

**U.S. House of Representatives**  
**Committee on Oversight and Government Reform**  
**Darrell Issa (CA-49), Ranking Member**



Public Disclosure As A Last Resort:  
How the Federal Reserve Fought to Cover Up  
the Details of the AIG Counterparties Bailout  
From the American People

**Special Report**  
**U.S. House of Representatives**  
**111<sup>th</sup> Congress**  
**Committee on Oversight and Government Reform**  
**January 25, 2010**

On Wednesday, January 27, 2010, at 10:00 a.m., in room 2154 of the Rayburn House Office Building, the Committee will hold a hearing entitled, “Factors Affecting Efforts to Limit Payments to AIG Counterparties.” The hearing will examine the federal bailout of American International Group (“AIG”), the payment of \$62.1 billion to counterparties of AIG’s credit default swaps (“CDS”), and efforts to conceal information about these payments from the American people.

## **INTRODUCTION AND BACKGROUND: THE AIG BAILOUT**

Starting in 2007, AIG began to suffer financial difficulties due, primarily, to payments of collateral to counterparty institutions that had purchased insurance from AIG on complex financial assets, including bundles of sub prime mortgages, through insurance-like derivatives contracts called credit default swaps.<sup>1</sup> These derivatives contracts were sold by AIG Financial Products (“AIG FP”), a subsidiary of AIG.<sup>2</sup>

On September 15, 2008, the three major credit ratings agencies downgraded AIG’s credit rating due to rising calls for AIG to post billions of dollars in cash collateral.<sup>3</sup> These collateral calls, combined with the ratings downgrade (which triggered calls for more collateral under the terms of the contracts), put AIG on the verge of a bankruptcy filing.<sup>4</sup> The following day, September 16, 2008, the Federal Reserve Board, with the support of the Treasury Department (“Treasury”), authorized the Federal Reserve Bank of New York (“FRBNY”) to lend up to \$85 billion to AIG to enable AIG to avoid filing for bankruptcy.<sup>5</sup> Federal officials claimed that an AIG bankruptcy would lead to systemic consequences across the U.S. and international economies.<sup>6</sup>

AIG subsequently received billions of dollars in additional taxpayer assistance, from both the Federal Reserve and Treasury. As of September 2009, AIG had received a total of \$120 billion out of a total credit line of \$182 billion.<sup>7</sup>

## **THE FRBNY REJECTS ALTERNATIVES TO PAYING AIG’S COUNTERPARTIES AT PAR**

Throughout September and October of 2008, AIG continued to post collateral to its CDS counterparties, and by November 5, 2008, AIG had drawn down approximately \$61 billion of its initial \$85 billion line of credit from the FRBNY.<sup>8</sup> These payments and related loss of liquidity led to concerns that the ratings agencies would further downgrade AIG’s credit rating, which, according to the FRBNY, “would have been catastrophic and would most likely have led to an AIG bankruptcy.”<sup>9</sup> Throughout this period, AIG was negotiating with its counterparties in an attempt to get the counterparties to accept cash

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<sup>1</sup> See SIGTARP, “Factors Affecting Efforts to Limit Payments to AIG Counterparties,” November 17, 2009. Available at [http://www.sig tarp.gov/reports/audit/2009/Factors\\_Affecting\\_Efforts\\_to\\_Limit\\_Payments\\_to\\_AIG\\_Counterparties.pdf](http://www.sig tarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf)

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> See “Status of Government Assistance Provided to AIG,” Government Accountability Office, September 2009. Available at <http://www.gao.gov/new.items/d09975.pdf>.

<sup>8</sup> See SIGTARP, note 1, *supra*.

<sup>9</sup> *Id.*

payments (in addition to the collateral AIG had already posted) in exchange for winding down, or tearing up, the CDS contracts.<sup>10</sup> On October 31, after AIG had failed to convince its counterparties to wind down the CDS contracts, the FRBNY ordered AIG to “stand down on all discussions with counterparties.”<sup>11</sup>

The FRBNY evaluated multiple options for dealing with the liquidity problems related to AIG’s counterparties’ collateral demands.<sup>12</sup> According to Elias Habayeb, a former AIG employee, he and another AIG employee presented ideas for mitigating these liquidity problems to FRBNY officials on September 30, 2008.<sup>13</sup> According to the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”), Blackrock Solutions, a firm hired by FRBNY to evaluate AIG’s liquidity needs, presented similar ideas to the FRBNY between late October and early November 2008.<sup>14</sup>

One idea presented to FRBNY officials would have allowed the counterparties to keep the underlying assets and the protection provided by the credit default swaps. Under this option, the obligation to perform under the contract would have been transferred from AIG to a special purpose vehicle (“SPV”) funded by the FRBNY, in exchange for the counterparties agreeing to waive any further collateral calls.<sup>15</sup> FRBNY officials cited a lack of statutory authority in rejecting this option.<sup>16</sup> This excuse is problematic, as the Federal Reserve guaranteed assets against losses in bailouts of other firms during the height of the financial crisis.<sup>17</sup>

Another option would have involved the sale of the underlying assets to an FRBNY-financed SPV, with the counterparties maintaining some interest in the assets and the FRBNY holding a senior note to be repaid first when the assets regained value.<sup>18</sup> FRBNY officials also rejected this option, claiming insufficient time to negotiate these deals with AIG’s counterparties.<sup>19</sup>

The final option, which the FRBNY ultimately selected on November 3, 2008, was to purchase the underlying assets insured by the CDS contracts from AIG’s counterparties, through funding provided by the FRBNY into a special purpose vehicle called Maiden Lane III (“ML3”).<sup>20</sup> FRBNY officials argued that by purchasing the underlying assets from the counterparties, canceling the CDS contracts, and compensating the counterparties at par, or 100 cents on the dollar, the counterparties would agree to the

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<sup>10</sup> *Id.*

<sup>11</sup> See email from Elias Habayeb to David Herzog, October 31, 2008. Bates #AIGHORGM0014.

<sup>12</sup> See SIGTARP, note 1, *supra*.

<sup>13</sup> Committee staff interview with Elias Habayeb, January 20, 2010.

<sup>14</sup> See SIGTARP, note 1, *supra*.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> The Federal Reserve guaranteed assets against losses in the Bear Stearns – JP Morgan Chase merger, the Bank of America bailout, and the Citigroup bailout. As David Wessel notes in his book on the financial crisis, *In Fed We Trust*, the Federal Reserve repeatedly used creative and innovative techniques to broadly interpret its statutory authority and get around potential legal obstacles. Assuming, *arguendo*, that FRBNY officials were correct, at a minimum the Federal Reserve could have come to Congress and requested targeted authority to adopt this approach if necessary.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

transactions and AIG would no longer have to post collateral, easing its liquidity problems and avoiding another credit rating downgrade.<sup>21</sup>

### **THE FRBNY “NEGOTIATES” WITH AIG’S COUNTERPARTIES: “I DON’T KNOW WHY WE EVEN BOTHERED TO ASK”**

After consulting with the Federal Reserve Board and Treasury, the FRBNY informed AIG of its decision.<sup>22</sup> On November 6, 2008, AIG requested that the FRBNY engage in discussions with its counterparties.<sup>23</sup> Over two days, between November 6 and 7, 2008, the FRBNY “negotiated” with AIG’s counterparties to determine the price that would be paid for the underlying assets that ML3 would acquire from the counterparties.<sup>24</sup>

According to SIGTARP:

FRBNY developed talking points for its staff for these negotiations. The talking points stressed that *participation in concession negotiations with FRBNY was voluntary....*<sup>25</sup> [emphasis added]

Thus, the FRBNY essentially began the discussions with the counterparties with a disclaimer that they had no obligation whatsoever to agree to any concessions. The fact that there was no serious attempt at real negotiations was confirmed in an interview Committee staff conducted with Tom Baxter, General Counsel of the FRBNY, on January 21, 2010. Mr. Baxter was uncomfortable with the term “negotiations” to describe these discussions.<sup>26</sup> He said, “I don’t know why we even bothered to ask [for any concessions].”<sup>27</sup> When asked why the FRBNY bothered, Mr. Baxter responded, “I guess it doesn’t hurt to ask.”<sup>28</sup>

The response of the counterparties reflected the lack of serious negotiations. While one counterparty, UBS, said it would accept a haircut of two percent below par if all of the other counterparties also granted a similar concession, all of the other counterparties rejected the FRBNY’s request.<sup>29</sup> These discussions ended quickly, and on November 10, 2008, the Federal Reserve Board formally approved the establishment and funding of Maiden Lane III.<sup>30</sup> These decisions began the backdoor bailout of AIG’s counterparties, and the direct payment of \$27.1 billion of taxpayer money (and the waiver of an additional \$35 billion in collateral) to the largest banks in the U.S. and around the world.<sup>31</sup> (For a list of AIG’s counterparties and the payments they received, see Appendix II below.)

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<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> Committee staff interview of Tom Baxter, General Counsel, FRBNY, January 21, 2010.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> See SIGTARP, note 1, *supra*.

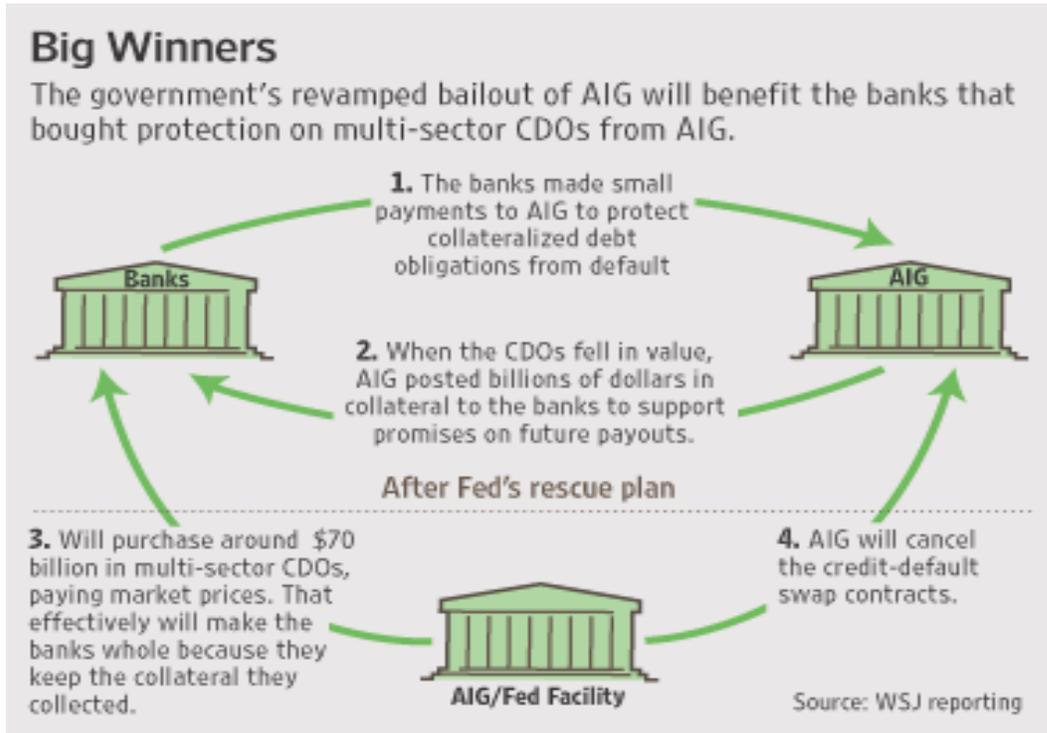
<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

## THE FRBNY PAYS PAR

After AIG's counterparties rejected the FRBNY's request for concessions and the FRBNY created ML3, the FRBNY compensated the counterparties at par – 100 cents on the dollar. The FRBNY transferred \$27.1 billion through ML3 to the counterparties, *and allowed the counterparties to keep an additional \$35 billion* that had already been posted as collateral by AIG, for a total of \$62.1 billion, equal to the total par value of the assets.<sup>32</sup> The collateral, some of which had been posted before AIG received its initial bailout on September 16, 2008, and some of which had been posted subsequent to the initial bailout, had been obligated to be returned to AIG if/when the value of the assets recovered in value or the term of the contracts expired. Instead, the FRBNY allowed the counterparties to permanently keep the collateral *and* the FRBNY paid the counterparties an additional amount of money to bridge the gap between the collateral that had already been posted and the face value of the assets, meaning that each counterparty received par.<sup>33</sup>

The following diagram illustrates the structure of the backdoor bailout of AIG's counterparties:<sup>34</sup>



<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> This diagram is reprinted from "New AIG Rescue Is Bank Blessing," *Wall Street Journal*, November 12, 2008.

## **TREASURY AND FED PROPAGATE MYTH THAT TAXPAYERS WILL PROFIT FROM COUNTERPARTY PAYMENTS**

Officials from the Federal Reserve and the Treasury Department have repeatedly attempted to mislead the American people into believing that these transactions were a responsible use of taxpayer money. For example, Treasury spokesman Andrew Williams recently argued,

Those investments have turned out to be very sensible, and the fund at the center of the controversy [ML3] is on track to return every dollar to taxpayers, and may well yield a profit.<sup>35</sup>

These claims assume that one focuses only on the \$27.1 billion in direct outlays to AIG's counterparties, and measures the current value of the securities in ML3 against this price. However, this comparison is deceptive and dishonest, since it ignores the fact that the FRBNY also allowed the counterparties to keep *an additional* \$35 billion in collateral. The collateral was obligated to be returned to AIG as the value of the underlying assets recovered, or the term of the contract expired. Thus, allowing the counterparties to permanently keep the collateral represented a significant cost to AIG (and to the American taxpayers, who own approximately 80% of the company). When the value of the assets of ML3 is measured against the total cost of the counterparty payments, the idea that taxpayers will profit is ludicrous.

## **GEITHNER ADMITS LEADING ROLE IN DECISION TO PAY COUNTERPARTIES AT PAR**

Treasury Secretary Timothy Geithner served as the President of the FRBNY until he was confirmed by the Senate on January 26, 2009.<sup>36</sup> The Treasury Department claims that Secretary Geithner recused himself "from working on issues involving specific companies, including AIG," when he was nominated to his current position on November 24, 2008.<sup>37</sup>

According to SIGTARP's report on the counterparty payments:

At the end of the day on November 7 [2008], after FRBNY officials had received negative reactions from seven of the eight counterparties, ... senior FRBNY officials met with then-President Geithner. After discussing the counterparties' reactions, ... the officials recommended to President Geithner that the [ML3] transactions go forward without haircuts because it would be impractical to obtain haircuts from all the counterparties. Mr. Geithner concurred, and it was decided that FRBNY would cease efforts to negotiate haircuts.... FRBNY officials then communicated this recommendation to officials of the Federal Reserve Board, who assented.<sup>38</sup>

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<sup>35</sup> See "A Rift at the Fed Over the Bailout of A.I.G.," *New York Times*, January 23, 2010. Available at <http://www.nytimes.com/2010/01/23/business/economy/23aig.html>.

