Congressional Oversight Panel Hearing on TARP
and Other Assistance to AIG

Testimony of Jim Millstein

May 26, 2010

STATEMENT OF JIM MILLSTEIN, CHIEF RESTRUCTURING OFFICER, U.S. DEPARTMENT OF THE TREASURY

Mr. MILLSTEIN. Chair Warren, members of the panel, thank you for the opportunity to testify today. Since joining the Treasury Department in May of 2006, I have been—2009, sorry. I have been—it feels like four years. I have been primarily responsible for overseeing the taxpayers' significant investment in American International Group.

As you know, prior to joining the Treasury Department I spent 28 years working in the private sector focused exclusively on financial restructurings.

I will use my time today briefly to outline our current investments and commitments to AIG, the company's restructuring plan, and the Government's exit strategy.

As of today, the Federal Reserve Bank of New York and the Treasury Department have extended $132 billion of financial support to AIG. The New York Fed has provided $83 billion of this support, $26 billion of which represents loans outstanding to the parent company.

$25 billion of which represents the preferred interest in AIG's two largest international life insurance subsidiaries, AIA and ALICO, and $31 billion of which represent loans to two special purpose vehicles formed to acquire troubled assets from AIG in November of 2008.

The Treasury has provided $49 billion in the form of Series E and F Preferred stock. In addition, the AIG Credit Facility Trust established for the benefit of the taxpayers in connection with the original funding of the New York Federal Reserve Credit Facility, holds AIG's Series C Preferred stock which represents approximately 80 percent of AIG's outstanding common stock on a fully diluted basis.

This substantial financial commitment has enabled AIG to remain a going concern with an investment grade rating. However, without government support, because of its leverage and the risks associated with its financial products business, it would not have an investment grade rating, a rating that is critical to the competitiveness of its insurance subsidiaries.

Therefore, the objective of the company's restructuring plan is to restructure its balance sheet and business profile so that it can sustain an investment grade rating on its own. Thereby, permitting the government to exit its support and to monetize its investments.

The restructuring plan has six essential components. First, the company will have to substantially reduce its debt through asset sales and divestitures. Next, the Company will have to demonstrate independent access to the capital markets and secure standby lines of credit.

Third, the wind down of AIGFP will have to be substantially completed. Fourth, AIG will need to divest any businesses whose potential cash needs or credit rating represent a potential drag on the parent company rating.

Fifth, the company will have to demonstrate that its core insurance subsidiaries are profitable, well capitalized, and have repaired the damage to their franchises that the uncertainty associated with rescue has generated. Finally, the company will have to demonstrate that it has improved its risk management procedures and practices.

Today as you've heard, AIG has made significant progress on each critical front. The pending AIA and ALICO divestitures will result in a substantial deleveraging of AIG's balance sheet and will facilitate its access to third party capital.

AIG's leasing and finance businesses have accessed the long term debt markets again, allowing them to refinance their maturing debt and meet their own liquidity needs without recourse to the parent. The wind down of FP has made significant progress and is targeted to be completed substantially by year end.

Financial results have stabilized and begun to improve at Chartis and SunAmerica Financial, the core businesses of AIG's future. And finally, its risk management practices have improved.

At the conclusion of this process, once it can sustain an investment grade rating without government support the government will exit as promptly as practicable. Whether we get all of our money back remains an open question. Let me briefly review where we stand today.

If the AIA and ALICO divestitures close as planned, proceeds of those sales and the sale of other non-core assets should be sufficient to repay the New York Fed facility and redeem the preferred interest it holds in AIA and ALICO in full with all interest and dividends.

Cash flows from the assets in Maiden Lane 2 and 3 and recent valuations of those assets suggest that the New York Fed loans to Maiden Lane II and III will also be paid in full with interest. And that the equity they own in each of those facilities is likely to have a real value.

As a result, it seems very likely that the $83 billion dollars of outstanding Fed support will be paid in full. Similarly, at current market prices, the common stock that the Series C represents has value. Market conditions may change before the trustees have the opportunity to sell that stock, and the very selling of that stock, given how much they have, will put significant downward selling pressure on the price of AIG's common stock. But the stock market today suggests there's real value there.

Finally, that leaves the Treasuries Series E and F Preferred, the $49 billion. The timing of our ability to monetize those investment in AIG will depend on the pace at which the other steps of the restructuring plan are accomplished.

Whether Treasury ultimately recovers all of its investment or makes a profit, will in large part depend on the company's operating performance and market multiples for insurance companies at the time the government sells its interests.

Chair WARREN. Mr. Millstein, we're at five minutes.

Mr. MILLSTEIN. I'm done.

Chair WARREN. Do you want to just give me another sentence?

Mr. MILLSTEIN. One more sentence.

Chair WARREN. You got it.

Mr. MILLSTEIN. But as soon as we are confident that AIG can stand alone, we will move to exit these investments as promptly as practicable. Now I'm ready for your questions.

Chair WARREN. There we go. I like that, "promptly as practicable."

[The prepared statement from Mr. Millstein follows.]

Written Testimony of Jim Millstein

Chief Restructuring Officer

U.S. Department of the Treasury

before the Congressional Oversight Panel

May 26, 2010

Good morning.

Chair Warren, and members of the Congressional Oversight Panel, thank you for the opportunity to testify today. Since joining the Treasury Department (the "Treasury") in May of 2009, I have been primarily responsible for overseeing the taxpayers' significant investment in American International Group ("AIG" or the "Company"). Prior to joining the Treasury, I spent 28 years working in the private sector focused on financial restructurings.

I am here today in response to the Panel's request for an explanation of the terms of the government's investments in AIG, the evolution of those investments and the strategy for the government's exit. The Treasury is very much a reluctant shareholder, and while we leave the day-to-day management of the Company to the CEO and the Board of Directors, we actively monitor progress on the restructuring front. Our primary goals are to protect the taxpayers' investment in AIG, promote financial stability, and expedite the government's exit.

As of today, the Federal Reserve Bank of New York (the "FRBNY") and the Treasury Department have extended $132.3 billion of financial support to AIG in a variety of forms.[1]

The FRBNY has provided $83.2 billion of this support. This support is in three different forms. First, there $26.3 billion outstanding on the FRBNY loan (the "FRBNY Facility") that was first extended to AIG in September of 2008.[2] Second, the FRBNY holds $25.4 billion of preferred interests in two investment vehicles which hold, respectively, AIG's two largest international life insurance companies, AIA and ALICO (the "AIA and ALICO Preferred Interests").[3] Third, there is $31.5 billion outstanding on loans that the FRBNY made to two other investment vehicles, Maiden Lane 2 and Maiden Lane 3, which purchased certain troubled financial assets from AIG.

The Treasury has provided $49.1 billion of the total support. $41.6 billion of this support is in the form of Series E Preferred and $7.5 billion is in the form of Series F Preferred. The proceeds of the Treasury's preferred stock investments were used to reduce the Company's debt burden, to help buttress the regulatory capital of certain insurance subsidiaries, and to untangle the web of cross-ownership and intercompany funding arrangements between and among AIG and its various subsidiaries.

Finally, the AIG Credit Facility Trust (the "Series C Trust"), established for the benefit of the taxpayers in connection with the original funding of the FRBNY Facility, holds AIG's Series C Preferred, which is convertible into approximately 79.8% of AIG's common stock. The Series C Trust is governed by three independent trustees who act as fiduciaries on behalf of taxpayers.

The purpose of my testimony today is to explain how the taxpayer came to own this varied portfolio of AIG interests and the plan to extract the government from these positions, as soon as practicable.

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[1] This represents the existing outstanding amounts. Currently, there is approximately $12 billion of undrawn capacity under the FRBNY Facility, and approximately $22 billion of undrawn capacity under the Treasury Series F Preferred commitment.

[2] Amount includes accrued fees and interest.

[3] The AIA and ALICO Preferred Interests were taken in transactions that closed on December 1, 2009 in satisfaction of a portion of the debt then outstanding under the FRBNY Facility.

AIG's rescue in September 2008 sought to avoid the catastrophic consequences to our economy and to American families and businesses that would have resulted from its sudden collapse. As a result of necessary government intervention, the taxpayer became a substantial equity holder in AIG, and taxpayers' ultimate recovery on their investment in AIG depends on the strength of the Company's underlying insurance subsidiaries. Today, AIG is a "going concern" [4] with an "A-"[5] investment grade rating only because of government support. Therefore, the objective of the restructuring plan is to restructure AIG's balance sheet and business profile so that it can maintain this status on its own, thereby permitting the government to monetize the taxpayers' investment.

As a substantial equity holder in AIG, the taxpayers' ultimate recovery on its equity interests in AIG depends on the ability of AIG's management to improve the results of its core insurance businesses. Together with the trustees of the Series C Trust, the government has worked with the Company to recruit an almost entirely new Board of Directors,[6] a new CEO, a new Chief Risk Officer, a new General Counsel and a new Chief Administrative Officer. All of these executives and directors are committed to the objective of protecting the taxpayers' investment in the Company and paying back the taxpayers as promptly as practicable.

The mechanics of the restructuring plan itself are relatively straightforward in concept: sell sufficient assets at fair prices to pay off AIG's obligations to the FRBNY, streamline AIG's business portfolio, and recapitalize AIG's balance sheet to support investment grade status without the need for ongoing government support. At that point, the Company will be a simplified life, property and casualty insurer with solidly capitalized insurance subsidiaries, adequate liquidity, and a stable balance sheet. Executing this plan will enable the government to sell its equity interests in the Company as soon as market conditions permit.

The Structure of USG Assistance

On September 16, 2008 the government committed to provide unprecedented assistance to AIG. In the absence of such assistance, AIG would have then defaulted on more than $2 trillion notional of derivative obligations and on over $100 billion of debt to institutions. Those defaults would have inevitably forced AIG to commence Chapter 11 proceedings for itself, its Financial Products subsidiary (AIGFP), its aircraft leasing subsidiary, and its consumer finance subsidiary.

