STENOGRAPHIC MINUTES
Unrevised and Unedited
Not for Quotation or
Duplication

****Preliminary Transcript****

HEARING ON THE CAUSES AND

EFFECTS OF THE AIG BAILOUT

Tuesday, October 7, 2008

House of Representatives,

Committee on Oversight and

Government Reform,

Washington, D.C.

"This is a preliminary transcript of a Committee Hearing. It has not yet been subject to a review process to ensure that the statements within are appropriately attributed to the witness or member of Congress who made them, to determine whether there are any inconsistencies between the statements within and what was actually said at the proceeding, or to make any other corrections to ensure the accuracy of the record."

Committee Hearings

of the

U.S. HOUSE OF REPRESENTATIVES

OFFICE OF THE CLERK
Office of Official Reporters

1 RPTS MCKENZIE
2 DCMN SECKMAN

3 HEARING ON THE CAUSES AND
4 EFFECTS OF THE AIG BAILOUT
5 Tuesday, October 7, 2008
6 House of Representatives,
7 Committee on Oversight and
8 Government Reform,
9 Washington, D.C.

10 The committee met, pursuant to call, at 10:04 a.m., in
11 Room 2154, Rayburn House Office Building, Hon. Henry A.
12 Waxman [chairman of the committee] presiding.
13 Present: Representatives Waxman, Maloney, Cummings,
14 Kucinich, Tierney, Watson, Higgins, Yarmuth, Braley, Norton,
15 McCollum, Van Hollen, Sarbanes, Welch, Speier, Davis of
16 Virginia, Shays, Mica, Souder, Turner and Bilbray.
17 Staff Present: Kristin Amerling, General Counsel;
18 Russell Anello, Counsel; Caren Auchman, Press Assistant;
19 Alvin Banks, Staff Assistant; Phil Barnett, Staff Director
20 and Chief Counsel; Jen Berenholz, Deputy Clerk; Stacia

21 Cardille, Counsel; Zhongrui "JR" Deng, Chief Information
22 Officer; Ali Golden, Investigator; Michael Gordon, Senior
23 Investigative Counsel; Earley Green, Chief Clerk; Karen
24 Lightfoot, Communications Director and Senior Policy Advisor;
25 David Rapallo, Chief Investigative Counsel; Leneal Scott,
26 Information Systems Manager; Roger Sherman, Deputy Chief
27 Counsel; Mitch Smiley, Special Assistant; Lawrence Halloran,
28 Minority Staff Director; Jennifer Safavian, Minority Chief
29 Counsel for Oversight and Investigations; A. Brooke Bennett,
30 Minority Counsel; Brien Beattie, Minority Professional Staff
31 Member; Molly Boyl, Minority Professional Staff Member; Larry
32 Brady, Minority Senior Investigator & Policy Advisor; Alex
33 Cooper, Minority Professional Staff Member; John Cuaderes,
34 Minority Senior Investigator & Policy Advisor; Adam Fromm,
35 Minority Professional Staff Member; Todd Greenwood, Minority
36 Professional Staff Member; Patrick Lyden, Minority
37 Parliamentarian & Member Services Coordinator; Brian
38 McNicoll, Minority Communications Director; and Nick
39 Palarino, Minority Senior Investigator & Policy Advisor.

40 Chairman WAXMAN. The committee will please come to
41 order. Today we're holding our second day of hearings on the
42 financial crisis in Wall Street. Yesterday we examined the
43 collapse of Lehman Brothers. Our focus today is AIG.
44 There are obvious differences between Lehman and AIG.
45 Lehman is an investment bank. AIG is an insurance company.
46 Lehman fell because it placed highly leveraged bets in the
47 subprime and real estate markets. AIG's problems originate
48 in the complex derivatives called credit default swaps. But
49 their stories are fundamentally the same.
50 In each case, the companies and their executives grew
51 rich by taking on excessive risk. In each case, the
52 companies collapsed when these risks turned bad. And in each
53 case, their executives are walking away with millions of
54 dollars while taxpayers are stuck with billions of dollars in
55 costs. The AIG CEOs are like the Lehman CEO in one other
56 respect: In each case, they refused to accept any blame for
57 what happened to their companies.
58 In preparation for this hearing, the committee has
59 received tens of thousands of pages of documents from AIG.
60 Our review of the documents raises three fundamental sets of
61 questions. Answering these questions will be the focus of
62 today's hearing.
63 The first set of questions is whether AIG's executive
64 compensation practices were fair and appropriate. AIG has a

65 Seniors Partners Plan that provides cash bonuses for its 70
66 executives. These are the top 70 executives. This plan is
67 supposed to be performance based. In 2005, AIG's CEO, Martin
68 Sullivan received $2.7 million under this plan. In 2006, his
69 first full year as CEO, he received $5.7 million under the
70 plan. These payments are not in question. Both years were
71 good years for AIG, and as CEO, Mr. Sullivan naturally was
72 well rewarded.
73 2007 is a completely different story. AIG lost over $5
74 billion in the final quarter of 2007 due to the losses
75 attributable to its Financial Products Division called
76 AIG-FP. Under the terms of the Senior Partners Plan, Mr.
77 Sullivan and the other top executives should have had their
78 bonuses slashed due to poor performance. But when the
79 compensation committee met on March 11, 2008, the award
80 bonuses for 2007, Mr. Sullivan urged the committee to ignore
81 the losses from the Financial Products Division in
82 calculating his bonus and the bonuses of the other top
83 executives. We obtained a copy of the minutes from that
84 meeting, and here's what they say: Mr. Sullivan next
85 presented management's recommendation with respect to the
86 earn-out for the Senior Partners Plan, suggesting that the
87 AIG-FP unrealized market valuation losses be excluded from
88 the calculation. The board approved this change in the
89 Senior Partners Plan, ignored the losses from the Financial

90 Products Division, and gave Mr. Sullivan a cash bonus of over
91 $5 million. Today we'll ask what could possibly justify this
92 change in the compensation formula.

93 There are other compensation questions we will also ask.
94 In March, the board approved a new compensation contract for
95 Mr. Sullivan that gave him a golden parachute worth $15
96 million. We will ask why that was in the interest of the
97 shareholders. And we will ask about the compensation of
98 Joseph Cassano who was the executive in charge of the
99 Financial Products Division. Mr. Cassano was well
100 compensated by AIG. He received more than $280 million over
101 the last 8 years. After his division imploded, AIG
102 terminated him without cause in February and did not seek to
103 recover any of Mr. Cassano's compensation. Instead, AIG
104 allowed him to keep up to $34 million in unvested bonuses and
105 put him on a $1 million-a-month retainer. Last month the
106 taxpayers bought out AIG in an $85 billion bailout. This was
107 a direct result of the mistakes made by Mr. Cassano. Yet
108 even today he remains on the company payroll, receiving $1
109 million a month.

110 The Federal bailout occurred on September 16. Less than
111 one week later AIG held a week-long retreat for company
112 executives at the exclusive St. Regis resort in Monarch
113 Beach, California. And we have a photograph on display of
114 that resort. Rooms at this resort can cost over $1,000 per

115 night. Invoices provided to the committee show that AIG paid
116 the resort over $440,000 including nearly $200,000 for rooms,
117 over $150,000 for meals, and $23,000 in spa charges.
118 Well, average Americans are suffering economically.
119 They're losing their jobs, their homes and their health
120 insurance. Yet less than one week after the taxpayers
121 rescued AIG, company executives could be found wining and
122 dining at one of the most exclusive resorts in the Nation.
123 We'll ask whether any of this makes any sense.
124 The second set of questions we'll ask is whether Mr.
125 Sullivan and Robert Willumstad are right when they say they
126 bear no responsibility for the collapse of AIG. Mr. Sullivan
127 was CEO from March 2005 to June 2008. Mr. Willumstad was his
128 successor. He joined the AIG board in January of 2006 and
129 has served as Chairman from November 2006 until he was named
130 CEO in June 2008. According to their testimony, AIG failed
131 because it was caught in a vicious cycle and hit by a global
132 financial tsunami. Mr. Willumstad says, quote, I don't
133 believe AIG could have done anything differently, end quote.
134 The information we received paints a different picture.
135 We have obtained a confidential letter from the Office of
136 Thrift Supervision to AIG's general counsel. In this March
137 10, 2008 letter, the Office of Thrift Supervision writes
138 quote, we are concerned that the corporate oversight of AIG
139 Financial Products lacks critical elements of independence,

140 transparency and granularity, end quote. Internal documents
141 show that AIG's auditor, PricewaterhouseCoopers, reported
142 similar problems. Minutes from a meeting of the board's
143 audit committee in March 2008 revealed that
144 PricewaterhouseCoopers told the committee that the root cause
145 of AIG's problems was that risk control groups did not have
146 appropriate access to the Financial Products Division.
147 As part of our investigation, the committee requested
148 information from a former AIG auditor Joseph St. Denis. Mr.
149 St. Denis was a senior SEC enforcement official who was hired
150 by AIG to address its ongoing accounting problems. But when
151 he expressed concerns about how the Financial Products
152 Division was valuing its liabilities, Mr. Cassano told him, I
153 have deliberately excluded you from the valuation because I
154 was concerned that you would pollute the process, end quote.
155 Ultimately, Mr. St. Denis resigned in protest. As he
156 explains, quote, Mr. Cassano took actions that I believe were
157 intended to prevent me from performing the job duties for
158 which I was hired. Unlike Mr. Cassano and Mr. Sullivan, Mr.
159 St. Denis's actions cost him his bonus.
160 There are other questionable actions by Mr. Sullivan and
161 Mr. Willumstad. As losses were mounting and resources were
162 getting scarce, AIG depleted its capital by over $10 billion
163 through stock buybacks and rising dividend payments. This
164 prompted shareholders to write the board, quote, the

165 management and board inexcusably and inexplicably raised the
166 dividend while simultaneously issuing expensive preferred
167 stock at a discount, end quote.
168 And finally, we'll ask whether AIG and in particular Mr.
169 Sullivan misled investors and the public about the financial
170 conditions of the company. On December 5, 2007, Mr. Sullivan
171 told investors, we are confident in our marks and the
172 reasonableness of our valuation methods. We have a high
173 degree of certainty in what we have booked to date, end
174 quote. What Mr. Sullivan didn't tell investors was that, on
175 November 29, one week earlier, PricewaterhouseCoopers had
176 raised their concerns about Mr. Sullivan, informing him that
177 PWC believed that AIG could have a material weakness relating
178 to the risk management of these areas.
179 There is one witness who should be here today but who
180 will be missing, Maurice "Hank" Greenberg, the long-time CEO
181 of AIG. Mr. Greenberg blames Mr. Sullivan and Mr. Willumstad
182 for the downfall of AIG. Many others think it is Mr.
183 Greenberg who sowed the seeds that led to AIG's failure.
184 Regrettably Mr. Greenberg has told the committee that he is
185 too ill to appear today to answer questions.
186 There is a lot of ground for this committee to cover
187 today. We will probe AIG's executive compensation
188 arrangements, the leadership of its top officials and the
189 veracity of their public statements. Our goal is to examine

190 the details of AIG's fall so that we can learn lessons about
191 the reforms needed to restore stability to our financial
192 markets.
193 Like all of our witnesses, Mr. Sullivan and Mr.
194 Willumstad know we will ask hard questions. I also want them
195 and our other witnesses to know that we appreciate their
196 cooperation and appearance before the committee today.
197 Before yielding to Mr. Shays, who will deliver the
198 statement on behalf of the Republicans, I do want to announce
199 that the request that we have received to look at Fannie Mae
200 and Freddie Mac, which is an investigation already underway,
201 will be pursued in conjunction with the minority on the
202 committee. And we will look at holding a hearing on those
203 two as well as the other hearings that we have scheduled.
204 Mr. Shays, I want to recognize you at this time.
205 Mr. SHAYS. Thank you, Mr. Chairman.
206 Today we consider the case of the American International
207 Group, AIG, a global insurance conglomerate saved from
208 insolvency by an $85 billion loan from American taxpayers.
209 As part of the deal, we, the American taxpayers, own a
210 controlling stake in the company. In these bailouts, the
211 United States Treasury is now in the business of picking
212 winners and losers as the global economy struggles to purge
213 the toxins of speculative greed polluting capitalism's
214 bloodstream. We need to understand what makes a private

215 company like AIG too big to fail and what drew such a large
216 and venerable enterprise to the brink of failure.
217 In the search for causes, all roads lead to the housing
218 market, dominated by the Federal National Mortgage
219 Association, Fannie Mae, and the Federal Home Loan Mortgage
220 Corporation, Freddie Mac. Without question, mortgage-backed
221 assets sliced and diced and scattered throughout the
222 financial system lie at the epicenter of the economic
223 earthquake shaking world markets. Ripples from defaults on
224 subprime loans underwritten by Fannie and Freddie grew to a
225 tsunami that helped swamp Lehman Brothers and others,
226 including AIG. And Fannie and Freddie were able to launch
227 more than $1 trillion, $1 trillion of bad paper into the
228 private market because regulators and Congress let them do
229 it.
230 This committee cannot conduct a credible examination of
231 the current crisis without focussing on the market distorting
232 power of the Federal mortgage giants and the firewall against
233 reform, manned by their enablers here in Congress.
234 No one is disputing the committee's focus on executive
235 pay. We agree; company compensation is a telling indicator
236 of a corporate culture detached from larger market realities
237 and the fundamental fiduciary duty to be frugal stewards of
238 other people's money. And that "me first" self-indulgence
239 was just as rampant at Fannie Mae as in its private sector

240 partners and competitors.

241 From 1998 to 2003, Fannie Mae CEO Franklin Raines alone
242 took over $90 million in salary and bonuses. The Raines team
243 was even caught manipulating accounting practices to
244 overstate profitability so they could grab what their
245 overseer called, quote, ill-gotten bonuses in the hundreds of
246 millions of dollars. The Fannie Mae board gave recently
247 ousted CEO Daniel Mudd a $2.6 million bonus in 2005 on top of
248 his $3.5 million salary based on a set of nonfinancial goals,
249 such as promoting respect, appropriate and productive
250 relationship with regulators.

251 In the context of a $6 trillion mortgage securities
252 portfolio, those paydays may seem like small change, but it's
253 indicative of a prevalent and noxious rot that threatens the
254 moral underpinnings of the entire capitalist business model.
255 So we need to keep the toxic twins, Fannie and Freddie, at
256 the center of this investigation, not on the edge, not out in
257 the future but right now.

258 Yesterday we sent a formal request to the chairman
259 asking for a specific commitment to make the Federal mortgage
260 companies a priority in this hearing, not after afterthought.
261 We can't wait until Halloween to unmask these two failed
262 monsters of mortgage finance.

263 As for AIG, I'm interested in learning more about the
264 corporate decision-making that took a solid insurance

265 business into the far less stable world of credit default
266 swaps and other exotic derivatives. They thought they were
267 selling insurance, when in fact they were betting the
268 company's soul in a high stakes game of Russian roulette. We
269 need to ask what AIG knew about the risk behind these novel
270 products, when they knew the bet soured, and how they
271 informed investors, policyholders, regulators and the public
272 that the company was in peril. AIG, like Fannie Mae and
273 Freddie Mac, was considered too big to fail.
274 Going forward we need to grapple with the implications
275 of the concept, government will be there to break the fall of
276 some large businesses but not others. It's been said,
277 capitalism without failure is like religion without sin. Any
278 doctrine loses its moral authority when bad conduct is
279 rewarded and the consequences of poor choices are foisted on
280 someone else. Investigating the causes and effects of this
281 financial debacle should involve assigning capability,
282 culpability, and restoring integrity and balance to the
283 system of risks, rewards, and penalties our society uses to
284 assign value to labor, capital, and commerce.
285 Thank you, Mr. Chairman.

286 STATEMENTS OF ERIC R. DINALLO, SUPERINTENDENT, NEW YORK STATE
287 INSURANCE DEPARTMENT; AND LYNN E. TURNER, FORMER CHIEF
288 ACCOUNTANT, SECURITIES AND EXCHANGE COMMISSION

289 Chairman WAXMAN. Thank you very much, Mr. Shays.
290 Chairman WAXMAN. For our first panel, we'll hear from
291 Lynn Turner, who served as chief accountant of the Securities
292 and Exchange Commission from 1998 to 2001. He has served on
293 the boards of public companies as a professor of accounting,
294 as a partner in an auditing firm and as the managing director
295 of a research firm. He is currently a senior advisor at
296 Kroll, Inc.
297 Eric Dinallo currently serves as the superintendent of
298 the New York State Insurance Department. From 1999 to 2003,
299 he served as the chief of the Securities Bureau at the New
300 York State Attorney General's Office. Mr. Dinallo has also
301 served as general counsel at a large insurance broker and as
302 managing director for regulatory affairs at Morgan Stanley.
303 We're pleased to welcome both of you to our hearing this
304 morning. It's the practice of this committee that all
305 witnesses that testify before us do so under oath. So I
306 would like to ask if you would stand and raise your right
307 hand.
308 [Witnesses sworn.]

309 Chairman WAXMAN. The record will indicate that both of
310 the witnesses answered in the affirmative.
311 You have given us prepared statements, some quite
312 lengthy. And I want you to know that all of those
313 statements, both of those prepared statements will be in the
314 record in its entirety. What we would like to ask you to do
315 is try to be mindful of 5 minutes that we allocate to the
316 oral presentation. We won't cut you off if you exceed 5
317 minutes, but we will have a clock in front of you that will
318 be green for 4 minutes. For the last minute, it will turn
319 yellow. After 5 minutes, it will turn red. And then we
320 would like you to then wind down your presentation.
321 Mr. Dinallo, why don't we start with you.

322 STATEMENT OF ERIC R. DINALLO

323 Mr. DINALLO. Thank you, Chairman. Thank you, Chairman.
324 It's an honor to be here. I'm here to try to explain,
325 from our perspective, a little bit about what happened at AIG
326 and what the New York State Insurance Department's role in
327 that was.
328 The Insurance Department regulates certain insurance
329 companies. I think that's a very important distinction to
330 make at the beginning. AIG was not strictly an insurance
331 company, as was said earlier. It was probably the largest
332 financial services company in the world. And in fact, I
333 think its economic activity on the financial services side
334 exceeded its economic activity on the insurance side.
335 I agree that a large number of the problems there were
336 due to credit default swaps and collateralized debt
337 obligations stemming from subprime and the mortgage industry.
338 But that activity was largely, if not exclusively, done out
339 of Financial Products Division, which was sort of a
340 subsidiary of the holding company.
341 The most immediate problem that got our attention was
342 the pending downgrade of the company. So one of the rating
343 agencies had threatened on I think it was September, I don't
344 know, 9th or so to downgrade the company. That's when I

345 received a call from the general counsel and the former CFO
346 asking if we would be able to help provide certain liquidity
347 through the insurance subsidiaries, which were very solvent
348 and well capitalized. For the time before that, we had been
349 monitoring the situation but it was a monitoring of the
350 situation based on the declining stock price of the company
351 and our wanting to confirm that the insurance subsidiaries
352 were solvent and policyholders were protected.
353 So it was in those conditions that we showed up at the
354 company on Friday, Saturday and Sunday, the long weekend,
355 which went into Monday and Tuesday at the Federal Reserve
356 where different private solutions were looked at. The
357 history is well written now in the press. But I can answer
358 questions about that.
359 But the solvency problem was fine. The liquidity
360 problem kept on growing over the weekend. And the hole
361 looked larger and larger. And whatever we could have done
362 through New York State, which the Governor of New York, David
363 Paterson, had authorized us to try to help do, became not
364 enough, and we ended up with a larger and larger liquidity
365 holder problem.
366 We were there to validate the concerns of the company,
367 which were true. We were also there I think to validate for
368 the Federal Reserve that there was real solvency and capital
369 in the insurance companies which was what the bedrock of the

370 transaction was. In other words, the $85 billion could not
371 have been loaned if there was not any hope of getting the
372 money back, and to a large extent whatever returns there are
373 going to be is because of the robustness of the insurance
374 company.
375 To a large extent, I agree. I think that AIG got well
376 away from its core competency of insurance. It went into
377 very complex instruments called credit default swaps, which I
378 can explain some of the basics as I've been asked. But
379 overall, the State regulation of it, I think, worked quite
380 well. It is a lesson for us to talk about, I hope, about
381 what is the right way to regulate holding company
382 undertakings.
383 There were 71 U.S. insurance companies. As I said,
384 without them, there would not have been a bailout. But to an
385 almost exclusive extent, the problem was caused by activities
386 conducted out of Financial Products. Those activities were
387 largely through the writing of credit default swaps. They
388 are a legitimate need for hedging of risk, which was the
389 beginning of credit default swaps probably in the 1980s.
390 It's where you own a bond, let's just say, you own Ford
391 bonds. And you want to hedge your risk that Ford is going to
392 default on those bonds, so you go to a third party and you
393 ask them to essentially insure you against that default.
394 That's the swap. That's the part of the swap. You're

395 swapping the risk of the default with a third a party. That
396 is called hedging also. And it is often also called
397 insurance in the sense you are buying insurance against the
398 default of the bond.
399 But I think that the committee should know that that is
400 now only about 10 percent or so of credit default swaps that
401 are outstanding in the world. There are probably over $60
402 trillion of credit default swaps. An overwhelmingly high
403 percentage are what I termed a couple months ago naked credit
404 default swaps. What that means is you enter into a contract
405 with a party. Neither of you own any exposure to Ford.
406 You're just taking a bet. You're taking a gamble on whether
407 Ford is going to default or enter into bankruptcy or not.
408 It's a form of shorting. It's the way we short the
409 credit-worthiness of our industries. It is far larger than
410 the equity shorting--and you've heard about naked shorting in
411 the equities market and how Chairman Cox asked to have that
412 prohibited and did.
413 It's interesting that on the bond side, on the
414 credit-worthiness side, we've permitted this to run
415 completely unchecked to the point that it is larger than the
416 entire economic output of the world annually. That's where
417 we are on credit default swaps.
418 And the Governor has said that he's willing to regulate
419 the piece that we can, which is the insurance piece, that

420 original 10 percent we can easily call an insurance product.
421 We can regulate that because it is an insurance transaction
422 as I described. You own the bonds. You have exposure.
423 You're not going to the track and placing a bet, and that's
424 when you get your exposure. And we can do that. And the
425 Governor has announced that as of January 1, if there is not
426 a more holistic solution through a central counter-party
427 clearing or an exchange or some kind of clearing house that
428 the Governor and the insurance department is willing to do
429 that to help sort of clarify what Chairman Cox called the
430 regulatory black hole of credit default swaps.
431 I will note, just because I'm in front of Congress and
432 maybe this is helpful, that it required the Commodity Futures
433 Modernization Act of 2000 which I believe was a statute
434 passed by Congress to exempt credit default swaps, the naked
435 kind that I described, from being subject to the gaming laws
436 of the various States and to what are called the bucket shop
437 laws. That is a very--it's kind of funny, but it is kind of
438 funny. I could read to you that there's a law that's
439 directly on point that prohibits that kind of activity,
440 entering into this agreement without any exposure to the
441 reference. And it required the CFMA to say that's not
442 gambling. And likewise, as Chairman Cox pointed out, it also
443 was required that it be not a security, otherwise it would
444 have been regulated by the SEC.

445 So the CFMA both in one fell swoop said CDSs are not a
446 security, and they're also not subject to the gaming laws of
447 the land. And I think when you talk about moral hazard and
448 the way they got it right in the 1920s, which is the law I'm
449 referencing, 1907, they probably understood some things then
450 that we sort of forgot along the way. And now we're $63
451 trillion to the worse. Later on, I can read you if you'd
452 like, but it's pretty well established, and I think it's
453 something that we should at least examine along with whether
454 Glass-Steagall was such a mistake or not and other ways that
455 we sort of protect our depository institutions, like
456 insurance companies and commercial banks, from attendant
457 activities at the holding company level.
458 Thank you very much.
459 [Prepared statement of Mr. Dinallo follows:]

460 ******** INSERT 1-1 ********

461 Chairman WAXMAN. Thank you, Mr. Dinallo.

462 Mr. Turner.

463 STATEMENT OF LYNN E. TURNER

464 Mr. TURNER. Thank you, Chairman Waxman, committee
465 members.

466 I think this is a very important hearing in light of the
467 fact that we're watching millions of Americans lose their
468 jobs. They've lost their homes. Now, as we watch the stock
469 market come down, they're also losing their savings. Much of
470 this is destruction and devastation I think that could have,
471 and quite frankly should have, been avoided.

472 Chairman WAXMAN. Could you pull the mike a little
473 closer to you? There is a button on the base.

474 Mr. TURNER. It is on. Is that better?

475 Put it in the words of philosopher George Santana, those
476 who cannot remember the past are condemned to repeat it. And
477 certainly we fall in that category today.

478 AIG serves as a reminder, an unfortunate but excellent
479 example of what is wrong with our financial system today.
480 While there are many capital participants that have operated
481 within sound business, ethical, and legal boundaries, there
482 have been far too many that have not. We began the decade

483 with the mess around names such as Enron and WorldCom,
484 followed by the Wall Street analyst scandal, then on to
485 mutual fund late trading and market timing, then the stock
486 option backdating at such companies as United Health, and now
487 we find ourselves in the midst of the biggest and by far and
488 away the most destructive of all, the subprime fiasco.
489 This is a crisis that could have and, in my opinion,
490 should have been averted before it cost the American
491 taxpayers what appears to be in excess of a trillion dollars
492 before we're all said and done with it. And certainly
493 there's plenty of blame to go around. All of us I think
494 probably share in that to some degree. But I hope the focus
495 of Congress and this committee would be, on a bipartisan
496 basis, holding hearings that, much like an investigation
497 occurs when a plane crash goes down, determines what went
498 wrong and then promptly turns around and fixes it so we don't
499 repeat history.
500 From my perspective, some of the causes of this economic
501 crisis include executives and mortgage brokers engaging in
502 unsound if not illegal business practices, compensation and
503 incentives resulting in some business executives being paid
504 both coming and going as they walk away from the equivalent
505 of quite frankly a train wreck with huge severance packages
506 that their corporate boards actually agreed to; accounting
507 standard setters who failed to provide the markets with the

508 necessary transparency; woefully inadequate due diligence by
509 investment banks underwriting the securities; cheap debt set
510 up by our monetary policy people that created low interest
511 rates and led to tremendous leverage in debt in this country;
512 as Eric mentioned, a $62 trillion unregulated credit
513 derivative market which had absolutely no transparency
514 whatsoever; the SEC being handcuffed by a lack of resources,
515 lack of regulatory authority and changes in policy that no
516 doubt have hampered enforcement; the lack of a regulator that
517 could regulate at the holding company level for national and
518 global insurance companies; and the failure of the Federal
519 Reserve and banking regulators whose exams failed to identify
520 and rectify unsound lending practices at institutions such as
521 IndyMac, WaMu, Countrywide, and Citigroup, and often these
522 practices led to what is our fundamental problem, loans got
523 made that people could not repay.
524 In addition, policymakers and regulators have allowed
525 financial institutions to merge and grow into colossal
526 entities that have shown they can have a devastating impact
527 on our economy when they get into trouble. Some are arguing
528 that, as we've heard, they're now too large to fail. And
529 with their failure now, though, resulting in taxpayers paying
530 hundreds of billions to rescue them, it's time to examine
531 good public policy to ensure that regulation of these
532 entities provide much greater transparency, freedom from some

533 of the conflicts we've seen, accountability for their actions
534 and oversight.
535 Investor confidence is paramount to the success of any
536 capital market. And transparency is what creates that
537 confidence. Indeed, it is the lifeblood of any capital
538 market system. When people believe they can no longer trust
539 those for whom they invest their money, they withdraw it
540 quickly and find safer havens for it, as we're seeing today.
541 And when they demand their money back from a financial
542 institution for fear of losing it, it can cause a serious
543 liquidity crisis and failure, as we've seen at Bear Stearns,
544 Lehman, and others. And as the money dries up and demand for
545 the investment of the stock in these institutions falls, so
546 does their stock price, making capital difficult if not
547 impossible to raise. It's a vicious cycle. But it is one
548 that has occurred many times in the past.
549 More specifically, with respect to AIG, there has been,
550 in my opinion, poor management and governance that has led to
551 a poor tone at the top and lack of risk management controls.
552 I heard the chairman talk about Mr. St. Denis and his
553 concerns. Mr. St. Denis worked for me at the SEC. He worked
554 for me when I was a partner in the accounting firm. And his
555 credibility is beyond reproach, and I'd seriously consider
556 the comments that he has provided you.
557 The company has engaged in questionable business

558 practices, including assisting others engage in illegal
559 activities. This along with a constant slew of errors being
560 reported in its financial statements have led to various
561 investigations by legal authorities and sanctions. It's not
562 a company that has a good track record. And in addition,
563 opaque disclosure has been less than forthcoming. In the
564 summer of 2007 an AIG executive said that the company would
565 not incur a dollar of loss, would not incur a dollar of loss
566 on its derivatives. Yet by December of last year,
567 counterparties to the credit insurance required posting a
568 collateral of over $5 billion, a number that had grown to $14
569 billion as of June of 2008. And in a stunning revelation,
570 the company disclosed on October 3 that it borrowed $61
571 billion of the $85 billion made available to it by the
572 Federal Reserve. The rapid changing disclosures on this,
573 from zero to $61 billion in less than 12 months, is
574 phenomenal, and investors certainly have to raise the
575 question of, did we get the straight scoop back a year ago?
576 At the same time, AIG, in a move that appears to deflect
577 criticism, blamed its problems on accounting rules which
578 required it to disclose losses to its investors. This is
579 like blaming the thermometer folks for a fever. As we saw
580 with the savings and loan crisis and as the GAO, Congress's
581 own watchdog has reported at the time, the ability of
582 financial institutions to reporting--to avoid reporting to

583 clients in the value of assets contributes to unsound
584 business practices and large losses for the government who
585 has to step in with a bailout. Again, we should not forget
586 the past and repeat these costly mistakes. Thank you, Mr.
587 Chairman.
588 [Prepared statement of Mr. Turner follows:]

589 ******** INSERT 1-2 ********

590 Chairman WAXMAN. Thank you very much, Mr. Turner.
591 We'll now recognize members for 5 minutes each to ask the two
592 of you questions.
593 And I want to recognize Mrs. Maloney first.
594 Mrs. MALONEY. Thank you, Mr. Chairman.
595 And I'd like to welcome our panelists and thank them for
596 their public service, particularly Mr. Dinallo from New York
597 State. Thank you and the Governor for your creative response
598 to the AIG crisis.
599 Last night and this morning I have been criticized for
600 some pundits of my line of questioning on deregulation. Some
601 of them called it partisan. I just want to begin by saying
602 that our financial crisis is not a partisan issue. I truly
603 do believe that every Republican, Democrat, Independent,
604 conservative, liberal are dedicated to working towards a
605 solution, and I believe the Members of Congress want to find
606 a solution.
607 I am going to ask questions on deregulation and the
608 relationship to the problems we confront. But I want to
609 preface it by saying I am not being partisan. I am not
610 criticizing anyone or any act or any particular thing. I am
611 just trying to understand more about it.
612 And so with that being said, I'd like to ask Mr. Dinallo
613 a few questions about the lack of regulation around credit
614 default swaps of which seem to be at the center of AIG's

615 downfall. Credit default swaps are basically insurance
616 contracts to protect against defaults on bonds and loans.
617 It's an enormous market.
618 Since 2000, it has exploded from $900 billion to $58
619 trillion. That's roughly twice the size of the entire United
620 States stock market. It is also bigger, I understand, than
621 the annual output of the entire world economy for 1 year.
622 And yet, incredibly, the market for credit default swaps is
623 entirely unregulated. Although they operate like insurance
624 contracts, parties selling these guarantees are not required
625 to have capital reserves to protect the other party. And I
626 would first like to ask, because they are so huge, $58
627 trillion, if there is no value behind them, as some
628 economists allege, could they bring down our entire economy?
629 Mr. DINALLO. Well, I guess we're going to find out. I
630 hope not. But I will say that the distinction between credit
631 default swaps and insurance policies is when you write an
632 insurance policy, you're required to have a certain amount of
633 solvency and capital behind that commitment. For a large,
634 large, large percentage of credit default swaps, you're
635 required to have absolutely no collateral or capital behind
636 them. I--I do agree that it is interesting to note that, as
637 Lynn said, it is not, you know, insider trading or late
638 trading or the analyst cases or lax regulation or firm
639 regulation or hard enforcement or soft enforcement that

640 brought down the global economy.

641 I think it's politically neutral to observe; it's what
642 we chose not to regulate. And I don't think that's actually
643 very partisan at all. I think we as a country in 2000 made
644 certain choices, along Gramm-Leach-Bliley and the CFMA, to
645 permit this kind of activity as being a way to, ironically,
646 to hedge risk. This is the ironic part. CDSs were to meant
647 to hedge risk. But they multiplied risk incredibly in part
648 because now only about 10 percent of what you describe is
649 actually an insurance policy kind of transaction. The rest
650 is really just a bet about the future of a company's
651 credit-worthiness.

652 Mrs. MALONEY. So are those products just gambling, as
653 you mentioned?

654 Mr. DINALLO. Well, the Governor called them gambling.

655 Mrs. MALONEY. We had the bucket shop laws, and we
656 banned it in New York State. And then the commodities law
657 usurped our position, and you think that that should change?

