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The AIG Story (Chapter 18, Nationalization)

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The AIG Story:
Chapter 18, Nationalization

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Abstract

This is the final chapter of The AIG Story, a book about the growth of a large international insurance company that pioneered the opening of new markets and helped forge milestone international trade agreements, followed by an account of its near-destruction, first at the hands of an overzealous state attorney general and underwhelming board of directors, and then, as detailed in this chapter, at the hands of federal government officials overwhelmed by a financial crisis they could not understand. This chapter begins in mid-2008, when AIG's losing financial products bets presented the company with a huge liquidity problem, though it commanded nearly a trillion dollars in assets that made it entirely solvent. The world's largest banks faced both liquidity and solvency problems that threatened a global financial meltdown. Swooping into the maelstrom, the U.S. Treasury and New York Fed engineered a solution that portrayed AIG as the greatest villain of the crisis and its treatment by the government as a rescue of the company. The truth is more complex and this chapter of the book explains, in what Kirkus has aptly described, reviewing the book, as "a useful contribution to the ongoing shaping of the story of the recent financial crisis."

18. Nationalization

In July 2008, Robert Willumstad, AIG's chairman and chief executive, informed its board that the company would soon face a liquidity problem.[1] During July and August, AIG continued to pursue routine negotiations with customers, including Goldman Sachs, to settle disagreements about valuations given market uncertainty. The two would compromise by AIG paying a discount from the face value of the contracts, something less than 100 cents on the dollar, and reducing posted collateral accordingly. From late July through early September, Willumstad pursued extraordinary discussions with officials of the Federal Reserve Bank of New York about the possibility of the Fed lending AIG money by opening its "discount window," the liquidity resource it uses to support the nation's banking system.[2]

None of these overtures produced desired results. By mid-September, AIG was in a liquidity crunch, needing $9 billion in cash to survive the week—astonishing for a company commanding $800 billion in assets.[3] On Friday, September 12, AIG was unable to access a routine source of funds, the commercial paper market, as collateral calls rose, reaching $7.6 billion from Goldman alone and totaling $23.4 billion.[4] In late August, Greenberg and Willumstad had dinner in Greenberg's apartment building in New York. Greenberg offered to assist AIG in any way that he could. Willumstad declined the assistance, expressing concern that he said the board shared, that allowing Greenberg to help would "overshadow " him—the same concern some board members expressed three years earlier at the time of his resignation.[5]

During the global financial crisis of 2008, many institutions, domestic and foreign, faced illiquidity or insolvency as the world financial system teetered. The Fed opened its discount window to nearly any applicant, dispensing hundreds of billions of dollars in loans to scores of U.S. banks and many foreign ones, including Dexia of Belgium, Depfa Bank of Ireland, the Bank of Scotland, and Arab Banking Corporation, then 29 percent owned by the Libyan central bank.[6] All these arrangements were made at market interest rates with the borrowers posting reasonable security. The Fed lent Bank of America $91 billion and Morgan Stanley $107 billion—at a market interest rate of 1.5 percent, in exchange for the customary borrower promise to repay, without the government taking any equity ownership; it lent Citigroup $99 billion on such terms, though also taking nearly 30 percent of its equity[7] while guaranteeing $300 billion of its debt.[8] The Treasury supplied some $200 billion to others through its Troubled Asset Relief Program (TARP), often using creative maneuvers to grant requests. The Hartford, an insurance company, bought a small bank (for $10 million) in order to characterize a $3.4 billion loan as eligible for TARP, which was earmarked for banks—the Hartford sold the bank two years later.[9]

The Fed and Treasury were running a kind of soup kitchen for financially strapped institutions, so many and varied that the Treasury Secretary, Henry M. Paulson Jr., a former chairman of Goldman Sachs, wondered in bemusement, "Who are these guys that just keep coming?"[10] Americans recoil at government assistance to failed private enterprise, though such incidents recur in U.S. economic history. A few recent episodes include the Chrysler Corporation of the late 1970s, the savings-and-loan industry in the 1980s, and both the automotive and financial sector in 2008–2009. Even as officials orchestrate vital stabilizing efforts, the public, politicians, and media strenuously protest. Often using strident rhetoric, critics object that the "taxpayers" are "bailing out" irresponsible corporations. Government officials charged with the unloved task of executing the mission avoid using words like *bailout;* some try earnestly to show that they are punishing rather than rescuing. In the 2008 financial crisis, though government's intentions were kept opaque, the result both vilified and victimized AIG: government made AIG the "poster child" for the unpopularity of bailouts while also imposing the most punishing terms imaginable unlike those imposed on any other financial institution.

Through the weekend of September 13–14, 2008, AIG continued to appeal for access to the Fed's discount window, as it had been requesting since late July, on terms that would be routinely granted to others. Willumstad dispatched vice chairman Jacob Frenkel, a dean of international finance and former head of the Israeli central bank, who maintained professional relationships with many senior officials of the Fed and Treasury.[11] Frenkel told the officials that AIG would run out of liquid funds in 5 to 10 days. To help AIG survive, it sought an emergency loan from the Fed. Timothy F. Geithner, president of the Federal Reserve Bank of New York, overseer of New York–based banks, sent members of his staff to AIG to study the matter.[12] But the officials would make no commitments at that point, as the top brass, Geithner and Paulson of the Treasury, were preoccupied with the fate of Lehman Brothers, the investment bank that would soon fail.

So AIG kept seeking nongovernment solutions.[13] Attempts, begun during the last week of August, included assembling private equity investors, strategic buyers, and sovereign wealth funds to discuss investment options.[14] The government discouraged AIG from pursuing foreign sources, however, such as sovereign wealth funds or private investors, though many such prospects knew AIG very well.[15] AIG's management also considered an insolvency filing under state insurance laws, which would continue to segregate the insurance companies, all liquid, solvent, and well capitalized.[16] The process would isolate AIG's disastrous noninsurance businesses, especially the financial products and securities lending divisions, thus protecting policyholders while potentially cutting shareholder losses as well.

