IN THE UNITED STATES COURT OF FEDERAL CLAIMS

STARR INTERNATIONAL COMPANY,)
INC., Individually and on)
Behalf of All Others)
Similarly Situated,)
Plaintiffs,) Case No. 11-779C
vs.)
UNITED STATES OF AMERICA,)
Defendant.)
---------------------------------)

Courtroom 4
Howard T. Markey National Courts Building
717 Madison Place, N.W.
Washington, D.C.
Thursday, October 30, 2014
9:30 a.m.
Trial Volume 23

BEFORE: THE HONORABLE THOMAS C. WHEELER

Susanne Bergling, RMR-CRR-CLR, Reporter

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I N D E X

*All exhibits premarked for identification prior to trial.
*See full attached list of admitted exhibits following

P R O C E E D I N G S

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(Proceeding called to order, 9:30 a.m.)

THE COURT: Good morning.

ALL COUNSEL: Good morning, Your Honor.

THE COURT: Please be seated.

We're on the record for day 23 in the trial of Starr International Company versus the United States.

Good morning, Mr. Dintzer.

MR. DINTZER: Good morning, Your Honor.

THE COURT: And, Dr. Cragg, good morning.

THE WITNESS: Good morning, sir.

THE COURT: You, of course, understand you are still under oath?

THE WITNESS: Yes.

THE COURT: All right. Let's go ahead.

MR. DINTZER: Thank you, Your Honor.

Whereupon --

MICHAEL CRAGG

a witness, called for examination, having previously been duly sworn, was examined and testified further as follows:

CROSS EXAMINATION (cont.)

BY MR. DINTZER:

Q. We wanted to start by just moving in some of the things we talked about yesterday. We started with Mr. Mishkin, a portion of his book. That's DX 2233.

Sir, Mr. Mishkin, are you aware was a member of the Board of Governors of the Federal Reserve?

A. Yes.

Q. Okay. And, in fact, he was a member of the Board of Governors up until August of 2008?

A. Yes.

MR. DINTZER: Your Honor, we would move in DX 2233 or the excerpt that we have included.

MR. BOIES: First of all, Your Honor, I don't think we should be moving in just the excerpt. We have before moved in the entire exhibit but only used the excerpt with the witness.

Second, I don't know what the purpose is of the offer. If it's for the truth of the matter asserted, it's obviously hearsay, and we object. If it is simply to show the existence of literature, I think that is ordinarily the kind of thing that is cited to the Court, not admitted.

I have no objection to putting an exhibit on it so the Court has it in a more convenient form, but I think it has to be limited simply to the fact that there is this book that exists as part of the general literature.

THE COURT: Mr. Dintzer, do you accept these limitations?

MR. DINTZER: Your Honor, as far as whether we would move in the whole book, we are happy to do that, but we don't feel it's necessary. The rule does say I can read in the portion and it is made part of the record as having been read in. It was my understanding the Court preferred a physical copy when we sort of are doing that transaction, and it is for that purpose that I'm offering it.

So, if -- I'm happy to just have the stated portion that was read in, the witness identified it as authoritative, in the record, or if it's the Court's pleasure, to move in a portion with that in it.

THE COURT: Well, I don't really feel like I need another book. I think in this instance I'm happy to have the material in the record that you talked to the witness about yesterday, and I don't feel like I really need this article. Now, Mr. Boies can, of course, use it in redirect if he wishes, but I don't think I really need this text in the record.

MR. DINTZER: Okay. Then we will withdraw our offer to admit it, Your Honor.

THE COURT: All right.

MR. DINTZER: May I approach, Your Honor?

THE COURT: Yes.

BY MR. DINTZER:

Q. I'm handing the witness what has been marked DX 2240.

A. Thank you.

Q. We're just marking this for convenience. This is part of the trial transcript, Your Honor. We will not be moving this in.

Sir, I just have some questions about this portion of the transcript. If you would like, I'd be happy to give you the portion from that day.

MR. BOIES: Your Honor, I do think, if he is going to be shown a portion of the trial transcript, he ought to at least be shown the complete page and surrounding pages of the transcript.

MR. DINTZER: May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

THE COURT: Is this now an official transcript or is it still in draft?

MR. DINTZER: This is the official. This is the official transcript, Your Honor.

BY MR. DINTZER:

Q. And so, sir, I saw in your presentation with Plaintiffs' counsel, you know, you cited and relied on a number of things that Chairman Bernanke said. I just wanted to know, so, at trial transcript 2168, at that page, he was asked -- Chairman Bernanke was asked this question and gave this answer:

"QUESTION: If an individual firm met the requirements of 13(3), the ones you just identified, did that require the Board of Governors or the participating district Reserve Bank to make a loan?

"ANSWER: Absolutely not.

"QUESTION: Why?

"ANSWER: It was purely to the discretion of the Federal Reserve whether to use the 13(3) authority based on policy considerations. And the fact that 13(3) had not been used since the 1930s suggested that there was quite a high bar for using that authority."

Do you see that?

A. Yes.

Q. And do you agree with that?

MR. BOIES: Your Honor, I assume that the question is not a question of legal authority but is a question of economic policy.

THE COURT: I assume that's correct.

You don't want a legal opinion from this witness?

MR. DINTZER: I do not, Your Honor, and I'll just give a stipulation right now that anything I ask the witness would be to the extent that he has an economically based answer to provide and not looking for a legal answer, of course.

THE COURT: Sure.

BY MR. DINTZER:

Q. Go ahead, sir.

A. Well, I think Mr. Bernanke is recognizing here that the Federal Reserve has a monopoly position as lender of last resort that gives them a tremendous economic power in -- in the marketplace, and he's describing the type of -- the way that they could use that discretion if they wanted.

So, when I say "if they wanted," they are able to do that because they're monopolists, and I think ultimately the question is what the -- for the Court, obviously, is what the limit of that discretion is. We have heard witnesses who have said that that authority is unlimited, but as an economic matter, that just doesn't seem warranted.

Q. Okay. And, sir, my question is a yes or no question, sir. Do you agree with what Chairman Bernanke said here? Yes or no.

A. Yes, as I just explained.

Q. Okay.

May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

THE COURT: It seems like the binders you gave us are just a decoy.

MR. DINTZER: I promise to get back to them, Your Honor.

BY MR. DINTZER:

Q. And, sir, this is the deposition of Dr. Spatt, who I believe we started with yesterday. You indicated that you had reviewed this deposition transcript in preparation for your deposition. Is that right?

A. Yeah. I quickly reviewed it, yes.

Q. Okay. And so -- and he was one of the Plaintiffs' experts. Is that right?

A. Yes.

Q. Okay. And he was asked these questions and he gave these answers.

THE COURT: What page are we on?

MR. DINTZER: Page 5 of the deposition, Your Honor.

BY MR. DINTZER:

Q. "QUESTION: Sir, was the Fed obligated to provide assistance to AIG in 2008?

"ANSWER: No."

So, now I'm going to ask you, Mr. Cragg or Dr. Cragg, do you agree with that answer? Yes or no. Yes or no, and then you are welcome to explain.

A. No. At the point where the Federal Reserve had determined that, you know, unusual and exigent circumstances existed and that AIG, you know, required liquidity in a way that if it weren't provided that liquidity, there would be grave systemic consequences from that, I think the Fed is at that stage certainly obligated to act.

Q. Okay. So, we have one disagreement, sir. So, we are going to move to the next question.

"QUESTION: So the Fed could have just turned its back on AIG and let it fail?

"ANSWER: That's right."

Do you disagree with Mr. Spatt on that answer?

A. I'm not sure what the full context of his answer is, but as I just stated, given what was happening in the week when support was extended to AIG, I don't see any evidence that would say that the Fed should have or would have turned its back on AIG.

Q. And you said "should have" and "would have," and actually the question here is "could." So, I am going to just ask you to answer my question, sir.

"QUESTION: So the Fed could have just turned its back on AIG and let it fail?

"ANSWER: That's right."

Yes or no, sir. Do you agree with Dr. Spatt or not?

A. Well, mechanically, of course, it could do that.

Q. Okay.

A. I think we're talking about -- sorry, I didn't mean to go beyond your question. I apologize.

Q. Sure.

"QUESTION: And the Fed did not have an obligation to save AIG from bankruptcy, is that correct?"

After objection:

"ANSWER: That's correct."

Do you agree with Dr. Spatt on that point? Yes or no.

A. I think I have already answered that question, which is --

Q. Yes or no, sir.

A. -- no in the context of what was happening.

Q. Okay.

MR. BOIES: Your Honor, in the interest of completeness, could we have the next question and answer read, the very next question and answer?

THE COURT: Sure, let's do that.

MR. DINTZER: And I'm happy to read it, Your Honor, but the questions were about these specific questions. I'm sure Mr. Boies can -- let me see...

BY MR. DINTZER:

Q. The next question -- it goes on then:

"QUESTION: And so the AIG shareholders were not entitled to an expectation in 2008 that the Fed would come forward and rescue AIG?

"Objection to form. Go ahead, sir.

"ANSWER: Well, they were not entitled to that expectation. They were entitled to an expectation of fair treatment, of course."

Okay. And I might as well ask you about that, so let's break that down. He gives two parts to that answer, so I might as well use that.

So, the next question is:

"QUESTION: And so AIG's shareholders were not entitled to an expectation in 2008 that the Fed would come forward and rescue AIG."

Do you see that?

A. Yes.

Q. Okay. And he gives two answers. I am going to break them down.

The first one is, he says, "Well, they were not entitled to that expectation." Do you agree with him on

that point? Yes or no, sir, or I don't know.
A. It's hard for me to parse through these specific words given there's a much broader context to them.
Q. Right.
A. I do think his answer, in full, is a reasonable one.
Q. Okay. And so I need you to answer yes, no, or I don't know, sir. Do you agree that they were not entitled to an expectation in 2008 that the Fed would come forward and rescue AIG? Yes, no, or I don't know. We have heard your explanation, but I would like a yes, no, or I don't know.
A. Well, as a policy matter, having an expectation of liquidity support, as a significantly important financial institution at that point in time, I think is a reasonable expectation.
Q. Okay. And so I just need to know whether you agree or disagree with me, sir. Yes, no, or I don't know.
A. I don't know what he meant by "entitlement."
Q. Okay. Well, I guess I won't ask you the next question. No further questions on that document, sir.
Sir, you're familiar with the term "due diligence"?
A. Yes.

Q. And due diligence -- why don't you give us a brief operating definition.

A. It would be, you know, before entering into some kind of a deal or a transaction, it's the process of investigating, you know, the underlying facts and circumstances around that transaction.

Q. To reduce your risk of stepping into something you don't want to step into?

A. That could be one of the reasons you do it.

Q. When the Fed entered into the September 16th agreement, they didn't know what risks AIG had taken. Is that right?

A. That's right.

Q. And the Federal Reserve --

A. As I said, they didn't -- you know, obviously they knew -- you know, there were parts of the Federal Reserve that had been doing investigation, but there are large parts that hadn't been, and they had not done extensive supervision of the institution.

Q. No place in the Fed had done an extensive -- extensive supervision of the institution on September 16th or by September 16th. Is that right?

A. Well, actually, there was a -- a decent-sized team that over the previous couple days had been engaged with AIG discussions, but it's not of the sort where you have a bank supervisor reviewing AIG on a continuous basis.

Q. Right.

A. So, there's a difference between the knowledge they obviously had about AIG versus other institutions.

Q. So, when the Government entered into the transaction on September 16th, the Government did not know, ex ante, what risks AIG had taken at that time, correct?

A. They didn't know -- they didn't know AIG's ex ante risk, that's correct.

Q. And when the Fed had entered into the 9/16 agreement, the Federal Reserve had not had the opportunity for due diligence.

A. In terms of the amount of due diligence that they could do, obviously, it was a rush to transaction. So, it was limited.

Q. Okay. In the hours before the Fed offered a loan to AIG, there were questions about the company's solvency.

A. Yes. People in the marketplace had that -- that perspective.

Q. And not just people in the marketplace, but JPMorgan and Goldman Sachs had raised questions about AIG's solvency on September 15th. Is that right?

A. I don't know.

Q. Okay. Sir, I'm going to ask you to turn to PTX 549, and that will be in your binder. I take that back. Make that -- I take that back, sir. Go to DX 382 instead. Do you see this document, sir?

A. Yes.

Q. And is this something you reviewed as part of forming your opinions?

A. I don't recall.

Q. Okay. And so the -- do you know who Kevin Warsh is?

A. Yes.

Q. Okay. Who is he?

A. He's at the Federal Reserve Board.

Q. Okay. And the date is September 15th at 8:00 in the evening, and the subject is AIG, and he's writing to Chairman Bernanke and Don Kohn.

"Received a report tonight on capital hole at AIG; far worse than expected; hole too big to be filled, according to Goldman, Morgan. Not good."

Do you see that?

A. Yes.

MR. BOIES: Your Honor, I think counsel inadvertently misread the document. At least my copy of the document does not refer to a "capital hole."

THE COURT: Mine does.

MR. DINTZER: Mine does. I think you're looking at --

MR. BOIES: I'm at the top email, Your Honor. He was reading the bottom email.

THE COURT: He's reading the second email in this text, or maybe it's the first one, but it's at the bottom.

MR. DINTZER: I should have been clear, Your Honor. Temporally, it's the first one, but as counsel notes, it's actually the second one in the line.

BY MR. DINTZER:

Q. Do you see that, sir?

A. Yes.

Q. And a capital hole, that's insolvency, right?

A. Ordinarily it would be thought of that way. I think in the context of this email and in the facts of what was happening with AIG, it's actually a liquidity issue.

Q. But they don't say liquidity, actually; they say capital, don't they?

A. No, I agree with you that they have written "capital." If it was an insolvency issue, then they would have treated AIG the way Lehman was treated.

Q. And if you could, sir, now go to PTX 549.

A. Okay.
Q. And this is the SIGTARP report. Is that right?
A. Yes.
Q. And you cite this in your report. Is that right?
A. Yes.
Q. Okay. And if you can go to page 8 of this document. And did you read the whole report?
A. Not recently.
Q. Did you do it when you were writing your report?
A. Yes.
Q. So, numbered page 8 at the bottom, it's exhibit page 12. Just let me know when you're there, sir.
A. Yes.
Q. Second paragraph, second sentence. "That same day, then Federal Reserve Bank of New York President Geithner spearheaded an effort to encourage a private solution to AIG's liquidity crisis."
Do you see that?
A. Yes.
Q. And you understand that that happened, right?
A. I think the facts that we've heard at trial is that that was started earlier.
Q. The next sentence is that "Mr. Geithner mobilized a consortium of banks led by representatives

from JPMorgan Chase & Company and Goldman Sachs to arrange private financing for a $75 billion loan to address AIG's liquidity crisis."

Do you see that?

A. Yes.

Q. Now, I'm going to skip down two sentences. "The group developed a loan term sheet, but an analysis of AIG's financial condition revealed that liquidity needs exceeded the valuation of the company's assets, thus making the private participants unwilling to fund the transaction."

Do you see that?

A. Yes.

Q. And you personally don't have any information that is inconsistent with that, do you?

A. I haven't seen any factual basis for that statement.

Q. Sir, have you done a solvency analysis for AIG on September 15?

A. No.

Q. Okay. No further questions on that --

A. And by that what I mean is I haven't undertaken a -- gone down and done a valuation of all of AIG's assets and liabilities. I've relied on the work that others have done to that extent.

Q. Now, a risk-free rate would be compensation -- I think you talked a little bit about a risk-free rate being sort of the rate at LIBOR, and you may have said that in talking to Plaintiffs' counsel, but maybe not. A risk-free rate is the rate that the Government pays to borrow. Is that right?
A. That's generally how it's viewed.
Q. And that would be compensation for the time value of money with the understanding that both the principal and interest would be repaid.
A. Yes.
Q. And in your deposition, you told me that you understood the term "fully secured" to mean a risk-free rate. Is that still true?
A. I'm not sure what I said in my deposition to that extent.
Q. Okay. So, let me ask you, do you consider the term "fully secured" as -- just so we understand what you mean when you talk about it in your testimony -- to mean a risk-free rate or to be risk-free?
A. I think it's -- it varies from circumstance to circumstance when you're talking about fully secured, but at its -- at its extreme, fully secured would mean that the loan is fully collateralized and that there would be no risk of -- if there was nonpayment of the

principal, you'd be holding an asset that exceeds the value of the principal.

