and we don't get into an extraordinarily negative spiral.

Chairman KANJORSKI. Ms. Moore of Wisconsin.

Ms. MOORE OF WISCONSIN. Thank you so much, Mr. Kanjorski, and thank you again, Mr. Liddy, for your service.

I think the public generally understands the bonus structure, and are we calling them the correct thing? Were these bonuses that the Financial Product Services division were getting?

Mr. LIDDY. They were retention payments, yes, commonly referred to as bonuses.

Ms. MOORE OF WISCONSIN. Okay. Good. Okay. Because here is what we don't understand. I guess I think we understand that bonuses are for good performance. And earlier we had the Office of Thrift Supervision in here, Mr. Polakoff, and he testified that as early as December 2005, the Financial Products group, on their general observation, knew that the underwriting standards for mortgage-backed securities were declining, that by March of 2006, that the Office of Thrift Supervision was talking to the AIG board about this weakness and certainly by June 2007, they had taken supervisory action against them.

So I am trying to get a timeline of when these bonuses were put in place in these contracts because I did read your letter, the very difficult situation that you feel that you are in having to honor these contracts. What I understand a contract to be is kind of a meeting of the minds. I mean, I offer my employees a bonus because they are going to produce a good result, but clearly, it seems to me, if I have the timeline right, that it was—according to your letter, it was the first quarter of 2008 when you put these bonuses in place.

And so I guess what I would like for you to help me to understand is how you knew that this particular division of AIG was failing, that you would offer bonuses as a sort of a perverse thing in terms of what we all understand?

Mr. LIDDY. Congresswoman, I was not there.

Ms. MOORE OF WISCONSIN. Okay.

Mr. LIDDY. I just wasn't there. So it is very hard for me to answer except with broad conjectures.

Ms. MOORE OF WISCONSIN. I mean, I guess you might agree that it is sort of weird.

Mr. LIDDY. Well, I listened to the previous testimony and I agree with it.

Ms. MOORE OF WISCONSIN. Okay.

Mr. LIDDY. There were some—

Ms. MOORE OF WISCONSIN. Let me ask another question before I get gaveled down. Do you know how other divisions fared—okay. The fiscal year for AIG is January 1st to December 31st?

Mr. LIDDY. Correct.

Ms. MOORE OF WISCONSIN. So the first quarter of 2008, March, is that sort of an awkward time to offer bonuses? I mean, wouldn't bonuses come like at the last quarter when you get the report and find out that everybody has done wonderfully? Was March a sort of an off-schedule time to offer a bonus?

Mr. LIDDY. Not necessarily. Remember, these were not performance related bonuses. They were arrangements that said if you stay

in your job and do something specific, wind down a book of business, we will pay you a certain amount of money. So they were really retention arrangements. And while they were signed in March of 2008, the process of deciding should they be offered and negotiating them and crafting them would have begun 6 months before that.

Ms. MOORE OF WISCONSIN. Okay. Let me ask you this, and perhaps you won't know this, sir. Do you know how the other divisions of AIG fared? I mean, I guess some people just worked in the wrong division. I mean, the healthy parts of AIG, how they fared in the bonus area?

Mr. LIDDY. 2006 was a—I'm going to answer generally because I just don't—

Ms. MOORE OF WISCONSIN. Yes, sir. I understand, sir.

Mr. LIDDY. 2006 was a very, very strong year for AIG, which means all of the businesses, including FP, would have performed well. 2007 was not because towards the end of 2007 was when AIG began to write the value of those credit default swaps down. But the other businesses within AIG, the commercial insurance and the life insurance and the aircraft leasing, they would have had good years.

Ms. MOORE OF WISCONSIN. So sir, let me ask you a question while I still have some time. You know, in your letter, you talked about your legal department talking about how very difficult it would be not to honor these contracts, but again, you know, our commonsense, and I'm not an attorney, but our commonsense understanding of a contract is that it is kind of a meeting of the minds. You know, it is a deal that is made in good faith that all things are put together.

And knowing that there was tremendous—trillions of dollars of exposure, not necessarily to the public at that point because we hadn't taken over, but to the company and to its health, could it—might it just, theoretically, be argued that this sort of ethic, you know, negates a contract when in fact it wasn't necessarily executed with the great expectation that there would be a positive outcome given just the ordinary commonsense notion of what bonuses are for?

Mr. LIDDY. I'm only speculating on the answer because I simply was not there. I don't think anybody—as the gentleman on the panel before me testified, I don't think anybody expected that we would have two things: Incredible meltdown in the value of residential real estate in this country; and the liquidity risk or the liquidity crisis that it unleashed. Both of those happened in roughly the second and third quarters of 2008. But back at the end of 2007 when these contracts were being fashioned, I believe there was a belief that this was a viable ongoing business. AIG wanted those people in place to drive that business forward.

Ms. MOORE OF WISCONSIN. Well, my time has expired. I just want to simply make a comment, Mr. Chairman, that, you know, as best as I could reconstruct the timeline, the Financial Products group knew that they were in decline as early as 2005. So they knew at a minimum that $165 million worth of bonuses, perhaps, were not warranted. And with that, I yield back.

Chairman KANJORSKI. Thank you.

The gentlelady from Minnesota.

Mrs. BACHMANN. Mr. Chairman, thank you, and I appreciate as well, Mr. Liddy, your willingness to be here today and the candor with which you are answering the questions. I appreciate that, and I, too, would like to submit written questions and I would appreciate having written responses.

But I will start. I took some notes during some of your earlier testimony. I was wondering, you had said that you expect AIG's FP business will be wound down. Do you know when you expect that to be? I know you said you don't have a crystal ball, you don't know, but just on the basis of your history and what your expectations are, when do you believe that FP business will wind down?

Mr. LIDDY. Warren Buffett had a business very similar to this, except it was about a third the size. It took him 4 years to wind it down and he did it in a better economic environment. I just put that out there because sometimes other people's experience is a good indication of what it is going to take us.

I think you will see tremendous progress winding it down. Much as we did at the end of 2008, you will see tremendous progress at the end of the first quarter 2010 because many of those regulatory trades go away. But it is difficult because you have—some of these contracts go out 50 years. Can you imagine debating what the cost of oil is going to be out 50 years from now? So it requires a delicate balance of you and I negotiating whether we want to settle that contract.

This business will get a lot smaller at the end of 2009, and a whole lot smaller at the end of 2010. And as it gets smaller, it just represents much less risk. But I think it is instructive if it took Warren Buffett, who is an investor of some agility and some acumen, if it took him 3 or 4 years to wind down a book of business that had many of the similarities, but was a third the size.

Mrs. BACHMANN. So Mr. Liddy, what would you say then? What would be your guesstimate? We are not holding you to it.

Mr. LIDDY. Four years—

Mrs. BACHMANN. Oh, you think you could do it within 4 years?

Mr. LIDDY. —before it is entirely gone. I do. I think it will be that.

Mrs. BACHMANN. Do you think that once the business has gone through this transition, that you will retain the name AIG?

Mr. LIDDY. No, I do not. I think the AIG name is so thoroughly wounded and disgraced that we are probably going to have to change it and in fact, as we think about our property casualty business in the United States, which did travel on the AIG name, we have already begun the rebranding process to AIU and on the life side, many of those businesses already have different names. So where there may have been an approach to use one single name like AIG, we are reversing that and going back to some other individual brand names.

Mrs. BACHMANN. Thank you. Do you believe that AIG has underlying assets sufficient to pay back the taxpayer? You had said that you didn't want to sell them at fire sale prices. That was part of your concern. Is it your belief, sir, that you have collateralization sufficient that the taxpayer will be paid back and made whole?

Mr. LIDDY. Yes. It is our belief. It is a belief of our financial advisors. It is difficult for me to speak for the Federal Reserve, but I think it is their belief, and they have a set of financial advisors, and it is their belief. The thing I cannot control is when does the market get better and when do people begin to want to invest in business.

Mrs. BACHMANN. Mr. Liddy, if you did, you would be worth more than a dollar a year.

Mr. LIDDY. I would be.

Mrs. BACHMANN. Thank you, sir. I just want to go back to some of your first comments in your opening statement. You had said, and I realize this is a long time, but you said the Federal Reserve knew about the bonuses and acquiesced to them in a meeting that I believe you had in mid-November? Is that correct?

Mr. LIDDY. Actually, I think my words were we began this process of debating what we should do with these in November. We didn't come to a final conclusion until, oh, the early part of March, at a board meeting at which the Federal Reserve was present.

Mrs. BACHMANN. Okay. And then Mr. Kanjorski had asked the question, why didn't the committee know? And I believe that your response was that AIG had met with staff from the committee. Was that true?

Mr. LIDDY. Yes, it was. I'm told that we have provided a great deal of information to the committee and to various members of the committee. I can't sit here and tell you exactly what it was or whether we previewed these bonuses or not, but we have tried to be very responsive to the inundation of requests that we have had.

Mrs. BACHMANN. And when was that? Was that beginning in mid-November or when was that?

Mr. LIDDY. Oh, that would have—you mean specifically on the bonuses?

Mrs. BACHMANN. Yes.

Mr. LIDDY. I'm hazarding a guess. I don't have the command of those facts at my fingertips. I would guess that would have been starting in December.

Mrs. BACHMANN. Starting in December. Is it possible to get a list of which Members of Congress' staff knew about this and when?

Mr. LIDDY. We will provide you information of what we provided to whom and when we provided it.

Mrs. BACHMANN. Okay. Thank you. How about anyone in the Administration? I believe you had been asked that question as well. Any members of the Administration who knew about the bonuses and conversations about the bonuses?

Mr. LIDDY. As I mentioned earlier, the conversation I had was with Secretary Geithner approximately a week ago, two conversations on a Tuesday and Friday or Wednesday and Friday, and he called to my attention that the first time he had heard anything about it was approximately a week before those conversations.

Mrs. BACHMANN. And so no conversations with the transition team or with anyone else in the Administration other than Secretary Geithner.

Mr. LIDDY. Not to my recollection. It is possible that there were communications between staff, but I just don't know that.

Mrs. BACHMANN. To your knowledge, did any Members of Congress know anything about these bonuses?

Mr. LIDDY. The obligation to pay the bonuses, I think probably several people did. They have been in our various financial documents, our 10–Ks and our 8–Ks and our 10–Qs. And to the extent that we have provided that information to congressional staff, I would presume the answer is yes.

Mrs. BACHMANN. Could you be responsive about which Members of Congress knew about these bonuses?

Mr. LIDDY. We will provide you the information. I can't as I sit here, no. I just don't know.

Mrs. BACHMANN. But you will be able to—

Mr. LIDDY. Yes.

Mrs. BACHMANN. —let me know which Members of Congress knew and when they knew—

Mr. LIDDY. Sure.

Mrs. BACHMANN. —about the bonuses. Both Members of the House and Members of the Senate.

Mr. LIDDY. Sure.

Mrs. BACHMANN. Thank you, Mr. Liddy. I had a few other questions as well. One is, it was just about exactly a year ago, just over a year, when the United States—when the Federal Reserve opened the discount window for the first time to Bear Stearns.

Mr. LIDDY. Right.

Mrs. BACHMANN. We just celebrated that anniversary. And I wonder had we—had the Federal Reserve chosen not to open that discount window and had Bear Stearns failed as a result of that, do you think that would have served as an example to AIG to stop with the risky bets that were going on?

Mr. LIDDY. It is hard to speculate, but I think the aggressive behavior of AIG started really 2 or 3 or 4 years before that. So I think by then, it probably wouldn't have.

Mrs. BACHMANN. That is what your testimony indicated.

Mr. LIDDY. I think by then it would have been too late.

Mrs. BACHMANN. Do you think had AIG, had the managers involved in that fund, had they seen that, do you think that would have altered their perspective?

Mr. LIDDY. I don't think so. Not in the timeframe that you have indicated. By the time you have—remember, it was at the end of 2005 that AIG, the first quarter of 2006, that AIG stopped writing any credit default swaps whatsoever because they saw some risk in the housing market. But once you have written that contract, you are exposed to it. Now there may be things they could have done to hedge it differently, to try to offload the risk, and some of that was done. We just had too much of it.

Mrs. BACHMANN. Mr. Chairman, I think I will be submitting the rest of these questions to Mr. Liddy in writing. I just want to end with the Federal Government did approve, prod, enable AIG in a lot of ways to ensure these risky bets. And what I'm wondering is, why didn't AIG have the institutional fortitude to say no to Uncle Sam?

Mr. LIDDY. I think you have to ask to come before you the people who constructed these risky businesses at AIG FP and the prede-

cessors, my predecessors, who ran this company before I was here 6 months ago and ask them that question.

Mrs. BACHMANN. Thank you.

And I yield back, Mr. Chairman.

Chairman KANJORSKI. Thank you.

Mr. Donnelly.

Mr. DONNELLY. Thank you, Mr. Chairman, and Mr. Liddy. You were handed a mud pie and the thanks of your government and one dollar a year for doing this. So we appreciate your efforts.

In terms of credit default swaps, how much have they cost AIG at this point approximately?

Mr. LIDDY. $50 billion.

Mr. DONNELLY. $50 billion. How much of that was the naked credit default swaps, would you say?

Mr. LIDDY. How much of it was what?

Mr. DONNELLY. The naked credit default swaps where there wasn't even anything to them, other than just a gamble.

Mr. LIDDY. I don't recall what the split of that would be.

Mr. DONNELLY. Does that product seem to be—you know, I mentioned earlier today that back home, a naked credit default swap is called gambling. And this seems to be very much the same exact thing and back home if we do that, we go to jail. And it seems that Wall Street dreamed this up to create additional profits and if we dreamed it up back in Indiana, we would be on the other side of the sheriff's department.

Mr. LIDDY. Congressman, I just do not recall exactly what the split was of traditional credit default swaps versus what you are referring to as naked ones. I would be delighted to have another conversation with you. I just don't—

Mr. DONNELLY. You don't have to do that, but one of the things that struck me when you came in, you said, your job is to try to pay back everybody who money is owed to with AIG, and I understand that. It is incredibly distasteful, especially with the naked credit default swaps, where these were nothing more than gambling. And when the casino closes down or goes bust, usually all the guys who are gambling close down shop and head for the next bookie they can find.

And it is very, very unfortunate that taxpayers from Indiana and other places had to pay hedge funds who had gambled on the American housing market going even lower. It is almost as if they bet against their own country, these people.

Mr. LIDDY. Congressman, if you would. I understand your point. I don't know that we wrote any contracts to hedge funds. We would have written a contract through—to a counterparty and that counterparty could have done—we don't have visibility as to what they did.

Mr. DONNELLY. The reason I mentioned that is today's Wall Street Journal mentions hedge funds who work through Goldman Sachs to AIG for these kind of contracts.

The derivatives that are left, how much do you think at the end of the day? It is about $1.6 trillion?

Mr. LIDDY. Correct.

Mr. DONNELLY. Where do you think we will wind up? Close to even on those?

Mr. LIDDY. That certainly would be our goal. As I mentioned earlier, I think we probably have a couple billion dollars left to put into FP so that they can settle that $1.6 trillion in trades. It is hard to tell exactly what the size of the number is, but some of those trades are good trades. Some of those trades are not good trades, and netting them out, of course, is the art or science of it.

Mr. DONNELLY. Sure. And the other divisions, are they holding their own at this point? Are they at least staying even?

Mr. LIDDY. They are. The insurance operations of AIG are rock solid from a policyholder standpoint. The AIG name has tarnished those businesses. As I said earlier, we are trying very hard to make sure those businesses stay strong and aren't contaminated to any great extent. So we are changing names. We are isolating those businesses. We are going to take pieces of them public in order to protect them.

Mr. DONNELLY. In terms of—not in today's market, but in a regular market, would they still command premium prices, those other divisions?

Mr. LIDDY. Those are good businesses, sir. I mean, we are a leader in the property casualty world, we are one of the largest insurance companies in the United States and one of the largest in the world, so they would, in a normal world where you can actually sell things, they would be very prized assets.

Mr. DONNELLY. The commitment we like to make to the American people, and I know you would, too, is that all the waitresses and truck drivers whose paychecks are dinged a couple of pennies or a buck every week to keep this going, we want to try and make this whole so that at the end of the day AIG is—it comes out and we can say, well, we may not have made a buck, but we didn't lose a buck. That is the goal and I am sure that is yours, too.

Mr. LIDDY. Congressman, you and I are in violent agreement. That is my ambition as I said in my opening statement. We have two things we want to do: We want to pay back the American taxpayer every dollar that has been invested in us; but second, we need a victory in this country. We need a confidence building victory. It is important that President Obama's Administration be successful.

We would like to serve that up just as quickly as we can, but the markets are not very cooperative, so we have come up with other structures. When you owe people money, you can pay them in cash, you can pay them in diamonds, you can pay them in gold, you can pay them in anything that is worthwhile. It is the anything that is worthwhile that we are moving towards.

Mr. DONNELLY. Well, you just try to run them well and chip away a little at a time until the markets do turn, I guess would be the other thing.

Mr. LIDDY. The only way I know to solve a problem is take a big problem and break it down into small pieces and just keep knocking them off, and after awhile you look backwards and you have really come a long way.

Mr. DONNELLY. And obviously, on the bonuses, it does rub people—or the retention bonuses—it does rub people wrong and anything you can do to help on that front certainly makes everyone in this country feel a lot better.

Thank you, sir. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you. The gentlelady from California.

Ms. SPEIER. Thank you, Mr. Chairman. Mr. Liddy, you are in many respects the knight on the white horse, and that is not a reference to the color of your hair.

Mr. LIDDY. Sometimes it doesn't feel like a good place to be either.

Ms. SPEIER. I would like to give you some unsolicited advice. The American people and the Congress are at their wit's end relative to funding AIG and if you do us the favor of communicating directly with the chairman of this subcommittee and the chairman of this full committee in addition to the Chairman of the Fed, we will be in much better stead moving forward on any of the issues that will continue, I think, to be challenges for you and for the Congress.

You referenced just a few moments ago that you were a leader in insurance and that it is a solid market and that those divisions are doing very well. I believe that they are doing very well in part because they have been regulated by the States for all these years. Would you agree with me?

Mr. LIDDY. Yes. I would say State regulation didn't cause AIG's difficulties.

Ms. SPEIER. No. But State regulation may, in fact, have saved what is left of AIG in terms of the insurance components, correct?

Mr. LIDDY. State regulation has worked well.

Ms. SPEIER. So this whole idea of a optional national charter may be, in fact, be a very flawed idea?

Mr. LIDDY. Oops, let me see if I can explain my point of view. The State regulatory system has worked well, but the insurance products have gotten so complicated and the rapid rate with which capital moves around the globe now may just be surpassing the State regulators' ability to stay current on everything.

Ms. SPEIER. Wait a minute. Time out. Time out. With all due respect, the OTS was in a position to regulate you and didn't know what a credit default swap was and, in fact, said they are so complex that the risk was not properly addressed because of the complexity. So complexity is not something that is going to ring well for any of us moving forward because if you can't understand it, how can you really assess what the risk is?

Mr. LIDDY. No. I agree with that, and therefore, where I was going was, I think there needs to be some overarching systemic risk regulator. When you have these large $100 billion companies that are so complex and interrelated, it defies the regulatory scheme that is currently in place and there has to be something that comes along that can really guide and review the interaction of those companies. I think that was missing in this case.

Ms. SPEIER. All right. How much of the $30 billion that is now at your disposal do you expect to use?

Mr. LIDDY. I hope none. It is there for a reason. If we need it, it is there for us to help accomplish certain things that will enable us to effect a plan to pay back the taxpayer. It will be difficult to say until we see what happens in the marketplace in general.

Ms. SPEIER. The $1.6 trillion that has to be unwound is probably the toughest credit default swaps left. Is that a safe assumption?

Mr. LIDDY. No. Most of the credit default swaps are gone. We have—I know people aren't interested in hearing success stories—

Ms. SPEIER. No. We are, please.

Mr. LIDDY. The original arrangement that the Fed and the Treasury put in place for AIG worked. We did not go bankrupt and we walled off the securities lending and the credit default swap issues. They are gone. So what is left in AIG FP is really just—I am going to use the term "traditional" book of derivatives contracts, although it is hard to use traditional and derivatives in the same sentence.

Ms. SPEIER. So what is left are derivative contracts. Are they going to be more difficult to unwind because they are still there?

Mr. LIDDY. Yes. And some of them, as I said earlier, are very long so it is you and I entering into a contract; you want to hedge against an interest rate increase, so I offer you a derivative that does that. Well, you may not want to give up on that hedge, and if that is a 20-year hedge you may not want to give up on that, so it is an interesting dynamic of give-and-take to try to resolve these hedges. If we get that book of business small enough it is entirely possible that we can sell it or we can have somebody else run it off, run the balance of it off for us.

Ms. SPEIER. In 2008, were there any performance bonuses offered to employees in the insurance silos within AIG?

Mr. LIDDY. Performance bonuses, yes, there were.

Ms. SPEIER. And how much were they?

Mr. LIDDY. I just don't have that number.

Ms. SPEIER. Okay. Would you make that available to the committee? How much, how many people, what amounts. And let me give you some more unsolicited advice. Right now, AIG is owned by the taxpayers of this country. Until the $70 billion is returned nobody, in my view, should be getting retention bonuses or performance bonuses until that money is paid back. I yield back.

Chairman KANJORKSI. The gentleman from Ohio, Mr. Wilson.

Mr. WILSON. Thank you, Mr. Chairman. Mr. Liddy, thank you for coming today. I don't envy your position but thank you for serving in the capacity that you are. I—like all my friends—am outraged about what has happened with AIG. Back in Ohio where I represent, that is a magic word or acronym, if you will, AIG; and everybody just—it is sad. I just can't understand how people can be so arrogant and impractical about thinking that they can dole out bonuses to people who have literally run the company in the ground and then also contributed to the country being run into the ground.

And, please, when I hear about contracts that were in place and the people needed to have their contracts, I represent an area in Ohio where General Motors has had to break their contracts, not necessarily because of anything that they have done, but what the result has been is how can we ask working families to break their contracts and yet support the contracts like AIG have done. I just don't think it is fair.

That being said, I would like you to explain why the pay structure at your company is like it is. It is my understanding that most

Wall Street folks use the compensation approach and the bonuses are where they make the majority of their money. That kind of a package is certainly something that seems to be applied pretty basically. So salaries are kept relatively low and then the bonus comes at the end of the period, whether it is a performance bonus or whether it is a retention bonus or whatever kind of bonus is it.

Is this the way it works at AIG?

Mr. LIDDY. No, sir. We are a Wall Street firm only by geography. You know, that is a term that generally applies to investment banks and commercial banks. We are an insurance company with this difficult hedge fund attached to it, so we tend to have an entirely different pay structure than that which you just described where you have across the company, excluding AIG FP, you tend to have a little bit higher base salaries, not that much in an annual bonus, and then most of the upside comes in the performance of the stock, which, of course, has been wiped out. The AIG FP structure would be more similar to what you described.

Mr. WILSON. I see. Yesterday, I read in the Wall Street Journal an article that companies are anticipating congressional action and are trying to go around this by proposing significant pay increases as a way of getting around the security of bonuses. Have you heard anything of that nature?

Mr. LIDDY. I have not.

Mr. WILSON. Okay. That is why today I introduced a bill that is going to be called the TARP Wage Accountability Act, and basically what it is for is to prohibit companies from going around by switching it back to salary and taking away, or lowering the bonus, or minimizing it. We are hoping that it will be one of the things that will make salary increases to be something that would be along the lines of 3.9 percent, which is what is given to the government employees and soldiers of our country, and it just seems like if it is good enough for them, it should be good enough for the companies that have contributed to the problems that we are suffering right now.

Mr. LIDDY. And Mr. Wilson, for the top executives, the top 70 or 75 executives at AIG, no salary increases for 2009. For the top seven or eight people at AIG, including me, no bonuses whatsoever. So we clearly understand and agree with the spirit of what you said.

Mr. WILSON. Good. I know that the outrage this week has been focused on the bonuses and rightfully so, but I worry about what is going to be the next shoe to drop. Will it be the additional $30 billion? Will it be the flipping of compensation structures, in other words, going back to salary and minimizing bonuses? I think it is all about trust and it is all about what has happened over the last several months; very, very difficult situation.

I just want to make sure that the taxpayer money does not go for outrageous raises and so many times, Mr. Liddy, this is the kind of thing that happens in a classic case where a bank has failed or a business has failed, the people who ride out with their golden parachutes are out with their golden parachutes, and thank goodness there is someone like yourself who will come in and try to put the pieces back together. It just seems terribly unfair and I know, as a representative of the taxpayers, that we just feel that

it is something that is very, very unfair to the people in our country.

And one of the things that I heard you say earlier is that one of the reasons that happened here was the appetite for risk, but yet I never heard the word greed, and it just seems like that seemed to be what had to be driving what was going on with some of the appetite for risk that was going forward. I need to be able to wake up in the morning and feel sure that at least we are trying to point out the problems that have happened and I would like to hear more common sense as to what we are going to do in the future. Thank you.

Mr. LIDDY. Thank you, sir.

Chairman KANJORSKI. Thank you very much, Mr. Wilson. Let us hear from the gentleman from Florida, Mr. Grayson. I am sorry, Mr. Grayson, we have another gentleman from Florida, Mr. Klein.

Mr. KLEIN. Thank you. We try to all be gentlemen from Florida, but thank you. Thank you, Mr. Chairman. Mr. Liddy, it is been a long day and we understand that and you have been through a lot of questions. I understand your comments earlier today and also appreciate the fact that you came back from retirement to work on this. You have heard a lot of frustration today. You have heard a lot of concern. We heard your explanation about the reason why the bonuses were provided in terms of retention. We heard about contractual rights. I thought Mr. Kanjorski, earlier today, made an excellent observation.

I am a lawyer by background and I also represent a number of people who many times insurance companies first say no before they settle claims or settle issues and this seems to be one of those times when, you know, with legal advice, I understand, your folks seem to tell you that the better way to proceed on this was to give the bonuses and not have to deal with that. But I think in retrospect I think we all understand now this has created a huge backlash of concern, and it is not so much about AIG—it is about AIG—but it seems to be that the public has just allowed this to accumulate in their minds about what has gone wrong in our system.

And, you know, I know that the comment you made about retention, I guess one of my local newspapers this morning wrote an editorial about this—and this is the newspaper, the Sun Sentinel in south Florida, and it said, "If not for the Federal bailout of AIG, the company would have gone bankrupt. Then the contracts calling for the bonuses would have been nullified and the executives who wrecked the company would have lost their jobs."

And I guess the point of that is that even if there were some type of performance bonuses—and I don't know all the terms of how these were, whether they were discretionary or otherwise—but for the Federal Government and all of us as taxpayers, the American people having stepped up, there wouldn't be a company to pay the bonuses. So I guess the notion, and I guess where I still haven't really got the answer, and maybe you can just address this for us, is understanding that principle.

You know, why is it that you and your colleagues felt like this was necessary? It didn't feel like it was—whether it was a legal, or equitable, or moral, or ethical right to say, you know, companies that make money pay dividends, companies that make money pay

bonuses. That is the American way. We all support free enterprise. As shareholders, we support that to a point. But a company that is not making money as a whole doesn't pay bonuses. And if you could just share with me, at least, the moral/ethical side of this thing as well.

Mr. LIDDY. Sure. We have talked about that during the course of the afternoon. These are not performance-based bonuses in the way you are using that word. They are retention bonuses. We want to wind down the FP business just as quickly as we can so we don't expose the company and the American taxpayer to anymore risk than we have right now.

So the judgment we made was with $1.6 trillion in a derivatives book out there we need these people to keep making progress to shut it down. We made real progress in 2008. So this was more about risk. What I clearly do not want to have happen is I don't want to have this company fail after all that the American public has gone through with AIG. The judgment we made was we stood a better chance by paying these bonuses, $165 million, a large amount of money, we stood a better chance of protecting the business that has $1.6 trillion of exposure.

And it gave us a better opportunity to wind that down in an orderly way and not have it erupt on us in some sort of disorderly way. The legal argument was the secondary argument. The primary argument, or thought process, was weighing the risk of a disorderly breakdown in that business against keeping those people in place at the cost of $165 million.

Mr. KLEIN. And I appreciate the thinking. But at the same time the average American, trying to apply a common-sense standard here, would say, well, first of all, some of these people left anyway. Secondly, are these really the kind of people that you would—because some of them made mistakes along the way in creating some of these things, and I recognize that not everybody's in that basket.

And also what about the notion of we are all Americans here? This is a serious situation we are in in our economy. Isn't there any commitment to our country to stick with it and fix this thing as opposed to, if I don't get my million dollar bonus I am not staying here? I mean, where is this notion that these are Americans and we are all in this together that I think most American taxpayers feel? Don't some of these people have that same commitment?

Mr. LIDDY. They do, sir, and I think they have been so vilified over the last couple of years that really many of them just want to go someplace else and work. What we said is, we understand that. Please, stick with us until your area of responsibility is wound down in a responsible way. We will pay you a retention bonus to do that and then you can go someplace else. So I would not conclude from their apparent or perceived behavior that they aren't Americans very interested in having this country get out of the mess that we are in.

Mr. KLEIN. Thank you, Mr. Chairman.

Chairman KANJORKSI. Thank you very much, Mr. Klein. Next we will hear from the gentleman from Florida, this time, Mr. Grayson.

Mr. GRAYSON. Still a gentleman, huh? Thank you, Mr. Chairman. Mr. Liddy, I took a look at the 10–K that you filed about 2 weeks

ago with the Securities and Exchange Commission. Are you generally familiar with the AIG 10–K?

Mr. LIDDY. Yes.

Mr. GRAYSON. Thanks. We copied some pages for you. Do you have it in front of you?

Mr. LIDDY. I do. Someone handed it to me.

Mr. GRAYSON. All right. I want to ask you some questions. Let's start with page 153. This is a chart of shareholder equity, and it says the changes in AIG's consolidated shareholder equity from the beginning of 2008 to the end of 2008 were as follows: Beginning of the year the shareholder equity was roughly $96 billion. You had $99 billion in losses realized in 2008. And somehow you ended up with a shareholders' equity of $53 billion. Certainly 96 minus 99 means that without anything else happening you would have ended up $3 billion in the hole. Is that correct?

Mr. LIDDY. Yes.

Mr. GRAYSON. All right. Now, I see two large entries here. I was hoping you would explain them. One is excess of proceeds over par value of preferred stock issued. This is $40 billion and it was recorded on your books as an increase in the shareholders' equity. Can you explain who provided the preferred stock that you recorded on your books as a $40 billion increase in shareholders' equity?

Mr. LIDDY. I believe that is the TARP money that was provided to us.

Mr. GRAYSON. So you recorded the TARP money in your books as essentially equivalent to profit, correct?

Mr. LIDDY. No. It is reported as equity, not as profit.

Mr. GRAYSON. As equity?

Mr. LIDDY. Right, this is an equity statement.

Mr. GRAYSON. All right. And equity is something that you get without any legal liability except to the same liability you would have to any shareholder. Is that correct?

Mr. LIDDY. No, sir. I think it comes with a pretty heavy liability. You have the liability of making whatever the dividend payment rate is that you have to make on it. And in our case there is an expectation that at some point in time that money will be repaid.

Mr. GRAYSON. Well, it is interesting that you say that because there is another line here that says $23 billion, and without that line then your company would have been close to being in the red even by this accounting method. Without this you would have been in the red. It says, consideration received for preferred stock not yet issued.

Mr. LIDDY. It is the loan from the Federal Reserve. At the time this was prepared we had not yet issued, or maybe this was the 10–Q or the 10–K with which we actually issued the 79.9 percent ownership that the Federal Reserve has of AIG.

Mr. GRAYSON. So essentially what this means is that the taxpayers gave you $23 billion and before you even gave the preferred stock to the taxpayers in return, you counted that as increase in shareholders' equity for AIG. Is that correct?

Mr. LIDDY. Yes. It was in anticipation of giving that preferred stock.

Mr. GRAYSON. All right. Let's turn two more pages to page 179. This is one that says, "The following table provides estimates of AIG's sensitivity to a yield curve upward shift, equity losses, and foreign currency; exchange rate losses at December 31, 2008." And you see the entry that says, yield curve 500,000?

Mr. LIDDY. Yes.

Mr. GRAYSON. Now that 500,000 actually corresponds to $500 billion. Is that correct?

Mr. LIDDY. I believe so, yes.

Mr. GRAYSON. All right. So what this is telling us, this stress test analysis, is that if the yield curve, which is simply the difference between long term rates and short term rates, increased by 100 basis points, which is 1 percent, then you are telling us that AIG would be on the hook for half-a-trillion dollars. Is that correct?

Mr. LIDDY. I am not sure. I am looking to see whether those are billions of dollars or hundreds of millions of dollars and I don't see the designation in front me, sir.

Mr. GRAYSON. Well, look above the words "yield curve" where it says "dollars in millions." Do you see that?

Mr. LIDDY. Yes, I do.

Mr. GRAYSON. Okay. What is $500,000 million?

Mr. LIDDY. Yes.

Mr. GRAYSON. Okay. So is it correct, then, that according to your own 10–K, that if the yield curve changed 1 percent, if long-term rates went 1 percent higher and short-term rates stayed the same, then you would be on the hook for half-a-trillion dollars?

Mr. LIDDY. Well, you would have the offsetting effect of the impact on the liabilities.

Mr. GRAYSON. Well, why isn't that reflected here in the stress test?

Mr. LIDDY. You know, I can only assume that stress tests are put together according to a very specific formula so that they can be compared from one institution to the next.

Mr. GRAYSON. Well, that sounds like an awful lot of stress for the taxpayers if they are on the hook, doesn't it?

Mr. LIDDY. And to that exact point is why we wanted to make certain that the AIG FP business gets wound down in an orderly way.

Mr. GRAYSON. Let's take a look at the next page because time is short. If there were an earthquake in San Francisco, then according to your table on page 184, that would cost AIG $8.6 billion. But if interest rates increased 1 percent, that would cost AIG $500 billion. Correct?

Mr. LIDDY. Well, as I said, on the second of those pages that you called out, there is an offset on the liability side. On the page on the insurance, the cost of insurance, it would be $4,966,000,000 after reinsurance if there was an earthquake along the lines of what occurred in the early 1900's.

Mr. GRAYSON. Well, what exactly was AIG insuring? The entire U.S. economy?

Mr. LIDDY. I don't know, sir. That has been my point, that we are a very good insurance company with an internal hedge fund attached to it. We need to wind down that internal hedge fund quick-

ly and efficiently so it doesn't cause the taxpayers even more distress.

Mr. GRAYSON. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. Grayson. We will hear from Mr. Peters of Michigan.

Mr. PETERS. Thank you, Mr. Chairman.

Thank you, Mr. Liddy. I know it has been a long day, and luckily I am one of the more junior members here, or probably the most junior member, so your day is about over. I know it has been a long day, and I want to join some of my colleagues in saying that I know you have come into the situation late and are faced with a very difficult task.

I missed some of the most recent testimony. I was just at a press conference for a bill that is going to be on the Floor tomorrow in which I have worked with leadership to place a 90 percent tax on bonuses for those individuals working with companies with sales—or have received over $5 billion in TARP money.

But I want to ask a couple of questions related to the business as a whole. Now, most of the losses from your company, from AIG, have come from the Financial Products unit. Let me wrap my head around this a little bit.

How much money was actually lost by the Financial Products unit in this last year?

Mr. LIDDY. If you will permit me, I think we have a schedule that we submitted for this hearing. Of the money that has come in to us, $52 billion has gone out to support Financial Products. That might be a better way to—

Mr. PETERS. Is that the money from the Federal Government?

Mr. LIDDY. Yes.

Mr. PETERS. How much was lost? Just how much was lost? Because you took a hit on your—how much was the total loss that the Financial Products unit has actually had?

Mr. LIDDY. It would be in the range of $30 billion. I am sorry, I just don't have that number tucked in the back of my head.

Mr. PETERS. And had the Federal Government not put in money, that loss would have been considerably larger?

Mr. LIDDY. No. Not necessarily.

Mr. PETERS. So $30 billion was the loss. $30 billion of loss required $170 billion of taxpayer money?

Mr. LIDDY. I would like to go back. The taxpayer money is not $170 billion. We have $40 billion of TARP money and about $38 billion of a loan from the Federal Reserve. So it is $78 billion.

Mr. PETERS. Okay. So the loss of $30 billion, how many people are actually in this unit? There are about 300-plus people in the unit?

Mr. LIDDY. At its high-water mark, it was 435. We wound it down last year. It is 360 now.

Mr. PETERS. How many are actually involved in the derivative business that accounted for these losses? How many people are actually engaged in that activity out of the—

Mr. LIDDY. Very, very few. Again, if you think of it as a couple of buckets, you have the credit default swaps, you have other—the other swap business, and you have the $1.6 trillion of derivatives business. Most of what is left in FP now is all under $1.6 trillion.

Mr. PETERS. Right.

Mr. LIDDY. The credit default swap business is gone or is winding down rapidly.

Mr. PETERS. Well, all of it. So of the whole unit, this type of liability that is out there. I mean, I guess my point is that you had a relatively small unit. A very large company that insures about 81 million people in this country, a large insurance company. And it is really a small number of people that really brought your company to the brink.

Now, we want to make sure that we never let this happen again. And I know in your testimony, when I heard you earlier, you talked about what would happen if AIG failed, that it would be absolutely devastating for the entire American U.S. economy, devastating for the international economy.

How can a relatively small number of people bring the U.S. economy to the brink? What sort of controls need to be in place going forward so this doesn't happen again? How can the fate of the U.S. economy be in the hands of just 100 or 200 people? How do we prevent this?

Mr. LIDDY. In fact, sir, it wasn't even that many. You know, the number of people involved in the credit default swap business was probably 20 or 25.

Mr. PETERS. So 20 people brought your company to the brink, and brings our economy to the brink?

Mr. LIDDY. I think the answer to your question is we need a much more hefty systemic risk regulator. So we get a ton of regulation on the insurance side from State regulators, the United States, from other regulators around the globe.

What we need is someone who can look at the systemic risk that a large company like AIG represents, pair that with the systemic risk that a large bank or investment bank represents, and decide whether there is too much risk there or not. I don't think that regulation—

Mr. PETERS. But where was your company's risk management? To take on, what, $3 trillion in risk, where was the risk management of your company? Where was the failure of your own internal risk manager procedures?

Mr. LIDDY. We had risk management practices in place. They generally were not allowed to go up into the Financial Products business. It was—

Mr. PETERS. How could that be? How could they not be allowed to go when they are putting trillions of dollars at risk?

Mr. LIDDY. As I said earlier to a similar type question, you need to get the people who ran FP, Mr. Cassano, and the people who ran AIG before my arrival, and ask them that question.

Mr. PETERS. Yes. Well, it is a big question.

Mr. LIDDY. It is an excellent question. We should ask the right people that question.

Mr. PETERS. Good. I appreciate it, sir. Thank you. I yield back my time.

Mr. MOORE OF KANSAS. [presiding] Thank you.

Next, Ms. Kilroy of Ohio. You have 5 minutes, ma'am.

Ms. KILROY. Thank you, Mr. Chairman. I appreciate it.

I, like my colleagues, am just absolutely astounded by the situation of paying $165 million in bonuses with a company that is being propped up with the help of the Federal Reserve and with the TARP money, still seeing $62 billion of loss in the last quarter.

And, you know, the question that the average American would ask is, how can you pay bonuses when you don't really have the money to pay them, when it is somebody else's money that is being put to work here to pay down these bonuses, which is, just recently commented, bonuses paid to people who have caused cataclysmic losses and damage to both AIG, to its shareholders, and to the economic system?

And yet we are told, and I think you said this earlier, that if something happens to AIG, that can have dire consequences for the rest of the country. And you kind of get the feeling that there is a bit of coercion here being put to the American taxpayer by saying, you have to—this is another version of we are too big to fail And I think the American public is really wanting to see something different here.

This afternoon, we voted on the GIVE Act, people who are giving service, people who are working hard to make their community better for small stipends. And we have seen people around the country—we have heard earlier about the teachers who are taking cutbacks in their pay, and the auto industry, which is modifying their contracts, and the pensioners who are taking cutbacks.

You see this willingness to come forward and to help out. And you are among those as well, serving at the request of President Bush and the former Treasury Secretary for $1 a year.

You know, I am reminded that one of our great presidents, John F. Kennedy, said, "Ask not what your country can do for you—ask what you can do for your country." And yet my feeling is some of these traders and others are asking our country to just keep giving them more, and not owning up to the responsibilities that they have.

And one of my concerns is a responsibility that has been brought to light, brought to my attention, from the State of Ohio, a case brought by the Ohio Public Employees Retirement System, the State Teachers Retirement System, and the Ohio Police and Fire Pension Fund against AIG, making some very serious allegations about misrepresentations and nondisclosures of material fact made by AIG that has hurt these pension funds with respect to paying contingent commissions and other practices alleged to be direct market manipulation.

And I understand that the suit—other parties to the suit have settled; other parties to the suit have paid out a significant amount of money in terms of settlement, but that the meter is still running with respect to AIG's obligations and the attorney fees, which I have been told are somewhere in the vicinity of $3 million a month for AIG to defend against this suit.

I am wondering—and I understand that there have been some attempts at settlement, and that those attempts at settlement have kind of come to an end. But in terms of this orderly wind-down that you talk about, is that orderly wind-down going to include considering the millions that could be owed to the pensioners of Ohio, New York, Texas, Florida, New Mexico, Virginia, California, or

Michigan, all of whom have had substantial losses in AIG during the class period, during the period involved in this case?

Mr. LIDDY. I have to confess I just don't have any specific knowledge of that particular case. I will look into it. My general counsel is sitting behind me, and we will look into it, and we will do everything we can to make sure that it gets resolved. I assume this is the loss of the equity value of AIG. I just don't have any perspective on it whatsoever.

Ms. KILROY. I appreciate you taking a look at it. I just worry about what happens. And that is one of the reasons I think Congress is taking a look.

Mr. MOORE OF KANSAS. We are out of time. Thank you.

Mr. Foster of Illinois, please, for 5 minutes, sir.

Mr. FOSTER. Certainly. Let's see. I was wondering if you could walk me through some of the details on the mechanisms.

When people talk about your assets blowing up or the other things you worry about, bad things that would happen, if someone—if the people who are currently managing the wind-down of the book were replaced by people who are equally expert but not familiar with them, what are the sort of mistakes that would get made if the people currently managing the books were replaced by equally competent people brought off the street? And what are examples of the way in which taxpayer funds would be at risk in that replacement?

Mr. LIDDY. Sure. First, each contract is unique unto itself, as I mentioned earlier. If you have seen one, you have not seen them all. So each one will have a specific type of an arrangement, a specific type of settlement.

If we have a hedge on an interest rate and the interest rates move a percent in a day or currency moves a percent in a day, we have to re-hedge that book. There is some dynamic hedging, things that happen automatically. But much of the hedging has to be done with some thought attached to it.

So because each of those contracts—there are now 29,000 of them; there used to be 44,000 of them—because each of those contracts is somewhat unique unto itself, you have to know what to do with respect to currency movements or interest rate movements or oil price movements so that you can minimize the exposure to loss on that contract.

Mr. FOSTER. And what is the range in the final value that you would realize after you wound down the things, between ones that were managed with the best team that you currently have versus the best one you could buy off the street? I mean, do you have any feeling for what the difference might be in the final valuation there?

Mr. LIDDY. I just don't. I think the issue is how quickly could someone else get familiar with each of those individual contracts. You know, right now people know those contracts and they can react to changes in whatever it is that is the underlying instrument; they can react right away. How long would it take for people to get up to speed on those contracts? That becomes the risk factor.

Mr. FOSTER. And you had mentioned you were in the process of getting some bench depth in this so that you had a backup person in each of these places.

What fraction of the way along are you on that path?

Mr. LIDDY. Let's call it 40 or 50 percent. Again, it is hard to find people who want to work on these books of business at AIG. You know, people don't want to work at AIG. They are not cheap if you try to get them.

Mr. FOSTER. What fraction of their compensation that we have been talking about do you have to pay when you get the backup person in? Does he end up costing, you know half as much or a quarter as much or an equal amount?

Mr. LIDDY. We have tried to do that differently, and we have hired a firm. So the firm has the responsibility for those people, and they have the responsibility for backing up those people. So it is more a matter of a contract with the firm that helps to provide the backup or the insurance.

Mr. FOSTER. And do you end up spending a roughly comparable amount compared to the compensation levels we have been talking about?

Mr. LIDDY. I believe so, sir. Again, I just don't travel with that information in the back of my brain.

Mr. FOSTER. Okay. And when you visited my office yesterday, you described some of the legal opinions that you had gotten in an effort to understand what your freedom—what freedom you had to cancel these things.

And you had indicated that canceling these, if you just refused to pay them, that the likely result, according to legal opinions that both you and the Fed had obtained, would end up—you would end up losing the court cases, in all probability, and the likely result would be doubling and in some cases tripling the size of the bonus that would eventually be paid.

Mr. LIDDY. Correct.

Mr. FOSTER. Correct. And so that is your sworn testimony as well. That is your best legal reading of the position you are in?

Mr. LIDDY. Yes. And those documents have been provided to the committee. But I would just like to add, remember, the first issue that we were trying to address here was not the legal issue. It was the risk issue of can we effectively manage this book of business now in a way that doesn't cause us difficulty, that doesn't have it erupt and have to have more money come in from the American taxpayer.

Mr. FOSTER. Okay. And in regards to the counterparties, are you familiar with what happened when European banks were bailed out and there were American counterparties? And do you get a feeling there is a rough symmetry between European banks that are bailed out with U.S. taxpayer money and American banks and so on that were bailed out with European or Asian or other—

Mr. LIDDY. I don't have a perspective on it, sir.

Mr. FOSTER. Okay. Thank you. Well, I yield back.

Mr. MOORE OF KANSAS. Thank you, Mr. Foster.

The Chair next recognizes Mr. Clay from Missouri for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. And thank you, Mr. Liddy, for being here today. I know it has been a long day, so let me try to expedite some of my questions.

Initially I voted against the TARP legislation, and at this point I have no regrets about my vote. It was still the correct thing to

do. However, this is not a concern of yours, and I know that you were placed in your position just a few months ago, after the meltdown.

The American taxpayers have put over $165 billion into AIG in the last several months, and AIG is still not stabilized. And it is looking like we are putting money into a sinkhole. I also understand that there remains a possibility that AIG will come back for additional TARP funds associated with the $1.6 trillion in your derivatives portfolio.

Can you convincingly illustrate to us why this is not an exercise in staving off the obvious collapse or prolonging the agony? Is this a bad deal? And can you elaborate?

Mr. LIDDY. I do not think it is a bad deal. I think the Federal Reserve and Treasury made an appropriate decision back in September, particularly on the heels of Lehman Brothers and the banking crisis and credit crisis that was in place.

As I mentioned earlier, the amount of money we owe the American taxpayer right now, at the end of December, was $78- to $79 billion. We have sufficient assets that we should be able to repay that in full.

The market is a pretty difficult place right now. There are not people with money who can afford to buy assets. So we are attempting to put up a structure which will isolate these assets, break the business up into component parts, and isolate those that are particularly healthy.

I would like to wind this whole thing down and be the first company that is able to make a meaningful repayment to the American taxpayer. I think we have the potential to do that, but it is somewhat out of our control because it very much depends upon what happens with the worldwide capital markets, not just the stock market but liquidity and capital flows.

I think the American taxpayer has a better chance of getting paid from AIG than perhaps many of the other companies that have received TARP dollars. I would like nothing better than to prove that statement to you.

Mr. CLAY. Mr. Liddy, I am pulling for you to succeed with AIG. I want you to succeed. And you have gotten questions today from numerous members about the bonuses. But let me ask the question a different way.

I represent St. Louis, Missouri. Our daily paper is the St. Louis Post-Dispatch, and they run a political blog. And Geno writes on the blog, and hopefully you can answer Geno's question: "How can AIG defend bonuses given to people who have run the company into the ground? Every place I have worked, bonuses are given to people who make money for the company. As far as retaining good help, you have really missed the boat." End of Geno's blog entry.

What can you say to Geno?

Mr. LIDDY. These are not performance-based bonuses. They are retention bonuses. These are not the people who ran the company into the ground. While they are in the FP unit that has caused us such distress, they are in a different section of that business for the most part.

I would say to Geno that if we really want to maintain a fighting chance to repay the American taxpayer, we have to wind down this

$1.6 trillion that exists in AIG FP. We can do that more securely and more quickly with people that we have asked to stay there and run that book down.

So it is a risk assessment. If we keep those people, we have a higher probability of running this book down and not having it cost the American taxpayer more. That is what those bonuses were about.

Mr. CLAY. And that is based on the familiarity of the people who are in place there.

Mr. LIDDY. Correct. Correct.

Mr. CLAY. I mean, even the point about honoring the contracts, I mean, don't we change contracts every day in this country, and could in some those instances those contracts be altered?

Mr. LIDDY. Well, that is why I say it was secondarily a legal consideration and primarily a risk consideration. Contracts can always be altered as long as the two parties, or multiple parties to a contract, agree to it.

Mr. CLAY. Okay. Well, I appreciate your responses and I wish you well, Mr. Liddy.

I yield back, Mr. Chairman.

Mr. MOORE OF KANSAS. Thank you, Mr. Clay. I next recognize myself, the Chair, for up to 5 minutes.

Mr. Liddy, there are a lot of people in our country hurting very badly right now, and I think you know that. I know you know that.

Have you asked any of the executives who received these bonuses if they would voluntarily forgo these bonuses and pay the taxpayers' money back so we can try to get on with this whole thing?

Mr. LIDDY. I have. I asked them this morning.

Mr. MOORE OF KANSAS. And?

Mr. LIDDY. I have been in this hearing all day. I don't know what the outcome is.

Mr. MOORE OF KANSAS. You haven't received any e-mails or phone calls?

Mr. LIDDY. No. I would prefer to ask the right people, and I will do that.

Mr. MOORE OF KANSAS. And we would like a report back. If you get information about that, will you be willing to provide that information to us, sir?

Mr. LIDDY. Yes.

Mr. MOORE OF KANSAS. Within a short time after you receive it, if you do receive that information?

Mr. LIDDY. Yes. I will be very transparent with you. I just want to—I need to get the information. I need people to—I need to give them a chance to make a rational decision, and then provide it to everyone who has an interest in it.

Mr. MOORE OF KANSAS. Sure. I don't know that we can—our country can afford to wait until 2012 for AIG to pay its money back. So if AIG continues to behave like this, despite being supported by not only current taxpayers but also by future generations, our children and grandchildren, when will you pay the money back? When will AIG pay the money back, sir?

Mr. LIDDY. As I mentioned, we have a plan to do that in 2 to 3 years. We will do it just as quickly as we can. I know it is frustrating to hear that long a timeframe. You can't sell assets if there

is no one prepared to buy those assets. We need to sell assets or transfer them to the Federal Reserve in payment of that debt.

We think we have a good plan to do exactly that. We will act on pieces of it within the next couple of quarters.

Mr. MOORE OF KANSAS. Did any of the executives who left AIG who received retention bonuses return the money? Were there in fact people who left after receiving retention bonuses?

Mr. LIDDY. Yes. There were people at AIG Financial Products who had a book of business to wind down, and our commitment to them was if they wound it down within certain parameters, they would get a retention bonus. In some cases they did that before the end of the year. They left. We paid them their retention bonus.

Mr. MOORE OF KANSAS. A retention bonus is to retain the person in your employ. Isn't that correct?

Mr. LIDDY. It was offered to them at the beginning of 2008 for them to stay and be retained and wind down the book of business so we could get out of that as quickly and expeditiously as possible. So they did stay for the period of time we needed them.

Mr. MOORE OF KANSAS. And how much did you pay to those individuals?

Mr. LIDDY. I don't know. I will—

Mr. MOORE OF KANSAS. Were there different bonuses to each different person?

Mr. LIDDY. Well, yes. It would have depended upon what their activity was and what their compensation was.

Mr. MOORE OF KANSAS. But we are talking about several million dollars in some cases?

Mr. LIDDY. Yes. It would have probably been in the range of a million dollars. I just don't have the numbers, sir.

Mr. MOORE OF KANSAS. So some of these people received retention bonuses of a million dollars or more for staying on for an additional, say, less than 1 year. Is that correct, sir?

Mr. LIDDY. Well, they received a retention bonus for doing what we asked them to do: wind down your book of business in a way that we agree with it and doesn't cost us any money. If you can do that in 6 months, that is okay. If it takes you 18 months, we understand that. But wind that book of business down. That is how we got the $2.7 trillion derivatives book down to $1.6 trillion.

Mr. MOORE OF KANSAS. But do you understand how frustrating that must be to people who are watching this on television, understanding some of these people received in excess of a million dollars as a retention bonus and now they are gone? Can you understand that, sir?

