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YPFS Lessons Learned Oral History Project: An Interview with James Millstein

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Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	James Millstein[1] Chief Restructuring Officer at the U.S. Treasury
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Introduction:

The Yale Program on Financial Stability (YPFS) reached out to James Millstein to request an interview regarding his time as Chief Restructuring Officer at the U.S. Treasury and, more specifically, his involvement with the American International Group (AIG) intervention[2]. Millstein originally started his role with the Department of Treasury in 2009 and served until 2011. During his tenure he was regarded as the principal architect of AIG's restructuring and recapitalization. Since his time at Treasury, Millstein has founded and is the Chief Executive Officer of Millstein & Co., a financial advisory firm based out of New York, NY.

On September 16, 2008, the Federal Reserve Bank of New York (FRBNY) announced an $85 billion rescue package, in the form of a fully secured revolving credit facility, for AIG, one of the largest insurance and finance companies in the world, with over $1 trillion in assets. In return for access to the credit line, AIG was to provide the FRBNY a series of convertible voting preferred stock equal to a 79.9% voting interest in AIG, to be held by an independent trust. The credit line would be only the first of a series of government investments in AIG (totaling $185 billion) as it restructured. The Fed exited its investment in AIG on January 14, 2011.

[This interview transcript has been edited for accuracy and clarity.]

Transcript

YPFS: **Could you start by giving us some background of how you came into the government, starting with Treasury? Was that in November of 2008?**

[1] The opinions expressed during this interview are those of Mr. Millstein, and not those any of the institutions for which the interview subject is affiliated.
[2] A stylized summary of the key observations and insights gleamed from this interview with Mr. Millstein is available here in the Yale Program on Financial Stability's *Journal of Financial Crises*.

Millstein: I joined on the transition team right after, probably a week after the election (2008) when the team first assembled. And I was there more or less full time in November, December and January.

But at some point, Secretary Geithner asked me if I would join the department in an assistant secretary role, but it wasn't clear which assistant secretary they wanted me to be. I had to go through senate confirmation and initially, the thought was that I was going to work on the auto team as sort of Steven Ratner's co-lead, because I had a lot of background in the autos, and just by virtue of what I had done at Lazard.

But I got caught on, as I said on the Financial Times podcast[3], on the two-year look back rule, they caught the very tail end of my work for the UAW. So that coming in and being the auto czar or co-czar kind of disappears, as a result of the conflict rule. And that must have happened right after the inauguration, because they signed this two-year look back requirement the day Obama was inaugurated, it was the first thing he did when he got into office.

So that was over, and then the Secretary or Chief of Staff called me and said, "What about the financials? Can you work on the financials?" And I said, "Yeah," I was already representing Lehman and Bear, but those were over in terms of Treasury's role. So, I said, "Yeah, I could work on the rest of the TARP portfolio." And so, I started filling out all of my forms and getting ready for Senate confirmation, and then the AIG bonus thing blew up. The AIG Financial Products retention bonuses became the subject of a Congressional hearing with the government-appointed Chief Executive Officer Ed Liddy, getting really raked over the coals by Congress for having agreed to paying out the bonuses.

Secretary Geithner called me and said, "Would you dispense with confirmation, because we really need somebody there now." And I said, "Sure." I was not eager to go through a confirmation. They had some authority under TARP to hire folks on an emergency contract basis. And so, I became the Chief Restructuring Officer, whatever that meant, and started work somewhere around February.

YPFS: During your transition time between the Paulson and Geithner Treasuries, did you have any knowledge or work with anyone when they were starting to implement TARP at that time? How did you get up to speed on the background before becoming more of a decision-maker in that process?

Millstein: On the transition team, I looked at three things. I looked at Fannie and Freddie and what had been done before and after September 8th to put them into conservatorship and how their Treasury Department's financial support was structured I worked on understanding the auto stuff, because it was clear that the

[3] Podcast can be found at https://www.ft.com/content/7158f98b-7f9a-41f3-93a3-5a5e8143619e (Accessed 07/12/2018).

auto companies were going to need financial support. And the first TARP loans to GM were made in December during the transition. And again, since I knew the GM management from my days representing the UAW, I was asked to look at what the Paulson guys were doing as part of my work on the transition team.

