

October 30, 2009

Mr. William C. Dudley  
President  
Federal Reserve Bank of New York  
33 Liberty Street  
New York, NY 10045

Dear Mr. Dudley:

As Ranking Member of the Committee on Oversight and Government Reform, I am deeply concerned by news reports that the Federal Reserve Bank of New York (“FRBNY”) may have unnecessarily cost the American taxpayers billions of dollars.<sup>1</sup>

As you know, in late 2008 American International Group (“AIG”) was attempting to negotiate a haircut for banks that held \$62 billion in credit default swaps (“CDS”) from AIG. AIG was reportedly seeking to persuade the banks to accept haircuts of as much as 40 cents on the dollar in order to retire these CDS contracts.<sup>2</sup>

On September 16, 2008, the FRBNY extended AIG an \$85 billion line of credit, effectively nationalizing it. According to news reports, late in the week of November 3, then-FRBNY President Timothy Geithner, along with the U.S. Department of the Treasury and the Federal Reserve Board in Washington, took over negotiations with AIG’s counterparties.<sup>3</sup>

News reports indicate that Mr. Geithner’s team circulated a draft term sheet to set the terms under which AIG would settle its CDS obligations, including a blank space in which the haircut for creditors was to have been inserted. However, the haircut provision was reportedly crossed out and, after less than a week of secret negotiations between the FRBNY and the banks, FRBNY ordered AIG to pay its creditors at par – 100 cents on the dollar – not 60 cents as AIG had been attempting to negotiate.<sup>4</sup>

Thus, behind closed doors and with no approval from Congress, the FRBNY may have added an additional \$13 billion of debt on the backs of taxpayers.<sup>5</sup> These allegations, if true, amount to nothing less than a backdoor bailout of AIG’s creditors, including Goldman Sachs, Merrill Lynch, Société Générale and Deutsche Bank.<sup>6</sup>

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<sup>1</sup> See Richard Teitelbaum and Hugh Son, “New York Fed’s Secret Choice to Pay for Swaps Hits Taxpayers,” *Bloomberg.com* (October 27, 2009), available at <http://bloomberg.com/apps/news?pid=20601109&sid=a7T5HaOgYHpE>.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* *Bloomberg.com* reports that the excess payment was “at least \$13 billion...40% of the \$32.5 billion AIG paid to retire the swaps.”

<sup>6</sup> *Id.*

The lack of transparency and accountability in this transaction is disturbing enough. However, there is evidence that this \$13 billion expenditure was entirely unnecessary. According to Janet Tavakoli of Tavakoli Structured Finance, “There’s no way they should have paid at par. AIG was basically bankrupt.”<sup>7</sup>

Another expert has said that the typical outcome in cases like this involves counterparties being forced to accept haircuts of anywhere from 30 to 50 cents on the dollar.<sup>8</sup> This suggests that the FRBNY may have paid AIG’s counterparties at par to surreptitiously provide another bailout for large financial institutions. According to Donn Vickrey of Gradient Analytics, “Some of those banks needed 100 cents on the dollar or they risked failure.”<sup>9</sup>

However, another source close to the transaction suggested the FRBNY may have paid AIG’s counterparties at par out of pure expediency: “[S]ome counterparties insisted on being paid in full and the [FRBNY] did not want to negotiate separate deals.”<sup>10</sup>

Furthermore, many of AIG’s counterparties reportedly hedged their exposure to the troubled insurance giant, obviating any need for a taxpayer bailout of these large financial institutions. According to Goldman Sachs’ Chief Financial Officer, “There would have been no credit losses [at Goldman Sachs] if AIG had failed.”<sup>11</sup>

All of this begs the question why the FRBNY would not drive a better bargain for the American taxpayer. If the FRBNY thought it was necessary to provide another taxpayer bailout of AIG’s counterparties, it should have come to Congress and made its case that this action was necessary. However, if the FRBNY simply paid AIG’s counterparties at par out of expediency, it raises serious questions about its judgment and motives.

