Washington and Lee Law Review

Volume 72 | Issue 2 Article 7

Spring 3-1-2015

Afterword to The AIG Bailout

William K. Sjostrom Jr.
University of Arizona College of Law

Recommended Citation
William K. Sjostrom Jr., *Afterword to The AIG Bailout*, 72 Wash. & Lee L. Rev. 795 (2015),
https://scholarlycommons.law.wlu.edu/wlulr/vol72/iss2/7

Afterword to The AIG Bailout

William K. Sjostrom, Jr.*

Table of Contents

I. Introduction

In the early spring of 2009, I wrote an article on the federal government's bailout of American International Group, Inc. (AIG) entitled *The AIG Bailout*.[1] The bailout was necessitated by AIG's disastrous multi-billion dollar bets on the United States housing market that brought it to the brink of bankruptcy.[2] At the time, AIG was the largest insurance company in the United States.[3] Because of its size and interconnectedness, and the fact that financial markets were already under serious distress, it was feared that AIG's failure would lead to the disintegration of the

---

* Professor of Law, University of Arizona James E. Rogers College of Law.

1. *See generally* William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009).

2. *See id.* at 959–62.

3. *See id.* at 944.

entire financial system.[4] Hence the federal government stepped in with an $85 billion loan,[5] with total aid ultimately reaching $182.5 billion.[6]

Many events related to the bailout transpired after my article was published. Hence, this Article serves as an afterword to *The AIG Bailout*, detailing some of these post-article events. In that regard, the Article proceeds as follows: Part II picks up where Part IV of *The AIG Bailout* left off.[7] It describes the further restructuring of government assistance through the recapitalization of AIG, details the government's exit as AIG's controlling shareholder, and considers the U.S. Department of Treasury's claim of a $22.7 billion "overall positive return" on the AIG Bailout.[8] Part III delves into the Maiden Lane III transactions, perhaps the most controversial part of the bailout, pursuant to which Société Générale, Goldman Sachs, Merrill Lynch and other AIGFP[9] counterparties were bought out at essentially 100 cents on the dollar.[10] Part IV examines the

---

4. *See id.* at 979; *see also Actions Related to AIG*, FEDERAL RESERVE BANK OF NEW YORK, http://www.newyorkfed.org/aboutthefed/aig/ (last visited Apr. 2, 2015) (describing a litany of consequences that could have been triggered by AIG's failure) (on file with the Washington and Lee Law Review); THE FINANCIAL CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 352 (2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

> AIG was so interconnected with many large commercial banks, investment banks, and other financial institutions through counterparty credit relationships on credit default swaps and other activities such as securities lending that its potential failure created systemic risk. The government concluded AIG was too big to fail and committed more than $180 billion to its rescue. Without the bailout, AIG's default and collapse could have brought down its counterparties, causing cascading losses and collapses throughout the financial system.

5. *See* Sjostrom, *supra* note 1, at 964 (clarifying the terms of the bailout).

6. *See id.* at 975.

7. *See infra* Part II (chronicling the government's involvement with AIG following the initial bailout).

8. *See id.*

9. *See infra* note 66 (listing the entities that make up AIGFP).

10. *See infra* Part III; Rick Newman, *3 Lessons from the AIG Bailout*, U.S. NEWS & WORLD REP. (Dec. 11, 2012, 12:23 PM), http://www.usnews.com/news/blogs/rick-newman/2012/12/11/3-lessons-from-the-aig-bailout (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank),[11] the principal federal regulatory response to the financial crisis, most relevant to what happened at AIG.[12] Specifically, it considers how these regulations would have applied to AIG had they been in place prior to its collapse.[13] Part V concludes the Article.[14]

II. Recapitalization and Government Exit

This Part picks up where Part IV of *The AIG Bailout* left off regarding the details of the bailout and subsequent restructurings. As noted in that article, after the second restructuring, which was announced on March 2, 2009, total aid available to AIG under various facilities was $182.5 billion as specified in the following table[15]:

	Amount Authorized (in billions)	**Amount Borrowed/Used (in billions)**
Fed Credit Facility	$60.0	$42.0
TARP Investment	$40.0	$40.0
RMBS Purchase Facility	$22.5	$19.8
Multi-Sector CDO Purchase Facility	$30.0	$24.3
Equity Capital Commitment Facility	$30.0	$0
Total	**$182.5**	**$126.1**

The government's ownership stake in AIG at that point in time was represented by various AIG securities as follows:[16]

---

11. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), Pub. L. No. 11-203, 124 Stat. 1376 (2010) (modifying the United States' financial regulatory system).

12. *See infra* Part IV (describing the closure of the CDS regulatory gap).

13. *See infra* Part IV (analyzing specifically Titles I and VII of the Dodd–Frank Act).

14. *See* Part V (proposing that one of the most important legacies of the AIG bailout is the expansion of the financial regulatory system).

15. *See* Sjostrom, *supra* note 1, at 971 (providing information on the bailout restructuring).

16. *See* Am. Int'l Grp., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A) (Apr. 12, 2010) [hereinafter AIG '10 Proxy Statement] (detailing the government's ownership interests in AIG).

Securities	Owner	Amount	Notes
Series C Preferred Stock	AIG Credit Facility Trust (Trust)[17]	100,000 shares	Issued as compensation for Fed Credit Facility
Series E Preferred Stock	Treasury	400,000 shares	Issued in exchange for Series D Preferred Stock which Treasury purchased as part of its TARP investment in AIG
Series F Preferred Stock	Treasury	300,000 shares	Issued as part of Equity Capital Commitment Facility
Warrants	Treasury	Exercisable for 2,690,088 shares of Common Stock	Issued as part of Equity Capital Commitment Facility

The Series C Preferred Stock entitled the Trust to approximately 532 million votes on any matters put to a stockholders' vote, which translated into approximately 77.8% of AIG's outstanding voting power.[18] In other words, following the second restructuring, the Trust was AIG's controlling shareholder.

On December 1, 2009, as contemplated by the second restructuring,[19] AIG paid down $25 billion of the amount it owed the NY Fed under the Fed Credit Facility by transferring to it preferred equity interests in two newly formed special purpose vehicles (SPVs).[20] One SPV held all of the outstanding common stock of AIG's operating subsidiary, American International Assurance Company (AIA), and the other SPV held all of the outstanding common stock of AIG's operating subsidiary, American Life Insurance Company (ALICO).[21]

On September 30, 2010, AIG and the government announced a complex recapitalization plan to simplify AIG's capital structure and put the government "in an excellent position to begin

17. *See* Sjostrom, *supra* note 1, note 137 and accompanying text.

18. *See* AIG '10 Proxy Statement, *supra* note 16, at 11.

19. *See* Sjostrom, *supra* note 1, at 974 (outlining AIG's repayment plan).

20. *See* AIG '10 Proxy Statement, *supra* note 16, at 11 (describing the payment plan).

21. *See id.* at 11.

realizing value for taxpayers."[22] The recapitalization was completed on January 14, 2011.[23] It included the following components:

- AIG repaid the NY Fed the $21 billion it then owed under the Fed Credit Facility, and the facility was terminated. AIG funded this repayment with (1) a loan from AIA SPV which held cash from selling 67% of the ordinary shares of AIA in a Hong Kong initial public offering, and (2) a loan from ALICO SPV that held cash from the sale of ALICO to MetLife, Inc.[24]
- AIG drew down approximately $20 billion from the Equity Capital Commitment Facility to buy back the NY Fed's preferred equity interests in AIA SPV and ALICO SPV.[25]
- The Trust exchanged its shares of Series C Preferred Stock for 562.9 million shares of AIG Common Stock, which the Trust then transferred to Treasury.[26]
- Treasury exchanged its Series E Preferred Stock for 924.5 million shares of AIG Common Stock.[27]
- Treasury exchanged its Series F Preferred Stock for the preferred equity interests in AIA SPV and ALICO SPV (the interests formally owned by the NY Fed), 20,000 shares of Series G Preferred

22. *See* Press Release, Am. Int'l Grp., AIG Announces Plan to Repay U.S. Government (2010), http://phx.corporate-ir.net/phoenix.zhtml?c=76115&p=irol-newsArticle&ID=1477531 (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review); Press Release, U.S. Dep't of the Treasury, Treasury Announces Completion of the Am. Int'l Grp. Recapitalization Transaction (Jan. 14, 2011), http://www.treasury.gov/press-center/press-releases/Pages/tg1024.aspx (last visited Apr. 2, 2015) (stating that the United States government remains hopeful to fully recover the loan for the taxpayers) (on file with the Washington and Lee Law Review).