<sup>36</sup> See Timothy F. Geithner, Federal Reserve Bank of New York. Available at <http://www.newyorkfed.org/aboutthefed/orgchart/geithner.html>.

<sup>37</sup> See "Lawmakers Call on Geithner to Testify About Concerns Over AIG Bailout," *The Hill*, January 8, 2010. Available at <http://thehill.com/homenews/administration/74957-lawmakers-call-on-geithner-to-testify-about-aig-bailout-concerns>.

<sup>38</sup> See SIGTARP, note 1, *supra*.

Secretary Geithner has since vigorously defended his decision to pay the counterparties at par, saying that it was “absolutely” the right thing to do.<sup>39</sup>

### **IMMEDIATELY AFTER GEITHNER MADE THE DECISION TO PAY THE COUNTERPARTIES AT PAR, THE FRBNY BEGAN TO COVER UP DETAILS ABOUT THE TRANSACTIONS**

After the public announcement of the Maiden Lane III transactions, the FRBNY tried to cover up the fact that AIG’s counterparties were receiving par in exchange for the underlying assets. On November 11, 2008, FRBNY Assistant Vice President Alejandro Latorre edited a draft request for proposals for banking services for the ML3 transactions. The draft request for proposals included a sentence revealing that the counterparties had received par.<sup>40</sup> Latorre deleted the sentence and e-mailed his colleagues: “As a matter of course, *we do not want to disclose that the concession is at par unless absolutely necessary.*”<sup>41</sup> [emphasis added]

The FRBNY’s desire to prevent disclosure of the counterparties’ windfall was very clear within AIG. On the same day as Latorre’s e-mail at the FRBNY, Elias Habayeb, CFO of AIG FP, recommended to AIG’s financial and communications officials that the company explain the transaction to the public:

There seems to be a lot of confusion as to the price at which these transactions are being terminated. I think we should be clear on that point. The total cost of terminating the CDS and buying the underlying super senior CDO bond held by the counterparty is par ... The only price being negotiated with the counterparty is the total price ... and the Fed offered all counterparties par.<sup>42</sup>

Senior Vice President for Communications Nicholas Ashooh responded to Habayeb:

This would be very helpful, but I understand that the Fed is very sensitive and we have to clear it with them.<sup>43</sup>

### **THE FRBNY AND ITS LAWYERS EDITED AIG’S SEC FILINGS TO REMOVE INFORMATION ABOUT THE PAYMENTS TO AIG’S COUNTERPARTIES**

In September 2008, after its first round of bailouts from the FRBNY, AIG agreed to submit all of its filings to the Securities and Exchange Commission (“SEC”), press releases, and other “significant” communications to the FRBNY’s counsel, Davis Polk & Wardwell (“Davis Polk”).<sup>44</sup> Starting in October 2008, the FRBNY and Davis Polk reviewed and edited all of AIG’s draft SEC filings – including its regular quarterly and annual financial reports, its shareholder meeting announcements, and its reports on

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<sup>39</sup> See interview of Secretary Geithner on CNBC, January 14, 2010.

<sup>40</sup> Draft Request for Proposals, Nov. 11, 2008, BATES #FRBNY-TOWNS-R3-025895 (Showing deleted sentence: “As consideration for the Transaction, the counterparties will be paid aggregate consideration equal to the total notional exposure of the CDS Transactions as of the date they are terminated, subject to technical adjustments and true-ups”).

<sup>41</sup> Email from Alejandro Latorre to Paul Whynott and others, Nov. 11, 2008, BATES #FRBNY-TOWNS-R1-191773 (emphasis added).

<sup>42</sup> E-mail from Elias Hayabeb to Nicholas Ashooh and others, Nov. 11, 2008, BATES #AIGHOGRM0074.

<sup>43</sup> E-mail from Nicholas Ashooh to Elias Hayabeb and others, Nov. 11, 2008, BATES #AIGHOGRM0074.

<sup>44</sup> E-mail from Sarah Dahlgren to Thomas Baxter and others, Sept. 19, 2008, BATES #FRBNY-TOWNS-R3-002401.

executive compensation changes and major contracts.<sup>45</sup> Moreover, AIG's SEC disclosure became a government group project: the FRBNY and Davis Polk shared draft filings with the Treasury Department as well.<sup>46</sup>

Under the securities laws, AIG was required to report its transactions with ML3 to the SEC. On December 2, 2008, AIG reported ML3's formation and its first round of transactions, which had occurred seven days earlier.<sup>47</sup> AIG made a second filing on December 24, 2008, describing ML3's second round of transactions.<sup>48</sup>

Davis Polk edited both the December 2 filing and the December 24 filing, and the press releases that AIG issued along with these filings. Some of Davis Polk's edits tended to obscure controversial details of the transactions. For example, the proposed December 24 filing included a sentence referring to par value: "As a result of this transaction, the AIGFP counterparties received 100 percent of the par value of the Multi-Sector CDOs sold and the related CDS have been terminated." Davis Polk attorneys crossed out this sentence.<sup>49</sup>

#### **THE FRBNY DIRECTLY INTERVENED WITH THE SEC TO PREVENT INFORMATION ABOUT THE AIG COUNTERPARTY PAYMENTS FROM BECOMING PUBLIC**

AIG's two December 2008 SEC filings describe the transactions between AIG, the FRBNY, and ML3. Following its usual procedure, AIG included copies of the agreements it signed with the FRBNY and ML3 as exhibits to the draft filings. E-mails between FRBNY officials indicate that they wanted to keep these agreements secret from the SEC and the public.<sup>50</sup> When these officials learned that AIG intended to include the agreements as part of its SEC filings, they objected. FRBNY Assistant Vice President Alejandro LaTorre asked, "But can [AIG] make these docs public without our consent? Aren't we parties to this and shouldn't we have a say?"<sup>51</sup> However, Davis Polk advised the FRBNY that SEC rules required the contracts to be disclosed.<sup>52</sup>

The FRBNY was particularly concerned about the potential disclosure of an attachment to an agreement between AIG and ML3. This attachment, known as "Schedule A," included the names of all of AIG's counterparties, the identification numbers of each transaction, and the prices at which ML3 was purchasing the underlying assets. In the end, AIG's filings on December 2, 2008, and December 24, 2008, included the agreements between AIG and ML3 but omitted Schedule A.<sup>53</sup>

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<sup>45</sup> See, e.g., e-mail from Michel Beshara, Davis Polk, to Eric Bishop, Morgan Stanley, Oct. 23, 2008, BATES #FRBNY-TOWNS-R1-028075 (attaching copy of draft quarterly report); e-mail from Peter Bazos, Davis Polk, to Andrea Stan, Davis Polk, April 3, 2009 (attaching copy of draft annual report).

<sup>46</sup> See, e.g., e-mail from Peter Bazos, Davis Polk, to Stephen Albrecht, Treasury, and others, Dec. 2, 2008, BATES #FRBNY-TOWNS-R1-012739.

<sup>47</sup> AIG Form 8-K, filed Dec. 2, 2008.

<sup>48</sup> AIG Form 8-K, filed Dec. 24, 2008.

<sup>49</sup> E-mail from Joel Pulliam to Kathleen Shannon, Dec. 23, 2008, BATES #AIGHOGRM2198 (attaching PDF scan of handwritten edits).