The initial decision to loan money to AIG fell to the Federal Reserve because, at that time, no one else could act in the same manner as the Federal Reserve. The Emergency Economic Stabilization Act (EESA) was not authorized by Congress until October 2008, and none of the agencies with supervisory authority over AIG had any tools to help directly meet the funding requirements of AIG. No one in the federal government had a mechanism, as we do for banks, to provide for the orderly unwinding, dismantling, selling, or liquidating of a global, non-bank financial institution like AIG.

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[4] In accounting terminology "going concern" refers to a company's ability to continue functioning as a business entity.
[5] Throughout this testimony Standard & Poor's ratings are used as a proxy for all agencies that rate the Company's debt.
[6] The Series C Trust has elected 11 of the 13 existing board members. The two remaining directors were nominated and elected by the Treasury pursuant to rights under the documents that govern the Treasury's Series E and Series F Preferred shares.

Many observers, with the benefit of hindsight, have concluded that AIG could have been handled differently. Some have suggested that AIG should have simply been allowed to file for bankruptcy and let the losses fall where they may so as to diminish "moral hazard." Others have suggested that AIG could have negotiated a prepackaged plan of reorganization with its creditors and fixed itself without government support. Finally, there has been the suggestion that the government should have structured its rescue financing so as to protect the valuable insurance franchises without protecting the creditors who enabled and underwrote the growth in AIG's leverage.

My colleagues at the Treasury and the FRBNY have devoted thousands of hours over the past year and a half to try to maintain the Company's stability in extremely volatile markets while also de-risking and deleveraging the Company so as to protect the taxpayers' substantial investments. I am convinced today—with the benefit of hindsight and significant experience with AIG, the Treasury, and the FRBNY—that the support provided to the Company in the fall of 2008 was the only responsible and viable option on the table. I will explain why as I address certain suggested alternatives and illustrate the challenges that we still face as we attempt to exit the taxpayers' extraordinary investments in AIG.

Many observers have argued that AIG simply should have been left alone to fail and file for bankruptcy. By virtue of both the size of its balance sheet and the nature of its liabilities, an AIG bankruptcy in September of 2008 would have been catastrophic to global financial and insurance markets.

AIG was one of the largest life insurers in the United States. An uncoordinated bankruptcy filing and the consequent seizure of AIG's insurance subsidiaries could have had devastating "run" effects.[7] In rehabilitation or wind down proceedings for AIG's subsidiaries, AIG's policyholders' access to the cash and the surrender values of their life and annuity policies would have been restricted as regulators sorted out the adequacy of capital and reserves to pay all claims in full. As those restrictions became widely known, other life and annuity providers could have experienced a sharp increase in surrenders and redemptions, forcing those firms to meet the run against them with asset sales of their own. That, of course, would have put even further pressure on markets.

AIG's failure directly threatened the savings of millions of Americans. AIG had provided financial protection to municipalities, pension funds, and other public and private entities through guaranteed investment contracts and products that protect participants in 401(k) retirement plans. Doubts about the value of AIG life insurance products could have generated doubts about similar products provided by other life insurance companies, and opened an entirely new channel of contagion.

Upon the filing of a bankruptcy petition by AIG, holders of hundreds of billions of dollars of financial assets "insured" by AIGFP would have been entitled to: (i) immediately terminate their

[7] Total weekly surrenders in AIG's Retirement Services division spiked to almost $800 million per week in the fall of 2008, before returning to a normalized level of $200 million per week after the November 2008 TARP investment.

insurance contracts with AIG,[8] (ii) apply the collateral AIG had previously posted with them to their termination claims against AIG, and (iii) offset remaining contractual claims they had against AIG against any other obligation they might owe AIG on any other qualified financial contract.

The market consequences of this rapid unwinding of AIG's credit insurance would have been severe. Having lost the benefit of AIG's insurance or "wrap" on hundreds of billions of dollars of credit instruments, AIG's counterparties would have sought to replace the insurance if it were available, or (because such insurance was largely unavailable in September of 2008) to sell the underlying credit instruments so as to mitigate future losses. The widespread sale of hundreds of billions of dollars of a concentrated class of financial assets would have created significant incremental downward selling pressure on financial assets, amplifying the selling panic that had already started following the Lehman bankruptcy. Of equal concern, the default by AIG and AIGFP on more than $100 billion of institutional indebtedness, including $15 billion of commercial paper and $85 billion of short-term repurchase obligations,[9] would have exacerbated the stresses in the money market and repo markets driven by Lehman's bankruptcy.

At that time, with the world economy under severe stress, the failure of a large, global, highly-rated financial institution that had written hundreds of billion dollars of insurance on a range of financial instruments would have dramatically amplified the crisis. Investors around the world would have pulled back from funding, out of fear that other financial institutions would fail as well. Investors would have completely lost confidence in their ability to evaluate the financial sector and distinguish between firms that were viable and those that were not. Financial firms would have been forced into even more dramatic selling of assets.

This damage would have rapidly spread beyond Wall Street. Borrowing costs for businesses would have increased dramatically, the value of pension funds would have fallen even more sharply, and job losses would have skyrocketed. While the decision to save AIG was not an easy one, it was a better choice for the American people than letting it fail.

Some have suggested that the choice between rescue and bankruptcy is a false one and that the government could have helped to arrange a prepackaged bankruptcy. As a way to shorten the Chapter 11 restructuring process, prepackaged plans only have a chance of success if there is sufficient time, before a company defaults, to organize creditors into a negotiating committee, and to negotiate and agree on a comprehensive restructuring plan which can be implemented in an expedited proceeding before the bankruptcy court.

At the end of 2008, in my private sector role as a financial advisor to companies experiencing financial distress, I negotiated just such a prepackaged plan of reorganization for Charter Communications, using the urgency of the financial crisis and Charter's imminent default to accelerate a normally cumbersome, time consuming process. However, even on that accelerated basis, it still took three months to negotiate and agree on the restructuring plan and another six

[8] Under the qualified financial contract exceptions to the automatic stay provisions of the Bankruptcy Code otherwise applicable to creditors in a Chapter 11 proceeding.
[9] Includes securities lending obligations.

months to implement it through the courts (and Charter was only a fraction of the size and complexity of AIG).

In the second week of September 2008, barely a week before AIG would have defaulted on hundreds of billions of dollars of obligations, the FRBNY, having had no previous regulatory or supervisory authority over AIG or AIGFP, simply had no time to organize AIG's thousands of creditors into an effective negotiating committee, let alone negotiate a plan of reorganization with them and implement it.

In addition, the impracticality of a prepackaged plan process for AIG was not merely about timing. Rather, there was a more fundamental problem. AIG's revenues and funding depend on its customers' and lenders' perception of its long-term viability. Unlike a manufacturing company, or a retailer, or a cable company like Charter, the stability of a financial institution like AIG depends entirely on its customers' and counterparties' confidence that it will be "good for the money." A manufacturer or a retailer or a cable company can continue to sell its products through the restructuring of its balance sheet so long as it has cars, clothes or a cable signal to sell. A financial institution like AIG cannot.

A balance sheet restructuring involving the compromise of its debt obligations, whether in or out of formal bankruptcy proceedings, is fundamentally inconsistent with the basic commitment that an insurance company gives to its customers: that it has the financial wherewithal to honor a long-term payment obligation. To seek to compromise indebtedness or to compromise counterparties' credit insurance claims is fundamentally inconsistent with what an insurance company is trying to sell to its customers – its ability to pay valid claims in full as they come due.

For illustrative purposes, assume that:

i. There existed a regulatory regime in which someone had robust supervisory authority over AIG,
ii. That regulator was vigilant and ready to prompt the Company to take actions to improve its capital position well ahead of its potential ratings downgrade,
iii. AIG's thousands of creditors could have been organized into an effective negotiating committee well in advance of its possible default, and
iv. AIG's insurance regulators in the United States and in the 130 countries in which its insurance subsidiaries operate could have been convinced to forebear from ring-fencing the subsidiaries' assets or from pushing them into protective rehabilitation proceedings while AIG negotiated with its creditors.

Even assuming all four of these held true, the highly public negotiations among creditors and regulatory uncertainties would have completely undermined the viability of AIG's insurance businesses. This is because, at the first hint of financial distress (such as any public announcement that the Company had commenced negotiations with its creditors over the potential restructuring of their debt), AIG's ability to sell new insurance policies would have evaporated. Equally, redemptions of old policies would have accelerated. Together, the loss of new sales and the increase in redemptions would have quickly created a huge drain on the insurance subsidiaries' liquidity. Similarly, short-term creditors, such as AIG's securities lending counterparties, would have refused to roll over their loans, demanding immediate payment to avoid being caught up in AIG's prepackaged plan negotiations. That "run" on AIG and its subsidiaries' liquidity would have been a regulatory trigger, forcing the hands of regulators to protect all policyholders by ring-fencing the insurers' assets or, in the extreme case, forcing the insurer into wind down proceedings.

The rating agencies would also have complicated, if not completely undermined, the possible success or utility of a prepackaged plan. Upon the announcement of a prepackaged plan, under the rating agencies' "distressed exchange" guidelines, AIG at the very least would have immediately been put on "watch negative" and, at the commencement of any plan that sought to reduce AIG's debt burden by paying AIG's creditors less than what they were owed, the rating agencies would have immediately downgraded AIG below investment grade. Further downgrades would have triggered additional collateral calls at AIGFP, putting AIG's liquidity under stress. The policyholder run on AIG's insurance subsidiaries and the counterparty run on AIGFP would have started in earnest before the prepackaged plan could be put to vote.

In my opinion, there were only two practical choices in September of 2008: (i) allow AIG to fail and put the entire financial system at risk of collapse, or (ii) fund AIG to avoid the severe financial maelstrom that would otherwise have ensued had it filed for bankruptcy.