Mr. LIDDY. I do understand it. And the only thing I can say is we got the benefit of the bargain. We got from them what we asked them to do. That was, help us reduce the risk in this book of business.

Mr. MOORE OF KANSAS. Can you understand that some American people might think you paid way too much to get that bargain?

Mr. LIDDY. I can understand that, yes.

Mr. MOORE OF KANSAS. Thank you, sir.

The Chair next recognizes Mr. Cummings from Maryland.

Mr. CUMMINGS. Thank you very much. Thank you very much, Mr. Chairman. I want to thank the committee.

Mr. Liddy, it is certainly good to see you again, and I want to just ask you a few question. The media has been focused on the $165 million installment of the $450 million retention program for AIG's Financial Products division. However, for months, you and I have been going back and forth overall about the $1 billion retention program that covers thousands of employees throughout AIG.

We know that the Financial Products retention contracts were drawn up before you became CEO of a company in September 2008, which you passionately stressed to Mr. Lynch a little bit earlier today. However, in your letter to me on December 5th, you wrote these words: "On September 18, 2008, AIG's compensation committee of the board of directors approved retention payments for 168 employees."

Did you approve those?

Mr. LIDDY. Yes.

Mr. CUMMINGS. All right. Because we keep talking about things that happened before you came, and I am trying to make some—you know, try to figure out what happened under your watch.

How many retention payments of any kind have you approved during your tenure? Of any kind?

Mr. LIDDY. There is a group of about 4,500 people who work in our healthy insurance businesses that we are trying to sell. These are the leaders and critical players in those businesses that we have approved retention bonuses for that can go out 2 years in length.

Mr. CUMMINGS. On January 15th at a meeting, when you and I met, you told me, "We have expanded the retention program to cover other employees since the first phase, and we voluntarily announce that we implemented two additional phases of this program, covering an additional 2,100 employees."

Would that be included in the number that you just gave me, the 4,500?

Mr. LIDDY. Yes. I don't remember the exact number. I think it is about 4,500 to 4,700.

Mr. CUMMINGS. And so you approved those additional phases. Is that correct?

Mr. LIDDY. Correct.

Mr. CUMMINGS. You also noted that business units have adopted their own retention plans.

Did you approve those also?

Mr. LIDDY. I would not have. They would have been approved by the business units.

Mr. CUMMINGS. So there are other retention plans within AIG, the big AIG umbrella, under the umbrella?

Mr. LIDDY. Those are more—I believe they are more severance plans. What happens if somebody buys you and you lose your job?

Mr. CUMMINGS. How much in non-financial product retention payments have you paid in 2008, and how much will be paid in 2009?

Mr. LIDDY. I don't have the numbers at my fingertips. We will be delighted to get them to you.

Mr. CUMMINGS. All right. Have you reduced these payments below the levels approved on September 18th?

Mr. LIDDY. We have either—in some cases we have reduced them, and in some cases we have stretched them out to a longer period of time.

Mr. CUMMINGS. Now, you sent a letter to Secretary Geithner. It was a very interesting letter you sent over the weekend—well, it is dated March 14th. And it says something that I want you to help me out on because I don't understand it, and I think the committee has just sort of passed it by.

It said, "AIG"—and this is your letter—it says, "AIG hereby commits to use best efforts to reduce expected 2009 retention payments by at least 30 percent." Now, what I am trying to figure out is—so we already have some people in place. We have been talking about 2008 performance. Now, we have some folks in place to get bonuses for 2009 performance. Is that correct?

Mr. LIDDY. Yes. That letter specifically relates to AIG FP, and it is the second part of the retention program which, if they are there and they accomplish their goals, we would pay in 2010.

And I don't mean to interrupt you, but I think that whole issue is going to be moot because what we will find is those individuals will in fact return much if not all of the retention bonus that we paid them, and it will be accompanied by their letters of resignation.

Mr. CUMMINGS. Well, I am hoping—another member said something a little bit earlier. I am hoping—President Obama has made it clear that he is trying to reverse our economy here and get it straightened out. And these people are very central people, one making as much as $6.5 million in bonuses.

I would hope that they would stick around, take a regular paycheck like most people do, and stick around and help us get through this. They have benefitted from the greatness of this country, and I would hope that they would do that, and I hope you will appeal to them to do that.

Finally, you wrote in your letter to Secretary Geithner that the Secretary had asked AIG to "rethink our 2008 corporate bonus proposals."

How much in bonuses—we keep saying bonuses and retention payments. How much in bonuses, not retention payments, have you paid to AIG employees in 2008, and what was the range of the bonuses paid?

Mr. LIDDY. I will provide you the information. I think it was—I think it might have been in the range of $9 million.

Mr. CUMMINGS. Thank you very much.

Mr. MOORE OF KANSAS. Thank you, Mr. Cummings.

The Chair next recognizes Ms. Kaptur of Ohio for up to 5 minutes.

Ms. KAPTUR. Thank you, Mr. Chairman.

I agree, Mr. Liddy, with the statement in your formal testimony: "Insurance is the oxygen of the free enterprise system, and without it the fundamentals of capitalism are undermined." I think that is a very important sentence.

I think that the spirit of those who work for AIG, whatever division it is, isn't being well communicated to the American people. I would guess those who received $165 million in extra compensa-

tion, whatever you want to call it, are probably among themselves worth billions of dollars.

And for them—you know, for you to have to come here today and not even say, you know, by such-and-such a date—I thought you were going to come and present in your testimony, well, it is the middle of March, and this is what is going to happen by the beginning of April. This is what they have decided to do on behalf of the Republic. I am disappointed that wasn't forthcoming in your testimony.

I have several questions, and I thank you for your endurance today. The Wall Street Journal discloses today that AIG has put funds in escrow for Deutsche Bank, whose hedge fund clients bet against the housing market.

Could you please disclose which hedge funds could receive funds, money, as a result of payments to counterparties, and how much each fund could get?

Mr. LIDDY. I can't. I have no access to the information. We would have to ask the representatives of Deutsche Bank. What we had was a relationship, a credit default swap, between us and Deutsche Bank. We honored that. They would have had other counterparties beyond that that only they are privy to.

Ms. KAPTUR. Could you provide this information to the record if you don't know it here today? I am not only asking about Deutsche Bank. I am asking about other hedge funds.

Mr. LIDDY. We don't have it. They are not our customers. Our customers are the companies or the names that were listed on the release of the counterparty names. What you are asking is what did they do? What were the relationships that they had? I don't have any access to that information.

Ms. KAPTUR. All right. Then let me ask this next question. In terms of the face value of the Financial Products derivatives that you stated in your testimony are now worth about $1.6 trillion—I read that correctly. Correct? Okay. What is your best estimate of the trading value of those securities underlying your Financial Products derivatives, as opposed to just the face value? What is the trading value?

Mr. LIDDY. I just don't know. I will get the information for you. We will provide it for you. I just don't know as I sit here today.

Ms. KAPTUR. All right. You don't know that. What is the possible remaining taxpayer exposure?

Mr. LIDDY. Well, as I said, winding down that book of business in a very effective and costly way is important to us. We think it will probably cost us several billion dollars to do that. That is baked into the amount of money that we think we would have to borrow from the Federal Reserve and that we anticipate repaying to the taxpayer.

Ms. KAPTUR. If the contracts are successfully terminated, is it possible that the counterparties would have to return any of the tens of billions of collateral to our taxpayers?

Mr. LIDDY. No. They are totally different buckets, if you will. The first one are credit default swaps, and that was a unique set of customers; the second one, our derivatives that are with a—could be with a whole different set of customers for a whole different set of arrangements.

Ms. KAPTUR. So you are saying from that bucket there might not be any return to the taxpayers?

Mr. LIDDY. From the credit default swap?

Ms. KAPTUR. From the derivatives?

Mr. LIDDY. Oh, I am sorry. Yes.

Ms. KAPTUR. From either one.

Mr. LIDDY. Yes.

Ms. KAPTUR. But you are telling me from the credit default swaps, no.

Mr. LIDDY. Well, on the credit default swaps, the way that was solved was we put it into a financing vehicle with the Federal Reserve. The Federal Reserve—we put equity in. The Federal Reserve put debt in. They own those at a number of 50 cents on the dollar.

If they are worth more than 50 cents on the dollar, the American taxpayer will do very, very well on it. That was Maiden Lane III. My personal assessment is that they will be worth more than what the Federal Reserve paid for them.

Ms. KAPTUR. All right. And what about the derivatives?

Mr. LIDDY. It is not an analogous situation because the derivatives are live documents. The credit default swaps are, for the most part, already behind us. The derivatives are traded on a daily basis, on an active basis. So I simply can't answer the question.

Ms. KAPTUR. Okay. What percent of your company is owned by the U.S. Government today?

Mr. LIDDY. 79.9.

Ms. KAPTUR. And how does our government get back its money out of AIG?

Mr. LIDDY. We have an aggressive plan to do that. We are going to sell some assets. That will help us in repayment. We are going to give some assets to the Federal Reserve. These are very well-performing, good value life insurance companies. We will give them to the Federal Reserve in exchange for lowering some of the debt.

We will take some of the insurance policies that we have and do what is called a monetization, give that cash flow to the Federal Reserve or the Treasury. We will take our insurance business, our property casualty business, and sell a minority interest in it, and perhaps eventually increase that minority interest. We will take the proceeds from that and give it back to the Federal Government.

Ms. KAPTUR. How long will it take and how much money will the taxpayers lose?

Mr. LIDDY. I would hope the taxpayers won't lose any money. It will take us a good 2 to 3 years, but we will make material progress quickly.

Ms. KAPTUR. Thank you.

Mr. MOORE OF KANSAS. Thank you. The Chair next recognizes Mr. Crowley from New York.

Mr. CROWLEY. I thank the chairman. Thank you for allowing me to sit in on the committee, my old committee, Financial Services. It is good to be back. Unfortunately, not under these circumstances, but it is always good to be back. Mr. Liddy, welcome to the committee. Let me thank you for being here.

I do feel, like many of my colleagues, Mr. Liddy, that—I feel for you having to be here today to take this. I know you came into the

scene in September of last year after the government's first bailout of AIG.

And whether it is fair or not, AIG has become the face of everything that has been wrong with Wall Street, and it has become the face of American greed. I am a New Yorker as well. I come from Woodside, Queens, not Wall Street.

So I want to make clear that while it is clear that there are some bad actors, we must also remember that there are a lot of good people working in the financial services sector, on the street, and at the businesses surrounding the street as well. Take, for example, people who helped the orderly transfer of Bear Stearns or Wachovia to prevent the additional chaos in our markets.

But no American, not myself and definitely not any of my constituents, can understand millions of dollars in bonuses to people at AIG Financial Products division, the very division that helped sink the company and caused the government to prop the company up with $170 billion in taxpayer funds. In fact, my mother always thought that a bonus was given to someone who did something good and above and beyond the call of duty, not actually help bring down a company.

During tough economic times, we must all make sacrifices. In doing so, we share each other's pain and we earn each other's trust. I feel that AIG's actions demonstrate a complete lack of understanding for the need for shared sacrifice, and in turn, it has triggered a complete lack of confidence in my constituents, in our economy, and it has shaken their belief in the system of capitalism.

As such, I want to touch on a few other compensation issues outside of bonuses at AIG FP that have preoccupied this hearing today. There are reports that AIG is considering awarding additional bonuses in the coming days, including an additional $121.5 million incentive bonuses for 2008 that AIG will start making this month to approximately 6,400 of its roughly 116,000 employees; and that AIG is also making over $600 million in retention payments to an additional 4,000 employees.

Could you comment on those bonuses?

Mr. LIDDY. The first number you have I believe is an accurate number. It's about $120 million. It is to all of the good businesses that performed in accordance with business objectives that we established in the beginning of 2008. It is a very traditional and very classic annual performance, variable performance, award.

Mr. CROWLEY. I think it is important to state that for the record, as we anticipate this coming down the road, that there is some understanding that this is not necessarily—this is not the FP? This is not AIG FP?

Mr. LIDDY. No. No. No. It is entirely separate. Now, you asked a question similar to what Mr. Cummings had asked, and that is, we are going to sell many of these—or transfer them to the Federal Reserve—

Mr. CROWLEY. Right.

Mr. LIDDY. —many of these good assets that we have. We want the good players, the really critical players in those businesses, to please stay with us and not go someplace else. So there are retention payments for those folks, much simpler, much smaller in value

than what we have been talking about with AIG FP, that would be paid over the next 12 to 18 to 24 months.

Mr. CROWLEY. Thank you. Let me just go back a moment to something that Mr. Cummings also mentioned, and that was the retirement—the retention programs that were entered into.

Prior to coming there, when was the last one entered into, the agreement, retention agreement?

Mr. LIDDY. Prior to my coming there?

Mr. CROWLEY. Yes.

Mr. LIDDY. March 2008.

Mr. CROWLEY. Do you think the people who put those agreements together had any indication back then that their company was in deep trouble?

Mr. LIDDY. I really don't think so, Mr. Crowley. Those agreements would have been started, the discussion and negotiation process would have been started—it takes a while to get these done—probably in mid-2007. So I don't think it was done in anticipation of anything. That is speculation on my part.

Mr. CROWLEY. Can we find—is it possible for this committee or the House to know who those individuals were who entered—who made those agreements?

Mr. LIDDY. Who authored them? Who signed—

Mr. CROWLEY. Who authored those agreements?

Mr. LIDDY. I am sure that information exists. We will try to get it for you.

Mr. CROWLEY. Were any of those individuals beneficiaries of those agreements?

Mr. LIDDY. I just don't know. I'll—

Mr. CROWLEY. Was there a conflict of interest? In other words, would they have benefitted by the agreement?

Mr. LIDDY. Well, no. For AIG Financial Products, it would have been negotiated by an individual to whom that business works. He would not have been covered by those retention agreements.

Mr. CROWLEY. Well, if we could—if it is possible to get to us that information, I would appreciate that as well.

As many of the people who work under you within AIG know, I have been very interested in this issue for some time. And unfortunately, it has gotten to a point I had hoped we could have avoided, but unfortunately, that didn't happen, because I think—not because of the people who work for you, but others within your company who put the company and their country last and themselves first. And I yield back.

Mr. MOORE OF KANSAS. Thank you, Mr. Crowley, and thank you, Mr. Liddy.

Are there any additional questions? Do you want to submit those in writing or take a couple of minutes here? We do want to wind up this hearing, sir.

Mr. GRAYSON. For a couple of minutes, thank you.

Mr. MOORE OF KANSAS. All right. Mr. Grayson is recognized for a couple of minutes.

Mr. GRAYSON. Thank you. Mr. Liddy, you said before that there were 20 or 25 people who were involved in the credit default business.

What are their names, please?

Mr. LIDDY. I don't have their names at my disposal, sir.

Mr. GRAYSON. Well, I am sure you remember a few of the names. I mean, they did cause your company to crash.

Mr. LIDDY. You know, I have been at the company, as you know, for 6 months. I don't know all the people who were in AIG FP, and many of them are gone.

Mr. GRAYSON. Well, there or gone, it doesn't really matter. I want to know who they are. Names, please.

Mr. LIDDY. Yes. If you're asking for the names of the people who got the bonuses at FP, is that—

Mr. GRAYSON. No. I am asking for the names of the people who ran the credit default business, the 20 to 25 that you referred to earlier who caused your company to lose $100 billion.

Mr. LIDDY. If it is possible to provide you the names, we want to. If we are—we will cooperate with you.

Mr. GRAYSON. Well, that is good. But I want to know the names you know right now.

Mr. LIDDY. I don't know them, sir.

Mr. GRAYSON. Not a single one? You are talking about a group, a small group of people who caused your company to lose $100 billion, and as you sit here today, you can't give me one single name?

Mr. LIDDY. The single name I would give you is Joseph Cassano, who ran—

Mr. GRAYSON. That is a good start. You already gave that name. Give me another name.

Mr. LIDDY. I just don't know them. I do not know those names. I don't have them all at my command.

Mr. GRAYSON. Well, how can you propose to solve the problems of the company that you're now running if you don't know the names of the people who caused that problem?

Mr. LIDDY. Because there are great people running AIG FP now who do know each and every one of those individuals.

Mr. GRAYSON. That is a great thing to say. But the fact remains that I would expect you to at least know more than one name. How about two names?

Mr. LIDDY. Yes, sir. I am just not going to do that, sir, because that could be a list of people that—individuals who want to do damage to them could do that. It is just not—

Mr. GRAYSON. Well, listen. These same people could now be working, right now, today, at Citibank. Is it more important to protect them, the ones who caused the $100 billion loss, or protect us? Which is more important to you right now?

Mr. LIDDY. The important thing is to protect both—I will—if that is the information you want, we will do everything we can to cooperate with you. I am just not going to sit here and give it to you until I understand what the implications are.

Mr. GRAYSON. Can I count on you to give us that list? Yes or no?

Mr. LIDDY. I will—I do not know. I will consult with our general counsel and decide what the appropriate course of action is.

Mr. GRAYSON. Not the answer I was hoping for, but my time is up.

Mr. MOORE OF KANSAS. Thank you, sir.

At this time, the Chair notes that some members may have additional questions for this witness which they may to submit in writ-

ing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to this witness and to place his responses in the record.

Before we adjourn, the following will be made part of the record of this hearing: a letter Chairman Kanjorski received from Secretary Geithner last night. Without objection, it is so ordered.

The panel is dismissed, and this hearing is adjourned. Thank you, Mr. Liddy.

[Whereupon, at 6:45 p.m., the hearing was adjourned.]

A P P E N D I X

March 18, 2009

Statement by Rep. Michele Bachmann
House Financial Services Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises
"American International Group's Impact on the Global Economy: Before, During, and After Federal Intervention"

March 18, 2009

Thank you, Mr. Chairman, for holding this incredibly timely hearing.

And, thank you, Mr. Liddy, for being here today. It would be hard not to begin by expressing the same distaste that you did over the $165 million in retention bonuses that have become the eye of the public storm of taxpayer outrage these days. Like so many of my colleagues, I am just stupefied by the audacity of executives who even as they were able to retain their jobs by the grace of hard-working taxpayers are unwilling to deny their million-dollar bonuses.

But – and I say this as someone who voted against the financial service sector bailouts each and every time – I am equally stunned at the feigned surprise of those in government who say they are shocked by these bonuses. AIG disclosed these payments as far back as May 8, 2008 in a filing with the SEC. And, then in November –after American taxpayers had already funded a commitment of over $150 billion to AIG, giving the U.S. government an 80% stake in the company – AIG convened a working group to examine the bonuses. Representatives from the Federal Reserve were part of that reviewing committee.

So, I find it rather disingenuous that so many in government, from the Secretary Geithner to Senator Dodd and others in Congress – are expressing shock not only about these particular bonuses, but about the stark reality that the misguided bailout "strategy" has led America's political class to this conundrum. When you insert yourself as the lead stakeholder in American businesses, don't be surprised when you are held accountable for business decisions like these.

In this particular case, AIG is literally rewarding with bonuses as high as $6.4 million some of the very same executives who were selling the risky products that got AIG in trouble in the first place. And, over the next year, the amount of bonuses promised under current AIG contracts will rise to about $450 million. Simultaneously, taxpayer assistance to AIG has grown to $170 billion.

This situation makes crystal clear one thing: We need an exit strategy from the bailout mania.

Yet, even as Congress and the Administration fretted about the lack of oversight and accountability in the TARP, they conspired to release the second $350-billion tranche of taxpayer dollars under the program. And, the President's budget includes another financial service sector bailout that could put American taxpayers on the hook for another

$750 billion. TARP has not received high marks for success from anyone. *Clearly* there is not adequate transparency or accountability in the program, or in several other lending facilities administered by the Fed, for that matter. AIG has now received four taxpayer-funded bailouts. Every single one was negotiated in secret and taxpayers have been left wondering where or how their money was being spent.

We need an exit strategy from the current bailout-band-aid-short-term strategy for addressing the lagging market that has been implemented thus far. That should be our number one focus.

I look forward to the opportunity to hear from today's panel about the current situation with AIG.

Thank you, Mr. Chairman, and I yield back the balance of my time.

ANDRÉ CARSON
7TH DISTRICT, INDIANA

COMMITTEE ON FINANCIAL SERVICES
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OFFICE OF CONGRESSMAN CARSON

Capital Markets Subcommittee Hearing Statement addressed to Mr. Edward Liddy, Chairman and Chief Executive Officer for American International Group.

March 18, 2009

Mr. Liddy, I understand you stepped into your current role at AIG after the company's tremendously risky behavior undermined its solvency and forced the Federal Reserve to step in and prevent systemic failures. I respect your willingness to step in and lead the company forward responsibly during this time of crisis. However, I believe that significantly more could have been done to prevent those responsible for this catastrophe from being rewarded with taxpayer funded bonuses.

Before the current bonus controversy, your company paid for spa treatments, retreats and hunting trips after receiving federal assistance. Now, your company is hiding behind the Connecticut Wage Act to appear guiltless in paying out these bonus contracts. The American people are not fooled.

You contend that these extravagant bonuses help retain the best and brightest in the industry. Mr. Liddy, the employees in your financial products division who are receiving bonus payments are the same employees who wrote the credit default swaps that have exposed your company and our financial system to huge losses. I would hardly say their service to our financial markets will be missed.

Because of your company's actions, federal efforts to stabilize our economy in this most severe of times have been vilified. We are not a country that believes in rewarding the failures of the Wall Street elite at the expense of hardworking taxpayers. Yet, the American public perceives this to be the case and believes we are supporting a double standard.

While our nation's auto companies have received $17 billion in federal assistance to date, your company has required a record $170 billion. While middle class autoworkers have been forced to renegotiate their contracts – to cut their pay, eliminate their bonuses and freeze cost-of-living adjustments – your company pays out big for wildly irresponsible behavior.

Mr. Liddy, I recognize AIG's downfall began before you took the helm. As current CEO, however, it is your responsibility to show your employees the error in this decision and compel them to turn down these bonuses. Trust us when we say that Congress and the Administration will pursue every legal avenue to recoup these funds. We are not asking you politely, we are telling you to fix it, or we will.

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Congresswoman Lynn Jenkins
Capital Markets Subcommittee Hearing
3/18/09
Opening Statement submitted for the record

Over the past year, the American taxpayer has been forced to foot the bill for the bad decisions made by financial institutions that were deemed 'too big to fail.'

Earlier this month, the administration said they were confident they knew how one of those institutions, AIG, was spending their bailout dollars. Sadly, for the American taxpayers, that proved not to be the case.

Since then we've learned that tens of billions were sent overseas and that AIG used some $165 million of their bailout money to pay bonuses to many of the same executives who got them into the mess to begin with.

I do not believe that government should interfere with the inner workings of private business. However, we are in a whole new ballgame with AIG.

The federal government now owns nearly 80% of AIG, giving us all a major stake in the success or failure of their internal decisions. As the primary unwilling investors, the American taxpayers deserve assurance that the close to $200 billion in taxpayer dollars will not be squandered and further, how and when they will be repaid.

I thank the chairman for today's hearing and appreciate the opportunity this committee has to ask questions on behalf of our constituents.

Statement by Rep. Carolyn McCarthy
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Financial Services Committee
3/18/09

I am disappointed and disgusted to learn of the recent reports that AIG will pay roughly $165 million in bonuses to their executives, when the company is in a financial disaster. Bonuses are a means of rewarding and recognizing an employee's positive contribution that would have guided the company to a state of positive health and revenue. It is inexplicable why AIG is "rewarding" executives that participated in risky business decisions and led to the failure of the company. Taxpayers have every right to be angered by the reasoning CEO Edward Liddy offered to Treasury Secretary Geithner, that "AIG's hands are tied." As a result of companies like AIG's participation in the economic meltdown, people have lost their houses, jobs and pension funds. Executives who presided over the downfall of AIG Financial Products unit, the division that greatly contributed to the company's serious liquidity problems, should not be allowed to receive additional compensation.

We can not forget that AIG has received billions of dollars in emergency help from the American taxpayer! While we have been trying to shore up AIG to prevent a further hit to the overall economy, their corporate leadership is rewarding bad behavior with our money.

This is the height of irresponsibility, arrogance and hypocrisy. This is, in some ways, the type of behavior that put us in the circumstances we are in today.

AIG's involvement in the economy is complex and far-reaching. They do not operate in a bubble, which is why we have been working so hard to infuse cash into the corporation. We wanted to stop the bleeding so other people do not go down innocently with AIG's sinking ship.

We *did not* support AIG so they could slap us in the face by giving our money away. I, for one, want my money back from these bonuses and so do the nation's taxpayers.

To that end, I have cosponsored a bill introduced by my colleague from Long Island, Congressman Steve Israel that would tax bonuses at 100% for companies like AIG, who receive TARP funding. The bonus bailout rate would apply only to the bonus portion of an individual's taxable income. Currently the IRS holds 25% from bonuses less than $1 million and 35% for a bonus of more than $1 million. Taxing these bonuses at 100% would not only send an important cautionary message to AIG and other TARP recipients, it will help taxpayers recoup some of our money.

If companies decide it's acceptable to waste money on bonuses that are not deserved, they should face consequences for those bad decisions. I look forward to working with

my colleagues on the Committee to ensure that in the future, companies think twice before granting bonuses to executives who do not deserve them.

Testimony of the
National Association of Insurance Commissioners

Before the

Subcommittee on Capital Markets, Insurance, and Government

Sponsored Enterprises

Committee on Financial Services

United States House of Representatives

Regarding:

"American International Group's Impact on the Global Economy: Before, During and After Federal Intervention"

Wednesday, March 18, 2009

Joel Ario

Insurance Commissioner

Pennsylvania Insurance Department

Testimony of Joel Ario
Insurance Commissioner
Pennsylvania Insurance Department

I would like to thank Chairman Paul Kanjorski, Ranking Member Scott Garrett and the members of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises for inviting me to testify today at this hearing on the "American International Group's Impact on the Global Economy: Before, During, and After Federal Intervention."

My name is Joel Ario and I am the Insurance Commissioner for the Commonwealth of Pennsylvania. I am appearing here today on behalf of the National Association of Insurance Commissioners (NAIC).

I very much appreciate the Subcommittee holding this hearing so that we can discuss what has happened at AIG and how to improve financial services regulation in the future.

Only AIG's Domestic Insurance Companies are Subject to State Insurance Regulation

I would like to start by clearing up some confusion. AIG is typically described as the world's largest insurance company, which reinforces the misconception that AIG is entirely the province of state insurance regulation. In fact, AIG is a huge, global financial services conglomerate that does business in 130 countries. AIG includes 71 U.S. insurance companies, but it also has 176 other financial services companies, including significant non-U.S. insurers.

State insurance regulatory authority is limited to the 71 U.S.-based insurance companies. Under the nationally-coordinated system of state-based insurance regulation, state insurance departments have primary authority for those insurance companies domiciled in their state. In Pennsylvania's case, we are the domestic regulator for 11 of AIG's 71 U.S. insurance companies.

These 71 insurance companies are primarily involved in three lines of insurance: life and annuities, commercial lines (e.g., workers compensation and other business insurance), and personal lines (e.g., auto). AIG pools its business in each of these three lines and there are lead regulatory states for each

line, starting with the state in which the lead AIG company in each pool is domiciled: Pennsylvania for commercial lines, New York for personal lines, and Texas for life and annuities.

Six of the Pennsylvania companies are members of AIG's commercial lines pool, including the lead commercial lines company, National Union Fire Insurance Company of Pittsburgh, PA. The other commercial lines companies are AIG Casualty Insurance Company, Insurance Company of the State of Pennsylvania, New Hampshire Insurance Company, American International South Insurance Company and Granite State Insurance Company.

The other five Pennsylvania domestics are personal lines companies: AIG Centennial Insurance Company, AIG Indemnity Insurance Company, AIG Preferred Insurance Company, AIG Premier Insurance Company and New Hampshire Indemnity Company.

AIG does not have any life insurance companies domiciled in Pennsylvania.

One of the checks and balances inherent in the state-based regulatory system is that multiple states look at each AIG line of business. Our critics may question the efficiency of having multiple eyes on a complex enterprise such as AIG, but the reality is that these multiple eyes have served policyholders well by protecting the solvency of the AIG insurance companies despite turmoil at the AIG holding company level.

Efficiency is important, and through the NAIC, state regulators have developed tools and technologies to improve efficiency and coordination. But effectiveness is more important, and one reason our state-based system has worked well to identify and limit damage from the inevitable mistakes that come with any regulatory system is that we are careful not to trade minor gains in efficiency for our effectiveness in protecting solvency and policyholder interests.

The core principle of our nationally-coordinated financial accreditation system is the requirement that insurers hold conservative reserves to ensure that they can honor their obligations to policyholders and claimants. The concept sounds simple enough -- companies must practice sound risk management by setting aside funds to pay obligations down the road – but it is a concept that other segments of the financial sector have failed to enforce. One clear lesson of the current crisis is the importance of having plenty of capital and not having too much leverage.

AIG Financial Products was the Problem, Not the AIG Insurance Companies

Federal Reserve Chairman Ben Bernanke recently described the source of AIG's troubles as coming from "a hedge fund, basically, that was attached to a large and stable insurance company." He was right on both counts. The "hedge fund" is the AIG Financial Products unit, which, according to Chairman Bernanke, "made huge numbers of irresponsible bets" and "took huge losses." The "large and stable insurance company" is the 71 state regulated insurance companies.

Let me be more specific. When the credit rating agencies announced potential rating downgrades for AIG on September 12, 2008, the primary focus of concern was AIG Financial Products and the $440 billion in credit default swaps it had outstanding at that time, many of which included subprime housing loans. As it became clear that Financial Products had bet more than twice the market value of AIG in these credit default swaps, and failed to hedge or otherwise protect itself against collateral calls, the situation turned dire.

Faced with ratings downgrades over that fateful September weekend, AIG Financial Products and AIG holding company were staring at tens of billions of dollars of demands for cash collateral on the credit default swaps written by Financial Products and guaranteed by the holding company. To make matters worse, the counterparties to those credit default swaps included many of the world's largest financial institutions, all of which had hedged their own involvement in the risky credit default swap business through Financial Products. To quote Chairman Bernanke again, Financial Products "took all these large bets where they were effectively, quote, 'insuring' the credit positions of many, many banks and other financial institutions."

In summary, the reason the federal government decided to rescue AIG was not because of the insurance companies, which were stable and well capitalized. Rather it was because of the systemic risk created by Financial Products. I will address the future role of insurance regulation in avoiding systemic risk later in my testimony, but it is important to understand that the systemic risk created and still ongoing at AIG came from the Financial Products operation. Also important is the fact that the federal government acted more to protect the counterparties rather than AIG itself.

In Chairman Bernanke's words: "We're not doing this to bail out AIG or their shareholders, certainly. We're doing this to protect our financial system and to avoid a much more severe crisis in our global economy. We know that the failure of major financial firms in a financial crisis can be disastrous for the economy. We really had no choice."

Put simply, AIG Financial Products' reach was so broad and so interconnected with the world's largest financial institutions that it has become the poster child for systemic risk.

AIG Financial Products and Holding Company Are Federally Regulated

By purchasing a savings and loan in 1999, AIG was able to select as its primary regulator the federal Office of Thrift Supervision (OTS), the federal agency that is charged with overseeing savings and loan banks and thrift associations.

AIG Financial Products is not a licensed insurance company and is not regulated by the states. Financial Products is an investment unit based chiefly in London. It was able to evade regulation under the British Financial Services Authority because the AIG holding company was registered with an "equivalent regulator," the OTS.

Although OTS has acknowledged its role as the holding company supervisor, it is worth noting that credit default swaps were exempted from regulation under the Commodities Futures Modernization Act of 2000, which prevented both the C.F.T.C. and the states from regulating these instruments.

AIG and its Insurance Competitors Continue to Engage in Vigorous Competition

AIG's insurance companies continue to perform well in a troubled economic times, well enough that allegations have been raised by their competitors as to whether the AIG companies are using their current situation to unfair advantage in the marketplace. The allegations are most prominent in the highly competitive commercial property and casualty markets, where some of the nation's largest insurers routinely bid against each other on multi-million dollar accounts for the privilege of insuring the nation's largest businesses.

AIG's competitors have argued that AIG is deliberately under pricing its insurance in a desperate attempt to maintain premium volume at a time when policyholders might otherwise move their business to a safer competitor given AIG's uncertain future. Not surprisingly, AIG has fired back that its competitors are targeting AIG business by making disparaging comments about AIG and selectively under pricing their products in an unfair bid to take business away from a vulnerable competitor.

Each of these allegations has some plausibility, and state regulators have spent considerable time listening to such allegations, asking for specific facts, and following up as appropriate. When AIG complained of disparagement by competitors in the aftermath of the federal government's September actions, Pennsylvania and other states issued notices reminding everyone that disparaging a competitor violates state insurance laws. Later, when AIG did the same thing by making unfair comparisons between its investments and those of competitors on its website, Pennsylvania and New York required them to focus on their own strengths and delete the offending material.

The latest round of allegations have involved specific cases where the charge is that a particular account was deliberately under priced in a manner that would present a solvency risk if done systematically. Such disputes are common in highly competitive markets and typically reflect insurers trying to protect profit margins. However, there is a point at which low prices for policyholders can threaten long term stability, especially considering that the effects of under pricing may not show up for years given the time lapse between collecting premium and paying claims.

The Pennsylvania department has devoted special attention to the current allegations because both AIG and its competitors may have distorted incentives to put their competitive engines into overdrive – to preserve business on one side and to deliver a knock out blow on the other side. With the caveat that these issues are very complex, we have not seen any clear evidence of under-pricing to date, though we continue to look both at individual cases and at aggregate numbers on both renewals and new business at AIG.

State Insurance Regulation Has Performed Well

Some have rather disingenuously tried to use AIG's problems as an argument for an optional federal charter for insurance companies. There are some lessons to be learned from the AIG situation, but

shifting the primary locus of insurance regulation to the federal level is the wrong lesson to learn from AIG for two reasons.

First, when you permit companies to pick their regulator, you create the opportunity for regulatory arbitrage. The whole purpose of financial services regulation is to appropriately control risk. But when you allow regulatory arbitrage, you increase risk, because you create the opportunity for a financial institution to select its regulator based on who might be more lenient, who might have less strict rules, who might demand less capital.

Second, what happened at AIG demonstrates the strength and efficacy of state insurance regulation. Indeed, the federal rescue of AIG would have been an even tougher call were it not for the well-capitalized insurance companies that provide the possibility that the federal government and taxpayers will be paid back. AIG's insurance companies remain strong, in part because state regulation continues to wall them off from the high risk activities engaged in by AIG Financial Products.

In most industries, the parent company can reach down and use the assets of its subsidiaries. With insurance, that activity is greatly restricted. Insurance is a promise to pay, often many years, even decades, down the line. Companies must be well capitalized to ensure that they can pay claims. That is why state regulators require insurance companies to maintain healthy reserves backed by investments that cannot be used for any other purpose. As New York Superintendent Eric Dinallo says, "the insurance companies are the bars of gold" within the AIG conglomerate.

State Insurance Regulation Must Continue to Improve, Including Securities Lending

There are certainly activities that the states need to modernize, such as producer licensing, product review, and market regulation. State regulators are making progress in each of these areas, often by applying the lessons we learned in developing our financial accreditation program. That program has a strong and solid history of safeguarding the most important consumer protection: a solvent insurer to honor its promises and pay claims. At a time when many financial firms are in trouble because they do not have adequate capital and are too highly leveraged, insurance companies remain relatively strong.

This is not to say that the state financial regulation system is perfect. There are always improvements to be made and new challenges to address. The current economic crisis has exposed new clouds on the horizon, particularly within the life insurance sector, and there will be some serious challenges if the economy continues to deteriorate at current rates. But that is true of virtually every sector of our economy, and only reinforces the need to be wary of changing a part of our regulatory system that has proven effective.

That brings me to the question of securities lending, because this is one area where the AIG situation has exposed some problems and improvements are underway. Before addressing those issues, however, let me again emphasize that securities lending did not pose unmanageable systemic risk and was not the reason for federal intervention. AIG Financial Products was the source of federal intervention.

If there had been no Financial Products unit and only the securities lending program, as it was, we would not be here today. There would have been no federal rescue of AIG. Financial Products, which wrote $440 billion in credit default swaps, as well as other derivatives and futures, with a total notional value of about $2.7 trillion dollars as of September 2008, created systemic risk. Securities lending, with a $58 billion balance in the U.S. life insurer portion of the pool outstanding in September 2008, did not create systemic risk. If not for the run on the bank caused by Financial Products, the securities lending pool would likely have continued to decline at a manageable pace, as it had been doing under state regulator supervision for the year before the Financial Products crisis.

It is also important to understand that securities lending is an activity that has been going on for decades without serious problems. Many, if not most, large financial institutions, including commercial banks, investment banks and pension funds, participate in securities lending.

Securities lending involves financial institution X lending a stock or bond it owns to financial institution Y. X still owns the security and will benefit from any growth in its value. In return, Y gives X collateral, usually cash, to secure the borrowing. Generally, the cash collateral provided is about 102 percent of the value of the security it is borrowing. X then invests the cash to gain an additional amount of return. These contracts typically mature in 30 to 90 days, with an option to "rollover" and continue the contract for an additional term.

Problems can occur if Y decides it wants to return the security it borrowed from X rather than allowing the contract to rollover. X is then required to sell the investments it purchased with the cash collateral in order to obtain the cash it owes Y. Generally, in a big securities lending program, X will have some portion of the collateral investments in liquid assets it can easily sell. But if borrowers choose to terminate contracts more frequently than planned for, then X may not be able to sell enough assets quickly enough to obtain the cash it needs. If collateral investments have declined in value, X may be required to sell assets for less than what is owed to Y. If the number of borrowers choosing to terminate contracts grows large enough, X may not have enough assets with enough value to provide the cash it must return to the borrowers. This is the proverbial "run on the bank" scenario.

In the case of AIG, it was the crisis at Financial Products that caused such a run, which exacerbated a securities lending problem that state regulators were otherwise on the way to resolving. Furthermore, even with the collateral damage caused by the Financial Products crisis, it must be noted that the securities lending problems at AIG have been defined, contained and fixed, meaning that securities lending is not any part of the ongoing challenges at AIG.

AIG securities lending was consolidated by the holding company at a special unit it set up and controlled, totaling about $76 billion in the U.S. life insurer portion of the pool at its height. This special unit was not a licensed insurance company, but directed the securities lending program for a variety of AIG affiliates, including the twelve U.S. life insurers.

Traditionally securities lending pools operated by insurers primarily invest in conservative, highly liquid investments, such as treasuries and short-term paper, and include cash set aside to offset some liquidity risk with these transactions. The AIG securities lending program initially operated in this more traditional manner; however, as with some other holding company activities, the special unit changed course and became more aggressive in its management and collateral investment practices to generate additional revenue for AIG.

This change in philosophy was not disclosed by AIG and only came to light in 2006 under questioning by state insurance regulators. By then, many of the collateral investments were already facing some liquidity and market value stress. State insurance regulators immediately began working with the companies to deal with those issues. While most of the AIG securities lending collateral

investments were top-rated assets, about 60% of these assets were mortgage-backed securities, including almost 29% in subprime. Today, with the perfect clarity of hindsight, we all know that those ratings were not aligned with the market value of many mortgage-backed securities.

State insurance regulators were making steady progress in reducing the securities lending program, but were thwarted by the Financial Products crisis in September 2008. From its peak of about $76 billion, the securities lending pool had declined by $18 billion, or about 24 percent, to about $58 billion by September 12, 2008. At that point, the crisis caused by Financial Products caused a run on the AIG securities lending program. Borrowers that had reliably rolled over their positions from period to period for months began returning the borrowed securities and demanding their cash collateral. From September 12 to September 30, borrowers demanded the return of about $24 billion in cash.

To avoid massive losses from sudden forced sales, the federal government, as part of its rescue, provided liquidity to the securities lending program. In the early weeks of the rescue, the holding company used federal rescue funds to meet the collateral needs of the program. In November 2008, the Federal Reserve Bank of New York created Maiden Lane II, a special purpose vehicle that used about $20 billion in federal funds to purchase the remaining securities lending collateral at market value. The federal government still holds that collateral, which has held its market value in the $20 billion range since November.

State insurance regulators have closely monitored the securities lending programs operated within other insurance entities, most of which have not posed problems. AIG's property and casualty companies had securities lending programs, but they were phased out without problems by August 2008. State insurance regulators have also acted to increase disclosure requirements for these programs through the NAIC Statutory Accounting Principles Working Group.

Going forward, state insurance regulators are considering changes to regulations involving holding company groups, as well as investments held by insurers. The issues that impacted the U.S. life insurers due to the securities lending program operated by the AIG holding company will be key considerations in these discussions.

Financial Regulation can be Improved With a Coordinated Approach to Systemic Risk

State insurance regulators recognize that action is needed at the federal level to identify and manage systemic risk within the nation's financial marketplace. That shared objective calls for a collaborative approach to the regulation of financial enterprises that create true systemic risk, such as AIG Financial Products.

We caution, however, that collaboration does not mean federal preemption. Under our supervision, AIG and other insurance companies have weathered the current economic crisis relatively well, and our conservative solvency standards have been validated. State insurance regulation should be integrated into the framework for managing systemic risk.

In addition to consideration of financial stability or systemic risk regulation, Congress should also consider imposing greater transparency in the capital markets so that financial products or interactions that cause systemic risk can be more readily identified. The magnitude of the credit default swaps market illustrates the need for this reform.

State insurance regulators have been analyzing the potential for systemic risk within the insurance industry, particularly regarding the oversight of financial holding companies, and we look forward to contributing to the solutions being sought by Congress and the Administration.

Dr. Terri Vaughan, the new CEO of the NAIC, recently testified on behalf of state insurance commissioners before this Subcommittee on the topic of systemic risk. She outlined the nature of systemic risk within the insurance industry and proposed three principles supported by the state insurance commissioners for achieving greater collaboration among financial service regulators while securing and maintaining existing expertise through the principle of functional regulation:

- Primary role for states in insurance regulation. The framework should preserve the current flexibility to address state needs at the state level and ensure consumer access to state-based regulatory officials. The framework should include information sharing and confidentiality protocols that give state insurance regulators access to the information they need to fulfill their consumer protection responsibilities.

- Formalization of regulatory cooperation and communication. Formal structures should be enhanced to provide a forum for all financial service regulators to consult about emerging trends and issues and develop best practices for systemic risk management.
- Group supervision of holding companies. The concept of "supervisory colleges" should be used to involve all financial regulators in understanding the risks within holding companies deemed to pose systemic risk. This form of collaboration should operate in a transparent and accountable manner that defers to the functional regulator and does not compromise one company within the holding company structure simply for the benefit of another company. Preemption of state insurance regulation should take place, if at all, only under the very limited circumstances where necessary to address a material risk to the financial system and only to the extent that obligations to policyholders and claimants are met and state regulatory authority has been exhausted.

We look forward to continuing to work with Congress and the Administration on fleshing out these principles and developing an effective approach to systemic risk that preserves the proven strength of state-based insurance regulation.

Consumer Protection Must Remain Job One for Insurance Regulators

The primary goal of state insurance regulators throughout the AIG ordeal has been to protect insurance company policyholders and stabilize the insurance marketplace. I believe we share this goal with the federal government and with AIG officials, if only because all parties recognize that the insurance companies are AIG's most valuable assets and the key to preserving that value is the continued confidence of policyholders. As efforts to resolve the ongoing problems at AIG Financial Products continue, it is imperative that whatever actions are taken are guided by doing what is best for policyholders. I can assure you that state insurance regulators will continue to evaluate any transactions involving AIG insurance companies on that basis.

Thank you and I would be happy to answer your questions.

TESTIMONY OF RODNEY CLARK
MANAGING DIRECTOR, RATINGS SERVICES,
STANDARD & POOR'S FINANCIAL SERVICES LLC
BEFORE

THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES
UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 18, 2009

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, good morning. My name is Rodney Clark. I serve as a managing director in Standard & Poor's Ratings Services business, and from 2005 until very recently, I served as S&P's lead ratings analyst covering American International Group ("AIG"). I am pleased to appear before you today, and intend to cover three broad topics: (i) the history of S&P's ratings on AIG; (ii) our reasoning in arriving at those rating opinions, particularly those that we published over the last six months; and (iii) our views with respect to the effect of AIG's troubles on the creditworthiness of its subsidiaries.

At the outset, I would like to take a moment to speak generally about our ratings process and to explain what ratings are and are not intended to convey.

S&P's Credit Ratings

S&P's credit ratings are our current opinions on the future credit risk of an entity or a debt obligation. They express our opinion about the capacity and willingness of an entity to meet all of its contractual and financial obligations as they come due. S&P's ratings do not speak to the market value of a security or the volatility of its price and they are not recommendations to buy, sell or hold a security; they simply provide a tool for investors to use as they assess risk and differentiate credit quality of obligors and the debt they issue.

S&P forms its rating opinions through quantitative and qualitative analysis performed by rating analysts. These analysts gather information about a particular obligor or debt issue, analyze the information according to our published criteria, form opinions about the information and then present their findings to a committee of analysts that votes on what ratings to assign. After a rating opinion is formed, S&P publishes the opinion in real-time and for free on its Web

site, www.standardandpoors.com. We also generally publish a narrative along with our ratings that provides additional detailed information about our opinion.

This is the process by which S&P arrived at its ratings on AIG, which I will now address in some detail.

S&P's AIG Rating History

Attached to my written submission is a table listing our global ratings history on AIG since 1990. As the table shows, as of June 1990 S&P's rating on AIG was 'AAA.' This is our highest rating, and it reflected our view that AIG's capacity to meet its financial commitments was extremely strong. Our view took into consideration AIG's internationally diversified business mix, historically superior earnings performance, conservative balance sheet management, and exceptional liquidity characteristics. Our opinion began to change, however, starting in March 2005. Since then, S&P has lowered its rating of the company four times.

Recent Ratings Actions on AIG

S&P downgraded AIG on March 30, 2005, when it lowered AIG's rating from 'AAA' to 'AA+'. Our opinion of AIG had changed in large part due to the company's involvement in a number of questionable financial transactions, and reflected our revised assessment of AIG's management, internal controls, corporate governance and culture. In publishing this rating change, we expressed the view that AIG's globally diversified financial services group was still expected to generate very strong earnings and profits. We also reported that the company had told us that its new management had initiated a rigorous review of internal controls.

In June 2005, we again lowered our rating on AIG — this time to 'AA' — reflecting our revised credit assessment based on significant accounting adjustments that had just been

announced by the company. Despite strong overall earnings, we believed that AIG's adjusted financial statements indicated greater volatility and lower profitability than had been previously reported. At this time, AIG's capitalization — that is, its ability to absorb losses — was considered good.

In February 2008, S&P placed a negative outlook on the company based on concerns about the way AIG was determining the fair value of credit default swaps — or "CDS" – it had entered into. As has recently been widely reported, CDS are essentially guarantees of credit risk on securities or entities. AIG's CDS guaranteed an array of structured finance securities, including securities backed by subprime residential mortgages.

Three months later, in May 2008, we lowered our rating on AIG further to 'AA-'. This rating action was based in large part on our reaction to the company's announcement of an after-tax loss of $7.8 billion, including $5.9 billion in losses related to its CDS portfolio. S&P maintained a negative outlook on AIG throughout the summer of 2008.

In August, following a deal-by-deal credit analysis of AIG's investment and CDS portfolios, S&P reached its view — and stated publicly — that AIG's actual credit-related losses in these areas would likely amount to around $8 billion with significantly higher mark-to-market losses.

As has been well publicized, AIG's financial condition deteriorated sharply in September 2008 following substantial market disruptions, including government takeovers of Freddie Mac and Fannie Mae, the bankruptcy of Lehman Brothers, and the sale of Merrill Lynch, among other things. These events led to a sudden drop in the market value of AIG's investments and, more importantly, the investments of third parties that had purchased CDS guarantees from AIG.

In light of these events, on September 12, 2008, S&P placed its ratings of AIG and all AIG subsidiaries on CreditWatch with negative implications. Three days later, on September 15, 2008, as AIG's condition continued to deteriorate, S&P lowered its rating further to 'A-'. As stated in our published reports at the time, our decision to downgrade AIG was based primarily on a combination of AIG's reduced flexibility in meeting collateral needs and its increasing CDS-related losses.

Two days later, on September 17, 2008, the Federal Reserve Bank of New York extended an $85 billion borrowing facility to AIG. Were it not for this government assistance, we believe that AIG's creditworthiness would have continued to deteriorate. Indeed, our current rating on AIG, which remains at 'A-', includes a six-notch "uplift" to account for federal government support. Thus, without government support, our rating on AIG today would be 'BB-'.

S&P's Current Outlook For AIG

Two weeks ago, on March 2, 2009, S&P affirmed its 'A-' rating on AIG. This rating, as noted, is adjusted to account for continuing federal government support. We expect that, as the federal government's recapitalization improves AIG's access to equity capital, the pressure on debt holders will likely be reduced.

In our view, the government's continuing actions with respect to AIG have significantly reduced the risk of further rapid deterioration in the company's creditworthiness. However, we maintain our negative outlook on the company going forward. This is based in part on intermediate-term concerns about the company's ability to retain key staff and to engage in profitable new business, as well as its ability to carry out plans to raise capital by selling off some of its subsidiaries, particularly in light of the current lack of liquidity in the capital markets.

Our ongoing negative outlook for AIG also reflects our expectation that there will be increased pressure on the company's insurance businesses, as well as an overall susceptibility to broader market trends in light of AIG's weakened position. Although at this point we have not seen clear evidence of long-term damage to AIG's insurance franchise, there have been widespread reports that competitors are actively pursuing AIG's accounts and key underwriting personnel. If in our view these factors become a significant threat to future business prospects, we could lower AIG's rating again. On the other hand, if AIG's business were to stabilize and government support continues, we would consider revising the outlook to stable.

The Relationship Between AIG and its Subsidiaries

With respect to the effect of AIG's troubles on the creditworthiness of its subsidiaries, we believe those subsidiaries are to some extent insulated. For example, if AIG had been forced into bankruptcy, the bankruptcy would have likely included a relatively small number of AIG's subsidiaries — such as AIG Financial Products Corp. — with only a marginal impact on AIG's insurance subsidiaries. That is because the insurance subsidiaries' capital is generally insulated by state insurance laws and regulations.

Nevertheless, when S&P lowered its credit rating on AIG to 'A-' on September 15, we also lowered the ratings on most of AIG's insurance subsidiaries to 'A+' from 'AA+', where they remain today. While AIG's financial problems have no direct effect on the solvency of its insurance subsidiaries, we believe the creditworthiness of those subsidiaries is nevertheless indirectly affected in two primary respects. First, financial problems at AIG generally make it less likely that AIG will provide additional capital to its subsidiaries in the event the subsidiaries suffer investment losses of their own or otherwise require recapitalization. This concern is

somewhat muted by AIG's receipt of government support — indeed, the parent company just recently recapitalized certain of its U.S. and Asian life insurance subsidiaries. Nevertheless, there is, in our view, still some risk that recapitalizations of subsidiaries will be less likely to continue while the parent company seeks to stabilize itself.

The second issue we see affecting the creditworthiness of AIG's insurance subsidiaries relates more generally to overall reputational risk resulting from the parent company's financial problems. For example, it may be more difficult for the subsidiaries to retain and attract new customers where there is uncertainty surrounding the parent company — particularly in light of the widely-held expectation that some of the subsidiaries will be sold off by AIG as part of the ongoing effort to strengthen its balance sheet.

As a general matter, S&P believes that AIG's insurance subsidiaries are currently well capitalized to meet their policy obligations. The strength of the subsidiaries is a positive factor in our view of AIG's overall creditworthiness. Our ratings on any particular subsidiary could change in the event of a sale of the subsidiary by AIG. The nature of the change would likely depend on the buyer and the impact of the sale on the subsidiary's competitive position, capital structure, and earnings. It is quite possible that the ratings on some subsidiaries could move in a different direction than others.

The Effect of S&P's Ratings on the Decline of AIG

Another subject the Subcommittee asked me to address is whether S&P's ratings may have contributed to the decline of AIG. While some have argued that S&P was too slow to downgrade AIG, others have said that we acted too aggressively and that our downgrades contributed to AIG's decline. We believe that AIG's difficulties resulted from the convergence

of many factors, including the unprecedented and substantial deterioration in the market value of AIG's assets and CDS portfolio. Our rating changes were driven by, and reflected our view of, these developments. In any event, we do not believe it would have been appropriate or consistent with our independent role in the markets for S&P to have refrained from taking any rating action we otherwise believed was warranted based on changing credit risks simply out of deference to a particular issuer. Our ratings are not driven by market sentiment. Rather, our role is to act as independent observers offering our views of creditworthiness.

