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# FEDERAL RESERVE BANK *of* NEW YORK *Serving the Second District and the Nation*

## TESTIMONY

### **Factors Affecting Efforts to Limit Payments to AIG Counterparties.**

January 27, 2010

Thomas C. Baxter Jr., Executive Vice President and General Counsel

#### **Testimony before the Committee on Government Oversight and Reform, U.S. House of Representatives**

Good morning, Chairman Towns, Ranking Member Issa and other members of the Committee. Thank you for inviting me to testify today. As the General Counsel of the Federal Reserve Bank of New York, I welcome the opportunity to talk about the Federal Reserve's work to stabilize AIG, and more specifically the Federal Reserve's restructuring of certain problematic AIG contracts in November of 2008, at a critical point in what is aptly characterized as the worst financial crisis since the Great Depression. I will also speak about the role played by the Federal Reserve Bank of New York (the New York Fed) in securities disclosures made by AIG over the following months. The actions of the New York Fed and the Board of Governors of the Federal Reserve System (the Board of Governors) in stabilizing AIG were undertaken to avoid the potentially catastrophic consequences that would have resulted from an AIG bankruptcy.

#### **Stabilizing AIG**

##### I. Background

As is now well known, AIG's liquidity crisis emerged at nearly the same time that the securities firm Lehman Brothers collapsed, one week after the GSEs Fannie Mae and Freddie Mac were placed in conservatorship, and amidst ongoing acute stress in U.S. and global financial markets. It was against this backdrop, and in recognition of the financial stability threat posed by the abrupt and disorderly failure of an even larger and more complex firm than the one that had failed a day earlier, that the Board of Governors, with the full support of the Treasury Department, decided to intervene to prevent the bankruptcy of AIG on September 16, 2008.

AIG was a \$1 trillion company when it alerted the Treasury and the Federal Reserve that it was encountering severe liquidity problems. It remains one of the largest insurance and financial services companies in the world. AIG conducts insurance and finance operations in more than 140 countries and has more than 76 million individual and corporate customers globally. In the United States, AIG has approximately 30 million customers, including commercial, institutional and individual customers. It is also a major provider of protection to municipalities, pension funds, and other public and private entities through guaranteed investment contracts and products that protect participants in 401(k) retirement plans.

In terms of net premiums underwritten, AIG is both the largest life and health insurer, and the second largest property and casualty insurer in the United States. It has written more than 81 million life insurance policies worldwide, with a face value of \$1.9 trillion. The company insures approximately 180,000 small businesses, non-profit organizations and other corporate entities. Estimates are that close to one-third of the United States population, or 106 million people, are employed by entities that are protected by insurance coverage issued by AIG. AIG is the largest issuer of fixed annuities in the United States. It is also one of the largest providers of retirement services to non-profit healthcare groups, schools and universities. More than six million people hold retirement plans or accounts with AIG.

AIG had also been a major participant in derivatives markets through its Financial Products business unit (AIG FP), an unregulated subsidiary. AIG FP had engaged in financial transactions with a broad range of customers, which include many major national and international financial institutions, as well as U.S. pension plans, stable value funds and municipalities.

An AIG bankruptcy under the economic conditions existing in the fall of 2008 would have had catastrophic consequences for our financial system and our economy. Money market mutual funds to which so many Americans entrust their savings were major holders of the roughly \$20 billion of commercial paper issued by AIG. Losses to these funds would have had potentially devastating effects on confidence and would have accelerated the run on financial institutions of all kinds. By way of comparison, money market mutual funds and other investors held approximately \$5 billion of commercial paper issued by Lehman Brothers. Lehman's collapse triggered a run on money market funds after the Reserve Primary Fund "broke the buck" due to losses on Lehman commercial paper.

Global commercial banks and investment banks would have suffered losses on loans and lines of credit to AIG and on derivatives contracts and other transactions with AIG FP. This could have led to the outright collapse of the financial system. At a minimum, it would have caused even greater constraints on the availability of credit to homeowners and businesses.

