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OVERSIGHT OF THE FEDERAL GOVERNMENT'S INTERVENTION AT AMERICAN INTERNATIONAL GROUP

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MARCH 24, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–20

U.S. GOVERNMENT PRINTING OFFICE

48–873 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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OVERSIGHT OF THE FEDERAL GOVERNMENT'S INTERVENTION AT AMERICAN INTERNATIONAL GROUP

Tuesday, March 24, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Velazquez, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Capuano, Hinojosa, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Ellison, Klein, Wilson, Donnelly, Foster, Carson, Speier, Childers, Minnick, Kilroy, Driehaus, Kosmas, Grayson, Himes, Peters, Maffei; Bachus, Castle, King, Royce, Lucas, Paul, Manzullo, Jones, Biggert, Capito, Hensarling, Garrett, Barrett, Gerlach, Neugebauer, Price, McHenry, Campbell, Putnam, Bachmann, Marchant, McCotter, McCarthy of California, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order, and members will be seated.

This is a very important public hearing. It will not be disrupted. There will be no distractions. This is a chance for us to have a thoughtful public discussion, both critical and negative and positive. And there will be no disruption. If behavior becomes disruptive, I will ask the people who are causing the disruption to leave. I hope that is understood.

I will say that my own view is that critical conversation questions, indeed whole sentences and even paragraphs, advance even a negative view more than bumper stickers, no matter what sort of bumper those stickers are worn on. And I will enforce those rules.

We—I will just announce before we start with the time—have two hearings this week. This hearing is a special hearing, an ad hoc hearing, called as the second half of our conversation about the question of bonuses paid to the AIG, but it is also open to questions on other matters.

And, on Thursday, the Secretary of the Treasury will be here again. So members will have a chance to question the Secretary again on Thursday as part of the series we are having on the question of regulatory reform—a process, I will remind members, that really began in April of last year, when Secretary Paulson made a

very sweeping proposal for an increased degree of regulatory authority. And we have been in a conversation since then, and we will be continuing that.

Today's hearing deals with AIG. And I, in particular, want to emphasize the importance of looking both backwards and forwards. As we look back at what happened with AIG, the context should be clear. And, as I have said, I know there are people in the society, with whom I disagree scientifically, who believe in a theory that says the world was created some 4,000-plus years ago. That is not an issue today, but I do think it is important to remember that the world was not created on January 20, 2009, and there is an historical context. The historical context goes back at least as far as the Bear Stearns issue. And I think we need to set the stage.

Bear Stearns was failing, and the Secretary of the Treasury and the Chairman of the Federal Reserve last year, Mr. Paulson and Mr. Bernanke, together worked out an arrangement so that the creditors of Bear Stearns—not Bear Stearns shareholders—but that the creditors of Bear Stearns were compensated, for fear that a failure to compensate them would have severe negative consequences in the economy.

Then Lehman Brothers found itself in the same situation. And when efforts to find another private party to step in failed, the Bush Administration made the decision at the time, I think in part in the context of criticism that had come from the intervention with Bear Stearns' creditors, to allow it to fail, so that Lehman Brothers failed and none of the creditors of Lehman Brothers were aided.

I recently was visited by two Members of the House, our colleague Ms. Speier, and our colleague Ms. Eshoo, because the county they represent in California lost a lot of money when Lehman Brothers went under. And we have others—we have many, many other municipalities that are suffering from that.

But the decision was made not to intervene in Lehman Brothers. And I think it was fueled in part by the view that there had been too much intervention in Bear Stearns. People said, "Let's have free enterprise. Let's let it work." "Free enterprise" means the right to fail with no safety net, so Lehman Brothers was allowed to fail with no safety net.

A consensus formed, I believe, fairly soon after that, that allowing Lehman Brothers to totally fail had severe negative economic consequences. And that is the context which needs to be remembered when we think about what was done by the Federal Reserve, with the support of the Treasury, in 2008, with regard to AIG.

My own view is that the negative example of Lehman Brothers—and that included a number of political criticisms—as well as a view that it had a severe economic negative effect was, I believe, behind the decision to intervene for AIG.

I will remind people the decision to intervene on behalf of AIG was a decision the Federal Reserve took under its statutory authority. Unlike the subsequent vote in the House to create the Troubled Asset Relief Program, there was no congressional involvement, except you might say it was congressional involvement when we sit in a room and are told something and we say, "Wow." That was the congressional involvement with regard to that. We did raise some questions, but we were being informed.

I cite that because the going-forward part—people talk about the bonuses, but the going-forward part is this: I believe we have two very important negative examples before us of how not to proceed. One was the Lehman Brothers example, where they were allowed to totally fail and there was no help to any of the creditors. The other is the AIG example, where there was help for all of the creditors. Neither one is what we should be doing going forward.

The problem is—and I would contrast what we saw with Lehman and with AIG with what we saw with Wachovia, IndyMac, WaMu, and Countrywide. Banks also failed in 2008. And that was not a happy occasion in every case, although those of us who will mourn Countrywide are a very small number. But the fact is that we have in place mechanisms involving a very well-run FDIC, with the cooperation of other financial regulators, that contained the damage. So when these banks failed, it was neither a Lehman Brothers total negative on the economy or an AIG excessive intervention in the minds of some on behalf of creditors.

Our job—and, again, this was first raised by Secretary Paulson last year and Mr. Bernanke, and we are now at the point where we will be addressing that—is that when nonbank major financial institutions need to be put out of their misery, we need to give somebody the authority to do what the FDIC can do with banks. It is called "resolving authority." But it is giving somebody—and it is, as people should understand, a form of the bankruptcy power given under the Constitution. It allows us to avoid the choice of all or nothing—nothing, in the case of Lehman Brothers; all, in the case of AIG—equally unacceptable alternatives, and our job is to work together to try and find some other way.

The gentleman from Alabama is recognized for 5 minutes.

Mr. BACHUS. Thank you, Mr. Chairman.

Mr. Chairman, I am going to distribute our time as follows: 3 minutes to the gentleman from New Jersey, Mr. Garrett; 3 minutes to the gentleman from Texas, Mr. Hensarling; and 2 minutes to the gentleman from Delaware, Mr. Castle.

The CHAIRMAN. The gentleman from New Jersey is recognized for 3 minutes.

Mr. GARRETT. I thank you, Mr. Chairman.

You know, today I look forward to hearing all the testimony, as well as the answers to many questions that Americans have, I believe, for this panel. Indeed, like many of my colleagues, I have questions to pose to our witnesses.

To Chairman Bernanke, I am interested in hearing more about the Fed's ongoing relationship with AIG's leadership as they work together in running and also dismantling this entity on behalf of its largest shareholder, the American taxpayer.

I am also concerned, though, about the Fed's transparency and its independence in regards to publicly releasing details about AIG's counterparties. As the chairman knows, back in December, I sent a letter asking for specific counterparties to AIG and who would benefit from that if they went insolvent.

In a reply I received on March 4th, I was told that, "In keeping with normal business practices, CDS contracts had not been made publicly available because counterparties and AIG considers this information to be commercially sensitive and nonpublic informa-

tion," endquote. Then, lo and behold, just less than 2 weeks later, this information was released, and we found out just who those counterparties were, some being foreign banks.

So, since it is my understanding that AIG doesn't do anything without the approval of the Fed these days, why, then, did the Fed basically do an about-face on its policy of disclosing AIG counterparties? Was it, in part, due to bowing to pressure from the Administration in what many would say are politically difficult times? And do you feel that there is pressure in performing these regulatory functions and that those pressures undermine your independence in performing your monetary functions?

But probably more important than that whole issue is, why didn't the Fed insist on negotiating with foreign and also domestic counterparties for a more reasonable resolution to these contracts instead of paying dollar-for-dollar, especially when we learned after the fact that many of these counterparties had themselves hedged their bets or hedged their exposures with AIG anyway?

Next, I would also like to revisit Chairman Bernanke's assertion the AIG problems originated, as he said, with unregulated portions of its holding company. But, you know, we heard testimony last week from OTS Acting Director Polakoff that seems to contradict this assertion. Mr. Polakoff explained that OTS was actively regulating that division and was aware of AIG's CDS dealings and that they did raise concerns with AIG back in 2005.

From Secretary Geithner, many members of this committee, as well as the American people, would like a straight answer on the handling of the AIG bonus fiasco. The Secretary has been referred to as, "the original architect" of the AIG bailout. There have also been some questions as to the extent of the Treasury Department's involvement in altering provisions in the so-called stimulus package, ensuring that the bonuses would, in fact, be honored. Moreover, we are told he was informed about the bonuses at least a week-and-a-half before they were paid out. We also know the Secretary had specific conversations with AIG's CEO, Mr. Liddy, about it just a few days before.

So, as Secretary Treasurer and a representative of the United States and the people, which is the largest shareholder, again, at AIG, I would like to hear from the Secretary his recollection of that conversation with Mr. Liddy, and the letter as well, and would like to know if he raised these issues with the President before the bonuses were paid and did the President sign off on them?

The CHAIRMAN. The gentleman from Texas for 3 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, and thank you, Chairman Bernanke, for joining us today.

Bonuses paid out by profitable companies to outstanding employees make sense. Taxpayer-funded bonuses paid out by failing companies who owe taxpayers money makes no sense. The close to $200 million in bonuses paid out to AIG's employees was merely last week's TARP outrage of the week. The outrage, however, pales in comparison to the outrage that taxpayers have now seen in 4 different bailouts and have pumped $173 billion into a failed company with no apparent end in sight.

It pales in comparison to the outrage that taxpayer money is being used to make counterparties whole, many of which are foreign financial institutions. They assumed a risk that the school teacher in Mesquite, Texas, who is now helping make those counterparties whole, did not take.

It also pales in comparison to the outrage that we have seen no convincing plan of sustainability, profitability, or taxpayer recoupment that has been presented to us, this committee, or the Congress, much less the American people.

And finally, it pales in comparison to the outrage that we should have that the Democrat leadership in Congress and the Obama Administration either knew about these bonuses or should have known about these bonuses and could have stopped them.

After we learned a provision in the so-called stimulus legislation—which, as a practical matter, the Republicans were not permitted to read—ensured that these bonuses would be paid out, we witnessed the spectacle of Speaker Pelosi pointing a finger at Senator Dodd, Senator Dodd pointing a finger at Secretary Geithner, and Secretary Geithner and the Treasury staff seemingly pointing a finger at Senator Dodd. In a town where few are loathe to brag about legislation they authored, this bonus-enabling provision appears to be one of a kind, in that it is an apparent orphan.

The House went to great lengths to cover up this embarrassment, passing what many believe to be an unconstitutional tax to punish action with which Congress did not agree. We could have simply required AIG to pay back 100 percent of the bonuses before they receive another bailout, which we all know is coming. But the majority insisted on setting the dangerous precedent of punishing people after the fact who engaged in conduct with which they did not agree.

Secretary Geithner, I hope this legislation has not jeopardized your efforts to attract the private portion of your public-private investment partnerships.

There is something else that is needed, Mr. Secretary. The public needs a straight answer: What did the Obama Administration know, and when did they know it? For your plan to succeed, it needs confidence. And for there to be confidence restored, there must be openness, accountability, and honesty.

As one of my colleagues told me last evening, if you like the way the government has been running AIG, you are going to love socialized health care.

The CHAIRMAN. The gentleman from Pennsylvania is recognized for 3 minutes.

Mr. KANJORSKI. Good morning, Mr. Chairman.

Thank you for working with me to schedule this important hearing to hear directly and publicly from those Federal entities now responsible for overseeing American International Group, or AIG. As I said last week, the Treasury Department and the Federal Reserve have much to explain not only to us, but also to the American people.

Since last fall when it received governmental assistance for the first time, I have maintained an active, ongoing, and strong interest in AIG. Early on, I wrote to the Federal Reserve to inquire about its oversight of AIG. I have contacted them regularly since

then. After AIG's TARP investment, I also contacted the Treasury Department about these matters.

Taxpayers now own 80 percent of AIG. Today, I therefore hope that we can learn more about how Federal officials are protecting the taxpayers' interest in AIG. I also want to learn more about the plan, the people, and the resources dedicated to AIG oversight.

Additionally, because the Federal Reserve was the first to intervene in AIG, I would greatly appreciate an explanation from them on how and why they made the decision to get involved. Further, I want to know the plan to recover the loans from AIG so that taxpayers can be paid back in full with interest, as quickly as possible.

During the last week, the American people have rightly expressed outrage about the sizable retention bonuses given to workers at the very unit that caused AIG to seek Federal aid. If Federal officials had exercised effective, proactive oversight at the company, we could have prevented this problem. Going forward, I would like the Federal Reserve and Treasury to be more active and transparent in their oversight of AIG.

That said, Mr. Chairman, we are in the midst of an economic crisis. As a result, the Treasury Department and the Federal Reserve have assumed an extraordinary amount of responsibility, and they have worked to develop and implement a broad array of innovative programs. As such, they may lack the resources and attention needed to properly oversee all aspects of AIG.

During the WorldCom bankruptcy, however, the Securities and Exchange Commission and WorldCom agreed to a private, corporate monitor to oversee compensation at WorldCom. I would welcome the views of our witnesses about whether the Congress should consider a similar appointment with respect to AIG now.

Moreover, I want us to focus our deliberations today on whether powers exist in the Federal Government to unwind AIG in an orderly manner, if necessary. If not, I would like to learn about the powers the government needs to disband and dissolve nondepository Federal institutions.

In sum, Mr. Chairman, I look forward to hearing from our witnesses about these important matters, and I yield back the balance of my time.

The CHAIRMAN. The gentleman from Delaware for 2 minutes.

Mr. CASTLE. Thank you, Mr. Chairman.

We talk about transparency a lot, and I just don't see the transparency here. And I still have a lot of questions about all this, some of which relate to the Secretary, and some of which relate to the Federal Reserve.

But we know, Mr. Secretary, that you were very involved in the AIG business back in the fall of 2008. In fact, when you were head of the New York Fed, that is where the first tranche, the first loan came from. And we don't know what you knew at that point, but, according to a spokesman for the Federal Reserve, the Federal Reserve, the Treasury, and the New York attorney general knew about the AIG bonuses in the fall of 2008. I would assume, with that knowledge, you would have known it all the way up until you eventually, apparently, told the President.

Then we have the whole business with Senator Dodd and the language change. I don't know who was in the room or who got

that language changed in the stimulus program, but the new language was the prohibition required under clause (i), "should not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009." To me, that is a place where it could have been stopped. And I don't know who was in that room when that was done or who drafted that language. Senator Dodd, I think, originally said he did it, and then he pointed the finger at others, not at you necessarily, but at others, and that is a matter of some concern.

Also, I have seen and read anecdotally, at least, that the Federal Reserve shared with Treasury all the discussions they had since you left, Mr. Secretary, and went on to the position of being the nominee and then the Secretary of the Treasury, which would raise a concern of when were you reminded about these bonuses.

And we raise all these questions because, could something have been done before we passed legislation that probably nobody really wanted to vote for last week that may be leading to the fact that these bonuses are now being repaid? But the bottom line is maybe there wasn't transparency, maybe it could have been prevented, and I hope we can get some of those questions answered today.

I yield back.

The CHAIRMAN. We will now begin with the testimony of the Secretary of the Treasury, please.

STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER, SECRETARY, U.S DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman. Good morning, Ranking Member Bachus, and members of the committee. It is a privilege to be in this room again, testifying before you. We are debating important, consequential issues for the country. I welcome the attention you are bringing to it. I am going to try to answer as many of your questions as I can in my oral statement, but I am sure we will need to go over many of these things in more detail.

I am very pleased to be here with Chairman Bernanke and President Bill Dudley of the New York Fed.

AIG highlights very broad failures of our financial system. Our regulatory system was not equipped to prevent the buildup of dangerous levels of risk. Compensation practice rewarded short-term profits over long-term financial stability, overwhelming the checks and balances in the system.

We came into this crisis as a country—and this is a tragic thing—we came into this crisis without the authority and the tools necessary to contain the damage to the American economy posed by the very severe pressures working through the financial system.

Now, I share the anger and frustration of the American people, not just about the compensation practices at AIG and in other parts of our system, but that our financial system permitted a scale of risk-taking that has caused grave damage to the lives of so many Americans. The companies insured by AIG in the United States alone employ one in three Americans. AIG directly guarantees over $30 billion of 401(k) and pension plan investments and is the leading provider of retirement services for teachers and education institutions.

In September, at a time of unprecedented financial market stress, losses on derivatives contracts entered into by AIG's Financial Products group forced the entire company to the brink of failure. The Department of the Treasury, the Federal Reserve, and the Federal Reserve Bank of New York acted to prevent the collapse of AIG.

That action was based on a judgment, a collective judgment, that AIG's failure would have caused catastrophic damage—damage in the form of sharply lower equity prices and pension values, higher interest rates, and a broader loss of confidence in the world's major financial institutions. This would have intensified an already-deepening global recession, and we did not have the ability to contain that damage through other means. And we did not have the authority to unwind AIG.

For these reasons, with extreme reluctance, on September 16th, the Federal Reserve Board authorized an $85 billion revolving credit facility to provide liquidity and avoid default. As a condition of that loan, 79.9 percent of the shares of the company were placed in a trust run by appointees of the Federal Reserve Bank of New York. The government installed a new management team and began the process of restructuring AIG's board. And the new management team committed to return AIG to its core insurance business by winding down its derivatives trading operation and selling non-core businesses.

This loan, of course, was only the first step in a series of efforts to stabilize the company and provide the funding and liquidity necessary to execute that restructuring plan. Following that initial action in September, the Federal Reserve Bank of New York initiated a broad review, using outside experts, of the full range of executive compensation plans that exist across this large company.

In November, as part of the government's infusion of capital, the Treasury Department imposed the executive compensation conditions and standards that were required under the Emergency Economic Stabilization Act.

Earlier this month, in March, when in response to further losses on the company's portfolio we committed additional resources alongside the Fed, we made that assistance subject to forthcoming conditions on executive compensation that were based on both the President's proposals of February 4th and the provisions adopted in the American Reinvestment and Recovery Act.

Now, on March 10th, I received a full briefing from my staff on the details and extent of AIG FP's pending retention payments, including information on the details of payments to individual executives. I found those payments, as have so many, deeply troubling. And after consulting with colleagues at the Fed and exploring our legal options, I called Ed Liddy, the CEO of this company, and asked him to seek to renegotiate these payments.

He explained that the contracts for the retention payments were legally binding and pointed out the risk that, by breaching the contract, some employees might have a claim under Connecticut law to double payment of the contracted amounts. He committed, however, to renegotiate and reduce future payments totaling hundreds of millions of dollars, and that process is now underway.

In addition, Treasury is working with the Department of Justice to determine what legal avenues may be available to recoup retention bonuses that have already been paid out and have not been voluntarily repaid. Treasury will also impose on AIG a contractual commitment to pay the Treasury from the operations of the company the amount of retention awards not recouped. And, finally, Treasury will deduct from the $30 billion in recently committed capital assistance an amount equal to those payments.

Now, this issue of executive compensation extends beyond AIG and requires substantial reform of the incentives and compensation throughout the financial sector. As we move forward, we need to ensure that taxpayer resources do not reward failure but are used to get our financial system back to the business of providing credit on reasonable terms to American businesses and families.

I know that much of the public anger has fallen on Mr. Liddy, but this is not fair. Mr. Liddy did not create this mess; he did not seek this job. He agreed, in response to a request by the Government of the United States, to work to restructure the company and help us get back the assistance provided by the taxpayer. And in taking on what I think is the most challenging job in the American financial system today, he inherited an enormous range of problems, including these retention contracts that are the understandable source of public outrage.

AIG has thousands of employees who are working now, every day, to unwind the very business that got us into this situation and return AIG to the business of insurance. They are working hard to reduce the company's risks and exposures, and it is important that we support them in this effort to wind down AIG in an orderly way that protects the American taxpayer.

Now, in addition to the problems with executive compensation, this financial crisis has revealed very problematic gaps in the regulatory structure of governing our financial markets. The lack of an appropriate regulatory regime and resolution authority for large nonbank financial institutions contributed to this crisis and will continue to constrain our capacity to address future crises. I will testify before this committee on Thursday and discuss in that context a broad set of regulatory reform proposals, particularly those related to mitigating systemic risk, to creating a more stable financial system.

The CHAIRMAN. Mr. Geithner, will you stop for a moment, please?

Will you please act your age back there and stop playing with that sign? If you have no greater powers of concentration, then you can leave the room. We are trying to have a serious discussion, which will include, as you understand, a lot of criticism. We really need people to grow up.

Secretary GEITHNER. Thank you, Mr. Chairman.

As we have seen with AIG, distress at large, complex financial institutions can pose risks as dangerous as those that led the United States to establish a full framework of tools for dealing with banks. We need to extend those protections and authorities to cover the risks posed by our more diverse and complicated financial system today. And we are proposing legislation to provide those tools,

and look forward to working with this committee and the Congress to pass such legislation as quickly as possible.

The proposed resolution authority would allow the government to provide financial assistance to make loans to an institution, to purchase its obligations or assets, to assume or guarantee its liabilities, and to purchase an equity interest. The U.S. Government, as conservator or receiver, would have additional powers to sell or transfer the assets or liabilities of the institution in question, to renegotiate or repudiate the institutions' contracts, and to prevent certain financial contracts with the institution from being terminated on account of conservatorship or receivership.

This proposed legislation would fill a significant void in the current financial services regulatory structure in respect to these large, complex institutions. And implementation would be modeled on the resolution authority that the FDIC has under current law with respect to banks.

This an extraordinary time for our country, and your government has been forced to take extraordinary measures. We will do what is necessary to stabilize our financial system and, with the help of the Congress, develop the tools we need to make our economy more resilient and our financial system more stable and more just. We need to work together to create an environment where it is safe to save and invest and where all Americans can trust the rules governing their financial decisions.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Geithner can be found on page 83 of the appendix.]

The CHAIRMAN. Mr. Bernanke?

STATEMENT OF THE HONORABLE BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Chairman Frank, Ranking Member Bachus, and other members of the committee. I appreciate having this opportunity to discuss the Federal Reserve's involvement with AIG.

In my testimony, I will describe why supporting AIG was a difficult but necessary step to protect our economy and stabilize our financial system. I will also discuss issues related to compensation and note two matters raised by this experience that merit congressional attention.