And then the third task was understanding the implementation of TARP, because it was happening just after the election even though TARP passed in earlier October, the implementation of TARP was really happening right then and there. So, I was part of a group of people that met with Neil Kashkari, who was the point person for the Paulson team in implementing the TARP program.

But I have to say, I don't have any recollection of having been consulted or asked to study the specifics of the November restructuring of the Fed credit facility at AIG, and by the time I was in the Treasury Department and they said, "Go to work on AIG," the February-March restructuring was already in process.

YPFS: **And who did you take on AIG from? Did you have a role in deciding what the March restructuring would look like or was it more of an implementation role that you had?**

Millstein: This was the real problem in the transition, Dan Jester was the only person in the Treasury who had anything to do with AIG in the Fall of 2008 because it was a Fed-run process. He left, I want to say right after the January inauguration. To the extent anyone in the Geithner Treasury Department picked up the ball from Jester, it was Matt Kayaker and Lee Sachs, but the two of them were doing 18 other things in January and February. So there really was a gap at Treasury and that's the gap I filled. But most of what happened in September with the original loan, November with the first restructuring, and in February to March with the second restructuring was really being run out the Fed. The New York Fed had a huge team working on it.

During the Fall of 2008 the Fed was meeting AIG's liquidity needs on an emergency basis. And then the rating agencies woke up and realized that the formerly Triple-A, now single-A, insurance holding company that was AIG suddenly had tens of billions of dollars of secured debt on its balance sheets. And generally, investment-grade companies don't have a lot of secured debt. But more importantly, from a rating agency point of view, its debt-to-equity ratio was out of balance and inconsistent with a single-A rating.

So in effect, what really happened in November was the first recapitalization of the Fed facility, where TARP funds were used to deleverage and pay down the credit facility, so as to create a better balance between the debt-to-equity ratio on the parent company's balance sheet.

YPFS: **So as to avoid any further downgrade?**

Millstein: Exactly.

YPFS: We were trying to understand why the Revolving Credit Facility was being repaid so quickly when the term sheet said it had to be repaid by September 2013 – is this why?

Millstein: Yeah, so of the $40 billion that came in as TARP equity in November, $35 billion of the proceeds of that was used to pay down the credit facility. The other $5 billion was just kept as cash on the balance sheet. So, if you think about it, if you consolidated the Fed and the Treasury, if you just viewed it as the US government. It's obviously in two different pockets and different statutory authorization and budget implications, but if you just said it's a unitary government with one financial exposure, in effect the US government converted a portion of its debt to equity. It basically drew down $40 billion from the TARP program to pay off $35 billion from the Fed program. And thereby, in effect, converted $35 billion of what had been debt to equity, to satisfy the rating agencies.

YPFS: One question we had relates to the Financial Times podcast, where you described that as a restructuring officer you had to manage AIG's balance sheet and operations and how you had to decide whether the problem was the balance sheet itself, the operations, or both. So, while Financial Products clearly played a large part in AIG's troubles, how do you think AIG's balance sheet and the operations of its subsidiaries influenced each other?

Millstein: With financial institutions, it is really about liquidity risk management. And AIG was not the only financial institution to have been naïve about the rollover risk and refinancing risk they had. Companies may get into bad habits of how they manage their liquidity. For investment grade companies going into the financial crisis, particularly like AIG or any of the other SIFIs (Systemically Important Financial Institutions) who had very, very high credit ratings of single-A or double-A, they had all gotten very used to accessing liquidity easily during the period running up to the crisis. If they raised their hands and said, "I need to raise $10 billion," there would be 25 investment banks jumping up saying, "I'll do that for you." Before September, AIG had always assumed it could access liquidity markets quickly. So during AIG's rescue in September 2008, when the government asked AIG "How much cash do you need to meet your maturing liabilities?", AIG had no idea because the company hadn't managed their liquidity in that fashion and didn't have a detailed firm-wide forecast of maturing liabilities on a consolidated global basis.

