Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Eric Dinallo Superintendent of Insurance, New York State
Interviewer Name	Maryann Haggerty (Contractor) Yale Program on Financial Stability
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Summary:

The Yale Program on Financial Stability (YPFS) interviewed Eric Dinallo on Feb. 25, 2020, regarding his involvement in the rescue of American International Group (AIG) in 2008.

From January 2007 through July 2009, Dinallo was New York State Superintendent of Insurance. In New York, as throughout the United States, insurance companies are regulated at the state level. In his position as Superintendent, Dinallo oversaw AIG's insurance operating companies within New York. AIG's holding company, however, was supervised at the Federal level, as was its subsidiary AIG Financial Products (AIGFP or FP). Much of AIG's problems came from its non-insurance subsidiary AIG Financial Products (AIGFP or FP), which was a major presence in the market for credit default swaps (CDS), a type of derivative that was a factor behind the 2007-09 financial crisis. In addition to his work as a supervisor touching on AIG, Dinallo also was actively involved in dealing with the early 2008 crisis among monoline insurers, or bond insurance firms. He testified at numerous government hearings about the role of insurance companies and insurance regulation in the crisis, and has written several articles on the subject.

Dinallo is a lawyer with a range of public-sector and private-sector experience. As of 2020, he is a partner at Debevoise & Clinton and chair of the Insurance Regulatory Practice there. Immediately previously, he served as the executive vice president and general counsel at Guardian Life Insurance Company of America, where he led the company's legal, regulatory, compliance and government relations functions, as well as its corporate governance activities. Prior to his time at Guardian, he was a partner at Debevoise for seven years beginning in 2010.

[*This transcript of a telephone interview has been edited for accuracy and clarity.*]

Transcript:

YPFS: **We'll be focusing largely on American International Group, generally called AIG, during this conversation. Back in 2008, Mr. Dinallo was the**

New York State insurance superintendent, and actively involved in supervision of AIG. Let's start just with some background on the multi-tiered nature of insurance regulation—the state and the federal and the global levels, then and now. You've come from the perspective of being a state regulator. How did you interact during the crisis with your counterparts in other supervisory organizations? Then we'll get into what you were also hearing from other stakeholders. But let's start with your peers in the other organizations.

Dinallo: It was a bit unprecedented, obviously. But I had become sort of a leader at the National Association of Insurance Commissions (NAIC). I wasn't the president or anything, but I got the Esprit de Corps award in 2008. Which was a big deal, because New York had historically been considered a bit of a lone wolf.

That gave me a certain buy-in with that. It ended up becoming frankly a lot of phone calls, and just outright reach-outs. Because as you know, there's no meta regulator for any of it. You're essentially relying on what I would say, trust with the other supervisors. It doesn't matter how big the state is or small. If they're the primary regulator for that insurance subsidiary, then you kind of have to work together or not.

I ended up doing a lot of it by phone, and by creating weekly calls with all of the states that had a stake in AIG. Then weekly international calls. It was definitely ad hoc. There's no doubt that there is not a systemic system, so to speak, for communication on this.

The states I think work very hard to produce united results through NAIC, because they don't want the perception that somehow, it's random and hodgepodge. But the fact is that it's only as good as those communications and those trusts. You can't really make anyone do anything, because they are the king or queen of a castle that is that regulated entity.

I don't have exactly a memory for every single way we communicated. But I do remember kind of, it being like I just described. It got more and more critical.

I remember that the absolute most critical moments of communication, that actually really sent a little bit of a chill through me, and I'm not kidding. I got a call from Rodgin Cohen [a private-sector lawyer involved in several crisis-era negotiations] very late in the process of the rescue of AIG. I remember these words to this day. He and I were friends. He said, "Eric, we've got two choices. The White House has reached out to me." Which probably at that point was [Secretary Treasury Hank] Paulson. Because I had already dealt with Paulson and [New York Federal Reserve Bank President] Tim [Geithner] on teaching them, I don't mean to be arrogant, but teaching them about how insurance companies are structured from a regulatory point of view. What happens if a parent declares bankruptcy and all that.

He said, "The real question is whether you can keep the states together long enough for us to do what I think is going to happen." Which was essentially the bailout, we'll call it. "Because if one single state seizes the [insurance] operating company … Then the whole thing will just go off the rail. I'm not talking about weeks, but in days."

He said, "Or, because I trust you and I know you're kind of a bit of a patriot, as I am, we could have, the president is willing," or someone. I think he may have said the president, "... is going to call the governors that are critical here, and tell them not to do anything."

I said to him, "Rodgin, the problem with Plan B is that a bunch of these guys and gals are elected commissioners. They don't give a crap what the governor thinks. In fact, some of them are looking forward to running against that governor."