We at the Federal Reserve, working closely with the Treasury, made our decision to lend to AIG on September 16th of last year. It was an extraordinary time. Global financial markets were experiencing unprecedented strains and a worldwide loss of confidence. Fannie Mae and Freddie Mac had been placed into conservatorship only 2 weeks earlier, and Lehman Brothers had filed for bankruptcy the day before. We were very concerned about a number of other major firms that were under intense stress.

AIG's financial condition had been deteriorating for some time, caused by actual and expected losses on subprime mortgage-backed securities and on credit default swaps that AIG's Financial Products unit, AIG FP, had written on mortgage-related securities. As confidence in the firm declined and with efforts to find a private-

sector solution unsuccessful, AIG faced severe liquidity pressures that threatened to force it imminently into bankruptcy.

The Federal Reserve and the Treasury agreed that AIG's failure under the conditions then prevailing—

The CHAIRMAN. Please, with all—no, you understood, you had the sign up. The next one to hold a sign—it is distracting to people. I understand that there are some people for whom rational discussion is not an appropriate means of expressing themselves. You are entitled to do that in general but not in a way that interrupts those of us who are trying to have rational discussions. So the next one who holds a sign will be ejected. I do not know how you think you advance any cause to which you might be attached by this kind of silliness.

Mr. Bernanke, please proceed.

Mr. BERNANKE. Thank you, Mr. Chairman.

The Federal Reserve and the Treasury agreed that AIG's failure under the conditions then prevailing would have posed unacceptable risks for the global financial system and for our economy. Some of AIG's insurance subsidiaries, which are among the largest in the United States and in the world, would have likely been put into rehabilitation by their regulators, leaving policyholders facing considerable uncertainty about the status of their claims.

State and local government entities that had lent more than $10 billion to AIG would have suffered losses. Workers whose 401(k) plans had purchased $40 billion of insurance from AIG against the risk that their stable value funds would decline in value would have seen that insurance disappear. Global banks and investment banks would have suffered losses on loans and lines of credit to AIG and on derivatives with AIG FP. The banks' combined exposure exceeded $50 billion. Money market mutual funds and others that held AIG's roughly $20 billion of commercial paper would also have taken losses. In addition, AIG's insurance subsidiaries have substantial derivatives exposure to AIG FP that could have weakened them in the event of the parent company's failure.

Moreover, as the Lehman case clearly demonstrates, focusing on the direct effects of a default on AIG's counterparties understates the risk to the financial system as a whole. Once begun, a financial crisis can spread unpredictably. For example, Lehman's default on its commercial paper caused a prominent money market mutual fund to break the buck and suspend withdrawals, which in turn ignited a general run on prime money market mutual funds, with resulting severe stresses in the commercial paper market. As I mentioned, AIG had about $20 billion in commercial paper outstanding, so its failure would have exacerbated the problems of the money market mutual funds.

Another worrisome possibility was that uncertainties about the safety of insurance products could have led to a run on the broader insurance industry by policyholders and creditors. Moreover, it was well-known in the market that many major financial institutions had large exposures to AIG. Its failure would likely have led financial market participants to pull back even more from commercial and investment banks, and those institutions perceived as weaker would have faced escalating pressure.

Recall that these events took place before the passage of the Emergency Economic Stabilization Act, which provided the funds that the Treasury used to help stem a global banking panic in October. Subsequently, it is unlikely that the failure of additional major firms could have been prevented in the wake of a failure of AIG. At best, the consequences of AIG's failure would have been a significant intensification of an already severe financial crisis and a further worsening of global economic conditions. Conceivably, its failure could have resulted in a 1930's-style global financial and economic meltdown, with catastrophic implications for production, income, and jobs.

The decision by the Federal Reserve on September 16, 2008, with the full support of the Treasury, to lend up to $85 billion to AIG should be viewed with this background in mind. At that time, no Federal entity could provide capital to stabilize AIG, and no Federal or State entity outside of a bankruptcy court could wind down AIG.

Unfortunately, Federal bankruptcy laws do not sufficiently protect the public's strong interest in ensuring the orderly resolution of nondepository financial institutions when a failure could pose substantial systemic risks, which is why I have called on the Congress to develop new emergency resolution procedures. However, the Federal Reserve did have the authority to lend on a fully secured basis consistent with our emergency lending authority provided by the Congress and our responsibility as the Central Bank to maintain financial stability.

We took as collateral for our loan AIG's pledge of a substantial portion of its assets, including its ownership interest in its domestic and foreign insurance subsidiaries. This decision bought time for subsequent actions by the Congress, the Treasury, the FDIC, and the Federal Reserve that have avoided further failures of systemically important institutions and have supported improvements in key credit markets.

Having lent AIG money to avert the risk of a global financial meltdown, we found ourselves in the uncomfortable situation of overseeing both the preservation of its value and its dismantling—a role quite different from our usual activities. We have devoted considerable resources to this effort and have engaged outside advisors. Using our rights as creditor, we have worked with AIG's new management team to begin the difficult process of winding down AIG FP and to oversee the company's restructuring and divestiture strategy. Progress is being made on both fronts.

However, financial turmoil and a worsening economy since September have contributed to large losses at the company, and the Federal Reserve has found it necessary to restructure and extend our support. In addition, under its Troubled Asset Relief Program, the Treasury injected capital into AIG in both November and March.

Throughout this difficult period, our goals have remained unchanged: to protect our economy and preserve financial stability; and to position AIG to repay the Federal Reserve and return the Treasury's investment as quickly as possible.

In our role as creditor, we have made clear to AIG's management, beginning last fall, our deep concern surrounding compensa-

tion issues at AIG. We believe it is in the taxpayers' interest for AIG to retain qualified staff to maintain the value of the businesses that must be sold to repay the government's assistance. But, at the same time, the company must scrupulously avoid any excessive and unwarranted compensation. We have pressed AIG to ensure that all compensation decisions are covered by robust corporate governance, including internal review, review by the compensation committee at the board of directors, and consultations with outside experts.

Operating under this framework, AIG has voluntarily limited the salary, bonuses, and other types of compensation for 2008 and 2009 of the CEO and other senior managers. Moreover, executive compensation must comply with the most stringent set of rules promulgated by the Treasury for TARP fund recipients. The New York attorney general has also imposed restrictions on compensation at AIG.

Many of you have raised specific issues with regard to the payout of retention bonuses to employees at AIG FP. My reaction upon becoming aware of these specific payments was that, notwithstanding the business purposes that might be served by this action, it was highly inappropriate to pay substantial bonuses to employees of a division that had been the primary source of AIG's collapse.

I asked that the AIG FP payments be stopped but was informed that they were mandated by contracts agreed to before the government's intervention. I then asked that suit be filed to prevent the payments. Legal staff counseled against this action on the grounds that Connecticut law provides for substantial punitive damages if the suit would fail. Legal action could thus have the perverse effect of doubling or tripling the financial benefits to the AIG FP employees. I was also informed that the company had been instructed to pursue all available alternatives and that the Reserve Bank had conveyed the strong displeasure of the Federal Reserve with the retention payment arrangement.

I strongly supported President Dudley's conveying that concern and directing the company to redouble its efforts to renegotiate all plans that could result in excessive bonus payments. I have also directed staff to work with the Treasury and the Administration in their review of whether the FP bonus and retention payments can be reclaimed. Moreover, the Federal Reserve and the Treasury will work closely together to monitor and address similar situations in the future.

To conclude, I would note that AIG offers two clear lessons for the upcoming discussion in the Congress and elsewhere on regulatory reform:

First, AIG highlights the urgent need for new resolution procedures for systemically important, nonbank financial firms. If a Federal agency would have had such tools on September 16th, they could have been used to put AIG into conservatorship or receivership, unwind it slowly, protect policyholders, and impose haircuts on creditors and counterparties as appropriate. That outcome would have been far preferable to the situation we find ourselves in now.

Second, the AIG situation highlights the need for strong, effective, consolidated supervision of all systemically important firms.

AIG built up its concentrated exposure to the subprime mortgage market largely out of the sight of its functional regulators. More effective supervision might have identified and blocked the extraordinarily reckless risk-taking at AIG FP.

These two changes could measurably reduce the likelihood of future episodes of systemic risk like the one we faced at AIG.

Thank you, Mr. Chairman.

[The prepared statement of Chairman Bernanke can be found on page 70 of the appendix.]

The CHAIRMAN. Thank you.

Mr. Bernanke, let me go back again. The context is important, and I do want to be clear. There was some reference earlier to TARP—excuse me.

Oh, I am sorry. Mr. Dudley hasn't given his statement yet. I didn't realize—I hadn't looked at the agenda, and I didn't know Mr. Dudley was going to give a statement.

Go ahead, Mr. Dudley.

STATEMENT OF WILLIAM C. DUDLEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL RESERVE BANK OF NEW YORK

Mr. DUDLEY. Good morning, Chairman Frank, Ranking Member Bachus, and other members of the committee. Thank you for giving me the opportunity to appear before you today. I appreciate having this opportunity to discuss the Federal Reserve Bank of New York's involvement with AIG.

At the outset, it is important to note that before the New York Fed became involved with AIG as a lender on September 16, 2008, the Federal Reserve lacked any kind of authority to oversee AIG. The lack of effective, consolidated supervision over AIG was a critical contributing factor to the debacle that occurred at the company.

The Federal Reserve made its decision to lend based on a judgment that a failure of AIG would cause dramatically negative consequences for the financial system and the economy, consequences worse than what occurred in the aftermath of the failure of Lehman Brothers. We stand by that judgment today.

In the case of Lehman, some of the most severe repercussions related to the difficulties in coordinating crossborder insolvency regimes and in coordinating the insolvency regimes among different types of institutions within the organization's corporate structure. In light of AIG's unparalleled global footprint, operating in more than 130 countries around the globe, the multiplicity of different types of financial service entities within its structure—including insurance providers, foreign banks, consumer lending companies, and over-the-counter derivatives affiliates—the factors that proved unmanageable in the Lehman insolvency threatened to be much more severe in AIG's case.

The fact that no effective emergency resolution procedures exist under U.S. law to reconcile these difficulties heightened the need for quick, effective action by the Federal Reserve in consultation with and supported by the U.S. Treasury.

From the outset, the New York Fed has been sharply focused on addressing two overarching goals with respect to AIG: one, the sta-

bilization of the company so that it no longer poses a disruptive threat to our financial system and the economy; and two, obtaining full repayment of government funds that had been extended to AIG.

In light of the exceptional size and scope of AIG's operation, with over 110,000 employees in more than 130 countries, spanning hundreds of legal entities, it was clear from the beginning that the New York Fed, which has never been engaged in any regulatory oversight of this company, was not in a position to exert day-to-day management control over it.

Rather, the New York Fed's actions have consistently been directed at securing its objectives as lender. As any lender in our position would do, the New York Fed has put into place a loan agreement that contains covenants designed to help ensure ultimate repayment of the loan. But these creditor rights do not create an ability on our part to manage AIG. Responsibility for AIG's day-to-day affairs continues to rest with AIG's chief executive officer, Edward Liddy, under the oversight of AIG's board of directors.

Mr. Liddy, who has only become involved with AIG in a public-spirited attempt to resolve its troubled affairs, has made strides in dealing with AIG's opaque corporate structure, lack of centralized controls, and complex risk exposures, but much remains to be done.

In light of the inherent conflicts that would arise from either the U.S. Government or the Federal Reserve exerting ownership control over the world's largest insurer, the Federal Reserve, with support of the Treasury Department, directed in the loan agreement that an approximately 77.9 percent equity interest in AIG would be issued to an independent trust established for the sole benefit of the U.S. Treasury.

The trust, which now holds that controlling equity interest, is overseen by three independent trustees, who are of the highest integrity and who have considerable experience leading major companies. These trustees have a legally binding obligation to exercise all their rights as majority owner of AIG in the best interest of the U.S. taxpayer, with the proceeds of any ultimate sale of shares going directly to the Treasury of the United States.

As has been widely noted, the activities of AIG's Financial Products group were a principal cause of the losses that drove AIG to the brink of bankruptcy in September 2008. Risks of substantial magnitude, including derivative positions with a current total notional value exceeding $1 trillion, still remain in force at FP, meaning that not millions, but billions of taxpayer dollars are potentially at stake today as the orderly wind-down of FP continues to progress. The winding down of these risk positions at FP is a delicate and complex matter with systemic implications for the U.S. and global economy. Our oversight of this risk-reduction process remains a top priority.

With respect to the retention awards owed to FP employees under their preexisting contracts, we believe that Mr. Liddy weighed a number of factors in deciding not to attempt to prevent payment. These include: the likely negative effects of disruption in staffing at FP in managing its multi-billion-dollar exposures; legal advice that the contracts were valid, meaning that breaking them would likely increase the amount of company funds ultimately paid

to the cover employees; and the negative consequence to AIG's business that could result from public abrogation of these contracts.

In conducting our oversight as lender, the New York Fed did not see any reason to disagree with Mr. Liddy's judgment from a risk perspective. Equally important, we did not think it was legally permissible or within the proper role of the New York Fed to attempt to substitute our judgment for that of Mr. Liddy's in this circumstance, even though we found the payment of these retention awards extremely distasteful.

The broad public disapproval of sizable retention payments being directed towards the unit most responsible for last fall's downfall of AIG is understandable. Americans naturally feel outrage when confronted with news of such payments to an entity that worsened the financial crisis and that is dependent on taxpayer funds to stay out of bankruptcy court, where these contracts would not have been fully honored. Moreover, the payments occurred during a time when so many Americans are struggling to find jobs, seeing their wages reduced, or watching their retirement savings plummet as a result of a crisis they had no hand in creating.

This feeling of outrage underscores the urgent need to reform the system of compensation at our financial institutions in order to more closely align the incentives of executives, owners, and taxpayers. Congress saw fit to impose appropriate compensation restrictions on recipients of Troubled Assest Relief Program funding. We think it is crucial for Congress and the U.S. Department of the Treasury to continue to craft effective and sensible policies in this area.

Although oversight of TARP-related compensation matters rests with the Treasury Department, the New York Fed has played a role since September in reviewing the adequacy of AIG's corporate governance procedures. This review has helped to identify longstanding deficiencies with respect to compensation committee governance, compensation benchmarking, and a lack of a centralized control over compensation policy. We will continue to work with our colleagues at Treasury and the independent trustees to ensure that AIG's management properly addresses these deficiencies.

The total package of assistance that the Federal Reserve and Treasury Department have committed to AIG has established a more durable capital structure for the company that gives AIG greater time and flexibility to execute its assets disposition plans to repay government funds. Notably, we have recently agreed in principle to accept preferred interest in two of AIG's large, foreign life insurance subsidiaries, AIA and ALICO, in order to make repayment of our loan less dependent on forced divestitures into what is now a depressed acquisition market. Although it will take time, we still expect that the proceeds from asset sales should enable AIG to repay the New York Fed in full.

In all that we have done, we have been motivated by two goals: one, to preserve the stability of the U.S. economy; and, two, to protect the U.S. taxpayer. The threat of a major systemic risk event has been averted by honoring all of AIG's contractual obligations around the globe, from insurance policy obligations owed to individuals, municipalities, and businesses across the United States, to

the posting of collateral under credit default swap arrangements with the full range of counterparties that has been recently disclosed. As unattractive as certain aspects of this treatment may be, these negative aspects have followed unavoidably from the decision to avert a systemically disruptive bankruptcy.

I look forward to your questions today and, in the longer term, to working with you and your staffs on the broader public policy questions, such as a formulation of a resolution regime for institutions like AIG and consideration of the appropriate supervisory structure for OTC derivatives that are posed by events at AIG.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dudley can be found on page 77 of the appendix.]

The CHAIRMAN. As I was saying, I want to begin with Mr. Bernanke, but first an announcement—stop the clock, please—that is going to be very important. Restart the clock, please, when I am through with this.

We have a lot of members here; it is a very important hearing. I wish we didn't have the 5-minute rule, and I wish we didn't have so many members, and I wish I could lose weight without dieting. In the absence of the reality of any of those, the following will happen:

At the conclusion of each member's 5 minutes, whomever is speaking will be allowed to finish the sentence, and then that will be it, and they will have to not have too many dependent clauses. Members should understand that. If they want answers to questions, leave time for the answers. It simply isn't fair to the more junior members for us to abuse the 5-minute principle. So that will happen. I will probably also gain weight, since we are talking about what will happen.

Now I will begin with my 5 minutes.

Mr. Bernanke, again, I think it is important to remember—because I think an unfortunate partisan effort has slipped in here—that this is a decision made by yourself, I presume in consultation with the Secretary of the Treasury, last September, and it was not one that required any congressional involvement. That came a couple of days later with the TARP.

When you made the decision to intervene, to deal with the creditors of AIG, was that in consultation with Secretary of the Treasury Paulson?

Mr. BERNANKE. It was in full consultation with the Secretary and full agreement with the Secretary. And we both came in and informed—obviously we did not get approval—but we did inform in advance of this final decision a large number of Members of Congress.

The CHAIRMAN. No, I remember, I was one of those. And I remember the Secretary and you were there, and he was fully in support of this. I do remember raising, myself, the question of why there was no foreign participation, since one of the arguments that we were given for the need for this was to maintain foreign confidence. And I certainly don't shrug that off. People who thought we could take that for granted, I think, got a little bit of a start from the Prime Minister of China on that subject. But it is important that this was fully supported by the Secretary of the Treasury

acting for the President. And when you came up and informed us, that was clearly the case.

Let me now ask, on the question of compensation, Mr. Dudley, you talked about the need to reform compensation. I assume you were talking about reforms that go beyond recipients of capital funds under the TARP, is that correct?

Mr. DUDLEY. That is correct. We have looked at the compensation governance arrangements at AIG, and we have put considerable pressure on the company to improve those corporate governances.

The CHAIRMAN. Well, I understand. But are you talking about outside of the context of people who receive funding?

Mr. DUDLEY. Pardon me?

The CHAIRMAN. When you talk about the need to improve compensation, I thought you were talking about more than just AIG.

Mr. DUDLEY. No, this is with respect to AIG.

The CHAIRMAN. Just with AIG.

But, Mr. Bernanke, you talked about compensation in the broader context. Would you elaborate?

Mr. BERNANKE. Yes, sir, I have. I do think it is very important that compensation that links performance and reward appropriately and, in particular, does so in a way that does not incentivize excessive risk-taking, that makes sure that we don't get short-term compensation for long-term outcomes, and that in general is more consistent with both appropriate proportionality but also with maintaining the appropriate incentives for safe and sound behavior. And that was missing in AIG.

The CHAIRMAN. And you think that should be done across-the-board with large financial institutions, whether or not they are receiving Federal monies.

Mr. BERNANKE. Yes, sir, I do. We have already undertaken that through the supervisory process.

The CHAIRMAN. So you think that lessens the possibility that people will get into trouble?

Mr. BERNANKE. It is an important issue for avoiding a future systemic crisis.

The CHAIRMAN. Well, I appreciate that, because, in 2006 and 2007, I was involved with legislation. We had a hearing on it in 2006, when my Republican colleagues were in the Majority, and we petitioned under the rules for a hearing. And then, in 2007, we brought forward legislation dealing with executive compensation, at that point more of a restraint on pay. And it became a very partisan issue.

So I do want to say we are probably going to revisit this. We ran into a great deal of opposition. And it is apparently something that divides the parties. There is a considerable view, particularly on the Republican side, that we should not intervene at all in the questions of compensation, unless we are talking about people getting Federal money. We all agree that is a different category.

I was pleased to hear you say what you said, because it does seem to me that—and we are not talking now about the amount of compensation, although you do mention proportionality, but the incentive structure of the compensation; that compensation which

incentivizes top decisionmakers to take risks unduly adds to the risk in the system.

I solicited that comment because that is one of the things we will be returning to. And there will be a debate this year in the Congress, as part of our effort to diminish systemic risk, on whether or not the structure, the incentive structure, of compensation be included. As I said, the last time that came up, there was a partisan debate. I hope there is a less partisan debate the next time.

Now, on the resolution authority, again, let me ask this directly, Mr. Bernanke: If the resolution authority had existed on September 1, 2008, would AIG have been handled differently?

Mr. BERNANKE. Quite differently. It could have been taken into receivership or conservatorship. This bonus issue would not have arisen because all the contracts could have been adjusted by the conservator. As necessary, we could have taken haircuts against some of the counterparties without creating a default or disorderly situation.

So it is very similar, as you pointed out, to the way the FDIC would now handle an IndyMac, for example, and with some disruption obviously but not nearly the consequences of a failure, of a disorderly failure of a large insurance company.

The CHAIRMAN. Thank you.

The gentleman from Alabama.

Mr. BACHUS. Thank you.

Secretary Geithner, on September 14th, you and Secretary Paulson met with AIG to discuss Lehman's failure and their worsening condition?

Secretary GEITHNER. We had a series of meetings in the days preceding the action by the Fed on the 16th—

Mr. BACHUS. On the 16th, okay.

Secretary GEITHNER. —with AIG and a range of other financial institutions. As the chairman said, you know, the world is going through a—

Mr. BACHUS. Yes, I understand that. But you met with him. And, as a result of those meetings, there was a government intervention supervised and coordinated and led by the New York Fed. And you were president of the New York Fed.

Secretary GEITHNER. I was president of the New York Fed.

Mr. BACHUS. On September 16th, the government became the 79.9 percent owner of AIG. Is that correct?

Secretary GEITHNER. That is correct.

Mr. BACHUS. Then there was an $85 billion government guarantee that went to AIG, or funds. Is that correct?

Secretary GEITHNER. That is correct.

Mr. BACHUS. Then, on October the 8th, a good amount of that money was paid to the counterparties. Is that correct?

Secretary GEITHNER. Well, again, the purpose of the intervention was to prevent default by AIG, because our judgment was the consequence of default would have been catastrophic to the American economy.

Mr. BACHUS. Sure, I understand that.

Secretary GEITHNER. So AIG was able to, as a result of the intervention, to meet a full range of its obligations as a large, complex financial institution.

Mr. BACHUS. Sure, I understand that. But what I am saying is that you took over on September 16th, then on October the 8th, began to pay the counterparties off.

Secretary GEITHNER. Well, again, throughout that period of time—and this was critically important to the stability of the financial system—we wanted to make sure AIG was able to meet its commitments.

Mr. BACHUS. I understand that. To pensioners, to retirees, to—

Secretary GEITHNER. Municipalities.