The same thing was true for each of AIG's major business units that had access to the capital markets before the crisis. But when the crisis hit and the interbank lending market, the commercial paper market, the repo market, and the securities lending market dried up, nobody wanted exposure to anybody else. As lines of credit, overnight repo, one-month repo and securities lending loans all became due, AIG faced a liquidity crisis because nobody was there to refinance them. So, AIG turned to the Fed as the lender of last resort. The interesting thing was that AIG had no idea how much they really needed, and this answers the question of why the line of credit was $85 billion.

My understanding from Sarah Dahlgren and the team at the Fed, whom I started working with in February and March 2009, was that they asked AIG the weekend of the bailout [September 13-14], "How much do you need?" and AIG said, "Well, we think $14 billion will get us through the end of the month of September. The Fed then asked "Well, what about October?" and AIG's response was, "We'll get back to you." There was just no schedule of maturing liabilities on a consolidated basis.

So, AIG did some internal analysis and said something like, "Maybe another $25 billion, for a total of $40 billion, all in, give or take." So, the team went to the Fed and Tim, who was president of the New York Fed at the time, who said, "I don't want to do this again. I want to be one and done. Let's just increase the line to $85 billion dollars." He put in a huge margin in order to avoid having to do further assistance, and it turned out that was not enough.

YPFS: **That's very insightful and interesting. With the drains on the Securities Borrowing Facility, and then, the CDS program, AIG was pulling money out of the Revolving Credit Facility at rates that Sarah Dahlgren and her Fed team said they didn't expect at all.**

Millstein: Right. AIG got close to exhausting the line by the end of October. Then the Fed, under the Securities Borrowing Facility, extended another $37.8 billion to them on a repo basis. The November 2008 restructuring was intended to restore the debt-to-equity ratio to a level that was consistent with the rating agencies' criteria for a high rating.

One motivation the Fed had behind their interventions was that it didn't want further downgrades, but the second motivation for their interventions, including Maiden Lane II and III, was to reduce and restructure the Fed's exposure to AIG. The first way of restructuring the Fed's exposure was to pay down the outstanding amount of the credit facility using the proceeds from the TARP investment. The second way was the second 13(3) facility, the Securities Borrowing Facility, that had been provided on a repo basis to restructure some of AIG's portfolios. Ultimately, they created the two special purpose vehicles, Maiden Lane II and III to refinance amounts outstanding under the Securities Borrowing Facility.

Following the November restructuring, the Government's exposure consisted of two special purpose vehicles with $60 billion of loans against them, the two Fed facilities (Revolving Credit Facility and Securities Borrowing Facility), and the first TARP investment in AIG which paid down part of the outstanding amounts of the Fed credit facility, and subsequently reduced the credit facility line. So, at the end of November, the Fed had a smaller outstanding credit agreement with AIG and the Securities Borrowing Facility was repaid with the proceeds of the two special purpose Maiden Lane financings.

YPFS: **Because the Fed had to fund the two Maiden Lanes, how does the existence of the two special purpose vehicles reduce the Fed's total exposure?**

Millstein: Well, it doesn't reduce the total exposure. It restructured the nature of the exposure. Instead of having advances outstanding on a short-term basis against various AIG securities on AIG's balance sheet, the Fed and AIG created an special purpose vehicle funded by the Fed and AIG, the proceeds of which funding were used to buy certain securities from AIG thereby removing them from AIG's balance sheet. The net effect was to convert a short-term loan by the Fed to AIG secured by certain AIG investments into a long-term loan by the Fed and AIG to two special purpose vehicles to which AIG sold certain of its most volatile investments

YPFS: **The Fed's creation of Maiden Lane III, where they bought the CDOs so they could cancel the corresponding CDSs, has come under a lot of attack because the CDS holders were made whole. Do you have any thoughts on whether that's a valid argument or whether that was the right thing to do at the time?**

Millstein: The whole purpose of the bail-out was to enable AIG to meet its obligations in the ordinary course of business and not default on anyone. It's in the essence of an insurance contract, right? You buy life insurance from an insurance company. The credit rating of the insurer, the AM Best rating, is a critical component of your purchase because you're paying premiums for the rest of your life hoping your beneficiaries collect the life insurance benefit, 25 to 30 years from now. So, you want a creditworthy counterparty.

