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Bonus flap puts future bailout funds for AIG in question

By JUDY GREENWALD  
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NEW YORK—American International Group Inc. will have a much harder time obtaining more federal funds due to controversy stirred by its bonus program, but likely still would get the aid if needed, many observers say.

However, the flap about the bonuses and, to a lesser degree, the amount of AIG bailout money that has gone to foreign banks, is likely to cast a shadow on the property/casualty units that AIG plans to spin off under AIU Holdings Inc., a separate holding company.

A total of \$165 billion in bonuses were paid to employees of AIG Financial Products Corp., a unit held largely responsible for the insurer's financial struggles. Word of the bonuses last week upset federal officials from President Obama on down.

The House of Representatives overwhelmingly approved a measure last week that would impose a 90% income tax surcharge on bonuses given to employees of companies that receive at least \$5 billion in federal emergency financial aid. The Senate is expected to follow suit.

Meanwhile, New York Attorney General Andrew Cuomo last week said AIG had complied with a subpoena to provide him with a list of financial products employees who received retention payouts.

"As we perform our review, we will simultaneously be working with AIG over the next few days to determine which employees received payments and which chose to return the money they received," Mr. Cuomo said in a statement.

AIG Chairman and Chief Executive Officer Edward Liddy testified before a congressional hearing that he has asked certain employees to voluntarily return at least part of the bonus.

In a March 17 letter to Rep. Barney Frank, D-Mass., chairman of the House Committee on Financial Services, Mr. Cuomo said the most paid to a bonus recipient was more than \$6.4 million; the top seven bonus recipients received more than \$4 million each and the top 10 received a combined \$42 million. He also said 11 individuals who received at least \$1 million or more no longer work at AIG, including one who received \$4.6 million.

According to AIG, the \$165 million in bonuses paid recently is in addition to \$55 million paid in December, under a retention plan adopted during the first quarter of 2008.

Another \$230 million in bonuses had been slated to be paid this year, but in a March 14 letter to Treasury Secretary Timothy Geithner, Mr. Liddy said AIG is committed to reducing 2009 retention payments "by at least 30%."

"I do not like these arrangements and find it distasteful and difficult to recommend to you that we must proceed with them," Mr. Liddy said in the letter. "With the benefit of hindsight, I would have designed these differently and at significantly lower levels."

"In dealing with turnarounds and runoffs, it is very common to put into place retention packages which include stay bonuses to keep people on board (who are) necessary for the successful resolution of the problem," said Bruce C. Shulan, managing director at Stamford, Conn.-based Princeton Partnership L.L.C., which works with runoff insurers. "Having said that, it is also very uncommon to pay retention bonuses or stay bonuses to those who were the principal architects of the problems."

Most observers say while it will be harder for AIG to obtain any more federal funding in light of the controversies, federal officials still are likely to provide more funds if necessary, albeit reluctantly.

John L. Ward, CEO of Cincinnatus Partners L.L.P. in Cincinnati, said, "The government is in too deep into AIG to deny them any further assistance in the future if it's needed. I think they're committed to sticking with the problem until its, hopefully, successful resolution."

"At the end of the day, I have to believe" that the government, which is already an 80% shareholder, "will behave sensibly to protect that," said Jonathan Terrell, president of Washington-based Kenesis Corporate & Information Consulting L.L.C., which specializes in litigation support and insurance-related asset and liability management. "Making a fuss about AIG bonuses is a wonderful way for the political establishment to allow us to be distracted from the real issues" of the failure of regulatory oversight, he said.

Any future bailout funds likely will be structured differently, said Jim Amen, a partner with Philo Smith & Co. in Stamford, Conn. "I think it'll come with a lot more strings attached, and the funding would be quite specific to particular assets or a different structure," he said.

"The government has made their support of that company clear, and our rating is dependent on continued support," said Joyce Sharaf, assistant vp at Oldwick, N.J.-based A.M. Best Co. Inc.

"I think it's less likely than it was, say, a month ago, but you can be very creative in how you deliver aid," said Bill Bergman, an analyst with Morningstar Inc. in Chicago.

An AIG spokeswoman said, "We work closely with our partners at the Fed and Treasury. They have already invested tens of billions of dollars in AIG, and we're all committed to doing everything we can to making sure the taxpayers don't lose that investment."

Meanwhile, observers point out that relatively little attention has been paid to billions in federal bailout dollars paid by AIG to foreign entities—all counterparties to either credit default swaps or securities lending programs—even though the total is many times what has been paid in financial products unit bonuses. In addition to Goldman Sachs and others, these banks include Societe Generale, Deutsche Bank A.G. and Barclays P.L.C.

The funds' distribution to foreign entities was not particularly surprising to those who know AIG's "tentacles reach pretty far abroad," except perhaps the average taxpayer "who wouldn't have a reason to be intimately familiar with the insurance industry," said Sharilyn Pastor, who heads the insurance coverage group at McCarter & English L.L.C. in Newark, N.J.

Some observers see an irony, though, in AIG's apparent willingness to turn over billions to foreign banks in light of its reputation for being difficult about paying claims. AIG faces the

challenge of balancing its financial troubles "and, at the same time, trying not to lose too much more standing in its markets and in its own industry," Ms. Pastor said.

"They probably felt they had the obligation and so they did it," said David W. Steuber, an attorney with Howrey L.L.P. in Los Angeles and co-chairman of its insurance recovery practice. "Certainly, AIG never used to give up without a fight if they thought they had a good argument," he said. "They never would have rolled over and played dead on that."

Mr. Ward had a slightly different reaction.

"It seems to me that AIG perhaps could have been a little bit tougher in negotiating a resolution of those credit default swaps short of just posting the collateral and passing through the funds to those entities. And if the U.S. government had been more actively involved in the process, there may have been points of leverage they could have brought to the transaction," Mr. Ward said.

"We met our legal binding and contractual obligations," said the AIG spokeswoman.

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