23. Am. Int'l Grp., Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (8-K) (Jan. 14, 2011) [hereinafter AIG Current Report (Jan. 14, 2011)].

24. *See id*. at 2.

25. *See id*. (describing the repurchasing of the SPV Preferred Interests).

26. *See id.* at 3 (detailing the exchange of Series G Preferred Stock to the U.S. Treasury for Series C, E, and F Preferred Stock).

27. *See id.*

Stock,[28] and 167.6 million shares of AIG Common Stock.[29]

The end result of the above transactions was the consolidation of the government ownership of AIG with Treasury. Specifically, Treasury became the record holder of 1,655,037,962 shares of AIG Common Stock, or 92% of AIG's outstanding voting power, and neither the Trust nor NY Fed any longer owned AIG shares.[30]

Five months later (May 2011), Treasury sold 200 million of its 1.66 billion shares of AIG Common Stock in a public offering through a syndicate of underwriters.[31] It followed that with five other public offerings in the ensuing months, and by December 2012 it had completely liquidated its AIG Common Stock position as depicted in the following table:

Date	Shares Sold	Price per Share	Proceeds[32]	Shares Remaining	Cumulative Percentage Sold
May 24, 2011[33]	200,000,000	$29.00	$5.80 billion	1.46 billion	12.08%
March 8, 2012[34]	206,896,552	$29.00	$6.00 billion	1.25 billion	24.59%

28. *See* AIG Current Report (Jan. 14, 2011), *supra* note 23, at 2.

29. *See id.* at 3.

30. *See id.* As mentioned in *The AIG Bailout*, *supra* note 1, at 966, it was reported that the government's AIG stake was set below 80% for accounting reasons. Whether this was true or not at the time, staying below 80% was obviously no longer at issue for the recapitalization. See Steven M. Davidoff and David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 489 (2009) for a more detailed look at this 80% issue.

31. *See* Am. Int'l Grp., Prospectus Supplement to Prospectus (Form 424B5) (May 24, 2011) [hereinafter Prospectus Supplement (May 24, 2011)].

32. *Compare* William K. Sjostrom, Jr., *The Untold Story of Underwriting Compensation Regulation*, U.C. DAVIS L. REV. 625, 628 (2010) (explaining that in a typical public offering the proceeds received by the seller reflect that the seller sells the shares to the underwriting syndicate at a discount (called the underwriting discount) to the price the shares are sold to the public to compensate the underwriters for handling the deal), *with* Prospectus Supplement (May 24, 2011), *supra* note 31 (noting that for these offerings AIG actually agreed to pay the underwriting discount on behalf of Treasury).

33. *See* Prospectus Supplement (May 24, 2011), *supra* note 31.

34. *See* Am. Int'l Grp., Prospectus Supplement to Prospectus dated April 5, 2011 (Form 424B3) (March 8, 2012).

May 6, 2012[35]	188,524,589[36]	$30.50	$5.75 billion	1.06 billion	35.98%
August 3, 2012[37]	188,524,590[38]	$30.50	$5.75 billion	871 million	47.37%
September 10, 2012[39]	636,923,075[40]	$32.50	$20.70 billion	234 million	85.85%
December 10, 2012	234,169,156	$32.50	$7.61 billion	0	100.00%
Totals	1,655,037,962	$31.18[41]	$51,61 billion		

The May 24, 2011 offering was actually for 300,000,000 shares with AIG selling 100,000,000 in the deal, yielding net proceeds to AIG of $2,856,500,000.[42] As a result of this sale, Treasury's shares of Series G Preferred Stock were cancelled as agreed to by AIG and Treasury as part of the recapitalization.[43]

In June 2009, AIG's stock traded at less than $1.00 per share.[44] Its stock price, however, did not come roaring back as one might conclude from the above table. After the market closed on June 30, 2009, AIG effected a one-for-twenty reverse stock split.[45] The purpose of the split was "to increase the per share trading

35. *See* Am. Int'l Grp., Prospectus Supplement to Prospectus dated April 5, 2011 (Form 424B3) (May 6, 2012).

36. *See* Press Release, Am. Int'l Grp., AIG Announces the U.S. Dep't of Treasury Completes Offering of AIG Common Stock (May 11, 2012), http://in.reuters.com/article/2012/05/10/idUS256544+10-May-2012+BW20120510 (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

37. *See* Am. Int'l Grp., Prospectus Supplement to Prospectus dated June 29, 2012 (Form 424B3) (Aug. 3, 2012).

38. *See* Anthony Hughes, *Treasury's Latest AIG Offering Gets Upsized*, REUTERS (Aug. 4, 2012), http://in.reuters.com/article/2012/08/03/aig-shares-idINL2E8J3C9W20120803 (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

39. *See id.*

40. *See id.*

41. Weighted average price per share, i.e., $51,610,497,444.50 divided by 1,655,037,962.

42. *See* Prospectus Supplement (May 24, 2011), *supra* note 31.

43. *See* Am. Int'l Grp., Amended and Restated Purchase Agreement (Form 8-K), Exhibit 2.1, §§ 2.08(b), 3.02 (Jan. 14, 2011); Prospectus Supplement (May 24, 2011), *supra* note 31.

44. *See* Sjostrom, *supra* note 1, at 945.

45. *See* Am. Int'l Grp., Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 10-Q) (July 31, 2009).

price of AIG Common Stock."[46] AIG's stock closed at $1.16 per share on that day and opened on July 1, 2009 at $19.65 per share as a result of the split going into effect.[47] Thus, the $31.18 average price at which Treasury sold its shares equates to a pre-split price of $1.56 per share.

In light of its exit from AIG, Treasury issued a press release on December 11, 2012, touting a $22.7 billion "overall positive return on the Federal Reserve and Treasury's combined $182

46. Am. Int'l Grp., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 66 (June 5, 2009). AIG's rationale for the split was that:

> Many investment funds and institutional investors have investment guidelines and policies that prohibit them from investing in, or holding in their portfolios, stocks whose price is below a certain threshold, which, at current AIG Common Stock market prices, reduces the number of potential investors for AIG Common Stock. AIG believes that brokerage firms are reluctant to recommend lower-priced stocks to their clients. Also, other investors may be dissuaded from purchasing lower-priced stocks because the brokerage commissions, as a percentage of the total transaction, tend to be higher for such stocks. The reverse stock split could address these concerns by helping to ensure that the price of AIG Common Stock attains a level that would be viewed more favorably by potential investors.
>
> The share price of AIG Common Stock has declined significantly since the third quarter of 2008, and, during February and March 2009, and occasionally since then, it has closed below $1.00 per share. With the shares trading at this level, small moves in absolute terms in the price per share of AIG Common Stock translate into disproportionately large swings in the price on a percentage basis.
>
> AIG Common Stock currently trades on the NYSE under the symbol "AIG." AIG Common Stock will be quoted on the NYSE at the post-split price on and after the effective date of the amendment. The NYSE has several continued listing criteria that companies must satisfy in order to remain listed on the exchange, including minimum share price requirements. While the NYSE has temporarily suspended the minimum share price requirement, this suspension may be terminated at any time and, in any event, the suspension expires on June 30, 2009. As a result, unless the trading price of AIG Common Stock continues to trade above $1.00 per share, AIG Common Stock could be delisted from the NYSE after June 30, 2009.