Some have suggested that the rescue should have been structured so as to protect the valuable insurance franchises without protecting the creditors who enabled and underwrote the growth in AIG's leverage. In September 2008, there was no TARP authority nor was there any other federal government mechanism to provide for the orderly dismantling of a large, systemic, non-bank financial institution like AIG. This made it impossible to decouple the ratings of the insurance subsidiaries from the AIG parent company, and therefore impossible to extract concessions from the parent company's creditors without impairing the operating abilities of the insurance subsidiaries.

This situation could have been avoided if certain of the elements of financial reform advancing in Congress had been in place then. Despite regulators in 20 different states being responsible for the primary regulation and supervision of AIG's U.S. insurance subsidiaries, despite AIG's foreign insurance activities being regulated by more than 130 foreign governments, and despite AIG's holding company being subject to supervision by the Office of Thrift Supervision, no one was adequately aware of what was really going on at AIG. If there had there been a systemic regulator with robust oversight authority over AIG and AIGFP in the years preceding September 2008, that regulator would have been in a position to constrain AIG's risk taking. It could have imposed higher capital and liquidity requirements on AIG in the run up to the crisis, and if so AIG might never have needed government support. Both the House and Senate versions of financial reform provide such authority.

Moreover, had the resolution authority included in the regulatory reform bills been available in the fall of 2008, any support from the government that was needed would have taken an entirely different path. For example, if the systemic regulator had been required to supervise the coordination of a resolution plan involving AIG's insurance regulators, it could have pre-arranged the ownership transfer of certain insurance subsidiaries in the months leading up to

AIG's liquidity shortfall. Then, when AIG failed, the systemic regulator could have formed a "bridge bank" and transferred – with all necessary insurance regulatory approvals secured in advance – all of AIG's valuable operating businesses to it. Government financial support would have then been effectively secured by the unencumbered assets of those operating businesses, and limited to the amounts necessary to bridge the insurance subsidiaries' liquidity needs. This would have effectively decoupled the ratings of the insurance subsidiaries from the rating of the AIG parent company, and would have ensured that AIG's unsecured creditors received a recovery only after government support had been repaid.

The comprehensive financial reform legislation proposed by the Administration and advancing in Congress would remedy both deficiencies.

First, the government needs the ability to limit risk-taking for institutions that threaten the overall stability of the system and can cause extraordinary damage to the American economy. The government needs this ability not just for banks, but for institutions that operate like banks. These non-bank financial institutions existed alongside banks and yet were not subject to those constraints in the period leading up to this crisis. The government also needs to make sure that regulators have accountability and flexibility, and that they enforce sensibly-designed constraints on risk. The systemic regulatory authority that is part of financial reform addresses these needs.

Second, the government must have the ability to resolve failing major financial institutions in an orderly manner, with losses absorbed not by taxpayers but by equity holders, unsecured creditors and, if necessary, other large financial institutions. This resolution authority would allow an orderly response to a potential future crisis, protecting both the taxpayer and the overall economy. Both the Senate and House versions of financial reform generally include such tools.

The Evolution of Government Support

Forced to fund AIG's immediate liquidity needs, the government structured its rescue financing as secured debt; that is, amounts outstanding under the FRBNY Facility have priority against the value of AIG's unrestricted assets. That structure protected taxpayers in the short term if AIG had proved not to be viable in the longer term. Fortunately, AIG is proving to be viable. In addition, the FRBNY took nearly 80% of AIG's fully diluted common equity[10] to provide additional compensation to taxpayers for their assistance, and to penalize the shareholders of the Company for the fact that the Company had no alternative but to ask the government for extraordinary assistance.

The FRBNY Facility solved AIG's immediate liquidity problems, but did not alleviate the pressure on its long term credit ratings. By having drawn down a substantial amount of the FRBNY Facility to meet its cash requirements, AIG's debt to equity ratio[11] became inconsistent with its investment grade rating. A further downgrade would have brought with it the potential of significant incremental collateral calls and termination payments at AIGFP. Similarly, given the link between the parent's and insurance subsidiaries' ratings, if the parent company was

[10] In the form of the Series C Preferred Stock placed into the Series C Trust for the benefit of the taxpayer, convertible into 79.8% of the fully-diluted AIG common equity.
[11] A company's debt to equity ratio is a fundamental metric by which credit rating agencies derive corporate credit ratings.

downgraded below investment grade, it could have been the death knell to the insurance subsidiaries' abilities to write new business. A substantial and immediate reduction in the amounts outstanding under the FRBNY Facility was required to avoid another downgrade. With TARP authority having become available in early-October 2008, the Treasury injected $40 billion of preferred equity into the Company in November 2008. This allowed AIG to reduce the outstanding debt under the FRBNY Facility and increase its equity by an equal amount. This avoided downgrade and was essential for protecting the taxpayers' investment in the Company.

At the same time, to protect AIG's balance sheet against further mark-to-market losses on the RMBS portfolio it had acquired as part of its securities lending activities, and to protect AIG's liquidity position against further collateral calls arising from the deterioration in the market prices of the CDOs on which AIGFP had written credit insurance, the FRBNY created Maiden Lane 2 and Maiden Lane 3, respectively.[12]

While the actions taken in November 2008 left AIG with sufficient liquidity to weather the continuing deterioration of the credit and equity markets, its record fourth quarter losses due to deterioration in its asset portfolio (in excess of $60 billion) prompted AIG's auditors and rating agencies to require incremental equity in order to ensure that it had sufficient liquidity. Failure to obtain such a commitment would have led to a "going concern" qualification on its annual audit opinion,[13] and with that qualification, the failure of the Company. To solve this problem, the Treasury committed in April 2009 to purchase nearly $30 billion of AIG preferred stock if and when such funds were needed in the future. Since that time, AIG has requested and the Treasury has purchased $7.5 billion of the Series F Preferred. At all points since April 2009, the Company's auditors have required the Treasury to reiterate its commitment to fund the Series F Preferred – up through and including the Company's first quarter 2010 financials.[14] Without this continuing support, the auditors would issue a "qualified opinion," the rating agencies would downgrade the Company, and the taxpayers' investment would be severely impaired.

The AIG Restructuring Plan

To protect the taxpayers' now substantial investment in AIG, the restructuring plan must ultimately ensure that public confidence in AIG is restored. The Company's policyholders must be confident that AIG will be able to pay claims. The people and firms that lend money to AIG must be confident that they will be paid back. All stakeholders must be confident that AIG can independently meet all of its obligations, in full, as they come due. This is the concept upon which "investment grade status" is built, and this why the restructuring plan is centered on the maintenance of this status.

[12] On January 27, 2010 Secretary Geithner testified before the House Committee on Oversight and Government Reform regarding the Maiden Lane investment vehicles. Please see that testimony for a more robust discussion of the formation of Maiden Lane 2 and Maiden Lane 3.

[13] The company's auditor must consider whether the use of the going concern assumption is appropriate, and whether there are material uncertainties about the entity's ability to continue to operate as a going concern that need to be disclosed in the financial statements. An auditor who concludes that substantial doubt exists with regard to the appropriateness of the going concern assumption is required to issue an opinion reflecting this – a "going concern qualification."

[14] Currently, there is approximately $12 billion of undrawn capacity under the FRBNY Facility and approximately $22 billion of undrawn capacity under the Treasury's Series F Preferred commitment.

The reason for this is simple: businesses and consumers do not buy insurance products from firms whose long-term viability is in question. Credit ratings are a short hand by which consumers and businesses alike evaluate an insurance companies' financial condition and its prospects. An investment grade rating represents a ratings agency's assessment, upon which businesses and consumers alike rely, that there is a very low probability that the entity will default on its long-term obligations. All of the Company's primary competitors in the property and casualty insurance market are rated "A-" or higher,[15] making it impossible to compete in this market without an investment grade rating.

The need to maintain an investment grade rating makes it extremely complicated, and perhaps impossible, to pursue the creditor negotiations that some have advocated should have been pursued with AIG's CDO counterparties in connection with the creation of Maiden Lane 3. The promise of full payment is the very essence of an investment grade credit rating. To act in any way inconsistent with that promise, such as by trying to coerce counterparties to give concessions on their credit insurance claims, as the agencies have made clear in their criteria governing "distressed exchanges," is a path to a downgrade.

As the last eighteen months have unfolded, the rating agencies have begun to clarify the interaction between their rating for AIG and the substantial government support it has received. Currently, as a result of the government's financial support, AIG enjoys an upward "notching" of its ratings above what it would otherwise receive on a standalone basis. Standard & Poor's has provided the most detailed public description of this relationship, specifying that the Company receives a five-notch uplift due to government financial support. In April 2010, S&P reaffirmed the Company's ratings and indicated that, absent government support, the Company would have a senior unsecured rating of BB, which is two notches below investment grade.

In order to regain a standalone "A" rating the Company needs to eliminate this gap. The elimination of that gap is a key objective of the government's resolution plan for AIG. Once AIG can maintain an investment grade rating without government support, the government can begin to sell down its equity interests in the Company. This requires substantial improvements to AIG's operations and to its leverage and capital profile. The essential elements of the resolution plan are as follows:

First, the Company will have to substantially reduce its debt. The two metrics by which this is measured are (i) "leverage," which is the amount of debt on a company relative to the amount of equity in a company, and (ii) "coverage," which is the amount of earnings or cash flow the company generates relative to the annual interest payments on its debt.

Next, the Company will have to demonstrate independent access to the capital markets and secure standby lines of credit. Policyholders, potential customers and investors must be confident that the Company has access to liquidity in times of potential stress. Finding a private market participant or facility to replace the government's support will be a key milestone.

Third, the risk profile of AIGFP will need to be reduced to the level where potential losses are inconsequential to the parent company's financial condition. More specifically, investors must

[15] Primary competitors include Ace Group, Chubb Group, Hartford, Liberty Mutual, Travelers, XL, and Zurich.

be satisfied that AIGFP does not pose a substantial threat to the Company's liquidity position, even in times of stress.

Fourth, AIG will need to divest those subsidiaries that are deemed to be non-core to its long-term strategy, and it will need to deconsolidate any businesses whose potential cash needs represent a potential drag on the AIG parent company.

