TESTIMONY OF MARTIN SULLIVAN
BEFORE THE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
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My name is Martin Sullivan. From March 2005 until June of this year, I was the President and Chief Executive Officer of American International Group, a leading international insurance organization with operations in more than 130 countries and jurisdictions. Though I was no longer with the company as the events of last month unfolded, I am here today to assist the Committee in understanding the events that led to the federal rescue of AIG, how the example of AIG fits into the broader financial crisis currently plaguing the world economy, and the regulatory lessons that we can learn from AIG's experience.

I thank the Committee for holding this important hearing. People around the world are reeling from the financial tsunami that has ravaged the global economy. We had all hoped that the very unfortunate collapse of Bear Stearns this past spring would be an isolated incident. Instead, the financial storm gained momentum, and many of the world's most respected financial institutions crumbled, one after another. The federal government took control of Fannie Mae and Freddie Mac, Lehman Brothers and IndyMac declared bankruptcy, and Washington Mutual and Wachovia had to be taken over to avoid a similar fate. Meanwhile, other prominent institutions sought additional capital, merger partners, and redefined their corporate status. Of course, AIG avoided potential bankruptcy only with the help of the government. Now, the U.S. government is establishing a $700 billion fund to provide additional relief to threatened financial institutions.

I hope that my testimony about events that occurred during my tenure at AIG can help the Committee understand the formation of what is best described as a global financial tsunami. We are all struggling to understand how this crisis happened in the first place and to find out what might have prevented it. There are no simple answers to these questions. I am not an accountant or economist - I have been an insurance man all my life. However, many factors appear to have been at play including lending and borrowing practices, illiquid markets, the absence of credit, loss of investor confidence, and even accounting rules which required companies like AIG to take billions of dollars of unrealized "mark to market" losses.

I would like to start by telling you a little bit about myself and my career at AIG. I was born in Essex, England, and I began working for AIG when I was seventeen years old. My first job in the company was as a clerk in one of AIG's offices in London. Over the next thirty-seven years – my entire adult life – I literally worked my way to the top of the company, ultimately becoming CEO in 2005. I have held management positions at AIG in three different countries, working here in the United States for the past twelve years.

When, in 2005, the AIG Board asked me to step into the role of Chief Executive Officer, the company was straining under the weight of several crises very different from the financial crisis currently threatening our financial institutions. I became CEO of AIG at a time when the company was in the midst of governmental investigations that had cast a cloud of suspicion over the company's future. In the face of that crisis, my responsibility was to stabilize the ship and improve our relationships with our regulators. I think I succeeded. I worked very closely with the auditors and with government regulators to resolve these issues and to improve the company's compliance culture and process. I believe that my entire tenure as CEO was marked by unprecedented transparency with our investors and regulators. Every quarter we published a wealth of detailed information in our public filings and in the supplemental data we provided on our website.

Even as I worked to shepherd AIG through the initial crisis that I had inherited, three more disasters struck, namely Hurricanes Katrina, Rita, and Wilma which left American cities under water and left countless Americans devastated. In addition, an enormous amount of money, in excess of $2 billion, was required to meet the needs of the hurricane victims that we insured. As CEO of the company, I personally visited the affected area to offer my support to our customers and AIG employees. As much as these hurricanes affected AIG's business, the human toll and devastation were greater than I could have imagined.

It was against this backdrop that I began my tenure as CEO of the company. I am very proud to say that, in spite of these challenges, AIG emerged as a successful and resilient company. In 2006 and early 2007, AIG was enjoying great success, and those of us within the company's management had tremendous confidence in our company's future. However, as we now know, a different storm was gathering over the global financial markets.

No disaster as massive as the unforeseen and unprecedented financial market disruption that has occurred over the past year is the result of a simple or single cause. The world's current economic challenges are obviously related to multiple actions by multiple parties. To assist the Committee, I would like to focus on one particular factor—the role played by one accounting rule applied to corporations.

The accounting rules require that certain assets be "marked to market." In other words, companies must declare the value of those assets, on a quarterly basis, at the price such assets could sell for on the market at that point in time. Companies must declare these values on their books even if they have no intention of, or immediate need to, sell the assets, and even if they have not realized any actual gain or actual loss. FAS 157, which was adopted relatively recently, set out specific guidelines as to how companies must determine the "market price" of certain categories of assets. However well FAS 157 operates under any reasonably foreseeable market conditions, in the unprecedented credit crisis which began in the summer of 2007, FAS 157 had, in my opinion, unintended consequences.

In a distressed market where assets cannot be readily sold, companies are forced to declare the value of those assets at fire-sale prices. Just last week, the SEC made changes with respect to the application of FAS 157 when entire markets stop functioning. Of course, AIG did not have the benefit of this guidance during my tenure.

At AIG, I encountered FAS 157's unintended effects through the credit default swap portfolio of AIG-Financial Products, a business that my predecessor had established and funded many years earlier. These credit default swaps essentially provided insurance to counterparties in the case of default on underlying bonds. The underlying bonds were very highly rated, and the risk of default was viewed as extremely remote.

The credit default swap business had, since its inception in the late 1990s, generated a reliable and steady source of income for AIG-FP. In fact, AIG-FP intended to retain its derivative interest in these highly rated bonds until they reached maturity. When the credit markets seized up, like many other financial institutions, we were forced to mark our swap positions at fire-sale prices as if we owned the underlying bonds, even though we believed that our swap positions had value if held to maturity. The company nevertheless began reporting billions of dollars of unrealized losses on the basis of then-current market valuations.

Suddenly, a company with a trillion dollars of assets was reporting unrealized losses on its income statement that ultimately climbed into the tens of billions. As AIG's reported losses mounted, there was a domino-like series of repercussions. Although we had raised approximately $20 billion in capital, it appears that even this precaution was not sufficient protection in the face of the overwhelming and unprecedented market crisis that exists today:

AIG nevertheless suffered credit rating downgrades which triggered billions of dollars in collateral calls, leading to the most recent events. Of course, by the time the Board was presented with the federal plan, I had been out of the company for over three months.

In fact, just last week both the Securities Exchange Commission and this Congress recognized the effect of FAS 157. The SEC recognized that FAS 157 can have unintended consequences for financial institutions when markets seize up. The SEC has attempted to provide more flexibility for companies operating and reporting under the rule. In the recently passed legislation, Congress directs the SEC to further examine mark-to-market accounting and grants the SEC authority to suspend mark-to-market accounting requirements. These measures make a lot of sense to me.

I have spent my entire adult life in service to AIG, and I am heartbroken at what has happened. I hope to see the company, and indeed the entire global economy, emerge from this crisis. I hope that my testimony today has been helpful to the Committee. I will do my best to answer any questions that you have.

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