Q. And there has been some testimony regarding the term "fully secured" in this case. Is that right?

A. Yes.

Q. And you used the term or you cited the term "fully secured" on some of your slides. Is that right?

A. Yes.

Q. And when you cite it, are you using the term to mean risk-free?

A. I'm using it as an analog for that.

Q. For risk-free?

A. Yeah, that for the most part, the expectation of repayment is one of full repayment.

Q. I just want -- I need an answer from you, sir. When you use the term "fully secure" on your slides, you use it to mean risk-free? Yes or no, sir.

A. I mean that in the way that I think it was being presented by government officials, which is the expectation of repayment was very high.

Q. Okay. But not risk-free?

A. I mean, there's always risk.

Q. Okay. So -- so, you under --

A. When we say there -- you know, when we talk about risk-free with the U.S. Government, there is risk.

I mean, and we saw --

Q. There's always --

A. -- and we saw that realized during the financial crisis.

Q. So, there's always risk of loss on every loan. Isn't that right, sir?

A. Yes.

Q. Now, sir, under 13(3), you understand that the standard, the required showing, is that it's -- that the loan -- among other showings that must happen, is that the loan must be fully secured to the satisfaction of the president whose bank is making the loan. Do you understand that?

A. Yes.

Q. Okay. And is it your interpretation that that standard, fully secured to the satisfaction of that individual, is the same as -- I'm sorry, let me restate that.

Is it your understanding -- well, actually, let's pull up CX 40, DX 2243.

May I approach, Your Honor?

THE COURT: Yes.

BY MR. DINTZER:

Q. Do you understand what this is, sir?

A. It would be helpful if I knew what the context of it fully was. I can guess at what it is, but I'd rather not do that.

Q. Okay. This is 13(3).

A. That was my expectation, but I didn't want to --

Q. And I didn't mean to make this a guessing game. Actually, I left the citation off, but this is 13(3), and -- I'm sorry, I'm having a little trouble with the camera. There we go. So, here we have -- okay, do you see?

A. Yes.

Q. "Secured to the satisfaction of the Federal Reserve Bank." And my only question is, is it your reading, your understanding that the "secured to the satisfaction" standard of 13(3) is equal to "fully secured," or do you understand that they may be different? And if you don't have an understanding, that's fine.

A. I understand it to be fully secured in the sense that essentially 13(3) is extending the discount window to nonbanks, and the way the discount window works and was intended to work is that collateral was being provided through a frosted glass. So, you wouldn't actually know the identity of the borrower.

That was to ensure that there was nondiscrimination that was happening, as well as to remove a process of kind of picking winners and losers and then discriminating across the interest rates that were being charged. That's how I understand how collateral, in the sense of 13(3), is being utilized.

Q. Okay. And my only question, sir, is -- and if you don't have an understanding, that's fine -- is it your understanding that the term "fully secured" is the same thing or different than the standard of "secured to the satisfaction"?

A. I'm sorry. Can you say that again, because I'm not quite getting your -- the difference you're trying to get at.

Q. I'm not trying to get at anything. I'm just trying to ask you, sir. We have heard the term "fully secured," heard the term "secured to the satisfaction." Are you offering the opinion that they are the same thing, that they are different things, or do you just not know?

A. I don't know what the legal intention of the -- of that differentiation is.

Q. Okay. No further questions on that document, sir.

Now, Chairman Bernanke and President Geithner, around the time -- in the time after the AIG loan was made, they made statements indicating that they believed

that there was risk in the loan. Is that right?
A. Yes.
Q. And that they believed that the taxpayer was exposed to some risk of loss in the AIG loan. Is that right?
A. I'm not -- they certainly said that here at trial.
Q. And they said that before trial actually, too, right?
A. Well, I'm not sure. You'll have to show me the documents as to when exactly you have in mind.
Q. Well, actually, that's what I'm asking you, sir, is you've testified somewhat about sort of what they've said and stuff, and I'm asking you, in your examination and what you've looked through, did you find statements from them before trial indicating that they believed that there was risk in the AIG loan?
A. I didn't -- in my investigation, I didn't see that type of contemporaneous evidence about how they were thinking about the loan at that point in time.
Q. Did you look?
A. Yes.
Q. And you couldn't find anything?
A. It's not that I couldn't find anything. My judgments of what -- was about what were the -- the

dominant explanations and what was the basis for those explanations.

Q. I see. So, you looked at what they said and then you chose some and you rejected others.

A. I was investigating the various types of explanations that were being forwarded by different members of the Government and parsing through to see what the basis for that explanation was and then testing the validity of that explanation.

Q. Right. And so my only question is, sir, when you were looking through, did you see specific comments from Chairman Bernanke and President Geithner, contemporaneous within the few years after the AIG loan was made, that they believed that there was risk in the loan? Did you see those?

A. Yes. Certainly, you know, later in time, that's been expressed.

Q. Within two years after the loan was made, correct, sir?

A. I don't remember when exactly that was expressed.

Q. Okay. Let's go to CX 4.

THE COURT: Mr. Dintzer, I don't know if you intend this or not, but you must have an internal numbering system, and that's all going to appear in the transcript, and it -- we don't know what it means really.

MR. DINTZER: Oh, I'm sorry. I'm not saying that for the record. I'm --

THE COURT: Well, it's on the record because you're saying it.

MR. DINTZER: I will avoid --

THE COURT: I'm just alerting you to that because these CX numbers are showing up in the transcript.

MR. DINTZER: It is an internal --

THE COURT: It doesn't have a lot of meaning.

MR. DINTZER: I apologize, Your Honor. I'm speaking to my colleague here a little louder than intended, but I appreciate the heads-up. I will try to avoid that.

May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

MR. DINTZER: Sure.

BY MR. DINTZER:

Q. Sir, I'm showing you what's been marked as DX 2204. This didn't show up on your documents relied upon. It's a speech by Chairman Bernanke at Morehouse College, April 2009. Do you see that?

A. Yes.

Q. And do you remember if you -- if you reviewed this?

A. Well, let me just look through this.

Q. Sure, take your time. And this is April 14th, 2009, at Morehouse College in Atlanta, Georgia.

A. Yes.

Q. And it's titled "Four Questions About the Financial Crisis." Do you see that?

A. Yes.

Q. Okay. And if you go to -- they are not numbered, but if you go to the second to the last page in the exhibit, the one with the words "Why did the Fed and the Treasury act..." Do you see that? Actually, the whole thing is, "Why Did the Fed and the Treasury Act to Prevent the Bankruptcy of Some Major Financial Firms?"

Do you see that?

A. Yes.

Q. And then if you go to the very bottom paragraph, it says (as read): "In my view, preventing the failure of AIG was the best of the very bad options available, but it nonetheless involved major costs, including financial risks to the taxpayer."

Do you see that?

A. Yes.
Q. So, this would be an instance about six, seven months after the loan was made, when Chairman Bernanke, in a public speech, indicated that AIG presented financial risks to the taxpayer, right?
A. That's what it says here.
Q. And you did not consider this document in forming your opinion, correct?
A. I've read many, many of Mr. Bernanke's speeches. I don't remember this particular one.
Q. Okay. No further questions on that document, sir.
Now, you believe that the loan to AIG was a low-quality investment for the Federal Reserve. Is that correct?
A. When you say -- are you quoting me or --
Q. Well, do you -- is that a belief that you have? Let me ask you -- make it that way.
A. Yeah, I think there are a variety of ways of investigating that question without doing that...
MR. DINTZER: May I approach, Your Honor?
THE COURT: Yes.
THE WITNESS: Thank you.
BY MR. DINTZER:
Q. Do you recognize this document, sir?

A. Yes.
Q. Okay. And this is PTX 1995. Is that right?
A. Yes.
Q. And this is something that was put out by The Brattle Group. Is that right?
A. Yes.
Q. And this was in 2009.
A. Yes.
Q. And if you go to -- and this is by you and Mr. Oldfield and a person named Jehan deFonseka?
A. Mr. deFonseka.
Q. All right. And you wrote this in 2009. Is that correct?
A. Yes.
Q. And if you go to page 5 -- and this is about the part -- the financial crisis. Is that right?
A. It is, yes.
Q. And if you go to page 5, in the second column, it says, "The Appendix summarizes major Fed initiatives to provide credit to the private sector." Do you see that?
A. Yes.
Q. "While the Fed holds some low quality investments (Bear Stearns-related Maiden Lane positions and AIG loans), its primary effort has been to support

the market for agency-sponsored mortgage-backed securities (MBS)."
Do you see that?
A. Yes.
Q. So, when you wrote this, you believed that the AIG loans were a low-quality investment, correct?
A. Yes. That's based upon what I could understand from the public information. Obviously, I know far more now than I did then.
Q. And if you could go now to footnote 9 of that same document, and it's in one of the endnotes on page 12.
A. Yes.
Q. And you write, "The specter of defaults raises the issue of the Fed's capitalization and its ability to recognize write-downs." Do you see that?
A. Yes.
Q. "A 50 percent default rate net of recoveries on the AIG and Maiden Lane positions would almost break the Fed's balance sheet." Do you see that?
A. Yes.
Q. So, in that footnote you contemplate the possibility of a default on the AIG loan, correct?
A. I'm illustrating what the impact would be.
Q. It would be enormous, correct?

A. Well, no, you have to read the rest of the footnote.

Q. And I will read the rest of the footnote, but --

A. Well, I -- I would just emphasize, this is based -- the statement is -- in the footnote is designed to illustrate the difference between book value and market value. So, if you look at the book value of these loans and you look at the book value of the Federal Reserve's gold position, it would look like the consequences would be enormous.

If you go back -- if you go to the end there, it says, if you look at the market value of the Federal Reserve's gold, it's marked at 42.22, its market price is $1,000 to $1,200 an ounce, providing $300 billion worth of assets, as opposed to what they're marked at, which is a fraction. The next sentence says, "This would easily keep the Fed afloat."

Q. And then you go on to say, of course, that if they made this gold sale, it would affect the market price of gold. Do you see that?

A. Yes.

Q. But my question, sir, with that analysis under us, is that in the second sentence in the -- the second sentence here, you contemplate a default or the possibility of default on the AIG loans that the Fed had made in September -- I mean, in 2009, correct?

A. Yes.

Q. Okay.

A. I'm illustrating what the impact would be, but why doing a book value analysis of the Federal Reserve's balance sheet wouldn't be the right way to go.

Q. And when you -- when you are illustrating what the impact would be, sir, you picked an example that you believed at the time was a possible example, correct? Possibility of default.

A. Based upon what I knew then, the way AIG was being presented in 2009 --

Q. Yes.

A. -- that's a reasonable example.

Q. I need my answer, though. Let me try again, sir.

In 2009, in that footnote, based on what you knew then, you gave an example that contemplated the default or the possibility of default on the AIG loan, correct?

A. That's what the example is, yes.

Q. And you did that because you believed that there was at least some possibility that there would actually be -- some possibility that there would actually be a default on the AIG loan, right?

A. No. I was giving the example to illustrate how to evaluate the Federal Reserve's balance sheet using this as an example, and it wasn't an unreasonable example given the way AIG was being written about in the press.

Q. How was AIG being written about in the press at that time, the part that made you think, well, maybe there was some risk in the loan?

A. I mean, I don't have a specific recollection of what I was thinking at that point in time, but it wasn't receiving favorable coverage, let's say.

Q. Because people thought there was risk in the loan, right?

A. There were a huge range of reasons why it wasn't receiving favorable coverage.

Q. And one of them was because people thought there was risk in the AIG loan, correct?

A. I just don't know.

Q. Okay. AIG's insurance subsidiaries incurred some loss after the government rescue. Is that correct?

A. I'm not sure what you mean.

Q. They -- they...

AIG's insurance subs lost sales in the time between September 2008 and two thousand and -- and early 2009. Is that correct?

A. I'm not sure what you're looking at, so --

Q. Well, I'm just asking you. Do you know if that's true or not, sir?

A. When you say they lost sales, I -- I don't know what you mean.

Q. Let's go to Exhibit 589.

THE COURT: Whose exhibit?

MR. DINTZER: Plaintiffs' Exhibit. Thank you, Your Honor.

BY MR. DINTZER:

Q. This is the June Oversight Report, and you cite this in your report as well, right?

A. Yes.

Q. And I'm going to take you to page 154 and the third sentence on the bottom paragraph.

"Due to suspensions by broker-dealers (getting closed out of many of its distribution outlets) related to AIG's financial risk and the losses that it incurred over the course of 2008 (and that occurred despite -- despite -- AIG's receipt of substantial government assistance), AIG's ability to issue new insurance policies was significantly curtailed between September 2008 and March 2009."

Do you see that?

A. Yes.

Q. And then it goes on, "SunAmerica Financial, AIG's umbrella for its life and retirement insurance companies, has estimated that it lost between $2 and $3 billion in sales during this time period." Do you see that?

A. Yes.

Q. "This demonstrates that AIG's subsidiaries incurred some loss even after the government's rescue, but the amount likely would have been much larger had a bankruptcy occurred." Do you see that?

A. Yes.

Q. And do you agree with that?

A. I haven't done the analysis either way, so I will take it on its face that it's right.

Q. Thank you, sir.

A. But when you look at the valuations that were done by Morgan Stanley and Ernst & Young, which, you know, were done sequentially over time, taking into account these types of events, the valuations of the collateral maintained their value.

Q. Do you recall if those valuations had limitations that they were only if AIG continued as a going concern?

A. I would presume they would have that limitation.

Q. Okay. Now, in March 2008, the Federal Reserve used 13(3) for the first time since the Great Depression. Is that right?

A. I'm sorry. Can you repeat that?

Q. Sure. In March 2008, the Federal Reserve used 13(3) for the first time since the Great Depression.

A. Yes.

Q. And no one could have entered 2008 with the expectation of getting a 13(3) loan.

A. When you say "nobody," what --

Q. No firm could have entered 2008 with an expectation that they would get a 13(3) loan.

A. I don't think that was part of their planning, generally speaking.

Q. Okay. And specifically in January 2008, AIG didn't have assistance from the Fed in its business plan for its future liquidity. Is that correct?

A. I'm sorry, are you -- I'm confused. Are you saying that AIG consulted with the Fed on their liquidity plans?

Q. I'm sorry. I don't mean to confuse you.

In January 2008, AIG, as part of its business plan -- AIG had a business plan --

A. Yes.

Q. -- and as part of its business plan in January of 2008, AIG didn't include an expectation that it would

get assistance from the Federal Reserve.
A. Not that I'm aware of, no.
Q. Okay. Now, in 2007 and two thousand and -- and early 2008, AIG reported losses that were larger than expected.
A. Yes.
Q. And in --
A. I mean, it was -- I should say it depends on the point in time that you're saying losses than were expected, but generally losses in 2008 were certainly higher than anybody expected for any company.
Q. And the loss at the end of 2007 as well, sir, correct?
A. I don't remember, in 2007, what the forecasts were for AIG's Q-4 results. I just -- I don't remember what those are.
Q. In 2008, the credit rating agencies criticized AIG's management. Is that correct?
A. I don't -- they didn't make that type of sweeping generalization.
Q. Do you know what A.M. Best is, sir?
A. Yes.
Q. What is A.M Best?
A. They are a rating agency that focuses on or specializes in the insurance industry.

Q. And like other rating agencies, they issue releases after they've done an analysis of a firm if they -- if they have concerns about the firm. Is that correct?

A. Yes.

MR. DINTZER: May I approach, Your Honor?

THE COURT: Yes.

MR. DINTZER: This is DX 2214.

THE WITNESS: Thank you.

BY MR. DINTZER:

Q. And, sir, is this something that you reviewed as part of writing your report?

A. I have looked at A.M. Best material. I don't remember whether -- let me just look through this to see if I remember seeing this specific document.

Q. Okay. And --

A. Could I just take a quick look through it?

Q. No, please do. Please do.

A. (Document review.) Yes.

Q. Okay. And so this is a release that A.M. Best put out in May two thousand -- on May 28th, 2008. Is that right?

A. Yes.

Q. And the first two items are then affirming ratings for some of AIG's subs. Is that right?

A. Yes.

Q. Okay. And then the third one says, "Concurrently, A.M. Best has downgraded ICR to 'aa-' from 'aa' of American International Group, Inc." Do you see that?