Fifth, the Company will have to demonstrate that its core insurance subsidiaries are profitable, well capitalized, and have repaired the damage to the franchise caused by the financial crisis and the negative attention that the government's rescue has generated.

Finally, the Company will have to demonstrate that it has improved its risk management policies and procedures. In short, AIG will have to demonstrate that it can appropriately identify, monitor, manage and mitigate the risks inherent in its operating businesses.

Taxpayer Exit

Taxpayer exit from AIG will be in a series of steps. We expect that AIG will sell sufficient assets at fair prices to pay off obligations to the FRBNY, and the assets of Maiden Lane 2 and 3 will continue to generate cash flows sufficient to repay the loans FRBNY made to those entities. We expect that AIG will streamline its business portfolio and reduce its debt to a level that is consistent with an "A" rated company. This will enhance the value of the taxpayers' equity interests in AIG, and the Treasury will then seek to sell these interests as soon as practicable.

Asset Sales

In March 2010 the Company reached a substantial milestone, having signed separate definitive agreements to sell its two largest international life insurance subsidiaries – AIA to Prudential PLC and ALICO to MetLife. Prudential PLC is currently seeking shareholder and regulatory approvals for its $35.5 billion purchase of AIA, and MetLife is seeking regulatory approvals for its $15.5 billion purchase of ALICO. Combined with the additional financings and asset sales that the Company is currently pursuing, the proceeds from these two sales are expected to be sufficient to pay off the Company's obligations to the FRBNY in full: that is, the FRBNY Facility ($26.3 billion) and the AIA and ALICO Preferred Interests ($25.4 billion).

The consummation of the AIA and ALICO sale transactions will be a significant step on the path towards a standalone investment grade rating. First, the transactions will eliminate over $50 billion of "senior" debt, significantly reducing AIG's leverage. Second, by repaying the FRBNY Facility in full, the Company will free up assets that AIG can then use to secure new lines of credit with commercial banks — facilitating access to independent, non-governmental sources of liquidity.

AIGFP

While the Company works to close the divestitures of AIA and ALICO, it is also continuing to wind down AIGFP. The Company has reduced the notional amount of derivatives at AIGFP from $2.0 trillion in September of 2008 to $755 billion.[16] Similarly, AIGFP has reduced total number of trade positions from 44,000 to 14,300.

[16] As of March 31, 2010.

When you look specifically at credit derivatives, the notional amount of exposure has been reduced from nearly $400 billion to $136 billion. $109 billion of this remaining exposure relates to transactions with European banks, whereby AIGFP provided regulatory capital relief to these banks under the Basel I regime. Thus far, these positions have generally been eliminated at no cost to AIGFP.

With respect to AIGFP's other derivative exposures, the firm has made significant progress towards removing complex and illiquid positions – an important step because these positions would be the most challenging to manage over time. These removals ensure that the reductions in notional and trade count metrics are not achieved simply by closing out only the most "plain vanilla" derivatives exposures.

While several hundred billion dollars of notional amount of positions will remain on AIGFP's books at year-end, most will be hedged positions that do not pose a threat to the Company's rating profile or, more importantly, the financial system. Overall, the wind down of AIGFP's riskiest positions is expected to be largely completed by year-end 2010. The wind down of AIGFP has already significantly reduced the interconnectedness between the Company and other large financial institutions — reducing the risk that, in the future, AIG could pose a systemic threat.

Non-Core Asset Sales and Divestitures
The Company continues to explore opportunities to divest itself of its non-core businesses and deconsolidate subsidiaries that represent a drag on the parent company's ratings. These actions will reduce potential liquidity or capital drains from the parent company and strengthen AIG's independent credit profile. After the consummation of the AIA and ALICO sales and the divestiture of other non-core businesses and assets, the Company will be a streamlined version of the financial behemoth it once was. The largest remaining core businesses will be AIG's property and casualty insurance business (Chartis) and AIG's life and retirement services business in the United States (SunAmerica Financial). Overall, the reduction in both the number and diversity of its business units as well as the shrinking of its geographic footprint will make the Company easier to monitor and to manage.

Maiden Lane 2 and 3
The FRBNY loans to the Maiden Lane 2 and Maiden Lane 3 vehicles will be repaid over time as the assets in those vehicles generate income and are sold or otherwise retired. According to current projections, it is expected that cash inflows from those assets will significantly exceed the principal and interest due on the outstanding FRBNY loans to those entities. Even under a very adverse set of assumptions, it is expected that the loans made by the FRBNY to each of the entities will be paid in full. Currently, the fair value of the Maiden Lane 2 assets is $15.8 billion versus a FRBNY loan balance of $14.9 billion. The fair value of Maiden Lane 3 assets is $23.4 billion versus a FRBNY loan balance of $16.6 billion.

Taxpayer Recovery
Of course, the key question with respect to AIG is whether taxpayers will get all of their money back. Let me review the current prospects.

If the AIA and ALICO divestitures close as planned, proceeds of those sales are expected to be sufficient to repay the FRBNY Facility and redeem the AIA and ALICO Preferred Interests held by FRBNY almost in full. Any shortfall will be made up by other non-core asset sales that the Company is currently pursuing. It is likely that the FRBNY loans to Maiden Lane 2 and 3 will not only be fully repaid, but could also earn a profit. As a result, it seems likely that all of the credit extended by the FRBNY to AIG will be repaid in full.

At current market prices, the common stock that the Series C preferred shares represents has value.[17] Market conditions can change before the Series C Trustees have the opportunity to sell those shares and, given the number of shares that the Series C represents compared to shares currently held by the public, the sale itself may put some significant downward pressure on the trading price of AIG's common stock. That said, given today's market prices it seems that the Series C Preferred has value that will inure to the taxpayers' benefit.

That leaves the Treasury's Series E and Series F preferred equity interests (together, approximately $49 billion). The recovery on the Series E and F will largely depend on the performance of the then-remaining businesses in the AIG portfolio after it completes its asset sales and how they are valued in the stock market.

With AIA and ALICO divested, AIG's core businesses will be centered on Chartis (its global property and casualty insurance business) and SunAmerica Financial Group (its U.S. life and retirement services business). Chartis is one of the largest property and casualty insurers both in the U.S. and globally, and holds leading positions in both commercial insurance and specialty lines. SunAmerica Financial is a leading player in the U.S. life insurance and annuity sector, and a provider of comprehensive retirement services — primarily in the education and healthcare markets.

The Company has work to do in order to return these businesses to their previous levels of profitability, and it will take time to repair fully the damage to their franchises, particularly in the United States. That said the Company's progress to date is encouraging. At Chartis, first quarter 2010 operating income was $879 million (versus $710 million in the first quarter of 2009).[18] Premium retention has risen, pricing has stabilized and employee turnover has reverted to normal levels. At SunAmerica, first quarter 2010 operating income was $1.1 billion (versus a loss of $160 million in the first quarter of 2009).[19] Aggregate assets under management in the retirement services businesses have increased and premiums in the life insurance businesses have stabilized.

While it remains unclear what the Treasury's ultimate recovery on its Series E and F preferred interests will be, it is clear that the prospects for the recovery on those interests have improved, and the government remains committed to protecting the value of these taxpayer investments. The steps taken during the crisis were solely to prevent further financial contagion, and

[17] The Series C Preferred shares are convertible into 79.8% of AIG's common stock. At the closing price of $34.49 on May 25, 2010, the market capitalization of the publicly held AIG common stock, which represents 20.2% of the fully-diluted common equity (i.e., the amount not controlled by the Series C Trust), is approximately $5 billion.

[18] Before net realized capital gains and losses.

[19] Before net realized capital gains and losses.

ownership of AIG was a byproduct of these steps. As the government exits it seeks to do so in a manner that recoups as much money for the taxpayer as possible.

The timing of the Treasury's ability to monetize its investments in AIG will depend on the pace at which the other steps of the resolution plan outlined earlier in my testimony are accomplished. Whether the taxpayers ultimately recover all of their investment or make a profit will depend on the Company's operating performance and market multiples for insurance companies at the time the government seeks to monetize the taxpayers' stock interests. But AIG has made significant progress towards being able to garner standalone market confidence, without the government's continuing support. And as soon as we are confident that the stability is durable we will move to exit the taxpayers' investments as promptly as practicable.

Thank you very much for your time.

Chair WARREN. So let me just get started here, I want to walk through this. I'm hearing you say that it is very likely that the American taxpayer will be repaid in full from AIG?

Mr. MILLSTEIN. I think——

Chair WARREN. Is that what I heard you say?

Mr. MILLSTEIN. What I said is that the New York Fed, which has about $83 billion dollars outstanding today, is very likely to be paid in full. The asset values that we've seen in both Maiden Lane II and III, and the sales prices for AIA and ALICO, should be sufficient to pay them in full.

The Series——

Chair WARREN. That's not everyone though.

Mr. MILLSTEIN. No, that's not everyone. The Treasury Department has $49 billion dollars outstanding in Series E and F Preferred. And as I said in my testimony, the recovery on that will depend on the performance of the remaining businesses and how those businesses are valued in the market at the time.

Chair WARREN. So do you have any estimate at this point? You've heard the estimates——

Mr. MILLSTEIN. I have.

Chair WARREN [continuing]. We've referred to them multiple times——

Mr. MILLSTEIN. I have.

Chair WARREN [continuing]. From CBO.

Mr. MILLSTEIN. I have. I think that there are, you know, substantial—there's a lot of things that have to occur before we'll know the answer to that question. And I think if—as you heard from the KPW analyst today, if the common stock has a value of $5.00, the preferred is paid in full.

While that may be a lower stock price than the company is trading at today, that implies that the preferred is money good.

Chair WARREN. Okay.

Mr. MILLSTEIN. And even at that $5.00 stock price, the Series C Preferred held by the Series C Trust would have a value of $3 billion dollars. That's pure profit to the taxpayers.