658 Mr. DINALLO. We did ban it. In 1909, after the crash
659 of 1907, we banned this kind of activity that used to be done
660 in bucket shops where they would just take bets on the
661 market, bucket the trades. And yes, that is what we did.
662 And it required this--and no lawyer, no good lawyer could
663 convince a client that a naked credit default swap was not
664 also possibly prosecutable as gaming, so the CFMA,

665 appropriately, because we do need some kind of futures
666 market--there is a role here--but it completely exempted
667 them. And the results are, in part, what you see today,
668 which is not necessarily all about credit default swaps, as
669 Lynn said, but also just the opacity.
670 One of the important points, I think, is when we were
671 working through the bond insurers and back at MBIA and all
672 the work we did on those, as you know, and at AIG, no one,
673 including ISDA, could tell you how much credit default swaps
674 were written on those entities as reference points. So if
675 AIG had failed, no one knew how much CDS was written on AIG.
676 Mrs. MALONEY. My time has expired.
677 Chairman WAXMAN. Yes. Thank you.
678 Thank you, Mrs. Maloney.
679 Mr. Mica.
680 Mr. MICA. Thank you.
681 First of all, let me say that I'm pleased that we may be
682 looking at Fannie Mae and some of its responsibility in
683 fomenting the financial crisis and the mess that we see right
684 now.
685 I'm disappointed, though, that we didn't start with some
686 of the culprits, and we should actually have reviewed some of
687 what took place with the Federal backed agency that helped,
688 again, get us started down this wrong path. Yesterday and
689 today we're sort of splashing around in the wading pool, and

690 we really need to be looking at the cesspool. We're talking
691 today about AIG, a private firm, now with government backing,
692 but it was a private firm; and yesterday about Lehman
693 Brothers, a private investment firm and their compensation,
694 their running away with millions of dollars of investor
695 dollars. And we're ignoring the core perpetrator of all
696 this, Fannie Mae, whose executives ran away with tens of
697 millions of dollars in public-backed bonuses, public-backed
698 activities.

699 Is it correct that AIG and Lehman are private investor
700 firms as opposed to Fannie Mae?

701 Mr. DINALLO. Yes.

702 Mr. MICA. Just for the record, they both nodded their
703 heads affirmatively.

704 Mr. Turner, I read your written testimony. I agreed
705 with most of it. You didn't mention Fannie Mae or Freddie
706 Mac. Were their practices in any way contributory to the
707 financial mess we're in?

708 Mr. TURNER. I have actually done work on behalf of
709 OFHEO at both Fannie and Freddie.

710 Mr. MICA. Ok, then I don't want to hear your opinion--

711 Mr. TURNER. But let me just say that I see great
712 similarities between both of those institutions and AIG. And
713 I applaud you, very highly, for taking a look at those two
714 because I don't see a whole lot of distinction.

715 Mr. MICA. Well, I want to do more than applaud because
716 if this committee isn't going to investigate, I intend to ask
717 the now--the special counsel statute has expired, but it's my
718 understanding that the Attorney General can help us drain the
719 swamp and go after those who created the cesspool. And I'm
720 going to ask my fellow Republicans and Democrats to consider
721 asking the Attorney General to go after those folks who
722 robbed the American taxpayer and start with Fannie Mae, which
723 is a federally-backed institution, which you both nodded to,
724 which started, in my opinion, this whole mess. There were
725 contributing factors. Glass-Steagall, didn't that
726 contribute? Just answer yes if you agree.
727 Mr. Turner, did you think Glass-Steagall, the repeal--
728 Mr. TURNER. I think the repeal of Glass-Steagall was a
729 contributing factor here.
730 Mr. MICA. Okay, Mr. Commissioner?
731 Mr. DINALLO. I agree.
732 Mr. MICA. One of the interesting things, too, New York
733 did--in most cases, the States were pretty good regulators of
734 insurance, is that correct?
735 Mr. DINALLO. Thank you. Yes. I think the record would
736 support that.
737 Mr. MICA. And default swap is really out of your
738 purview. But even regulation of what Fannie Mae and what
739 they were doing and some of the activities that took place at

740 government-sponsored financial enterprises: 2002, Mr. Shays
741 and I introduced a law that would have brought this activity
742 under the SEC. That would have helped regulate it. 2004, it
743 was introduced and passed, actually, I think in 2005 by the
744 House and blocked in the Senate, is that right?
745 Mr. TURNER. It was actually--Congressman Frank, much to
746 his credit, did introduce legislation that got passed in the
747 House over here, and I applaud--
748 Mr. MICA. But it was blocked in the Senate.
749 Mr. TURNER. But it was not passed in the Senate, and
750 that was greatly unfortunate.
751 Mr. MICA. Yes, I voted against it--Glass-Steagall, Mr.
752 Waxman and I voted against--not to repeal that. We voted
753 opposite for the regulation in 2005.
754 But the responsibility lies with Congress, not with a
755 State of New York Department of Insurance or some other State
756 to regulate and go after some of these speculative investment
757 activities at that level. Is that not right?
758 Mr. DINALLO. The responsibility of the State
759 regulators, which I think they executed on extremely well
760 here--
761 Mr. MICA. Yes, but you couldn't control the situation,
762 is that correct?
763 Mr. DINALLO. To protect policyholders and protect the
764 solvency of the insurance company.

765 Mr. MICA. It's the responsibility of the Congress of
766 the United States, and also it's the responsibility of the
767 Congress to start first with its--and clean up its own dirty
768 cesspool, which is Fannie Mae. And we still don't have a
769 commitment or a date to do that. And I know exactly why.
770 Chairman WAXMAN. The gentleman's time has expired.
771 Mr. Cummings.
772 Mr. CUMMINGS. Thank you very much, Mr. Chairman.
773 And to the witnesses, I want to thank you all for being
774 here.
775 And my constituents are concerned about where the $700
776 billion is going. They want to know, because they get up
777 every morning. They work hard. They give up their tax
778 dollars, and they're trying to figure out where did the money
779 go? Where is it going?
780 Mr. Turner and Mr. Dinallo, after the bailout of AIG
781 last month, the United States Government effectively bought
782 an 80 percent share in the company. That should have caused
783 a fundamental change, you would think, in how the company was
784 spending funds on compensation, bonuses and benefits. But it
785 doesn't look like that's what happened. The committee
786 learned that shortly after the bailout went through,
787 executives from AIG's major U.S. life insurance subsidiary,
788 AIG American General, held a week-long conference at an
789 exclusive resort in California.

790 The resort is called the St. Regis Monarch Beach. Let
791 me put up some pictures of the hotel up on the screen. It's
792 very impressive. This is an exclusive resort. The rooms
793 start, gentlemen, at $425 a night. Some are more than $1,200
794 a night. By the way, that's more than some of my
795 constituents pay on a mortgage payment every month on the
796 homes that they're now losing, by the way.
797 We contacted the resort where AIG held this week-long
798 event. And we requested copies of AIG's bills. We learned
799 that AIG spent nearly half a million dollars in a single week
800 at this hotel. Now this is right after the bailout.
801 Mr. Turner, have you heard of anything more outrageous,
802 a week after taxpayers commit $85 billion to rescue AIG, the
803 company's leading insurance executives spend hundreds of
804 thousands of dollars at one of the most exclusive resorts in
805 the Nation? Mr. Turner?
806 Mr. TURNER. I've been a business executive myself, and
807 I tell you what, when our company--you know, when things got
808 tough, you cut back on expenses. You just go out and
809 eliminate those type of things. I'm sure they had the issue,
810 they were probably already committed to it and were going to
811 have to spend it one way or another. But nonetheless, I
812 remember, we--as business executive VP and CFO of a company,
813 we would actually go out and cancel those conferences because
814 we just didn't want to send a message to the employees that

815 we are spending on this type of thing and we need to cut back
816 expenses.
817 Mr. CUMMINGS. And if a company is drowning, then you're
818 going to go and spend that kind of money? It's crazy. And I
819 agree with you.
820 Let me describe for some of you the charges that the
821 shareholders who are now U.S. taxpayers had to pay. Check
822 this out. AIG spent $200,000 for hotel rooms. And almost
823 $150,000 for catered banquets. AIG spent--listen to this
824 one--$23,000 at the hotel spa and another $1,400 at the
825 salon. They were getting their manicures, their facials,
826 their pedicures and their massages while the American people
827 were footing the bill. And they spent another $10,000 for, I
828 don't know what this is, leisure dining.
829 Ms. SPEIER. That's bars.
830 Mr. CUMMINGS. Oh, thank you very much.
831 Mr. Dinallo, let me ask you, not as the insurance
832 commissioner but as a taxpayer, does this look right to you?
833 Mr. DINALLO. I think there are some regrettable
834 headlines in that. But I will say one thing, having been at
835 large global companies and knowing what condition AIG was in
836 when the injection occurred, the absolute worst thing that
837 could have happened to AIG after the Government extended $85
838 billion would have been for them to basically go into a
839 run-off situation, for employees to leave, for traders and

840 major underwriters to flee the company. So if there was a
841 thinking that they needed to bring everybody together in
842 order to keep the productivity of the insurance companies in
843 tact and protect policyholders by keeping them from going
844 into a run-off status, I do agree there is some profligate
845 spending there, but the concept of bringing all the major
846 employees together to mix--let me just--to ensure that the
847 $85 billion could be as greatly as possible paid back would
848 have been not a crazy corporate decision.
849 Mr. CUMMINGS. Well, I would tend to disagree with you.
850 When it comes to pedicures facials manicures, the American
851 people are paying for that.
852 Mr. DINALLO. I agree.
853 Mr. CUMMINGS. And they're very upset.
854 Mr. DINALLO. I said there are regrettable and wrong
855 headlines in that. But the idea of making sure that you can
856 get the game plan back on track so you can pay off the loan
857 is not an irrational one.
858 Mr. CUMMINGS. That is an expensive way to get the game
859 plan back on track.
860 Mr. DINALLO. I agree.
861 Chairman WAXMAN. The gentleman's time has expired.
862 Mr. Bilbray.
863 Mr. BILBRAY. Thank you, Mr. Chairman.
864 And, Mr. Chairman, let me say personally, thank you very

865 much for agreeing to do a hearing on Freddie and Fannie. I
866 appreciate you doing that. I hope we can get that date.
867 Mr. Turner, I appreciate your frankness of saying, even
868 though I'm not talking about it, we need to go back and look,
869 concentrate on Freddie and Fannie.
870 I appreciate, Mr. Chairman, your ability to respond to
871 that reality.
872 And in fact, Mr. Chairman I would almost say that we may
873 be sitting in a situation that now that Freddie and Fannie
874 has become public agencies, that we may want to talk to the
875 Attorney General about the possibility of a special
876 prosecutor to go in and take a look at that as one of the
877 public agencies. And I think that's important to show the
878 American people we really are serious at getting to
879 correcting some of these problems and really doing it based
880 on an in-depth study of the problem.
881 Let me sort of backtrack. This issue of the credit
882 swaps, it seems like there are two--there's a balancing line
883 here, where it is an insurance hedge and then they move into
884 a gambling. Now, the preemption that the feds put in to say
885 it is not gambling totally, wouldn't you agree that maybe we
886 ought to go back and revisit that and try to develop a bright
887 line between what is gambling and the States can intervene on
888 as opposed to what is insurance and States can't intervene?
889 Mr. DINALLO. Yes. What I would have done is I would

890 have said that each one of those activities had to get some
891 kind of an exemption activity by activity. So there is a
892 good argument that sort of, in crop insurance, you need
893 futures to protect yourself against crop failure, et cetera.
894 There are lots of hedging activities that are kind of on the
895 border. You don't maybe absolutely own the security or the
896 bond, but you do have exposure. But we basically through the
897 law--I could read to you--we completely exempted all of it.
898 And I think it needs to be seriously revisited.

899 Mr. BILBRAY. Mr. Chairman, this is the type of line
900 that I wish, instead of just us meeting, and maybe we ought
901 to ask the Speaker to reconvene the Financial Services
902 Committee, to meet now, not out a month from now, to talk
903 about the specific proposals that the House could come back
904 into session and address.

905 Gentlemen, if you were in Congress, you were a Member of
906 Congress and maybe in the Financial Services Committee, what
907 changes and what proposals would you propose to the Speaker
908 of the House of Representatives, to the President and the
909 leader of the Senate at this time and place?

910 Mr. DINALLO. I would first revisit the CFMA on its
911 credit default swap decisions that it's a completely
912 unregulated and open field and that it's neither a security
913 nor subject to the gaming laws and get back to the hedging
914 instrument, which is I think core for our society and

915 appropriate. I would take a serious look at
916 Gramm-Leach-Bliley and decide whether the supermarket of
917 financial services is worth it when sometimes things really
918 smell on aisle six and infect the rest of what we view as
919 kind of sacred stuff, which is depository money; whether it's
920 insurance policy proceeds or banking, commercial banking
921 deposits, there needs to be a greater clarity about how the
922 holding company activities, which here did not bring down the
923 insurance companies but did ding them from a franchise value
924 greatly, can harm those two depository type institution
925 activities, and whether it's always good to just let them
926 willy-nilly be together under a holding company type
927 umbrella.

928 Mr. TURNER. Congressman Bilbray, you actually raised a
929 very good question. My first comment would be that
930 certainly, I think, the American public were concerned about
931 how quick we ran into the $700 billion bailout, but I do
932 applaud you for doing the bailout. I think without a doubt
933 it needed to be done. It could have been done in perhaps a
934 different fashion.

935 But I think the public is looking for Congress to do
936 what this committee--and I agree with you, what the Financial
937 Services and the Senate Banking Committee should be doing,
938 and that is immediately holding a series of hearings, just
939 like the Pecora hearings were held in the 30s. We need a set

940 of hearings that first identify some of the issues where each
941 of the problems should be. It should be all inclusive. It
942 should be the whole swamp. As people mentioned, let's drain
943 it all out, and then turn around and, once we know where each
944 of the issues are, bring in very knowledgeable people, like a
945 Chairman Volker and like a Chairman Leavitt and the type, to
946 turn around and get the best of their thinking.

947 And then with that, then let's go take a real good shot
948 at putting in the things that need to be fixed. And there's
949 a gob of things. There's questions about who should be doing
950 the examination of these. There's questions about failures
951 at the Fed and failures at the SEC. Do we need to
952 restructure those examination functions, which I think we
953 probably do? Do we have adequate resources? Do we need to
954 repeal the Gramm-Leach-Bliley in light of what's happened
955 with the growth of these institutions and they're too big to
956 fail?

957 Certainly there's things that need to be done in terms
958 of transparency because both in the credit derivatives market
959 as well as some of the other subprime stuff, there's been a
960 tremendous, tremendous lack of transparency, which has
961 directly contributed to the lack of confidence. And I serve
962 on two--the boards of two investment funds. And right now,
963 people can't tell which companies they can trust and which
964 ones they can't because of that lack of transparency. Until

965 we get that problem solved, we are going to continue to see
966 days like we saw yesterday in the stock market.
967 Mr. BILBRAY. Mr. Chairman, thank you.
968 I just got back from my district. And the outrage is
969 not that we threw money at the problem but that we threw
970 money at the problem and look like we've walked away for a
971 month. And if it such a crisis to throw that much money out
972 there, my constituents are saying there should be a crisis
973 that you get in and not walk away from answers or demanding
974 answers to solve the problem.
975 Thank you very much for the opportunity to question the
976 panel.
977 Chairman WAXMAN. Thank you very much Mr. Bilbray.
978 Of course, that's the purpose of this hearing.
979 Mr. Kucinich.
980 Mr. KUCINICH. Thank you very much, Mr. Chairman.
981 To Mr. Dinallo, Treasury Secretary Paulson is the former
982 CEO of Goldman Sachs. Mr. Paulson, of course, was involved
983 in helping to save AIG. And Goldman Sachs is AIG's largest
984 trading partner. News reports say that Goldman Sachs had at
985 least $20 billion at stake in AIG.
986 Now you, sir, were involved in negotiations to rescue
987 AIG. Was the CEO of Goldman Sachs Lloyd Blankfein and other
988 Goldman Sachs executives present at meetings to save AIG?
989 Mr. DINALLO. Yes.

990 Mr. KUCINICH. Could you speak into the mike.

991 Mr. DINALLO. Yes. Yes.

992 Mr. KUCINICH. Was Secretary Paulson at any of those
993 meetings?

994 Mr. DINALLO. None that I was present at.

995 Mr. KUCINICH. Do you have any knowledge that Secretary
996 Paulson was present at any meetings relating to saving AIG?

997 Mr. DINALLO. I'm not trying to avoid the answer. I
998 just had no personal knowledge of that.

999 Mr. KUCINICH. Do you have knowledge that he was the
1000 former CEO of Goldman Sachs?

1001 Mr. DINALLO. Oh, absolutely. Oh, I can talk to you--I
1002 am happy to talk to you about this. You're asking me
1003 yes-or-no questions, and I'm finding it hard to--

1004 Mr. KUCINICH. Before the bailout, did Secretary Paulson
1005 or other Federal officials raise concerns about the impact
1006 that the AIG collapse would have on Goldman Sachs?

1007 Mr. DINALLO. Yes, but not only Goldman Sachs. In fact,
1008 if I may, I'll just tell you that I--I admire Tim Geithner,
1009 the president of the Federal Reserve. He has taught me
1010 various techniques in working through some of these problems.
1011 One of them is he believes--

1012 Mr. KUCINICH. I'm not really asking you about Mr.
1013 Geithner, so I want to know--

1014 Mr. DINALLO. Well, I just want to finish--please, sir.

1015 Mr. KUCINICH. But you are on my time and I want you to
1016 answer my questions. Now my question is, the head of global
1017 commerce--
1018 Mr. DINALLO. Yes.
1019 Mr. KUCINICH. For Lehman sent an e-mail on July 13,
1020 2008, to Lehman's CEO which said, and I quote from, it is
1021 very clear GS, speaking of Goldman Sachs, is driving the bus
1022 with the hedge fund cabal and greatly influencing downside
1023 momentum, meaning that Goldman Sachs was working to
1024 intentionally drive down the price of Lehman's stock. This
1025 was in mid July. 2 months later, Lehman went down with
1026 tremendous impact on the market and impact all over the
1027 world. But AIG was saved.
1028 Now, what I'm trying to find out, you know, if Lehman's
1029 death was natural causes or murder. Now we're told that
1030 Secretary Paulson, as a former CEO of Goldman Sachs, has
1031 brought in another former Goldman Sachs employee to manage
1032 the $700 billion bailout fund.
1033 Now, Mr. Dinallo, you are the superintendent of New York
1034 insurance.
1035 Mr. DINALLO. Yes.
1036 Mr. KUCINICH. You are a regulator. As a regulator, do
1037 you have any concerns that Mr. Paulson, as the former head of
1038 Goldman Sachs, was and continues to be in a position of
1039 conflict of interest with respect to being able to make

1040 decisions that would enhance the position of Goldman Sachs or
1041 be able to make decisions that would adversely affect those
1042 who might be in competition with Goldman Sachs? As a
1043 regulator, do you have any of those concerns?
1044 Mr. DINALLO. From what I witnessed in the 4 days and 5
1045 days that I was exposed to what I was exposed to based on my
1046 personal knowledge, I don't have concerns. I can't
1047 personally attest to Secretary Paulson's management of
1048 whatever conflicts of interest.
1049 Mr. KUCINICH. So your answer is you don't know?
1050 Mr. DINALLO. My answer is I don't feel I have the basis
1051 to answer the question asked. I could give you reasons that
1052 I think AIG was treated differently than Lehman. I could do
1053 that--
1054 Mr. KUCINICH. Thank you, Mr. Chairman.
1055 Chairman WAXMAN. The gentleman yields back his time.
1056 The Chair now recognizes Mr. Souder.
1057 Mr. SOUDER. Thank you, Mr. Chairman.
1058 This unbridled greed, this callous abuse of trust of
1059 hardworking Americans' savings is just so disgusting it's
1060 hard to put into words. And the anger level in America is
1061 coming, as it often has, directly at Wall Street but at
1062 everybody. They're worried they're going to lose everything
1063 they've worked to save because some people were living so
1064 high on the hog, so disrespectful of what was going on. The

1065 issue of that hotel wasn't the amount of money. It is the
1066 insensitivity of how people behaved with our dollars. And
1067 it's just massive discouragement to all of us that--I wanted
1068 to ask a few questions about the State insurance fund first
1069 in New York.

1070 Is there sufficient guidelines to wall off the divisions
1071 from dipping in when they're dealing with these credit
1072 futures and money market things and so on to the insurance
1073 reserves? How is that walled off?

1074 Mr. DINALLO. Yeah. That's what I--I think the system
1075 worked well because there's a fairly strong regulatory moat
1076 around each of the insurance operating companies versus the
1077 holding companies. So I think that there is--there was kind
1078 of an instinct at AIG that maybe there was more capital for
1079 liquidity purposes than was really available. And that's how
1080 they got it arguably into their liquidity crunch. So
1081 policyholders are extremely well protected from the holding
1082 companies reaching into the operating companies for capital
1083 and liquidity needs--

1084 Mr. SOUDER. --disclosure to stockholders at AIG that in
1085 fact those assets are walled off and cannot be used, and is
1086 part of the problem here that they discovered, the insurance
1087 assets were protected, markets started to adjust and caved
1088 AIG?

1089 Mr. DINALLO. That's a very sophisticated statement.

1090 And I think there is some truth to the--I don't know, because
1091 I'm not in their minds. But certainly there is--there is
1092 a--I think a good realization among policyholders across this
1093 country that their--the operating companies are relatively
1094 walled off from that kind of activity.

1095 Mr. SOUDER. In your State insurance fund, we have--I
1096 met with one company that's in danger of going under, an
1097 insurance company, because they had too much Fannie Mae
1098 stock. Do you have an inventory as a State insurance
1099 regulator of how exposed your insurance companies are in
1100 Fannie Mae? Because right now preferred stock's probably
1101 worth zero. Common stock certainly is.

1102 Mr. DINALLO. We do constant examinations of the
1103 company. We have--one of the reasons I think insurance
1104 companies have done well is there are fairly strict rules and
1105 accounting standards which Lynn and I could try about what
1106 insurance companies can buy and hold in their asset liability
1107 match. I will just tell you right now, the worst exposure an
1108 insurance company can have right now is some, but the
1109 percentages that we've looked at are very low, some exposure
1110 to what had been AAA rated, CDOs, the famous AAA rated
1111 mortgage-backed CDOs, but actually the default levels of
1112 those are still relatively small, so if you hold them to
1113 term, you may be okay for an asset liability match.

1114 Mr. SOUDER. This insurance company I believe had 25

1115 percent liability in Fannie Mae. Do you have a guideline in
1116 New York on Fannie Mae?
1117 Mr. DINALLO. As I sit here today, I can't answer that.
1118 I do know that we have a bureau that sort of specializes in
1119 rehabilitation of distressed insurance companies.
1120 Mr. SOUDER. If I was trying to go through the different
1121 guarantee funds and so on, if insurance companies would start
1122 to need to be rescued, do you have a fee much like do we for
1123 FDIC--
1124 Mr. DINALLO. Yes.
1125 Mr. SOUDER. And others like the insurance companies
1126 would kick in?
1127 Mr. DINALLO. You are being very helpful. Thank you.
1128 Yes, we have what's called a guarantee fund.
1129 Mr. SOUDER. Do you have right now--because I would
1130 assume everybody should be going, because one of the debates
1131 here is, can the States do this as opposed to Federal?
1132 Mr. DINALLO. Yes.
1133 Mr. SOUDER. It sounded like you were looking at but do
1134 not have a clear analysis of the Fannie Mae exposure but
1135 others exposures that you have so that you could have an idea
1136 of your kind of your plan at the State level if the economy
1137 continues to tank, if more of these risky purchases that
1138 didn't seem so risky, because even Fannie Mae just this
1139 summer was insured by the Department of the Treasury,

1140 investors were told, hey, this is great. And then all of a
1141 sudden, it collapses. How are you dealing at the State
1142 level?
1143 Mr. DINALLO. We have very frequent reporting through
1144 our capital markets bureau. We regulate over a thousand
1145 companies. So I can't, on any one company, I cannot sit here
1146 and tell you what the numbers are. We do have in place a
1147 system where, if there was a distress, we would bring the
1148 company into what's called rehabilitation, which is a form of
1149 bankruptcy proceeding to protect the policyholders so the
1150 capital is there to pay off the loans. If there is a
1151 shortfall, there are, as you pointed out, both life and
1152 property guarantee funds behind those.
1153 What bothers me about the whole AIG episode the most
1154 from what I do for a living is I think it's--it's a broad
1155 misunderstanding bordering on the inappropriate that people
1156 would use it as an argument that there needs to be Federal
1157 regulation of insurance. I actually have been open to
1158 discussion of Federal regulation of insurance. I've
1159 testified several times in front of Chairman Kanjorski's
1160 committee, and I think I am one of the more open to those
1161 ideas. But AIG is Exhibit A for how well the States did, not
1162 how poorly they did. And that has to be said clearly because
1163 it's bad for policy holders if they think that actually their
1164 regulators did not execute well on that part of the industry.

1165 Chairman WAXMAN. Thank you, Mr. Souder.

1166 Mr. Tierney.

1167 Mr. TIERNEY. Thank you, Mr. Chairman.

1168 Let me follow up on that, Mr. Dinallo. And Mr. Souder
1169 makes the point. You noted in your written statement that
1170 AIG is a holding company and owns a variety of insurance and
1171 other businesses. And Massachusetts' insurance commission
1172 was quick to share with me the fact that the problems at AIG
1173 are really those that deal not with its insurance
1174 subsidiaries but with its operations and holding company,
1175 those in the Financial Products Division, securities lending
1176 division and that area there. The State-regulated insurance
1177 subsidiaries remain solvent and able to that pay their
1178 claims, correct?

1179 Mr. DINALLO. Yes, sir.

1180 Mr. TIERNEY. And in fact, it's that solvency and
1181 ability to pay their claims that really gives them the basis
1182 for the Federal loan and the comfort that it will be paid
1183 back.

1184 Mr. DINALLO. Absolutely.

1185 Mr. TIERNEY. Now your office regulates insurance
1186 subsidiaries, not the corporate parent. The only agency with
1187 authority to regulate the corporate parent is, in fact, the
1188 Federal Office of Thrift Supervision.

1189 Mr. DINALLO. Yes. That was a choice by the company

1190 back I think a few years ago. They could have chosen us.

1191 Mr. TIERNEY. Yes, they could have chosen a regulatory

1192 agency that would have been more difficult to deal with. And

1193 then they probably would have supervised them better.

1194 Mr. DINALLO. I didn't say that.

1195 Mr. TIERNEY. They chose the Federal Office of Thrift

1196 Supervision, which is not known for its expertise in this

1197 area, and we should get that on the table.

1198 But the committee has obtained a letter that the Office

1199 of Thrift Supervision sent to the AIG board on March 10 of

1200 2008. According to the letter, the agency criticized AIG's

1201 management and AIG's oversight of its subsidiaries, including

1202 in particular the Financial Products Division. I'd like to

1203 read from you a part of the letter and get your reactions.

1204 RPTS MERCHANT

1205 DCMN MAGMER

1206 Mr. TIERNEY. The letter says, we are concerned that
1207 risk metrics and financial reporting provided to corporate
1208 management by AIGFP and other key subsidiaries may lack the
1209 independence, transparency and granularity needed to provide
1210 effective risk management oversight.

1211 It also says, a material weakness exists within
1212 corporate management's oversight of AIGFP's super senior
1213 Credit Default Swaps, CDS, valuation process and financial
1214 reporting.

1215 Lastly, it says that AIGFP was allowed to limit access
1216 of key risk control groups while material questions relating
1217 to the valuation of the super senior CDS portfolio were
1218 mounting.

1219 So it wouldn't let in the people that would deal with
1220 this, and it kept that secret. Now, obviously, it says the
1221 oversight in key divisions has failed and that AIG apparently
1222 didn't have a full understanding of the risks taken by the
1223 financial products division. As an insurance regulator, I
1224 imagine you spend a lot of time assessing how well companies
1225 manage their risk, so we ask you, do the problems identified
1226 by the Office of Thrift Supervision sound serious to you?

1227 Mr. DINALLO. If I authored such a letter as a
1228 regulator, I would view those as very serious allegations,

1229 yes.

1230 Mr. TIERNEY. The letter also says that the AIG's
1231 outside auditor, PricewaterhouseCoopers, had reported the
1232 same criticisms to AIG's risk management and the lack of
1233 transparency issues. Things were so bad that the agency
1234 decided to downgrade AIG's risk management rating, its
1235 earnings rating and its composite rating.

1236 Mr. Dinallo, can you tell us what that means in layman's
1237 terms?

1238 Mr. DINALLO. It means that they were--I guess if
1239 they--I don't know where they downgraded it from and to, but
1240 it would indicate that they had some kind of enterprise risk
1241 management matrix and they brought them down at least a notch
1242 on how they were managing those core risks, which would,
1243 again, be something for concern.

1244 Mr. TIERNEY. Mr. Turner, you indicated at the beginning
1245 of your testimony, I think we ought to be looking at what
1246 went wrong here; and I agree. What's your reaction to the
1247 agency's conclusions about inadequate controls at AIG and
1248 what does it tell us about the corporate governance there?

1249 Mr. TURNER. Given the fact that AIG had been going
1250 through numerous restatements, literally since the beginning
1251 of the decade have said they've had errors in their
1252 financials, to get a letter like that out of an agency saying
1253 you had those type of risk management problems I think is

1254 extremely serious. I would agree with Mr. Dinallo on that.
1255 And I would say that you've got a serious problem from the
1256 top down, tone at the top. People just aren't giving it
1257 enough attention and aren't serious enough about making sure
1258 these things are dealt with. And in an organization this big
1259 that can bring an organization down, and obviously there is a
1260 contributing factor here. So I think it's very, very
1261 serious.

1262 Mr. TIERNEY. So when our two next witnesses take the
1263 stand and tell us it's all about mark to marketing and
1264 circumstances beyond their control, in fact, management very
1265 much was a part of this problem in your understanding, is
1266 that correct?

1267 Mr. TURNER. I would totally agree with that.

1268 Mr. TIERNEY. Thank you very much.

1269 I yield back, Mr. Chairman.

1270 Chairman WAXMAN. Thank you very much, Mr. Tierney.

1271 Mr. Turner.

1272 Mr. TURNER OF OHIO. Thank you, Mr. Chairman.

1273 Thank you both. I greatly appreciate your explanations,
1274 your descriptions. This is very helpful, not only just for
1275 the American people but for all of us in Congress as we're
1276 taking a look at what do we do next and how do we approach
1277 what other hearings are necessary.

1278 In looking at your written testimonies, Mr. Dinallo, you

1279 say that using its noninsurance operations AIG, just like
1280 many other financial services institutions, invested heavily
1281 in subprime mortgages.
1282 And then, Mr. Turner, you say--and I love this paragraph
1283 in your written testimony. You're talking about mark to
1284 market, and that comes into play because of the issue of
1285 subprime mortgages and the securitization of the
1286 mortgage-backed securities that were having to be mark to
1287 market. You say, I note the banks are requesting a
1288 moratorium on their fair value report card, but they are also
1289 requesting $700 billion of American's money to bail them out
1290 for the bad loans they've made, and they want both.
1291 Then you go on to say, it is a red herring, that
1292 obviously if it was just mark to market they wouldn't need
1293 both the shift on mark to market and the cash.
1294 And then you conclude here, ultimately, it's no
1295 different than someone who spends more than their paychecks
1296 each month, indicating that the banks spent more on assets
1297 bought or created than they are subsequently getting paid
1298 back.
1299 And that brings us back to the subprime mortgages. So I
1300 think it is so important that we have additional hearings on
1301 Fannie and Freddie and the subprime mortgage area. And I've
1302 got a question about that for you, and I want to tell you
1303 what the experience is in my community.

1304 Yesterday, when we had our hearing on Lehman Brothers,
1305 we had a panel that spoke beforehand. And they say that this
1306 all comes from a period of easy credit, housing prices
1307 escalating and then declining, securitization of mortgages,
1308 people using their houses as ATMs; and, of course, excessive
1309 CEO compensation was cited. In my community, subprime
1310 mortgage lending, predatory lending has had a decimating
1311 impact on neighborhoods and families. We are at the
1312 forefront of the foreclosure crisis.
1313 In 2001, our community held a hearing on predatory
1314 lending. A city commissioner, Dean Lovelace, pushed for
1315 this. There was legislation passed to try to deal with it
1316 that was ultimately knocked down.
1317 But the community experience is about 5,000 foreclosures
1318 a year, Ohio about 80,000 a year. Every 3 years, that's the
1319 size of an entire congressional district that we see being
1320 foreclosed.
1321 But the experience we found in those hearings and what
1322 is happening in Ohio is that, many times, these are loans
1323 where the loan origination amount exceeded the value of the
1324 property. It's not mortgage values declining, although they
1325 are now, which is compounding the problem, but that there was
1326 systematic efforts to give people loans that were in excess
1327 of the value of their homes. Many times capitalizing the
1328 fees, many times giving them terms that either had escalating

1329 rates or payments that got them into difficulty, and then
1330 also economic conditions causing them not being able to keep
1331 up with payments. Then having a house that has a greater
1332 mortgage than the value would result in abandonment and
1333 foreclosure.

1334 Many of the things that we hear about in this, what we
1335 should do and what has happened, fall in the category of bad
1336 business judgments or areas of regulation. But to me loaning
1337 people a loan greater than the value and then securitizing
1338 that and not disclosing that there's a gap between the loan
1339 value and the value of the ongoing asset should be, if it's
1340 not, a crime; and I believe it is. And I think, ultimately,
1341 when we start looking at all these things, we're going to
1342 find that there were real crimes committed here that real
1343 people stole and that had a big impact on our economy.