A. Yes.

Q. "The rating has been removed from under review with negative implications and assigned a negative outlook." Do you see that?

A. Yes.

Q. And then it goes on.

I want to draw your attention to the second page, where -- the second full paragraph (as read): "The holding company downgrade reflects A.M. Best's view of the detrimental implications of AIG's risk management and aggressive risk appetite relating to investment concentrations within the securities lending portfolio and matched investment programs tied to mortgage related securities."

Do you see that?

A. Yes.

Q. And just to be clear, the securities lending portfolio, that's their securities lending program, right?

A. Yes.

Q. And then it goes on, "The risk appetite, larger than A.M. Best's expectations, was regardless of AIG's market surveillance resources within the mortgage industry." Do you see that?
A. Yes.
Q. And so in May 2008, AIG -- I mean, A.M. Best was expressing -- was actually downgrading the holding company based on the detrimental implications of its risk management and its aggressive appetite -- risk appetite. Do you see that?
A. Yeah. That's what this says.
Q. Okay. And A.M. Best wasn't the only rating agency that criticized AIG around that time. Is that correct?
A. That's right.
Q. If you could go to PTX 5300, this is your first slide. And your first opinion is, "The liquidity crisis at AIG was caused by," and then you go on to describe the market forces.
A. I'm sorry, you said PTX 5330?
Q. No, 5300, the first slide in your deck.
A. Got it, yes.
Q. You say, "The liquidity crisis at AIG was caused by," and then you go on, "the same market forces." Do you see that?

A. Yes.

Q. And I've got to ask, do you mean was only caused by that or there were other causes as well?

A. I think I presented yesterday that the primary causes of AIG's liquidity problems were related to the CDS portfolio and the -- and securities lending portfolio. With regards to the CDS portfolio, the primary problems that arose there were the result of the RMBS market being in such dysfunction that AIG's counterparties could take advantage of the divergence between fire sale pricing and intrinsic values to essentially get AIG to lend them money.

Then on the securities lending portfolio, again, while AIG was unwinding that portfolio over the course of 2007, 2008, by the time the September financial crisis, you know, hit everybody, that caused a run on AIG's wholesale lending. So, those are the two factors that I've identified which are the primary cause of AIG's liquidity problems in September.

Q. Okay. And, sir, I -- now I'm going to go back to the A.M. Best document, and so my question is, sir, is that -- did AIG's aggressive risk appetite, as described by a rating agency, have any role in causing -- your word -- AIG's liquidity crisis? Yes or no, sir.

A. I don't know where they -- how they've come to the conclusion that AIG had an aggressive risk appetite. The securities lending portfolio -- and I think it said it earlier in this document -- it's a fairly standard investment. It's a carry trade that was being done throughout the financial services industry. That's not a -- when you say is it a -- you know, aggressive, it's --

Q. Well, I didn't say it, sir, just so we're clear. It was something that --

A. No, so that's what -- when you say -- when they say aggressive, I'm not sure what they're referring to, but I don't think the securities lending trade is an aggressive trade. It's a very standard trade.

Q. So, I --

A. And likewise, the risk of the CDS portfolio, again, when you look carefully at it, I don't think you can characterize that on an ex ante basis as a risky trade. So, I can't analyze the degree to which A.M. Best's statements here reflect hindsight or an analysis of AIG's ex ante risk-taking.

Q. Okay. Sir --

A. When I look at AIG's ex ante risk-taking, with regards to the two pieces that caused its liquidity crisis, on an ex ante basis, they don't meet the characterization that A.M. Best has here. So, I'm not sure what they're referring to and whether this reflects hindsight by us or not. I just can't tell from the limitation that's here.

Q. So, I need to ask you, sir -- and this is a yes or no -- do you agree or disagree with A.M. Best's conclusion that AIG had an aggressive risk appetite in May 2008? Yes or no or I don't know. I need you to answer my question. I need you to answer my question.

A. I don't know. I would have to -- to know whether I agree or disagree with them, I would have to engage in a conversation to understand why they're saying that. I just can't tell why they're saying this.

Q. You haven't done the research.

A. I haven't had the conversation I just spoke about.

Q. Okay. So --

A. My opinion regarding the two elements that were the primary cause of AIG's liquidity problems, I don't think they reflect how A.M. Best has characterized the company overall. I just -- I don't see the -- the evidentiary basis for that.

Q. So, you disagree with A.M. Best and their characterization as AIG having an aggressive risk appetite. Yes or no, sir.

A. I disagree -- I've tried to, I think, answer your question. I don't know whether they're talking about --

Q. So, I don't know. Is that your answer?

A. I'll say I don't know, because as I say, I can't tell whether they're talking about the causes of AIG's liquidity crisis several -- you know, a couple months later.

Q. Well, sir, I mean, let's be clear. You said that one of the things that happened that caused their liquidity crisis was security lending, and that's what they say, too. They say that -- "aggressive risk appetite relating to investment concentrations within securities lending portfolio." So, I just -- just -- I mean, you gave me an answer and then you kind of took it back. So, I need to know.

Do you agree -- yes or no -- with A.M. Best that AIG had an aggressive risk appetite relating to their investment concentrations within the securities lending portfolio? Yes or no.

A. I don't know what they mean by that.

Q. Okay. No further questions on that document, sir.

Do you have an opinion as to whether AIG's liquidity problems, as you described in your slide, were caused -- and I understand you think -- you've told us what you think caused them, but I'm asking if there were other causes. Was there also a cause in that AIG had poor risk management in 2008?

A. You'll have to be more specific than that. That's such a broad question, I don't know what you mean.

Q. Okay. Now, in 2008 -- 2007, 2008, AIG's shareholders became concerned with AIG's performance. Is that right?

A. Again, you'll have to point me to what you're thinking about.

Q. Have you seen any letters from AIG's shareholders to AIG or internal correspondence amongst the AIG shareholders about their concerns about AIG?

A. I don't remember.

Q. If you could go in your binder, sir, to DX 130. This will be in your white binder, sir, the one we gave you.

A. Yes.

Q. And have you seen this document before?

A. I may have seen this. I don't -- I don't remember it sitting here right now, though.

Q. Do you know if you relied on it as part of reaching your conclusions?

A. I don't recall.
Q. Okay. This is a letter from C.V. Starr & Company. Do you see that?
A. Yes.
Q. To AIG's board of directors. Do you see that?
A. Yes.
Q. And it's on the stationery of Mr. Maurice R. Greenberg. Do you see that?
A. Yes.
MR. DINTZER: Your Honor, we move for the admittance of DX 130.
MR. BOIES: No objection, Your Honor.
THE COURT: Defendant's Exhibit 130 is admitted.
(Defendant's Exhibit Number 130 was admitted into evidence.)
BY MR. DINTZER:
Q. Okay. And this is in May of 2008, around the time of the A.M. Best analysis, correct?
A. Yes.
Q. And it says:
"Dear Board Members:
"As AIG's largest individual shareholder, I am as concerned as millions of other investors as I watch the deterioration of a great company. As you know, I am also Chairman of Starr International, AIG's largest

shareholder."

Do you see that?

A. Yes.

Q. And did you understand -- I assume you do -- that at least at that time, between Starr and Mr. Greenberg, that they were a significant shareholder in AIG?

A. Yes.

Q. It says, "AIG last week announced a net loss for the first quarter of 2008 of $7.1 billion" --

A. 81.

Q. 7.81. Thank you, sir.

" -- billion, or $3.09 per diluted share. It is the worst performance in AIG's approximately 40-year history -- and follows almost equally poor results from the last quarter, which was the worst quarter in the company's history before this quarter. Over the last twelve months, shareholders of AIG have lost $80 billion in the aggregate."

Do you see that?

A. Yes.

Q. And then he writes, "Several top shareholders of AIG have called me expressing deep concern about the persistent and seemingly endless destruction of value at AIG. They, and I, are deeply distressed by the

excessive loss of value."
Do you see that?
A. Yes.
Q. And then he goes on, "The facts are disturbing, for example:" And the first one he lists is (as read): "On December 5th, 2007, management announced that the cumulative decline in the value of its super senior circuit default swap portfolio was between $1.4 and $1.5 billion as of November 30, 2007." Is that right?
A. That says "credit default swap portfolio."
Q. I'm sorry?
A. You meant "credit default swap portfolio."
Q. Yes.
So, what was the date on that, sir?
A. December 5th, 2007.
Q. December 5th.
A. The loss was as of November 30th, 2007.
Q. And how much was the loss, sir?
A. Between 1.4 and 1.5 billion.
Q. And do you know if that amount got restated at some point?
A. I don't know if those -- that specific number got restated.
Q. Okay. And then he goes on, "On February 11, 2008, that same estimate was increased by $4.5 billion

to approximately $6.0 billion, and the company announced that the auditors found a material weakness in its internal controls over financial reporting and oversight."

Do you see that?

A. Yes.

Q. Okay. So, then, February 11th, 2008, so now we've got 2/11/08, it's restated, right? Is that right, sir?

A. I don't see the word "restated" here. The estimate was increased.

Q. Okay, the estimate was increased. Fair enough. And what was it increased to?

A. It was increased to 6 billion.

Q. Okay. And then he writes, "On February 28th, 2008 (two weeks later), the company updated its estimate to reflect further valuation declines through December 31, 2007, and increased the cumulative valuation loss to $11.5 billion on the same portfolio."

Do you see that?

A. Yes.

Q. So, now -- is that 2/28? Is that the date?

A. Yes.

Q. And what was the amount?

A. 11.5 billion.

Q. So, their estimates are going up monthly or weekly at that time. Is that correct?
A. That's what the letter says.
Q. And then it says, "With the release of first quarter earnings on May 8th, 2008, AIG announced that the portfolio lost an additional $9.1 billion in value -- and the company would need to raise $12.5 billion in capital."
Do you see that?
A. Yes.
Q. And we know that they actually raised 20 billion, is that right, in May 2008?
A. Yes.
Q. And then he writes, "These events have led to a complete loss of credibility with the investment community and an even further loss of value for shareholders." Do you see that?
A. Yes.
Q. And do you agree with Mr. Greenberg that these events that we have been looking at affected AIG's credibility with the investment community at that time, in May 2008?
A. I can't speak to their credibility with the investment community and his perception of that.
Q. And, you know, I'm not asking about his

perception now. I'm just asking you, sir. Do you have an understanding, one way or the other, if in May 2008 AIG had a loss of credibility with the investment community?

A. I mean, it raised 20 billion, which would speak to a contrary conclusion, but --

Q. So, you disagree?

A. -- I just can't -- I haven't done the analysis to understand the basis for that.

Q. So, as you sit -- you haven't done the analysis to know what the investment community thought of AIG in 2008? Yes or no, sir.

A. I have just told you that they raised 20 billion. I haven't done a deep dive on trying to figure out what AIG's credibility was with the investment community at that point in time.

Q. You don't know one way or the other?

A. Again, it's not categorical. I've given you my general understanding, but I haven't developed a deep analysis of that question.

Q. Let me put it this way, sir. You don't have any information to know that Mr. Greenberg, on May 11, 2008, was wrong when he said these events have led to a complete loss of credibility with the investment community, correct?

A. I've cited already with you that they raised 20 billion at this point in time.

Q. Okay. So, you disagree? Yes?

A. I'm -- I'm --

Q. I just need an answer. Yes, no --

A. Repeat the question so I can know exactly what you want me to disagree with.

Q. You disagree with Mr. Greenberg's conclusion that these events have led to a complete loss of credibility with the investment community. You disagree with him.

A. I don't disagree one way or the other with him.

Q. Okay. And then it goes down four paragraphs to the paragraph beginning, "The company's problems..." Do you see that?

A. Yes.

Q. (As read): "The company's problems are more than financial and extend beyond its subprime credit exposure or approach to capital management. Core businesses are also deteriorating."

And those core businesses are the insurance companies, right?

A. Yes. I think he goes on to explain what he means.

Q. Yes. "The U.S. life operations are stagnant.

The company has lost its leading and unique market position in China and Japan. The life business in Asia had been a crown jewel, but now the company's position has eroded. In Taiwan, the company must now find up to an additional $1 billion to cover losses."

Do you have any knowledge to disagree with his concerns raised in that paragraph?

A. I mean, these are such sweeping generalizations that, you know, for instance, we saw the A.M. Best document just a couple seconds ago which showed that the Hartford Steam Boiler Company, which is one of the best -- is the best in its segment, was rated aa-plus at the time. I mean, we can find statements that, you know, agree and disagree with these statements. So, it's --

Q. And all I'm asking you, sir, is I'm just asking you your opinion, a yes or no, and I can go sentence by sentence here if you would prefer. Do you agree or disagree or you don't know about whether Mr. Greenberg's statements in that paragraph on May 11, 2008, are accurate?

A. I don't have an opinion about this paragraph.

Q. I'm not asking you for an opinion, sir. Yes, no, or you don't know on whether it's accurate.

A. I'd have to look more carefully at each statement here to develop an opinion. I haven't done that.

Q. So, you don't know?

A. I don't know.

Q. So, then he goes down to the last paragraph, and he says, "AIG is in crisis," okay? Do you see that?

A. Yes.

Q. Okay. And so he concluded in May 2008 that he believed that AIG was in crisis, correct?

A. I think you've read those four words correctly.

Q. Okay. And nowhere does he -- well, let me stop there for a second and let me go on to the next one.

Do you agree or disagree that in May 2008, AIG was in crisis? Yes, no, or I don't know, sir.

A. I wouldn't describe it as a crisis.

Q. Okay. So, no.

If we could now, sir, let's go to -- if we can go to CX 32. I'm sorry.

May I approach, Your Honor?

THE COURT: Yes.

BY MR. DINTZER:

Q. Sir, I have handed -- Your Honor, I have handed up DX 2232, and, sir, have you seen this document before?

A. I don't recall seeing this. Well, let me take a --

Q. Take your time, sir.

A. -- a look. (Document review.) Yeah, I don't remember seeing this.

Q. Okay. Do you have an understanding of what it is, sir?

A. It's a complaint.

Q. It's a complaint, and it was filed by Mr. Greenberg in the Southern District of New York. Do you see that?

A. Yes.

Q. In February 2009. Is that right?

A. Yes.

Q. And who's the defendant?

A. AIG and some of its executives.

Q. And he writes, you know, the standard sort of complaint language under "Complaint."

"Maurice R. Greenberg (Plaintiff) alleges the following upon his personal knowledge or otherwise on information and belief." Do you see that?

A. Yes.

Q. And going down further, the second paragraph -- actually, towards the end of the first, do you see that it's alleging fraud there?

A. So, can you point me to what you're looking at?

Q. Sure. If you look at the end of the first paragraph -- I don't need to get into all the specifics of what he's looking at, but he writes "under New York state law for common law fraud.

A. Yes. He uses the word "fraud" at the end of the first paragraph.

Q. And the second paragraph is, "Defendants' material misrepresentations and omissions caused Mr. Greenberg to acquire, at an artificially inflated price, stock in AIG" --

MR. BOIES: Your Honor, I am going to object to the reading of the document that is not in evidence and is not on their exhibit list.

MR. DINTZER: Your Honor, it's impeachment. So, I -- I mean, this is cross examination. I'm happy to ask the Court to take judicial notice of it. I -- the -- judicial notice of the information in it, but --

THE COURT: I hope you are not going to read the whole thing.

MR. DINTZER: I promise. I will -- I will limit my --

THE COURT: I will give you a little leeway on this. That's fine.

MR. DINTZER: I appreciate that, Your Honor.

BY MR. DINTZER:

Q. And so if you go to page 39, sir, and just let me know when you're there.

A. Yes.

Q. Okay. And it says here -- and you understand that -- I mean, it's a complaint, so it's signed and people who wrote it believed that it was true when they submitted it to the Court, right?

A. Yeah. I presume that's the standard, yes.

Q. Okay. And in paragraph 130, they write, "In his testimony before the Oversight Committee on October 7, 2008, Defendant Sullivan" -- do you understand that he was the CEO?

A. Yes.

Q. Okay. Before Mr. Willumstad, right?

A. Yes.

Q. -- "continued insisting that, during his tenure as AIG's CEO, he achieved 'unprecedented transparency,' and blamed AIG's financial troubles on the mark-to-market accounting required by FAS 157. Similarly, when testifying before the Oversight Committee, Mr. Willumstad blamed the crisis that led to the bailout on mark-to-market accounting rules that resulted in unrealized mark-to-market losses."