Lack of Involvement in Government Aid Packages

Finally, in my invitation to testify, the Subcommittee asked me to describe any involvement S&P may have had in connection with the structuring or restructuring of the government's support packages to AIG. Although S&P has been informed by government officials about the actions that have been taken, we have had no participation in the structuring or restructuring of these packages; nor has S&P provided, or been asked to provide, any advice or consultation to the government in connection with its support of AIG.

Conclusion

I thank you for the opportunity to participate in this hearing, and I would be happy to answer any questions you may have.

Table of S&P ratings history for American International Group Inc. since June 1990

Date	Rating/Outlook
26-Jun-1990	AAA/Stable
29-Oct-2004	AAA/Negative
15-Mar-2005	AAA/Watch Neg
30-Mar-2005	AA+/Watch Neg
03-Jun-2005	AA/Negative
10-Nov-2006	AA/Stable
12-Feb-2008	AA/Negative
08-May-2008	AA-/Watch Neg
21-May-2008	AA-/Negative
12-Sep-2008	AA-/Watch Neg
15-Sep-2008	A-/Watch Neg
17-Sep-2008	A-/Watch Dev
03-Oct-2008	A-/Watch Neg
02-Mar-2009	A-/Negative

TESTIMONY BY

MR. EDWARD M. LIDDY,

CHAIRMAN AND CHIEF EXECUTIVE OFFICER,

AMERICAN INTERNATIONAL GROUP

BEFORE THE HOUSE FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE

AND GOVERNMENT-SPONSORED ENTERPRISES

WEDNESDAY, MARCH 18, 2009

THANK YOU CHAIRMAN KANJORSKI, RANKING MEMBER GARRETT, HONORABLE MEMBERS OF THE SUBCOMMITTEE. I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY.

MY NAME IS EDWARD LIDDY. SIX MONTHS AGO, I CAME OUT OF RETIREMENT TO HELP MY COUNTRY. I HAVE HAD THE DUTY, HONOR, AND EXTRAORDINARY CHALLENGE OF SERVING AS CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF AMERICAN INTERNATIONAL GROUP – AIG. I SPEAK TO YOU TODAY ON BEHALF OF 116,000 AIG EMPLOYEES AROUND THE WORLD WHO ARE UNITED AROUND THREE SIMPLE BELIEFS:

- FIRST, WHEN YOU OWE SOMEONE MONEY, YOU PAY THAT MONEY BACK.
- SECOND, WHEN YOU HAVE SHAREHOLDERS – AND TODAY THE AMERICAN TAXPAYER, THROUGH THE U.S. GOVERNMENT, IS OUR BIGGEST SHAREHOLDER – YOU ARE ACCOUNTABLE TO THEM FOR HOW YOUR BUSINESS IS RUN.
- THIRD, WHEN A FINANCIAL CALAMITY OF THE KIND THAT HIT AIG STRIKES, THE ONLY POSSIBLE RESPONSE IS TO ROLL UP YOUR SLEEVES, ACKNOWLEDGE THE MISTAKES OF THE PAST, CORRECT THOSE MISTAKES AND MOVE FORWARD – EXACTLY WHAT AIG'S EMPLOYEES HAVE BEEN DOING.

WE ARE MEETING TODAY AT A HIGH POINT OF PUBLIC ANGER. AMERICANS WANT TO KNOW HOW THE COUNTRY GOT INTO THE FINANCIAL MESS WE ARE IN, HOW WE ARE GOING TO GET OUT OF IT, AND HOW QUICKLY WE CAN GET BACK TO THE ECONOMIC GROWTH AND PROSPERITY WE ENJOYED FOR SO MANY YEARS.

I SHARE THAT ANGER. AS A BUSINESSMAN OF SOME 37 YEARS, I HAVE SEEN THE GOOD SIDE OF CAPITALISM. OVER THE LAST FEW MONTHS, IN REVIEWING HOW AIG HAD BEEN RUN IN PRIOR YEARS, I HAVE ALSO SEEN EVIDENCE OF ITS BAD SIDE.

MISTAKES WERE MADE AT AIG ON A SCALE FEW COULD HAVE EVER IMAGINED POSSIBLE. THE MOST CRITICAL OF THOSE MISTAKES WAS THAT THE COMPANY STRAYED FROM ITS CORE COMPETENCIES IN THE INSURANCE BUSINESS. THIS WAS TYPIFIED BY THE CREATION OF WHAT GREW TO BECOME AN INTERNAL HEDGE FUND, WHICH THEN BECAME SUBSTANTIALLY OVEREXPOSED TO MARKET RISK.

THOSE MISSTEPS HAVE EXACTED A VERY HIGH PRICE, NOT ONLY FOR AIG BUT FOR AMERICA'S TAXPAYERS, THE FEDERAL GOVERNMENT'S FINANCES AND THE ECONOMY AS A WHOLE.

OUR NEW MANAGEMENT TEAM CONCLUDED VERY QUICKLY THAT THE COMPANY'S OVERALL STRUCTURE IS TOO COMPLEX, TOO UNWIELDY, AND TOO OPAQUE FOR ITS COMPONENT BUSINESSES TO BE WELL-MANAGED AS ONE COMPANY. WE IMMEDIATELY TOOK STEPS TO RESTRUCTURE AIG, ALTHOUGH THE CONTINUED DETERIORATION OF WORLD MARKETS AND THE INABILITY OF BUYERS TO ACCESS CAPITAL HAVE IMPEDED OUR ABILITY TO SECURE SUFFICIENT VALUE FOR AIG ASSETS AT THIS TIME.

WE HAVE ALSO CONCLUDED – AS MANY IN THE CONGRESS HAVE AS WELL – THAT THERE MUST BE SAFEGUARDS IN PLACE AGAINST THE SYSTEMIC CONSEQUENCES OF FAILURES OF LARGE, INTER-CONNECTED FINANCIAL INSTITUTIONS.

LET ME BRIEFLY DISCUSS THE PROGRESS WE HAVE MADE OVER THE PAST SIX MONTHS WORKING WITH OUR PARTNERS FROM THE FEDERAL RESERVE AND U.S. TREASURY. I AGREED TO TAKE THE REINS AT AIG LAST SEPTEMBER, AT THE REQUEST OF THE U.S. GOVERNMENT AND AFTER THE COMPANY HAD TURNED TO THE U.S. GOVERNMENT FOR FINANCIAL SUPPORT.

THE COMPANY'S REQUEST FOR SUPPORT POSED TO THE FEDERAL RESERVE AND U.S. TREASURY A DIFFICULT DILEMMA: SHOULD THEY LET THE COMPANY FAIL, OR SHOULD THEY PROVIDE INTERIM SUPPORT GIVEN AIG'S DEEPLY EMBEDDED ROLE IN THE GLOBAL FINANCIAL SYSTEM? AS WE ALL KNOW, THE U.S. GOVERNMENT DETERMINED THAT A COLLAPSE OF AIG AND THE CONSEQUENT BLOWS TO OUR COUNTERPARTIES AND CUSTOMERS AROUND THE WORLD POSED TOO GREAT A RISK TO THE GLOBAL ECONOMY, PARTICULARLY IN THE CONTEXT OF THE NEAR OR ACTUAL FAILURE OF OTHER FINANCIAL INSTITUTIONS.

ON BEHALF OF MY COLLEAGUES, I WANT TO THANK THE FEDERAL RESERVE AND THE U.S. TREASURY FOR MAKING THAT EXTRAORDINARILY TOUGH CALL. IT HAS MEANT THAT TOGETHER WE HAVE BEEN ABLE TO PRESERVE JOBS AND BUSINESSES, AND PROTECT POLICYHOLDERS WHO RELY ON THE PROMISE OF INSURANCE TO SECURE THEIR WELL-BEING.

WE HAVE ADDRESSED OUR LIQUIDITY CRISIS AND STABILIZED THE COMPANY'S CASH POSITION.

WE ARE EXECUTING A METHODICAL, ORDERLY WIND-DOWN OF AIG FINANCIAL PRODUCTS, THE BUSINESS THAT CAUSED MANY OF THE COMPANY'S FINANCIAL PROBLEMS; WE HAVE REDUCED THE NOTIONAL VALUE OF AIG FINANCIAL PRODUCTS' DERIVATIVES BUSINESS FROM $2.7 TRILLION TO $1.6 TRILLION.

AND ALTHOUGH THE PACE OF OUR MOST IMPORTANT ASSET SALES HAS SLOWED BECAUSE OF POOR MARKET CONDITIONS, WE HAVE EXECUTED SEVERAL SALE TRANSACTIONS AND EXPECT MORE IN THE FUTURE.

THOSE ARE SIGNIFICANT STEPS. MOREOVER, WE HAVE ACHIEVED THIS PROGRESS AGAINST STIFF HEADWINDS. INSURANCE COMPANY STOCKS IN THE LAST FIVE WEEKS HAVE GONE DOWN 35 PERCENT; SINCE THE BEGINNING OF THE YEAR, 50 PERCENT; AND IN THE LAST FIVE MONTHS, 65 PERCENT. THE SAME MACRO-ECONOMIC FORCES THAT MAKE FOR ROUGH SAILING FOR AIG ARE BUFFETING OTHERS IN THE FINANCIAL SERVICES SECTOR AS WELL. AND THIS CREATES PROBLEMS FOR POTENTIAL BUYERS OF AIG ASSETS.

WE UNDERSTOOD THAT SINCE OUR RELATIONSHIP WITH THE GOVERNMENT AND TAXPAYERS HAD CHANGED, OUR BEHAVIOR AS A COMPANY NEEDED TO CHANGE. SO, ON OUR OWN INITIATIVE, WE ADOPTED A SERIES OF RESTRICTIONS ON EXECUTIVE COMPENSATION, ELIMINATED OUR FEDERAL LOBBYING ACTIVITIES, HALTED CORPORATE POLITICAL CONTRIBUTIONS, AND KEPT CONTROLS ON OUR EXPENSES.

WE ARE ALSO MOVING URGENTLY ON A BUSINESS PLAN DESIGNED TO MAXIMIZE THE VALUE OF OUR CORE BUSINESSES, SO THAT IN TURN WE CAN MAXIMIZE THE AMOUNT THAT WE REPAY TO AMERICAN TAXPAYERS.

ON MARCH 2ND, WE ANNOUNCED ROBUST NEW ARRANGMENTS WITH THE FEDERAL RESERVE AND U.S. TREASURY THAT GIVE US ADDED FLEXIBILITY TO EXECUTE THAT BUSINESS PLAN. WITH THESE CHANGES, WE WILL TAKE TWO OF AIG'S INSURANCE COMPANIES – AIA AND ALICO – AND PLACE THEM IN A TRUST FOR THE BENEFIT OF THE FEDERAL RESERVE. WHEN WE DO THAT, WE WILL SUBSTANTIALLY REDUCE THE $40 BILLION IN AIG'S OUTSTANDING DEBT ON THE $60 BILLION FEDERAL RESERVE CREDIT FACILITY.

WE WILL ALSO IMPLEMENT A SECURITIZATION PROCESS THROUGH WHICH AIG WILL REALIZE TODAY THE CASH VALUE OF SOME OF OUR INSURANCE BUSINESSES. WITH THOSE TWO STEPS, PLUS CASH FROM THE SALE OF BUSINESSES, WE SHOULD BE ABLE TO EXTINGUISH OUR DEBT TO THE FEDERAL RESERVE.

WE WILL ALSO COMBINE THE COMPANY'S COMMERICIAL INSURANCE AND FOREIGN GENERAL INSURANCE UNITS, CREATING A STRONGER ENTITY THAT WE BELIEVE COULD ATTRACT SUBSTANTIAL INTEREST IN A MINORITY INVESTMENT.

IT IS OUR INTENT TO BE AS TRANSPARENT AND FORTHCOMING AS POSSIBLE. IT IS IN THAT SPIRIT THAT WE TOOK STEPS EARLIER THIS MONTH TO POST TO OUR WEB SITE AN "AIG SYSTEMIC RISK ANALYSIS". AFTER CLOSE CONSULTATION WITH THE FEDERAL RESERVE, AIG HAS ALSO DISCLOSED INFORMATION IDENTIFYING CERTAIN CREDIT DEFAULT SWAP COUNTERPARTIES, MUNICIPAL COUNTERPARTIES AND SECURITIES LENDING COUNTERPARTIES. AS WE MOVE FORWARD, WE WILL BE VIGILANT ABOUT OUR RESPONSIBILITIES TO BE ACCOUNTABLE TO, AND TRANSPARENT WITH, THE AMERICAN PEOPLE.

LET ME CLOSE WITH THESE FINAL THOUGHTS:

NO ONE KNOWS BETTER THAN I THAT AIG HAS BEEN THE RECIPIENT OF GENEROUS AMOUNTS OF GOVERNMENT FINANCIAL AID. WE HAVE BEEN THE BENEFICIARY OF THE AMERICAN PEOPLE'S FORBEARANCE AND PATIENCE. AND WE ARE ACUTELY AWARE NOT ONLY THAT WE MUST BE GOOD STEWARDS OF THE PUBLIC FUNDS WE HAVE RECEIVED, BUT THAT THE PATIENCE OF AMERICA'S TAXPAYERS IS WEARING THIN.

WHERE THAT PATIENCE IS ESPECIALLY THIN IS ON THE QUESTION OF COMPENSATION. I AM PERSONALLY MINDFUL BOTH OF THE ENVIRONMENT IN WHICH WE ARE OPERATING AND THE PRESIDENT'S CALL FOR A MORE RESTRAINED COMPENSATION SYSTEM. AT THE SAME TIME, WE ARE ESSENTIALLY OPERATING AIG ON BEHALF OF THE AMERICAN TAXPAYER SO THAT WE CAN MAXIMIZE THE AMOUNT OF MONEY WE PAY BACK TO THE GOVERNMENT.

IN ORDER TO DO THAT, WE HAVE TO CONTINUE MANAGING OUR BUSINESS AS A BUSINESS – TAKING ACCOUNT OF THE COLD REALITIES OF COMPETITION FOR CUSTOMERS, FOR REVENUES AND FOR EMPLOYEES. BECAUSE OF THIS, AND BECAUSE OF CERTAIN LEGAL OBLIGATIONS, AIG HAS RECENTLY MADE A SET OF COMPENSATION PAYMENTS, SOME OF WHICH I FIND DISTASTEFUL.

WE AT AIG WANT TO BELIEVE THAT WE ARE ALL IN THIS TOGETHER. WE HAVE BEEN WORKING SHOULDER-TO-SHOULDER WITH THE NEW YORK FEDERAL RESERVE AND U.S. TREASURY. I WANT TO ASSURE YOU THAT THE PEOPLE AT AIG TODAY ARE WORKING AS HARD AS WE CAN TO EXECUTE THE RESTRUCTURING PLAN THAT, WE BELIEVE, OFFERS AMERICA'S TAXPAYERS THE BEST POSSIBLE OUTCOME:

- REPAYMENT OF AIG'S DEBT TO THE GOVERNMENT TO THE MAXIMUM EXTENT POSSIBLE;
- CONTINUATION OF AIG'S MAIN INSURANCE UNITS AS STRONG, THRIVING BUSINESSES;
- AND THE CONTINUED PROTECTION OF POLICYHOLDERS THAT HAS ALWAYS BEEN AT THE CORE OF THE COMPANY'S MISSION.

WITH THAT, MR. CHAIRMAN, I WOULD REQUEST THAT MY REMARKS AND SEVERAL ADDITIONAL DOCUMENTS BE INCLUDED IN THE HEARING RECORD, AND I AM HAPPY TO RESPOND TO YOUR QUESTIONS. THANK YOU.

ADDENDUM TO TESTIMONY BY MR. EDWARD M. LIDDY,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN INTERNATIONAL GROUP
BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE AND GOVERNMENT-SPONSORED ENTERPRISES
WEDNESDAY, MARCH 18, 2009

The AIG Financial Crisis: A Summary

AIG traces its roots back 90 years when an American entrepreneur named C.V. Starr founded AIG's earliest predecessor company in Shanghai. What began as a small insurance business grew to become one of the world's largest companies. By early 2007 AIG had assets of $1 trillion, $110 billion in revenues, 74 million customers and 116,000 employees in 130 countries and jurisdictions. Yet just 18 months later, AIG found itself on the brink of failure and in need of emergency government assistance.

What Happened?

Building upon its premier global life franchise and general insurance, AIG expanded into a range of financial services businesses. One of these, created in 1987, was AIG Financial Products (AIGFP), a company that provides clients with risk management solutions. Among other activities, AIGFP sold credit default swaps to other financial institutions to protect against the default of certain securities. Many of these securities at the time were given a bond rating of AAA and higher. However, in late 2007, as the U.S. residential mortgage market began to deteriorate, these securities were severely impacted. As a result, AIG recorded severe unrealized valuation losses on AIGFP's credit default swap portfolio.

At the same time, AIG incurred heavy losses in the value of its securities lending operation, which invested in high-grade residential mortgage-backed securities. Through this program, AIG made short-term loans of certain securities it owned to generate revenues. At the same time, other AIG real estate-related investments also suffered sharp value losses.

It is important to note that throughout the crisis, AIG's insurance businesses were – and continue to be – healthy. The losses that occurred as a result of AIGFP's action had no impact on AIG policyholders. AIG's insurance companies are closely regulated by New York and other states and regions worldwide. Their reserves are protected through regulations that prevent the removal of capital so that each AIG member insurance company has adequate assets to back each policy and meet all policyholder obligations.

Even though AIG had incurred virtually no actual credit losses, the severe write-downs led to downgrades in its credit ratings. In addition, AIG was forced to post billions of dollars in collateral to cover potential losses to holders of AIG credit default swaps. Meanwhile, the world capital and credit markets deteriorated rapidly, making it virtually impossible to access other sources of capital to fund these collateral requirements or meet other cash needs.

Deteriorating conditions in global financial markets only made matters worse for AIG. The collapse of respected financial institutions such as Bear Stearns and Lehman Brothers sent shockwaves through the world economy. The failure of the U.S.-sponsored mortgage companies Fannie Mae and Freddie Mac added to the financial disruption. During this time, AIG was seeking private capital solutions to its liquidity problem, exploring possible solutions with state insurance regulators in New York and Pennsylvania. However, as the market deteriorated further, AIG's share price dropped. In mid-September 2008, AIG's credit ratings were downgraded once again, triggering additional collateral calls and cash-flow issues in excess of $20 billion. Suddenly, AIG, although solvent, faced an acute liquidity crisis.

Because of its size and substantial interconnection with financial markets and institutions around the world, the federal government and financial industry immediately recognized that an uncontrolled failure of AIG would have had severe ramifications. In addition to being the world's largest insurer, AIG was providing more than $400 billion of credit protection to banks and other clients around the world through its credit default swap business. AIG also provides credit support to municipal transit systems and is a major participant in foreign exchange and interest rate markets.

Initial Investment From the U.S. Government

To stabilize AIG and prevent the potential ripple effects should it fail, the United States government extended a two-year emergency loan of $85 billion on September 16, 2008. The facility carried a rate of LIBOR (the London Interbank Offered Rate – a widely used benchmark used to set short-term interest rates) plus 8.5%, a commitment fee of 2% on the loan principal and a fee on the undrawn portion of 8.5%. Additionally, the government would be entitled to 79.9% ownership of the company and also, at the government's request, AIG agreed to elect a new Chairman and Chief Executive Officer. After consultation with the U.S. Treasury and Federal Reserve Bank of New York, AIG's Board of Directors elected Edward M. Liddy Chairman and Chief Executive Officer.

With the loan in place, Mr. Liddy devised a restructuring plan to enable AIG to sell many of its leading businesses around the world and pay back the government loan with interest. However, AIG still had to address the two principal sources of its liquidity losses: the multi-sector credit default swap portfolio and the securities lending operation.

As the financial industry continued to falter in October and November, it became apparent that the terms of AIG's original government loan would not provide the flexibility necessary for AIG to resolve its financial challenges. A revised plan was needed to better address the company's liquidity losses and give the company more time and greater flexibility to sell assets and pay back the government. On November 10, 2008, the original government loan was restructured to include a $40 billion investment by the U.S. Treasury through the Troubled Asset Relief Program (TARP) and a five-year Federal Reserve Bank of New York credit facility with a borrowing limit of up to $60 billion. In addition, two financing entities, Maiden Lane II and Maiden Lane III, were created to acquire AIG's multi-sector credit default swap assets and AIG's securities lending assets respectively. The entities were funded primarily by the Federal Reserve Bank of New York with a smaller capital contribution by AIG. Under the terms of the agreement, the majority of any appreciation in the securities held by the entities would go to the government.

Economic and Market Conditions Worsen

The assistance provided by the U.S. government in November succeeded in addressing AIG's liquidity issues. However, economic and capital market conditions continued to deteriorate, which created significant mark to market losses for AIG in the fourth quarter of 2008. At the same time, potential buyers of AIG's businesses were facing significant financial challenges of their own, which diminished their ability to raise capital to purchase AIG assets.

As economic and capital market conditions worsened, AIG worked with the U.S. government on developing a new set of tools to help AIG achieve a comprehensive restructuring over the next several years. On March 2, 2009, AIG announced these new tools, which include exchanging the U.S. Treasury's cumulative preferred shares in AIG for preferred shares that more closely resemble common equity; a new five-year standby equity capital facility, which will allow AIG to raise up to $30 billion of capital by issuing non-cumulative preferred stock to the U.S. Treasury from time to time as needed; debt-for-equity swaps that allow AIG to tap the value of its insurance companies to repay a portion of the government credit facility; elimination of the LIBOR floor on the credit facility, which will lower AIG's interest cost; and continued access to the credit facility, although with reduced borrowing capacity.

AIG's Plans Going Forward

A comprehensive and orderly restructuring of AIG is essential to pay back support it has received from the U.S. government. The company's overall structure is too complex, too unwieldy and too opaque for its component businesses to be well managed as one entity. So AIG is now executing a strategy, in close cooperation with the Federal Reserve and U.S. Treasury, to protect the value of its component businesses, capture part of that value to pay back monies owed to the government, and position its businesses for the future as more independently run, transparent companies.

The corporate leadership team now in place has made progress executing its restructuring plan by: reducing the excessive risk from exposure to certain financial products, derivatives trading activities, and securities lending; rationalizing AIG's cost structure; selling easily separable assets; and stabilizing the company's liquidity.

The new set of tools announced on March 2, 2009 will allow AIG to redirect is restructuring plan away from relying solely on immediate sales for cash to a process that allows AIG to maximize the value of its individual business for the benefit of all stakeholders, including U.S. taxpayers. AIG expects to achieve a complete and orderly restructuring over the next several years through a process that protects policyholders, continues to reduce risk, and produces strong, focused franchises that can operate as independent entities. In the meantime, the leaders of AIG's insurance companies remain focused on running well-capitalized and competitive enterprises.

AIG is dedicated to maintaining its well-known underwriting discipline and providing value to policyholders, agents and the other business partners who are central to its success. AIG's employees, the vast majority of whom have had nothing to do with the problems that have devastated AIG and wiped out some or all of their life savings, are at the heart of this effort. They have reduced costs and sharpened their focus on AIG's customers despite very difficult conditions.

AIG also recognizes the importance of its relationship with the U.S. government. AIG has taken several steps in this regard, including restrictions on executive compensation, suspension of federal lobbying and cessation of corporate political contributions. In addition, AIG is engaged in improving transparency by working with regulators on capital adequacy, appropriate accounting treatment during times of market disruption, and risk management metrics.

Resolving the economic problems facing the U.S. and world markets will require a cooperative effort by the public and private sectors. AIG is committed to playing a constructive role in this process to ensure that it can serve shareholders and pay back taxpayers as it contributes to the U.S. and world economies.

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AIG

ADDENDUM TO TESTIMONY BY MR. EDWARD M. LIDDY,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
AMERICAN INTERNATIONAL GROUP

BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE
ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT-SPONSORED ENTERPRISES

WEDNESDAY, MARCH 18, 2009

AIG Agenda

I. What does AIG do?

II. What went wrong?

III. Why was AIG rescued?

IV. How much money is at risk?

V. Where did the money go?

VI. What are the sources of value underlying the U.S. Taxpayers' investment in AIG?

VII. How will AIG repay the U.S. Government support?

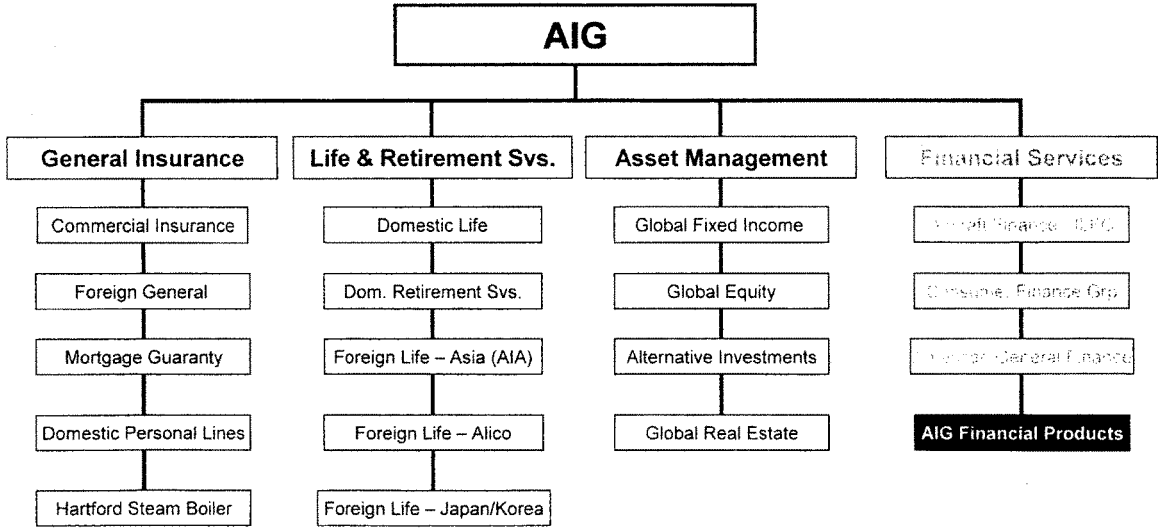
VIII. How did the U.S. Government support for AIG evolve?

IX. Why did AIG report such a large loss in the 4th quarter?

X. What is the status of AIG's Financial Products business?

AIG What does AIG do?

Until the late-1990's, AIG was a well-respected, regulated and conservative insurance operation. Starting in the late-1990's, the Company aggressively grew its non-insurance Financial Services businesses, in particular, its derivatives and capital markets businesses. This exposed AIG to new forms of risk, greatly increased its operating leverage and increased the proportion of lightly regulated business to the total.



AIG What went wrong?

	I	II	III	IV
Critical Event	**AIG FP wrote Credit Default Swaps on securities tied to residential housing** **2001 - 2005**	**Credit crunch hits in Fall of 2007**	**AIG downgraded by principal Ratings Agencies** **9/15/2008**	**AIG exhausts its liquidity resources** **9/16/2008**
Results	▪ Exposed AIG to potential collateral calls for price declines in guaranteed securities and credit downgrade of AIG	▪ Indices[1] measuring High-grade and BBB-rated residential mortgage backed securities prices were down 22% and 85%, respectively, from 9/07-9/08 ▪ Required AIG to post significant collateral to counterparties of AIGFP -- $22.4 bn through 9/16/08 ▪ Put AIG's capital and liquidity position at risk and forced AIG to raise $20 bn of capital in May 2008	▪ Increased collateral posting requirements ▪ Securities Lending counterparties stopped rolling their positions, generating additional liquidity needs	▪ After failed attempts to raise capital from the private sector, AIG turned to the FRBNY for assistance

Notes: 1) ABX06-1 Index

AIG Why was AIG rescued?

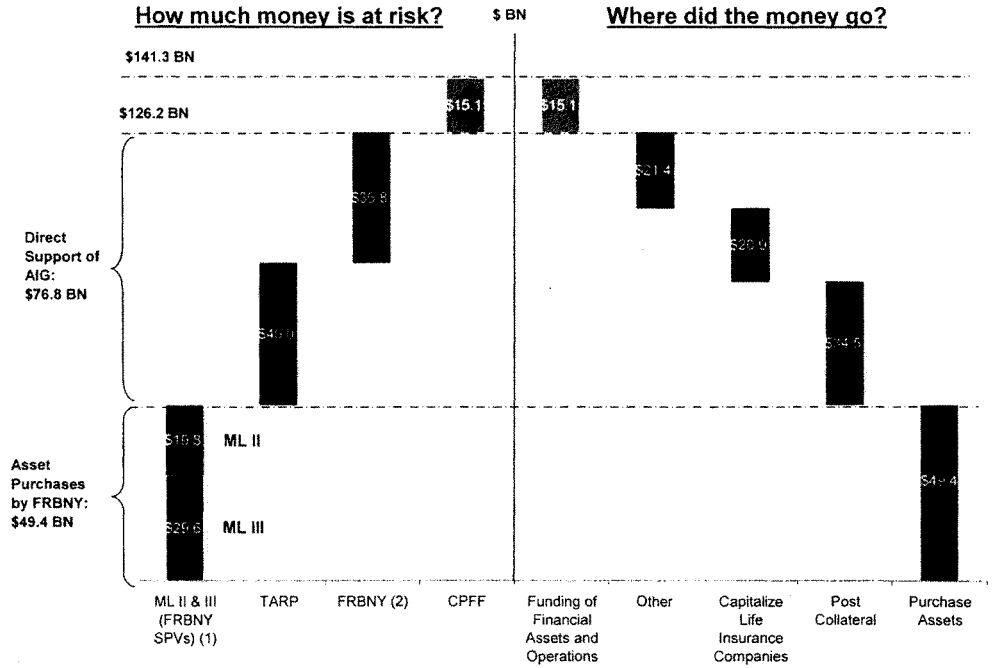
AIG was the world's premier financial institution serving institutional and retail clients globally, and trading on capital markets and through other institutions around the world.

Systemic Risk	The FRBNY and the U.S. Treasury recognized that the risk to the U.S. and global financial systems from the contagion of an AIG failure was too great for the system to handle
Market Fragility	The failure of Bear Stearns and Lehman Brothers, coupled with the nationalization of Fannie Mae and Freddie Mac, had created significant disruptions in the capital markets and added momentum to the downward spiral in asset prices
Protect Policy Holders	AIG has written more than 81 million life insurance policies to individuals worldwide, with a face value of $1.9 trillion. The Company paid over $12 billion in claims in 2008 alone. Increased surrender activity or a "run-on-the-bank" could impair the capital supporting policy holders, forcing more asset sales at lower prices and reinforcing the declining asset value spiral. Should this contagion spread to the $19 trillion of face value policies in the U.S., the outcome would be catastrophic.

AIG's rescue was as much about Main Street as it was about Wall Street

AIG How much money is at risk and where did it go?

Total From 9/16/08-12/31/08

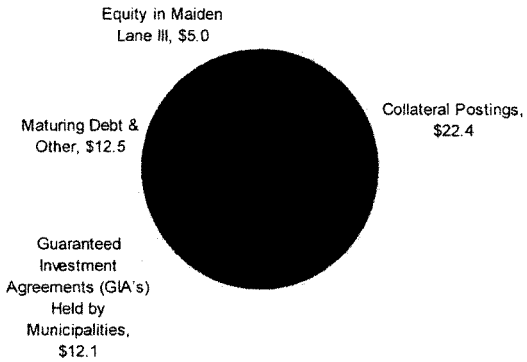


Notes: 1) $29.6 includes payments under shortfall agreements 2) excludes accrued compounding interest and fees through 12/31/08 of $3.6 bn

AIG Where did the money go?

Direct Support to AIG from 9/16/08-12/31/08

AIG FP Related: $52.0 bn



Other AIG Related: $29.4 bn

($ billions)	
AIG FP Related	$52.0
Other AIG Related	29.4
Sub Total	**$81.4**
Less: Repayments	(4.6)
Total Direct Support for AIG	**$76.8**

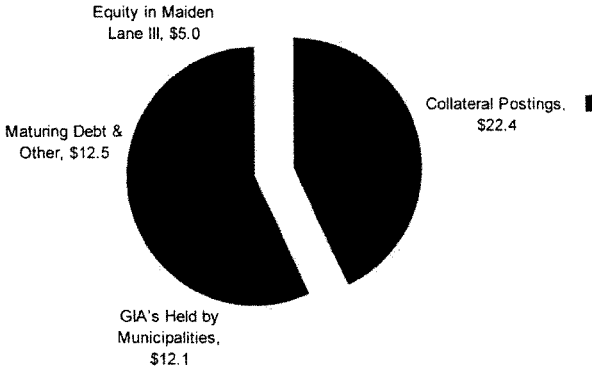
Sources of Funding

($ billions)		
TARP		**$40.0**
FRBNY Drawn		**36.8**
Total Direct Support for AIG		**$76.8**
FRBNY Not Drawn	23.2	
Total FRBNY Commitment	60.0	

AIG Where did the money go? – Meet contractual obligations to counterparties [1]

Direct Support to AIG from 9/16/08-12/31/08

AIG FP Related: $52.0 bn



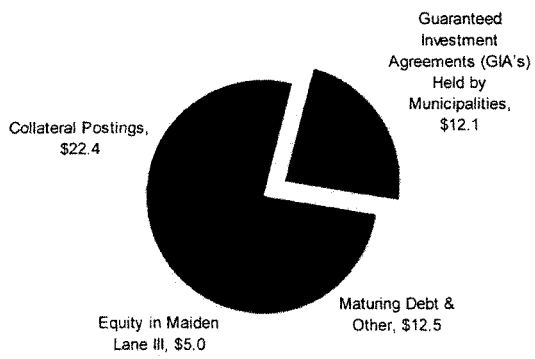
Counterparty	Amount Posted ($ bn)
Societe Generale	$4.1
Deutsche Bank	2.6
Goldman Sachs	2.5
Merrill Lynch	1.8
Calyon	1.1
Barclays	0.9
UBS	0.8
DZ Bank	0.7
Wachovia	0.7
Rabobank	0.5
KFW	0.5
JPMorgan	0.4
Banco Santander	0.3
Danske	0.2
Reconstruction Finance Corp	0.2
HSBC Bank	0.2
Morgan Stanley	0.2
Bank of America	0.2
Bank of Montreal	0.2
Royal Bank of Scotland	0.2
Top 20 CDS Total	**$18.3**
Other	4.1
Total Collateral Postings	**$22.4**

Note 1) The collateral amounts reflected in Schedule A represent funds provided by AIG to the counterparties indicated after September 16, 2008, the date on which AIG began receiving government assistance. The counterparties received additional collateral from AIG prior to this date, and AIG's SEC report relating to ML III reflects the aggregate amount of collateral that counterparties were entitled to retain pursuant to the terms of the ML III transaction.

AIG Where did the money go?– Support over 600 municipalities

Direct Support to AIG from 9/16/08-12/31/08

AIG FP Related: $52.0 bn

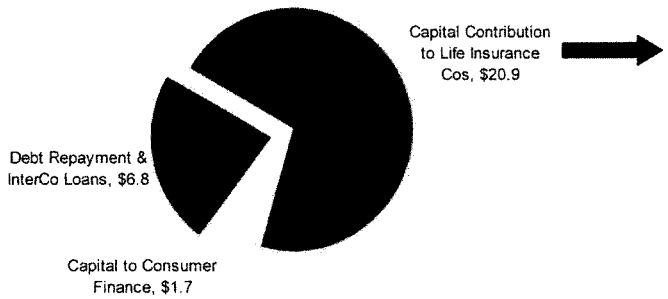


State	Amount ($ bn)
California	$1.02
Virginia	1.01
Hawaii	0.77
Ohio	0.49
Georgia	0.41
Colorado	0.36
Illinois	0.35
Massachusetts	0.34
Kentucky	0.29
Oregon	0.27
Delaware	0.26
New York	0.21
New Jersey	0.21
Mississippi	0.18
Washington	0.17
Pennsylvania	0.15
Florida	0.15
Rhode Island	0.14
Arizona	0.12
Texas	0.10
Top 20 Total	**$7.00**
Other	5.10
Total Guaranteed Investment Agreements	**$12.10**

AIG Where did the money go? – Protect life policy holders

Direct Support to AIG from 9/16/08-12/31/08

Other AIG Related: $29.4 bn



Entities	Amount
Domestic Life and Retirement Services	$17.2
Foreign Life Companies	3.7
Total	**$ 20.9**

Direct Uses	Amount
Securities Lending	$16.2
Other	4.7
Total	**$20.9**

AIG Where did the money go? – Maiden Lane III

($ billions)

Institution (Counterparty may differ)	Maiden Lane III Payments Made to Counterparties	Maiden Lane III Payments Made to AIGFP
Deutsche Bank	$2.8	
Landesbank Baden-Wuerttemberg	0.1	
Wachovia	0.8	
Calyon	1.2	
Rabobank	0.3	
Goldman Sachs	5.6	
Société Générale	6.9	
Merrill Lynch	3.1	
Bank of America	0.5	
The Royal Bank of Scotland	0.5	
HSBC Bank USA	0.0*	
Deutsche Zentral-Genossenschaftsbank	1.0	
Dresdner Bank AG	0.4	
UBS	2.5	
Barclays	0.6	
Bank of Montreal	0.9	
Other payments to AIGFP under Shortfall Agreement		$2.5
Total	**$27.1**	**$2.5**

* Amount rounds to zero

AIG

What are the sources of value underlying the U.S. Taxpayers' investment in AIG?

Maiden Lane II (RMBS)

$39.3 bn par value
RMBS

% Performing	100%
Avg Purchase Price	50.4% Par
Senior Note (FRBNY)	19.5
Equity (AIG)	1.0
Total Purchase Price	**$20.5**

Maiden Lane III (CDO)

$62.1 bn par value
CDO

% Performing	100%
Avg Purchase Price	47.7% Par
Senior Note (FRBNY)	24.3
Equity (AIG)	5.0
Total Purchase Price	**$29.3**

Sources of AIG's Value

($ billions)	2008
Total Assets	$860.4
Insurance Premiums and Net Investment Income	$95.7
Pre-Tax Operating Income (1)	
Global Commercial Ins (2)	$2.1
Domestic Life and Retirement Svcs	$1.5
Foreign Life and Retirement Svcs	$5.4

Customers (Globally)	74 million
Customers (U.S.)	30 million

- #1 in Domestic Term Life and Ordinary Life
- #1 Retirement Services provider to primary and secondary education
- #1 Foreign Life insurer in Japan, with significant cash in Japan for all insurers
- Largest U.S. underwriter of commercial and industrial insurance
- Largest foreign-owned P&C insurance franchise in Japan and mainland China
- Largest life insurer in Southeast Asia
- Largest investor (including all of AIG's investments) in corporate bonds in the U.S.
- Highest fleet value of any aircraft lessor and Boeing's largest client
- Top 5 largest institutional asset managers in the world

Notes: 1) excludes realized capital gains / losses 2) Includes Commercial Insurance and Foreign General business units

AIG How will AIG repay the U.S. Government support?

AIG has undertaken a massive restructuring that will effectively break up the Company and unlock value to repay taxpayers. There are four principal mechanisms for accomplishing this.

Sales of Businesses for Cash and Securities	▪ Principally for smaller AIG units ▪ Easier to finance, less capital-intensive businesses
Debt for Equity Swaps	▪ Allows AIG to move large, highly-valued foreign life businesses out from under the holding company – preserves and maximizes value ▪ FRBNY will receive preferred interests in SPVs that will own these businesses in exchange for reducing debt owed to FRBNY ▪ Ultimately these businesses will be monetized through sales or IPOs
Securitizations	▪ Allows AIG to capture the embedded value of its domestic life insurance companies while avoiding distressed sales ▪ FRBNY receives senior notes backed by cash flows from underlying policies ▪ These securities will be rated and marketable when markets improve
IPOs	▪ Attractive alternative path to monetization of larger, unique, highly valued businesses ▪ Execution could take several years to ultimate exit ▪ Likely to generate more attractive valuations

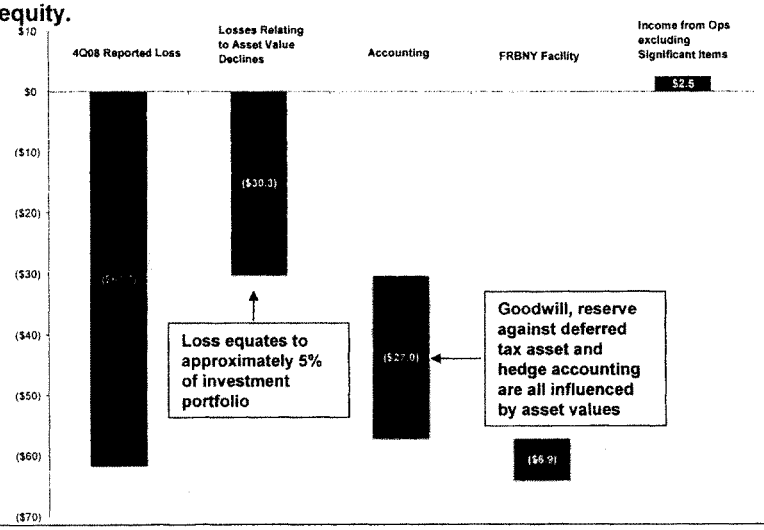
AIG How did the U.S. Government support for AIG evolve?

AIG was the first insurance-based financial institution to require Federal assistance. As such, existing regulatory policies and tools were not designed to fix the underlying causes of AIG's distress, requiring several modifications in November 2008 and again in March 2009.

	Rescue 1	Rescue 2	Rescue 3
Date:	September 16, 2008	November 10, 2008	March 2, 2009
Problem:	▪ Severe liquidity crisis brought on by: - Falling asset prices - Ratings downgrade ▪ AIG was unable to tap the capital markets and did not have access to the funding programs that banks were able to utilize	▪ Excessive leverage from FRBNY debt ▪ Continued bleeding from AIG Financial Products CDS portfolio	▪ Large 4th quarter loss driven by asset value decline eroding capital ▪ Lack of success selling quality businesses into a distressed market
Solution:	▪ $85bn Senior Secured lending facility - 2 year term	▪ $40bn TARP Preferred Capital injection ▪ Reduction in FRBNY line and extension of term to 5 years ▪ ML II and ML III	▪ Debt for Equity Swaps ▪ Securitizations ▪ $30bn of standby TARP capacity
Other Terms:	▪ U.S. Treasury received 77.9% ownership of AIG	▪ AIG gives up 5/6 and 2/3 of upside on MLII and MLIII	▪ Improved terms of FRBNY facility ▪ Modified TARP preferred to achieve better capital treatment
Comments:	▪ Did not solve AIGFP or Securities Lending problems ▪ Did not prevent further capital erosion from asset value declines	▪ Mitigated AIGFP multi-sector CDO risks and Securities Lending risks ▪ AIG remained exposed to declines in asset valuations	▪ Stabilized AIG's balance sheet by providing access to additional capital and reduces financial leverage ▪ AIG remains exposed to declines in asset valuations

AIG Why did AIG report such a large loss in the 4th quarter?

AIG is a very large company - the largest insurance company in the US and one of the largest in the world. Much of AIG's loss was due to declines in asset values in its $637 billion investment portfolio. Mark to market accounting rules require declines in market values of investments to be reflected either as a loss on the income statement or a direct reduction in shareholders equity.



- **During 2008, major U.S. Life insurers lost $118 bn of their combined market caps during the year, largely attributable to asset value declines that caused losses in their investment portfolio**
- **Since 1/1/09 these companies' shares are down 79% on average**

AIG What is the status of AIG's Financial Products business?

AIG has been actively de-risking and running off its Financial Products business.

	Sept 30	Dec 31	Current	
Number of trade positions	44,000	36,000	29,000	▪ Reduced client trades by 30% since year-end 2008 ▪ Number of long-dated trades (>50 years) reduced from 70 to 12 ▪ Additional 15% naturally maturing in 2009
Notional of derivatives outstanding ($ Trillion)	$1.8 Tr	$1.6 Tr	$1.4 Tr	▪ Multi-sector CDO Notional reduced by 85% via Maiden Lane III ▪ 40% of Regulatory Capital Notional effectively terminated or called over the past year
Exposure to change in volatility (Gross Vega in $ Billion)*	$1.30 Bn	$1.25 Bn	$0.80 Bn	▪ Interest Rates – down 30% ▪ Equity – down 35% ▪ Commodities – down 50% ▪ Foreign Exchange – down 50%
Number of businesses (risk books)	22	21	17	▪ 5 books almost completely wound down, including Commodities Index, Infrastructure Investments, exotic Foreign Exchange/Rates
Number of employees	428	375	365	▪ FP will close two locations, Tokyo and Hong Kong in 2009

* The Gross Vega is calculated as the sum of all the individual position's absolute vegas as if each position is not hedged. Although FP's books are almost completely hedged on a net Vega basis, the Gross Vega measure will help monitor how well the volatility risk is being eliminated, not just hedging that risk. The interest rate option vega denotes the change in value due to a 0.1% increase in normal volatility. For other derivatives (i.e., Equity, Commodity and FX option), vega denotes the change in value due to a 1% increase in lognormal volatility.

AIG

Appendix

AIG Who were AIG's counterparties? – Securities Lending

9/18/08-12/12/08

($ billions)

Institution	Payments to Counterparties by U.S. Securities Lending
Barclays	$7.0
Deutsche Bank	6.4
BNP Paribas	4.9
Goldman Sachs	4.8
Bank of America	4.5
HSBC	3.3
Citigroup	2.3
Dresdner Kleinwort	2.2
Merrill Lynch	1.9
UBS	1.7
ING	1.5
Morgan Stanley	1.0
Societe Generale	0.9
AIG International Inc.	0.6
Credit Suisse	0.4
Paloma Securities	0.2
Citadel	0.2
Total	**$43.7***

Sources of Funding

Maiden Lane II	$19.5
FRBNY Senior Secured Facility	17.2
AIG Funded	7.0
Total Related to Securities Lending	$43.7

* Amounts may not total due to rounding

AIG

DRAFT – March 6, 2009

AIG: Is the Risk Systemic?

This draft Presentation has been prepared by American International Group, Inc. ("AIG") with respect to certain information relating to its businesses. AIG does not intend to update this Presentation following its distribution. Although AIG believes the information included in this Presentation is accurate, AIG makes no representation or warranty as to its accuracy or completeness

AIG What is Systemic Risk?

- *Systemic risk* is the risk imposed by *inter-linkages* and *interdependencies* in a system or market, which could potentially bankrupt or bring down the entire system or market if one player is eliminated, or a cluster of failures occurs at once.
- Systemic financial risk occurs when contingency plans that are developed individually to address selected risks are collectively incompatible. It is the quintessential "knee bone is connected to the thigh bone..." where every element that once appeared independent is connected with every other element.
- AIG's business model – a sprawl of $1 trillion of insurance and financial services businesses, whose AAA credit was used to backstop a $2 trillion dollar financial products trading business – has many inherent risks that are correlated with one another. As the global economy has experienced multi-sector failures, AIG's vast business has been weakened by these multi-sector failures.
- AIG's original problem – an over-reliance on U.S. residential mortgage-backed securities (RMBS) in its investment portfolios – has now been deepened by weakness in the commercial mortgage-backed securities market, the global real estate market, the global equities market, slowing business and consumer spending activity and the concomitant demand for higher liquidity by regulators and customers around the world.
- Systemic risk afflicts all life insurance and investment firms around the world. Thus, what happens to AIG has the potential to trigger a cascading set of further failures which cannot be stopped except by extraordinary means.

AIG Risk Assessment Summary

• In the fall of 2008, the Federal Reserve and Department of the Treasury determined that the systemic risk of a failure of AIG was so great that they should provide a support program by injecting liquidity and equity capital into AIG.

• To repay the debt and reduce the degree of financial risk to the firm, AIG has instituted a wind-down of its Financial Products business and a massive divestiture process to sell businesses, despite the increasingly difficult M&A and credit environment.

•The previously provided solution addressed short-term liquidity needs and AIG's over-concentration in the RMBS market. But AIG still faces massive investment losses and credit downgrades. Without additional federal tools being deployed in the AIG situation, AIG will not be able to repay its obligations. Despite adequate current security against the U.S. government's investment, that investment may not be recovered.

• AIG operates in more than 130 countries around the world, whose customers, regulators, and governments have thus far refrained from liquidating or seizing assets based largely on the support given to AIG by the U.S. government.

• The failure of AIG would cause turmoil in the U.S. economy and global markets, and have multiple and potentially catastrophic unforeseen consequences.

•The inability of AIG to immediately secure additional assistance from the Federal Reserve and the Department of the Treasury threatens not only AIG's sales process, but also consumer and business confidence around the world.

AIG How Big is the Systemic Risk in Insurance ?

- While the term "insurance" is used, AIG and its industry brethren sell and service not just the traditional property and casualty and death benefit life insurance policies, but accident and health coverage, pension and retirement policies, and a variety of wealth accumulation vehicles, such as annuities.
- The systemic risk is principally centered in the "life insurance" business because it is this subsector that has the greatest variety of investments and obligations that are subject to loss of value of the underlying investments.
- The life insurance industry employs approximately 2.3 million people in the U.S. who sell individual and group policies. There are over $19 trillion of face value "life" policies in force in the U.S. and 375 million policies.
- Over the past decade, the voluntary termination rate on individual policies declined remarkably (to six percent by 2007) as consumers could obtain liquidity from numerous other sources.
- A significant rise in surrender rates – inspired by consumers' needs for cash or because of rumored or real failure of insurance companies – could be disastrous. Because of widespread loss of liquidity, the industry would struggle to raise adequate cash to meet surrender requests. A "run on the bank" in the life and retirement business would have sweeping impacts across the economy in the U.S. In countries around the world with higher savings rates than the U.S., the failure of insurance companies like AIG would be a catastrophe.

AIG Impact on U.S. Government's Efforts to Stabilize Economy

- If AIG were to fail notwithstanding the previous substantial government support, it is likely to have a cascading impact on a number of U.S. life insurers already weakened by credit losses. State insurance guarantee funds would be quickly dissipated, leading to even greater runs on the insurance industry.

- Given AIG's insurance companies' relative size compared to other U.S. insurance companies, there is no ability for an "arranged marriage" of AIG's largest units with other U.S. insurance companies.

- In addition, the government's unwillingness to support AIG could lead to a crisis of confidence here and abroad over other large financial institutions, particularly those that have thus far remained viable because of government support programs.

- This loss of confidence is likely to be particularly acute in countries that have large investments in U.S. companies and securities and whose citizens may suffer significant losses as a result of the failure of AIG's foreign insurance subsidiaries.

- This could lead directly to a decrease in the attractiveness of U.S. government securities and a consequent increase in borrowing costs for the U.S. government and related issuing entities.

AIG Impact on U.S. Government's Efforts to Stabilize Economy

- Moreover, permitting AIG to fail would be even more serious today than in September, especially in view of the support of the U.S. government. Public confidence in financial institutions is at a nadir and it is questionable whether the economy could tolerate another shock to the system that a failure of AIG would produce.

- The extent and interconnectedness of AIG's business is far-reaching and encompasses customers across the globe ranging from governmental agencies, corporations and consumer to counterparties. A failure of AIG could create a chain reaction of enormous proportion.

- While some of these potential consequences are inherently judgmental and, to an extent, speculative, if there is one conclusion that can be unquestionably drawn from the failure of Lehman, it is that the adverse consequences of the failure of a major financial institution cannot be foreseen.

- Just as the government was unable to predict that the failure of Lehman would lead to the collapse of the Reserve Fund, followed by much of the money market industry, the government would be even less capable of predicting the fallout from the collapse of a much larger, more global and more consumer-oriented institution such as AIG.

AIG's Global Impact

Domestic General

- Largest U.S. underwriter of commercial and industrial insurance
- #1 U.S. underwriter of Directors & Officers, Employment Practices Liability, Professional Liability, Workers' Comp, Surplus Lines, Environmental, Aviation and many other lines

Domestic Life & Retirement Services

- #1 retirement services provider to primary and secondary education, #3 healthcare groups, #3 higher education
- #1 in term life and total issued insurance
- Largest issuer of fixed annuities

Foreign General

- Most extensive international property-casualty network
- Largest foreign owned property-casualty insurance franchise in Japan, mainland China, Hong Kong, Korea and Thailand
- Largest U.S. based general insurer in Europe

Foreign Life & Retirement Services

- Most geographically diversified life insurance organization
- Leading foreign life insurer in Hong Kong, Thailand, Singapore, Malaysia, the Philippines, and China
- # 1 foreign life insurer in Japan

Financial Services

- Highest fleet value of any aircraft lessor
- 2nd largest consumer finance branch network in U.S.

Asset Management

- Second largest investor (including all of AIG's investments) in corporate bonds in the U.S.
- Top five largest institutional asset managers in the world
- Largest independent broker-dealer organization in the U.S.

