**MEMORANDUM FOR THE RECORD**

Event: Interview of Joseph Cassano

Type of Event: Group Interview

Date of Event: June 25, 2010, 11:00 a.m. - 4:30 p.m.

Team Leader: Chris Seefer

Location: FCIC, large conference room

Participants - Non-Commission: Joseph Cassano, Jim Walden (Gibson Dunn), Georgia Winston (Gibson Dunn), Stacy Nettleton (Weil Gotshal & Manges LLP), Mindy Wu (Weil Gotshal & Manges LLP).

Participants - Commission: Chris Seefer, Dixie Noonan, Al Crego, Donna Norman, Clara Morain

Date of MFR: June 26, 2010

Summary of the Interview or Submission:

FCIC Staff interviewed Mr. Joseph Cassano (“Cassano”) on 6/25/10 at the FCIC’s office from approximately 11:00 am to 4:30 pm. The interview was taped and a transcript should be available by Monday, June 28, 2010. Below are some highlights of the interview.

**Education and Professional Background**

* Brooklyn College, B.A., political science
* First Boston (1978-1985) – Clerk in operations; Credit Analyst, credit department; Product Developing Team (interest rate swaps)
* Drexel Burnham Lambert (1985-1987) – VP & Controller, Interest Rate Products Group
* AIG FP (1987-2008) – CFO (1987-1994); COO (1994-2002); CEO (2002-2008)

**Growth in SSCDS Portfolio**

* Cassano confirmed there were no portfolio limitations or caps with respect to the total notional value of CDS written relative to AIGFP total capitalization; parameters were isolated toward (1) meeting the 99.85 confidence level that over the average life of the CDS, losses would not erode subordination and exceed attachment point and (2) ensuring that the attachment point would be above the AAA risk layer.
* Cassano described AIG’s CDS business as having a “robust underwriting process,” which he says is supported by the fact that the SSCDS in Maiden Lane III (“MLIII”) have not suffered any losses to date, as far as he knows. Mr. Cassano said that no government official has been able to state that the SSCDS in MLIII has suffered losses.
* Cassano did not personally review the deals, but saw them reported in the daily P&L reports which he, Bensinger, Dooley, Lewis, Sullivan, Habayeb and others received).
* Cassano stated that there was no conscious effort to increase the multi-sector CDS book, rather, that the book grew along with the growth in the broader CDO market. Cassano also noted that AIG’s 2005 growth was not as rapid as the underlying CDO market itself.

**Decision to Stop Writing SSCDS on Subprime CDOs**

* Cassano stated that the primary reason FP decided to stop writing CDS on subprime CDOs was due to slippage in underwriting standards.
* Cassano stated that Andrew Forster came to him in the summer of 2005 and raised concerns about the subprime mortgage market. They agreed that Forster and others would conduct research and report back. Cassano stated that Forster and others, including Al Frost and Gary Gorton, went to New York and met with investment bankers, mortgage originators, and others to get information on the market. After this, Forster concluded that FP needed to wind down the business, and Cassano agreed. Cassano stated that Forster could have stopped the business without Cassano’s approval, but that he sought Cassano’s agreement because others would have resisted and Cassano’s approval would put an end to the discussion.
* Cassano told Bill Dooley (Head of AIG Financial Services Division and Cassano’s immediate boss) about the decision. Dooley first asked how FP would replace the revenue, but after hearing the reasons for the decision, he agreed with Cassano that FP should exit the business. Cassano stated that he believed that Andrew Forster also told Kevin McGinn (AIG Inc. Chief Credit Officer) of FP’s decision while Forster was in New York in early 2006.

**Absence of Hedging the SSCDS Book**

* Cassano stated that he considered the SSCDS book “effectively” hedged. He said that the high attachment points provided an inherent or structural “hedge” with respect to credit losses. Cassano also said that the fact that AIGFP only had exposure to pre-2006 vintages was another “structural hedge,” because the pre-2006 vintages performed better than 2006 and 2007 vintages given the existence of home price appreciation and stricter underwriting standards in the earlier vintage mortgages.
* Cassano also said that in 2006 when AIGFP stopped writing subprime CDS and questioned whether the company should hold its outstanding $78 billion in exposure, home prices were still appreciating, and the company viewed risk of default as “remote” given that AIGFP’s mezz-CDS had an average of 34% subordination, and its high-grade also had substantial subordination.
* Cassano did not recall if he knew in 2005 and 2006 that the securities lending business increased its exposure to subprime while AIGFP stopped writing SSCDS on subprime CDOs.