47. *See Yahoo! Finance AIG Historical Stock Prices*, YAHOO!, http://finance.yahoo.com/q/hp?s=AIG&a=06&b=1&c=2009&d=06&e=1&f=2009&g=d (last visited Apr. 2, 2015) (providing daily AIG stock information) (on file with the Washington and Lee Law Review).

million commitment to stabilize AIG during the financial crisis . . . ."[48] Here are Treasury's calculations:[49]

	Max Combined Commitment	Repayments, Canceled/Reduced Commitments, Interest/Fees/Gains	Positive Return
Federal Reserve	**$112.5 billion**	**$130.2 billion**	**+$17.7 billion**
Fed Loans to AIG	$35.0 billion	$41.8 billion	+$6.8 billion
AIA/ALICO SPV, Preferred Interests	$25.0 billion	$26.4 billion	+$1.4 billion
Maiden Lane II & III	$52.5 billion	$62.0 billion	+$9.5 billion[50]
Treasury	**$69.8 billion**	**$74.8 billion**	**+$5.0 billion**
Common Stock	$47.5 billion	$51.6 billion	+$4.1 billion
Preferred Stock	$22.3 billion	$23.2 billion	+$0.9 billion
Total	**$182.3 billion**[51]	**$205.0 billion**	**+$22.7 billion**

As you can see, the biggest portion of the $22.7 billion came from Maiden Lane II and Maiden Lane III. Maiden Lane II was a NY Fed-controlled limited liability company formed as part of the RMBS Purchase Facility. This facility was established as part of the first restructuring of aid to AIG to address continuing

48. Press Release, U.S. Dep't of the Treasury, Treasury Sells Final Shares of AIG Common Stock, Positive Return on Overall AIG Commitment Reaches $22.7 Billion (Dec. 11, 2012), http://www.treasury.gov/press-center/press-releases/Pages/tg1796.aspx (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

49. *Id.*

50. NY Fed press releases put this number at $9.4 billion—$2.8 billion by Maiden Lane II (see Press Release, Fed. Reserve Bank of NY, New York Fed Sells Remainder of Maiden Lane II LLC Securities; Approximately $2.8 Billion Net Gain Generated for U.S. Public from the Portfolio (Feb. 28, 2012), http://www.newyorkfed.org/newsevents/news/markets/2012/an120228.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review)), and $6.6 billion by Maiden Lane III (see Press Release, Fed. Reserve Bank of NY, New York Fed Sells MAX CDO Holdings in Competitive Process (Apr. 26, 2012) [hereinafter Press Release, NY Fed Sells], http://www.newyorkfed.org/newsevents/news/markets/2012/an120426.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review)). Presumably, the discrepancy comes from rounding.

51. *See e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-490T, FEDERAL FINANCIAL ASSISTANCE: PRELIMINARY OBSERVATIONS ON ASSISTANCE PROVIDED TO AIG 3 (2009) (calculating the value at $182.5 billion, the number used in *The AIG Bailout*). It is unclear what explains this $0.2 billion discrepancy, but that difference should be viewed as immaterial.

problems with AIG's securities lending program.[52] Specifically, in December 2008, the NY Fed loaned Maiden Lane II $19.5 billion, which it used to purchase $39.3 billion face amount in residential mortgage-backed securities (RMBS) from AIG. These securities were originally purchased by AIG with cash collateral posted by borrowers under its securities lending program.[53] The NY Fed retained BlackRock Financial Management Inc. to manage Maiden Lane II's portfolio.[54] BlackRock sold off the portfolio through a series of transactions over an eight-month period beginning in January 2012.[55] As a result of improved conditions in the RMBS market, Maiden Lane II repaid the $19.5 billion loan to the NY Fed plus interest, fees, and a five-sixths share of the remaining profits made on the portfolio.[56] The end result was a $2.8 billion net gain by the NY Fed on the deal.[57]

Maiden Lane III was a NY Fed-controlled limited liability company formed as part of the Multi-Sector CDO Purchase Facility. This facility was established as part of the first aid restructuring to address AIG's continuing collateral posting obligations from its credit default swap (CDS) portfolio.[58] Specifically, the NY Fed loaned Maiden Lane III $24.3 billion, which it used to purchase collateralized debt obligations (CDOs)

---

52. Am. Int'l Grp., Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K) (Dec. 15, 2008); *see also* Sjostrom, *supra* note 1, at 971.

53. *See* Sjostrom, *supra* note 1, Part IV.B (describing AIG's securities lending program). For much more detail on AIG's securities lending program, see Hester Pierce, *Securities Lending and the Untold Story in the Collapse of AIG* Part IV (George Mason University Mercatus Ctr., Working Paper No. 14-12, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2435161.

54. *See* Press Release, Fed. Reserve Bank of NY, New York Fed to Sell Maiden Lane II Assets in Competitive Process over Time (Mar. 30, 2011), http://www.newyorkfed.org/newsevents/news/markets/2011/an110330.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

55. *See* Press Release, Fed. Reserve Bank of NY, New York Fed Sells Remainder of Maiden Lane II LLC Securities; Approximately $2.8 Billion Net Gain Generated for U.S. Public from the Portfolio (Feb. 28, 2012), http://www.newyorkfed.org/newsevents/news/markets/2012/an120228.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

56. *See id.*

57. *See id.*

58. *See* Am. Int'l Grp., Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K) (Dec. 2, 2008); *see also* Sjostrom, *supra* note 1, at 971–72.

from various counterparties to AIGFP's multi-sector CDO CDSs in exchange for these counterparties concurrently terminating the related CDSs (as discussed in the next Part, these transactions stirred up a bit of controversy).[59] As it did with Maiden Lane II, the NY Fed retained BlackRock to manage Maiden Lane III's portfolio.[60] BlackRock sold off the portfolio through a series of transactions over a four-month period beginning in April 2012.[61] As a result of improved conditions in the CDO market, Maiden Lane III repaid the $24.3 billion loan to the NY Fed plus interest, fees, and a 67% share of the profits made on the portfolio.[62] The end result was a $6.6 billion net gain by the NY Fed on the deal.[63]

Some commentators have taken issue with the government combining returns earned by Treasury and the Fed in arriving at the $22.7 billion positive net return (Neal Barofsky, former Special Inspector General for TARP, being the most prominent), characterizing it as misleading.[64] I disagree. As the Fed notes:

---

59. *See Maiden Lane Transactions*, FED. RESERVE BANK OF NY, http://www.newyorkfed.org/markets/maidenlane.html (last visited Apr. 2, 2015) (chronicling the history of the transactions) (on file with the Washington and Lee Law Review); Press Release, Fed. Bank of NY, New York Fed Sells Remainder of Maiden Lane III LLC Securities; Marks End of AIG-Related Assistance; Approximately $6.6 Billion Net Gain Generated for U.S. Public from the Portfolio (Aug. 23, 2012), http://www.newyorkfed.org/newsevents/news/markets/2012/an120823.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

60. *See* Press Release, NY Fed Sells, *supra* note 59.

61. *See id*.

62. *See id*.

63. *See id*.

64. *See, e.g.*, Mark Gongloff, *Huge AIG Bailout Profit 'Misleading', Says Ex-TARP Watchdog*, HUFFINGTON POST BUSINESS (Dec. 11, 2012, 2:39 PM), http://www.huffingtonpost.com/2012/12/11/aig-bailout-profit_n_2277676.html (last visited Apr. 2, 2015) (explaining the figure is misleading because a third of the stock sold came from the Federal Reserve and not the bailout) (on file with the Washington and Lee Law Review); Francine McKenna, *Did the Government Profit from AIG? That's the Wrong Question,* AM. BANKER (Sept. 14, 2012, 10:00 AM), http://www.americanbanker.com/bankthink/did-the-government-profit-from-AIG-thats-the-wrong-question-1052653-1.html (last visited Apr. 2, 2015) (noting that the government uses the term "positive return" instead of "profit") (on file with the Washington and Lee Law Review); James Tilson and Robert E. Prasch, *It Was Not a Free Lunch: The True Cost of the AIG Bailout*, THE BIG PICTURE (Jan. 28, 2013, 8:30 AM), http://www.ritholtz.com/blog/2013/01/the-true-cost-of-the-aig-bailout/ (last visited Apr. 2, 2015) (describing multiple cover-

"After it pays its expenses, the Federal Reserve turns the rest of its earnings over to the U.S. Treasury. About 95 percent of the Reserve Banks' net earnings have been paid into the Treasury since the Federal Reserve System began operations in 1914."[65] In other words, the overwhelming majority of Fed earnings are aggregated with Treasury's earnings as a matter of course, and it has been that way since 1914.

The bottom line is that the government committed so much money to AIG out of fear that global financial markets would otherwise collapse, and not to generate a positive net return. At one point, in fact, many thought the government would lose billions on the AIG bailout.[66] Thus, I view the final tally as a pleasant surprise.

III. Maiden Lane III Transactions

A. Overview

As discussed in *The AIG Bailout*, the principal culprit in the collapse of AIG was the collateral posting obligations with respect to CDSs AIGFP[67] wrote on multi-sector CDOs with subprime

---

ups, including special tax treatment for AIG) (on file with the Washington and Lee Law Review).

65. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 11 (2005), http://www.federalreserve.gov/pf/pdf/pf_complete.pdf.