Chair WARREN. But—since I see you wince and hesitate on the second number, that is you feel confident about the $83 billion repayment, a little less confident about the $49 billion.

Do you feel that Mr. Benmosche perhaps is a bit optimistic?

Mr. MILLSTEIN. No, in fact he knows his business better than I do. And if he can, in fact, drive——

Chair WARREN. You are principally responsible for overseeing him though——

Mr. MILLSTEIN. Yes, I am.

Chair WARREN. So I take it only a little bit better.

Mr. MILLSTEIN. Well no, he's a you know, an experienced insurance executive. I'm a financial restructuring professional. He knows his businesses better than I do. And his confidence that he can get Chartis and SunAmerica Financial to an $8 billion dollar net after tax earning. If he can do that, we're going to be paid in full.

Chair WARREN. All right, so what do you see as the biggest risk here that we won't get repaid? I know you've laid out some of the things that have to happen. But where do you see the biggest risk?

Mr. MILLSTEIN. I think the biggest risk——

Chair WARREN. You assess risks.

Mr. MILLSTEIN. The biggest risk for an insurance company are the state of the financial markets and the impact it has on their franchise values. Remember, an insurance company you know, writes long dated risk and it takes the premiums and invests in a variety of financial assets.

The markets go up, the assets perform. The markets go down, the assets are impaired, and so they vary. The fortunes of this company, like every other insurance company, in part ride on the performance of the financial markets. We're obviously in very volatile times still. And so to me, that is the greatest risk.

Chair WARREN. All right. So the American taxpayer is on this ride along with the up and down of the stock market?

Mr. MILLSTEIN. Yeah, I think——

Chair WARREN. Or the down of the stock market.

Mr. MILLSTEIN. There's no question we've made a substantial investment in the largest insurance company in the world. And we did that for, in my view, good and valid reasons to prevent a further catastrophe in the financial markets.

I think it's been very successful. We have stabilized AIG. And the returns on that investment and on that policy approach will depend on the future performance of the company, which in part, depends on the performance of the financial markets.

Chair WARREN. Actually, let me ask you about that performance since we're hearing a lot of good news here. The preferred stocks held by Treasury are not paying or accumulating dividends. And that means that we have, we the American taxpayers, have given up about $5 billion dollars in foregone cash?

Mr. MILLSTEIN. Actually——

Chair WARREN. Why has Treasury chosen this course of action?

Mr. MILLSTEIN. The math is a little more complicated than that. Remember, we own 80 percent of the common stock. So we really, the giving up of dividends on the preferred, was really just giving up 20 percent of them because the value of those, the value of that dividend would otherwise flow to the common stock if it doesn't go to the preferred. And we own 80 percent of the common stock.

Chair WARREN. Now wait, wait, wait though. But those pockets don't match. So you're saying that we gave away $1 billion of the $5 billion to the other——

Mr. MILLSTEIN. We haven't given it away.

Chair WARREN [continuing]. AIG shareholders——

Mr. MILLSTEIN. We haven't given it away.

Chair WARREN [continuing]. By not collecting the dividends that belong to the taxpayer?

Mr. MILLSTEIN. Chair Warren, with all due respect, we haven't given away anything. These are dividends the company could not afford to pay. And in its current——

Chair WARREN. Well I'm hearing so much optimistic news I——

Mr. MILLSTEIN. I know, but——

Chair WARREN. So they can't afford to pay their dividends.

Mr. MILLSTEIN. I understand.

Chair WARREN. And that's cost us $5 billion.

Mr. MILLSTEIN. It hasn't cost us anything. These are dividends they could not afford to pay.

Chair WARREN. All right. And you're saying but that's all right because we're still going to sit in the common shareholder position——

Mr. MILLSTEIN. Had they been able to pay the dividend, they would first have to bring the preferred dividends current before they could pay a dividend to the common stock, and that's where we are today. But at this point, at this point, the company's cash flows, its net income after taxes are insufficient to support a preferred dividend.

Chair WARREN. Okay, so where do you anticipate between this optimistic view of AIG repaying the American taxpayer in full, and the position where we are today, which is they can't pay the dividends owed.

Where are we going to cross that line where we don't continue——

Mr. MILLSTEIN. Okay.

Chair WARREN [continuing]. To lose money from a company that can't pay us dividends that it owes us.

Mr. MILLSTEIN. I laid out the six steps of the restructure plan.

Chair WARREN. I heard those.

Mr. MILLSTEIN. Okay, so if you just bear with me for a minute. What is going on is a resolution of a large financial company. And that resolution involves its downsizing, okay?

We're selling stuff to pay back debt. We're selling AIA and ALICO. We've got a sale transaction for the life insurance operations in Taiwan. We've sold buildings and real estate around the world. All of——

Chair WARREN. I understand all this.

Mr. MILLSTEIN. Wait, wait.

Chair WARREN. I've read the Treasury.

Mr. MILLSTEIN. Bear with me.

Chair WARREN. I've read your report.

Mr. MILLSTEIN. Bear with me. It takes time to take a company of this size and scope to get it down to a footprint where it's actually reduced its debt, reduced its leverage, reduced its risk——

Chair WARREN. I understand that. That's why I——

Mr. MILLSTEIN [continuing]. And can pay a dividend.

Chair WARREN [continuing]. Asked a time question.

Mr. MILLSTEIN. What was your—what time question?

Chair WARREN. And the time question was, I hear this enormous optimism which suggests that you have some kind of plan in mind and that AIG has a plan in mind for where it will end up. And what I see today, is that it is not able to pay the dividends owed on the preferred shares.

So what I'm asking is, when in this downsizing do we expect those two to cross over so that it can at least meet its obligations——

Mr. MILLSTEIN. Okay.

Chair WARREN [continuing]. Before the happy day comes that it pays us back in full?

Mr. MILLSTEIN. If the AIA and ALICO deals close, they'll likely close sometime in the third and fourth quarter of this year, okay?

So that's—that will result in an immediate pay down of the Federal Reserve facility—sorry, of the preferred interest at the—at AIA and ALICO, that's about $25 billion that will be immediately retired with the cash proceeds.

And the balance of the consideration can be sold, given the terms of the lock ups we've negotiated with MetLife and Prudential over the course of a year to a year-and-a-half. When those proceeds are realized, they should be sufficient to pay off the credit facility at the parent level in full.

So sometime, I would expect, in 2011, if those deals close, the Federal Reserve will be paid in full for all of its existing exposure to AIG.

Chair WARREN. Okay.

Mr. McWatters.

Mr. MCWATTERS. Thank you. Mr. Millstein, when the deal was struck in September, current shareholders of AIG stayed in place. It was not a bankruptcy, they weren't wiped out.

So today we have sort of an odd situation of pre-bailout shareholders that may live to collect dividends someday, may live to sell their stock for a profit even though the tax payers may lose, CBO $36 billion dollars, OMB $50 billion dollars, is that correct?

Mr. MILLSTEIN. Well let me just—if in fact, the preferred stock interests lose money. It's unlikely the common are going to get anything, right? In the way a balance sheet is constructed, the preferred stockholders are going to get paid first before the common stockholders get anything.

Now we have, it is true that the stock is trading. The common stock is trading and 20 percent of it was left outstanding. People are buying in and selling that every day. No dividends are being paid on that stock. So it's a bet on the company's future.

Mr. MCWATTERS. But given that it's trading for $33.00 a share today, there must be a lot of people, a lot of smart people, a lot of analysts who think the preferred stock will be repaid.

Mr. MILLSTEIN. That would be the inference you would draw, yes.

Mr. MCWATTERS. Yeah.

Mr. MILLSTEIN. So that's good news for the taxpayers. The common stock, the common—the people who are trading the common stock are suggesting the preferred stock is money good.

Mr. MCWATTERS. Okay, but the equity, the pre-bailout equity was not wiped out in this deal?

Mr. MILLSTEIN. It was substantially diluted.

Mr. MCWATTERS. Substantially diluted, but not wiped out.

Mr. MILLSTEIN. If I may though, again, just to take the market price of the common stock. The 80 percent of the stock that was represented by the Series C, if you valued that at the $33.00 a share, at which the common stock market is trading the outstanding float, that's an $18 billion dollar profit to the taxpayer for the privilege of having made all creditors whole, and for having put a wall up around this company to keep it from failing. You know, if that's how it plays out, I think all of you would agree that this was a very successful rescue.

Mr. MCWATTERS. It was only successful because the taxpayers got lucky. If we go back to September 16, 2008, and we start looking at the CDOs, we start looking at the RMBS, that was junk, nobody wanted it. Because there was not a market. We had no idea what it was worth and it was simply purchased because it had to be purchased.

The fact that it appreciated, that's to our benefit, and that's great. But that was far from assured or guaranteed at the time.

Mr. MILLSTEIN. Listen, I was a private citizen at the time that this rescue occurred. So I had no greater involvement with it than you did. And I stood back at probably the same distance from it that you did.

But I think if you listen to the testimony of my colleagues, my now colleagues at the Federal Reserve, what you hear them tell you is, that this wasn't done to make a profit. It wasn't done for the protection of Goldman Sachs, or JP Morgan, or any of the other counterparties. It was for the protection of the financial system of this country, to try to prevent a panic. A panic that had already started that would have been worsened and exacerbated had this company failed. And I believe that.

Mr. MCWATTERS. I agree, but that's the reason I said in my opening statement that if you, if the supposition is, we need to save AIG to save the world financial system, well the world financial system is Goldman Sachs and JP Morgan and some others.

So if the world financial system had collapsed, these institutions would have collapsed. So it was certainly in their best interests to have AIG bailed out. And if they can be bailed out at 100 cents on the dollar, it's a happy day.

Mr. MILLSTEIN. Listen, I understand the ambivalence about—the view that AIG is a vehicle to pay other large financial institutions. But if you believe that its a collapse would have created fear and panic across all financial markets, and it wasn't just Goldman Sachs and JP Morgan who were being helped by this rescue.