In the event of an AIG failure, many of AIG's insurance subsidiaries likely would have been seized by their state and foreign regulators, leaving U.S. policyholders facing considerable uncertainty about their rights and claims. State and local government

entities that had lent in excess of \$10 billion to AIG would have been exposed to losses in an already difficult and deteriorating municipal budget environment.

AIG also had approximately \$38 billion of what are called stable value wrap contracts. These contracts allow trustees and investment managers of defined contribution plans to manage the asset-liability mismatch arising from withdrawals. Workers whose 401(k) plans had purchased these contracts from AIG to insure against the risk that their stable value funds would decline in value could have seen that insurance disappear in the event of an AIG bankruptcy. Pension plans would have been forced to write down their assets from book to market value, resulting in significant losses in participants' portfolios.

Ultimately, AIG, the world's largest insurance company, received extraordinary assistance because of the impact its failure would have had all across America. As Federal Reserve Vice Chairman Donald Kohn has testified, "because of the dependence of modern economies on the flow of credit, serious financial instability imposes disproportionately large costs on the broader economy. The rationale for public investment in the financial industry is not, therefore, any special regard for managers, workers, or investors in that industry over others, but rather the need to prevent a further deterioration in financial conditions that would destroy jobs and incomes in all industries and regions."

## II. AIG Credit Facilities

On September 16, 2008, the Board of Governors authorized the New York Fed to lend up to \$85 billion to AIG through a secured revolving credit facility (Fed Facility). The Fed Facility was (and remains) secured by a pledge of a substantial portion of AIG's assets, including ownership interests in the company's domestic and foreign insurance subsidiaries. As additional compensation for this Facility, AIG issued, to a trust for the benefit of the Treasury, preferred stock convertible into approximately 78 percent of AIG's outstanding common stock.

The policy decision to authorize a loan to AIG was a difficult one, because addressing the systemic crisis facing the United States required the Federal Reserve to assist a private company at the center of the risks that led to the crisis. Nonetheless, the potentially far-reaching consequences of an AIG bankruptcy compelled policymakers to take affirmative action. The failure of AIG in the fall of 2008 would have imposed significant financial losses on many individuals, households and businesses, shattered confidence in already fragile financial markets, and greatly increased fear and uncertainty about the viability of our financial institutions. Last month, Chairman Bernanke observed that the Federal Reserve did not lend support to AIG for the Fed's own benefit, "because it obviously has hurt the Federal Reserve in the public's view. We did it because we felt that there was no other way to avoid what [many] have called the risk of a catastrophic collapse of the financial system."

The initial emergency \$85 billion Fed Facility was successful in stabilizing AIG in the short term, but the company's financial condition and capital structure remained vulnerable to further deterioration in market conditions. AIG's pressing liquidity needs were resulting in rapid and sizeable draws on the Fed Facility, prompting concern that AIG's needs might well exceed the facility's capacity. The prospect of further downgrades of AIG's credit rating by rating agencies intensified the liquidity concerns AIG faced, because such downgrades would have immediately triggered billions of dollars of additional liquidity demands related to AIG FP's business. Absent further government action, a ratings downgrade was all but inevitable.

In early October of 2008, the Board of Governors approved an additional secured credit facility that permitted the New York Fed to lend AIG up to \$37.8 billion in order to address liquidity needs related to the securities lending program of certain AIG domestic insurance subsidiaries. Additionally, toward the end of October 2008, four AIG affiliates began participating in the Federal Reserve's Commercial Paper Funding Facility (CPFF) on the same terms and conditions as other participants.

Notwithstanding AIG's access to these additional Federal Reserve credit facilities, AIG continued to face serious liquidity pressures. Some of these pressures arose out of AIG's losses on residential mortgage backed securities (RMBS) it had invested in as part of its securities lending program. In November 2008, the Board of Governors authorized the New York Fed to take a second step to alleviate these pressures by funding Maiden Lane II, which purchased RMBS at market value and allowed AIG to unwind its securities lending transactions. With this transaction, the original \$37.8 billion facility to fund AIG's repayment of its securities lending transactions was fully repaid and terminated.