66. *See* Associated Press, *AIG Likely Won't Be Able to Pay Taxpayers Back*, U.S. BUS. (Mar. 16, 2009, 8:06:39 PM), http://www.nbcnews.com/id/29728732/ns/business-us_business/t/aig-likely-wont-be-able-pay-taxpayers-back/#.VR19LvnF98E (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review); CONGRESSIONAL OVERSIGHT PANEL, JUNE OVERSIGHT PANEL REPORT, THE AIG RESCUE, ITS IMPACT ON MARKETS, AND THE GOVERNMENT'S EXIT STRATEGY 4 (Jun. 2010) [hereinafter JUNE OVERSIGHT PANEL REPORT], http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT56698/pdf/CPRT-111JPRT56698.pdf (stating, with respect to AIG, that "[e]ven at this late stage, it remains unclear whether taxpayers will ever be repaid in full" and that "[t]he Congressional Budget Office . . . currently estimates that taxpayers will lose $36 billion").

67. *See* Am. Int'l Grp., Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (10-K), at 3 (Feb. 28, 2008) (explaining that AIG operated its CDS business through its subsidiaries, AIG Financial Products Corp. and AIG Trading Group, Inc., and their respective subsidiaries, which are collectively known as AIGFP).

mortgage exposure (the Subprime CDSs).[68] Specifically, as the U.S. housing market deteriorated, AIG was required to post more and more collateral with the protection buyers of the Subprime CDSs.[69] These growing collateral posting obligations, combined with additional collateral calls triggered by AIG's credit rating downgrade, drained AIG of cash, pushed it to the brink of bankruptcy, and ultimately led to the bailout.[70] These collateral calls continued unabated following the initial bailout because the U.S. housing market continued to deteriorate. AIG was able to draw on the $85 billion Fed Credit Facility to meet these calls, but it became apparent that the facility would be inadequate.[71] Thus, to help alleviate the situation, AIG and NY Fed established the Multi-Sector CDO Purchase Facility, as mentioned above.[72]

The basic idea behind this facility was to eliminate the constant outflow of cash from the collateral posting obligations of the Subprime CDSs by striking deals with the counterparties to these contracts.[73] Specifically, Maiden Lane III agreed to (1) purchase from the counterparties the CDOs underlying the Subprime CDSs at fair market value, and (2) allow the counterparties to retain the collateral payments they had received from AIG pursuant to the CDSs.[74] As a result, these counterparties received effectively the par value of the CDOs, or 100 cents on the dollar, when the market value of the CDOs at the time was less than 50 cents on the dollar.[75] In exchange, the counterparties agreed to terminate the related Subprime CDSs which, among other things, would put an end to AIG's attendant

68. *See* Sjostrom, *supra* note 1, at 960 (describing the problems with multi-sector CDOs).

69. *See id.* (analyzing the impact of the defaults).

70. *See id.* at 990 (noting the causes of AIG's collapse).

71. *See* JUNE OVERSIGHT PANEL REPORT, *supra* note 66, at 68 (discussing the inadequacies of the Fed Credit Facility); OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, FACTORS AFFECTING EFFORTS TO LIMIT PAYMENTS TO AIG COUNTERPARTIES 12 (Nov. 17, 2009) [hereinafter SIGTARP REPORT], http://www.sigtarp.gov/Audit%20Reports/ Factors_Affecting _Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf (warning that more government support was needed).

72. *See* SIGTARP REPORT, *supra* note 71 and accompanying text.

73. *See id.* at 14.

74. *See id.* at 2.

75. *See* JUNE OVERSIGHT PANEL REPORT, *supra* note 66, at 74.

collateral posting obligations. Maiden Lane III closed on these transactions in November and December of 2008.[76] The below table lists the counterparties and the amounts received (in billions).[77]

AIG Counterparty	**Maiden Lane III Payment**	**Collateral Payments Posted** (as of 11/7/08)	**Total**	**Percent of Total**
Société Générale	$6.9	$9.6	$16.5	26.6%
Goldman Sachs	$5.6	$8.4	$14.0	22.5%
Merrill Lynch	$3.1	$3.1	$6.2	10.0%
Deutsche Bank	$2.8	$5.7	$8.5	13.7%
UBS	$2.5	$1.3	$3.8	6.1%
Calyon	$1.2	$3.1	$4.3	6.9%
Deutsche Zentral-Genonssenschaftsbank	$1.0	$0.8	$1.8	2.9%
Bank of Montreal	$0.9	$0.5	$1.4	2.3%
Wachovia	$0.8	$0.2	$1.0	1.6%
Barclays	$0.6	$0.9	$1.5	2.4%
Bank of America	$0.5	$0.3	$0.8	1.3%
The Royal Bank of Scotland	$0.5	$0.6	$1.1	1.8%
Dresdner Bank AG	$0.4	$0.0	$0.4	0.6%
Rabobank	$0.3	$0.3	$0.6	1.0%
Landesbank Baden-Wuerttemberg	$0.1	$0.0	$0.1	0.2%
HSBC Bank, USA	$0.0[78]	$0.2	$0.2	0.3%
Total	**$27.1**	**$35.0**	**$62.1**	

76. *See* Current Report, *supra* note 53.
77. *See* SIGTARP REPORT, *supra* note 71, at 20.
78. *See id.* (rounding down amount in SIGTARP Report to $0).

These Maiden Lane III transactions ended up being "perhaps the most controversial element" of the entire AIG bailout[79] for two reasons: (1) the counterparties were not required to take a "haircut," and (2) the NY Fed initially refused to disclose the counterparties' identities. The Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) investigated both of these issues.[80] I draw on the resulting report below (SIGTARP Report).[81]

B. No Haircuts

The term "haircut" in this context refers to the counterparties voluntarily taking less than 100 cents on the dollar in exchange for terminating their Subprime CDS contracts.[82] From a purely economic standpoint, it is easy to see why they would be reluctant to do so as demonstrated by the following hypothetical. Assume that the investment portfolio of X Bank includes a $10 million CDO with subprime exposure that it bought at par ($10 million) in 2005. To reduce the risk associated with this CDO, X Bank decides to buy a five-year CDS on this CDO in the notional amount of $10 million from AIGFP. X Bank timely makes all quarterly payments due AIGFP under the CDS contract. Because of the housing market collapse, X Bank's CDO plummets in value from $10 million to $4.5 million. X Bank, however, is not overly concerned about this $5.5 million decrease because the CDS protects it from losses. Either (1) the CDO issuer will be able to meet its payment obligations, which means X Bank will get 100 cents on the dollar plus interest on its investment, or (2) the CDO issuer will not be able to meet its payment obligations thereby triggering AIGFP's obligation to pay

79. Newman, *supra* note 10.

80. *See generally* Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765, § 12 (2008) (establishing SIGRARP, which provided that SIGTARP has the duty "to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets" under the Troubled Asset Relief Program (TARP)).

81. *See generally* SIGTARP REPORT, *supra* note 71.

82. *See id.* at 14 (stating that the NY Fed "could seek a reduction in the amount that counterparties would receive, otherwise known as concessions or a 'haircut'").

X Bank 100 cents on the dollar for the CDO underlying the CDS. On top of this, the government has essentially eliminated the counterparty credit risk to X Bank on the CDS by making it clear that it will not let AIG fail. Under either scenario, X Bank recovers its full $10 million investment. Thus, why would it agree to take a haircut as part of the Maiden Lane III deal when doing so would mean X Bank would recover less than $10 million?

With that said, agreeing to a *small* haircut does perhaps make economic sense for X Bank. Specifically, by terminating the CDS, X Bank would no longer have to make the quarterly CDS spread payments to AIGFP and would get a time value of money benefit from receiving the $10 million sooner than under scenarios (1) or (2). However, if the CDS was just one piece of a complicated transaction, as is often the case in this realm, and not the straightforward situation of the hypothetical, these savings could easily be swallowed up by costs incurred to restructure the transaction in light of the early termination of the CDS. Regardless, insisting on par strikes me as a sensible initial negotiating position for the counterparties.

NY Fed officials did contact by telephone the eight counterparties with the largest Subprime CDS positions (Société Générale, Goldman Sachs, Merrill Lynch, Deutsche Bank, UBS, Calyon, Barclays, and Bank of America) and asked them to agree to haircuts.[83] The NY Fed's main negotiating strategy apparently was to point out "the considerable direct and indirect benefits that the counterparties had derived from the Federal Reserve's support of AIG."[84] Not surprisingly in light of the above analysis, seven of the eight counterparties refused to agree to a haircut.[85] UBS, the eighth counterparty, agreed to a two percent concession on the condition that the other counterparties agreed to the same.[86] It seems the NY Fed then dropped the issue and, as a result, no counterparty took a haircut.[87]

---

83. SIGTARP REPORT, *supra* note 71, at 15.

84. *Id.*

85. *Id.*

86. *Id.*

87. *See id.* at 18 ("[I]t was decided that FRBNY would cease efforts to negotiate haircuts and pay the counterparties the market value of the CDOs.").