It was you and I as depositors in our banks. It was the insurance policy holders across AIG and every other insurance company. It was the pensioners whose pension plans were racked by AIGFP. It was the holders of stable value funds, whose——

Mr. MCWATTERS. I agree. I totally agree with what you're saying. But none of those folks you just mentioned got the wire transfer that Goldman Sachs and the others did.

Mr. MILLSTEIN. In fact though, they did. In fact they did, because the 44,000 trades that Mr. Benmosche talked about include all those stable value insurance contracts that FP wrote that FP has honored. It includes the various transactions they did with pension funds to insure their assets too.

We've singled out, because they happen to have held very, very volatile assets on AIG's—that AIG had insured, and that the decline in the price of which were running through AIG's income statement and creating enormous losses in the fourth quarter of 2008.

So in order to try to mitigate the losses at AIG, and in order to try to stabilize its balance sheet, the Federal Reserve went after these two asset classes that were causing such losses and such instability. And tried to buy them in at those prices to terminate the losses going forward so as to try to keep this company from needing more money and it becoming even more unstable.

So yes, Goldman Sachs, and Société Générale, and the other counterparties to those RMBS and to the CDOs, got paid, but it was part of a broader effort to stabilize this company so they could honor everybody's contracts in full. They weren't the only parties whose contracts were honored in full. Everybody since September of 2008, has had their contracts honored by AIG.

Chair WARREN. Mr. McWatters.

Mr. MCWATTERS. I understand.

Chair WARREN. Are you okay?

Mr. MCWATTERS. I'm done.

Chair WARREN. Are you through?

Mr. MCWATTERS. I'm done.

Chair WARREN. Mr. Silvers.

Mr. SILVERS. I wasn't planning to ask this, but I now feel compelled to do so. I notice Mr. McWatters didn't bring up Goldman Sachs or JP Morgan, so obviously it's on Treasury's mind.

Is it not the case that in the week of September 15, 2008, that the cash calls that the company could not meet were in two lines of business and two lines of business only. And but for those cash calls, none of this would have been necessary?

And those two lines of business were, and it depends on what—you know you can believe or not—you can argue I guess with the state insurance regulators, they certainly were the swaps business and they may have been the securities lending business.

And but for those two enterprises, none of this would have occurred? Is that not so?

Mr. MILLSTEIN. That is not so. So let me——

Mr. SILVERS. Are you seriously asserting that if you wipe those two pieces of business off the books, that AIG was nonetheless insolvent?

Mr. MILLSTEIN. Let me——

Mr. SILVERS. And are you accusing the New York State Insurance Commissioner of lying to this panel?

Mr. MILLSTEIN. Can I answer the question? I'm trying to be——

Mr. SILVERS. I'm just astounded at the lengths you will go to to defend something that may, in fact, be defensible in a perfectly straightforward way.

Mr. MILLSTEIN. No, I actually have sat through the entire hearing today.

Mr. SILVERS. I know.

Mr. MILLSTEIN. I've heard——

Mr. SILVERS. I'm impressed.

Mr. MILLSTEIN. And I've heard the testimony of all the expert witnesses and fact witnesses before you. And I've spent a year now with this company's balance sheet and understanding its liability structure. And I want to give you the benefit of my learning.

All of the contracts at AIGFP are guaranteed by the parent. The parent has a $100 billion dollar balance sheet of its own. On September 8th of 2008, with $15 billion dollars of commercial paper, we all know what happened to Lehman Brothers, to the commercial paper markets after Lehman Brothers filed and defaulted on $5 billion dollars of commercial paper.

Fifteen billion dollars of commercial paper at the parent company. Eighty billion dollars of repo. Again, the repo markets went into seizure after the Lehman Brothers filing. And a much smaller amount of repo. Two trillion dollars of notional derivatives, $400 billion of credit derivatives, concentrated very much in the real estate part of the market.

Had AIGFP defaulted on the collateral posting requirements that it had on September 16, every counterparty, 44,000 trades could have terminated their trades, declared cross default——

Mr. SILVERS. You know Mr. Millstein, you've—you're not paying attention to what I was asking you.

Mr. MILLSTEIN. I'm sorry.

Mr. SILVERS. And you've actually agreed with me.

Mr. MILLSTEIN. Oh.

Mr. SILVERS. What you've said is, is that—you said that all kinds of terrible things would have happened had they defaulted on the collateral posting obligations. But it was, but it's the collateral posting obligations that were the triggering issue, right?

Mr. MILLSTEIN. The collateral posting obligations were actually triggered by the downgrade. The downgrade——

Mr. SILVERS. Yes, I know that. But that's where the cash need was that week.

Mr. MILLSTEIN. I'm sorry.

Mr. SILVERS. All the witnesses, all day long have said this.

Mr. MILLSTEIN. And the——

Mr. SILVERS. You're not disputing that.

Mr. MILLSTEIN. And the securities lending part——

Mr. SILVERS. Right, exactly.

Mr. MILLSTEIN. They refused to roll over——

Mr. SILVERS. Okay, so we all agree.

Mr. MILLSTEIN. Okay.

Mr. SILVERS. Let me move to the present. As my colleagues have expressed, there are these estimates from the government accounting bodies that $30 billion or $50 billion dollar losses is likely.

It appears from your testimony, that what that really means is that they believe that the preferred Series E is worthless. Or in the better case scenario, the $30 billion dollar loss, they believe that it is worth 60, no 40 percent, of the face.

Mr. MILLSTEIN. Right.

Mr. SILVERS. Am I understanding their point of view correctly? I know it's a little unfair to ask you what they think. But is that essentially what that means?

Mr. MILLSTEIN. Yeah, I mean there's $50 billion outstanding, if they think it's only worth $30, there's going to be a $20 billion dollar loss.

Mr. SILVERS. And we're not—explain to me why you think they are wrong, because clearly you do.

Mr. MILLSTEIN. Well no, I don't think any of us can predict the future.

Mr. SILVERS. Okay.

Mr. MILLSTEIN. I think that the Government Accountability Office and the OMB have to, under the regulations they're subject to, they have to make estimates of this for purposes of budgetary accounting.

Mr. SILVERS. Yes.

Mr. MILLSTEIN. And I suspect they're being conservative in their view. You know, I'm working to get the taxpayer's money back.

Mr. SILVERS. Right.

Mr. MILLSTEIN. I think we have a—or the company—has a restructuring plan that they've worked on with us that is going to take time to implement. But it should—and we've spent a lot of time on it, if they can implement it—should leave them as an investment grade company and if it can perform, if the two core businesses can perform the way that Mr. Benmosche suggested they can, the NEF should do very well.

Mr. SILVERS. My time is up. Thank you.

Chair WARREN. Professor Troske.

Dr. TROSKE. Maybe we'll continue on a related line. And you were here for Mr. Gallant's testimony as well and his estimate of what the stock price should be. And can you sort of respond to that a little.

And apparently you disagree with him as well. I don't know whether you've had a chance to look at his estimate. And there are widely different estimates out there. And I recognize that people are making—I understand how we come up with different estimates that we're making different assumptions about the outcome.

Mr. MILLSTEIN. Yeah I've seen his work and you know, an analyst report such as that is built on a number of assumptions. And——

Dr. TROSKE. Can you tell me which ones you would quibble with specifically?

Mr. MILLSTEIN. In part I'm constrained not to quibble with any particular assumption because I actually know more than he does. I have much more material non-public information and it is a publicly traded stock and it would be inappropriate for me to do so.

Dr. TROSKE. Okay.

Mr. MILLSTEIN. I mean I'm not—I'm not trying to——

Dr. TROSKE. No, I respect that. Can you give us some broad indication that you're comfortable with where you think that there are differences that you might have.

Mr. MILLSTEIN. From my point of view of representing the Series E and F, I take some comfort from his conclusion that the stock actually has positive value because it means the interests I'm trying to recover are going to be paid in full.

Dr. TROSKE. Okay.

Mr. MILLSTEIN. And it also means that the Series C stock has real value. And that's pure profit to the tax payers.

Dr. TROSKE. So I guess you—I believe you answered Chair Warren's question about when you thought the AIG will no longer need government support. Was that what your estimate was in 2011? Or I guess that's where you said it was going to cross the line.

Mr. MILLSTEIN. Yeah, I think the de-leveraging that is a predicate to its being able to garner a stand alone investment grade rating, is dependent upon these major asset sales closing and our monetizing the value of the stock that we're taking back on those deals.

And I see that occurring you know, sometime between year end this year and year end next year when we've fully monetized those interests.

Dr. TROSKE. Okay.

Mr. MILLSTEIN. And therefore, you know if its got its leverage profile, that is its debt down and its coverage to a point where it looks like an investment grade company. Then I think we can begin you know, assuming the other elements of the restructuring plan that I outlined.

Which, as I said, independent access to capital, that the parent company starts tapping the credit and capital markets again independent of the government. You know I think that's when we can start thinking about exiting the Series E and F.

Dr. TROSKE. Mr. Gallant also said that he thought the share price, the current share price reflected the trader's beliefs that the government was going to walk away leaving—you know, giving a gift, another gift to AIG.

Mr. MILLSTEIN. I think you can be certain that that is not going to occur.

Dr. TROSKE. Okay. Let me change gears just a little.

You are an expert in restructuring. If you're—and you were not in the room at the time, as you made clear. Had you been, would you have done anything different?

Mr. MILLSTEIN. Yeah, Mr. Bienenstock and I go a long way back together. We've been on opposite sides of the table, we've been on the same side of the table on numerous occasions.

I think that his confidence in the ability to actually have a discount negotiation with 16 counterparties is misplaced. In part because I think he's simplified some of the assumptions on which his analysis relies.

During the period from September to November, when he assumes we had that three months in the Federal Reserve and the government to conduct a negotiation, collateral was required to be posted almost every other day.

So the failure, while it—well he's right, having put the $85 billion dollar loan in place, bankruptcy was remote, but default was not remote. Every day, those 16 counter-parties or every week those 16 counter-parties were making demands for collateral.