It would be inconsistent with the whole purpose of the bail-out (which was to enable AIG to meet all of its obligations in the ordinary course of business) to single out the CDS counterparties – such as Goldman Sachs, Société Générale, Banque Nationale de Paris – and say, "Oh, you have to take a discount. We're not going to pay those insurance contracts in full."

I got into a huge fight with Elizabeth Warren over this, because she insisted that "You could have gotten a discount." I said "Liz, let me understand this. We have TARP money in AIG. We have TARP money in Goldman Sachs. For the TARP investment in AIG to benefit, I'm supposed to get Goldman Sachs to take a discount on their contractual claims against AIG, thereby potentially undermining or impairing the TARP investment in Goldman Sachs? We are on both sides of this trade."

Second, if AIG started asking for a discount on the payment of its contractual obligations, the rating agencies would have immediately downgraded AIG because seeking to extract a discount from one of its contractual counterparties would have been tantamount to an admission that it couldn't pay its obligations in full. And such a downgrade would have just caused the federal government to have to put more money into AIG as it would have triggered further collateral posting obligations as AIG Financial Products. The whole purpose of the exercise was to allow AIG to pay its obligations in the ordinary course, whether those obligations were life insurance claims, claims on investment guaranties, claims for credit default insurance, or commercial paper, or payments on property and casualty claims.

How were we supposed to decide which of these claims we were supposed to be discounted? The answer to this question goes to a bigger issue: how should the government behave as owner and investor in a private company: if the government started to throw its weight around and demand discounts from various counterparties, what were the standards by which we were going to do that?

Assuming that we were prepared to take the risk of a downgrade and put more money into AIG so as to say we extracted a discount from AIG's major financial institution counterparties, what was the principle that we would be using to throw our weight around to force AIG to demand that Goldman Sachs or Société Générale give us a discount on their CDS claims on the CDOs?

I testified in front of the Congressional Oversight Panel and wrote written testimony[4] which included a couple of paragraphs on this difficult question. Elizabeth Warren called Martin Bienenstock, who's a well-respected bankruptcy lawyer, as a witness and his testimony was that we could have done a series of exchange offers at a discount for various AIG obligations.

Martin was telling the Oversight Panel that AIG could have done that, both with the CDS on the CDOs as well as with a variety of its other obligations. What all of the people who were harping about what we were doing at the time missed is the centrality of the rating agencies as a constraint on how bailouts were structured, because a financial institution cannot operate without at least an investment grade rating.

Because a variety of counterparties are taking short- and long-term credit risks in investments or contractual relationships with a large financial institution, the credit rating is a shorthand that investors, lenders and insurance contract holders use to evaluate if that credit risk is worth taking. The way rating agencies react to discounted exchange offers, where you offer less in exchange for an existing obligation than the par amount of that obligation is to immediately mark down the rating of the existing obligation to a version of "D" for default. The mere act of

[4] Mr. Millstein's written testimony to the Congressional Oversight Panel can be found at https://cybercemetery.unt.edu/archive/cop/20110401232000/http://cop.senate.gov/documents/testimony-052610-millstein.pdf (Accessed on 07/17/2018).

even thinking about this as a strategic alternative to deal with liabilities that are maturing, let alone the actual commencement of such an exchange offer, would have resulted in an immediate downgrade of the entirety of the parent company's credit rating and potentially, if it was being done out of Financial Products or the insurance companies, of the subsidiary's rating. Where we have been criticized for having failed to make an exchange offer was at Financial Products, but the consequence of that would have been a massive cash collateral call as a result of the credit rating downgrade which would have forced us to put more "good money" into Financial Products after what then would have proven to have been "bad money" because of the downgrade. We would have been saying – having put $85 billion dollars into the company, plus the Securities Borrowing Facility, having invested around $125 billion dollars into the company, we are now going to trigger a default by doing a distressed exchange and liquidating AIG.