Consistent with my above hypothetical, according to the SIGTARP Report, counterparties gave the following reasons for refusing a haircut:

- They had collateral already posted by AIG to protect against the risk of AIG default. The combination of collateral in their possession plus the fair market value of the underlying CDOs also in their possession equaled the par value of the credit default swaps. Thus, from the counterparty's perspective, offering a concession would mean giving away value and voluntarily taking a loss, in contravention of their fiduciary duty to their shareholders.
- In addition to the collateral, they had a reasonable expectation that AIG would not default on any further obligations under the credit default swaps because the U.S. government had already demonstrated that it would not allow AIG to go bankrupt.
- They had already incurred costs to mitigate the risk of an AIG default on its obligations that would be exacerbated if they were paid less than par value.
- They were contractually entitled to the par value of the credit default swap contracts.[88]

The French banks (Société Générale and Calyon) made the additional argument, supported by French bank regulators, that under French law they could not legally agree to a haircut, absent an AIG bankruptcy.[89]

The NY Fed came under fire for not insisting on haircuts or at least pressing counterparties harder on the issue,[90] with the

88. *Id.* at 16.

89. *See id.* at 18 ("The Commission Bancaire spoke again with FRBNY and forcefully asserted that, under French law, absent an AIG bankruptcy, the banks could not voluntarily agree to less than par value for the underlying securities in exchange for terminating the swap contracts.").

90. *See, e.g.*, Michael Goodwin, *Follow the Money: Enough About the AIG Bonuses—Focus on the Banks' Billions*, N.Y. DAILY NEWS (Mar. 28, 2009), http://www.nydailynews.com/opinion/follow-money-aig-bonuses-focus-banks-billions-article-1.366610 (last visited Apr. 2, 2015) ("In a letter signed by 26 of his House colleagues, all Democrats, Maryland Rep. Elijah Cummings wrote: 'Was any attempt made to renegotiate and close out these contracts with 'haircuts'? If not,

House Committee on Oversight and Government Reform characterizing the NY Fed's efforts as "just 'going through the motions.'"[91] The NY Fed cited various reasons for not pressing the issue, the primary one being it had little negotiating leverage.[92] Specifically, a standard negotiating technique by a distressed company seeking concessions from its creditors is to play the bankruptcy card, i.e., if you do not agree to concessions we will go bankrupt and you will end up with a lot less money than we are offering now. As mentioned above, the NY Fed could not play the bankruptcy card because prior government actions had essentially removed it from the deck.[93] Further, the NY Fed was not comfortable suggesting otherwise out of concern that such a suggestion would "introduce doubt into the marketplace about the resolve of the U.S. government in following through on its commitments in support of financial stability" and perhaps negatively affect AIG's credit rating.[94]

With that said, the NY Fed could have used its status as regulator of several of the counterparties as negotiating leverage over them. It chose not to, however, for several reasons: "in the negotiations it was acting as a creditor of AIG and not as the counterparties' primary regulator," it was "uncomfortable with violating the principle of sanctity of contract," and it felt strongly about treating all counterparties equally.[95] On this last point, it

---

why not?'") (on file with the Washington and Lee Law Review); Jim Puzzanghera & Tom Hamburger, *Goldman Sachs Defends $13-Billion Payment from AIG*, L.A. TIMES (Mar. 21, 2009), http://articles.latimes.com /2009/mar/21/business/fi-aig-goldman21 (last visited Apr. 2, 2015) ("But some lawmakers and others contended that holders of the insurance should have been forced to take less than 100%—a haircut in Wall Street parlance—because they would have gotten much less if AIG had been allowed to slip into bankruptcy.") (on file with the Washington and Lee Law Review); Mary Williams Walsh, *Audit Faults New York Fed in A.I.G. Bailout*, N.Y. TIMES (Nov. 16, 2009), http://www.nytimes.com/2009/11/17/business/ 17aig.html?_r=0 (last visited Apr. 2, 2015) ("The report concluded that the Fed's efforts to negotiate concessions from A.I.G.'s trading partners had no chance of success because of several crucial positions taken by the Fed.") (on file with the Washington and Lee Law Review).

91. JUNE OVERSIGHT PANEL REPORT, *supra* note 66, at 148.

92. *See* SIGTARP REPORT, *supra* note 71, at 18.

93. *Id.*

94. *Id.*

95. *Id.* at 19.

could not exert regulatory pressure over counterparties not subject to its regulation, and therefore could not force concessions on all counterparties by this means.[96] As a result, its self-imposed equality limitation prevented it from forcing anyone to take a haircut, or at least, that is the story.[97]

The Treasury defended the NY Fed's "negotiating strategy" in a November 16, 2009 letter to SIGTARP after reviewing a draft of the SIGTARP Report. Specifically, the letter stated as follows:

> What must be remembered is that the decision by the government not to let AIG go bankrupt meant that AIG had to meet its contractual obligations. The government could not unilaterally impose haircuts on creditors, and it would not have been appropriate for the government to pressure counterparties to accept haircuts by threatening to retaliate in some way through its regulatory power.[98]

The explanation of the NY Fed and Treasury for not flexing any regulatory muscle is fair enough. As the SIGTARP Report points out, however, the "Treasury and the Federal Reserve were fully prepared to use their leverage as regulators to compel the nine largest financial institutions (including some of AIG's counterparties) to accept $125 billion of TARP funding and to pressure Bank of America to conclude its merger with Merrill Lynch."[99] There are certainly a number a factors that distinguish those situations from the Maiden Lane III situation, but given the NY Fed's emphasis on equal treatment, it should have articulated its reasons for what looks like different treatment of similar situations.

---

96. *See id.*

97. *See id.* ("Secretary Geithner further explained to Congress that '. . . because we have no legal mechanism in place for dealing with this, like we deal with banks, we did not have the ability to selectively impose losses on their counterparties.'").

98. SIGTARP REPORT, *supra* note 71, at 41–42.

99. *Id.* at 29; *see also* Mark Landler & Eric Dash, *Drama Behind a $250 Billion Banking Deal*, N.Y. TIMES (Oct. 14, 2008), http://www.nytimes.com/2008/10/15/business/economy/15bailout.html?pagewanted=all (last visited Apr. 2, 2015) (describing Treasury and Fed pressure put on banks to take deals) (on file with the Washington and Lee Law Review).

C. Delayed Disclosure

As a public company,[100] AIG is required by Securities and Exchange Commission (SEC) regulations to file with the SEC a "current report" generally within four business days after the occurrence of various events.[101] The reports are posted on the SEC's website within minutes of filing thereby becoming publicly available.[102] Among the events that trigger a filing is entry by the company "into a material definitive agreement not made in the ordinary course of business . . . ."[103] Such a filing must include the date of the agreement, the parties to the agreement, and "a brief description of the terms and conditions of the agreement . . . that are material to the [company]."[104] AIG filed an initial current report regarding the Maiden Lane III transactions on December 2, 2008. Here is what the report said:

> AIGFP, [Maiden Lane] III and the NY Fed have entered into agreements with AIGFP's CDS counterparties to terminate approximately $53.5 billion notional amount of CDS and purchase the related Multi-Sector CDOs. Of these, CDOs with a principal amount of approximately $46.1 billion settled on November 25, 2008 and a corresponding notional amount of CDS were terminated. Settlement on the remaining $7.4 billion notional amount of CDS is contingent upon the ability of the related counterparty to obtain the related Multi-Sector CDOs and thereby settle with [Maiden Lane] III and terminate . . . .[105]

---

100. In this Article, the term "public company" is used to denote a company with securities registered under the Securities Exchange Act of 1934.

101. *See* 15 U.S.C. § 78m(a)(1) (2012) (requiring security issuers to file "information and documents (and such copies thereof) as the Commission shall require to keep reasonably current" such information); 17 C.F.R. § 240.13a-11(a) (2014) (noting the requirement for registrants to "file a current report on Form 8–K within the period specified in that form"); SEC, Form 8-K, General Instructions, B(1) (providing the instructions for which events to report and when to report).

102. *See* Press Release, SEC, SEC Announces Free, Real-Time Public Access to EDGAR Database at www.sec.gov (May 30, 2002), http://www.sec.gov/news/press/2002-75.htm (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

103. SEC, Form 8-K, Information to be Included in the Report, § 1-1.01(a).

104. *Id.* § 1-1.01(a)(2).