On Monday morning, September 15, Lehman filed for federal bankruptcy, wiping out its shareholders' equity.[17] The global financial crisis took another tailspin. Turning their attention to AIG, Paulson and Geithner hastily brokered talks between it and a consortium of domestic banks led by Goldman Sachs, JP Morgan Chase and Morgan Stanley.[18] Greenberg, on behalf of himself, Starr International Company (SICO), then AIG's largest shareholder, and the Starr Foundation, another large shareholder, asked to attend these meetings, but representatives of Paulson's and Geithner's offices refused the request. There Greenberg would have seen conflicts of interest that would be widely documented after the fact: a global financial intervention being orchestrated using a coterie of firms representing multiple clients and opposing interests all at once.[19]

That Monday afternoon, rating agencies downgraded AIG's long-term credit rating, and its stock price plunged. AIG could not access short-term liquid funds in the credit markets and was prepared to take the ultimate step of drawing down its back-up lines of credit, which Willumstad analogized to a captain abandoning ship.[20] Geithner opposed this move.[21] He and Paulson decided that the government would step in, though eschewing any sense that government's overtures toward AIG would be any sort of "bailout."[22]

The next day, Tuesday, September 16, Geithner and Paulson called Willumstad to inform him of their decision and the terms, which—true to Paulson's commitment that this was no "bailout" of AIG—were mandatory, nonnegotiable and punishing.[23] The government would take 79.9 percent of AIG's ownership, initially in the form of a new preferred stock that could be issued quickly and massively dilute existing common shareholders; separately, it would also lend $85 billion, at a 14 percent annual rate, vastly exceeding the prevailing market interest rate of 1.5 percent, fully secured by 100 percent of AIG's assets and to be repaid within two years.[24] The only way such a loan could be repaid was by selling substantial assets.

Willumstad received a formal statement of those terms at 4:00 P.M., ahead of an emergency board meeting set for 5:00 P.M. The terms were bizarre: there was no relationship between the stock and the loan, as the government would keep the stock even after AIG repaid the loan in full. It was as if your bank lent you money to buy a home, and even if you repaid the loan, they took ownership of your home as well. The government had "rescued" a number of institutions during the financial crisis and not one was subject to such arbitrary and punishing terms.

At 4:40 P.M., minutes before the AIG board meeting, Paulson and Geithner called Willumstad to add yet more pressure: "This is the only proposal you're going to get," Geithner threatened, making it clear that the government was giving more an ultimatum than an opportunity.[25] Paulson gave a further order: the government was replacing Willumstad, effective immediately.[26] Aware that he had scant legal authority to fire Willumstad or commandeer AIG's equity, Paulson that evening succumbed to a bout of the dry heaves.[27] Geithner worried that his terms were draconian.[28]

Within three hours of receiving government's ultimatum, AIG's board capitulated. Yet it lacked detailed information about the matter. No one—not the board, nor the government—had made any assessment of AIG's business value. No one could make even a rough guess about whether what the government was providing was proportional to what it was taking.[29]

During the earlier call, Willumstad learned from Paulson that his successor would be Edward M. Liddy, causing Willumstad and his advisers on the phone to wonder: *Ed Liddy?* Liddy, a former head of Allstate Corporation, a domestic firm specializing in car insurance, was a strange choice to run AIG, as AIG directors at the emergency board meeting observed.[30] Liddy had presided over the break up in the 1990s of Sears, Roebuck & Company, from which Allstate had been spun out. Paulson and Liddy, fellow Chicagoans, were also friends. Several years earlier, when Paulson ran Goldman Sachs, he nominated Liddy to join that firm's board of directors, where Liddy still served[31] and in which he owned millions of dollars' worth of stock.[32] Goldman and AIG were then engaged in multibillion-dollar negotiations over the value of securities AIG had insured, revolving around how much collateral AIG was required to post to Goldman and what ultimate payments would be due. Liddy would effectively become a one-man creditor's committee, following orders from Paulson and Geithner, not advocating for the interests of AIG or its shareholders.

Willumstad had promptly called Greenberg to report the government's punishing terms, stressing that they did not resemble any of the financial support the government dispensed to hundreds of other financial institutions. On the contrary, as one senior Fed official explained, the security that Paulson and Geithner demanded for the loan—100 percent of AIG's $800 billion in assets—was enough to secure the entire debt held by the Federal Reserve.[33] Greenberg immediately tried to contact Paulson and Geithner. Paulson's assistant said that the Treasury Secretary was unavailable but would return the call. Paulson ducked the discussion, leaving a message on Greenberg's office voicemail at 5:30 A.M. the next morning. The two never spoke.

Determining why Paulson avoided Greenberg requires speculation. It cannot be simply because Paulson was too busy, or struck by panic or fear, as his memoirs reveal an intense daily work schedule. Every day he made scores of calls and participated in dozens of meetings addressing vexing challenges. Perhaps Paulson's avoidance was due to his awareness of the dubious legality of his actions concerning AIG. He may have felt uncomfortable knowing that the decisions would benefit Goldman Sachs, his former firm, by inflicting pain on AIG, both in dollar-for-dollar terms and in terms of incalculable damage to corporate reputation. One can only wonder, however, as Paulson's lengthy memoirs do not discuss it or mention Greenberg.

Reaching Geithner later that Tuesday, Greenberg spoke plainly: "As the representatives of AIG's largest shareholders, we want a seat at the table in any discussion of the company's future." Greenberg said they urgently needed to explore alternative solutions to FP's liquidity needs, finding the planned state takeover deplorable for many reasons, including the massive dilution of existing common stockholders and draconian loan terms. Greenberg specifically suggested adding foreign investors, which the government had earlier discouraged, or providing partial government guarantees of FP's obligations, as Paulson and Geithner had arranged for Citigroup and others. Either would solve FP's liquidity crunch, Greenberg explained, reminding Geithner that AIG as a whole, and every one of its insurance companies, had ample capital and was healthily solvent. "I hear you," Geithner said, indicating that he would get back to Greenberg. He never did.