YPFS: **When you testified to Congress and you were talking about this very complicated, sophisticated financial situation, did it feel as if you were being heard by people that had a different level of understanding?**

Millstein: Yeah. This stuff is complicated, for sure. The way that banks were levered and how they funded themselves largely in the short-term credit markets to take advantage of the arbitrage involved in maturity transformation (borrowing short and lending long) led to a liquidity crisis when the short-term lending markets froze. I mean, what do these financial institutions do? They earn net interest margin, so they borrow short and lend long taking advantage of a generally upward sloping yield curve which creates the margin. Banks generally lever themselves up in the short-term credit markets and use that funding to create long-term assets. It's the same in banks as it is in insurance companies. There are very few people on the Hill and in Congress, who understand this stuff, let alone the interaction of how that magic of maturity transformation and leverage in financial institutions is highly dependent on credit ratings.

In my view, one of the key villains of the financial crisis was the rating agencies. The recklessness with which they issued triple-A ratings on senior tranches of private label securitizations and CDOs misled millions of investors into believing that a variety of structured finance vehicles were as default proof as the Federal Government. It was madness. Although Dodd-Frank directed regulators to figure out some alternative to the current ratings regime, the current regime remains in place and the inherent conflict of interest under which ratings agencies operate remains unresolved.

YPFS: **By late 2008, the credit ratings agencies were feeling the heat. They would have been looking to make sure they didn't miss anything else though, right?**

Millstein: Right. They were definitely on the defensive and doing far more diligence than they had done in the lead-up to the crisis.

YPFS: **Can we talk on a broad level about the AIG stock that the government received, since there were many different classes of preferred stock exchanged with the government? With the TARP investments, the government received other preferred stock, which was even later exchanged for a different class of preferred stock. As a lawyer you might be able to help us understand. Was a variety of classes of preferred stock normal or just good lawyering?**

Millstein*:* As part of the initial credit facility, the Fed contemplated including a warrant or something that would give the Fed 79.9% of AIG's common stock. That was in furtherance of the famous dictum of Bagehot, that the lender of the last resort is supposed to make unlimited liquidity available at penalty rates. So this was the penalty for having AIG having left itself no alternative but to come to the Fed to meet its liquidity needs, the Fed requiring that AIG give up 79.9% of the equity value of the company as a quid pro quo for the Fed's emergency loan. I think you probably want to talk to Tom Baxter, who is the general counsel of the New York Fed and was intimately involved in the structuring of that warrant. Between the term sheet, against which the Fed funded, and the actual creation of a full-blown revolving credit agreement, the warrant evolved into a Series C convertible preferred stock. The Series C preferred stock was to be held by a trust to be established for the benefit of the Treasury. You'll have to ask Baxter exactly why they structured the equity interest in this fashion. This has been the subject of litigation with Starr International with Hank Greenberg.

YPFS: **You mean what they were worried about in terms of having it held in a trust or something else?**

Millstein: They had it held in a trust to avoid it being held at the Fed. The Fed was the lender – and if this was just a different way of imposing a penalty interest rate and theoretically, they could have just held the Series C preferred stock at the Fed, as part of quid pro quo for the loan – but they determined that they'd rather have it held in a trust managed by a set of independent trustees.

I thought the law was pretty clear and I thought the Fed's argument about its authority to take and hold equity in a borrower was sound and that the Fed had the better side of the argument in the Starr litigation which was in essence that the Fed is a national bank and national banks have the right to hold equity. But the Fed determined that they wanted to have that equity held in a trust and the beneficiaries of the trust be in effect the same beneficiary of dividends on the Feds' capital, which is the Treasury Department.

Then you have the Series D from the November restructuring. The Series D stock got converted to Series E stock in March 2009, and there was also Series F preferred stock that came into play in March. When Treasury converted the Series D to Series E stock, it really had to do with a replacement capital covenant, which was a rating agency requirement. The rating agency wanted to know that this was permanent capital and AIG would not redeem the Series D, now Series E, without replacing it with an equal amount of capital. The Series F stock was separate from the Series E, because the rating agencies were not content that the capital represented by the Series E would be sufficient to cushion the future losses AIG might suffer so the Series F was put in place to evidence the Treasury Department's willingness to put incremental capital into AIG if it needed it in the future. with the level of potential of the Series E stock. In effect, the Series F was a standby commitment by Treasury to provide $30 billion dollars more of preferred equity, if AIG needed it at any time.