105. Am. Int'l Grp., Current Report (Form 8-K), at 2 (Dec. 2, 2008).

Notice that there is no mention of the amount or price paid to the counterparties or their identities.

AIG filed another current report regarding the Maiden Lane III transactions on December 24, 2008 which stated as follows:

> On December 18, 2008 and December 22, 2008, [Maiden Lane] III purchased $16 billion in par amount of additional Multi-Sector CDOs, including approximately $8.5 billion of Multi-Sector CDOs underlying 2a-7 Puts written by AIGFP.
>
> The purchase of these Multi-Sector CDOs was funded with a net payment to counterparties of approximately $6.7 billion and the surrender by AIGFP of approximately $9.2 billion in collateral previously posted by AIGFP to CDS counterparties in respect of the terminated CDS.[106]

As you can see, AIG disclosed more information on the transactions, specifically the total par value of the CDOs purchased ($16 billion) and the amount paid ($6.7 billion plus $9.2 billion, or $15.9 billion), making it easy to deduce that the price paid was par, even though the disclosure does not explicitly state this. Once again, however, the identities of the counterparties were not disclosed.

In addition to a description of the material terms of an agreement, the filing of a current report for entry into a material definitive agreement must also include a copy of the actual agreement or agreements.[107] AIG filed a copy of a Master Investment and Credit Agreement and a Shortfall Agreement as part of its December 2, 2008 current report,[108] and Amendment No. 1 to the Shortfall Agreement as part of its December 24, 2008 current report.[109] The Shortfall Agreement and the Amendment

---

106. Am. Int'l Grp., Current Report (Form 8-K), at 1 (Dec. 24, 2008).

107. *See* 17 C.F.R. § 229.601(a)(1) (2014) (requiring exhibits to be "filed as indicated" by exhibit table); 17 C.F.R. § 229.601(b)(10) (2014) (defining material contracts required by exhibit table); SEC, Form 8-K, Information to be Included in the Report, § 9-9.01(d) (requiring exhibits).

108. *See Filing Detail, American International Group, Inc.*, U.S. SEC. AND EXCH. COMM'N (Dec. 2, 2008), https://www.sec.gov/Archives/edgar/data/5272/000095012308016800/0000950123-08-016800-index.htm (last visited Apr. 2, 2015) (listing master investment and credit agreement and shortfall as exhibits to form 8-K) (on file with the Washington and Lee Law Review).

109. *See Filing Detail, American International Group, Inc.*, U.S. SEC. AND EXCH. COMM'N (Dec. 24, 2008), https://www.sec.gov/Archives/edgar/data/5272/000095012308018339/0000950123-08-018339-index.htm (last visited Apr.

both apparently included a Schedule A that specified with respect to each counterparty its identity, the notional amount of Subprime CDSs it held, how much collateral the counterparty had received from AIGFP for such CDSs, and the difference between the notional value and the market value of the CDOs underlying such CDSs.[110] AIG, however, omitted Schedule A from the copies of these agreements it filed with the related current reports.[111]

The lack of disclosure regarding the Maiden Lane III transactions did not go unnoticed for long. On December 30, 2008, the SEC sent a letter to AIG noting the missing Schedule A and stating that when filing an agreement in connection with a current report "you are required to file the entire agreement, including all exhibits, schedules, appendices and any document which is incorporated in the agreement."[112] It thus directed AIG to amend its fillings.[113] AIG responded by filing an amended current report on January 14, 2009, that included another copy of the Shortfall Agreement, which contained Schedule A.[114] However, AIG deleted all information from the schedule, replacing it with the following: "The confidential portion of this Schedule A has been omitted and filed separately with the Securities and Exchange Commission. Confidential Treatment has been requested for the omitted portions."[115]

2, 2015) (listing amendment no. 1 to shortfall agreement as exhibit to Form 8-K) (on file with the Washington and Lee Law Review).

110. *See* Am. Int'l Grp., Current Report (Form 8-K), Exhibit 10.2, Shortfall Agreement, at 1 (Dec. 24, 2008); Am. Int'l Grp., Current Report (Form 8-K), Exhibit 10.1, Shortfall Agreement as Amended, at 1 (Dec. 24, 2008).

111. *See* sources cited *supra* note 110 (showing no Schedule A attached to the agreement or amendment).

112. Letter from Jeffrey P. Riedler, Assistant Director, SEC, to Edward M. Libby, Chairman and Chief Executive Officer, A.I.G., 1 (Dec. 30, 2008), https://www.sec.gov/Archives/edgar/data/5272/000000000008063970/filename 1.pdf.

113. *Id.* at 2. For more on confidential treatment requests, see *SEC Staff Legal Bulletin No. 1*, U.S. SEC. AND EXCH. COMM'N (July 11, 2001), http://www.sec.gov/interps/legal/slbcf1r.htm (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

114. Am. Int'l Grp., Current Report (Form 8-K/A), at 2 (Jan. 14, 2009).

115. Am. Int'l Grp., Current Report (Form 8-K/A), Exhibit 10.1, Schedule A (Jan. 14, 2009).

What AIG did here is not unusual; SEC regulations allow a company to omit portions from a filed document in connection with requesting confidential treatment from the SEC,[116] but omitting the information was not well received by the public. Hence, in a March 5, 2009 United States Senate Committee on Banking, Housing, and Urban Affairs hearing on AIG, Senator Dodd called for disclosure of the counterparties and amounts paid.[117] In response, Donald L. Kohn, Vice Chairman of the Fed, stated: "We need AIG to be stable and to continue in a stable condition, and I would be very concerned that if we started giving out the name of counterparties here, people wouldn't want to do business with AIG."[118] Vice Chairman Kohn further stated "that giving the names would undermine the stability of the company and could have serious knock-on effects to the rest of the financial markets and the government's efforts to stabilize them."[119]

The issue was widely picked up by the press following the hearing, intensifying pressure on AIG to disclose the information.[120] Thus, on March 15, 2009, AIG, "after close

---

116. *See* 17 C.F.R. § 240.24b-2 (2014) (describing the procedure to obtain confidential treatment).

117. *See American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation*, U.S. COMMITTEE ON BANKING, HOUSING, & URBAN AFFAIRS (Mar. 5, 2009), http://www.banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing_ID=1655fd01-154e-48de-9fd8-2832a68f04d6 (last visited Apr. 2, 2015) (providing majority statement and list of witnesses) (on file with the Washington and Lee Law Review); *American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. (2009), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-111shrg51303/html/CHRG-111shrg51303.htm (providing a copy of the transcript of the senate hearing).

118. *American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. (2009) (statement of Donald Kohn, Vice Chairman, Board of Governors of the Federal Reserve System).

119. *Id.*

120. *See, e.g.*, Colin Barr, *Fed Wants to Keep AIG Secrets*, FORTUNE (Mar. 5, 2009), http://archive.fortune.com/2009/03/05/news/fed.transparency.fortune/index.htm?postversion=2009030512 (last visited Apr. 2, 2015) (discussing negative responses of senators to AIG withholding information) (on file with the Washington and Lee Law Review); Sue Kirchhoff, *Lawmakers Press Fed for AIG Answers, Overall Price Tag*, USA TODAY (Mar. 6, 2009), http://abcnews.go.com/

consultation with the Federal Reserve," disclosed the names of the counterparties in a press release but not the amounts each counterparty received.[121] The next day AIG filed amended current reports that included the now infamous Schedule A to the Shortfall Agreement with the counterparty names and aggregate totals for notional value, collateral posted, and negative mark to market now included, with all other information largely redacted.[122] On August 15, 2009, AIG once again filed amended current reports with a new Schedule A to the Shortfall Agreement, still with substantial redactions, but disclosing how much collateral each counterparty received from AIGFP and the additional amounts Maiden Lane III paid each counterparty.[123]

To be sure, it was AIG and not the NY Fed or Treasury that was obligated under SEC regulations to disclose details regarding the Maiden Lane III transactions. It appears, however, that AIG was essentially not permitted to file the Maiden Lane III current reports until it incorporated NY Fed edits such as removing references to buying out counterparties at par.[124] Hence, it is fair

---

Business/story?id=7019341 (last visited Apr. 2, 2015) ("Lawmakers Thursday sharply criticized state and federal regulators for failing to prevent the meltdown of insurance giant American International Group AIG, and for what they termed the secretive handling of its multibillion-dollar government bailout.") (on file with the Washington and Lee Law Review); Mary Williams Walsh, *Senators Ask Who Got Money From A.I.G.*, N.Y. TIMES (Mar. 5, 2009), http://www.nytimes.com/2009/03/06/business/economy/06insure.html?_ r=0 (last visited Apr. 2, 2015) ("[A] Senate panel told the vice chairman of the Federal Reserve to identify all the parties made whole by the bailout of the American International Group or forget about coming back to ask Congress for more rescue money.") (on file with the Washington and Lee Law Review).