<sup>50</sup> See E-mail from Alejandro LaTorre to James Bergin and others, Nov. 24, 2008, BATES #FRBNY-TOWNS-R3-007544; E-mail from HaeRan Kim to James Bergin and others, Nov. 25, 2008, BATES #FRBNY-TOWNS-R3-007543.

<sup>51</sup> E-mail from Alejandro LaTorre to James Bergin and others, Nov. 24, 2008, BATES #FRBNY-TOWNS-R3-007544.

<sup>52</sup> E-mail from James Bergin to HaeRan Kim and others, Nov. 25, 2008, BATES #FRBNY-TOWNS-R3-007543.

<sup>53</sup> AIG Form 8-K, filed Dec. 2, 2008, and AIG Form 8-K, filed Dec. 24, 2008.

At the end of 2008, the SEC objected to the absence of Schedule A from AIG's filings, and ordered AIG to either file Schedule A publicly or provide it to the SEC for review along with a request for confidential treatment.<sup>54</sup> When officials at the FRBNY learned of the SEC's objection, they intervened directly with the SEC to try to avoid having to provide a copy of Schedule A – even to the SEC's staff, on a confidential basis. James Bergin of the FRBNY's legal group asked the SEC's staff to grant an “alternative process ... like SEC staff reviewing the material at the Federal Reserve,”<sup>55</sup> so that the SEC would not have custody of the document and could not provide it in response to FOIA requests. Bergin told the SEC that Schedule A should be exempted from the SEC's usual FOIA process because of an extraordinary “governmental interest” in keeping its contents secret.<sup>56</sup>

Despite the FRBNY's pressure, the SEC insisted on reviewing a copy of Schedule A. However, the FRBNY succeeded in getting the SEC to treat it differently from every other company's confidential submissions: the document was hand-delivered to a senior SEC official and kept “in a special area at the SEC where national security related files are kept.”<sup>57</sup> Davis Polk conveyed word to AIG that the FRBNY had set up these special SEC procedures, then added, “You should, however, hear this directly from the SEC.”<sup>58</sup>

Following the SEC's instructions, AIG prepared a formal request for confidential treatment – a letter arguing that AIG would suffer “substantial competitive harm” if Schedule A were disclosed. The FRBNY and Davis Polk advised AIG extensively while it prepared the confidential treatment request, and even provided arguments for insertion in AIG's filings.<sup>59</sup> On January 14, 2008, AIG submitted Schedule A and the confidential treatment request to the SEC, following the special procedures that the FRBNY had arranged.<sup>60</sup>

### **PUBLIC PRESSURE FINALLY FORCES FRBNY TO PERMIT NAMES OF COUNTERPARTIES TO BE DISCLOSED IN MARCH 2009**

Meanwhile, Members of Congress continued to try to obtain information about the counterparty payments. On March 5, 2009, Fed Vice Chairman Donald Kohn testified before the Senate Banking Committee, where Senators criticized the FRBNY's decision to keep the names of the counterparties secret. After Vice Chairman Kohn's disastrous appearance before the Senate Banking Committee, FRBNY Assistant Vice President

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<sup>54</sup> Letter from Sebastian Gomez Abero, Division of Corporation Finance, SEC, to Kathleen Shannon, Dec. 30, 2008, BATES #AIGHOGRM003094.

<sup>55</sup> E-mail from James Bergin to Thomas Baxter, Jan 13, 2009, BATES #FRBNY-TOWNS-R3-004119.

<sup>56</sup> E-mail from James Bergin to Helen Mucciolo, Alejandro LaTorre, and Joyce Hansen, Jan. 13, 2009, BATES #FRBNY-TOWNS-R3-009189; *see also* E-mail from James Bergin to Thomas Baxter, Jan 13, 2009, BATES #FRBNY-TOWNS-R3-004119 (“[W]e reached out to the SEC staff ... We highlighted the substantial harm that the public disclosure of the information could cause to ML III, and the Federal Reserve's significant interest in the information”).

<sup>57</sup> E-mail from James Bergin to Thomas Baxter, Jan 13, 2009, BATES #FRBNY-TOWNS-R3-004119.

<sup>58</sup> E-mail from Diego Rotsztain to Kathleen Shannon, Jan. 13, 2009, BATES #AIGHOGRM1149.

<sup>59</sup> *See* e-mail from Diego Rotsztain to Kathleen Shannon, March 13, 2009, BATES #AIGHOGRM0699 (suggesting arguments for why the disclosure of Schedule A would harm AIG's competitive position).

<sup>60</sup> Letter from Kathleen Shannon to the Secretary of the Securities and Exchange Commission, Jan. 14, 2009, AIGHRM003097.

Alex Latorre mused: “I wonder if there is a way to get [Congress] off the fixation on counterparty names ....”<sup>61</sup>

The day after Vice Chairman Kohn’s testimony, the FRBNY began to comprehend that they weren’t going to be able to keep the names of the counterparties from Congress. FRBNY staff member James Bergin e-mailed several other FRBNY staff:

I have to think this train is probably going to leave the station soon and we need to focus our efforts on explaining the story as best we can. There were too many people involved in the deals – too many counterparties, too many lawyers and advisors, too many people from AIG – to keep a determined Congress from the information.<sup>62</sup>

The FRBNY was unsuccessful in getting Congress off its “fixation,” and as a result of the ensuing public pressure, the FRBNY finally allowed the counterparty names to be revealed.

AIG appears to have intended to release Schedule A in its entirety, without any confidential redactions.<sup>63</sup> A letter to the SEC drafted by AIG’s outside counsel, Sullivan & Cromwell, on March 10, 2009, reveals AIG’s intentions:

In light of current disclosure in the media regarding certain counterparties to credit default swaps guaranteed by [AIG], AIG hereby withdraws its Application for Confidential Treatment.... AIG intends to file ... a complete version of Schedule A without any redactions.<sup>64</sup>

However, the draft letter withdrawing AIG’s confidential treatment request was never sent to the SEC. An e-mail from the FRBNY’s James Bergin to Sarah Dahlgren on March 12, 2009, explained the FRBNY’s fear of Congress gaining access to the information from the SEC:

[E]ven if we succeed in redacting the stuff we want to redact, people should be conscious that this redacted information will still sit in the SEC’s files, and the SEC may well get a request from Congress for that information. I don’t know if there’s a way to manage it so that Congress won’t ask for it, or if they do, won’t release it.<sup>65</sup>

As an apparent result of FRBNY pressure, AIG released only the names of the counterparties and the aggregate amounts each counterparty received, and renewed its confidential treatment request with the SEC for the rest of the data.<sup>66</sup> Throughout its discussions with AIG about the partial disclosure of Schedule A, the FRBNY showed its preference for less, rather than more, disclosure. The FRBNY viewed transparency as a

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<sup>61</sup> E-mail from Alejandro Latorre to James Bergin, March 6, 2009, BATES #FRBNY-TOWNS-R3-010178.

<sup>62</sup> E-mail from James Bergin to Alejandro LaTorre et al, March 6, 2009, BATES #FRBNY-TOWNS-R3-008604.

<sup>63</sup> Draft letter to SEC prepared by Sullivan & Cromwell on March 10, 2009. Bates #AIGHOGRM0293.

<sup>64</sup> *Id.*

<sup>65</sup> E-mail from James Bergin to Sarah Dahlgren et al, March 12, 2009, BATES #FRBNY-TOWNS-R3-029216.