So in order to have the dissident account negotiation, the company would have had to be prepared to say, I'm not paying. And to take the risk that anyone of those 16 counterparties or anyone who had cross-default rights, the other 44,000 claimants, or anyone at the parent who had cross-default rights, would not exercise their rights to cross-default.

So while we could—you could have gathered the 16 major counterparties in a room and had a negotiation. I can tell you at the time, I was actually concluding a very—the very similar negotiation to that which was urged upon AIG, after nine months of negotiating with that very same group over the extent of their discounts and how it would be done in another entirely different situation.

But most importantly for AIG, the company would have had to be prepared to take the risk of nonpayment, and have that nonpayment put at risk every other debt instrument that had a cross-default at the parent level and at FP.

And if I may, I know where you're going. If I may, that would have made that company completely unstable. Any creditor with the right to declare a cross-default could have brought the house of cards down.

Chair WARREN. So if I can just follow-up on that. Is that—you were talking about you were negotiating the same thing. Were you negotiating something like that with a government back stop behind it? Where the government said, I will make sure that between us, we get you paid so long as you don't cross-default and bring this company down?

Mr. MILLSTEIN. No I——

Chair WARREN. Doesn't that change the negotiating dynamic somewhat? A carrot the size of Manhattan——

Mr. MILLSTEIN. Yeah.

Chair WARREN [continuing]. And a stick the size of——

Mr. MILLSTEIN. Right.

Chair WARREN [continuing]. The global economy.

Mr. MILLSTEIN. If—I mean I'm not sure I'm comfortable with, as a citizen, with the Federal Reserve using that power to pick and choose winners.

Chair WARREN. I'm sorry, were you uncomfortable with Long Term Capital Management?

Mr. MILLSTEIN. The government didn't put any money up in that situation.

Chair WARREN. The government had nothing to do with what happened in Long Term Capital Management?

Mr. MILLSTEIN. No, no. I think you heard——

Chair WARREN. I think we heard, they were in the room——

Mr. MILLSTEIN. We were both——

Chair WARREN [continuing]. And said nobody leaves the room until there's a deal done here.

Mr. MILLSTEIN. I know it's tempting to believe this, that the government could have made this possible and extracted discounts. But just assume with me for the moment that among the creditors who had cross-default rights with someone not within the territorial limits of the United States, who held a material claim and didn't care about the government of the United States or its policies wanted just to perfect its rights to payment.

Chair WARREN. And how exactly—you know this is—you weren't there—I wasn't there. This is a crazy conversation to have. But how exactly was that person going to enforce those rights? Either they had collateral, in which case they hang on to them or they've got to go to court. And I think you and I both have an idea of how long that takes. I just——

Mr. MILLSTEIN. I understand that. I understand that. But this is a huge balance sheet with numerous creditors on it.

Chair WARREN. This is what bankruptcy lawyers do for a living.

Mr. MILLSTEIN. I understand that. And I did this for a living. And I can tell you that I would have been very nervous——

Chair WARREN. Well who wouldn't have been nervous?

Mr. MILLSTEIN [continuing]. About creating—about threatening default or even defaulting on this without being prepared to put this company into bankruptcy. Because you would be putting holders of claims of $100 billion of debt and of $2 trillion of notional derivatives at the table on the first default.

Chair WARREN. So let me see, this may be an unartful pivot. But from that very point I want to go to another one that you made. And that's the question, it's ironic that AIG is in the insurance business because the American taxpayer ended up in the insurance business here. They ended up insuring, in effect, that AIG's creditors were going to get paid 100 cents on the dollar.

And so I'm wondering, what was the value of that insurance? What's the value of the guarantee that we won't let your company fail?

Mr. MILLSTEIN. Yeah.

Chair WARREN. You described potentially here an $18 billion profit. Except it treats that insurance policy that came from the American taxpayers as worth nothing.

Mr. MILLSTEIN. No, I think we're coming at this from two different frames of reference. And I think again, just having spent time with the Federal Reserve and understanding what they thought they were doing at the time, in 2008.

And I don't think they thought they were underwriting creditor recoveries at AIG. They thought they were preventing a meltdown of the financial system. And a consequence of that was that everybody at AIG had to get paid.

Because just imagine that the government had tried to extract concessions from major counterparties, other systemically significant firms who did business with AIG. What would the risk have been then? What would be the inference that other creditors of those institutions would draw——

Chair WARREN. I'm sorry Mr. Millstein, we've been around this before. But the question I started with is, what is the value of the guarantee that the American taxpayer put into this? You describe the profit here as $18 billion.

Mr. MILLSTEIN. No, I think——

Chair WARREN. Potentially $18 billion. And I just want to put it against—you treat the guarantee from the American taxpayers as if it costs nothing.

Mr. MILLSTEIN. No, I think the benefit to the American taxpayers is that the financial crisis we all have lived through, which has been—had horrible effects on the economy wasn't worse.

And if it turns out that the cost of this operation with AIG is—that there is some cost to it in the billions of dollars, I hope it won't be, that was money well spent in the sense of avoiding what could have been a much, much worse crisis.

Chair WARREN. I just have one small question to finish with this. And that is, you can't tell us why Mr. Gallant is wrong. And I understand the reason for that. Others agree with Mr. Gallant, others obviously don't. The market is trading somewhere else.

But I'd just like your advice for what you would offer to an oversight panel. Are we just supposed to take your word for it? That it's all going to work out fine? How do we evaluate these very differing points of view if you can't give us anything more specific?

Mr. MILLSTEIN. The question I think you need to ask yourself today is, as a result of the government's actions is the company today stable? The answer is yes. Is it improving? Yes. Is it executing against the restructuring plan? Yes. Is it moving to a position where it can give up on its government support and stand alone? Yes. Are there risks? Certainly.

A company of this size and scope can't help but have risks to its outcomes and financial performance. But in terms of you know, where it was and where it's going, it's making progress. That's all that can be told.

Chair WARREN. So when people ask us whether or not the American taxpayer's going to get repaid, the answer is, we don't know and we don't have anything to look at.

Mr. MILLSTEIN. No I think I did answer it. I think you can say with confidence, as an oversight panel, that the Federal Reserve is going to be paid in full. You can say that the——

Chair WARREN. But——

Mr. MILLSTEIN. Wait. You can say that—it was a comma, not a period. You can say that an analyst, a well respected analyst, came in to your hearing and said that the—basically the E and F is going to be paid in full and that the government Series C is worth something.

Chair WARREN. But there will be losses——

Mr. MILLSTEIN. No.

Chair WARREN [continuing]. According to the——

Mr. MILLSTEIN. No, that's not what this gentleman is telling you.

Chair WARREN. You think he thinks we're going to get paid in full.

Mr. MILLSTEIN. If he's——

Chair WARREN. And that the CBO——

Mr. MILLSTEIN. If the stock is——

Chair WARREN [continuing]. Estimate is simply wrong.

Mr. MILLSTEIN. If he believes the stock has a positive value of $5.00, that means that what I'm trying to recover is going to get recovered.

Chair WARREN. Because we're going to be paid in full. Okay, thank you Mr. Millstein.

Mr. Silvers.

Mr. SILVERS. What——

Chair WARREN. No, Mark isn't finished. Oh, I'm sorry, Mr. McWatters.

Mr. MCWATTERS. So this means that AIG is solvent, in your opinion? In the opinion of the Department of the Treasury?

Mr. MILLSTEIN. It's a—you know solvent's a legal term. It has a positive net worth and it's paying its debts as they come due.

Mr. MCWATTERS. Okay, fair enough. AIG to me appears like it is still too big to fail. What are you doing, as the majority shareholder to lessen that risk?

Mr. MILLSTEIN. I think if the restructuring plan that we have worked with the company on designing and implementing is a plan that is downsizing this company relatively rapidly.

We're selling off its international life insurance operations. FP has—is not a shadow of its former self, but it's about a third of its former self. And those risks should be wound down substantially by the end of the year.

The aircraft leasing business and consumer finance businesses are now financing themselves, not drawing on the government to finance them. And as you heard Mr. Benmosche say, the inter-company loan that last year was necessary to finance ILFC, he hopes to be able to raise money to refinance it this year.

So the core business of AIG, at the end of this restructuring plan, will be Chartis and SunAmerica Financial, the largest property casualty company in the world and a very strong annuity and life insurance provider in the United States.

A much smaller, much simpler—and a company that he's confident he can manage with the help of his Board. And that is much smaller than the company that the Fed confronted on September of 2008.

Mr. MCWATTERS. So let's say a year from now, a year-and-a-half from now, after this had been implemented, if AIG was to fail again for whatever reason, then a filing under Chapter 11 followed by the insurance regulators doing whatever insurance regulators do.

In other words, would working the resolution of AIG in its bankruptcy—and its insurance subsidiaries through the normal protocol seem to work? In other words, there's nothing out there that would start triggering the dominoes that take down the other too big to fail institutions?

Mr. MILLSTEIN. Yeah, I mean if that plan that I just outlined has been implemented and the environment stays as relatively friendly as it is today, I think that you know, it's not up to me to make a systemic risk determination but it seems to me this will be much less of a risk to the system than it was in September of 2008.

Mr. MCWATTERS. What are the consequences on the competitors of AIG's insurance business who have received perhaps a subsidy, or at least AIG subsidiaries who have received a subsidy from the U.S. taxpayers. If you're competing against AIG in the insurance business, what's the consequence?

Mr. MILLSTEIN. It's a pretty competitive business. And in some sense, I think AIG's burdened by its government ownership in the competition it has with other insurance companies. I think you know, we're not a natural holder, we're a reluctant owner, but we're still a majority owner.

And you know when the government of the United States rolls over you know, you might not like being underneath it. So I think the answer is, that I think the sooner they can shed us the more competitive they will be.