YPFS: **Why wasn't the Series F subject to a replacement capital covenant like the Series E stock?**

Millstein: It wasn't drawn. The Series F was a commitment to provide equity later on if needed as it turned out it was. There's probably one more rating agency driven thing that you should be aware of. At the end of the first quarter 2009 when AIG announced the largest loss in American corporate history for the year ended 2008, the Treasury Department and the Federal Reserve put out a joint press release[5], that said in effect not only have we turned the credit facility into a long-term credit facility and we created this Series F capital commitment for an incremental $30 billion of potential equity in the future, but the two agencies, the Fed and the Treasury Department stand behind the firm. The government's support wasn't an unlimited guarantee, but the release was worded to suggest that if AIG needed more, we would do more.

YPFS: **That was done to satisfy the rating agencies?**

Millstein: Yes, and also the auditors. Had PricewaterhouseCoopers (PwC), AIG's auditors, issued a going concern qualification to their year-end audit opinion the rating agencies would have immediately downgraded the company and their ability to operate in the ordinary course would have been over. We could not afford to have a going concern qualification, and in order to make the auditors comfortable that they could issue unqualified opinions on AIG's 2008 financial statements, where it had lost around $60 billion dollars, the auditors wanted the assurance that Treasury and the Fed would be there for AIG if it needed even more than $30 billion of incremental capital represented by the Series F commitment. So, we issued that press release to satisfy PwC, to get AIG a clean opinion to avoid a ratings' agency downgrade.

YPFS: **At that point, AIG still couldn't get funding from the private market correct?**

Millstein: Exactly.

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[5] The joint press release from the Board of Governors of the Federal Reserve and the Treasury Department can be found at https://www.federalreserve.gov/newsevents/pressreleases/other20090302a.htm (Accessed on 07/12/2018).

YPFS: **So, in 2009, the government held Series C preferred stock, there's Series E preferred stock, there's Series F preferred stock. There was also preferred interest in two special purpose vehicles that were created during the March restructuring from the AIA and ALICO life insurance subsidiaries. Do you know what authority the Fed had in holding preferred interest in subsidiaries like that?**

Millstein: Again, this was a deleveraging transaction where the Fed converted a portion of their outstanding loan into preferred stock in these special purpose subsidiaries.

Because the Fed held equity in these two important AIG subsidiaries, which were intended to be sold to help pay off the Fed loans – we all believed it was substantial equity, which was ultimately proved – the Fed comforted itself that it could convert part of the credit facility into preferred stock where there was substantial equity through the life insurance subsidiaries.

From the rating agency's point of view, AIG still owned the common equity interest in those two special purpose vehicles, so nothing had really changed. And since there was substantial equity value in excess of the notional values of the preferred interest given to the Fed in those two special purpose entities, in effect, AIG had reduced some of its debt outstanding to the Fed by converting it into equity interests. The rating agency viewed this as a positive because it reduced AIG's debt.

YPFS: **To summarize, in a rescue of a large public company like this, the risk of downgrade and the risk of what the rating agencies will do always has to be looked at because although you have massive liquidity being provided, it could easily become an issue where the company still might fail because of a downgrade?**

Millstein: Yes, the rating agencies were a key constraint in the design of the rescue, a fundamental objective being to maintain an investment grade credit rating, and in the case of AIG, at least single-A. Because if AIG were downgraded to BBB or BBB+, it was likely that no one would buy insurance from AIG going forward. If you don't have a high investment grade credit rating as an insurance company, you really don't have a business. In the case of a financial institution, the balance sheet influences operations.

YPFS: **Is there anything else you would like to share with us about AIG?**

Millstein: I'll just tell you about the recapitalization transaction (which was announced in September of 2010 and consummated in 2011) where we paid off the Fed credit facility with the proceeds of various asset sales, converted the Series C, Series E, and the Series F preferred stock to 92% of the common stock, and gave a short-term commitment through Series G preferred stock.

The structure of that recapitalization and all its details were driven by the need to keep AIG's rating in place, notwithstanding the fact that the federal government would no longer be standing behind AIG. During the entirety of the period from September 16, 2008 through January 14, 2011, the credit rating of the parent company was being bolstered explicitly by the government's support. The credit rating agencies, Moody's and S&P, maintained AIG's single A rating by virtue of government support.