What I did was, I just said to Rodgin, "Look. I don't want to be the big man here. But I'm willing to make another round of calls. But I think if you do what Plan B is, it will not end well." He said, "That's what I told them. Make the calls." And so I called every one of the states again and said, "Look. I can't promise anything. But you've got to just ... Don't do anything for a couple days. I don't necessarily trust them either, but I don't even see how they would be able to do anything of what you're afraid of. Yet it's better to have the money than not have the money." So that's what happened.

But it was like that. Literally, there were no official memos. Maybe there were some emails, which I'm happy to share if I could find them. But it was nothing like that. It was very, ad hoc is a bad word. But it was very informal, in the sense there was no script. There is no formal way. To this day, I don't think that aspect has changed. I think there's a little bit more recognition of the need to, as you know, be an internationally recognized regulator. That that's become increasingly important.

The International Association of Insurance Commissioners (IAIS) in the European Union has demanded this thing called equivalency. I think that's forced NAIC in the States to be better at presenting a united face. Because it would be bad if our companies were not recognized from a reserving point of view, fairly and equally internationally. I think that's forced—ironically more than AIG I feel like—that's forced them to get better at, we'll call it equivalence and coming together in a united way, when they deal with, say IAIS, or whoever the international regulator is.

YPFS: **Now at the same time that you're dealing with your peers across the country, I'm guessing that you're also hearing a lot from the industry,**

AIG, and others. From consumers. From politicians in your state. How did that play in? How did you balance those concerns?

Dinallo: Well, it was sort of, I think you make some good questions about dealing with these different stakeholders, and the prominence of the company versus the insurance company. I will tell you that it started, clearly as you know, I've always felt that the monolines were definitely the canary in the coal mine, or canaries for the crisis. No doubt. The moment I saw the monolines, I knew something bad was going to happen. I didn't exactly totally get it right. I didn't really understand. But it's interesting. I don't think I've ever heard anyone say this. I wish I had written it sooner. That the financial products division of AIG was, when all is said and done, it was an unlicensed monoline. It was exactly why there's a monoline law.

In other words, in 1980-something, Jim Corcoran, one of my predecessors. He was there 10 years. He introduced the monoline law, Article 69 of the insurance law. The reason he did was, he saw AIG and Citibank, I think it was AIG at the time, starting to sell what you and I would call credit insurance. They were taking their [credit] rating, and they were monetizing it by guaranteeing others' commitments.

They realized that the kind of stuff that they were guaranteeing, like municipal debt, etc., could be, if it moves in the wrong direction, it could wipe out any large company. I hope now you understand what I'm saying. This is hilarious that this actually happened. So they passed the monoline law, and they licensed MBIA, Ambac, etc.

They made it, and the reason it's called monoline is because you're only allowed to do that one kind of insurance. Because you don't want it to bring down an otherwise healthy financial institution. Insurance or Citibank or whatever.

Somehow, we could debate how this was done, I realized late in the game that what FP really was, was an unlicensed [monoline], attached just the way it shouldn't have been, attached to an otherwise healthy company. It did exactly what everyone worried about in 1987. But I always give myself a little bit of a break on this. Back to what you're talking about. Which is, even if I had caught it and demanded that we fix it, the amount of political energy that would have been leveled against me would be inconceivable. Until the crisis happened.

In other words, when you think about, if I just sat there and said, "You know what? I think this is an unlicensed monoline, governor. Let's go and fix this," they would have ... It was the most profitable part of AIG. The stock was at 100 or whatever. It wasn't until the stock started to go low, that that's when I got the call.

I remember Sen. [Joseph] Bruno, who was a friend. I only got the job because ultimately he permitted me to have the job. I had to be voted in the [New York] senate. He called me and he was like, "What's going on? The stock's 25. I'm getting all of these calls." I sent in [Deputy Superintendent] Michael Moriarty to do a rough-ish examination of AIG. Meaning looking at the reserving. The big picture.

He came away and said that they were, from an insurance point of view, at least the New York company, very financially secure. But definitely the stock was getting hammered, and the politicians were appropriately concerned. A lot of jobs in New York. I went back to [Bruno], and I said, "I've done what I can do."

There's a law. Which is I think article 15 of the insurance law. Every state has a version of this, that says, this is back then, it said that the superintendent or commissioner does not have the authority to examine the holding company without cause. I didn't have a reason. I think this law has changed. Maybe not in New York, but in other states.

I wouldn't have even been able to arguably reach up and over to FP, without some cause. Without some belief that there was impact, at the time, on the insurance subsidiary. That is a law that, you wanted to get about lessons learned? That's a law that has changed in many of the states. Now it says, "May examine." Not, "Can not, unless." Because that's restricting.

Now it could be arguably chaotic for the holding company, to have all these insurance commissioners able to go up and do their own examinations. But if I had been completely on my game, and if I had figured out this unlicensed monoline aspect, maybe a year before I might have been able to sever it or something. I don't know. But I would have had to have an argument that it was impacting the insurance companies, which I don't think I had at the time.