Mr. BACHUS. Municipalities.

Secretary GEITHNER. Banks.

Mr. BACHUS. But what I am saying is, within about 2 weeks, these payments—or 3 weeks—payments were made to the counterparty. I am not—

Secretary GEITHNER. Well, I think probably within hours, technically, within minutes probably.

Mr. BACHUS. All right, within hours.

There has been now a total somewhere over $50 billion worth of these payments to counterparties. I am very interested in that. I mean, these payments to counterparties, these were parties that took a risk and entered into agreements with AIG, were they not?

Secretary GEITHNER. Absolutely.

Mr. BACHUS. Okay. And these were credit default swaps, securities lending, things of that nature, which you can lose money on.

Secretary GEITHNER. Well, any insurance contract written by AIG poses a risk to the person who bought that insurance contract.

Mr. BACHUS. Sure. And a credit default swap is sort of a—I guess you could call it a form of insurance. But what I am saying is it was an agreement between two parties. And AIG defaulted or was on the verge of defaulting.

Secretary GEITHNER. Well, AIG was on the verge of default. So, again, any of the contracts AIG had with millions of people who bought insurance from it—

Mr. BACHUS. Well, I understand those people and those contracts with people, you know, retired teachers, etc. But now I am focusing on the counterparties. They were paid 100 percent of everything AIG owed them. Is that correct?

Secretary GEITHNER. I am not sure if technically that is right, but, again, the purpose of the intervention was—

Mr. BACHUS. No, I am not talking about the purpose of the intervention. I am—

Secretary GEITHNER. So the result of the intervention was AIG was able to meet its obligations under—

Mr. BACHUS. But what I am saying, Mr. Secretary, is that AIG's counterparties were paid 100 cents on the dollar.

Secretary GEITHNER. The people who had contractual obligations from AIG, from the person who bought an insurance protection product or a basic insurance product, were paid—

Mr. BACHUS. Well, we are not talking about insurance policies here. I am talking about—

Secretary GEITHNER. No, but this is very important.

Mr. BACHUS. I am talking about the foreign banks, Goldman Sachs. They were paid 100 cents on the dollar, were they not?

Secretary GEITHNER. Again, that was the purpose and result of—

Mr. BACHUS. Well, I am not talking about whether—I am just saying they were paid 100 percent of what they were owed.

Secretary GEITHNER. AIG was able to meet its commitments and met its commitments.

Mr. BACHUS. At 100 percent.

Secretary GEITHNER. It fully met its obligation, yes.

Mr. BACHUS. Sure, fully met its obligation.

Well, my question to you—and I am not—was there any discussion about a haircut, or 95 percent, taking 95 percent or 90 percent as full payment?

Secretary GEITHNER. We explored, at that time, every possible means to reduce the drain on their resources, including what you referred to. But, again, because we have no legal mechanism in place for dealing with this like we deal with the bank, we did not have the ability to selectively impose losses on their counterparts.

Mr. CHAIRMAN. I am sorry. The gentleman has now exceeded 5 minutes. As I said before, the last person speaking during the 5 minutes will complete a sentence, and we will move on.

Mr. Geithner, do you want to complete the sentence?

Secretary GEITHNER. I have forgotten where I was in my sentence, but—

The CHAIRMAN. Well, that is all right.

Then we will now go to Mr. Kanjorski. There are too many members here for those of us in the top row to abuse the 5-minute privilege.

The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Mr. Geithner, it is interesting to note, just in the questioning of the gentleman from Alabama, how we are not sure of what happened, when, and under what circumstances.

Have you understood yet that the American people's reaction last week to a large extent was due to the fact that they feel that they are boxed out of knowing what is really going on in this economic crisis, and they are not well-informed?

Secretary GEITHNER. Absolutely, Congressman. I think that the American people are deeply frustrated and concerned and angry and skeptical, frankly, that they understand what is happening and whether taxpayers' moneys are being used wisely to deal with this. I completely understand it, and it is a completely reasonable reaction to the damage caused by this crisis.

Mr. KANJORSKI. Do you feel that ultimately the Federal Reserve and yourself will have to come up to Congress and ask for additional authority in a "rescue II" to replenish the capital of some of these banks after we get rid of the asset problem, and whether or not the activities of the last several weeks and this lack of information as to what the problem is, and what the potential solutions are, will cause grave question as to whether or not the Congress will authorize further rescue money?

Secretary GEITHNER. Of course, I understand that. I think there are—it is clear that we are going to need to ask them. We will ask for broader authority to deal with future AIGs. That is in the interest of the country. We will do that.

Now in the President's budget, as you know, we have put in a reserve fund against a contingency that to solve this crisis ade-

quately, we may need to come back to the Congress and ask for additional resources. We have not made that judgment yet, but I completely understand the scale of skepticism and the public opposition to the provision of additional resources.

But our responsibility is to recommend to the Congress what is necessary to help get the economy back on track, and if that requires more resources, it will be our obligation to come to you and make the case for that. But we recognize it is going to be extraordinarily difficult, particularly in the wake of not just the last 2 weeks, but the last 9 months, frankly.

Mr. KANJORSKI. Well, that being the case, I assume that you recognize that there is not an awful lot of sympathy up here to necessarily provide additional funds, not going on the merits of whether the funds are necessary. I, for one, am absolutely convinced that for orderly process we need additional funding, and probably will, as we did back in September and October, vote in favor of that funding. But it is not going to be an easy lift on behalf of the Congress.

In light of those facts, what are you designing or what are you putting in place so that we could adequately inform the American people as to what the real problems are and what the potential solutions to those problems are so there are more partners in this act that we are going through?

Secretary GEITHNER. That is a very important question. Thanks for asking it.

Within the first weeks of taking office, we put in place a set of clear commitments to put in the public domain the precise terms of all the financial contracts that my predecessor entered into and that we would enter in the future that would provide taxpayer assistance to financial institutions under the Emergency Economic Stabilization Act. Because of that commitment, the American people will be able to see, as I said, the precise terms for the first time of those commitments.

In addition, we are going to require extensive reporting by any recipient of TARP assistance to go into how they are going to use those resources, what it is going to do to their lending capacity, and what is actually happening to lending. We have proposed very strong conditions on compensation, on dividends, and a range of other things.

But I completely agree that the American people deserve to see much higher standards for transparency and accountability over the use of these resources, and they are understandably skeptical that they are going to see enough benefit from these resources, in part because of the decisions you have seen made across the financial sector in the wake of Congress passing that exceptional authority back in September.

Mr. KANJORSKI. Would you call this putting together rules of engagement that in the future, as you move down this track, that you are—the people you are dealing with, the companies you are bailing out, and also the American people will know the rules of the road?

Secretary GEITHNER. I think that is a very important thing. I mean, it is very important that the American people understand we are going to devote these resources to things that are going to get

credit flowing again, get interest rates down, and improve the access for businesses and consumers to credit. That is the central obligation and purpose of this authority.

And if you look at what we have done over the last several weeks, you can see we have moved quickly to put in place very substantial measures to address the housing crisis. You are seeing the actions of the Fed and the Treasury together bring down interest rates, allow Americans to refinance and take advantage of lower interest rates. You have seen us move to put in place very important new programs to help support small business lending, to get lending flowing again across the financial system as a whole. Those are very important things. But as part of that, we need better clarity on the rules of the game going forward. I completely agree.

Mr. KANJORSKI. Thank you very much.

The CHAIRMAN. Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

Mr. Chairman, I appreciate your opening response to the chairman with regard to your first involvement with the bailout, saying that it was in consultation with Treasury, but also, if I heard you correctly, also in consultation but not with the approval of the chairman of this committee as well; is that correct?

Mr. BERNANKE. Secretary Paulson and I informed a large group of congressional leaders about the issue, and also the President, prior to the final signing of the agreement.

Mr. GARRETT. Did the chairman or anyone else ask the question at that time whether or not bonuses or pay or anything else should be considered at that point in time?

Mr. BERNANKE. I don't recall any discussion of bonus or pay.

Mr. GARRETT. Thank you.

Mr. Geithner, I really do appreciate sincerely your opening comment—one of your comments with regard to Mr. Liddy and saying that some of the comments about him were over the top, and some of the vitriolic comments coming out of this committee, as well, were certainly over the top. I appreciate very much the fact that we are not going to get people like him to come in under circumstances like this. And I also appreciate the fact that, with all due respect, you are having a difficult time in the Treasury as far as filling all the spots that you need.

I think it is difficult, with that sort of action going on in Congress, for you to be able to do that. And I think it is also difficult for all of you to get your job done in light of what was done in Congress last week imposing impediments, if you will, in the legislation that we passed as far as accomplishing what you need to accomplish.

With all that said, I appreciate that.

Mr. Chairman, going back to your comments, you knew about this to some extent, and you elaborate on page 5 of your testimony, which I think is very insightful, as far as the litany of your involvement and who you are looking at on the loss side and what have you. There was a filing with the SEC at the beginning of September at that time which laid out of some that information. I presume both of you, Mr. Geithner is nodding, and Mr. Bernanke, I presume you knew as well, saying at that time as far as the compensation packages that were out there that would have to be con-

sidered, I presume that one or both of you knew about that filing at that period of time, at least laying out the information? Yes or no?

Mr. BERNANKE. Congressman, I knew that there were general compensation packages throughout the company. I did not know, I was not informed about the specific payments to AIG FP.

Mr. GARRETT. If you had that information, would that have been germane to your discussion of this?

Mr. BERNANKE. It would have given us more time to talk, negotiate, and look for options, but, frankly, we still would have faced the same legal obstacles that we are currently facing.

Mr. GARRETT. Likewise, Mr. Geithner.

Secretary GEITHNER. May I just say something? This is hugely important.

Mr. GARRETT. Sure.

Secretary GEITHNER. A huge amount of information was available in the public domain. We knew from the beginning that we had a mess on our hands, a very complicated mess we were going to have to work through. We were spending every minute, every molecule of oxygen to contain this fire.

Mr. GARRETT. I appreciate that. I only have 5 minutes, but let me finish the question.

Secretary GEITHNER. But on the specific question you asked—

The CHAIRMAN. The gentleman from New Jersey has the time. Remember he has the time.

Mr. GARRETT. If I go around again, I will let you elaborate on that.

The CHAIRMAN. In your dreams.

Mr. GARRETT. And I do dream about this stuff, oddly enough.

The CHAIRMAN. I yield the gentleman an additional 10 seconds, please.

Mr. GARRETT. While some of this was in the public domain, clearly Congress was not thinking about this during that period of time. Was it in the consideration of either one of during that period of time, while you were discussing it—I do appreciate the fact how you were discussing it and weighing all the legal considerations, what have you—was not conveyed to Congress in a formal manner, one way, shape, or form? Was that ever considered that you would discuss it with Congress, both of you?

Mr. BERNANKE. Congressman, one mechanism is congressional letters, and, as you know, we have received a large number of letters. We have responded in great detail, not often as quickly as we should have, and I apologize for that. But we have provided lots of information about governance, about compensation and other issues through that mechanism. Also, we report on the financial issue.

Mr. GARRETT. Well, to be candid with you, I don't remember any letters from September on between that time and now, or just a few weeks ago, discussing these particular issues, as far as compensation and the bonuses, what have you.

Was it ever your consideration, either one of you, at that period of time that if this information was discussed more publicly, that Congress may be hesitant about going forward with their voting in

favor of the additional TARP monies? That was never a discussion, never an issue?

Mr. BERNANKE. As I said, I was not aware of the specific set of payments until basically the same day, the 10th of March, I believe it was.

Mr. GARRETT. Right, but between that time forward, we have not been advised of this on the committee in a formal matter. We have? You are shaking your head yes.

Secretary GEITHNER. You are saying from March 10th forward?

Mr. GARRETT. From March 10th, we were.

Finally, we only have about 15 seconds left. With regard to the disorderly—or the not disorderly, but the orderly winding down of AIG, what can you tell us in about 15 seconds? If there are no prospects of parties out there to pick up the good assets of AIG, what are the prospects of additional taxpayers' dollars having to go into AIG to prop it up for a continued length or period of time while you continue to wind it down?

Mr. BERNANKE. It is going to depend very much on how the economy evolves and asset markets evolve, but contrary to what has been alleged, we have a very substantial and detailed plan for the unwinding, which involves selling off noncore assets and winding down the risky parts of the company.

The CHAIRMAN. The gentleman's time has expired.

The gentlewoman from California. I ask her for 15 seconds to respond.

The gentleman from New Jersey raised some questions about what I was told. We were told, not asked, but told that they were going to make this loan. I did, without a lot of time to react, raise one question, which is why there was not an effort to get foreign participation. I was told by Mr. Paulson and Mr. Bernanke that they did not think that was possible.

Two days later, we were asked by the same two gentleman to do the TARP money. At that point, at that meeting, I did raise questions of compensation and continue to make that a high priority.

The other thing I would say, I do notice, again, it seems to me, an unfortunate partisan tint. I was there at the same time as the ranking member. We were both there. We were both informed at the same time. We were not given any indication that our input was going to have any impact on what happened.

The gentlewoman from California. I appreciate her yielding to me.

Ms. WATERS. I would like to ask Mr. Geithner about the way that they have arranged to do the asset management for the new program that had been rolled out. You mentioned that there are five fund managers to manage the program for Treasury, and you set out the qualifications. Who will these five fund managers be?

Secretary GEITHNER. We don't know yet. We have to see who applies.

Ms. WATERS. Is it possible Goldman Sachs could be one of them?

Secretary GEITHNER. It is possible. If they are qualified, we would consider them—

Ms. WATERS. Were they included in one of the managers—when Mr. Paulson first rolled out the asset management program, before he pulled it back, was Goldman Sachs one of those five?

Secretary GEITHNER. I don't know, but I would be happy to go back and check.

Ms. WATERS. I will check it.

Let me tell you why I asked that. You hear a lot about the dissatisfaction about the bonuses, etc., but underneath all of this is a conversation about the linkages and the connections of the small group of Wall Street types that are making decisions. And I just want to ask you, because you may be able to clear some of this up, it is true that Goldman Sachs received money from AIG; is that right?

Secretary GEITHNER. That is true.

Ms. WATERS. How much was that?

Secretary GEITHNER. I don't have—I don't know exactly, but I would be happy to make sure—

Ms. WATERS. Okay, we will find out.

And also, they received money from the TARP Program, Goldman Sachs; is that right?

Secretary GEITHNER. That is correct.

Ms. WATERS. And Goldman Sachs is where Mr. Paulson really spent some time of his career, right?

Secretary GEITHNER. Absolutely.

Ms. WATERS. Your CEO that you hired to work with you is from Goldman Sachs also?

Secretary GEITHNER. My CEO.

Ms. WATERS. Well, whomever works for you. I don't want to get the nuances to the point where we misunderstand each other. Do you have—your chief of staff, is your chief of staff from Goldman Sachs?

Secretary GEITHNER. My chief of staff, who is an honorable person—

Ms. WATERS. Just tell—

Secretary GEITHNER. But, Congresswoman, my chief of staff did spend a brief period of time working in the past for Goldman Sachs, that is correct.

Ms. WATERS. Okay. That is all I want to know.

Then I want to know, was Goldman Sachs involved with the decision that was made that weekend before they came to the Congress—

Secretary GEITHNER. No.

Ms. WATERS. —to ask for money on the sale of Bear Stearns?

Secretary GEITHNER. No.

Ms. WATERS. Was anybody from Goldman Sachs involved in that discussion that weekend?

Secretary GEITHNER. Well, let me go back on this. At the time when Bear Stearns was on the brink of default, and the Federal Reserve then acted to try to avoid default, there were a range of institutions that considered buying and assuming the obligations of Bear Stearns.

Ms. WATERS. I really wish I had time for you to go into it, but Goldman Sachs was involved in some way in that decision based on whether or not they were considering the purchase themselves or they were advising about it; is that correct?

Secretary GEITHNER. No, not in the decision and not advising us.

Ms. WATERS. In some way.

Secretary GEITHNER. Certainly not advising us, no.

Ms. WATERS. Well, in some way. In some way, they were involved.

Secretary GEITHNER. Well, there were a whole range of institutions that Bear Stearns approached—

Ms. WATERS. Were they also involved in the decision not to support Lehman Brothers?

Secretary GEITHNER. No.

Ms. WATERS. In no way?

Secretary GEITHNER. No.

Ms. WATERS. All right.

Secretary GEITHNER. Those are decisions made by your government.

Ms. WATERS. I am just asking the questions, because the talk is, underneath what you may not know about, is this small group of decisionmakers at the center of it is Goldman Sachs, and that is what is causing a lot of the distrust, because people are thinking or believing that Goldman Sachs, because of the connections, have had a lot to do with the decisions that are being made.

Now, on the big fund, is there some reason why you only have to have 5 managers involved in this fund, with at least $500 million in private capital? This eliminates a lot of firms being involved, and we believe that Goldman Sachs will again be one of those who will be the beneficiary.

Secretary GEITHNER. Well, as I said, we are going to run an open, competitive process so that the taxpayers of the United States enjoy the best type of expertise in managing these funds. And there are some obvious practical concerns about why we can only have a limited number to do it.

But can I just come back to your basic premise, Congresswoman? Of course I am aware of this concern. I think it is deeply unfair to people who are party to these decisions to suggest they were making judgments that in their view were not in the best interests of the American people. But I understand that concern. I understand that concern.

The CHAIRMAN. The gentleman from New York, Mr. King.

Mr. KING. Thank you, gentlemen. I thank each of you gentlemen for your testimony today.

Secretary Geithner, I would like to follow-up on some of the questions by Congressman Kanjorski, and I would like to address the AIG bonus issue in the context of lessons learned and how what occurred with AIG would impact the toxic asset plan which you announced yesterday, because for that plan to succeed, there must be cooperation between the government and the private sector. There must be trust, and there must be assurance that rules are in place, and the rules won't be changed in the middle of the game.

Now, based on your experience with AIG, as painful as that may have been over the last several weeks or months, what can you do to assure the private sector that if they do participate, and they are profitable, and for whatever reason, justified or not, there is a public outcry, and we see the type of hysteria and hyperbole and histrionics, hyperventilating and conspiracy theories and retalia-

tory legislation that we saw last week, that these private institutions will not have their profits confiscated?

I am speaking now specifically especially of marginal institutions who may be deciding whether or not to participate.

I also ask in the context of your testimony today and recent comments regarding excessive compensation. Now, if the government gets involved in setting compensation, that is going too far. If you are setting standards, could that be too vague? And would private institutions, will they have—will they be protected from their compensation being subjected to ex post facto moralizing and judgments?

Secretary GEITHNER. Those are thoughtful questions. Let me just go quickly through them.

Mr. KING. Sure, take your time.

Secretary GEITHNER. I think it is absolutely right that we are not going to get through this financial crisis unless this system is willing to take risks, unless banks and private investors are able and willing to take risks again. That does require some confidence and clarity about the rules of the game going forward, and I think it is an important obligation we share with the Congress to try to make sure we are providing Congress with that level of competence and clarity.

Also important, though, is to make sure that we reassure the American people that the taxpayers' money is not going to go to reward failure and to encourage excessive risk-taking in the future.

Mr. KING. Well, if I could just interrupt here a second, obviously all of us agree the AIG bonuses were wrong. But how do we protect against that without going too far?

Secretary GEITHNER. It is a difficult judgment. As the chairman said in response to a previous question, the choices we faced were very constrained by the fact these were legal contracts, and we are a nation of laws, and we have to be very careful about the circumstance in which we raise questions about the government intervening with respect to legally valid contracts.

But we do have an obligation now to go back and try to recoup those payments, and we are going to do that carefully and explore legal avenues in that context.

Now, looking forward, I do think it is important for the country to put in place strong standards that govern compensation practices across the financial community as a whole, because, as we have seen, those can have systemic consequences, creating a more fragile and unstable system.

You are right, it is a difficult balance. The government should not be setting detailed or prescribing detailed regulations to govern amounts of compensation and their distribution. We have to hold to broad standards that again make sure that we are not encouraging short-term risk-taking at the expense of long-term stability.

And here is one other example. You want to make sure that people responsible for running the checks and balances in these firms, for running risk management, for doing the audit process, those people, too, are compensated adequately so you attract strong talent to run the checks and balances that our system depends on.

Mr. KING. What is the timeline as to when you expect to have these guidelines in place and your legacy asset plan goes forward?

Secretary GEITHNER. Our immediate priority is to lay out guidelines to apply the new legislative requirements on compensation that were passed as part of the American Recovery and Reinvestment Act, but we are going to move quickly, we hope, to lay out broad standards that help govern compensation practices in the future, beyond those that would apply to institutions that receive taxpayer assistance.

Mr. KING. On the legacy asset—toxic asset plan, do you intend to implement changes in mark to marketing?

Secretary GEITHNER. As you know, I believe the SEC, or the relevant legal authority, has put out for comment some important new clarifications to the fair-value accounting regime.

Mr. KING. What would Treasury's opinion be on that?

Secretary GEITHNER. I want to be careful on how I respond to that, but I will give you my initial reaction, which is they are a constructive set of changes. They provide a right balance between preserving confidence in the quality of public disclosure, which is very important to getting through this, but still address some of the complications of applying those experiences in a market like we are experiencing today.

Mr. KING. Thank you, Mr. Secretary.

The CHAIRMAN. The gentlewoman from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you, and I thank all of the panelists.

I received a report from AIG that they presented to our government during this critical time where they outlined the need for a bailout. They claimed that they were America's largest insurance company, and if they failed, the entire economy would fail. They more or less put a gun to our heads and said, if you don't bail us out, the economy will fail.

I would put it another way. If we bail out firms every time someone says it, our economy will collapse.

And since I have their detailed explanation, I would like to request from the Federal Reserve, Treasury, and the New York Fed the analysis that the government did that AIG needed to be saved. I would like to study that and also request the analysis that was made that Lehman should fail. I think the opportunity we have now is to study what happened so that we can make better decisions going forward.

So, Mr. Bernanke, does such a document exist, and could we receive copies of both the Lehman analysis and the AIG analysis from the government? Surely we did not just take AIG's analysis—

Mr. BERNANKE. We certainly did not take AIG's analysis. We have done our own analysis and had substantial discussions about the systemic risks associated with AIG. We will find what we have and try to provide it for you.

On Lehman, we did not choose to let it fail; it failed because we could find no solution. But our strong preference would have been to avoid failure, because we have seen the consequences of the failure.