AIG General Impact on Economy

A failure of AIG would have a devastating impact on the U.S. and global economy. The economic effects may include:

- Potential unemployment for a large portion of the 116,000 employees, including 50,000 employees in all 50 states and the District of Columbia (generating annual U.S. salaries totaling $3.5 billion)

- Adverse impact on AIG's 74 million customers worldwide, including 30 million U.S. customers in its general insurance, life insurance and retirement services, and financial services businesses

- **The immediate damage to credit markets worldwide from an AIG failure would dwarf the Lehman fallout. Possible outcomes for which the Treasury would need to be prepared to respond:**
  - Fall in the foreign exchange value of the dollar
  - Increase in Treasury borrowing costs
  - Doubts about the ability of the U.S. to support its banking system

AIG Life Insurance Policyholders: "Run on The Bank"

- **AIG has written more than 81 million life insurance policies to individuals worldwide**
  - Face value: $1.9 trillion
  - Claims paid in 2008: more than $12 billion

- **If AIG fails, policyholders are likely to seek to "cash in" policies, placing enormous strain on the insurance system, as well as bond and equity markets as assets are liquidated to pay policyholders**
  - Surrender of insurance policies at above-normal actuarial rates could impair current policyholders as capital, along with state guarantee funds, might be insufficient to pay all policyholder claims
  - Third-party sellers of AIG products would face an unmanageable spike in customer redemption demands, damaging consumer confidence
  - Forced sales of assets would be required to cover withdrawals

- **Existing AIG policyholders could be unable to obtain insurance coverage from other insurance companies**
  - Potential dramatic increases in policy costs and/or significant decline in available products (e.g. fixed annuities)
  - Some life policyholders may no longer be insurable at commensurate rates or as a result of adverse health situations since purchase of original policy

AIG Impact on Retirement Savings

- **AIG Retirement Services**
  - 6.9 million customers – including many retired Americans
    - Total account value: approximately $134 billion
    - Many policyholders are middle-class Americans earning around $50,000-60,000 a year
    - Income from AIG's 403(b) plans is often the beneficiary's primary source of retirement income
  - Products include defined contribution retirement accounts, such as 403(b) (VALIC), deferred fixed annuities (AIG Annuity), variable annuities and brokerage accounts
  - AIG Annuity: #1 ranked seller of fixed annuities through financial institutions
  - VALIC: #1 or #3 ranked across non-profit sectors (#1 in K-12 teachers, #3 in higher education and #3 in healthcare)

- **Consequences of Failure**
  - A failure of AIG's life insurance companies would be one of the largest failures in the history of life insurance, putting applicable retirement savings significantly at risk and causing a loss of confidence in the private retirement savings market in the U.S.
  - Failure would produce an immediate "run on the bank," which would likely lead to state seizures of local operations, causing a potential lock-up in customers' retirement accounts and payment of monthly/quarterly annuity checks
  - Seizure by state regulators would have an adverse impact on state guarantee funds, which are unfunded, resulting in assessments against other insurance companies
  - Such assessments in an already weak market could lead affected industry players to sell assets, resulting in further downward pressure on fixed income markets
  - Under current market conditions and because of the capital intensive nature of the fixed annuity business, capacity may not be picked up by peers
  - Given the foregoing, there is a risk of undermining the confidence in the private retirement savings market in the United States

AIG Consumer Finance Impact

- An AIG failure could lead to the failure of American General Finance (AGF), America's second largest "Main Street" lender
  - AGF:
    - Has prudently helped American consumers and small businesses for more than 85 years
    - Is serving more than 2 million American families with more than $24 billion of loans through 1,400+ offices in 40 states
    - Supports more than 20,000 retail merchants
    - Employs approximately 8,000 people
    - Serves communities in small / medium sized cities that are underserved by U.S. megabanks
  - A failure of AGF could:
    - Eliminate $12 billion to $15 billion in U.S. consumer lending over the next 3 years that is not provided by banks
    - Trigger a default (and related litigation) on more than $23 billion of AGF debt held by U.S. and European investors

- Also, AIG Consumer Finance Group, Inc. (AIGCFG) operates in Latin America, Europe and Asia
  - In September, there were significant "runs on the bank" in various Asian and European countries
  - Bank runs resulting from the failure of AIG or AIGCFG may lead to systemic risk in certain countries in which it operates

AIG Extensive Business Disruption

- **AIG Commercial Insurance (AIGCI):**
  - Largest property casualty insurance operation in the United States
  - Underwrites more than 450 insurance products and services across 83 industries
  - Protects and insures approximately 180,000 entities employing over 106 million people in the U.S.
  - Nearly 1/3 of all people in the United States are employed by an entity that is protected by insurance coverage through AIG Commercial Insurance
  - Protects 20 million commercial and individual policyholders & certificate-holders
  - Paid approximately $18.3 billion in U.S. claims in 2008

- **Worldwide, AIG writes insurance for:**
  - 94% of the Fortune 500 – Global, with annual premiums of over $10.5 billion
  - 97% of the Fortune 500, with annual premiums of nearly $9 billion
  - 97% of the Fortune 1000, with annual premiums of over $10.2 billion
  - 81% of the Forbes 2000, with annual premiums of nearly $15 billion
  - 90% of the Financial Times 500 – Europe, with annual premiums of $6 billion
  - 77% of the Financial Times 500 – U.K., with annual premiums of $2 billion

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AIG Extensive Business Disruption (cont.)

- **AIGCI covers a wide range of business and non-profit organizations, including:**
  - **15,000** farms and agricultural businesses
  - **30,000** commercial and residential contractors, including almost every major U.S. infrastructure project
  - **5,000** schools; school boards; elementary, secondary and higher education facilities; libraries; museums; and art galleries
  - **23,000** non-profit and social service organizations
  - **2,600** energy and environmental organizations, including power utilities, superfund sites, oil and gas exploration businesses, alternative energy concerns and electric utilities
  - **21,000** healthcare providers, including doctors, medical facilities, hospitals, and nursing homes.
  - **7,000** real estate businesses including real estate agencies, commercial and retail buildings and mobile homes
  - **9,800** transportation and travel concerns, including airlines, buses, trains, cargo ships, hotels, taxi cab companies and trucking companies
  - **550** public entities including local governments, water authorities, airport authorities, housing departments, community development administrations and police and fire departments

AIG Extensive Business Disruption (cont.)

- **Consequences of a failure of AIGCI include:**
  - AIGCI would immediately write less business and many businesses would cancel their existing policies, causing a substantial impact on cash flow
  - In the event of negative cash flow, AIGCI would start liquidating its investment securities, including its municipal bonds holdings (AIGCI is the second largest U.S. investor in municipal bonds)
  - As clients turn to other carriers, the loss of AIGCI's capacity in the marketplace would significantly drive up the cost of securing property-casualty insurance
    - Given AIGCI's higher tolerance for insuring riskier businesses, premium raises would be especially substantial in riskier industries, including financial services and automotive, and in riskier lines of business, such as property and terrorism
    - Price increases could lead to smaller businesses "self-insuring" for some risks
  - AIGCI is the primary U.S. incorporated insurer offering comprehensive global policies for multinationals; these businesses would therefore turn to foreign-owned competitors to meet their significant and complex insurance needs
  - Residual market facilities (insurers of last resort) would see significant increases in new business, resulting in further financial strain on states and other insurers (who would be assessed)

AIG Extensive Business Disruption (cont.)

- **American International Underwriters (AIU) is a leader in providing commercial insurance worldwide:**
  - AIU has a presence in approximately 85 countries, and has the unique ability to provide multi-national coverage to U.S. and foreign companies all over the world
  - In personal lines (PL), AIU insures 36 million households worldwide
  - AIU is a leader in financial lines (FL):
    - Covering 70% of the top 50 international banks
    - Leading underwriter of directors and officers (D&O) insurance for large corporations globally
    - Providing significant capacity for U.S. exposures in the London market
  - The AIU Lloyd's Ascot syndicate provides significant capacity in U.S. catastrophic excess coverage (Cat Excess)
  - Combined with Cat Excess, AIU is the largest capacity provider in the world to the top 50 global banks
  - AIU insures the U.S. military, the U.N., U.S. and foreign embassies, and important commercial and other organizations worldwide, including the Panama Canal, oil rigs, trucking, marine cargo and Doctors without Borders
  - AIU's Defense Base Act program provides coverage to contractors in support of the rebuilding of the infrastructure in Iraq and Afghanistan
  - AIU has over 20,000 employees and over 70,000 agents globally

AIG Extensive Business Disruption (cont.)

- **Consequences of a failure of AIU include:**
  - Increased financial stress on airlines in view of AIU's leadership position in aviation insurance:
    - AIU was a leader in putting planes back in the air after 9/11 by developing new capacity. This helped to restart the economy and stabilize personal and business travel.
    - AIU currently insures 20% of the global aviation market. If AIU exits the market, there would be an immediate move by remaining carriers to rapidly increase rates. Airlines are already under severe financial stress and this would add to their difficulties.
  - Major disruption in accident and health (A&H) insurance markets worldwide, particularly in Asia Pacific where AIU is a market leader in major economies (including Japan, Korea and China).
  - Significant loss of capacity in commercial D&O and FL D&O:
    - AIU's total exposure is close to $500B. Commercial D&O is estimated to be $450B and FL D&O and personal lines are approximately $33B.
    - Without AIU's capacity in FL, there would be a shortfall in capacity, which would cause a tightening of terms and conditions and a resulting large premium increase. Many of the largest global banks would be unable, at any price, to replace AIU's capacity and expertise.
    - The commercial D&O market would be less accessible since insurers would opportunistically increase pricing.
    - It would be difficult to replicate AIU's international network that allows AIU to issue D&O underlyer polices for multinational customers in 85 countries, leaving many multinational customers exposed in local countries.
  - A failure of AIU may disrupt international trade:
    - AIU is one of the top 3 suppliers of coverage for ocean cargo, the vessels that transport goods and the ports that receive and handle those goods.
    - AIU provides product liability coverage to exporters (e.g., AIU is the number 1 provider of export product liability coverage in China).

AIG Impact on Global Capital Markets

- **An AIG failure could have similar or worse consequences on the global financial markets as that of the Lehman bankruptcy.** Similarities include:
  - **The large size of their derivatives books:** AIG Financial Products Corp. (AIGFP) has approximately $1.6 trillion in notional derivatives exposures
    - Unwinding of the portfolio in an AIG failure would likely cause enormous downward pressure on valuations across a wide range of associated asset classes
  - **The large number of counterparties** involved in a wind-down of the derivatives books.
    - Counterparties include top banks, sovereign wealth funds, money managers and hedge funds
    - Total client base: more than 1,500 major corporations, governments, and institutional investors would be affected
- **Widespread impact of ratings downgrades**
    - Certain AIGFP contracts include a ratings downgrade as an "event of default;" all AIGFP contracts include bankruptcy as an "event of default," providing a termination right to each counterparty
    - Downward pressure on values of underlying assets resulting from terminations of and the calls pursuant to the underlying and associated contracts
- **Spotlight: U.S. Municipal Market**
  - **2nd largest holder of U.S. municipal bonds:** AIG's commercial insurance (AIGCI) business has more than $70 billion of invested assets, 73% in U.S. municipal bonds. A forced sale of AIGCI's investment portfolio would significantly stress the U.S. municipal bond market

AIG Direct and Indirect Impact of AIGFP failure

	Effect of FP Failure	Parties affected
AIG FP / AIG debt (issued securities)	– Inability to repay a significant portion of $30 billion of AIGFP issuances, including commercial paper issuances – Signal to markets that debt of other entities with government support at risk	– Institutional Investors – Retail Investors – Entities with government support
Benefit Responsive Options ("BROs")	– Failure to provide a wrap on $38 billion of stable value funds could result in millions of lost value on money market positions potentially "breaking the buck" – Massive retail investor withdrawals may occur on stable value funds and damage confidence in 401(k) plans – May in turn prompt sponsors to make individual investors whole	– Retail Investors – Pension Funds – Large Mutual Fund Complexes
Credit Protection on Corporate Arbitrage and CDOs / CLOs	– Credit protection on ~$63 billion in CDOs / CLOs may be eliminated – Major U.S. banks would lose hedges on correlation books ~ consequent higher CDS spreads for major corporates will raise funding costs across economy – Widening spreads and illiquidity in CDO and CLO market could lead to dramatic further write-downs	– Major banks – Corporate Borrowers – Institutional Investors
Regulatory Capital	– European Banks could need to raise additional ~$10 billion in equity capital rapidly – could result in multiple downgrades resulting in catastrophic market disruptions	– Major European Banks • e.g. RBS, SocGen, BNP, Banco Santander, Danske, Rabobank, Credit Logemont, Calyon
Other Derivatives (Rates, FX, Equities, Commodities)	– Forced client terminations will result in massive spread widening and significant unhedged positions – Disrupted markets could cause large losses for dealer / bank counterparties as they attempt to replace lost positions with AIGFP – Risk in individual unhedged portfolios could jump by 20-30x from current levels	– Corporations – Supra-nationals • e.g. World Bank/IFC, IBRD, EIB – Dealers
Guaranteed Investment Contracts ("GICs") / Leases	– Failure to collateralize $2 billion in GICs / Leases would lead to downgrades, and further disruption to the municipal bond markets	– Municipalities

AIG Impact of Failure of ILFC

- International Lease Finance Corporation (ILFC) is the largest aircraft lessor in the world, with more than 950 aircraft

- ILFC's role in U.S. Economy:
  - Since 1978, ILFC has purchased more new Boeing aircraft (approximately 670 units) than any other airline or leasing company
  - ILFC is the largest commercial customer of General Electric (engines), Honeywell, Rockwell Int'l (avionics) and United Technologies (engines/APU)
  - ILFC is the largest buyer of U.S. made engines and components for new Airbus aircraft
  - ILFC has 102 new jets on order from Boeing as of December 2008, with a value of $12.5 billion, for deliveries in 2009 and beyond
  - ILFC's new Boeing planes are primarily for export, helping U.S. balance of payments, via long term leases to foreign airlines
- A failure of ILFC may lead to:
  - Loss by Boeing of its largest customer, including $12.5 billion of forward order book, which may result in reduction in Boeing's 183,000 strong workforce
  - ILFC may be forced to liquidate its 1,000-plane aircraft portfolio at distressed prices, severely impacting the already weak aircraft industry
  - Losses to U.S. banks and U.S. institutional holders of ILFC debt (currently $30 billon+)
  - Less taxable income due to distressed sale prices (current potential taxable gain of $13.1 billion)

AIG Seizure of foreign assets

- **An AIG failure would likely result in the immediate seizure of certain insurance businesses of AIG by domestic and foreign regulators.**
  - The seizure by one regulator in a given region (*e.g.*, Asia) would almost certainly have a domino effect and lead to the seizure of insurance businesses in multiple jurisdictions across the region
  - Once these assets were effectively nationalized they would be out of the reach of the U.S.
  - Given the substantial "footprint" of AIG's insurance presence in these regions, the consequence of a seizure would significantly impair, if not cripple, the entire insurance industry within certain regions
  - Even if there is not an immediate seizure of the insurance businesses, there will be significant policy cancellations which will likely lead to seizures

- Seizure of foreign assets could lead to:
  - Loss of assets to repay the Federal Reserve
  - Collapse of AIG's public debt
  - Loss of value of the U.S.Treasury's Preferred Shares

AIG Conclusion

• Insurance is the oxygen of the free enterprise system. Without the promise of protection against life's adversities, the fundamentals of capitalism are undermined.

• The failure of the world's largest insurer at a time of major global financial and economic instability will exacerbate the challenge of reigniting consumer confidence.

• Since life insurance has changed greatly in character over the last two decades – from just a basic provision of death and disability benefits to a vehicle for retirement savings and wealth accumulation – the effects of disrupting the industry are wide-ranging and significant.

• There is a legitimate public policy rationale for regulatory reform of the industry, and the federal government's continuing role in AIG's destiny would be consistent with such a policy direction.

Embargoed until
March 18, 2009, at 10:00 a.m.

Statement of

Scott M. Polakoff
Acting Director, Office of Thrift Supervision

regarding

American International Group's Impact on the Global Economy: Before, During, and After Federal Intervention

before the

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives

March 18, 2009

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on American International Group's Impact on the Global Economy: Before, During, and After Federal Intervention
Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services

Scott M. Polakoff, Acting Director
Office of Thrift Supervision

March 18, 2009

I. Introduction

Good morning, Chairman Kanjorski, Ranking Member Garrett and members of the Subcommittee. Thank you for inviting me to testify regarding the Office of Thrift Supervision's (OTS) examination and supervisory program and its oversight of American International Group, Inc. (AIG). I appreciate the opportunity to familiarize the Subcommittee with the complex, international operations of AIG as well as the steps the OTS took to oversee the company.

At the Subcommittee's request, in my testimony today, I will discuss the complicated set of circumstances that led to the government intervention in AIG. I will provide details on our role as the consolidated supervisor of AIG, the nature and extent of AIG's operations, the risk exposure that it accepted, and the excessive concentration by one of its companies in particularly intricate, new, and unregulated financial instruments. I will also outline the Agency's supervisory and enforcement activities.

I will describe some lessons learned from the rise and fall of AIG, and offer my opinion, in hindsight, on what we might have done differently. Finally, I will outline some needed changes that could prevent similar financial companies from repeating

AIG's errors in managing its risk, as well as actions Congress might consider in the realm of regulatory reform.

II. History of AIG

AIG is a huge international conglomerate that operates in 130 countries worldwide. As of year-end 2007, the combined assets of the AIG group were $1 trillion. The AIG group's primary business is insurance. AIG's core business segments fall under four general categories (*e.g.*, General Insurance, Life Insurance and Retirement Services, Financial Services, and Asset Management). AIG's core business of insurance is functionally regulated by various U.S. state regulators, with the lead role assumed by the New York and Pennsylvania Departments of Insurance, and by foreign regulators throughout the 130 countries in which AIG operates.

My testimony will focus primarily on AIG, the holding company, and AIG Financial Products (AIGFP). Many of the initial problems in the AIG group were centered in AIGFP and AIG's Securities Lending Business.

It is critically important to note that AIG's crisis was caused by liquidity problems, not capital inadequacy. AIG's liquidity was impaired as a result of two of AIG's business lines: (1) AIGFP's "super senior" credit default swaps (CDS) associated with collateralized debt obligations (CDO), backed primarily by U.S. subprime mortgage securities and (2) AIG's securities lending commitments. While much of AIG's liquidity problems were the result of the collateral call requirements on the CDS transactions, the cash requirements of the company's securities lending program also were a significant factor.

AIG's securities lending activities began prior to 2000. Its securities lending portfolio is owned pro-rata by its participating, regulated insurance companies. At its highest point, the portfolio's $90 billion in assets comprised approximately nine percent of the group's total assets. AIG Securities Lending Corp., a registered broker-dealer in the U.S., managed the much larger, domestic piece of the securities lending program as agent for the insurance companies in accordance with investment agreements approved by the insurance companies and their functional regulators.

The securities lending program was designed to provide the opportunity to earn an incremental yield on the securities housed in the investment portfolios of AIG's insurance entities. These entities loaned their securities to various third parties, in return for cash collateral, most of which AIG was obligated to repay or roll over every two weeks, on average. While a typical securities lending program reinvests its cash in short duration investments, such as treasuries and commercial paper, AIG's insurance entities invested much of their cash collateral in AAA-rated residential mortgage-backed securities with longer durations.

Similar to the declines in market value of AIGFP's credit default swaps, AIG's residential mortgage investments declined sharply with the turmoil in the housing and mortgage markets. Eventually, this created a tremendous shortfall in the program's assets relative to its liabilities. Requirements by the securities lending program's counterparties to meet margin requirements and return the cash AIG had received as collateral then placed tremendous stress on AIG's liquidity.

AIGFP had been in operation since the early 1990's and operated independently from AIG's regulated insurance entities and insured depository institution. AIGFP's

$100 billion in assets comprises approximately 10 percent of the AIG group's total assets of $1 trillion.

AIGFP's CDS portfolio was largely originated in the 2003 to 2005 period and was facilitated by AIG's full and unconditional guarantee (extended to all AIGFP transactions since its creation), which enabled AIGFP to assume the AAA rating for market transactions and counterparty negotiations.

AIGFP's CDS provide credit protection to counterparties on designated portfolios of loans or debt securities. AIGFP provided such credit protection on a ''second loss'' basis, under which it repeatedly reported and disclosed that its payment obligations would arise only after credit losses in the designated portfolio exceeded a specified threshold amount or level of ''first losses.'' Also known as "super senior," AIGFP provided protection on the layer of credit risk senior to the AAA risk layer. The AIGFP CDS were on the safest portion of the security from a credit perspective. In fact, even today, there have not been credit losses on the AAA risk layer.

AIGFP made an internal decision to stop origination of these derivatives in December 2005 based on their general observation that underwriting standards for mortgages backing securities were declining. At this time, however, AIGFP already had $80 billion of CDS commitments. The housing market began to unravel starting with subprime defaults in 2007, triggering a chain of events that eventually led to government intervention in AIG.

III. OTS's Supervisory Role and Actions

Supervisory Responsibilities

Mr. Chairman, I would like next to provide an overview of OTS' responsibilities in supervising a savings and loan holding company (SLHC). In doing so, I will describe many of the criticisms and corrective actions OTS directed to AIG management and its board of directors, especially after the most recent examinations conducted in 2005, 2006 and 2007.

As you will see, our actions reveal a progressive level of severity in our supervisory criticism of AIG's corporate governance. OTS criticisms addressed AIG's risk management, corporate oversight, and financial reporting, culminating in the Supervisory Letter issued by OTS in March 2008, which downgraded AIG's examination rating.

You will also see that where OTS fell short, as did others, was in the failure to recognize in time the extent of the liquidity risk to AIG of the "super senior" credit default swaps in AIGFP's portfolio. In hindsight, we focused too narrowly on the perceived creditworthiness of the underlying securities and did not sufficiently assess the susceptibility of highly illiquid, complex instruments (both CDS and CDOs) to downgrades in the ratings of the company or the underlying securities, and to declines in the market value of the securities. No one predicted, including OTS, the amount of funds that would be required to meet collateral calls and cash demands on the credit default swap transactions. In retrospect, if we had identified the absolute magnitude of AIGFP's CDS exposures as a liquidity risk, we could have requested that AIGFP reduce its exposure to this concentration.

OTS' interaction with AIG began in 1999 when the conglomerate applied to form a federal savings bank (FSB). AIG received approval in 2000, and the AIG FSB commenced operations on May 15, 2000. OTS is the consolidated supervisor of AIG, which is a savings and loan holding company by virtue of its ownership of AIG Federal Savings Bank.

OTS supervises savings associations and their holding companies to maintain their safety, soundness, and compliance with consumer laws, and to encourage a competitive industry that meets America's financial services needs. As the primary federal regulator of savings and loan holding companies, OTS has the authority to supervise and examine each holding company enterprise, but relies on the specific functional regulators for information and findings regarding the specific entity for which the functional regulator is responsible.

Once created, a holding company is subject to ongoing monitoring and examination. Managerial resources, financial resources and future prospects continue to be evaluated through the CORE holding company examination components (*i.e.*, Capital, Organizational Structure, Risk Management and Earnings). The OTS holding company examination assesses capital and earnings in relation to the unique organizational structure and risk profile of each holding company. During OTS's review of capital adequacy, OTS considers the risk inherent in an enterprise's activities and the ability of the enterprise's capital to absorb unanticipated losses, support the level and composition of the parent company's and subsidiaries' debt, and support business plans and strategies.

The focus of this authority is the consolidated health and stability of the holding company enterprise and its effect on the subsidiary savings association. OTS oversees the enterprise to identify systemic issues or weaknesses, as well as ensure compliance with regulations that govern permissible activities and transactions. The examination

goal is consistent across all types of holding company enterprises; however, the level of review and amount of resources needed to assess a complex structure such as AIG's is vastly deeper and more resource-intensive than what would be required for a less complex holding company.

OTS Supervisory Actions

OTS's approach to holding company supervision has continually evolved to address new developments in the financial services industry and supervisory best practices. At the time AIG became a savings and loan holding company in 2000, OTS focused primarily on the impact of the holding company enterprise on the subsidiary savings association. With the passage of Gramm-Leach Bliley, not long before AIG became a savings and loan holding company, OTS recognized that large corporate enterprises, made up of a number of different companies or legal entities, were changing the way such enterprises operated and would need to be supervised. These companies, commonly called conglomerates, began operating differently from traditional holding companies and in a more integrated fashion, requiring a more enterprise-wide review of their operations. In short, these companies shifted from managing along legal entity lines to managing along functional lines.

Consistent with changing business practices and how conglomerates then were managed, in late 2003 OTS embraced a more enterprise-wide approach to supervising conglomerates. This shift aligned well with core supervisory principles adopted by the Basel Committee and with requirements adopted by European Union (EU) regulators that took effect in 2005, which required supplemental regulatory supervision at the conglomerate level. OTS was recognized as an equivalent regulator for the purposes of AIG consolidated supervision within the EU, a process that was finalized with a determination of equivalence by the French regulator, Commission Bancaire.

Under OTS's approach of classifying holding companies by complexity, as well as the EU's definition of a financial conglomerate, AIG was supervised, and assessed, as a conglomerate. OTS exercises its supervisory responsibilities with respect to complex holding companies by communicating with other functional regulators and supervisors who share jurisdiction over portions of these entities and through our own set of specialized procedures. With respect to communication, OTS is committed to the framework of functional supervision Congress established in Gramm-Leach Bliley. Under Gramm-Leach Bliley, the consolidated supervisors are required to consult on an ongoing basis with other functional regulators to ensure those findings and competencies are appropriately integrated into our own assessment of the consolidated enterprise and, by extension, the insured depository institution we regulate.

Consistent with this commitment and as part of its comprehensive, consolidated supervisory program for AIG, OTS began in 2005 to convene annual supervisory college meetings. Key foreign supervisory agencies, as well as U.S. state insurance regulators, participated in these conferences. During the part of the meetings devoted to presentations from the company, supervisors have an opportunity to question the company about any supervisory or risk issues. Approximately 85 percent of AIG, as measured by allocated capital, is contained within entities regulated or licensed by other supervisors. Another part of the meeting includes a "supervisors-only" session, which provides a venue for participants to ask questions of each other and to discuss issues of common concern regarding AIG. OTS also uses the occasion of the college meetings to arrange one-on-one side meetings with foreign regulators to discuss in more depth significant risk in their home jurisdictions.

As OTS began its early supervision of AIG as a conglomerate, our first step was to better understand its organizational structure and to identify the interested regulators throughout the world. In this regard, AIG had a multitude of regulators in over 100

countries involved in supervising pieces of the AIG corporate family. OTS established relationships with these regulators, executed information sharing agreements where appropriate, and obtained these regulators' assessments and concerns for the segment of the organization regulated.

As OTS gained experience supervising AIG and other conglomerates, we recognized that a dedicated examination team and continuous onsite presence was essential to overseeing the dynamic and often fast paced changes that occur in these complex structures. In 2006, OTS formally adopted a risk-focused continuous supervision program for the oversight of large and complex holding companies. This program combines on- and off-site planning, monitoring, communication, and analysis into an ongoing examination process. OTS's continuous supervision and examination program comprises development and maintenance of a comprehensive risk assessment, which consists of: an annual supervisory plan; risk-focused targeted reviews; coordination with other domestic and foreign regulators; an annual examination process and reporting framework; routine management meetings; and an annual board of directors meeting.

OTS conducted continuous consolidated supervision of the AIG group, including an on-site examination team at AIG headquarters in New York. Through frequent, on-going dialogue with company management, OTS maintained a contemporaneous understanding of all material parts of the AIG group, including their domestic and cross-border operations.

OTS's primary point of contact with the holding company was through AIG departments that dealt with corporate control functions, such as Enterprise Risk Management (ERM), Internal Audit, Legal/Compliance, Comptroller, and Treasury. OTS held monthly meetings with AIG's Regulatory and Compliance Group, Internal

Audit Director and external auditors. In addition, OTS held quarterly meetings with the Chief Risk Officer, the Treasury Group and senior management, and annually with the board of directors. OTS reviewed and monitored risk concentrations, intra-group transactions, and consolidated capital at AIG, and also directed corrective actions against AIG's Enterprise Risk Management. OTS also met regularly with Price Waterhouse Coopers (PwC), the company's independent auditor.

Key to the continuous supervision process is the risk assessment, resulting supervisory plan, and targeted areas of review for each year. OTS focused on the corporate governance, risk management, and internal control centers within the company and completed targeted reviews of non-functionally regulated affiliates within the holding company structure.

In 2005, OTS conducted several targeted, risk-focused reviews of various lines of business, including AIGFP, and made numerous recommendations to AIG senior management and the board with respect to risk management oversight, financial reporting transparency and corporate governance. The findings, recommendations and corrective action points of the 2005 examination were communicated in a report to the AIG Board in March 2006.

With respect to AIGFP, OTS identified and reported to AIG's board weaknesses in AIGFP's documentation of complex structures transactions, in policies and procedures regarding accounting, in stress testing, in communication of risk tolerances, and in the company's outline of lines of authority, credit risk management and measurement.

Our report of examination also identified weaknesses related to American General Finance (AGF), another non-functionally regulated subsidiary in the AIG family that is a major provider of consumer finance products in the U.S. These weakness included

deficiencies regarding accounting for repurchased loans, evaluation of the allowance for loan losses, Credit Strategy Policy Committee reporting, information system data fields, and failure to forward copies of state examination reports and management response to the Internal Audit Division.

The examination report also noted weaknesses in AIG's management and internal relationships, especially with the Corporate Legal Compliance Group and the Internal Audit Division, as well as its anti-money laundering program

In 2006 OTS noted nominal progress on implementing corrective measures on the weaknesses noted in the prior examination; however, the Agency identified additional weaknesses requiring the board of directors to take corrective action. Most notably, OTS required the board to establish timely and accurate accounting and reconciliation processes, enhance and validate business line capital models, address compliance-related matters, adopt mortgage loan industry best practices, and assess the adequacy of its fraud detection and remediation processes.

During 2007, when there were signs of deterioration in the U.S. mortgage finance markets, OTS increased surveillance of AGF and AIGFP. OTS selected AGF for review because of its significant size and scope of consumer operations, and to follow-up on the problems noted in prior examinations.

OTS also has supervisory responsibility for AIG Federal Savings Bank. OTS took action against AIG FSB in June, 2007, in the form of a Supervisory Agreement for its failure to manage and control in a safe and sound manner the loan origination services outsourced to its affiliate, Wilmington Finance, Inc. (WFI). The Agreement addressed loan origination activities and required AIG FSB to identify and provide timely assistance to borrowers who were at risk of losing their homes because of the thrift's loan

origination and lending practices. OTS also required a $128 million reserve to be established to cover costs associated with providing affordable loans to borrowers.

Later, in light of AIG's growing liquidity needs to support its collateral obligations, OTS took action in September 2008 at the FSB level to ensure that depositors and the insurance fund were not placed at risk. OTS actions precluded the bank from engaging in transactions with affiliates without OTS knowledge and lack of objection; restricted capital distributions; required maintenance of minimum liquidity and borrowing capacity sensitive to the unfolding situation; and required retention of counsel to advise the board in matters involving corporate reorganization and attendant risks related thereto. AIG FSB continues to be well capitalized and maintains adequate levels of liquidity.

After a 2007 targeted review of AIGFP, OTS instructed the company to revisit its modeling assumptions in light of deteriorating sub-prime market conditions. In the summer of 2007, after continued market deterioration, OTS questioned AIG about the valuation of CDS backed by subprime mortgages. In the last quarter of 2007, OTS increased the frequency of meetings with AIG's risk managers and PwC. Due to the Agency's progressive concern with corporate oversight and risk management, in October 2007 we required AIG's Board to:

- Monitor remediation efforts with respect to certain material control weaknesses and deficiencies;
- Ensure implementation of a long-term approach to solving organizational weaknesses and increasing resources dedicated to solving identified deficiencies;
- Monitor the continued improvement of corporate control group ability to identify and monitor risk;

- Complete the holding company level risk assessment, risk metrics, and reporting initiatives and fully develop risk reporting;
- Increase involvement in the oversight of the firm's overall risk appetite and profile and be fully informed as to AIG Catastrophic Risk exposures, on a full-spectrum (credit, market, insurance, and operational) basis; and
- Ensure the prompt, thorough, and accountable development of the Global Compliance program, a critical risk control function where organizational structure impediments have delayed program enhancements.

OTS further emphasized to AIG management and the board that it should give the highest priority to the financial reporting process remediation and the related long-term solution to financial reporting weaknesses. In connection with the 2007 annual examination, the Organizational Structure component of the CORE rating was downgraded to reflect identified weakness in the company's control environment.

Shortly after OTS issued the 2007 report, AIG disclosed its third quarter 2007 financial results, which indicated for the first time a material problem in the Multi Sector CDS portfolio evidenced by a $352 million valuation charge to earnings and the disclosure that collateral was being posted with various counterparties to address further market value erosion in the CDS portfolio.

As PwC was about to issue the accounting opinions on the 2007 financial statements, the independent auditor concluded that a material control weakness existed in AIGFP's valuation processes and that a significant control deficiency existed with Enterprise Risk Management's access to AIGFP's valuation models and assumptions. Due to intense pressure from PwC, in February 2008, AIG filed an SEC Form 8K announcing the presence of the material weakness. AIG pledged to implement complete remediation efforts immediately.

OTS's subsequent supervisory review and discussions with PwC revealed that AIGFP was allowed to limit access of key risk control groups while material questions relating to the valuation of super senior CDS portfolio were mounting. As a result of this gap, corporate management did not obtain sufficient information to completely assess the valuation methodology. In response to these matters, AIG's Audit Committee commissioned an internal investigation headed by Special Counsel to the Audit Committee to review the facts and circumstances leading to the events disclosed in the SEC Form 8K. The Special Counsel worked with OTS to evaluate the breakdown in internal controls and financial reporting. Regulatory entities such as the Securities Exchange Commission and Department of Justice then also commenced inquiries.

The OTS met with AIG senior management on March 3, 2008, and communicated significant supervisory problems over the disclosures in the SEC Form 8K and the unsatisfactory handling of the Enterprise Risk Management relationship with AIGFP. OTS downgraded AIG's CORE ratings and communicated the OTS's view of the company's risk management failure in a letter to AIG's General Counsel on March 10, 2008.

As part of this remediation process and to bolster corporate liquidity and oversight, AIG successfully accessed the capital markets in May of 2008 and raised roughly $20 billion in a combination of common equity and equity hybrid securities. This action coupled with existing liquidity at the AIG parent, provided management with reasonable comfort that it could fund the forecasted collateral needs of AIGFP. AIG also added a Liquidity Manager to its corporate Enterprise Risk Management unit to provide senior management with more timely stress scenario reporting and formed a liquidity monitoring committee composed of risk managers, corporate treasury personnel and business unit members to provide oversight.

On July 28, 2008, AIG submitted a final comprehensive remediation plan, which OTS reviewed and ultimately accepted on August 28, 2008. The AIG audit committee approved the company's remediation plan, which also was used by PwC to assess AIG's progress in resolving the material control weakness covering the valuation of the CDS portfolio and the significant control deficiency attributable to AIG's corporate risk oversight of AIGFP, AGF and International Lease Finance Corporation (ILFC). OTS continues to monitor these remediation efforts to this day, notwithstanding AIG's September 2008 liquidity crisis.

As AIG's liquidity position became more precarious, OTS initiated heightened communications with domestic and international financial regulators. Through constant communication, OTS monitored breaking events in geographic areas where AIG operates, kept regulators in those jurisdictions informed of events in the U.S. and clarified the nature of AIG's stresses. OTS's identification of AIGFP as the focal point of AIG's problems added perspective that allowed foreign regulators to more accurately assess the impact on their regulated entities and to make informed supervisory decisions.

In September 2008 the Federal Reserve Bank of New York (FRB-NY) extended an $85 billion loan to AIG and the government took an 80 percent stake in AIG. On the closure of this transaction, Federal statute no longer defined AIG as a savings and loan holding company subject to regulation as such. This result would be true whether AIG had been a savings and loan holding or bank holding company subject to regulation by the Federal Reserve Board. Nonetheless, OTS has continued in the role of equivalent regulator for EU and international purposes. FRB-NY's intervention had no impact on OTS's continued regulation and supervision of AIG FSB.

Although OTS has scaled back some regulatory activities with regard to AIG, the Agency continues to meet regularly with key corporate control units and receive weekly reports on various exposures and committee activities. OTS closely monitors the activities at AIGFP to reduce risk, as well as the divesture efforts of the holding company. OTS will continue to focus on Residential Mortgage Backed Securities exposures and the ultimate performance of underlying mortgage assets. OTS is tracking AIG's remediation efforts. Finally, OTS continues to work with global functional regulators to keep them apprised of conditions at the holding company, as well as to learn of emerging issues in local jurisdictions.

IV. Lessons Learned

Despite OTS's efforts to point out AIGFP's weaknesses to the company and to its Board of Directors, OTS did not foresee the extent of the risk concentration and the profound systemic impact CDS products caused within AIG. By the time AIGFP stopped originating these derivatives in December 2005, they already had $65 billion on their books. These toxic products posed significant liquidity risk to the holding company.

Companies that are successful have greater opportunities for growth. AIG was successful in many regards for many years, but it had issues and challenges. OTS indentified many of these issues and attempted to initiate corrective actions, but these actions were not sufficient to avoid the September market collapse.

It is worth noting that AIGFP's role was not underwriting, securitizing or investing in subprime mortgages. Instead, AIGFP simply provided insurance-like

protection against declines in the values of underlying securities. Nevertheless, in hindsight, OTS should have directed the company to stop originating CDS products before December 2005. OTS should also have directed AIG to try to divest a portion of this portfolio. The pace of change and deterioration of the housing market outpaced our supervisory remediation measures for the company. By the time the extent of the CDS liquidity exposure was recognized, there was no orderly way to reduce or unwind these positions and the exposure was magnified due to the concentration level. The CDS market needs more consistent terms and conditions and greater depth in market participants to avoid future concentration risks similar to AIG.

I believe it is important for the Subcommittee to understand the confluence of market factors that exposed the true risk of the CDS in AIGFP's portfolio. OTS saw breakdowns in market discipline, which was an important element of our supervisory assessment. Areas that we now know were flawed included: over reliance on financial models, rating agency influence on structured products, lack of due diligence in the packaging of asset-backed securities, underwriting weaknesses in originate-to-distribute models, and lack of controls over third party (brokers, conduits, wholesalers) loan originators.

Shortcomings in modeling CDS products camouflaged some of the risk. AIGFP underwrote its super senior CDS using proprietary modeling similar to that used by rating agencies for rating structured securities. AIGFP's procedures required modeling based on simulated periods of extended recessionary environments (i.e. ratings downgrade, default, loss, recovery). Up until June 2007, the results of the AIGFP models indicated that the risk of loss was a remote possibility, even under worst-case scenarios. The model used mainstream assumptions that were generally acceptable to the rating agencies, PwC, and AIG.

Following a targeted review of AIGFP in early 2007, OTS recommended that the company revisit its modeling assumptions in light of deteriorating sub-prime market conditions. In hindsight, the banking industry, the rating agencies and prudential supervisors, including OTS, relied too heavily on stress parameters that were based on historical data. This led to an underestimation of the unprecedented economic shock and misjudgment of stress test parameters.

Approximately six months after OTS's March 2008 downgrade of AIG's examination rating, the credit rating agencies also downgraded AIG on September 15, 2008. That precipitated calls that required AIGFP to post huge amounts of collateral for which it had insufficient funds. The holding company capital was frozen and AIGFP could not meet the calls.

V. Recommendations

From the lessons learned during our involvement with supervising AIG, we would like you to consider two suggestions in your future exploration of regulatory reform.

Systemic Risk Regulator

First, OTS endorses the establishment of a systemic risk regulator with broad authority, including regular monitoring, over companies that if, due to the size or interconnected nature of their activities, their actions, or their failure would pose a risk to the financial stability of the country. Such a regulator should be able to access funds, which would present options to resolve problems at these institutions. The systemic risk regulator should have the ability and the responsibility for monitoring all data about

markets and companies, including but not limited to companies involved in banking, securities, and insurance.

Regulation of Credit Default Swaps - Consistency and Transparency

CDS are financial products that are not regulated by any authority and impose serious challenges to the ability to supervise this risk proactively without any prudential derivatives regulator or standard market regulation. In November 2008, The President's Working Group announced a series of initiatives to strengthen oversight and the infrastructure of the Over The Counter (OTC) derivatives market. We are aware of and support the recent efforts by the Federal Reserve Bank of New York to develop a common global framework for cooperation. There is a need to fill the regulatory gaps the CDS market has exposed by strengthening cooperation among regulatory authorities and through legislation, where necessary.

We have also learned there is a need for consistency and transparency in CDS contracts. The complexity of CDS contracts masked risks and weaknesses in the program that led to one type of CDS performing extremely poorly. The current regulatory means of measuring off-balance sheet risks do not fully capture the inherent risks of CDS. OTS believes standardization of CDS would provide more transparency to market participants and regulators.

In the case of AIG, there was heavy reliance on rating agencies and in-house models to assess the risks associated with these extremely complicated and unregulated products. I believe that Congress should consider legislation to bring CDS under regulatory oversight, considering the disruption these instruments caused in the marketplace. Prudential supervision is needed to promote a better understanding of the risks and best practices to manage these risks, enhance transparency, and standardization

of contracts and settlements. More and better regulatory tools are needed to bring all potential instruments that could cause a recurrence of our present problems under appropriate oversight and legal authority.

A multiplicity of events led to the downfall of AIG. An understanding of the control weaknesses and events that transpired at AIG provides an opportunity to learn to identify weaknesses and strengthen regulatory oversight of complex financial products and companies. OTS has absorbed these lessons and has issued risk-focused guidance and policies to promote a more updated and responsive supervisory program.

VI. Closing

Thank you, Chairman Kanjorski, Ranking Member Garrett and Members of the Subcommittee, for the opportunity to testify on behalf of the OTS on the collapse of AIG.

We look forward to working with the Subcommittee to ensure that, in these challenging times, thrifts and consolidated holding companies operate in a safe and sound manner.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services

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FEDERAL FINANCIAL ASSISTANCE

Preliminary Observations on Assistance Provided to AIG

Statement of Orice M. Williams, Director
Financial Markets and Community Investment

GAO-09-490T

March 18, 2009

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-09-490T, a testimony to Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, House of Representatives

FEDERAL FINANCIAL ASSISTANCE

Preliminary Observations on Assistance Provided to AIG

Why GAO Did This Study

The Board of Governors of the Federal Reserve System (Federal Reserve) and the Department of the Treasury (Treasury) have made available over $182 billion in assistance to American International Group (AIG) to prevent its failure. However, questions have been raised about the goals of the assistance and how it is being monitored. Also, because AIG is generally known for its insurance operations, questions exist about the effect of the assistance on certain insurance markets.

This statement provides preliminary findings on (1) the goals and monitoring of federal assistance to AIG and challenges to AIG's repayment of the assistance; and (2) the potential effects of the federal assistance on the U.S. commercial property/casualty insurance market. GAO's work on these issues is ongoing. To date, we have reviewed relevant documents on the assistance and ongoing operations of AIG, as well as documents issued by the Federal Reserve and Treasury. We also interviewed officials from these organizations as well as industry participants (competitors, brokers, and customers) and insurance regulators, among others.

View GAO-09-490T or key components. For more information, contact Orice M. Williams at (202) 512-86785555 or williamso@gao.gov.

What GAO Found

Federal financial assistance to AIG, both from the Federal Reserve and Federal Reserve Bank of New York through their authority to lend funds to critical nonbank institutions and from Treasury's Troubled Asset Relief Program (TARP), has focused on preventing systemic risk that could result from a rating downgrade or failure of AIG. The goal of the assistance and subsequent restructurings was to prevent systemic risk from the failure of AIG by allowing AIG to sell assets and restructure its operations in an orderly manner. The Federal Reserve has been monitoring AIG's operations since September, and Treasury has begun to more actively monitor AIG's operations as well. Although the ongoing federal assistance has prevented further downgrades in AIG's credit rating, AIG has had mixed success in fulfilling its other restructuring plans, such as terminating its securities lending program, selling assets, and unwinding its AIG Financial Products portfolio. For example, AIG has made efforts at selling certain business units and has begun an overall restructuring, but market and other conditions have prevented significant asset sales, and most restructuring efforts are still under way. AIG faces ongoing challenges from the continued overall economic deterioration and tight credit markets. AIG's ability to repay its obligations to the federal government has also been impaired by its deteriorating operations, inability to sell its assets and further declines in its assets. All of these issues will continue to adversely impact AIG's ability to repay its government assistance.

As part of GAO's ongoing work related to the federal assistance provided to AIG, GAO is reviewing the potential impact of the assistance on the commercial property/casualty insurance market. Specifically, GAO is reviewing potential effects of the assistance on AIG's pricing practices. According to some of AIG's competitors, federal assistance to AIG has allowed AIG's commercial property/casualty insurance companies to offer coverage at prices that are inadequate for the risk involved. Conversely, state insurance regulators, insurance brokers, and insurance buyers said that while AIG may be pricing somewhat more aggressively than in the past in order to retain business in light of damage to the parent company's reputation, they did not see indications that this pricing was inadequate or out of line with previous AIG pricing practices. Moreover, some have noted that AIG has lost business because of the problems encountered by its parent company. As GAO evaluates these issues, it faces a number of challenges associated with determining the adequacy of commercial property/casualty premium rates, especially in the short term. These challenges include the unique, negotiated nature of many commercial insurance policies, the subjective assumptions involved in determining premiums, and the fact that for some lines of commercial insurance it can take several years to determine if premiums charged were adequate for the related losses.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing to provide preliminary observations on the federal government's assistance to the American International Group (AIG)—a large financial conglomerate with an estimated 70 U.S. insurance companies—and the potential impact of this assistance on U.S. insurance markets, especially the commercial property/casualty insurance market.[1] As you know, the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Reserve Bank of New York (FRBNY) provided assistance to AIG in September 2008 following its rating downgrade, which had prompted collateral calls by its counterparties and raised concerns that a rapid failure of the company would further destabilize financial markets. However, AIG's condition continued to decline, and in November 2008 the Federal Reserve and the Department of the Treasury (Treasury) under the newly created Troubled Asset Relief Program (TARP) announced plans to restructure AIG's federal assistance to further strengthen its financial condition and, once again, prevent the failure of the company. On March 2, 2009, the Federal Reserve and Treasury provided additional assistance and further restructured the terms, which raised questions about the ongoing viability of the company and the likelihood that the federal assistance could be repaid.

The assistance provided to AIG has also raised questions among AIG's competitors about whether the assistance provided to AIG's parent company is being used to benefit its insurance companies. AIG's competitors have argued that the assistance has allowed AIG's insurance companies to price coverage aggressively compared to the premiums being charged by the rest of the market, thereby providing AIG with a competitive advantage, particularly in commercial property/casualty insurance markets.

My statement today focuses on the preliminary results of our ongoing review of the federal financial assistance to AIG and its impact on the U.S. property/casualty insurance market, initiated at the request of Ranking Member Bachus (full committee) and Chairman Kanjorski (subcommittee). Specifically, I will discuss (1) the goals and monitoring of the federal government's assistance to AIG, the associated setbacks, and

[1]AIG comprises at least 223 companies and it has operations in 130 countries and jurisdictions worldwide.

challenges to AIG's repayment of this assistance and (2) the potential effects of this federal assistance to AIG on the U.S. insurance market, especially the commercial property/casualty market.

To achieve these objectives, we analyzed publicly available reports, congressional testimonies, and other documentation issued by the Federal Reserve, FRBNY, Treasury, Securities and Exchange Commission, Congressional Research Service, and rating agencies. We also conducted numerous interviews with officials and staff from the Federal Reserve, FRBNY, Treasury, three state insurance regulators with major roles in regulating AIG's insurance companies, the National Association of Insurance Commissioners (NAIC), five insurance brokers, four large commercial property/casualty insurers that compete with AIG, two reinsurers, three rating agencies, two industry observers, and an association representing purchasers of commercial property/casualty insurance. Finally, we consulted with a group of actuaries to discuss our methodology, bolster our understanding of insurance markets, and evaluate what we heard from others.

We conducted our work from January 2009 to March 2009, in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for our preliminary findings and conclusions.

Summary

Federal financial assistance to AIG, both from the Federal Reserve and FRBNY through their authority to lend funds to critical non-bank entities in certain circumstances and from Treasury's TARP, has focused on preventing the systemic risk that could result from a failure or further rating downgrade at AIG. The goal of the initial assistance and subsequent restructurings was to prevent systemic risk from the failure of AIG by allowing AIG to sell assets and restructure its operations in an orderly manner. The Federal Reserve has been monitoring AIG's operations since September, and Treasury will more actively monitor AIG's operations as well. Although the ongoing federal assistance has prevented further downgrades in AIG's credit rating, AIG has had mixed success in fulfilling its other restructuring plans, such as terminating its securities lending program, selling assets, and unwinding its AIG Financial Products (AIGFP) portfolio. For example, AIG has made efforts at selling certain business units and has begun an overall restructuring, but market and other

conditions have prevented significant asset sales, and most restructuring efforts are still under way. AIG faces ongoing challenges from the continued overall economic deterioration and tight credit markets. AIG's ability to repay its obligations to the federal government has also been impaired by its deteriorating operations, inability to sell its assets and further declines in its assets. All of these issues will continue to adversely impact AIG's ability to repay its government assistance. Table 1 provides an overview of the total federal investment in AIG of $182.5 billion as of March 2, 2009.

Table 1: Amounts of AIG Federal Assistance Used and Authorized as of March 2, 2009

Date Program Announced Program Title	Amount Borrowed/Used (dollars in millions)	Total Amount Authorized (dollars in millions)	Transaction Details
Federal Reserve Bank of New York (FRBNY)			
September 2008 Revolving Credit Facility	$41,969[a,f]	$60,000[b,d]	Revolving loan for the general corporate purposes of AIG and its subsidiaries, and to pay obligations as they come due. In September this comment was $85 billion but was reduced to $60 billion. By the end of the March 2009 the amount will be reduced to no less than $25 billion.
November 2008 Maiden Lane II LLC	19,500	22,500	FRBNY extended credit to Maiden Lane II to purchase residential mortgage-backed securities from the U.S. securities lending portfolio of AIG subsidiaries.
November 2008 Maiden Lane III LLC	24,300	30,000	FRBNY extended credit to Maiden Lane III to purchase multi-sector collateralized debt obligations on which AIG Financial Products had written credit default swaps.
March 2009 Securitization of domestic life insurance cash flows	0	(8,500)[c]	FRBNY loan to special purpose vehicles (SPVs) established by domestic life insurance subsidiaries of AIG. The SPVs would repay the loans from the net cash flows they receive from designated blocks of existing life insurance policies held by the parent insurance companies.
March 2009 Preferred stock in foreign life companies		(26,000)[d]	Preferred interests in two SPVs created to hold all of the outstanding common stock of two life insurance holding company subsidiaries of AIG.

Date Program Announced Program Title	Amount Borrowed/Used (dollars in millions)	Total Amount Authorized (dollars in millions)	Transaction Details
U.S. Treasury Department[e]			
November 2008 Series D Preferred Stock	40,000[f]	40,000	AIG issued Series D preferred stock to Treasury and proceeds of $40 billion were used to pay down AIG's Revolving Credit Facility balance.
March 2009 Equity Capital Facility[g]		30, 000	This facility will be available for AIG to draw down cash as needed over time in exchange for non-cumulative preferred stock to the U.S. Treasury.
Credit Facility Trust			
September 2008 Series C Preferred Stock	0.5		Shares of convertible preferred stock representing an approximately 77.9 percent equity interest in AIG.
Total	**$125,770**[h]	**$182,500**	

Source: Federal Reserve, Treasury, and AIG data.

Notes:

[a]The debt outstanding in the Revolving Credit Facility includes accrued interest and has been reduced by the $40 billion AIG received from issuing preferred stock to Treasury.

[b]The Revolving Credit Facility was initially authorized for up to $85 billion but was reduced to $60 billion in conjunction with the $40 billion paydown of the outstanding debt. The amount of this facility will be reduced to no less than $25 billion by the end of March 2009 based on the terms of the March 2 restructuring (see notes c and d).

[c]The proceeds from the new loans to SPVs established by domestic life insurance subsidiaries of AIG will be used to pay down an equivalent amount of outstanding debt under the Revolving Credit Facility up to an aggregate of about $8.5 billion. Therefore, this amount does not affect total authorized amount outstanding.

[d]The revolving credit facility is to be reduced by up to about $26 billion in exchange for preferred interest in two SPVs created to hold all of the outstanding common stock of two life insurance holding company subsidiaries of AIG. Therefore, this amount does not affect total authorized amount outstanding.

[e]Treasury provided the assistance under the Troubled Asset Relief Program's (TARP) Systemically Significant Failing Institutions (SSFI) Program.