There's another things people don't really realize. That what FP wrote was actually pretty good. They wrote insurance on pretty good-quality mortgages from the earlier years. But they didn't have the liquidity to stay behind their bets. But the federal government did, and made a fortune.

YPFS: Let's look at some of the other AIG businesses. Particularly, we know there were problems with both CDS and securities lending. Can you talk about how you dealt with securities lending?

Dinallo: I just want to try to explain to you how I testified about it, and I got attacked by [Sen. Richard] Shelby and the whole business. To this day, this one I will never back down on. Never, ever, ever. Because I did the work afterward to prove my thesis. We examined every other life insurance company post-AIG. I don't even know if it was rescued yet. But I remember, before I went and testified ...

When I was attacked by him and [then-Senate aide] Hester Peirce, who is now on the SEC, and we're friends now. That yes, there was extreme pressure on the insurance companies because of the securities lending business. But no other New York life insurance [company] was experiencing that.

Okay, so the reason I'm saying this, why is that? Well, I'll tell you why. Because in essence, I'm going to use a term, I'm going to put huge quote marks around, "insider trading." Because it's not illegal insider trading. But what was happening was, as FP was getting in trouble, all the counterparty banks went and ripped the cash out of the securities lending agreements. They put back the securities and took the cash, which is their right. But the only way they knew to do that, and the only reason that they did it, was because they had concern about the company itself through being counterparties of FP.

One of my lessons is, personally, I think securities lending is the ... make a little, lose a lot. I don't see, it is such a marginal gain on monetizing, that I've never understood why it's permitted. It just looks dangerous. AIG showed it was dangerous. It's not worth the wax, or whatever the word is.

To this day, I've always felt that the solvency of the insurance companies, which was ultimately long term, I was right, they were solvent, they were healthy. But the only reason that they were experiencing distress, well there was two reasons, which we could talk about. One was the securities lending aspect, which I just explained was exogenous, and maybe in a different time without wanting to cause more financial distress, I might have actually confronted these banks. Maybe if AIG had come to me, I might have actually given [them] the backbone to say, "No. Don't."

They have information that arguably, they shouldn't be using to be pulling out of the securities lending agreements. I don't know, I'd need a lawyer's analysis on that. But it was unique.

We went back. I remember, we sent 25 [section] 308 letters, which is basically a subpoena, to every single life insurer. None of them were having any issues with securities lending.

YPFS: So it was just AIG and its counterparties, up until September 2008?

Dinallo: Right. You know, so what I had to do was, as you know, I had to just go with my view, that you have to keep the confidence in insurance companies. This is a whole other thing that we were talking about. Which is the difference between the company and the insurance company. You simultaneously have to balance the perception and the confidence of the insurance subsidiary.

I wrote an op-ed for the [Financial Times] that lays out that there's a law, that [hedge fund manager] Bill Ackman and I argued about. About not disparaging or questioning the solvency of an insurance company. You can short the stock all day, and you can go out there and trash MBIA stock all day. But when you start to question its solvency, that's actually against the law.

Then he got very angry with me. Then we became friends. But I was upset with him, not because he was ... He taught me all about the monolines. Everything I learned at the beginning was all from Bill. Brilliant guy. Showed me everything about CDS squared and all this stuff, and how it really was actually all correlated. He was right. But one needs to draw a line at the holding company, so I did the op-ed.

Now back to AIG. I decided that I had enough information, and enough belief in the statutory accounting, which we can talk about. Which is really part of the story. That I was going to go out there and make statements about my confidence in the insurance companies of AIG. Because I did believe that on a statutory accounting basis, they had more than enough assets to match their long-term liabilities on a statutory accounting basis. Not mark to market. Which Geithner to this day …

YPFS: Can you talk a little bit more about that?

Dinallo: When Geithner heard this, I made this joke. I don't know if I've been quoted. I think he thought I was explaining the Mayan calendar to him. It was so alien and so weird. But basically, life insurance companies have long-term liabilities, and they match it with long-term assets that are going to perform by maturing 20 years from now. That's why so much of the reserves are put towards basically debt, Treasuries, etc., that are highly rated. So that they will almost certainly, hopefully, certainly perform. Which means mature. You're going to get the coupon along the way, albeit a small yield.

The volatility before maturation over the 20 years does not count. This is the biggest debate in insurance right now. Between Europe, the feds, and the United States. That the inter-period where there's volatility, and this is what I mean by, back with Shelby. They were like, "Oh my god, they're insolvent."

I'm like, "They're not insolvent. They may be, on some reporting basis, marginally insolvent." But of course, my argument was that securities lending was exacerbating that. But even taking it out of the equation, if you as a regulator are seeing depression on the asset that you know is just market-based and is going to recover, and they're going to perform at the end. They're going to pay their obligation. Then what statutory accounting permits is, in essence, you ignore that volatility, with the idea that you're looking for long-term match of the assets to the obligation.

When someone's going to die 30 years from now, you're going to have enough to pay then. It doesn't matter what's going on now.

