Emails implicate Treasury Secretary Geithner in cover-up of AIG deal to bail out the banks

Barry Grey
12 January 2010

A financial scandal has erupted that implicates Treasury Secretary Timothy Geithner in efforts to conceal the funneling of $62 billion in taxpayer funds to 16 large banks as part of the government bailout of the insurance giant American International Group (AIG).

The revelations coincide with the imminent announcement by the big US banks of their profits and year-end bonuses for 2009. Most of the major banks are expected to report huge profits—in the case of Goldman Sachs, its highest profits ever—and combined bonuses of $30 billion or more.

On January 7, Congressman Darrell Issa, the ranking Republican on the House of Representatives Committee on Oversight and Government Reform, released emails he had obtained from AIG showing that between November of 2008 and March of 2009, the Federal Reserve Bank of New York pressed the bailed out company to delay or withhold critical details of arrangements between it, its major bank counterparties and the Fed.

The most important of these was the government's decision to pay off the banks at 100 cents on the dollar for billions of dollars in credit default swaps they had purchased from AIG, which the company could not redeem.

Credit default swaps are a major part of the unregulated derivatives market, valued at $600 trillion at the time of the financial crash in 2008. Corporations and banks buy credit default swaps as insurance against the default of specific corporate bonds or other securities. The seller guarantees to back the face value of the insured securities in the event that they default. AIG was by far the biggest seller of credit default swaps, with bank counterparties throughout the world.

This so-called "shadow banking system" enabled the banks to vastly increase their borrowing, with the blessing of federal regulators, so they could make super-profits from bigger and more varied speculative bets, such as subprime mortgages. The vast and deregulated market in swaps played a major role in the breakdown of the US and global financial system.

The banking regulatory overhaul backed by the Obama administration and passed last month by the House of Representatives neither eliminates this market nor imposes serious oversight on it.

The backdoor bailout of the banks in the form of a government payoff for credit default swaps that had gone sour was part of the rescue of AIG, beginning with an $85 billion line of credit from the Fed in September of 2008, and now totaling $182.3 billion. The US government owns 80 percent of the insurance firm.

The banks had purchased the swaps from AIG to insure collateralized debt obligations backed by subprime mortgages. The value of the CDOs had collapsed along with the bursting of the subprime mortgage bubble, leaving major banks in the US and Europe holding worthless securities and facing bankruptcy in their own right.

Among the banks most exposed was Goldman Sachs, which was the largest customer for the insurance firm's credit default swaps. Goldman was the biggest beneficiary of the government scheme to cover the banks' bad investments with AIG, receiving $12.9 billion from the deal. Bank of America got $5.2 billion and Citigroup received $2.3 billion.

At the time of the government's decision to pay off the banks at par value and the first series of emails pressing AIG to withhold information about the deal from the Securities Exchange Commission and the public, Geithner was the president of the New York Federal Reserve Bank, a post which he had held for five years.

He remained at that post until he joined the Obama administration as treasury secretary in early 2009. Both as president of the New York Fed and as treasury secretary, Geithner has played a key role in the multi-trillion-dollar bailout of the banks.

Now emails have been published that strongly indicate he was involved in a cover-up of a key aspect of the government's rescue of Wall Street.

The emails also show that the New York Fed, during Geithner's tenure as president, pressed AIG to conceal some $10 billion in so-called "synthetic" CDOs it owned or insured. Synthetic CDOs are bundles of derivatives rather than bundles of loans—i.e., securities one dimension further removed from any real value—and are now considered among the most toxic of speculative assets.

Releasing the emails last week, Issa said: "Inadvertent reporting errors are one thing. Directing a bailed-out company to withhold crucial information from a government agency in order to keep the American public in the dark is another. Whether or not the United States treasury secretary was directly implicated in the scheme is a key question. Either he didn't know and he was negligent or he did know and presided over a blatant attempt to withhold information from the American people."

Last week the Treasury and the New York Fed issued statements claiming that Geithner was not involved in the potentially incriminating emails because he had already been nominated by President Obama to become his treasury secretary and had recused himself from any direct dealings with bailed-out companies. Amid calls from some Republicans for Geithner to resign, Obama's press spokesman, Robert Gibbs, on Friday said the president retained confidence in Geithner.

