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New trial will shine light on 2008 bailout of insurance giant AIG

By Joseph Lawler

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One of the most controversial bailouts of the 2008 financial crisis is about to get renewed attention and public scrutiny, six years after the fact.

This week, the U.S. Court of Federal Claims begins hearing a lawsuit against the government for its 2008 bailout of the insurance giant American International Group, led by the company's former CEO, Maurice "Hank" Greenberg, who is suing on behalf of the company's investors. The trial, which will feature a reunion of the major characters involved in the bailouts, is an opportunity for both sides to hash out what really happened during the darkest days of the crisis.

Greenberg, who stepped down as AIG's chief before its bets on derivatives linked to mortgage-backed securities set it up for a taxpayer-funded bailout, is seeking upwards of $40 billion for his investment firm, Starr International, for what he claims was unfair treatment. The suit contends that the government treated AIG's shareholders discriminatorily compared with the big banks that received more favorable bailout terms.

By withholding access to the alphabet soup of recovery programs it created to bail out banks, and then demanding an 80 percent stake in the company and high interest rates when they did offer a rescue, Greenberg says, the Federal Reserve and the Treasury cheated AIG's owners. Furthermore, the suit claims, "the purpose of the government taking control of AIG ... was to enable the use of AIG as a vehicle to provide discriminatory, non-public 'backdoor bailouts' to other institutions, including foreign institutions."

Whether or not the 89-year-old Greenberg has a shot at winning the case, the trial will attract interest because it could shine a light on the circumstances of those "backdoor bailouts" for banks such as

Goldman Sachs and JPMorgan Chase. The trial will involve previously unseen documents and testimony from the architects of the bailouts, including then-Federal Reserve Chairman Ben Bernanke, Treasury Secretary Hank Paulson and Federal Reserve Bank of New York President Timothy Geithner, who went on to become President Obama's first Treasury secretary.

“This one provides an impressive window into a number of things,” said Bartlett Naylor, a financial policy expert for the watchdog group Public Citizen.

“I would like to see that extraordinary care and rigor was taken when these decisions were made, but I expect we’ll find the opposite,” Naylor said, adding that “the lesson should be that we make sure that reform laws are implemented carefully” to avoid regulators making momentous decisions without clear guidelines in the future.

In particular, financial reform advocates and members of Congress who have criticized the AIG bailout will be looking for new information about what led regulators to give 100 cents on the dollar to banks for bets on mortgage-backed securities with AIG that the insurer otherwise wouldn't have been able to pay out.

The New York Fed, as part of the total $182.3 billion in federal aid ultimately extended to AIG, created a program to buy out the assets underlying the derivative contracts AIG had entered into with Wall Street banks. By doing so, regulators hoped to remove the pressure on AIG to have to post collateral for those bets.

The New York Fed paid face value to the banks for the assets, even though the market was in a panic and highly illiquid at the time. According to accounts from the Government Accountability Office and the inspector general for the bailouts, New York Fed officials initially demanded some discounts from a few banks, before then paying all of AIG’s counterparties 100 cents on the dollar for the assets, with no explanation. That action effectively subsidized the banks, leading critics to label it a backdoor bailout.

Naylor said he was hoping that the testimony of Bernanke, Paulson and Geithner could make it clear why the New York Fed didn’t negotiate a tougher deal for taxpayer funds. “I’m looking forward to seeing the contradictions between these high-profile people who were once in the same room together,” he said.

Mark Calabria, the director of financial regulation studies at the Cato Institute, warned that he suspected the government would “try to seal all the good stuff,” keeping the most damning documents off the record. “That said,” he added, “I suspect the suspicion that AIG was assisted to help its counter-parties will be reinforced. I suspect we will also learn that the regulators were making it all up as they went along.”

The trial is expected to take six weeks, and the main players from the financial crisis will not testify until several weeks in. When they do, Capitol Hill and Wall Street will be watching.