At 8:30 A.M. on Wednesday September 17, Liddy appeared at 70 Pine Street, along with Dan H. Jester, Paulson's aide at the Treasury Department and also a former Goldman banker, as were many of Paulson's aides at Treasury. Willumstad asked the two how he could be helpful in the impending transition. They said he could sign a document authorizing the government's takeover of AIG. Willumstad immediately declined. Besides finding the terms of the deal unattractive for AIG, Paulson had fired him the night before and anointed Liddy his successor.[34]

Liddy signed the first batch of formal takeover papers on September 23; Goldman Sachs announced his resignation from its board on September 26, stating the resignation was effective as of September 23.[35] The conflict of interest was clear but ignored: a Goldman director signed over AIG to the government, which would then call the shots in settling fateful negotiations between the two companies.

Willumstad had expected that when FP resolved disputes with customers over how much it owed, they would give concessions and settle disputes at a discount from face value—something less than 100 cents on the dollar.[36] Any rational party in the strained commercial situation would have asked for a discount, and any reasonable party in the trying financial circumstances would have granted it.[37] One FP customer made it clear that it believed it was only right to reach such a compromise.[38] Another developed a range of discounts for negotiation, indicating a reasonable range might extend as low as 40 cents on the dollar, given prevailing severe credit market conditions.[39]

Paulson and Geithner, however, engineered the opposite. AIG paid 100 cents on the dollar to every one of FP's 16 largest financial product customers, a clique of Wall Street firms and foreign banks, led by Goldman Sachs.[40] The actions made it clear that government's interest was not so much to help AIG but to use AIG to flood the market with capital, without publicly tarnishing the image of the recipients as "bailout" bandits. Government officials began to implement the plan on November 5 and 6. They created a special conduit, called Maiden Lane III. (The name reflected the location of the offices of the New York Fed, but was an ironic choice considering that 102 Maiden Lane was the location for many years of the offices of both Starr and Greenberg.)

Government officials funded the conduit in part by equity that AIG staked and in part by loans the Fed added. The officials then contacted FP's 16 largest customers and offered to pay off their outstanding contracts, by surrendering previously-posted collateral and covering any shortfall in cash via the conduit. The officials did not broach possible discounts in half of those contacts.[41] To the half given that suggestion, officials asked the customer to make a proposal within 24 or 48 hours. None did.[42] As for the two customers who had volunteered to give a discount, officials insisted on paying them 100 cents on the dollar anyway.[43] Officials transferred $60 billion of funds nominally at AIG's disposal to the following banks, with no strings attached[44]: Société Générale $16.5 billion; Goldman Sachs $14 billion; Deutsche Bank $8.5 billion; Merrill Lynch $6.2 billion; Calyon $4.3 billion; UBS $3.8 billion; and another 10 at an average of $1 billion each.

To ordinary observers, the government's decision sounds like a waste of AIG's corporate assets. Geithner offered a strained rationale for his actions[45]:

> If we had sought to force counterparties to accept less than they were legally entitled to, market participants would have lost confidence in AIG and the ratings agencies would have downgraded AIG again. This could have led to the company`s collapse, threatened our efforts to rebuild confidence in the financial system, and meant a deeper recession, more financial turmoil, and a much higher cost for American taxpayers.

Government officials invested considerable effort in hiding these arrangements from the public. They succeeded, in part, as it would take three months before outsiders began to learn what the government was up to with AIG—and several years to learn the full scale of funding made to essentially every financial institution other than AIG. Among government's efforts at secrecy, in December 2008, after these payouts were completed, AIG's lawyers drafted and filed with the Securities and Exchange Commission an investor disclosure document that described how AIG had settled all these contracts at 100 cents on the dollar.[46] Before the filing was publicly released, AIG's general counsel reviewed it with the Fed, the company's controlling shareholder. The Fed objected to disclosing these facts, insisting that AIG's lawyers remove the statements. The SEC said it would only allow that if AIG filed a formal request for confidentiality, which the Fed insisted that it do.

Not until March 15, 2009, after snooping from the press and pressure from Congress, did the government reluctantly disclose these clandestine payouts.[47]

Howls of criticism resulted, as the government's actions in this matter were condemned in all subsequent official reports[48] and most media.[49] The scheme distorted markets and rewarded those who made bad bets on risky trades.[50] That created what is often referred to as "moral hazard," providing downside protection for peoples' excessively risky decisions. Nor was the scheme necessary: negotiating commercially reasonable discounts would have inflicted limited pain on the banks—which were substantially hedged on these trades[51]—and alleviated the punishing effects on AIG. To critics, it appeared as if cronyism rather than commercial sense drove government decisions.[52]

Not only did the government keep the terms of its dealings quiet, AIG was prohibited for speaking about them as well. The prohibition emanated from congressional grandstanding during debates about the government's intervention amid the crisis. One week after Paulson's decision to inject capital into AIG, Representative Harry Waxman of California showed a photograph during an open committee session of what he said was an AIG executive retreat at a lavish resort in Monarch Beach.[53] As other committee members and journalists piled on, Americans recoiled in disgust, venomously protesting the obscenity of "taxpayer money" funding such luxury. The party may have been today's version of the three-martini lunch that Greenberg decades ago squashed at AIG, though insiders say it was a party not for AIG executives but agents it relied on for business and was paid by insurance subsidiaries that did not receive government funds.[54] But it was one of a dozen examples of public protest against uses of funds by AIG—the ultimate revolt arose in March 2009 over bonuses AIG paid its FP executives.[55]

Responding to such uproars, AIG's government relations department decided to suspend its traditional activities, such as lobbying or edifying public opinion. The government liked AIG's reticence policy and insisted that the company commit to it in the takeover documents that Paulson and Geithner proposed and Liddy signed.[56] The clause cannot be changed without government approval.[57] AIG is therefore barred from publicly challenging any terms that government imposed, whether the taking of 79.9 percent of its equity, the appointment of Liddy as chief executive or any term of the loans. The clause, which remained in effect through the writing of this book, provided political cover to the officials, something they could point to as showing that government was controlling how taxpayer funds were being spent. The constraint on AIG remained tight, though by consultation between AIG's general counsel and the Fed, AIG is allowed to participate in limited lobbying on major pending legislation.