Mrs. MALONEY. And, likewise, AIG came back several times for more money, and at each point we could have put restrictions on the executive compensation or management, or a number of ways. Each time they came back, we could have analyzed the systemic risk more, and I would like to request the documentation that was

done during those three periods that they came back for more money.

Mr. BERNANKE. We did impose considerable restrictions on executive compensation and the process for setting it. So did the TARP, when that became part of it.

The problem with the AIG FP bonuses was they were set by a contractual agreement prior to the government taking over the firm.

Mrs. MALONEY. Well, contracts can be changed. We change contracts all the time. Contracts are being renegotiated now with General Motors and with mortgage, housing, and all kinds of places, so they can be changed.

But when we saw the counterparties, it included one firm that has publicly said that they could have managed the default of AIG and been whole, so clearly there was no systemic risk with that company and possibly with others. I am sure you are aware of those public statements.

And, also, when you looked at the counterparties, there were municipal governments. Do you consider municipalities systemic risk?

Mr. BERNANKE. As I discussed in some detail in my testimony, the systemic risk goes well beyond specific counterparties. In the case of the company you are referring to, perhaps they were hedged, but then it means that some other party that hedged them would have lost. But more important than the specific losses associated with the counterparties would be the loss of the confidence in the system as a whole and the likelihood that we would have seen a run on banks, given that markets would not know ultimately who was exposed to AIG.

Mrs. MALONEY. And, likewise, it had counterparties that were a number of foreign banks. Do you consider bailing out foreign banks systemic risks to the American economy?

Mr. BERNANKE. I think it is essential that AIG meet its obligations. Otherwise it would have created substantial problems, yes.

Secretary GEITHNER. Congresswoman, could I add to that?

Mrs. MALONEY. Yes.

Secretary GEITHNER. We did not act because AIG asked for assistance. We did not act to protect the individual counterparties from the consequences of their defaults. We did not act to help foreign banks.

We acted because, in our judgment, the consequences of a default for the American people would have been catastrophic in ways that go directly to the value of their pension plans, and their capacity to borrow.

If you look at what happened across the source of the fall, you can see concrete evidence of exactly what would have happened in the wake of a failure of AIG.

It is very important to understand this. I don't believe there is any plausible argument that AIG was not systemic then, or that its failure today would not be systemic. I think all the judgments that went into that very difficult judgment in September still apply today.

And our obligation, the three of us here today, is to do what we believe is in the interest of, using the authority you have given us, to protect the American economy from the kind of catastrophic

damage that could come with default by a major institution like this.

Mrs. MALONEY. Reclaiming my time, basically, could the systemic risk have been contained at a much lower cost, Mr. Bernanke? Obviously—

The CHAIRMAN. The Chair was distracted. The gentlewoman completed her sentence. The time has expired.

The gentlewoman from Minnesota.

Mrs. BACHMANN. Mr. Chairman, thank you for this opportunity. These truly are extraordinary times in our financial services sector since 1 year ago the Federal Reserve opened the Fed's discount window in the amount of $29 billion for Bear Stearns.

The American people are looking at the actions of both the Federal Reserve and the Treasury Secretary, and they are wondering if their government is making an historic shift, jettisoning the free-market capitalism in favor of centralized government economic planning.

I wonder, Mr. Secretary, if you would comment on that.

Secretary GEITHNER. I do not believe that concern is justified. I understand why people would be worried about this. But what we are doing is using the authority the Congress gave us, authority that was designed to help protect the American economy from these—

Mrs. BACHMANN. Reclaiming my time, Mr. Secretary. What provision in the Constitution could you point to to give authority for the actions that have been taken by the Treasury since March of 2008?

Secretary GEITHNER. Oh, well, the Congress legislated, in the Emergency Economic Stabilization Act, a range of very important new authorities.

Mrs. BACHMANN. Sir, in the Constitution. What in the Constitution could you point to, to give authority to the Treasury for the extraordinary actions that have been taken?

Secretary GEITHNER. Every action that the Treasury and the Fed and the FDIC has been using authority granted by this body, by the Congress.

Mrs. BACHMANN. And in the Constitution, what could you point to?

Secretary GEITHNER. Under the laws of the land, of course.

Mrs. BACHMANN. And if I could move to the Federal Reserve Chair, if you could point to what provision in the Constitution would give authority to the Federal Reserve? This has been over $10 trillion that we are talking about.

Mr. BERNANKE. I don't know where $10 trillion comes from. The Congress has the right to authorize funds, which is what they did in the TARP Program. And in the 1930's, they gave the Federal Reserve the power for emergency lending as a means for addressing financial crises, which is what we have done.

Mrs. BACHMANN. And for the Federal Reserve Chair, do you believe there are any limits on the authorities that the Federal Reserve has taken since last March of 2008?

Mr. BERNANKE. The loans we make have to be fully secured and collateralized. We have practical limits in terms of our ability to manage monetary policy. So there are, obviously, limits.

We have reported extensively to the Congress on all the actions that we have taken, and the actions we have taken have been solely and entirely for the purpose of protecting the American economy from the effects of financial collapse.

Mrs. BACHMANN. We have seen both China and Kazakhstan make calls for an international monetary conversion to an international monetary standard as soon as the G–20, and I am wondering, would you categorically renounce the United States moving away from the dollar and going to a global currency, as suggested this morning by China and also by Russia?

Mr. Secretary?

Secretary GEITHNER. I would, yes.

Mrs. BACHMANN. You would, categorically?

And the Federal Reserve Chair?

Mr. BERNANKE. I would also.

Mrs. BACHMANN. Could you tell me why AIG was not put into receivership as opposed to conservatorship?

Mr. Secretary.

Secretary GEITHNER. Again, no legal means existed under U.S. law to resolve AIG using the kind of powers available to the FDIC to resolve a bank. Because of the absence of authority, your government was faced with no good options, and we chose the best option available at the time to help protect the economy from systemic damage. If we had different authority, we would have had different choices.

Mrs. BACHMANN. And to the Federal Reserve Chair, the Federal Reserve has denied giving information to the American people about the overnight loans that are made to the companies in terms of the bailout. Bloomberg had initiated a lawsuit, and the Federal Reserve has rejected. Twenty Members of this Congress have written a letter to the Federal Reserve asking that the American people be given the information about which banks made the loans, what the collateralization is.

Can you tell me why the Federal Reserve does not want the American people to know who these loans are made to on an overnight basis?

Mr. BERNANKE. First of all, it has nothing to do with the bailout. This is short-term lending done by the Federal Reserve to banks, as has been done by central banks around the world for hundreds of years. The purpose is to provide short-term liquidity to these banks.

Hundreds of banks, both large and small, come to the discount window. They provide collateral for their loans. We have never lost a penny on this program.

Mrs. BACHMANN. Mr. Chairman, why would the American people be disadvantaged for knowing this information?

Mr. BERNANKE. They would not be disadvantaged necessarily—well, they would in the following sense: the concern is that if banks were revealed to be borrowing and others were not, inference might be drawn that they were in weaker condition than they, in fact, might be.

The problem is what is called stigma, so that if banks are being perceived as weaker, if they have to come to the Fed, then others

might not wish to deal with them, and they might not come to the Fed.

In fact, that was the problem we had at the beginning of this episode, that no one wanted to come borrow, even though it was clear that the banking system needed to get liquidity from us. So we have tried to make sure that their information is protected so they will, in fact, come and take the liquidity they need—

Mrs. BACHMANN. Mr. Secretary, as I understand it, approximately 90 to 95 percent in the new program that you have just announced yesterday of the funding would come from the taxpayers; is that true? Or perhaps the leveraging is a 6 to 7-to-1 leveraging on the purchasing of the public-private partnership, the toxics assets that are available.

When the returns come back to the American people, will the American people be receiving 90 to 95 percent of the benefit, or will it be another figure?

The CHAIRMAN. The gentlewoman's time has expired.

Mrs. BACHMANN. Mr. Chairman, could I have an answer from the—

The CHAIRMAN. No. As I explained, members control the time. You cannot extend your time into somebody else's time and then get an answer. As I said, the person speaking at the expiration of the time will be the last person speaking.

You cannot—if members use their time to extend the discussion, then members lower down will not get a chance to question. When the time expires, the person speaking will be the last person speaking.

The gentlewoman from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Bernanke, in September when you established the credit facilities for AIG, what sort of specific restriction did the Fed impose at that time on compensation to AIG management and employees?

Mr. BERNANKE. Well, President Dudley might be able to help me, but first of all, we replaced the CEO and other top management. We imposed very tough restrictions on the pay to the top executives. In fact, three of the top executives are working for zero or $1 a year right now.

Then when the TARP money came in, the strictest terms of the TARP compensation restrictions were imposed, and, in addition, the company agreed to go well beyond the legal requirements imposed by the TARP law.

So, throughout the top executive ranges, there have been very substantial restrictions on compensation.

Bill, did you have anything else there?

Mr. DUDLEY. In addition to that, we have worked on the governance of the compensation structure at AIG to basically firm it up so that they do a better job in terms of coordinating how compensation is done throughout the company. AIG is a company with a very weak core and lots of big business units spread all over the world. And so compensation was not done on a consistent basis across the company, and we are working to improve that with AIG.

Ms. VELAZQUEZ. So if you imposed all those restrictions, how can you explain the types of bonuses that were provided by AIG?

Mr. BERNANKE. Those restrictions, as have been the case in most of the TARP activities, for example, apply to the top management of the firm. These were not bonuses at the top management of the firm. They were bonuses to individuals working in the AIG FP division. They were highly compensated because they were using very complex financial derivatives and applying their knowledge.

But, and, again, as we have discussed, the contracts were signed prior to the takeover.

But I certainly agree. I mean, to be very clear, I think that the bonuses were disproportionate. And we are doing all we can to claw them back and to reduce any further bonuses to that division.

Ms. VELAZQUEZ. So, did you have any—did you or any senior Fed official have discussions or e-mail communications regarding AIG's intention to make these bonuses not to the top level, but to the other employees that were given?

Mr. BERNANKE. As I mentioned, I was not personally informed about this specific set of payments until March 10th. I then checked the various options that we had, legal and otherwise, and President Dudley communicated with CEO Liddy, as did the Treasury Secretary, and President Dudley wrote a letter expressing our deep concern about these bonuses.

Ms. VELAZQUEZ. Mr. Chairman, the Fed directly, through special purpose entities, has extended AIG nearly $100 billion in loans. For the record, are you confident that AIG will fully pay back its loan to the Fed?

Mr. BERNANKE. I am very confident. First of all, half of the $100 billion is now no longer directly on the credit of AIG. It is secured by other types of securities, which we are assured will likely, very likely, pay us back and perhaps provide some profit.

The remainder, $50 billion, half of it is directly owed, by AIG; the other half is secured by senior preferred positions in two of their strongest subsidiary insurance companies.

Ms. VELAZQUEZ. Given everything that we have seen, in the event of a default by AIG on its government loans, the Fed will seize AIG assets. Given the massive lapses made in the area of executive compensation, I want to make sure that the Fed is planning for the worst-case scenarios.

What plans has the Fed established to recover the funds lent to AIG in the event it defaults on its loan from the Fed?

Mr. BERNANKE. Well, as I have indicated, we have collateral for all of our loans, including for the $25 billion, for example, a senior lien essentially on all the assets of the company. So we are quite confident that we will be repaid.

Ms. VELAZQUEZ. And so you are confident. Do you have anything written to that matter that you can provide to this committee?

Mr. BERNANKE. We provide information regularly by law. I think section 129 reports. We have given all of our 13(3) lending, which provides in detail the arrangements we will have, and we will be happy to provide you more information if you would like to have it.

Ms. VELAZQUEZ. Thank you.

The CHAIRMAN. The gentlewoman from Kansas, Ms. Jenkins.

Ms. JENKINS. Thank you, Mr. Chairman, and thank you all for your testimony today.

My constituents in Kansas have bailout fatigue, and just last night, I had a telephone townhall meeting where folks expressed a lot of frustration, especially regarding AIG spending their tax dollars on these bonuses and for sending some of their dollars to foreign counterparties.

So I am just curious, at what point did the Federal Reserve or the Treasury Department realize that such a large sum of American tax dollars would be sent to foreign financial institutions, and is there a point at which European central banks or other foreign governments have or will step in to help?

Mr. BERNANKE. Well, as we have discussed, it goes well beyond the counterparties. The critical issue was AIG going into default and creating enormous chaos in the financial markets, or was it going to meet all of its obligations, including those to foreign counterparties?

I would point out that the Europeans have also saved a number of major financial institutions, and the issue of whether those institutions owed American companies money has not come up.

So I think that there is a sense that we all have the obligation to address the problems of companies in our own jurisdictions. In particular, the Europeans can appropriately point out that it was under U.S. regulation or lack of regulation and U.S. law that AIG failed, and in their sense, we do bear some responsibility.

But our appropriate objective, I believe, was to avoid the default of the company, which would have led to very severe consequences in financial markets.

Ms. JENKINS. All right. Thank you.

And then finally, very simply, how much more money is AIG going to need, and when can the American taxpayer expect to start recouping their money?

Mr. BERNANKE. Is there a timeframe that you would like to talk about, Bill?

Mr. DUDLEY. Obviously, what happens to AIG going forward is going to depend on the state of the economy and the state of the financial system. And if we can get the financial system repaired, then the outlook for the economy is going to improve, and, therefore, the prospects for AIG will improve as well.

So we cannot say unconditionally what sort of money AIG is going to need or not need in the future, but if we make the right steps in terms of fixing the financial system, we will improve the economy, and that will benefit AIG and protect the U.S. taxpayer.

Ms. JENKINS. Thank you.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Dudley, it seems to me the other two gentlemen keep punting the questions on AIG up to you, so I want to ask you to provide, because I think the committee would benefit from having an analysis of what the upside potential of the 79 percent ownership in AIG and the various other ownership interests that we are taking in various other entities associated with AIG.

I assume at some point we will divest that, but it would be helpful to have a written analysis, I think, for the committee of what that upside potential is; I know it is to some degree speculative.

Mr. Geithner, Secretary Geithner, all of these questions that I am asking are really forward-looking. I want to go to your proposal for resolution authority.

We found out in the midst of this crisis that there was emergency exigent circumstances authority given to the Fed to do a lot of things that have been very important and productive, but have also created a substantial degree of discomfort going forward, with one entity having such substantial authority to do what Chairman Bernanke has done, we think, admirably, but creates some angst.

The effect of the resolution authority that you proposed in your opening statement seems to me to suggest that basically the Secretary of the Treasury would be the de jure interim systemic regulator for things outside the banking system. Am I misreading that?

Secretary GEITHNER. I did not mean to imply that, but you are right that I think if you think about what is the right balance for the country going forward, we can't put all of this on the Fed.

Mr. WATT. Okay. But to put it on a political appointee, as opposed to somebody who is not subject to political pressures. Theoretically at least, Chairman Bernanke and the Fed is not subject to those, the politics of the day. We know it is at best, somewhat a theoretical statement.

But I guess the concern I would raise is about the prospect of either making that a political appointee who has that substantial authority, making it someone who has not affirmatively been given the responsibility for—as a systemic regulator, and the prospect that that, in an odd sort of way, might even slow down our urgency to do this on a more permanent basis.

I assume the authority you are talking about is authority that you and Chairman Bernanke would think would be appropriate to be given to whoever the systemic regulator is; is that correct?

Secretary GEITHNER. There are two separate things. One is where regulatory authority lies for containing risk in the financial system.

Mr. WATT. I am not talking about the one you talked about today; I am talking about outside the regulatory authority.

Secretary GEITHNER. Our resolution authority, our judgment is we want to use a mechanism built on the current FDIC model where a judgment to intervene, in some sense, requires a judgment by the President and the Secretary of the Treasury, by the Chairman of the Fed and by the Board, in a case—it is likely to be also in the case of the Board of the FDIC.

Mr. WATT. But isn't that authority that you ultimately would think would be appropriately vested in whoever has the responsibilities for systemic regulation?

Chairman Bernanke, I would like your opinion on that, too.

Mr. BERNANKE. No, those could be separated. The FDIC or some other body could be in charge of resolution and deals with those specific issues. And then in the oversight and financial stability regulation, it could be done.

Mr. WATT. Even the decision about whether to exercise it?

Mr. BERNANKE. The decision should be a joint decision, and, in particular, the President should be involved.

Mr. WATT. Thank you, Mr. Chairman. My time has expired.

The CHAIRMAN. The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Geithner, there are many reports that back in September, when all this was done, you were president of the Federal Reserve Bank of New York, that you were heavily involved in this, and you probably had knowledge of the bonus payments, at least that they may occur, at that point.

Can you tell us when you first really knew that these bonus payments to AIG would be made?

Secretary GEITHNER. Congressman, I was deeply involved in the decisions to intervene in AIG and the initial restructuring decisions made. I knew that we had a big mess on the compensation side to deal with, but I did not have—I should have had, but I did not have detailed knowledge of these particular legally contracted retention bonuses for AIG FP until I was, as I said, briefed by my staff on March 10th.

Even though there was a lot of information that was in the public domain, I was not aware of the details then until March 10th, but it would not have affected our choices at that time because of the legal nature of those contracts.

Mr. CASTLE. There was also some discussion that you learned in January, but you did not, about the bonuses?

Secretary GEITHNER. As I have discovered, a lot of this was in the public domain earlier and in January, too. Although I don't believe—well, in any case, I was not aware of the details of the payments or their legal nature until March 10th.

Mr. CASTLE. Looking at the time around the time the stimulus passed in the Senate, February 11th or 12th, whenever it was, the Dodd language has been very much put into question. I read it before, but, quickly, it shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009.

A lot of finger pointing is going on there.

My question is, were you involved in the writing of that, or in the room? Was anyone who answers to you involved in the writing of that or in the room? And do you know who might have been in the room? Because Senator Dodd has indicated that there were others in the Administration who were actually urging that language.

Secretary GEITHNER. Treasury staff expressed concern, as part of the legislative process, about that particular provision as originally drafted. Because of concerns it was retroactive, it could be vulnerable to legal challenge. I know many other people who are part of that process expressed a similar concern.

But the bill that emerged was a very strong bill, and it did create an obligation on me, in a specific constructive set of words in the public interest, to try to recoup those payments. And that was the balance that was struck in the legislation.

Mr. CASTLE. But you were not personally there when all that occurred; is that correct?

Secretary GEITHNER. No, I was not. But as I said, the Treasury Secretary did express concern about this specific provision, and we did consult with Senator Dodd and his other colleagues about a range of other dimensions of that legislation in draft.

Mr. CASTLE. Mr. Bernanke, you indicated in your opening about some of the pure lessons. There is an urgent need for systemic reg-

ulation on nonbanks. And I am not sure exactly what you meant by that, but I think of investment banks and hedge funds and private equity insurance companies, and maybe people like Warren Buffett, for all that matters, and maybe other corporations. But exactly what did you mean by that in terms of the kind of regulation that could be imposed?

Some of these are unregulated entities altogether at this point. So if we were to have a systemic regulator, what should we be doing in that capacity?

Mr. BERNANKE. Congressman, there is a great deal to be discussed here, but I would point to at least two elements. One would be that every systemically critical firm, particularly those organized as holding companies, should have a consolidated regulator looking at the entire firm.

Now, in the case of AIG, for example, the OTS was nominally the holding company supervisor because they had a small thrift, but they were focused, presumably, on the actions relative to the thrift. And it was obviously a poor match for them to be looking at the activities of AIG FP.

What is needed would be a strong oversight regulator who would be able to deal with all the aspects of the company for all systemically relevant companies.

The second part, I believe, that would be important would be to have some general authority to look at the system as a whole, to look for weaknesses in regulation, to look for problems in payment systems, to look for buildups of risky positions, to look for issues with derivatives and so on to try to provide an overview of problems in the financial system as a whole, as opposed to focusing solely on each individual institution in isolation.

Mr. CASTLE. Well, I tend to agree with you, although I think it is very, very complicated. I know a lot of the credit in this country shifted from banks to some of these other entities, and we do need to have some control over it. But I would hope we can all work together on making sure that is done and done correctly at some point. It is relevant in the near future.

Thank you. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from New York.

Mr. ACKERMAN. Thank you, Mr. Chairman.

The furor last week on the part of the public, the media, and the Congress over the outrageous bonuses was very, very understandable, but the truth of the matter is the bonuses did not create the problem. And even if all those people gave back double the amount that they got in bonuses and spent the week in the public pillory, which I presume they did, it wouldn't fix the problem.

The real problem is greed, and I think that with all of the roaring and chest beating that we did, and are continuing to do, we are not really fixing the problem here.

I am sorry to say that some of us are learning that we have hurt a lot of otherwise innocent and decent people who just fulfilled their contractual obligations in different parts of some of this massive company, having nothing to do with the real problem that took place in the financial products division. And we probably owe them an apology. And maybe, even more than that, we owe them some

kind of a remedy to the damage that it looks like we have been engaging in. And we have to start looking at that, too.

The problem is greed, assisted by innovation. And I think part of the solution has to be that we have to exert a little bit of common sense into the process, and I don't know that we can legislate that or you can enforce it. But certainly there are regulations and changes that we should be looking at, and one of them should be expressed in a legal regulatory way that says gimmicks are not financial products, and credit default swaps, although they might have some value somewhere, are really not insurance.

Looking forward, we should know that AIG is not the only company that used credit default swaps. How big is that market? How many other companies are out there, and are we looking at them, and are we going to stop pretending that they are issuing insurance and get those products back into the range of reality, rather than letting people think they are insured and then having to bail out all those other companies?

Mr. BERNANKE. Secretary Geithner can speak about this because he has done a lot of the work involved in trying to strengthen the CDS market.

It was a particularly intense problem at AIG because they were essentially using these swaps to sell insurance against which they neither had capital nor hedging. And so when the insured event occurred, then there were enormous losses. So that was clearly a bad situation.

So one approach would be to make sure, from a regulatory perspective, that those who use CDS instruments have appropriate hedging or other protections to make sure that they can pay off.

The other approach, complementary approach, is to trade CDS not bilaterally over the counter, but through some kind of a clear central counterparty.

Mr. ACKERMAN. We are in a crisis mode right now. You know, if we discover that an airplane has a faulty flycam, whatever that might be, you know, they usually ground the whole fleet that has them, because of obvious reasons.

