# AIG lawsuit reveals global economy on the brink

**Gabriel Black**
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The failure of the insurance giant American International Group (AIG) at the height of the financial crisis in September 2008 "would have been catastrophic for the broader economy" and led to "mass panic on a global scale," according to recent court testimony by Timothy Geithner, President Obama's first-term Treasury Secretary and former President of the New York Federal Reserve Bank.

Geithner was questioned last month, along with former Federal Reserve Chairman Ben Bernanke and Bush administration Treasury Secretary Henry Paulson, in the trial of a lawsuit filed by AIG's largest single shareholder, Hank Greenberg, against the federal government. In their testimony, the financial officials most directly involved in organizing the multi-trillion-dollar bailout of the major US banks made clear just how close the global financial system came to a complete collapse in the aftermath of the bankruptcy of the Wall Street investment bank Lehman Brothers on September 15, 2008.

While these top bank regulators have their own reasons for stressing the depth and acuteness of the financial crisis in the fall of 2008, arguing that the measures they took were the only possible means of staving off a new world depression, there is no doubt that their depiction of the perilous state of the global financial system at the time is basically accurate.

Greenberg, former CEO of AIG, is suing the federal government over the $182 billion taxpayer bailout of AIG that began with an $85 billion loan by the Federal Reserve one day after the collapse of Lehman Brothers. The AIG bailout was the largest single bailout of a private institution by a public one in world history. In exchange for the massive cash infusion into AIG, the government took a little more than 90 percent of the company's shares.

Greenberg claims that AIG shareholders deserved more generous treatment from the government, including a lower interest rate on the Federal Reserve's bailout loan.

AIG was at the heart of the financial crisis. No other company in the world had as much money invested in the credit default swaps that ostensibly insured the enormous sub-prime mortgage bubble.

AIG had made a fortune during the credit-fueled housing boom of the early 2000s by charging banks and speculators to back up their holdings in high-risk, high-return securities based on home mortgages. The insurance firm was, as a result, liable to make good on any such assets held by its clients should those assets lose value. The solvency of many of the biggest banks and financial firms around the world ultimately depended on the ability of AIG to cover their losses in the event of a housing collapse.

But when the housing market imploded, it quickly became clear that AIG could not fulfill its obligations, shattering investor confidence not only in itself, but in its Wall Street bank counterparties as well, including Goldman Sachs, JPMorgan Chase, Citigroup, Bank of America, Morgan Stanley and others. A chain reaction implosion of the American and world financial system was in the offing.

By September 16, 2008, AIG's stock had lost 91 percent of its value at the start of the year.

According to James Cox, professor of law at Duke University, Greenberg, the plaintiff in the lawsuit, was in large measure responsible for AIG's massive speculation in credit default swaps. Cox told the Associated Press, "Greenberg probably did create a culture at AIG that nurtured the aggressiveness of the swaps business and the excessive greed that we associated with the crisis."

*Forbes* ranked Greenberg number 214 in the list of the world's richest people in 2006. After serving as AIG CEO for nearly 40 years, Greenberg stepped down amidst probes into the company's potentially illegal business practices. AIG ended up settling for $1.64 billion out of court and Greenberg paid $15 million in fines.

Henry Paulson, who was treasury secretary at the time of the 2008 crash, defended the bailout in court. He said that it was imperative that AIG be rescued, because otherwise "the country faced a real disaster." Paulson was asked if at the time he believed AIG's collapse "would have wreaked havoc on the American people," to which he replied, "Yes."

Geithner testified that had AIG collapsed, it would have been "even more damaging" than Lehman's bankruptcy.

Bernanke, then head of the Fed, wrote in an email at the time: "We think they [AIG] are days away from failure … They think it is a temporary problem. The disconnect is dangerous."

In his testimony, Bernanke insisted that the collapse of AIG would not simply have been a national issue, but would have led to an unraveling of the world economy. He said AIG's bankruptcy, which he believed was imminent, "would have posed unacceptable risks for the global financial system and for our economy."

The bailout of AIG was a bailout of the entire financial system. In the words of attorney Kenneth Dintzer, representing the US Justice Department, "We call this a rescue loan, but the goal was not to save AIG. The goal was to save the world from AIG."

In order to make AIG's bailout carry through to its counterparties, the Fed and Treasury required AIG to pay back the big banks at 100 cents on the dollar, using bailout funds provided by the government. There were no strings attached to this: the banks simply received all the money nominally owed to them on their virtually worthless investments, no questions asked.

Neil Barofsky, the Special Inspector General of the Troubled Asset Relief Program (TARP), wrote in a 2009 report that the Fed "refused to use its considerable leverage" to compel the banks to take losses. Barofsky added, "[T]he structure and effect of FRBNY's (the Federal Reserve Bank of New York's) assistance to AIG, both initially and through loans to AIG, and through asset purchases … effectively transferred tens of billions of dollars of cash from the government to AIG's counterparties, even though senior policy makers contend that assistance to AIG's counterparties was not a relevant consideration in fashioning the assistance to AIG. …"

Following the first bailout of AIG, the government went on to enact the $700 billion TARP bailout, and funneled trillions of dollars to the major banks through a variety of loans and programs. Neither the AIG bailout nor the TARP bailout led to any significant reform of Wall Street and its predatory practices.

Just months after AIG's bailout, in March 2009, it was revealed that AIG International was paying out $450 million in bonuses to executives at its London-based subsidiary AIG Financial Products, which was primarily responsible for the company's $99.3 billion loss in 2008.

In an open letter to Treasury Secretary Timothy Geithner defending the bailout, Edward Liddy, the government-installed chairman of AIG, wrote that, "Quite frankly, AIG's hands are tied." Liddy, a former board member of Goldman Sachs, claimed that bonuses were "binding obligations" that were effectively sacred and not subject to impairment.

The Obama administration, after a few rhetorical protests for public consumption, came out in support of the $450 million executive bonus package. Lawrence Summers, chairman of the White House National Economic Council at the time, told *ABC* in an interview in 2009, "We are a country of law. These are contracts. The government cannot just abrogate contracts."

For the Obama Administration, of course, this maxim does not apply to the municipal workers and retirees of Detroit, whose constitutionally-protected pension benefits are being cut with the administration's support as part of the Detroit bankruptcy. Nor did it apply to autoworkers at GM and Chrysler, who had their contractual obligations to health benefits and wages slashed at the White House's insistence in the 2009 auto restructuring.