It is also disturbing that, at the time this secret deal was made, FRBNY Chairman Stephen Friedman, a member of the board of Goldman Sachs, purchased more than 50,000 shares of Goldman Sachs before knowledge of the FRBNY’s bailout of Goldman Sachs and other AIG counterparties became public knowledge.<sup>12</sup> According to news reports, this transaction has earned Mr. Friedman over \$5 million in profit.<sup>13</sup>

Finally, according to one AIG executive quoted in news reports, the FRBNY may have attempted to manage public disclosure of its decision to pay AIG’s counterparties at par by pressuring the company not to file pertinent documents with the U.S. Securities and Exchange Commission (“SEC”):

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> See Kate Kelly and Jon Hilsenrath, “New York Fed Chairman’s Ties to Goldman Raise Questions,” *The Wall Street Journal* (May 4, 2009), available at <http://online.wsj.com/article/SB124139546243981801.html>.

<sup>13</sup> See note 1, *supra*.

They'd tell us that they don't think that this or that should be disclosed. They'd say, "Don't you think your counterparties will be concerned?" It was much more about protecting the Fed.<sup>14</sup>

These allegations raise serious questions about the transparency, accountability and wisdom of the FRBNY's actions. The American people have a right to know the full details behind the FRBNY's decision to stop negotiations with AIG's counterparties and pay them billions of dollars of taxpayer money.

To assist the Committee with its investigation of this matter, please provide the following information no later than close of business on Friday, November 13, 2009:

All records and communications referring or relating to the FRBNY's negotiations with AIG's CDS counterparties, including but not limited to:

- a) Emails, phone logs and meeting notes of the following people: Timothy Geithner, Stephen Friedman, Tom Baxter, and Sarah Dahlgren;
- b) Term sheets, including drafts, relating to AIG's payments to its CDS counterparties;
- c) Emails, phone logs and meeting notes referring or relating to public disclosure of AIG's payments to its CDS counterparties including disclosure to the SEC.

Please note that, for purposes of responding to this request, the terms "records," "communications," and "referring or relating" should be interpreted consistently with the attached Definitions of Terms.

Thank you for your cooperation in this matter. If you have any questions regarding this request, please contact Christopher Hixon or Brien Beattie with the Committee staff at (202) 225-5074.

Sincerely,

Darrell E. Issa  
Ranking Member

cc: Hon. Edolphus Towns, Chairman

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<sup>14</sup> *Id.*

Attachment

### **Definition of Terms**

1. The term "record" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded, and whether original or copy, including, but not limited to, the following: memoranda, reports, expense reports, books, manuals, instructions, financial reports, working papers, records notes, letters, notices, confirmations, telegrams, receipts, appraisals, pamphlets, magazines, newspapers, prospectuses, interoffice and intra office communications, electronic mail (e-mail), contracts, cables, notations of any type of conversation, telephone call, meeting or other communication, bulletins, printed matter, computer printouts, teletypes, invoices, transcripts, diaries, analyses, returns, summaries,

minutes, bills, accounts, estimates, projections, comparisons, messages, correspondence, press releases, circulars, financial statements, reviews, opinions, offers, studies and investigations, questionnaires and surveys, and work sheets (and all drafts, preliminary versions, alterations, modifications, revisions, changes, and amendments of any of the foregoing, as well as any attachments or appendices thereto), and graphic or oral records or representations of any kind (including without limitation, photographs, charts, graphs, microfiche, microfilm, videotape, recordings and motion pictures), and electronic, mechanical, and electric records or representations of any kind (including, without limitation, tapes, cassettes, disks, and recordings) and other written, printed, typed, or other graphic or recorded matter of any kind or nature, however produced or reproduced, and whether preserved in writing, film, tape, disk, videotape or otherwise. A record bearing any notation not a part of the original text is to be considered a separate record. A draft or non-identical copy is a separate record within the meaning of this term.

2. The term "communication" means each manner or means of disclosure or exchange of information, regardless of means utilized, whether oral, electronic, by document or otherwise, and whether face-to-face, in a meeting, by telephone, mail, telexes, discussions, releases, personal delivery, or otherwise.
3. The terms "referring or relating," with respect to any given subject, means anything that constitutes, contains, embodies, reflects, identifies, states, refers to, deals with or is in any manner whatsoever pertinent to that subject.