Are we looking at doing that, these other companies with credit default swaps, to a large extent to see if we can ground them until we fix the mechanism?

Mr. BERNANKE. Well, that would have negative as well as positive effects, because some companies use the credit default swaps in order to hedge, that is to protect themselves, as opposed to taking gambles, in the case of AIG.

Mr. ACKERMAN. I just want to suggest that we take a very, very close look at that, because there is a clear and present danger here that just like we are finding that there are many Madoffs, there are many AIGs out there, and before we have to start bailing them all out, maybe we should ground some of them, too.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman.

On the front page of the Wall Street Journal, Mr. Bernanke, there is a headline titled, "AIG's Rivals Blame Bailout for Tilting Insurance Game."

Now, this is something that a number of insurance companies have talked to us about. I originally opposed the concept of bailouts, and one of the reasons I thought it was important to let AIG fail is the fact that now that the government is behind them, they have extra power in the market.

Anyway, the story says, "In the 6 months since the government stepped in, AIG at times has slashed insurance prices by more than 30 percent in some cases to fend off rivals and to keep or win contracts, according to public documents, insurance buyers, execs and others in the industry. This tack has helped AIG ensure customers ranging from the U.S. Olympic Committee and an Arizona airport, to an Illinois nursing home and a Florida town government, as examples."

Now, I raise this issue for two reasons. First, the obvious competitive advantage AIG would gain within the market, if they are, in fact, undercutting their competitors; and second, if AIG is not offering actuarially sound rates on their insurance products, it could result in more losses taken on down the road by the owners of AIG, in other words, taxpayers, since taxpayers now own 80 percent of AIG.

Can you verify to the markets within which AIG is operating that AIG's subsidies will not have the full faith and credit of the Federal Government in the future? And how confident are you that the domestic insurance subsidies that have been put into the process with respect to the subsidiaries of AIG are not using the systemically significant label within the market to undercut their competitors?

Mr. BERNANKE. Well, on the competitive side, I am of two minds, because AIG is losing business because of the taint and the other problems with the reputational problems, and so you would expect them to be more aggressive to try to retain some of that business. So it is not clear whether that is an undercutting or not. I am more concerned about the possibility of underpricing in the second sense that you have mentioned.

There are investigations of this issue going on, or have been undertaken. I believe that at least one or two of the State insurance regulators who testified before Congress last week suggested that they had looked into this, and, as far as I understand, they have not found any substantial evidence of this underpricing.

I believe the GAO is also looking at the issue, and I am not sure exactly what stage that investigation is, but we will obviously be very interested in that outcome.

Mr. ROYCE. Well, how can we assure down the road that AIG and other recipients of government assistance are not being viewed as being backed by the Federal Government? And this is the concern that I have about your overall plan, that at the end of the day we undermine market discipline because we telegraph the message to the market that the government is behind these institutions, and, therefore, as a consequence, they are going to end up someday being overleveraged. They are going to be able to borrow far more because the market discipline won't be there, at far less interest rates, because they are going to be perceived basically as borrowing at near government rates.

And, you know, we saw this with Fannie Mae and Freddie Mac that borrowed at very close to government rates and reported profits to their shareholders, while the Federal Government held the risk that eventually materialized last September. And we saw them, basically, go into the business of arbitraging, borrowing at near government rates, and then building up those portfolios to $1.7 trillion and taking those risks that you couldn't have taken in the market. But they became the biggest player in the market because of the perceived government backing of the institutions.

That is what I worry about in terms of the proposal that you are making today, in terms of the impact of converting other institutions basically into, shall we call them, government-sponsored enterprises in a way, because you would have the concept of the government behind them.

Mr. BERNANKE. Congressman, I gave a speech, I believe, last week exactly on the issue of too-big-to-fail, which I consider to be a critical issue. And I addressed a number of approaches to eliminating or reducing this problem, including, among other things, having tougher regulations and supervision of these companies, making sure they are not taking advantage of any implied government backing to take risks and so on, and also having the resolution regime that we have discussed that would allow us to resolve these companies and to perhaps take haircuts on creditors so that they will not be assured that they will be protected.

Mr. ROYCE. Mr. Geithner, I would ask you the same question, very quickly.

Secretary GEITHNER. I think you are absolutely right to be concerned about this. I share that concern very much. That is why the reform effort we are going to have to work with the Congress on is going to have to address the moral hazard created by these extraordinary interventions.

You are absolutely right to be worried about it. We need to dial back this assistance when we get through the crisis, and we have to put in place much stronger restraints on future risk-taking.

Mr. ROYCE. But if you let them go bankrupt, you would actually then have market discipline, and you wouldn't have to worry about this, offsetting all of this.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from California.

Mr. SHERMAN. Thank you.

What I fear here is that we are doing a Kabuki theater in three acts. In the first act, Washington tells the American people, we understand your anger at Wall Street. In the second act, we nitpick to death any proposal that actually adversely affects Wall Street. And then in the third act, we bestow another trillion dollars on Wall Street under extremely favorable terms.

Chairman Bernanke, in the hands of a maniacal Fed, section 13(3) could be used to make trillions of dollars of highly risky loans. Fortunately, you have interpreted the law to say that you are only going to buy paper that is triple A and similar instruments. But let us say a year from now, Wall Street comes to you and they say they need another trillion dollars, and the TARP money has run out, and Congress is a bunch of buffoons and populists and they won't provide additional money, and they are idiots,

so don't listen to them. And Wall Street is unanimous in telling you that only you can save the economy, and the only way you can do it is to buy double-A paper or single-A paper and subject the Fed to that higher level of risk. Would you then change your interpretation of the law?

Mr. BERNANKE. The law requires that we lend on a fully secured basis; in other words, to be comfortable that the collateral we are taking will allow for repayment of the loan. That is why in the TALF and in the program that Secretary Geithner just announced, we are not only taking a variety of protections, including haircuts and the like, but we are also having TARP capital to stand between us and the credit risk, so we will be very, very careful not to take any credit risk.

Mr. SHERMAN. No credit risk; is that correct?

Mr. BERNANKE. You never can go literally to zero, but very, very little credit risk.

Mr. SHERMAN. Well, that is what triple A is, as little as you can get.

Mr. BERNANKE. Right.

Mr. SHERMAN. Mr. Geithner, you promised transparency, but what the American people want to know is about the compensation packages. Will you publish a list of all the TARP recipients, the companies that got the money, and how many of their executives—I don't want any person's name, just how many of the executives earned more than $1 million in 2008, how many of them got bonuses of over half a million dollars; and likewise for 2009, how many of them are earning salaries of over $1 million a year, and how many of them have what appear to be contractual rights to receive a bonus in excess of a quarter million dollars? I don't think it is just about AIG compensation, and I don't think the American people should be blindsided and find out about bonuses on a Saturday that are about to be paid on a Sunday. Can you give us a chart for each TARP recipient?

Secretary GEITHNER. Congressman, you are absolutely right, this goes well beyond the AIG. And the President proposed on February 4th a range of reforms to broad compensation practices, including proposing that boards of directors submit—

Mr. SHERMAN. Mr. Secretary, it is my time, and I will reclaim it. Are you going to give us the chart, or are you going to hide the ball?

Secretary GEITHNER. I am not going to hide the ball.

Mr. SHERMAN. Are you going to give us the chart?

Secretary GEITHNER. I will reflect on the suggestion you made and—

Mr. SHERMAN. In other words, you won't commit to telling the American people how many folks at Goldman Sachs or AIG are going to make $1 million this year?

Secretary GEITHNER. Congressman, I will think carefully about your proposal.

Mr. SHERMAN. Thank you for thinking. Let me move on. I will move on to the next question.

The law says the TARP bill—we said that the Treasury shall require that the financial institutions that you invest in meet appropriate standards for executive compensation. That is the law. You

are supposed to write the regulations. Not to your credit, you have kept on Assistant Secretary Kashkari to honcho this program. He came before this committee, and I asked him, I said on December 10th—and I mailed a copy of this transcript to you just as soon as you got sworn in, I am asking about AIG—is a $3 million bonus an appropriate standard of executive compensation, or has the law been violated? And your quarterback said that he didn't think that a $3 million bonus was necessarily inappropriate compensation. Then I asked him about $30 million bonuses to AIG executives, and his response was, well, I can't opine that wouldn't be appropriate compensation.

Is this the guy who should be running the TARP program, and when are you going to give us the regulations required by law, and are those regulations going to prohibit million-dollar bonuses and million-dollar-a-year salaries?

Secretary GEITHNER. Congressman, we are committed to putting out those regulations. We will do so as soon as we can. Mr. Kashkari, who is an excellent public servant, it is not his job to make those judgments. That is my job. I am accountable for making those judgments.

The CHAIRMAN. The gentleman may finish his sentence.

Secretary GEITHNER. And we are working on putting those out so that we will have some clear standards to the American people to govern these compensation practices going forward.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Oklahoma, I believe, is next.

Mr. LUCAS. Thank you, Mr. Chairman.

Let us continue to look at the process of cleaning up behind this parade. In Oklahoma, in the 1980's, we went through a twin agriculture and energy resource boom and bust. And it was fascinating after the FDIC got done stomping through the arena how 5 and 10 and 15 years later, amazingly there were some millionaires made of dealing and disposing of these assets.

Could we talk for a moment about the public-private investment fund? And if you could, just let me give you a real world—from a perspective of the real world. For a typical investor who might participate in this kind of a thing, this effort to clean up the legacy assets, the toxic assets, for $100, it could be $100 million, it could be $100 billion, but for $100, how many dollars' worth of assets, Secretary, do you envision that controlling or being worth?

Secretary GEITHNER. In the model we laid out, $1 of capital from the government would come with $1 of capital from a private investor, and they would be able to get borrowing from the government in a range that is yet to be determined. But it is potentially up to 6-to-1 leverage in this basic structure, substantially less leverage than the bank normally operates with, but that is the broader magnitude that is possible.

Mr. LUCAS. So potentially the investor's dollar might conceivably get them as much as $6 worth of assets, if the assets—some assets would be a different value. Some would be good, some would be bad, some would be totally worthless. If the assets turned out to be bad, of that dollar put into the fund, what is the investor's potential loss? Can he or she lose it all?

Secretary GEITHNER. Yes.

Mr. LUCAS. And the upside?

Secretary GEITHNER. The upside would be shared in portions of the capital they put in. So the taxpayer will share in the upside alongside the private investor.

Mr. LUCAS. So my mighty dollar might get me 6 in assets; I could lose it all if they turn out to be a bad portion of the program. If they turn out to be good assets, as was observed in Oklahoma in the 1980's, sometimes those ag properties and those energy-producing properties are so dramatically undervalued that a decade later—so there is a potential for it not only of a complete loss of investment, but a potentially tremendous gain then for the investor.

Secretary GEITHNER. For the taxpayer, too. The taxpayer would share equally in those gains.

Mr. LUCAS. As you envision the program, what dollar amount—what level of player are we talking about? I am sure this is not something that the small investor will be able to be a part of.

Secretary GEITHNER. We want this designed so that the potential gains can be shared as broadly as possible.

Mr. LUCAS. So does that mean the buy-in is $100,000, $1 million, $5 million?

Secretary GEITHNER. We laid out some details proposed for minimum investments. But, again, people will be able to participate through—as the general asset management companies that manage the pension assets of average Americans. So the idea is to allow the American people the benefit alongside the government of any potential gains, and the taxpayer, of course, ultimately gets a better deal with this kind of structure than they would if the government simply took on all the risk.

Mr. LUCAS. And the reason I bring all this up, of course, is potentially there will be some tremendous winners on down the road, ones who have either picked wisely or by good circumstance.

Let me flip to one more question. We have been very focused on AIG compensation, the bonuses and all those sorts of things. One other subject. A lot of compensation—and I am not a part of corporate America, but a lot of compensation is not just bonuses and outright salaries, it is things like stock options, correct? As this economy picks up, how many of these financial institutions—and I am asking a question that may not be answerable, of course, but are we going to see at some point a year or 2 or 3 or 5 years from now, the really big sums of money made when these stock options that might be worth pennies now or dollars now become tens or hundreds of dollars in the future? Is that something that we should be prepared for as a public official to explain to the folks back home 2 years, 3 years, or 5 years down the road?

Secretary GEITHNER. Technically, I think most of those will have to be fundamentally renegotiated for the risk you are raising to materialize. But it is very important that compensation practice across the industry be fundamentally reformed so that compensation is tied to long-term performance of outcomes by the firm itself. And what the President proposed on February 4th is that compensation above a certain limit, particularly in cases where the firms are getting assistance from the government, be it in the form of restricted stock that is at risk, only pays back over time only

after the taxpayer is repaid. And for all firms that participate in these markets, we want them to subject their compensation proposals to a shareholder vote, so the shareholders will have the opportunity to look at these compensation practices and make their own judgment about whether they are appropriately rewarding risk and not incenting excessive risk-taking at the expense of the system as a whole.

Mr. LUCAS. Have we ever had these kind of standards before, just as a question?

Secretary GEITHNER. No. I think this is a necessary, important part of a reform agenda. I think it is not possible to run an effective risk-management framework without looking also at compensation incentives, because they, as we have seen, overwhelm all the checks and balances and limits that were set by supervision and risk managers.

The CHAIRMAN. The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

I want to thank all three of you for your testimony today. I think it has been very enlightening for me.

I want to just touch on a couple of things. First, one of Mr. Ackerman's questions was about credit default swaps. Do you think that we in Congress and you should work on some further regulations, specific regulations, in regards to credit default swaps? And if we do that, what effect do you think it will have on the global financial system, and how can we work that out in that regard?

Secretary GEITHNER. I think it is very important that through a mix of law and regulation, we bring these markets into an oversight framework that provides better protection for the financial system. As part of this, I think it is very important that the standardized part of these markets be moved onto central clearinghouses and exchanges, and that we also put in place much better reporting disclosure requirements. And as the chairman just said, it is critically important that people who get exposure to these instruments hold enough capital or reserves or cushions against the risk those instruments present. But I think comprehensive reform bringing these under oversight should be a critical part of the reform agenda we hope to work with the Congress on.

Mr. MEEKS. Now, one of the—and we all—and sometimes we do this often in Congress, we react to a situation, and all of us reacted to the bonuses by AIG last week. And one of the things that I heard when I got back home from some, coming from New York, we are very concerned, because, of course, the financial Wall Street is in New York. It contributes to a lot of jobs, a lot of our economy, etc. One of the things that often was heard was, when I got home, that a lot of jobs could leave New York and go elsewhere, elsewhere being not in the United States; in London.

My question to you is, what is your reply to that? I mean, is that just talk because Wall Street tried to protect itself? Is that a reality of something that could possibly happen? And what should we do or could we do to try to make sure that as we recover, we don't lose those jobs in the United States, and New York, for example, remains the financial capital?

Secretary GEITHNER. The best thing we can do for New York and the U.S. financial system is create a much stronger system, a more

stable system for the future. But to do that, we need to make sure we bring the world with us, and the world as a whole, all those other financial centers, London, Asia, continental Europe, also put in place higher standards for protection, because without that, there is a risk that capital will move, business will shift from the United States, and we will end up with a weaker system overall, as we have seen.

So the best defense for us is to make our system stronger, not to wait for the world; make our system stronger, but try to encourage them to move with us to put in place higher standards, and that is what the President has committed to do.

Mr. MEEKS. And I was wondering—and I know that there is time for you to come with your standards that you are talking about with reference to executive compensation and bonuses, but I was wondering if there is a framework of which or reference of which you are working on to make that determination, because that is part of what the problem is here. Folks feel that there has been the greed, or others feel that there has not been a system put in place that they can understand and follow and say, okay, this is what the rules are. Basically when people say, tell me what the rules are, we will play by the rules; don't change the rules in the middle of the game.

So is there something that you are putting in place so that the markets and others can understand what the rules will be or what you are governing by so we can have that confidence in the market so we can move again in the direction that we should be?

Secretary GEITHNER. Yes, we share that objective. And just to come back to the point you made before, even in this area, there is broad support internationally to having standards that apply to compensation, so that, again, there is more of a level playing field generally across the financial system.

Mr. MEEKS. I think my time has expired. I yield back.

The CHAIRMAN. The gentleman from Texas.

Dr. PAUL. Thank you, Mr. Chairman.

When the chairman of the committee opened up the committee today, he suggested that we look backward as well as forward, and that all our problems didn't come from January 20th on, and I agree with that. As a matter of fact, just looking back at the last Administration isn't quite enough. And in order to understand the problems that we face and understand the cause, we have to look back possibly even several decades.

The debate today, so much of the discussion has been on technical aspects, which I think are very important, but, quite frankly, I think that deals a lot with the symptoms rather than the basic cause, and I would like to deal more with the cause, so I have a question for the entire panel, and the question keys around this cause.

Right now, I think the Congress and the Treasury as well as the Fed operate on the condition that the free markets failed, and we didn't have enough regulation. Others will say that we got into this mess because we have been living with a condition of crony corporatism, inflationism, and interventionism. We had inbred into this system a lot of moral hazard which encouraged a lot of risk and a lot of guarantees, and that we would have the lender of last

resort, and we really didn't have to worry. And it created, once again, a phenomenon that has been known throughout history. It is called the "madness of crowds." And that certainly—that is nothing new. But there was certainly a lot of madness going in the economy and in the marketplace.

But the question really comes out, who should allocate capitalism, the free market, or should the government? And I think that we had a system where the free market wasn't working, and we didn't have capitalism. The allocation of capital came from the direction of the Federal Reserve and a lot of rules and regulations by the Congress. We had essentially no savings, and capital is supposed to come from savings. And we had artificially low interest rates.

So looking at all that, then this means we would have to look differently at what our solutions should be. Everybody loves the boom. That was great. Nobody questions all this. But when the bust comes, everybody hates it, and then they quickly to have decide what to do.

Unfortunately, I don't see that we are addressing the real problems. We are not addressing—what we are dealing with is trying to find a victim. Who is going to soak up the derivatives, who is going to soak up the debt, who is going to be penalized? And right now it looks like Wall Street is getting bailed out, and the little guy and the middle Main Street America and all are going to pay the penalty. And I think this is—we are absolutely going in the wrong direction, whether it is AIG or the rest. So we failed because we didn't follow the marketplace, and then we do the same thing over and over again, and we don't seem to improve anything.

So my question is this: How do the three of you operate in your own minds? Do you operate with the idea that capitalism failed, and they need us more than ever before to solve these problems; or do you say, no, there is some truth to this? As a matter of fact, a lot of truth to it is that we brought this upon ourselves, that we had too much government, too much interference in interest rates, too much risk, moral risk, built into the system. Because if you come from the viewpoint that says that the market doesn't work, I can understand everything you do, but if I see that you have totally rejected the market, and that we have to do something about it, I can understand why we in the Congress and you in Treasury and you in the Fed continue to do this.

So where do you put the blame; on the market or on crony capitalism that we have been living with probably for 3 decades?

Mr. BERNANKE. Congressman, I certainly do not reject capitalism. I don't think this was a failure of capitalism per se. And I also think the free market should be the primary mechanism for allocating capital. Markets have shown over many decades that they can allocate money to new enterprises, to new technologies, very effectively. And so we want to maintain that free capital market structure.

It is nevertheless the case that we have seen over the decades and the centuries that financial systems can be prone to panics, runs, booms, and busts. And for better or worse, we have developed mechanisms like deposit insurance and lender of last resort to try

to avert those things. Those protections, in turn, require some oversight to avoid the buildup of risk.

Dr. PAUL. May I interrupt, please?

Mr. BERNANKE. Certainly.

Dr. PAUL. Isn't that what creates the moral hazard though? Isn't that the problem rather than the solution?

Mr. BERNANKE. Well, the reason the Fed was created in 1913 was because in 1907 and in 1914 there were big financial panics, and there was no regulation there, and people thought that was a big problem. Back in the 19th Century as well.

Dr. PAUL. But they usually lasted about a year. And now we are determined to make our corrections last 10 to 15 years, and that is what we are working on right now.

Any other answers, please?

The CHAIRMAN. Not on this round, because the time has expired.

The gentleman from Kansas.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

To Secretary Geithner and Chairman Bernanke, the Special Inspector General for TARP, Mr. Neil Barofsky, testified before the Financial Services Oversight and Investigations Subcommittee a few weeks ago that he estimated the total exposure of the taxpayer was $2.875 trillion if you count all the programs authorized by the Treasury Department, FDIC, the Fed and others. Is that number still accurate, or do you have a different estimate of how much taxpayer exposure we currently have in all of these financial rescue programs; and do you expect, can we expect, that the taxpayers will be fully repaid?

Mr. Secretary?

Secretary GEITHNER. Congressman, that, I suspect, represents the total loans outstanding and capital extended by the government. It does not reflect the risk to the taxpayer. That requires a more careful judgment about the level of collateral backing behind those loans. That requires a—that is a hard judgment to make, but we would be happy to come back to you and give you our best sense of what the components are in that $2.875 trillion number and how you should think about ultimately the risk to the taxpayer. But we are being very careful to make sure these are designed in a way that they come with very strong protections against the taxpayer.

I want to conclude, though, just with a sense of the importance about our candor in this. The government is going to take risk in this. There is no way we are going to get through this financial crisis without the government taking risk the markets can't take. So I cannot stand before you, nobody in my business can stand before you, saying there is no risk of loss to the taxpayer here, but we are going to do our best to minimize that risk of loss.

Mr. MOORE OF KANSAS. Mr. Chairman?

Mr. BERNANKE. Speaking for the Federal Reserve, less than 5 percent of our lending is associated with the Bear Stearns and AIG episodes. We believe that we will be fully repaid for those loans, but concede that they are riskier than the other loans we make.

The other 95 percent of our balance sheet is extremely safe, mostly very short term. We have never lost a penny in any of those programs. So even though it is true that the Fed has—in one capacity or another—lent out a great deal of money, we believe it is

quite safe and that the taxpayer will, in fact, make money, because the Federal Reserve through its profits sends to the Treasury every year tens of billions of dollars.

Mr. MOORE OF KANSAS. Mr. Chairman, I believe it was you who testified and told a group of Members of Congress, myself included, that if—and I think this was September of last year—that if Congress didn't pass the legislation you were looking for, there might not be a market the following week. That strikes fear right there. I voted for both of the so-called rescue recovery programs, and I told people back home, I have been here 10 years, and those were probably the most uncomfortable, hardest votes I have had, but I didn't see that we had an option. And I take it you still believe that was the right option.