A substantial additional cause of AIG's liquidity pressure was its exposure to credit default swaps, or CDSs, one of many derivative products AIG FP offered. A CDS is essentially an unregulated insurance policy that protects the holder of a security from default. AIG FP, the CDS seller, agreed to protect its counterparties, the CDS buyers, from losses incurred on certain securities owned by the counterparties. In return, the counterparties paid AIG FP periodic premiums.

Under the terms of these particular CDS contracts, counterparties had the right to require AIG FP to post cash collateral as a result of adverse events relating either to the underlying securities, which in this case were multi-sector collateralized debt obligations (CDOs), or to AIG's credit condition, such as a ratings downgrade. The posted collateral secured each counterparty in the event AIG FP was not able to perform on the contract as contemplated. AIG FP's performance on these contracts was also guaranteed by its parent, AIG, making it impossible to isolate AIG FP's problems from AIG or its insurance subsidiaries. As AIG's financial condition deteriorated in 2008, and as the CDOs declined in value as the nation fell deeper into crisis, AIG FP was forced to post

more and more collateral to the counterparties, a cash outflow that in turn caused AIG's liquidity and credit condition to deteriorate further. It was a vicious cycle.

As explained in the report by the Office of the Special Inspector General for the Troubled Asset Relief Program, or SIGTARP, entitled "Factors Affecting Efforts to Limit Payments to AIG Counterparties" (SIGTARP-10-003), the Federal Reserve considered a number of options in an effort to address the liquidity drain created by AIG's CDS exposure. One critical constraint applied to any option chosen: it had to be arranged by the earnings announcement on November 10th, when AIG was facing an imminent credit ratings downgrade in connection with its announcement of a \$25 billion loss for the third quarter.

The first proposed option would have allowed the counterparties to keep their multi-sector CDOs and the protection provided by the credit default swaps. The counterparties would have agreed to forego additional collateral calls in exchange for a New York Fed guarantee of AIG's performance under the credit default swaps. Under this proposal, the New York Fed would not own the underlying CDOs, but the New York Fed—through the guarantee—would eliminate the downside risk to the counterparties of a further decline in the CDOs' market value. Not only did this structure have unappealing economics—taxpayer funds would have been exposed to the downside risk with no opportunity to participate in the upside—it also was not viable because the Federal Reserve lacked legal authority to issue the proposed guarantee under this structure.

The second proposed option would have involved persuading AIG's counterparties to take back some of the risk relating to the CDOs from AIG by canceling their credit default swaps and selling the underlying CDOs to an SPV. The SPV would be funded by the counterparties, the New York Fed, and AIG, with the counterparties' interests subordinated to those of the New York Fed. The New York Fed was concerned that the counterparties would not be motivated to cancel the swaps if they were left with un-hedged CDO risk associated with their part of the financing. This option was also deemed impractical because the complex negotiations required for each counterparty could not be completed quickly enough to satisfy AIG's liquidity needs, i.e., before November 10th.

The third option became Maiden Lane III.

### III. Maiden Lane III

In the months leading up to early November 2008, AIG had been actively engaged in efforts to negotiate tear-ups of its CDS contracts with its counterparties. AIG was completely unsuccessful. The need for the tear-ups was real; AIG was effectively hemorrhaging cash. Throughout October, while the New York Fed worked to identify various restructuring options, AIG continued to negotiate with its counterparties. The New York Fed ultimately agreed to participate in these counterparty negotiations, extremely mindful of the exigency of obtaining final agreement with at least the eight largest counterparties by Monday, November 10th, when earnings were to be released by AIG.

The earnings release would show a third quarter loss of approximately \$25 billion. The ratings agencies had advised AIG that, absent a parallel announcement of solutions to its liquidity problems, a ratings downgrade was certain following the earnings announcement. With that further downgrade, additional collateral calls, and possibly terminations, would be triggered. As of November 6, 2008, AIG had drawn down approximately \$61 billion of the \$85 billion Fed Facility, leaving \$24 billion of liquidity for operations and further collateral calls. Continuing to borrow from the Fed Facility, however, was not a solution to AIG's problems. First, additional borrowing from the Federal Reserve would significantly add to AIG's overall debt burden, which was a very negative factor in the eyes of the rating agencies. Second, it was doubtful that the remaining \$24 billion in the line of credit would cover the anticipated collateral calls under the CDS contracts and AIG's other liquidity needs.

