Before the United States House of Representatives
Committee on Oversight and Government Reform

Statement of Maurice R. Greenberg

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Chairman Waxman, Ranking Member Davis, and Members of the Committee, good morning. I am the Chairman and Chief Executive Officer of C.V. Starr & Co., Inc. and the former Chairman and Chief Executive Officer of American International Group, Inc. Thank you for the opportunity to appear today before the Committee.

Before I began my career in business, I enlisted in the United States Army at age 17 in 1942. During the Second World War, I landed on Omaha Beach on D-Day and helped to liberate the Dachau concentration camp. When I returned to the United States, I completed my education under the G.I. Bill. I graduated from law school and was recalled during the Korean War. When I separated from the service, I held the rank of Captain in the United States Army. I received the Bronze Star in Korea.

In 1960, I joined C.V. Starr & Company. The firm's founder, Cornelius Vander Starr, became my friend and mentor. Since 1981, I have served as the Chairman of the private charitable foundation to which Mr. Starr gave virtually all of his assets upon his death in 1968. The Starr Foundation, which had $15 million when Mr. Starr died, became one of the largest charitable foundations in the United States. Over time, it has provided more than $2 billion in grants to charities and non-profit organizations in the United States and around the world.

In the late 1960s, I became the first CEO of AIG, which at the time was a brand new company. I led AIG for more than 35 years until my retirement in March 2005. During that time, AIG grew from a modest enterprise into the largest and most successful insurance company in the world. Its market capitalization increased 40,000 percent between 1969, when AIG went public, and 2004, my last full year as Chairman and CEO.

I devoted much of my adult life to building AIG. As a result of the hard work of tens of thousands of employees around the world, AIG became a national asset. During my tenure there, AIG opened markets for U.S. businesses all over the world, and contributed significantly to U.S. gross domestic product. For more than three decades, it stood at the vanguard of the movement to liberalize the global trade in services.

AIG had a unique culture when I was its CEO, particularly in comparison with the way many large public companies operate today. Neither I nor other members of my senior management team had employment contracts. I received no severance package in connection with my retirement, and I never sold a single share of AIG stock during the more than 35 years that I served as CEO (although I did contribute tens of millions of dollars in stock I owned to a family foundation to be used for charitable purposes). When I left AIG, the company operated in 130 countries and employed approximately 92,000 people. AIG had a market capitalization of $170 billion and its stock traded at $64 a share in March 2005. AIG's net income per employee was over $100,000. It was a great place to work. AIG also became one of the most widely held stocks in the United

States. Today, the company we built up over almost four decades has been virtually destroyed. The enormous drop in AIG's share price in recent months has affected millions of Americans who own AIG stock directly or indirectly, including retirees and participants in public pension plans.

Today, AIG, a company with over $1 trillion in assets, has been effectively nationalized. How did this happen?

To the best of my knowledge, the problems that came to a head this year did not originate in AIG's insurance businesses, which remain fundamentally strong, but rather in a unit of AIG known as AIG Financial Products, or AIGFP. Among other things, AIGFP operated in the market for derivatives, which are financial instruments that transfer various types of risk from one party to another.

Our AAA rating was an asset that made it possible to create AIGFP in 1987 as part of AIG's philosophy that generating earnings from diverse business lines would add to earnings stability if any particular business unit encountered a downturn. In 1985, the fire and casualty business in the United States recovered sharply from the distressed conditions that prevailed in 1984 and before. AIG, in part due to disciplined underwriting, kept its capital base intact, which led to AIG becoming the leading commercial and industrial insurer in the U.S. AIG also recognized that the property casualty business, by its very nature, was cyclical. Therefore, to differentiate itself from other insurance companies, it needed to diversify its earnings base. It did so by expanding its life insurance operations and aggressively increasing its overseas insurance presence which ultimately led to doing business in 130 countries. It also created new lines of insurance to meet the constantly changing needs of industry and business. AIG was AAA rated in recognition of those results and the company's strong capital base.

Diversification of earnings will usually lead to greater stability when one part of the insurance business suffers from catastrophic events in a particular year and other parts make it up. AIG's strategy, accordingly, was to look for opportunities in businesses that benefitted from its AAA rating, strong capital base, risk management skills, as well as the intellectual capital needed to manage such diversification.

That led to the creation of AIGFP in 1987. At that time, the derivative market was small and growing. From the beginning, AIG's policy was that AIGFP conduct its business on a "hedged" basis - that is, its net profit should stem from the differences between the profit earned from the client and the cost of offsetting or hedging the risk in the market. AIGFP would therefore not be exposed to directional changes in the fixed income, foreign exchange or equity markets.

AIGFP, at that time, reported directly to me and Ed Matthews, Senior Vice Chairman, and later to William Dooley, Senior Vice President, supported by AIG's credit risk and market risk departments. When I was AIG's CEO, AIG management closely monitored AIGFP and its risk portfolio. AIGFP was subject to numerous internal risk controls, including credit risk monitoring by several independent units of AIG, review of AIGFP transactions by outside auditors and consultants, and scrutiny by AIGFP's and AIG's Boards of Directors. Every new type of transaction or any transaction of size, including most credit default swaps, had to pass review by AIG's Chief Credit Officer.

Our model worked. From 1987 to 2004, AIGFP contributed over $5 billion to AIG's pre-tax income. During that period, AIG's market capitalization increased from $11 billion to $181 billion, and its stock price increased from $4.50 per share to $62.34 per share.