**Goldman Sachs’s Marks which Precipitated Collateral Calls**

* Cassano said that he had a supervisory role in the collateral call disputes with Goldman Sachs. He said that Andrew Forster had the day-to-day responsibility for managing the disputes.
* Cassano stated that he thought “something was up” with Goldman’s marks because the first collateral call was quickly revised downward from $1.8B to $1.2B, and then again to $600M. He also stated that Mike Sherwood at Goldman admitted as much when he and Cassano spoke in September 2007. Cassano recalled that Mr. Sherwood said that Goldman “didn’t cover ourselves in glory” during this period.
* Cassano felt that the fact that Goldman often revised its marks was an indication that no one could get a handle on the market.
* Cassano said that AIG agreed to post $450 million in 8/07 as a good-faith deposit, although AIGFP and Goldman continued to disagree about the appropriate amount of collateral. Cassano said that he wanted this resolution so both he and Forster could go on vacation (Cassano went on a cycling vacation with the family in Austria and Germany). (Exhibit 2 to the Goldman Summary PIR shows that AIG posted the $450 million on 8/10/07)
* Cassano said he did not think there was much, if any, discussion between AIG and Goldman until late 10/07 or early 11/07 because the market recovered a bit in a “relief rally” in 9/07 and 10/07.
* Cassano stated that during Q42007, Sherwood called Cassano to alert him that Goldman’s collateral call was about to increase significantly (as reflected in Exhibit 2 to the Goldman Summary PIR, Goldman increased its margin call from $1.06 billion on 11/1/07 to $2.8 billion on 11/2/07). During this call, Sherwood told Cassano that Goldman may have been early, but that “the market’s starting to come our [Goldman’s] way.” Cassano said that he interpreted Sherwood’s comment as an implicit admission that Goldman’s initial marks were too low. Cassano also noted that later in November or December, Mr. Blankfein announced that Goldman was short subprime. Cassano said that he started wondering whether Goldman was pushing or driving the market, a market which Cassano described as opaque, where no trades were being done.
* As early as Q4 2007, Cassano was of the view that the parties should invoke the dispute resolution provision of the CDS contracts and conduct a dealer poll to resolve the collateral dispute. Cassano said that Forster favored a negotiated solution, and that Dooley did not want to “air dirty laundry in public” by seeking a dealer poll. He said that ultimately, no dealer poll was conducted.
* Cassano recalled that AIG posted $1.55 billion, and the parties still did not agree on the amount to be posted. (Exhibit 2 to the Goldman Summary PIR shows that AIG posted the $1.55 billion on 11/23/07)
* Cassano said that Goldman provided AIGFP with Goldman’s methodology for calculating its marks/values. Cassano said that based on Goldman’s own methodology, AIG’s analysis showed Goldman’s marks/values were too low, and therefore AIGFP demanded Goldman return approximately $1 billion of collateral. However, Cassano also noted it was time for Christmas vacation and that the parties decided to talk after the beginning of the year.

*Note:* on 12/14/07, Forster sent an email to demand Goldman return collateral or continue negotiating and that it would not be appropriate to delay the discussions. However, Forster stated in the letter that Goldman should contact Forster’s colleague, presumably because Forster was also going on holiday. On 12/21/07 Cassano sent an email to Sherwood and Viniar in which he wrote that Goldman’s exposure calculations were too high, i.e., Goldman’s marks/valuations were too low; it was unfortunate Goldman’s super senior CDO prices were not received by Cassano until the previous night because the Christmas and New Year’s holiday week was now in front of us; and that the parties needed to “pick this up as soon as we can in January in order to resolve the matter.”

* Cassano said other companies did make collateral calls, but Goldman’s were clearly the largest. Cassano said that there were some discussions with other counterparties who were considering making collateral calls, but after discussing it with AIG decided not to. For example, SocGen decided not to make a collateral call after discussions with AIG, and in fact told AIG that SocGen had seen Goldman’s marks and did not agree with them.

*Note*: in a 1/7/08 email to Cassano, Frost, Forster and Shirley, Tom Athan wrote that (1) SocGen gave AIG a heads up on 11/13/07 that they were going to make a $1.7B margin call on the $17.3B of deals they had with AIG, (2) the margin call was based on prices provided by Goldman, (3) Athan told SocGen AIG would dispute the margin call, and (4) SocGen never made the margin call.

* Cassano stated that he believed that Goldman was negotiating in good faith, but that this did not mean its marks were right. He also commented that if Goldman believed its marks were right, it is surprising that the firm would be willing to settle for a 50-60% discount, which was what Goldman effectively did. Cassano further commented that Goldman was not giving AIG marks based on deals with the same attributes as AIG’s, namely, of the same vintage, with the same percentage subprime exposure, etc.
* Cassano believes Goldman’s marks didn’t make sense because the market was seizing so there were no market prices (Cassano recalls CIBC tried to do a dealer poll and only received one quote, which was an actual counterparty to the trade and therefore not independent).
* Cassano said “everyone” at AIG (parent company) was involved and knowledgeable about the collateral dispute because: (1) it was a big number; and (2) Goldman was an important client.
* On 1/16/08 Cassano sent an email to Viniar and Sherwood following up his 12/21/07 email (i.e., after Christmas and New Year’s holiday) in which he demanded the return of $1.1 billion of collateral based on valuations included in an attachment to the email. That attachment showed that AIG was valuing nine securities at par. Cassano did not know the specifics of how the values were determined and said he did not recall hearing that Goldman said valuing any securities at par in 1/08 made them question the credibility of AIG’s marks.

