The problem with flogging A.I.G.

Joe Nocera

Can we all just calm down a little?

Yes, the $165 million in bonuses handed out to executives in the financial products division of American International Group was infuriating. Truly, it was. As many others have noted, this is the same unit whose shenanigans came perilously close to bringing the world's financial system to its knees. When the Federal Reserve chairman, Ben Bernanke, said recently that A.I.G.'s "irresponsible bets" had made him "more angry" than anything else about the financial crisis, he could have been speaking for most Americans.

But death threats? "All the executives and their families should be executed with piano wire — my greatest hope," wrote one person in an e-mail message to the company. Another suggested publishing a list of the "Yankee" bankers "so some good old southern boys can take care of them."

Or how about those efforts to publicize names of individual executives who received bonuses — efforts championed by Attorney General Andrew Cuomo of New York and Barney Frank, chairman of the House Financial Services Committee. To what end?

How does outing these executives fix skewed compensation incentives, which have created that unjustified sense of entitlement that pervades Wall Street? No, it's mostly about using subpoena power to satisfy the public's thirst for blood. (In light of the death threats, when Mr. Cuomo received the list of A.I.G. bonus recipients on Thursday, he promised to consider "individual security" and "privacy rights" in deciding whether to publicize the names.)

Then there was that awful Congressional hearing on Wednesday, in which A.I.G.'s newly installed chief executive, Edward Liddy, was forced to listen to one outraged member of Congress after another rail about bonuses — and obsess about when Treasury Secretary Timothy Geithner learned about them — while ignoring far more troubling problems surrounding the A.I.G. rescue.

Oh, and let's not forget the bill that was passed on Thursday by the House of Representatives. It would tax at a 90 percent rate bonus payments made to anyone who earned over $250,000 at any financial institution receiving significant bailout funds. Should it become law, it will affect tens of thousands of employees who had absolutely nothing to do with creating the crisis, and who are trying to help fix their companies.

Meanwhile, the real culprits — like Joseph J. Cassano, the former head of A.I.G.'s financial products division— are counting their money in "retirement." Nobody on Capitol Hill seems much interested in getting that money back. (And the bill does nothing about bonuses that were paid before 2009, meaning that most of those egregious Merrill Lynch bonuses, paid at the end of last year, will not be touched.)

By week's end, I was more depressed about the financial crisis than I've been since last September. Back then, the issue was the disintegration of the financial system, as the Lehman

bankruptcy set off a terrible chain reaction. Now I'm worried that the political response is making the crisis worse. The Obama administration appears to have lost its grip on Congress, while the Treasury Department always seems caught off guard by bad news.

And Congress, with its howls of rage, its chaotic, episodic reaction to the crisis, and its shameless playing to the crowds, is out of control. This week, the body politic ran off the rails.

There are times when anger is cathartic. There are other times when anger makes a bad situation worse. "We need to stop committing economic arson," Bert Ely, a banking consultant, said to me this week. That is what Congress committed: economic arson.

How is the political reaction to the crisis making it worse? Let us count the ways.

It is destroying value During his testimony on Wednesday, Mr. Liddy pointed out that much of the money the government turned over to A.I.G. was a loan, not a gift. The company's goal, he kept saying, was to pay that money back. But how? Mr. Liddy's plan is to sell off the healthy insurance units — or, failing that, give them to the government to sell when they can muster a good price.

In other words, it is in the taxpayers' best interest to position A.I.G. as a company with many profitable units, worth potentially billions, and one bad unit that needs to be unwound. Which, by the way, is the truth. But as Mr. Ely puts it, "the indiscriminate pounding that A.I.G. is taking is destroying the value of the company." Potential buyers are wary. Customers are going elsewhere. Employees are looking to leave. Treating all of A.I.G. like Public Enemy No. 1 is a pretty dumb way for a majority shareholder to act when he hopes to sell the company for top dollar.