Mr. BERNANKE. Everything we have seen since then suggests that the effect of the financial effects on the global economy are extraordinarily powerful.

Mr. MOORE OF KANSAS. Mr. Secretary, any further comment?

Secretary GEITHNER. I think that was an enormously difficult act, but a brave, important act. I think without that action and authority we would be in a much greater, much deeper peril today, much deeper recession causing much more damage to the American people, and facing a much more protracted period before we have the chance of getting growth back, and it would have been much more expensive ultimately to deal with it. So I think that was a necessary act, and it helped prevent a much more catastrophic outcome.

Mr. MOORE OF KANSAS. Thank you.

I yield back my time, Mr. Chairman.

The CHAIRMAN. The gentleman from Illinois.

Mr. MANZULLO. Thank you, Mr. Chairman.

Secretary Geithner, on page 1, paragraph 5, line 4, and, Chairman Bernanke, page 2, line 3, of your respective testimonies, you state that 401(k) plans, and presumably IRAs, purchased insurance from AIG; is that correct?

Mr. BERNANKE. Yes.

Mr. MANZULLO. And the purpose of insurance was so that the value would not fall precipitously; is that correct?

Mr. BERNANKE. Correct.

Mr. MANZULLO. So they bought insurance, and because of the bailout, their requirement plans did not get cut in half; is that correct?

Mr. BERNANKE. They avoided the losses.

Mr. MANZULLO. That is right.

What about the rest of the Americans; what about the rest of the Americans who lost half of their savings in retirement plans, plus had to put up $40 billion so other people could be made whole because they bought insurance at AIG? Does that seem fair?

Mr. BERNANKE. Most of that decline has occurred since Lehman Brothers failed in September. If we had been able to avoid the failure of Lehman Brothers—

Mr. MANZULLO. Wait a second. Most Americans have lost 40 to 50 percent of their IRAs and retirement plans. And in addition to that, they have had to spend $40 billion in order to honor the in-

surance plan of AIG so that the people who bought insurance with them wouldn't lose any of their retirement plans; isn't that correct?

Mr. BERNANKE. These are loans which we expect to get paid back.

Secretary GEITHNER. Congressman, could I try to answer that?

Mr. MANZULLO. I think that is an improper answer. The American people have lost 40 to 50 percent of their retirement plans.

Mr. BERNANKE. The purpose of the action we took with AIG, as I discussed in some detail in my testimony, was not to help any specific counterparty.

Mr. MANZULLO. But you did, you did. That is what happened.

Mr. BERNANKE. It is unavoidable. We are trying to address the entire—

Mr. MANZULLO. No, I understand. You did not address the entire issue because most Americans still lost 40 to 50 of their retirement—

Mr. BERNANKE. We are working hard to get—

Mr. MANZULLO. —plan.

The CHAIRMAN. Mr. Chairman, the rule is that we get to talk whenever we want. That is the rule.

Mr. BERNANKE. Sorry.

The CHAIRMAN. The gentleman from Illinois.

Mr. MANZULLO. And they are paying $40 billion so that other people don't lose any of their retirement plan. That is what your testimony says, and that is what happened, isn't it?

Secretary GEITHNER. Congressman, those losses to the American people—

Mr. MANZULLO. Give me a yes or a no, please.

Secretary GEITHNER. —would have been far greater—

Mr. MANZULLO. No. I am asking the questions. Did the people who took out insurance with AIG to insure their retirement plans get reimbursed 100 percent so they suffered very little loss, yes or no?

Secretary GEITHNER. It depends on the nature of those specific contracts, it depends on each of those contracts. But what the critical thing is the damage to the average American pension fund—

Mr. MANZULLO. But you did not answer the question. The average American person has already lost 40 to 50 percent of their insurance plan.

The CHAIRMAN. If the gentleman will withhold.

I would ask the people in that second row to stop the gesturing and the conversations. People are here to listen. Conversations are going on. They will end, and if there is any further disruption, I will ask the officers without any further intervention to simply escort people out.

Please continue.

Mr. MANZULLO. Thank you.

The American people have lost 40 to 50 percent of their retirement plans; IRAs and 401(k)s. But people with retirement plans who bought insurance from AIG did not suffer that loss; isn't that correct?

Mr. DUDLEY. If I could just make one point here?

Mr. MANZULLO. Can't anybody just say yes or no?

Mr. DUDLEY. Could I make one point?

Mr. MANZULLO. If you can give me a yes or no.

Mr. DUDLEY. The insurance was on the stable value funds. If the investors in the stable value funds had taken losses in the AIG case, this would have destabilized stable value funds broadly—

Mr. MANZULLO. The answer is yes, isn't it?

Mr. DUDLEY. —broadly throughout the U.S. economy.

Mr. MANZULLO. The American people paid $40 billion so people with retirement plans that had insurance with AIG did not have to lose; isn't that correct?

Mr. BERNANKE. They lent $40 billion to avoid a catastrophic collapse to the system.

Mr. MANZULLO. Can you give me a yes or no, anybody there, please?

Mr. BERNANKE. You said it was the purpose. That was the purpose.

Mr. MANZULLO. I have 14 percent unemployment back home. We could lose lots of factories. People are desperate. Half of the people have lost half their retirement, or most have lost half of the retirement, and not one of you three can give me a yes on that answer or no.

Mr. BERNANKE. Because it is a poorly posed question.

Mr. MANZULLO. Well, then it is poorly written in your statements. The question is very simple. Maybe I should make a statement that American people had to bail out AIG so that they could honor the insurance plans with people who bought insurance on their retirement plans, but most Americans still lost 40 to 50 percent of their retirement plans.

Mr. BERNANKE. If we had not made that action, they would have lost 70 percent.

Mr. MANZULLO. The AIG people lost 70 percent?

Mr. BERNANKE. No, the American people.

Mr. MANZULLO. Well, thank you for that correction. That makes me feel even better.

But the point here is that American people had to pay $40 billion in order to make sure that people in AIG got 100 percent of their retirement plan, and that is why American people are really upset.

The CHAIRMAN. The gentleman from Massachusetts.

Mr. CAPUANO. Thank you, Mr. Chairman. Thank you, gentlemen.

I am not going to focus too much on the AIG issue because I think most of it has been said the other day when Mr. Liddy was here. I think Congress has spoken. I think you understand how we feel and what we would like to do. And I also think that in comparison, the proposal that was put out today is much more important to the general economic wellbeing of this country.

I guess I want to start with a couple of things. I heard, I think, at least two of you say, maybe three of you, that you didn't have the authority to do something earlier. Well, I would respectfully disagree with that legal. I understand. I don't want to rehash it, but you have used the term "exigent circumstances" to a fare-thee-well to get into things the Fed never got into before, no one would have thought they could have gotten into: auto loans; student loans; mutual funds. And the truth is I have supported that because I think it is necessary at the moment. I believe you could have used the same term to get into these issues beforehand to

have avoided these issues had you tried. Again, past history, but nonetheless I still believe that you can do it.

I want to talk about the plan. I have a few questions. I am trying to figure out the last 24 hours or so. And I guess I want to, first of all, understand. I see the FDIC as effectively a taxpayer-funded organization. I know it is not technically through taxes, but it is, because we all know that if the FDIC failed, we would bail it out. I don't think anybody really doubts that, number one.

Number two is taxpayers pay it through fees, if not through taxes. I know the fees aren't assessed to them directly, but effectively we all pay it through higher bank fees or lower interest paid by the bank. It is all passed through. If the FDIC is included, it is not a 6-to-1 ratio, it is a 13-to-1 ratio. Every dollar that is spent on this new program through the FDIC and the taxpayers directly will be 93 percent paid by taxpayers. So it is a 13-to-1 ratio, not 6-to-1, if you count the FDIC. If somehow you don't count them, I guess it is 6-to-1, but if the FDIC fails, it is on us.

I guess a couple other questions I have, we are targeting about $1 trillion of these toxic assets. Am I wrong to think we have anywhere from $20 trillion to $50 trillion of these assets sitting out there someplace? Is that a wrong number?

Secretary GEITHNER. Well, that is large. The total assets of the banking system are roughly the size of the annual GDP, which is roughly $14 trillion now. So that is too big a number. Global financial assets are much larger than those held by U.S. banks.

Mr. CAPUANO. So globally, all right. But it is higher than a trillion?

Secretary GEITHNER. True. But the assets that this program targets—

Mr. CAPUANO. I understand that. I understand what it targets. It targets all the triple A stuff, which, of course, amazes me. You are using ratings by the very credit rating agencies that have now been completely undermined. And anybody with faith in these ratings, I guess, hasn't been paying attention the last year. But so be it, you have to draw the line somewhere, and I guess that is all we have.

I want to ask specifically about the FDIC's role here. The FDIC, as I understood it, but, again, without getting into glorious words, was there to protect me as a depositor up to $100,000, now $250,000. We are trying to extend that. That is what they are there for. And yet in this case, they are being used to finance the purchase of toxic assets, nothing to do with what anybody would have thought the FDIC was supposed to be used for. And they are being used, as I understand it, and correct me if I am wrong, to basically float collateralized debt obligations backed by these very toxic assets in order to fund the purchase of these toxic assets, getting them off the books of the investors and putting them on the books of the taxpayers. What am I missing?

Secretary GEITHNER. First, FDIC fully supports this program. It uses an existing—

Mr. CAPUANO. I don't care whether they support it.

Secretary GEITHNER. But it is important because this is based on an existing mechanism that they use in design as a normal part of what they do as the principal resolution authority in the United

States today. So they have broad experience doing this well, and they helped design this, fully support it.

The reason we are doing this, Congressman, is because we think it is the best way to protect—

Mr. CAPUANO. No, I understand why you are doing it. Answer my question. Are they going to fund these things by floating collateralized debt obligations?

Secretary GEITHNER. No.

Mr. CAPUANO. Then why is it that on your Web site? You say, the buyer would receive financing by issuing debt guaranteed by the FDIC. The FDIC-guaranteed debt would be collateralized by the purchased assets. What am I—is this not right, or am I reading it wrong?

Secretary GEITHNER. I just wouldn't call that a CDO.

Mr. CAPUANO. Okay. But it is a collateralized debt somehow backed by a toxic asset.

Secretary GEITHNER. But, Congressman, it is good for the FDIC borrowing to be secure.

Mr. CAPUANO. No, no, no, no. We can disagree on what is good or bad. That is what it is. And I understand that you think it is good; otherwise you wouldn't have proposed that.

First of all, I want to make it very clear, I think you gentlemen are well-intended, intelligent men who are trying to save the economy. I think your motivations are fine. I just think you are dead wrong on this one. I think you are jeopardizing the FDIC. I think you are taking it—in this particular case, yes, taxpayers may benefit if there is a profit, 50/50 benefit, but if there is a loss—

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman.

I think that from the very beginning we have always said we need to restore confidence in the market and to provide the taxpayer with protection. But I think we also—and I think what has happened in the last week or so, that we need to restore investor confidence and confidence in our government, in the Federal leaders, rather, and the regulators that if Americans work hard and run a solid company, they are not going to be subject to punishment from the government if they do well.

And on that note, I think that we need to work together really to focus on this economy, and I am afraid that we are just not doing it, or not getting all the information. What came up at our hearing last week was I asked the question of Mr. Liddy about the three trustees that were appointed to—I believe to represent U.S. taxpayers' interest on the AIG Board. We never even heard, or at least I hadn't, and I suspect most of the members hadn't even heard, about these trustees and how did they—you know, how did they—what happened with informing the taxpayers about the bonuses and things?

And I think we need to move ahead, and I hope that we are going to really take a holistic look at all of these provisions. We are talking about executive compensation without looking at the whole picture. Now we have a new plan, and we see that there seems to be some increase in confidence here.

So I have just a couple of questions. Number one, how many—Secretary Geithner, how many actual—what are your resources in the Treasury Department to do this right now?

Secretary GEITHNER. We have a very strong overview; we are working very hard. We are going to need some more people, though, and we are working very hard to bring in enough talent to help us get through this.

Mrs. BIGGERT. And I think that should be a focus. I mean, it is going to be difficult to find these people, isn't it?

Secretary GEITHNER. We are finding a lot of people willing to come serve their country in this moment of challenge, and I think that is very encouraging.

Mrs. BIGGERT. So can you give me a number of people?

Secretary GEITHNER. A number of people that we need?

Mrs. BIGGERT. A number of people who are actually working.

Secretary GEITHNER. Across the entire Treasury?

Mrs. BIGGERT. Yes.

Secretary GEITHNER. Oh, I can't do that today.

Mrs. BIGGERT. No, no, no. I meant that you are relying on to do this.

Secretary GEITHNER. In the domestic finance part of the Treasury, I would be happy to give you the exact numbers of staffing today. And again, these are terrific people working very hard, but we are going to need more.

Mrs. BIGGERT. Thank you.

And then, Mr. Chairman, how many are working on this issue in the Federal Reserve?

Mr. BERNANKE. Which specific issue?

Mrs. BIGGERT. Well, working on AIG right now.

Mr. BERNANKE. AIG is being managed by the Federal Reserve Bank of New York, primarily President Dudley, who is here. He has about 10 of his people in the firm every day all the time, and they are supported by analysts both at the Federal Reserve Bank of New York and at the Board.

Mr. DUDLEY. We also have some outside consultants that we have hired to help us in certain areas where we don't have the expertise internally.

Mrs. BIGGERT. I saw an ad in one of our local newspapers just asking for someone who could unravel the mortgage-backed securities. Which brings me to the next question. So I have an investor in my district, and they want to be part of this and purchase some of these legacy assets, as you are calling them now. How would they go about doing that? Can an individual apply if this program goes through to purchase this, or do they have to be part of this five or six management group?

Secretary GEITHNER. Individuals will most realistically benefit through the professionals who manage their pension funds or other financial assets. That is the most direct way they are going to be able to benefit.

Mrs. BIGGERT. Well, what if they are an investor, and they have private equity?

Secretary GEITHNER. Well, it depends on whether they meet the broad conditions we are going to establish to try to protect the American taxpayer. Again, we want to make sure that the inves-

tors and the asset managers meet the highest standards for care and competence.

Mrs. BIGGERT. Then, Chairman Bernanke, could you answer the question about the three trustees? Are you in touch with them?

Mr. BERNANKE. Yes. They have only been appointed relatively recently, and their job is basically to oversee the voting interest of the U.S. Treasury. They are very high-quality people, and they will be involved in our discussions.

Mrs. BIGGERT. And Secretary Geithner?

Secretary GEITHNER. Yes.

Mrs. BIGGERT. Are you working with the three trustees?

Secretary GEITHNER. Yes, although I haven't had the opportunity to do so since I took on this post, but I am sure I will have the chance.

Mrs. BIGGERT. And you were doing that, working with one of them when, you were the trustee or in the New York Fed.

Secretary GEITHNER. Well, this structure was designed in cooperation with the Treasury and the Board when I was president of the New York Fed, and the selection process for those trustees, I believe, concluded before I left the New York Fed. And as the chairman said, these are very capable public servants.

The CHAIRMAN. The time has expired.

The gentleman from Massachusetts.

Mr. LYNCH. Thank you, Mr. Chairman.

Thank you, gentlemen, for trying to help the committee with its work. The AIG situation is a special case. I want to ask you about an agreement that I tried to question Mr. Liddy about last week. But AIG was a special case because of, as you said in your opening testimony, Mr. Secretary, that they were basically on the brink, and that you did act with greater urgency at a very precarious moment. We also—as the taxpayer, we stepped up in a very big way, taking a 79.9 percent share, call it 80 percent. We became the rescuer of AIG. But for the presence and intervention of the American taxpayer, I don't think anybody would argue this company was going under.

And, in fact, I handed out copies of the retention bonus that is at the source of a lot of this hearing. The language in the retention bonus agreement drafted in December of 2007, basically covering the AIG financial products employees, anticipates this in a way; not in a way, specifically. It clearly says that the impact of the credit default swaps and underlying collateral debt obligations will not affect the bonuses.

This infuriates me that employees at the firm in this business saw that these things were so weak and said, okay, what are we going to do here, we are going to build a firewall between the damage that is going to affect the taxpayer—they didn't know it was the taxpayer, but their creditors—and we are going to protect our bonuses. It makes me crazy that they did this. It also, in fact, reserves a certain part of the—well, $67.5 million, I think it was—that regardless of what happened to the company, they would get their bonuses.

And it just seems to me that there are grounds in that for repudiating these contracts. The fact that as they saw bankruptcy looming, they said, okay, the creditors are going to come in here at any

point now and lay claim to our assets, so what we are going to do is we are going to make a special agreement to take care of ourselves. And that is why I made the analogy last week of the captain and the crew reserving the lifeboats.

This is completely objectionable. And I just want to ask you, you know, I think we have a cause of action here as shareholders. You know, I don't dispute bonuses generally. I think they can work. But in this special case, is there not, in essence, a fraudulent conveyance here to escape the creditors who are the people we represent, the people who stepped up and did the right thing, rescued this company? And what did we get, you know? We get this. So if you just talk to me about this. And I know about the Connecticut law, and I still think that these are supervening incidents that could delete the contract.

Mr. Secretary?

Secretary GEITHNER. Congressman, I say it well, and I completely share your frustration. Think of the position I am in. I feel more strongly than you do. And we are looking very carefully working with lawyers in the Executive Branch at all legal avenues to go back and see if we can get this back. And I am sure that we are looking through at exactly the argument you are making, but I can't tell you today that we found a way to do it in a way that is going to be effective for us. But we are on it, and we are looking at it.

Mr. LYNCH. Well, look, if you are not going to go forward, then this committee needs to know that so that we can go forward, because I certainly think the argument needs to be made. And I also know that Connecticut law gives discretion to the judge. I don't think our case is arbitrary or capricious; I don't think it is unreasonable. I think it is well-grounded. It is not made in bad faith. We are actually looking at circumstances that we didn't see when these agreements were made.

Mr. Chairman.

Mr. BERNANKE. We will check this with our legal advisors, or we will work with the Secretary as well. I am hopeful that you are right. We would like to explore every possible option. And this is a perfect example of what I was talking about before where compensation is not related to the risk-taking in an appropriate way.

Mr. LYNCH. Mr. Dudley?

Mr. DUDLEY. I agree with what you just heard from the Treasury Secretary and the Chairman. It is pretty egregious, as you have noted, and we will look into what can be done on that basis.

Mr. LYNCH. Mr. Chairman, I yield back.

The CHAIRMAN. Let me make an announcement. The Secretary of the Treasury has to leave at 1:00, but he will be back on Thursday. So I will announce that on the Democratic side, any members who wish to pass in this hearing now will go at the head of the list on Thursday. Mr. Bernanke can stay a little longer. But members who wish to ask the Secretary of the Treasury after 1:00, there will be a few more we can get in. On the Democratic side, we will begin with any member who is here and passes up his chance, a lot of people aren't here, and then we will go back to the regular order.

The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

Secretary Geithner, I would like to understand the AIG bonus timeline a little better, if you could comment upon it. It was September 16th, when you were president of the New York Fed, that the first intervention took place, correct?

Secretary GEITHNER. That is right.

Mr. HENSARLING. And then I think you said in earlier testimony, you knew there were—there were public filings. You were not personally aware of them. As I understand, on September 22nd, AIG filed its AK, which discusses a retention program, but you were not—is that correct?

Secretary GEITHNER. I was not aware of those filings then. Again, I knew at that point, we all knew, that there was a whole range of compensation issues we were going to have to deal with.

Mr. HENSARLING. Okay. But you were not personally aware of this public disclosure? I understand in November of 2008, a spokesman for the Federal Reserve, Calvin Mitchell, stated that the Federal Reserve, the Treasury, and the New York attorney general all knew about the AIG bonuses in the fall of 2008. Do you have any knowledge of that?

Secretary GEITHNER. Well, I am sure what he said is correct. But again, there is an enormous number of compensation plans that crossed this entity, and they have required—we had different approaches for dealing with them. They had different basic challenges for us, as you have heard. And the particular challenge we are dealing with today is these legally contractual commitments.

Mr. HENSARLING. Mr. Secretary, AIG, representatives of AIG, have alleged—and I may mispronounce her name—Sarah Dahlgren, who was one of your top aides when you were heading the New York Fed—they state that on November 11th, she was personally briefed on the AIG bonus plan in New York. Do you have any knowledge of that?

Secretary GEITHNER. Well, again, I am sure that those dedicated public servants were looking at a whole range of compensation that we are dealing with.

Mr. HENSARLING. I am just asking, were you personally aware of it, yes or no?

Secretary GEITHNER. I don't know if she was briefed on that particular moment, no.

Mr. HENSARLING. And then again on November 24th, AIG again disclosed in a Form AK about these retention programs, but, again, you did not specifically read that AK?

Secretary GEITHNER. About these specific retention programs?

Mr. HENSARLING. Yes.

Secretary GEITHNER. No.

Mr. HENSARLING. Okay. And then on February 28th, according to Time Magazine, the New York Fed informed Treasury staff that the bonus payments were imminent.

Do you have any personal knowledge of Time Magazine's assertion in this regard?

Secretary GEITHNER. Again, I did not know of the details, timing, or precise nature of these things until March 10th. But, Congressman, as I said, that is my responsibility. The question is whether

we had better options than the ones we were confronted with on March 10th, and I do not believe we did.

Mr. HENSARLING. Let me ask you another question, Secretary Geithner. In your testimony, I believe on page 2 you talk about AIG's financial products division, "This division was an unregulated entity operating an unregulated market."

Several days ago, the head of OTS testified before this committee, and we had an opportunity to question him. He testified under oath, and I asked him if he had the power to regulate the financial products of this division that brought AIG down. And I will give you the specific question and answer.

So this is myself: "So again, in retrospect, it wasn't the lack of authority, it wasn't the lack of resources, it wasn't the lack of experience; you just flat made a mistake; is that a correct assessment?"

Mr. Polakoff: "Yes, sir. In 2004, we failed to assess how bad the mortgage economy, the real estate economy would be in 2008."

Now, he testified under oath. So did he perjure himself, did he make a mistake, or are we talking about apples and oranges here when you said that this was an unregulated entity? Because the head of the OTS seems to think it was a regulated entity.

Secretary GEITHNER. I believe that neither the entire entity nor that particular division was subject to an effective framework of oversight with broad authority and appropriate sophistication in the exercise—

Mr. HENSARLING. So it was effective regulation, not necessarily lack of unregulated entity.