[f]The $40 billion was used to reduce the outstanding amount of the Revolving Credit Facility. The outstanding amount of $42 billion reflects that reduction. As announced in the March 2, 2009 restructuring plan, the Treasury will exchange its existing $40 billion cumulative perpetual preferred shares for new preferred shares with revised terms that more closely resemble common equity.

[g]As of March 16, 2009, Treasury was still in the process of finalizing the terms of this facility.

[h]This excludes the $14 billion obtained from the Commercial Paper Lending Facility.

As part of our ongoing work on AIG, we are reviewing the potential impact of AIG's federal assistance on the commercial property/casualty insurance market. Specifically, we are reviewing potential effects on AIG's pricing practices. According to some of AIG's competitors, federal assistance to AIG has allowed AIG's commercial property/casualty insurance companies to offer coverage at prices that are inadequate for the risk involved.

Conversely, state insurance regulators, insurance brokers, and insurance buyers said that while AIG may be pricing somewhat more aggressively than in the past in order to retain business in light of damage to the parent company's reputation, they did not see indications that this pricing was inadequate or out of line with previous AIG pricing practices. Moreover, some have noted that AIG has lost business because of the problems encountered by the parent company. As we evaluate these issues, we face a number of challenges associated with determining the adequacy of commercial property/casualty premium rates. For example, the terms of the policy are often negotiated, and pricing adequacy is ultimately determined by future losses.

Background

AIG is a holding company that, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad, including general insurance, life insurance and retirement services, financial services, and asset management. The AIG organization includes the largest domestic life insurer and the second largest domestic property/casualty insurer, and it has a large foreign general insurance business. It also has a financial products division, which has been a key source of AIG's financial difficulties, particularly AIGFP, which engaged in a wide variety of financial transactions, including standard and customized financial products.

AIG's Financial Problems Mounted Quickly

From July 2008 to August 2008, ongoing concerns about AIG's securities lending program and continuing declines in the value of super senior collateralized debt obligations (CDO) protected by AIGFP's super senior credit default swap (CDS) portfolio, along with ratings downgrades of the CDOs, resulted in AIGFP having to post additional cash collateral, which raised liquidity issues.[2] By early September, collateral postings and securities lending requirements were placing increased pressure on the AIG parent company's liquidity. AIG attempted to raise additional capital

[2]The securities lending program allowed insurance companies, primarily the life insurance companies, to lend securities in return for cash collateral that was invested in residential mortgage-backed securities (RMBS). When the value of these securities declined in 2007, AIG incurred significant losses when it had to return the cash collateral when its borrowed securities were returned. Collateralized debt obligations are securities backed by a pool of bonds, loans, or other assets. Credit default swaps are bilateral contracts that are sold over the counter and transfer credit risks from one party to another. The seller, who is offering credit protection, agrees, in return for a periodic fee, to compensate the buyer, who is purchasing it, if a specified credit event, such as default, occurs.

in September but was unsuccessful. It was also unable to secure a bridge loan through a syndicated secured lending facility. On September 15, 2008, the rating agencies downgraded AIG's debt rating three notches, resulting in the need for an additional $20 billion to fund its additional collateral demands and transaction termination payments. As AIG's share price continued to fall following the credit rating downgrade, counterparties withheld payments and refused to transact with AIG. Also around this time, the insurance regulators no longer allowed AIG's insurance subsidiaries to lend funds to the parent under a revolving credit facility that AIG maintained and demanded that any outstanding loans be repaid and that the facility be terminated.

Overview of Federal Assistance Provided

Ongoing instability in global credit markets and other issues have resulted in over $182 billion in federal assistance being made available to AIG. First, in September 2008, the Federal Reserve created the Revolving Credit Facility, which was intended to stabilize AIG by providing it with sufficient liquidity and enabling AIG to dispose of certain assets in an orderly manner while avoiding undue disruption to the economy and financial markets (see table 2). The original amount available under the facility was up to $85 billion. While the amount borrowed reached $82 billion, the debt was reduced by the proceeds from AIG's sale of preferred shares to Treasury as well as repayments from the Fed Securities Lending Agreement and the Commercial Paper Facility. As of February 18, 2009, AIG had $38.8 billion in debt outstanding under this facility.

Table 2: Use of Federal Funds and Borrowings Outstanding from the Federal Reserve Bank of New York Revolving Credit Facility as of February 18, 2009

Borrowings:	Total (millions)
Loans for AIGFP to post for collateral required by its counterparties on credit default swaps and postings, guaranteed investment agreements (GIA) and payment of other maturing debts	$47,547
Capital contributions to insurance companies[a]	20,850
Repayments of obligations to life companies in securities lending program	3,160
Repayments of short-term inter-company loans by annuity and life companies to parent company	1,528
Contributions to AIGCFG subsidiaries[a]	1,686
Repayments of AIG non-federal debt of AIG parent company	2,319
Funding for AIG's Equity interest in Maiden Lane III[b]	5,000
Subtotal	**$82,090**

Borrowings:	Total (millions)
Repayment of Fed facility from proceeds of issuance of Series D Preferred Stock	(40,000)
Repayments of Fed facility from other sources[c]	(6,890)
Net borrowings	**$35,200**
Accrued compounding interest and fees	3,631
Total balances outstanding	**$38,831[d]**

Sources: AIG Form 10-Q for Sept. 30, 2008, Form 10-K for Dec. 31, 2008.

Notes:

[a]During 2008 and through February 27, 2009, AIG contributed capital of $22.7 billion (including $18.0 billion borrowed under the Fed Facility) to its Domestic Life Insurance and Domestic Retirement Services subsidiaries. AIG also contributed $4.4 billion to the Foreign Life Insurance companies during 2008 including $4.0 billion from borrowings under the Fed Facility).

[b]AIG purchased its equity stake in Maiden Lane III with money borrowed from the Federal Reserve Bank of New York's facility.

[c]Includes repayments from funds received from the Fed Securities Lending Agreement and the Commercial Paper Funding Facility.

[d]According to the Federal Reserve, the Revolving Credit Facility balance was $42 billion as of March 2, 2009, but AIG's 10-K provided details as of February 18, 2009.

Second, in November 2008, the Federal Reserve and Treasury announced additional assistance to AIG and restructured its original assistance. On November 9, 2008, the Treasury announced plans to use its Systemically Significant Failing Institutions (SSFI) Program, under TARP, to purchase $40 billion in AIG preferred shares. This purchase allowed AIG to reduce its debt outstanding to the Federal Reserve and enabled the Federal Reserve to reduce the amount available under the Revolving Credit Facility from $85 billion to $60 billion. On November 10, 2008, the FRBNY announced plans to lend up to $22.5 billion to Maiden Lane II LLC, a facility formed to purchase residential mortgage-backed securities (RMBS) from the U.S. securities lending investment portfolio of AIG subsidiaries. When this facility was established, it replaced an interim securities lending agreement with the Federal Reserve. Also on November 10, FRBNY announced plans to lend up to $30 billion to Maiden Lane III LLC, a FRBNY facility formed to purchase multi-sector CDOs on which AIGFP had written CDS protection. In connection with the purchase of the CDOs, AIG's CDS counterparties agreed to terminate the CDS contracts.

Most recently, on March 2, 2009, the U.S. Treasury and FRBNY announced plans to further restructure the terms of the assistance. Consistent with earlier assistance, this was also designed to enhance the company's capital and liquidity in order to facilitate orderly restructuring of the company. The restructuring of the assistance would, among other things, provide the

government with interests in two AIG foreign life insurance companies, as well as certain cash flows from certain domestic insurance companies, each in exchange for reducing AIG's Revolving Credit Facility balance. The assistance also would include a new Treasury equity capital facility that would allow AIG to draw down up to $30 billion as needed over time in exchange for newly issued non-cumulative preferred stock to the U.S. Treasury. Treasury and FRBNY would also exchange the previously issued Series D preferred stock for Series E preferred stock that would more closely resemble common stock and provide for non-cumulative dividends. To date, AIG has not drawn against this facility.

As noted above, some federal assistance was designated for specific purposes, such as reducing the loan outstanding to the Federal Reserve or for purchasing specific assets, such as CDOs and RMBS. Other assistance, such as that available through the Federal Reserve Revolving Credit Facility, is available to meet the general financial needs of the parent company and its subsidiaries. Some of the assistance also places restrictions on actions that AIG can take while it has loans outstanding to the federal government or as long as the federal government has an ownership interest in AIG assets, as well as restrictions on executive compensation. Executive compensation restrictions for TARP recipients were also included in the American Recovery and Reinvestment Act of 2009, which was enacted on February 17, 2009. In general, the restrictions prohibit

- bonus and incentive compensation payments to certain employees, depending on the amount of TARP assistance received;
- golden parachutes; and
- compensation plans that encourage risk-taking.

See appendix I for a detailed chronology of events.

Federal Efforts Have Focused on Maintaining and Monitoring AIG's Solvency, but AIG Faces Challenges in Repaying Federal Assistance

Federal assistance to AIG has been focused on preventing systemic risk from a potential AIG failure and monitoring its progress, but AIG faces challenges in repaying the assistance. Federal Reserve and Treasury officials have said that a failure of AIG, potentially triggered by further credit downgrades or additional collateral calls, would result in liquidity concerns for other financial market participants. A disorderly failure of AIG would not only create difficulties for AIG's counterparties as described, but could further erode confidence in and uncertainty about the viability of other financial institutions. This, in turn, would further constrict the flow of credit to households and businesses, potentially deepening and lengthening the current recession. If the ultimate goal is avoiding the failure of AIG, the Federal Reserve and Treasury have achieved that goal in the short-term. However, maintaining solvency has required federal assistance beyond that provided in September and November 2008, and rating companies have stated that their current ratings are contingent on continued federal support for AIG. AIG and federal regulators acknowledge that there may be a need for further assistance given the significant challenges AIG continues to face. Therefore, more time is required to determine if the goal will be fully achieved in the long-term.

Federal and State Monitoring Efforts Are Focused on AIG Solvency

We asked Treasury and the Federal Reserve how they were monitoring AIG's progress toward reaching the goals of the federal financial assistance and AIG's compliance with the restrictions placed upon it as a condition of receiving the assistance. According to Treasury and Federal Reserve officials, the agencies are working together to monitor AIG's solvency by reviewing the reports required by the terms of the financial assistance, and the Federal Reserve is in contact daily with AIG officials regarding AIG's liquidity needs and their efforts to sell the company's assets. AIG regularly files several reports with FRBNY, including daily cash flow reports, reports identifying risk areas within the company, and daily liquidity requests/cash flow forecasts, allowing the Federal Reserve to monitor AIG's liquidity. Also, AIG has a divestiture team that meets at least weekly with the Federal Reserve to discuss potential sales deals, including bids from potential buyers, financing, and other terms of sales agreements, so that the Federal Reserve can monitor AIG's efforts to sell its assets.

The Federal Reserve and Treasury said that they are monitoring the various federal agreements with AIG, and these agreements place restrictions on AIG's use of the funds. For example, the Federal Reserve monitors restrictions on the Revolving Credit Facility, including whether

AIG has inappropriately paid dividends or financed extraordinary corporate actions like acquisitions. According to Treasury officials, it is in the process of finalizing new executive compensation requirements based on the American Recovery and Reinvestment Act of 2009, and will begin monitoring AIG's compliance with those regulations once they are in place. This is an area we will continue to monitor as part of our broader TARP oversight.

State insurance regulators are responsible for monitoring the solvency of insurance companies generally, as well as for approving transactions regarding those companies, such as changes in control or significant transactions with the parent company or other subsidiaries. For example, regulators told us that AIG's insurance companies, like all insurance companies, file quarterly reports with them. Since AIG began receiving federal assistance in September 2008, regulators also said that AIG's insurance companies have been submitting additional reports on their liquidity, investment income, and statistics on surrender and renewal of policies, sometimes on a daily or weekly basis. The various regulators also coordinate their monitoring of the companies' insurance lines. State regulators also evaluate potential sales of AIG's domestic insurance companies. NAIC formed a working group designed to expedite any regulatory approvals required for asset sales, with a goal of completing the approvals within 45 days of filing for a sale.

AIG Faces a Number of Challenges to Its Ability to Repay Its Federal Funds

AIG's restructuring has hinged on efforts in three areas: (1) terminating its CDS portfolio, (2) terminating its securities lending program, and (3) selling assets. Federal assistance was targeted to the first two areas that posed a significant risk to AIG's solvency—AIGFP's CDS portfolio and the securities lending program—and the risks from both activities appear to have been reduced, but some risks remain. One arrangement, Maiden Lane III—the FRBNY facility created to purchase CDOs—has purchased approximately $24.3 billion in multi-sector CDOs (with a par value of approximately $62 billion), which were the assets underlying the CDS protection that AIG sold. Concurrent with the purchase of the underlying CDOs, AIGFP counterparties agreed to cancel the CDS written on the CDOs, thus unwinding significant portions of AIGFP's CDS portfolio. According to AIG, some arrangements did not qualify for sale to the facility, generally either because the counterparties did not own the instruments on which CDS were written or because they were in denominations other than U.S. dollars. As of February 18, 2009, approximately $12.2 billion in notional amounts of CDS remained with AIG. According to AIG, these remaining CDS continue to present a risk to

AIG, as further losses from these assets could require additional funding. A second FRBNY facility—Maiden Lane II—purchased approximately $19.5 billion in RMBS and other assets related to the securities lending program. Both the Maiden Lane II and Maiden Lane III facilities allow AIG to participate in the residual proceeds after the FRBNY loan has been repaid. However, AIG faces other potential losses from other investments.

The federal assistance has allowed AIG to undertake restructuring efforts, which continue. As of September 2008, AIG was to wind down the operations of AIGFP and sell certain businesses. In October 2008, the company announced plans to sell some of its life insurance operations and other businesses. AIG is continuing to wind down AIGFP but expects the process to take at least several years in order to avoid further losses given the current market conditions. AIG has been unable to sell its insurance assets for prices it deems acceptable given the general state of the global economy. As a result, the plan has been modified, and the federal government will now assume an ownership interest in some of AIG's life insurance companies. The federal government's ownership stake will be a percentage of the fair market value of these companies based on valuations acceptable to the Federal Reserve. In addition, AIG plans to consolidate its commercial property/casualty insurance operations in a free-standing entity and potentially offer an equity interest in part of this new entity to public investors.

Asset sales have been difficult, not only because tight credit markets are limiting buyers' ability to obtain the capital needed to purchase the companies, but also because of challenges faced by AIG in retaining key employees, who contribute to the value of the company. In addition, the timely sale of CDOs and RMBS held by the Federal Reserve facilities will be challenging, not only because it may be difficult to value those assets, but because many are tied to home values, which have been in decline.

AIG's ongoing financial problems have resulted in additional assistance and restructuring of the terms of the original assistance, and AIG faces numerous, significant challenges to its ability to repay federal assistance in the future. AIG's ability to repay the federal government hinges on it remaining solvent and effectively restructuring the organization, including the sale of subsidiaries. The federal government recouping its assistance also depends in part on FRBNY being able to obtain a satisfactory return on the sale of the CDO- and RMBS-related assets purchased by Maiden Lane II and III.

AIG's ability to pay interest and dividend payments has been and may continue to be a challenge because its ability to make payments is dependent on the profitability of AIG operations, which face a number of hurdles. As of December 31, 2008, AIG insurance subsidiaries had statutory capital levels that exceeded the minimum requirements. However, damage to AIG's reputation has made it difficult for its insurance companies to maintain current business and write new business. In addition, profitability is also dependent on the overall state of the economy—many of AIG's insurance premium sources are tied to economic activity, such as payroll—and its insurers, especially its life insurers, depend on strong investment returns. To the extent the overall economy is experiencing difficulty, it will present challenges to the profitable operations of AIG's insurance companies. While recent federal assistance has been restructured to reduce AIG's interest and dividend payment requirements, it is too soon to tell whether further assistance or further restructuring will be needed in the future.

Some of AIG's Competitors Claim that AIG's Commercial Insurance Pricing Is Out of Line With Its Risks but Other Insurance Industry Participants and Observers Disagree

We are examining the potential effect of federal assistance to AIG on the insurance market, particularly AIG's pricing practices within the commercial property/casualty market. Market participants (actuaries, regulators, brokers, customers, and insurance companies) we talked with indicated that, foremost, insurance premium rates follow an insurance underwriting cycle that is generally characterized by a long period of "soft market" conditions, where premium rates are relatively low and underwriting standards are less stringent, followed by a much shorter period of "hard market" conditions, where premium rates flatten or increase and underwriting standards are more stringent. They explained that starting with the September 11, 2001, terrorist attacks and continuing until late 2003 or early 2004, the commercial property/casualty market was in a hard market, but since this time the markets have softened and premium rates have been declining. For example, according to the Council of Independent Agents and Brokers (CIAB) surveys, quarterly changes in commercial property/casualty premium rates have been negative (falling) for all commercial line accounts since the second quarter of 2004 (except for catastrophe-exposed property lines in early 2006), and while the magnitude of the changes leveled off in the last quarter of 2008, the average quarterly premium rate change was still negative in that period.

Industry participants also said that premiums charged by commercial property/casualty insurers for a given coverage are influenced by several factors that could allow one insurer to price lower than another on a given risk and that AIG Commercial Insurance historically had been able to take

advantage of several of these factors. Such factors include a long history of experience with complex risks, a lower operating expense ratio relative to competitors, global operations that allow offsetting risks, and the ability to leverage the size and the financial strength of the parent company to write larger coverage amounts than competitors, in some cases without the need to purchase reinsurance. It is not yet clear to what extent the current financial difficulties the AIG parent company may have diminished these advantages for AIG Commercial Insurance.

Some insurers we spoke with said that they had observed instances, in some cases numerous instances, where AIG had sold commercial property/casualty coverage for a price that these insurers believed was inadequate for the risk involved. They cited examples where AIG Commercial Insurance's prices had decreased significantly from the prior year's price, when circumstances appeared to indicate that higher prices were warranted. Some insurers said that they had brought several of these instances to the attention of the relevant state insurance regulator. Insurers expressed concern that while current market conditions would dictate increased prices in most commercial property/casualty lines of insurance, they believe that AIG Commercial Insurance has decreased its prices. They added that when such pricing activity is combined with AIG Commercial Insurance's market power, AIG Commercial Insurance can prevent prices from increasing and thus hurt other insurers' ability to price insurance at a cost adequate to cover the risk involved. The insurers said they believed that AIG Commercial Insurance's recent pricing behavior is the result of its desire to retain existing business in the face of concerns over the financial health of its parent company, and some suggested that the federal financial assistance is providing them the means to do this. For example, some suggested that AIG Commercial Insurance officials know that the federal government will not let them fail, so they can charge very low prices without fear of the consequences when the premiums collected turn out to be less than the losses those premiums were meant to cover. Some also suggested that buyers in the market are choosing to stay with AIG Commercial Insurance because they also believe that the insurance company is now backed by the federal government and that their losses will ultimately be covered.

AIG told us that AIG Commercial Insurance has the biggest policyholder surplus in the industry and that they are solvent and financially sound. They maintained that they are charging prices adequate for the risk being covered and that their commercial insurance rates have been mirroring the overall trends in the current soft market. That is, they indicated that their rates have been declining at an increasingly slower pace since the

fourth quarter of 2008, and in some cases have increased. They also cited other factors that they said would indicate that they were not pricing inadequately or taking market share from other companies. First, AIG Commercial Insurance told us that they have actually been losing market share because the financial situation of the parent company had impacted the reputation of the AIG commercial insurance companies. In addition, they cited instances where competitors were using the AIG parent company's financial problems as a way to discourage customers from buying AIG commercial insurance coverage. Finally, AIG Commercial Insurance provided us with examples of recent contracts that they have lost to competitor bids that were below their own. However, AIG Commercial Insurance acknowledges that these examples reflect the nature of the business, not necessarily inappropriate pricing by the competitors.

State insurance regulators, insurance brokers, and insurance buyers that we have spoken to said that they have seen no indications that AIG's commercial property/casualty insurers are selling coverage at prices inadequate to cover the risk involved:

- State insurance regulators we spoke to said that they generally do not closely watch commercial insurance rates because they may have been largely deregulated by the states, as well as because of the highly negotiated nature and complexity of many commercial lines of insurance. However, they said that they investigate complaints about pricing activities and monitor insurer solvency measures that would indicate inadequate pricing—although in some lines the consequences of such pricing may not show up in these measures for several years. State regulators indicated that complaints of pricing inadequate for the risk involved would need to be numerous enough to indicate a potential systemic problem or would need to prove an intentional predatory strategy from the part of a particular company. Based on what they have reviewed, the regulators we spoke with said they have seen no indications of inadequate pricing by AIG's commercial property/casualty insurers.

- Insurance brokers we spoke with said that when helping a customer obtain coverage, they see all of the prices and conditions offered by each insurer placing a bid on that coverage. They also indicated that commercial property/casualty insurance is competitive, and that in several lines of commercial insurance, especially where large coverage amounts are involved, prices offered by insurers can deviate significantly on the same risk. For example, one broker said that insurers' bids on large policies regularly vary by as much as 20 percent below and above the median bid. Several brokers told us that AIG Commercial Insurance has

historically priced aggressively in some lines, and that while in some instances in the past several months AIG Commercial Insurance may have priced more aggressively in order to retain certain customers, it did not appear to be a widespread practice and was viewed as an expected response given the reputational hit the company has taken. They also cited instances where AIG Commercial Insurance has lost business because other insurers' prices were lower than theirs.

- Insurance buyers, who also see all of the prices and conditions offered by each insurer bidding on their coverage, said that AIG Commercial Insurance is known to be competitive in some lines and that they have not seen any indications of a widespread change in pricing by AIG's commercial insurers. They also said that they would recognize, and be concerned about, an insurer charging suspiciously low rates for the coverage because it would create a risk that the insurer would be unable to pay the policyholder's claim.

However, according to insurance regulators and other industry participants, for many lines of commercial insurance, determining whether prices charged by a commercial property/casualty insurer are adequate for the risk involved pose a number of challenges:

- In many lines of commercial insurance, in the case of very large risks as opposed to routine policies, the terms of coverage, in addition to the price, are often negotiated, resulting in unique policies. For example, the amount of a claim the policyholder would be responsible for, and the collateral the policyholder would be required to post to guarantee payment of this amount, would be negotiated. Without knowing all the terms of an individual policy, it could be difficult to determine the extent to which that policy was priced adequately for the risk involved.

- Insurers price policies based on predictions of future losses, which contain a number of subjective assumptions about risk, interest rates, litigation costs, and other costs. Underwriters may price a given risk differently and still be able to defend the reasoning behind their calculations.

- The most concrete indication of systematic inadequate pricing comes several years later, depending on how far into the future the losses associated with the policies in question are realized. However, a company may ultimately end up with higher-than-expected losses even if it charged actuarially determined premiums using reasonable assumptions at the time the policies were written.

In closing, the extent to which the assistance provided by the government will achieve its goal of preventing systemic risk continues to unfold and will be largely influenced by AIG's success in meeting its ongoing challenges in trying to restructure its operations. Likewise, it is too soon to tell whether AIG will be able to repay its outstanding debt to the federal government, which in large part depends on the stability of the overall financial system. While we have found no evidence that federal assistance has been provided directly to AIG's property/casualty insurers, as has been the case for AIG life insurers, AIG's insurance companies have likely received some indirect benefit to the extent that the property/casualty insurers would have been adversely affected by a credit downgrade or failure of the AIG parent. While we are continuing to complete our work in the area, some of AIG's competitors claim that AIG's commercial insurance pricing is out of line with its risks but other insurance industry participants and observers disagree. At this time, we have not drawn any final conclusions about how the assistance has impacted the overall competitiveness of the commercial property/casualty market.

Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions that you or Members of the Subcommittee may have.

Contact and Acknowledgements

For further information about this testimony, please contact Orice M. Williams at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Patrick Ward (Assistant Director), Joe Applebaum (Chief Actuary), Susan Offutt (Chief Economist), Silvia Arbelaez-Ellis, Tania Calhoun, John Forrester, Dana Hopings, Jennifer Schwartz, and Melvin Thomas.

Appendix I – Timeline of AIG Financial Difficulties Leading Up to Federal Assistance

- July 2008 to August 31, 2008:
  - The super senior collateralized debt obligation (CDO) securities protected by American International Group Financial Products' (AIGFP) super senior credit default swap (CDS) portfolio continued to decline and ratings of CDO securities were downgraded, resulting in AIGFP posting additional $5.9 billion collateral.
  - AIG was doing a strategic review of AIG's businesses and reviewing measures to address the liquidity concerns in AIG's securities lending portfolio and to address the ongoing collateral calls regarding AIGFP's super senior multi-sector CDS portfolio, which as of July 31, 2008, totaled $16.1 billion.

- Early September 2008: These collateral postings and securities lending requirements were placing increasing stress on the AIG parent company's liquidity.

- September 8 to September 12, 2008: AIG's common stock price declined from $22.76 to $12.14, making it unlikely that AIG would be able to raise the large amounts of capital that would be necessary if AIG's long-term debt ratings were downgraded.

- September 11 or 12, 2008: AIG approached the Federal Reserve with two concerns:
  - AIG had significant losses in the first two quarters of calendar year 2008, primarily attributable to AIGFP and decreasing values in their securities, leading AIG to request to place large amounts of cash collateral.
  - AIG's investments in mortgage-backed securities (MBS) were very illiquid. Consequently, AIG would not be able to liquidate its assets to meet the demands of counterparties. Since AIG is not regulated by the Federal Reserve, the agency was not aware of the company's financial problems.

  Also, because AIG was facing a downgrade in its credit rating the next week, it needed immediate liquidity help. Over the weekend, the Federal Reserve was examining AIG to determine if it was systemically important, meaning that its failure would have a broader effect on the economy. This was the same weekend that Lehman Brothers went into bankruptcy.

- September 12, 2008:
  - Standard & Poor's (S&P), placed AIG on CreditWatch with negative implications and noted that upon completion of its review, the agency could affirm the AIG parent company's current rating of AA- or lower the rating by one to three notches.

- AIG's subsidiaries, International Lease Finance Corporation (ILFC) and American General Finance, Inc. (AGF), were unable to replace all of their maturing commercial paper with new issuances of commercial paper. As a result, AIG advanced loans to these subsidiaries to meet their commercial paper obligations.

- September 13 and 14, 2008: AIG accelerated the process of attempting to raise additional capital and discussed potential capital injections and other liquidity measures with private equity firms, sovereign wealth funds and other potential investors. AIG also met with Blackstone Advisory Services LP to discuss possible options.

- September 15, 2008:
  - AIG was again unable to access the commercial paper market for its primary commercial paper programs, AIG Funding, ILFC and AGF. AIG advanced loans to ILFC and AGF to meet their funding obligations.
  - AIG met with representatives of Goldman, Sachs & Co., J.P. Morgan, and the Federal Reserve Bank of New York (FRBNY) to discuss the creation of a $75 billion secured lending facility.
  - S&P, Moody's, and Fitch Ratings (Fitch) downgraded AIG's long-term debt rating. As a result, AIGFP estimated that it needed in excess of $20 billion to fund additional collateral demands and transaction termination payments in a short period of time.

- September 15, 2008: AIG's common stock price fell to $4.76 per share.

- September 16, 2008:
  - AIG's strategy to obtain private financing failed. Goldman, Sachs & Co. and J.P. Morgan were unable to syndicate a lending facility. Consequently, counterparties were withholding payments from AIG, and AIG was unable to borrow in the short-term lending markets.
  - To provide liquidity, both ILFC and AGF drew down on their existing revolving credit facilities, resulting in borrowings of approximately $6.5 billion and $4.6 billion, respectively.
  - AIG was notified by its insurance regulators that it would no longer be permitted to borrow funds from its insurance company subsidiaries under a revolving credit facility that AIG maintained with certain of its insurance subsidiaries acting as lenders. Subsequently, the insurance regulators required AIG to repay any outstanding loans under that facility and to terminate it.
  - The Federal Reserve extended the facility to AIG to prevent systemic failure. AIG had no viable private sector solution to its liquidity issues. It received the terms of a secured lending agreement that FRBNY was prepared to provide. AIG estimated that it had an immediate need for

cash in excess of its available liquid resources. That night, AIG's Board of Directors approved borrowing from FRBNY based on a term sheet that set forth the terms of the secured credit agreement and related equity participation.

- September 22, 2008:
  - The inter-company facility was terminated effective September 22, 2008.
  - AIG entered into the Fed Credit Agreement in the form of a two-year secured loan.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

March 17, 2009

The Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20510

Dear Chairman Kanjorski:

I know that there is considerable outrage in the House of Representatives, as there is throughout the country, about the bonuses awarded to employees of AIG Financial Products division at a time when the company is reliant on significant taxpayer dollars. The President shares that outrage, and so do I.

I am writing to outline the steps taken by the Department of the Treasury to date, to update you on the actions we are taking to recoup the retention payments just made, and to deal with future payments of executive compensation by AIG.

I registered my strong objections to Mr. Edward Liddy, the CEO of AIG, last week when I was first informed by my staff about the pending payment obligations.

Mr. Liddy told me that a tranche of $165 million in retention bonuses were contractually committed and payable by March 15 to employees within the financial products division - the very division most culpable for the rapid deterioration of AIG. Mr. Liddy, who took the reins of the firm after the bonuses were negotiated in April of 2008, said AIG's lawyers had concluded that the contracts were legally binding. I asked for a written explanation and legal analysis to support that claim, including the legal liabilities that would arise if the contracts were breached, and turned it over to Treasury's own lawyers to review.

Our lawyers agreed, in consultation with outside counsel, that it would be legally difficult to prevent these contractually-mandated payments. Even the new executive compensation restrictions recently passed in the American Recovery and Reinvestment Act (ARRA) allow for the payment of contracts signed before the act went into effect.

I demanded of Mr. Liddy that he scrap or cut hundreds of millions of dollars in additional payments due this year and beyond. He has committed to do this on terms that are consistent

with the executive compensation provisions of ARRA, the administration's executive compensation guidelines, and the interests of the American taxpayers.

As you know, the President has asked me to fully review all additional measures at my disposal to recoup these bonuses and to recover funds on behalf of taxpayers.

We are presently working with the Department of Justice to determine what avenues are available by which we can recoup the retention awards that have been paid. The executive compensation provisions of the ARRA provide that the Secretary of the Treasury "shall review compensation paid to the senior executive officers and the next 20 mostly highly-compensated employees of each entity receiving TARP assistance before the date of enactment of the ARRA, to determine whether any such payments were inconsistent with the purposes of this section or the TARP or were otherwise contrary to the public interest." If such a determination is made, the Secretary "shall seek to negotiate with the TARP recipient and the subject employee[s] for appropriate reimbursements to the Federal Government." Our review will determine whether we can recoup these bonuses under the authority granted by ARRA or by other means.

We also want to insure that taxpayers are compensated for any monies we cannot recover.

Therefore, as part of our provision of recently announced taxpayer funds, we will impose on AIG a contractual commitment to pay the Treasury from the operations of the company the amount of the retention awards just paid. In addition, we will deduct from the $30 billion in assistance an amount equal to the amount of those payments.

Going forward, future AIG bonuses will be subject to the strict executive compensation provisions enacted by Congress in the ARRA. We are currently developing the regulations to implement those provisions, which will apply broadly to AIG and other companies receiving assistance from Treasury. These actions, consistent with the ARRA and other executive compensation guidelines under consideration by the Administration, are being taken to protect taxpayer funds and align long-term compensation with the interests of taxpayers.

But in working to resolve the AIG bonus problem, we should not lose focus on the larger issue it raises.

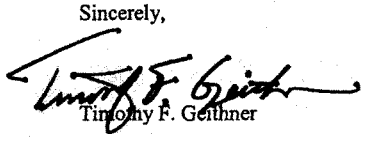
This situation dramatically underscores the need to adopt, as a critical part of financial regulatory reform, an expanded "resolution authority" for the government to better deal with situations like this. Such a resolution authority should include a comprehensive and broad set of regulatory tools that would enable the government to deal with financial institutions, like AIG, whose failure would pose substantial risks to our financial system, but to do it in a way that will protect the interests of taxpayers and innocent counterparties. Without this expanded authority, the government has been forced to take extreme measures to prevent the catastrophic collapse of AIG and allow the time necessary for its orderly wind down.

We will continue our aggressive efforts to resolve the future status of AIG in a manner that will reduce the systemic risks to our financial system while minimizing the loss to taxpayers. And we will explore any and all responsible ways to accelerate this wind down process.

I know that much of the public ire has fallen on Mr. Liddy, which is understandable, since it is his name on the door. But it also is unjustified. Mr. Liddy was put in place as the CEO of AIG last year at the request of the U.S. government to help rehabilitate the company and repay taxpayer funds. He inherited a difficult situation, including these AIGFP retention contracts, which were entered prior to his or the government's involvement in AIG. As long as he is there, we will work with him on measures to wind down AIG in an orderly way and protect the American taxpayer.

Most important for the long-term health of the credit markets that are a key to the economy, I look forward to working with Congress to modernize our financial regulatory system in way that protects the American taxpayer, meets the challenges of a dynamic global market and reduces the chance that we will face a financial crisis of this magnitude in the future.

Sincerely,



Timothy F. Geithner

[Identical letters sent to Speaker Pelosi, Senate Majority Leader Reid, House Minority Leader Boehner, and Senate Minority Leader McConnell.]

derivatives. You know, we've actually gone back and tried to drill down into the models on which some of these derivatives are actually based. And in some cases they probably stretch from myself to Mr. Hensarling down there.

And I'm just wondering, is there anything in your proposed reforms that might get at this issue? I mean, some of these derivatives, I have to admit, it's just very, very tough to value them or marking them to book, as some of my friends in the industry have described it, these credit default swaps that are a huge, huge part of the market out there, these collateral debt obligations, the failure of these risk and recovery models to really predict or to ascertain the value of these things.

I honestly -- they are so complex, I honestly believe if we adopted a simpler rule that said an investor had to understand these things before they bought them, that this whole market would come to a screeching halt. I honestly believe that. And I'm only half-joking.

But is there anything that you propose that would get at that opaqueness and, I guess, lack of transparency and complexity, something that would allow investors to have more confidence? I mean, in some of these cases we can't -- in these synthetic CDOs, we don't even know who the actual ownership -- you know, where the ownership lies. So it's just very, very tough for an investor, especially in difficult times, to have confidence in their investment when they can't really determine that on their own.

SEC. PAULSON: I think, Congressman, both the chairman and I spoke about how important it was to make enhancements in the infrastructure and the transparency around credit default swaps and other over-the-counter derivatives. And I think you heard him say that the New York Fed is driving an effort where we need to have a clearinghouse. We need more transparency. We need better protocols, I think more standardization. So there's a lot of work being done.

Now, I want to also say to you that there's -- these contracts have done a lot to make the markets more efficient. And we've gone through periods of time where we've had some major failures, you know, at the time of Enron and so on. And the markets were able to weather it because of the efficiency of these markets. But they clearly need more discipline and stronger infrastructure.

Now, there are other things that have been suggested and are being pursued quite aggressively to deal with this. One is -- you made the point investors need to do their work to make sure they understand. And if they don't, then they shouldn't be investing. And there's a lot of work being done on the part of the writing agencies. And Chairman Cox has spoken to that, and he's done a lot of good work there in terms of reforming those practices.

The President's Working Group has suggested that when the rating agencies make their ratings, that they make a differentiation between a rating that goes to a standard corporation or a municipality and one that's a structured, highly structured financial product; they maybe should get a different designation.

So there have been a number of suggestions that have been made, and they're all being pursued. Now, it's going to take some time to work through this, but progress is being made here.

REP. LYNCH(?): Mr. Chairman?

REP. FRANK: Quickly, Mr. Chairman.

MR. BERNANKE: I would just say that the Federal Reserve is very much involved in this process to make the post-trade clearing and settlement process -- the management of the risk associated with this, the transparency, the standardization, these are all things we're working on. And I elaborated a bit on that in my speech I gave earlier this week, and this is a very high priority for us.

REP. LYNCH(?): I'll look at it. Thank you.

Thank you, Mr. Chairman.

REP. FRANK: The gentleman from New Jersey.

REP. SCOTT GARRETT (R-NJ): Thank you, Mr. Chairman.

And thank you, Mr. Chairman, Mr. Secretary, for your service to the country.

HEARING OF THE HOUSE FINANCIAL SERVICES COMMITTEE; SUBJECT: SYSTEMIC RISK AND THE FINANCIAL MARKETS; WITNESSES: HENRY PAULSON, SECRETARY OF THE TREASURY; BEN BERNANKE, CHAIRMAN, THE FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS,; CHAIRED BY: REPRESENTATIVE BARNEY FRANK (D-MA); LOCATION: 2128 RAYBURN HOUSE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service July 10, 2008 Thursday

Secretary Paulson, I was very pleased to see your comments on Tuesday regarding covered bonds and how they can be maybe another way to increase the availability and lower the cost of mortgage financing to hopefully get us back to normal home buying in this country.

I agree with covered bonds, both in the commercial area and in the residential area, present a great way to provide more liquidity to the U.S. housing market during this credit crunch. I've spoken to Chairwoman Bair directly about covered bonds, and I know my staff has been in touch over the weeks with your colleagues at the Treasury. And over the last three months, I've been working with outside interested parties to see whether we can work together on coming up with legislation to help -- (inaudible) -- covered bonds.

Chairman Bernanke, on this topic, I've not heard -- maybe you made the statement, but I have not heard it. Do you have a position generally in favor, support of Secretary Paulson with regard to helping address the mortgage situation?

MR. BERNANKE: Like you, Congressman, I think it's very important for us to be -- here we mean both the regulatory community, but also the private sector -- to be looking for new ways to get financing. Covered bonds are a very successful financing vehicle in Europe, and therefore it's an attractive thing for us to look at here.

The FDIC has got a rule it's gotten worked out that will clarify some of the issues associated with the priority of covered bond collateral versus deposit insurance fund. I'm in favor --

REP. GARRETT: (Inaudible.) Sorry. You're in favor of --

MR. BERNANKE: I'm in favor of working in this direction. I wonder -- I think it's not yet known whether this can be successful without legislation. I think that's a question we want to --

REP. GARRETT: Well, I look forward to working on this legislation.

Turning now to the issue that most of us have talked about so far, the Bear Stearns situation, I had a chart, but I know the numbers are pretty small. But you should be familiar with it because it comes from your own folks on your own website. It's the Federal Reserve balance sheet as of June 25th, 2008.

As I read it and others explain it, it indicates that there's only roughly $22 billion, generally speaking, of Treasury bills remaining, and the Fed has already exchanged $255 billion, roughly, for a variety of types of private debt, some of which you've questioned the quality of.

Now, today the secretary has made remarks of the need for a new statutory framework to deal with the unwinding of the situation. I'm sure you've seen a number of the articles that talk about this, and the press indicates there are several other brokers out there that might be facing significant problems as well going forward. And you've already indicated you hate to have to deal with the situation as you've had with Bear Stearns in the past.

So, Mr. Chairman, it appears to me that if one of these highly interconnected investment banks were to fail in the near-future, the Fed's balance sheet then has limited or no room left on it, coupled with there being no legislative framework in place going into this.

Would the Fed, in essence, have to monetize the situation to bail them out? Would the Fed have to deal with new Treasury paper to bail out bondholders, which is what you really incurred with the Bear Stearns situation, if another situation came?

So my questions to you is three. Can you assure us -- I think I know the answer to this question, but can you assure us that you will not conduct any similar Bear Stearns transaction if another investment bank or GSE gets in trouble without prior explicit authorization of the Congress via some sort of enabling legislation?

Two, if you decide that there is no alternative than to conduct another bailout or support, however you want to call it, to one of these troubled organizations, will you be willing to monetize the debt to finance such a transaction due to the current limitations on your balance sheet?

And thirdly, your claim that your actions with the Bear Stearns transactions are granted to you under Section 13 of the Federal Reserve Act, are there any limitations within that section or elsewhere as to your abilities going forward to deal with these situations?

HEARING OF THE HOUSE FINANCIAL SERVICES COMMITTEE; SUBJECT: SYSTEMIC RISK AND THE FINANCIAL MARKETS; WITNESSES: HENRY PAULSON, SECRETARY OF THE TREASURY; BEN BERNANKE, CHAIRMAN, THE FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS,; CHAIRED BY: REPRESENTATIVE BARNEY FRANK (D-MA); LOCATION: 2128 RAYBURN HOUSE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service July 10, 2008 Thursday

MR. BERNANKE: I'll try to address those range of questions. Over the weekend, when we were working on the Bear Stearns issue, I was in touch with congressional leaders and kept them informed. And the sense I got was that, you know, there was not an objection to pursuing it. I also, of course, worked very closely with the Treasury and with the SEC and other authorities to develop a consensus for the actions we took. And as I've argued before, I think they were necessary.

So, you know, I don't want to make any commitments. I don't think a situation like this is at all likely. But unless I hear from Congress that I should not be responding to a crisis situation, I think that it's a long-standing role of the central bank to use lender-of-last-resort facilities to address --

REP. GARRETT: Your first answer is yes. So the second question, then, is would you potentially monetize the situation if the balance sheet --

MR. BERNANKE: There's no monetization. This is a sterilized operation. There's no effect on the money supply. And in addition, I would add that our lending, not only to the Bear Stearns issue, but more generally to the banks and so on, is not only collateralized with good haircuts; it's also recoursed to the banks themselves. We have not lost a penny on any of this lending. And it is just lending. You're not purchasing any of it. It goes back to the bank when the term of the loan is over.

REP. GARRETT: So there's no limit to the amount --

REP. FRANK: No, I'm sorry, no further questions. The gentleman's time --

REP. GARRETT: Can he answer the last question?

REP. FRANK: He can answer it, but no further questions.

MR. BERNANKE: So it does not affect the money supply. We have plenty of balance sheet room left. So I don't visualize that as a constraint in the near term.

REP. FRANK: The gentleman from North Carolina.

REP. : Thank you. I have served on this committee for almost six years, and I remember the testimony pretty well on mortgage lending. But I've recently gone back and reviewed some of it to see what the lending industry was saying at the time about the kind of mortgage practices that have led to the problem.

And what they always said was that the provisions of the mortgages -- that they seem to be a problem; they seem unfavorable to consumers -- actually were risk-based. They were responding to a greater risk by certain borrowers, and that without those provisions they would not be able to lend to those borrowers and those borrowers would be denied credit. They would be unable to buy homes, would be unable to borrow against their homes to provide for life's rainy days.

Looking back on the practices that actually led to the problem, the subprime mortgages made in 2005-2006, it's pretty clear that those provisions had nothing to do with risk and nothing to do with benefiting consumers and making credit available to them that would otherwise not have been available.

It was a fundamental change in consumer lending from making an honest living off the spread to trying to trap consumers -- homeowners -- into a cycle of having to borrow repeatedly and paying penalties and fees when they did. And that the loans were intended to become unpayable for the borrowers, so the borrower would have to borrow again.

Insurance regulation at the state level generally requires that policy forms -- provisions and policies and premiums -- be approved in advance by the state regulator and that the insurer has to justify those provisions. So the kinds of arguments that we heard in this committee that we were not really in a position to judge on a provision-by-provision basis, a reasonably competent regulator could judge and determine whether that really was related to the risk, whether it really was to the advantage of the consumer and whether it also presented a policy for an insurer.

Secretary Paulson, the proposed regulator to protect consumers -- will that regulator have the authority, should it have the authority, to review consumer lending products in advance to see if the practices can be justified both for what it might do to the solvency of the institution, and also what it does for the consumer?

SEC. PAULSON: I would say this: Whether it reviews in advance or not, I believe that if we had a regulator that was focused solely, completely on consumer protection and investor protection, it's difficult to imagine we would have had some of the abuses that we've had today.

And in terms of we did not intend when we set out this blueprint to get involved in exactly what this regulator would do and how they would do it, but if there was -- that was the pure focus, there's no doubt that it would be involved there. And I think in the meantime, because that is a long-term vision, in the meantime, I think the things that we're seeing done at the Fed right now in terms of their -- (inaudible) -- in terms of looking at, you know, unfair lending practices -- is very, very essential.

And again, in the meantime, I do hope, because I think it's unlikely that anytime soon you are going to supplant the state regulation of mortgage origination, I do encourage you -- even if it's in the next Congress -- to pick up the idea of this mortgage origination commission, which will be able to work with states and evaluate the state programs and do it in a very transparent way. And I think that may help.

REP. : Chairman Bernanke, do you think there should be some way to review in advance, before they go into widespread use, consumer financial products to make sure that they are not rapacious to the consumer?

MR. BERNANKE: Well, to some extent that's happening in the following sense that first, as Secretary Paulson mentioned, the Federal Reserve is releasing on Monday a new set of rules which will limit the parameters, essentially, of how the mortgage can be constructed and will eliminate certain kinds of confusing and other practices from the possible contracts.

Secondly, we are continuing -- as we have recently done in credit cards -- we are continuing a very extensive set of disclosure reviews so that the lender will be required to explain and write essential information to the borrower. So I think we're going to go a long way towards reducing both the predatory aspects of the lending that you were referring to, and also I would just call the bad lending, which ended up being losses for the lenders themselves, because they had insufficient oversight and care when they paid for the loans.

In terms of creating a standardized product in advance I think is an interesting idea. It would simplify things in some ways, but on the other hand, there are some benefits to having flexibility and innovation in the mortgage market to have different types of mortgages available, like share appreciation mortgages or variable maturity mortgages and so on. So I wouldn't want to take government action to eliminate the possibility of innovation in that market.

REP. FRANK: The gentleman from California.

REP. : Thank you, Mr. Chairman.

There seems to be general agreement, with which I concur, that we need regulatory restructuring, regulatory reform and that we want to do it right rather than quickly. However, markets don't wait. If we go on -- if we're waiting till next year -- which is, I think, the implication here -- and the next Congress, next president, three quarters are going to pass at least before we have something in place.

So my question to both of you is: If there were a financial institution that -- to you use your terms, Secretary Paulson -- that is either too big or too connected that were approaching some failure or some difficulty, do you currently have the transparency to know in time, and the tools to deal with that? And/or if not, is there -- and/or is there anything we can give you quickly to help with that?

SEC. PAULSON: Well, let me say: What history shows us it is very difficult to predict in advance. And I don't think you're going to be able to reasonably give us any tool right now. So I'm going to just tell you that there is an urgent need. We're not saying, take your time, wait. There is an urgent need to get more tools.

But I also will tell you that I believe that the focus on market stability and the actions that the Fed has taken -- not just in the Bear Stearns episode, but in the follow up in the opening the PDCF to the -- opening the discount window to investment banks, has sent a very strong signal. And the world that the Fed and the SEC has done with these good institutions as they strengthened their liquidity management is, I think, very important.

So neither of us are predicting another incident. And we are looking the progress that's been made. We both would like additional tools. We're not saying "take forever", but we recognize that the fact that the regulatory structure hasn't

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REVIEW & OUTLOOK | MARCH 17, 2009

The Real AIG Outrage

President Obama joined yesterday in the clamor of outrage at AIG for paying some $165 million in contractually obligated employee bonuses. He and the rest of the political class thus neatly deflected attention from the larger outrage, which is the five-month Beltway cover-up over who benefited most from the AIG bailout.

Taxpayers have already put up $173 billion, or more than a thousand times the amount of those bonuses, to fund the government's AIG "rescue." This federal takeover, never approved by AIG shareholders, uses the firm as a conduit to bail out other institutions. After months of government stonewalling, on Sunday night AIG officially acknowledged where most of the taxpayer funds have been going.

Since September 16, AIG has sent $120 billion in cash, collateral and other payouts to banks, municipal governments and other derivative counterparties around the world. This includes at least $20 billion to European banks. The list also includes American charity cases like Goldman Sachs, which received at least $13 billion. This comes after months of claims by Goldman that all of its AIG bets were adequately hedged and that it needed no "bailout." Why take $13 billion then? This needless cover-up is one reason Americans are getting angrier as they wonder if Washington is lying to them about these bailouts.

* * *

Given that the government has never defined "systemic risk," we're also starting to wonder exactly which system American taxpayers are paying to protect. It's not capitalism, in which risk-takers suffer the consequences of bad decisions. And in some cases it's not even American. The U.S. government is now in the business of distributing foreign aid to offshore financiers, laundered through a once-great American company.

The politicians also prefer to talk about AIG's latest bonus payments because they deflect attention from Washington's failure to supervise AIG. The Beltway crowd has been selling the story that AIG failed because it operated in a shadowy unregulated world and cleverly exploited gaps among Washington overseers. Said President Obama yesterday, "This is a corporation that finds itself in financial distress due to recklessness and greed." That's true, but Washington doesn't want you to know that various arms of government approved, enabled and encouraged AIG's disastrous bet on the U.S. housing market.

Scott Polakoff, acting director of the Office of Thrift Supervision, told the Senate Banking Committee this month that, contrary to media myth, AIG's infamous Financial Products unit did not slip through the regulatory cracks. Mr. Polakoff said that the whole of AIG, including this unit, was regulated by his agency and by a "college" of global bureaucrats.

But what about that supposedly rogue AIG operation in London? Wasn't that outside the reach of federal regulators? Mr. Polakoff called it "a false statement" to say that his agency couldn't regulate the London office.

And his agency wasn't the only federal regulator. AIG's Financial Products unit has been overseen for years by an SEC-approved monitor. And AIG didn't just make disastrous bets on housing using those infamous credit default swaps. AIG made the same stupid bets on housing using money in its securities lending program, which was heavily regulated at the state level. State, foreign and various U.S. federal regulators were all looking over AIG's shoulder and approving the bad housing bets. Americans always pay their mortgages, right? Mr. Polakoff said his agency "should have taken an entirely different approach" in regulating the contracts written by AIG's Financial Products unit.

That's for sure, especially after March of 2005. The housing trouble began -- as most of AIG's troubles did -- when the company's board buckled under pressure from then New York Attorney General Eliot Spitzer when it fired longtime CEO Hank Greenberg. Almost immediately, Fitch took away the company's triple-A credit rating, which allowed it to borrow at cheaper rates. AIG subsequently announced an earnings restatement. The restatement addressed alleged accounting sins that Mr. Spitzer trumpeted initially but later dropped from his civil complaint.

Other elements of the restatement were later reversed by AIG itself. But the damage had been done. The restatement triggered more credit ratings downgrades. Mr. Greenberg's successors seemed to understand that the game had changed, warning in a 2005 SEC filing that a lower credit rating meant the firm would likely have to post more collateral to trading counterparties. But rather than managing risks even more carefully, they went in the opposite direction. Tragically, they did what Mr. Greenberg's AIG never did -- bet big on housing.

Current AIG CEO Ed Liddy was picked by the government in 2008 and didn't create the mess, and he shouldn't be blamed for honoring the firm's lawful bonus contracts. However, it is on Mr. Liddy's watch that AIG has lately been conducting a campaign to stoke fears of "systemic risk." To mute Congressional objections to taxpayer cash infusions, AIG's lobbying materials suggest that taxpayers need to continue subsidizing the insurance giant to avoid economic ruin.

Among the more dubious claims is that AIG policyholders won't be able to purchase the coverage they need. The sweeteners AIG has been offering to retain customers tell a different story. Moreover, getting back to those infamous bonuses, AIG can argue that it needs to pay top dollar to survive in an ultra-competitive business, or it can argue that it offers services not otherwise available in the market, but not both.

* * *

The Washington crowd wants to focus on bonuses because it aims public anger on private actors, not the political class. But our politicians and regulators should direct some of their anger back on themselves -- for kicking off AIG's demise by ousting Mr. Greenberg, for failing to supervise its bets, and then for blowing a mountain of taxpayer cash on their AIG nationalization.

Whether or not these funds ever come back to the Treasury, regulators should now focus on getting AIG back into private hands as soon as possible. And if Treasury and the Fed want to continue bailing out foreign banks, let them make that case, honestly and directly, to American taxpayers.

Please add your comments to the Opinion Journal forum.

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Responses to Congressional Questions

1. Who and under what authority, committed AIG/AIG FP to the AIG FP 2008 Employee Retention Plan ("ERP")? When was this plan initially contemplated? When was the commitment made? Please provide a specific time line of actions and persons involved in the making the decision.

The ERP was first discussed in February 2008 when Joseph Cassano announced his departure as head of AIGFP. It was believed that Cassano's departure, combined with unrealized mark-to-market losses experienced by AIGFP in its multi-sector CDS portfolio and potential limits on compensation in future years, created a significant risk that AIGFP employees would leave the company in a manner that could substantially destabilize its operations and potentially lead to significant additional losses and the loss of additional future revenues. The ERP was put in place to retain these employees.

Senior management of both AIG and AIGFP approved an outline of the plan that was presented to AIGFP employees in a global call in mid-March 2008. The plan was also discussed in executive session by the Compensation and Management Resources Committee of the AIG Board on March 11, 2008 and by the AIGFP Board on March 12, 2008. A term sheet describing the plan was sent to all AIGFP employees on March 31, 2008. The final plan document, including the execution page for participants was distributed on April 23, 2008. All participants returned signed confirmations agreeing to the terms of the plan shortly thereafter.

