10-3-2014

N.Y. Fed Lawyer Says AIG Got Billions Without Paperwork

Andrew Zajac

Business

N.Y. Fed Lawyer Says AIG Got Billions Without Paperwork

Andrew Zajac
October 3, 2014, 12:01 AM EDT

The Federal Reserve Bank of New York poured billions of dollars into rescuing American International Group Inc. in September 2008 without drawing up documents that would cement the government's control of the giant insurer, the bank's lawyer testified.

AIG's dire condition required an immediate infusion of cash, and paperwork memorializing the terms of the loan wasn't complete, Thomas Baxter, the New York Fed's general counsel, told a judge in Washington yesterday in a trial over a shareholder challenge to the terms of the rescue.

The Fed wanted to quickly get control of AIG because of concern that Rodgin Cohen, an attorney for the company, might try to re-negotiate the rescue terms, Baxter said. Cohen had succeeded in re-working the terms of JPMorgan Chase & Co.'s takeover of Bear Stearns and the Fed was worried that he might try again with AIG, Baxter testified.

"The more credit we put into AIG, the less bargaining power we had," Baxter said.

Maurice "Hank" Greenberg's Starr International Co., the biggest shareholder in AIG when the financial crisis struck, sued the U.S. in 2011 seeking more than $25 billion for losses from the insurer's bailout. Starr claims the assumption of 80 percent of AIG's stock in exchange for an $85 billion loan was an unconstitutional "taking" of private property because the Federal Reserve Board of Governors lacked the legal authority to take equity in a company in consideration of a loan.

14 Percent

AIG also was charged 14 percent interest, more than three times higher than other financial institutions seeking assistance from the Fed during the financial crisis, according to the complaint.

Documents introduced during Baxter's testimony yesterday showed that an aborted private bailout of AIG led by investment banks including Goldman Sachs Group Inc. and JPMorgan Chase & Co. contemplated an interest rate of a minimum of 10 percent.

The term sheet signed by AIG as part of the deal put the interest rate at at least 12 percent, according to documents in the case.

Baxter testified that Timothy Geithner, then head of the New York Fed, made the decision to increase the cost of the loan.

A high rate was needed in part to offset the risk that stock in AIG insurance units pledged as collateral would lose value if the parent company didn't regain its footing, Baxter told the court.

'Fully Secured'

"I believe we were fully secured, but that does not mean risk-free," Baxter testified. "Things happen between the first day and when the loan matures."

Geithner also rejected a last-ditch appeal from AIG's then-chief executive officer, Robert Willumstad, to reduce the government's stake in the company to 50 percent and to allow it to break the deal if it found a better offer.

Baxter said that the New York Fed wanted to quickly conclude the lifeline agreement to calm anxiety in the markets linked to the bankruptcy of Lehman Brothers Holdings Inc. and the near bankruptcy of several other financial institutions.

"We had fires all over the economy," Baxter said. "We had to get one deal done. We had to get one fire out."

Complete Documentation

The initial absence of complete documentation on the AIG bailout, what Baxter called "low doc lending," didn't give the government the power it wanted to address how the company was run, Baxter testified.

The New York Fed wanted to replace some board members to improve AIG's risk management and it worried that shareholders unhappy with the bailout might try to install a new board that would pick leaders who "wanted to double down on bets" with taxpayers' money, Baxter said.

"If you look at those legal documents, they could do nothing to address governance," Baxter said during questioning by Starr's attorney, David Boies.

The incomplete paperwork also presented a risk that Cohen, of Sullivan & Cromwell LLP, would try to re-negotiate the deal, Baxter testified.

Bear Stearns

"I knew he had done that with Bear Stearns," Baxter said.

Boies, as he did with the trial's first witness, Scott Alvarez, the general counsel of the Federal Reserve Board of Governors, confronted Baxter with documents in which he appears to express misgivings about regulators' power to take stock as a condition of the bailout.

A central element of Starr's complaint is that the Fed's bailout authority at the time was limited to setting interest rates and that it could not demand a surrender of stock as a condition for lending.

Interview Summary

In one document introduced by Boies, a summary of an interview of Baxter by staff of the Financial Crisis Inquiry Commission, the lawyer is quoted saying, "We learned many things in September, and one was that we didn't have the ability to own shares."

Baxter told Boies he didn't remember making the statement and "this is not consistent with my views."

The case is being heard without a jury by U.S. Court of Federal Claims Judge Thomas Wheeler.

The case is Starr International Co. v. U.S., 11-cv-00779, U.S. Court of Federal Claims (Washington).

SHARE THIS ARTICLE

Share

Tweet

Post

Email

In this article

AIG
AMERICAN INTERNA
46.48 USD ▲ +1.49 +3.30%

0120149Z
BAXTER
Private Company

JPM
JPMORGAN CHASE

152.76 USD ▲ +2.14 +1.42%

GS
GOLDMAN SACHS GP
330.83 USD ▲ +2.18 +0.66%

LEHMQ
LEHMAN BROTHERS HOLDINGS INC
Private Company

UP NEXT

Carcinogen Found in Hand Sanitizers That Plugged Covid Gap