1344 What are your guys' thoughts on the subprime mortgage
1345 crisis that has brought this about? What are some of the
1346 things that we should be looking at, or practices like this,
1347 that might lead us to how we stop these practices? Because
1348 in the bailout Congress did not stop the practices that got
1349 us here.

1350 Mr. DINALLO. I would amend one of my earlier answers.
1351 I was asked what are the things that I would have the
1352 Financial Services Committee look at working with you, and I
1353 said CDSs, and I said Gramm-Leach-Bliley. The third would be

1354 that there is only so much good risk in any community. And
1355 we have permitted, through securitization underwriters, to
1356 basically do a set of loans to their community and then re-up
1357 the tank for doing more loans an endless amount of times.
1358 So the first set of loans that were CDO'd, the first set
1359 of mortgages performed very well; and that banker probably
1360 said, you know, there's at least twice as many loans that I
1361 would have made, because I got great people in my community.
1362 I wanted them to own homes, so I had to make some tough
1363 decisions. And a banker on Wall Street securitized it, and
1364 the second set did really well. And those were made with
1365 proper underwriting, due diligence decisions.
1366 After the sixth or seventh or eighth iteration, for
1367 however we got there, I think that there is a basic,
1368 fundamental issue with people not owning the underwriting
1369 risks of their decisions. They have to have exposure to
1370 their underwriting risks. And if you put into place a system
1371 where they no longer have to worry about whether they get
1372 paid back on their loans because they've handed it off to
1373 Wall Street who's handed it over to investors seven, eight
1374 times, we will repeat this again.
1375 Mr. TURNER OF OHIO. Mr. Turner.
1376 Mr. TURNER. I would agree with Eric on this one, that
1377 this intermediation that the banking regulators allowed to
1378 happen to whoever was lending the money no longer had any

1379 skin in the game and you got paid handsomely for doing those
1380 type of deals is a major contributing factor here. And I
1381 think you got to go back and look at the regulation of the
1382 mortgage brokers. Certainly the appraisal process is going
1383 to be part of that.

1384 But I think people have to go back and say, as a matter
1385 of public policy, we all love securitization because it gave
1386 everyone a chance to get into a home; and no one was
1387 complaining about it when we gave everyone the chance to get
1388 into a home. But when we loaned up 100 percent on those
1389 values, and there were a lot of those homes, I think there's
1390 something like 55 million of these of which 10 or 12 to 13
1391 million are now in foreclosure, clearly something wasn't
1392 working out about them; and someone needs to go back to the
1393 banking regulators. And they've done some work on this, but
1394 people need to make sure that they've done enough work to
1395 make sure those type of loans can't be made.

1396 And then the bigger question of the role of
1397 securitizations, which, quite frankly, Fannie and Freddie
1398 play a big role in here, we have got to reexamine that policy
1399 and say, if there's securitizations, do we have enough
1400 safeguards? The underwriting that occurred on them was undue
1401 diligence by the investment bankers, was atrocious; and that
1402 played a role as well.

1403 Mr. TURNER OF OHIO. Thank you.

1404 Mr. Chairman, I just want to make an additional point
1405 that most of the loans that went into default in my community
1406 were actually refinances where the family had the American
1407 dream but that someone went back and sold them then a product
1408 that they could not maintain. Thank you, Mr. Chairman.
1409 Chairman WAXMAN. Thank you very much, Mr. Turner.
1410 Mr. Higgins.
1411 Mr. HIGGINS. Thank you, Mr. Chairman.
1412 Gentlemen, I would like to talk to you about internal
1413 audits of independent AIG auditors advising the CEO of AIG of
1414 a precarious situation that wasn't reported to investors in a
1415 conference call. In fact, the internal audits' warnings were
1416 ignored and an optimistic picture was painted relative to
1417 AIG's financial situation, which I think goes to the heart of
1418 credibility and trust. Or, in this case, lack of credibility
1419 and lack of transparency.
1420 For example, there was an all-day conference on December
1421 5, 2007. During this investor conference, Mr. Sullivan
1422 painted an optimistic picture of the firm's management and
1423 fiscal health. He said that we are confident in our marks
1424 and the reasonableness of our valuation methods. We have a
1425 high degree of certainty in what we have booked to date.
1426 However, according to internal minutes from the audit
1427 committee meeting on January 15, 2008, AIG's independent
1428 auditor, PricewaterhouseCoopers, raised serious concerns

1429 before this investor meeting took place. At this meeting,
1430 auditors warned Mr. Sullivan personally back in November in
1431 preparation for the investor conference. Here is what the
1432 minutes said:

1433 Mr. Ryan, a PricewaterhouseCoopers' auditor, reported,
1434 in light of AIG's plan to hold an investor conference on
1435 December 5th, PricewaterhouseCoopers had raised their
1436 concerns with Mr. Sullivan and with Mr. Bensinger, the Chief
1437 Fiscal Officer, on November 29th informing them that
1438 PricewaterhouseCoopers believed that AIG could have a
1439 material weakness relating to risk management in these areas.
1440 Mr. Ryan expressed concern that the access that the
1441 enterprise risk management and the AIG senior finance
1442 officials have into certain business units, such as AIG
1443 Financial Products Group, may require strengthening. At no
1444 point during the December 5, 2007, investor conference did
1445 Mr. Sullivan mention these warnings from the auditors. He
1446 never disclosed them.

1447 Mr. Turner, you used to be a senior official at the
1448 Securities and Exchange Commission. What do you think about
1449 Mr. Sullivan's failure to disclose the auditor's warnings to
1450 investors?

1451 Mr. TURNER. If you go back and look through the filings
1452 and go back and look through the third quarter filing for the
1453 period ending September 30th--and, Congressman, you raise an

1454 excellent question--you don't see any notion of the fact that
1455 this company probably doesn't have the necessary models to be
1456 valuing this stuff. So if you look at September 30th
1457 filings, there's no indication we don't have the ability to
1458 value these things in the way we do or no indication that you
1459 don't have controls. You're still saying things are fine.
1460 You go then to the communication from
1461 PricewaterhouseCoopers and then to an investors day meeting
1462 on December 5th where we're saying things are okay; we don't
1463 have a problem. If you're an executive and you've known by
1464 that point in time that you've got these disclosures out at
1465 September 30th saying in essence we don't have this
1466 problem--and while this is going on keep in mind you also, as
1467 I understand it, have counter parties to these derivatives
1468 starting to argue. And I think in fact there's some
1469 disclosure by October 31st people were questioning their
1470 valuations. So it's not only that you got a September 30th
1471 cue out there, you've now got questions from outside parties,
1472 not only the auditors but very well--you know, Goldman Sachs
1473 might have been one of them raising the questions.
1474 Back to the questions that Mr. Kucinich was raising, if
1475 you've got an outfit that is probably no one better in the
1476 world at valuing this stuff like Goldman Sachs about these
1477 values and your auditors are now raising your value, I think
1478 it's unconscionable you go out to the investors on an

1479 investor day and pretend like you've got yourself under
1480 control and you know what all the numbers are and there's no
1481 problem. And subsequent events turn around and I think pan
1482 that out when you say you've got $5 billion in collateral at
1483 the end of December and then up to 14 and now we've borrowed
1484 61, it raises a serious question about was anyone on top of
1485 this.

1486 Mr. HIGGINS. I yield back, Mr. Chairman.

1487 Chairman WAXMAN. Thank you, Mr. Higgins.

1488 Mr. Yarmuth.

1489 Mr. YARMUTH. Thank you, Mr. Chairman.

1490 In the chairman's opening statement he said we were
1491 going to ask questions about the compensation packages of the
1492 CEOs at AIG, and so I'm going to ask that now.

1493 You said in your written testimony that one of the
1494 problems here is that we had CEOs walking away from a train
1495 wreck, essentially, with huge severance packages. And we've
1496 seen or heard many times now that in the fourth quarter of
1497 2007 fiscal year, 2008 fiscal year, the loss posted by AIG
1498 was $5.3 billion and shortly thereafter that the compensation
1499 committee of AIG met and extended the contract of CEO Martin
1500 Sullivan, including a $15 billion severance package. And I
1501 guess my question that most every American would have is, is
1502 there any way that the compensation committee or corporation
1503 could justify that type of activity as being responsible, in

1504 the best interest of the stockholders if there was such a
1505 dramatic turnaround and loss in the corporation and then
1506 granting a very generous package in light of that?
1507 Mr. TURNER. I'm a believer that if a company has
1508 performed well the executives should be compensated well for
1509 that. So I have no problem with people if they've done very
1510 well and created a lot of value--like I said, I am on the
1511 board of two of these investment funds. If they created a
1512 lot of value for our shareholder, I certainly am one that
1513 would support them on getting tremendous compensation.
1514 On the other hand, when you don't perform, having been
1515 an executive, I don't believe you deserve a bonus. If you've
1516 had a lousy year, you just shouldn't get a bonus. And then
1517 to walk away and get paid millions for walking away and doing
1518 nothing further to create value for us as shareholders I
1519 think is just wrong.
1520 In this case, the question probably goes back to did the
1521 board agree to that agreement when they first put Mr.
1522 Sullivan in place. That was probably not a high mark for
1523 this board.
1524 Twice I flew to New York and met with their then
1525 chairman of the board Frank Zarb and seriously questioned how
1526 they had gone through the process. They didn't go through an
1527 outside search for a new chairman. They just very quickly
1528 selected and put in place with very little due diligence the

1529 next chairman.

1530 And, quite frankly, then when you put in place a
1531 severance agreement with the guy and agree to it at that
1532 point in time, even if things turn out bad later on, you're
1533 committed to it and you need to honor a contract. But for
1534 the board to have put something like that in place just shows
1535 very, very poor governance, very poor.

1536 Mr. YARMUTH. And it was compounded subsequently because
1537 the next quarter the loss was almost $8 billion. So that's
1538 $13 billion in two quarters. And at that point they
1539 terminated Mr. Sullivan but allowed him to retire so that he
1540 could receive that bonus. If they had terminated him for
1541 cause, then he wouldn't have received it, as I understand it.
1542 Is that something that you would consider to be in the
1543 interest of the stockholders or in his interest?

1544 Mr. TURNER. Again, whenever you're paying someone for
1545 walking away from the company where they're not creating any
1546 further value and haven't been creating value, that's
1547 certainly not in the best interest of shareholders.

1548 Mr. YARMUTH. Thank you for that.

1549 I have a question going back to these credit default
1550 swaps that I would like to get some clarification on. We
1551 threw out the number or you threw out the number $62 trillion
1552 that's out there. Is that $62 trillion a potential loss, is
1553 it absolute obligation, is somebody going to have to pay $62

1554 trillion at some point to somebody or is that just a
1555 potential loss and to whom is that owed? I mean, in general,
1556 to whom is it owed?
1557 Mr. TURNER. The $62 trillion, which, by the way, I
1558 believe has come down to the mid 50s at this point in time.
1559 It's only 55 trillion or 57 trillion, you know. But you
1560 raise an interesting question, because I don't think anyone
1561 really knows what the real exposure is. That's the nominal
1562 value or the amount of debt that these things have been
1563 written on, although the actual amount of debt is actually
1564 substantially less than this.
1565 As Mr. Dinallo mentioned, some of this is nothing more
1566 than wagers of bets against one another in trading, and
1567 that's a fairly significant portion of that. But no one
1568 knows because there's no disclosure. There's no central
1569 market.
1570 And this isn't the first time this thing almost came
1571 apart. The Fed in 2005 had to bring about 17 of these
1572 institutions together because they had gotten so far late in
1573 just doing their paperwork no one knew who owed one at that
1574 point in time. Which goes back to your question then, does
1575 anyone really know what's going on here? And the answer is
1576 probably no. No one can tell you what's going on, there's no
1577 regulation, there's no FASB, and no one can answer the
1578 questions with a high degree ofcertainty because there's no

1579 place that gathers that data.

1580 Mr. DINALLO. This is just a very overly simplistic
1581 statement which will not hold in practice, but there's an
1582 argument that the total notional value of CDSs should not
1583 exceed the total face value of corporate bonds out there.
1584 Because if you bought insurance for all corporate bonds that
1585 anybody owned it would be--and I'm going to make up a figure.
1586 I've heard something like $15 trillion, $17 trillion--$6
1587 trillion, I'm being told $6 trillion.

1588 Well, I'm an optimist. So if you think of it that way,
1589 that's why we say 10 percent. Do you remember I said 10
1590 percent? So if it's 10 percent of 62--so, yes, $6 billion is
1591 the right number. Ninety percent of it is written on just
1592 going to the track and putting a bet on whether Ford is going
1593 to fail or not. It does not represent a securitized bond
1594 exposure to the companies.

1595 Mr. YARMUTH. If I can ask just one question in
1596 follow-up. So this is one corporation, in this case AIG,
1597 betting against another corporation on value that doesn't
1598 exist? I mean, they're wagering money, wagering presumably
1599 shareholders' money, and in this case it may turn out to be
1600 taxpayers' money, on basically you and I betting on a
1601 football game.

1602 Mr. DINALLO. Yeah. Just technically I'm going to
1603 correct you to the extent it kind of went the other way.

1604 People, they sold protection as a triple A or double A rated
1605 vehicle, they sold their protection to those who wanted to
1606 take a bet on whether Ford was going to say--I'm just making
1607 that up. I'm picking on Ford. It's unfair--Ford was going
1608 to default or not. And when they got downgraded--I think
1609 this is an important fact that didn't really come out. When
1610 they got downgraded, the reason they had the liquidity crisis
1611 that we've all discussed is when they got downgraded they had
1612 to put collateral beyond those obligations. When they were a
1613 certain high rating they didn't have to post any collateral.
1614 So getting back to the congresswoman's point, I would
1615 say all the more frightening about all this is there's no
1616 "there" there. There's no collateral behind any of these
1617 four A, double A and triple A rated companies. And that's a
1618 big number that there may not be backing for. Not the case
1619 for insurance.
1620 Chairman WAXMAN. Thank you, Mr. Yarmuth.
1621 Mr. Braley.
1622 Mr. BRALEY. Thank you, Mr. Chairman.
1623 Mr. Dinallo, I want to start with you.
1624 Twenty-five years ago, I was a research assistant to
1625 Professor Alan Whitus, who was updating the Keeton and Whitus
1626 basic text on insurance law; and I think both Professor
1627 Whitus and Professor Keeton would be rolling over in their
1628 graves seeing what has happened to the industry that they

1629 were so passionate about. I think you would agree with me
1630 that that industry has changed radically in the 25 years that
1631 I've been talking about.
1632 Mr. DINALLO. Yes. In particular going from mutual
1633 companies to publicly traded companies.
1634 Mr. BRALEY. And a lot of those demutualizations
1635 resulted in a significant financial loss to policy owners who
1636 owned the shares of those mutual companies--who owned the
1637 mutual companies and during the conversion in many cases were
1638 screwed out of their financial share of those companies.
1639 Mr. DINALLO. I might not use the same verb, but I will
1640 agree.
1641 Mr. BRALEY. I think you get my point.
1642 Mr. DINALLO. Well, I think it's important for everyone
1643 to know there's a very strong tension between policyholders'
1644 interest and shareholders' interest in a publicly traded
1645 company. The board and management has a fiduciary interest
1646 to shareholders under our law, fiduciary interest to
1647 shareholders, but, at the same time, whenever they release
1648 capital to satisfy that to get a bigger return on equity,
1649 they are necessarily taking incremental protection against
1650 policyholders.
1651 Mr. BRALEY. And you also have a fiduciary obligation to
1652 policyholders under their contractual obligation with the
1653 policyholder.

1654 Mr. DINALLO. Yes. Sadly, there is some debate,
1655 actually, because they've been so trained under our law and
1656 after Enron, et cetera, to worry about fiduciary duty to
1657 shareholders that there is a good argument that, although
1658 it's in their blood to worry about policyholders, the legal
1659 requirements are a little bit gray, actually.
1660 Mr. BRALEY. Well, one of the things we know, in your
1661 opening statement you said AIG was not strictly an insurance
1662 company. And that's one of the big problems. Because
1663 insurance companies are fond of talking to consumers about
1664 gaps in coverage and how they should eliminate those gaps.
1665 But based on both of your testimonies we've got a massive $63
1666 trillion gap in coverage where we've got a product that
1667 according to most commonsense interpretations would be
1668 considered insurance. We're not regulating in the State
1669 insurance commissioners' offices. We've taken action in
1670 Congress before I got here to declare that it's not subject
1671 to gaming regulations, which again under the Constitution are
1672 historically made by States rather than by the Federal
1673 Government, and you've eliminated any oversight from the
1674 Securities and Exchange Commission, which has the only
1675 Federal capability to exercise jurisdiction over these
1676 companies. So how did we get here?
1677 Mr. DINALLO. I wish I could have said it so clearly. I
1678 don't know how we got here. We thought it was important to

1679 permit leverage, we thought it was important to permit risk
1680 mitigation, and we thought that mega holding companies were
1681 accretive to shareholder value and to be competitive.
1682 And I will say that we are--that one of the big issues
1683 is after Basel II and what's called Solvency II we are in
1684 danger of going the European route, which is a lot more
1685 holding company control over the operating company, which is
1686 code for much more ability to move around policyholder
1687 money--that's what we are talking about--around for holding
1688 capital liquidity purposes. If AIG had been under a Solvency
1689 II regime, I would think we would be in much worse straits
1690 than we are today.
1691 Mr. BRALEY. But one of the concerns I have is this
1692 blurring distinction between financial services
1693 providers--real estate, insurance, banking, other financial
1694 institutions--and how you hold accountability when these
1695 holding companies are involved in all these different
1696 financial services. Because clearly the system we have in
1697 place now is not working.
1698 Is it time for Congress to revisit the fundamental
1699 premise of the McCarran-Ferguson Act and talk about a Federal
1700 intervention that takes into account the need to have some
1701 oversight of insurance companies that choose to engage in
1702 risky financial propositions like the ones we've been talking
1703 about today with no ability to have accountability to their

1704 shareholders?

1705 Mr. DINALLO. Earlier, I said we should--I think I would
1706 recommend a revisitation of Gramm-Leach-Bliley and the
1707 concept of supermarkets when you're dealing with policyholder
1708 money and depository commercial--money. I'm not sure--I will
1709 just remain agnostic--whether the solution is a Federal
1710 oversight or continue with the States or some hybrid.

1711 Because I think that it is important to have States in
1712 the solvency business. They've done extremely well on that.
1713 They've done not so well, clunky on other things like product
1714 registration and licensing of the agencies. We're pretty
1715 clunky on that. But the one thing we got right and the
1716 reason that we're even here today to the extent there's
1717 optimism here is because there was solvency done by State
1718 regulators.

1719 Mr. BRALEY. And just to follow up on Mr. Souder's
1720 comment about the guarantee funds, you would agree that most
1721 State insurance laws provide a cap on those guarantee funds
1722 typically in the amount of $500,000 or surely $1 million or
1723 less. And when you're talking about an exposure of $63
1724 trillion that would have no impact to protect taxpayers.

1725 Mr. DINALLO. Actually, New York is one of the richest
1726 guarantee funds; and I think the numbers you just described
1727 are New York numbers. Most States--and this is not to be
1728 pejorative to other States--but most States are substantially

1729 lower. Some people think that lower is better because it
1730 stops the moral hazard of writing bad policies because
1731 there's always the guarantee fund behind it. But, yes, it
1732 would have been a real stress on the system, undoubtedly.
1733 Chairman WAXMAN. Thank you, Mr. Braley.
1734 Mr. Davis.
1735 Mr. DAVIS OF VIRGINIA. Thank you.
1736 Do you think anybody ought to go to jail over this? Do
1737 you want to take a stab at that? Do you think anybody should
1738 go to jail over this?
1739 Mr. DINALLO. To whom is your question directed?
1740 Mr. DAVIS OF VIRGINIA. Both of you. I'm not asking you
1741 to name anybody or build a case. But I'm just saying,
1742 looking at the end results, how the companies operated, at
1743 this point, were they all within the law or did somebody
1744 break some rules along the way because nobody caught it?
1745 Mr. DINALLO. I don't have sufficient evidence to have
1746 an opinion about it.
1747 The only thing I would say is I think that as a
1748 regulatory society, so to speak, we all did kind of chase
1749 after mortgage default numbers. In other words, some of what
1750 was described earlier about the escalating losses at AIG were
1751 certainly a default rate loss. In other words, we've all
1752 seen how the rating agencies have hugely changed the ratings
1753 based on how quickly the default numbers are coming in for

1754 mortgages.

1755 And I'm not taking a position whether it's criminal or
1756 even civil, but it is the case that a lot of us, including
1757 the best rating agencies, some of the best securitization
1758 people in the world and some regulators, got wrong what was
1759 going to be the default rates, which it turned out our global
1760 economy was hinged on.

1761 Mr. DAVIS OF VIRGINIA. Well, if it wasn't criminal, was
1762 it at least negligent in some areas?

1763 Mr. DINALLO. I won't even opine on that. But I would
1764 say that--I did say that the letter, if true, that I heard is
1765 something that you would be concerned about.

1766 Mr. DAVIS OF VIRGINIA. Mr. Turner, do you have any
1767 thoughts on that?

1768 Mr. TURNER. Yes Congressman. I don't think you send
1769 people to jail for making bad business decisions. That
1770 happens day in and day out, and people shouldn't be
1771 prosecuted for that.

1772 On the other hand, if someone knew there were problems
1773 in the company and failed to comply with the security laws
1774 and disclosed those to investors who bought them and are now
1775 seeing their retirement savings go away and disappear, then,
1776 yes, I would turn around and say a little time behind the
1777 bars would probably be good.

1778 Mr. DAVIS OF VIRGINIA. Well, let me ask this. How

1779 about the people writing the mortgages? You talked about the
1780 first tier and the second tier and how it got lax. I mean,
1781 at the end, they weren't even asking tough questions.
1782 Mr. DINALLO. I think the term is a NINJNA, no income,
1783 no job and no assets, or something like that. It's
1784 unbelievable. We were harvesting mortgages at a rate that I
1785 think is completely unacceptable as a society; and we were in
1786 various ways encouraging people to engage in underwriting
1787 decisions that I find shocking, frankly.
1788 Mr. DAVIS OF VIRGINIA. In fact, didn't AIG--they got
1789 caught up in this. Their competitors were doing it. They
1790 started a new line that they had no expertise in, used an
1791 insurance model, and it just blew up on them. Is that
1792 basically what happened?
1793 Mr. DINALLO. I think to a large extent people did
1794 not--this is what I was trying to say before. We relied on
1795 historical default rates in housing that maybe for the first
1796 two iterations of loans was wholly appropriate. By the
1797 seventh or eighth, we had basically injected--we correlated
1798 the system because we weren't securitizing natural loans, we
1799 were securitizing created loans.
1800 Mr. DAVIS OF VIRGINIA. Now, your argument, as I
1801 understand it, is that the Commodities Futures Modernization
1802 Act, in retrospect, went too far. It was a mistake.
1803 Mr. DINALLO. I think that's a fair implication of what

1804 I said, yes.

1805 Mr. DAVIS OF VIRGINIA. And that was signed just on the
1806 eve of the 2000 election. I think it passed Congress.
1807 Fortunately, I did not support it. But as I was looking at
1808 that, just going through the votes and everything, it was
1809 signed right on the eve of the 2000 election. Obviously,
1810 some modernization was needed, because there was a huge
1811 congressional and, at that point, administration consensus.
1812 But you think it just went too far. You wouldn't have argued
1813 it shouldn't have been changed. You just think in retrospect
1814 it went too far.

1815 Mr. DINALLO. No, it was just absolute. It says this
1816 Act shall supercede and preempt the application of any State
1817 or local law that prohibits or regulates gaming or the
1818 operation of bucket shops other than anti-fraud provisions.

1819 Mr. DAVIS OF VIRGINIA. I agree.

1820 What about the reauthorization act this year, did you
1821 follow that, that was reauthorized this year? Do you know
1822 how they reauthorized it? They attached it to a farm bill,
1823 an agriculture bill, which was vetoed by the President and
1824 overridden in Congress. That's how a lot of these things get
1825 done. So that's how a lot of this business gets done.

1826 What about Gramm-Leach-Bliley in retrospect? Again,
1827 that was done over 8 years ago. In retrospect, obviously, a
1828 need to modernize Glass-Steagall. Would you agree with that?

1829 Mr. DINALLO. Yes. Some in need, yes. But I've learned
1830 a lot through this process.
1831 Mr. DAVIS OF VIRGINIA. Well, let me finally ask, should
1832 the SEC or should Congress have stepped in much earlier to
1833 suspend the mark-to-market accounting rules as a way to head
1834 off some of the problems we're experiencing today?
1835 Mr. DINALLO. I think Mr. Turner would be better
1836 qualified to answer that. I'll just say that insurance
1837 companies do it a different way; insurance regulators do it a
1838 different way. It's much more conservative and, fortunately,
1839 beneficial, I think, to what we're talking about.
1840 Mr. DAVIS OF VIRGINIA. Mr. Turner, do you have any
1841 thoughts on that?
1842 Mr. TURNER. I don't think Congress should step into
1843 that. As I mentioned in my testimony, the GAO
1844 found--actually supported going to mark to market and
1845 believes that when you suspend it--when you allow a bank to
1846 turn around and have losses, okay, and not tell us as
1847 investors about it, I got to tell you we ain't got any
1848 confidence in the system or trust. And if Congress goes in
1849 and says, we're going to let you hide those things from us, I
1850 got to tell you, you're going to see a devastation in spark.
1851 We will not be investing in financial institutions if you do
1852 that.
1853 Mr. DAVIS OF VIRGINIA. Okay. Thank you.

1854 Chairman WAXMAN. Thank you, Mr. Davis.

1855 Ms. McCollum.

1856 Mr. DAVIS OF VIRGINIA. Mr. Chairman, can I ask
1857 unanimous consent that members be allowed to submit
1858 statements for the record today?

1859 Chairman WAXMAN. Without objection, that will be the
1860 order.

1861 Ms. MCCOLLUM. Thank you, Mr. Chairman.

1862 Mr. Turner and Mr. Dinallo, AIG didn't suddenly collapse
1863 and need to be bailed out on September 18th. AIG's financial
1864 situation had been growing increasingly dire with each
1865 passing quarter, but AIG's executives kept telling
1866 shareholders that their finances were in great shape.

1867 And in fact, Mr. Chair, I would like to submit a New
1868 York Times article dated September 28th which numerates time
1869 and time again how these people have said AIG was in great
1870 shape.

1871 [The information follows:]

1872 ******** COMMITTEE INSERT ********

1873 Ms. MCCOLLUM. In December, 2007, for example, Mr.
1874 Sullivan told AIG investors, quote, we believe we have a
1875 remarkable business platform with great prospects that
1876 represent tremendous value. Two months later, AIG posted
1877 $5.3 billion losses for the quarter.
1878 February, 2008, Mr. Sullivan said, based on our most
1879 current analysis, we believe any credit impairment loss
1880 realized over time by AIGFP would not be material to AIG's
1881 consolidated financial condition. Then AIG posted $7.8
1882 billion in losses for that quarter.
1883 On May 28th, Mr. Sullivan told investors, the underlying
1884 fundamentals of our core business remains solid. The next
1885 month the board voted to replace Mr. Sullivan.
1886 Mr. Turner, I have a couple of questions. What do you
1887 think of Mr. Sullivan's statements? Do you think they
1888 accurately reflected AIG's conditions? And, Mr. Dinallo, I
1889 would like to know if have you a view on that as well.
1890 Mr. Turner, in your written statement you said--and I'm
1891 going to quote you--trust and confidence in markets and in
1892 any company begins and ends with transparency, transparency
1893 that ensures investors can fully understand the assets and
1894 rewards of investing in a company. You should be able to
1895 trust what the CEO is saying.
1896 So if you gentlemen could please elaborate.
1897 Mr. TURNER. As you go through these filings and you

1898 look at the disclosures that start to occur and the time
1899 frame in which they are, the one thing I take away from this
1900 is I don't think the company ever was honest with the
1901 investors about the magnitude of the potential impact of
1902 these things. And I think that's what is grossly missing
1903 here. And then, as things start to go bad, they go bad very
1904 quickly; and we're finding out about everything not
1905 prospectively here's what could happen.
1906 Keep in mind, the SEC rules are very clear. They
1907 require you to tell the investor right through the eyes of
1908 management what's happening with the company. And I don't
1909 think we ever get that out of here. I don't think the rules
1910 were followed.
1911 I just think it's astounding that all of a sudden you're
1912 borrowing $61 billion and yet you've never told the investors
1913 up to that point in time, hey, we've got these credit
1914 derivatives out there that could cause us such a problem that
1915 we could come short.
1916 And granted the market goes down, okay, and certainly
1917 people were not wishing for the market to go down the way it
1918 was, but, nonetheless, when you've got that type of exposure
1919 and that type of potential, you owe it to me as an investor
1920 to tell me that's the type of risk I'm taking on when I'm
1921 investing in you. You've got this thing that may all of a
1922 sudden blow up and cause you to need tens of billions and you

1923 can't get to it because all the cash is in regulated
1924 subsidiaries that Mr. Dinallo is appropriately trying to
1925 protect. And that's the disclosure, the gist I cannot find
1926 in these filings.
1927 The SEC and the DOJ I hope will go through, get the
1928 e-mails, get the data and then everyone is entitled to their
1929 day in court and due process. But, right now, there is a
1930 question there that I can't answer for myself as to why we
1931 didn't get that.
1932 Ms. MCCOLLUM. Mr. Dinallo.
1933 Mr. DINALLO. Obviously, I have to be sort of--I'm not
1934 informed enough at the holding company level on some of the
1935 disclosures to have a position about this.
1936 I think I did say earlier that I witnessed sort of a
1937 very shocking realization as to the liquidity needs of the
1938 company on that weekend. I was surprised that some of the
1939 risk was being rolled up at that--sort of contemporaneously
1940 at that time.
1941 I will say, just one observation that we just touched
1942 on, which is one of the lessons learned. There are these
1943 things called lines of credit that every company has, and
1944 they assume they're there in these liquidity crunches. But
1945 what is kind of interesting I think that the committee should
1946 know about, and the Financial Services Committee should
1947 probably be told about, is if you touch them you get a

1948 three-notch downgrade from the rating agencies. And so
1949 they're kind of fictitious in some ways.
1950 I don't mean this badly, but people have them and they
1951 convince us that they have this line of credit that will help
1952 them through these tough times. But God forbid you need to
1953 hit the $15 billion line of credit these companies have. The
1954 consequences are such that you might as well not have them
1955 because you might as well have gone through the downgrade
1956 because you're going to go through it for touching the line
1957 of credit. We're all learning together to some extent. And
1958 I think that that's one of the lessons that I would kind of
1959 inject in this.
1960 Ms. MCCOLLUM. Thank you, Mr. Chair; and thank you for
1961 the hearing because I think this is clearly showing people
1962 were gambling--they weren't investing--with the dollars that
1963 these investors had.
1964 Chairman WAXMAN. Thank you, Ms. McCollum.
1965 Mr. Van Hollen.
1966 Mr. VAN HOLLEN. Thank you, Mr. Chairman.
1967 Thank you both for your testimony today.
1968 Mr. Turner, I just want to follow up on my colleague Mr.
1969 Yarmuth's questions. He asked you about some of the golden
1970 parachutes that were available for Mr. Sullivan and others at
1971 AIG.
1972 I want to talk about the regular compensation and bonus

1973 plan. And as you state in your statement you talked about
1974 the dangers that bonus plans that are, quote, designed to pay
1975 executives hundreds of times what their average employees
1976 made as they engaged in business that would eventually
1977 cripple the business that they ran. And you hear a lot of
1978 talk from some of the CEOs about how they have these
1979 pay-for-performance plans, that in the good times they
1980 benefit but when times are bad they take a hit. And I think
1981 the more we look at these different companies like AIG you
1982 find that they rigged the rules so in good times they do well
1983 and in bad times they do well.

1984 I would like to get your opinion of the actions of AIG's
1985 former CEO Martin Sullivan at a meeting of the company's
1986 compensation committee on March 11, 2008. The committee has
1987 obtained documents of that meeting.

1988 AIG has two bonus programs. The first is called the
1989 Partners Plan, and that covers the top 700 executives. The
1990 second is called the Senior Partners Plan, and that applies
1991 only to the top 70 executives. Mr. Sullivan benefits from
1992 both plans.

1993 Now, according to the plans--and, again, if you listen
1994 to what they're saying, rewards were supposed to be based on
1995 the company's performance. But I want to show you or at
1996 least mention to you--I don't if we have it on the screen,
1997 but we have the internal minutes of the meeting that was held

1998 by AIG's compensation committee on March 11, 2008; and, as
1999 you can see, what those committee meetings show is that
2000 Martin Sullivan, who was CEO at the time, personally urged
2001 the committee to waive, to waive the bonus rules right after
2002 the company posted a record loss.
2003 And as you can see that what the minutes say is Mr.
2004 Sullivan next presented management's recommendation with
2005 respect to the earnout for the senior partners for the 2005
2006 through '07 performance period suggesting that the
2007 AIGFP--that's the financial products division--that their
2008 unrealized market valuation losses be excluded from the
2009 calculation. Essentially what he's saying there is the
2010 rules, if we applied them, wouldn't let me get my bonus, so
2011 let's change the rules, isn't that right?
2012 Mr. TURNER. That's the way I would read that.
2013 Mr. VAN HOLLEN. And this comes on the heels of the
2014 February 8th--28 AIG posting of losses of $5.3 billion for
2015 the quarter, which came primarily from the financial products
2016 division, isn't that right?
2017 Mr. TURNER. Yes.
2018 Mr. VAN HOLLEN. And the record also makes clear that in
2019 fact the board, not surprisingly, agreed with their CEO; and
2020 he got his $5.4 million bonus, despite the fact that AIG ran
2021 up $5.3 billion in losses in the quarter before.
2022 I just have to ask you, you know, because people

2023 understand when people get rewarded for doing well. But
2024 everybody else out there operating in the economy, when they
2025 don't perform, they get their pay cut. They get fired.
2026 These guys, there is absolutely no accountability. So I
2027 would like you to comment on the kind of changes that need to
2028 be made in your view to make sure this kind of thing does not
2029 happen going forward.