YPFS: In other words, the opposite of mark to market.

Dinallo: Exactly. The dead opposite. You have such a mismatch on this, with Europe and the feds, and the way the feds think about it, and the way they think about banks. Because banks, you can have a run. You can't have a run on an insurance company quite the same way as a run on a bank. It's very hard. It doesn't work. In fact, you could put the wall down if you want, and slow walk rescission. There's a lot of things you can do that you can't do with a bank.

It's hard. People don't really understand it. But the statutory accounting to me has always been the right way, and it's worked for 150 years so far. If you think about it, it actually worked very well during the crisis. That the outcome was correct. The insurance companies, at both Hartford and AIG, were in fact solvent. The holding companies were disastrous. But the insurance companies, which had the moat around them as I've said, that each one of them, if well regulated, was what was solvent

I mean, we could talk about AIG all day, and I'm happy to do it. But it's remarkable, when you step back, there were basically no insolvencies during the crisis of insurance companies. No one ever says that. The industry performed perfectly. If you take away the holding company issues with Hartford and AIG, which was not caused by the insurance companies, let's be clear. You have almost a perfect story. It's only because AIG happened to be an insurance company, that people talk about the insurance crisis at AIG. It wasn't an insurance crisis. It was an FP crisis.

I don't know why the industry doesn't do better on that. If this was the banking industry, oh my God. They wouldn't stop talking about it

YPFS: At one point you said that New York would let the insurance subsidiaries loan to the AIG parent. I don't think that actually in real life happened.

Dinallo: Correct.

YPFS: But what was the thinking leading up to that?

Dinallo: I can tell you. Because at the time, there were a couple of things. I don't remember, this is where you might want to talk to John Kenny [special counsel to Dinallo in 2008], who would have almost a minute-by-minute recollection. But remember, when we first showed up, there was a lot of calculation going on that made it seem like, if you could connect, I believe it was $20 billion from the insurance subsidiaries of us and Pennsylvania, and $20 billion in private equity, oh, and the lines of credit. Which I need to talk about. That's really important, by the way. You want to talk about lessons learned? That one is something that we should talk about.

That you could do a bailout, we're going to call it, or a rescue, that would work. Unfortunately, the numbers kept going wrong and wrong and wrong. But I still wanted to go through with the offer. Because again, I felt that people needed confidence that there was going to be a solution. That New York state was willing to be involved, and that I was willing to, on a basis where I think we would have felt protected. Because again, I knew, I understood the quality of the assets at FP. I knew it was a liquidity crisis, not a risk issue.

It's back to Long-Term Capital Management [the hedge fund that was bailed out in 1998]. They wrote great risk. I know people would say, "How can that be? How can that be?" No, their risk understanding was excellent. They didn't have liquidity to stay in it. Remember the famous quote of Long-Term Capital, "The market's irrationality will outlast your money." Even if you're right.

My view was that we needed to send, that was the other way to send a jolt of some confidence. Which was to make the offer. At the time, I think I was already feeling like the offer, so to speak, wasn't going to be accepted, and it was going to be replaced by the Fed. Because already, Geithner was changing his mind about opening the [discount lending] window to AIG. But that was basically the thinking.

I felt secure as the regulator that, based on the quality assets, based on the insurance subsidiary's extreme excess capital, they were really over-capitalized, over-reserved you would call it. Because New York demands way beyond anyone else on a national basis, that we would definitely get the money back.

There's one more thing. Quality assets, over-reserving, and I knew they were going to start selling companies, and we were going to be first lien on those sales. They started selling companies that—they owned 1,000 companies—that I was going to demand, or I wasn't going to do the deal, that we were going to be first lien on those.

Now back to the lines of credit. If you want to talk about lesson learned: There's a level at which they're worthless. Because when AIG went to access those lines of credit which they had paid for, for years and years, and years—— every one of the credit rating agencies said that they would be downgraded. I made the calls and I was told that if they touched the lines of credit, they're going to get knocked down four levels. Every single one told me. Moody's, S&P, everyone.

I was like, "But they bought these lines of credit." "Yep. But if you need them then you're not credit worthy." I was like, "This is circular logic. They had the risk analysis and foresight to get the lines of credit." "Nope, four levels." Which would have been disastrous for the insurance companies.

But then why even have the lines of credit? I mean, all that money spent on those lines of credit, and when they needed them, they were useless. Honestly useless. I mean, to me, that's a lesson. If I were a CEO I would be like, "The last time I checked, when you need them you can't get them, so why pay for them?" I don't know. Maybe the board makes you do it or whatever. But I would warn the board, "Look at AIG. They were useless."

I think that's an important lesson. The other one obviously is liquidity. It's all about liquidity. The older I get, it's all about liquidity. They just weren't liquid enough to stay in those bets. The insurance companies are not there for those purposes.