Another device the government used to protect the arrangements it implemented was even more extraordinary and permanent: the payout agreements the government had AIG sign with Goldman Sachs and the other banks contained AIG's binding release of the other side from any liability.[58] AIG surrendered any right to sue Goldman and the others for any reason.[59] On their face, such provisions seem out of place in the transactions. True, a settlement of claims would ordinarily include a release of liability, but in this case AIG was paying out 100 cents on the dollar, warranting them in releasing AIG, not the other way around.

A possible explanation is that AIG had rights against Goldman and other customers for any misrepresentations to AIG about the quality of mortgage securities pooled for coverage. In April 2010, the Securities and Exchange Commission filed a case against Goldman alleging it had fraudulently misrepresented the quality of similar pools in a transaction called Abacus. Goldman settled the case by paying $550 million.[60] The releases AIG signed, at the government's behest, seem to prevent AIG from filing similar claims against Goldman and other recipient banks, such as the $10 billion fraud suit AIG filed against Bank of America, which was not among the government-favored banks.[61]

The government went to great lengths to secure control over AIG, riding roughshod over state corporate law in the process. The preferred stock it demanded on day one was easy enough for the corporation to issue without the need for shareholder approval. But at the time, AIG's corporate charter did not authorize it to issue the large number of common shares the government sought. The charter authorized issuing 5 billion common shares, 3 billion of which were outstanding. One way to enable the government to own 79.9 percent of the total shares would be to increase the number of authorized shares to above 5 billion and issue all the unissued shares to the government. (For example, increasing the total authorized to more than 12 billion and issuing all but the 3 billion already outstanding to the government.) Changing AIG's corporate charter to increase the number of authorized common shares required a vote of the existing common shareholders voting as a separate group—not counting the government's preferred shares. That requirement is designed to protect the common shareholders because increasing the number of shares decreases each shareholder's percentage ownership interest (called "dilution" in corporate parlance).

Knowing this, the government's agreement with AIG called for proposing to amend AIG's corporate charter to increase the authorized common shares. A vote of the common shareholders would occur at the company's next annual shareholders' meeting set for June 2009. Company officials assured the shareholders, as well as a judge, that it would submit a proposal for a vote of the common shareholders voting as a group.[62] The company listed such a vote on the agenda for the meeting.[63] Expectably, the shareholders voted it down, since the dilution would be massive: someone owning 10 percent of the outstanding common shares before the vote would own only about 2 percent if the new shares were issued.

Anticipating that outcome, the government-directed AIG had added a second proposal to achieve its objective, one that it believed did not require a separate vote of the common shareholders but a vote in which it could cast its preferred share votes as well, guaranteeing victory. Rather than increasing the number of authorized shares above 5 billion, this approach would reduce the number of outstanding shares to significantly less than 5 billion. Called a "reverse stock split," the government proposed to reclassify each existing common share into one-twentieth of a share. As a result, only 150 million shares would be outstanding, leaving 4.85 billion that could be issued to the government. By that subterfuge, government forced formal shareholder "approval" of its equity takeover of AIG.[64]

Geithner subsequently offered different accounts of his thinking in all these decisions about AIG. He once contended that his purpose was to protect AIG policyholders.[65] AIG's policyholders, however, were not at risk, as its insurance subsidiaries were segregated by state law and under little financial pressure: they were liquid and solvent.[66] In fact, AIG's insurance subsidiaries were so safe and sound throughout its liquidity crunch that the New York State Insurance Department authorized the parent company to use $20 billion of subsidiary capital to ease the liquidity pressure.[67]

Ultimately, Paulson and Geithner chose a "public purpose" rationale for their actions. They said that their decision to seize AIG, impose punishing terms, and then exercise total control over it—including transferring substantial capital to Goldman Sachs—was to protect America from a financial meltdown, though without explaining exactly how that would occur. Testifying before Congress in January 2010, Paulson said,[68] "If AIG collapsed, it would have buckled our financial system and wrought economic havoc on the lives of millions of our citizens." Geithner echoed the testimony at the same time[69]:

> [We] were motivated solely by what we believed to be in the best interest of the American people. We did not act because AIG asked for assistance. We did not act to protect the financial interests of individual institutions. We did not act to help foreign banks. We acted because the consequences of AIG failing at that time, in those circumstances, would have been catastrophic for our economy and for American families and businesses.

By refusing to lend to AIG through the standard route of the Fed's discount window, the government failed to exercise its valid authority. An important purpose of the discount window is to provide short-term liquidity during credit crunches that threaten the economy. Lending helps healthy firms needing short-term bridges during a crisis period and is neither intended to sustain failing firms nor limited to banks. During the 2008–2009 crisis, however, the discount window was used to fund at least 100 banks that failed within a year and was closed to AIG despite its abundant long-term capital and ownership of a savings and loan association. Experts detected politics playing an inappropriate role in the Fed's decisions.[70] Had the Fed opened the discount window to AIG, FP's liquidity crisis would have been nipped in the bud.