121. *AIG Discloses Counterparties to CDS, GIA and Securities Lending Transactions*, BUS. WIRE (Mar. 15, 2009), http://www.businesswire.com/news/home/20090315005036/en (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

122. *See* Am. Int'l Grp., Current Report (Form 8-K/A), Exhibit 10.1, Schedule A (Mar. 16, 2009); Am. Int'l Grp., Current Report (Form 8-K/A), Exhibit 10.1, Schedule A (Mar. 16, 2009).

123. *See* Am. Int'l Grp., Current Report (Form 8-K/A), Exhibit 10.1, Schedule A (May 15, 2009); Am. Int'l Grp., Current Report (Form 8-K/A), Exhibit 10.1, Schedule A (May 15, 2009).

124. *See* COMM. ON OVERSIGHT & GOV. REFORM, PUBLIC DISCLOSURE AS A LAST RESORT: HOW THE FEDERAL RESERVE FOUGHT TO COVER UP THE DETAILS OF THE AIG COUNTERPARTIES BAILOUT FROM THE AMERICAN PEOPLE, 111TH CONG., at 6–7 (Jan. 25, 2010) [hereinafter OVERSIGHT PANEL REPORT II] (describing chronologically the actions of the FRNBY to prevent AIG information from

to view the NY Fed as the final arbiter of the content and timing of AIG's Maiden Lane III transactions disclosure. In other words, it was the NY Fed and not AIG that was trying to keep various details private.

D. "Backdoor Bailout"

The combination of no haircuts for the counterparties and the obvious reluctance of the government to release various details about the Maiden Lane III transactions led to this facet of the AIG bailout being labeled as a "backdoor bailout" of the counterparties.[125] As the story goes, the NY Fed structured the Maiden Lane III transactions and tried to keep their details secret at least in part to surreptitiously funnel billions of dollars to Goldman Sachs, Merrill Lynch, and other large banks.[126] NY Fed officials denied this characterization, asserting that benefiting the counterparties was not a relevant consideration for these transactions.[127] As the SIGTARP Report points out, "[i]rrespective of their stated intent, however, there is no question that the *effect* of [the NY Fed's] decisions—indeed, the very *design* of the federal assistance to AIG—was that tens of billions of dollars of Government money was funneled inexorably and directly to AIG's counterparties."[128]

---

becoming public).

125. *See* Matthew Goldstein, *E-mails on AIG Bailout Detail Fed's Push for Secrecy*, L.A. TIMES (Jan. 25, 2010), http://articles.latimes.com/2010/jan/25/business/la-fi-aig25-2010jan25 (last visited Apr. 2, 2015) ("Lawmakers on Capitol Hill have labeled the AIG bailout . . . a 'backdoor bailout' for the 16 financial institutions) (on file with the Washington and Lee Law Review); *see also* OVERSIGHT PANEL REPORT II, *supra* note 124, at 16.

126. *See* Frank Rich, *The Other Plot to Wreck America*, N.Y. TIMES (Jan. 9, 2010), http://www.nytimes.com/2010/01/10/opinion/10rich.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review); *see also* OVERSIGHT PANEL REPORT II, *supra* note 124, at 2 (stating that Maiden Lane III facilitated "the backdoor bailout of AIG's counterparties, and the direct payment of $27.1 billion of taxpayer money (and the waiver of an additional $35 billion in collateral) to the largest banks in the U.S. and around the world").

127. *See* SIGTARP REPORT, *supra* note 71, at 30.

128. *Id.*

IV. Regulatory Response

As discussed in *The AIG Bailout*, CDSs fell into an intentional regulatory gap that AIG exploited to pursue a multi-billion dollar CDS business free from regulatory filings, mandated capital requirements, and government intervention.[129] As discussed in this Part, the gap has since been closed by the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank),[130] the principal federal regulatory response to the financial crisis. This Act was signed into law by President Obama on July 21, 2010.[131] Its stated purposes were "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[132] The Act consisted of fifteen titles addressing a variety of aspects of the financial crisis.[133]

A. Dodd–Frank Title VII

Dodd–Frank Title VII—Wall Street Transparency and Accountability is the most relevant title to what happened at AIG. Among other things, it provides for comprehensive regulation of credit default and other swaps.[134] Below I discuss how these regulations would have applied to AIG had they been in place at the time AIGFP started selling CDSs.

---

129. *See* Sjostrom, *supra* note 1, at 983–89 (discussing the CDS regulatory gap).

130. Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), Pub. L. No. 11-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 5301).

131. *See Bill Summary & Status*, LIBRARY OF CONGRESS, http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR04173:@@@S (last visited Apr. 2, 2015) (noting at the second-to-last entry that it was signed by the President on July 21, 2010) (on file with the Washington and Lee Law Review).

132. Dodd–Frank, 124 Stat. at 1376.

133. Dodd–Frank § 1(b).

134. *See* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release Nos. 33-9338, 34-67453, 77 Fed. Reg. 48,208 (proposed Aug. 13, 2012) [hereinafter Further Definition Release].

The regulatory scheme is complicated, with different regulations applying depending on the type of swap involved.[135] The two broad categories of swaps are security-based swaps (SBS), which are generally regulated by the SEC, and non-security based swaps, which are generally regulated by the Commodity Futures Trading Commission (CFTC).[136] Somewhat confusingly, the regulations refer to non-security based swaps simply as "swaps." To avoid confusion, I refer to them here as "NSBS."

A CDS can fall under either category depending on what it references, or is based on.[137] SBSs are generally swaps based on securities or loans. Included in this category are the following:

- swaps based on "a single security or loan, including any interest therein or on the value thereof";[138]
- swaps based on "an index that is a narrow-based security index,[139] including any interest therein or on the value thereof";[140] and
- swaps based on the occurrence or nonoccurrence of an event relating to the issuer of a security that "directly affects the financial statements, financial condition, or financial obligations of the issuer."[141]

A CDS that falls outside of the definition of SBS generally falls under the definition of NSBS.[142]

---

135. *See id.* at 48,210 ("[T]he CFTC is given regulatory authority over swaps, the SEC is given regulatory authority over security-based swaps, and the Commissions shall jointly prescribe such regulations regarding mixed swaps as may be necessary to carry out the purposes of Title VII.").

136. *Id.*

137. *See id.* at 48,249 (noting that a CDS "may be a swap or a security-based swap").

138. 15 U.S.C. § 78c(a)(68)(A)(ii)(II) (2012).

139. *See id.* § 78c(a)(55)(B) (stating that a narrow-based security index is generally defined as an index comprised of nine or fewer component securities and meeting specified weighting criteria).

140. *Id.* § 78c(a)(68)(A)(ii)(I).

141. *Id.* § 78c(a)(68)(A)(ii)(III). "[S]uch events could include, for example, the bankruptcy of an issuer, a default on one of an issuer's debt securities, or the default on a non-security loan of an issuer." Further Definition Release, *supra* note 134, at 48,267.

142. *See* 7 U.S.C. §§ 1a(47)(A)–(B) (specifying that a CDS is a swap but excluding from the definition of swap a SBS, other than a mixed swap).

As described in *The AIG Bailout*, the bulk of AIGFP's $527 billion net-notional amount CDS portfolio was comprised of protection it wrote on what it referred to as the "super senior" tranche of various types of asset-backed securities.[143] In this context, a tranche refers to one of multiple series, or types, of debt securities issued by an SPV.[144] In other words, a CDS on a tranche is a swap based on a "single security" and therefore an SBS. Thus, for this Part, I assume that all CDSs written by AIGFP were SBSs, and therefore subject to SEC and not CFTC regulation.[145]

A primary purpose of the SEC SBS rules is to regulate the significant players in the SBS market—so called "security-based swap dealers" and "major security-based swap participants."[146] AIGFP would have fallen under the definition of a security-based swap dealer (SBSD). Specifically, an SBSD is a person[147] that (1) holds itself out as a dealer in SBSs, (2) makes a market in SBSs, (3) regularly enters into SBSs "with counterparties as an ordinary course of business for its own account," or (4) "engages in activity causing itself to be commonly known in the trade as a dealer or market maker" in SBSs,[148] unless, among other things, the person never engaged in $8 billion or more in notional amount of SBS CDS transactions over any particular twelve-

143. *See* Sjostrom, *supra* note 1, at 955 (discussing in detail AIG's super senior tranche).