MR. BOIES: Your Honor, I am going to object if he says he's offering this for impeachment. I mean, first, I don't know what testimony by the witness this is impeaching; and second, the right way to do it, as he's told me when I've been in a similar position, is to put the testimony in front of the witness, have him read it, and then ask him questions about it.

THE COURT: Mr. Dintzer, where are we going with this?

MR. DINTZER: The next sentence, sir -- Your Honor, is what I'm looking at to compare with the witness' testimony, if I could read one more sentence and ask my question.

THE COURT: All right, but, I mean, it's not his testimony.

MR. DINTZER: It's not, and I'm just going to ask him if he agrees with the statements of the Plaintiff in a prior pleading.

THE COURT: All right, go ahead.

BY MR. DINTZER:

Q. (As read): "Both former CEOs refused to take any blame for the crisis they brought upon AIG and insist that they did everything to protect AIG..." Do you see that?

A. Yes.

Q. Do you have an opinion, sir, as to whether Mr. Willumstad and Mr. Sullivan had responsibility for

the crisis that they brought upon AIG?
A. I haven't developed an opinion about this sentence.
Q. I'm asking you, sir, about whether you have -- whether you agree or disagree -- you can put the document down now -- whether you agree or disagree with the statement that Mr. Willumstad and Mr. Sullivan had responsibility for the crisis that AIG ultimately went through.
A. No. I think I've been very clear about what I think of the causes of AIG's crisis.
Q. And you don't think it was management?
A. No. I think AIG was, you know, ultimately swept up in the financial crisis.
Q. No further questions on that document, sir.
Now, let's go to DX 146. Sir, have you reviewed this document in preparation for your testimony or in forming your opinions?
A. Sitting here now, I don't recall looking at this.
Q. If you would turn to the second page, and it says -- and if you'd go ahead and just read that first paragraph. I'm just going to ask you a question.
A. (Document review.)
Q. Are you done, sir?

A. Yes.

Q. Do you have an understanding that this letter was written by AIG's shareholders to AIG?

A. Well, it's -- I think it's coming from Eli Broad, Shelby Davis, and Bill Miller. They say that they own, you know, shares.

MR. DINTZER: Your Honor, we move for the admission of this document, DX 146.

MR. BOIES: Objection, Your Honor. I don't know what the basis for the admission would be. It's hearsay, obviously.

THE COURT: Mr. Dintzer?

MR. DINTZER: Well, these are -- these are some of the shareholders of AIG and their thinking of what -- I mean, in June of 2008, of what is causing AIG's financial problems and crisis and is directly relevant to the case and addresses the witness' expert opinions.

THE COURT: I'll allow the document. So, Defendant's Exhibit 146 is admitted.

(Defendant's Exhibit Number 146 was admitted into evidence.)

BY MR. DINTZER:

Q. If you go to the second page of the document, sir.

A. Yes.

Q. It says, "This letter is a follow-up to our May 12 letter expressing our deep concern and dissatisfaction with the management and governance of AIG." Do you see that?

A. Sir, I am -- I see it starts with, "Despite these facts"?

Q. Oh, I apologize, sir. So -- "Despite these facts"? I'm talking about the second page of the document.

A. Oh, you mean the second page of the email. Sorry, I thought we were looking at the letter. Sorry.

Q. No, that's okay.

Do you see that that first sentence is expressing their deep concern and dissatisfaction with the management and governance of AIG?

A. Yes. That's what it says.

Q. And this is in June 2008.

A. June 11th.

Q. And if you go to -- and they then say "to review the facts," and then they list a number of facts that they're concerned about. Do you see that?

A. Yes.

Q. And number 4 is, "The company has been downgraded by all the major rating agencies." Do you see that?

A. Yes.
Q. And that happened -- I mean, we looked at A.M. Best. That happened in late May, is that correct, 2008?
A. Yes.
Q. And then they say, "These downgrades have significantly increased the cash collateral that the company must post on credit default swaps." Do you see that?
A. That's what it says.
Q. And that's accurate, right?
A. Yes. They had to post additional collateral that's summarized in my chart, which we can look at if you want.
Q. And then they write, "The company's independent accountants have warned of material weaknesses in financial controls." Do you see that?
A. Yes.
Q. Okay. So, in June of 2008, AIG's shareholders were already concerned about AIG's CDS collateral exposure. Is that right?
A. Yes.
Q. And --
A. These shareholders were, at least, yes.
Q. Do you have any reason to doubt that other shareholders were also concerned?

A. No.

Q. Okay. And then it says, "The management" -- in number 7, "The management and board inexcusably and inexplicably raised the dividend while simultaneously issuing expensive preferred stock and common stock at a discount."

Do you see that?

A. Yes.

Q. So, then we go to the second page here and paragraph two, and they write, "Significant and immediate changes at both the management and board level are clearly called for. As this process gets underway, we have two specific requests." And then they go on.

Do you see that?

A. Yes.

Q. They asked for change in AIG's management. Is that correct?

A. Yes.

Q. And do you have an understanding as to whether AIG's management changed soon after that?

A. I don't remember the exact date of the management change, but it's fairly contemporaneous.

Q. Mr. Willumstad takes over for Mr. Sullivan at some time around this point. Is that correct?

A. Yes.

Q. And these shareholders, at least, have a concern about the way AIG is being managed. Is that correct?

A. Yes.

Q. Okay. No further questions on that document.

And I think we got this, but let me just make sure we know, sir. AIG raised $20 billion in May. Is that right?

A. Yes.

Q. And then they raised another 3 billion in August.

A. Yes.

Q. And they -- AIG believed they could have raised more money at those times, but they thought that what they had was adequate.

A. I don't know if they expressed it that way, but I think I've said that if -- you know, at the margin, they could have raised more money if they felt that was warranted.

Q. So, I'm not going to try to redo what Plaintiffs' counsel did, but we've -- we've talked about CDOs and CDSs, and I don't want to write on theirs, so I -- very simply, a CDO is a collection, is that correct, of -- of bonds, of -- I want to use your words, sir, but I just don't want to write on their demonstrative. A CDO is a collection of investments.

Is that correct?
A. Yes.
Q. Okay. And some of these can be mortgage-based while others might be not mortgage-based. Is that correct?
A. Yes.
Q. And then a CDS is insurance on the CDO, correct? It's a form of insurance.
A. I'm assuming that you mean that they -- a CDS contract has been written against -- you know, it's a derivative of the CDO that you have.
Q. That's exactly right, sir. It's a contract, and it has terms, and one of the terms is -- identifies the CDO that is being -- that is being insured. Is that right?
A. In your example, yes.
Q. And that's generally what a CDS is on a CDO. A CDS is a contract that insures the performance of a CDO.
A. Well, yeah. The way you just described it, yeah, it -- a CDS on that CDO is just as you've described it, a contract on the CDO.
Q. Okay. And AIG wrote CDS contracts on CDOs. Is that correct?
A. Yes.
Q. Okay. Like this (indicating).

A. Yes.
Q. Okay. Now, the -- now, if I'm the owner of this CDO, each one of these investments -- and some might be tied to mortgages, some might be tied to corporate bonds -- but each one of these, as they pay each month, I get some slice of that -- those payments to me, depending on which piece of the CDO I own, correct?
A. Just to be a little more accurate, the CDO is tranched out into a bunch of securities, and so depending on which security you purchased would give you entitlement to the cash flows from the underlying collateral.
Q. Right. And those underlying collateral could be tied to different things, but some of them could be tied to the mortgage market, could be mortgages, correct?
A. Could be, yes.
Q. Now, at points in time AIG was the largest writer of CDS contracts on multisector CDOs in the country, correct?
A. I think that's correct for 2003 and 2004.
Q. And every CDS contract can be a little different. It's not necessarily that they're different, but they could be because they're a contract.
A. As I described, physical settlement of CDS, and then I described how the prevailing contract changed in

two thousand -- there was a new contract that was introduced in 2005, which was, you know, called a pay-as-you-go contract.

Q. But in its CDS contracts, AIG agreed to post collateral under certain circumstances.

A. Yes.

Q. And this meant that AIG had to give money to the counterparties if certain things happened.

A. Yes.

Q. Now, those collateral requirements protected the buyer from the risk that -- so, I'm the buyer here, this is me, and they protect -- a CDS contract will protect me in case something happens. If either the CDO gets downgraded or it stops paying, it protects me against -- against losses on my CDO, correct?

A. More specifically, if there's an event of default, AIG was required to purchase the CDO from me at par.

Q. And that's fine. A CDS, okay, if there's a default, purchase at par.

Now, there's also collateral posting provisions, right?

A. Just to be clear, though, when you say default, it's an event of default. It's not necessarily your CDO that experiences default. There could be a variety of things that lead to that event.

Q. Okay. And then there's collateral posting, right?

A. Yes.

Q. Now, collateral posting could be required if AIG's rating was downgraded, correct?

A. It could be, yes.

Q. Well, and that was one of the collateral posting provisions in AIG's CDS agreements, right?

A. Yes.

Q. Okay. Now, the second way that collateral could be posted -- well, why don't you tell me, sir. What's the second way that collateral could be posted under AIG's CDS agreements?

A. Well, alternatively, if the underlying bonds were downgraded, then the amount of collateral posted would change. Ultimately, the amount is determined by a -- by the settlement agent -- by the settlement agent determining what the valuation should be.

Q. And if the insured CDO went down in value, AIG would have to post collateral for that, correct?

A. If it went through the -- if it went through the full threshold buffer that's there into the range where collateral had to be posted, at that stage, it would -- it would post.

Q. Okay. Were there any other reasons, sir? We have got collateral posting if there's an AIG rating downgrade, the bonds are downgraded, or there's a drop in the CDO's value. Is that correct?

A. Those are the primary ones.

Q. Okay. And --

THE COURT: Should we take a break?

MR. DINTZER: Absolutely, Your Honor.

THE COURT: All right. Let's come back at 11:15.

(Court in recess.)

THE COURT: Thank you. Please be seated.

Please go ahead.

MR. DINTZER: Thank you, Your Honor.

BY MR. DINTZER:

Q. And we may have hit on this, sir, but these collateral requirements, collateral postings was so that the buyer of the CDS was protected from the risk that AIG would be unable to perform its obligation under the contract.

A. That's the general role of collateral, yes.

Q. Okay. And that was the purpose of it in the CDS contracts, right?

A. Yes.

Q. And the obligation to post collateral under those contracts created a risk that the obligations would come due some day.

A. Sir, I don't follow.

Q. Sure. AIG is writing up a bunch of CDSs, and they have these collateral posting provisions, and so it created a risk to AIG, when it was writing these, that someday they might have to post the collateral.

A. Oh, I see what you mean. Yes.

Q. And AIG's portfolio -- CDS portfolio, when it was writing them, were concentrated on the types of contracts that had collateral posting provisions, because it stopped writing them when they changed -- before they changed the contracts, correct?

A. I'm sorry. Do you -- I'm --

Q. I'll simplify it. No problem.

AIG's CDS contracts, its multisector CDO contracts -- CDS contracts were concentrated on -- on contracts that had collateral posting provisions.

A. Yes.

Q. Okay. Now, in 2005 or 2006, right around that time --

A. Just to be clear, though, we're talking about the multisector CDO portfolio, not -- I mean, there are other CDS contracts it wrote, and I think you're speaking specifically about those.

Q. Yes. Those are the ones that ultimately created a lot of grief for the company, right?
A. Yes.
Q. Okay. Those are the ones I'm talking about.
And the CDOs that AIG was insuring, those that we talked about relied predominantly on mortgages for collateral. Is that correct?
A. Sorry, you say they relied predominantly on mortgages? They -- I think more accurately, they had collateral -- they had underlying securities that contained mortgages. There are other types of security that was in there.
Q. Exactly. And so -- now, at the time of your deposition, we were kind of -- was it 2005 or 2006 that AIG stopped writing CDSs on multisector CDOs, the troubling CDSs?
A. Sorry?
Q. 2005 or 2006?
A. They -- they, as a policy decision, chose to stop writing in 2005, and they had existing commitments that, you know, eventually closed in 2006.
Q. Okay. So, I'll write "Stop 2005 and 2006." Right on that borderline.
A. It was at the end of 2005, yes.
Q. Okay. And -- I'll write that, "End of 2005."

And it did that because it believed that the underwriting standards had deteriorated for mortgages, that it had some concerns about sort of the new mortgages that were being created, the vintage 2006, 2007 mortgages.

A. That was an input to their decision.

Q. Okay. So -- whenever I use the word "vintage," I always think of wine, but vintage mortgages, okay?

A. Um-hum.

Q. Because they saw that the underwriting standards were going down. Is that right?

A. Yes.

Q. And that those mortgages -- because the underwriting standards were going down, those vintage mortgages were becoming riskier.

A. The future ones were becoming riskier.

Q. Right.

A. But one of the underlying problems at the time was that the overall volume of securities was -- was rising, which was creating risk for existing mortgages.

Q. Now, the decision to stop writing new CDS contracts affected sort of the intake mechanism. They weren't adding any more CDS contracts to their collection, but they already had a pretty sizeable collection of multisector CDO -- CDS con -- let me be

clear.
They already had a pretty sizeable collection of CDS contracts written on multisector CDOs, correct?
A. They had an existing portfolio, yes.
Q. And that, even after 2005, 2006, they kept and they -- they continued to be responsible for those contracts.
A. Yes.
Q. And because these were CDS contracts, they continued to get paid to maintain those CDS contracts, correct?
A. Yes. I mean, they received on the order of 11 basis points a year for each contract, on average.
Q. Okay. And so, after 2005, 2006, AIG continued to insure those existing CDOs that they had already written the insurance for, correct?
A. Yes.
Q. Now, some of AIG's CDS contracts had collateral substitution provisions, correct?
A. Yes.
Q. Okay. And so a collateral substitution provision means -- so, this takes us back to our CDO that we talked about, and we know that it has commitments in the CDO, right?
A. Yes.

Q. And collateral substitution says that if one of these existing obligations expires -- is it that they time out? What happens? How do the old ones leave when there is collateral substitution?

A. You are allowed to swap security for something of like security.

Q. Okay. So, when one -- when one of these goes out, there's a manager who sits sort of managing the CDO, and they're allowed to swap in something else to maintain the CDO, correct?

A. Yeah, of a similar quality.

Q. Exactly. So, this manager, when some of these expire -- when some of the obligations in the CDO expire, they've got to -- they can bring in things -- items of similar quality, correct?

A. Yes.

Q. Okay. And that was actually a term in the CDS agreement, correct?

A. Yes.

Q. And --

A. Sorry. It's a term of the CDO contract.

Q. And -- but --

A. When the CDS is derived, it's a derivative of the CDO.

Q. But in writing the CDS contracts, AIG must have understood that that was one of the -- that collateral substitution was one of the provisions of the CDO.

A. I presume so.

Q. Okay. So, what ended up happening, sir, is that -- is that the 2006 and 2007 mortgages ended up getting substituted into some of the A -- the CDOs that AIG insured, correct?

A. To be accurate, 2006 and 2007 vintage RMBS were substituted for earlier vintage RMBS under the representations and warranties that they were, you know, similar from a security perspective.

Q. Okay. So, there's -- there's -- let's say there's that 2004 RMBS, and it ex -- for whatever reason, it expires, it gets traded out, and this manager here decides to go ahead and substitute in a 2007 RMBS or a 2006 RMBS under representations involved in the CDO. Is that correct?

A. Yes.

Q. And you talked about it -- well, I'll get to that.

Hedging, I don't think we've mentioned the word "hedging." Hedging is used to insure against a particular risk. Is that right?

A. Yes. Hedging is the concept that you acquire an asset that offsets some existing risk.

Q. And I can show, but you Mishkin in his glossary, I think the way he defines it is in its most basic form, hedging is "to protect one's self against a risk." Is that right? Is that -- would you accept that? I'd be happy to show it to you if you would like to see it.

A. Yeah, I think that's analogous to what I just said.

Q. Sure, okay. Now, AIG did not hedge its multisector CDS portfolio. Is that correct?

A. Not directly.

Q. It -- it --

A. It didn't consciously go and hedge these risks.

Q. Okay. And so it didn't take out insurance or any of the other ways that it might have insured against the risks that it was carrying in its CDS portfolio. Is that correct?