The ERP was publicly disclosed by AIG in its Form 10-Q for the first, second and third quarter of 2008.

2. Who or which group proposed and designed the ERP? Was outside counsel consulted in drafting the ERP?

The ERP was designed and approved by senior management of AIGFP and AIG. Outside counsel prepared the plan documents.

3. Was this program used in other parts of AIG?

No.

4. Are similar ERPs used by other participants in the financial services industry?

We believe, but have not confirmed, that other financial services institutions adopted retention plans around this time.

5. What indices or best practices did AIG FP use to establish its ERP?

Payments under the ERP were based on 2007 compensation levels, including deferred bonuses that were paid to employees that have since been wiped out due to AIGFP's losses. AIGFP and AIG consulted with a compensation consultant with extensive experience in the financial services industry concerning the compensation paid to AIGFP employees in 2007

compared to market benchmarks. The consultant advised that for the positions of professionals in the Derivatives & Structured Markets Group, AIGFP paid "at approximately 80-85th percentile of relevant comparators, but below a number of significantly larger investment banking and independent groups."

6. Was the ERP discussed and/or considered by the AIG & AIG FP boards of directors? Provide all minutes of the relevant boards' meetings where this issue was discussed and/or considered.

   See response to Question 1 above.

7. What was the chain of command for approving ERP?

   See response to Question 1 above.

8. Which AIG FP employees were eligible to participate in the ERP and who determined such eligibility? Which other AIG employees or contractors were eligible to participate? How was continued eligibility determined? Does AIG believe that a person who has committed malfeasance remains entitled to a payment?

The ERP was designed to retain the AIGFP employee group as a whole, so most AIGFP employees are covered by the plan. Employees were generally considered eligible to participate in the plan if they were employed by AIGFP on March 31, 2008 and had received a bonus for 2007. One employee in this group, who played a major role in marketing and structuring the multi-sector CDSs in question, was excluded from the plan. Two other employees who did not receive a bonus for 2007 because they were on warning for poor performance likewise did not participate in the plan. Three consultants were included in the plan because of the belief that their continued services were important to the company's future business plans. Employees who resign prior to the payment date forfeit eligibility for subsequent retention payments.

The plan does not cover other AIG employees or contractors.

The plan provides that employees terminated for cause (defined as "intentional wrongdoing, fraud, dishonesty, gross negligence, material breach of the AIG Code of Conduct or other policies of AIGFP or AIG, or conviction of or entry of plea of guilty or no contest to a criminal offense") forfeit any ERP payment that has not yet been made. If an employee is guilty of malfeasance which would support a for cause termination, the company would terminate that employee and forfeit the ERP payment. To date, neither AIG nor AIGFP is aware of any fraud or malfeasance in connection with the underwriting and creation of the multi-sector CDS portfolio, as opposed to what with hindsight turned out to be bad business decisions. AIG and AIGFP are, however, aware of ongoing investigations by the Department of Justice and the SEC with respect to the subsequent valuation of the multi-sector CDS portfolio under fair value accounting rules and disclosures relating thereto. We have cooperated fully with these investigations and will continue to do so.

9. Did AIG conduct performance reviews to determine eligibility to participate in the ERP? Was performance or merit even considered a factor when these bonus plans were agreed to? Was this intended to retain employees regardless of performance?

Payments under the plan were tied to 2007 compensation levels for employees, including deferred bonus awards (that have since been wiped out by AIGFP's losses) which were related to performance. For senior management the plan provides that 2008 and 2009 compensation will be 75% of 2007 compensation levels (including deferred bonuses). Other participants' payments were set at the full 2007 level. As noted in the response to Question 8, certain individuals did not participate in the ERP because of performance issues.

10. What were the eligibility requirements for the ERP? Were the criteria based on performance? Why or why not? What are the criteria for payment? Is no minimum performance standard required?

See the response to Questions 8 and 9. The plan does not provide for payment to employees terminated "for cause," or, for the second payment due in March 2010, for terminations for failure to meet performance standards prior to December 31, 2008.

11. How many people receiving bonuses worked in the derivatives trading group? Did anyone check to see whether any of these employees engaged in malfeasance? Why or why not? Did these employees receive regular performance reviews and were they above average? Were they outstanding?

Only a handful of the approximately 400 individuals receiving payments under the ERP were involved in decisions to approve the multi-sector CDS transactions responsible for the company's financial distress. See also the response to Question 8.

12. What role did management play in approving these bonus plans?

See response to Question 1.

13. In 2009, what other companies are providing 100% bonuses? How many of these companies are in the financial sector? How many of these are receiving government bailout funds?

We do not know how many other companies have plans in place that contractually obligate them to pay bonuses equal to last year's expected compensation.

14. What would happen if you didn't pay these bonuses?

As detailed in the White Paper provided to Secretary Geithner, the failure to pay the bonuses would have resulted in lawsuits against AIGFP and AIG which would have exposed the companies to double damages and attorneys fees. A failure to pay would also have allowed participants to resign, claim constructive discharge and seek immediate payment of both the 2009 and 2010 awards under the ERP.

Moreover, a failure to pay the bonuses could have constituted a cross default under various derivative and other transactions to which AIGFP is party and that are guaranteed by AIG, which would have allowed counterparties to terminate the transactions and replace AIGFP. Under current market conditions, it is not possible to reliably estimate the replacement cost of these transactions that AIGFP and AIG would have to bear, but the portfolio with these types of provisions is in the several hundreds of billions of dollars and a cross-default in this portfolio could trigger other cross-defaults over the entire $1.6 trillion AIGFP portfolio.

In addition, it was believed that a failure to pay the bonuses would have precipitated a mass departure of employees who are critical to managing the wind-up of AIGFP. The consequences of such departures are detailed in the White Paper.

15. How many hundreds of billions has AIG received in government assistance to date? How much of the taxpayers' money have you used to pay out bonuses?

The details concerning the assistance received from the government to date are summarized in the attached presentation to investors dated March 2, 2009. Funds received from the government are not earmarked for specific purposes, but the amount received from the government is obviously far in excess of what has been paid in bonuses.

16. Was individual or group performance a factor in determining eligibility to participate in the ERP?

See the response to Questions 8 and 9 above.

17. Is continued individual or group performance a factor in determining eligibility to participate in the ERP?

The only criteria for payment under the ERP is that a participant may not quit without good reason, be terminated for cause or be terminated for failure to meet performance standards (as to the second ERP payment only.)

18. Was any factor other than retention used to determine eligibility to participate in the ERP?

See responses to Questions 8, 9 and 17.

19. Was the 2007 management of AIG FP's derivatives trading group eligible to participate in the ERP? If so, how many managers from AIG FP's 2007 derivatives trading group are currently employed at AIG FP or remain eligible to receive payments under the ERP? How many of the recipients of these bonuses are those who made the decisions to enter into these transactions that now they are unwinding? Or are these bonus recipients the ones who merely implemented the orders of those fund managers?

As noted in the response to Question 11, only a handful of the approximately 400 individuals receiving payments under the ERP were involved in decisions to approve the multi-sector CDS transactions responsible for AIG's financial distress. A few of these individuals are

currently involved in unwinding AIGFP's business, remain employed by AIGFP, and participate in the ERP.

20. Do employees terminated for cause remain eligible to receive payments under the ERP?

No.

21. Do former employees not terminated for cause remain eligible to receive payments under the ERP?

Yes.

22. I understand these are retention bonuses. Why does AIG FP provide retention pay to individuals who have left the company? How many bonuses were paid to persons who are no longer with the company? How could that possibly serve any purpose related to retention if the bonus is to be paid to former employees? Under what circumstances would you benefit by paying a retention bonus to "retain" the services of someone who no longer works for AIG? Was this not another major oversight in your contract?

The ERP was designed to provide a guaranteed minimum compensation level and job security to employees of AIGFP to ensure their continued service. A common provision in retention contracts provides that employees will be paid the amounts specified if they are terminated without cause (but not if they voluntarily leave). The absence of such a provision would provide little security, since an employer could always avoid its contractual obligations by terminating the employee before payment came due. At the time the ERP was put in place, AIG did not anticipate layoffs, but when layoffs became necessary, the provision requiring payment in the event of a termination without cause was triggered. Approximately 53 former employees who have been recently laid off received ERP payments.

23. What law, federal and state, governs the terms of the ERP? What international laws cover the ERP?

The ERP is governed by Connecticut law. Employees working in foreign jurisdictions (UK, France, Japan and Hong Kong) may have rights under local law as well.

24. What steps has AIG taken to evaluate the enforceability of both the ERP and the corresponding "cross default" clauses on which AIG relies in asserting its obligation to perform under the ERP?

Outside counsel has expressed the view that the ERP is enforceable based on a detailed analysis that has been shared with Congress. Both inside and outside counsel have reviewed the cross default provisions in selected derivative and other transactions and concluded that a failure to make the ERP payments would constitute a cross default with respect to those transactions.

25. Has AIG requested advisory legal opinions on any of the above questions? Have any such advisory opinions been made available to the Federal Reserve Bank of New York or the Treasury?

Yes. Outside counsel's views on the enforceability of the ERP have been shared with the Federal Reserve Bank of New York and Treasury.

26. Did the Federal Reserve Bank of New York or Treasury make any recommendations regarding this matter? If so, what were they and how did AIG respond to them?

The Federal Reserve Bank and Treasury were advised of the company's decision to make these payments in advance of the payments. AIG would not have proceeded with the payments without discussing the matter with them.

27. How many AIG FP employees received more than $100,000, $250,000, $500,000, and $1,000,000 in payments from the ERP for 2008? What about employees in other parts of AIG?

See the attached chart for the distribution of payments. The ERP does not apply to employees in other parts of AIG which have separate retention plans.

28. Has AIG or AIG FP management considered requesting employees voluntarily re-negotiate the terms of the ERP in light of current conditions?

The companies are vigorously pursuing requests to voluntarily return some or all of the ERP payments for individuals who received payments of more than $100,000.

ADDITIONAL MATERIAL TO THE TESTIMONY BY MR. EDWARD M. LIDDY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN INTERNATIONAL GROUP BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT-SPONSORED ENTERPRISES ON WEDNESDAY, MARCH 18, 2009

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3504 No performance bonuses at FP, zero. It's a different issue
3505 than the retention bonuses, where we basically said to
3506 people, ''You have a job, that job's going to go away, after
3507 you wind down the book of business that you manage. If
3508 you'll stay--
3509 Mr. FRANK. So are you talking about the only bonuses
3510 that were paid recently were the retention bonuses?
3511 Mr. LIDDY. Yes.
3512 Mr. FRANK. There were no other bonuses paid?
3513 Mr. LIDDY. Not at AIG FP. No, I don't believe so.
3514 Mr. FRANK. All right. And the retention bonuses, some
3515 people we're told who got retention bonuses have since left.
3516 Is that correct?
3517 Mr. LIDDY. Yes, sir. The arrangement--
3518 Mr. FRANK. Did they give back their retention bonuses?
3519 Mr. LIDDY. No. The arrangement is if you stay, wind
3520 down your particular business, do a good job of it, and were
3521 comfortable with the job you've done, you'll get that
3522 retention bonus. So--
3523 Mr. FRANK. So--the people who got a retention bonus and
3524 then they left, what would be the average period of time
3525 after which people got a retention bonus that they left? I
3526 don't expect you to know that off the top of your head, I'd
3527 ask you to submit to us.
3528 Mr. LIDDY. Okay.

Rep. Barney Frank (MA)

Issue: Average period of time in which an AIG Financial Products (AIGFP) employee remains with the company after receiving a retention payment. (Page 151, Line 3523)

The AIGFP employee retention plan (ERP) was established in the first quarter of 2008 to retain necessary employees for the years 2008 and 2009 as AIGFP managed more than $2 trillion in complex trades. The ERP was negotiated six months before AIG received or contemplated assistance from the Federal Reserve Bank of New York and, at the time, AIGFP was considered an important component of AIG's business. The ERP only applies to compensation years 2008 and 2009 and is paid retroactively for services; payments made in 2009 are for work provided by employees in 2008, for example. The last payment under the ERP will be made on or about March 15, 2010.

Employees must be employed on a scheduled payment date to be eligible for a retention payment unless previously subjected to a reduction in force (RIF). Since AIG decided to place AIGFP into a run-off mode in late 2008, a number of employees have been subject to a RIF since the ERP was established. As Mr. Liddy noted in response to questioning before the Subcommittee: "The arrangement is if you stay, wind down your particular business, do a good job of it, and were [sic] comfortable with the job you've done, you get the retention bonus."

Consistent with the ERP, AIGFP made payments on March 15, 2009 to 392 employees for the 2008 compensation year. Of these 392 employees, 52 were previously subject to a RIF after their required work was successfully completed. The 52 employees, pursuant to the ERP, were paid for completing their work. After March 15, 2009, 19 employees voluntarily resigned (as of April 6, 2009) and three employees left the company through a further RIF after their required work was successfully completed. The 19 employees who resigned are not eligible to receive any future retention payments.

3529 Mr. FRANK. One other issue before I get to--well, two
3530 others. You are optimistic in here about paying down the
3531 Federal Reserve debt. You don't mention the debt to the
3532 Treasury. Is that next after the Federal Reserve debt?
3533 Mr. LIDDY. Yes. It's really important for us, sir, to
3534 pay the debt down first so the rating agencies remain--
3535 Mr. FRANK. As opposed to the TARP, which is considered a
3536 different category? Is that the--
3537 Mr. LIDDY. Yes. Although, could I clarify? I think
3538 there's some confusion. Right now the Federal Government has
3539 invested two major tranches of money in us. One is $40
3540 billion of TARP and the other is just under $38 billion of a
3541 loan from the Federal Reserve. That's it. It's $78 billion.
3542 There's another $30 billion of TARP, which is available
3543 to us if we have to draw--
3544 Mr. FRANK. Which are--and you're talking about paying
3545 off the Federal Reserve debt, the $38 billion?
3546 Mr. LIDDY. The order in which we would do things is
3547 first the Federal Reserve debt, and then the TARP dollars.
3548 Mr. FRANK. Next question before I ask you my final one.
3549 I'm running of time. I would be interested in your
3550 submitting in writing, given your experience, whether we
3551 should be dealing with this question of an orderly resolution
3552 procedure. You were put in place where there wasn't any.
3553 The Secretary of the Treasury previously and currently

3554 has said: We need an orderly way to wind down a troubled
3555 non-bank.
3556 But let me ask you this now, and you've said some people
3557 are giving the bonuses back. I'm now asking you to send us
3558 the names of those who received bonuses, who have not given
3559 them back. Can you do that?
3560 Mr. LIDDY. Sir, I will if I can be absolutely assured
3561 that they will remain confidential.
3562 Mr. FRANK. Well, I won't give you that assurance, sir.
3563 And so if that's the condition, it would be my intention to
3564 ask this committee to subpoena them. And this is a situation
3565 where there's a lot of public activity.
3566 I ask you to submit the names of the people who've
3567 received the bonuses, noting that they paid them back, or
3568 not, and I would accept them under a confidentiality
3569 personally. In fact, you've submitted some confidential
3570 information, and I frankly threw it away after reading it,
3571 because I was afraid I would inadvertently breach the
3572 confidentiality.
3573 But I do ask that you submit those names with
3574 restriction, and if you feel unable to do that, then I will
3575 ask the Committee to subpoena them.
3576 Mr. LIDDY. Congressman, if you'll let me explain. I very
3577 much want to comply with your request. I would hope it
3578 doesn't take a subpoena. If it does, then we will obviously

Rep. Barney Frank (MA)

Issue: List of names of AIGFP employees receiving retention payments. (Page 153, Line 3556)

AIG continues to be concerned about the safety of all its employees, including those at AIG Financial Products (AIGFP) who received retention payments. AIG believes that threats to employees' physical safety make it necessary to continue to maintain confidentiality for individuals who received retention payments. Since March 15, 2009, the company has received tens of thousands of email and voicemail messages regarding the AIGFP employee retention program. AIG's security team evaluated these messages and subsequently referred those determined to be a threat to employee safety to the FBI Threat Squad. AIG continues to work with the FBI and the Connecticut State Police to facilitate their investigations of these threats. Names of employees have been provided to the office of the Attorney General of the State of New York, which has agreed to keep the names confidential, pending completion of a risk assessment by the Attorney General's office.

3979 Mr. CASTLE. I request, Mr. Chairman, as I close
3980 here--and would it be possible to ask if Mr. Liddy or those
3981 working with him could submit a list and the chronology of
3982 the meetings that occurred at which the Fed was available
3983 there and who was there and the basic outline of what was
3984 discussed at that meeting?
3985 Mr. ACKERMAN. Would you submit that in writing?
3986 Mr. CASTLE. Could you submit that in writing? I'm not
3987 asking you to do it now.
3988 Mr. LIDDY. We don't have it available to us right now.
3989 I--
3990 Mr. CASTLE. No, would you submit it in writing? Could
3991 you go back and after several days be able to submit
3992 something of that nature, looking at your minutes or
3993 whatever?
3994 Mr. LIDDY. Yes.
3995 Mr. ACKERMAN. Thank you.
3996 Mr. CASTLE. Yeah, from your board minutes or whatever
3997 other writing you might have. Thank you.
3998 Mr. ACKERMAN. The answer was yes.
3999 Before moving to Mr. Sherman, if the Committee would
4000 indulge a quick clarification? If you could give us a yes or
4001 no? During the exchange with Chairman Frank, requesting a
4002 list of those people who have accepted the bonuses or to whom
4003 bonuses were given, you also referenced the fact that you

Rep. Mike Castle (DE)

Issue: Chronology of communication between AIG and the Federal Reserve Bank on the AIGFP Employee Retention Plan. (Page 170, Line 3979)

See attachment *Chronology of Contacts with U.S. Government officials regarding AIGFP Employee Retention Plan Payments*, which list contacts with Federal Reserve Bank officials.

HIGHLY CONFIDENTIAL
DATE CREATED: MARCH 24, 2009

CHRONOLOGY OF CONTACTS WITH U.S. GOVERNMENT OFFICIALS REGARDING AIGFP EMPLOYEE RETENTION PLAN PAYMENTS

DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
9/26/08	Four AIG Attorneys Two Human Resources Executives Financial Services Executive	FRBNY Analyst	Email from AIG Attorney to AIG Attorneys and Executives, and FRBNY Analyst re the FRBNY's desire to review the compensation plans for AIGFP and Banque AIG early the following week.	Email
9/29/08	Two AIG Attorneys Financial Services Executive Human Resources Executive Outside Counsel	FRBNY Executive Several FRBNY representatives	AIG Attorneys, AIG Outside Counsel, and AIG Executives met with representatives of the FRBNY to discuss the AIGFP Employee Retention Plan and all other compensation plans.	Meeting
9/29/08	AIG Attorney	FRBNY Executive	AIG Attorney sent electronic copies of all plans, including the AIGFP Employee Retention Plan, to FRBNY Executive via email.	Email

* This table is based on the collective recollection of American International Group, Inc.'s employees, agents, and representatives. To expedite production of this table, it was not produced pursuant to American International Group, Inc.'s customary document production and review process. It is conceivable that other contacts with U.S. Government officials may have occurred and additional participants may have been present during some meetings and telephone calls.

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DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
9/30/08	AIG Attorney Financial Services Executive Human Resource Executive	FRBNY Executive FRBNY Counsel FRBNY Analyst	Meeting with FRBNY relating to the "AIG Financial Products Compensation Restructuring Proposal."	Meeting
10/2/08	AIG Executive Human Resources Executive Outside Counsel AIG Attorney	FRBNY Executive	Conference call to discuss AIGFP compensation plans.	Telephone call
10/6/08	AIG Attorney Human Resources Executive	FRBNY Counsel FRBNY Analyst	Email from AIG Attorney to FRBNY Analyst and FRBNY Counsel stating that FRBNY Counsel asked to set up a time to speak about what happened at the Compensation and Management Resources Committee meeting that morning. (On the agenda for the meeting was "Approve AIG Financial Products Corp. retention program"). FRBNY Analyst replied (copying FRBNY Counsel) with a proposed time for the call that day.	Email

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DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
10/6/08	AIG Attorney Compensation and Benefits Executive	FRBNY Counsel Several FRBNY representatives	Conference call with representatives of the FRBNY including FRBNY Counsel. During the call, Compensation and Benefits Executive provided information concerning AIG's compensation plans, including retention plan payments.	Conference call
10/10/08	Compensation and Benefits Executive	FRBNY Counsel	Letter from FRBNY Counsel to Compensation and Benefits Executive re the October 6 conference call. FRBNY Counsel states that the FRBNY will not be "approving" or "signing-off" on compensation plans, but will ask questions and air its concerns about them. The letter proceeds to detail concerns, *inter alia*, about whether the retention plan was narrowly tailored and whether it might foreclose access to TARP funding. Representatives of the FRBNY; FRBNY Outside Counsel; and AIG Executives and Attorneys were copied on the letter.	Letter
11/7/08	Compensation and Benefits Executive	FRBNY Counsel	After the November 7 call in preparation for the November 11 meeting of the Compensation and Management Resources Committee, Compensation and Benefits Executive had a call with FRBNY Counsel where the AIGFP Employee Retention Plan was discussed, among other topics.	Telephone call
11/8/08	AIG Attorney	FRBNY Counsel FRBNY Outside Counsel	AIG Attorney sent FRBNY Attorneys and FRBNY Outside Counsel materials in advance of the November 11 Compensation and Management Resources Committee meeting. The materials included a PowerPoint presentation titled "Financial Products compensation programs" which contained specific information on the AIGFP Employee	Hand delivery

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DATE CREATED: MARCH 24, 2009

DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
			Retention Plan.	
11/11/08	Three Directors AIG Outside Counsel AIG Executive Three AIG Attorneys Two Human Resources Executives Compensation and Benefits Executive Investment Executive Financial Services Executive	FRBNY Counsel FRBNY Outside Counsel FRBNY Outside Accountants	AIG Board of Directors Compensation and Management Resources Committee Meeting. The AIGFP Employee Retention Plan was reviewed at the meeting. A PowerPoint presentation titled "Financial Products compensation programs" was given containing specific information on the AIGFP Employee Retention Plan.	Meeting
12/2/08	Compensation and Benefits Executive Human Resources Executive Compensation	FRBNY Counsel Three FRBNY Representatives FRBNY Analyst Two FRBNY	Initial drafts of materials for the December Compensation and Management Resources Committee meeting sent in early December, prior to a December 2, 2008 prep meeting. The December agenda included "An Overview of Recent Compensation Discussions and Inquiries," which included an October 22, 2008 letter from Andrew Cuomo requesting	Meeting and associated emails

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DATE CREATED: MARCH 24, 2009

DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
	Executive Outside Compensation Consultant Outside Counsel	Outside Accountants FRBNY Outside Counsel	information on AIGFP.	
12/17/08	AIG Attorney	FRBNY Representatives	Emails from FRBNY Representatives to AIG Attorney asking to discuss AIG's strategy in light of news article titled "AIG Should Reveal Extent of Bonuses, Cummings says."	Email
2/1/09	AIG Attorney Two Human Resources Executives Compensation and Benefits Executive Compensation Executive	FRBNY Counsel FRBNY Outside Accountant	AIG Attorney sends an email re having to reschedule the planned meeting for February 2. Suggests an internal meeting to establish an agenda for the meeting. States that one goal is "FP Retention. A discussion of what steps or analysis we have done on this topic and what we plan to propose." Also suggests having representatives from Compensation Strategies, Inc. meet with representatives of FRBNY Outside Accountant.	Email
2/9/09	AIG Attorney	FRBNY Counsel	FRBNY Counsel emails FRB Representative stating that the FP retention program was put in place as early as 2007 as "another fact relevant to any question Bernanke gets on FP retention." AIG Attorney replies in the affirmative, adding that it was amended in 2008 before the market collapsed.	Email
2/24/09	Outside Counsel	FRBNY Counsel	FRBNY Counsel advises AIG Attorney and AIG Outside	Email

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HIGHLY CONFIDENTIAL
DATE CREATED: MARCH 24, 2009

DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
			Counsel of the status of conversations with Treasury on 2008 bonuses and notes that detailed compensation materials prepared by FRBNY Outside Accountants may be provided to Treasury (the presentation was still being finalized).	
2/27/09	Compensation Executive	FRBNY Outside Accountant	FRBNY Outside Accountant indicated that sometime prior to February 27, 2009, AIG forwarded: (i) summary description of FP retention plan; (ii) list of expected payments to top 21 employees; (iii) total payout amounts by year. FRBNY Outside Accountant received additional information about the FP retention plan on February 27, 2009.	Email
2/27/09	Outside Counsel	FRBNY Counsel	AIG Outside Counsel provided detailed AIG compensation materials to FRBNY Counsel (including proposal to delay AIGFP payments).	Email
3/2/09	Compensation Executive	FRBNY Outside Accountant	Follow-up email from FRBNY Outside Accountant re February 27 questions on proposed restructuring of AIGFP Employee Retention Plan payments.	Email
3/2/09	AIG Attorney	FRBNY Counsel	Multiple emails between FRBNY Attorney and AIG Attorney re AIGFP Employee Retention Plan proposal and expected payments.	Emails
3/2/09	AIG Attorney Outside Counsel	FRBNY Counsel	FRBNY Counsel requests additional information from AIG Attorney and AIG Outside Counsel regarding AIGFP proposal, including at the request of the Federal Reserve.	Email
3/2/09	AIG Attorney	FRBNY Counsel	AIG Attorney provided FRBNY Counsel with document	Email

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			drafted by outside counsel entitled "AIG Financial Products" that detailed retention payments for FP division and possible legal ramifications of failing to make such payments. AIG Attorney and AIG Outside Counsel were copied on the email.	
3/3/09	Compensation and Benefits Executive Two Human Resources Executives AIG Attorney Compensation Executive Outside Counsel Outside Compensation Consultant	FRBNY Counsel FRBNY Outside Accountants FRBNY Outside Counsel	Prep meeting for the March 10 Compensation and Management Resources Committee meeting. Per FRBNY Outside Accountants' request, AIG Human Resources Executive joined, and together with AIG Outside Counsel, discussed the FP retention plan and answered questions about it.	Meeting
3/3 – 3/5/09		FRBNY Outside Accountant	FRBNY Outside Accountants prepare compensation summary for the FRBNY to provide to Treasury.	
3/4/09	AIG Attorney	FRBNY Counsel	Email from AIG Attorney to FRBNY Counsel to schedule a telephone call to discuss AIGFP compensation.	Email
3/4/09	AIG Attorney	FRBNY Counsel	Telephone call re AIGFP Employee Retention Plan payments.	Telephone call

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3/4/09	AIG Attorney Outside Counsel	FRBNY Counsel	Email from FRBNY Counsel requesting that, in addition to the descriptions of the 2008 bonus program, AIG provide bullets regarding the impact of new standards and regulations on the program. The email states "[w]ith those bullets, and other materials, I think I can get Treasury's attention and say that we need a decision by the March 10 committee meeting."	Email
3/5/09	AIG Attorney Outside Counsel	FRBNY Counsel	Multiple emails between AIG Outside Counsel, AIG Attorney, FRBNY Counsel, and others re AIG's strategy for discussing AIGFP Employee Retention Plan proposals with Congressional staff members.	Email
3/5/09	Outside Counsel	FRBNY Counsel	FRBNY Counsel asks that the AIGFP retention materials forwarded to him by AIG Outside Counsel on February 27, 2009 be revised to reflect recent changes. Also states that the white paper discussing AIG's rationale for the retention plan should be included among the materials.	Email
3/5/09	Outside Counsel	FRBNY Counsel	FRBNY Counsel sent summary of AIG compensation matters to Treasury	Email
3/6/09	Human Resources Executive AIG Attorney	FRBNY Counsel	Email from FRBNY Counsel stating that a summary of AIG compensation matters was sent to Treasury, highlighting the slides detailing 2008 bonuses and the AIGFP Employee Retention Plan. Also noted that a Representative of Treasury would want to speak early the following week about both topics. States that "I suspect we won't know anything certain from Treasury prior to the CRMC meeting on March 10."	Email

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3/6/09	Outside Counsel	FRBNY Counsel	Per FRBNY Counsel's request, AIG Outside Counsel forwards updated retention materials to his attention.	Email
3/9/09	Outside Counsel	FRBNY Counsel	AIG Outside Counsel sends an AIGFP white paper, AIGFP spreadsheets on payments and a copy of the AIGFP retention plan to FRBNY Counsel and FRBNY Counsel	Email
3/9/09	Outside Counsel	FRBNY Counsel	FRBNY Counsel indicates that the AIGFP whitepaper, AIGFP spreadsheets on payments and copy of the AIGFP retention plan was forwarded to Treasury.	Email
3/9/09	AIG Attorney Outside Counsel	FRBNY Counsel	Emails from FRBNY Counsel re an hour long call with FRBNY Outside Counsel and Treasury. States that "I am nearly certain that they will ask the comp committee to hold off tomorrow on the 2008 bonus." In a follow-up email, FRBNY Counsel states that "I have just spoken to Treasury, [which requests] that the board delay at least a day with the 2008 Bonus. We are going to have another call tomorrow morning with Treasury."	Email
3/9/09	Compensation and Benefits Executive AIG Attorney Human Resources Executive Outside Counsel	FRBNY Outside Accountants FRBNY Outside Counsel	Conference call re the AIGFP Employee Retention Plan. Documents distributed prior to the conference call include: (i) AIGFP Employee Retention Plan plan; (ii) AIGFP Employee Retention Plan Whitepaper; and (iii) anonymous list of Employee Retention Plan payment recipients.	Telephone call and Email

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3/10/09	Five Directors AIG Executive Three AIG Attorneys AIG Human Resources Executive Compensation and Benefits Executive Outside Counsel Outside Compensation Consultant	FRBNY Counsel FRBNY Outside Accountants FRBNY Outside Counsel	The March 10 meeting of the Compensation and Management Resources Committee involved significant discussion of employee retention.	Meeting
3/10/09	Ten Directors Two Executives Three AIG Attorneys	FRBNY Counsel FRBNY Outside Counsel	During the meeting of the Board of Directors, significant discussions about the AIGFP Employee Retention Plan occurred.	Meeting
3/11/09	AIG Attorney	FRBNY Counsel	FRBNY Counsel forwarded AIG Attorney (copying AIG Executive) his email to Representatives from Treasury. States assumption that the document Treasury wants from AIG is a revised version of the White Paper.	Email

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3/11/09	AIG Attorney	FRBNY Counsel	Multiple emails between FRBNY Counsel and AIG Attorney regarding the AIGFP Employee Retention Plan and Treasury's consideration of the payments.	Email
3/12/09	Outside Counsel AIG Attorney	FRBNY Counsel	Email re drafts of letter from AIG Executive to Treasury re AIGFP Employee Retention Plan and attached documents; FRBNY Counsel to AIG Outside Counsel re "Treasury's comments on the [March 12 draft] letter."	Email
3/13/09	Outside Counsel	FRBNY Counsel	Emails to FRBNY Counsel from Outside Counsel providing revised version of draft letter to Treasury.	Email
3/13/09	AIG Attorney Outside Counsel	FRBNY Counsel Representative from Treasury FRBNY Outside Counsel	AIG Attorney, AIG Outside Counsel, FRBNY Counsel, FRBNY Outside Counsel and Representative from Treasury discuss 2008 bonuses.	Telephone call
3/13/09	AIG Attorney	FRBNY Counsel	AIG Attorney advises FRBNY Counsel that AIGFP payments are underway.	Email
3/13/09	AIG Executive AIG Attorney Outside Counsel	FRBNY Counsel	FRBNY Counsel emails AIG Attorney to report that Treasury staff indicate that AIG Executive and Treasury have reached agreement on how to deal with the senior partners under the 2008 bonus program.	Email
3/13/09	AIG Attorney	FRBNY Counsel	Email from FRBNY Counsel to AIG Attorney stating that a	Email

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DATE	AIG CONTACT	GOVERNMENT CONTACT	DESCRIPTION	DELIVERY
			call from House Financial Services Committee Staff Member about the AIGFP retention payments had just been received.	
3/14/09	AIG Attorney	FRBNY Counsel	AIG Attorney informs FRBNY Counsel that about requests for information about "FP and bonuses" from Representatives Frank, Kanjorski and Crowley. Asks if "the letter and the 2 white papers" can be provided. FRBNY Counsel responds that the letter from AIG Executive and the FP retention white paper (without the attachment relating to the 2008 bonus program) should be forwarded to Treasury, and then the AIG Attorney can send the documents to Congress.	Emails
3/15/09	AIG Attorney	FRBNY Counsel	FRBNY Counsel emailed AIG Attorney a copy of a letter sent to AIG Executive from the FRBNY.	Email
3/16/09	Outside Counsel Two AIG Attorneys	FRBNY Counsel	Email from FRBNY Counsel inquiring whether AIG Outside Counsel or AIG Attorney have any issues with the FRBNY or Treasury sharing the AIGFP Employee Retention Plan payment letter with Congress.	Email
3/16/09	AIG Attorney	FRBNY Counsel	Email from FRBNY Counsel to AIG Attorney asking about the status of the nameless list of employee retention plan payment recipients and whether it would be produced to the NY OAG that day.	Email
3/16/09	Outside Counsel	FRBNY Counsel	Letter from AIG Outside Counsel to FRBNY Counsel re legal analysis of AIGFP's employee retention plan.	Letter
3/17/09	AIG Attorney	FRBNY Counsel	AIG Attorney sent an email to FRBNY Counsel of the	Email

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			FRBNY providing him with the nameless list of AIGFP employee retention plan payment recipients AIG Outside Counsel had provided to the NY OAG on March 16, 2009.	
3/23/09	Human Resources Executive	FRBNY Outside Accountant	Emails between FRBNY Outside Accountant and AIG Human Resources Executive regarding confirmation of FRBNY Outside Accountant's summary of AIGFP Employee Retention Plan payments.	Email

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4054 But I don't want to go home and tell my constituents
4055 ''We may have some chance of getting some of the money
4056 back.'' The American people are skeptical.
4057 And so as a tax attorney, I can assure my constituents
4058 that if we pass the tax bill, we're sure to get virtually all
4059 the excess compensation back for the American taxpayers.
4060 Now if the Federal Reserve Board knew about the
4061 particulars of these bonuses and didn't tell us, then they
4062 should be called to account. Because that calls into
4063 question not only their competence, but their dedication to
4064 democracy. Because they may have deliberately prevented the
4065 American people from weighing in on the decision as to
4066 whether AIG should have been put into receivership.
4067 Mr. Liddy, can I count on you to provide the members of
4068 this committee with every document that you give the Fed,
4069 excluding those documents that have the names or other
4070 identifying information of your employees?
4071 Mr. LIDDY. I'd like the opportunity to talk to my
4072 general counsel about that and make sure that that in fact is
4073 the right thing to do.
4074 Mr. SHERMAN. Well, if you're going to keep your
4075 shareholders informed, you've got to keep the members of this
4076 Committee informed, and not just give it to a Fed that seems
4077 to have let us down.
4078 I would ask you provide for the record a chart, focused

4079 on future bonuses and future high compensation, which we
4080 could stop if we pushed you into receivership. At least we
4081 can stop future payments.
4082 And in that chart, show us how many employees are
4083 getting more than $100,000 a month in salary and how many
4084 stand under current compensation plans to get over half a
4085 million, a million, or two million during 2009 in bonuses?
4086 Can you furnish that for the record?
4087 Mr. LIDDY. I believe we can.
4088 Mr. SHERMAN. Thank you.
4089 Now are the employees of the company able to consult at
4090 AIG expense criminal defense lawyers, especially the
4091 high-paid $500-an-hour or $1,000-an-hour criminal defense
4092 attorneys? Is that allowed under your policies?
4093 Mr. LIDDY. Only if there's an assertion of criminal
4094 wrongdoing.
4095 Mr. SHERMAN. I think anybody listening to this Committee
4096 would say that there is an assertion of criminal wrongdoing,
4097 at least being made by the America people.
4098 You have an obligation to keep your shareholders
4099 informed. The shareholders are the 300 million American
4100 people. You can't just tell one or two shareholders. You
4101 got to tell all the shareholders.
4102 You knew a month ago that if we put this company into
4103 receivership, we not only would save the $30 billion that was

Rep. Brad Sherman (CA)

Issue: Information on how many employees earn more than $100,000 a month in salary, and how many (under current compensation plans) are due to receive over $500,000, $1 million, or $2 million during 2009 in bonuses. (Page 173, Line 4078)

> There are only three out of more than 116,000 AIG employees who currently earn more than $100,000 per month in salary. Compensation plans for 2009, including those related to salary, variable performance pay, retention programs and other compensation, will be designed and implemented throughout the year.

4104 provided to the company, or the risk that was taken by the
4105 federal taxpayer, in providing an additional $30 billion
4106 credit line, but that we would invalidate these bonus
4107 contracts.
4108 You seem to have informed one or two people of that. You
4109 did not inform all of the shareholders.
4110 The other issue is the contracts themselves seemed to
4111 have been entered into in contemplation of huge losses; and
4112 whether there was a criminal conspiracy to conceal these
4113 losses from the shareholders that AIG had about a year ago,
4114 and enter into these contracts, both of issues raise issues
4115 of whether there's criminal liability.
4116 Under those circumstances, will AIG spend the money to
4117 provide criminal defense counsel to its employees and
4118 officers?
4119 Mr. LIDDY. I really need to look at the facts, sir. And
4120 in much more detail than what you just indicated.
4121 Mr. SHERMAN. I would ask that you would provide for the
4122 record what your policies are, because as of, you know--the
4123 Miranda rights don't entitle you to a $1,000-an-hour criminal
4124 defense attorneys, they entitle you only to what is called,
4125 the rights that Miranda was given.
4126 I believe my time is expired.
4127 Mr. ACKERMAN. The gentleman from illinois, Mr. Manzullo.
4128 Mr. MANZULLO. Thank you Mr. Chairman.

Rep. Brad Sherman (CA)

Issue: AIG policy regarding the provision of defense attorneys for employees. (Page 175, Line 4121)

Like all public companies, AIG's policies with regard to circumstances under which it can or should provide counsel for employees or others is dictated by the corporation's bylaws (or those of the relevant subsidiary) and the law of the state in which they are incorporated. AIG is incorporated in Delaware.

5079 Mr. ROYCE. Thank you, Mr. Chairman.

5080 Mr. Liddy, I had a conversation for you or a
5081 conversation I wanted to have with you and it has to do with
5082 the issue of any discussions which AIG might have had with
5083 members of the Senate over the provision that was put in the
5084 Senate Bill in order to guarantee the payment of the bonuses.

5085 The explicit provision that went in in conference said:
5086 ''The prohibition required under this clause shall not be
5087 construed to prohibit any bonus payment required to be paid
5088 pursuant to a written employment contract executed on or
5089 before February 11, 2009.'' But the wider discussion I was
5090 interested in was whether AIG had contacted any members of
5091 the United States Senate about this particular problem of the
5092 bonuses. And, so, I just like your response to that.

5093 Mr. LIDDY. I believe the answer is no, at least not to
5094 my knowledge. We have a strict prohibition against lobbying.
5095 We will respond if called, but we do not make outbound
5096 calls, if you will. So as far as I know that's not anything
5097 we had any engagement in whatsoever.

5098 Mr. ROYCE. Let me ask this, then. Could you check and
5099 see if there are any e-mails or any written communication
5100 around this issue that would have attempted to bring this to
5101 the attention of members of the United States Senate, or the
5102 House for that matter. But I understand the provision went
5103 on in the Senate.

5104 Mr. LIDDY. I'll answer. At your request we will check.
5105 I feel quite certain the answer is no.
5106 Mr. ROYCE. And then let me ask you about discussions
5107 that you may have had with members of the administration and
5108 get into a little more detail in terms of who had those
5109 discussions and the basic thrust of them.
5110 Mr. LIDDY. The only discussion I would have had with
5111 members of the administration would have been with Secretary
5112 Geithner. The first of those conversations would have been
5113 about a week ago. I'm sorry to be not more precise. I don't
5114 have the exact date. And there probably would have been two
5115 of those: one on a Tuesday and one on a Friday; or one on a
5116 Wednesday and one on a Friday, something like that. And the
5117 purpose of the discussions was for Secretary Geithner to hear
5118 from me--my view of the bonuses and what we were going to do.
5119 As I indicated earlier, he indicated to me that he had
5120 become aware of those only maybe a week or ten days
5121 beforehand, and we shared a healthy exchange on this is going
5122 to be rough for the American public. He understood the risk
5123 issues, I believe, understood the legal issues, asked for me
5124 to make some changes to them, which we did. I sent him a
5125 note, which was vetted with his staff beforehand, and that's
5126 pretty much been the extent of it.
5127 Mr. ROYCE. I understand.
5128 Mr. LIDDY. When you said administration I didn't include

Rep. Ed Royce (CA)

Issue: Whether AIG lobbied on the American Recovery and Reinvestment Act of 2009. (Page 214, Line 5089)

Effective November 1, 2008, AIG adopted a company-wide policy prohibiting any federal lobbying activity on the part of company personnel or its consultants. A copy of that policy statement is attached. Consistent with this lobbying policy, AIG did not lobby on the American Recovery and Reinvestment Act of 2009.

Effective Date: 11/01/2008

AIG Policy on Lobbying, Government Ethics, and Political Activity

Introduction

AIG regularly interacts with the U.S. government and government entities, and our business is impacted by government policies and regulation. As a result, AIG and third parties working on its behalf have regular communication with government officials, regulators, and government agencies to express opinions on existing or pending laws, regulations, and policies and to discuss potential business opportunities. This policy supplements the AIG Code of Conduct and establishes guidelines to ensure that AIG employees involved in lobbying activities strictly comply with all lobbying laws and regulations wherever AIG does business. Many of the jurisdictions in which AIG conducts business have specific limitations or requirements related to lobbying activities, and the other topics of this Policy – AIG employees must comply with these laws and, where AIG's policy is more stringent than local law, AIG employees will follow the stricter limitations and requirements as set forth in the AIG Policy on Lobbying, Government Ethics, and Political Activity.

This policy applies to all relevant employees of AIG and joint ventures, private equity investments, foundations, and other subsidiaries of AIG who interact with government officials or agencies. Where relevant, it also applies to third parties acting on behalf of AIG or these related entities. Each subsidiary and business and operating unit is responsible for ensuring that this Policy is distributed to all applicable AIG employees and other relevant personnel.

Temporary Moratorium

AIG's Policy on Lobbying, Government Ethics, and Political Activity is temporarily qualified by the following, pending a comprehensive review of the relevant activities by senior management:

All federal lobbying activities by AIG or its representatives related to advocacy on legislation, as well as political contributions on behalf of AIG, and including the operation of AIG's political action committee, are suspended. AIG may, however, still respond to Federal Register solicitations for comment on specific agency proposals, and may also provide information to members of Congress, state legislatures, Executive branch and regulatory officials at the state and federal level, or their staffs to inform on AIG issues, to respond to requests made either to AIG, to government officials, or related to AIG, or to correct misinformation about AIG activities. AIG will also maintain its membership in trade associations that, in turn, may conduct lobbying activity for their members. AIG will not specifically request that these organizations advocate on our behalf while the AIG lobbying moratorium is in place.

In the event that pending legislation threatens to materially impact AIG's ability to continue its operations – or its ability to repay the company's loan to the Federal Reserve – AIG will be permitted to proactively advocate the company's position. Such activity would only be permitted with the express approval of both of the following individuals: AIG's General Counsel and AIG's Chief Regulatory & Compliance Officer, and then only for the specific matter at hand.

The State Relations Department is permitted to track, support, or oppose state bills that will have a direct impact on AIG's state-regulated entities. Monies to fund this activity will come from these state-regulated operations.

AIG will abide by and comply with all applicable laws, as passed by Congress, as it relates to firms that have received federal assistance.

Lobbying Activities

All lobbying activities must comply with applicable laws and AIG's Code of Conduct. Employees who engage in lobbying activities are expected to obtain and follow guidance from the Corporate Affairs Group in Washington, D.C. and the State Relations Group in New York, who will coordinate with their appropriate regional representatives. All of those who serve as advocates for the Company are expected to maintain the highest standards of professional integrity and conduct.

It is important to the success of AIG that advocacy on behalf of AIG be consistent, coordinated, and focused on the long-term interests of AIG and its employees, customers, and shareholders. Therefore, employees are prohibited from engaging in lobbying activities on their own or without the express approval of the relevant Corporate Affairs or State Relations Groups. The approval of the Corporate Affairs or State Relations Groups is not required for contacts by employees with regulators for everyday business, including submissions, proposed filings, examinations, complaints, consultations, regulatory inquiries or similar contacts with government officials by or through trade organizations of which AIG is a member. Instead, employees must confer with their Business Unit Chief Compliance Officer (CCO) or the Chief Regulatory and Compliance Officer in consultation, as necessary with the respective Business Unit General Counsel.

In addition, lobbying is strictly regulated by federal, state and local laws. When the lobbying activities of AIG employees require registration in a jurisdiction as a lobbyist or a lobbyist employer, both AIG and its employees will follow all relevant registration, reporting, and disclosure requirements. Regulated lobbying activities may include direct communication with government officials and employees as well as efforts in support of such contacts. In addition, lobbying is often defined more broadly than contacts with respect to legislation; federal lobbying laws and the laws in many states and local jurisdictions cover contacts with respect to executive action, administrative matters, the execution of government programs, and regulatory proceedings.

Federal, state, and local registration and reporting statutes vary by jurisdiction and place different requirements on companies that retain or employ lobbyists, on firms that engage in lobbying on behalf of clients, and on individual lobbyists. The Global Regulatory and Compliance Group is responsible for maintaining an auditable record of lobbying activities as may be necessary under a jurisdiction's disclosure requirements, including but not limited to time spent by AIG employees on lobbying activities, the identity of those who serve as lobbyists, the issues on which lobbying occurs, an accounting of the governmental officials and bodies before which lobbying occurs, and information on expenditures by AIG related to lobbying activities.

Offering or Providing Anything of Value to Government Officials

When lobbying and other activities of AIG bring employees into contact with government officials and employees, AIG and its employees must be sensitive to compliance with applicable laws and must adhere to all restrictions on the provision of gifts, including the restrictions contained in AIG's Global Anti-Corruption Policy. Gifts are defined broadly in federal, state, and local rules to include not only tangible items but also a gratuity, favor, discount, entertainment, hospitality, loan, service, meal, transportation, lodging, and anything else having monetary value. Such gifts may not be frequent and under no circumstances may a gift or

anything of value be offered to a government official to secure any improper advantage or to influence or reward the official with respect to his or her official actions or duties. This includes gifts intended to obtain or retain business or for assistance in obtaining a government license or regulatory approval, or settling a dispute with a local government agency or department.

In addition, depending upon the jurisdiction, providing gifts to government officials and employees may be prohibited by law, create reporting obligations, or create potential conflicts of interest. While many gift restrictions are contained in government ethics rules applicable to government officials and employees, a growing number of laws apply these restrictions specifically to those who make or offer a gift, particularly if offered or given by a lobbyist or a company that employs or retains lobbyists. Exceptions to the various federal, state, and local rules may allow the provision of some kinds of gifts but only in particular circumstances and under certain conditions.

The hiring of a government official or a member of his/her family must be treated with care, as it can be perceived as the provision of a thing of value to the government official. The Human Resources representative supporting the Business Unit seeking such a hire must obtain the approval of the Business Unit CEO or CCO, in consultation with the Business Unit General Counsel, to determine appropriate terms of the hire.

Employees who interact with government officials are expected to obtain and follow guidance from the Corporate Affairs or State Relations Groups prior to considering the offering or provision of gifts to governmental officials. In addition, those employees who are registered lobbyists may be asked to certify, in internal documents or in filings with governmental entities, their compliance with such rules. All employees must accurately record all expenses and payments made in connection with items provided to government officials. Employees must notify their supervisors and Business Unit CCOs of any circumstances suggesting the provision of improper gifts or anything of value or of any request from a government official to provide anything of value to retain government business.

Doing Business with the Government and Government Officials

Doing business with government bodies presents different risks from doing business in the commercial sector. Laws related to contracting with international, federal or state entities are more stringent and complex. All employees should consult with their Business Unit CCO prior to making a decision about doing business with government entities.

Moreover, note that conducting lobbying activities in connection with procurement matters may impact AIG's ability to obtain or retain government business. For example, when a company responds to a Request for Proposal ("RFP") issued by a government agency, lobbying activities outside the standard RFP process could subject the company to certain requirements and prohibitions, including disqualification.

Additionally, when AIG does business with government officials in their personal capacity (providing life insurance, property or casualty coverage, etc.), employees must treat such clients as they would any other client. Government officials may not receive special benefits or services as a result of their government status.

Effective Date: 11/01/2008

Political Activities

AIG respects the rights of its employees to support candidates and issues and to seek elected and appointed office. Company employees are encouraged to participate in political activities on their own time and in accordance with their individual desires and political preferences. Employees considering becoming a candidate for an elected public office shall advise the appropriate Business Unit CEO or CCO, who, in consultation with the Business Unit General Counsel, will ensure that no conflict of interest results and that all applicable laws that impact AIG are followed in the course of the employee's candidacy.

Employees who engage in personal political activities must be clear at all times that such participation is as an individual and not as a representative of AIG. In the course of voluntary political activity, no employee shall use AIG's name in any way to ensure that there can be no interpretation of sponsorship or endorsement by the company. In addition, no employee shall use corporate facilities or resources for personal political activity except as permitted by law. Any use of facilities or resources for such purposes that results in increased overhead or operating costs to AIG is prohibited.

Like other political activities, political contributions by individual employees are entirely personal and voluntary. No corporate resources may be utilized to make or facilitate personal political contributions, and AIG will not recognize, reimburse, or in any way compensate an employee for his or her personal political contributions. Moreover, employees may not use their position within AIG to coerce or pressure other employees, or appear to coerce or pressure other employees, to make political contributions or to support or oppose political candidates or elections.

AIG sponsors a federal political action committee (PAC), which receives voluntary contributions from employees and makes contributions to candidates for public office and political committees. In addition, AIG may, where permissible under relevant law, make corporate contributions to political candidates and committees. Only authorized AIG representatives may commit PAC or corporate funds for such purposes. All PAC and corporate contributions must be made in strict compliance with governing law and AIG policy.

Because laws and regulations governing corporate political activities and contributions are complex, the Corporate Affairs or State Relations Groups must be consulted regarding such contributions and activities to ensure that they are permissible and fit within AIG's overall business strategy for the region.

Record Keeping

AIG must maintain books and records that accurately reflect AIG's business transactions and establish and maintain internal controls. All lobbying expenses, gifts, entertainment and travel, and other expenditures made to or for the benefit of government officials must be recorded accurately in AIG's books and records in reasonable detail.

Any failure to accurately record these business transactions must be reported no less than quarterly to the Business Unit CCO. The Business Unit CCO will compile all information for the Global Regulatory and Compliance Group and, as necessary, the General Counsel and Chief Financial Officer.

Effective Date: 11/01/2008

Business Unit Role & Penalties for Non-Compliance

Each subsidiary and business and operating unit is responsible for ensuring that monitoring processes designed to detect and prevent violations of this policy are implemented. Actual or perceived violations could also cause serious damage to AIG's reputation.

AIG will take appropriate action against any employee whose actions are found to violate this policy. Disciplinary action also may be taken against responsible employees who unreasonably fail to detect or report such violations, as well as those who retaliate. In addition, penalties may include criminal, civil and regulatory penalties for AIG and its employees individually, including imprisonment and fines.

Exceptions

Employees may request, in writing, exceptions or modifications to this policy by contacting their respective Business Unit CCO, who will refer the request to the Global Regulatory and Compliance Group.

Questions Regarding the Policy

General: Global Regulatory and Compliance Group

Karen Nelson, Deputy Chief Compliance Officer – Programs/Training
Phone: 646-857-1812
Email: karen.nelson2@aig.com

Katherine Segersten, Senior Regulatory Officer
Phone: 202-861-8656
Email: katherine.segersten@aig.com

State: State Relations Group

Cecilia Norat, Director of State Relations and Associate General Counsel
Phone: 212-770-5235
Email: cecilia.norat@aig.com

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4429 Mr. LIDDY. You know, I have met with the trustees on a
4430 number of occasions. They were just appointed approximately
4431 the middle of February or so. I don't remember the exact
4432 date.
4433 Again, we've reviewed these with the Federal Reserve and
4434 the Federal Reserve is the repository gatekeeper, if you
4435 will, of the relationship with AIG.
4436 Mrs. BIGGERT. So they were appointed after the
4437 decision--well no, the decision was in March.
4438 Mr. LIDDY. No. Before.
4439 Mrs. BIGGERT. So did they notify anybody? Or did you
4440 talk to them about the bonuses?
4441 Mr. LIDDY. I do not know if they were reviewed or not.
4442 Mrs. BIGGERT. Okay. Who are the trustees?
4443 Mr. LIDDY. There are three trustees. To be honest with
4444 you--Doug Fuge. I can get you that list, if you will--
4445 Mrs. BIGGERT. I'd appreciate it.
4446 Mr. LIDDY. Bill Considine. I can get you that list.
4447 Mrs. BIGGERT. All right.
4448 So did you or your staff make the Treasury aware of the
4449 bonuses, other than talking to the trustees, or--
4450 Mr. LIDDY. I'm sorry, did we make the Treasury?
4451 Mrs. BIGGERT. Yes. Treasury aware?
4452 Mr. LIDDY. No, as I said earlier, we began discussing
4453 this at our board meeting starting in the middle of November,

Rep. Judy Biggert (IL)

Issue: Trustees selected to oversee U.S. government's equity interest in AIG. (Page 188, Line 4442)

See attached press release issued by the Federal Reserve Bank of New York on January 16, 2009. The press release includes the names and biographies of the three independent trustees selected to oversee the U.S. government's equity interest in AIG.