<sup>66</sup> *See* AIG Forms 8-K, March 16, 2009.

“slippery slope”<sup>67</sup> – arguing that each new release of public information about the Maiden Lane III transactions raised the danger of additional disclosures.

In an interview with Committee staff, FRBNY General Counsel Tom Baxter admitted that the FRBNY’s arguments for concealing the contents of Schedule A – at least with regard to the names of the counterparties – had proved to be unfounded.<sup>68</sup> SIGTARP agreed:

Notwithstanding the Federal Reserve’s warnings, the sky did not fall; there is no indication that AIG’s disclosure undermined the stability of AIG or the market or damaged legitimate interests of the counterparties.<sup>69</sup>

The SEC granted AIG’s amended confidential treatment request in May 2009. Under the SEC’s order granting confidential treatment, certain portions of Schedule A will remain secret through November 25, 2018.<sup>70</sup> The confidential portions include information that would identify each asset that Maiden Lane III purchased and reveal the exact purchase price. This information would allow analysts to determine which assets were performing best and which were most severely devalued – and, therefore, which AIG counterparties benefited most from being paid at par.

#### **THE FRBNY PRESSURED AIG TO AVOID DISCLOSING AN AIG OFFICIAL’S COMPENSATION IN ORDER TO AVOID EMBARRASSMENT AT A POTENTIAL HEARING OF THE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM**

Throughout the fall of 2008 and the spring of 2009, the FRBNY and its lawyers at Davis Polk reviewed and approved *all* of AIG’s draft SEC filings, not just those that dealt directly with the counterparty payments. The FRBNY used this power to prevent embarrassment to the Fed. On at least one occasion, pressure from the FRBNY appears to have resulted in a violation of disclosure rules.

On November 17, 2008, AIG was about to make a required filing to disclose a new compensation package for its CFO, David Herzog. AIG shared its draft filing with Davis Polk. The filing disclosed that Herzog was about to rake in millions of dollars in bonuses.<sup>71</sup>

Less than 40 minutes after receiving the draft filing from AIG, Davis Polk senior partner Marshall Huebner sent a frantic e-mail, entitled “READ ME,” to the FRBNY’s General Counsel, Thomas Baxter: “Sometimes I really do feel like evil gremlins are running this deal somehow. Very bad timing to have this [filing] come out just before the Secretary [Henry Paulson] and the Chairman [Ben Bernanke] go before Waxman ...”<sup>72</sup> Huebner asked Baxter, “Is there any chance – and maybe it is just too late – to get the Herzog comp package unagreed to? ... [W]e could help get the package changed/fixed before it

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<sup>67</sup> E-mail from Zachary Taylor to James Bergin, March 18, 2009, BATES #FRBNY-TOWNS-R3-008556.

<sup>68</sup> Committee staff interview with Thomas Baxter, Jan. 21, 2010.

<sup>69</sup> See SIGTARP, note 1, *supra*.

<sup>70</sup> See Orders Granting Confidential Treatment, BATES #AIGHOGRM003242, BATES #AIGHOGRM003243.

<sup>71</sup> Draft Form 8-K, BATES #FRBNY-TOWNS-R3-002271.

<sup>72</sup> E-mail from Marshall Huebner to Thomas Baxter and others, Nov. 17, 2008, BATES #FRBNY-TOWNS-R3-002270.

is disclosed.”<sup>73</sup> This issue, Huebner said, needed to go “right to [AIG CEO] Ed [Liddy] right now.”<sup>74</sup>

Apparently, the FRBNY’s coercion succeeded in getting Herzog’s compensation package “unagreed to,” for AIG never made the filing.

### **THE FRBNY’S ATTEMPTS TO KEEP INFORMATION SECRET WERE MOTIVATED BY A DESIRE TO AVOID SCRUTINY OVER ITS CONDUCT OF THE AIG BAILOUT**

The SEC’s disclosure rules are intended to protect investors by ensuring that they receive all material information about public companies’ business and financial condition. The FRBNY’s interference with AIG’s disclosure obligations was not in AIG’s investors’ interests, or in the public interest. Instead, the FRBNY’s goal was to avoid public scrutiny of the embarrassing details of the bailout.

When FRBNY lawyers first realized that the agreements among AIG, ML3, and the FRBNY might become public, they asked how disclosure might be avoided:

There is a mechanism to request confidential treatment from the SEC, but the standards are narrower than under FOIA. Trade secrets confidentiality is one of the most frequently claimed exemptions, but the SEC has a rigorous process for looking at these requests. I asked [Davis Polk] to take a look to see what else might be applicable – to the extent that we did want to try to keep these agreements confidential for *policy purposes*, which we may or may not want to.<sup>75</sup> [emphasis added]

In other words, the FRBNY recognized that the normal reasons recognized by the SEC for keeping a filing confidential might not apply, and the FRBNY hoped to find a way to justify non-disclosure for “policy purposes” – *i.e.*, to protect the Fed’s institutional interest in secrecy.

E-mails between FRBNY officials confirm that secrecy, not accountability, was their goal. In January 2009, as the FRBNY considered the SEC’s request for portions of Schedule A to become public, James Bergin of the FRBNY legal group argued that *not even the column headings* on Schedule A should be disclosed:

Alex [Latorre, FRBNY Assistant Vice President] had articulated the desire at one point to have the *whole* schedule [A] be confidential. *It’s less of a legally motivated worry than a worry that including the column headings could further incite FOIA requests or litigation* – that if people know the counterparty names and amounts are indeed on this schedule, they will be all the more likely to request it.<sup>76</sup> [emphasis added]

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<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> E-mail from James Bergin to HaeRan Kim and others, Nov. 25, 2008, BATES #FRBNY-TOWNS-R3-002391 (emphasis added).

<sup>76</sup> E-mail from James Bergin to Alejandro Latorre, January 14, 2009, BATES #FRBNY-TOWNS-R3-008637.

The FRBNY's James Bergin further explained that one of the reasons why the FRBNY resisted allowing AIG to provide a copy of Schedule A to the SEC was Congressional oversight:

Pursuant to the SEC's rules for confidentiality requests, filers must file a paper copy of the requested confidential portion with the SEC, and must also consent to its further disclosure to other agencies and Congress. *This requirement is giving us some pause, since we haven't otherwise disclosed this information to Congress.*<sup>77</sup> [emphasis added]

The FRBNY clearly hoped to prevent Congress from fully understanding the payments to AIG's counterparties.

### **GEITHNER'S ROLE IN THE AIG COVER UP REMAINS UNCLEAR**

When asked directly if he was involved in the efforts by the FRBNY to prevent disclosure of the AIG counterparty payments, Secretary Geithner responded, "I wasn't involved in that decision."<sup>78</sup> On January 8, 2010, FRBNY General Counsel Thomas Baxter wrote Ranking Member Issa to clarify the role of then-President Geithner:

[M]atters relating to AIG securities law disclosures were not brought to the attention of Mr. Geithner .... In my judgment as the New York Fed's chief legal officer, disclosure matters of this nature did not warrant the attention of the president.<sup>79</sup>

Mr. Baxter reiterated this claim in an interview with Committee staff.<sup>80</sup> Questions of securities disclosure, Baxter said, were "legal stuff," and Baxter did not bring legal stuff to the attention of then-President Geithner.<sup>81</sup> However, Baxter said that "on significant policy issues, of course I would go" to Geithner.<sup>82</sup>

However, documents received by the Committee suggest that Secretary Geithner was, at a minimum, engaged personally in reviewing what information about the AIG bailout would be revealed to Congress and the public. On November 6, 2008, Sarah Dahlgren, the FRBNY's lead staff member in AIG's operations, e-mailed Geithner with a proposed statement regarding AIG's upcoming equity capital raise for Geithner's approval:

[I]n terms of saying something publicly about our intentions, we ... think that saying something that conveys the following ... makes sense:

It is our (Federal Reserve/Treasury) continued intention to put the company in a sound capital position and exit the facility/preferred securities/common stock ownership as soon as practicable...