In the limited time available, agreement had to be obtained from at least the eight largest counterparties, who together represented the bulk of AIG's CDS exposure. A ratings downgrade on November 10th would have created a possibly fatal downward spiral for AIG. Unless the Federal Reserve was prepared to pump substantially more funds into AIG by increasing the \$85 billion credit line, the only option would have been to reverse course and allow AIG to file for bankruptcy. This abrupt reversal of course would not only have triggered all of the adverse consequences for the U.S. and global economies that prompted the initial intervention, it would also have undermined the public's trust in the U.S. government's commitment to the broader range of extraordinary financial stability initiatives underway during that very fragile period. With bankruptcy not an option, it was necessary to find a solution that stemmed the liquidity drain arising from the continuing collateral calls on the CDS contracts, stabilized AIG and protected the taxpayer interests. The Maiden Lane III transaction was that solution.

In this context, the Board of Governors authorized the New York Fed to lend Maiden Lane III up to \$30 billion, and to secure that loan with the multi-sector CDOs that were insured by the AIG CDS contracts. Pursuant to this authorization, the New York Fed lent \$24.3 billion to Maiden Lane III that it used, in combination with a \$5 billion equity investment from AIG, to purchase CDOs from 16 of AIG's counterparties. At the time, the CDOs had a fair market value of about \$29.6 billion and a par value of approximately \$62 billion. In exchange for agreeing to terminate AIG's CDS contracts and turning over the underlying CDOs to Maiden Lane III, the counterparties would also be allowed to retain approximately \$35 billion in collateral previously posted by AIG. The result was that counterparties essentially received "par," with Maiden Lane III obtaining the CDOs and AIG obtaining the tear-up of the CDSs.

AIG's \$5 billion equity investment in Maiden Lane III was subordinated to the Fed's \$24.3 billion secured loan, and the Fed also obtained two-thirds of the upside in Maiden Lane III—securing both downside protection and upside participation for the U.S. taxpayer. Moreover, because Maiden Lane III can hold the underlying CDOs to maturity, it is largely immune from trading prices and liquidity needs, and is therefore in a better position to maximize the value of the CDO portfolio.

The Federal Reserve executed a transaction that involved an asset purchase and the termination of AIG's CDS contracts. By terminating the CDS contracts, the Federal Reserve stopped the collateral calls and the resulting liquidity drain on AIG. By stopping this liquidity drain, the Federal Reserve avoided AIG's downgrade and downward spiral and the resulting threat to the U.S. economy.

#### IV. Negotiating Concessions from AIG's Counterparties

The Federal Reserve has been criticized by some for not using its regulatory power to force the counterparties to accept less money for the CDOs. The critics overlook a number of key factors.

First, there was little time, and substantial execution risk and attendant harm of not getting the deal done by the deadline of November 10th. As noted above, AIG had attempted for some time to negotiate tear-ups of its CDS contracts with its counterparties under terms more favorable than Maiden Lane III. It did not succeed. When the Federal Reserve reached out to AIG's counterparties, we believed, based on AIG's own experience, that our probability of success of getting them timely to agree to concessions was slim. Even in a best-case scenario, we did not expect that the counterparties would offer anything more than a modest discount to par. In our judgment, taking additional time to press further for a discount was not justified in light of the overwhelming risk and catastrophic consequences of failing to complete the transaction by November 10. Today, it might be tempting to suggest that a transaction that was in the best interests of the taxpayers could have been improved had the New York Fed pressed harder for concessions. But it is much more likely that continuing to push the counterparties toward concessions would not have gotten us to final agreements on November 10th. The consequences to AIG and our economy of failing to reach an agreement made obtaining concessions a lower priority than executing the transactions.