2030 And then, Mr. Dinallo, I would like any comment you've
2031 got.

2032 Mr. TURNER. As someone who has followed governance and
2033 read many of these type of plans--quite frankly, when I was
2034 running the research at Glass, Lewis, this is not an isolated
2035 occurrence. We've seen this time and time again in corporate
2036 America where you set up a pay for performance plan but then,
2037 when you didn't hit the performance triggers, you changed the
2038 triggers, you didn't change the compensation. And there's
2039 just something fundamentally wrong with that.

2040 And that's one of the reasons this institution, quite
2041 appropriately so, I believe, last year voted and approved the
2042 "say on pay proposal" that is a middle of the ground proposal
2043 and a very, very good proposal. It's unfortunate. I know it
2044 was in one of the drafts of the bailout legislation and
2045 didn't stay in it. That is very unfortunate.

2046 But I think certainly we need to have in this
2047 country--give the shareholders the vote and opportunity to

2048 pay on--or vote on situations like this with full disclosure
2049 so you're aware this type of stuff is going on; and I think
2050 only by doing that are we going to get this reigned in. I
2051 think anything short of that is going to leave these plans in
2052 place, leave this type of behavior in place, and people are
2053 going to continue to be outraged about it, and you're not
2054 going to get the changes that you need.

2055 So when we have say on pay as investors, when we invest
2056 in the U.K., when we invest in Netherlands, when we invest in
2057 Australia, but we don't even have that right as investors
2058 here in the U.S., there's just something fundamentally wrong
2059 with it. So we need this institution, the House, and we need
2060 the Senate, by golly, to follow your good leadership on that
2061 and pass the say on pay proposal now, not a year from now,
2062 but now.

2063 Mr. VAN HOLLEN. Thank you. Thank you, Mr. Turner.

2064 Mr. DINALLO. I would only add that a lot of Wall Street
2065 and traders--and I think AIGFP is analogous to this--are paid
2066 on a revenue basis, as opposed to an end-of-year profit
2067 basis, and there is something to that. And you can create a
2068 lot of revenues without actually booking a profit sometimes.
2069 And so that's something that people have written about
2070 recently, about sort of changing that approach to
2071 compensation for certain financial services activities.

2072 Mr. VAN HOLLEN. Thank you. Thank you both.

2073 Chairman WAXMAN. Thank you, Mr. Van Hollen.

2074 Mr. Sarbanes.

2075 Mr. SARBANES. Thank you, Mr. Chairman.

2076 I'm trying to understand this in the context or in terms
2077 of how we got all these toxic assets infecting the markets
2078 out there which at the end of the day just gets back to this
2079 insatiable appetite to generate new loans. And when there
2080 weren't enough loans out there in the conventional market we
2081 then had these people that were reaching into the
2082 unconventional market, into a very risky market, and that
2083 created this toxin that went up the chain.

2084 So my interest in what AIG was doing is to the extent
2085 that it was seen as providing the hedge/insurance backstop to
2086 these Wall Street firms that were increasingly getting into
2087 the business of trading in very unstable or risky security
2088 products, with the effect, I take it--and I would like your
2089 view on this--with the effect that it increased their risky
2090 behavior, and that gets pushed down the chain. So they begin
2091 to encourage more and more risk on the front end. And once
2092 you've relaxed the underwriting standards on the front end of
2093 this thing, it becomes very difficult to continue to manage
2094 the risk up the line, because the original thing that you've
2095 created in and of itself is unstable.

2096 So talk to me about that. Talk to me how what the
2097 product that AIG was offering basically led to riskier

2098 behavior on the part of these Wall Street firms which in turn
2099 led them to encourage risky behavior all the way down the
2100 chain. Mr. Dinallo.

2101 Mr. DINALLO. Well, I think, Congressman, you sort of
2102 said it in there. They were arguably at the end of a chain
2103 of exceedingly ridiculous optimism about the value of these
2104 mortgages. So people harvested the mortgages. They
2105 securitized them. The rating agencies rated those at the
2106 highest levels; and, through CDO squared, triple A traders at
2107 various trading houses held them. And then wanting to
2108 prudently, arguably, have a default protection on those
2109 bought a credit default swap from certain guarantors, AIG
2110 being one of them.

2111 So I would say that at some level what AIG did was it
2112 gave--kind of it was the last line of defense with its high
2113 rating--I think it was double A at this time--saying, well,
2114 the rating agencies rated it triple A, so we'll even
2115 guarantee it against default.

2116 And one of your points I thought you were sort of making
2117 was maybe if anyone in that line of activity had acted
2118 with--this will be a little bit impolite--but acted with
2119 common sense instead of models they might have said this
2120 doesn't feel right and I'm not going to put my reputation,
2121 assets, shareholder value, rating at risk for this.

2122 Mr. SARBANES. Well, you had two things happening. You

2123 had a bunch of people along the way who could keep
2124 off-loading the risk to somebody further up the chain. So
2125 then they have no incentive themselves to stop or curb their
2126 behavior, particularly if they're making money off the deal.
2127 Then you start getting to the end of the chain, right,
2128 the people that are actually holding these securities at the
2129 end of the line. And the way they, quote, offload the risk
2130 is to go insure against it. So they turn to an AIG as a way
2131 of doing that.
2132 And I guess in the initial iteration of that maybe it
2133 made sense. But then you have AIG basically opening a casino
2134 in London, right, to start this other activity. So at what
2135 point should the investors that were purchasing this as an
2136 insurance policy, should they have known that AIG, their,
2137 quote, insurer was getting into this other risky enterprise?
2138 Did they know that? Did they realize that they had opened
2139 the casino in London and something else was going on that was
2140 putting their policies, quote, unquote, at risk?
2141 Mr. DINALLO. I just want to clarify. I think we're
2142 mixing the term insurance policy somewhat loosely. When you
2143 ask that, you mean the people who had actual property--the
2144 common man and woman who had life insurance policies and
2145 property polices with AIG? Is that what you meant?
2146 Mr. SARBANES. No, no. I'm talking about the insurance
2147 product that was the CDS, because it began that way, right?

2148 Mr. DINALLO. But my understanding, Congressman, is it
2149 was always out of financial products.
2150 Mr. SARBANES. Right. But I'm saying is it began as a
2151 legitimate, quote, unquote, hedge against the downside risk
2152 of this particular security that you hold. But the reason it
2153 got up to $55 trillion or $62 trillion or whatever it was is
2154 because it became a betting house. And what I'm trying to
2155 figure out is, at the point that happened, no longer should I
2156 as an investor who is hedging against the security that I
2157 actually own have taken any comfort from the fact that AIG--
2158 Mr. DINALLO. I think I can answer that, yes. I think
2159 that at AIG most of the activity in the CDS was off of
2160 covered, nonnaked activity. These people really owned the
2161 CDOs. These were traders that owned CDOs, and they wanted
2162 default protection on the CDOs. But it is actually a
2163 profound observation that the Governor has made that for the
2164 10 percent of people who thought that they actually had
2165 capital and some kind of insurance protection behind those
2166 covered CDSs, it turns out that possibly the continued
2167 unregulated activity that is naked could seriously impact
2168 their ability to receive payment. I think that's what one of
2169 the congress people was--I think that's what Congresswoman
2170 Maloney was very concerned about before.
2171 Chairman WAXMAN. Thank you, Mr. Sarbanes.
2172 Mr. Welch.

2173 Mr. WELCH. Thank you very much.

2174 I really appreciate your testimony. Very informative,
2175 very helpful.

2176 A couple of things. One, Mr. Turner, I think you said
2177 that the SEC Office of Risk Management was reduced to a
2178 staff, did you say, of one?

2179 Mr. TURNER. Yeah. When that gentleman would go home at
2180 night, he could turn the lights out. In February of this
2181 year, that we had gotten down to just one person at the SEC
2182 responsible for identifying the risk at all the institutions.

2183 Mr. WELCH. So that included the $62 trillion credit
2184 default swap.

2185 Mr. TURNER. That's correct.

2186 Mr. WELCH. And how did he do?

2187 Mr. TURNER. Well, I suppose he got the lights turned
2188 out but didn't get the problems taken care of.

2189 Mr. WELCH. It reminds me we had a hearing earlier on in
2190 this committee about these tainted toys kids were buying, or
2191 they were getting toys that had lead paint. And it turned
2192 out that the Consumer Product Safety Commission apparently
2193 had one person--I hope it wasn't the same person--inspecting
2194 all the Chinese imports.

2195 Mr. TURNER. In all fairness to the SEC, the staff over
2196 there that I've dealt with over the years have been
2197 excellent. But when you only have one person there's no way

2198 on God's green Earth anyone, Chairman Cox or anyone else,
2199 could have even imagined that this person could do the job.
2200 When you cut it down to one, you know what you're doing. You
2201 know that you're basically saying we're not going to do the
2202 job.

2203 Mr. WELCH. Was there a systematic depopulating of the
2204 regulatory force so that it was impossible actually for
2205 regulation to occur? If you have one person in that
2206 office--and then I understand that 146 people were cut from
2207 the enforcement division at the SEC. Is that what you also
2208 testified to?

2209 Mr. TURNER. Yes. I think there has been a systematic
2210 gutting or whatever you want to call it of the agency and its
2211 capability through cutting back of staff. We talked about
2212 risk management, we talked about enforcement, but as well
2213 just in some basic fundamental policies. The enforcement
2214 staff are now asked to jump through many more hoops before
2215 they can proceed with investigations, a change that's been
2216 written a lot about in the media, and it's not a healthy
2217 change for the agency.

2218 Mr. WELCH. You in your testimony--and I think it was
2219 really supported by Mr. Dinallo--identified a number of
2220 things that have contributed--and there is plenty of blame to
2221 go around--the executive compensation, people coming and
2222 going, making money, the accounting standards being lax,

2223 cheap debt, this whole unregulated casino-like $62 trillion
2224 credit default swap, handcuffing of the SEC, lack of
2225 regulation at the holding company level, failure of the
2226 Federal Reserve to tighten up on credit and mergers that were
2227 too large.

2228 But I want to get back--and that was quite a laundry
2229 list. In all the things that we could act on, but on this
2230 specific question of having public servants in the job so
2231 they can do the job on behalf of the American public, would
2232 it be your recommendation that we've got to boost the
2233 personnel levels at these organizations to protect the
2234 consumer?

2235 Mr. TURNER. Unequivocally yes. I believe in the
2236 Appropriations Committee over in the Senate Banking they've
2237 given them about a $30 million increase. And I suspect that
2238 that falls short. It probably is going to need to be--if you
2239 really want the SEC to do a job and you're serious about it,
2240 given the cutbacks that have occurred in the last 3 years or
2241 so, you're probably going to need an increase at the SEC
2242 realistically more in the range of $50 million to $75
2243 million.

2244 Mr. WELCH. And that's paid for by that SEC transaction
2245 fee?

2246 Mr. TURNER. Yeah. And, in fact, the SEC collects more
2247 in transaction fees, substantially more in transaction fees

2248 from businesses than they actually pay out for their costs
2249 and their staff.
2250 Mr. WELCH. Let me ask you this. Some of us have
2251 suggested that there be an SEC fee or transaction fee that
2252 would go into an escrow account to offset any cost to the
2253 taxpayer of this bailout. Is that something that you have an
2254 opinion on?
2255 Mr. TURNER. I've always believed that the SEC from a
2256 funding perspective should be treated solely as an
2257 independent agency and that the SEC be given the ability to
2258 collect its fees and whatever it collect it spends on that
2259 and that those fees don't go elsewhere. They just basically
2260 go to fund the SEC so that they don't--you know, they get
2261 what they need but not more than what they need.
2262 Mr. WELCH. Mr. Dinallo, how about you, both on this
2263 question of personnel to get the job done and establishing
2264 basically an escrow fund to help offset the cost of the
2265 bailout?
2266 Mr. DINALLO. Obviously, I'm a big fan of hiring
2267 regulators. I think the department is--I think we're
2268 well--you know, we have a lot of--there's hundreds of people
2269 who do what they do at the New York State Insurance
2270 Department. It takes a lot of people to regulate closely. I
2271 think it is definitely the case that you can design a system.
2272 I certainly feel independent in our work, but we are net, we

2273 are net, you know--

2274 Mr. WELCH. Thank you.

2275 One last question for both of you.

2276 Mr. DINALLO. So I think you can do it without costing

2277 the taxpayer any money.

2278 Mr. WELCH. There are a number of companies that are

2279 going to participate in this bailout program, and my question

2280 to you is this: Do you believe it would be right and

2281 appropriate for the taxpayers to have the right to claw back

2282 some of these outrageous executive salaries and golden

2283 parachutes from companies that have voluntarily opted to

2284 participate in this bailout?

2285 Mr. TURNER. The provisions that are in the legislation,

2286 you know, does under what I would consider to be limited

2287 situations allow claw back. But people need to understand

2288 it's limited. It's not everyone. I thought it should have

2289 been everyone, quite frankly.

2290 Mr. WELCH. That's what I'm asking. We have another

2291 crack at this. This was a gun-at-our-head piece of

2292 legislation we had to pass, we were told, in order to avert a

2293 catastrophe. But we have an opportunity to improve it, and

2294 we are going to have to. So would you support a stronger

2295 claw-back provision?

2296 Mr. TURNER. Yes. And I communicated with Members of

2297 Congress already that I think the claw-back provision, the

2298 severance provision--there were three provisions there on
2299 compensation, and they all could have been much stronger than
2300 what was done the first go-around.
2301 Mr. WELCH. Mr. Dinallo, how about you?
2302 Mr. DINALLO. I don't think I have enough of a basis to
2303 give an opinion. I think Congress did a pretty good job the
2304 first time around. But I would have to see some kind of
2305 proposal to know for all such instances.
2306 Mr. WELCH. Okay. Thank you.
2307 Thank you, Mr. Chairman.
2308 Chairman WAXMAN. Thank you, Mr. Welch.
2309 Ms. Speier.
2310 Ms. SPEIER. Thank you, Mr. Chairman.
2311 Mr. Dinallo, I am one of those that believes that the
2312 regulation of insurance companies should be at the State
2313 level. And if there ever was a great example of why it works
2314 it is AIG, because the insurance part of AIG is solid.
2315 Now, having said that, you as a regulator have the
2316 authority to conserve, to take institutions into
2317 conservatorship. And once you do that my understanding is,
2318 certainly is in California law, that all bets are off. The
2319 contract is off. You are there to make sure that the corpus
2320 is protected for the policyholders, is that correct?
2321 Mr. DINALLO. Yes.
2322 Ms. SPEIER. In this situation we now own AIG. The

2323 taxpayers of this country for all intents and purposes own
2324 AIG. It's in conservatorship. Mr. Cassano, who was the
2325 golden boy of the casino in London, had his compensation very
2326 attractively devised so that over the course of 8 years he
2327 actually earned more money than the CEO, some $280 million,
2328 because he was getting $0.30 back for every--on every dollar
2329 he was receiving $0.30 back in terms of the products that
2330 were being sold. So he also was eligible for bonuses. He
2331 was eligible for $34 million of what were unvested bonuses.
2332 But in February of this year he took that company, that
2333 division, down by $5.3 billion. And yet he was fired the
2334 next day, and the following week the committee has a copy of
2335 a letter, that's a contract, I presume, here, that confirms
2336 this agreement in which he was given the $34 million, and,
2337 oh, by the way, he is now on contract as a consultant to the
2338 tune of $1 million a year, and we, the taxpayers, are picking
2339 up that tab.
2340 So here's someone who brought the company down, the
2341 taxpayers now own this company, it should be in
2342 conservatorship, and this man is still getting $1 million a
2343 year. Now, in conservatorship as an insurance company, you
2344 would be able to void those contracts, wouldn't you?
2345 Mr. DINALLO. Yes.
2346 Chairman WAXMAN. Let me intervene just to say it's $1
2347 million a month.

2348 Ms. SPEIER. Excuse me. $1 million a month.

2349 Mr. DINALLO. If those contracts were--

2350 Ms. SPEIER. Thank you, Mr. Chairman, for that

2351 clarification.

2352 RPTS MCKENZIE

2353 DCMN BURRELL

2354 [12:15 p.m.]

2355 Mr. DINALLO. If those contracts were with an operating
2356 company that we brought into rehabilitation, which you would
2357 call conservatorship, we do have incredibly potent powers
2358 over policies and contracts. The company, we basically step
2359 in and become the management at our, you know, salary.

2360 Ms. SPEIER. So that fancy conference in California
2361 could have been stopped under those circumstances?

2362 Mr. DINALLO. Yes. Although I presume--yes. Although
2363 again we're talking about a holding company activity.

2364 Ms. SPEIER. So Mr. Turner, knowing what we know,
2365 knowing that Mr. Cassano now is getting a million dollars a
2366 month paid for by the taxpayers even though he's no longer
2367 working there and he did get his bonus even though he didn't
2368 earn it, do you think we should claw back?

2369 Mr. TURNER. Well, there is always the legal question of
2370 legally what you can or cannot do. Unfortunately, one of our
2371 problems is we've paid out or investors are quite frankly
2372 going to pay out now, as you mention taxpayers time and time
2373 again, it's not just this situation, it's this situation as
2374 you aptly describe, others at their institutions, Merrill
2375 Lynch, Countrywide and the likes. If there's a way you could
2376 find legally to go enact legislation that would allow

2377 clawbacks of those sums where there was absolutely no pay and
2378 no performance, if not destruction, I would be a big fan of
2379 it. And the real question is legally whether or not you
2380 could do that. I would certainly say though we've learned a
2381 lesson and let's not repeat it again and let's go fix this
2382 going forward as well. If you can do something in the past,
2383 I'm sure--I've heard from a number of my fellow neighbors
2384 that they'd love to see you go get what you couldn't back
2385 from the past as well.

2386 Ms. SPEIER. One last question to Mr. Dinallo. You
2387 determined to take $20 billion from the insurance company and
2388 give it to the holding company.

2389 Mr. DINALLO. Yes.

2390 Ms. SPEIER. Explain to us why you did that. Did you
2391 think that that was going to be enough to hold them over?

2392 Mr. DINALLO. Yes. So we didn't actually do it. But we
2393 did at a certain point offer to do it as part of a holistic
2394 solution. We did believe at the time that the liquidity
2395 problem of the downgrade that I talked about before was on
2396 the order of $15 billion, a need for liquidity. So there was
2397 a plan to take what was excess surplus--this is an important
2398 point. There's the asset liability match, promises versus
2399 assets held. There's a statutory surplus above that. And
2400 then there's excess surplus even above that which companies
2401 often have the right to decide how to use. And we thought

2402 that prudently we could loan that essentially through the
2403 property and casualty companies to fix the liquidity problem
2404 on the basis that the life insurance companies were going to
2405 be sold, which is part of the AIG plan, or some companies to
2406 repay that loan. So at the time the Governor thought given
2407 AIG's presence in the community, the number of jobs at stake,
2408 et cetera, that that was a--and given it was not in any way
2409 going to put policyholder protection at risk, it was a
2410 reasonable use of excess surplus.

2411 Ultimately we didn't need to do to it. But that was the
2412 beginning of that weekend where I was called in and the
2413 Governor sent me in to understand how we could be pragmatic
2414 on a liquidity basis, yes.

2415 Ms. SPEIER. Thank you.

2416 Chairman WAXMAN. Thank you very much, Ms. Speier. Ms.
2417 Watson.

2418 Ms. WATSON. Mr. Chairman, I want to thank you for this
2419 opportunity to have the public listen in as we try to
2420 unscramble eggs. And Mr. Dinallo, Mr. Turner, thank you very
2421 much. I don't know if your responses are really doing that,
2422 but at least I hope at the end of the series of hearings, we
2423 as the policymakers will have a little more clarity as to
2424 where we need to go forward and what we need to do.

2425 Mr. Turner, in your written testimony you told the
2426 committee about AIG's disclosure on May 2005 that it had

2427 inadequate internal controls. You also said the errors
2428 overstated AIG's income by approximately $3.9 billion. And
2429 Mr. Turner, AIG has had a history of internal control
2430 problems. Would you say that's true?
2431 Mr. TURNER. Yes.
2432 Ms. WATSON. Okay. As part of the committee's
2433 investigation, we reviewed internal minutes from AIG's audit
2434 committee meetings, which are not public, and these minutes
2435 show that the company's independent auditor,
2436 PricewaterhouseCoopers warned the company as recently as this
2437 year that there were significant problems and that these
2438 problems were growing worse. Now here are some of the
2439 examples, and they might be up on the screen.
2440 As of February 7, the meeting of the audit committee,
2441 PWC warned that the role and reporting of risk management
2442 needs a higher profile in AIG. And at a February 26 meeting,
2443 PWC indicated that the process at AIG seemed to break down,
2444 in that--and it was kind of unlikely that other companies,
2445 where there was good dialogue at appropriate levels of
2446 management on the approach, alternatives considered and key
2447 decisions--at AIG only AIG-FP was involved in the December
2448 valuation process.
2449 At the next meeting on March 11 PWC reported that there
2450 is a common control issue and root cause for these problems
2451 and that AIG does not have appropriate process or access or

2452 clarity around the roles and responsibilities of critical
2453 control functions.
2454 Mr. Turner, as a former SEC accountant, do you consider
2455 these deficiencies serious? Can you elaborate?
2456 Mr. TURNER. Yeah. Again going back into 2007, there's
2457 obviously some questions about whether the company at a time
2458 it had disclosed--and in all fairness to the company they had
2459 disclosed that they had a half trillion in nominal value of
2460 these derivatives. They didn't tell people just the
2461 magnitude of what that could turn into, but they had told the
2462 public they had a half trillion. But in light of that and
2463 the fact there was some very, very serious concerns about the
2464 models and where they could do the valuation right, which
2465 would raise the question of could you actually disclose
2466 something with integrity, I think the things that PWC is
2467 telling the company here are extremely serious. If I was--I
2468 must say though if I was sitting on the audit committee --and
2469 I've chaired a couple of audit committees--one of my concerns
2470 would be obviously the company has been doing credit
2471 derivatives for quite some period of time. And now all of a
2472 sudden we're just seeing it from the auditors for the very
2473 first time as we get down to a very critical stage and things
2474 are in essence imploding on us. I would have the question
2475 for AIG management, one, why hadn't you solved the problem
2476 before now? Why didn't you have the systems in place to make

2477 sure you could get your hands around these and get the right
2478 disclosures? But I'd also have a question for PWC, who had
2479 been for a number of years auditing the internal controls,
2480 why are you just now coming and telling me about this at
2481 December--November/December of '07 going into '08? If I was
2482 audit committee Chair, I would feel almost blinded that the
2483 auditors hadn't come and told me about this beforehand as
2484 well. So--and quite frankly, if the auditors were just
2485 coming and telling me this as CEO, if I was sitting there in
2486 Mr. Sullivan's position, I would be raising the same question
2487 with the auditors.

2488 Ms. WATSON. Okay. And I would just like to get Mr.
2489 Dinallo's opinion on this, too, as well.

2490 Mr. DINALLO. I think that those are--I think that those
2491 would certainly get my attention. Whether they were
2492 rectified or not, I can't say. So I think it's--I think it's
2493 important. I think you want outside auditors and risk
2494 management to come in and make those kinds of assessments.
2495 And the way you should--this is my modest opinion. The way
2496 you should judge sometimes is what the company did in
2497 response.

2498 Ms. WATSON. Thank you very much, gentlemen.

2499 Chairman WAXMAN. Thank you, Ms. Watson.

2500 Mr. Shays.

2501 Mr. SHAYS. Thank you. Mr. Turner, Fannie Mae had

2502 assets ranking at number two--only Citigroup had a larger
2503 asset ranking. Freddie Mac ranked number five. Just to give
2504 you some perspective, GE ranked number 11, Goldman Sachs
2505 number 12, Ford Motor Company 15. That was in the year 2002
2506 when I introduce a bill to say they need to be under the SEC.
2507 Did it ever strike you as curious that the second highest
2508 ranking asset company in the marketplace and the fourth were
2509 not under any oversight by the SEC?

2510 Mr. TURNER. I just think it was flat out wrong. That's
2511 the only way to say it. I think that someone that's selling
2512 that much of--you know in the securities market in trading
2513 and being held by public investors, I think unquestionably it
2514 should have been from the git-go underneath SEC regulation,
2515 nonexempted.

2516 Mr. SHAYS. Would you take issue with Federal Chairman
2517 Alan Greenspan's warning to Congress in 2005 about the growth
2518 of Fannie and Freddie's portfolios when he said, so I think
2519 that going forward, enabling these institutions to increase
2520 in size, we are placing this total financial system of the
2521 future at a substantial risk. Would you disagree with that?

2522 Mr. TURNER. At the beginning of 2007 I think these two
2523 institutions were doing somewhere in the mid 30, 35 percent
2524 of the total mortgage loans in the country. And by September
2525 or so of last year it had gotten up to about 75 to 78
2526 percent. There is no question as that risk expanded--and

2527 keep in mind the decision was made quite frankly going back
2528 into the late 90s to allow these two institutions to grow the
2529 way they did. If you allow them to grow, you have got to
2530 make sure you've got adequate controls and processes around
2531 them. And regulator. And quite frankly--
2532 Mr. SHAYS. And we had a weak regulator named OFHEO.
2533 Mr. TURNER. A very weak regulator.
2534 Mr. SHAYS. The Federal Housing Enterprise Regulatory
2535 Reform Act of 2005, under the previous Congress, passed and
2536 was sent to the Senate. It would establish what we basically
2537 did in 2008. But when it got to the Senate, it was
2538 unanimously opposed in committee by, candidly, the Democrats.
2539 And therefore it never had a vote on the House floor.
2540 When I introduced this bill with Mr. Markey, it had 22
2541 cosponsors. And one of the individuals when we were talking
2542 about having a stronger regulation in committee said that
2543 this was a political lynching because we were questioning
2544 Frank Raines and our oversight of this committee. I want to
2545 know, do you think that somehow Mr. Raines who got $190
2546 million, do you think that somehow he should be exempt from
2547 coming before this committee if we're going to have others
2548 with less responsibility getting the same sums? If you don't
2549 want to answer, you don't have to.
2550 Mr. TURNER. No, no. You asked the question, and the
2551 question's fair, okay? First of all, I go back to what

2552 Congresswoman Maloney said at the beginning. This is not a
2553 partisan issue. And as I said, this issue needs to be dealt
2554 with on a bipartisan basis. I think you need to drain the
2555 entire swamp, Congressman, and I think you need to take a
2556 good look at what went wrong at all of these institutions.
2557 Freddie and Fannie are two humongous institutions that we've
2558 had to bailout here and it has an impact. And having worked
2559 with OFHEO on both of those institutions, I would encourage
2560 you to bring the executives, the appropriate executives and
2561 appropriate board members before the committee.

2562 Mr. SHAYS. In that bill that we sent to the Senate we
2563 had a clawback provision to be able to go back after these
2564 outrageous salaries. Would you recommend that that be part
2565 of any bill?

2566 Mr. TURNER. As I said earlier, I am a big supporter of
2567 the clawback. What was in the bill was exceedingly weak to
2568 the extent that Congress can determine that there is a
2569 legal--an appropriate legal remedy to go back and give power
2570 to someone to claw back. For prior severance where there was
2571 no performance, I would certainly support that.

2572 Mr. SHAYS. Thank you, Mr. Turner.

2573 Chairman WAXMAN. The gentleman yields back the balance
2574 of his time. I agree with you, Mr. Turner, that this should
2575 not be a partisan issue. And that's why I was somewhat taken
2576 aback when the Republicans on--some Republicans on this

2577 committee started making a big deal about Freddie and Fannie.
2578 It is an important issue. And they're right. And our
2579 committee staff has already been looking into this thing, and
2580 we are going to hold a hearing on it. So I think it's
2581 appropriate.
2582 Mr. SHAYS. When?
2583 Chairman WAXMAN. We'll have to negotiate that with the
2584 minority to get a day that will be convenient for the staff.
2585 But obviously we're going to do it.
2586 Mr. Shays talked about a bill that he introduced which
2587 you thought was a good idea. I'm a cosponsor of that bill.
2588 And some of the proposals that have been put forward
2589 Democrats and Republicans have supported. Unfortunately some
2590 of the proposals have not been agreed to, as we were
2591 discussing with the clawback provision in the Barney Frank
2592 bill that was just adopted. We would have wanted it to be
2593 stronger. The transparency provisions that we suggested to
2594 Chairman Frank as well as some of the other provisions that
2595 you've mentioned that we ought to adopt, we've also
2596 recommended should have been in that bill. When you do
2597 legislation, you get what you can. You don't always get what
2598 you want.
2599 But I want to thank both of you for your presentation.
2600 I think you've been superb witnesses. You've educated this
2601 committee enormously. And I have to say about the members on

2602 both sides of the aisle, I thought the questions had been
2603 asked of the two of you in the conversation--more of a
2604 conversation than anything else has been very, very
2605 constructive and generally not partisan because these are not
2606 partisan issues. Our country and our economy is at stake,
2607 and therefore we've got to work together and not look
2608 for--even though we're a short time before an
2609 election--opportunities to try to zing the other party.
2610 These are not the kind of issues that ought to be put out--in
2611 my view--on a partisan basis. They're the kinds of things
2612 that we need to look at very carefully together. I don't
2613 know that there's a Republican or a Democratic response to
2614 abuses of shareholders and taxpayers. I don't think there's
2615 going to be any difference as we look at those issues
2616 together. And that's why we're holding these hearings to
2617 find out how we got to where we are and what kinds of
2618 suggestions we want to put forward for the future. We don't
2619 have the jurisdiction that the Banking Committee has, but we
2620 certainly can put ideas out there. And I would hope that on
2621 a bipartisan basis not only are we going to hold these
2622 hearings but we may come out with some suggested proposals
2623 that I hope the committees in charge and the leadership of
2624 both the Democratic and Republican side of the House and the
2625 Senate will entertain.
2626 Mr. SHAYS. Would the gentleman yield for a question?

2627 Chairman WAXMAN. Yes.

2628 Mr. SHAYS. Thank you. I want to compliment this
2629 committee on the way they have asked their questions. I do
2630 think we're trying to get at the answer both on a bipartisan
2631 basis. What is troubling to us though is we scheduled five
2632 hearings. And Fannie Mae and Freddie Mac are not scheduled.
2633 And we didn't hear that you were even doing this
2634 investigation, which our side isn't a part of, until we
2635 raised this question. Is it fair to assume that we will have
2636 this hearing within this five hearing range? Or is it your
2637 intention to do it after the election?

2638 Chairman WAXMAN. Well, we'll have to look at the
2639 schedule. We have, for the interest of the witnesses and the
2640 public, we had a hearing yesterday on Lehman, which many
2641 people say triggered the stampede. We had the hearing today
2642 on AIG. Next week we're going to have a hearing on the
2643 rating--I think it's the rating agencies. And we're going to
2644 hear--have a hearing from the regulators. And what is--what
2645 am I missing?

2646 Mrs. MALONEY. Hedge funds.

2647 Chairman WAXMAN. And we're going to have a hearing on
2648 hedge funds, because they're involved in this whole new world
2649 that our regulatory system did not anticipate. So while
2650 we've scheduled those hearings, Members on the other side of
2651 the aisle say, well, what about Freddie and Fannie, Fannie

2652 Mae and Freddie Mac? Well, we're looking at that in
2653 preparation for hearings. I will work with the Republican
2654 staff and Republican members to make sure that we have all
2655 the hearings that's necessary and I think it's appropriate
2656 that we will look at them and we will hold a hearing on it.
2657 And we will have to discuss the date.

2658 Mr. DAVIS OF VIRGINIA. Mr. Chairman, let me just add
2659 that we look forward to working with you on that. I think
2660 Freddie and Fannie are huge pieces of this puzzle, and our
2661 testimony today illustrates that as well. It's a shame that
2662 the committees of jurisdiction didn't hold hearings on this
2663 18 months ago. I think we might not have been in the bind
2664 we're in. But I very much appreciate you calling this now
2665 and that we can examine what happened and what we might do as
2666 we move forward in the future.

2667 Chairman WAXMAN. Thank you. I do want to mention that
2668 one of the reasons we hadn't scheduled that as the first
2669 hearing, as some Members suggested, is that the committee of
2670 jurisdiction just held a hearing on Freddie Mac and Fannie
2671 Mae 2 weeks ago with their CEOs. So we thought we would go
2672 into this in a different direction.

2673 Mr. SHAYS. Would the gentleman yield just for a second
2674 question?

2675 Chairman WAXMAN. Yes.

2676 Mr. SHAYS. We have 360 degrees jurisdiction over every

2677 activity of government for investigation. We have no
2678 jurisdiction in any of these issues to promulgate
2679 legislation. So I just don't want there to be the impression
2680 that somehow we don't have jurisdiction over Fannie and
2681 Freddie. We have total jurisdiction to examine anything they
2682 have done.