If you call AIG a trillion-dollar balance sheet, which it was at one point, it's kind of a trillion-dollar balance sheet. But you have to sever all the insurance companies from that analysis when you analyze holding company obligations.

YPFS: **Now can we talk a little about CDS? Again, didn't turn out to be something that you actually put your hands in. But you did say that you were willing to regulate at least the insurance part of the CDS market. Why did you do that? What happened? Can you talk about what state regulators have had to do as the regulation in the CDS market has changed over the last decade? What do you think happened then, and how has it affected the current state of derivatives regulation?**

Dinallo: I also did an op-ed for the FT that was about this topic. Fareed Zakaria talked about it on GPS, because he thought it was the simplest explanation of the crisis he had read. It was pretty simple. It was basically that you have these four buckets of financial instruments.

I keep trying to find a fifth, but I don't think there is. One is banking obligations. One is insurance obligations. One is speculative instruments, which you could call gambling. Which is not an impolite word. Gambling, futures, etc. The fourth, investments, like bonds and stocks. Okay.

Each one of those have regulatory reserving that go with them. You know, there's regulation, and the reserving as you know for bank, and insurance, and even for gambling and stuff, it's very high. It's heavily regulated. You've got to set aside a lot of money to be in those businesses, because your obligations have to be good. They have to perform.

Investments may be a little bit different, because that's regulated more by transparency. By financial documents. By people knowing what they're investing in. Your AIG stock might be worth $100 today. Tomorrow it could be worth zero. There's no promise that your stock will be there at a certain value 10 years from now. There is a promise around the other three. The system is wired to have regulators and solvency behind it.

Then we just invented this thing called derivatives, which we thought was alchemy or something. We thought that we would take derivatives, and it would substitute for those four buckets. If you tell Wall Street that they can sell insurance, in essence, or speculative futures, with no reserves set aside, they're going to make a fortune. Until they have to pay on claims.

My view was that we actually had somehow convinced ourselves that credit default swaps [were safe]—both the speculative, naked credit default swaps that [were] making shorts in the equities market, where you don't even have any exposure to the company, [and] the insurance side, where you do have exposure to the company. Say they're a counterparty for technology, or for debt or whatever.

We had permitted both sides to be unregulated, and sure enough, Wall Street found that that was going to be a hugely profitable business. Because you don't have to set aside any money, because it was deregulated under the Commodities Futures Modernization Act.

I was kind of throwing sand at the feds a little bit. Saying, "Someone's got to regulate this. I could regulate the insurance side of it. No doubt in my mind. We'll have a big fight." In fact, there was a general counsel opinion that I think I reference in this. Where it was clear that they were unregulated, but you could regulate them.

My view was that people were out there writing insurance, that it qualified for every definition of insurance under the New York state insurance law. They were basically writing unlicensed insurance.

Then, I don't recall why I backed down. It wasn't like I was scared or anything. I think what I got was promises that it was going to be better regulated. I think that the Commodity Futures Trading Commission (CFTC) stepped up, and did a pretty good job.

I don't purport to be an expert. But I got convinced that they were going to do something, and I think they did. My question, again for lessons learned. If I had to have a legacy on this, I'd still ask the question, "Okay. I don't care what the CFTC is doing. Or, I do actually care. The simple question is, are the reserves, the money that is required to be set aside, being overseen by someone? Is it the same as if it were straight up insurance, or straight up futures?" Because that's what it is. I mean, it's either one or the other. There's no alchemy here. There's no fifth bucket, no asset class that someone's invented. I think derivatives should be extremely, extremely limited in use, because they are there when you can't get ... When you have to have it, sometimes you have, I don't know, SPYDERs in ETFs, and they require it. They require a certain asset, but you can't get it, so you do it by derivative. I understand that there are reasons for it.

But the point is that the moment they were deregulated, they were used overnight to attain whatever business and outcomes and commitments that were [available] because you no longer had to set aside capital, for the same activity. That's what I never understood. Maybe the CFTC, etc., is doing a great job now. I would just always go back to the same question. When the music stops, is the capital there for those commitments? In the same way they would be there if it were reserved, as if it were insurance, reserved, as if it were a future.

YPFS: **Let's talk about protection of policy holders, and how that responsibility fits in with regulation of the companies and the supervision of the companies' operations, on the insurance level.**

Dinallo: I mean, I guess on that one, I would say that they're kind of, what's the word I'm looking for? They're kind of hand in glove. I'm not trying to be trite. It's just a fact that solvency is the best consumer protection. I think some people didn't love it because it sounded like I was not serious about market conduct supervision. But it seems to me that solvency is the best consumer protection there is. Because the insurance companies have obligations, and the number one thing is to make good on those obligations.

If they don't, that's why there's a guarantee fund. That's why I went out and said what I said about AIG. Because if consumers lose confidence…

That's why the reserving is so heavy. It's all about maintaining the confidence in those obligations. While we could debate about what consumer protection really is, and sure, insurance companies at times do bad things. They probably get a higher margin than they should get.