Second, the Federal Reserve had little or no bargaining power given the circumstances. This restructuring negotiation was taking place in November of 2008, less than two months after the decision to rescue AIG from insolvency and the infusion of tens of billions of dollars. The Federal Reserve had already acted to rescue AIG, and the counterparties fully expected that we would stand by that decision, especially because the economic situation had gotten worse, not better. So, the typical threat in such negotiations—we will stand down and watch AIG file for bankruptcy—would have been an idle threat had we made it. In addition, the counterparties were unwilling to offer concessions because their contractual rights were already well-protected. The value of the CDOs they held, combined with the \$35 billion of collateral they had previously obtained from AIG was, in most cases, equal to or in excess of par value. Thus, if AIG defaulted, and even filed for bankruptcy protection, the counterparties would have kept both the collateral and the underlying CDOs (and would have been made whole if they had sold the CDOs for fair value).

Finally, even if we had had bargaining power, the rating agencies, as discussed above, were closely examining AIG for signs that it would not be able to address its financial situation. If they saw the Federal Reserve take any action that seemed to suggest a lack of full support, in particular a bankruptcy threat, it might well have led to an immediate downgrade and the irreversible destruction of AIG, with the attendant consequences on the financial stability of our economy.

Some have said that, in the absence of other bargaining power, the Federal Reserve should have used its regulatory power—threatening an adverse use of that power, or suggesting some kind of a benefit flowing from it—to make regulated counterparties give up or compromise their contractual rights. We see that as an abuse of regulatory power. The idea that the Federal Reserve would threaten a financial institution with supervisory action when no grounds for such action exist, or give a financial institution special treatment simply to gain an advantage in a commercial transaction is, in our view, an abuse of our authority. Such conduct by the Federal Reserve might have generated bargaining power over the counterparties, but it is simply inconsistent with the rule of law.

It also would have resulted in unfair treatment of supervised firms. Institutions regulated by the Federal Reserve would have been required to make concessions, while those not subject to the Federal Reserve's supervisory authority would not. As a result, domestic banking organizations regulated by the Federal Reserve would have received less for their property than would foreign banks. This would violate the principle of equality of treatment, a fundamental value of the Federal Reserve.

By getting the eight largest counterparties and AIG to execute term sheets by November 10th, and another eight to do the same shortly thereafter, the Federal Reserve accomplished its overarching goal of avoiding the failure of AIG. As a subsidiary objective, the taxpayers have a well-structured vehicle with downside protection and upside potential, which owns a securities portfolio worth billions more than the loan balance. Moreover, it bears mention that more than \$6 billion of the loan has already been repaid.

The situation faced by AIG and the Federal Reserve in the fall of 2008 with respect to the CDS contracts pointedly demonstrates the urgent need for adoption of new resolution procedures for systemically important nonbank financial firms. Had such a tool

been available at that time, it could have been used to put AIG into conservatorship or receivership. Not only would this option have allowed AIG to be unwound in an orderly way, protecting policyholders, customers and taxpayers, but it would have provided a clear and effective mechanism for imposing appropriate haircuts on creditors and counterparties.

### **AIG's Securities Disclosures**

On November 25, 2008, Maiden Lane III began purchasing the underlying CDOs from AIG FP's counterparties. Under SEC rules, because AIG had entered into a "Material Definitive Agreement," it was required to file a Form 8-K with the SEC within four business days. On November 24th, a lawyer for AIG sent a draft version of the 8-K to lawyers for the New York Fed to review, asking for their comments. This made sense: Maiden Lane III was created, funded and majority-owned by the New York Fed, and AIG wanted to ensure that its public filings would be accurate.

It is commonplace for a publicly traded company to share draft securities filings with another company where the subject matter involves a material transaction affecting both companies. Both the reporting company and the second company—whether the second company is publicly traded or not—want to ensure that the public filing is accurate. What is described here is the kind of thing that routinely happens in major transactions.

Although AIG was consulting regularly with the New York Fed, it is important to note that AIG fully understood that it was wholly responsible for the content of its SEC filings. Indeed, lawyers for both sides were very aware of their respective roles. Lawyers for the New York Fed, both at the Bank and through its outside law firm of Davis Polk & Wardwell LLP, made suggestions about content and timing. AIG and its outside counsel at Sullivan & Cromwell LLP and Weil Gotshal & Manges LLP, accepted the edits that they felt improved the accuracy of the descriptions of the transactions, and declined those edits that they felt did not.