2683 Chairman WAXMAN. I don't think anybody would deny that.

2684 Mr. DAVIS OF VIRGINIA. We don't have jurisdiction over
2685 anyone. We have oversight.

2686 Chairman WAXMAN. Oversight jurisdiction. I think
2687 that's what the gentleman from Connecticut was referring to.

2688 You've been very generous in your time and in your
2689 answers to the questions.

2690 Mr. DAVIS OF VIRGINIA. Mr. Chairman, can I just say
2691 thank you very much. I think they're great witnesses. I
2692 think you've added a lot to both sides of the record.

2693 Chairman WAXMAN. And let me ask unanimous consent of
2694 the committee that all the documents and exhibits that have
2695 been referred to by members of the committee be made a part
2696 of the hearing record.

2697 [The information follows:]

2698 ******** COMMITTEE INSERT ********

2699 Mr. DAVIS OF VIRGINIA. Mr. Chairman I also just ask
2700 unanimous consent to have AIG's PAC contributions over the
2701 last decade be put in the record as well.
2702 Chairman WAXMAN. Without objection, they will be put in
2703 the record as well.
2704 [The information follows:]

2705 ******** COMMITTEE INSERT ********

2706 Chairman WAXMAN. Thank you very much. We will move on
2707 to the next panel, but we will break for sufficient time for
2708 these witnesses to leave and for the next two witnesses to
2709 come to the table.
2710 [Brief recess.]
2711 Chairman WAXMAN. The committee will please come back to
2712 order.
2713 We're pleased now to welcome to our committee hearing
2714 Martin Sullivan, who served as the CEO of AIG from March 2005
2715 until June 2008. Before being named CEO, Mr. Sullivan served
2716 as Vice Chairman and co-Chief Operating Officer of AIG. And
2717 Robert Willumstad, who served as CEO of AIG from June 2008
2718 until September 2008. Prior to being named CEO, Mr.
2719 Willumstad served as Chairman of AIG's Board of Directors
2720 beginning in November 2006. He was first elected to AIG's
2721 Board of Directors in January of 2006.
2722 We're pleased to welcome both of you to the hearing.
2723 It's the practice of this committee that all witnesses who
2724 testify before us do so under oath. So I'd like to ask if
2725 you would to please stand and raise your right hand.
2726 [Witnesses sworn.]
2727 Chairman WAXMAN. The record will indicate that both the
2728 witnesses answered in the affirmative. And before we even
2729 begin, I'd like the police officer in charge to take the
2730 person who's holding up a sign and let's get that cleared out

2731 of the room right now. That woman who was holding up the
2732 sign, who intends to hold up a sign and to make a raucous. I
2733 don't think it's appropriate in a congressional committee.
2734 Gentlemen, your prepared statements will be in the
2735 record in full. And we want to recognize you for any oral
2736 presentation that you wish to make. While we usually give 5
2737 minutes and I know you're mindful of that, I don't want to
2738 limit you in any way in the amount of time you have to make
2739 your statement.
2740 Mr. Sullivan, why don't we begin with you?
2741 Mr. SULLIVAN. Thank you very much, Mr. Chairman.
2742 Chairman WAXMAN. There's a button on the base of the
2743 mic.
2744 Mr. SULLIVAN. It's on. Is that much better? Okay. I
2745 have it now. Thank you.
2746 Chairman WAXMAN. Okay. That's better.

2747 STATEMENTS OF MARTIN J. SULLIVAN, FORMER CHIEF EXECUTIVE
2748 OFFICER, AIG; AND ROBERT B. WILLUMSTAD, FORMER CHIEF
2749 EXECUTIVE OFFICER, AIG

2750 STATEMENT OF MARTIN J. SULLIVAN

2751 Mr. SULLIVAN. Thank you, Mr. Chairman, and a very good
2752 afternoon. My name is Martin Sullivan. As you said, from
2753 March 2005 until June of this year, I was President and Chief
2754 Executive Officer of AIG. Though I was no longer with the
2755 company as the events of last month unfolded, I'm here today
2756 to assist the committee in understanding the events that led
2757 to the Federal rescue of AIG, how the example of AIG fits
2758 into the broader financial crisis currently plaguing the
2759 world economy, and the regulatory lessons that we can learn
2760 from AIG's experience.
2761 People around the world are reeling from the financial
2762 tsunami that has ravaged the global economy. While we had
2763 all hoped the unfortunate collapse of Bear Stearns this past
2764 spring would be an isolated incident, instead the financial
2765 storm gained momentum and many of the world's most respected
2766 financial institutions crumbled one after another. The
2767 Federal Government took control of Freddie Mac and Fannie

2768 Mae, Lehman Brothers and IndyMac declared bankruptcy and
2769 Washington Mutual and Wachovia had to be taken over to avoid
2770 a similar fate.

2771 Meanwhile, other prominent institutions sought
2772 additional capital, merger partners and redefined their
2773 corporate status. Of course AIG avoided potential bankruptcy
2774 only with the help of the government.

2775 Now the U.S. Government is establishing a $700 billion
2776 fund to provide additional relief to threatened financial
2777 institutions.

2778 I hope that my testimony about these events that
2779 occurred during my tenure at AIG can help the committee
2780 understand the formation of what is best described as a
2781 global financial tsunami. While we're all struggling to
2782 understand how this crisis happened in the first place and to
2783 find out what might have prevented it, there are no simple
2784 answers to these questions. I'm not an accountant nor an
2785 economist. I've been an insurance man all my life. However,
2786 many factors appear to have been at play, including lending
2787 and borrowing practices, illiquid markets, the absence of
2788 credit, loss of investor confidence, and even accounting
2789 rules which require companies like AIG to take billions of
2790 dollars of unrealized mark-to-market losses.

2791 When in 2005 the AIG board asked me to step into the
2792 role of Chief Executive Officer, the company was straining

2793 under the weight of several crises very different from the
2794 financial crisis currently threatening our financial
2795 institutions. I became COO of AIG at a time when the company
2796 was in the midst of governmental investigations that had cast
2797 a cloud of suspicion over the company's future. In the face
2798 of that crisis my responsibility was to stabilize the ship
2799 and improve our relationships with our regulators. I think I
2800 succeeded.

2801 It was against that backdrop that I began my tenure as
2802 CEO of the company. I'm very proud to say that in spite of
2803 these challenges AIG emerged as a successful and resilient
2804 company. In 2006 and in early 2007 AIG was enjoying great
2805 success, and those of us within the company's management had
2806 tremendous confidence in our company's future.

2807 However, as we now know, the different storm was
2808 gathering over the global financial markets. No disaster as
2809 massive or as unforeseen and as unprecedented financial
2810 market disruption that has occurred over the past year is the
2811 result of a simple or single cause. The world's current
2812 economic challenges are obviously related to multiple actions
2813 by multiple parties.

2814 To assist the committee, I would like to focus on one
2815 particular factor, the role played by one accounting rule
2816 applied to corporations. The accounting rules require that
2817 certain assets be mark to market. In other words, companies

2818 must declare the value of those assets on a quarterly basis
2819 at the price such assets could sell for on the market at that
2820 point in time. Companies must declare these values on their
2821 books even if they have no intention of or immediate need to
2822 sell the assets or even if they have not realized any actual
2823 gain or actual loss.

2824 FAS 157, which was adopted relatively recently, set out
2825 specific guidelines as to how companies must determine the
2826 market price of certain categories of assets. However well
2827 FAS 157 operates under any reasonably foreseeable market
2828 conditions in the unprecedented credit crisis which began in
2829 the summer of 2007, FAS 157 had, in my opinion, unintended
2830 consequences. In a distressed market where assets cannot be
2831 readily sold companies are forced to declare the value of
2832 those assets at fire sale prices.

2833 Just last week the SEC made changes with respect to the
2834 application of FAS 157 when entire markets stop functioning.
2835 Of course AIG did not have the benefit of this guidance
2836 during my tenure. At AIG I encountered FAS 157's unintended
2837 effects through the credit default swap portfolio of AIG
2838 financial products, the business that my predecessor had
2839 established and funded many years earlier. These credit
2840 default swaps essentially provided insurance to
2841 counterparties in the case of default on underlying bonds.
2842 The underlying bonds were very highly rated and the risk of

2843 default was viewed as extremely remote.

2844 Finally, the credit default swap business had since its
2845 inception in the late 1990s generated a reliable and steady
2846 source of income for AIG-FP. In fact, AIG-FP intended to
2847 retain its derivative interest in these highly rated bonds
2848 until they reach maturity. When the credit market seized up,
2849 like many other financial institutions, we were forced to
2850 mark our swap positions at fire sale prices as if we owned
2851 the underlying bonds even though we believed that our swap
2852 positions had value if held to maturity. The company
2853 nevertheless began reporting billions of dollars of
2854 unrealized losses on the basis of then current market
2855 valuations. Suddenly a company with a trillion dollars of
2856 assets was reporting unrealized losses on its income
2857 statement that ultimately climbed into the tens of billions.
2858 As AIG's reported losses mounted, there was a domino like
2859 series of repercussions. Although we had raised
2860 approximately $20 billion in capital, it appears that even
2861 this precaution was not sufficient protection in the face of
2862 the overwhelming and unprecedented market crisis that exists
2863 today. AIG nevertheless suffered credit rating downgrades
2864 which triggered billions of dollars in collateral cause
2865 leading to the most recent events.

2866 Of course by the time the board was presented with the
2867 Federal plan, I had been out of the company for 3 months. In

2868 fact, just last week both the Securities and Exchange
2869 Commission and this Congress recognized the effects of FAS
2870 157. The SEC recognized that FAS 157 can have unintended
2871 consequences for financial institutions where markets seize
2872 up. The SEC has attempted to provide more flexibility for
2873 companies operating and reporting under the rule.
2874 In the recently passed legislation Congress directs the
2875 SEC to further examine mark-to-market accounting and grants
2876 the SEC authority to suspend mark-to-market accounting
2877 requirements. These measures make a lot of sense to me.
2878 I have spent my entire adult life in service to AIG, and
2879 I am heartbroken as to what has happened. I hope to see the
2880 company and indeed the entire global economy emerge from this
2881 crisis.
2882 I hope that my testimony today has been helpful to the
2883 committee, and I will do my very best to answer any questions
2884 you may have. Thank you, sir.
2885 [Prepared statement of Mr. Sullivan follows:]

2886 ******** INSERT 3-1 ********

2887 Chairman WAXMAN. Thank you very much, Mr. Sullivan.
2888 Mr. Willumstad.

2889 STATEMENT OF ROBERT B. WILLUMSTAD

2890 Mr. WILLUMSTAD. Good morning, Chairman Waxman, Ranking
2891 Member Davis, and members of the committee.
2892 AIG remains a great company, and I want to stress that
2893 AIG's problems never threatened AIG's policyholders. The
2894 crisis that required AIG to accept assistance from the
2895 Federal Reserve is a crisis in confidence that has affected
2896 the entire global economy. When I became CEO of AIG in June
2897 of this year, the decline in the U.S. housing market had
2898 already been underway for months. Though most homeowners
2899 were still making their mortgage payments, there was an
2900 unexpected and unprecedented breakdown in the market for
2901 mortgage-backed securities that were held by many banks and
2902 other financial institutions.
2903 Mark-to-market accounting rules forced AIG along with
2904 Citigroup, Merrill Lynch, and others to book tens of billions
2905 of dollars in accounting losses. By the end of the second
2906 quarter of 2008, AIG had booked $50 billion of losses. AIG
2907 was downgraded by the major rating agencies in early May.
2908 And AIG's stock price fell from a high in 2007 of $72 per

2909 share to $26 per share this June. This decline occurred
2910 despite raising $20 billion in new capital and the vigorous
2911 actions of AIG's board and Martin Sullivan before I became
2912 CEO.

2913 In June 2008, the board asked me to replace Martin
2914 Sullivan as CEO. I was initially reluctant to do so.
2915 However, the board ultimately persuaded me that my experience
2916 in the financial services industry, including my time as
2917 President and Chief Operating Officer of Citigroup, put me in
2918 a position to lead AIG in this difficult period.

2919 On my first day as CEO I publicly announced that I would
2920 present my plan for AIG in 90 days. It became apparent that
2921 if the markets continued to decline and if AIG were further
2922 downgraded by the rating agencies, AIG could potentially face
2923 a liquidity problem.

2924 I met with the rating agencies in July, and they told me
2925 they would not review AIG's ratings until after I announced
2926 our plan, which was then scheduled for September 25. Even
2927 so, I immediately took steps to cut expenses and further
2928 protect AIG in the event of a liquidity problem.

2929 We identified nonstrategic businesses, retained
2930 financial advisers and began the process of selling those
2931 businesses to raise cash. To conserve cash, we stopped
2932 discussions relating to a number of acquisitions. We were
2933 negotiating a transaction with Berkshire Hathaway that would

2934 have protected billions of dollars of AIG's liquidity.

2935 In late July I met with the President of the Federal
2936 Reserve Bank of New York to discuss the situation. These
2937 were precautionary steps. Through the first week of
2938 September we believed AIG could weather the difficulties in
2939 the financial markets. When the market meltdown began the
2940 week of September 8, the rating agencies indicated they would
2941 no longer wait to review AIG's ratings until September 25.
2942 AIG was in a vicious circle. The rating agencies were
2943 considering a downgrade largely because of market-driven
2944 liquidity concerns. But it was a downgrade or the threat of
2945 one that would trigger a liquidity crisis.

2946 We worked around the clock during the week of September
2947 8 to take measures that would provide AIG the liquidity
2948 needed to make it through the crisis, but the private markets
2949 simply could not provide enough liquidity. On September 9 I
2950 met again with the Federal Reserve Bank, and during the rest
2951 of the week I stayed in contact with the Federal Reserve and
2952 the Treasury Department.

2953 On Tuesday, September 16, 2008, AIG was preparing for
2954 the unthinkable, bankruptcy. That afternoon the Federal
2955 Reserve and the Treasury Department told AIG they would
2956 provide the necessary liquidity because an AIG bankruptcy
2957 would have massive negative effects on the stability of the
2958 entire financial system. Terms of the offer were

2959 nonnegotiable. After a long discussion and with the advice
2960 of counsel and our financial advisers, the AIG Board of
2961 Directors accepted the Federal Reserve's plan as the best
2962 available option.
2963 As part of that plan I was asked by the Treasury
2964 Department and the Federal Reserve to step down as CEO, and I
2965 did so.
2966 Looking back on my time as CEO, I don't believe AIG
2967 could have done anything differently. The credit default
2968 swap contracts had been in place for years. The market
2969 seizure was an unprecedented global catastrophe. We and our
2970 advisers explored every avenue. There was no private market
2971 solution to AIG's situation.
2972 I regret the pain that events in the market have caused
2973 AIG employees and its shareholders. I'm grateful that the
2974 Treasury and the Federal Reserve and, most important, the
2975 American people offered their assistance to preserve a vital
2976 part of the financial system and a great American
2977 institution.
2978 Because my 3-month tenure as Chief Executive Officer did
2979 not provide me the opportunity to execute my restructuring
2980 plan and in light of the fact that AIG shareholders and
2981 employees have lost so much value, I have notified the
2982 company I do not intend to accept the payments available to
2983 me under the AIG severance plan.

2984 Thank you.

2985 [Prepared statement of Mr. Willumstad follows:]

2986 ******** INSERT 3-2 ********

2987 Chairman WAXMAN. Thank you both very much. We are now
2988 going to have questions for members of the panel. And
2989 without objection, the chairman and the ranking member will
2990 be allotted 10 minutes each to use as they see fit. And
2991 without objection, that will be the order.
2992 Both of you seem to be saying that these events had
2993 nothing to do with your management. It had to do with the
2994 tsunami of activities over which you had no control. And
2995 we're trying to assess whether that's true or whether there
2996 was mismanagement by the executives at AIG.
2997 Now I want to submit for the record a disturbing letter
2998 that I've received from Joseph St. Denis. He's a very
2999 reputable man. He was Assistant Chief Accountant at the SEC
3000 Enforcement Division. He was hired by AIG to address
3001 material weaknesses cited by AIG's auditors and to provide
3002 greater visibility and control with respect to the operations
3003 and accounting policy process of AIG-FP. Mr. St. Denis says
3004 that in 2007--and without objection, his letter will be made
3005 part of the record--he says in 2007 he became concerned about
3006 the valuation model used by AIG's Financial Products
3007 Division. But when he tried to audit this division he was
3008 blocked by Mr. Cassano, who was the head of that division.
3009 Mr. St. Denis wrote the committee that the only--what Mr.
3010 Cassano said was that I have deliberately excluded you from
3011 the valuation of the super seniors because I was concerned

3012 that you would pollute the process. That's what Mr. Cassano
3013 said to Mr. St. Denis. And Mr. St. Denis said to the
3014 committee, the only pollution Mr. Cassano was concerned about
3015 was the transparency I brought to AIG-FP's accounting policy
3016 process.
3017 [The information follows:]

3018 ******** INSERT 3-3 ********

3019 Chairman WAXMAN. Mr. Sullivan, you were the CEO at the
3020 time. Mr. St. Denis was hired to give you insight into Mr.
3021 Cassano's activities. And he said he was blocked from doing
3022 that. And he resigned.
3023 Were you aware of this?
3024 Mr. SULLIVAN. To the very best of my knowledge, sir, I
3025 don't believe I ever saw the letter. But I do recall the
3026 content being brought to my attention. And I understand that
3027 a very thorough investigation both from our compliance people
3028 and from I believe the audit committee--I'm not sure on that.
3029 But certainly compliance and legal looked into what Mr. St.
3030 Denis was saying. Of course at that time we were already
3031 putting in place compensating controls to make sure that our
3032 valuation process was obviously accurate.
3033 Chairman WAXMAN. You were trying to put these controls
3034 in, but the man who was hired by your company to give you the
3035 information as to what controls were needed was fired because
3036 he was told he couldn't look into what was happening in this
3037 particular division of AIG, the FP Division, from which all
3038 the problems seemed to arise.
3039 Mr. SULLIVAN. From the very little I know about Mr. St.
3040 Denis, and I have no reason to believe he's not a first-class
3041 individual, I think he resigned, sir. I don't think he was
3042 terminated.
3043 Chairman WAXMAN. He resigned because he was blocked

3044 from doing his job.

3045 Mr. SULLIVAN. Exactly. And I think, as I said, from
3046 what I recall about the letter, it was investigated from the
3047 legal and compliance people. But at the same time obviously
3048 we were trying to put compensating controls in there to make
3049 sure that our results were as accurate as possible.

3050 Chairman WAXMAN. He said he reported Mr. Cassano's
3051 actions to AIG's independent auditors. He also said that he
3052 spoke with AIG's Director of Internal Audit Michael Roemer.
3053 Mr. Roemer thought this was a serious matter, and on November
3054 6, 2007, he personally briefed the board's audit committee on
3055 Mr. St. Dennis' resignation, according to minutes from that
3056 meeting.

3057 Mr. Willumstad, you were the chairman of the board at
3058 this time. What steps did you and the board take to
3059 investigate this matter?

3060 Mr. WILLUMSTAD. I actually don't remember the comments
3061 in the audit committee.

3062 Chairman WAXMAN. You do not remember?

3063 Mr. WILLUMSTAD. I do not.

3064 Chairman WAXMAN. Well, we don't have a full record of
3065 the committee. But we did request all the minutes of the
3066 audit committee. And there's nothing we can see that
3067 indicates that AIG took any action to respond to Mr. St.
3068 Dennis' concerns. So it looks like you both brushed it

3069 aside. Is that an unfair characterization?

3070 Mr. WILLUMSTAD. I don't recall the audit committee or

3071 the comments. So I can't answer that.

3072 Chairman WAXMAN. And you were the chairman of the board

3073 at that time?

3074 Mr. WILLUMSTAD. I was.

3075 Chairman WAXMAN. And Mr. Sullivan, you were the CEO.

3076 And you don't have much recollection of this either.

3077 Mr. SULLIVAN. Other than I believe I recall that it was

3078 investigated by legal-compliance, and as you refer to, the

3079 internal audit division, sir.

3080 Chairman WAXMAN. Well, the reason of course why this is

3081 significant is that this man was brought in to find out about

3082 these kinds of problems which ended up bringing AIG to its

3083 knees, and it could have given you that information except he

3084 was blocked by the fellow in London, Mr. Cassano, who didn't

3085 want him to know what Mr. Cassano was up to. So I just find

3086 that very disturbing.

3087 I'm going to reserve the balance of my time and

3088 recognize Mr. Davis.

3089 Mr. DAVIS OF VIRGINIA. Thank you, Mr. Chairman. Mr.

3090 Sullivan, according to the documents obtained by the

3091 committee, on March 11, 2008, it was recommended that losses

3092 in AIG-FP not be considered when calculating your

3093 compensation package. How do you justify this while also

3094 advocating pay for performance as a prudential standard for
3095 executive compensation?
3096 Mr. SULLIVAN. First of all, sir, can I just clarify
3097 that my compensation was obviously discussed in executive
3098 session and with the compensation committee. And they
3099 ultimately made a recommendation to the board at large who
3100 ultimately had to approve my compensation. From what I can
3101 recall, and if--if you're referring--it would be helpful if I
3102 could know the minutes you're referring to, but some were put
3103 up on the screen earlier. But if you're referring to the
3104 discussions we had on the super senior--the senior partners
3105 and the partners plan, is that what you're referring to, sir?
3106 Mr. DAVIS OF VIRGINIA. We asked the staff to get that.
3107 I will go on for another question.
3108 I was just looking at your resume. And I saw that you
3109 went to the Sydney Russell School and were very generous to
3110 them afterward. Did you have further education after that?
3111 Mr. SULLIVAN. I put myself through night school, sir,
3112 and became a chartered insurer. I received my associateship
3113 at the Charter Insurance Institute in the United Kingdom.
3114 Mr. DAVIS OF VIRGINIA. Okay. You joined AIG in 1971?
3115 Mr. SULLIVAN. Yes, sir, when I was 17.
3116 Mr. DAVIS OF VIRGINIA. When you were 17 years old.
3117 Mr. Willumstad, can you tell us how the mark-to-market
3118 accounting rules affected AIG's position and do you think it

3119 contributed to the deterioration of the company?

3120 Mr. WILLUMSTAD. Well, I would like to make a couple of

3121 comments. I have no concern or problems--

3122 Mr. DAVIS OF VIRGINIA. Could you move that closer to

3123 you? Thank you.

3124 Mr. WILLUMSTAD. I would make a couple comments about

3125 mark to market. One, I have no concerns about the validity

3126 of mark-to-market accounting. I think the concerns that I've

3127 shared in my written statement is that when there is no

3128 market, the ability to value securities based on FAS 157

3129 becomes somewhat difficult and requires a fair amount of

3130 judgment. There are, as I said, no specific market for these

3131 securities. And the company, along with others, has to go

3132 through a process which uses formulas and other indicative

3133 prices to come up with these values. So accordingly, it's

3134 very difficult to determine whether the values are actually

3135 correct.

3136 According to the procedures that AIG followed, there

3137 were very substantial writedowns in these securities.

3138 Mr. DAVIS OF VIRGINIA. So did it help or hurt you?

3139 Mr. WILLUMSTAD. Well, it obviously resulted in

3140 substantial writedowns, which were obviously not helpful to

3141 the company.

3142 Mr. DAVIS OF VIRGINIA. Your statement alludes to the

3143 fact that in 2005 AIG stopped writing policies on

3144 multi-sector credit default swaps. So somebody I guess at
3145 AIG saw that there were problems or questions with this
3146 portion of the business. Why did AIG stop writing these
3147 policies?
3148 Mr. WILLUMSTAD. I don't know. I was not on the board
3149 at that time.
3150 Mr. DAVIS. Mr. Sullivan, do you know why?
3151 Mr. SULLIVAN. Sorry, sir?
3152 Mr. DAVIS OF VIRGINIA. In Mr. Willumstad's statement he
3153 talked about that AIG in 2005 stopped writing policies on
3154 multi-sector credit default swaps. Obviously they did
3155 that--somebody recommended this inside and this was an early
3156 warning signal. Can you tell us--
3157 Mr. SULLIVAN. Yes. From the best of my recollection
3158 based on what I understood, because obviously at that time I
3159 was very focused on resolving the regulatory issues that AIG
3160 was facing and making sure that we got our accounts issued.
3161 Obviously there was a big delay in 2005 in our issuing our
3162 accounts. From what I understand on investigation, that
3163 decision was made by AIG-FP in conjunction with the risk
3164 management--the risk--the chief risk officer and chief credit
3165 officer of AIG.
3166 Mr. DAVIS OF VIRGINIA. So they saw a problem obviously.
3167 Mr. SULLIVAN. Again, from what I understand, they saw a
3168 deterioration in pricing and were beginning to get concerned

3169 about credit quality. So they took a very proactive step in
3170 2005.
3171 Mr. DAVIS OF VIRGINIA. Did AIG rely heavily on the
3172 mortgage-backed assets of Fannie Mae and Freddie Mac? And
3173 did their demise play a role?
3174 Mr. SULLIVAN. I don't know the answer to that, sir.
3175 Mr. DAVIS OF VIRGINIA. Is there any linkage between AIG
3176 and the GSEs in terms of what was happening with Freddie and
3177 Fannie buying these with implied government backing?
3178 Mr. SULLIVAN. I'm not aware of what our exposure was to
3179 Freddie or Fannie off the top of my head, sir.
3180 Mr. DAVIS OF VIRGINIA. Okay. I have your statement up
3181 here on the board. And I'll ask you--
3182 Mr. SULLIVAN. Thank you for putting that up. I
3183 appreciate that.
3184 When I was talking to the compensation committee on
3185 March 11th, what I was proposing there was the--what
3186 they--proposing what they should actually award the partners
3187 and the senior partners. And as I think somebody mentioned
3188 earlier, there was 700 partners and there were about 70
3189 senior partners. And I was making a recommendation--and by
3190 the way, I should stress, nobody in AIG-FP participated in
3191 this partners plan or senior partners plan. And what
3192 obviously I was anxious to do was to make sure that we
3193 retained our key people. See, shareholders would expect me

3194 to be focused on retaining our key people in those parts of
3195 the business, the insurance businesses and other sectors of
3196 the businesses that were performing well whilst these
3197 unrealized losses but nonetheless losses--nobody is
3198 differentiating between--

3199 Mr. DAVIS OF VIRGINIA. So what you are saying is with
3200 these sectors, they were meeting their goals, they were doing
3201 their job. In other sectors they weren't.

3202 Mr. SULLIVAN. Not everybody was hitting targets. Some
3203 were exceeding, some were not exceeding, as you would expect
3204 in a business. But what I was anxious to do is to make sure
3205 that we retained the 700 key executives that, you know, were
3206 running other parts of our business and participating in
3207 other parts of our business and were not in AIG-FP. The
3208 important distinction there is nobody is in AIG-FP
3209 participated in these programs.

3210 Mr. DAVIS OF VIRGINIA. Mr. Willumstad, you don't see
3211 any relation between what was happening with Freddie and
3212 Fannie and what was happening with AIG then? Do you agree
3213 with Mr. Sullivan?

3214 Mr. WILLUMSTAD. I do not.

3215 Mr. DAVIS OF VIRGINIA. Did the accounting scandals
3216 there raise a red flag, that you were insuring investments
3217 that could be tainted that were coming out of there?

3218 Mr. WILLUMSTAD. I'm sorry. Could you--

3219 Mr. DAVIS OF VIRGINIA. You were buying, you were
3220 getting into some of the business. Did the accounting
3221 scandals at Fannie and Freddie raise any red flags as to
3222 whether you were insuring investments that might be tainted?
3223 Mr. WILLUMSTAD. No.
3224 Mr. DAVIS OF VIRGINIA. Okay. Let's take you both to
3225 the early 2000 time frame. Is there anything in government
3226 regulation going back to this early time frame that would
3227 have changed your business model and would have prevented
3228 this catastrophe?
3229 You were somewhere else at that point, Mr. Willumstad.
3230 But with Citigroup.
3231 Mr. WILLUMSTAD. That's correct.
3232 Mr. DAVIS OF VIRGINIA. Mr. Sullivan.
3233 Mr. SULLIVAN. Can I just clarify? You mentioned the
3234 year 2000, sir?
3235 Mr. DAVIS OF VIRGINIA. In that time frame, yes.
3236 Mr. SULLIVAN. Maybe it's helpful for the committee
3237 there. But from the best of my knowledge, the CDS portfolio
3238 started to be underwritten in the late '90s, 1998. And
3239 obviously as I testified--
3240 Mr. DAVIS OF VIRGINIA. But the rules were changing as
3241 we speak. What happened in that time frame of course is you
3242 had several rule changes taking place at Congress
3243 statutorily.

3244 Mr. SULLIVAN. Well, if you're referring to my comments
3245 regarding FAS 157 in particular?
3246 Mr. DAVIS OF VIRGINIA. Well, no, I'm talking about the
3247 regulatory framework on the commodities futures and
3248 Glass-Steagall repeal, those kinds of things.
3249 Mr. SULLIVAN. Right. I don't think anything in the
3250 regulatory field to the very best of my knowledge would have
3251 changed what occurred. You're going back to 1998.
3252 Mr. DAVIS OF VIRGINIA. That's what I'm asking.
3253 Mr. SULLIVAN. I don't.
3254 Mr. DAVIS OF VIRGINIA. I'll reserve the balance of my
3255 time.
3256 Chairman WAXMAN. Mr. Sullivan, just so I have this
3257 correct, you asked that your bonus based on performance not
3258 count the losses at AIG-FP, is that right?
3259 Mr. SULLIVAN. No, sir. What I was referring to here
3260 was what should be paid under our partners and senior
3261 partners plan.
3262 Chairman WAXMAN. You were included in that.
3263 Mr. SULLIVAN. I was included in that. But at the time
3264 I was speaking--
3265 Chairman WAXMAN. So everybody in that group, including
3266 you, got the bonuses as if you performed very well because
3267 you didn't count the losses?
3268 Mr. SULLIVAN. But with respect, sir, the compensation

3269 committee of our board sets my remuneration and it's then
3270 discussed with the board at large. They could have.
3271 Chairman WAXMAN. But you requested the board to take
3272 that position?
3273 Mr. SULLIVAN. On behalf of the employees of AIG, yes,
3274 sir.
3275 Chairman WAXMAN. Including yourself?
3276 Mr. SULLIVAN. But trust me, I was focusing on them more
3277 than me.
3278 Chairman WAXMAN. AIG-FP, they were getting paid bonuses
3279 that were even higher than the bonuses you were getting,
3280 isn't that correct?
3281 Mr. SULLIVAN. In certain instances, yes, sir. In most
3282 instances.
3283 Chairman WAXMAN. So everybody did really well even
3284 though there were losses. You didn't get penalized, you and
3285 the others you represented. You are getting penalized
3286 because of the losses, even though your bonus was dependent
3287 on--getting a bonus higher if you got earnings, higher
3288 earnings, higher bonus. You got lower earnings and therefore
3289 you still got the bonus. And AIG-FP got their bonuses
3290 because they were being handled in a different way even
3291 though they were the ones bringing on the losses. Is that a
3292 fair statement?
3293 Mr. SULLIVAN. Just for clarity, sir, with regard to my

3294 bonus it was substantially reduced in 2007 by AIG's Board of
3295 Directors, which I concurred with. With regard to AIG-FP, I
3296 don't believe--and again, this is from the very best of my
3297 recollection--that they received their bonuses in 2007. I
3298 think we put in place a deferred compensation plan--again I'm
3299 doing this from memory. But they certainly received their
3300 bonus for 2006 and prior.

3301 Chairman WAXMAN. Okay. Mrs. Maloney.

3302 Mrs. MALONEY. Thank you, Mr. Chairman. We heard from
3303 our first panel that one of the key factors that caused this
3304 financial mess was not accounting rules that shed light on
3305 these risky exotic tools that you were investing in, have no
3306 value and that people don't want to buy them. What the first
3307 panel said was that one of the key factors was inadequate
3308 deregulation of so-called credit default swaps. And it is a
3309 $58 trillion market, double the size of the entire New York
3310 Stock Exchange. The market is four times larger than our
3311 national debt. But unlike the stock exchange, the swap
3312 market has no transparency, no rules and no oversight.

3313 The result of the failure to regulate these credit
3314 default swaps seems pretty clear. AIG had to be bailed out
3315 by the taxpayers because of your risky investment in credit
3316 default swaps. And I for one don't think any of the
3317 management deserves a bonus or any pay from the taxpayers'
3318 purse and certainly not an exotic weekend to discuss the

3319 future of AIG, which was a great company.

3320 You have cost my constituents and the taxpayers of this
3321 country $85 billion and run into the ground one of the most
3322 respected insurance companies in the history of our country.
3323 And the company's failure has tremendous implications in our
3324 entire economy. I got hundreds of calls from constituents
3325 concerned about AIG because of their interaction with this
3326 company.

3327 So I would like first to ask you, Mr. Sullivan, do you
3328 believe the swaps markets should be regulated?

3329 Mr. SULLIVAN. Well, obviously with the benefit of
3330 considerable hindsight, if there is good regulation that can
3331 be put in place, personally I would support that.

3332 Mrs. MALONEY. And Mr. Willumstad, do you believe that a
3333 swap market should be regulated?

3334 Mr. WILLUMSTAD. Yes.

3335 Mrs. MALONEY. Could you give to this committee how much
3336 AIG lost in these swaps? Do you have any idea? Out of the
3337 $58 trillion, how much is held by AIG? Could you get to us
3338 back in writing? Maybe that's something that is something
3339 you would need to look at.