Mr. MCWATTERS. Okay, so there's no indication to you that the rates or the underwriting standards of an AIG——

Mr. MILLSTEIN. You know there was some——

Mr. MCWATTERS [continuing]. Are considered different——

Mr. MILLSTEIN. There was some chat about—you heard some noise about that in the marketplace shortly after—you know in early 2009. You haven't heard that since.

Mr. MCWATTERS. Okay, I'm done.

Chair WARREN. Mr. Silvers.

Mr. SILVERS. Mr. Millstein, AIG is the only participant in the Treasury Department's SSFI program, Systemically Significant Failing Institutions program. What are the—this may seem silly after this day's worth of testimony, but it's not. What are the characteristics of AIG that made it an SSFI?

Mr. MILLSTEIN. You know, for a company you're going to take a majority ownership in and invest $132 billion to create a program called failing institution, you know, it's—it's a little contrary to the objective of getting your money back. I don't know who named it that. I myself don't tend to use it a lot as the program description. It's the—you know, it's the AIG program.

Mr. SILVERS. But the fact that it was the only participant in that program, the only institution—you know, my colleagues have made a big—Mr. McWatters was talking about how the Treasury left 20 percent of the common stockholders intact. That was actually pretty tough treatment in relation to what happened later with other people.

And Treasury at the time articulated to this panel—and I know this is a different administration, but, you know, there's some continuity—articulated to this panel that AIG was different. Do you disagree? Do you think AIG wasn't different?

Mr. MILLSTEIN. I really—I can't—I don't know what was in their minds in that regard. You mean in terms of taking their common stock?

Mr. SILVERS. Well, no, just in general. What made—what made AIG—why does AIG have a unique program all to itself?

Mr. MILLSTEIN. I don't know. I mean, you know, we have—we—the Federal Reserve was the lender of last resort here first.

Mr. SILVERS. And this comes back to my question this morning about sort of what's the—you know, when did things kind of get set in stone? You seem to be sort of saying that you guys—the Treasury—inherited a circumstance created by the Fed.

Mr. MILLSTEIN. Well, I think the sequence—actually in my written testimony I lay this out.

Mr. SILVERS. Yes.

Mr. MILLSTEIN. And—and if, you know, in September—and again, this is sort of an advertisement for a regulatory reform resolution regime because in September of 2008 the government really didn't have the tools to resolve an institution of this size. The Federal Reserve could make a loan. But you really didn't have the tools to put it to bed quietly.

Mr. SILVERS. Now, let me—I mean—you know, I think it's critical—the fact that there's not a—the fact that you can't give a clear answer to this—to the question of—and I understand why. It's not a criticism of you necessarily. But the fact that there's not a clear answer that can be articulated across administrations to why it was that AIG got unique treatment is a problem, I think. And I just leave that as an observation.

I wanted to shift to something you said earlier in response to one of my colleagues' questions. You said that you had to think about the impact on other systemically significant firms during the period, you know, in September 2008. What firms are you talking about?

Mr. MILLSTEIN. No, no, I was—I did say that, but I said it in the context of Chair Warren's questioning with regard to, you know, we insured all of AIG's creditors through this bailout. And again, what I was trying to convey there is that I don't think that was a consequence of what we did. I don't think that was the intent of policy.

Policy intent was to draw a line and try to prevent a further collapse of the system. And they drew the line at AIG. And the next point I was going to try to make was that if, as some have urged, the government rather in November or some time else along the way, should have tried to extract concessions from AIG's creditors, having intervened in AIG, what would that have communicated to the broad market about—about the government's role with regard to other firms that—you know, the other 20 large financial institutions, which by then it had made investments in? Would it have promoted financial stability to think—for the markets to think that the government was going to turn around for all of the large financial institutions in which it then owned preferred stock and demand creditor concessions?

Would that have encouraged financial intermediation or discouraged financial intermediation? Would it promote stability or promote instability? I submit that if that were official government policy that we were going to use our ownership stakes in these large institutions to demand concessions from their creditors, I think you would have had risk running away from those companies—the contagion associated with that government policy would have been enormous.

Mr. SILVERS. No, I'm sorry. I think my——

Mr. MILLSTEIN. You would have discouraged people from doing business with our large financial institutions.

Chair WARREN. But the point is about the debt that existed prior to the government putting its own money on the table. This is like post-petition financing. The haircut is for those who were dealing with the company so that you get some market discipline, so you keep some market discipline.

And the government says we're going to provide the backstop going forward. But we're not paying off the old people who understood the risks they were taking, at least not paying them off 100 cents on the dollar.

Mr. MILLSTEIN. But, Chair Warren, you know and I know the staff knows that these large financial institutions don't have near long-term debt. Their debt is coming in and out everyday. So once you communicate to the financial markets that these large institutions are going to be—have required haircuts, the people who are lending money on a short-term basis to them withdraw their credit.

Chair WARREN. No.

Mr. MILLSTEIN. They withdraw their credit.

Chair WARREN. Not from AIG. What you're now talking about are all the other participants in the financial market.

Mr. MILLSTEIN. No, AIG—that's——

Chair WARREN. Once the government says I am putting money on the table and the money will be available to backstop the creditors, there's been no indication the government has ever backed off from that. And indeed, we have heard repeatedly in every meeting we've had with the Fed that they could not back off.

Mr. MILLSTEIN. No.

Chair WARREN. That's why the decisions made in September had to be followed through in November in the way that they did.

Mr. MILLSTEIN. But, if I may, what you have been urging or at least inquiring about is whether or not they should have done something different.

Chair WARREN. Right. Yes.

Mr. MILLSTEIN. And what I'm suggesting to you——

Chair WARREN. That—that is——

Mr. MILLSTEIN. Had they done that, their short-term creditors would have run on them before you could have asked them may I have a discount.

Chair WARREN. I think we will simply have to agree to see the world differently on that. I apologize.

Professor Troske.

Dr. TROSKE. So as a professional economist, I don't deal in individual companies. I sort of look broader at the economy.

But I think when I hear the comments that my colleagues on the Panel are making, what I think about is the moral hazard problem going forward. The fact that when we make credit—when the government consistently makes creditors whole—creditors play an important regulatory role in a market economy in that they regulate the performance of the people that they're lending money to. If the creditors don't believe that that's important because the government's going to come in and bail them out, they no longer play that regulatory role.

And obviously then we have to create a government structure to regulate, which is incredibly challenging. And it's much cheaper for the taxpayers if creditors actually do the regulation for them.

And I would argue much more efficient. Can you sort of—I mean, so you've talked about this instance. Can you maybe expand a little on the moral hazard that's introduced by what we've done? Because I'm not sure I would agree with your statement that even if we get paid off and make a profit, we're better off once you consider the dynamic implications.

Mr. MILLSTEIN. I think if we fail to follow this episode in American economic history with strong regulatory reform, then we will have created—we will have compounded the problems that existed in early September of 2008 before AIG was bailed out. The system that allowed an AIG to run up $2 trillion of risk without really any capital behind it, that allowed it to lever itself up the way it had without any effective holding company regulator supervising it and demanding that it have both capital and liquidity to support the risks it was underwriting—that system, you could argue, created the moral hazard that certainly has been compounded by what occurred. So we need to have a regulatory reform package to counter what has occurred and to make sure this doesn't happen again.

Dr. TROSKE. You know, I think I would disagree with you. I think that if the government had consistently allowed creditors to fail in Long Term Capital Management, in—you know, back over the last 30 years, then we would have regulators. They would be called creditors.

And this problem wouldn't exist in the first place because the creditors to AIG would have taken a much more active role in ensuring the company didn't get into the problems in the first place. And the solution you're proposing is for the government to go out and hire creditors to do the job——

Mr. MILLSTEIN. No, not at all.

Dr. TROSKE. Excuse me—the government to go out and hire regulators to do the job that creditors should have been doing is going to produce a much more inferior solution to the one we would have if we actually allowed the market to function in an efficient fashion.

Mr. MILLSTEIN. No, I actually agree with what you've said.

Dr. TROSKE. Okay.

Mr. MILLSTEIN. But when firms of this size fail, they have spillover effects that are enormous. And so, when I say strong regulatory reform, I mean a resolution regime that can contain the spillover effects of a failure of the size of this firm.

Dr. TROSKE. And that offers me a good segue into my next question, which is, again, a fairly general question that I want to ask. I have heard the term systemic used more often since I've been appointed to this panel than I had, you know, in the last—in my entire previous life. Yet I have yet to see an operational definition that would allow me to know what a systemic firm looks like and what one doesn't look like.

And if you seem to be arguing that we need a regulatory regime that regulates systemic firms that offer a systemic risk—to do that, I think we need a definition. And I would love for someone to give me one. And you're sitting here, so I'm asking you. Sorry about that.

Mr. MILLSTEIN. And I would love to take the bait and join issue with you on that. But I think we don't have the time.

Dr. TROSKE. Okay.

Mr. MILLSTEIN. I mean, I think it's important. I agree with you. It's important. And if the regulatory reform bill passes, I think you'll see one emerge from the new systemic risk regulator that is——

Dr. TROSKE. So you think we're going to come up with a definition? Because, I mean, I would be happy if we did in which, you know, the government basically said these are the firms that we're going to backstop—and so, we know the moral hazard is here with these firms—and everybody else we're not. And we've got this dynamic definition. I guess I'm less confident than you are that that's going to arise in a——

Mr. MILLSTEIN. Well, I mean, I think the premise, though, is wrong, that—some people worry about that the systemic—the systemic designation means that no, we're not going to backstop you, you're in the resolution regime where, you know, you're going to be put to bed and you're going to have, you know, living wills or whatever you want to call it, but severe regulatory oversight to prevent us from having to do what we did with AIG again.

Dr. TROSKE. That's all.

Chair WARREN. Thank you very much, Mr. Millstein. I appreciate your being here today.

Mr. MILLSTEIN. Thank you all.

Chair WARREN. This hearing is concluded. We will hold the record open for questions and additional documentation from our various witnesses. Hearing adjourned.

[The Congressional Oversight Panel, at 3:45 p.m., was adjourned]