It is, unfortunately, beside the point. Even on Wall Street this week, I didn't hear anyone condoning the A.I.G. bonuses. They should never have been granted, and Mr. Liddy should have been tougher about renegotiating them. (A rich irony here is that any nonfinancial company in A.I.G.'s straits would be in bankruptcy, and contracts would have to be renegotiated. The fact that the government is afraid to force A.I.G. into bankruptcy, despite its crippled state, is the main reason Mr. Liddy felt he couldn't try to redo the contracts.)

But there is a much bigger issue that has barely been touched upon by Congress: the way tens of billions of dollars of taxpayers' money has been funneled to A.I.G.'s counterparties — at 100 cents on the dollar. How can it possibly make sense that Goldman Sachs, Bank of America, Citigroup and every other company that bought credit-default swaps from A.I.G. should be made whole by the government? Why isn't it forcing them to take a haircut?

What's worse, some of those companies are foreign banks that used credit-default swaps to exploit a regulatory loophole. Should the United States taxpayer really be responsible for ensuring the safety of European banks that were taking advantage of European regulations?

The person who has made this point most forcefully is Eliot Spitzer, of all people. In his column for Slate.com, he wrote: "Why did Goldman have to get back 100 cents on the dollar? Didn't we already give Goldman a $25 billion cash infusion, and aren't they sitting on more than $100 billion in cash?" Mr. Spitzer told me that while "there is a legitimate sense of outrage over the bonuses, the larger outrage should be the use of A.I.G. funding as a second bailout for the large investment houses." Precisely.

It is destalizing. How can you run a company when the rules keep changing, when you have to worry about being second-guessed by Congress? Who can do business under those circumstances?

Take, for instance, that new securitization program the government is trying to get off the ground, called the Term Asset-Backed Securities Loan Facility — or TALF. Although it is backed by large government loans, it requires people in the marketplace — Wall Street bankers! — to participate.

This program could help revive the consumer credit market. But at this point, most Wall Street bankers would rather be attacked by wild dogs than take part. They fear that they'll do something — make money perhaps? — that will arouse Congressional ire. Or that the rules will change. "The constant flip-flopping is terrible," said Simon Johnson, a banking expert who teaches at the M.I.T. Sloan School of Business.

A.I.G. offers another good example. Not all the employees who face the possibility of having their bonuses taxed out from under them work for the evil financial products division. Many of them work in insurance divisions. Very few of them pull down million-dollar bonuses, and none of them brought A.I.G. to its knees. (And employees who bought the company's stock are already hurting financially, having seen its value virtually wiped out.) They are the ones the company badly needs to keep if it hopes to sell those units at a healthy price. Taking away their bonuses — after they've already put the money in their bank accounts — hardly seems like the right way to motivate them. And demonizing them in Congressional hearings doesn't help either.

In previous columns, I have been an advocate of nationalizing big banks like Citigroup. But after watching Congress this week, I'm having second thoughts. If this is how Congress treats A.I.G., what would it do if it had a bank in its paws?

What the country really needs right now from Congress is facts instead of rhetoric. Instead of these "raise your hand if you took a private jet to get here" exercises of outraged populism, we need hearings that educate and illuminate. Hearings like the old Watergate hearings. Hearings in which knowledge is accumulated over time, and a record is established. Hearings that might actually help us get out of this crisis. It's happened before. In 1932, Congress established the Pecora committee, named for its chief counsel, Ferdinand Pecora. It was an intense, two-year inquiry, and its findings — executives shorting their own company's stock, for instance — shocked the country. It also led to the establishment of the Securities and Exchange Commission and other investor protections. One person who has been calling for a new Pecora committee is Senator Richard Shelby of Alabama, a Republican and key member of the Senate Banking Committee.

"As we restructure our regulatory system, we need to be thorough," he told me. "We need to understand what caused it. We shouldn't rush it."

Meanwhile, the House Financial Services Committee has scheduled a hearing on Tuesday featuring Mr. Bernanke and Mr. Geithner. The hearing has been called to find out only one thing: what did the two men know about the A.I.G. bonuses, and when did they know it?

Is that Nero I hear fiddling?

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