A. That's right.

Q. And if it had hedged, if it had sought to hedge, that -- hedging comes with a cost, right? I mean, you have to pay someone to take on whatever risk you're trying to hedge against, right?

A. Yeah. Typically they're offsetting positions. So, you know, they're going to net out to something less.

Q. But there's a cost to hedging, right? Just generally. I mean, besides netting out, there's always some fee or something. So, there's a cost to hedging.

A. Well, most -- at the most kind of conceptual level, you're reducing your level of risk, and so the offsetting positions -- since the market prices risk, as you reduce your level of risk, the expected payment is also going to -- or the expected return is also going to decline.

So, if you perfectly hedge a position so that it's risk-free, the value that you're going to get from that perfectly hedged position, in expectation, would be the risk-free rate. So, as you deviate from that, you take on more risk, and as the investor, you get compensated for that.

Q. Are there transaction costs to that hedging?

A. There are always transaction costs to anything.

Q. So, hedging would have transaction costs.

A. Yeah. If you enter into another position, as opposed to taking out a position that, you know, has the -- there are hedging -- there are transaction costs involved in all transactions. I think that would be an easier way of answering your question.

Q. And hedging, since it's a transaction, would involve transaction costs.

A. Yeah. It's an -- as an additional transaction, it would involve transcation costs.

Q. And do you know if -- if AIG's decision not to hedge its credit default swaps, if that made it the only unhedged business at AIG? Do you know if that was unique at AIG?

A. I'm sorry. I didn't follow your question there.

Q. Sure. Do you know if AIG hedged most of its other transactions and businesses and risks?

A. AIG's in the business of taking risk on. I mean, that's an insurance company. So, many of those risks are unhedged.

Q. Okay.

A. Many of them are hedged. So, it's -- you have to look portfolio by portfolio.

MR. DINTZER: May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

BY MR. DINTZER:

Q. Your Honor, I have passed out PTX 624.

Sir, I am going to -- and do you understand what this is, Financial Crisis Inquiry Report?

A. Yeah. It looks like it's an extraction from the report --

Q. Well, it's 662 pages, so we've tried not to --

A. No, no, that's not what I meant. As I recall, I

don't think I've ever had the full -- actually, I've got it. It's one of those books my wife complained about.
Q. And this is something that you cited in your report. Is that right?
A. Yes.
Q. This report. If you can go to page 294, and just sort of as a lead-in, I'm going to take us to the second full paragraph sort of at the middle.
A. Okay.
Q. "'The mantra at [AIG Financial Products] had always been (in my experience) that there could never be losses." And that's a quote by the vice president of accounting policy, Joseph St. Denis.
Do you see that?
THE COURT: I'm sorry, Counsel. Where are you?
MR. DINTZER: I'm sorry, Your Honor.
THE COURT: Page 294?
MR. DINTZER: Exhibit page 294, second full paragraph, the one that begins, "They had known..."
THE WITNESS: Oh, okay.
BY MR. DINTZER:
Q. Starting with the word -- and it's a quote -- "'The mantra at [AIG Financial Products] had always been (in my experience) that there could never be losses, "and that's a quote from vice president of accounting

policy Joseph St. Denis.

Do you see that?

A. Yes.

Q. Then it goes on, "Then came that first collateral call. St. Denis told FCIC staff that he was 'stunned' when he got the news that he 'had to sit down.' The collateral provisions surprised even Gene Park, the executive who had insisted 18 months earlier that AIG stop writing the swaps. He told the FCIC that 'rule Number 1 at AIG FP was to never post collateral. This was particularly important in the credit default swap business, he said, because it was the only unhedged business that AIG ran.'"

Do you see that?

A. Yes.

Q. Were you aware that the credit default swap, the CDS business, was unique at AIG in that it didn't -- they didn't hedge there?

A. No, I don't remember reading this or looking at whether it was the only unhedged business.

Q. Okay. But by not hedging, AIG exposed itself to the full risk that existed in the CDS portfolio, correct?

A. I think you have to be careful when saying that and identify which risks it could have hedged versus which risks it couldn't have hedged.

Q. Regardless of which ones it could or couldn't, AIG sat completely exposed to all the risks in its CDS portfolio, correct?

A. That's tautological, but yes.

Q. Now, in 2007, AIG could have reduced its exposure to the risks in the CDS portfolio. Is that correct?

A. I think we talked about this during my deposition, that to do that, it's not obvious how they would have been able to do that in 2007, because the risk that ultimately materialized was the risk that the RMBS market, you know, became very illiquid, which then allowed counterparties to use marks that deviated from intrinsic values in a significant way. To hedge that particular kind of risk would be very difficult to do.

Q. Well, one of the things AIG could have done was they could have gotten out of the CDS agreements earlier to -- by buying their way out, by simply going to their contracting party and saying, "Hey, why don't we tear this thing up and let's find a price." That could have been one way.

A. Yes.

Q. And another way is -- do you know what a novation is, sir?

A. Yes.
Q. And a novation is you find somebody who's got the money and you pay them and they come and they take over the contract for you. Is that right?
A. Yes.
Q. And that was something else that they could have done in 2007 to -- to offload some of these CDS agreements, correct?
A. As a hypothetical, yes.
Q. Okay. Well, you haven't inspected or looked at, one way or another, whether they actually could have done that, I mean, whether they --
A. I haven't investigated the market reality of that.
Q. Okay. Either way?
A. Either way.
Q. Okay. Now, so we've talked about the CDS portfolio and the CDOs. Now let's talk a little bit about the securities lending. Now, in securities lending, AIG exchanged securities for cash collateral, right? And we'll just go partner -- for the partner. Do you see that? So, AIG would send over securities --
A. So, it would lend a security to its counterparty.
Q. Okay. So, we have AIG and the counterparty. Do

you see that, sir?
A. Yes.
Q. Okay. So, they would send a security over to the counterparty, and the security -- the counterparty would return money or something very negotiable, but --
A. Yes, something that was equivalent to money, that's what they would send back.
Q. Okay. And so that's the lending. They're lending -- it's actually literal. They're lending securities, correct?
A. Yes.
Q. And the security loans were short term with an average of approximately 13 days.
A. I don't remember what the duration is, but --
Q. Okay. Well, let's go to your report at -- this is your initial report at Section 154. Just let me know when you're there, sir.
A. Paragraph 154?
Q. Yes, sir.
A. Yes. The second sentence says, "with an average term of approximately 13 days as of June 30th, 2008."
Q. Okay. So, I mean, no -- can we agree that it's 13 days, on average, for the security lending?
A. Yes.
Q. Okay. And after those 13 days, on average, then

the counterparty, if they wanted their money back, could ask to swap it back or it would come to an end and they would get their money back unless they decided to re-up for another round.

A. Yes.

Q. Okay. Now, so -- and AIG had this extra money, right, this money that they got from their partners as part of the lending program, correct?

A. That's right. So, they get the collateral from the counterparty, and then the agreement is that AIG will invest the collateral and split the return from that.

Q. And who suffers the losses if the -- if whatever they invest in loses money? It's AIG, right?

A. Well, that's not quite right. In the -- so, the RMBS portfolio is generating a return which is being shared with the counterparties. If AIG's not able to roll over its support for -- sorry, its -- roll over or, put differently, lend out more securities, then it has to finance that -- the portfolio that it holds for investing the collateral. So, if it doesn't get collateral from counterparties, it's got to finance that portfolio itself.

Q. Okay. So, let's break that down. So, the money comes in, and AIG puts the money in RMBSs, right?

A. Yes. So, it's got an existing portfolio that it's invested in.
Q. Okay. It's got a whole bunch of RMBSs, right?
A. Yes.
Q. And it's using --
A. I mean, it's got other types of securities in there, but the problem -- the ones that created the problem were RMBSs.
Q. Right. So, there's some other things here, too, but let's -- the RMBSs are more interesting, so let's talk about them.
A. Okay.
Q. So, it takes the money, and it -- it -- that it gets from its securities lending and it uses that to fund its RMBS portfolio, correct?
A. Yes.
Q. Okay. And -- now, the securities lending program's investment portfolio -- so, these RMBSs, these are -- are longer term investments, correct?
A. Yes.
Q. In fact -- and I'll be happy to show you where I think you say it in your report, but they average five years.
A. Yes. So, the -- the trade that AIG is doing is a carry trade. So, it's getting short-term funding,

investing in a long-term asset, so both the counterparty and AIG are benefiting from this carry trade.

Q. And I'm just capturing what you said there, sir. So, the securities lending is short-term funding, and the RMBS -- the RMBS portfolio was a long-term asset. Is that right?

A. Yes. And then --

Q. And --

A. -- the profit that is generated from that type of trade, which is called a carry trade, is that it's split between AIG and the counterparty.

Q. Right. And this, the short-term funding versus the long-term asset, that's a security mismatch, right?

A. It's a -- it's a --

Q. It's a funding mismatch. I want to get my --

A. It's a duration mismatch. What I mean by that is the duration of the short-term funding is shorter than the duration of the long-term investment.

Q. A maturity mismatch.

A. Yes.

Q. Okay. So, this is the duration/maturity mismatch.

Now, the decision to invest cash collateral from AIG's securities lending customers into those RMBSs was found to have been a misjudgment on the volatility and liquidity risks in the mortgage market. Do you agree with that?

A. I mean, we know with hindsight that this turned out to be a very risky trade that was done --

Q. Yes.

A. -- because of the financial crisis. We know that in hindsight.

Q. So, now, we talked about AIG, that they stopped their CDS contracts in subprime-backed securities because of the riskiness, right? We already talked about that, in 2005, 2006?

A. Yes.

Q. But even though AIGFP stopped doing that, AIG continued past 2005 to buy RMBSs which are based on the mortgage market, and they continued to do that in 2006 and 2007. Is that right?

A. Yes. The portfolio for the securities lending business was established in the 2006, 2007 time frame.

Q. Right. So, in fact, they were jumping into the RMBS mortgage pond just as AIGFP was starting to climb out of the pond, right?

A. Yes.

Q. Okay. And they bought -- the securities lending side bought RMBSs in 2006, 2007, and 2008, right?

A. I'm not aware of them buying them in 2008, but you can show me a document that shows that or I'll take your representation.

Q. Now, if we could go --

A. Because I -- because as I recall the composition of that portfolio, it consists of 2005, 2006, and 2007 RMBS, plus a variety of other types of collateral.

Q. Okay. And I'm going to capture the 2005, because I want it to be accurate here.

So, now I'm going to take you, sir, to your slides, PTX 5312. Actually, let's make it PTX 5309. Are you there?

A. Yes.

Q. Okay. And the heading says -- and I believe you had testified about this -- "Cumulative Default Rates on" -- I think this is sort of -- and I think the Court asked you a question, but this is sort of how many of these are starting to default six months after they were started, is that right, the mortgages?

A. Yes.

Q. Okay. And so things start getting bad on your chart here, for the vintage 2006, 2007, I mean, 3 1/2 percent are failing -- of these mortgages are failing six months after they were written. Is that right?

A. Yes.

Q. Okay. So, in 2006, when AIG is continuing to invest in RMBSs, we're already seeing mortgages failing six -- 3 percent -- 3 1/2 percent of mortgages failing within six months after they were written, correct?

A. Yes.

Q. And in 2007, we're seeing that that number is even rising. Is that correct?

A. Yes.

Q. And then the next page in your -- in your PTX, PTX 5310, that's showing that after 12 months, there's -- so, there's ones that were written in 2006, 12 months later, 2007, 12 months, we're already seeing 9 percent of them are failing, and AIG is still out there buying RMBSs, right?

A. Yes.

Q. Okay. No further questions on that slide, sir.

And I'm going to take you to DX 567, which should be in the white binder, sir. Just let me know when you're there, sir.

A. I am.

Q. Do you have an understanding of what this is, sir?

A. Attached to this email is a BlackRock PowerPoint presentation called "AIG Security Lending Portfolio Discussion, September 25th, 2008."

Q. Do you know if this -- I apologize, sir. Do you

know if this is one of the documents you looked at?
A. I'm sure I looked at this.
Q. Okay.
Your Honor, we move for the admission of DX 567.
MR. BOIES: If it's limited to 703, we have no objection, Your Honor.
MR. DINTZER: Your Honor, we move for it for substantive purposes. The witness has said he reviewed it as part of his analysis.
THE COURT: Well, that's the same standard we used yesterday.
MR. DINTZER: Fair enough.
THE COURT: Trying to pull a fast one on me, aren't you?
Defendant's Exhibit 567 is admitted with a 703 limitation.
MR. DINTZER: Fair enough.
(Defendant's Exhibit Number 567 was admitted into evidence.)
BY MR. DINTZER:
Q. Sir, I am going to take you to the page that's got -- if you just look at the Bates number, the 15512, and just let me know when you're there.
A. Oh, I see, the third page of the presentation.
Q. The third page of -- now, if you count that

first little slide, yes, sir.

A. Yes.

Q. Okay. And what you see on the screen is what we're looking at.

So, it says, "RMBS Portfolio Breakdown -- By Collateral, Vintage, and Seniority." Do you see that?

A. Yes.

Q. So, it's showing that -- and the document, I guess we should establish, the document is dated September 2008. Do you see that? September 25th, 2008.

A. Yes.

Q. Okay. And then we see a collateral breakdown. The heading is "RMBS Portfolio Breakdown." So, that's this RMBS portfolio that we have been talking about for securities lending, right?

A. Yes.

Q. And it says "Collateral Breakdown," and then it shows -- it shows -- there's a big bar there, and it shows subprime at 20 billion and change and Alt-A ARM as 12 billion and change. Do you see that?

A. Yes.

Q. So, if we look at the -- so, we see that 32 billion of this AI -- this RMBS portfolio, 32 billion of it is in either subprime or Alt-A, right?

A. Yes. So, the underlying -- the collateral underlying each of the RMBS portfolios, so it's the -- you've got a structured investment vehicle that's holding the collateral, and then that's tranched out. If you look at the collateral composition underlying all of the RMBS, this is the breakout.

And then to the right, to the far right -- then in the middle it tells you what the average composition is by vintage. And then to the far right, I'm presuming that this is the seniority of the bonds that AIG Securities Lending's investments were held in.

Q. Okay. And actually, that's very helpful, sir. So, these are aggregated -- I mean, there are individual RMBSs in here, but these are sort of the aggregating of what is collectively held in those RMBSs, correct?

A. That's how I understand this slide.

Q. Okay. So -- and we've got subprime -- and I know you defined Alt-A yesterday, but if you can just confirm, Alt-A is below prime. Is that right?

A. Yes. It's between prime and subprime.

Q. Okay. And so then what the middle shows us is that about 50 percent of the subprime had a vintage of 2006, right?

A. That's how I'm interpreting this slide.

Q. And 25 percent of the subprime had a vintage of 2007, right?

A. Yes.
Q. So, if -- if BlackRock's analysis is correct, about 70 percent of the subprime in the RMBS portfolio was vintage 2006 and 2007.
A. Yeah. I think the big "if" is if we understand this slide properly. I'm pretty positive they did the analysis right, so...
Q. Okay. And then if we look up at the Alt-A, we can see that about 74 percent of that is vintage 2006, 2007 as well. Is that right?
A. That's what that arrow suggests to me.
Q. Okay. Okay. And -- no further questions on that document, sir.
And, sir, I believe I saw you here when Dr. Kothari was here. Is that right?
A. Yes.
Q. And I'm just going to show you some of his testimony, but I'm going to pass out the transcript for the whole day, just in case.
I'm sorry, I forgot to ask, may I approach, Your Honor?
So, this is the transcript of -- you know, the days start to run together, but this is the transcript with Dr. Kothari's testimony, and if you go to page -- transcript page 4870, and just let me know when you're

there.
A. Yes.
Q. And Dr. Kothari was sometimes answering rather on a longer scale, and so this answer begins on transcript page 4869, and it goes all the way to 4872, and so I'm certainly not going to make an effort to read that into the record. You are welcome to read any part of that, anything that you want to see here.
I'm going to ask you about a portion that's on 4870 --
A. Do you mind if I just read it so that I know the context?
Q. You are welcome to read as much as you want, sir. It might be easier if I -- let me show you the question I'm going to ask you.
A. Okay, that would be great.
Q. Okay. On 4870, at the beginning, it says, "Then they also had a financial products business, and they had made some -- made use of some proceeds that they had received from securities lending to invest in risky products."
Do you see that?
A. Yes.
Q. And so the only thing I'm going to ask you is, do you agree with Dr. Kothari that AIG Securities

Lending used its proceeds to invest in risky products? And you are welcome to read anything else.