3340 [The information follows:]

3341 ******** COMMITTEE INSERT ********

3342 Mrs. MALONEY. I would also like to ask you, Mr.
3343 Sullivan, that if the same rules that had applied to your
3344 insurance company where you had some backup and some
3345 reserves, would this have avoided the bailout that AIG is
3346 confronting now?
3347 Mr. SULLIVAN. Well, Congresswoman, at the time I left
3348 the company I believed it was well capitalized and had the
3349 liquidity to work its way through.
3350 Mrs. MALONEY. But the swaps had no capital behind them.
3351 Do swaps have any capital behind them?
3352 Mr. SULLIVAN. Well, only the capital ultimately of AIG.
3353 Mrs. MALONEY. Pardon me?
3354 Mr. SULLIVAN. Only the capital ultimately of the
3355 holding company.
3356 Mrs. MALONEY. I'm talking about the swaps. There was
3357 no capital reserve behind those swaps, right?
3358 Mr. SULLIVAN. That's right.
3359 Mrs. MALONEY. So you were gambling billions, possibly
3360 trillions of dollars.
3361 Mr. SULLIVAN. Well, I wouldn't refer to it as gambling.
3362 These transactions were individually underwritten very
3363 carefully. And maybe I can provide some more background to
3364 you that may be helpful.
3365 Mrs. MALONEY. If they were carefully underwritten how
3366 come no one wants to buy them? And our first panel said when

3367 you securitize them the first time, maybe the second time
3368 they had value. But when you get to the sixth and seventh
3369 time that there's no value there. That's what the first
3370 panel said. And you did not follow the insurance rules of
3371 having any collateral or capital behind these risky swaps.
3372 Mr. SULLIVAN. Maybe it would be helpful--because there
3373 was a lot of generalization in the first panel. Maybe it
3374 would be helpful if I just explain. And as I say, I'm not an
3375 accountant.
3376 Mrs. MALONEY. But you did make a good decision not to
3377 sell them anymore after 2005?
3378 Mr. SULLIVAN. Or underwrite. To accept any more swaps
3379 after 2005.
3380 Mrs. MALONEY. You must have realized that they didn't
3381 have any value. And what I'm angry about now is when you
3382 blame accountants for coming forward looking at a product and
3383 saying it has no value because absolutely no one in the
3384 entire world wants to buy it. It's not their fault. You
3385 want them to say there's value there when there's none? I
3386 believe in the fair market value. If no one wants to buy it,
3387 I think there's an indication that there's no value there,
3388 that you were generating fees, making all of your employees
3389 rich, wrecking a great company, and tearing down our economy,
3390 and now turning to the taxpayers and asking us to bail you
3391 out.

3392 I think you should be apologizing to the American people
3393 for your mismanagement.
3394 Mr. SULLIVAN. Well, maybe it would be helpful if I can.
3395 First of all, I'm not blaming accountants. I said in my
3396 testimony--
3397 Mrs. MALONEY. You said the mark-to-market rules, which
3398 is how accountants determine whether there is fair market
3399 value, they have determined no one wants to buy it.
3400 Therefore, it does not help their market value. That--I
3401 believe they're shedding light on the problem. And there
3402 have been many memos from many executives saying they should
3403 change the accounting rules and say there's value there when
3404 there is no value.

3405 RPTS MERCHANT

3406 DCMN SECKMAN

3407 Chairman WAXMAN. The gentlelady's time has expired.

3408 Do you want to make any comment?

3409 Mr. SULLIVAN. With the utmost respect, what I said in
3410 my testimony was the unintended consequences of FAS 157. I
3411 have never criticized FAS 157. My concern, which ultimately
3412 the SEC and this Congress have concurred with, when I made my
3413 remarks, I started making these remarks back in March of this
3414 year, was the unintended consequences of trying to mark to
3415 market these assets in an illiquid market.

3416 And one of the concerns I had, if I may, again which may
3417 be educational, is back many years ago, many of you may
3418 recall the Piper Alpha exploded in the North Sea, if you
3419 remember the tragic circumstances of Piper Alpha exploding.
3420 There was something in the London market insurance area that
3421 was called the London market spiral. And what Piper Alpha
3422 precipitated was a spiraling effect throughout the market
3423 that forced the market ultimately to collapse. The London
3424 market insurance fire was no longer there.

3425 What I saw in early 2008 was what I believe was an
3426 unintended consequence of FAS 157. I wasn't attempting in
3427 any way, shape, or form to criticize it. What I was trying
3428 bring to everybody's attention and what I'm trying to bring
3429 to everybody's attention today was the unintended consequence

3430 of trying to mark to market assets that had value, that you
3431 were happy to hold to maturity, that interest was being paid,
3432 dividends were being paid, but you couldn't mark to market in
3433 an illiquid market. And that was, with the greatest respect,
3434 the point I was trying to make.

3435 I don't think there is any one individual, any one
3436 entity, any one body that you can point the finger to. I
3437 think when you look back and see these great institutions
3438 that we are addressing today and this committee has addressed
3439 in the past, if you look at the German Government
3440 guaranteeing bank deposits, you look at the Irish
3441 government--

3442 Chairman WAXMAN. Mr. Sullivan, we're going to have more
3443 questions.

3444 Mr. SULLIVAN. I'm terribly sorry, but I'm trying to
3445 bring it in perspective if I may. I'm not trying to point
3446 the finger at accountants or FAS 157; I'm trying to raise the
3447 issue of unintended consequences.

3448 Chairman WAXMAN. Mr. Davis you wanted to say something
3449 else?

3450 Mr. DAVIS OF VIRGINIA. I yield myself a couple of
3451 minutes because I'm still puzzled by both of your comments
3452 about not relying on Freddie and Fannie.

3453 My understanding is people would buy these secondary
3454 mortgages. And you had said you would sell them credit

3455 default swaps; isn't that what happened?

3456 Mr. SULLIVAN. Yes. We were selling, to the very best

3457 of knowledge--

3458 Mr. DAVIS OF VIRGINIA. But you weren't relying on the

3459 fact that this government-backed group was insuring them and

3460 that had bought them originally. That had nothing.

3461 Now let me just tell where you I'm going with this. In

3462 documents submitted to the committee, a former AIG CEO Hank

3463 Greenberg asserts that in the 8 years from 1988 to March 2005

3464 AIG wrote credit default swaps on only about 200 CDOs; those

3465 are collateralized debt obligations. Only a handful, he

3466 says, of these were exposed to subprime mortgages. He goes

3467 on to assert that after his departure from AIG, the company

3468 under your leadership, Mr. Sullivan, wrote about 200 CDO

3469 credit default swaps in just 10 months, from March to

3470 December 2005, but that these, unlike his CDOs, were heavily

3471 exposed to subprime mortgages.

3472 Essentially, as I read it, Mr. Greenberg is blaming you

3473 for exposing AIG to the most risky credit default swaps. Do

3474 you agree with that assertion or not?

3475 Mr. SULLIVAN. Clearly not, sir. But what I again would

3476 point out, that these CDS swaps were being written since the

3477 late 1990s, not just in 2005--

3478 Mr. DAVIS OF VIRGINIA. I know they were written in the

3479 1990s. But my question here is, he's saying that in the

3480 early stages, it was not heavy on subprimes; that after this,
3481 it became very heavy with subprimes.
3482 You claim Freddie and Fannie have nothing to do with
3483 this, is what I heard you saying. You weren't relying on the
3484 fact that they were buying these up and that they had
3485 government backed. But you went ahead with this, according
3486 to Mr. Greenberg, and that in the 10 months before you
3487 stopped, that the alarm went out, that you were buying these
3488 up and that he says that's basically what put you at risky
3489 credit default swaps.
3490 In fact, in earlier testimony from Mr. Willumstad, he
3491 notes that the FP wrote a large number of instruments called
3492 credit default swaps over time, that they wrote insurance
3493 bank swaps on bonds with a face value of over $500 billion.
3494 Is that correct?
3495 Mr. SULLIVAN. From recollection, I don't believe the
3496 number got to $500 billion, but it was certainly in totality
3497 around $400 billion, yes.
3498 Mr. DAVIS OF VIRGINIA. And what are they actually
3499 worth?
3500 Mr. SULLIVAN. Well, that's the notional value, sir.
3501 Let me just point out if I may. Up until the time I left
3502 AIG, to the very best of my knowledge AIG had not suffered $1
3503 realized loss.
3504 Mr. DAVIS OF VIRGINIA. They're still holding them,

3505 aren't they?

3506 Mr. SULLIVAN. They're still holding them. At the time,
3507 this valuation can come back. As these contracts mature, and
3508 they have an average tenure of 4 or 5 years, as these
3509 contracts mature, the valuation, assuming there is no loss
3510 under the contract, the valuations would come back.

3511 Mr. DAVIS OF VIRGINIA. But you carry them on the books
3512 as zero.

3513 Mr. SULLIVAN. Well, I'm not sure they're carried at
3514 zero, sir. They're mark-to-market valuation. But coming
3515 back to the point of 2005, I don't want to underestimate the
3516 fact that AIG was in a different sort of crisis in 2005. We
3517 had advised the market that they couldn't rely on our
3518 accounts. We had major regulatory issues that were
3519 dominating the focus of my attention. I had to negotiate
3520 with the SEC, the DOJ, my friends at the New York Insurance
3521 Department, as well as the New York Attorney General. And we
3522 had to stabilize a ship that could have come very much
3523 unglued. During that process of time obviously the capital
3524 markets division, AIG-FP, continued to write their business.
3525 Nobody had any concerns about the profitability of that
3526 business at the time. And as they progressed through 2005,
3527 as the Congresswoman said, you know, fortunately, you know,
3528 those people involved in the underwriting of that, including
3529 the corporate risk and corporate credit offices, made the

3530 determination that the market was deteriorating, not only in
3531 pricing but in credit quality, and made the decision
3532 fortunately to stop. That's the point I would like to make.
3533 The day I left the company, sir, all of these losses to
3534 the best of my knowledge were unrealized at the time,
3535 nonetheless losses but unrealized.
3536 Chairman WAXMAN. Thank you, Mr. Davis.
3537 Mr. Cummings.
3538 Mr. CUMMINGS. Thank you very much, Mr. Chairman.
3539 Mr. Sullivan, are you, like Mr. Willumstad, considering
3540 giving back some of that money?
3541 Mr. SULLIVAN. No, I'm not, sir.
3542 Mr. CUMMINGS. After the bailout on September 16th, the
3543 taxpayers in effect became the owners of AIG. That should
3544 have meant a change in its approach to executive compensation
3545 and benefits, but apparently, it did not. The committee has
3546 learned that a week after the bailout, executives from AIG's
3547 main life insurance subsidiary, AIG American General, held
3548 this week-long conference at an exclusive resort in
3549 California. Are you all familiar? Are you familiar with
3550 that at all?
3551 Mr. WILLUMSTAD. I am not.
3552 Mr. CUMMINGS. The resort is called the St. Regis
3553 Monarch Beach Resort. We've gotten somepictures, and we put
3554 them up. And let me give you a sense of how exclusive the

3555 resort was. Rooms start at $425. Some cost as much as
3556 $1,200. And it's interesting, they've got, 5 nights they had
3557 a room for, a presidential suite, for $1,600. And then they
3558 had 5 nights the royal suite, really nice and swanky, another
3559 $1,600 for 5 nights; that was $8,000. And we contacted the
3560 resort, and we got a copy of the bill. AIG spent $200,000,
3561 $200,000, Mr. Sullivan, for rooms and $150,000 for banquets.
3562 They spent $23,000 for the hotel spa. I don't know whether
3563 you heard me asking the experts questions earlier. And of
3564 course, that was for the pedicures manicures facials massages
3565 and whatever they do in the spa. And they spent about $1,400
3566 at the salon. The guests in the spa and salon actually had
3567 different amenities. They had all kinds of things at St.
3568 Regis. But they spent $7,000 on something very, very,
3569 important; that is green fees at the golf course. And then,
3570 I'm not even sure what this charge means, but my colleagues
3571 tell me that the $10,000 for leisure dining was for drinking.
3572 Mr. Willumstad, you're no longer CEO, and I understand
3573 that. When this all happened, do you--I mean, what's your
3574 opinion? I mean, you seem to be a very honorable man. Would
3575 you have gone along with that?
3576 Mr. WILLUMSTAD. Absolutely not.
3577 Mr. CUMMINGS. And what do you think of it.
3578 Mr. WILLUMSTAD. It seems very inappropriate.
3579 Mr. CUMMINGS. And it seems kind of--a very bad thing

3580 when you think about the fact that the United States
3581 taxpayers would be basically ending up paying for this, was
3582 that not correct?
3583 Mr. WILLUMSTAD. I'm not aware of the facts, but I'll
3584 take your word for it.
3585 Mr. CUMMINGS. But could you understand why taxpayers
3586 would be upset?
3587 Mr. WILLUMSTAD. Of course.
3588 Mr. CUMMINGS. And, Mr. Sullivan, I'm curious what were
3589 your views on this?
3590 Mr. SULLIVAN. Well, obviously I share Mr. Willumstad's
3591 comments. You know, obviously, I left the company many
3592 months earlier prior to Mr. Willumstad.
3593 Mr. CUMMINGS. I understand.
3594 Mr. SULLIVAN. But if I had seen bills like that, I can
3595 assure you, as the CEO, I would have been asking questions.
3596 At the time I left, AIG within its travel department had a
3597 unit that organized conferences that were supposed to,
3598 obviously, get the best rates and make sure that the
3599 conferences were being held in appropriate locations. This
3600 is obviously some months later.
3601 Mr. CUMMINGS. But you can understand why taxpayers
3602 would be very upset, wouldn't you? Couldn't you?
3603 Mr. SULLIVAN. Yes, sir.
3604 Mr. CUMMINGS. I'm going to contact the AIG to find out

3605 who was responsible for all of this, because I think that
3606 person ought to be fired don't you.
3607 Mr. SULLIVAN. Well, without knowing the full facts, you
3608 may reach that conclusion when you reach those facts, but I
3609 don't know the facts, sir. I had left many months earlier.
3610 Mr. CUMMINGS. One of the experts earlier said they
3611 wanted to make sure these kind of things did not happen
3612 again. What kind of--now that we the taxpayers of America
3613 are part of this process, what kind of things and procedures
3614 can we put in place to make sure these kinds of things don't
3615 happen again?
3616 Mr. SULLIVAN. Well, I think you have to look, and I
3617 think with respect to, Mr. Dinallo mentioned this at the
3618 time, that you need to look at for what purpose is this
3619 conference being used. You know, obviously, the company at
3620 that stage had gone through a transition. Maybe they
3621 believed it was an appropriate thing to calm everybody down.
3622 I think Mr. Dinallo made some reference to that.
3623 But as you look going forward as a manager, you would
3624 look at the appropriateness of, one, what's the reason for
3625 the conference? Is it appropriate? And what's the benefit
3626 to the company? And what's the appropriate cost that should
3627 be associated with that, as you would do with any
3628 management--
3629 Mr. CUMMINGS. I do find it interesting that Mr.

3630 Willumstad knows nothing about it, but this came just a week
3631 after you left. Did you know that, Mr. Willumstad?
3632 Mr. WILLUMSTAD. I've heard you say that, but I was
3633 totally unaware that there was any plan for any conference.
3634 Mr. CUMMINGS. So you wouldn't have been aware of this
3635 subsidiary spending some $500,000--
3636 Mr. WILLUMSTAD. I was not aware of that.
3637 Mr. CUMMINGS. --in a week.
3638 Mr. WILLUMSTAD. I was not aware of it. And had I been
3639 aware of it, I would have prevented it from happening.
3640 Mr. CUMMINGS. Thank you very much.
3641 Mrs. MALONEY. [Presiding.] Mr. Cummings' time is
3642 expired.
3643 The Chair recognizes Mr. Souder.
3644 Mr. SOUDER. Thank you. One of the big frustrations
3645 that anybody watching this across America has is, both of you
3646 used the term market driven, financial tsunami, as if you
3647 weren't part of it. Do you feel you have any responsibility
3648 for what's happened in our economy with a huge company that
3649 the taxpayers now have put $61 billion in with 85 going, do
3650 you feel you have any personal responsibility?
3651 Mr. Sullivan.
3652 Mr. SULLIVAN. I take responsibility for everything that
3653 occurred as my tenure as AIG's president and chief executive.
3654 And that's the role of a president and chief executive--

3655 Mr. SOUDER. In other words, you're acting like, during
3656 your period, you were doing fine. You were having all these
3657 nice profits, and that somewhere between July and September,
3658 your company lost $61 billion that we've already had to bail
3659 out that--and you're claiming that the accounting rule which
3660 was the law, it was just a matter of interpretation of how to
3661 apply it, and I basically don't agree with how it was
3662 enforced and like many others have argued that that was a
3663 wrong enforcement, but quite frankly, what it did was it
3664 showed up that your assets didn't have great value. And do
3665 you acknowledge that you are part what triggered the
3666 financial tsunami? That your risky strategies in your
3667 company--let me ask you another question. Your insurance
3668 division is fine, correct?
3669 Mr. SULLIVAN. To the very best of my knowledge at the
3670 time I left, certainly.
3671 Mr. SOUDER. Mr. Willumstad, wouldn't you say your
3672 financial division, we heard earlier, your financial division
3673 appears to be in good shape--I mean your insurance division.
3674 Mr. WILLUMSTAD. That's correct.
3675 Mr. SOUDER. Now, if your insurance division is in good
3676 shape, it means that this is concentrated in your financial
3677 services division. And your insurance division, which is
3678 also investing assets, chose not to invest in as risky of
3679 assets that didn't yield as much but were less risky. Is

3680 that not true? Or how would you explain that one division in
3681 a short period of time could have had $61 billion in taxpayer
3682 investment and your other division not needing it when your
3683 other division, as insurance companies do, also invests in
3684 properties, also have been struggling with mark to market,
3685 have also had, but have more regulation on the value of those
3686 assets prior to that decision? Why does not your risky
3687 strategies in the financial services show that, in fact, to
3688 get higher return you went for more risk in that category?
3689 Mr. Sullivan.
3690 Mr. SULLIVAN. Well, again, what I would like to point
3691 out is that we actually stopped running that business, thank
3692 goodness, in 2005. That's a point I would like to, because I
3693 don't think it was made clear in the first session that,
3694 fortunately, we had been in that business for some 10 years.
3695 But as my colleagues determined that market--you know, the
3696 credit quality was changing and the pricing of these--
3697 Mr. SOUDER. Let me clarify, because you referred to
3698 this several times. Are you saying that the $61 billion that
3699 we put in is mostly of things that were pre-2005.
3700 Mr. SULLIVAN. I don't know what the $61 million is,
3701 sir.
3702 Mr. SOUDER. $61 billion is what the taxpayers have
3703 already put in of the 85 to cover the losses of AIG. And are
3704 you maintaining that this is just to rescue bad decisions

3705 pre-2005, or is any of that money because you had
3706 questionable decisions between 2005 and 2008? Do you bear
3707 any responsibility? That's what I'm asking.
3708 Mr. SULLIVAN. Well, I want to be clear--
3709 Mr. SOUDER. You asked for raises because you said you
3710 were making profits a little bit ago. You said that you were
3711 making profits, that you hadn't lost any money. But yeah,
3712 but you had a shell that was anchored in less than secured
3713 mortgages that had been leveraged multiple times. Your
3714 insurance division, which also presumably has mortgages and
3715 other types of investments, seems fine. The question is, why
3716 weren't you warning your stockholders? Why weren't you
3717 making declarations that would leave your company--I mean, I
3718 have a business background, an MBA, just a small town
3719 business guy. But at the same time, you took incredible risk
3720 without warning people, and the evidence of that risk is
3721 that, one accounting--by your own explanation, one accounting
3722 rules change put your company under, and the taxpayers are
3723 putting $61 billion in; how in the world does an executive
3724 leave their company so vulnerable that, when they leave, all
3725 of a sudden they go broke when they were claiming they were
3726 making money before, and they act astounded like everything
3727 was just fine if they hadn't done this one accounting rule,
3728 which I don't agree that you have to balance out when the
3729 assets are going to be sold, I understand that, you're

3730 holding them long term. But the reason they're trying to do
3731 some of this kind of thing is we might have had a complete
3732 collapse if we hadn't done any mark to market here, we hadn't
3733 done any of these kind of accounting changes. Our assets
3734 were deteriorating, and we would have had an even bigger
3735 blowup later potentially. We needed some kind of a mix in
3736 there. But in effect, you left your company so exposed that
3737 when a little bit of softness came to the economy and it
3738 started down and they do an accounting change, you go belly
3739 up and stick everybody else in America with it, and you're
3740 saying, oh, it was a market tsunami, as if you didn't help
3741 cause it.

3742 Mr. SULLIVAN. Again, if I may, sir, with the utmost
3743 respect, in my testimony, if I emphasize FAS 157 as being the
3744 only cause, it was not, again with the greatest respect, I
3745 was not criticizing FAS 157. I was referring to its
3746 unintended consequences, which of course this Congress has
3747 now and the SEC have now recognized.

3748 There were many other reasons that have affected many
3749 other companies and many other countries around the world.
3750 It's not just the United States. This tsunami that many have
3751 referred to--others have mentioned the equivalent of
3752 financial Pearl Harbor, you know, much more intelligent
3753 people than I. There were many issues that contributed to
3754 this. As I mentioned, whether it was inappropriate lending

3755 or borrowing, whether it was lack of investor confidence,
3756 whether it was the freezing of the credit markets, I just in
3757 my testimony to be helpful to the committee focused on what I
3758 believed back in my tenor as AIG something that I was
3759 concerned about, which was the unintended consequences of FAS
3760 157.

3761 And I responded to the Congressman earlier, at the time
3762 I left, as Mr. Willumstad articulated in his testimony, we
3763 had taken substantial unrealized losses, losses nonetheless.
3764 But at the end of the day, these CDS transactions at the time
3765 I had left the company had not incurred, to the best of my
3766 knowledge, $1 of realize. That's not to say they wouldn't as
3767 the situation progressed. But at the time I left the
3768 company, this was multiple issues, not one entity, not one
3769 individual. And that was the point I was trying to make. If
3770 I referred to FAS 157 too much in my testimony, it was only
3771 because that was something I was particularly concerned about
3772 as--not being an accountant, but as, again, like you. Sir--

3773 Mrs. MALONEY. The gentleman's time has expired.

3774 I yield 1 minute to the ranking member.

3775 Mr. DAVIS OF VIRGINIA. I guess the thing to all of us
3776 is puzzling is, how come you get bailed out, Lehman doesn't?
3777 Who makes these choices? It is kind of mysterious, I think,
3778 to a lot of us. The regrettable thing here is that you get
3779 bailed out. Your employees get to stay. Your shareholders

3780 take a bath, but you're bailed out because there would be a
3781 lot of collateral damage if we were to have not stepped in.
3782 That's at least the rationale that we are hearing from
3783 Treasury. But, frankly, given the quality of some of the
3784 decisions that were made, you deserve to fail.
3785 And it is, I think for a lot of us, puzzling why you
3786 were singled out and kept your doors open, your employees
3787 kept moving, while other companies were left to fail and just
3788 fall on their sword. And I think that's what's troubling to
3789 me and I think to a lot of other members up here. And I
3790 think we'll explore more of that in the testimony and the
3791 questions as we follow.
3792 Thank you.
3793 Mrs. MALONEY. Thank you.
3794 The Chair recognizes Congressman Kucinich for 5 minutes.
3795 Mr. KUCINICH. I thank the gentlelady.
3796 It appears that in the last month this country has taken
3797 steps, unprecedented circumstances, unprecedented steps. We
3798 interfered in the free market. We bailed out Wall Street.
3799 The market is not responding. We see today's headline in the
3800 Wall Street Journal, "Markets Fall on Doubts Rescues Will
3801 Succeed." And I think what this does is I think it raises
3802 questions as to whether it was wise for government to
3803 intervene directly in the markets and whether or not a
3804 financial rescue plan should have addressed the core problem,

3805 which is, tens of millions of Americans losing their homes,
3806 needing government to get a controlling interest in these
3807 mortgage-backed securities, so that we can work out a plan
3808 where people can get a break on their interest rates, on
3809 their principal, extended terms of their loan, and help
3810 people save their loans. We had other choices of priming or
3811 pumping the economy. We didn't do any of that.
3812 Now, questions are raised. For example, you talk about
3813 mark to market. AIG went into the government's hands on
3814 about September 18th. Interesting, mark to market was
3815 basically suspended on the 30th. I think the timing of that
3816 needs to be explored a little bit more carefully. We know it
3817 went into effect on the 15th of November. We've got a
3818 bailout plan by the Secretary of the Treasury which clearly
3819 is not working, and we've got--which the taxpayers are paying
3820 for, and we've got another $85 billion of a bailout for AIG.
3821 And according to the testimony submitted to this
3822 committee by former CEO of AIG Mr. Greenberg, he raises
3823 questions as to whether or not a government bailout of AIG
3824 was absolutely necessary. In fact, he admits there was a
3825 liquidity crisis that required action. But he goes on to say
3826 in his testimony, the action was, it was not necessary to do
3827 a government bailout. He said that it was not necessary to
3828 wipe out virtually all of the shareholder value held by AIG's
3829 millions of shareholders, including tens of thousands of

3830 employees and many more pensioners and other Americans on
3831 fixed income. He said that perhaps they could have filed
3832 bankruptcy, limited the parent company, and that millions of
3833 stockholders would have fared better. This goes back to a
3834 question of my friend that the stockholders would have fared
3835 better. But he says that other stakeholders, like AIG's Wall
3836 Street counterparties, would have fared worse.

3837 So, according to the testimony of another CEO of AIG,
3838 private sector solutions for AIG were rejected. He talked
3839 about the tens of billions of capital that were offered. He
3840 talked about the State of New York ready to permit AIG to use
3841 $20 billion in excess capital of its insurance subsidiaries,
3842 plus he says there was no effort made for a temporary and
3843 limited bridge fund from the government; plus we have this
3844 mark-to-market problem, and plus you have, without the
3845 mark-to-market problem, you have possibly $1 trillion that
3846 could have been pledged to secure an, instead of trying to
3847 secure an $85 billion loan from the government.

3848 Now, instead, the government takes over. AIG, now we
3849 have 85 percent ownership of AIG. Here's what's going on
3850 with AIG. AIG is paying interest on undrawn capital.
3851 They're paying interest on money it doesn't borrow. The
3852 company is encouraged to draw down the full amount of the
3853 loan even if it doesn't need the money. Now, in order to
3854 service the principal and loan, the AIG has to engage in a

3855 fire sale of profitable assets.

3856 Who buys though assets, Mr. Sullivan, who buys AIG

3857 assets.

3858 Mr. SULLIVAN. Well, obviously, I can't comment on the

3859 events that--

3860 Mr. KUCINICH. Who buys their assets?

3861 Mr. SULLIVAN. Well, if you recruit investment bankers,

3862 they will go out and I assume get the best deal that they

3863 possibly can for the assets for sale.

3864 Mr. KUCINICH. Mr. Willumstad, you were involved with

3865 negotiations with Treasury Secretary Paulson. Why do you

3866 think AIG was bailed out while Lehman Brothers was allowed to

3867 fail?

3868 Mr. WILLUMSTAD. I'm not sure why Lehman Brothers was

3869 allowed to fail. I think it was understood that the

3870 consequences to the financial system if AIG failed would be

3871 very significant.

3872 Mr. KUCINICH. My time is expired, Madam.

3873 Mrs. MALONEY. The Chair recognizes Congressman Bilbray

3874 of California for 5 minutes.

3875 Mr. BILBRAY. Thank you, Madam Chair.

3876 You know, Madam Chair, I do an editorial note. I'm not

3877 going to ask you gentlemen from prepared statements that

3878 somebody else has written up before this hearing. I'm going

3879 to ask questions that basically respond to your testimony.

3880 Madam Chair, I do have to point out that it's sort of
3881 interesting the way we throw around terminologies. And
3882 somebody born and raised on the ocean and spent some time in
3883 the water myself, I find it funny that we use the terminology
3884 like tsunami. We can't even use plain language like tidal
3885 wave. But maybe because some people don't understand some of
3886 the words they're using.
3887 Gentlemen, the term tsunami or tidal wave is not just a
3888 wave coming in. You land lovers and people that don't surf
3889 may not understand that long before that crest breaks,
3890 there's an indication that something is going on. Granted,
3891 usually tourists see the tide going out and think it's a good
3892 time to go out and pick up seashells. And a lot of people
3893 seem to have seen that the tide shifting and the major
3894 changes that were happening were an opportunity to go in and
3895 clean out, and they got caught below the high water mark.
3896 I hope the Chair doesn't mind me using that analogy, but
3897 as an old surfer, I just can't go back addressing that. When
3898 Freddie and Fannie went from 30 percent to 70 percent of a
3899 certain part of the market; when we saw major portions of our
3900 oil money that's going overseas coming back and buying up
3901 paper and inflating a market; don't you think that we should
3902 have seen some concern there, when we say--well, let me just
3903 ask it out.
3904 When Freddie and Fannie went from 30 to 70 percent, how

3905 much of the problem should have been seen by all of us that
3906 we have a portion of the market that was very, very
3907 vulnerable, and did that vulnerability have an effect to your
3908 operation and the problems we're facing with AIG, with
3909 Freddie and Fannie?
3910 Mr. SULLIVAN. Would you like me to respond, sir?
3911 Mr. BILBRAY. Yes.
3912 Mr. SULLIVAN. First of all, I don't believe, with the
3913 greatest respect, I'm qualified to comment on Freddie and
3914 Fannie and the implications thereof.
3915 But what I did say in my testimony was one of the
3916 factors that I think has contributed to, and the tsunami
3917 equivalent, I defer to your expertise, sir, but what's
3918 contributed to what has impacted the global financial economy
3919 is, you know, one of the things could be inappropriate
3920 borrowing and lending. And if that correlates to your
3921 analogy of Freddie and Fannie, maybe that's helpful, I don't
3922 know. But I certainly don't know enough about Freddie and
3923 Fannie to pass any qualified opinion.
3924 Mr. BILBRAY. And I apologize, I had to fly back from
3925 the West Coast just to be here at this hearing, and I just
3926 got to look at the waves and didn't get to enjoy them at all
3927 this weekend, so we're here getting our work done.
3928 Let's just talk about the mark to market. We developed
3929 a concept based on the Enron model of how to address Enron.

3930 Now, would you agree that when it applies to mortgage-backed
3931 securities, when there's real estate involved, the existing
3932 or the traditional accounting process with mark to market
3933 really didn't reflect the real value, the real assets, and
3934 the real situation on the ground and gave an artificial
3935 appearance of volatility that scared the hell out of the
3936 market in a lot of ways that maybe it shouldn't have.
3937 Mr. SULLIVAN. I would agree with that statement.
3938 As I testified, sir, I think what occurred was when FAS
3939 157 of mark-to-market accounting was put in place, you know,
3940 it was really the ability to mark to market in an illiquid
3941 market when there is no visible valuation. And again, maybe
3942 it's helpful if I can just give an example. It's like owning
3943 an apartment block. And the valuation of that apartment
3944 block goes up and down. But all of the tenants, you're the
3945 owner of that building, and you've got it fully occupied.
3946 Everybody is paying their rent on time. You can pay your
3947 mortgage, and you can pay your--any capital expense you have
3948 in repairs or whatever. And you don't have to sell that
3949 building. You can hold it for as long as you want. It
3950 doesn't really matter what the valuation of that building is
3951 because you can hold it, and you'll get in all the cash that
3952 you need in from that.
3953 And what's occurred in the illiquid markets is that
3954 you're trying to value assets that are still paying their

3955 rent, they're still providing you with the cash flow that you
3956 need, but there isn't a valuation that--you know, response to
3957 that in an illiquid market. And that was the point--that's a
3958 very simplistic example. But that was the point I was trying
3959 to make about the unintended consequences.

3960 Mr. BILBRAY. So, in other words, our theory of trying
3961 to go in and correct the Enron, we need to go back and
3962 readdress it because we've moved too far the other way to
3963 where it doesn't reflect the reality. And I think one of the
3964 things a lot of people were interested in those
3965 mortgage-backed securities because they always knew that
3966 there was real estate involved, but the accounting process
3967 doesn't reflect that reality.

3968 Mr. SULLIVAN. Well, I think, obviously, as I said, it
3969 wasn't a criticism of FAS 157. I think there was an
3970 unintended consequence that I am pleased that Congress and
3971 the SEC have agreed to at least take a look at.

3972 Mr. BILBRAY. Thank you, Mr. Chairman.

3973 Chairman WAXMAN. [Presiding.] The gentleman's time has
3974 expired.

3975 Mr. Tierney.

3976 Mr. TIERNEY. Thank you, Mr. Chairman.

3977 Gentlemen, I think people are a little bit baffled here.
3978 We look at Mr. Greenberg's testimony, and it's not his
3979 fault; according to him, it all happened after his watch.