Secretary GEITHNER. Congressman, I am not going to disagree with what my colleague at the OTS said, but I don't believe you can look at the system today we have in the United States and say that there was an effective framework of regulation over that entire entity, not just this particular division.

Mr. HENSARLING. I see my time is running out. We will see if we have time at least for the question, perhaps not the answer.

In today's Wall Street Journal it says that various Administration officials, including yourself, have called various folks on Wall Street to apprise them of the plan that you announced yesterday. And part of it says, White House aides returned to some key Wall Street fundraisers who had helped give credibility to Mr. Obama's Presidential campaign.

Do you agree with what the Wall Street Journal said, and if so, did these people receive any advantage from knowing about the program?

Secretary GEITHNER. I have not read that report, and I do not agree with the implication you are drawing from it. But as part of designing these programs, we normally do have to do some consultations, carefully designed consultations, with market participants. But those are all carefully managed to prevent against the risks you were referring to.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

I understand that Ed Liddy is working for $1 a year. I don't doubt that he took the position to serve his country. I don't suspect for a second that he has personally profited in any way by any decision that he has made. And I know he took harsh questions last

week, including from me. But he was also, at the time he accepted the position on the board of Goldman Sachs, and had been for more than 5 years—he had been chairman of the audit committee, and presumably was involved in decisions about valuing counterparty positions on credit default swap contracts with AIG FP.

Was there any discussion about whether appointing Mr. Liddy created issues of appearances, and about whether he really brought in the detachment and the fresh eyes that were needed? To either Secretary Geithner or Chairman Bernanke.

Secretary GEITHNER. I want to say one thing is important about this. I would never, and I don't believe anybody at this table would ever, make a judgment because it would benefit a specific firm in this context, either AIG or any of the specific counterparties in this context. I would never do that, never put my Department in the position of doing that.

Now in that particular case, with respect to Mr. Liddy, the choice of the chief executive and the suggestion that he be appointed was not made by the Fed, the New York Fed. I was presented with him as a possible candidate. I did an independent assessment of whether he was qualified for that. In my judgment he was an excellent choice and brought us the extraordinary benefit of having somebody very experienced and capable come in and run this company. Now, and I don't believe that anything he has done since then is vulnerable to criticism that he has been doing so in a way effective—anything but serving the interest of the American taxpayer and helping that company dig out of this mess.

Mr. MILLER OF NORTH CAROLINA. Secretary Geithner, there is a concept called the appearance of impropriety; not impropriety, but the appearance of impropriety. He was on the board of directors of the company that had—Goldman Sachs, which had the most exposure to credit default swap contracts with AIG FP.

Now, I was very careful in saying I am not suggesting that he has personally profited, but there may be a natural tendency to think of the public interest in terms of the interest of people you actually know. And there might be a tendency to think of the public interest and Goldman Sachs' interest as being more interrelated than other Americans would see them. And that appearance is what I am getting at.

Was there not any discussion of whether there was a problem with the appearance?

Secretary GEITHNER. We have to make choices in this context. It is about alternatives. In our judgment that was the best choice at the time.

Mr. MILLER OF NORTH CAROLINA. So there was no discussion of any appearance, any issue of appearances, or whether by virtue of his own having been involved in decisions about valuing credit default swap positions that he would be pretty sympathetic to people who are counterparties?

Secretary GEITHNER. No concern about that particular issue. But, of course, we knew where he was coming from and what his experience was, but that broad mix of experience made him an exceptionally qualified person to take this job.

Mr. MILLER OF NORTH CAROLINA. Okay. I have been assuming all along that we had smart, aggressive, mean lawyers looking at

possible personal liability claims against people who have been involved personally in these decisions; that, yes, these companies are now unable to pay their bills, unable to pay their debts, but a couple of years ago were doing fabulously well. That money is now gone. In the words of the country music song, it is in a bank in someone else's name. And we have showed very little interest, Mr. Liddy showed no interest, in pursuing personal liability claims against officers or directors or employees based upon breach of fiduciary duty, or other fraud, fraudulent conveyance, negligence, any other theory. Are we looking at personal liability claims against the people who are involved in these decisions and have profited fabulously from them?

Secretary GEITHNER. As I said, we are looking at a range of legal avenues with lawyers, smart and aggressive lawyers. I don't think they are mean lawyers, but smart and aggressive lawyers.

Mr. MILLER OF NORTH CAROLINA. I know some mean lawyers.

Secretary GEITHNER. Maybe we could use some mean lawyers at the Treasury and the Justice Department. And I promise you, we are exploring all available legal avenues.

Mr. MILLER OF NORTH CAROLINA. Thank you. No further questions.

The CHAIRMAN. The gentleman from South Carolina, Mr. Barrett. And this will be the last question for Mr. Geithner.

Mr. BARRETT. Gentlemen, thank you for coming.

Secretary Geithner, last year Secretary Paulson came to the United States Congress and sold the TARP, the Troubled Assets Relief Program, and they were going to buy toxic assets. Was the Treasury's assistance to AIG consistent on how he sold the TARP originally?

Secretary GEITHNER. Congressman, I don't think I can answer that question. I was not Secretary of the Treasury then, was not present in that context.

Mr. BARRETT. I understand. But you understand how he came, the last Administration came and sold it to the United States Congress. And I think it is really simple: Do you think it was consistent with how it was sold to the United States Congress?

Secretary GEITHNER. I do know that the legislation you passed did provide this very important authority for the government to put capital into the financial system. And I think he did use that authority appropriately and very quickly to help save the system.

Mr. BARRETT. I understand that.

Mr. Chairman, what would you say?

Mr. BERNANKE. Yes, I think it was appropriate. The legislation allowed for purchase of financial securities—

Mr. BARRETT. You said appropriate, but was it consistent? Was it consistent with the way it was sold to the United States Congress?

Mr. BERNANKE. The emphasis that the Secretary put was on purchases of assets, and it is true that he did not follow through on that. But it was still part of the discussion and part of the legislation to use the money to support failing institutions or to provide capital to healthy institutions.

Mr. BARRETT. Secretary Geithner, I applaud you on your statement yesterday about going to buy the toxic assets. I think that is

something we should have done months ago. But because of Congress' action last week with the AIG bonuses, who in their right mind in the private sector would want to enter a contract with the United States Government and say, hey, yes, we are going to help you, and not expect some type of the full weight of the Federal Government going to come down on them if they make the wrong decision?

Secretary GEITHNER. Well, you are right to express that concern, and we are going to have to make sure that we design these conditions carefully to help mitigate that risk. And we are going to have to come to a better balance with the Congress as again we try to figure out how to respond to the reasonably perfectly understandable public outrage. We are not using public assistance to reward failure, but still get our system working again, and that is going to require people taking risk, be willing to take risk so the government doesn't have to assume all the losses in solving this financial crisis. And we are going have to get to a better place, both the Congress and the Executive Branch, on this very complicated question.

Mr. BARRETT. And I would hope before we do that, we have some very clear guidelines from both sides. If I am in the private sector, and I am thinking about buying one of these toxic assets, I think somebody has something in my water, there is no way.

Mr. Chairman, would you agree with that? I mean, are we going to have some problems in the private sector with that?

Mr. BERNANKE. I do think we have to provide assurances to participants and say the TALF and the PPIF, that their involvement will not be retroactively penalized in some way.

Mr. BARRETT. Yes.

Secretary Geithner, undated letters of resignation, I know you know what those are. Have we used any of these with AIG? Have we used any of these with other organizations, you know, when the Federal Government steps in? Do we have a letter that says, "Hey, you sign it, and I will date it?" Are we doing anything like that to make sure that people are held responsible for their actions?

Secretary GEITHNER. Good question. Absolutely, we will hold people responsible for their actions. And, again, just remember, on that day in September when we acted, right away we changed management, brought in a new management team and began a process of changing compensation, because we wanted to ensure there was accountability for the judgments they made that brought this company to the brink where it was going to threaten the basic framework of the U.S. financial system.

Mr. BARRETT. Specifically with undated letters of resignation?

Secretary GEITHNER. I don't know that we used that tool, but I am not sure we need that tool, Congressman. But I think you are right to insist we need to make sure there is accountability in these cases.

Mr. BARRETT. I guess the last question I have, which is the $64 million question—or I guess maybe I should say the $64 trillion question—is, what is the backup plan? I mean, if everything fails, what do we do? Where do we go from here?

Mr. Geithner?

Secretary GEITHNER. Congressman, this plan will work. This plan, because of the authority provided by the Congress, not just

to the Treasury but the Fed, gives us broad ability to do what you need to get through a financial crisis like this. It just requires will. It is not about ability. And we just need to keep at it. And we will need to work with Congress to make sure we can do this on a scale that is going to make it work.

But the program we need to lay out, which will help make sure that there is capital available to financial institutions, that these institutions have confidence that they can meet their commitments, have access to funding liquidity and allow them to play their role in providing credit in these programs to get credit markets working again—you can already see, where we are doing this, you can see interest rates come down in ways that benefit small businesses, working families across the country. We just need to keep at it and make sure people understand we are going to get through it and we are going to do what is necessary.

Mr. BARRETT. Thank you, Mr. Chairman. I know my time is up. Thank you, Mr. Chairman.

The CHAIRMAN. I would ask the gentleman for a second to yield to me to say that, in the legislation we are dealing with, we are being very clear that we want to restrict this to people who get the capital program. And we will work with the gentleman to make it very clear that we do not intend to ever extend that.

We advised the Ways and Means Committee of that. We didn't write that legislation. In the compensation legislation we will be marking-up, it is very clearly—it is one thing to be in the Capital Purchase Program to be the recipient of funds, but in the other programs, I do not think we should put those restrictions on. I think the gentleman and I would agree, and we will work together on that.

The Secretary gets tomorrow off. We will see you Thursday.

Mr. BACHUS. Mr. Chairman—oh, he wanted to say something.

Secretary GEITHNER. Just, I look forward to Thursday. Thank you.

The CHAIRMAN. Well, you weren't under oath when you said that, so I am going to go by—

Mr. BACHUS. As he leaves, could we ask that he and his staff get up, but that everybody else will remain seated—

The CHAIRMAN. Yes. We are going to go two more rounds with Mr. Bernanke, if we can do that.

And we now have the gentleman from California.

No, if you are going to leave, you leave right away, and you don't come back. If you are leaving, you leave right away.

Mr. BACHUS. Well, let—I think, if everybody will remain seated until they get out.

The CHAIRMAN. The gentleman from California, I believe, is next, Mr. Baca. Do you wish to question?

Mr. BACA. Yes, I guess along the same lines—I know that Mr. Geithner just left—but we are still very much concerned with the financial institutions receiving large payouts for AIG, including nearly $12 billion each for Societe Generale in France and Deutsche Bank in Germany, as well as $8.5 million for Barclays in the United Kingdom.

How were these payouts meant to stabilize the United States economy, and how can we recoup the American tax dollars?

Mr. BERNANKE. Well, Congressman, again, many of the issues and concerns that people have raised and are appropriate ones boil down, again, to the lack of a resolution regime, which means that we had really no alternative but to make good all of the obligations of AIG, else they would have been in default and in bankruptcy with the chaos that would have followed.

In this particular case, as I argued before, though, the Europeans have also protected financial institutions. They have not distinguished between American and European creditors. And I think we need to work collaboratively with our partners around the world to try to stabilize the global financial system.

But, again, it is really a much broader issue of stabilizing the overall system, not the specific counterparties.

Mr. BACA. Right. And many of the people are really so outraged with, I believe, $85 billion that has gone to AIG executives receiving bonuses, whether it is in London or a foreign country. What, if anything, is being done to reclaim the American tax dollars? What are we doing? Can anything be done to reclaim the tax dollars right now? And this is why the public is outraged about. What is it that we can do? Why didn't we have the oversight? Why didn't we have the accountability before this even happened? It seems like we saw it, but we didn't take any action. What can be done now?

Mr. BERNANKE. Well, in terms of the collapse of AIG itself, we didn't see it. Our regulatory system was not adequate, and I believe it was not adequate to find the problem and identify it and stop it in time.

I think, going forward, we need a stronger, comprehensive holding company supervision plan, together with resolution authorities that would allow us to wind down a firm like this in this kind of circumstances. So I think there are important financial reforms that need to take place.

With respect to getting the money back, again, we have put a lot of money into AIG, it is absolutely true. But speaking at least for the Federal Reserve, we think we have good collateral; we expect to receive that money back.

Mr. BACA. You just mentioned that we were not adequately, I guess, prepared. Why not?

Mr. BERNANKE. Well, what we found in this crisis is that through many, many parts of our financial regulatory system and in our financial institutions we simply were not adequately prepared for a crisis of this magnitude. And—

Mr. BACA. Why not, if we knew that there was loopholes?

Mr. BERNANKE. I don't know the answer to that, Congressman. And I guess it had to do with the design of the system and omission of certain important areas.

Mr. BACA. Were we turning our ears or our nose and just allow this process to happen? I mean, it seems like we knew it was still coming, we weren't adequately prepared. We should have been adequately prepared. Why is it that it still happened? I mean, this is what is puzzling to the American people.

Mr. BERNANKE. So I think an absolutely critical part of the deal here is that, if we are going to put out the fire in the financial system, we also have to promise the American people we are going to

take the steps necessary that this will not happen again. And that requires a very extensive rethinking of our financial regulatory system as well as elements of our financial system more broadly.

So I absolutely agree with you that we have to fix the system, but it was broken and it did not succeed in the context of this crisis.

Mr. BACA. When was it broken?

Mr. BERNANKE. Well, evidently, in this particular case, I think that, notwithstanding Mr. Polakoff—I admire him for standing up and saying that it was his responsibility—but the Office of Thrift Supervision is a small agency that specializes in addressing the problems of thrifts. It was, in this case, involved only because AIG owned a small thrift. Its main concern is the protection of the thrift.

It is true, as he said, that he looked at some of these elements in the AIG FP division, but I do think that, given the size of the company and the risk being taken, a larger, more effective, stronger, better-funded regulatory effort would have been needed in order to identify these problems.

Mr. BACA. I understand where we need to go, but when was it broken? Approximately when was the system broken, that it was inaccurately—I mean, do we have a rough year, as to when?

Mr. BERNANKE. Many different aspects of the system just proved inadequate under the pressure of the crisis. And I can't identify one specific cause for the crisis.

Mr. BACA. No, I am just trying to—because, you know, this Administration is trying to clean up its act and I know, under the leadership of our chairman, has come up with regulations, accountabilities, and oversight. We never had this in the past because we always stated that we didn't want to be overregulated. But yet, in this case, we needed to be regulated because the American people are the ones that are hurting right now.

The CHAIRMAN. The gentleman from Florida.

Mr. POSEY. Thank you, Mr. Chairman. And thank you for your judicious handling of this committee in some kind of rough words here.

The CHAIRMAN. Thank you.

Mr. POSEY. You know, I don't want to beat a dead horse any more. We have beaten a lot of dead horses today. I think what I am looking for and really what my colleagues are really looking for and our people back home are looking for is probably just a big-picture approach, you know?

I think everybody is upset with what at least some of us perceive is a crisis-of-the-day management of the situation. They think this is a solution, and then, "Oops, that is not it; it is over here." And now we are going to have son of TARP, grandson of TARP, great-grandson of TARP. You know, when will it ever stop?

Most businesses would approach this, and I think most prudent people, with a long-term plan, you know, a plan that maps out the contingencies and just doesn't walk around every day looking for more land mines, more bad reports, and more changes in adjustment. And I haven't ever seen that.

You know, hopefully somewhere there is a flow chart that says, "Here is the direction we want to go. Here is what we want to ac-

complish. And here is the way that we measure if we are on task or not. If we have reached this point, we need to do this. If we don't reach that point, these are the contingencies."

I think everybody would be so much more comfortable dealing with this if we saw a real, legitimate plan, a timeline that would let everyone note, the public as well, would provide a transparency with where we have been, we know where we are, and where we hope to go. But just shooting in the dark every day, you know, crisis du jour, what is it today, what is the next new plan that is going to solve all these problems, you know, I really don't have much comfort in that, and I can't imagine how anybody would.

So do you all—are you familiar with the plan, or are you prepared to help us set forth on a plan? I mean, you know, we wouldn't take a vacation without a road map. We wouldn't try to leave the District, even try to get around the District right now for me, without a road map. But we have no roadmap for the financial future of this country, and it is really pretty scary.

Mr. BERNANKE. Well, Congressman, that is a very good question. I am sure you appreciate how complex and difficult this whole situation has been. I do think there is a plan.

First, I should mention the Federal Reserve has been very aggressive on a lot of fronts, both in terms of lowering interest rates, both short-term and long-term interest rates, and providing liquidity to the system.

Secondly, the Treasury now has essentially a five-point plan. It includes supervisory review and putting in capital, buying assets off of balance sheets, the foreclosure mitigation plan, and then the joint program with the Federal Reserve, the TALF, which will help get the securitization markets going. That covers all the major elements needed to get the banking system going again.

But then, to make this all work for the future, in order to avoid an AIG or a similar situation, we also have to very seriously undertake a financial reform program. The Federal Reserve has developed some proposals, which I talked about last week. I know Secretary Geithner will be here on Thursday to talk about the Treasury's proposals.

So I think there is a plan. If you have ever read books on battles and warfare, you know that a lot of battles are very chaotic at the beginning until the situation becomes clear and the smoke starts to clear. I think we have gotten to the point now where we can see the terrain, and we are taking the steps necessary to stabilize the situation and get out of this downturn we are in.

Mr. POSEY. And I appreciate that, and I hope that most betters are one with a good plan. But a five-point plan I kind of see is just like we are going to throw these five Hail Marys and we hope to make a touchdown or maybe five touchdowns. But I would really like to see more detail. In other words, you know, if the receiver, for whatever reason—your fault, my fault, God's fault, his fault, nobody's fault—drops the ball, that plan is out of the way. Now, where are we going to move that plan, with that first Hail Mary—you know, what is the contingency plan? And that is what I haven't seen unfold.

The lack of accountability—and a large part of the reason that we are not here is we didn't measure stuff properly. Usually, what

doesn't get measured doesn't get done. It is the same with production. If you don't measure something, it usually means it is not important and it doesn't get finished. And if we set out on a path to solve this crisis—and I believe you all have the brains and the wisdom and the experience to do it if we stay on task—the less politicized it is, the better, and the less politicized it will be, the more clear your path is.

But I think everyone needs to know what we expect to happen tomorrow and the next day and the next week and the next month.

The CHAIRMAN. The gentleman's time has expired, and so has the hearing.

I thank the Chairman and the president for their 3 hours and 15 minutes.

We will begin with those members who stayed going first on our side, in terms of Mr. Geithner on Thursday.

Mr. BACHUS. Mr. Chairman, I would like to say that, President Dudley, you did an outstanding job fielding all those difficult questions today.

Mr. DUDLEY. Thank you, sir.

Mr. BERNANKE. He is a fine man.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 1:15 p.m., the hearing was adjourned.]

A P P E N D I X

March 24, 2009

Statement by Rep. Michele Bachmann
House Financial Services Committee Hearing
"Oversight of the Federal Government's Intervention at American International Group"

March 24, 2009

Thank you, Mr. Chairman.

When last week's news broke to the public and the mainstream media that AIG paid $165 million in retention bonuses to its executives, many of which are not even with the company today, every member of this committee heard from outraged constituents that were asking the same questions: How could the government allow this? When did they know about the imminent bonuses? And when, if ever, will the taxpayers be repaid?

The people are frustrated. They are angry. And, quite frankly, given how freely their government has been doling out their money: They were justified.

After a few days it has become clear that the Federal Reserve and the Treasury Department both know about the bonuses long before the story broke. As far back as May 2008, the bonuses were made public in SEC documents. In November 11, 2008, AIG claims that one of then-New York Federal Reserve Bank President Geithner's top deputies was briefed on the bonus plan at AIG headquarters in New York. Two weeks later, AIG disclosed more bonus information to the SEC. And, according to Calvin Mitchell, a spokesman for the Federal Reserve, the Treasury, the Federal Reserve and the New York Attorney General all knew about the AIG bonuses in the fall of 2008.

Mind you: All along, taxpayer dollars were being funneled to AIG by the government to bail them out of their troubled finances.

More than four months later, everyone from President Obama and Secretary Geithner to Senate Banking Committee Chairman Chris Dodd reacted with sheer disbelief and surprise at today's situation. But the truth is: they knew it was coming. Worse, Senator Dodd has admitted that he inserted language at the Treasury Department's behest into the so-called "stimulus" bill which specifically allowed these bonuses to go forward.

Like my constituents, I am incensed that AIG employees would accept these taxpayer-funded bonuses when they retained their jobs and their company was kept afloat by the grace of the taxpayers in the first place. Yesterday's news that 15 of the top 20 bonus recipients have agreed to return the taxpayers' money, amounting to only about $30 million, is more than welcomed.

But that doesn't mean that those who knew about the bonuses should not be held accountable. And let's not forget that the complete bonus roll-out is actually scheduled to total about $450 million over the next year. We're left to wonder if the back end of this contract will be renegotiated.

Finally, this type of collision of two worlds – business and political – with very different decision-making processes and radically different pressures is to be expected when government steps into the board room, as we did when we passed the $700-billion bailout and when government infused Wall Street with trillions of dollars. These types of

contractual decisions take place everyday in the business world. Government reached its hand deep into the inner workings of private companies and it should come as no surprise to the President or others that supported the bailouts that this day could eventually come. I voted against the bailouts and this inherent flaw was certainly one of the critical reasons why.

Thank you Secretary Geithner, Chairman Bernanke, and Mr. Dudley for being here today. I look forward to hearing from each of you. Thank you, Mr. Chairman, and I yield back the balance of my time.

For release on delivery
10:00 a.m. EDT
March 24, 2009

Statement by

Ben S. Bernanke

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

March 24, 2009

Chairman Frank, Ranking Member Bachus, and other members of the Committee, I appreciate having this opportunity to discuss the Federal Reserve's involvement with American International Group, Inc. (AIG). In my testimony, I will describe why supporting AIG was a difficult but necessary step to protect our economy and stabilize our financial system. I will also discuss issues related to compensation and note two matters raised by this experience that merit congressional attention.