There's a whole complex system about making sure that they pay out more than less. People actually don't know that. But there's something called minimum loss ratios. At the end of the year they've got to explain why they're making too much money.

By the way, if you own a credit card and you ever lose, or the thing, lost, damaged, or stolen? You want to put that claim in, because those insurance companies that do that for Amex, etc., they love taking claims. Because no one knows about it, so no one uses it. They're always up against a version of minimum loss ratios. I've gotten incredible results, actually.

My view is that while I had come from Eliot Spitzer's attorney general's office as this enforcer on Wall Street and all this stuff, I quickly understood, and the crisis kind of proved to me, that it was about solvency. That while I could have made more political points for Eliot, for [then-Gov.] David [Paterson], maybe for myself running for office [later] if I was this great consumer protectionist, I didn't really think that's what the job was entirely about. I thought it was about mindful regulation, and making sure that the companies that we were on top of were as solvent, reasonably, as possible.

You could make them so solvent that they can't price competitively, that's the counter side. If you make them reserve too much money, they're priced out of the market. Their market viability can end rather quickly. That's kind of what I was thinking the whole time.

I do admit that I came in with the instinct that I was going to do a lot more, we'll call it enforcement. We'll call it consumer protection or market conduct. But what happened was, I went from the World Trade Center case, to medical malpractice crisis insurance reform, to then the monolines, to then AIG. I never really had any time to do anything else but deal with what seemed like one crisis after another, that all revolved more or less, except for the World Trade Center arguably, around solvency. Or liquidity, which is, again, not quite the same thing. But they're hand in glove.

YPFS: **Obviously we've been talking about looking at the insurance operating company. How about, where should supervision of the holding companies sit?**

Dinallo: This is the great complexity. I think that, look. Let's go back to, actually AIG is a good example, of how really wrong that was. Apparently my predecessor, Neil Levin—he died in the World Trade Center attack—had offered to be the holding company regulator for AIG. [One-time AIG CEO Hank] Greenberg somewhat predictably, and maybe intelligently, turned him down. Instead they ended up with the Office of Thrift Supervision (OTS). The way they got there was because they owned this little thrift in Delaware or something. That permitted Greenberg to designate them the supervisor.

YPFS: **Its office was in downtown Wilmington, and there was a little deli right next to it.**

Dinallo: You can't make this stuff up. Greenberg was brilliant. When I teach my NYU class, I just draw a really quick diagram of AIG. I have the holding company. This is with people who don't understand, they've never heard the story. But I draw, back to what we were saying before, I draw the diagram. I have all these different subsidiaries. Japan, and whatever, New York. I give them a quick understanding of the operating company, versus the holding company. I draw the thrift off to one side, and I draw the financial products division off the other side.

I say, "You know, when it came to financial products division, if God were looking down at this," and they all laugh. "You'd see that there was reserving going on in these operating companies that were not same reserving over in this thing called FP." But I would make the argument that they were doing exactly the same kind of activity. Back to the buckets that I talked to you about. They were not reserving the same way, and it blew up the whole holding company.

My answer is that this is not some argument for state supervision. But I think if the company is predominantly an insurance company, then it ought to be regulated at the holding company by an insurance regulator. I don't think it's that deep. It could be New York. It could be someone else. We could debate who it should be. New York seemed like a logical choice for AIG. But I just think that's kind of the way it ought to be.

Now if the feds could develop the expertise, and the man and woman power to actually do that at a hold-co level, I'm hip with that. It doesn't have to be just a state regulator up there. But the problem is, that's such a huge apparatus, that they don't have and they probably will never have. The one thing that's changed, although we could debate if it's in the right place, is FIO, Federal Insurance Office, is a good thing.

The federal side needs to have experts that they can trust, that are their people, that are their analysts, to understand the insurance industry, so that you don't have just me testifying. I remember once, [Rep. Paul] Kanjorski [D-Pa.], who was kind of a crotchety guy, he would say, "Dinallo, you're back again. Where's my guy?" I said, "Sir, NAIC asked me to testify." "But where's my guy?" He was literally saying that. I was like, "You need a guy, yeah. You don't have a guy. You've got me. Until you get a guy, I'm here." The whole room laughed. But that was basically his point. They didn't have a guy.

Now they've got someone, which is good. Because I think it helps with the dialog, and it helps with the demystification of distrust between state and federal. The problem is, I'm not sure I would have put it in [the Treasury Department]. You could debate whether it's in the right place. I understand why they put it there. Because Congress ultimately controls, it's a little bit about control and access. It all reports to the White House. Then also to Congress. It's not bad, but it's not where the game is. Right now, the game is about international regulation and solvency requirements, and that's being run out of the Fed.

I kind of saw it coming. But it's done now. But I didn't really understand the choice exactly, to be honest. My answer is, I don't know who should be regulating the holding companies. I just think an insurance regulator ought to be regulating the holding companies if it's primarily an insurance company.

