STATEMENT OF ROBERT B. WILLUMSTAD
BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
OCTOBER 7, 2008

Good morning Chairman Waxman, Mr. Davis and Members of the Committee. I am glad to help the Committee in any way that I can.

I want to begin by saying that AIG's problems never threatened its policyholders. AIG has been a great company for more than thirty years and remains a great company today. AIG's franchises around the world in insurance and financial services are unparalleled. Its entrepreneurial culture and the dedication and talent of AIG's 100,000 employees are unmatched.

I became CEO of AIG a little more than three months ago, at a time when the financial markets around the world were already in crisis. Before becoming CEO, I had been non-executive Chairman of AIG's board of directors for a roughly a year and a half. But, today I am going to focus my comments on the period when I was CEO.

The crisis that required AIG to seek assistance from the Federal Reserve is not limited to AIG. It is a market wide crisis of confidence that has affected the entire financial industry and the American and global economy. In June 2008, when I became CEO, the decline in the U.S. housing market had been under way for months. Though most homeowners were still making their mortgage payments, there was an unprecedented and unexpected breakdown in the market for mortgage backed securities which were held by many banks and other financial institutions, including AIG. As a result, "mark to market" accounting rules – the interpretation of which I understand the SEC is now revisiting – forced Citigroup, Merrill Lynch, UBS, Morgan Stanley and other financial institutions, including AIG, to book tens of billions of dollars in accounting losses, despite the fact that most of the underlying securities were not in default. Those accounting losses in turn forced many of the affected companies to raise capital in the public markets or from sovereign wealth funds in China, the Middle East and elsewhere. Bear Stearns failed in March, being acquired by JP MorganChase with significant government assistance. Banks and brokerage stocks here and abroad had declined significantly.

The unforeseen and extreme market conditions that were destroying billions in shareholder value at other companies hit AIG also. By the end of the second quarter of 2008, AIG had booked $50 billion of unrealized losses on credit default swaps and on declines in the value of mortgage related securities held in its investment portfolio. AIG was downgraded by the major rating agencies in early May. AIG’s stock price fell from a high in 2007 of $72 per share to $26 per share in June 2008.

These events occurred despite extensive actions by AIG’s Board and Martin Sullivan before I became CEO. In May 2008, AIG raised $20 billion in new capital. AIG brought in new management at its Financial Products division, the source of much of AIG’s exposure to the faltering mortgage backed securities market. AIG had also begun a search process to bring in a new Chief Financial Officer from outside of AIG, seeking to add another talented executive with deep experience in the capital markets.

In June 2008, the Board asked me to replace Martin Sullivan as CEO. I was initially reluctant to do so. However, the Board ultimately persuaded me to accept this responsibility and I felt that my experience in the financial services industry, including my time as President and Chief Operating Officer of Citigroup, put me in a position to successfully lead AIG in a difficult period. On my first day as CEO, I publicly announced that I would present my long-term strategic plan for AIG in ninety days. This was an ambitious time-frame for a strategic review of a company that in 2007 had $1 trillion in assets and $110 billion in revenue, and which employs more than 100,000 people in more than 100 countries and includes a diverse array of businesses operating under scores of different regulatory regimes. To meet that schedule, the AIG team worked tirelessly, and the plan began to come together.

While we were formulating the plan, I also took immediate actions. The markets declined further, and it became apparent that if the decline continued and AIG were again downgraded by the rating agencies, AIG could potentially face a liquidity problem. A week after I became CEO, I retained a pre-eminent financial services firm, BlackRock, to provide an outsider's view of AIG Financial Products' exposure to mortgage backed securities. I met with the rating agencies in July, and they told me that they would not review AIG's ratings until after I announced our strategic plans, which was then scheduled for September 25. Even so, to be prudent, we immediately put in place a number of additional measures to further protect AIG in the event of a liquidity problem. We worked through July and August to further strengthen AIG's balance sheet should a crisis arise. We identified non-strategic businesses, retained financial advisors and began the process of selling those businesses to raise cash. To conserve cash, we stopped discussions relating to a number of acquisitions. We developed and implemented an aggressive plan to further reduce expenses. We were negotiating a transaction with Berkshire Hathaway that would have protected billions of dollars of AIG's liquidity. We were working with JP MorganChase and other banks to obtain additional credit lines. These were precautionary steps. Through the first week of September, we believed AIG could weather the difficulties in the financial markets, and we believed we would be able to announce and implement the new strategic plan on September 25.

In late July, and again on September 9, I met with the President of the Federal Reserve Bank of New York to apprise him of the situation and discuss ways in which AIG and the Federal Reserve might work together in the event that a liquidity problem did arise.