There was no legal authority to permit the government to oust Willumstad or commandeer 79.9 percent of AIG's equity. Officials had authority to lend money to AIG, or anyone else, under the pre-Depression era statute creating the Fed. But while this statute also allowed the Fed to assume control of banks in extraordinary circumstances, it did not authorize the Fed to seize ownership of insurance companies or replace their senior executives. Nor did any laws Congress passed abruptly during the financial crisis, such as TARP, provide such authority. (In any event, TARP was not enacted until October, after Treasury's intervention at AIG.)[71]

Paulson, in his memoirs, suggested the shaky ground for his and Geithner's actions concerning AIG.[72] He recounted warnings he gave to President Bush about needing congressional authority as well as inconclusive meetings he held with congressional leaders.[73] They raised doubts about the legality of this seizure and told the Secretary he was acting not by the authority of Congress but on his own. Paulson was correct that his actions were not a "taxpayer bailout of AIG," at least not entirely. In significant part, they were a covert bailout of Goldman Sachs and Wall Street and foreign banks. Had officials in other countries seized property in similar circumstances, U.S. authorities, including Secretary Paulson and President Bush, would have cried foul, classifying it as nationalizing and expropriating private assets.[74] They would declare the action a violation of the rule of law and basic principles of a free society—values AIG embraced and projected worldwide for many decades and now found, paradoxically, its own government flouting.

Having ousted Willumstad and commandeered voting control of AIG, Paulson and Geithner's installation of Liddy as chief executive was effective for them. Liddy embraced the rationales Paulson and Geithner testified to, believing that his duty was not to AIG and its shareholders but to the public. Liddy testified[75]: "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."[76]

Days after the takeover, Paulson announced on *Meet the Press,* a national television show, that AIG was to be liquidated.[77] The selling of AIG's assets, which Liddy promptly began under what he called "Project Destiny,"[78] would continue for years. Such action became necessary due to the combination of punishing terms the government imposed and its decision to divert considerable capital to others. AIG had a greater need for liquid capital after government's intervention than before.

To obtain it, AIG was forced to sell substantial assets—at a time when global market conditions meant that they would fetch discounted prices. This put AIG on a debtor's treadmill: more payments due the government, in a short period of time at high interest rates, than its business generated. It had to keep selling assets, which further reduced revenue, ad infinitum. This prompted some experts to wonder whether, as structured, AIG could ever repay the government's loans and escape its clutch.[79] The compulsory sale of assets at discounts to repay the government was anguishing for the legions of AIG employees worldwide who dedicated their careers to building the businesses.[80]

Among the assets sold:

- AIA, the flagship Asian insurance company that was among AIG's most valuable assets.
- Philamlife, the crown jewel life insurance company in the Philippines, which AIG divested by first folding it into AIA for reasons that remain mysterious.
- ALICO, the prized global life insurance company.
- Trans Re, the reinsurance company acquired in 1968 and then grown into a force in reinsurance.
- Nan Shan, the life insurance company in Taiwan acquired in 1970 with the help of K. K. Tse.
- Hartford Steam Boiler, the fabled engineering and industrial equipment insurer that AIG acquired in 1999.
- AIG's investment in the Blackstone Group.
- Most of AIG's iconic buildings around the world, including its landmark 70 Pine Street headquarters building in New York and its storied Tokyo locale featuring a monumental sculpture of Starr installed at the 1974 dedication ceremony.

Many of these sales were made at prices the buyers considered a steal. AIG sold 70 Pine in 2009 for $150 million to a Korean investment firm; not two years later, that firm flipped the building, for $205 million, to a New York real estate developer for conversion into residential condominiums.[81] HSB was sold in 2008 for $742 million, down from AIG's 1999 purchase price of $1.2 billion, which the buyer's CFO said on a conference call was "very low."[82] The *Wall Street Journal* lampooned the very low price as reflecting a "giant neon 'fire sale' sign" hanging on AIG.[83]

Senior executives of Nippon Life Insurance Company, buyer of the Tokyo building, told Greenberg that they regarded the deal as an unbelievable bargain. For AIG employees in Japan, this sale to a competitor was an extraordinary loss of face. Nippon proceeded to tear the building down with plans to erect a larger more modern structure on the plot and adjoining land. It is not known what the parties did with the commemorative bust of Starr.

The piecemeal selling of discrete businesses, such as Nan Shan in Taiwan or HSB in the United States, neglected to capture the synergistic value of those operations within the broader AIG family. Sold as stand-alone entities, the going price was less than their value within broader business segments at AIG.

Management initially ran away from the AIG brand, rebranding many retained companies as "Chartis." Rebranding exercises are costly, likely reaching tens of millions of dollars, and of uncertain value.[84] AIG's decision must have assumed that 40 years of brand development became worthless or worse in a matter of months. Perhaps it did. But the move did not support favorable valuations of the AIG businesses being sold out of the family. These decisions attested to the short-term view AIG was operating under, which contradicted its traditional long-term horizon based on notions such as patient capital that were its trademark worldwide.

Hope eventually emerged that AIG could avert the course toward destruction. In early 2009, it had become clear that AIG needed new senior management. Greenberg urged Robert Benmosche, the distinguished former head of MetLife then in retirement, to take the position of CEO. After several discussions that met considerable resistance, Greenberg finally persuaded Benmosche to consider the job. In searching for a new CEO, the Fed took a leading role, and Geithner asked Greenberg for his assessment of Benmosche. Greenberg gave a ringing endorsement.

Benmosche became CEO of AIG in August 2009. He immediately began returning the company to its traditions and cultures and even restored the AIG brand name. He said that the company's ability to weather all the upheaval of the Spitzer assault and the U.S. government takeover was due to the outstanding workforce that Greenberg had assembled and left behind.[85] Those employees—the innovative, entrepreneurial and loyal backbone of AIG for decades—continue to give it promise today.

* * * * *

The government's takeover of AIG prompted SICO, AIG's largest shareholder after the government, to challenge the government action in a lawsuit. The Fifth Amendment of the U.S. Constitution directs that the U.S. government cannot deprive anyone of "property without due process of law" and forbids the government from appropriating private property "for public use, without just compensation." The government is not empowered to trample shareholder and property rights even in the midst of a financial emergency, SICO stressed. True, public policy goals can justify the taking of private property, the company acknowledged, but that does not change the requirement that government pay fair price for what it takes.