PRESS RELEASE

Statement Regarding Establishment of the AIG Credit Facility Trust

January 16, 2009

The Federal Reserve Bank of New York announced today, with the full support of the Treasury Department, the formation of the AIG Credit Facility Trust. The Trust is being established for the sole benefit of the United States Treasury to hold the 77.9 percent equity interest in American International Group, Inc. (AIG) that will be issued in connection with the previously announced credit facility extended to AIG.

Three independent trustees have been selected by the New York Fed, in close consultation with the Treasury Department, to oversee this equity interest in the best interests of the U.S. Treasury. They are Jill M. Considine, former chairman of the Depository Trust & Clearing Corporation; Chester B. Feldberg, former chairman of Barclays Americas; and Douglas L. Foshee, president and chief executive officer of El Paso Corporation.

Pursuant to the terms of the Trust Agreement, the trustees will have absolute discretion and control over the AIG stock, subject only to the terms of the Trust Agreement, and will exercise all rights, powers and privileges of a shareholder of AIG. The trustees will not sit on the board of directors of AIG. Day-to-day management of AIG will remain with the persons charged with such management.

To avoid possible conflicts with the New York Fed's supervisory and monetary policy functions, the Trust has been structured so that the New York Fed cannot exercise any discretion or control over the voting and consent rights associated with the equity interest in AIG. The New York Fed will, however, continue to monitor closely the financial operations of AIG in connection with its role as lender.

Trustees' CVs PDF

AIG Credit Facility Trust Agreement PDF
Posted January 22, 2009

Contact:
Calvin A. Mitchell III
(212) 720-6136
(646) 720-6136
calvin.mitchell@ny.frb.org

Jill M. Considine

Jill Considine served as senior advisor of The Depository Trust & Clearing Corporation (DTCC) and its subsidiaries (securities depository and clearing house) from August 2007 to May 2008, having served as chairman since August 2006, and as both chairman and chief executive officer from January 1999 to August 2006.

Prior to joining DTCC, Ms. Considine served as the president of the New York Clearing House Association, L.L.C. from 1993 to 1998. Ms. Considine served as a managing director, chief administrative officer and as a member of the Board of Directors of American Express Bank Ltd., from 1991 to 1993. Prior to that, Ms. Considine served as the New York State Superintendent of Banks from 1985 to 1991. Ms. Considine also serves as a director of the Atlantic Mutual Insurance Companies, The Interpublic Group of Companies, Inc., Ambac Financial Group, Inc. and is chairman of Butterfield Fulcrum Group, Limited.

Ms. Considine recently completed a six-year term as a member of the Board of the Federal Reserve Bank of New York where she served as chairman of the Audit and Operational Risk Committee.

Ms. Considine is a member of the Council on Foreign Relations and the Economics Club of New York. She served on the Group of Thirty Steering Committee on global clearance and settlement and as a member and speaker at the World Economic Forum in Davos. Ms. Considine was a Presidential appointee to the Advisory Committee for Trade Policy and Negotiations from 2003-2004. She was named Six Sigma CEO of the Year Award in 2006 and one of Crain's New York Business 100 Most Influential Women in Business.

Ms. Considine earned a Bachelor of Science degree, with honors, from St. John's University and a Master of Business Administration degree, with honors, from Columbia University. She also attended Bryn Mawr College.

Chester B. (Chet) Feldberg

Chester B. Feldberg served as Chairman of Barclays Americas from 2000 until his retirement in 2008. Prior to joining Barclays Americas, Mr. Feldberg had been executive vice president in charge of the Bank Supervision Group at the Federal Reserve Bank of New York from 1991 through 2000. In total, Mr. Feldberg was an employee of the New York Fed for 36 years, starting as a lawyer in the Bank's Legal Department before moving to the Credit and Capital Markets Group and then the Bank Supervision Group. He was also a member of the Basle Committee on Banking Supervision from 1993 through 2000.

Mr. Feldberg serves on the Board of Directors and Audit Committee of Mizuho Securities USA, a subsidiary of the Mizuho Financial Group.

Mr. Feldberg earned a Bachelor of Laws degree in 1963 from the Harvard Law School and a Bachelor of Arts degree in economics in 1960 from Union College. He also attended the advanced management program at the Harvard Business School in 1974.

Douglas L. Foshee

Douglas L. Foshee is president, chief executive officer and a director of El Paso Corporation, which owns North America's largest natural gas pipeline system and one of North America's largest natural gas producers.

Prior to joining El Paso in 2003, Mr. Foshee served as executive vice president and chief operating officer for Halliburton. He joined Halliburton in 2001 as executive vice president and chief financial officer. Prior to that, Mr. Foshee was president, chief executive officer and chairman of the board at Nuevo Energy Company. From 1993 to 1997, Mr. Foshee served Torch Energy Advisors Inc. in various capacities, including chief operating officer and chief executive officer. He held various positions in finance and new business ventures with ARCO International Oil and Gas Company and spent seven years in commercial banking, primarily as an energy lender.

Mr. Foshee earned a Master of Business Administration degree from the Jesse H. Jones School at Rice University in 1992 and a Bachelor of Business Administration degree from Southwest Texas State University in 1982. He is also a graduate of the Southwestern Graduate School of Banking and Southern Methodist University.

Mr. Foshee serves on the boards of Cameron International Corporation, Children's Museum of Houston, Texas Business Hall of Fame Foundation and Greater Houston Partnership. He also chairs the board of directors of the Federal Reserve Bank of Dallas, Houston Branch, and Central Houston, Inc. He is a member of the Independent Petroleum Association of America, Houston Producers' Forum, 25 Year Club of the Petroleum Industry, National Petroleum Council, the Council of Overseers for the Jesse H. Jones Graduate School of Management at Rice University, Rice University's board of trustees and KIPP's board of trustees. Mr. Foshee is a recipient of the 2007 Ellis Island Medal of Honor for his commitment to helping children succeed and his leadership role in the business community. In 2008, Mr. Foshee was named Distinguished Alumni at Texas State University.

5904 the question why didn't the Committee know. And I believe
5905 that your response was that AIG had met with staff from the
5906 Committee. Was that true?
5907 Mr. LIDDY. Yes, it was. I'm told that we have provided
5908 a great deal of information to the Committee and to various
5909 members on the Committee. I can't sit here and tell you
5910 exactly what it was or whether we previewed these bonuses or
5911 not, but we have tried to be very responsive to the
5912 inundation of requests that we have had.
5913 Ms. BACHMANN. And when was that? Was that beginning in
5914 mid November or when was that?
5915 Mr. LIDDY. Oh, it would have--that would have--you mean
5916 specifically on the bonuses?
5917 Ms. BACHMANN. Yes.
5918 Mr. LIDDY. I'm hazarding a guess. I don't have the
5919 command of those facts at my fingertips. I would guess that
5920 would have been starting in December.
5921 Ms. BACHMANN. Starting in December. Is it possible to
5922 get a list of which Members of Congress staff knew about this
5923 and when?
5924 Mr. LIDDY. We will provide you information of what we
5925 provided to whom and when we provided it.
5926 Ms. BACHMANN. Okay. Thank you. How about anyone in the
5927 administration? I believe you had been asked that question
5928 as well. Any members of the administration that knew about

5929 the bonuses and conversations about the bonuses?

5930 Mr. LIDDY. As I mentioned earlier, the conversation I

5931 had was with Secretary Geithner approximately a week ago, two

5932 conversations on a Tuesday and Friday or Wednesday and

5933 Friday, and he called to my attention that the first time he

5934 had heard anything about it was approximately a week before

5935 those conversations.

5936 Ms. BACHMANN. And so no conversations with the

5937 transition team or with anyone else in the administration

5938 other than Secretary Geithner.

5939 Mr. LIDDY. Not to my recollection. It is possible that

5940 there were communications between staff, but I just don't

5941 know that.

5942 Ms. BACHMANN. To your knowledge, did any Members of

5943 Congress know anything about these bonuses?

5944 Mr. LIDDY. The obligation to pay the bonuses, I think

5945 probably several people did. They have been in our various

5946 financial documents, our 10-K's and our 8-K's and our 10-Q's.

5947 And to the extent that we have provided that information to

5948 Congressional staff, I would presume the answer is yes.

5949 Ms. BACHMANN. Could you be responsive about which

5950 Members of Congress knew about these bonuses?

5951 Mr. LIDDY. We will provide you the information. I can't

5952 as I sit here, no. I just don't know.

5953 Ms. BACHMANN. But you will be able to do that--

Rep. Michele Bachmann (MN)

Issue: Members of Congress and staff informed about the AIGFP retention payments and when. (Page 247, Lines 5921, 5949)

See below for contacts prior to March 18, 2009.

Congressional Contacts*	Dates
House Financial Services Committee and Subcommittee on Capital Markets, Majority staff	January, February, March 2009
Senate Banking Committee Majority and Minority staff	February, March 2009
Senate Finance Committee, Majority and Minority staff	March 2009
Rep. Spencer Bachus and staff, including Minority House Financial Services Committee staff	March 2009
Rep. Michael Castle and staff	March 2009
Staff, Rep. Joe Crowley	January, February, March 2009
Rep. Bill Foster and staff	March 2009
Rep. Elijah E. Cummings and staff	December, January 2008
Rep. Scott Garrett and staff	March 2009
Rep. Jim Himes and staff	March 2009
Rep. Paul E. Kanjorski and staff	January 2009
Staff, Rep. Carolyn Maloney	March 2009
Rep. Henry A. Waxman	December 2008
Staff, Senator John E. Ensign	March 2009

*This table is based on the collective recollection of American International Group, Inc.'s employees, agents, and representatives. Listed dates reflect contact between Members of the House and the Senate and their staffs that took place in response to requests from those offices. Members and staff may have known about the AIGFP Retention Plan before contacts took place. It is conceivable that other contacts with U.S. Government officials may have occurred and additional participants may have been present during some meetings and telephone calls.

6179 gone. We have--I know people aren't interested in hearing
6180 success stories--
6181 Ms. SPEIER. No. We are, please.
6182 Mr. LIDDY. The original arrangement that the Fed and
6183 Treasury put in place for AIG worked. We did not go bankrupt
6184 and we walled off the securities lending and the credit
6185 default swap issues. They are gone. So what is left in
6186 AIGFP is really just - I am going to use the word traditional
6187 book of derivatives contracts, although it is hard to use
6188 traditional and derivatives in the same sentence.
6189 Ms. SPEIER. So what is left are derivative contracts.
6190 Are they going to be more difficult to unwind because they
6191 are still there?
6192 Mr. LIDDY. Yes. And some of them, as I said earlier,
6193 are very long so it is you and I entering into a contract;
6194 you want to hedge against an interest rate increase, so I
6195 offer you a derivative that does that. Well, you may not
6196 want to give up on that hedge, and if that is a 20-year hedge
6197 you may not want to give up on that, so it is an interesting
6198 dynamic of give and take to try to resolve these hedges. If
6199 we get that book of business small enough it is entirely
6200 possible that we can sell it or we can have somebody else run
6201 it off, run the balance of it off for us.
6202 Ms. SPEIER. In 2008, were there any performance bonuses
6203 offered to employees in the insurance silos within AIG?

6204 Mr. LIDDY. Performance bonuses, yes, there were.

6205 Ms. SPEIER. And how much were they?

6206 Mr. LIDDY. I just don't have that number.

6207 Ms. SPEIER. Okay. Would you make that available to the
6208 committee? How much, how many people, what amounts. And let
6209 me give you some more unsolicited advice. Right now AIG is
6210 owned by the taxpayers of this country. Until the $70
6211 billion is returned nobody, in my view, should be getting
6212 retention bonuses or performance bonuses until that money is
6213 paid back. I yield back.

6214 Chairman KANJORKSI. The gentleman from Ohio, Mr. Wilson.

6215 Mr. WILSON. Thank you, Mr. Chairman. Mr. Liddy, thank
6216 you for coming today. I don't envy your position but thank
6217 you for serving in the capacity that you are. I, like all my
6218 friends, are outraged about what is happened with AIG. Back
6219 in Ohio where I represent, that is a magic word or acronym,
6220 if you will, AIG; and everybody just--it is sad. I just
6221 can't understand how people can be so arrogant and
6222 impractical about thinking that they can dole out bonuses to
6223 people who have literally run the company in the ground and
6224 then also contributed to the country being run into the
6225 ground.

6226 And, please, when I hear about contracts that were in
6227 place and the people needed to have their contracts, I
6228 represent an area in Ohio where General Motors have had to

Rep. Jackie Speier (CA)

Issue: 2008 performance payments to AIG employees in insurance units. (Page 259, Line 6207)

AIG has approximately 374 plans that pay variable amounts based on some measure of performance, across the company.* The variable performance pay plans for the insurance businesses are outlined below.

In the Domestic Life and Foreign Life Operations, AIG maintained 140 plans with 23,851 participants in 2008. These plans paid an average award of $5,050 per employee for work performed in 2008.

Within the Property Casualty Group, AIG had 56 plans that covered 3,943 employees with an average payment of $5,403 for work performed in 2008.

The Foreign General Insurance Operations maintained 115 plans, covering 8,669 employees with an average award of $5,074 for work performed in 2008.

AIG also maintained a corporate-wide variable plan that covered 6,410 employees with an average payout of $18,954 for 2008 performance. This plan includes senior executives and managers from the insurance businesses.

* This does not include approximately 236 plans across AIG pursuant to which employees earn varying amounts based on sales and commissions on those sales or the nine plans governing payments required by local governments of the various countries within which AIG operates. Nor do these numbers reflect plans that pay amounts based on ownership interests on investments in certain products or real estate investments.

6640 question, you need to get the people who ran FP, Mr. Cassano,
6641 and the people who ran AIG before my arrival, and ask them
6642 that question.
6643 Mr. PETERS. Yes. Well, it is a big question.
6644 Mr. LIDDY. It is an excellent question. We should ask
6645 the right people that question.
6646 Mr. PETERS. Good. I appreciate it, sir. Thank you.
6647 Yield my time.
6648 Mr. MOORE OF KANSAS. [Presiding] Thank you.
6649 Next, Ms. Kilroy of Ohio. You have five minutes, ma'am.
6650 Ms. KILROY. Thank you, Mr. Chair. Appreciate it.
6651 You know, I like my colleagues am just absolutely
6652 astounded by the situation of paying $165 million in bonuses
6653 with a company that is being propped up with the help of the
6654 Federal Reserve and with the TARP money, still seeing $62
6655 billion of loss in the last quarter.
6656 And, you know, the question that the average American
6657 would ask is, you know, how can you pay bonuses when you
6658 don't really have the money to pay them, when it is somebody
6659 else's money that is being put to work here to pay down these
6660 bonuses, which is, just recently commented, bonuses paid to
6661 people who have caused cataclysmic losses and damage to both
6662 AIG, to its shareholders, and to their economic system?
6663 And yet we are told, and I think you said this earlier,
6664 that if something happens to AIG, that can have dire

6665 consequences for the rest of the country. And you kind of
6666 get the feeling that there is a bit of coercion here being
6667 put to the American taxpayer by saying, you have to--this is
6668 another version of we are too big to fail And I think the
6669 American public is really wanting to see something different
6670 here.

6671 And, you know, this afternoon we voted on the American
6672 Gives Act, people who are giving service, people who are
6673 working hard to make their community better for small
6674 stipends. And, you know, we have seen people around the
6675 country--we have heard earlier about the teachers who are
6676 taking cutbacks in their pay, and the auto industry, which is
6677 modifying their contracts, and the pensioners who are taking
6678 cutbacks.

6679 And, you know, you see this willingness to come forward
6680 and to help out. And you are among those as well, serving at
6681 the request of President Bush and the former Treasury
6682 Secretary for $1 a year.

6683 You know, I am reminded that one of our great
6684 presidents, John Kennedy, said, ''Ask not what our country
6685 can do for you--ask what you can do for your country.'' And
6686 yet my feeling is some of these traders and others are just
6687 asking our country to just keep giving them more, and not
6688 owning up to the responsibilities that they have.

6689 And one of my concerns is a responsibility that has been

6690 brought to light, brought to my attention, from the state of
6691 Ohio, a case brought by the Ohio Public Employees Retirement
6692 System, the State Teachers Retirement System, the Ohio Police
6693 and Fire Pension Fund, against AIG, making some very serious
6694 allegations about misrepresentations and nondisclosures of
6695 material fact made by AIG that has hurt these pension funds
6696 with respect to paying contingent commissions and other
6697 practices alleged to be direct market manipulation.
6698 And I understand that the suit--other parties to the
6699 suit have settled; other parties to the suit have paid out a
6700 significant amount of money in terms of settlement, but that
6701 the meter is still running with respect to AIG's obligations
6702 and the attorney fees, which I have been told are somewhere
6703 in the vicinity of $3 million a month for AIG to defend
6704 against this suit.
6705 I am wondering--and I understand that there have been
6706 some attempts at settlement, and that those attempts at
6707 settlement have kind of come to an end. But in terms of this
6708 orderly wind-down that you talk about, is that orderly
6709 wind-down going to include considering the millions that
6710 could be owed to the pensioners of Ohio, of New York, or
6711 Texas, of Florida, of New Mexico, of Virginia, of California,
6712 of Michigan, all of whom have had substantial losses in AIG
6713 during the class period, during the period involved in this
6714 case?

6715 Mr. LIDDY. I have to confess I just don't have any
6716 specific knowledge of that particular case. I will look into
6717 it. My general counsel is sitting behind me, and we will
6718 look into it, and we will do everything we can to make sure
6719 that it gets resolved. I assume this is the loss of the
6720 equity value of AIG. I just don't have any perspective on it
6721 whatsoever.
6722 Ms. KILROY. I appreciate you taking a look at it. And I
6723 just worry about what happens. And that is one of the
6724 reasons, you know, I think why Congress is taking a look.
6725 Mr. MOORE OF KANSAS. We are out of time. Thank you.
6726 Mr. Foster of Illinois, please. Five minutes, sir.
6727 Mr. FOSTER. Certainly. Let's see. I was wondering if
6728 you could walk me through some of the details on the
6729 mechanisms.
6730 When people talk about your assets blowing up or the
6731 other things you worry about, bad things that would happen,
6732 if someone--if the people who are currently managing the
6733 wind-down of the book were replaced by people who are equally
6734 expert but not familiar with them, what are the sort of
6735 mistakes that would get made if the people currently managing
6736 the books were replaced by equally competent people brought
6737 off the street? And what are examples of the way in which
6738 taxpayer funds would be at risk in that replacement?
6739 Mr. LIDDY. Sure. First, each contract is unique unto

Rep. Mary Jo Kilroy (OH)

Issue: Status of Securities Action. (Page 279, Line 6705)

See "Securities Action – Southern District of New York" on page 285 (attached) of the AIG 2008 Form 10-K, filed on March 2, 2009.

relationship with Allied World Assurance Company and includes an additional settlement payment of $500,000 related thereto.

AIG entered into an agreement effective March 13, 2008 with the Pennsylvania Insurance Department relating to the Department's investigation into the affairs of AIG and certain of its Pennsylvania-domiciled insurance company subsidiaries. The settlement calls for total payments of approximately $13.5 million, of which approximately $4.4 million was paid under previous settlement agreements. During the term of the settlement agreement, AIG will provide annual reinsurance reports, as well as maintain certain producer compensation disclosure and ongoing compliance initiatives.

NAIC Examination of Workers' Compensation Premium Reporting. During 2006, the Settlement Review Working Group of the National Association of Insurance Commissioners (NAIC), under the direction of the states of Indiana, Minnesota and Rhode Island, began an investigation into AIG's reporting of workers' compensation premiums. In late 2007, the Settlement Review Working Group recommended that a multi-state targeted market conduct examination focusing on workers' compensation insurance be commenced under the direction of the NAIC's Market Analysis Working Group. AIG was informed of the multi-state targeted market conduct examination in January 2008. The lead states in the multi-state examination are Delaware, Florida, Indiana, Massachusetts, Minnesota, New York, Pennsylvania, and Rhode Island. All other states (and the District of Columbia) have agreed to participate in the multi-state examination. To date, the examination has focused on legacy issues related to AIG's writing and reporting of workers' compensation insurance between 1985 and 1996. AIG has also been advised that the examination will focus on current compliance with legal requirements applicable to such business. AIG has been advised by the lead states that to date no determinations have been made with respect to these issues, and AIG cannot predict either the outcome of the investigation or provide any assurance regarding regulatory action that may result from the investigation.

Securities Action — Southern District of New York. Beginning in October 2004, a number of putative securities fraud class action suits were filed in the Southern District of New York against AIG and consolidated as In re American International Group, Inc. Securities Litigation. Subsequently, a separate, though similar, securities fraud action was also brought against AIG by certain Florida pension funds. The lead plaintiff in the class action is a group of public retirement systems and pension funds benefiting Ohio state employees, suing on behalf of themselves and all purchasers of AIG's publicly traded securities between October 28, 1999 and April 1, 2005. The named defendants are AIG and a number of present and former AIG officers and directors, as well as Starr, SICO, General Reinsurance Corporation (General Re), and PricewaterhouseCoopers LLP (PwC), among others. The lead plaintiff alleges, among other things, that AIG: (1) concealed that it engaged in anti-competitive conduct through alleged payment of contingent commissions to brokers and participation in illegal bid-rigging; (2) concealed that it used "income smoothing" products and other techniques to inflate its earnings; (3) concealed that it marketed and sold "income smoothing" insurance products to other companies; and (4) misled investors about the scope of government investigations. In addition, the lead plaintiff alleges that AIG's former Chief Executive Officer, Maurice R. Greenberg, manipulated AIG's stock price. The lead plaintiff asserts claims for violations of Sections 11 and 15 of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, and Section 20A of the Exchange Act. In April 2006, the court denied the defendants' motions to dismiss the second amended class action complaint and the Florida complaint. In December 2006, a third amended class action complaint was filed, which does not differ substantially from the prior complaint. Fact discovery is currently ongoing. On February 20, 2008, the lead plaintiff filed a motion for class certification. The motion remains pending.

ERISA Action — Southern District of New York. Between November 30, 2004 and July 1, 2005, several ERISA actions were filed in the Southern District of New York on behalf of purported class participants and beneficiaries of three pension plans sponsored by AIG or its subsidiaries. A consolidated complaint filed on September 26, 2005 alleges a class period between September 30, 2000 and May 31, 2005 and names as defendants AIG, the members of AIG's Retirement Board and the Administrative Boards of the plans at issue, and present or former members of AIG's Board of

Directors. The factual allegations in the complaint are essentially identical to those in the securities actions described above under Securities Actions — Southern District of New York. The

5404 of business to wind it down, get it to go away, and get it
5405 within certain parameters. If you can do that by the end of
5406 October, that's fine. We will pay you the retention bonus.
5407 If it takes you until March to do it, we will pay you the
5408 retention bonus then.
5409 Those people achieve the objective. That's how we got
5410 the book from $2.7 billion down to 1.6--$2.7 trillion down to
5411 1.6.
5412 Mr. POSEY. Thank you.
5413 Thank you, Mr. Chairman.
5414 Chairman KANJORSKI. Thank you very much.
5415 Next we'll have Mrs. Maloney of New York.
5416 Mrs. MALONEY. Thank you, Mr. Liddy, for your public
5417 service. I understand you are a retired CEO of one of
5418 America's great companies and you were asked to come back and
5419 serve. And we appreciate it. Thank you.
5420 I have so many questions I am going to have to submit
5421 them to you in writing and trust that you will respond to the
5422 committee because we have very limited time.
5423 On the question of bonuses, you mentioned that a number
5424 of people said that they would give back their bonuses. Well,
5425 I have been told by Chairman Rangel that on the floor
5426 tomorrow will be a version of my bill that will tax the
5427 bonuses at 90 percent, so the money will be coming back to
5428 the Treasury.

5429 How many people have said they will give money back to
5430 the Treasury? And, after this bill passes, maybe more will
5431 give back. Wouldn't you agree?
5432 How many people tell you they would give back the money?
5433 Mr. LIDDY. I don't have the information, Congresswoman.
5434 I have just made that request this morning and I have been in
5435 this hearing.
5436 Mrs. MALONEY. If you could get back to us we'd really
5437 appreciate it. Also, I requested from Treasury and the
5438 Federal Reserve for many, many months now to get information
5439 on who is receiving the money. The taxpayers own AIG now, 80
5440 percent, yet they were saying it is proprietary. We owned
5441 it. We should see the books.
5442 Just on Sunday night they released this information, and
5443 why were you fighting giving us this information when it
5444 belongs to the American taxpayer?
5445 Mr. LIDDY. I wasn't fighting anything. The Federal
5446 Reserve has a policy against disclosure of counter-parties;
5447 and, when we saw the testimony of Chairman Bernanke and Vice
5448 Chairman Kohn, I had a conversation I had a conversation with
5449 the people at the Federal Reserve and said we should figure
5450 out a way to disclose this.
5451 We made the various telephone calls to make sure that
5452 the counter-parties would be okay with that, and so we
5453 disclosed on the credit default swaps, and the RMBSes, the

Rep. Carolyn Maloney (NY)

Issue: Information on AIGFP employees who have agreed to give back their retention payments. (Page 228, Line 5432)

AIGFP continues to receive responses from its employees and cannot provide a final number pending the resolution of certain tax implications and administrative details posed by the return of the retention payments. Although published reports have purported to establish the amount of the retention payments committed to be returned, the final figure, in fact, has not been established. AIG is committed to providing Members of Congress with this information as soon as is practicable. While AIG is disappointed at the level of resignations from AIGFP, the company is gratified by the response of many to its request to return at least a portion of the retention payments.

7340 Mr. MOORE OF KANSAS. Thank you, Mr. Crowley. The
7341 chair--and thank you, Mr. Liddy.
7342 Are there additional questions? Do you want to submit
7343 those in writing or take a couple of minutes here? We do
7344 want to wind up this hearing, sir.
7345 Mr. GRAYSON. For a couple minutes. Thank you.
7346 Mr. MOORE OF KANSAS. All right. Mr. Grayson is
7347 recognized for a couple of minutes.
7348 Mr. GRAYSON. Thank you. Mr. Liddy, you said before that
7349 there was 20 or 25 people who were involved in the credit
7350 default business.
7351 What are their names, please?
7352 Mr. LIDDY. I don't have their names at my disposal, sir.
7353 Mr. GRAYSON. Well, I am sure you remember a few of the
7354 names. I mean, they did cause your company to crash.
7355 Mr. LIDDY. You know, I have been at the company, as you
7356 know, for six months. I don't know all the people that were
7357 in AIGFP, and many of them are gone.
7358 Mr. GRAYSON. Well, there or gone, it doesn't really
7359 matter. I want to know who they are. Names, please.
7360 Mr. LIDDY. Yes. If you're asking for the names of the
7361 people who got the bonuses at fp, is that--
7362 Mr. GRAYSON. Nope. I am asking for the names of the
7363 people who ran the credit default business, the 20 to 25 that
7364 you referred to earlier that caused your company to lose $100

7365 billion.

7366 Mr. LIDDY. If it is possible to provide you the names,
7367 we want. If we are--we will cooperate with you.

7368 Mr. GRAYSON. Well, that is good. But I want to know the
7369 names you know right now.

7370 Mr. LIDDY. I don't know them, sir.

7371 Mr. GRAYSON. Not a single one? You are talking about a
7372 group, a small group of people who caused your company to
7373 lose $100 billion, and as you sit here today, you can't give
7374 me one single name?

7375 Mr. LIDDY. The single name I would give you is Joseph
7376 Cassano, who ran--

7377 Mr. GRAYSON. That is a good start. You already gave
7378 that name. Give me another name.

7379 Mr. LIDDY. I just don't know them. I do not know those
7380 names. I don't have them all at my command.

7381 Mr. GRAYSON. Well, how can you propose to solve the
7382 problems of the company that you're now running if you don't
7383 know the names of the people who caused that problem?

7384 Mr. LIDDY. Because there are great people running AIGFP
7385 now who do know each and every one of those individuals.

7386 Mr. GRAYSON. That is a great thing to say. But the fact
7387 remains that I would expect you to at least know more than
7388 one name. How about two names?

7389 Mr. LIDDY. Yes, sir. I am just not going to do that,

7390 sir, because that will provide--that will be the--that could
7391 be a list of people that we could--individuals who want to do
7392 damage to them could do that. It is just not--
7393 Mr. GRAYSON. Well, listen. These same people could now
7394 be working, right now, today, at Citibank. Is it more
7395 important to protect them, the ones who caused the $100
7396 billion loss, or protect us? Which is more important to you
7397 right now?
7398 Mr. LIDDY. The important thing is to protect both--I
7399 will--if that is the information you want, we will do
7400 everything we can to cooperate with you. I am just not going
7401 to sit here and give it to you until I understand what the
7402 implications are.
7403 Mr. GRAYSON. Can I count on you to give us that list?
7404 Yes or no?
7405 Mr. LIDDY. I will--I do not know. I will consult with
7406 our general counsel and decide what the appropriate course of
7407 action is.
7408 Mr. GRAYSON. Not the answer I was hoping for, but my
7409 time is up.
7410 Mr. MOORE OF KANSAS. Thank you, sir.
7411 At this time, the chair notes that some members may have
7412 additional questions for this panel, which they may to submit
7413 in writing. Without objection, the hearing record will
7414 remain open for 30 days for members to submit written

Rep. Alan Grayson (FL)

Issue: Names of the AIGFP executives that ran the CDS business. (Page 305, Line 7351)

Given the severity of public hostility directed at employees of AIGFP, AIG does not believe it is appropriate to give the names of these employees, including those who no longer work at AIGFP. However, AIG can confirm that those who were responsible for establishing the CDS business, Maurice Greenberg, Joseph Cassano, and Alan Frost, all who have been named in published reports, are no longer with the company.

7140 They would have had other counter parties beyond that that
7141 only they are privy to.
7142 Ms. KAPTUR. Could you provide this information to the
7143 record if you don't know it here today? I am not only asking
7144 about Deutsche Bank. I am asking about other hedge funds.
7145 Mr. LIDDY. We don't have it. They are not our
7146 customers. Our customers are the companies or the names that
7147 were listed on the release of the counter party names. What
7148 you are asking is what did they do? What were the
7149 relationships that they had? I don't have any access to that
7150 information.
7151 Ms. KAPTUR. All right. Then let me ask this next
7152 question. In terms of the face value of the financial
7153 products derivatives that you stated in your testimony are
7154 now worth about $1.6 trillion--I read that correctly.
7155 Correct? Okay. What is your best estimate of the trading
7156 value of those securities underlying your financial products
7157 derivatives, as opposed to just the face value? What is the
7158 trading value?
7159 Mr. LIDDY. I just don't know. I will get the
7160 information for you. We will provide it for you. I just
7161 don't know as I sit here today.
7162 Ms. KAPTUR. All right. You don't know that. What is
7163 the possible remaining taxpayer exposure?
7164 Mr. LIDDY. Well, as I said, winding down that book of

Rep. Marcy Kaptur (OH)

Issue: Information on the fair value of the AIGFP derivatives portfolio. (Page 297, Line 7151)

See page 262 (attached) of the AIG 2008 Form 10-K, filed on March 2, 2009.

Notes to Consolidated Financial Statements — (Continued)

The fair values of derivative assets and liabilities on the consolidated balances sheet were as follows:

	At December 31,			
	Derivative Assets		Derivative Liabilities	
	2008	2007	2008	2007
	(In millions)			
AIGFP derivatives	$12,111	$12,319	$4,344	$14,817
Non-AIGFP derivatives	1,662	1,785	1,894	3,214
Total	$13,773	$14,104	$6,238	$18,031

AIGFP Derivatives

AIGFP enters into derivative transactions to mitigate risk in its exposures (interest rates, currencies, commodities, credit and equities) arising from its transactions. In most cases, AIGFP did not hedge its exposures related to the credit default swaps it had written. As a dealer, AIGFP structured and entered into derivative transactions to meet the needs of counterparties who may be seeking to hedge certain aspects of such counterparties' operations or obtain a desired financial exposure.

AIGFP's derivative transactions involving interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying notional amounts. AIGFP typically became a principal in the exchange of interest payments between the parties and, therefore, is exposed to counterparty credit risk and may be exposed to loss, if counterparties default. Currency, commodity, and equity swaps are similar to interest rate swaps, but involve the exchange of specific currencies or cashflows based on the underlying commodity, equity securities or indices. Also, they may involve the exchange of notional amounts at the beginning and end of the transaction. Swaptions are options where the holder has the right but not the obligation to enter into a swap transaction or cancel an existing swap transaction.

AIGFP follows a policy of minimizing interest rate, currency, commodity, and equity risks associated with securities available for sale by entering into internal offsetting positions, on a security by security basis within its derivatives portfolio, thereby offsetting a significant portion of the unrealized appreciation and depreciation. In addition, to reduce its credit risk, AIGFP has entered into credit derivative transactions with respect to $635 million of securities to economically hedge its credit risk. As previously discussed, these economic offsets did not meet the hedge accounting requirements of FAS 133 and, therefore, are recorded in Other income in the Consolidated Statement of Income.

Notional amount represents a standard of measurement of the volume of swaps business of AIGFP. Notional amount is not a quantification of market risk or credit risk and is not recorded on the consolidated balance sheet. Notional amounts generally represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps.

The timing and the amount of cash flows relating to AIGFP's foreign exchange forwards and exchange traded futures and options contracts are determined by each of the respective contractual agreements.

7290 Mr. CROWLEY. Right.

7291 Mr. LIDDY.--many of these good assets that we have. We
7292 want the good players, the really critical players in those
7293 businesses, to please stay with us and not go someplace else.
7294 So there are retention payments for those folks, much
7295 simpler, much smaller in value than what we have been talking
7296 about with AIGFP, that would be paid over the next 12 to 18
7297 to 24 months.

7298 Mr. CROWLEY. Thank you. Let me just go back a moment to
7299 something that Mr. Cummings also mentioned, and that was the
7300 retirement--the retention programs that were entered into.

7301 Prior to coming there, when was the last one entered
7302 into, the agreement, retention agreement?

7303 Mr. LIDDY. Prior to my coming there?

7304 Mr. CROWLEY. Uh-huh.

7305 Mr. LIDDY. March 2008.

7306 Mr. CROWLEY. Do you think the people that put those
7307 agreements together had any indication back then that their
7308 company was in deep trouble?

7309 Mr. LIDDY. I really don't think so, Mr. Crowley. Those
7310 agreements would have been started, the discussion and
7311 negotiation process would have been started--it takes a while
7312 to get these done--probably in mid 2007. So I don't think it
7313 was done in anticipation of anything. That is speculation on
7314 my part.

7315 Mr. CROWLEY. Can we find--is it possible for this
7316 committee or the House to know who those individuals were who
7317 entered--who made those agreements?
7318 Mr. LIDDY. Who authored them? Who signed--
7319 Mr. CROWLEY. Who authored those agreements?
7320 Mr. LIDDY. I am sure that information exists. We will
7321 try get it for you.
7322 Mr. CROWLEY. Were any of those individuals beneficiaries
7323 of those agreements?
7324 Mr. LIDDY. I just don't know. I'll--
7325 Mr. CROWLEY. Was there a conflict of interest? In other
7326 words, would they have benefitted by the agreement?
7327 Mr. LIDDY. Well, no. For AIG financial products, it
7328 would have been negotiated by an individual to whom that
7329 business works. He would not have been covered by those
7330 retention agreements.
7331 Mr. CROWLEY. Well, if we could--if it is possible to get
7332 to us that information, I would appreciate that as well.
7333 As many of the people who work under you within AIG
7334 know, I have been very interested in this issue for some
7335 time. And unfortunately, it has gotten to a point I had hoped
7336 we could have avoided, but unfortunately, that didn't happen,
7337 because I think--not because of the people who work for you,
7338 but others within your company who put the company and their
7339 country last and themselves first. And I yield back.

Rep. Joseph Crowley (NY)

Issue: AIG executives who authored the AIGFP Employee Retention Plan. (Page 304, Line 7315)

The Employee Retention Plan was designed and approved by senior management of AIGFP and AIG. Outside counsel and compensation consultants assisted in the preparation of the Plan. Related documents are attached.

AIG FINANCIAL PRODUCTS CORP.

2008 EMPLOYEE RETENTION PLAN

AIG FINANCIAL PRODUCTS CORP.

2008 EMPLOYEE RETENTION PLAN

Effective December 1, 2007

INTRODUCTION

This document sets forth the terms of the AIG Financial Products Corp. 2008 Employee Retention Plan, effective December 1, 2007 (the "Plan"). The Plan sets out the 2008 and 2009 Guaranteed Retention Awards to be provided hereunder to certain employees and consultants of AIG-FP (which term includes subsidiaries).

The objectives of the Plan are:

1. To provide incentives for AIG-FP's employees and consultants to continue developing, promoting and executing AIG-FP's business;

2. To recognize the uncertainty that the unrealized market valuation losses in AIG-FP's super senior credit derivative and originally-rated AAA cash CDO portfolios have created for AIG-FP's employees and consultants;

3. To ensure that AIG-FP's and its employees' and consultants' interests continue to be aligned with those of AIG and AIG's shareholders;

4. To continue to build and maintain the formation of capital in AIG-FP; and

5. To show the support by AIG of the on-going business of AIG-FP by implementing a meaningful employee retention plan.

SECTION 1

DEFINITIONS

For purposes of this AIG Financial Products Corp. 2008 Employee Retention Plan:

1.01. "Additional Return Payment" shall have the meaning ascribed thereto under the Deferred Compensation Plan.

1.02. "AIG" shall mean American International Group, Inc.

1.03. "AIG-FP" shall mean AIG Financial Products Corp., including all subsidiaries thereof.

1.04. "AIG General Guarantee Agreement" shall mean the General Guarantee Agreement of AIG, dated December 4, 1995, in favor of each holder of a monetary obligation or liability of AIG Financial Products Corp.

1.05. "Beneficiary" shall mean such person or trustee as may be designated by a Covered Person in his or her Confirmation and Acknowledgement.

1.06. "Board" shall mean the Board of Directors of AIG Financial Products Corp.

1.07. "Bonus Pool" shall have the meaning ascribed thereto in Section 3.02(a) of the Plan.

1.08. "Buy-Out Amount" shall mean the portion of any Previous Guarantee payable to a Covered Person that was intended to offset compensation from a previous employer that the Covered Person forfeited upon joining AIG-FP.

1.09. "Capped Realized Losses" shall have the meaning ascribed thereto in Section 3.07(a) of the Plan.

1.10. "CDO Portfolio" shall mean the existing multi-sector collateralized debt obligation ("CDO") portfolio of AIG-FP, including both super senior derivatives and originally-rated AAA cash CDO bonds.

1.11. "Committee" shall mean a committee consisting of the Chief Executive Officer of AIG Financial Products Corp., the Chief Administrative Officer of AIG Financial Products Corp., the Chief Financial Officer of AIG Financial Products Corp., and the Secretary of AIG Financial Products Corp.

1.12. "Compensation Year" shall mean the 12-month period beginning on December 1st of each calendar year and ending on November 30th of the following calendar year. The first Compensation Year under this Plan shall be the Compensation Year beginning on December 1, 2007 and ending on November 30, 2008 (the "2008 Compensation Year"); and the second Compensation Year under this Plan shall be the Compensation Year beginning on December 1, 2008 and ending on November 30, 2009 (the "2009 Compensation Year").

1.13. "Confirmation and Acknowledgement". The written confirmation and acknowledgement described in Section 3.01(e) of the Plan that is executed by each Covered Person.

1.14. "Covered Persons" shall mean all employees and certain designated consultants of AIG-FP as of March 31, 2008 (excluding any employees or consultants who have notified AIG-FP of their intent to resign on or prior to such date) who received

discretionary incentive compensation, or had a Previous Guarantee, in respect of the 2007 Compensation Year or who have a Previous Guarantee in respect of the 2008 Compensation Year. Covered Persons shall receive a Confirmation and Acknowledgement from AIG Financial Products Corp., as described in Section 3.01(e).

1.15. "Deferred Compensation Plan" shall mean, collectively, the AIG Financial Products Corp. Deferred Compensation Plan, as amended and restated effective March 18, 2005, and the AIG Financial Products Corp. Deferred Compensation Plan - Certain Banque AIG, Tokyo Branch Employees/Secondees, dated as of November 25, 2005, as amended, as each may be amended in the future.

1.16. "Distributable Income" shall have the meaning ascribed thereto under the Deferred Compensation Plan.

1.17. "Excess Deferral Amount" shall mean, in respect of any Covered Person for any Compensation Year, the amount of the Total Award deferred pursuant to the terms of the Deferred Compensation Plan that is in excess of $650,000 (as determined pursuant to Schedule A to the Deferred Compensation Plan).

1.18. "Guaranteed Retention Awards" shall mean the amounts guaranteed to be awarded to Covered Persons pursuant to Section 3.01 of the Plan for the 2008 Compensation Year and the 2009 Compensation Year.

1.19. "Japanese Plan" shall mean any retirement plan in which members of AIG-FP's Tokyo office participate in lieu of participating in the Deferred Compensation Plan.

1.20 "Notional Bonus Amount" shall have the meaning ascribed thereto under the Deferred Compensation Plan.

1.21. "Plan" shall mean the AIG Financial Products Corp. 2008 Employee Retention Plan, as set forth herein and as hereinafter amended from time to time.

1.22. "Previous Guarantee" shall mean, in respect of any Covered Person, any right of the Covered Person to receive guaranteed compensation (which, for the avoidance of doubt, does not include salary paid periodically during the term of employment) pursuant to a written letter or agreement with AIG-FP executed on or prior to March 31, 2008.

1.23. "Realized Losses" shall have the meaning ascribed thereto in the attached Schedule 2.

1.24. "Senior Management Team" shall mean the fourteen (14) Covered Persons whose status as a member of the Senior Management Team is so indicated on each such individual's Confirmation and Acknowledgement.

1.25. "Share Amount" shall mean the number of shares of AIG common stock into which a Stock-Indexed Deferral is translated pursuant to Section 3.05(c)(i) of the Plan, as

adjusted by the Committee to the extent necessary, in its reasonable good faith discretion, to take into account stock splits, stock dividends, spin-offs, reorganizations, recapitalizations, share combinations, mergers, consolidations, or other corporate actions with respect to AIG common stock.

1.26. "SIP" shall mean the AIG Financial Products Corp. 2007 Special Incentive Plan, dated January 20, 2008, as it may be amended in the future.

1.27. "Stock-Indexed Deferrals" shall mean the deferred amounts of 2008 Total Awards or 2009 Total Awards that are indexed to shares of AIG stock, as described in Section 3.05(b) of the Plan.

1.28. "Total Award" shall mean, for any Covered Person for either the 2008 Compensation Year or the 2009 Compensation Year, the Guaranteed Retention Award for such Covered Person for such Compensation Year plus any discretionary incentive compensation award in excess thereof for such Compensation Year.

1.29. "2007 Total Economic Award" shall mean for each Covered Person, the sum of (a) and (b), where (a) is the amount of the discretionary incentive compensation or Previous Guarantee awarded to such Covered Person in respect of the 2007 Compensation Year, before taking into account any deferrals of such compensation under, or contributions of amounts to, the Deferred Compensation Plan or any Japanese Plan, or payments of amounts under the Deferred Compensation Plan or any Japanese Plan in respect of previous Compensation Years, and (b) is the amount, if any, of the SIP Credit credited to such Covered Person under Section 3.01(a) of the SIP, excluding the amount of such SIP Credit, if any, received in lieu of an Additional Return Payment under the Deferred Compensation Plan (or as the equivalent for Covered Persons who participate in a Japanese Plan in lieu of participating in the Deferred Compensation Plan).

SECTION 2

PARTICIPATION

2.01. Participation.

(a) Participation by Covered Persons. Each Covered Person shall be entitled to participate under this Plan, subject to (i) AIG Financial Products Corp. determining that the Covered Person meets the requirements to be a Covered Person and delivering to such person the Confirmation and Acknowledgement referenced in Section 3.01(e), and (ii) such person executing such document and returning it to AIG Financial Products Corp.

(b) Deferrals. Each Covered Person who participates in the Deferred Compensation Plan and whose 2008 Total Award or 2009 Total Award is in excess of the level referred to in Schedule A of the Deferred Compensation Plan shall be required to defer, under the Deferred Compensation Plan, the portions of such Total Award that are required to be deferred pursuant to such Schedule A, subject, for the avoidance of doubt, to the provisions of Section 3.05 below in respect of Stock-Indexed Deferrals; provided, for the avoidance of doubt, that any payment of a Guaranteed Retention Award to a Covered Person or a Beneficiary shall not be subject to deferral under the Deferred Compensation Plan if such Covered Person or Beneficiary has received a distribution under Section 3.05(a) of the Deferred Compensation Plan. Additional voluntary deferral of any portion of such Total Award shall be permitted only in respect of the portion of such Total Award, if any, that exceeds the respective Guaranteed Retention Award, and shall be subject to the terms and conditions related thereto under the Deferred Compensation Plan, subject, for the avoidance of doubt, to the provisions of Section 3.05 below in respect of Stock-Indexed Deferrals.

(c) Beneficiary. Each Covered Person may designate on his or her Confirmation and Acknowledgement a Beneficiary or Beneficiaries under the Plan in the event he or she should die prior to receipt of all Guaranteed Retention Awards to which he or she is entitled under the Plan; provided that if none is designated, such Beneficiary shall be the Covered Person's estate or as otherwise provided under applicable law. Any payment to a Beneficiary or Beneficiaries shall be made when the respective Covered Person would have received such payment.

SECTION 3

2008 AND 2009 GUARANTEED RETENTION AWARDS

DETERMINATION OF AIG-FP BONUS POOL

3.01. 2008 and 2009 Guaranteed Retention Awards.

(a) Covered Persons Who Are Not Members of the Senior Management Team. Subject to Sections 3.01(c) and 3.01(d), for the 2008 Compensation Year and the 2009 Compensation Year, each Covered Person (other than members of the Senior Management Team) shall be awarded a Guaranteed Retention Award for each of those Compensation Years equal to one hundred percent (100%) of such Covered Person's 2007 Total Economic Award.

(b) Covered Persons Who Are Members of the Senior Management Team. Subject to Sections 3.01(c) and 3.01(d), for the 2008 Compensation Year and the 2009 Compensation Year, each Covered Person who is a member of the Senior Management Team shall be awarded a Guaranteed Retention Award for each of those Compensation Years equal to seventy-five percent (75%) of such Covered Person's 2007 Total Economic Award.

(c) Impact of Previous Guarantees on Amount of Guaranteed Retention Awards. The Guaranteed Retention Award for a Compensation Year for any Covered Person who has a Previous Guarantee for such Compensation Year will be reduced by the amount of such Previous Guarantee for such Compensation Year. Previous Guarantees will not be affected by this Plan. If (i) a Covered Person has a Previous Guarantee with respect to the 2008 Compensation Year, and (ii) such 2008 Previous Guarantee exceeds such Covered Person's 2007 Total Economic Award, then the Guaranteed Retention Award for such Covered Person for the 2008 Compensation Year shall be zero (by reason of the second preceding sentence), and for the 2009 Compensation Year shall equal the amount of such 2008 Previous Guarantee (reduced by the amount of the Covered Person's Previous Guarantee for the 2009 Compensation Year, if any).

(d) Impact of Buy-Out Amounts on Amount of Guaranteed Retention Awards. If (i) the Guaranteed Retention Award for a Covered Person is based in whole or in part on a Previous Guarantee for the 2007 Compensation Year or the 2008 Compensation Year, and (ii) a portion of such Previous Guarantee represents a Buy-Out Amount, then the Buy-Out Amount shall be excluded for purposes of calculating the Covered Person's Guaranteed Retention Awards and 2007 Total Economic Award.

(e) Notification of Guaranteed Retention Award Amounts and of Status as a Member of Senior Management Team. Each Covered Person individually will receive a written confirmation ("Confirmation and Acknowledgement"), in the form of Schedule 1, from AIG Financial Products Corp. of his or her Guaranteed Retention Awards for the 2008 Compensation Year and the 2009 Compensation Year under this Plan. Each Covered Person who has been designated as a member of the Senior Management Team for purposes of determining the Covered Person's Guaranteed Retention Awards has already been informed of such designation, which designation shall also be indicated on the Confirmation and Acknowledgement for such Covered Person.

(f) Currency. All 2008 and 2009 Guaranteed Retention Awards shall be denominated in US dollars.

3.02. Effect of Guaranteed Retention Awards on the Bonus Pool.

(a) General Rule for Bonus Pool Determination. Under the existing arrangement between AIG, AIG-FP, and its employees, Distributable Income of AIG-FP is payable each year on the basis of 70% to AIG and 30% to AIG-FP employees (and consultants) as bonuses (such 30% referred to hereunder as the "Bonus Pool"). The Bonus Pool will continue to equal 30% of Distributable Income of AIG-FP subject to calculation consistent with past practices and the provisions of Sections 3.02(b) and 3.02(c).

(b) Aggregate Amount of Guaranteed Retention Awards for a Compensation Year Equals or Is Less than the Bonus Pool for Such Compensation Year. If the aggregate amount of the Guaranteed Retention Awards for the 2008 Compensation Year or the 2009 Compensation Year is equal to or less than the calculated Bonus Pool for such Compensation

Year, the total amount of the Guaranteed Retention Awards for such Compensation Year will, in the first instance, be paid from the calculated Bonus Pool for such Compensation Year, with any excess remaining in the calculated Bonus Pool for such Compensation Year paid out to AIG-FP employees (and, in the discretion of AIG-FP, consultants) as discretionary incentive compensation with respect to such Compensation Year.

(c) Aggregate Amount of Guaranteed Retention Awards for a Compensation Year Exceeds the Bonus Pool for a Compensation Year. If the aggregate amount of the Guaranteed Retention Awards for the 2008 Compensation Year or the 2009 Compensation Year exceeds the calculated Bonus Pool for such Compensation Year, AIG will cover the shortfall so that Covered Persons are paid their full Guaranteed Retention Awards (subject, for the avoidance of doubt, to deferral pursuant to Section 3.05(a)). Any such Bonus Pool shortfall shall, for purposes of Section 3.07 related to the carry-forward of Capped Realized Losses, be deemed to give rise to a Capped Realized Loss equal to the amount of such shortfall.

3.03. Guarantee by AIG of 2008 and 2009 Guaranteed Retention Awards Under AIG General Guarantee Agreement. The obligation to pay the Guaranteed Retention Awards described under Section 3.01 is guaranteed by AIG pursuant to the AIG General Guarantee Agreement; provided that amounts deferred under the Deferred Compensation Plan (including Stock-Indexed Deferrals) will not, in accordance with the terms of the Deferred Compensation Plan, benefit from the AIG General Guarantee Agreement.

3.04. Forfeiture of 2008 and 2009 Guaranteed Retention Awards as a Result of Termination of Employment of Covered Person. If the employment (or, as applicable, consultancy) of a Covered Person terminates prior to payment of a Guaranteed Retention Award, the Covered Person will forfeit the right to such Guaranteed Retention Award in the following circumstances:

(a) the Covered Person resigns without good reason ("good reason" means a material reduction in base salary, a material reduction in title, duties or responsibilities, or transfer to a geographic location that is more than 50 miles from the Covered Person's current location); or

(b) the Covered Person's employment (or, as applicable, consultancy) is terminated by AIG-FP for cause ("cause" means conduct involving intentional wrongdoing, fraud, dishonesty, gross negligence, material breach of the AIG Code of Conduct or other policies of AIG-FP or AIG, or conviction of or entry of a plea of guilty or no contest to a criminal offense); or

(c) the Covered Person's employment (or, as applicable, consultancy) is terminated by AIG-FP during calendar year 2008 due to the Covered Person's failure to meet performance standards; provided, however, that in the case of a termination of employment (or, as applicable, consultancy) described in this Section 3.04(c), only the Guaranteed Retention Award attributable to the

Covered Person's 2009 Compensation Year will be forfeited, and the Guaranteed Retention Award for the Covered Person's 2008 Compensation Year will remain payable at the same time that Guaranteed Retention Awards are paid to Covered Persons whose employment (or, as applicable, consultancy) is not terminated (subject to deferral pursuant to Section 3.05(a)).