Reasons for Our Original Lending Decision

We at the Federal Reserve, working closely with the Treasury, made our decision to lend to AIG on September 16 of last year. It was an extraordinary time. Global financial markets were experiencing unprecedented strains and a worldwide loss of confidence. Fannie Mae and Freddie Mac had been placed into conservatorship only two weeks earlier, and Lehman Brothers had filed for bankruptcy the day before. We were very concerned about a number of other major firms that were under intense stress.

AIG's financial condition had been deteriorating for some time, caused by actual and expected losses on subprime mortgage-backed securities and on credit default swaps that AIG's Financial Products unit, AIG-FP, had written on mortgage-related securities. As confidence in the firm declined, and with efforts to find a private-sector solution unsuccessful, AIG faced severe liquidity pressures that threatened to force it imminently into bankruptcy.

The Federal Reserve and the Treasury agreed that AIG's failure under the conditions then prevailing would have posed unacceptable risks for the global financial system and for our economy. Some of AIG's insurance subsidiaries, which are among the largest in the United States and the world, would have likely been put into rehabilitation by their regulators, leaving

policyholders facing considerable uncertainty about the status of their claims. State and local government entities that had lent more than $10 billion to AIG would have suffered losses. Workers whose 401(k) plans had purchased $40 billion of insurance from AIG against the risk that their stable value funds would decline in value would have seen that insurance disappear. Global banks and investment banks would have suffered losses on loans and lines of credit to AIG, and on derivatives with AIG-FP. The banks' combined exposures exceeded $50 billion.[1] Money market mutual funds and others that held AIG's roughly $20 billion of commercial paper would also have taken losses. In addition, AIG's insurance subsidiaries had substantial derivatives exposures to AIG-FP that could have weakened them in the event of the parent company's failure.

Moreover, as the Lehman case clearly demonstrates, focusing on the direct effects of a default on AIG's counterparties understates the risks to the financial system as a whole. Once begun, a financial crisis can spread unpredictably. For example, Lehman's default on its commercial paper caused a prominent money market mutual fund to "break the buck" and suspend withdrawals, which in turn ignited a general run on prime money market mutual funds, with resulting severe stresses in the commercial paper market. As I mentioned, AIG had about $20 billion in commercial paper outstanding, so its failure would have exacerbated the problems of the money market mutual funds. Another worrisome possibility was that uncertainties about the safety of insurance products could have led to a run on the broader insurance industry by policyholders and creditors. Moreover, it was well known in the market that many major financial institutions had large exposures to AIG. Its failure would likely have led financial market participants to pull back even more from commercial and investment banks, and those

[1] In addition, many of these same banks had borrowed securities from AIG's securities lending program for which they had given AIG cash as collateral. Upon an AIG bankruptcy, the banks would have taken possession of the securities instead of receiving back their cash, exposing them to possible losses on those securities.

institutions perceived as weaker would have faced escalating pressure. Recall that these events took place before the passage of the Emergency Economic Stabilization Act, which provided funds that the Treasury used to help stem a global banking panic in October. Consequently, it is unlikely that the failure of additional major firms could have been prevented in the wake of the failure of AIG. At best, the consequences of AIG's failure would have been a significant intensification of an already severe financial crisis and a further worsening of global economic conditions. Conceivably, its failure could have resulted in a 1930s-style global financial and economic meltdown, with catastrophic implications for production, income, and jobs.

The decision by the Federal Reserve on September 16, 2008, with the full support of the Treasury, to lend up to $85 billion to AIG should be viewed with this background in mind. At that time, no federal entity could provide capital to stabilize AIG and no federal or state entity outside of a bankruptcy court could wind down AIG. Unfortunately, federal bankruptcy laws do not sufficiently protect the public's strong interest in ensuring the orderly resolution of nondepository financial institutions when a failure would pose substantial systemic risks, which is why I have called on the Congress to develop new emergency resolution procedures. However, the Federal Reserve did have the authority to lend on a fully secured basis, consistent with our emergency lending authority provided by the Congress and our responsibility as central bank to maintain financial stability. We took as collateral for our loan AIG's pledge of a substantial portion of its assets, including its ownership interests in its domestic and foreign insurance subsidiaries. This decision bought time for subsequent actions by the Congress, the Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve that have avoided further failures of systemically important institutions and have supported improvements in key credit markets.

The Federal Reserve's Ongoing Involvement with AIG

Having lent AIG money to avert the risk of a global financial meltdown, we found ourselves in the uncomfortable situation of overseeing both the preservation of its value and its dismantling, a role quite different from our usual activities. We have devoted considerable resources to this effort and have engaged outside advisers. Using our rights as creditor, we have worked with AIG's new management team to begin the difficult process of winding down AIG-FP and to oversee the company's restructuring and divestiture strategy. Progress is being made on both fronts. However, financial turmoil and a worsening economy since September have contributed to large losses at the company, and the Federal Reserve has found it necessary to restructure and extend our support. In addition, under its Troubled Asset Relief Program (TARP), the Treasury injected capital into AIG in both November and March. Throughout this difficult period, our goals have remained unchanged: to protect our economy and preserve financial stability, and to position AIG to repay the Federal Reserve and return the Treasury's investment as quickly as possible.

In our role as creditor, we have made clear to AIG's management, beginning last fall, our deep concern surrounding compensation issues at AIG. We believe it is in the taxpayers' interest for AIG to retain qualified staff to maintain the value of the businesses that must be sold to repay the government's assistance. But, at the same time, the company must scrupulously avoid any excessive and unwarranted compensation. We have pressed AIG to ensure that all compensation decisions are covered by robust corporate governance, including internal review, review by the Compensation Committee of the Board of Directors, and consultations with outside experts. Operating under this framework, AIG has voluntarily limited the salary, bonuses, and other types of compensation for 2008 and 2009 of the CEO and other senior managers. Moreover, executive

compensation must comply with the most stringent set of rules promulgated by the Treasury for TARP fund recipients. The New York Attorney General has also imposed restrictions on compensation at AIG.

Many of you have raised specific issues with regard to the payout of retention bonuses to employees at AIG-FP. My reaction upon becoming aware of these specific payments was that, notwithstanding the business purposes that might be served by this action, it was highly inappropriate to pay substantial bonuses to employees of the division that had been the primary source of AIG's collapse. I asked that the AIG-FP payments be stopped but was informed that they were mandated by contracts agreed to before the government's intervention. I then asked that suit be filed to prevent the payments. Legal staff counseled against this action, on the grounds that Connecticut law provides for substantial punitive damages if the suit would fail; legal action could thus have the perverse effect of doubling or tripling the financial benefits to the AIG-FP employees. I was also informed that the company had been instructed to pursue all available alternatives and that the Reserve Bank had conveyed the strong displeasure of the Federal Reserve with the retention payment arrangement. I strongly supported President Dudley's conveying that concern and directing the company to redouble its efforts to renegotiate all plans that could result in excessive bonus payments. I have also directed staff to work with the Treasury and the Administration in their review of whether the FP bonus and retention payments can be reclaimed. Moreover, the Federal Reserve and the Treasury will work closely together to monitor and address similar situations in the future.

Lessons Learned from AIG

To conclude, I would note that AIG offers two clear lessons for the upcoming discussion in the Congress and elsewhere on regulatory reform. First, AIG highlights the urgent need for

new resolution procedures for systemically important nonbank financial firms. If a federal agency had had such tools on September 16, they could have been used to put AIG into conservatorship or receivership, unwind it slowly, protect policyholders, and impose haircuts on creditors and counterparties as appropriate. That outcome would have been far preferable to the situation we find ourselves in now. Second, the AIG situation highlights the need for strong, effective consolidated supervision of all systemically important financial firms. AIG built up its concentrated exposure to the subprime mortgage market largely out of the sight of its functional regulators. More-effective supervision might have identified and blocked the extraordinarily reckless risk-taking at AIG-FP. These two changes could measurably reduce the likelihood of future episodes of systemic risk like the one we faced at AIG.

For release on delivery
10:00 a.m. EDT
March 24, 2009

Statement by

William C. Dudley

President and Chief Executive Officer

Federal Reserve Bank of New York

before the

Committee on Financial Services

U.S. House of Representatives

March 24, 2009

Good morning, Chairman Frank, Ranking Member Bachus, and other members of the Committee. Thank you for giving me the opportunity to appear before you today. As you know, on January 27, 2009, I became the President of the Federal Reserve Bank of New York. Before I assumed that position, I served as the head of the Markets Group at the New York Fed. I appreciate having this opportunity to discuss the Federal Reserve Bank of New York's involvement with American International Group, Inc. (AIG).

Role of the Federal Reserve Bank of New York

At the outset, it is important to note that before the New York Fed became involved with AIG as a lender on September 16, 2008, the Federal Reserve lacked any kind of authority to oversee AIG. The lack of effective consolidated supervision over AIG was a critical contributing factor to the debacle that occurred at the company.

The Federal Reserve made its decision to lend based on a judgment that a failure of AIG would cause dramatically negative consequences for the financial system and the economy – consequences worse than what occurred in the aftermath of the failure of Lehman Brothers. We stand by that judgment today. In the case of Lehman, some of the most severe repercussions related to the difficulties in coordinating cross-border insolvency regimes and in coordinating the insolvency regimes among different types of institutions within the organization's corporate structure. In light of AIG's unparalleled global footprint – operating in more than 130 countries around the globe – and the multiplicity of different types of financial services entities within its structure – including insurance providers, foreign banks, consumer lending companies and OTC derivatives affiliates – the factors that proved unmanageable in the Lehman insolvency threatened to be much more severe in AIG's case. The fact that no effective emergency resolution procedures exist under U.S. law to reconcile these difficulties heightened the need for

quick, effective action by the Federal Reserve, in consultation with and supported by the U.S. Treasury.

From the outset, the New York Fed has been sharply focused on addressing two overarching goals with respect to AIG: (1) the stabilization of the company so that it no longer poses a disruptive threat to our financial system and economy and (2) obtaining full repayment of the government funds that have been extended to AIG. In light of the exceptional size and scope of AIG's operations, with over 110,000 employees in more than 130 countries, spanning hundreds of legal entities, it was clear from the beginning that the New York Fed – which had never been engaged in any regulatory oversight of the company – was not in a position to exert day-to-day management control over the company. Rather, the New York Fed's actions have consistently been directed at securing its objectives as lender. As any lender in our position would do, the New York Fed has put into place a loan agreement that contains covenants designed to help ensure ultimate repayment of the loan – but these creditor's rights do not create an ability to manage AIG.

Responsibility for AIG's day-to-day affairs continues to rest with AIG's Chief Executive Officer, Edward Liddy, under the oversight of AIG's board of directors. Mr. Liddy, who has only become involved with AIG in a public-spirited attempt to resolve its troubled affairs, has made strides in dealing with AIG's opaque corporate structure, lack of centralized controls, and complex risk exposures, but much remains to be done.

In light of the inherent conflicts that would arise from either the U.S. government or the Federal Reserve exerting ownership control over the world's largest insurer, the Federal Reserve, with the support of the Treasury Department, directed in the loan agreement that an approximately 77.9 percent equity interest in AIG be issued to an independent trust established

for the sole benefit of the United States Treasury. The trust, which now holds that controlling equity interest, is overseen by three independent trustees who are of the highest integrity and who have considerable experience leading major companies. These trustees have a legally binding obligation to exercise all of their rights as majority owner of AIG in the best interests of the U.S. taxpayer, with the proceeds of any ultimate sale of shares going directly to the Treasury of the United States.

Efforts to Reduce Risk at AIG Financial Products

As has been widely noted, the activities at AIG's Financial Products unit (FP) were a principal cause of the losses that drove AIG to the brink of bankruptcy in September 2008. Risks of substantial magnitude – including derivatives positions with a current total notional value exceeding one trillion dollars – still remain in force at FP, meaning that not millions but billions of taxpayer dollars are potentially at stake as the orderly wind-down of FP continues to progress. The winding down of these risk positions at FP is a delicate and complex matter with systemic implications for the U.S. and global economy. Our oversight of this risk-reduction process remains a top priority.

With respect to the retention awards owed to FP employees under their pre-existing contracts, we believe that Mr. Liddy weighed a number of factors in deciding not to attempt to prevent payment, including:

- the likely negative effects of disruption in staffing at FP in managing its multi-billion dollar exposures;
- legal advice that the contracts were valid – meaning that breaking them would likely increase the amount of company funds ultimately paid to the covered employees; and

- the negative consequences to AIG's business that could result from the public abrogation of contracts.

In conducting our oversight as lender, the New York Fed did not see reason to disagree with Mr. Liddy's judgment from a risk perspective. Equally important, we did not think it was legally permissible – or within the proper role of the New York Fed – to attempt to substitute our judgment for that of Mr. Liddy in this circumstance, even though we found the payment of the retention awards extremely distasteful.

The broad public disapproval of sizeable retention payments being directed toward the unit most responsible for last fall's downfall of AIG is understandable. Americans naturally feel outraged when confronted with news of such payments to an entity that worsened the financial crisis and that is dependent on taxpayer funds to stay out of bankruptcy court where these contracts would not have been fully honored. Moreover, the payments occurred during a time when so many Americans are struggling to find jobs, seeing their wages reduced or watching their retirement savings plummet as a result of a crisis they had no hand in creating. This feeling of outrage underscores the urgent need to reform the system of compensation at our financial institutions to more closely align the incentives of executives, owners and taxpayers. Congress saw fit to impose appropriate compensation restrictions on recipients of Troubled Asset Relief Program (TARP) funding, and we think it is crucial for Congress and the U.S. Department of the Treasury to continue to craft effective and sensible policies in this area.

Although oversight of TARP-related compensation matters rests with the Treasury Department, the New York Fed has played a role since September in reviewing the adequacy of AIG's corporate governance procedures. This review has helped to identify longstanding deficiencies with respect to compensation committee governance, compensation benchmarking,

and lack of centralized control over compensation policy. We will continue to work with our colleagues at Treasury and the independent trustees to ensure that AIG's management properly addresses these deficiencies.

Ongoing Involvement with AIG

The total package of assistance that the Federal Reserve and Treasury Department have committed to AIG has established a more durable capital structure for the company that gives AIG greater time and flexibility to execute its asset disposition plan to repay government funds. Notably, we have recently agreed in principle to accept preferred interests in two of AIG's large foreign life insurance subsidiaries, AIA and ALICO, in order to make repayment of our loan less dependent on forced divestitures into a depressed acquisition market. Although it will take time, we still expect that the proceeds from asset sales should enable AIG to repay the New York Fed in full.

In all that we have done, we have been motivated by two goals: to preserve the stability of the U.S. economy and to protect the U.S. taxpayer. The threat of a major systemic risk event has been averted by honoring all of AIG's contractual obligations around the globe – from insurance policy obligations owed to individuals, municipalities and businesses across the U.S., to the posting of collateral under credit default swap arrangements with the full range of counterparties recently disclosed. As unattractive as certain aspects of this treatment may be, these negative aspects have followed unavoidably from the decision to avert a systemically destructive bankruptcy. I look forward to your questions today and, in the longer term, to working with you and your staffs on the broader public policy questions – such as formulation of a resolution regime for institutions like AIG and consideration of the appropriate supervisory structure for OTC derivatives – that are posed by the events at AIG. Thank you.

For release on delivery
10:00 a.m. EDT
March 24, 2009

Statement by

Timothy F. Geithner

U. S. Secretary of the Treasury

before the

Committee on Financial Services

U.S. House of Representatives

March 24, 2009

Good morning, Chairman Frank, Ranking Member Bachus, and other members of the Committee. Thank you for the opportunity to testify about the federal government's dealings with the American International Group, Inc. (AIG). I am pleased to be here with Chairman Bernanke and President Dudley.

AIG highlights broad failures of our financial system. Our regulatory system was not equipped to prevent the build up of dangerous levels of risk. Compensation practices encouraged risk-taking and rewarded short-term profits over long-term financial stability, overwhelming the checks and balances in the system. The U.S. government does not have the legal means today to manage the orderly restructuring of a large, complex, non-bank financial institution that poses a threat to the stability of our financial system.

I share the anger and frustration of the American people, not just about the compensation practices at AIG and in other parts of our financial system, but that our system permitted a scale of risk-taking that has caused grave damage to the fortunes of all Americans.

We must ensure that our country never faces this situation again. To achieve that goal, the Administration and Congress have to work together to enact comprehensive regulatory reform and eliminate gaps in supervision. All institutions and markets that could pose systemic risk will be subject to strong oversight, including appropriate constraints on risk-taking. Regulators must apply standards, not just to protect the soundness of individual institutions, but to protect the stability of the system as a whole. Finally, we must create a new resolution authority so that the federal government has the tools it needs to unwind an institution of the size and complexity of AIG.

Before the financial crisis, AIG was one of the largest insurance companies in the world with operations in 130 countries and a trillion dollar balance sheet. AIG's businesses provide insurance and retirement services for millions of individuals and businesses. AIG directly guarantees over $30 billion of 401(k) and pension plan investments and is a leading provider of retirement services for teachers and educational institutions.

AIG's Financial Products division (AIGFP) was a counterparty on thousands of over-the-counter derivatives contracts to major financial institutions and other entities across the globe. This division was an unregulated entity operating in unregulated markets.

In September, at a time of unprecedented financial market stress, losses on derivatives contracts entered into by AIG's Financial Products group forced the entire company to the brink of failure.

The U.S. Department of the Treasury (Treasury), the Federal Reserve Board, and the Federal Reserve Bank of New York agreed that the collapse of AIG could cause large and unpredictable global losses with systemic consequences -- destabilizing already weakened financial markets, further undermining confidence in the economy, and constricting the flow of credit. A disorderly failure of AIG risked deepening and prolonging the current recession.

There is no effective legal mechanism to unwind a non-bank financial institution like AIG. Therefore, on September 16th, the Federal Reserve Board authorized an $85 billion revolving credit facility to provide liquidity and avoid default. As a condition of government assistance, the government installed new management at AIG and began the process of restructuring the board. We initiated a strategy to return AIG to its core insurance business by winding-down its derivatives trading operation and selling non-core businesses. This loan was the beginning of a sustained effort to stabilize the company, which required additional commitments of capital in November and March.

In November, as part of the government's infusion of capital, Treasury imposed the strictest level of executive compensation standards required under the Emergency Economic Stabilization Act. When we were forced to take additional action in March, we required AIG to also apply the Treasury rules that will be promulgated based on the executive compensation provisions in the American Reinvestment and Recovery Act.

On March 10th, I received a full briefing on the details of AIGFP's pending retention payments, including information on the payments to individual executives.

I found these payments deeply troubling. After consulting with colleagues at the Fed and exploring our legal options, I called Ed Liddy and asked him to renegotiate these payments. He explained that the contracts for the retention payments were legally binding and pointed out the risk that, by breaching the contracts, some employees might have a claim under Connecticut law to double payment of the contracted amounts.

I demanded that Liddy reduce future payments by hundreds of millions of dollars. He committed to renegotiate the remaining retention awards on terms consistent with the American Recovery and Reinvestment Act, and the Administration's compensation guidelines.

Additionally, Treasury is now working with the Department of Justice to determine what legal avenues may be available to recoup retention bonuses that have already been paid. Treasury will also impose on AIG a contractual commitment to pay the Treasury, from the operations of the company, the amount of the retention awards just paid. Finally, Treasury will deduct from the $30 billion in recently committed capital assistance an amount equal to the amount of those payments.

The issue of excessive compensation extends beyond AIG and requires reform of the system of incentives and compensation in the financial sector.

On February 4th, the President and Treasury announced new restrictions on executive compensation for financial institutions that are receiving government assistance as part of the Financial Stability Plan. These measures are designed to ensure that public funds are focused on the public interest and that the compensation of top executives in the financial community is aligned not only with the interests of shareholders and financial institutions, but with the interests of taxpayers providing assistance to those companies.

On February 17th, the President signed additional limits on executive compensation into law as part of the American Reinvestment and Recovery Act. These limits included a requirement to recoup bonuses already paid in cases of misrepresentation or malfeasance. Treasury is currently working to promulgate rules to implement these provisions and to develop a program under the original TARP legislation to review certain bonus awards already paid. We will work with Congress on any new legislation proposed in this area.

We need to strike the right balance between encouraging investment and prudent risk-taking to get our financial system moving again, and, on the other hand, placing limits on executive compensation to avoid taxpayer funded rewards for failure. The objective is to promote long-term value and growth for shareholders, companies, workers and the economy at large, and to reduce the risk of financial crises like the current one from occurring again.

In addition to problems with executive compensation, the financial crisis has revealed systemic gaps in the regulatory structure governing our financial markets. The lack of an appropriate regulatory regime and resolution authority for large non-bank financial institutions contributed to this crisis and will continue to constrain our capacity to address future crises. I will testify before this committee on Thursday to discuss our regulatory reform proposals – particularly those relating to mitigating systemic risk – in more detail.

As we have seen with AIG, distress at large, interconnected, non-depository financial institutions can pose systemic risks just as distress at banks can. The Administration proposes legislation to give the U.S. government the same basic set of tools for addressing financial distress at non-banks as it has in the bank context.

The proposed resolution authority would allow the government to provide financial assistance to make loans to an institution, purchase its obligations or assets, assume or guarantee its liabilities, and purchase an equity interest.

The U.S. government as a conservator or receiver would have additional powers to sell or transfer the assets or liabilities of the institution in question, renegotiate or repudiate the institution's contracts (including with its employees), and prevent certain financial contracts with the institution from being terminated on account of the conservatorship or receivership.

This proposed legislation would fill a significant void in the current financial services regulatory structure with respect to non-bank financial institutions. Implementation would be modeled on the resolution authority that the FDIC has under current law with respect to banks.

Before taking any emergency action, the Treasury Secretary would need to determine that resolution authority is necessary upon the positive recommendations of the Federal Reserve Board and the appropriate federal regulatory agency.

This is an extraordinary time and the government has been forced to take extraordinary measures. We will do what is necessary to stabilize the financial system, and with the help of Congress, develop the tools that we need to make our economy more resilient and our system more just. Financial crises contain a basic and tragic unfairness – that those who were prudent and responsible in their personal and professional judgments are harmed by the actions of those were less careful and less prudent.

The actions that we take will help restore confidence in our markets and revive the flow of credit to households and businesses. They will create an environment where it is safe to save and invest and where all Americans can trust the rules governing their financial decisions. The process of repair will take time, but our actions will succeed. For all the challenges that we face, we still have a diverse and resilient financial system. Together we will help prevent future crises and the costs they would impose.

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