*[I]f you are good with this, ... we would also make sure that the company sticks to this line (echo)....*<sup>83</sup> [emphasis added]

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<sup>77</sup> E-mail from James Bergin to Thomas Baxter, Jan. 8, 2009, BATES #FRBNY-TOWNS-R3-004119.

<sup>78</sup> See interview of Secretary Geithner on CNBC, January 14, 2010.

<sup>79</sup> See letter from Thomas Baxter to Darrell Issa, January 8, 2010.

<sup>80</sup> Committee staff interview with Thomas Baxter, Jan. 21, 2010.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> E-mail from Sarah Dahlgren to Timothy Geithner and others, Nov. 5, 2008, BATES #FRBNY-TOWNS-R1-194341.

On November 13, 2008, Geithner received a report on AIG's restructuring that would be sent to Congress, which Geithner had asked to personally review.<sup>84</sup> Sophia Allison, a staff member of the Federal Reserve's Board of Governors, e-mailed the draft congressional report to several Federal Reserve staff:

Attached is a draft Congressional report for the restructuring package for AIG announced on Monday, November 10. ...I tried to take everything in the report from publicly available documents, such as press releases, the prior AIG Congressional Report, and AIG's most recent 10-Q. *If there is anything in the report that you believe should not be publicly disclosed, please specifically point that out.*<sup>85</sup> [emphasis added]

Michael Nelson, a staff member of the FRBNY, forwarded Allison's email to Geithner with the following message:

Tim – this is the draft EESA-required filing on AIG that the Board owes the Hill, *as you requested.*<sup>86</sup> [emphasis added]

In addition, Secretary Geithner's meeting logs from his tenure as President of the FRBNY show that he was regularly engaged with top AIG officials and the FRBNY officials directly responsible for AIG's disclosures to the SEC.<sup>87</sup> Geithner's schedule shows that he had at least six formal meetings with top FRBNY staff members about AIG-related issues between November 4, 2008, and November 21, 2008.<sup>88</sup> It is unclear whether AIG's disclosure obligations were discussed in these meetings.

At a minimum, the cover-up of the details about AIG's counterparty payments began on Secretary Geithner's watch, and the culture of the FRBNY in which this behavior occurred reflected his leadership. Secretary Geithner needs to explain his role in the cover-up, and if he thinks the behavior of his staff at the FRBNY was appropriate.

#### **EVIDENCE CONTRADICTS GEITHNER'S CLAIM THAT HEALTH OF COUNTERPARTIES WAS IRRELEVANT TO DECISION TO PAY COUNTERPARTIES AT PAR**

According to SIGTARP:

Then-FRBNY President Geithner and the FRBNY General Counsel [Tom Baxter] told SIGTARP that the financial condition of the counterparties was not a relevant factor in the decision to create [ML3] and pay counterparties effectively at par.<sup>89</sup>

Secretary Geithner's claim is contradicted by internal FRBNY communications obtained by the Committee. In an e-mail dated October 22, 2008, FRBNY official Margaret

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<sup>84</sup> E-mail from Michael Nelson to Timothy Geithner, Nov. 13, 2008, BATES #FRBNY-TOWNS-R3-029843.

<sup>85</sup> E-mail from Sophia Allison to Michael Nelson, et. al., November 13, 2008, BATES #FRBNY-TOWNS-R3-029843.

<sup>86</sup> See note 81, *supra*.

<sup>87</sup> See "Geithner's calendar at the New York Fed," *New York Times*, available at <http://documents.nytimes.com/geithner-schedule-new-york-fed/page/608#p=608>.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

McConnell relays to then-President Geithner the details of a conference call with staff from the Federal Reserve's Board of Governors:

The new ML 3 – in which they tear up the CDS and purchase the underlying CDOs – seems pretty good from a financial stability perspective (if it can be done), better than the original one they'd proposed bc *it seems to remove considerably more uncertainty for the firms* and arguably for the system. [emphasis added]<sup>90</sup>

This e-mail clearly suggests that removing uncertainty for AIG's counterparties was a primary purpose of ML3 and the decision to pay the counterparties at par.

### **GEITHNER'S CLAIMS RAISE QUESTIONS ABOUT PURPOSE OF AIG BAILOUT**

Secretary Geithner's claim to SIGTARP that the backdoor bailout of AIG's counterparties had nothing to do with the health of AIG's counterparties also raises questions about why AIG was bailed out in the first place. As the *Wall Street Journal* notes:

[I]f Mr. Geithner now says the AIG bailout wasn't driven by a need to rescue CDS counterparties, then what was the point? Why pay Goldman [Sachs] and even foreign banks like Societe Generale billions of tax dollars to make them whole?<sup>91</sup>

Secretary Geithner now claims that the point of AIG's bailout was to protect AIG's insurance policy holders:

AIG was providing a range of insurance products to households across the country. And if AIG had defaulted, you would have seen a downgrade leading to the liquidation and failure of a set of insurance contracts that touched Americans across this country and, of course, savers around the world.<sup>92</sup>

However, as the *Wall Street Journal* further explains:

Yet, if there is one thing that all observers seemed to agree on last year, it was that AIG's money to pay policyholders was segregated and safe inside the regulated insurance subsidiaries. If the real systemic danger was the condition of these highly regulated subsidiaries – where there was no CDS trading – then the Beltway narrative implodes.<sup>93</sup>

Secretary Geithner's inconsistent statements and apparent contradictions raise important questions about the decision to not only funnel billions of taxpayer dollars to AIG's counterparties, but also the decision to bail out AIG itself.

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<sup>90</sup> See e-mail from Margaret McConnell to Timothy Geithner, October 22, 2008. Bates #FRBNY-Towns-R1-195645.

<sup>91</sup> See "AIG and Systemic Risk," *Wall Street Journal*, November 23, 2009.

<sup>92</sup> Secretary Geithner is quoted in "AIG and Systemic Risk," *Wall Street Journal*, November 23, 2009.