With the market melting down during the week of September 8, the counterparties with whom we had been negotiating became unwilling to complete those deals. In addition, as the markets spiraled downward, with Lehman and others under increasing pressure, the rating agencies indicated they would no longer wait to review AIG's ratings until the investor meeting on September 25.

AIG was caught in a vicious circle. The rating agencies were considering a downgrade in large part because of market driven liquidity concerns. But it was a downgrade by the ratings agencies – or the threat of one – that would trigger a liquidity issue. The potential for a downgrade and the market's fears caused AIG counterparties on its securities lending program and on many other transactions – not just those related to the credit default swaps – to require AIG to post additional collateral or to demand the return of cash or investments, further increasing the need for liquidity.

We worked around the clock during the week of September 8 to take measures that would provide AIG the liquidity needed to make it through the crisis. We worked with potential private investors and new lenders. With assistance from the New York and Pennsylvania departments of insurance and the Governor of New York we were able to make available as much as $20 billion of additional liquidity. But the private markets, even with the help of New York and Pennsylvania, simply could not provide enough liquidity. On September 9, I met again with the Federal Reserve Bank of New York, and during the rest of the week I stayed in contact with the Federal Reserve and the Treasury Department.

On Tuesday, September 16, 2008, AIG was preparing for the unthinkable: bankruptcy. That afternoon, we met again with representatives of the Federal Reserve Bank of New York and the Treasury Department. The regulators said that they would provide the necessary liquidity, because an AIG bankruptcy would have massive negative effects on the stability of the entire financial system. The terms of the offer were non-negotiable. After a long and detailed debate, and with the advice of counsel and our financial advisors, the AIG Board of Directors accepted the plan offered by the Federal Reserve and the Treasury Department as the best available option. As part of that plan, I was asked by the Treasury Department and the Federal Reserve to step down as CEO. Though I would have liked to continue to work for AIG and its shareholders, I complied with this requirement two days later.

Let me explain what I believe were the major elements that led AIG to September 16. Fundamentally, AIG was affected by an unexpected and unprecedented market-wide crisis of confidence and the resulting seizure of the credit markets. This impacted AIG in many ways, including through the complex financial company AIG operated: AIG Financial Products or FP for short. FP wrote a large number of instruments called "credit default swaps" – essentially a kind of insurance on a bond. Over time, FP had written this insurance-like swap on bonds with a face value of approximately $500 billion. Approximately $70 billion of those swaps were on bonds that AIG referred to as "multi-sector" bonds, backed by student loans, credit card receivables and residential mortgages. AIG's multi-sector credit default swaps were almost all written before the end of 2005, when the housing market was still strong. Moreover, AIG only wrote these swaps on what are referred to as "super senior" bonds. That means that AIG only covered the safest bonds possible and had a built in cushion to further protect AIG from losses. They were viewed as extremely safe – better than AAA. Through June 30, 2007, these credit default swaps were carried on AIG's books at "par value." That means that AIG had analyzed them and did not expect to lose any money on them.

However, when the market for the underlying bonds froze toward the end of 2007, accounting rules required AIG to "mark to market" the value of its swaps. But the market was not functioning. The way the accounting rules were applied in this unprecedented situation forced AIG to recognize tens of billions of dollars in accounting losses in the fourth quarter of 2007 and the first two quarters of 2008, even though, as far as I am aware, AIG has made very few payments on any of the credit default swaps it wrote and the vast majority of the securities underlying the swaps are still paying and are still rated investment grade or better by the rating agencies.

In my view it was largely as a result of these unrealized mark to market losses that the rating agencies downgraded AIG's credit rating. The downgrade and the low accounting valuations on the bonds required AIG to post billions of dollars of additional collateral to its credit default swap counterparties as security for AIG's promise to pay if the underlying securities did not. In the unprecedented market wide crisis of the week of September 8, fears of a further downgrade and the frozen credit markets fed into the crisis of confidence that led AIG to need the liquidity ultimately provided by the Federal Reserve plan.

Looking back on my time as CEO, I don't believe AIG could have done anything differently. The market seizure was an unprecedented global catastrophe. We took every step we could to protect AIG's balance sheet and its liquidity. We and our advisors explored every avenue to protect AIG's shareholders. There was no private market solution to AIG's situation – just as there was no private market solution for Bear Stearns, Fannie Mae, Freddie Mac, Washington Mutual, or Lehman Brothers. The freezing of the mortgage backed securities market, the “mark to market” losses that decimated AIG’s book equity, the resulting downgrades by the rating agencies and the collateral posting requirements that arose after the downgrades were beyond our control. I regret the pain that events in the market have caused to AIG’s employees and its shareholders. I am grateful that the Treasury and the Federal Reserve – and most importantly the American people – offered their assistance to preserve both a vital part of the financial system and a great American institution.