The first 8-K was filed by AIG on December 2, 2008, after Maiden Lane III purchased the first group of CDOs. On December 18 and 22, 2008, Maiden Lane III purchased a second group of CDOs. Also, an agreement struck in November in conjunction with the original transaction, known as the Shortfall Agreement between Maiden Lane III and AIG FP, was amended as of December 18th. These events required the filing of a second 8-K on December 24, 2008. As with the initial public disclosure three weeks earlier, there were many e-mails among all the lawyers before the filing on the 24th. Once again, the New York Fed lawyers had two goals: (1) to help AIG make this filing accurate and consistent with the first; and (2) to protect, where appropriate, the substantial taxpayer funds at stake in Maiden Lane III. And once again, after receiving the New York Fed's suggestions, AIG, aided by its two outside law firms, made the disclosures that they deemed to be legally required and otherwise appropriate.

With that factual backdrop in place, I would now like to turn to the assertions that the New York Fed somehow pressured AIG into "covering up" parts of the transactions in its securities disclosures. There have been four separate allegations, and I would like to address each one in turn.

#### I. Disclosure of Par Value Payments to CDS Counterparties

First, let me address the assertion that the New York Fed pressured AIG to remove a line in the second 8-K filed on December 24th stating that "the AIG FP counterparties received 100 percent of the par value of the Multi-Sector CDOs sold." The New York Fed believed that disclosure of the actual arithmetic showing that the counterparties received essentially par value was more accurate and would make the new 8-K consistent with AIG's prior 8-K announcing Maiden Lane III. The draft 8-K listed the par value (\$16 billion) as well as the amount paid to the counterparties (\$6.7 billion), and the amount of collateral previously paid to the counterparties that AIG was surrendering (\$9.2 billion). Adding up the last two numbers (which total \$15.9 billion) shows that the counterparties were receiving essentially par (which was listed as \$16 billion). Because the sum tendered to the counterparties was slightly less than par, the proposed sentence about it being 100 percent of par value (and which was not in the prior 8-K) was not completely accurate, and it was therefore suggested that it be removed.

This was done to be accurate, not to cover up the fact that the counterparties were essentially receiving par. The New York Fed lawyers were motivated by concern for accuracy and precision in the content of these Form 8-Ks. In fact, the clearest evidence that there was no cover up was that it was widely understood in the market and reported in the press at the time that the counterparties were receiving very close to par value. For example, an analyst report published by Credit Suisse on December 2, 2008—the same day as the initial 8-K filing addressing the first settlements with the counterparties—opens with the following sentence: "This evening AIG terminated \$46.1b of its \$71.6b of targeted multi-sector CDO exposure, at par." Similarly, a Fox-Pitt-Kelton report dated the next day, December 3, 2008, contains the following statement: "Along with surrendering \$25.9 billion of collateral that had been previously posted by AIG with the counterparties, the purchase of the \$46.1 billion of par value essentially made the counterparties whole." On November 12, 2008, a month earlier and shortly after the initial announcement of the Maiden Lane III facility, an article in The Wall Street Journal stated: "The banks that participate will be compensated for the securities' full, or par, value in exchange for allowing AIG to unwind the credit default swaps it wrote." On December 25, 2008, the day after the second 8-K was filed, an article in The Washington Post further reported that, "The fund, called Maiden Lane III, paid about \$6.7 billion to the investors for the securities in the latest purchases. The counterparties were also able to keep more than \$9 billion that AIG had posted in collateral, reimbursing them at face value for the assets." The fact that the disclosure included all of the actual numbers, and that analysts and the media understood them immediately, belie any assertions of a cover up.