*Note*: Goldman witnesses have said the 1/16/08 email and 100% valuations were “incredible.”

* Cassano said that Goldman did not return the collateral and that negotiations continued. No dealer poll was ever conducted. He recalled Goldman’s margin call increased some time in 3/08, and that AIG posted another $1 billion in 3/08.

*Note:* Exhibit 2 to the Summary Goldman PIR shows the Goldman margin call increased from $2.4 billion on 2/29/08 to $4.2 billion on 3/1/08 to $4.9 billion on 3/14/08. It also shows AIG posted another $1 billion on 3/17/08.

* Cassano was not involved in the dispute after his retirement was announced on 2/28/08.
* Cassano said that he was always concerned that PwC was also Goldman’s auditor and seemed too take Goldman’s side when it came to the marks/valuations.

*Note:* Goldman witnesses (including Lehman) said that they wondered how PwC was signing off on the 2007 audits of both Goldman and AIG when the companies were using different marks.

**Whether AIG Inc & PWC Knew about Negative Basis Adjustments Prior to December 5 2007**

* Cassano asserted that both AIG executives (Sullivan and Lewis) as well as PwC knew that negative basis adjustments were part of one of the estimates used for valuing the SSCDS book before the company’s December 5, 2007 investor conference call. He cited the 11/29/07 notes of the PwC meeting, the spreadsheet that was discussed during the meeting, Bob Sullivan’s handwritten notes of the meeting, his 12/1/07 email, and other documents.
* Cassano said the initial $352 million SSCDS unrealized valuation loss estimate for 3Q07 (and $550M estimate for 10/07) reported on 11/8/07 (press release) and 11/9/07 (conference call) did not include a negative basis adjustment because, although PwC thought the concept made sense, PwC did not believe there was sufficient evidence to make the adjustment.
* Cassano said that in 1/08, PwC told AIG it still was not comfortable with the negative basis adjustment and that it was coming to the conclusion AIG had a material weakness in its valuation of the SSCDS portfolio. Cassano said “everyone” (including Sullivan, Lewis, Bensinger, Habayeb and others) “was shocked” because they were all involved in the process and had been well informed of valuation options and collateral call disputes.
* Cassano denies excluding St. Denis from the SSCDS valuation process because he would “pollute the process” as St. Denis wrote in the 10/4/08 letter to Waxman and did not otherwise try to prevent him from communicating with Habayeb or anyone else and AIG. He said he had problems with St. Denis’ performance because St. Denis was slow in completing work. He noted that St. Denis did not make these claims to AIG’s Chief Internal Auditor (Roemer) or to PwC, both of whom interviewed St. Denis after he resigned. Cassano also said that St. Denis asked for a bonus even though he quit before year-end. Cassano said he believes St. Denis’s accusations reflect his anger over being denied his bonus.

**The Concentration of U.S. Real Estate in “Multi-Sector” CDS Book & Decision to Exit Subprime**

* Cassano acknowledged that the multi-sector CDS book was weighted heavily toward the U.S. residential mortgage space.
* Cassano acknowledged that the 2005 decision to exit the subprime multi-sector CDS business did not incorporate a view with respect to ALT-A; meaning they continued to write SSCDS on super senior tranches of CDOs that included Alt-A, interest-only, option payment ARMs, low doc/no doc loans.

**Compensation**

* Cassano acknowledged that 30% of AIGFP’s earnings went to a bonus pool, that he decided how the bonus pool would be distributed but that he discussed the distribution with Dooley and Sullivan who could veto the amounts Cassano wanted to distribute. He said that approximately 50% of bonuses were deferred for approximately five years and reported as subordinated debt.
* In November 2007, Cassano (with Board approval) changed AIGFP’s compensation plan such that all compensation above $1.25 million (not 50%) would be deferred. He said Sullivan made the change in the AIG and AIGFP compensation plans that ***excluded*** SSCDS unrealized valuation losses from the net earnings. Cassano said the deferred compensation from 2007 was lost when AIG was taken over and that therefore no AIGFP executive made more than $1.25 million in compensation for 2007. AIGFP executives did receive prior year deferred payments -- Cassano received approximately $20 million in comp that vested from prior years
* Cassano said that he lost $70M of deferred compensation. He also said that he was paid $6M from March to September 2008 under the consulting agreement.
* From April-June 2008, while “consulting,” Cassano worked full-time in the office consulting, while Dooley ran FP from the US.

**Government Bailout**

* Cassano feels strongly that Maiden Lane III was not a good deal for the taxpayers. He believes that actual losses on the underlying bonds have not pierced the super senior tranches, which shows that there would have been little to no losses to AIGFP if the government held the SSCDS instead of unwinding and purchasing the underlying CDOs. He feels strongly that the credit rating agencies (unwarrantedly) sealed AIG’s fate when they downgraded the company in September 2008. Nevertheless, he believes AIG would have been entitled to a return of collateral after the government bailout in 9/08 because that effectively cured the problem of the downgrade by the rating agencies.

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