From the credit rating agencies' standpoint, the termination of the government's support – by getting rid of the credit facility, getting rid of the Series F standby capital commitment, and terminating any programs supporting AIG – may have served as an occasion for a potential downgrade. In designing the recapitalization, we had to engineer the resulting debt-to-equity ratios and interest coverage ratios, in a way that absolutely met the ratings criteria for a single-A investment grade company without the ratings uplift derived from the government's support. In fact, we believed that we had engineered AIG's ratios to support a AA- rating, two notches above where they were then rated , and we argued with the rating agencies to support the existing rating notwithstanding the withdrawal of government support by saying, "You cannot downgrade this company just because the government's walking away because we have engineered the financial profile of the company to be AA-. So, without government support, it should at least support a single-A rating." It took some jawboning with the rating agencies to get them there.

The final piece was the Series G standby capital commitment. The agencies came back to the government and said, "Well, you're taking away all government support. What if something happens where they need it and there's no one left?" and we said, "We'll give AIG an undrawn Series G preferred stock commitment, in case they need it for a short period of time. But as soon as they can demonstrate they have access to the equity markets and can replace the government's support with private investor support, we have to be able to terminate the Series G commitment without any impact on their ratings." AIG quickly accessed equity markets and proved that they didn't need the government for support.

YPFS: **It was only two months after the recapitalization in January 2011 that AIG was able to repay the $2 million Series G commitment.**

Millstein: Right, and the whole point was that the rating agencies wanted a demonstration that AIG had access to the capital markets before they would let the government fully off the hook.

YPFS: **After the recapitalization, the government held 92% of AIG's common stock and sold off the stake over the next two years through December 2012. Was there a plan that of how the government would slowly sell off the common stock and why it ultimately did so in six separate tranches?**

Millstein: No, we wanted to get out as fast as possible without having to sell the shares at a discount. At that point, we were fiduciaries for the Treasury Department and the taxpayers of the United States, so we wanted to maximize our selling price while also getting out of the shareholder relationship with AIG relatively quickly. We didn't say outright that we'll do five or six offerings. We took advantage of the market as it evolved.

YPFS: Lastly, can you please explain the disposition of the preferred interests that the Fed held in the two subsidiaries' special purpose vehicles that was transferred over to Treasury at recapitalization?

Millstein: We sold AIA via a public offering in the summer of 2010, and the proceeds were used to pay off the Fed's credit facility at the consummation of the recapitalization. Then we sold ALICO at the end of 2010. So those special purpose subsidiaries were liquidated in connection with each sale.

About Fannie Mae and Freddie Mac

YPFS: When you joined the transition team in November 2008 (between the Bush and Obama administrations), you said you reviewed the Fannie/Freddie transaction, which had been in place since September of 2008. Could you comment on what your observations were and then what your role was going forward?

Millstein: A group of us met with the interim-CEO at Fannie, Herb Allison (who ultimately became the head of the TARP office in 2009), and then I went over to meet with someone at Freddie, to understand their liquidity positions, their capital positions, their operations, and how the conservatorship was structured. In the fall of 2008, Fannie and Freddie were the only ones capable of creating mortgage credit and that was a function of Treasury's support for their solvency in the conservatorships.

I had to review and write a short report for Secretary Geithner's transition team's briefing book on what Paulson had done to stabilize housing finance. The Secretary created an interagency group of about 50 people that met with people from the U.S. Department of Housing and Urban Development (HUD), the Fed, from the Federal Housing Finance Agency (FHFA), and from Paulson's Treasury trying to answer questions like, "What do we do with Fannie and Freddie?" and "How do we reform the mortgage finance industry?" That went on for about nine months in 2010. At the very end of that process, Secretary Geithner asked me to look at what the group was coming up with as a recommendation, but I spent very little time on it.