3980 Mr. Sullivan, you say no mistakes were made as events
3981 unfolded.
3982 Mr. Willumstad, you say AIG couldn't have done it any
3983 differently.
3984 And yet I think that people really expected the
3985 management of the company, you as the leaders of the company,
3986 would have seen what risk you were taking and been able to
3987 just know what they were and assess them.
3988 We took a look at the internal minutes from your audit
3989 committee meetings. They're not public, but we were able to
3990 get them. They seem to tell a different story on that. And
3991 let me just go down.
3992 On January 15th, the audit committee minutes say this:
3993 Ongoing discussions revealed that PricewaterhouseCoopers
3994 believes to be an expectation gap among key parties,
3995 including the board, management and the internal control
3996 functions.
3997 The next month, on February 7th, the audit committee
3998 meeting: PWC warns the role or reporting of risk management
3999 needs a higher profile at AIG.
4000 At a February 26th meeting: PWC says, indicated that
4001 the process at AIG seemed to break down and that, unlike
4002 other companies where there was a good dialogue and
4003 appropriate levels of management on the approach,
4004 alternatives considered and key decisions, at AIG, only

4005 AIG-FP, the Financial Products Division, was involved in a
4006 December valuation process.
4007 And that may have something to do with the Chairman's
4008 letter that he received from Mr. St. Denis that he brought it
4009 to people's attention, and he couldn't get by that office
4010 over there.
4011 Then you have March 10, 2008, you get the Office of
4012 Thrift Supervision. They weigh in on this, and they say that
4013 your management of the company and your oversight of AIG
4014 subsidiaries, including in particular the Financial Products
4015 Division led by Mr. Cassano, should be criticized. And they
4016 also say that supervisory concerns regarding the corporate
4017 oversight of key AIG's subsidiaries exist, and they write
4018 that we are concerned that corporate oversight of AIG
4019 Financial Products lacks critical elements of independence,
4020 transparency and granularity.
4021 And the next day, PricewaterhouseCoopers reports that
4022 there is a common control issue, the root cause for these
4023 problems, and that AIG does not have the appropriate access
4024 or clarity around the roles and responsibilities of critical
4025 control functions.
4026 Gentlemen, that seems to stretch from January 15th all
4027 the way to March 11th, your own internal audits, your own
4028 PricewaterhouseCoopers group and the Office of Thrift
4029 Supervision repeatedly saying the serious lapses are there.

4030 They describe them, both the auditors and the regulators.
4031 Don't you think that management has some responsibility for
4032 what went on here?
4033 Mr. Willumstad.
4034 Mr. WILLUMSTAD. Yes, management has some
4035 responsibility.
4036 Mr. TIERNEY. Mr. Sullivan, do you agree?
4037 Mr. SULLIVAN. Yes, I would also say that, at the same
4038 time, we were putting compensating controls in place. You
4039 read the chronological list there, but we had put
4040 compensating controls in place that enabled us, obviously, to
4041 issue our financials for 2007 with a clean audit.
4042 Mr. TIERNEY. I guess the problem is, people expect
4043 management to be ahead of the curve, not to wait for the
4044 regulators and PricewaterhouseCoopers to start blowing the
4045 whistle late. The salaries that you gentlemen pulled down,
4046 you and your team on that, means to us that you anticipate
4047 these things and that you start putting those things in place
4048 before the whistle is blown, before these people come in and
4049 point out the seriousness of the situation.
4050 And I think that's what disturbs people on this and what
4051 continues to be a theme through here that it's not--and Mr.
4052 Chairman, I would like unanimous consent to put copies of the
4053 audit reports and the minutes, as well as the Office of
4054 Thrift Supervision letter of March 10, 2008, in the record,

4055 because I think it shows clearly that this is not something
4056 that external factors are responsible for solely on this;
4057 it's a fundamental failure here of management. And I'm glad
4058 that you both take responsibility for it. I hope your whole
4059 management team does, because certainly the price is
4060 extremely high on that.
4061 Chairman WAXMAN. Without objection those documents will
4062 be made part of the record.
4063 [The information follows:]

4064 ******** COMMITTEE INSERT ********

4065 Mr. SULLIVAN. Can I just respond on one point?

4066 One of the things that we set out to do in March of 2005
4067 was to make tremendous investments in a number of areas that
4068 previously had been underinvested. So we added a lot of
4069 staff in internal audit and legal compliance, risk management
4070 et cetera. So I wanted you to at least know there were
4071 compensating controls put in place.

4072 Mr. TIERNEY. And I appreciate that, if I may, Mr.
4073 Chairman, except these are reports from January, February and
4074 March of 2008. So, obviously, not enough had happened even
4075 remotely close to settling the qualms of the regulators and
4076 the auditors on that. So I think it shows some management
4077 issues there.

4078 Chairman WAXMAN. And if the gentleman will yield to me.
4079 And Mr. St. Denis, who was working for you to alert you to
4080 these problems, tried to get through in November of 2007, and
4081 neither of you remember him complaining or know anything
4082 about his concerns. So you did have an alarm, even in the
4083 previous year.

4084 Mr. Turner, I think you're next.

4085 Mr. TURNER OF OHIO. Thank you, Mr. Chairman.

4086 Yesterday we had a hearing concerning Lehman Brothers,
4087 and there was a discussion that Lehman Brothers had it's own
4088 subprime lender, BNC Mortgage I believe it was, where they
4089 were issuing subprime loans. With AIG, my understanding is

4090 that you were an insurer and you also traded mortgage-backed
4091 securities. I'm not certain, though, did you also have a
4092 lending function of subprime mortgages? And also, then, did
4093 you package loans, issuing them, selling them as
4094 mortgage-backed securities. In the subprime crisis that
4095 we're seeing, what activity in the subprime market did AIG
4096 have?

4097 Mr. SULLIVAN. We did have a--they do have--sorry. It
4098 is hard to differentiate when you've been there 37 years.
4099 AIG does have a consumer finance that's called AIG.

4100 Mr. TURNER OF OHIO. Then you also packaged and sold
4101 those loans as mortgage-backed securities; you also traded in
4102 them.

4103 Mr. SULLIVAN. What I was going to point out is that
4104 fortunately, AGF did not participate in, it is my
4105 understanding, any of the exotic mortgage products during
4106 that period of time and didn't participate in lending in what
4107 we're seeing to be the hot markets that we now discover. So
4108 whilst their results have not been at the level that we would
4109 normally expect them to be, they have not been as bad as
4110 others in their industry.

4111 Mr. TURNER OF OHIO. Because the first panel indicated
4112 that you were invested heavily in subprime mortgages. So
4113 that's direct. That's not mortgage-backed securities.
4114 That's in the mortgages themselves?

4115 Mr. SULLIVAN. I'm sorry, sir, I don't quite understand
4116 the question.
4117 Mr. TURNER OF OHIO. The first panel indicated that part
4118 of AIG's problems were that your financial services
4119 institutions invested heavily in subprime mortgages. In what
4120 form was that investment held?
4121 Mr. SULLIVAN. Again, I think that's the clarity that's
4122 required. These are super senior credit default swaps.
4123 These are the transactions that AIG-FP participated in, so
4124 there are--and we've made very, very fulsome disclosure on
4125 this. In fact, we've been complimented by the investment
4126 community and others about the fulsome disclosure that we've
4127 made. It's all on our Web site and has been for many
4128 quarters. Is that they were effectively insuring, and I'm no
4129 expert on this, but effectively insuring the super senior
4130 level of the transaction. So there are tranches of bonds,
4131 the CDOs below that, whether they are equity, triple B,
4132 double A minus, double A, triple A, and then there's another
4133 layer of protection before you get to the super senior. And
4134 what you're doing, and again, I'm no accountant, but you're
4135 valuing the assets that are underlying the super senior
4136 transaction. So that's, what FP wrote was a super senior
4137 credit default swap portfolio.
4138 Mr. TURNER OF OHIO. My concern that I have mentioned in
4139 many of these hearings is--I'm from Ohio. We're one of the

4140 leaders in foreclosures. You can go drive through
4141 neighborhoods in my community, and you can see the abandoned
4142 houses that are there. Our experience has been that
4143 predominantly these are a result of refinances where the
4144 loan, ultimately where the consumer gets in trouble, the
4145 value of the loan exceeds the value of the house at
4146 origination; that there are terms many times capitalization
4147 of the fees. There are terms that ultimately caused the home
4148 owners to get into trouble. Sometimes it's financial
4149 circumstances of the consumer that causes that they can't
4150 keep up with the payments. But usually, it's something to do
4151 with the mortgage product itself that causes the initial
4152 stress and a realization by the consumer that the mortgage
4153 value is higher than the house value itself. So they don't
4154 even have the ability to sell the home, which you would find
4155 in normal then real estate transactions, to escape their
4156 liability. They are in effect trapped and have the only
4157 recourse, not having the financial resources themselves to
4158 make up the gap, of abandoning the property, causing
4159 therefore the foreclosure because they're not able to keep
4160 up.

4161 In the county in which I reside, it's about 5,000
4162 foreclosures a year now in a community of about half a
4163 million people. The State of Ohio is experiencing somewhere
4164 around 80,000 a year. Every 3 years, that's a geographic

4165 size of one full congressional district.

4166 It's been interesting listening to you, Mr. Sullivan,
4167 about your discussion of mark to market because I was
4168 actually, until you began talking about it, kind of leaning
4169 toward perhaps maybe it was a policy that was a problem. But
4170 after hearing your statement on giving bonuses based upon
4171 excluding losses and your statement of these aren't really
4172 realized losses, that mark to markets, as you said,
4173 unintended consequences followed, I'm beginning to think that
4174 the advocates for significantly reducing mark-to-market
4175 applications are trying to say that we shouldn't look at
4176 value without looking at current value, which is kind of like
4177 your bonus description.

4178 So my concern here, though, is that if mark to market is
4179 a process that people get concerned with when markets
4180 fluctuate, if we have a situation where the loans are
4181 originated at a higher than the value, the mark to market on
4182 day one would tell you that the underlying mortgage security
4183 is not properly collateralized. In your discussions on the
4184 subprime effect, mortgage-backed securities, as you were
4185 saying with the swaps, did you ever have any discussions in
4186 your company where you heard that in fact some of these
4187 mortgages perhaps exceeded the value at loan origination?

4188 I would like you both to answer.

4189 Mr. WILLUMSTAD. Not to my knowledge.

4190 Mr. SULLIVAN. Not to my knowledge, sir.

4191 Chairman WAXMAN. The gentleman's time is expired now.

4192 We go to Mr. Yarmuth.

4193 Mr. YARMUTH. Thank you, Mr. Chairman.

4194 I think it was Mr. Bilbray earlier asked a question if
4195 you knew why AIG was bailed out and not Lehman. I'm going to
4196 ask a little bit more direct question.

4197 Mr. Willumstad, did Goldman Sachs have anything to lose
4198 if AIG went under?

4199 Mr. WILLUMSTAD. Goldman Sachs was a significant
4200 counterparty for AIG.

4201 Mr. YARMUTH. To what extent are the relationships
4202 intertwined, and how much do you think Goldman Sachs would
4203 have suffered financially? What kind of stake was there for
4204 Goldman Sachs and AIG's survival?

4205 Mr. WILLUMSTAD. I can't tell you what losses Goldman
4206 Sachs might have suffered because I don't know. The only
4207 thing I can tell you is that Goldman Sachs was a counterparty
4208 on approximately $20 billion worth of credit default swaps
4209 that AIG-FP had.

4210 Mr. YARMUTH. So it's a significant interest in AIG's
4211 survival it sounds like.

4212 Mr. WILLUMSTAD. Again, I don't want to jump to that
4213 conclusion. I don't know how those securities carried on
4214 Goldman Sachs' books, and I don't know whether they were

4215 hedged by Goldman Sachs, so it would be very difficult to
4216 draw that conclusion.
4217 Mr. YARMUTH. It sounds like a question we need to ask,
4218 Mr. Chairman.
4219 Several comments have been made about the fact that AIG
4220 was too big to fail. And we saw, I think you were in the
4221 room earlier, when the statement of Alan Greenspan about size
4222 and the question of whether we let companies get too big.
4223 Clearly, by your own admission, in this case the implications
4224 of AIG's failure on the financial markets would be
4225 substantial. Is this something that troubles you, that
4226 companies are able to reach the size where they can disrupt
4227 an entire economy? And I guess the corollary question or the
4228 follow-up question is, what benefits to society, our society,
4229 get by letting a company get so big that it puts the entire
4230 Nation's financial system at stake or at risk?
4231 Mr. WILLUMSTAD. I'm sorry, I'm not sure I understand
4232 the question.
4233 Mr. YARMUTH. Well, I mean, you're running a company
4234 now, albeit for just a few months--Mr. Sullivan ran the
4235 company for several years--that apparently was so big that
4236 its failure went--the implications of its failure, potential
4237 failure went far beyond its shareholders and its employees,
4238 and that's why our government decided that it needed to step
4239 in, because of that impact. Do you think that it is good

4240 that corporations can get to that size in our economy where
4241 their mistakes don't just affect them? And do you think
4242 there are benefits--you know, if we're going to allow
4243 companies to get that big, that their failures and their
4244 mistakes can affect all of us, then what does society get in
4245 return for allowing the company to get so large?
4246 Mr. WILLUMSTAD. Well, again, I think the size of AIG
4247 and the interconnection between AIG and the rest of the
4248 capital markets are really the issue. I'm not sure purely
4249 size by itself is the determinant factor. I would say also
4250 that there have been plenty of benefits to AIG's size, its
4251 ability to serve broad markets, to provide a competitive
4252 marketplace so customers and policy holders can get a good
4253 deal if you will, that AIG was a strong well-capitalized
4254 insurance operation that provided many benefits to its
4255 customers and consumers that did business with it.
4256 Mr. YARMUTH. And then that's the question I was asking,
4257 because we see this now in--we've seen it in many situations
4258 recently where companies that are so large that their
4259 failures just impact taxpayers throughout the system. And I
4260 think the question we have to ask as a society is, are the
4261 benefits of that size, whether it's a competitive--whether
4262 it's competitive pricing or whatever, adequate to justify the
4263 risk of a company disrupting, a company making a mistake and
4264 disrupting the entire economy. But that's something that's a

4265 little bit of a, I guess a 30,000-foot issue in this
4266 particular case. Just a quick question again. We've had
4267 some testimony about the fact that only $60 billion has been
4268 drawn down of the $85 billion. What specifically was the $85
4269 billion needed for?

4270 Mr. WILLUMSTAD. The $85 billion number was a number
4271 that was obviously determined by the Federal Reserve. The
4272 $85 billion, I believe, was intended to be a loan to cover
4273 liquidity needs inside the company. It's been characterized
4274 before as covering losses which I think is not an accurate
4275 representation. Again, the loan was taken down after I left
4276 the company, so I can't be specific about it. But what
4277 happens in a crisis of confidence like this and what was
4278 happening to AIG was not a question of losses. AIG has had a
4279 lot of money borrowed over the years. And when you go
4280 through one of these crises, people who have loaned you money
4281 in the past stop lending to you. People who give you money
4282 or put money on deposit with you want it back; that in
4283 another environment, without this crisis of confidence, AIG
4284 could have easily met all of those obligations. But when you
4285 have a series of counterparties who have decided for reasons
4286 of concern about the viability of the company stop doing
4287 business with you, the company can no longer meet its
4288 obligations.

4289 It's not very much different that if all the consumers

4290 of a particular bank showed up one day and asked for all of
4291 their money back, there's no bank in America that could
4292 provide that. Those dollars of deposits that were given to
4293 that bank are loaned out in the communities to small
4294 businesses, consumers, credit cards. The whole system is
4295 driven around confidence and viability. And once that breaks
4296 down, there is no company, certainly in the U.S. and I think
4297 anywhere around the world, that can sustain a run on the
4298 institution.

4299 Chairman WAXMAN. The gentleman's time has expired.

4300 Ms. Watson has requested that she be recognized next.
4301 Does anybody object to that? If not, the gentlelady is
4302 recognized.

4303 Ms. WATSON. Thank you so much, Mr. Chairman.

4304 I think you just about answered my question, but it's
4305 about the $85 billion, Mr. Willumstad, that has been given to
4306 bail out. And as I understand, last Friday, AIG reported it
4307 had already drawn down $61 billion of the $85 billion loan.
4308 Does that align itself to what you were just describing, that
4309 people want their money now?

4310 Mr. WILLUMSTAD. Again, I don't know what the use of the
4311 $61 billion was for because I wasn't there. I'm not there.
4312 But I would say, generally speaking, my assumption would be
4313 that that's exactly what it was used for.

4314 Ms. WATSON. In fact, AIG has drawn down the funds so

4315 quickly that credit rating agencies have now begun
4316 downgrading AIG again. And back on September 16th, AIG said
4317 that the bailout would prevent further rating downgrades.
4318 And we know that you're not at the company anymore, and I'm
4319 sure you're surprised by how quickly the $85 billion line of
4320 credit has been consumed. So one question that my
4321 constituents, and I'm sure that all American taxpayers, are
4322 asking, can you explain or try to how AIG could burn through
4323 $61 billion in just 3 weeks?

4324 Mr. WILLUMSTAD. Well, again, I don't know what the
4325 source for the use of that money was. But I'm assuming that
4326 counterparties who would normally lend money to AIG are no
4327 longer lending money to AIG, and consequently that's where
4328 the money is going.

4329 Ms. WATSON. The new CEO of AIG, Edward Liddy, publicly
4330 suggested that AIG might take a piece of the $700 billion
4331 bailout package that we just passed. So that would be in
4332 addition to the $85 billion that AIG already received. And
4333 my question would be to those who can look forward down the
4334 economic road, when is this going to end? Will it end? How
4335 much are we going to have to spend of the taxpayers' money to
4336 keep AIG afloat? Would you have any idea now that you're not
4337 actively with the company?

4338 Mr. WILLUMSTAD. I'm sorry, but I do not.

4339 Ms. WATSON. Okay.

4340 Well, I appreciate the going out of line, and I
4341 appreciate the gentleman coming here and being
4342 straightforward. A little honesty would help us very much.
4343 Thank you so much, Mr. Chairman, for accommodating me.
4344 Chairman WAXMAN. Thank you very much, Ms. Watson.
4345 Mr. Braley.
4346 Mr. BRALEY. Thank you, Mr. Chairman.
4347 Mr. Sullivan and Mr. Willumstad, I would like to ask you
4348 about the compensation paid to one particular AIG employee
4349 Joseph Cassano. Mr. Cassano was president of AIG's Financial
4350 Product Division, the unit that sold the credit default swaps
4351 that helped bring down AIG. During his tenure at AIG, Mr.
4352 Cassano repeatedly denied that these swaps posed any risk to
4353 AIG or its shareholders.
4354 And I'm going to quote to you from a September 28, 2008,
4355 article in the New York Times by Gretchen Morgenson which
4356 attributes this comment to Mr. Cassano in August of 2007:
4357 Quote, it is hard for us, without being flippant, to even see
4358 a scenario with any--within any kind of realm of reason that
4359 would see us losing $1 in any of these transactions.
4360 The committee has examined Mr. Cassano's pay, and we
4361 were shocked to find that AIG paid him more than it paid its
4362 CEOs. Over the last 8 years, he earned a total of $280
4363 million in cash, and most of that money came from a bonus
4364 program. For every dollar that Mr. Cassano's unit made $0.30

4365 came back to him and the other Financial Products executives.
4366 On February 28th of 2008, AIG posted losses of $5.3
4367 billion. The main reason for these losses was the $11
4368 billion lost by Mr. Cassano's division. The very next day,
4369 February 29th, Mr. Cassano was terminated from his position
4370 as president of the Financial Products Division. But when
4371 AIG terminated Mr. Cassano, it took two actions that, quite
4372 frankly, are hard for your new partners, the United States
4373 taxpayers, to comprehend. First, AIG let him keep up to $34
4374 million in uninvested bonuses. And second, the company
4375 amazingly hired Mr. Cassano as a consultant for the sum of $1
4376 million a month.
4377 So, Mr. Willumstad, let me start with you. As CEO of
4378 AIG, you had authority until September 17, 2008, to cancel
4379 Mr. Cassano's consulting agreement for cause, but you never
4380 did that, did you?
4381 Mr. WILLUMSTAD. No.
4382 Mr. BILBRAY. Mr. Sullivan, as CEO for AIG during the
4383 period from March 11, 2008, when this severance agreement was
4384 signed between AIG and Mr. Cassano, through June 15th of
4385 2008, you had authority to cancel Mr. Cassano's consulting
4386 agreement for cause, but you never took that action, did you?
4387 Mr. SULLIVAN. That is correct.
4388 Mr. BILBRAY. Mr. Chairman, I'm going to offer as part
4389 of the record the consulting agreement of March 11, 2008,

4390 which provides the CEO of AIG to terminate the consulting
4391 agreement for cause. And I certainly think that in light of
4392 what we've heard here today there was ample justification
4393 based upon the misrepresentations made by Mr. Cassano and
4394 based upon the financial peril he created for this
4395 longstanding company of great reputation and our entire
4396 financial marketplace, that that option should have been
4397 exercised and something should have been done for the
4398 taxpayers of the United States.
4399 Chairman WAXMAN. Without objection, the document will
4400 be made part of the record.
4401 [The information follows:]

4402 ******** COMMITTEE INSERT ********

4403 Mr. BRALEY. And Mr. Chairman, I agree that this is not
4404 a partisan issue. But there have certainly been some
4405 partisan comments made about the investigation by this
4406 committee of Fannie Mae and Freddie Mac.
4407 And I would just like to read for the record a portion
4408 of a Financial Times article dated September 9, 2008, titled,
4409 "Oxley Hits Back at Ideologues." This is an article
4410 interviewing the former chair of the House Financial Services
4411 division, Mike Oxley, who, instead of blaming Fannie Mae and
4412 Freddie Mac, headed the Financial Services Committee and
4413 blames the mess on ideologues within the White House as well
4414 as Alan Greenspan, former Chairman of the Federal Reserve.
4415 In fact, he talked about the GSE reform bill that passed the
4416 House overwhelmingly in 2005 and could have prevented the
4417 current crisis.
4418 And here's what he says: I quote, all the handwringing
4419 and bedwetting going on now without remembering how the House
4420 stepped up on this, he says, what did we get from the White
4421 House? We got a one finger salute, end quote.
4422 And finally, he says, we missed a golden opportunity
4423 that would have avoided a lot of the problems we're facing
4424 now if we hadn't had such a firm ideological position at the
4425 White House and the Treasury and the Fed, Mr. Oxley says.
4426 And I would offer that as part of the record as well.
4427 Chairman WAXMAN. Without objection, that will be made

4428 part of the record.

4429 [The information follows:]

4430 ******** COMMITTEE INSERT ********

4431 Chairman WAXMAN. Will the gentleman yield?

4432 Mr. BRALEY. Yes I would.

4433 Chairman WAXMAN. Why didn't you fire Mr. Cassano? You
4434 had the ability under the rules under which your corporation
4435 operated to fire him. And he's been kept on at a
4436 million-dollars-a-month retainer. He was discharged. Why
4437 didn't you fire him?

4438 Mr. Willumstad.

4439 Mr. WILLUMSTAD. Well, again, I was not the CEO at the
4440 time. Mr. Sullivan had recommended to the board and the
4441 compensation committee that Mr. Cassano's assistance in
4442 helping unwind, if you will, or work down the exposure in FP
4443 would be valuable to the company and that, as part of his
4444 agreement, he would have a noncompete, nonsolicitation
4445 agreement. It was important to keep the existing employees
4446 in FP to help work through the sizable exposure.

4447 Chairman WAXMAN. You were the chairman of the board.

4448 Mr. WILLUMSTAD. I was.

4449 Chairman WAXMAN. And you could have insisted that he be
4450 fired, but Mr. Sullivan told you not to fire him so he
4451 wouldn't go out and compete with you. I would have thought
4452 you would want him to go to some other corporation the way he
4453 had put yours so deeply in the hole.

4454 Mr. Sullivan, why didn't you fire him?

4455 Mr. SULLIVAN. I recommended that course of action to

4456 the board, and Mr. Willumstad articulated the reasons very
4457 well.
4458 One of the things that I wanted to ensure is that we
4459 retained the 20-year knowledge that Mr. Cassano had about the
4460 businesses. These are long-term transactions. These are not
4461 transactions that go on the books and expire 12 months later.
4462 They're very long term, and you want to make sure that the
4463 key players and the key employees within AIG-FP, that we
4464 retain that intellectual knowledge.
4465 Chairman WAXMAN. What would he have to have done for
4466 you to feel that you should fire him? He put you in a
4467 situation where you had to come up with $60 billion
4468 immediately, and you couldn't do it. Isn't that enough
4469 reason to feel that the guy shouldn't be kept on at a
4470 million-dollars-a-month salary just to be available?

4471 RPTS MCKENZIE

4472 DCMN MAGMER

4473 Mr. SULLIVAN. Well, at the time, you know, obviously,
4474 we made that decision. Mr. Casanno decided to retire, and I
4475 believed--and I made the recommendation, as Mr. Willumstad
4476 articulated, that his services be retained and--

4477 Chairman WAXMAN. When I retire, I want to come to work
4478 for you at $1 million a month. What a good deal that is.
4479 And what a good signal that is. The man goes out on his own
4480 in these derivative deals that bring down AIG, and he gets $1
4481 million a month retainer in case you need his advice. Is
4482 that what you're telling us?

4483 Mr. SULLIVAN. Well--and, in addition, Mr. Willumstad
4484 articulated all the reasons there, that he had a noncompete
4485 nonsolicitation so that we could retain the key employees in
4486 AIGFP, bearing in mind these are multi-year contracts. This
4487 wasn't the entirety of FP's businesses. There were other
4488 sectors that they were in as well.

4489 Chairman WAXMAN. Ms. Norton, I think you're next on the
4490 list.

4491 Ms. NORTON. Thank you, Mr. Chairman.

4492 I'd like to ask both of you questions about your
4493 statements as the company was collapsing. Because it didn't
4494 suddenly fall, suddenly collapse. Mr. Sullivan, let me ask
4495 you first.

4496 In December, 2007, you said the following: We believe
4497 we have a remarkable business platform with great prospects
4498 that represent tremendous value. How many superlatives in
4499 that sentence? And then you posted $5.3 billion in losses
4500 for the quarter. That was December.
4501 Move just a few months to February, 2008, and then you
4502 said, based upon our most current analysis, we believe that
4503 any credit impairment losses realized over time by AIGFP
4504 would not be material to AIG's consolidated financial
4505 condition. Then you went on to post $7.8 billion or more in
4506 losses for the quarter.
4507 A few months later, May, 2008, you said--and here I
4508 quote you, sir--the underlying fundamentals of our core
4509 business remain solid. The next month the board voted to
4510 replace you.
4511 Let me ask you, Mr. Sullivan, what was the source of
4512 those glowing statements as you were posting loss after loss,
4513 quarter after quarter?
4514 Mr. SULLIVAN. Well, I think, because you made a
4515 reference to a number of statements there, I need to break
4516 down my answer, if I may.
4517 First of all, my reference to the corporation is talking
4518 about AIG's global franchise. Because, obviously, AIG is in
4519 a number of businesses, not just the super senior credit
4520 default swap arena. Obviously, we have leading market

4521 positions in many other businesses. I'm talking current. I
4522 keep on saying "we". I'm no longer there, but for 37 years I
4523 was there. They have market leading positions.
4524 Ms. NORTON. Of course, there were the credit default
4525 swaps that were collapsing your fundamental business. Go
4526 ahead, sir.
4527 Mr. SULLIVAN. That's correct. But I'm just trying to
4528 clarify some of my remarks, because you've taken--there's
4529 different topics being covered there.
4530 So one is referring to the core franchise and the market
4531 leading positions that AIG holds in a number of businesses
4532 around the world. The other comment is trying to
4533 differentiate between the realized loss potential of that
4534 portfolio as against the unrealized loss potential.
4535 As I mentioned earlier, at the time I left the company,
4536 to the very best of my knowledge, certainly to the best of my
4537 knowledge at the end of the first quarter, I don't believe
4538 AIG had suffered any realized losses. That's not to say they
4539 wouldn't suffer realized losses as the market continued to
4540 deteriorate; and, in fact, we made very fulsome disclosure.
4541 As I mentioned earlier, we had a tremendous amount of
4542 information on our exposures to the U.S. residential housing
4543 market on our investor Web site.
4544 Ms. NORTON. Would not be material--credit losses
4545 realized over time would not be material to AIG's

4546 consolidated financial condition.

4547 Mr. SULLIVAN. Based on what I knew--

4548 Ms. NORTON. That is a pretty blanket, across-the-board

4549 statement. That's a pretty across-the-board, blanket

4550 statement.

4551 Mr. SULLIVAN. But I was trying to differentiate there,

4552 to the very best of my knowledge, the difference between the

4553 realized loss situation or the potential realized loss

4554 situation against the amount of unrealized loss--

4555 Ms. NORTON. It didn't occur to you, Mr. Sullivan, that

4556 in parsing your words this way that you might be misleading

4557 your shareholders?

4558 Mr. SULLIVAN. Absolutely not.

4559 Ms. NORTON. Do you think any of them were misled?

4560 Mr. SULLIVAN. No. I would refer you--and I'm sure

4561 you've been supplied with this information--very, very

4562 fulsome disclosures of our exposures not only in the CDS

4563 portfolio but in our mortgage insurance company which was

4564 clearly causing me some concerns in the early part of this

4565 situation when the issue was--

4566 Ms. NORTON. Well, you had departed very substantially

4567 from your core business. Are you saying to me that you

4568 believe your shareholders expected to be bailed out by the

4569 Federal Government at some point?

4570 Mr. SULLIVAN. Certainly not. As I testified earlier,

4571 when I left the company I believed the company was in a
4572 position where it would certainly not need intervention from
4573 the government. But when--if I may go back to the
4574 disclosures that we made, one of the things that I set out to
4575 do in March of 2005, given the challenges that we had with
4576 all of our regulators, we had--
4577 Ms. NORTON. You mean disclosures of the losses?
4578 Mr. SULLIVAN. No, no. When I took office, AIG was
4579 facing, as I mentioned, a crisis very different from the
4580 financial crisis. But I made it clear at day one that we
4581 were going to have an open and transparent relationship not
4582 only with our regulators but with our investors as well. We
4583 put very fulsome--I would encourage you to look at that
4584 information--we have put very fulsome disclosure on our Web
4585 site.
4586 Ms. NORTON. So you believed these were fair and honest
4587 characterizations and that your shareholders were not misled
4588 by any of the three statements even after they saw the losses
4589 posted?
4590 Mr. SULLIVAN. Absolutely. I believe what I said at the
4591 time to be truthful, very truthful based on all the
4592 information I was receiving and clarifying, you know, the
4593 difference between realized and unrealized losses.
4594 Ms. NORTON. Mr. Chairman, I'm going to yield back the
4595 balance of my time.

4596 But my question went to misleading; and I must say, in
4597 concluding, that it's difficult for me to believe that
4598 shareholders were not misled at least by the way in which you
4599 parsed your words and framed the condition--phrased the
4600 condition of the company.
4601 Thank you, Mr. Chairman.
4602 Chairman WAXMAN. The gentlelady yields back the balance
4603 of her time, and I now recognize Mr. Van Hollen.
4604 Mr. VAN HOLLEN. Thank you, Mr. Chairman.
4605 Gentlemen, I want to follow up on some of the questions
4606 regarding executive compensation, including the bonus
4607 structure. And, Mr. Sullivan, let me start with you and ask
4608 about your actions at the meeting of the AIG compensation
4609 committee that took place on March 11, 2008.
4610 According to the documents that this committee has
4611 received, AIG has two bonus programs to reward executive
4612 performance. The first is called the Partners Plan. It
4613 covers the top approximately 700 AIG executives. And the
4614 second is called the Senior Partners Plan, which applies to
4615 roughly the top 70 executives. Now, as CEO, you're paid
4616 under both those executive compensation plans, is that right?
4617 Mr. SULLIVAN. That is part of my compensation.
4618 Mr. VAN HOLLEN. Now as I understood it and looked at
4619 the rules that AIG had set, they tried to align pay with good
4620 performance. Rewards were supposed to be based on the

4621 company's performance. If performance went down and the
4622 company lost money, bonuses would be reduced or cut entirely.
4623 That was what was supposed to happen in 2007. And as a
4624 result of the disastrous fourth quarter results in 2007,
4625 bonuses under both those plans would have been cut under the
4626 normal rules.

4627 But according to the minutes of the meeting that took
4628 place on March 11, the meeting of the compensation committee,
4629 you personally urged the board to rewrite the rules. And
4630 according to the minutes--and I don't know if we're going to
4631 post them on the board. We had them earlier. But let me
4632 just read from the minutes of that meeting.

4633 It said, Mr. Sullivan next presented management's
4634 recommendation with respect to the earnout for the senior
4635 partners for the 2005-'07 performance period, suggesting that
4636 the AIGFP unrealized market valuation losses should be
4637 excluded from the calculation.

4638 I think it's important to point out that just weeks
4639 earlier, on February 28, AIG just posted a record fourth
4640 quarter loss, as we've heard about, of $5.3 billion as a
4641 result of the AIGFP division. My question is very simple.
4642 You have referred to the unintended consequences. The
4643 question is, why did you change the rules, the compensation
4644 rules that were supposed to pay for good performance? Why
4645 did you change them to give yourself and other executives a

4646 bigger bonus?

4647 Mr. SULLIVAN. If I may, just for clarity, this was not
4648 the bonus structure for AIG. These were long-term
4649 compensation programs for AIG executives. So just to clarify
4650 that for you, sir.

4651 And, secondly, I was not asking the compensation
4652 committee to rewrite the rules. I was asking them to use
4653 their discretion, which I believe existed under both
4654 programs.

4655 Coming back to--I testified earlier or responded earlier
4656 that my concern was that these 700 people that participated
4657 in the Partners Plan and the 70 in the senior Partners Plan,
4658 none of them were in AIGFP. They had their--as others have
4659 mentioned--their own compensation plan. And my concern was
4660 that, you know, other parts of the business that were not
4661 being impacted by the events in the credit markets, you know
4662 we would lose key individuals if we didn't at least
4663 acknowledge in their remuneration, which was a long-term
4664 remuneration. They didn't get their money until some time
4665 later--

4666 Mr. VAN HOLLEN. If I could ask, you, I understand,
4667 despite the fact that you left approximately June of this
4668 year, you received the $5.4 million bonus, isn't that right?
4669 Is that not correct?

