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The Real AIG Scandal

It's not the bonuses. It's that AIG's counterparties are getting paid back in full.

By Eliot Spitzer

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Everybody is rushing to condemn AIG's bonuses, but this simple scandal is obscuring the real disgrace at the insurance giant: Why are AIG's counterparties getting paid back in full, to the tune of tens of billions of taxpayer dollars?

For the answer to this question, we need to go back to the very first decision to bail out AIG, made, we are told, by then-Treasury Secretary Henry Paulson, then-New York Fed official Timothy Geithner, Goldman Sachs CEO Lloyd Blankfein, and Fed Chairman Ben Bernanke last fall. Post-Lehman's collapse, they feared a systemic failure could be triggered by AIG's inability to pay the counterparties to all the sophisticated instruments AIG had sold. And who were AIG's trading partners? No shock here: Goldman, Bank of America, Merrill Lynch, UBS, JPMorgan Chase, Morgan Stanley, Deutsche Bank, Barclays, and on it goes. So now we know for sure what we already surmised: The AIG bailout has been a way to hide an enormous second round of cash to the same group that had received TARP money already.

It all appears, once again, to be the same insiders protecting themselves against sharing the pain and risk of their own bad adventure. The payments to AIG's counterparties are justified with an appeal to the sanctity of contract. If AIG's contracts turned out to be shaky, the theory goes, then the whole edifice of the financial system would collapse.

But wait a moment, aren't we in the midst of reopening contracts all over the place to share the burden of this crisis? From raising taxes—income taxes to sales taxes—to properly reopening labor contracts, we are all being asked to pitch in and carry our share of the burden. Workers around the country are being asked to take pay cuts and accept shorter work weeks so that colleagues won't be laid off. Why can't Wall Street royalty shoulder some of the burden? Why did Goldman have to get back 100 cents on the dollar? Didn't we already give Goldman a \$25 billion capital infusion, and aren't they sitting on more than \$100 billion in cash? Haven't we been told recently that they are beginning to come back to fiscal stability? If that is so, couldn't they have accepted a discount, and couldn't they have agreed to certain conditions before the AIG dollars—that is, our dollars—flowed?

The appearance that this was all an inside job is overwhelming. AIG was nothing more than a conduit for huge capital flows to the same old suspects, with no reason or explanation.

So here are several questions that should be answered, in public, under oath, to clear the air:

What was the precise conversation among Bernanke, Geithner, Paulson, and Blankfein that preceded the initial \$80 billion grant?

Was it already known who the counterparties were and what the exposure was for each of the counterparties?

What did Goldman, and all the other counterparties, know about AIG's financial condition at the time they executed the swaps or other contracts? Had they done adequate due diligence to see whether they were buying real protection? And why shouldn't they bear a percentage of the risk of failure of their own counterparty?

What is the deeper relationship between Goldman and AIG? Didn't they almost merge a few years ago but did not because Goldman couldn't get its arms around the black box that is AIG? If that is true, why should Goldman get bailed out? After all, they should have known as well as anybody that a big part of AIG's business model was not to pay on insurance it had issued.

Why weren't the counterparties immediately and fully disclosed?

Failure to answer these questions will feed the populist rage that is metastasizing very quickly. And it will raise basic questions about the competence of those who are supposedly guiding this economic policy.

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