AIGFP took pride in its ability to design custom products to meet the needs of its governmental, corporate and institutional clients. Early in this decade regulators imposed a capital charge on commercial banks for unused bank lines outstanding to clients. AIGFP created a product that would assume approximately 90% of the credit risk in these credit lines for a fee which would be less than the capital charge the commercial banks would otherwise incur. AIGFP retained for itself this "super senior" layer, reasoning that the risk of loss in this layer was exceedingly remote. This business has been highly successful for AIGFP and at June 30, 2008, there existed a mark-to-market loss of only $100 million on a total net notional amount of exposure of $306.9 billion. Due to changes in the new Basel II capital standards, AIG stated in its June 30, 2008 Conference Call Credit Presentation that this business is expected to run off in the next 9 to 21 months.

It was recently reported that AIGFP began selling credit default insurance in 1998 and that the volume of this business exploded after I left the company in March 2005. AIGFP reportedly wrote as many credit default swaps on collateralized debt obligations, or CDOs, in the nine months following my departure as it had written in the entire previous seven years combined. Moreover, unlike what had been true during my tenure, the majority of the credit default swaps that AIGFP wrote in the nine months after I retired were reportedly exposed to sub-prime mortgages. By contrast, only a handful of the credit default swaps written over the entire prior seven years had any sub-prime exposure at all. Based on published information from AIG, AIG net notional exposure to Multi-Sector CDOs at June 30, 2008 amounted to $80.3 billion, of which $57.8 billion contained sub-prime mortgage collateral. The mark-to-market loss on this portfolio at that date amounted to $24.8 billion, of which $21.0 billion related to securities containing sub-prime mortgage collateral. The total mark-to-market loss on the AIGFP portfolio as of June 30, 2008, is $25.9 billion.

How did this happen? I was not there, so I cannot answer that question with precision. But reports indicate that the risk controls my team and I put in place were weakened or eliminated after my retirement. For example, it is my understanding that the weekly meetings we used to conduct to review all AIG's investments and risks were eliminated. These meetings kept the CEO abreast of AIGFP's credit exposure. Earlier this year, AIG's independent auditors, PricewaterhouseCoopers, found AIG to have a material weakness in its internal controls relating to AIGFP's portfolio of credit default swaps. It also appears to be the case that the problem created by the additional risk AIG had taken on through these new credit default swaps may have been aggravated by the fact that the new exposure appears to have been entirely or substantially unhedged.

When it became increasingly clear that AIG faced an intensifying liquidity crisis, I offered to assist the company in any way I could, including by raising tens of billions of dollars in private capital. Unfortunately, I was not able to even arrange a meeting with the company to present my proposals.

As the AIG crisis reached its apex last month, the State of New York was prepared to permit AIG to use $20 billion of excess capital in its insurance subsidiaries, and I called on the federal government to extend a temporary and limited bridge loan to AIG. Those steps would have enabled AIG to address its temporary liquidity problem and would have preserved AIG as a going concern, while also preserving the ability of the private sector to help AIG to address its problems over the longer term.

Instead, AIG's Board of Directors entered into an agreement with the Federal Reserve Bank of New York for a two-year, $85 billion credit facility. The deal includes the issuance of preferred stock that is intended to deliver ownership of 79.9 percent of AIG to the United States Treasury, and it is now clear that AIG and the Federal Reserve intend to do so without shareholder approval.

This is a bad deal for AIG's tens of thousands of employees and millions of shareholders. First, the credit facility requires AIG to pay interest on undrawn capital. By requiring AIG to pay interest on money it does not borrow, the agreement encourages the company to draw down the full amount of the loan even if it does not need the capital. In order to service the principal and interest on this loan, AIG will have no choice but to engage in a fire-sale of profitable assets. Second, the equity component of the deal is not necessary. AIG has more than $1 trillion in assets, including key AIG assets that already act as security for the $85 billion loan facility. That security provides sufficient protection to American taxpayers. It was not necessary to wipe out virtually all of the shareholder value held by AIG's millions of shareholders, including tens of thousands of employees and many more pensioners and other Americans on fixed incomes. Those millions of Americans could have fared better if AIG had filed for bankruptcy protection, since they would at least have had the chance of recouping value on their investments in AIG over the longer term. Bankruptcy would not have had to affect AIG's sound operating companies because the bankruptcy could have been limited to the parent company and impaired subsidiaries.

Although AIG stockholders could have fared better if the company had filed for bankruptcy protection, other stakeholders – like AIG's Wall Street counterparties in swaps and other transactions – would have fared worse. Those transactions would have been frozen in a bankruptcy rather than gradually unwound. Although that result could have posed systemic risk absent a broader federal bailout, it's not clear that dismantling AIG was a better solution. Nor is it clear why, in designing a federal response to AIG's short-term liquidity problem, some AIG stakeholders were prioritized over others. Questions have been posed, but answers have not yet been provided. I hope that we will hear some soon.

There is no doubt that AIG's liquidity crisis required action, but the question is what kind of action. The role and functioning of the ratings agencies needs to be carefully re-examined, and earlier changes to mark-to-market accounting rules and short selling regulations now being amended would have mitigated AIG's liquidity problems and, I believe, would have resulted in different outcomes. AIG would not have been nationalized and would not be in the process of substantial liquidation. Thousands of jobs would have been saved, and America's premier global insurer would be intact.

It was not necessary to design a program that both wipes out millions of stockholders and effectively precludes private sector solutions to AIG's manageable problems. As a general matter, public policy solutions should protect ordinary Americans and encourage private sector solutions to private sector problems. I will continue to work toward that goal, and I hope that Congress will too.

Thank you.