What AIG Needed Was Bankruptcy Reorganization

Feb. 1—Treasury Secretary Tim Geithner repeated, at the Jan. 27 House Oversight and Government Reform Committee hearing, that he opposes any restoration of the 1933 Glass-Steagall Act, repealed in 1999. He also claimed that the Treasury did not have the ability to put AIG into bankruptcy—an outright lie. Instead, he said, he had to compensate the banks that AIG owed, at 100%.

Rep. Dennis Kucinich (D-Ohio) gave Geithner the "Ferdinand Pecora" treatment, exposing many of his lies. Specifically, he showed that, if the government *or* bankruptcy court had taken over AIG's holding company, by law, none of its derivatives contracts and hedges would be honored. The toxic claims of Goldman and 15 other international banks would have been in direct conflict with the claims of many millions of individuals and institutions insured by AIG's insurance subsidiaries. State insurance commissioners and/or a bankruptcy court would have barred the banks' claims, and ordered them to return collateral on the toxic derivatives, which they had already paid to the banks. Goldman would lose $2.5 billion at least, twice the amount of its 2008 reported profit.

"Did you know that?" Kucinich asked Geithner. Geithner said no.

But Goldman had said so publicly when it seized "collateral" of $8 billion from AIG after the TARP bailout. Kucinich nailed down that once the government took control of AIG, the banks' *only* hope of payment was the New York Federal Reserve—which then bailed them out with $62 billion through AIG.

Goldman was "locked in battle" with the AIG holding company—often described as "a giant hedge fund placed on top of a lot of insurance companies"—over which company would loot the other of the losses from toxic derivatives. Those derivatives touched 50% of Goldman's net worth. Goldman "expected to take a very large haircut," Kucinich showed.

At the start of the AIG holding company's collapse, in July 2008, New York State Insurance Commissioner Eric Dinallo had bent—he allowed the holding company to borrow $19 billion from its subsidiaries to try to save its AAA credit rating—but he had not broken. He allowed no further impairment of the insurance subsidiaries after that. State insurance commissioners would have taken control of AIG's insurance subsidiaries, and protected them from the doomed holding company and the banks, which could pay for their own wild speculations by going through a bankruptcy reorganization.

As Kucinich documented, Goldman Sachs was facing bankruptcy, if the Glass-Steagall principle completely separating depository banking from casino operations, and protecting only the former, were in force. Goldman should have been allowed to go down.