Any Covered Person whose employment (or, as applicable, consultancy) terminates for a reason other than those described in Sections 3.04(a), 3.04(b), and 3.04(c) will receive any subsequent Guaranteed Retention Award at the same time that Guaranteed Retention Awards are paid to continuing Covered Persons (subject to deferral pursuant to Section 3.05(a)); provided that any such Guaranteed Retention Award in respect of the 2009 Compensation Year will be reduced by the amount of any compensation paid to the terminated employee or consultant by another employer in respect of work performed by the terminated employee or consultant during calendar year 2009; and further provided that prior to payment of any Guaranteed Retention Awards to such terminated employees or consultants, the former employee or consultant will be required to confirm in writing whether any such compensation has been received and, if so, the amount thereof.

3.05. Payment of 2008 and 2009 Guaranteed Retention Awards. Subject to the terms of this Plan, Guaranteed Retention Awards will be paid to Covered Persons in respect of each Compensation Year on or prior to the date on which discretionary incentive compensation for such Compensation Year is paid to employees of AIG-FP (subject to deferral as described below); provided, however, that such payment will not be later than March 15th of the calendar year next following the end of such Compensation Year (whether or not any discretionary incentive compensation is paid with respect to such Compensation Year). All payments to a Covered Person hereunder shall be paid to such Covered Person from the company or companies from which such payment represents compensation for services provided by such Covered Person; provided that, where any such company is not AIG Financial Products Corp., AIG Financial Products Corp. shall remain liable for any such payment not paid by such company.

(a) Deferral under Deferred Compensation Plan. The payment of 2008 and 2009 Total Awards to Covered Persons who participate in the Deferred Compensation Plan will be subject to partial mandatory deferral and subsequent payment under the Deferred Compensation Plan in accordance with its terms (in the same manner as discretionary incentive compensation is subject to partial mandatory deferral and subsequent payment under such plan); provided that subsequent payment of any Stock-Indexed Deferrals shall be indexed as described in Section 3.05(c) below for purposes of making payment of such deferrals under Section 3.05 of the Deferred Compensation Plan.

(b) Determination of Amount of Stock-Indexed Deferrals. If the Total Award for a Covered Person who participates in the Deferred Compensation Plan exceeds $2 million for the 2008 or 2009 Compensation Year, then, notwithstanding any term of the Deferred Compensation Plan to the contrary, fifty percent (50%) of the Excess Deferral Amount for

such Compensation Year will be deemed a Stock-Indexed Deferral under this Plan and, as such, will be indexed to AIG stock and paid as provided in Section 3.05(c) of the Plan.

(c) Indexing of Stock-Indexed Deferrals.

(i) The Stock-Indexed Deferrals will be translated into a number of shares of AIG common stock ("Share Amount"), based on the average daily closing price of a share of AIG common stock during the month of November in the respective Compensation Year.

(ii) Notwithstanding such indexing, the original US dollar value of the unpaid portion of any Stock-Indexed Deferral (without regard to any change in the market price of a share of AIG common stock) will accrue interest pursuant to Section 3.03 of the Deferred Compensation Plan, and shall be included when determining the aggregate amount credited to a Deferred Compensation Plan Participant's Deferred Compensation Account under the Deferred Compensation Plan for purposes of calculating any Additional Return Payments payable to such Participant pursuant to Section 3.04 of the Deferred Compensation Plan. No amount shall be payable to any Covered Person in respect of dividends paid on AIG common stock.

(iii) When a distribution of a Stock-Indexed Deferral (including any installment thereof) would otherwise be payable under Section 3.05 of the Deferred Compensation Plan, Covered Persons will receive, in lieu of receiving such distribution, at AIG's election, either:

(A) a number of shares of AIG common stock equal to the Share Amount for such distribution of the Stock-Indexed Deferral, or

(B) a cash amount equal to the value of such number of shares based on:

(1) in the case of a distribution under Sections 3.05(a) and 3.05(c) of the Deferred Compensation Plan, the closing price of a share of AIG common stock on the date that is five NYSE trading days before the payment date; and

(2) in the case of a distribution under Section 3.05(b) of the Deferred Compensation Plan, the average daily closing price of a share of AIG common stock during the month of November immediately preceding the applicable payment date.

(C) The election made by AIG in this Section 3.05(c)(iii) shall be made as follows:

(1) in the case of a distribution under Section 3.05(a) of the

Deferred Compensation Plan, not later than 15 calendar days prior to the applicable payment date;

(2) in the case of a distribution under Section 3.05(b) of the Deferred Compensation Plan, not later than November 1st immediately preceding the applicable payment date; and

(3) in the case of an early distribution under Section 3.05(c) of the Deferred Compensation Plan, not later than 15 calendar days following the determination to make an early distribution.

The original US dollar value of the applicable unpaid portion of any Stock-Indexed Deferral (without regard to any change in the market price of a share of AIG common stock) shall be paid by AIG-FP to AIG in exchange either for AIG's delivery of stock to AIG-FP pursuant to Section 3.05(c)(iii)(A) or for AIG's payment to AIG-FP of the cash amount provided for pursuant to Section 3.05(c)(iii)(B), as applicable.

(iv) Stock-Indexed Deferrals are not subject to the "Foreign Currency Alternative" provided in Section 3.05(d) of the Deferred Compensation Plan.

(d) Deferred Amounts Represent Subordinated Claims against AIG-FP. To the extent that Guaranteed Retention Awards are deferred under the Deferred Compensation Plan (including any Stock-Indexed Deferrals), such deferred amounts shall represent, in accordance with the terms of the Deferred Compensation Plan, subordinated claims against AIG-FP and shall not be guaranteed by AIG.

3.06. Effect on Bonus Pool of Mark-to-Market and Realized Losses. AIG-FP will continue to monitor and manage the existing CDO Portfolio.

(a) Effect of Mark-to-Market Losses on the Bonus Pool. The Bonus Pool for any Compensation Year beginning with the 2008 Compensation Year will not be affected by the incurrence of any mark-to-market losses (or gains) or impairment charges (or reversals thereof) arising from (i) the CDO Portfolio or (ii) super senior credit derivative transactions that are not part of the CDO Portfolio.

(b) Effect of Realized Losses on Bonus Pool. The Bonus Pool for any Compensation Year beginning with the 2008 Compensation Year will be affected by the incurrence of any Realized Losses (or gains) arising from any source, subject to the limitations set forth in Section 3.07.

3.07. Limitations Related to Realized Losses.

(a) Compensation Year Limit on Reduction to Bonus Pool Attributable to Capped Realized Losses. Notwithstanding any other provision of the Plan, for any Compensation Year beginning with the 2008 Compensation Year, there shall be a $67.5 million limit per Compensation Year on the extent to which the Bonus Pool can be reduced in the aggregate as

a result of Realized Losses arising from the CDO Portfolio and/or deemed Realized Losses arising as provided in Section 3.02(c) (collectively, "Capped Realized Losses"). Given the 70%/30% split of Distributable Income between AIG and the Bonus Pool described in Section 3.02(a), the Compensation Year limit will be applicable if Capped Realized Losses in respect of any Compensation Year (beginning with the 2008 Compensation Year) exceed $225 million. Capped Realized Losses for any Compensation Year that are in excess of $225 million will be carried forward to subsequent Compensation Years for Bonus Pool calculation purposes, subject each year to a per Compensation Year limit on Capped Realized Losses for Bonus Pool calculation purposes of $225 million (corresponding to the $67.5 million limit per Compensation Year on reductions to the Bonus Pool due to Capped Realized Losses). Carry-forwards of Capped Realized Losses to subsequent Compensation Years will continue until the aggregate Capped Realized Losses (Capped Realized Losses that reduce Distributable Income for Bonus Pool calculation purposes in the Compensation Year in which realized, plus Capped Realized Losses carried forward to reduce Distributable Income for Bonus Pool calculation purposes in future Compensation Years) are fully absorbed through reductions to Distributable Income for Bonus Pool calculation purposes of up to $225 million per Compensation Year (corresponding to reductions to the Bonus Pool of up to $67.5 million per Compensation Year).

(b) Effect of Realized Losses on Current and Future Balances under the Deferred Compensation Plan, Japanese Plans and SIP. Current and future balances under the Deferred Compensation Plan, Japanese Plans and SIP (including the deferred component of 2008 and 2009 Total Awards, including Stock-Indexed Deferrals) will remain subject to reduction as a result of Realized Losses from the CDO Portfolio or otherwise in accordance with the terms of the Deferred Compensation Plan, Japanese Plans and SIP (without reference to any annual limits, which will relate solely to the determination of the Distributable Income for Bonus Pool calculation purposes in the 2008 and subsequent Compensation Years).

SECTION 4

MISCELLANEOUS

4.01. Nonassignability. Subject to Section 2.01(c) of the Plan, no Covered Person or Beneficiary shall have the power to subject any right to receive payments under this Plan to assignment, pledge, sale, attachment, garnishment or any other transfer, alienation or encumbrance, nor shall such rights be subject to the Covered Person's or Beneficiary's debts or to seizure for satisfaction of judgments, alimony or separate maintenance obligations.

4.02. Continuation as Employee or Consultant. Neither this Plan nor the payment of any benefits hereunder shall be construed as giving the Covered Person any right to be retained as an employee or consultant of AIG-FP.

4.03 Amendment and Termination. The Committee may from time to time, with

the approval of the Board, amend these Plan terms in whole or in part; provided, however, that any such amendment may not reduce or delay payment of any Covered Person's benefits and entitlements under the Plan in respect of the Covered Person's 2008 and 2009 Guaranteed Retention Awards or increase the Compensation Year limit or the extent to which Distributable Income for Bonus Pool calculation purposes can be reduced as a result of Capped Realized Losses. Any such amendment shall be effective immediately or as otherwise specified therein and shall be communicated in writing (including e-mail) to all Covered Persons and to AIG.

4.04. Governing Law. The law of the State of Connecticut shall govern the interpretation, application and operation of this Plan document.

4.05. Claims Procedure. Claims for benefits under the Plan shall be filed with the Committee, on forms supplied by the Committee. Written notice of the Committee's disposition of a claim shall be furnished to the claimant within 30 days after the application therefor is filed. In the event the claim is denied the reasons for the denial shall be specifically set forth in writing, pertinent provisions of the Plan shall be cited, and, where appropriate, an explanation as to how the claimant can perfect the claims will be provided. If a Covered Person or Beneficiary has been denied a benefit, each shall be entitled, upon request to the Board, to appeal the denial of the claimed benefit within 90 days following the Committee's determination described in the preceding sentence. Upon such appeal, the Board (or a special committee designated by the Board) shall, as soon as practicable, meet with and hear the position of the claimant. Its decision following such meeting shall be made within 30 days and shall be communicated in writing to the claimant.

4.06. Effect of this Plan on the Deferred Compensation Plan. The terms and operation of the Deferred Compensation Plan are not affected by this Plan; provided that to the extent there is any inconsistency between the terms of this Plan and the terms of the Deferred Compensation Plan with respect to the treatment of Guaranteed Retention Awards, the determination of Distributable Income or the Bonus Pool, or the application of the terms of that plan to Stock-Indexed Deferrals, the terms of this Plan shall govern.

4.07. Compliance with Internal Revenue Code Section 409A. It is intended that amounts awarded under this Plan and/or deferred under the Deferred Compensation Plan will not be taxable under Internal Revenue Code Section 409A. This Plan shall be interpreted and administered, to the extent possible, in a manner that does not result in a "plan failure" (within the meaning of Internal Revenue Code section 409A(a)(1)) of this Plan or any other plan or arrangement maintained by AIG-FP.

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SCHEDULE 1

Confirmation and Acknowledgement

Name of Covered Person: _____
Member of Senior Management Team: _____Yes or No_____

Compensation Year	Previous Guarantee	Buy-Out Amount	Guaranteed Retention Award
2008			
2009			

I acknowledge that I have received, read and understood the AIG Financial Products Corp. 2008 Employee Retention Plan (the "Employee Retention Plan") and that my participation in the Employee Retention Plan, including any payment of a Guaranteed Retention Award to me under the Employee Retention Plan, will be subject to the terms of the Employee Retention Plan, which provide in part that payment of Guaranteed Retention Awards (i) is subject to continued employment to the extent provided pursuant to Section 3.04, and (ii) is subject, if I participate in the Deferred Compensation Plan (as defined in the Employee Retention Plan), to deferral and, to the extent deferred, shall become an unsecured subordinated liability of AIG Financial Products Corp. to me and my Beneficiaries.

I further acknowledge that my right to receive any Guaranteed Retention Award under the Employee Retention Plan is separate from and independent of any Notional Bonus Amount I might receive for 2008 or 2009, as that term is defined in the Deferred Compensation Plan, and that, to the extent the portion of any Guaranteed Retention Award or any additional Notional Bonus Amount is subject to deferral as a Stock-Indexed Deferral, I waive any claim that such deferred amount would be subject to, or payable to me pursuant to, the Deferred Compensation Plan without reference to the terms of the Employee Retention Plan.

In the event that I should die prior to receipt of all Guaranteed Retention Awards to which I am entitled under the Employee Retention Plan, I hereby direct that, pursuant to Section 2.01(c) of the Employee Retention Plan, all amounts due to me under the Employee Retention Plan be distributed as follows:

Proportion	Name of Beneficiary(ies)
_____	_____
_____	_____
_____	_____

_____ _____
Signature of Covered Person Date

SCHEDULE 2

Realized Losses

- Realized Losses:
  - Losses resulting from the termination or other unwind of a derivative transaction or from the sale of a cash bond position.
    - Realized Loss will be the termination/unwind payment for the derivative transaction, or the difference between par (plus accrued interest) and the sale proceeds for the cash bond position.
  - Losses resulting from a payment default on a cash bond position.
    - Realized Loss will be determined based on an evaluation by AIG-FP and AIG of the facts and circumstances of the underlying portfolio and the likelihood of payment of the defaulted amount, including the quality of the underlying portfolio and rights to control its liquidation. For example:
      - Where there has been a complete liquidation of the underlying portfolio, Realized Losses will equal the amount by which payments received are less than par (plus accrued interest).
      - Where there has been no liquidation of the underlying portfolio (e.g., because of stand-still provisions in the trust indenture), and it is reasonably likely that all amounts on the cash bond position will be paid (e.g., where the bond is still rated investment grade), there would be no Realized Loss.
        - Such a conclusion may apply even where the cash bond has been accelerated and the principal amount declared due and payable (but has not been paid).
  - Losses resulting from a payment default on a reference obligation (or equivalent) underlying a credit default swap ("CDS") transaction.
    - For CDS that have physical settlement provisions:
      - If the CDS is physically settled, Realized Losses will be determined as described above for the cash bond position that results from the physical settlement.
      - Pending physical settlement of such a CDS, there is no Realized Loss.

- For pay-as-you-go CDS:
    - Any payment under a pay-as-you-go CDS will be a Realized Loss unless (i) AIG-FP has a right to be reimbursed by the protection buyer if the buyer receives payment of the unpaid amount that gave rise to the CDS payment, and (ii) an evaluation by AIG-FP and AIG of the facts and circumstances of the underlying portfolio, including the quality of the underlying portfolio and rights to control its liquidation, indicates such payment is reasonably likely.
- For total return swaps (TRS):
    - To the extent that settlement of the TRS results in AIG-FP acquiring the reference obligation (the most likely circumstance), Realized Losses will be determined as described above for the cash bond position that results.
    - To the extent that settlement of the TRS results in AIG-FP making payment to the protection buyer without acquiring the reference obligation (unlikely), the Realized Loss equals the amount of such payment.
    - Pending settlement of the TRS, there will be no Realized Loss.

7040 me, the 4,500?

7041 Mr. LIDDY. Yes. I don't remember the exact number. I

7042 think it is about 45-, 4700.

7043 Mr. CUMMINGS. And so you approved those additional

7044 phases. Is that correct?

7045 Mr. LIDDY. Correct.

7046 Mr. CUMMINGS. You also noted that business units have

7047 adopted their own retention plans.

7048 Did you approve those also?

7049 Mr. LIDDY. I would not have. They would have been done

7050 by the business units.

7051 Mr. CUMMINGS. So there are other retention plans within

7052 AIG, the big AIG umbrella, under the umbrella?

7053 Mr. LIDDY. Those are more--I believe they are more

7054 severance plans. What happens if somebody buys you and you

7055 lose your job?

7056 Mr. CUMMINGS. How much in non-financial product

7057 retention payments have you paid in 2008, and how much will

7058 be paid in 2009?

7059 Mr. LIDDY. I don't have the numbers at my fingertips.

7060 We will be delighted to get them to you.

7061 Mr. CUMMINGS. All right. Have you reduced these

7062 payments below the levels approved on September 18?

7063 Mr. LIDDY. We have either--in some cases we have reduced

7064 them, and in some cases we have stretched them out to a

Rep. Elijah Cummings (MD)

Issue: Retention payments paid in 2008 to non-AIGFP employees and how much will be paid in 2009. (Page 293, Line 7056)

See "Restructuring expenses and related asset impairment and other expenses" on pages 69, 70, 221, 222 (attached) of the AIG 2008 Form 10-K, filed on March 2, 2009. The pages include information on retention payments announced during 2008 and paid to AIG and AIGFP employees in 2008 and scheduled to be paid in 2009, and thereafter.

Policy Acquisition and Other Insurance Expenses

2008 and 2007 Comparison

Policy acquisition and other insurance expenses increased in 2008 compared to 2007 primarily due to a $3.6 billion increase in General Insurance expenses and a $3.7 billion increase in Life Insurance & Retirement Services expenses. General Insurance expenses increased primarily due to goodwill impairment charges of $2.0 billion, including $1.2 billion from Commercial Insurance and $696 million from Personal Lines, respectively, primarily related to goodwill arising from acquisitions. Life Insurance & Retirement Services expenses increased primarily due to $1.2 billion of goodwill impairment charges related to Domestic Life Insurance and Domestic Retirement Services of $402 million and $817 million, respectively. Life Insurance & Retirement Services expenses also increased as a result of the effect of foreign exchange, growth in the business and the effect of FAS 159 implementation.

2007 and 2006 Comparison

Policy acquisition and other insurance expenses increased in 2007 compared to 2006 primarily due costs associated with realigning certain legal entities through which Foreign General Insurance operates and the increased significance of Foreign General consumer lines business, which have higher acquisition costs. Life Insurance & Retirement Services expenses increased principally as a result of the effect of growth in the Foreign Life Insurance & Retirement Services business, increased DAC amortization related to the adoption of SOP 05-1, higher operating expenses related to remediation activities and the effect of foreign exchange.

Interest Expense

2008 and 2007 Comparison

Interest expense increased in 2008 compared to 2007 on higher levels of borrowings. Interest expense in 2008 included $11.4 billion of interest expense on the Fed Facility which was comprised of $9.3 billion of amortization of the prepaid commitment fee asset associated with the Fed Facility, including accelerated amortization of the prepaid commitment asset of $6.6 billion in connection with the restructuring of the Fed Facility and $1.9 billion of accrued compounding interest. Interest expense in 2008 also included interest on the debt and Equity Units from the dates of issuance in May 2008. The above amounts are reflected in the Other category in AIG's segment results.

2007 and 2006 Comparison

Interest expense increased in 2007 compared to 2006 reflecting higher levels of borrowings, including interest on the junior subordinated debt issued in March and June 2007, borrowings used to fund the MIP and borrowings used for general corporate purposes.

Restructuring expenses and related asset impairment and other expenses

As described in Note 1 to the Consolidated Financial Statements, AIG commenced an organization-wide restructuring plan under which some of its businesses will be divested, some will be held for later divestiture, and some businesses will be prepared for potential subsequent offerings to the public. In connection with activities under this plan, AIG recorded restructuring and separation expenses of $758 million in 2008, consisting of severance expenses of $89 million, contract termination expenses of $27 million, asset write-downs of $51 million, other exit expenses of $140 million and separation expenses of $451 million.

Other exit expenses primarily include consulting and other professional fees related to (i) asset disposition activities, (ii) AIG's debt and capital restructuring program with the NY Fed and the United States Department of the Treasury and (iii) unwinding of AIGFP's businesses and portfolios.

Severance and separation expenses described above include retention awards of $492 million to key employees to maintain ongoing business operations and facilitate the successful execution of the restructuring and asset disposition plan. This amount also includes retention awards to AIGFP's employees under its retention program, which was established in the first quarter of 2008 due to the declining market environment, to manage and

unwind its complex businesses. The total amount expected to be incurred related to these retention programs is approximately $1.0 billion.

For the year ended December 31, 2008, $139 million, $68 million, $287 million and $69 million of the restructuring and separation expenses have been recorded within the General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management segments, respectively, while $195 million has been recorded in Other operations.

Total restructuring and separation expenses could have a material affect on future results of operations and cash flows.

Other Expenses

2008 and 2007 Comparison

Other Expenses increased in 2008 compared to 2007 primarily due to goodwill impairment charges of $791 million in 2008 in the Financial Services segment related to the Consumer Finance and Capital Markets businesses, which resulted from the downturn in the housing markets, the credit crisis and the intent to unwind AIGFP's businesses and portfolios. In addition, other expenses in 2008 increased compared to 2007 due to higher AGF provisions for finance receivable losses of $674 million in response to the higher levels of delinquencies in AGF's finance receivable portfolio.

2007 and 2006 Comparison

Other Expenses increased in 2007 compared to 2006 primarily due to increases in MIP and compensation related expenses in Asset Management, increases in depreciation expense on flight equipment in line with the increase in the size of the aircraft fleet and an increase in AGF's provision for finance receivable losses of $206 million.

Income tax expense (benefit)

2008 and 2007 Comparison

The effective tax rate on the pre-tax loss for 2008 was 7.7 percent. The effective tax rate was lower than the statutory rate of 35 percent due primarily to $26.1 billion of deferred tax expense recorded during 2008, comprising $5.5 billion of deferred tax expense attributable to the potential sale of foreign businesses and a $20.6 billion valuation allowance to reduce its deferred tax asset to an amount that AIG believes is more likely than not to be realized.

Realization of the deferred tax asset depends on AIG's ability to generate sufficient taxable income of the appropriate character within the carryforward periods of the jurisdictions in which the net operating losses and deductible temporary differences were incurred. AIG assessed its ability to realize its deferred tax asset of $31.9 billion and concluded a $20.6 billion valuation allowance was required to reduce the deferred tax asset to an amount AIG believes is more likely than not that to be realized. See Note 20 to Consolidated Financial Statements for additional discussion regarding deferred tax asset realization.

2007 and 2006 Comparison

The effective tax rate declined from 30.1 percent in 2006 to 16.3 percent in 2007, primarily due to the unrealized market valuation losses on AIGFP's super senior credit default swap portfolio and other-than-temporary impairment charges. These losses, which are taxed at a U.S. tax rate of 35 percent and are included in the calculation of income tax expense, reduced AIG's overall effective tax rate. In addition, other tax benefits, including tax exempt interest and effects of foreign operations were proportionately larger in 2007 than in 2006 due to the decline in pre-tax income in 2007. Furthermore, tax deductions taken in 2007 for SICO compensation plans for which the expense had been recognized in prior years also reduced the effective tax rate in 2007.

are accounted for under FAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect AIG's consolidated financial condition, results of operations, and cash flows. FAS 161 is effective for AIG beginning with financial statements issued in the first quarter of 2009. Because FAS 161 only requires additional disclosures about derivatives, it will have no effect on AIG's consolidated financial condition, results of operations or cash flows.

FAS 162

In May 2008, the FASB issued FAS 162, "The Hierarchy of Generally Accepted Accounting Principles" (FAS 162). FAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements presented in conformity with GAAP but does not change current practices. FAS 162 will become effective on the 60th day following Securities and Exchange Commission (SEC) approval of the Public Company Accounting Oversight Board amendments to remove GAAP hierarchy from the auditing standards. FAS 162 will have no effect on AIG's consolidated financial condition, results of operations or cash flows.

FSP FAS 140-3

In February 2008, the FASB issued FSP No. FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" (FSP FAS 140-3). FSP FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with or in contemplation of the initial transfer to be evaluated as a linked transaction unless certain criteria are met. FSP FAS 140-3 is effective for AIG beginning January 1, 2009 and will be applied to new transactions entered into from that date forward. Early adoption is prohibited. AIG is currently assessing the effect that adopting FSP FAS 140-3 will have on its consolidated financial statements but does not believe the effect will be material.

FSP FAS 132(R)-1

In December 2008, the FASB issued FSP FAS 132(R)-1, "Employer's Disclosures about Postretirement Benefit Plan Assets" (FSP FAS 132(R)-1). FSP FAS 132(R)-1 amends FAS 132(R) to require more detailed disclosures about an employer's plan assets, including the employer's investment strategies, major categories of plan assets, concentrations of risk within plan assets, and valuation techniques used to measure the fair values of plan assets. FSP FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009.

EITF 07-5

In June 2008, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock". Following the January 1, 2009 adoption date, instruments that are not indexed to the issuer's stock would not qualify for an exception from derivative accounting provided in FAS 133 (which requires that an instrument is both indexed to the issuer's own stock, and that it is classified in equity). AIG is assessing the effect that adopting EITF 07-5 will have on its consolidated financial statements, but does not believe the effect will be material.

2. Restructuring

As described in Note 1 herein, AIG commenced an organization-wide restructuring plan under which some of its businesses will be divested, some will be held for later divestiture, and some businesses will be prepared for potential subsequent offerings to the public.

Successful execution of the restructuring plan involves significant separation activities. Accordingly, AIG established retention programs for its key employees to maintain ongoing business operations and to facilitate the successful execution of the restructuring plan. Additionally, given the market disruption in the first quarter of 2008, AIGFP established a retention plan for its employees to manage and unwind its complex businesses. Other major activities include the separation of shared services, infrastructure and assets among business units and corporate functions.

At December 31, 2008, AIG cannot determine the expected date of completion or reliably estimate the total aggregate expenses expected to be incurred for all AIG's restructuring and separation activities. This is due to the significant scale of the restructuring plan, the fact that restructuring costs will vary depending on the identity of the ultimate purchasers of the divested entities, as well as the extended period over which the restructuring is expected to occur. For those activities that can be reasonably estimated, the total restructuring and separation expenses expected to be incurred is $1.9 billion at December 31, 2008.

Restructuring expenses and related asset impairment and other expenses, for the year ended December 31, 2008, by operating segment consisted of the following:

	Restructuring Expenses	Separation Expenses	Total	Total Amount Expected to be Incurred *
		(In millions)		
General Insurance	$ 38	$101	$139	$ 312
Life Insurance & Retirement Services	15	53	68	243
Financial Services	91	196	287	564
Asset Management	24	45	69	94
Other	139	56	195	724
Total	$307	$451	$758	$1,937

* *Includes cumulative amounts incurred and additional future amounts to be incurred that can be reasonably estimated at the balance sheet date.*

The initial restructuring liability and the corresponding movement from inception, for the year ended December 31, 2008, are summarized as follows:

	Severance Expenses(a)	Contract Termination Expenses	Asset Write-Downs	Other Exit Expenses(b)	Subtotal Restructuring Expenses	Separation Expenses(c)	Total Restructuring and Separation Expenses
				(In millions)			
Liability balance, beginning of year	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Amounts charged to expense	89	27	51	140	307	451	758
Paid	(12)	—	—	(53)	(65)	(167)	(232)
Non-cash	—	—	(51)	—	(51)	—	(51)
Liability balance, end of year	$ 77	$ 27	$ —	$ 87	$191	$ 284	$ 475
Total amount expected to be incurred(d)	$164	$106	$ 51	$585	$906	$1,031	$1,937

(a) Restructuring expenses include $44 million of retention awards and Total amount expected to be incurred includes $57 million for retention awards for employees expected to be terminated.

(b) Primarily includes consulting and other professional fees related to (i) asset disposition activities, (ii) AIG's debt and capital restructuring program with the NY Fed and the United States Department of the Treasury and (iii) unwinding most of AIGFP's businesses and portfolios.

(c) Restructuring expenses include $448 million of retention awards and Total amount expected to be incurred includes $1.0 billion for key employee retention awards announced during 2008.

(d) Includes cumulative amounts incurred and additional future amounts to be incurred that can be reasonably estimated at the balance sheet date.

7065 longer period of time.

7066 Mr. CUMMINGS. Now, you sent a letter to Secretary
7067 Geithner. It was a very interesting letter you sent over the
7068 weekend--well, it is dated March 14th. And it says something
7069 that I want you to help me out on because I don't understand
7070 it, and I think the committee has just sort of passed it by.

7071 It said, ''AIG''--and this is your letter--it says,
7072 ''AIG hereby commits to use best efforts to reduce expected
7073 2009 retention payments by at least 30 percent.'' Now, what I
7074 am trying to figure out is--so we have already got some
7075 people in place. We have been talking about 2008
7076 performance. Now, we have got some folks in place to get
7077 bonuses for 2009 performance. Is that correct?

7078 Mr. LIDDY. Yes. That specifically relates--that letter
7079 specifically relates to AIGFP, and it is the second part of
7080 the retention program which, if they are there and they
7081 accomplish their goals, we would pay in 2010.

7082 And I don't mean to interrupt you, but I think that
7083 whole issue is going to be moot because what we will find is
7084 those individuals will in fact return much if not all of the
7085 retention bonus that we paid them, and it will be accompanied
7086 by their letters of resignation.

7087 Mr. CUMMINGS. Well, I am hoping--another member said
7088 something a little bit earlier. I am hoping--President Obama
7089 has made it clear that he is trying to reverse our economy

7090 here and get it straightened out. And these people are very
7091 central people, one making as much as $6.5 million in
7092 bonuses.
7093 I would hope that they would stick around, take a
7094 regular paycheck like most people do, and stick around and
7095 help us get through this. They have benefitted from the
7096 greatness of this country, and I would hope that they would
7097 do that, and I hope you will appeal to them to do that.
7098 Finally, you wrote in your letter to Secretary Geithner
7099 that the Secretary had asked AIG to ''rethink our 2008
7100 corporate bonus proposals.''
7101 How much in bonuses--we keep saying bonuses and
7102 retention payments. How much in bonuses, not retention
7103 payments, have you paid to AIG employees in 2008, and what
7104 was the range of the bonuses paid?
7105 Mr. LIDDY. I will provide you the information. I think
7106 it was--I think it might have been in the range of $9
7107 million.
7108 Mr. CUMMINGS. Thank you very much.
7109 Mr. MOORE OF KANSAS. Thank you, Mr. Cummings.
7110 The chair next recognizes Ms. Kaptur of Ohio for up to
7111 five minutes.
7112 Ms. KAPTUR. Thank you, Mr. Chairman.
7113 I agree, Mr. Liddy, with the statement in your formal
7114 testimony: ''Insurance is the oxygen of the free enterprise

Rep. Elijah Cummings (MD)

Issue: Performance payments paid to AIG employees in 2008. (Page 295, Line 7102)

AIG has approximately 374 plans that pay variable amounts based on some measure of performance, across the company.*

In the Domestic Life and Foreign Life Operations, AIG maintained 140 plans with 23,851 participants in 2008. These plans paid an average award of $5,050 per employee for work performed in 2008.

Within the Property Casualty Group, AIG had 56 plans that covered 3,943 employees with an average payment of $5,403 for work performed in 2008.

The Foreign General Insurance Operations maintained 115 plans, covering 8,669 employees with an average award of $5,074 for work performed in 2008.

Within the Retirement Services Operations, AIG had 7 plans that covered 1,168 employees and paid an average of $11,889 for 2008 performance.

In the Financial Services businesses, AIG has 53 plans that cover 5,357 employees with an average payment of $4,994 for 2008 performance.

AIG's Asset Management Group had 3 plans that covered 2,095 employees with an average award of $51,026 for 2008 performance.

AIG also maintained a corporate-wide variable plan that covered 6,410 employees with an average payout of $ 18,954 for 2008 performance.

* This does not include approximately 236 plans across AIG pursuant to which employees earn varying amounts based on sales and commissions on those sales or the nine plans governing payments required by local governments of the various countries within which AIG operates. Nor do these numbers reflect plans that pay amounts based on ownership interests on investments in certain products or real estate investments.

6890 have a higher probability of running this book down and not
6891 having it cost the American taxpayer more. That is what
6892 those bonuses were about.
6893 Mr. CLAY. And that is based on the familiarity of the
6894 people that are in place there.
6895 Mr. LIDDY. Correct. Correct.
6896 Mr. CLAY. I mean, even the point about honoring the
6897 contracts, I mean, don't we change contracts every day in
6898 this country, and could in some those instances those
6899 contracts be altered?
6900 Mr. LIDDY. Well, that is why I say it was secondarily a
6901 legal consideration and primarily a risk consideration.
6902 Contracts can always be altered as long as the two parties,
6903 or multiple parties to a contract, agree to it.
6904 Mr. CLAY. Okay. Well, I appreciate your responses and I
6905 wish you well, Mr. Liddy.
6906 I yield back, Mr. Chair.
6907 Mr. MOORE OF KANSAS. Thank you, Mr. Clay. I next
6908 recognize myself, the chair, for up to five minutes.
6909 Mr. Liddy, there are a lot of people in our country
6910 hurting very badly right now, and I think you know that. I
6911 know you know that.
6912 Have you asked any of the executives who received these
6913 bonuses if they would voluntarily forgo these bonuses and pay
6914 the taxpayers' money back so we can try to get on with this

6915 whole thing?

6916 Mr. LIDDY. I have. I asked them this morning.

6917 Mr. MOORE OF KANSAS. And?

6918 Mr. LIDDY. I have been in this hearing all day. I don't

6919 know what the outcome is.

6920 Mr. MOORE OF KANSAS. You haven't received any e-mails or

6921 phone calls?

6922 Mr. LIDDY. No. I would prefer to ask the right people,

6923 and I will do that.

6924 Mr. MOORE OF KANSAS. And we would like a report back.

6925 If you get information about that, will you be willing to

6926 provide that information to us, sir?

6927 Mr. LIDDY. Yes.

6928 Mr. MOORE OF KANSAS. Within a short time after you

6929 received it, if you do receive that information?

6930 Mr. LIDDY. Yes. I will be very transparent with you. I

6931 just want to--I need to get the information. I need people

6932 to--I need to give them a chance to make a rational decision,

6933 and then provide it to everyone who has an interest in it.

6934 Mr. MOORE OF KANSAS. Sure. I don't know that we

6935 can--our country can afford to wait until 2012 for AIG to pay

6936 its money back. So if AIG continues to behave like this,

6937 despite being supported by not only current taxpayers but

6938 also by future generations, our children and grandchildren,

6939 when will you pay the money back? When will AIG pay the

Rep. Dennis Moore (KS)

Issue: Information on AIGFP employees who have agreed to give back their retention payments. (Page 288, Line 6924)

AIGFP continues to receive responses from its employees and cannot provide a final number pending the resolution of certain tax implications and administrative details posed by the return of the retention payments. Although published reports have purported to establish the amount of the retention payments committed to be returned, the final figure, in fact, has not been established. AIG is committed to providing Members of Congress with this information as soon as is practicable. While AIG is disappointed at the level of resignations from AIGFP, the company is gratified by the response of many to its request to return at least a portion of the retention payments.

House Financial Services Subcommittee on Capital Markets, Insurance and GSEs
March 18, 2009 Hearing
Additional Questions Submitted for the Record

Representative Elijah Cummings (MD)

1. **Please specify the exact amount in bonuses – not retention payments or any other form of compensation – paid by AIG to employees of any division of AIG in 2008 or paid in 2009 for work performed in 2008.**

   AIG has approximately 374 plans that pay variable amounts based on some measure of performance, across the company. This count does not include approximately 236 plans across AIG pursuant to which employees earn varying amounts based on sales and commissions on those sales or the nine plans governing payments required by local governments of the various countries within which AIG operates. Nor do these numbers reflect plans that pay amounts based on ownership interests on investments in certain products or real estate investments.

   - In the Domestic Life and Foreign Life Operations, AIG maintained 140 plans with 23,851 participants in 2008. These plans paid an average award of $5,050 per employee for work performed in 2008.
   - Within the Property Casualty Group, AIG had 56 plans that covered 3,943 employees with an average payment of $5,403 for work performed in 2008.
   - The Foreign General Insurance Operations maintained 115 plans, covering 8,669 employees with an average award of $5,074 for work performed in 2008.
   - Within the Retirement Services Operations, AIG had 7 plans that covered 1,168 employees and paid an average of $11,889 for 2008 performance.
   - In the Financial Services businesses, AIG had 53 plans that cover 5,357 employees with an average payment of $4,994 for 2008 performance.
   - AIG's Asset Management Group had 3 plans that covered 2,095 employees with an average award of $51,026 for 2008 performance.
   - AIG also maintained a corporate-wide variable plan that covered 6,410 employees with an average payout of $18,954 for 2008 performance.

2. **Please provide a list of the individuals who received bonus payments and the amount each individual received. Please also specify the unit within AIG where the bonus recipient worked and whether the bonus recipient is still a current employee of AIG as of the date the response to this question is prepared by AIG. Finally, please specify when each bonus was approved for award.**

   Because of the enormous number of employees covered under the approximately 374 plans across AIG, it is a vastly complex and expensive task to identify employees and amounts on an individual basis. More importantly, concerns for the safety of AIG employees and privacy issues in various jurisdictions around the world raise serious issues related to personal identification of employees. For the majority of these plans, an employee must be an active employee on the date of the variable performance payment.

3. **Did Edward Liddy approve the issuance of these bonuses? If not, who approved the issuance of these bonuses?**

   Variable performance plans are generally developed by the various business units based on performance goals for the year. Historically, most plans were approved by business units with information provided to the AIG Compensation and Management Resources Committee (CMRC) periodically. The CMRC specifically approves the corporate-wide variable performance plan, which is based on performance goals for the year. Actual payments under all of these plans are based on performance.

4. **What is the total amount of bonuses approved for work to be performed in 2009 and when will these bonuses be awarded?**

   Plans for 2009 are currently under development, in consultation with the Federal Reserve and Treasury, using the same approach outlined in question 3 above. The 374 plans across AIG have various payment schedules. Payments for the 2009 corporate-wide variable performance plan will be made, assuming successful performance against established goals, sometime in 2010.

Representative Al Green (TX)

1. **Is AIG planning an overhaul of 700 servers?**

   No, AIG is not planning an overhaul of 700 servers. However, AIG's servers are regularly assessed and upgraded as part of the company's standard maintenance procedures.

2. **Will information be purged as part of this overhaul?**

   As noted above, AIG does not plan to overhaul 700 servers. When servers are upgraded, new hardware is purchased and old data is migrated to the new server.

3. **Does AIG have the proper backup system in place?**

   AIG has in place an industry-standard backup system to protect against unexpected data loss.

Representative Andre Carson (IN)

1. **Your report detailing AIG's counterparty payouts from TARP funds revealed that Goldman Sachs topped the list at $12.9 billion. We all know that Secretary Paulson was the former CEO of Goldman Sachs and was instrumental in making sure a bailout was arranged for AIG, in which Goldman Sachs was heavily invested. Since you previously served on the board for Goldman Sachs and were subsequently asked by Secretary Paulson to lead AIG, how would you respond to this charge of preferential treatment?**

   AIG is a large institution that engages in standard commercial activity with companies all over the world. These activities are handled in the normal, day-to-day course of business and rarely, if ever, rise to the level of the CEO. AIG was not involved in the discussions with counterparties, including Goldman Sachs, that led to the purchase of CDOs by Maiden Lane III and the consequent termination of related credit default swaps. Discussions regarding these matters were handled exclusively by the Federal Reserve Bank of New York. While the U.S. Treasury is AIG's largest shareholder, AIG continues to be a publicly traded company and as such adheres to all applicable rules and governance protocols.

2. **If you must retain them (FP employees) to ensure the company is viable moving forward, why couldn't you renegotiate contracts that ensure those employees are invested in AIG's future profitability?**

3. **Why couldn't the bonuses be negotiated to be paid out in stock or other options to make sure that those employees share in the losses and be rewarded only if and when the company is performing once more?**

   The following response answers questions two and three.

   On March 18, 2009, Mr. Ed Liddy asked employees who received retention payments of $100,000 or more to return at least half of those payments. The requested return of retention payments has necessitated careful attention to administrative details and consideration of tax matters in the various jurisdictions in which AIG does business. The company is in the process of finalizing paperwork to be distributed to employees who have already indicated their intent to repay retention amounts. AIG has asked employees who have not already indicated their intent to repay retention amounts to agree to do so. The company intends to provide employees adequate time to review the paperwork that will be provided and to consider its request.

Representative Keith Ellison (MN)

1. **Please provide a breakdown of the types of derivatives left to be unwound.**

2. **Please also provide an assessment of AIG's net exposure on the $1.6 trillion in derivatives after taking into account bilateral netting agreements, collateral and other risk mitigants.**

In response to questions 1 and 2, please see attached presentation previously submitted for the hearing record, "What is the status of AIG's Financial Products business?"

AIG What is the status of AIG's Financial Products business?

AIG has been actively de-risking and running off its Financial Products business.

Sept 30 | Dec 31 | Current

Number of trade positions

- Reduced client trades by 30% since year-end 2008
- Number of long-dated trades (>50 years) reduced from 70 to 12
- Additional 15% naturally maturing in 2009

Notional of derivatives outstanding ($ Trillion)

- Multi-sector CDO Notional reduced by 85% via Maiden Lane III
- 40% of Regulatory Capital Notional effectively terminated or called over the past year

Exposure to change in volatility (Gross Vega in $ Billion)*

- Interest Rates – down 30%
- Equity – down 35%
- Commodities – down 50%
- Foreign Exchange – down 50%

Number of businesses (risk books)

- 5 books almost completely wound down, including Commodities Index, Infrastructure Investments, exotic Foreign Exchange/Rates

Number of employees

- FP will close two locations, Tokyo and Hong Kong in 2009

* The Gross Vega is calculated as the sum of all the individual position's absolute vegas as if each position is not hedged. Although FP's books are almost completely hedged on a net Vega basis, the Gross Vega measure will help monitor how well the volatility risk is being eliminated, not just hedging that risk. The interest rate option vega denotes the change in value due to a 0.1% increase in normal volatility. For other derivatives (i.e., Equity, Commodity and FX option), vega denotes the change in value due to a 1% increase in lognormal volatility.

Representative Marcy Kaptur (OH)

1. **What is your best estimate of the trading value of the securities underlying the outstanding derivatives held on the books of AIGFP?**

2. **What is the possible remaining taxpayer exposure? In a worst case scenario, could it really be $1.6 trillion?**

3. **Mr. Liddy told us in the hearing that it would cost an additional several billion dollars to unwind the contracts and that the amount was "baked in" to the rescue package. To which specific part of the package was he referring?**

4. **Have the counterparties been made whole?**

5. **If the outstanding contracts are successfully terminated, is it possible that the counterparties would have to return any of the tens of billions of collateral to the taxpayer? Why/not, given that the underlying securities are still good?**

6. **What were the terms of those payments? Apart from the cash, what else (if anything) were the counterparties paid?**

7. **Will AIG disclose what remaining contracts AIGFP still has on its books? If not, could they at least disclose the composition of those contracts (i.e., commercial mortgage-backed securities)? What else?**

The following response answers all of the questions listed above.

In response to the questions above, in October 2008, AIGFP began unwinding its businesses and portfolios. AIGFP is now entering into new derivative transactions only to maintain its current portfolio, reduce risk and hedge the currency and interest rate risks associated with its affiliated businesses. As part of its orderly wind-down, AIGFP is also opportunistically terminating contracts. Due to the long-term duration of AIGFP's derivative contracts and the complexity of AIGFP's portfolio, AIG expects that an orderly wind-down of AIGFP will take a substantial period of time. As noted in testimony on March 18, 2009, AIGFP has calculated an approximate dollar amount necessary to unwind the company's remaining derivative contracts. This cost has been previously accounted for, though the actual cost in the future will depend on myriad market and other factors. In any case, AIG does not anticipate needing additional funds from the federal government to cover these specific costs.

In the case of most of AIGFP's derivative positions, there is no specified underlying security. By contrast, in the case of the overwhelming majority (based upon notional amount) of the super senior multi-sector CDO CDS transactions that AIGFP entered into, there was a single security, or a pool of securities, underlying the transactions. As has been disclosed previously, the majority of these multi-sector CDO CDS transactions were terminated in connection with the Maiden Lane III transaction.

The $1.6 trillion number covers a broad spectrum of derivative transactions, ranging from "plain vanilla" interest rate swaps to credit default swaps, but it is not the best measure for potential losses that may be incurred thereunder. In the case of most derivative transactions, AIGFP is not, as a practical matter, at risk to the extent of the full notional amount of the trades. Rather, any losses AIGFP incurs in connection with its wind-down ultimately will depend upon prevailing market conditions at the time that AIGFP terminates each trade and AIGFP's ability to negotiate favorable termination pricing with counterparties.

The terms of many of AIGFP's derivatives transactions require AIGFP and/or its counterparties to post collateral. Upon the termination of any given transaction, whether related posted collateral is returned depends upon market conditions at the time of the termination, as one party's obligation to return posted collateral will generally be offset against its right to receive a termination payment. To the extent that AIGFP terminates a transaction at a price more favorable than the price used most recently to determine the amount of collateral posted by AIGFP, then, on a net basis, AIGFP will receive back some portion of the collateral previously posted; by contrast, if a transaction is terminated at a less favorable price, then AIGFP will have to make a termination payment in addition to forgoing the return of posted collateral. For a detailed discussion of the collateral posting provisions of AIGFP's derivative contracts, we draw your attention to the section entitled "Collateral" beginning on page 143 of AIG's most recent Form 10-K, filed with the Securities and Exchange Commission on March 2, 2009 (please see attached).

reasonably estimate the aggregate amount that it would be required to pay under the super senior credit default swaps in the event of any further downgrade.

Certain super senior credit default swaps written for regulatory capital relief, with a net notional amount of $161.5 billion at December 31, 2008, include triggers that require certain actions to be taken by AIG once AIG's rating level falls to certain levels, which, if not taken, give rise to a right of the counterparties to terminate the CDS. Such actions include posting collateral, transferring the swap or providing a guarantee from a more highly rated entity. In light of the rating actions taken in respect of AIG on September 15, 2008, AIGFP has implemented collateral arrangements in a large majority of these transactions. In the event of a termination of the contract that is caused by AIG's rating downgrade, AIGFP is obligated to compensate the counterparty based on its "loss." As a result of AIGFP posting collateral, AIG eliminated the counterparties' right to terminate under this downgrade provision, thereby avoiding the uncertainty of determining the "loss" from an early termination of a regulatory capital CDS.

Collateral

Most of AIGFP's credit default swaps are subject to collateral posting provisions. These provisions differ among counterparties and asset classes. Although AIGFP has collateral posting obligations associated with both regulatory capital relief transactions and arbitrage transactions, the large majority of these obligations to date have been associated with arbitrage transactions in respect of multi-sector CDOs.

The collateral arrangements in respect of the multi-sector CDO, regulatory capital and corporate arbitrage transactions are nearly all documented under a Credit Support Annex (CSA) to an ISDA Master Agreement (Master Agreement). The Master Agreement and CSA forms are standardized form agreements published by the ISDA, which market participants have adopted as the primary contractual framework for various kinds of derivatives transactions, including CDS. The Master Agreement and CSA forms are designed to be customized by counterparties to accommodate their particular requirements for the anticipated types of swap transactions to be entered into. Elective provisions and modifications of the standard terms are negotiated in connection with the execution of these documents. The Master Agreement and CSA permit any provision contained in these documents to be further varied or overridden by the individual transaction confirmations, providing flexibility to tailor provisions to accommodate the requirements of any particular transaction. A CSA, if agreed by the parties to a Master Agreement, supplements and forms part of the Master Agreement and contains provisions (among others) for the valuation of the covered transactions, the delivery and release of collateral, the types of acceptable collateral, the grant of a security interest (in the case of a CSA governed by New York law) or the outright transfer of title (in the case of a CSA governed by English law) in the collateral that is posted, the calculation of the amount of collateral required, the valuation of the collateral provided, the timing of any collateral demand or return, dispute mechanisms, and various other rights, remedies and duties of the parties with respect to the collateral provided.

In general, each party has the right under a CSA to act as the "Valuation Agent" and initiate the calculation of the exposure of one party to the other (Exposure) in respect of transactions covered by the CSA. The valuation calculation may be performed daily, weekly or at some other interval, and the frequency is one of the terms negotiated at the time the CSA is signed. The definition of Exposure under a standard CSA is the amount that would be payable to one party by the other party upon a hypothetical termination of that transaction. This amount is determined, in most cases, by the Valuation Agent using its estimate of mid-market quotations (i.e., the average of hypothetical bid and ask quotations) of the amounts that would be paid for a replacement transaction. AIGFP determines Exposure typically by reference to the mark-to-market valuation of the relevant transaction produced by its systems and specialized models. Exposure amounts are typically determined for all transactions under a Master Agreement (unless the parties have specifically agreed to exclude certain transactions, not to apply the CSA or to set a specific transaction Exposure to zero). The aggregate Exposure less the value of collateral already held by the relevant party (and following application of certain thresholds) results in a net exposure amount (Delivery Amount). If this amount is a positive number, then the other party must deliver collateral with a value equal to the Delivery Amount. Under the standard CSA, the party not acting as Valuation Agent for any particular Exposure calculation may dispute the Valuation Agent's calculation of the Delivery Amount. If the parties are unable to resolve this dispute, the terms of the standard CSA provide that the Valuation Agent is required to recalculate Exposure using, in substitution for the disputed Exposure amounts, the average of actual quotations at mid-market from four leading dealers in the relevant market.

After an Exposure amount is determined for a transaction subject to a CSA, it is combined with the Exposure amounts for all other transactions under the relevant Master Agreement, which may be netted against one another where the counterparties to a Master Agreement are each exposed to one another in respect of different transactions. Actual collateral postings with respect to a Master Agreement may be affected by other agreed CSA terms, including threshold and independent amounts, that may increase or decrease the amount of collateral posted.

Regulatory Capital Relief Transactions

As of December 31, 2008, 68.0 percent of AIGFP's regulatory capital relief transactions (measured by net notional amount) were subject to a CSA. In other transactions, which represent 1.0 percent of the total net notional amount of the outstanding regulatory capital relief transactions, AIGFP is obligated to put a CSA or alternative collateral arrangement in place if AIG's ratings fall below certain levels (typically, A-/A3). At December 31, 2008, 31.0 percent of the regulatory capital relief portfolio is not subject to collateral posting provisions. In general, each regulatory capital relief transaction is subject to a stand-alone Master Agreement or similar agreement, under which the aggregate Exposure is calculated with reference to only a single transaction.

The underlying mechanism that determines the amount of collateral to be posted varies from one counterparty to another, and there is no standard formula. The varied mechanisms resulted from varied negotiations with different counterparties. The following is a brief description of the primary mechanisms that are currently being employed to determine the amount of collateral posting for this portfolio.

Reference to Market Indices — Under this mechanism, the amount of collateral to be posted is determined based on a formula that references certain tranches of a market index, such as either Itraxx or CDX. This mechanism is used for CDS transactions that reference either corporate loans, or residential mortgages. While the market index is not a direct proxy, it has the advantage of being readily obtainable.

Market Value of Reference Obligation — Under this mechanism the amount of collateral to be posted is determined based on the difference between the net notional amount of a referenced RMBS security and the security's market value.

Expected Loss Models — Under this mechanism, the amount of collateral to be posted is determined based on the amount of expected credit losses, generally determined using a rating-agency model.

Negotiated Amount — Under this mechanism, the amount of collateral to be posted is determined based on bespoke terms negotiated between AIGFP and the counterparty, which could be a fixed percentage of the notional amount or present value of premiums to be earned by AIGFP.

The amount of collateral postings by underlying mechanism as described above with respect to the regulatory capital relief portfolio (prior to consideration of transactions other than AIGFP's super senior credit default swap portfolio subject to the same Master Agreements) were as follows (there were no collateral postings on this portfolio prior to March 31, 2008):

	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008	February 18, 2009
			(In millions)		
Reference to market indices	$212	$177	$157	$ 667	$417
Market value of reference obligation	—	142	286	380	299
Expected loss models	—	—	—	5	5
Negotiated amount	—	—	—	235	213
Other	—	—	—	—	18
Total	$212	$319	$443	$1,287	$952

Arbitrage Portfolio — Multi-Sector CDOs

In the large majority of the CDS transactions in respect of multi-sector CDOs, the standard CSA provisions for the calculation of Exposure have been modified, with the Exposure amount determined pursuant to an agreed