YPFS: **On the question of regulation, one of the artifacts of the crisis was the creation of the Financial Stability Oversight Council (FSOC), which had the responsibility of possibly designating companies as nonbank systemically important financial institutions. Over the ensuing years, a handful of companies were designated, including three big insurers. Now, none of them are any longer designated for enhanced supervision. What do you think about the designation process? Did it have the possibility of filling some of the gaps? Should these companies be designated?**

Dinallo: I never had any problem with the concept of FSOC, I actually thought it was excellent. I thought even if it wasn't going to save the world by designation, it was important for the regulators to understand and hash out and argue and discuss what systemically significant meant. What to do about it, if anything. Should there be enhanced reserving requirements? Should there be, God forbid, a breakup? I'm not sure that was ever really discussed. But it's a completely reasonable undertaking that I didn't think was misguided at all.

I used to joke that [the FSOC designation of Prudential] was like the *Marbury vs Madison* or *Brown vs Board of Education* of insurance decisions. But that designation of Prudential, that decision is the grand Supreme Court opinion of all time in the insurance industry. People should really read it, because it's a beautiful argument back and forth about why or why not insurance is or is not systemically significant.

It's just kind of hilarious that both sides land and argue about, back to what we were just talking about—insolvency—and how the state systems are not funded. It's not like FDIC. It's an unfunded promise that there'll be money there if someone goes into what we call rehabilitation, which is really bankruptcy. It's just an amazing document.

But it misses—well, doesn't really miss, because a dissent makes a point that I was making earlier. Which is, the unwinding of an insurance company is like nothing else in financial services. There's a bank. A bank goes under, you can just back up the cash machine and say, "Okay. What are the obligations? Who do we owe money? Who has deposits here? Done."

The problem with insurance companies is, you don't know how the movie's going to end, and it doesn't end overnight. You can't just back up a cash machine and bail it out. You have to actually let it run off, which is the term, and figure out, what are the obligations? It's very important that they get paid. It's not 100 cents on the dollar, but very close. Because again, they lose the confidence. But you don't know what the obligations are really going to be.

I thought that that kind of back and forth was fascinating, and it just struck me weirdly that the one thing that they all jumped on was the resolution issue, we'll call it, of an insurance company. Which I just found kind of fascinating.

I don't have a problem with the designation process entirely. I do think that there's a question about whether additional reserving at that point is really going to make a difference. It may be that the deeper question is, how big should insurance companies be permitted to be, etc.? What is the regulation? You go back to the question, what's the regulation at the holding company level?

The MetLife designation one was a little bit different. I think FSOC just didn't do a very good job on the administrative law on that. Prudential was an appropriately hashed out discussion and designation, that I'm not saying I think they should have been designated. I don't have enough knowledge or opinion. But the decision on Prudential was certainly robust and complete.

I think some people in my industry think it's the stupidest idea ever to have it. I thought, it's a rational reaction to the crisis. We ought to know, and we ought to at least, even if the answer is that we're not going to do anything about it, I think knowledge about how to deal with a future crisis, or institutions that could cause a future crisis, is a good thing.

When I teach this at NYU I literally say, "This is true. We had 10 people at AIG on that Saturday." Geithner called me and said, "I see you're down at AIG with your people, and you're being helpful." Which was code for, "I was willing to offer this $20 billion that you're talking about." In their world it's all about the money. I think he meant beyond that. But he was basically saying, "I hear you're trying to come with a financial solution, and you're including this money."

We were talking about opening the [Federal Reserve discount] window. He said, "That's not going to happen." But, of course, he changed his mind. He literally said, I remember, it was Saturday at 1:00 pm. He talks kind of fast, or at least he used to. He goes, "Okay, here's the deal. I've got Lehman, you've got AIG. Okay? Great, we'll talk on Monday. Bye." It was like pickup basketball. "I've got her, you've got him. Okay, let's play." It was absolutely from Lessons Learned. There was no manual. Zero.

The other thing is, I think the monolines, the other big lesson was, no one knew what they ... I mean, I could tell. That was the one where Geithner, we semi-argued about it. Because he woke up and realized that these things that he understood were so important to Wall Street, that all their trading books had been hooked on them, were regulated by state regulators. He had no idea. At the beginning, I think the Fed really had no idea what these things were or who regulated them.

Geithner was like, "Dinallo regulates them? Oh my God." That was kind of, and then I started, as you know, we started to split the book. Then people started to get angry that I was destroying western contract law or something. That's a whole other discussion. But that one was also, they woke up to the reality that this was a state regulated industry, that had this humongous impact on all the banks and all the investment banks. That was probably the most shocking thing to Geithner I think, was the monolines, actually. Not so much AIG.