It may be necessary for government to intervene in private enterprise to rescue the country's financial system, but that does not change the constitutional mandate. Perhaps especially in the exigent circumstances of the financial crisis, government must not ignore basic legal and constitutional rights. The government's taking of an 79.9 percent equity stake for essentially no compensation, while separately providing loans that the company had to repay, and without a required shareholder vote, demanded due process and just compensation, SICO contended. [86] [

SICO also challenged how the Fed, as controlling shareholder of AIG, operated the company after assuming control. Under state corporation law, controlling shareholders such as the Fed owe fiduciary duties to their fellow shareholders, which SICO alleged the Fed breached.[87] The Fed breached these duties by causing AIG's credit default swap counterparties to be paid 100 cents on the dollar when they could have been compromised for substantially less than that, SICO argued. The government apparently wished to help recipients weather the crisis and do so in a way that avoided any need for the government to confront the public and political opposition its program almost certainly would have engendered, SICO said. That may or may not have been good public policy, but using AIG funds to assist other troubled financial institutions violated the Fed's duties as the controlling shareholder of AIG to its fellow shareholders. SICO also contended that the Fed likewise violated its duties when concealing these dealings for several months and in helping to orchestrate the issuance of a massive number of new common shares to deliver to the government in violation of state corporation law.

In both cases, SICO acknowledged that government had a legitimate interest in resolving the financial crisis but stressed that this interest did not give it a license to rob Peter to pay Paul. One objection to SICO's lawsuits against the government is that all government did was force AIG and its shareholders to bear the costs of risks it undertook in operating its business. But that is not an accurate or faithful account of what happened. The government's approach imposed on AIG the costs of the risky businesses engaged in by Goldman and the others. True, the public should not be obliged to pay for the costs of private risk taking, but neither should a private company be obliged to pay for the costs of private risk taking of other companies.

One might ask how AIG allowed itself to be treated as it was by the government. There appeared to be little push back. Granted, Willumstad and Frenkel sought feverishly to find liquidity sources. But they were rebuffed and seemed simply unable to persuade authorities of the dire straits. When it was finally AIG's turn for assistance, Paulson and Geithner gave an ultimatum to which the board surrendered within hours.

Greenberg would not have allowed any of this activity to proceed, and had he been in the boardroom that night, he simply would have told the government no. But suppose that the particular AIG board assembled that night felt that it had few choices. If so, that would be due to many decisions made during the previous 42 months. Those began in early 2005 with Eliot Spitzer's decision to threaten AIG without investigating and the capitulation to that pressure by PwC and the incumbent AIG board, with the assistance of lawyers from Paul Weiss and Simpson Thacher. These were followed in late 2005 and early 2006 by the radical changes in corporate governance and culture initiated by Arthur Levitt and embraced by Frank Zarb. A board and management ceased to exercise the disciplined, systematic methodologies that made AIG great, plunging the company into chaos. Paulson, a wise man of Wall Street who heard Spitzer's speech indicting Greenberg back in February 2005, surely detected this disarray in September 2008. Like dogs sensing weakness, he and the Goldman alumni on his staff may have found it convenient to roll over AIG in order to prop up their old firm. Geithner, who implemented much of the nationalization of AIG, may have found it appealing to protect the favored financial institutions he oversaw as president of the New York Fed. But he did not act alone.

Notes

1. GAO Report (September 2011), 19.
2. Willumstad made informal overtures to the Fed on July 29 and a formal application on September 9, with various informal efforts in between. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; see Andrew Ross Sorkin, *Too Big To Fail* (New York: Viking, 2009), 207–209, 235–237.
3. FCIC Report, 344.
4. Ibid.
5. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; letter from Greenberg to Willumstad, September 16, 2008).
6. Bradley Keoun and Craig Torres, "Foreign Banks Tapped Fed's Secret Lifeline Most at Crisis Peak," *Bloomberg* (April 1, 2011); Neil Irwin, "Files Shed Light on Fed Lending Activity," *Washington Post* (April 1, 2011); Luca Di Leo and Maya Jackson Randall, "Fed Disclosure May Hurt Banks' Discount-Window Use," *Dow Jones Business News* (March 31, 2011).
7. See Bradley Keoun and Phil Kurtz, "Wall Street Aristocracy Got $1.2 Trillion in Secret Loans," *Bloomberg* (August 22, 2011).
8. David Ellis, "Citi Dodges Bullet," *CNN Money* (November 24, 2008).
9. See "The Hartford Sells Its Fla. TARP Bank," *Hartford Business* (November 14, 2011).
10. See Joe Nocera and Edmund L. Andrews, "Struggling to Keep Up as the Crisis Raced On," *New York Times* (October 23, 2008).
11. FCIC Report, 345.
12. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; see Sorkin, *Too Big To Fail,* 290.
13. FCIC Report, 347–349.
14. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; see Sorkin, *Too Big To Fail,* 224–227, 293, 316–317.
15. Factors Affecting Efforts to Limit Payments to AIG Counterparties Office of the Special Inspector General for the Troubled Asset Relief Program (Nov. 17, 2009) (hereafter called the SIG-TARP Report), 8; GAO Report (September 2011), 21–22.
16. Cunningham and Greenberg interview with Robert Willumstad, New York, May 16, 2012.
17. See Peg Brickley, "Lehman Makes It Official in Overnight Chapter 11 Filing," Wall Street Journal (September 15, 2008).
18. FCIC Report, 349; SIG-TARP Report, 8.

19. Warren Oversight Report.

20. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; see Sorkin, *Too Big To Fail,* 388.

21. Ibid.; Sorkin, *Too Big To Fail,* 393.

22. Paulson repeatedly urged all concerned not to call his decisions concerning AIG a "bailout," stressing that he was throttling shareholders, and protecting American taxpayers. Henry M. Paulson Jr., *On the Brink: Inside the Race to Stop the Cololapse of the Global Financial System* (New York: Business Plus, 2010), 233, 240.

23. See David Wessel, *In Fed We Trust: Ben Bernanke's War on the Great Panic* (New York: Crown Business, 2009), 196–197.

