REUTERS

AIG massive payments to banks stoke bailout rage

Mon Mar 16, 2009 2:09pm EDT

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WASHINGTON/NEW YORK (Reuters) - Goldman Sachs Group Inc and a parade of European banks were the major beneficiaries of $93 billion in payments from AIG -- more than half of the U.S. taxpayer money spent to rescue the massive insurer.

The revelation on Sunday by American International Group Inc was another potential public relations nightmare, coming on the same weekend that the Obama administration expressed outrage over AIG's plan to pay massive bonuses to the people in the very division that destroyed the company by issuing billions of dollars in derivatives insuring risky assets.

The size of the payments also illustrates how seriously a potential collapse of AIG was viewed by the regulatory authorities. U.S. Federal Reserve Chairman Ben Bernanke said in an interview with CBS news magazine "60 Minutes" that the failure of AIG would have brought down the financial system.

AIG, an embattled insurance giant that has received federal bailouts totaling $173 billion and is now paying $165 million in employee bonuses, is at the heart of a global financial crisis that President Barack Obama is trying to address with plans for trillions of dollars in spending.

As part of those efforts, Obama will announce steps on Monday to make it easier for small business owners to borrow money, officials said.

But the revelations that billions of U.S. taxpayer dollars were funneled through AIG to Goldman Sachs -- one of Wall Street's most politically connected firms -- and to European banks including Deutsche Bank, France's Societe Generale and the UK's Barclays could stoke further outrage at the entire U.S. bank bailout.

FINANCIAL SYSTEM AT STAKE?

The fact that billions of dollars given to prop up giant insurer AIG were then transferred to European banks and Wall Street investment houses could raise new doubts about whether the rescue was really economically necessary.

"It doesn't to me seem fair that the American taxpayer has got to bear the 100 percent of the downside," said Campbell Harvey, a finance professor at Duke University.

"A hedge is not a hedge if you did not factor in the counterparty risk. And the U.S. taxpayer should not be obligated to make people whole for hedges that were not properly executed."

Goldman Sachs, formerly led by Henry Paulson who was treasury secretary at the time of the original AIG bailout, said, as it has in the past, that its AIG positions were "collateralized and hedged."

Deutsche Bank and Barclays declined to comment. Societe Generale was not available for comment.

As it seeks to ease the credit crunch that was the original target of the Troubled Assets Relief Program (TARP), the Treasury will also offer more details this week about the workings of proposed public-private partnerships to take toxic assets off banks' books, including a timeframe, a senior department official said on Saturday.

"No taxpayer in these arrangements is going to lose money until the investor who put up the money has lost 100 percent," said Chief White House economic adviser Lawrence Summers.

Treasury officials have said the fund, or funds, would be a vehicle to provide as much as $1 trillion in financing for buying bad assets -- particularly mortgages gone bad as a result of the U.S. housing bust. The Federal Reserve and Federal Deposit Insurance Corp would participate.

STILL INCOMPLETE

As more Americans lose their jobs and homes, Obama's new administration is under heavy pressure to show that the rescue plan for AIG and major banks is working to free up lending and rein in the riskier excesses of Wall Street.

The payments to AIG counterparties include the provision of collateral to back up credit default swaps, a form of financial insurance that AIG's London office was writing; the purchase of the collateralized debt obligations, a type of complex debt security that underlay that insurance; and payments to counterparties of a securities lending program.

Through three separate types of transactions, Goldman received an aggregate $12.9 billion. Among European banks, SocGen was the biggest recipient at $11.9 billion, Deutsche got $11.8 billion and Barclays was paid $8.5 billion.

The AIG disclosures are still incomplete in that they do not include payments to the banks since December 31.

The list of counterparties was made public by AIG amid growing pressure on the insurer to come clean about the true beneficiaries of the bailout ahead of a congressional hearing on Wednesday at which AIG chief executive Edward Liddy is slated to testify.

Democratic Congressman Paul Kanjorski, whose committee will quiz Liddy, said the counterparties and bonuses would both be topics for investigation at the hearing.

Summers -- speaking before the payments to banks were made public -- called the AIG bonuses "outrageous" but said contracts must be honored, even though Treasury Secretary Timothy Geithner had "negotiated very forcefully" with AIG and done all that was "legally permissible" to limit the payments.

"We're not a country where contacts just get abrogated willy nilly," Summers, a former treasury secretary, said on CBS's "Face the Nation" program. "What the lesson is, is this: We don't really have a satisfactory regulatory regime in place."

HELP FOR BIG AND SMALL

To help small businesses, officials said Obama intends to provide $730 million from the congressionally approved $787 billion economic stimulus program to cut lending fees, boost loan guarantees and expand other programs.

"We know that small businesses are the engine of growth," Christina Romer, who chairs the White House Council of Economic Advisers, said on NBC's "Meet the Press."

"We absolutely want to do things to help them."

As part of the financial rescue, the Obama administration expects private investors to bolster government funds to help cleanse the banking system of bad assets, said Austan Goolsbee, a member of the Council of Economic Advisers.

"It's better to do this jointly with private capital," Goolsbee told "Fox News Sunday." "I believe there is a reasonable expectation that people will participate."

The idea of offering financing support from the government for private investors willing to buy the toxic assets was first put forward by Geithner in February but the lack of detail has disappointed financial markets.

CHECKING AIG CONTRACTS

AIG's Liddy said in a letter to Geithner the giant insurer was legally obligated to make 2008 employee retention payments but had agreed to revamp its system for future bonuses after the Obama administration objected.

"There are a lot of terrible things that have happened in the last 18 months, but what's happened at AIG is the most outrageous," Summers said.

Representative Barney Frank, the Democratic chairman of the powerful House of Representatives Financial Services Committee, said the government must see if the bonuses can be recovered, adding that the timing of AIG's commitment was important.

"We can't just violate law, legal obligations," Frank told Fox. "I understand that. But I do want to find out at what point these illegal obligations were incurred."

Mitch McConnell, the Republican minority leader in the Senate, called the AIG situation an "outrage" and said the nature of the contracts needed to be checked.

While the news that AIG bailout money went to foreign banks could further stoke political outrage, some experts said the alternative could have been worse.

"The nationality of the bank should not matter," said Peter Morici, professor at the Smith School of Business, University of Maryland. "We have an inter-related financial system. You do something to mess with that and all bets are off the table."

(Additional reporting by Phil Barbara, Christian Plumb, Paritosh Bansal, Thomas Ferraro, Jim Vicini and David Alexander; Editing by Phil Berlowitz)