YPFS: **Let's look a little forward. First, could another AIG happen? Could a large international insurance company become so systemically important—whether it's through CDS or something I don't know exists—that troubles that have nothing to do with the insurance subsidiaries could threaten the stability of the financial system?**

Dinallo: I don't think that anything that I know of conclusively prevents it from happening again. I do think, though, that I'm figuring on a couple of key issues. I don't know now to this day how holding companies are regulated. It's a critical question. Because as we know, it was all about the activities of the holding company. Not to point fingers or stiff arm, but it was the activities of the holding company.

I don't know who now is in charge of the holding companies of these big financial services giants. I think you have to know that. I always come back to, at least on the insurance side, I come back to what always appears to me a version of monetizing their rating off of the holding company. That is, they did it by selling either some version of insurance or speculative instruments, without the proper reserving of liquidity in place.

If companies can still do what I just said, then obviously it's possible that a AAA company could get in a lot of trouble. I would assume, I would hope that the supervisors are better informed, and better coordinated post-AIG. But I haven't kept current with this core question that you're asking. Which maybe I should kind of sleep on for a little while. But I would need to know the answer to that question as to whether complex companies could still monetize their ratings like AIG did.

YPFS: **What do you wish someone had told you back when you took this job? What would you recommend to others in the future, if you had to summarize?**

Dinallo: Well, I don't know that anyone could have warned me, or given me wisdom on the way in, that would have prepared me for what happened, which was kind of monumental. I remember, I used to joke that I was sitting there in the room with [Goldman Sachs Chairman Lloyd] Blankfein and Geithner, and Paulson on the phone. Everyone's in. The classic meeting, where everyone's confronting each other.

Geithner asks me—I'm the insurance guy in the room at this point. I've got [deputies] Hampton [Finer] in back of me, and John Kenny. I'd only been in the job, what was it, two years or something?—Geithner asked about, because they're seriously considering, giving serious thought about a debtor in possession—DIP—thing for AIG. He's like, "What do you think?" I'm like, "It's a horrible idea." He said, "Why?"

I said, "Because while it looks possible on paper, and I get the point. The operating companies are healthy, like the way an airline would do it. If you file for bankruptcy at the holding company level, all these subsidiaries, they're going to start ... Some states may even require by law … that the states will seize the operating companies, because the holding company filed for bankruptcy. They're going to pull up the drawbridge, and go into castle mode. Then you're going to have a run on insurance companies."

While I'm saying this, I swear to God, CNN is on. We took a break, and CNN was on. They were lining up in Singapore for, I don't know why, but at AIG's insurance company in Singapore, they were lining up. They were acting like a run-on-the-bank moment. Probably to check on their insurance policy.

The reason I'm telling you this story is because I'm very close to my parents. My dad's like my best friend. I talk to him every single day almost, or I did back then. I realized, there was nobody else. There was no one for me to get help on this. This was it. I'm in the room. Geithner's asking. Paulson's listening. There's no parent, I'm fully grown up at this point, at 45 years old or whatever it was.

I finally had no one else to ask. I mean, my experts obviously. But it was one of those moments in life where you're like, "Okay, this is it. You're either going to get this right, or you're going to get it wrong. There's no one else to go and chat with about it, and get a fatherly voice on it."

I guess my point is that someone would have told me that you could end up having to make these important decisions, with not as much preparation and knowledge as you would ultimately like. But you just keep with the script that we started with. It's solvency, it's policy holder confidence. It's a system that requires money keeps on coming in, so you can pay out on the other side 30 years from now. It's different than any other financial obligation out there. You have the right to have a unique voice, against people who will think it's a little bit anachronistic. Statutory accounting, the Mayan calendar, etc. But it's going to be important that you not reflexively throw in with them.

What I mean by that is, to this day, when I am at [law firm] Debevoise and Plimpton, and I call for my clients, various insurance regulators across the country. I say, I am calling them to get connected to someone else, I need help with a project, etc.

Before they transfer me or give me the guy's number, they say literally, "Eric, I just want to thank you." I don't know the person at all. They're like, "I want to thank you." I say, "Why?" "Because you stood up for us." I was like, "What do you mean?" He goes, "I remembered, you testified. You were on CNBC. You stood up for the state-based system."

Implicit in that was that they sensed that there was another world, where a superintendent would have been there in the heat of Congress, and Geithner, and everyone questioning. Even the president was kind of negative, if you remember, on insurance and AIG. They would have been like, "Oh my God. I can't believe I'm in the middle of this."

By the way, my background up to that point had been capital markets, securities, and Morgan Stanley. "I can't believe I'm in the middle of this nincompoop state thing." I never did that. But I could see someone, and I wouldn't even necessarily insult them. Just, the pressures were huge. To cozy up and say, "Oh yeah, this is the way. We have to have federal regulation. Geithner's convinced me," and all that.

I've got to say, people really watched. I didn't know that. It really mattered. I would say that that's it. You've got to have a mantra. You can't be inflexible. You can't be pigheaded. But it is a different industry, and it's regulated in a different way. You have to stay true to that.

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