A. Can I read -- since this has a bunch of pronouns, let me try to figure out what they refer to.

Q. Feel free.

A. (Document review.) All right. So, what was your -- I think I understand. What was your question?

Q. At the top of page 4870 -- and you can see it on the screen, too -- Dr. Kothari says, "Then they also" -- I believe he's talking about AIG -- "Then they also had a financial products business, and there they had made use of some proceeds that they had received from securities lending to invest in risky products."

Do you see that?

A. Yes.

Q. Okay. And so we've been talking about securities lending, and so my only question is, is do you agree with Dr. Kothari that they used the proceeds from securities lending to invest in risky products? Yes or no.

A. So, I don't understand what he's referring to specifically here. In the securities lending business, my understanding is that if you look at the portfolio, they invested in a mixed asset portfolio which included a lot of RMBS, which, as I talked about yesterday, ended up being at the heart of the financial crisis since they became very difficult to finance.

And also, apparently, because there was a run on AIG's short-term funding, AIG wasn't able to continue funding its RMBS portfolio in the way it could traditionally.

Q. Okay. So, I'm not going to ask you about Dr. Kothari. I'm just going to ask -- yes or no -- were these assets that AIG invested its securities lending money in risky at the time that they made the investment? Yes or no.

A. I --

Q. Yes or no or I don't know.

A. It's hard for me to answer that categorically, because I need to explain what my definition of "risk" would be.

Q. You can explain as much as you want, but first I need an answer.

A. No. The RMBS portfolio, as well as the other assets that were in that securities lending portfolio, were high rated assets for the most part, Aaa, some super senior, you know, a small fraction of lower rated bonds, but it was a diversified portfolio. And at the time of the investment, if you look at the expected returns on those assets, they would represent, on an ex ante basis, a low-risk portfolio.

With the benefit of hindsight and what we now know about the financial crisis, we know that RMBS investments in the short term turned out to be -- to have a lot of liquidity risk because of the financial crisis. In the longer term, high rated RMBS port -- securities continued to perform. And ultimately, the risk for AIG with regards to the RMBS underlying securities lending was one of a liquidity risk, that they couldn't fund the portfolio because of a run that it experienced on its wholesale lending in September.

Q. Do you believe that AIG's decision to get out of the -- to stop writing additional CDSs because of what they perceived as increased risk in the mortgage market at the same time that the securities lending portfolio was buying RMBSs in that mortgage market, that these two things happening at the same time demonstrated a failure of enterprise risk management at the company? Yes or no.

A. I don't have an opinion on that.

Q. Okay.

A. It would be completely typical, though, in a financial services firm, with a trillion dollar portfolio, to have -- I mean, in aggregate, where you have probably hundreds of portfolio managers, to be doing different things and putting together packages of different trades which will look different. You know, if you take some trades from one portfolio and some trades from another portfolio, they look like they're inconsistent with each other.

Q. And this looks like it's inconsistent with each other, doesn't it?

A. I think there are different reasons that AIGFP left the CDS market than why Securities Lending was investing in RMBS. They're actually -- we -- I think you've -- in the course of our conversation, we have been blending these securities together. They're actually different types of securities, and there are different reasons for why they withdrew.

I certainly know that obviously PwC, in their testimony earlier this week or last week, you know, identified enterprise risk management. I haven't done that analysis to be able to --

Q. Are you --

A. -- come to the same conclusion, either way.

Q. Are you an expert in enterprise risk management, sir?

A. I know what enterprise risk management is. I have not done that analysis here.

Q. Do you hold yourself out as an expert in

enterprise risk management?
A. As I say, I --
Q. Yes or no, sir.
A. -- I know what enterprise risk management is, I know how it works, how you do it. I could do that, but I didn't do that here.
Q. Okay. So, if you could turn to page PTX -- to Exhibit PTX 589 and please turn to exhibit page 49.
A. So, this is the June 9th Oversight Report?
Q. Yes, sir. And we're at the document page 48 but the exhibit page 49. And we're going to turn to that first full paragraph. Do you see that?
A. I'm sorry. I've got -- there are several extracts here. All right.
Q. Page -- exhibit page 49, it begins, "While the problems at AIGFP can be viewed as a valuation and risk management failure, exacerbated by accounting issues, the life insurance subsidiaries' securities lending business was a blatant risk-management failure."
Do you see that?
A. I do.
Q. Do you agree that -- with the Oversight Report that the securities lending business was a blatant risk management failure? Yes or no.
A. I would not describe it that way.

Q. Yes or no, sir.
A. No.
Q. "The decision to invest cash collateral from the firm's securities lending customers in RMBS represented a misjudgment of the volatility and liquidity risks in the mortgage market."
Do you agree that -- with that sentence, that the decision to invest cash collateral represented a misjudgment of volatility and liquidity risks? Yes or no.
A. No. I don't know what the basis for that judgment is.
Q. "It was the duration mismatch on these investments" -- and we talked about that -- "in the context of the collapse in the mortgage market that created a liquidity crunch for the parent company."
Do you see that?
A. Yes.
Q. And then it goes down, "In addition, the life insurance subsidiaries were ramping up the purchases of RMBS at the same time that AIGFP had decided to stop writing swaps on subprime mortgage backed securities because of the riskiness of the underlying bonds, highlighting the failure of enterprise risk management at the company."

Do you see that?

A. Yes.

Q. And I understand that you haven't done the analysis, so you don't have an opinion as to whether there was a failure of enterprise risk management at the company, correct?

A. That's right.

Q. Okay. No further questions on that document, sir.

Now, when AIG wrote the CDS contracts, it had a Aaa rating, is that right, at least a lot of them?

A. When AIG wrote its contracts?

Q. Yeah. So, it talked about when it would have to post collateral, and when AIG -- and we talked about how AIG was at one point the largest CDS writer in the country, right?

A. Yes.

Q. And when it wrote --

A. On these types of securities.

Q. On multisector CDOs. Is that correct?

A. Yes.

Q. Okay.

A. When the market was small, it was one of the largest writers.

Q. And AIG at one point had a Aaa rating. Is that right?

A. Yes.

Q. And do you remember when -- the first time it took a hit and went down?

A. I think it was 2005 or thereabouts.

Q. And that meant -- and when it had a Aaa rating, I mean, when it took that first jump, did it have to post collateral right then?

A. No.

Q. Did that first --

A. At least on these contracts, it didn't.

Q. Okay. And that's all I'm asking about, sir, just so we're clear, because I appreciate that you want to be clear on this. I'm only asking you about the CDS contracts on the multisector CDOs.

A. Okay.

Q. Okay. And if I'm asking about anything else, I'll let you know.

A. Great.

Q. The -- will you agree that the economics and risks of the CDS business changed with the ratings downgrade from Aaa?

A. Can you repeat that again?

Q. Sure. The economics and risks of the CDS business for AIG changed with the ratings downgrade from

Aaa.

A. Not necessarily, no.

Q. Okay. So, I'm going to take you back to 589, and I'm going to take you to page 36, if you can just let me know when you get there. And we're still in the June Oversight Report, and that's exhibit page 36.

A. Okay.

Q. At the top, the first incomplete paragraph, it says, "In fact, as noted above, legacy positions on AIGFP's books would soon reflect the more problematic credit issues as older reference securities were replaced with more suspect ones by CDO managers."

Do you see that?

A. Yes.

Q. And that's the substitution issue that we talked about?

A. I presume that's what this is referring to.

Q. Okay. Then the next sentence says, "Former AIG CEO Hank Greenberg has asserted publicly and in a conversation with Panel staff that the company should have exited the multi-sector CDO sector after AIG lost its AAA rating in March 2005, arguing that the economics and risks of this business changed with the ratings downgrade, since counterparties could contractually demand more collateral if the value of the CDOs began to

deteriorate."
Do you see that?
A. Yes.
Q. Do you agree with that, that at the time they should have said that the economics have changed and we should get out of this business?
A. I see that's what he said, yes.
Q. Do you agree with that, sir?
A. I haven't analyzed his statement.
Q. Okay. No further questions on that document.
Now, AIG lost money in the first quarter of 2008. I think we looked at that a little bit. Is that right?
A. Yes.
Q. A $7.8 billion loss. Do you recall that?
A. We had looked at -- the basis of that discussion was a letter from three shareholders.
Q. Okay. So, let's see if we can nail that down, and I'm going to take you, sir, to DX 126. And we talked about how there were multiple downgrades, right?
A. Yes.
Q. Different agencies downgraded. This is -- this is put out by Standard & Poor's. Is that right?
A. Yes.
Q. And it's dated May 8th, 2008.

A. Yes.
Q. "American International Group Rating Lowered to 'AA-' from 'AA.'" Is that right?
A. Yes.
Q. And the record should reflect this, but each rating agency has their own set of ratings, right?
A. Unfortunately, yes.
Q. So, each rating agency's best rating is different from every other rating agency's best rating. Is that correct?
A. The nomenclature is different.
Q. Okay. But in this case, Standard & Poor's was talking about lowering -- they -- AIG had had a AA and now it's going to AA-. Is that right?
A. Yes.
Q. And if you go to the second page of -- and, Your Honor, if we could move DX 126 in -- actually, did you review this as part of your analysis?
A. I've looked at lots of ratings reports. I don't remember whether this one specifically I looked at, but given that it was in May, I would -- I would expect that I, you know, looked at this one specifically. We can see if it's in my documents relied on, but --
Q. I mean, you are welcome to.
Your Honor, I would just move this in through

703 right now.

MR. BOIES: No objection on that basis, Your Honor.

THE COURT: All right, Defendant's Exhibit 126 is admitted with a Rule 703 limitation.

(Defendant's Exhibit Number 126 was admitted into evidence.)

BY MR. DINTZER:

Q. And the first paragraph on the second page talks about the action that it's taken, and then the second paragraph says, "These ratings actions follow the company's announcement of an after-tax loss of $7.8 billion in the quarter ending March 31, 2008."

Do you see that?

A. Yes.

Q. Okay. And I just wanted to nail down that there was a $7.8 billion loss for the first quarter for AIG in 2008.

A. That's what it says here.

Q. Do you have any reason to doubt that, sir?

A. No.

Q. Okay. And it says, "The loss includes charges of $5.9 billion (after taxes) for market valuation losses on AIG Financial Products (AIGFP) super senior credit default swap (CDS) portfolio," and I'll just stop there.

So, at that point, that loss includes almost $6 billion related to the CDS portfolio. Is that correct?

A. Yes.

Q. Okay. And so in the first quarter of 2008, AIG lost almost $6 billion on its CDS portfolio.

A. Yeah, on a mark-to-market basis.

Q. On a mark-to-market basis. And the record is perhaps a little thin on mark-to-market, so let's take two minutes and just -- just nail that down.

So, I buy an asset, let's call it an -- I mean, it could be anything, but let's call it a bond, and on the day I buy it, I pay $100. Is that correct?

A. Yes.

Q. Okay. And every day after that day, the price of the bond could go up or it could go down. Is that correct?

A. Yes.

Q. But on my books, the book value will stay $100, correct?

A. Well, it depends on the circumstances, but --

Q. In a simplified -- just for the sake of explaining mark-to-market on the record.

A. Yeah.

Q. Okay. This would be the book value.

If I'm required to mark it to market -- to mark it to market -- then the M-to-M value is whatever its current price happens to be at whatever time I'm looking at, as opposed to the book or carry -- initial carrying value.

A. Yes.

Q. Okay. And so when you say on a mark-to-market basis, they lost $6 billion on their -- on their CDS portfolio, AIG did, in the first quarter on a mark-to-market basis, which just means that that was its current value, right?

A. No.

Q. Okay. Well, let me put it this way. They identified a $6 billion loss in their portfolio on a mark-to-market basis, AIG did.

A. Yes.

Q. Okay. And the sentence goes on, "and $3.6 billion of other-than-temporary impairments on investments, largely related to U.S. residential mortgage-backed securities." Is that right?

A. Yes.

Q. Okay. So, that first quarter of 2008, AIG's -- AIG's $7.8 billion loss was centered on the CDS portfolio, which was about $6 billion, and $3.6 billion on its RMBSs, correct?

A. Yes.
Q. Okay. And then the next paragraph says, "Although we expected that AIG would have some losses in the first quarter, the level of the additional losses exceeds these expectations. AIG guarantees AIGFP's obligations, so the potential strain of the losses to the parent contributed to the downgrade."
Do you see that?
A. Yes.
Q. So, the losses AIG incurred in the first quarter were larger than expected. Is that correct?
A. That's what it says.
Q. And do you have any reason to doubt that?
A. No.
Q. And then the second part is, is that AIGFP is technically a subsidiary of AIG. Is that correct?
A. Yes.
Q. And so because AIG has guaranteed basically everything that AIGFP does, losses for AIGFP are losses for AIG.
A. Well, these contracts -- specifically, the AIG parent is a guarantor of AIGFP in these contracts.
Q. So, there's a specific contractual obligation that when these CDSs were written, that AIG, the parent, would use its resources to make the contractors whole.

Is that right?
A. Yes.
Q. Okay. So -- and I'll put that.
Now, those May 2008 downgrades that we talked about led to collateral calls from AIG's counterparties. Is that correct?
A. I don't recall what the change in the threshold numbers were there. If you look at my graph of the collateral calls, there's a small increase in May, which I presume is related to that downgrade, but I haven't parsed out or I don't remember how that increase parses out between changes in the marks versus change -- you know, changes in the threshold amounts. The big -- the big downgrade impact happened in September.
Q. Okay. If you could go to DX 191. Just let me know when you're there.
A. Yes.
Q. And is this something that you saw as part of your analysis?
A. I don't remember looking at this.
Q. Okay. This is a letter -- I'm sorry, this is a memo, an internal memo from Howard I. Smith, vice chairman of finance at C.V. Starr, to Mr. Greenberg. Do you see that?
A. Yes.

MR. DINTZER: Your Honor, this is marked as DX 191, and we would like to move for its admission.

MR. BOIES: No objection, Your Honor.

THE COURT: All right. Defendant's Exhibit 191 is admitted.

(Defendant's Exhibit Number 191 was admitted into evidence.)

BY MR. DINTZER:

Q. And the subject line says, "AIG-6/30/08 10Q Disclosure, Securities Lending Program." Do you see that?

A. Yes.

Q. And it says, in the first full sentence, "It is astounding to comprehend this disclosure with respect to both the current size of the program and the risky collateral that is being invested in by AIG." Do you see that?

A. Yes.

Q. And so I'll ask you, sir, did you understand that in August 2008 AIG's RMBS portfolio was a risky investment?

A. I don't know what they -- what -- what they mean here.

Q. Okay. So, you don't know one way or the other.

A. Not with regards to the document, no.

Q. And so the next sentence says, "Again, where is AIG's Risk Management process?" Do you see that?

A. Yes.

Q. Okay. So, in August of 2008, AIG's largest investors were concerned about the riskiness of the collateral in the RMBS portfolio. Is that correct?

A. Well, Mr. Smith is writing to Mr. Greenberg in a very shorthand way that would seem to be that's the sentiment he's expressing to Mr. Greenberg, whose letters we saw earlier.

Q. And then at that same time he's questioning AIG's risk management process. Do you see that?

A. Yes.

Q. Do you -- is it your opinion that AIG's risk management process, in April, May, June, July, August, did not lead to some of the effects that AIG felt in 2008, as far as its losses?

A. I haven't analyzed whether it's "some." What I've shown is that the cause of AIG's problems were liquidity problems that relate to primarily the securities lending and CDS portfolios that are a result of the financial crisis.