<sup>93</sup> *Id.*

## THE FRBNY HAS STONEWALLED THE COMMITTEE'S INVESTIGATION AT EVERY TURN

The Committee's investigation of the AIG counterparty payments began in October 2009, when Ranking Member Issa requested information about the payments and their disclosure from the FRBNY and AIG.<sup>94</sup> Chairman Towns was invited to become involved in this investigation at that time but his staff declined on his behalf. AIG submitted over 3,000 documents in response to the Ranking Member's request.<sup>95</sup> Unfortunately, the FRBNY refused to turn over any documents that were not already publicly available.<sup>96</sup> Multiple follow up attempts to obtain documents from the FRBNY by the Ranking Member and the Committee's minority staff were unsuccessful.<sup>97</sup>

Ranking Member Issa also requested documents that had been submitted by the FRBNY to SIGTARP, and which SIGTARP used to prepare its audit of these issues.<sup>98</sup> The Federal Reserve directed SIGTARP not to provide the Committee with the documents in SIGTARP's possession.<sup>99</sup>

On January 8, 2010, Ranking Member Issa and Congressman McHenry wrote Chairman Towns, calling on him to hold a hearing and bring Secretary Geithner before the Committee to testify.<sup>100</sup> In response, Chairman Towns announced the Committee's upcoming hearing, and Secretary Geithner's invitation to testify, later that day.<sup>101</sup>

On January 12, 2010, the Ranking Member wrote Chairman Towns, citing the FRBNY's efforts to conceal information from the Committee and requesting that the Committee issue a subpoena for the information to the FRBNY.<sup>102</sup> In response to the Ranking Member's request, Chairman Towns issued a subpoena on January 13, 2010.<sup>103</sup>

In response to the Committee's subpoena, the FRBNY provided the Committee with over 250,000 pages of documents on January 19, 2010.<sup>104</sup> Unfortunately, this document production is incomplete, and it appears that the FRBNY, despite the Committee's subpoena, remains reluctant to fully cooperate with the Committee's investigation. The FRBNY's document production does not include any documents responsive to the Committee's subpoena prior to September 2008, so the Committee is not currently able to

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<sup>94</sup> See letter from Darrell Issa to William Dudley, President, Federal Reserve Bank of New York, October 30, 2009; letter from Darrell Issa to Robert Benmosche, President and Chief Executive Officer, AIG, October 30, 2009.

<sup>95</sup> See letters and document productions from AIG to Darrell Issa, December 1, 2009, December 16, 2009, January 19, 2010, and January 21, 2010.

<sup>96</sup> See letter from William Dudley, President, Federal Reserve Bank of New York, to Darrell Issa, November 17, 2009.

<sup>97</sup> See Committee staff e-mail requests to staff of Federal Reserve Bank of New York, January 8, 2010, and January 10, 2010; letter from Darrell Issa to Thomas Baxter, General Counsel, Federal Reserve Bank of New York, January 11, 2010.

<sup>98</sup> See letter from Darrell Issa to Neil Barofsky, SIGTARP, January 7, 2010.

<sup>99</sup> See letter from Neil Barofsky, SIGTARP, to Darrell Issa, January 12, 2010.

<sup>100</sup> See letter from Darrell Issa and Patrick McHenry to Edolphus Towns, January 8, 2010.

<sup>101</sup> See "Chairman Towns Announces Hearing to Examine New York Fed's Role in Advising Public Disclosure of A.I.G. Counterparty Payments," January 8, 2010. Available at [http://oversight.house.gov/index.php?option=com\\_content&task=view&id=4731&Itemid=49](http://oversight.house.gov/index.php?option=com_content&task=view&id=4731&Itemid=49).

<sup>102</sup> See letter from Darrell Issa to Edolphus Towns, January 12, 2010.

<sup>103</sup> See "Subpoena to the New York Fed for AIG Counterparty Documents," Committee on Oversight and Government Reform, January 13, 2010. Available at [http://oversight.house.gov/images/stories/NYFedSubpoena\\_attested\\_1.13.09.pdf](http://oversight.house.gov/images/stories/NYFedSubpoena_attested_1.13.09.pdf).

<sup>104</sup> See letter and document production from Shari Leventhal, FRBNY, to Edolphus Towns and Darrell Issa, January 19, 2010.

learn when the FRBNY first became aware of potential problems at AIG. In addition, the FRBNY's document production does not include any documents responsive to the Committee's subpoena after May of 2009, so the Committee is not currently able to learn the full extent of the FRBNY's efforts to conceal information about the counterparty payments from this Committee and the public over the last eight months.

The Ranking Member pointed out these concerns in a letter to Chairman Towns on January 20, 2010, and asked Chairman Towns to clarify the scope of the subpoena with the FRBNY and hold FRBNY officials in contempt if they do not fully comply.<sup>105</sup> The Ranking Member has also asked Chairman Towns to issue subpoenas to the Federal Reserve Board of Directors and the Treasury Department for documents related to the AIG counterparty payments.<sup>106</sup> As of the writing of this memorandum, Chairman Towns has not responded to these requests.

### **GEITHNER AND BAXTER MEET IN ADVANCE OF HEARING**

It appears that the FRBNY is coordinating with the Treasury Department and Secretary Geithner in advance of the Committee's hearing. In an interview with Tom Baxter, General Counsel of the FRBNY (and witness at the hearing), Committee staff asked Mr. Baxter if he had spoken with Secretary Geithner about the hearing or his testimony.<sup>107</sup> Mr. Baxter indicated that he met with Secretary Geithner and a Democratic Member of the Committee, Congressman Elijah Cummings (D-MD), on Friday, January 15, 2010.<sup>108</sup> Mr. Baxter admitted that he explained his role in these transactions and their [non]disclosure to Congressman Cummings, and that Secretary Geithner confirmed Mr. Baxter's story to Congressman Cummings.<sup>109</sup> Mr. Baxter also admitted that he has discussed the Committee's upcoming hearing with George Madison, Treasury's General Counsel.<sup>110</sup>

Secretary Geithner did not respond to a request from Ranking Member Issa for an interview before the hearing,<sup>111</sup> nor has Secretary Geithner responded to a list of questions about these issues sent by Ranking Member Issa in advance of the hearing.<sup>112</sup>

### **THE AIG COUNTERPARTY PAYMENTS AND COVER-UP RAISE QUESTIONS ABOUT ROLE OF FEDERAL RESERVE MOVING FORWARD**

The impropriety of the actions of the Federal Reserve in the AIG bailout has important and far-reaching implications for public policy. First, the payment of AIG's CDS counterparties at par means that \$62.1 billion of taxpayer money may have been wasted. Second, these actions ought to inform the debate in Congress over a sweeping financial regulatory reform proposal that seeks to give the Federal Reserve vast new powers over the entire U.S. economy. Third, the FRBNY's interference with AIG's securities

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<sup>105</sup> See letter from Darrell Issa to Edolphus Towns, January 20, 2010.

<sup>106</sup> See letter from Darrell Issa to Edolphus Towns, January 15, 2010.

<sup>107</sup> Committee staff interview of Tom Baxter, General Counsel, FRBNY, January 21, 2010.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> See letter from Darrell Issa to Timothy Geithner, January 13, 2010.

<sup>112</sup> See letter from Darrell Issa to Timothy Geithner, January 22, 2010.

disclosure obligations demonstrates that the federal government is willing to subvert investor protection and the rule of law in order to protect bailouts from public and Congressional scrutiny. Finally, the secrecy, concealment, and lack of transparency in the Federal Reserve's actions have important implications for the continued health of democracy and free markets.

On December 11, 2009, the House passed H.R. 4173, a financial regulatory reform bill sponsored and guided through Congress by House Financial Services Chairman Barney Frank (D-MA). If enacted, this bill would make the Federal Reserve the systemic risk regulator, extending government control over vast swathes of the U.S. economy. Setting aside the substantive problems with the creation of a systemic risk regulator,<sup>113</sup> the AIG bailout, counterparty payments, and cover-up demonstrate the lack of wisdom in giving the Federal Reserve such broad new authority.

The FRBNY and its attorneys at Davis Polk interfered with AIG's securities disclosures in several ways. They edited AIG's SEC filings in ways that made it more difficult for investors and the public to understand the ML3 transactions. They contacted the SEC directly and pressured it to treat AIG's filings differently from other companies' filings. In addition, they appear to have forced AIG to cancel a compensation-related filing that it was required to make. The FRBNY's edits of AIG's filings and the FRBNY's pressure on the SEC were intended to serve the Fed's interests by obscuring embarrassing details about the FRBNY's backdoor bailout of AIG's counterparties. Investors cannot be protected by a disclosure system that only requires full transparency when the Federal Reserve's embarrassment is not at stake. The special SEC procedures established via FRBNY pressure also demonstrate that bailouts lead to enforced favoritism.