24. The odd ownership percentage figure was chosen for accounting reasons—so the government would not need to consolidate AIG on its own books. Later, the government would adjust some of these terms, doubling the loan amount, reducing the interest rate somewhat, and extending the repayment period to five years.

25. Cunningham and Greenberg interview with Robert Willumstad, New York, May 14, 2012; see Wessel, *In Fed We Trust,* 196; Sorkin, *Too Big To Fail,* 401, 406.

26. Paulson, *On the Brink,* 239 (Paulson recounting that he called Willumstad "to tell him that he was being replaced"); Sorkin, *Too Big To Fail,* 403.

27. Paulson, *On the Brink,* 241.

28. Sorkin, *Too Big To Fail,* 402.

29. SIG-TARP Report, 6.

30. Sorkin, *Too Big To Fail,* 404 (noting comments of AIG directors Virginia Rometty and James Orr).

31. Liddy resigned from the Goldman Sachs board on September 23, 2008. See Goldman Sachs press release, "Edward Liddy Resigns from Goldman Sachs Board of Directors" (September 26, 2008).

32. See Timothy P. Carney, "AIG Head's $3 Million in Goldman Stock Raises Apparent Conflict of Interest," *Washington Examiner* (April 8, 2009).

33. GAO Report (September 2011), 35–37; SIG-TARP Report, 6; see Wessel, *In Fed We Trust,*196–197.

34. Cunningham e-mail from Willumstad, July 23, 2012.

35. AIG press release, "AIG Signs Definitive Agreement with Federal Reserve Bank of New York for $85 Billion Credit Facility" (September 23, 2008); press release, "Edward Liddy Resigns from Goldman Sachs Board of Directors" (September 26, 2008).

36. Cunningham e-mail from Willumstad, July 23, 2012.

37. Warren Oversight Report, 9.

38. See SIG-TARP Report, 30, 19.

39. GAO Report (September 2011), 72.

40. Warren Oversight Report, 9; SIG-TARP Report, 19, 29–30; FCIC Report, 378 (noting that that government's decision to pay 100 cents on the dollar "has been widely criticized").

41. GAO Report (September 2011).

42. GAO Report (September 2011), 71.

43. GAO Report (September 2011), 71.

44. See FCIC Report, 353.

45. U.S. Treasury Press Center, Secretary [Geithner] Written Testimony before the House Committee on Oversight and Government Reform (January 27, 2010).

46. GAO Report (September 2011), 94–101.

47. Gretchen Morgenson, "At A.I.G., Good Luck Following the Money," *New York Times* (March 14, 2009); Andrew Frye and Hugh Son, "Geithner Says AIG Rescue Avoided 'Utter Collapse,'" *Bloomberg News* (January 27, 2010).

48. Warren Oversight Report, 9–10.

49. See, for example, Richard Teitelbaum and Hugh Son, "New York Fed's Secret Choice to Pay for Swaps Hits Taxpayers," *Bloomberg* (October 27, 2009); Serena Ng and Carrick Mollenkamp, "Goldman Fueled AIG Gambles," Wall Street Journal (December 12, 2009); David Skeel, "A Nation Adrift from the Rule of Law," Wall Street Journal (August 21, 2012).

50. Warren Oversight Report, 10.

51. FCIC Report, 202.

52. Warren Oversight Report, 9–10.

53. See, for example, Peter Whoriskey, "After Bailout, AIG Executives Head to Resort," *Washington Post* (October 7, 2008).

54. Cunningham telephone interview with Axel Freudmann, April 11, 2012.

55. See Lawrence A. Cunningham, "AIG's Bonus Blackmail," *New York Times* (March 18, 2009).

56. The AIG Lobbying Policy appears as Appendix H on the companion web site for this book, at www.wiley.com/go/theaigstory.

57. AIG Lobbying Policy; Section 6.04(e) of the Treasury-AIG Recapitalization Agreement.

58. See FCIC Report, 376 ("A condition of [the 100 cents settlements] was that AIG waive its legal claims against those counterparties.").

59. Louise Story and Gretchen Morgenson, "In U.S. Bailout of A.I.G., Forgiveness for Big Banks," *New York Times* (June 29, 2010).

60. See *Securities and Exchange Commission v. Goldman, Sachs & Co.,* Litigation Release No. 21489 (April 16, 2010).

61. See Louise Story and Gretchen Morgenson, "A.I.G. Sues Bank of America Over Mortgage Bonds, *New York Times* (August 8, 2011).

62. *Walker v. AIG,* Civil Action No. 4142-CC, Stipulation and Order of Dismissal, premised upon the following undertaking:

    AIG's counsel stated that any amendment to the Restated Certificate of Incorporation to increase the number of authorized common shares or to decrease the par value of the common shares would be the subject of a class vote by the holders of the common stock, and, based on this representation, plaintiff's counsel agreed that the plaintiff's request for an order granting this relief is moot. . . .

63. Press release, "AIG Announces Voting Results of Annual Meeting of Shareholders" (June 30, 2009).

64. In late 2012, SICO filed a lawsuit challenging this subterfuge. The Delaware corporate statute states that charters can be amended, including to effectuate a reverse stock split, § 242(a), and amendments require both board and shareholder approval. §242(b)(1). Separate shareholder votes by class are required whenever an amendment "would increase or decrease the aggregate number of authorized shares of such class" or "alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely." § 242(b)(2). A reverse stock split "increase[s]" the "number of authorized shares of [the common stock]" and therefore should require a class vote. See also *Sellers v. Joseph Bancroft & Sons Co.,* 2 A.2d 108 (Del. Ch. 1938).

    AIG promised in the settlement of the lawsuit to hold such a class vote but failed to do so. The government might argue that its purpose in effectuating the reverse stock split was proper, intended to restore luster to the battered stock, putting its trading price back in double rather than single digits. Relatedly, that may have been necessary to maintain its NYSE listing, where rules provide for delisting of stocks that trade below $1 for sustained periods as AIG common threatened. But while that purpose might help defend or explain the motives, SICO argued that it does not satisfy the Delaware statute's requirements. Shareholder voting rights are sacrosanct in corporate law. See *Paramount Communications v. QVC Network Inc.,* 637 A.2d 34, 42 (Del. 1994) ("Because of the overriding importance of voting rights [we] have consistently acted to protect stockholders from unwarranted interference with such rights.").