YPFS: **And they're still in conservatorship. Do you think that's just a timing issue? The FHFA created a strategic plan using the recommendations from Secretary Geithner and the Obama Administration were, and then the administration changed.**

Millstein: Yeah, there was legislation, the Corker-Warner Bill[6], "that was introduced in the Senate Banking Committee that had the tacit support of the Treasury Department to entirely restructure the government's role in mortgage finance." From my point of view, it suggested the creation of a 'Rube Goldberg-like' structure for the housing finance market, which I believed was ill advised. At that point, it was a Republican Congress and anything that had President Obama's imprimatur was dead on arrival in the Congress. So, Senator Bob Corker suggested that the Treasury Department take a backseat to his effort to reform the system. The White House or the Treasury Department never formally signaled its support of the Corker-Warner Bill. Nevertheless, it died in committee.

Now, there's some effort to revive it in some shape or fashion, but it's going nowhere. Fannie and Freddie trigger fundamental ideological differences between the Republican and Democratic parties that are irreconcilable. I wrote a piece in 2014 that was published at the Urban Institute[7] and said there's no way Congress can ever figure this out because of that ideological divide. I also wrote that the Housing and Economy Recovery Act (HERA) – the existing authority for the conservatorship and regulation of Fannie and Freddie that was passed in the summer of 2008 – gave enough authority to the FHFA to privatize Fannie and Freddie in an AIG-like structure and that's probably the best we can hope for at this point.

Additional Observations

YPFS: **Are there any general lessons learned from your experience throughout the crisis that you could share with us? Is there anything that you wish had been in place or wish that the government had done that would make us better prepared the next time a financial crisis occurs?**

Millstein: I say this as a person who's been doing bankruptcies and corporate restructurings for 36 years. Once there's the scent of insolvency around a financial institution, counterparties run, whether it's depositors or short-term creditors, the ability for the institution to fund itself in the short-term credit market becomes severely challenged. There's no incentive for any creditor to hang around and see if they are one of the lucky ones to be repaid before the company collapses. The only

[6] The Corker-Warner Bill, or the Housing Finance Reform and Taxpayer Protection Act of 2014, S. 1217, 113th Congress can be found at https://www.congress.gov/bill/113th-congress/senate-bill/1217?q=%7B%22search%22%3A%5B%22S.1217%22%5D%7D&r=1https://www.congress.gov/bill/113th-congress/senate-bill/1217?q=%7B%22search%22%3A%5B%22S.1217%22%5D%7D&r=1 (Accessed on 07/12/2018).

[7] The report can be found at https://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-reform-incubator/jim-millstein-administrative-plan-restructure-and-reform-gses (Accessed on 07/12/2018).

way these large financial institutions can deal with distress and not create systemic contagion is to utilize "open bank assistance."[8]

The real thing that concerns me about how the politics unfolded around Dodd-Frank were the restrictions put on the Fed's emergency lending authority, the Treasury Department's use of the Exchange Stabilization Act, and of the FDIC's ability to guarantee the obligations of individual institutions. Those restrictions will substantially impair the ability of the government to do open bank assistance in the future and will likely test whether or not Dodd Frank's orderly liquidation authority is actually workable.

I believe we are going to find out very quickly that except in the case of an idiosyncratic risk (that is where one institution has suffered a loss unique to it which forces it into a restructuring process), the orderly liquidation of any one of the SIFIs likely will become a systemic event for all the others. And Dodd-Frank having tied the hands of the government to do open bank assistance it will then dawn on whoever is the head of the Fed, whoever is the head of the Senate Banking Committee, whoever is the Secretary of Treasury that , the restrictions imposed on open bank assistance by Dodd Frank has left the government with many few tools than were available to us to deal with the crisis in 2008-2009. Then they'll go back and have to change the law in the middle of a crisis, which is no time to have to change the law, but that's where they've left themselves.

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[8] Open bank assistance (OBA) is a "resolution method in which an insured bank in danger of failing receives assistance in the form of a direct loan, an assisted merger, or a purchase of assets." OBA usually entailed a change in bank management and required substantial dilution of shareholder interests in the troubled institution. Dodd-Frank eliminated this option. https://www.fdic.gov/bank/historical/reshandbook/glossary.pdf; https://www.fdic.gov/bank/historical/reshandbook/resolutions-handbook.pdf#nameddest=Glossary