Finally, the secrecy, concealment, and lack of transparency in the conduct of the Federal Reserve have serious implications for the continued health of democracy and free markets. The Federal Reserve's payment of par to AIG's counterparties and the subsequent cover-up of information about these payments raise concerns about the accountability of the unelected bureaucrats within the Federal Reserve System. The fact that a quasi-government agency, unaccountable to the American people, likely wasted billions of taxpayer dollars and went to great lengths to prevent Congress and the American people from learning about these actions demonstrates the threat that the Federal Reserve poses to basic principles of American democracy.

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<sup>113</sup> See e.g. Peter J. Wallison, American Enterprise Institute, "TARP Baby: The Administration's Resolution Authority for Nonbank Financial Firms" (September 30, 2009), available at <http://www.aei.org/outlook/100077>.

## Appendix I - Summary Timeline of AIG Counterparty Payments and Disclosure

- **September 16, 2008:** the Federal Reserve Board, with the support of the Treasury Department, authorized the FRBNY to lend up to \$85 billion to AIG to enable AIG to avoid filing for bankruptcy.
- **September 19, 2008:** AIG agrees to submit all of its SEC filings to FRBNY and its counsel, Davis Polk, for edits before filing.
- **September - October 2008:** AIG is faced with growing liquidity pressures because of its obligation to post collateral to its CDS counterparties. AIG's previous credit facility is insufficient to cover the collateral calls.
- **October 31, 2008:** FRBNY tells AIG to stop negotiating with counterparties.
- **November 3, 2008:** FRBNY decides to create Maiden Lane III to purchase the underlying assets at par from AIG's counterparties.
- **November 6-7, 2008:** FRBNY "negotiates" with AIG's counterparties on concessions for the value of the underlying assets. The counterparties refuse to sell the assets and terminate the CDS contracts for less than par.
- **November 10, 2008:** Fed Board approves establishment and funding of Maiden Lane III; AIG announces Maiden Lane III during a conference call with analysts.
- **November 11, 2008:** Internal AIG e-mails: There is "confusion" in the marketplace about the ML3 transaction. "The Fed offered all counterparties par." But the Fed is "sensitive" about the details.
- **November 17, 2008:** Davis Polk warns FRBNY that a pending SEC filing by AIG, which discloses a new compensation package for AIG's CFO, might embarrass Chairman Bernanke at a hearing of the Committee on Oversight and Government Reform. The filing is never submitted to the SEC.
- **November 25, 2008:** Maiden Lane III is formed and purchases \$46.1 billion (par) of underlying assets from AIG's counterparties, and the corresponding CDS contracts are canceled. [first round of transactions; second round takes place on December 18 and 22, 2008]
- **November 25-December 2, 2008:** AIG prepares a report with the SEC that describes the formation of Maiden Lane III and the November 25 transactions. FRBNY and Davis Polk perform heavy edits. FRBNY initially objects to AIG's intention to file the agreements between itself, AIG, and Maiden Lane III as exhibits, but relents.
- **December 2, 2008:** AIG files the Maiden Lane III report with the SEC. The report includes the agreements as exhibits, but it omits Schedule A – a detailed list of the underlying assets, purchase amounts, and counterparty names.

- **December 18 and 22, 2008:** Maiden Lane III makes a second round of purchases: \$16 billion (par) of underlying assets from AIG's counterparties, and the corresponding CDS contracts are canceled.
- **December 18-24, 2008:** AIG prepares a report for the SEC describing Maiden Lane III's second round of transactions. FRBNY and Davis Polk edit the draft.
- **December 24, 2008:** AIG files its second report with the SEC. The report includes updated versions of the underlying agreements but does not include Schedule A.
- **December 30, 2008:** SEC writes to AIG directing AIG to either file Schedule A publicly or else provide a formal confidential treatment request .
- **January 13, 2009:** FRBNY intervenes directly with the SEC to create special procedures for the submission of AIG's confidential treatment request .
- **January 14, 2009:** AIG submits a confidential treatment request for Schedule A, using the special procedures arranged by FRBNY.
- **February 17, 2009:** The SEC responds to AIG's confidential treatment request, asking for more detailed arguments.
- **March 5, 2009:** Fed Vice Chairman Donald Kohn testifies before Senate Banking Committee. Public and Congressional pressure for the disclosure of information contained in Schedule A grows.
- **March 10, 2009:** AIG's lawyers draft a letter to the SEC canceling the confidential treatment request and permitting the SEC to release Schedule A in its entirety. The letter is never sent to the SEC.
- **March 16, 2009:** AIG publicly releases the names of the counterparties and aggregate information about amounts each counterparty received. AIG does not release the remaining information in Schedule A, such as identifications of each asset purchased and the amounts Maiden Lane III paid for each asset. AIG files a redacted copy of Schedule A reflecting the new disclosures and submits an amended confidential treatment request to the SEC asking that the remaining information stay secret.
- **May 22, 2009:** After further correspondence, the SEC grants AIG's amended confidential treatment request. The remaining information in Schedule A will stay secret until November 25, 2018.

## Appendix II – Total Payments to AIG Credit Default Swap Counterparties (in billions)<sup>114</sup>

AIG Counterparty	Maiden Lane III Payment	Collateral Payments Posted (as of 11/7)	Total
Société Générale	6.9	9.6	16.5
Goldman Sachs	5.6	8.4	14.0
Merrill Lynch	3.1	3.1	6.2
Deutsche Bank	2.8	5.7	8.5
UBS	2.5	1.3	3.8
Calyon	1.2	3.1	4.3
Deutsche Zentral- Genossenschaftsbank	1.0	0.8	1.8
Bank of Montreal	0.9	0.5	1.4
Wachovia	0.8	0.2	1.0
Barclays	0.6	0.9	1.5
Bank of America	0.5	0.3	0.8
The Royal Bank of Scotland	0.5	0.6	1.1
Dresdner Bank AG	0.4	0.0	0.4
Rabobank	0.3	0.3	0.6
Landesbank Baden-Wuerttemberg	0.1	0.0	0.1
HSBC Bank, USA	0.0*	0.2	0.2
<b>Total</b>	<b>27.1**</b>	<b>35.0</b>	<b>62.1</b>

Source: SIGTARP analysis of AIG and FRBNY data

\* Amount rounded down to \$0.

\*\* In addition to the \$27.1 billion in payments to the counterparties, AIGFP received a payment of \$2.5 billion as an adjustment payment to reflect overcollateralization.

<sup>114</sup> This chart was obtained from SIGTARP's report, "Factors Affecting Efforts to Limit Payments to AIG Counterparties," November 17, 2009, at p. 20. Available at [http://www.sig tarp.gov/reports/audit/2009/Factors\\_Affecting\\_Efforts\\_to\\_Limit\\_Payments\\_to\\_AIG\\_Co unterparties.pdf](http://www.sig tarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Co unterparties.pdf).

## About the Committee

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The Committee on Oversight and Government Reform is the main investigative committee in the U.S. House of Representatives. It has authority to investigate the subjects within the Committee's legislative jurisdiction as well as "any matter" within the jurisdiction of the other standing House Committees. The Committee's mandate is to investigate and expose waste, fraud and abuse.

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