144. *See id.* at 953.

145. My sentence on the size and composition of AIGFP's CDS portfolio is based on statements in AIG's 2007 annual report. It is not clear from this document if all of the CDSs written by AIGFP are in fact based on a single security. Had the swap categories existed in 2007, presumably AIG's 2007 annual report would have stated which of the two categories (SBS or NSBS) its CDSs fell into or would have structured all of them to fall only in the SBS category to avoid being subject to regulation by both the SEC and CFTC.

146. Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd–Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 34-67177, 77 Fed. Reg. 35,625, 35,626 (proposed June 14, 2012) [hereinafter Sequencing Release].

147. The Exchange Act defines the term "person" as "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78c(a)(9) (2012).

148. *Id.* § 78c(a)(71)(A).

month period.[149] At a minimum, AIGFP would have fallen under category three because "AIGFP, in the ordinary course of operations and as principal, structure[d] and enter[ed] into derivative transactions to meet the needs of counterparties."[150] and wrote more than $8 billion in notional amount of SBS CDSs in multiple twelve-month periods.[151]

The SEC is still in the process of finalizing regulations mandated by Dodd–Frank for SBSDs. These regulations will include the following:

- Required registration with, and reporting to, the SEC;[152]
- SBS data reporting and recordkeeping requirements;[153]
- External business conduct rules;[154]
- Capital and margin requirements;[155]
- Governance and risk-management requirements;[156] and
- SBS clearing and exchange trading requirements.[157]

This package of rules is similar to what was on the table when I wrote *The AIG Bailout*.[158] As I said there, had these sorts of regulations been in place, especially capital, margin, clearing, and exchange trading requirements, it is likely that AIG would not have been able to build such a large and uncollateralized CDS position and, therefore, perhaps would not have collapsed. It is impossible to know definitively, especially because the devil is in

---

149. *Id.* § 78(c)(a)(71)(D) ("The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers."); 17 C.F.R. § 240.3a71-2(a)(1) (2014). Note that the $8 billion notional value threshold will be lowered to $3 billion five years after certain data begins to be collected unless the SEC decides to either raise or lower sooner. 17 C.F.R. § 240.3a71-2(a)(2)(ii)(B).

150. Am. Int'l Grp., Annual Report (Form 10-K), at 162 (Feb. 28, 2008).

151. *See* JUNE OVERSIGHT PANEL REPORT, *supra* note 66, at 24 fig.9.

152. Dodd–Frank § 764(a); 15 U.S.C. § 78o-10(a) (2012).

153. Dodd–Frank § 766.

154. 15 U.S.C. § 78o-10(h).

155. *Id.* § 78o-10(e).

156. *Id.* § 78o-10(j).

157. *Id.* § 78c-3.

158. *See* Sjostrom, *supra* note 1, at 989.

the details and the details remain to be determined. The SEC has proposed, but not finalized, registration rules,[159] trade reporting rules,[160] business conduct rules,[161] capital and margin requirements,[162] and recordkeeping rules.[163]

It may seem surprising that these rules are not in place given that Dodd–Frank was signed into law over four years ago. Remember, however, that the SBS market was barely regulated prior to Dodd–Frank. In other words, the SEC has been tasked with creating a complicated regulatory framework out of whole cloth for a huge[164] and complex but historically opaque market.[165] As a result, the SEC wants to give market players

---

159. *See* Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 34-65543, 76 Fed. Reg. 65,784 (proposed Oct. 24, 2011) (proposing a rule "to provide for the registration of SBS Entities").

160. *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 34-63346, 75 Fed. Reg. 75208 (proposed Dec. 2, 2010) (proposing a rule to "provide for the reporting of security-based swap information to registered security-based swap data repositories or the Commission and the public dissemination of security-based swap transaction, volume, and pricing information").

161. *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 34-64766, 76 Fed. Reg. 42,396 (proposed July 18, 2011) (proposing a rule "relating to external business conduct standards").

162. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 34-68071, 77 Fed. Reg. 70,214 (proposed Nov. 23, 2012) (proposing capital and margin, segregation, and notification requirements).

163. *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 34-71958, 79 Fed. Reg. 25,194 (proposed May 2, 2014) (proposing a rule for "recordkeeping, reporting, and notification requirements").

164. For example, as of December 2013, there was $11.324 trillion in notional amount of single-name credit default swaps outstanding. Bank for Int'l Settlements, *Amounts Outstanding of Over-the-Counter (OTC) Derivatives*, BIS Q. Rev. (Dec. 2014), http://www.bis.org/statistics/dt1920a.pdf. Single-name CDSs generally fall under the definition of SBS. *See* Further Definition Release, *supra* note 134, at 48,266 ("[A] single-name CDS that is based on a single reference obligation would be a security based swap because it would be based on a single security or loan . . . .").

165. *See* Kristin N. Johnson, *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 U. COLO. L. REV. 167, 191 (2011) (noting limited recording requirements for CDS transactions prior to Dodd–Frank).

> adequate, but not excessive, time to come into compliance with the final rules applicable to them, which includes (a) having an appropriate amount of time to analyze and understand the final rules to be adopted pursuant to Title VII, (b) having an appropriate amount of time to develop and test new systems required as a result of the new regulatory requirements for [SBSs], and (c) being subject to a phasing in of the requirements arising from the final rules to be adopted pursuant to Title VII, as appropriate.[166]

B. Dodd–Frank Title I

Title I—Financial Stability also presumably would have come into play had it been in place pre-AIG bailout. Specifically, Subtitle A established the Financial Stability Oversight Council (FSOC),[167] "a collaborative body chaired by the Secretary of the Treasury that brings together the expertise of the federal financial regulators, an independent insurance expert appointed by the President, and state regulators."[168] Among other things, FSOC can designate "nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure" as systemically important financial institutions (SIFIs).[169] Such a designation triggers Fed supervision and enhanced prudential standards for the company.[170]

The FSOC designated AIG a SIFI on July 8, 2013.[171] Its reasoning was as follows:

---

166. Sequencing Release, *supra* note 146, at 35,630.

167. Dodd–Frank § 111.

168. *Financial Stability Oversight Council, Frequently Asked Questions: What Is the Financial Stability Oversight Council (FSOC) and What Does It Do?*, U.S. DEPT. OF THE TREASURY, http://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

169. Dodd–Frank § 112(a)(2)(H).

170. *See id.*

171. Financial Stability Oversight Committee, Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. at 1 (July 8, 2013), http://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf.

> Because of AIG's size and interconnectedness, certain characteristics of its liabilities and products, the potential effects of a rapid liquidation of its assets, [and] potential challenges with resolvability . . . material financial distress at AIG could cause an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy.[172]

As described by the FSOC:

> A final determination by the Council under section 113 of the Dodd-Frank Act . . . allow[s] the Board of Governors to apply a number of new requirements to AIG. These include the enhanced prudential standards required by sections 165 and 166 of the Dodd-Frank Act, which, among other things, . . . require the company to: (1) meet enhanced liquidity and capital standards; (2) undergo and report periodic stress tests; (3) adopt enhanced risk-management processes; (4) submit a resolution plan providing for its rapid and orderly resolution in the event of its material financial distress or failure; and (5) provide for the early remediation of financial distress at the company on a consolidated basis. The enhanced prudential standards required by section 165 of the Dodd-Frank Act are in addition to the authority that the Board of Governors now has to supervise and regulate [AIG] . . . for the purpose of "prevent[ing] or mitigat[ing] risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions." In addition, the Board of Governors [now has] additional authorities with respect to the review of any proposals by AIG to expand its size or scope.[173]

V. Conclusion

With the government's exit from AIG, we can now close the books on the AIG bailout. Certainly, one could view the bailout as a success given the financial markets did not collapse and the government actually made money. However, because it is not possible to know what would have happened if AIG had been allowed to fail, whether bailing out AIG was the right call will always be subject to debate.

---

172. *Id.* at 2.
173. *Id.* at 9–10.

A prominent part of the AIG bailout legacy is the ensuing regulation it spawned. Hopefully, regulators learned lessons from episodes—such as the handling of the Maiden Lane III transactions—that they can draw on in future financial crises, especially given the regulatory expansion resulting from the Dodd–Frank Act.