Rep. Edolphus Towns, Democrat of New York, the chairman of the House Committee on Oversight and Reform, announced that his committee would hold hearings next week on the AIG affair and invited Geithner to testify, along with the chief counsel for the New York Fed, Thomas Baxter. Senator Charles Grassley, Republican from Iowa, called for the Senate Finance Committee to hold similar hearings.

The claim that Geithner knew nothing about the efforts of the New York Fed to suppress information about the government bailout of AIG's bank counterparties strains credulity. In fact, the first of the emails from the Fed to AIG was sent on November 24, 2008, only hours after Obama publicly nominated Geithner as his treasury secretary.

Obama's choice for the post had been leaked by the press the previous Friday, sparking a celebration on Wall Street in the form of a 494-point rise in the Dow Jones Industrial Average.

Following the initial $85 billion bailout of AIG, the company sought to negotiate terms with its major bank counterparties, asking for discounts of up to 40 percent on its credit default swap liabilities. The banks flatly refused to accept anything less than face value, even thought the contracts would have fetched pennies on the dollar if sold into the market.

In late November of 2008, the New York Fed took over the negotiations between the banks and AIG, acting as the de facto broker for the major Wall Street firms. It set up a holding company, Maiden Lane III, which used taxpayer money to retire the banks' credit default swaps with AIG and buy the underlying toxic subprime CDOs from the banks.

AIG told the New York Fed on November 24 that it planned to publicly disclose details about Maiden Lane III the following day. The same day, a lawyer with the New York Fed sent an email urging AIG to delay making such a statement.

AIG also planned to file a report on the deal, as required under law, with the Securities and Exchange Commission (SEC). Another New York Fed lawyer on November 25 sent the company an email saying, "We believe that the agreements listed in the index [naming the banks to be covered and the fact that they would receive par value for their swaps] do not need to be filed."

Subsequent emails show that New York Fed lawyers struck out parts of AIG drafts of SEC filings including this information. In the event, AIG went public with the government bailout of its bank counterparties only in March of 2009, under pressure from some congressmen and the SEC.

One result of the New York Fed's tactics was to delay public knowledge of the government bailout of AIG's bank clients until after Geithner's Senate confirmation hearings in January of 2009, sparing the nominee from embarrassing questions about his role in covering the bad investments of the banks.

The evidence of what amounts to a government conspiracy to rescue the banks and keep the public in the dark underscores the incestuous and corrupt relationship between the state and the financial aristocracy. All of the official institutions of American capitalism are implicated, from the White House (both the Bush and Obama administrations), to Congress, to the media and the courts.

Obama chose Geithner for his treasury secretary precisely because of Geithner's long record of service to Wall Street. This service by no means ended with the establishment of Maiden Lane III and its concealment.

Geithner played a major role in opposing demands for limits on Wall Street pay. In March of 2009, when public outrage erupted over news that AIG had allocated $1 billion in bonuses, including $165 million for its Financial Products unit—which sold credit default swaps and other derivatives—Geither, together with Obama's chief financial adviser, Lawrence Summers, intervened to scuttle bills in Congress that would have imposed a surtax and other restrictions on bonuses issued by bailed-out firms.

Last month, Geithner's "special master for compensation," Kenneth Feinberg, agreed to allow AIG to raise the 2009 compensation of a top employee by $4 million. Both Feinberg and AIG have refused to divulge the identity of this recipient of government largess.

Geithner's predecessor at the Treasury, Henry Paulson, helped engineer the AIG deal which paid off the company's bank clients at taxpayer expense. It is hardly an accident that before joining the Bush administration, Paulson was the CEO of Goldman Sachs, the chief beneficiary of the secret deal.

When the government bailed out AIG in September of 2008, Paulson fired the CEO and replaced him with Edward Libby, who was then on the board of directors of Goldman. Libby, who has since resigned his AIG post, at the time owned more than 27,000 shares of Goldman Sachs, currently worth over $4.6 million dollars.