4670 Mr. SULLIVAN. The reference to a bonus--if that was a

4671 number under the Senior Partner Plan, I don't have the
4672 numbers in front of me. That may be the number, but it's not
4673 referred to as a bonus.
4674 Mr. VAN HOLLEN. But you received this payment under the
4675 Senior Partners Plan, did you not?
4676 Mr. SULLIVAN. It's paid out over a number of years.
4677 Mr. VAN HOLLEN. The question's pretty clear. Your
4678 company had just taken a record loss. Pay for performance is
4679 supposed to be based on how the company performed. And yet
4680 you went before the board of directors and specifically asked
4681 them to ignore those losses for the purpose of a compensation
4682 plan which had the direct result of giving you about $5.3,
4683 $5.4 million extra compensation.
4684 If I could just ask you, Mr. Willumstad, because the
4685 minutes say you were present--
4686 Mr. WILLUMSTAD. That's correct.
4687 Mr. VAN HOLLEN. --at this particular compensation
4688 meeting. I have to ask you, in your role as a fiduciary to
4689 the stockholders, how does that payment, including the
4690 payments to Mr. Sullivan and the other executives, ignoring
4691 the losses that had just taken place, how does that conform
4692 to the rules for pay for good performance? And how does that
4693 benefit any stockholder?
4694 Mr. WILLUMSTAD. If I could clarify some of the things
4695 you said. There are actually three components to the

4696 incentive compensation plan for Mr. Sullivan. It was the
4697 Partners Plan, it was the Senior Partners Plan and there was
4698 a discretionary bonus. Mr. Sullivan received a $9 million
4699 discretionary bonus in 2006 when the company had an
4700 exceptional year. Mr. Sullivan's bonus was reduced to in
4701 2007 from $9 million to $2.5 million. So to put--
4702 Mr. VAN HOLLEN. I understand that, Mr. Willumstad. I'm
4703 referring to a particular request that was made at the board
4704 meeting with respect to the senior partners program. And the
4705 request was made and complied with by the board, accepted by
4706 the board at a time of record loss. And my question is very
4707 simple. How did that decision help the shareholders at this
4708 particular point in time, which is the responsibility of the
4709 board, is it not?
4710 Mr. WILLUMSTAD. The Senior Partners Plan was a plan
4711 that recognized the performance over a 3-year time period.
4712 2007 was one of those 3 years. Mr. Sullivan's recommendation
4713 was to postpone the recognition of those losses because they
4714 were deemed to be unrealized losses. The understanding that
4715 the committee had and the board had is that, as Mr. Sullivan
4716 mentioned, there were 70 employees who were part of the
4717 Senior Partners Plan, none of which had anything to do with
4718 the FP operations. It was only Mr. Sullivan who had any
4719 direct responsibility for that. So his intention and I think
4720 the board's response was not to penalize the other 68 or 69

4721 employees for the result of one business unit.

4722 Mr. VAN HOLLEN. Well, Mr. Chairman, just to conclude, I
4723 mean, it seems that pay for performance means you get paid
4724 whether it's bad performance or good performance and you
4725 change the rules when it doesn't work out the way you
4726 intended. If that's what part of the unintended consequences
4727 of this have been, I've got to say a lot of people are
4728 scratching their heads when they look at how in good times
4729 you stick with the general scheme for pay for performance but
4730 in bad times it gets reinterpreted in a way that benefits
4731 executives. Anyway--

4732 Chairman WAXMAN. Would the gentleman yield to me?

4733 Mr. VAN HOLLEN. I would be happy to yield.

4734 Chairman WAXMAN. Just so we can get this straight, Mr.
4735 Sullivan, you were the CEO of the whole company, which
4736 included the FP in London, right?

4737 Mr. SULLIVAN. That is correct.

4738 Chairman WAXMAN. Okay. And when it came to the
4739 question of the bonuses for the 70 employees, which included
4740 you, you asked the board, upon which Mr. Willumstad sat as
4741 the Chair, to disregard the losses so that that 3-year bonus
4742 wouldn't be reduced. Is that right?

4743 Mr. SULLIVAN. What I recommended to the compensation
4744 committee was that for the purposes of the Senior Partners
4745 Plan and the Partners Plan that they use their discretion in

4746 the calculation of the '07 year, particularly--

4747 Chairman WAXMAN. Not to count the losses. Just to

4748 count the earnings but not the losses.

4749 Mr. SULLIVAN. The unrealized losses.

4750 Chairman WAXMAN. The unrealized losses. Now isn't it

4751 also the case that AIGFP changed the rules as well so that

4752 the bonuses there did not calculate the losses, unrealized as

4753 they might have been?

4754 Mr. SULLIVAN. Um--

4755 Mr. WILLUMSTAD. I don't think that's correct.

4756 Chairman WAXMAN. Well, I have a document that says so.

4757 This is the minutes of the meeting of the Compensation

4758 Management and Resources Committee of the board of directors.

4759 And it says--explained that AIG's Mr. Dooley presented

4760 management's recommendation and explained that AIG management

4761 believes it is critical to provide a special incentive to

4762 assure retention of the AIGFP team, while recognizing the

4763 serious effects of the valuation losses and described the

4764 proposed terms of the alternative arrangements.

4765 Then it goes on to say, no individual received

4766 compensation exceeding $1.25 million and employees affected

4767 by the reduced compensation would be eligible for the

4768 deferred compensation.

4769 It just--that's the way we read this document. I'll put

4770 it into the record, and we'll be able to look at it.

4771 [The information follows:]

4772 ******** COMMITTEE INSERT ********

4773 Chairman WAXMAN. But you've got this FP--you've got the
4774 bonus. You've got the 3-year partners compensation. Did you
4775 get an ordinary salary as well?
4776 Mr. SULLIVAN. Yes, sir.
4777 Chairman WAXMAN. And how much was that?
4778 Mr. SULLIVAN. $1 million a year.
4779 Chairman WAXMAN. So you got $1 million a year. Then
4780 you got a bonus that was reduced from $9 million to $2.5
4781 million, is that right?
4782 Mr. SULLIVAN. That's correct, sir.
4783 Chairman WAXMAN. Then what else did you get?
4784 Mr. SULLIVAN. My participation in the Senior Partners
4785 and the Partners Plan.
4786 Chairman WAXMAN. And how much money was that for that
4787 period of time?
4788 Mr. SULLIVAN. I can't recall.
4789 Chairman WAXMAN. Take a guess. More than $1 million?
4790 More than $2 million?
4791 Mr. SULLIVAN. I think my colleague here mentioned $5
4792 million. Yeah. I don't have the schedule in front of me.
4793 Chairman WAXMAN. We'd like to get it for the record.
4794 [The information follows:]

4795 ******** COMMITTEE INSERT ********

4796 Chairman WAXMAN. Let me tell you one person that didn't
4797 get a bonus while everybody else was getting bonuses. That
4798 was St. Dennis--Mr. St. Dennis, who tried to alert the two of
4799 you to the fact that you were running into big problems. He
4800 was blocked by the people in London from even understanding
4801 what was going on so he could report to you. He quit in
4802 frustration, and he didn't get a bonus.
4803 So the one guy that was really trying to do his job--and
4804 there may have been others as well--lost out on his bonus
4805 completely and was frustrated and felt he couldn't do his
4806 job, so he left.
4807 I thank the gentleman for yielding.
4808 Mr. SULLIVAN. May I suggest, Chairman, with respect
4809 that the company clarify the content of the compensation
4810 committee's reports so that you have an understanding? My
4811 view, obviously, and I think Mr. Willumstad may concur, was
4812 that was actually penalizing the FP folks at the time and
4813 trying to put a compensation structure in place that they
4814 would get rewarded as and when the marks came back.
4815 Chairman WAXMAN. That's not our understanding from the
4816 document.
4817 Mr. SULLIVAN. That's why I suggest, sir, for the
4818 subject of clarity it may help if the company explained it.
4819 Chairman WAXMAN. Whatever penalties you imposed upon
4820 them, it's hard to see how difficult it is when you have Mr.

4821 Casanno not doing any work but getting $1 million a month in
4822 case you need him in addition to whatever else he got by way
4823 of bonuses and salaries and other money sharing agreements.
4824 This is really quite a good deal.
4825 Mr. VAN HOLLEN. Mr. Chairman, I would just say--I mean,
4826 obviously, as CEO, you oversaw the whole FP division as well;
4827 and yet you received a bonus despite the fact that they had
4828 these huge losses. And so, again, it's just people have got
4829 to scratch their heads and wonder what pay for performance
4830 means when you have that kind of compensation structure and
4831 going before the board.
4832 Anyway, my time is up. Thank you, Mr. Chairman.
4833 Chairman WAXMAN. Thank you.
4834 Mr. Sarbanes.
4835 Mr. SARBANES. Thank you, Mr. Chairman.
4836 I'm just fascinated by this guy Joseph Casanno, because
4837 it appears to me that he single-handedly brought AIG to its
4838 knees and was the reason that taxpayers have had to step in
4839 with an $85 billion loan. So--
4840 Mr. SHAYS. Mr. Sarbanes, could you speak a little
4841 louder?
4842 Mr. SARBANES. Yeah. I was just talking about Joseph
4843 Casanno. Is your office in New York?
4844 Mr. SULLIVAN. When I was with AIG, yes, sir.
4845 Mr. SARBANES. Was in New York?

4846 And your office was in New York?

4847 Mr. WILLUMSTAD. Yes.

4848 Mr. SARBANES. And Casanno's office was in London?

4849 Mr. SULLIVAN. He spent his time between London and the
4850 Wilton offices, Wilton, Connecticut.

4851 Mr. SARBANES. So how often would you see him?

4852 Mr. SULLIVAN. Certainly at the FP board meetings and,
4853 obviously, occasionally when he was in town. He was not a
4854 direct report to me. He reported to Mr. Dooley, who was
4855 referenced earlier.

4856 Mr. SARBANES. And how did--I mean, you weren't there, I
4857 guess, when the FP thing got started, right?

4858 Mr. SULLIVAN. Well, I was certainly with AIG but in a
4859 completely different division, sir.

4860 Mr. SARBANES. Okay. You weren't heading the company
4861 up.

4862 Mr. SULLIVAN. No. This is 20-odd years ago.

4863 Mr. SARBANES. What's the company lore on how that
4864 happened? Did Mr. Casanno come to the powers that be and
4865 say, I have got this really neat idea of what we can do over
4866 in London. We can get into this new product line. And off
4867 he went? What's the story there?

4868 Mr. SULLIVAN. Oh, no, no. I think from what I
4869 know--you say folklore, but from what I know is that a number
4870 of executives came out of Drexel and were recruited by AIG at

4871 that time to form the capital markets division that became
4872 known as AIGFP. I don't believe Mr. Casanno was leading that
4873 at the time. He was one of the team that came in, and there
4874 were some management changes thereafter where ultimately Mr.
4875 Casanno became the head of capital markets. But I think
4876 there were two other executives prior to Mr. Casanno who ran
4877 that division.

4878 Mr. SARBANES. Well, you've probably heard me refer to
4879 that office in this hearing before as the London casino,
4880 because I think that terminology captures as well as anything
4881 what was happening over there.

4882 What I can't understand is why you were allowing these
4883 huge losses to build up with apparently no consequence for
4884 Mr. Casanno. So I'm just curious, in December of 2007, Mr.
4885 Casanno is telling the investors, with the data that you have
4886 in front of you, you can play this power game. And then,
4887 within weeks, AIG posts a loss of $5.3 billion. I assume
4888 most of that related to the activities of FP, right?

4889 Mr. SULLIVAN. The unrealized loss, yes.

4890 Mr. SARBANES. So when that happened--and this term
4891 "unrealized losses" which you are very careful to keep
4892 restating--

4893 Mr. SULLIVAN. It's a loss.

4894 Mr. SARBANES. Yeah. They turned out to be realized in
4895 a big way, it seems. Certainly the taxpayers are realizing

4896 these--

4897 Mr. SULLIVAN. Just to clarify, at the time I left, as I
4898 said earlier, none of it realized. What has happened since,
4899 I don't know. But just for clarity.

4900 Mr. SARBANES. I understand. So $5.3 billion. So then,
4901 obviously, you immediately get on the phone to Mr. Casanno
4902 and you say, what's going on over there at FP? Right?

4903 Mr. SULLIVAN. Well, in the December--

4904 Mr. SARBANES. I'm just assuming somebody calls him up
4905 or catches him the next time he's in town for a meeting and
4906 says, $5.3 billion of unrealized losses for the last quarter.
4907 What's happening over there, Mr. Casanno?

4908 And what does he say that gives you comfort? Does he
4909 tell you the same thing he was telling the investors? Well,
4910 we've got all this data, and we can play this power game. So
4911 then you say, okay, fine, we'll keep you in there.

4912 And then the next quarter he posts losses at $7.8
4913 billion. And apparently that's still not enough for him to
4914 be put on the hot seat. So off he goes to the quarter after
4915 that and posts $5.5 billion of losses.

4916 I just don't understand, in terms of the company and
4917 your stewardship of the company, how you can let this guy run
4918 up these huge losses, apparently with no consequence to
4919 himself in terms of the compensation. So just internally
4920 what was going on during that period? What was the

4921 discussion with Mr. Casanno?

4922 Mr. SULLIVAN. Well, clearly, at the time of December,
4923 2007, there was a lot of discussion taking place within the
4924 organization on the whole issue of the CDS super senior
4925 portfolio. There's no question about that.

4926 Don't forget--and I just want to point out that this
4927 business, that's been stopped writing in 2005. So
4928 effectively this portfolio was in run-off. These contracts
4929 were mature over a period of time. And as I said earlier, as
4930 they mature, if there's no loss, you know, on those
4931 contracts, that unrealized loss will then come back into the
4932 income statement of AIG. So I mean that's the point I wanted
4933 to make here. This business was stopped in 2005. I think
4934 that's an important thing.

4935 And, clearly, in December of 2007 a lot of dialogue is
4936 taking place between FP. There's additional resources going
4937 in there to make sure that we're--you know, we obviously have
4938 the compensating controls in there that I referenced to one
4939 of your colleagues earlier. So in December, 2005, there's a
4940 lot of interaction taking place between FP and the
4941 corporation.

4942 Mr. SARBANES. So what you're saying is by that time--by
4943 December, 2007, when the losses first started appearing, it
4944 was too late. You were already on a downward slide. And yet
4945 Mr. Casanno, having set off that situation, is still getting

4946 paid $1 million a month?

4947 Mr. SULLIVAN. What I'm saying is the portfolio stopped
4948 writing in 2005. And, obviously, as the credit market is
4949 starting to freeze and the subprime issues are coming
4950 through, then the losses started to emerge.

4951 Chairman WAXMAN. The gentleman's time has expired.

4952 Ms. Speier.

4953 Ms. SPEIER. Thank you, Mr. Chairman.

4954 To both of you gentlemen, I want to applaud you for the
4955 stiff upper lip that you have shown today under intense
4956 questioning. But I've got to tell you that you make a
4957 shameful profile of corporate America. To you, Mr.
4958 Willumstad, I will say thank you for foregoing your golden
4959 parachute. And to you, Mr. Sullivan, shame on you. The
4960 shareholders of that company have nothing, and you walked
4961 away with $50 million.

4962 Now I'd like to ask a question of you, Mr. Willumstad.
4963 In the final days, evidently Goldman Sachs' CEO was in on
4964 meetings. Is that correct?

4965 Mr. WILLUMSTAD. That's my understanding.

4966 Ms. SPEIER. You were not in those meetings?

4967 Mr. WILLUMSTAD. I was only at one meeting when the CEO
4968 of Goldman Sachs was there.

4969 Ms. SPEIER. And he was there. And what was he saying?

4970 Mr. WILLUMSTAD. This was a meeting that took place on

4971 September 15 at the Federal Reserve. The Federal Reserve had
4972 gotten Goldman Sachs and JPMorgan together to try and find a
4973 private solution to AIG's liquidity issues. That meeting was
4974 to discuss how much capital the company might need. That
4975 meeting lasted for about an hour and a half and then the
4976 meeting was adjourned.
4977 Ms. SPEIER. So they weren't interested in a private
4978 solution?
4979 Mr. WILLUMSTAD. I'm sorry?
4980 Ms. SPEIER. The CEO of Goldman Sachs was not interested
4981 in purchasing AIG--
4982 Mr. WILLUMSTAD. No. He was there to participate in
4983 looking for a private solution.
4984 Ms. SPEIER. Now you said that Goldman Sachs was one of
4985 the counterparties--
4986 Mr. WILLUMSTAD. Yes.
4987 Ms. SPEIER. --of AIG and that they are owed about $20
4988 billion, is that--
4989 Mr. WILLUMSTAD. No. No. As a counterparty, if the
4990 securities defaulted, AIG would have to pay that
4991 counterparty, Goldman Sachs, the amount of the insurance
4992 premium or the credit default swap.
4993 Ms. SPEIER. So they would receive about $20 billion,
4994 though. I used that term earlier. You actually referenced
4995 that amount of money.

4996 Mr. WILLUMSTAD. I did. That's the correct number.

4997 Ms. SPEIER. Now AIG has since taken up the taxpayers on
4998 $61 billion. Has $20 billion of that $61 billion gone back
4999 to Goldman Sachs?

5000 Mr. WILLUMSTAD. I don't know.

5001 Ms. SPEIER. Mr. Chairman, I think that's a question we
5002 may want to ask subsequently.

5003 Mr. Willumstad, do you believe that naked short selling
5004 was part of the problem?

5005 Mr. WILLUMSTAD. Well, AIG stock was down to about $26
5006 in June. Up until September 12, AIG stock was at $23. So
5007 during the course of--from late June to early September,
5008 there was not much movement on AIG stock. In the last week
5009 from September 8 to September 15, AIG stock went from $23 to
5010 $4. I actually don't know that it was necessarily driven by
5011 short sellers, although I would assume there's been some
5012 short selling in there.

5013 Ms. SPEIER. The rating was AA on Friday, and 2 days
5014 later you needed a total bailout. How did you go from being
5015 AA on Friday to needing a total bailout 2 days later?

5016 Mr. WILLUMSTAD. Well, the AA minus rating that was
5017 provided by S&P and Moody's was the ratings. I had met with
5018 the rating agencies actually the prior week and reviewed what
5019 our plan was. They were considering a downgrade at that
5020 time. And on Friday after 4:00 S&P put out a negative watch

5021 that indicated they might reduce their ratings anywhere from
5022 one to three notches. And then I believe it was the
5023 following Monday or Tuesday--I'm not sure exactly which--both
5024 rating agencies downgraded the company.
5025 I'm not sure I've answered your question. But I'm not
5026 sure what your question is.
5027 Ms. SPEIER. I was trying to understand how you can be
5028 rated as AA on Friday and the following week you need a $85
5029 billion bailout. I don't know how you go from being--that
5030 kind of rating doesn't make sense to me.
5031 Mr. WILLUMSTAD. You'd have to talk to the rating
5032 agencies about that.
5033 Ms. SPEIER. All right. One last question, Mr.
5034 Chairman; and this gets back to Joseph Casanno. In August of
5035 2007, he says, it's hard for us with--and without being
5036 flippant to even see a scenario within any kind of realm of
5037 reason that would see us losing $1 in any of these
5038 transactions. It's a lot of bravado.
5039 In December of 2007, he said, we have from time to time
5040 gotten collateral calls from people, and then we say to them,
5041 well, we don't agree with your numbers. And they go, oh, and
5042 they go away; and you say, well, what was that? It's like a
5043 drive-by in a way.
5044 Also in December--and this is a real difficult one to
5045 believe--he says, there are some morbid questions we get

5046 about what happens if the world rolls off its axis and the
5047 world goes to hell in a hand basket? But with the data that
5048 you now have in front of you, you can play this power game.
5049 Mr. Sullivan, you were on that same call. You knew that
5050 the company was in trouble. You allowed Mr. Casanno to make
5051 these statements, and you didn't stop him. You didn't
5052 suggest that he was overstating the case.
5053 Mr. SULLIVAN. Well--
5054 Ms. SPEIER. Is that transparent? Is that what you
5055 should be doing on behalf of the shareholders of the company?
5056 Mr. SULLIVAN. The December 5 meeting which you refer to
5057 there I think laterally we made a very fulsome presentation
5058 to the investor community on AIG's full exposure to the U.S.
5059 residential housing market and made reference to not only to
5060 AIGFP but our mortgage insurance company, our consumer
5061 finance company and our investments.
5062 And I don't want to take any of Joe's comments out of
5063 context, but we've put a lot of information into--you know,
5064 made available a lot of information to the investor community
5065 at that time. And I don't want to take the comments he's
5066 making out of context without seeing the slides that he was
5067 referring to at that moment in time.
5068 You know, obviously, what we told the market--what I
5069 truly believed was accurate at the time, based on all the
5070 information I had available.

5071 Ms. SPEIER. I yield back.

5072 Chairman WAXMAN. Thank you, Ms. Speier.

5073 Mr. Shays, I want to recognize you to close out the
5074 questioning. But before I do, I ask unanimous consent that
5075 we can put in the record a letter that was sent today to
5076 Secretary Paulson.

5077 This is a letter telling Mr. Paulson that we're
5078 concerned about the profligate spending at AIG, including the
5079 $1 million a month that's being paid to Mr. Casanno. Mr.
5080 Casanno received up to $34 million, and even today he's
5081 getting paid as a consultant for $1 million a month, and we
5082 think this is unfair to the taxpayers of this country. AIG
5083 received $85 billion of taxpayers' money, and it's lavishing
5084 these kinds of perks on Mr. Casanno and the event that was
5085 taking place shortly after the government took over.

5086 Without objection, the letter will be entered into the
5087 record.

5088 [The information follows:]

5089 ******** INSERT 5-1 ********

5090 Mr. KUCINICH. Mr. Chairman, could I ask who signed the
5091 letter?
5092 Chairman WAXMAN. The letter has been signed by Mr.
5093 Braley, Mr. Cummings, Ms. Speier and myself.
5094 Mr. KUCINICH. I would like to be associated with that
5095 letter.
5096 Chairman WAXMAN. Okay.
5097 Mr. KUCINICH. Thank you.
5098 Chairman WAXMAN. Mr. Shays, you are now recognized.
5099 Mr. SHAYS. Could we make it bipartisan and add my name
5100 to it?
5101 Chairman WAXMAN. We certainly will.
5102 Mr. Bilbray, do you want to join us?
5103 Mr. BILBRAY. Yes, Mr. Chairman.
5104 Mr. SHAYS. Mr. Willumstad and Mr. Sullivan, thank you
5105 for being here.
5106 There's one thing I think there is unanimity on on the
5107 part of members from both sides of the aisle, that we're
5108 deeply troubled by the compensation that has been paid to
5109 executives who, frankly, were not experiencing success and we
5110 don't think it was truly the executives' money to take.
5111 Ripples from defaults on subprime loans underwritten by
5112 the toxic twins, Fannie and Freddie, grew to a tsunami that
5113 helped swamp Lehman Brothers and others, including AIG; and
5114 Fannie and Freddie were able to launch more than $1 trillion

5115 of bad paper into the private market because regulators and
5116 Congress let them do it. Now what I want to do is ask you--
5117 And Mr. Chairman, I have a question for you as it
5118 relates to the testimony of Mr. Greenberg. Mr. Greenberg--my
5119 reading of his comments and testimony--Mr. Chairman, my
5120 reading of the testimony from Mr. Greenberg that was
5121 submitted to the committee is basically accusing the two
5122 individuals who are in front of us for all the problems of
5123 AIG. And I'm thinking how convenient we don't get to
5124 question him. And my question is, do we swear in the
5125 individual to make sure that their statement is under oath
5126 and that they are held accountable for what they say?
5127 Chairman WAXMAN. Well, if the gentleman would yield, we
5128 invited to Mr. Greenberg to testify. He responded that he
5129 was not well enough to come. He did submit information,
5130 testimony to us, which will be part of the record.
5131 [Prepared statement of Greenberg follows:]

5132 ******** INSERT 5-2 ********

5133 Chairman WAXMAN. While he wasn't here to take the oath
5134 and no oath was administered to him, there are laws that say
5135 if a congressional committee is doing an investigation and
5136 someone knowingly misleads or gives misinformation, that
5137 would be tantamount to a crime in and of itself.
5138 Mr. SHAYS. Thank you, Mr. Chairman.
5139 Let me ask you to respond to his comments. He said,
5140 moreover--and this is his testimony to the committee. Have
5141 you read his testimony?
5142 Mr. WILLUMSTAD. No, sir.
5143 Mr. SULLIVAN. No, sir.
5144 Mr. SHAYS. Moreover, unlike what had been true during
5145 my tenure, the majority of the credit default swaps that AIG
5146 wrote in the 9 months after I retired were reportedly exposed
5147 to subprime mortgages. By contrast, only a handful of the
5148 credit default swaps written over the entire prior 7 years
5149 had any subprime exposure.
5150 So later on he says, how did this happen? I was not
5151 there, so I cannot answer the question with precision. But
5152 reports indicate that the risk controls my team and I put in
5153 place were weakened or eliminated after my retirement.
5154 I would like to ask each of you, is this true? Were
5155 they weakened?
5156 Mr. SULLIVAN. Well, I think there's two parts there. I
5157 don't know what constituted the subprime exposure on the

5158 contracts written when Mr. Greenberg was CEO and thereafter.
5159 So I can't comment on that. All I can tell from you a risk
5160 control standpoint--
5161 Mr. SHAYS. I don't understand that statement. I mean,
5162 you run the company. You are not aware of the exposures you
5163 had earlier on?
5164 Mr. SULLIVAN. What I said is, I haven't got an analysis
5165 at hand as to what the percentages were in response to Mr.
5166 Greenberg's statements. Sorry, sir. What I can tell you
5167 from a risk control standpoint, it was exactly the same risk
5168 control procedures that were in place when Mr. Greenberg was
5169 in office that continued thereafter, both at the subsidiary
5170 level and at the parent company that ultimately resulted,
5171 obviously, in the decision taken to stop writing that
5172 portfolio.
5173 As I said, at that time I was focused on other issues
5174 that--
5175 Mr. SHAYS. So he preceded you, correct?
5176 Mr. SULLIVAN. Preceded me, yes, sir.
5177 Mr. SHAYS. But he is basically blaming you primarily
5178 and he's blaming Mr. Willumstad as well for the short time
5179 that you were on the board and so on and so on. So he's
5180 blaming both of you. Your testimony is that you did not
5181 change any of the controls that existed before him.
5182 Mr. SULLIVAN. In fact, what I would say from when I

5183 took office, as I mentioned earlier in response to one other
5184 question, I set out with the support of AIG's board to
5185 actually put in additional resource and enhance systems not
5186 only in our risk area but in our legal, compliance, finance
5187 and accounting areas.

5188 Mr. SHAYS. So the point is, you take issue with the
5189 statement?

5190 Mr. SULLIVAN. Yes, sir.

5191 Mr. SHAYS. Mr. Dinallo who testified--and I thought it
5192 was very interesting there, about four paragraphs, but he
5193 says, that brings us to the issue of what happened at AIG.
5194 The history has been well reported in the press. Using its
5195 noninsurance operations, AIG, just like many financial
5196 service institutions, invested heavily in subprime mortgages;
5197 AIG's financial products unit and noninsurance companies sold
5198 hundreds of billions of dollars of credit default swaps and
5199 other financial products. As with other financial service
5200 companies, AIG was forced to mark to market and so on.

5201 But your credit default swaps were basically--how did
5202 they relate to the subprime mortgage? Weren't you--you
5203 didn't buy subprime mortgages but you basically--my
5204 understanding is you insured them in a sense, correct?

5205 Mr. SULLIVAN. Correct. What I tried to explain to the
5206 previous question that I had is that what we were
5207 underwriting was the super senior portion of the CDS.

5208 Mr. SHAYS. I know you're trying to tell me you were
5209 trying to secure the best ones.
5210 Mr. SULLIVAN. We actually wrote the super senior--
5211 Mr. SHAYS. I understand. But you know what? They all
5212 were terrible.
5213 Mr. SULLIVAN. The bonds--the way the structures
5214 flow--and it's not easy to explain in a few minutes--is that
5215 you're writing a swap on lots of bonds that sit below you.
5216 And they can be--it can be an equity tranche. It can be a
5217 triple B tranche. And the way these were structured was that
5218 AIG swaps sat over and above the triple A and a little bit
5219 more additional protection. That is why, with respect, I've
5220 been trying to differentiate between the unintended
5221 consequences and the realized losses when you've had to mark
5222 to market in a liquid market.
5223 Mr. SHAYS. Let me just--we're going to deal with this
5224 in the Financial Services Committee, and it's probably going
5225 to scare the hell out of you. Because this committee, I'm
5226 sure, is going to look at how we dice and slice all these
5227 mortgages so it's very hard for people to have any sense of
5228 what their values truly are. And I don't know what that will
5229 do to the marketplace. But, clearly, we are going to be
5230 looking at that.
5231 And what I want to establish on the record, though, is
5232 that you were involved in the subprime market and you did

5233 have credit swaps relating to the subprime market. And you
5234 can give me the refinement of that. And I don't want to
5235 listen to a long dialogue. But isn't that true?
5236 Mr. SULLIVAN. To the best of my ability--
5237 Mr. SHAYS. You can say no or yes, if you want.
5238 Mr. SULLIVAN. Some of the bonds below the tranche that
5239 we were writing could have been in the subprime area.
5240 Mr. SHAYS. Thank you.
5241 Let me just ask you, as it relates to the compensation
5242 committee, I am absolutely convinced that it's one person
5243 scratching someone else's back. You're on the board of one
5244 company. You serve as a CEO of another. Do either of you
5245 serve on the boards of any other companies?
5246 Mr. SULLIVAN. Public companies, no, sir. No public
5247 companies.
5248 Mr. SHAYS. You are the exception, not the rule. But
5249 the question I want to ask you is, describe to me the
5250 compensation committee.
5251 Mr. SULLIVAN. The compensation committee, the structure
5252 of it, sir?
5253 Mr. SHAYS. Yes.
5254 Mr. SULLIVAN. As I mentioned earlier, there was a base
5255 salary.
5256 Mr. SHAYS. I want to know who appoints the compensation
5257 committee. Are they employees of the committee?

5258 Mr. SULLIVAN. No, sir. The compensation committee
5259 consists of independent directors of the board.
5260 Mr. SHAYS. They are members on the board, correct?
5261 Mr. SULLIVAN. Independent members, yes.
5262 Mr. SHAYS. Not employees of the company.
5263 Mr. SULLIVAN. That's correct.
5264 Mr. SHAYS. How are they appointed?
5265 Mr. SULLIVAN. From what I can recall--and you can defer
5266 to my chairman at the time--the recommendation of the
5267 committee membership is made by the nominating governance
5268 committee to the board at large, I believe is the process.
5269 Mr. WILLUMSTAD. That's correct.
5270 Mr. SHAYS. My sense is is that it's a club, and the
5271 club basically rewards their friends.
5272 Chairman WAXMAN. Would the gentleman yield to me?
5273 Mr. SHAYS. Yes.
5274 Chairman WAXMAN. We've held a couple hearings in this
5275 committee about these compensation committees that are
5276 appointed or consultants that are selected by the boards, and
5277 oftentimes the people that are selected are doing other
5278 consulting work for the corporation that's much more
5279 profitable for them. And, of course, they receive that from
5280 the management of the corporation. So they're then deciding
5281 what the compensation will be for the management of the
5282 corporation with clear understanding that they may well have

5283 a conflict of interest.

5284 I think it's an issue that we need to continue to

5285 explore on this committee, and I thank you for raising it.

5286 Mr. SHAYS. Thank you. Would you allow me one more

5287 minute to close?

5288 Chairman WAXMAN. Yes, sir.

5289 Mr. SHAYS. We all have our constituents. I have a

5290 friend who just wrote me, sent me an e-mail, and he said, my

5291 wife and I are among those investors who got badly burned

5292 with Lehman bonds. I am sure many in your district have a

5293 similar experience. We are prudent investors who must rely

5294 on the store of capital we have accumulated over the years to

5295 live decently. We always save more than we earn. Unlike the

5296 country and most citizens, we are completely debt free. We

5297 invested very significant amounts in what the so-called

5298 rating agencies called triple A, double A Lehman Brothers

5299 bonds. It now turns out that our trust in the rating agency

5300 was sadly misplaced. Either through incompetence or criminal

5301 fraud they led honest investors astray. Bonds that we bought

5302 are at par and now worth 10 or 12 cents on the dollar.

5303 This is why we're having these hearings. Because you

5304 may see your shareholders hurt, but there were far more than

5305 your shareholders that are hurt. And I won't read the rest

5306 of it, but you should see what it says about what it means to

5307 him to see CEOs of companies getting huge sums when they are

5308 working on 10 cents on a dollar on money they saved for most
5309 of their life.
5310 Chairman WAXMAN. Thank you, Mr. Shays.
5311 I want to thank the two of you for being here. You came
5312 here voluntarily. You've been here for many, many hours.
5313 You have been very generous. I know it hasn't been easy for
5314 you. But we very much appreciate it.
5315 That concludes our business, and we stand adjourned.
5316 [Whereupon, at 3:05 p.m., the committee was adjourned.]