Q. Right. And so my only question is, is with respect to the causes of those and with -- anything else at AIG, did you trace it back to find a failure of risk

management at AIG?
A. No. I traced it back to the impacts of the financial crisis.
Q. Okay. So, you aren't -- you don't have any concerns about AIG's risk management process in August of 2008.
A. I haven't developed a -- that opinion, no.
Q. You don't -- okay. No further questions on that document, sir.
Now, let's go to DX 211, and as the second page of the document demonstrates, this is a memo from Howard Smith to Mr. Greenberg on September 2nd, 2008. Do you see that?
A. Yes.
Q. And it's on C.V. Starr stationery. Do you see that?
A. Yes.
Q. And then the first page, which I assume was like a Post-it or something that was on it, it says, "From Howie for a meeting with Willumstad." Do you see that?
A. Oh, I'm not sure it's a Post-it. It's --
Q. Well, or a page or whatever it is. Do you see -- I just want to make sure we have the same first page.
A. Oh, yes.

MR. DINTZER: Your Honor, we move for the admission of DX 211.

MR. BOIES: No objection, Your Honor.

THE COURT: Defendant's Exhibit 211 is admitted.

(Defendant's Exhibit Number 211 was admitted into evidence.)

BY MR. DINTZER:

Q. So, this is September 2nd, 2008, and I'm not going to take you through the whole memo, but I am going to take you through to what's Bates numbered page 57 -- 576. Just let me know when you get there.

A. Okay.

Q. Okay. And the heading here is -- and you can verify this with the rest of this, but the heading here is "Page 16 - 10-K (2007)." Do you see that?

A. Yes.

Q. And then it's "Comments on Risk Management." Do you see that?

A. Yes.

Q. And then there's a big, long quote that I'm guessing -- and I'm not going to ask you, of course -- but it appears to be quoting from AIG's 10-K in 2007, but I am not going to ask you about that, so -- the thing I am going to ask you about is the sentence after the quote. Do you see that?

A. Yes.
Q. And that is, "It appears that their procedures to mitigate risk in the credit default swaps were a colossal failure!" Do you see that?
A. Yes.
Q. Okay. Did you come to the conclusion that AIG's efforts to manage risk in the credit default swaps were a colossal failure?
A. I haven't analyzed the procedures to mitigate risk.
Q. For AIG?
A. For the credit default swap portfolio.
Q. Okay. And you haven't analyzed AIG's efforts, or lack thereof, to mitigate risk in the CDS portfolio. Is that correct?
A. Yeah. I haven't done an analysis which would allow me to, you know, comment either way on Mr. Smith's views about these procedures being a colossal failure.
Q. Okay. Now, when AIG wrote the CDS contracts, they didn't anticipate that they would have to pay out on those agreements. Is that right?
A. Yeah, that was their design.
Q. Okay. And they didn't have a plan -- AIG didn't have a plan for how they would pay the CDS contracts if all the CDOs collapsed.

A. I think AIG, like every financial services company, any significant financial services company, didn't have a plan for the financial crisis.

Q. Right. And I'm not asking for the financial crisis. I'm just saying that they wrote these contracts, and they didn't have a plan for how they would pay these contracts if the CDOs all collapsed.

A. I don't know.

Q. Okay. On September 15th, the stock market understood that AIG faced the possibility of bankruptcy, correct?

A. Yes.

Q. They -- the company faced -- in your rebuttal report, you called it "tyrannosaurus-like risks with no predictable outcome." Is that correct?

A. If you could point me to where that is.

Q. Let's go to your rebuttal report at Section 32. The last full sentence on page 28 of your rebuttal report, you write, "On September 15, the level of implied volatility," and I'll skip the parenthetical, "was described by one commentator as 'suggesting nearly three times the perceived risk to AIG shares as the company faces tyrannosaurus-like risks with no predictable outcome.'"

Do you see that?

A. Yes.

Q. Do you agree with, at the time, that AIG shares faced -- that the company faced tyrannosaurus-like risks with no particular outcome?

A. The level of volatility -- of implied volatility was described that way. So, this is a comment about volatility.

Q. Right. And all I'm asking you, sir -- I mean, you have quoted the information, and I'm just asking you if you agree with it, that AI -- that the company faced -- I'm asking you, do you or don't you believe that AIG faced tyrannosaurus-like risks with no predictable outcome on September 15th? Yes or no. Yes or no, sir.

A. Well, the reason I'm hesitating is this is a comment about the volatility, and so I'm trying to evaluate how this applies to your question.

Q. Okay. So, close the book. Now -- close the -- I'm done asking you a question about that. Close the book.

Do you believe that on September 15th, 2008, AIG faced tyrannosaurus-like risks with no predictable outcome? Yes or no.

A. I think it's very -- it's very -- on September 15th, it's very hard to know what was going to happen to

AIG.
Q. So, yes?
A. Well, I'm -- I'm not using -- I'm not using the word "tyrannosaurus-like," because I don't know what -- I'm trying to answer your question about the types of risks they faced, which was -- it was a highly uncertain period of time.
Q. Tyrannosaurus-like?
A. That comment relates to volatility and how market commentators were reflecting on AIG's volatility.
Q. And the risk that the company had -- and how the volatility showed the risk of the company, correct?
A. Volatility is considered to be a measure of risk.
Q. Okay. Before the announcement of financial assistance by the Fed on September 16th, equity investors were faced with the uncertainty as to whether AIG could find outside financing to meet its liquidity demands, correct?
A. Yes.
Q. On September 15th, the risk of bankruptcy contributed to the decline in AIG's value, correct?
A. Yes.
Q. Once AIG received assistance from the New York Fed, its value increased.

A. That's a fact, yes.
Q. Now, if you could go to your slides, to PTX 5337. Now, you used this slide to discuss AIG's riskiness. Is that correct?
A. Yes.
Q. And you talked about a comparison, sort of, of AIG's leverage as compared to other institutions. Is that correct?
A. Yes.
Q. Now, leverage is a measure of how much debt an investor assumes in making an investment. Is that right?
A. It's a component of that, yes.
Q. And here you measure leverage as "liabilities divided by market value of equity." Is that correct?
A. Yes.
Q. This measure of leverage does not include the collateral posting requirements that existed in AIG's CDS portfolio, correct?
A. Yes. It doesn't include that kind of -- yes.
Q. Okay. And this -- this measurement of leverage does not include the risk in the mismatched securities that existed in AIG's securities lending portfolio, correct?
A. I mean, the measure is what it is. It

doesn't -- it -- I'm not sure whether it does or it doesn't include that specific risk.

Q. Okay. No further questions on that document, sir.

The U.S. approaches businesses with a belief in competition. Is that correct?

A. We generally have a -- I think that's a -- you know, a principle of --

Q. It's not meant to be a trick question.

A. -- our American democracy and -- yeah.

Q. In the U.S., we embrace the concept that businesses can fail, correct?

A. It is -- we accept failure.

Q. That's part of a capitalist system, correct?

A. It is.

Q. And, in fact, business failures are a normal outcome of the competitive process. Is that correct?

A. Yes.

Q. Sir, you were not asked to create a but-for world in this case, and you did not do so, correct?

A. I haven't been -- I haven't been asked to create a but-for world.

Q. And you didn't do so.

A. I haven't expressed that opinion, no.

Q. You didn't perform an analysis on what the range of scenarios could be if the New York Fed hadn't provided liquidity assistance to AIG in September 2008. You have not done that analysis.

A. I haven't provided a range of scenarios, no.

Q. And you haven't sought to --

A. I've talked a lot about alternative scenarios, but I haven't said, you know, "Here is the range of scenarios."

Q. And you haven't quantified what would have happened to AIG absent any government assistance.

A. No.

Q. And as you said in your deposition, there are many different things that could have happened absent the credit agreement. You haven't analyzed what AIG's value would have been in these alternative states, correct?

A. Correct.

Q. Now, on the evening of September 16th, AIG's board gathered to consider the Fed's loan offer. Is that right?

A. Yes.

Q. And they determined that it had two options. They could seek immediate support from the Government or bankruptcy. Is that correct?

A. Those were two of the options they considered.

Q. Those were the choices that the AIG board had on September 16th, correct?
A. That's how -- I would say that's how they are phrasing the decision they were making.
Q. Now, the primary dealers, you've talked about the primary dealers, and let's turn to that for a minute. The primary dealers have a role in -- in the Fed's operations. Is that correct?
A. Yes.
Q. They -- they engage with the Fed in open market operations, correct?
A. Yes.
Q. And were there 17 primary dealers in 2008?
A. I think that's right.
Q. And as part of being a primary dealer, there's an expectation that the primary dealer will regularly solicit trade desire from the customer to the Fed. Is that right?
A. Yes.
Q. So, let's just take another minute and -- so, we have the Federal Reserve. Is that right?
A. Yes.
Q. And then there are 17 primary dealers. Is that correct? I'm not going to draw all 17.
A. Yes.

Q. And the Federal Reserve -- and the primary dealers then have customers; each one of these has customers, right?
A. Yes.
Q. And the process by which -- the primary dealers are soliciting requests to buy securities from the customers. Is that correct?
A. Well, they are typically making a market. So, they are soliciting, you know, buy/sell orders from customers.
Q. Okay. And so here's the customers, and what -- when you make a market, basically you have to be the middle man. You're the person who brings them in and sells them and sort of carries them in between the purchases, right?
A. Yes.
Q. And so -- and in that process, they help the Federal Reserve when it sells securities. Is that right?
A. Buys or sells. So, the open market desk is making buy/sell orders itself.
Q. And so -- and there's 17 of these. So, the Federal Reserve needs these primary dealers to play the role of making a market, but -- between basically the rest of the world and the Federal Reserve. That's how

it uses them, correct?
A. That's how it's -- the market's structured now, yes.
Q. Okay. And it's been structured that way for years, correct?
A. Well, it's changed as time's gone -- you know, as technology's evolved and so on, but, yeah, that's -- that is generally how markets -- that's what market structures look like in a diagrammatic way.
Q. And this is the structure, sort of the Federal Reserve and the primary dealers and the customers, this is the structure that existed in 2005, 2006, 2008, in that time period.
A. Yes.
Q. Primary dealers had a special relationship with the Fed in implementing fiscal policy, correct?
A. This is the relationship.
Q. And it was unique. They are the only ones who had that relationship.
A. Yes.
Q. Now, the Federal Reserve limited access to the primary dealer credit facility to primary dealers, correct?
A. Yes.
Q. And you said something in your -- in your

testimony with Plaintiffs' counsel, the PDCF was not open to broker-dealers, correct?
A. It was open to primary dealers.
Q. But do you know what a broker-dealer is?
A. Yes.
Q. What's a broker-dealer?
A. They're generally a market maker in securities.
Q. In securities but not in -- they don't have the same relationship with the Fed.
A. Yeah, broker-dealer -- so, there are many, many broker-dealers. There are more broker-dealers than there are primary dealers. Primary dealers are a subset of broker-dealers that specialize in open market operations with the Federal Reserve. So, broker-dealers also are primary dealers in that they're engaged in market making and many other securities.
Q. Okay. And without getting -- they're -- the primary dealers are broker-dealers, but not -- it sounds like a law school test. Every primary is a broker-dealer, but most broker-dealers are not primary dealers, correct?
A. Yes. It sounds like a PSAT test.
Q. Yes, it does.
So, the -- and the broker-dealers did not have access to the PDCF, correct?

A. That's right.
Q. In fact, the definition of the PDCF was never expanded beyond the 17 primary dealers.
A. That's right, although when Morgan Stanley and Goldman Sachs became bank holding companies, their foreign subsidiaries were given access to the PDCF, as was Merrill Lynch's foreign subsidiaries.
Q. And I want to clarify that, sir. You said "when." Becoming a bank holding company -- and you didn't really talk about bank holding companies, I don't think, too much in your direct, but becoming a bank holding company doesn't expand an entity's access to the -- to the primary dealer credit facility, does it?
A. No.
Q. In fact, I mean, Goldman Sachs and Morgan Stanley, they had access to the primary dealer credit facility even before they became bank holding companies, correct?
A. Yes. Their foreign subsidiaries didn't, so --
Q. Their foreign subsidiaries didn't, and I'll ask you -- and I might have to come back after lunch to show you something, but do you know if getting -- becoming bank holding companies -- and there's testimony about both of those becoming bank holding companies -- if that was the thing that got their foreign entities access as

primary dealers? Do you know that? I mean, and I -- I'm sorry, I asked a bad question. Let me clean it up.

So, we have Morgan Stanley and Goldman Sachs, and we know that at some point they became bank holding companies, right?

A. Yes.

Q. And before they became bank holding companies, they were already primary dealers, so they already had access to the primary dealer credit facility, generally.

A. Yes.

Q. Around -- at the time that they became bank holding companies, something else happened as well, right, with respect to their foreign entities?

A. Yes.

Q. Okay. Their foreign entities also got some access to the PDCF. Is that correct?

A. Yes, theirs and Merrill Lynch's.

Q. Okay. MS, GS, and Merrill Lynch. I'm glad you said Merrill Lynch, because is Merrill Lynch a bank holding company?

A. No. They were part of B of A.

Q. Okay. And so my question for you, sir, is this: Do you know if, by becoming bank holding companies, that's what got the foreign subs access to the PDCF or if it just happened to happen at the same time?

A. I don't think there's a legal link between their being bank holding companies and getting access to the PDCF. So, I don't see a -- a legal necessity that combines those two outcomes together.

Q. Okay. So --

A. They happened contemporaneously.

Q. They did happen contemporaneously, at the exact same time really, right? Okay, I won't ask you that.

But -- they happened contemporaneously, but becoming bank holding companies alone, that thing did actually not get Morgan Stanley or Goldman Sachs any broader access to the PDCF, correct?

A. That's my understanding.

Q. Okay. And so -- and Morgan Stanley and Goldman Sachs becoming bank holding companies, that alone did not increase any risk to the Federal Reserve, correct?

A. I'm not sure how you're thinking about that.

Q. Well, okay. Bank holding company is a status, right?

A. Yes.

Q. And when you're a bank -- and the -- the Board of Governors has to approve you to become a bank holding company. Is that right?

A. Yes.

Q. And so it can approve you or it can deny you as

a bank holding company, correct?
A. Yes.
Q. And -- and they -- Morgan Stanley and Goldman Sachs got approved by the Board of Governors to become bank holding companies, right?
A. Yes.
Q. By doing that, by changing their status, the Board of Governors wasn't taking on any increased risk to the Federal Reserve. That one step did not, correct?
A. I'm not sure that's clear. The intention was to demonstrate a greater commitment to these institutions by the Federal Reserve. So, that was -- that was the intention of doing that, was to enhance market confidence in these institutions.
Q. Absolutely, market confidence. But market confidence, that alone did not -- if you opened the Board of Governors' books the next day, there is not an increased risk on the -- on the Board of Governors' books simply by making them bank holding companies, that one step. Whatever it was signaling to the market, whatever else might happen in the future, that step did not. Will you agree with me on that?
A. Yeah. It's like the GSEs, where you may say, well, there's no actual legal guarantee to the GSEs, but there is a perception of support, and once the market

starts to build its confidence about -- around that perceived support, it may end up -- you know, the Government may end up having to perform on that perceived obligation, as is what happened with the GSEs in September.

Q. And so I'm going to hit on that word, "legal." As you understand it, on the day that Morgan Stanley and Goldman Sachs became bank holding companies, there was no increased legal obligation by -- or opening of a facility that they didn't have, to these entities by the Board of Governors of the Federal Reserve, correct?

A. I haven't done the -- I don't know what the legal obligation was specifically.

Q. You don't know. You don't know.

A. I don't.

MR. DINTZER: With that, Your Honor...

THE COURT: I think that's our signal.

MR. DINTZER: I was trying to -- I'm getting so I can time it there, Your Honor.

THE COURT: Well done. Let's take a lunch break. We will reconvene at 1:45.

(Lunch recess, 12:45 p.m. to 1:45 p.m.)

AFTERNOON SESSION

(1:45 p.m.)

THE COURT: Thank you. Please be seated.

You are excused, Dr. Cragg, because we cannot start without you.

THE WITNESS: My apologies.

THE COURT: Please go ahead.

MR. DINTZER: Thank you, Your Honor.

BY MR. DINTZER:

Q. Good afternoon, Dr. Cragg.

A. Good afternoon.

Q. So, in 2008, AIG was not a primary dealer, right?

A. Correct.

Q. And they actually never became a primary dealer.

A. As far as I understand, yes.

Q. And for AIG to get access to the primary dealer credit facility would have required it to become a primary dealer, one, or the Federal Reserve to change the criteria to allow AIG to become one anyway.