## II. Disclosure of Transactions Involving Synthetic CDOs

The second assertion relates to the New York Fed's suggestion to delete that portion of AIG's draft press release accompanying the December 24th 8-K that implied that the New York Fed would enter into additional transactions with AIG concerning the termination of a portfolio of CDS relating to synthetic CDOs. This edit was proposed because there was in fact no commitment at the time for either the Federal Reserve or Maiden Lane III to acquire the synthetic CDOs that backed this portfolio of CDSs. Indeed, neither the Federal Reserve nor Maiden Lane III has acquired any synthetic CDOs from any counterparty of AIG FP. Thus, rather than seeking to conceal information, the New York Fed comment was made in an effort to help ensure the accuracy of the disclosures so as to avoid any suggestion that the New York Fed had made a commitment that was not made at the time (and in fact was never made). The comment also ensured that there would be no incorrect expectation created in the public markets that such additional Federal Reserve assistance to AIG would be forthcoming.

## III. Disclosure of the CDS Counterparties

Third, some have suggested that in November 2008, AIG had planned to disclose the identities of the CDS counterparties and that the New York Fed pressured or compelled AIG not to. This is not true. In December 2008, circumstances were very different than today. Markets were much more fragile, and AIG was concerned at the time that its counterparties, and potentially other AIG customers, would stop doing business with AIG if they believed that the government would cause the disclosure of what is ordinarily confidential customer information, including, in some cases, customer identities. If counterparties and customers began moving away from AIG, the company feared that it would be subject to a loss of business and possible additional downgrades from the rating agencies. This would have had the effect of harming the taxpayers' investment in AIG by reducing the public's interest in doing business with AIG.

For this reason, the New York Fed actively supported AIG's application to the SEC to have the names of its counterparties remain confidential. In March 2009, in response to requests by Congress that the identities of the CDS counterparties be made public, and after taking account of its decision to wind down the AIG FP derivatives business, AIG changed its view and decided to reveal the counterparty names. The Federal Reserve agreed with this decision. Indeed, the counterparty names were disclosed nearly one year ago.

## IV. Disclosure of Information Identifying Specific CDOs in the Portfolio

Finally, there have been allegations that the New York Fed inappropriately pressured AIG not to disclose certain commercially sensitive information, including CUSIPs and tranches, that would have identified the individual securities in the Maiden Lane III portfolio. To be sure, the New York Fed actively supported the idea of keeping this information confidential, but once again, only to maximize the value of the Maiden Lane III portfolio for the benefit of the taxpayer.

The portfolio of securities held by Maiden Lane III represents substantial value to the American taxpayer. At the end of the third quarter of 2009, the fair market value of the securities was several billion dollars more than the outstanding balance on the loan. The New York Fed also owns two-thirds of any eventual upside. The New York Fed's investment staff, with the concurrence of its outside advisors, was (and is) strongly of the view that if information identifying these individual securities in the portfolio and the individual prices paid by Maiden Lane III were to become available to traders in such securities, those traders would be able to use that information to their advantage. This, in turn, would undercut the ability of Maiden Lane III to sell those assets for their highest value, to the detriment of taxpayers. Furthermore, as AIG stated in its application to the SEC for confidential treatment, this data does not provide any additional information that would be material to investors in AIG. After lengthy and detailed dialogue, on May 22, 2009, the SEC concluded that this commercially sensitive information need not be disclosed. To be clear, it is only this sensitive security-by-security information that has received confidential treatment and has not been included in AIG's 8-K filings.

The Federal Reserve System shares this committee's goals of transparency and accountability. That is why the Federal Reserve provides weekly public reports on the *aggregate* performance of the Maiden Lane III assets—information that is highly relevant to taxpayers' evaluation of the success of this program, but that does not undercut the ultimate taxpayer recovery that is such an important objective. Also, on a monthly basis, the Federal Reserve publishes a transparency report called "Credit and Liquidity Programs and the Balance Sheet" that provides still more information and analysis regarding Maiden Lane III and the Federal Reserve's other lending programs. This represents a middle ground where our performance as stewards of taxpayer funds can be analyzed and evaluated, but without potentially compromising the taxpayers' prospective return on their investment.

Thank you again for giving me the opportunity to appear before you today. I look forward to answering your questions.

Maiden Lane Transactions »

Statement Regarding Public Disclosures of AIG Concerning Maiden Lane III LLC »