65. Joint Economic Committee, Hearing on Financial Regulatory Reform (November 19, 2009); see http://big.assets.huffingtonpost.com/geithnertestimonyaig.pdf.

66. See Arthur D. Postal, "NAIC Disagrees with Geithner and Paulson On AIG," *National Underwriter Life & Health Magazine* (February 4, 2010) (referencing letter from state insurance regulators challenging Geithner's position).

67. Cunningham and Greenberg interview with Robert Willumstad, New York, May 16, 2012; see FCIC Report, 348; Sorkin, *Too Big To Fail,* 382. The New York Insurance Department was later reorganized and merged into a new Banking Department.

68. Testimony by Henry M. Paulson before the House Committee on Oversight and Government Reform (January 27, 2010).

69. U.S. Treasury Press Center, Secretary [Geithner] Written Testimony before the House Committee on Oversight and Government Reform (January 27, 2010).

70. See Binuyamin Appelbaum & Jo Craven McGinty, "Fed Help Kept Banks Afloat, Until It Didn't," *New York Times* (April 4, 2011) (noting failure of 111 banks despite Fed discount window funding and quoting Charles Calomiris, Columbia University finance professor and historian of the Fed's discount window operations: "the Fed has become more politicized than at any point in its history, and I do worry very much that a lot of Fed discount window lending may just be part of a political calculation.").

71. The government officials were thus acting under the authority of their offices but engaged in unlawful conduct while doing so. See *Starr Int'l Co. v. United States,* No. 11-779C (Ct. Fed. Claims, July 2, 2012) (opinion denying most of the government's motion to dismiss and addressing the distinction between unauthorized conduct and authorized but unlawful conduct).

72. Paulson, *On the Brink,* 236-241.

73. Paulson explained that on Sunday September 14, when addressing the failing Lehman Brothers, he "warned [President Bush] that we might have to ask Congress for broader powers to stabilize the financial system [but two days later when addressing] the fire-alarm emergency of AIG, I didn't raise the issue of going to Congress again." Paulson, On the Brink, p. 237. Paulson recounts that he "next had to make arrangements to go to the Hill. . . as we probably would need to meet with congressional leaders to discuss [the takeover of AIG]." P. 239. Paulson met with Congressional leaders, including Harry Reid, Chris Dodd, Judd Gregg, John Boehner and Barney Frank. Ibid., p. 240-41. Paulson reports that "Dodd asked twice how the Fed had the authority to lend to an insurance company and seize control of it." Paulson says Ben Bernanke, Fed chairman, "explained how Section 13(3) of the Federal Reserve Act allowed the central bank to take such actions under 'unusual and exigent' circumstances.' It was the same provision the Fed had used to rescue Bear Stearns." Section 13(3) of that statute did not authorize the Fed to seize control of private property and the constitutionality of any such provision would be doubtful. It authorizes making loans to anyone, banks or others. Paulson reports candidly: "In the end, [Senator] Reid said: 'You've heard what people have to say. But I want to be absolutely clear that Congress has not given you formal approval to take action. This is your responsibility and your decision." Ibid., p. 241.

74. Only a handful of such exertions of government power have occurred in the United States—the Tennessee Valley Authority, Amtrak, and Conrail are the prime examples.

75. Testimony by Mr. Edward M. Liddy before the House Committee on Oversight and Government Reform (March 18, 2009).

76. Ibid. Federal Reserve chairman Ben Bernanke joined the chorus:

The AIG takeover was "a difficult but necessary step to protect our economy and stabilize our financial system [as AIG's] failure under the conditions then prevailing would have posed unacceptable risks for the global financial system and for our economy. [AIG's] failure could have resulted in a 1930s-style global financial and economic meltdown, with catastrophic implications for production, income, and jobs."

Chairman Ben S. Bernanke, Before the House Committee on Oversight and Government Reform (March 24, 2009).

77. Transcript, Tom Brokaw, "The American Financial System in Deep Crisis," Meet the Press (Sept. 21, 2008).

78. Guaazardi, Grose, et al., "Worth the Risk, chap. 23, p. 7.

79. Warren Oversight Report, p. 10.

80. Guaazardi, Grose, et al., "Worth the Risk", chap. 23, p. 8 (asset sales "represented a very deep blow to the morale of AIG employees around the world").

81. C. J. Hughes, "Rentals Offered, with Bragging Rights," *New York Times* (March 22, 2012).

82. Associated Press, "AIG Sells Hartford Steam Boiler for $742 Million" (December 22, 2008). The price was about 4.6 times earnings and no more than 1.5 times book value.

83. Heidi N. Moore, "AIG: Paying Off a $60 Billion Loan, One $742 Million Deal at a Time," *Wall Street Journal,* Deal Journal Blog (December 22, 2008).

84. See Ed Leefeldt, "AIG Rebrands Itself, But at What Cost?" CBS News (March 23, 2009).

85. Cunningham interview with Robert Benmosche, New York, September 12, 2012.

86. In SICO's case against Treasury, the Court of Federal Claims mostly denied the government's early motion to dismiss the case. *Starr Int'l Co. v. United States,* No. 11-779C (Ct. Fed. Claims, July 2, 2012).

87. The facts of the government takeover of AIG are unprecedented and the setting raises a host of novel issues. See Marcel Kahan & Edward B. Rock, "When the Government Is the Controlling Shareholder," *Texas Law Review* 89 (2011): 1293; Barbara Black, "The U.S. as 'Reluctant Shareholder': Government, Business and the Law, *Entrepreneurial Business Law Journal* (2010); J. W. Verret, "Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice," *Yale Journal on Regulation* 27 (2010): 283.