A. Yes, or to give access to it.

Q. Either way, it would have required a Board of Governors vote to make AIG -- to give PDCF access to AIG, correct?

A. I'm not sure whether it would require that vote, but --

Q. You don't know one way or the other?

A. I think it -- it obviously would require some legal analysis and perhaps a vote.

Q. All right. Becoming a primary dealer, separate from the Board of Governors' approval as one, requires that you be able to make a market, like we discussed, right?

A. To be a primary dealer, yes.

Q. And that requires liquidity. Is that correct?

A. That's -- I don't remember the list of criteria, but soundness would be a -- you know, a criterion which they would use, and that would, you know, connote liquidity.

Q. So, soundness and liquidity would have to be something that a primary dealer had to be able to make a market and to be -- let me try that again.

For -- to be a -- to make a market as a primary dealer requires both soundness and liquidity, correct?

A. Well, I think it's not that simple, but, you know, given what we know from the period of 2008, how the primary dealers were able to actually, you know, play their role in the open market operations was independent of their own soundness and liquidity, that they were obviously having plenty of trouble themselves but were able to function as market makers in spite of that.

Q. And so I'll take out the soundness. I just want to make sure I've got the right -- the answer, sir. To make a market, to be able to be the person who's buying and selling and the middle man in a series of transactions, requires a certain amount of liquidity. Is that correct?

A. Yes.

Q. Now, AIG talked about the possibility of becoming a primary dealer, correct?

A. Yes.

Q. And it thought it would take between six and twelve months for it become a primary dealer from where it was in August and September 2008, correct?

A. I know that in presentations they had from McKinsey, that was a number that was presented to them.

Q. Between six and twelve months, correct?

A. Yes.

Q. And you don't have any reason to doubt that that's the time -- somewhere between that time period it would take to become a primary dealer or at least to apply to -- to --

A. Yeah. If you went through the process of becoming labeled a primary dealer, that's typically how long it took. Now, obviously, in 2008, typical durations for those types of processes -- processes changed dramatically with, you know, some processes being, you know, shortened to hours as opposed to months.

Q. Some processes perhaps, sir, but no new primary dealers were created in 2008, were they?

A. No.

Q. Or 2007 or 2009, were they?

A. Not that I'm aware of.

Q. And so for the primary dealer part, there was no acceleration of anybody becoming a primary dealer. Isn't that correct?

A. Correct.

Q. And -- now, the primary -- the PDCF rate, that rate is tied to the -- to the federal funds rate. Is that correct?

A. Yes. It's the prime rate which is lowered from 50 basis points to 25 basis points over the Fed rate -- the target Fed rate.

Q. And if you could go to PTX 5260, and that's one of your slides, sir. I just want to clear up something on that slide.

A. Yes.

Q. And --

A. So, you can see here the PDCF rate is the same as the primary credit rate.

Q. Yes. And so -- and the only thing I wanted to show about this is that the reason that you're showing the PDCF rate decreasing is because the federal funds rate --

A. Oh, sorry, I was looking at 5359, so --

Q. Okay, so --

A. -- let me get to 5360.

Q. -- let me start over.

A. Sorry.

Q. No, that's okay.

So, what we're looking at here is the decline of the primary credit rate. Is that right?

A. Yes.

Q. And it declined not because of collateral or having anything to do with collateral; it declined because the federal funds rate went down, correct?

A. Yes. So, that's -- you know, it reflects partly the nondiscrimination policy of looking through the discount -- frosted discount window, you know, independent of who the borrower was.

Q. Well, not independent. They had to be a primary dealer, right?

A. Yes. So, what I mean by that, independent of the primary dealer's characteristics; you know, their credit risk wasn't taken into account.

Q. Well, their credit risk -- the risk of the collateral was taken into account by the proportion of the haircut, correct?

A. Yes.

Q. Okay.

THE COURT: Mr. Dintzer, I have one question, if you don't mind my interrupting.

MR. DINTZER: Please, Your Honor.

THE COURT: I'm just looking at your chart here, 5360, and Mr. Dintzer's question and your answer has caused me to wonder whether there's a cause and effect relationship between the primary credit rate decreasing and the PDCF collateral expanding to include noninvestment grade securities.

THE WITNESS: No, I think --

THE COURT: Is that just a coincidence?

THE WITNESS: -- there's a correlation of factors where the Federal Reserve is trying to, you know, pump liquidity into the system, and it's doing it in a variety of different ways. One is expanding the range of collateral it will accept, and the other is by reducing the federal funds rate.

THE COURT: Okay, thank you.

Sorry.
MR. DINTZER: No. Thank you, Your Honor.
BY MR. DINTZER:
Q. So, those are two mechanisms, but they are separate mechanisms; they are not connected.
A. Right.
Q. Now, if you could go to PTX 5344.
A. Yes.
Q. Okay. And so -- and you have a series of slides here that talk about the different ways that money is being provided to -- under different facilities, right?
A. Yes.
Q. And the first one is the STOMO?
A. Yes.
Q. And to be clear, the STOMO is not a 13(3) facility. Is that correct?
A. No. It was authorized under Section 14.
Q. Okay. And PTX 5345, the next one, the TSLF, the duration there was a month. Is that right?
A. Of a -- of a loan, yes.
Q. And so -- and it was a -- I mean, it wasn't -- it was a loan of security, right?
A. Yes. So, it was to exchange what was then illiquid collateral for U.S. Treasuries, which were liquid.

Q. So, just a swap.
A. Well, it wasn't --
Q. No, I take that back, because I know that has a special --
A. No, no, effectively it's a swap. I mean, there's a question of what the swap rate was, and that was set by auction.
Q. Okay. And PX 5346, this was the original Bear Stearns loan. Is that correct?
A. Yes.
Q. And do you know how long this loan was in place?
A. Just a couple days.
Q. And PT -- and it was intended to only be in place a couple of days. Is that right?
A. That was the hope. Who knows what would have happened if the weekend transaction wasn't consummated.
Q. Do you know what the maximum length of the Bear Stearns initial bridge loan was?
A. I don't remember what the --
Q. The maximum?
A. Yeah. I expect it was a demand note and...
Q. So, next we go to PTX 5347, and this is the actual Bear -- the loan that ultimately helps JPMorgan make the acquisition. Is that right?
A. Yes.

Q. And the loan is actually -- and you say this right here on the side, is the loan was made to Maiden Lane. Is that correct?
A. Yes.
Q. And so -- and this is Maiden Lane I, the one that doesn't get talked about as much. And basically you had Bear Stearns and some of its investments were put into Maiden Lane I. Is that right?
A. Yes, purchased.
Q. Purchased. And they were purchased -- and for Maiden Lane I to get the money to purchase it, the Federal Reserve made it a loan, correct?
A. Yes.
Q. And who owned Maiden Lane I?
A. It would have -- I'm not sure who had the -- it was a joint venture, essentially, that JPMorgan and the Federal Reserve paid into.
Q. And do you recall if the Federal Reserve had the majority interest in it?
A. I don't recall what the -- how the actual ownership stake was established.
Q. Okay. But --
A. But what -- I mean, the water flow here -- the waterfall here describes how the cash flows were disbursed. The residual was paid to the Federal Reserve

Bank of New York, so from kind of a residual ownership perspective, they are the ones that owned the residual cash flow after payment to the -- the lenders.

Q. Okay. And so I'm just going to show the residual, sort of that's what -- there were other tranches, but the residual goes to the Fed, right?

A. Yes.

Q. And so -- so, the Fed lends the money to this, and the way it works is, is if Maiden Lane I paid more for that loan, there would have been lower residuals to go back to the Fed at the end, right? I mean, if it's paying more for the loan, it just has fewer dollars to pay at the end, correct?

A. Do you mean if the cash flows were lower than expected?

Q. No. No, I'm saying the Fed charged -- you can tell me. What was the rate that the Fed charged Maiden Lane I on the loan?

A. The primary credit rate.

Q. Okay, so prime. So, they charged it a rate, and if they charged it more so that they made more money on the loan, they would have just made less money on the residual, right?

A. Yeah, holding the assets fixed and holding the return to Morgan Stanley fixed --

Q. JPMorgan.
A. -- JPMorgan fixed.
Q. And so my only question is that this loan, the loan that the Fed made on the Bear Stearns assistance, was never made to Bear Stearns; it was made to Maiden Lane I, which the Fed itself had a significant interest in, correct?
A. Yes.
Q. Okay. So, that's PTX 5347, and that's more or less what you're describing here, right, sir?
A. Yes.
Q. And then we get to the PDCF slide, PTX 5348.
A. Yes.
Q. Do you see that?
A. Yes.
Q. And I know you talked about this with Plaintiffs' counsel, and, in fact, I'm pretty sure he handed up DX 933, and it probably went into evidence. Is there any chance you could find that? It's the -- and I'd be happy to show it to you. It's the Federal Reserve press release, "Primary Dealer Credit Facility FAQs."
Your Honor, if I may inquire of counsel, I think he handed it up as a separate document.
MR. BOIES: I did, Your Honor. I handed it up

loose, I think.

MR. DINTZER: So, I wouldn't look in the binder, sir.

THE WITNESS: And which DX was it?

MR. DINTZER: DX 933.

THE WITNESS: Yes, I have it.

BY MR. DINTZER:

Q. Okay, sir.

Basically, my understanding is, is -- and I assume that -- this is from the Federal Reserve's Web site, and it basically answers questions about the PDCF, and it's effective September 15th. Do you see that?

A. Yes.

Q. And I'm going to draw your attention down to about four lines from the bottom.

A. Okay.

Q. "What is the duration of the loans made under the PDCF?

"ANSWER: All loans are made for a duration of one day. New loans can be taken out each day."

Is that correct?

A. Yes.

Q. So, each specific loan was for one day, and the point you were just making -- you were making when we were talking about this slide is that you could just --

day after day after day, you could keep renewing that loan.

A. Right.

Q. And so --

A. So, when I've used the term "roll," that's what I meant, renewing the loan, rolling the loan.

Q. Right. So, what we have with the PDCF, if you're Morgan Stanley and you borrow some money for one day, then at the end of the day, you've got to pay it back, and then the next day, you basically borrow -- you can borrow the same amount if you need it, and you keep doing that every day.

A. Yes.

Q. Okay. But on -- nothing guaranteed Morgan Stanley that the next day they would be entitled to get that next day's loan, correct?

A. Well, there's an economic circumstance that's happening within and then there's a legal circumstance -- you know, construct that's happening within.

Q. Let's do the legal, because that's actually -- and I am not asking you to make a legal decision. I'm --

A. Well, I am going to discuss it from my understanding of both perspectives.

Q. Go ahead, sir.

A. So, when 13(3) is used for this type of lending, one of the things that Mr. Hackley talks about in his book, the one I referred to being a centimeter thick, is that in 1968, there was an interpretation that was put forward of 13(3), which was that it should be used essentially for significantly important financial institutions to ensure that they don't have a negative impact -- that their failure doesn't have a negative impact on the -- economywide.

So, a solvent but illiquid institution was to be supported to avoid systemic impact, and that -- and they -- you know, they talk there of this could be a large group or a small group or it could be a single institution, but it's the "significantly important" part of it that kind of, you know, provided a requirement for creating a 13(3) facility.

So, in Morgan Stanley's case, for instance, there was obvious concern that it was a significantly important financial institution and that its failure would have systemic implications. You know, the behavior of the Federal Reserve over this entire period reflects that. So, it would be rational, given that policy framework, for Morgan Stanley, as well as the Federal Reserve and others, to infer that its access to

the PDCF wouldn't be withdrawn. And as we know, even when Lehman went into bankruptcy, you know, the very next day, it actually increased its PDCF borrowing.
Q. And so -- and I understand everything you're saying, sir, and all I'm asking is --
A. Yes.
Q. -- is that nothing in the paperwork said that they were legally entitled. There is no contract --
A. Yes.
Q. -- like, say, the RCF or something that said, "Tomorrow you're going to get to do this."
A. Absolutely.
Q. Each day -- right. So, each day, they woke up, they said, "Okay, let's do this," but there wasn't a legal, contractual right to do it, correct?
A. Correct.
Q. Okay. And you talked about with Plaintiffs' counsel that actually the facility, the existence of the PDCF, was actually extended, right, that it was set for one period and then it was extended to a longer period.
A. Yes.
Q. And actually that happened to the RCF as well, correct?
A. Yes.
Q. It started as two years and then, within weeks

of that, they went ahead and they extended it to five years. Is that correct?

A. Well, the circumstances were different. It was -- that happened within the context of refinancing the RCF in light of the original terms being ones that, you know, were onerous and didn't, you know, provide a workable solution to the problem.

Q. And so -- now, in your -- in your testimony, you talked about sort of the hypothetical world where if the insurance subs had access to the PDCF, what might have happened.

A. Yes.

Q. Okay. And now the insurance regulations -- I think you talked about this, but maybe not -- the insurance regulations limited the insurance subs -- it was a 40 percent limit, correct?

A. On, you know, their general account funds.

Q. Yes. So, they limited the fraction of assets that could be pledged as collateral for repo and securities lending, correct?

A. Correct.

Q. And so even if the insurance subs had access to something like the PDCF, they would have been -- by the insurance regulators, they would have been limited to 40 -- to basically using 40 percent of the -- of the

securities and items that they had, correct?
A. In the general accounts.
Q. In the general accounts, okay.
And so -- and so each insurance sub, if they had access to the PDCF, could -- couldn't exceed the 40 percent on a daily basis of what it had in its general accounts. Is that right?
A. That's my understanding.
Q. Okay. And if you could go to PTX 1502. Just let me know when you get there, sir.
A. Yes.
Q. Okay. Do you have an understanding of what this document is?
A. It's a PowerPoint presentation dated September 5th, "Securities Lending, Liquidity Contingency Plan."
Q. And did you look at this document or rely on this document as part of your analysis?
A. It doesn't immediately -- I don't recall.
Q. Okay.
Your Honor, I mean, it's stickered by the Plaintiffs. We move for the admission of PTX 1502.
MR. BOIES: Your Honor, we have no objection if it's coming in pursuant to the 703 limitation, but it is an AIG document. It's not our document.
THE COURT: But it's listed as a Plaintiffs'

trial exhibit?

MR. BOIES: As a Plaintiffs' trial exhibit for identification, Your Honor. We have not offered this document yet.

THE COURT: Okay. Well, I'm going to admit it with a 703 limitation at this time.

MR. DINTZER: Thank you, Your Honor.

(Plaintiffs' Exhibit Number 1502 was admitted into evidence.)

BY MR. DINTZER:

Q. If you could go to the last page, sir. Let's just check the date. It's September 5th, 2008. Do you see that?

A. Yes.

Q. Okay. And so this would be -- well, it's titled "Regulatory Constraints (Repo & Securities Lending/Affiliate Transactions)." Do you see that?

A. I do.

Q. And the first column is, "Admitted Account Assets of 12/31/07." Is that right? "Admitted General Account Assets as of 12/31/07."

A. Yes.

Q. So, that's the general account you were talking about. Is that right?

A. That's how I would interpret this column.

Q. Okay. And let's see, if you go down that column, you can see AIG Annuity Insurance Company. Do you see that? It's the fourth row from the bottom in the section labeled "Companies with Significant Pool Participation." So, if we count up from the bottom, AIG Annuity Insurance Company. Do you see that?

A. Yes.

Q. Okay. And what is AIG Annuity Insurance Company's general account assets?

A. It says 50.1 billion.

Q. Okay. So, that would be the thing that you're getting the -- and then you would take 40 percent off that to see what the -- to see what could be lent. Is that right?

A. Yes.

Q. And, in fact, they do that in the next column. Is that right?

A. Yes.

Q. And what do they come up with as lendable for AIG Annuity Insurance Company?

A. Approximately 20 billion.

Q. Okay. And do you see -- so, that would be -- for AIG Annuity Company, they would be limited to 20 billion of repo or, if they had access to the PDCF, $20 billion of lending. Is that right?

A. Yes.
Q. Okay. Now, can you go down -- can you see the Lexington? It is fourth from the bottom in the section titled "Companies with No Pool." So, it's the next section with the low or no pool, Lexington Insurance Company. Do you see that?
A. Yes, I do.
Q. And how much does it have in its general account?
A. It says 14.8 billion here.
Q. Okay. And what's the -- after taking the 40 percent limitation, how much -- what is it?
A. Approximately 6 billion.
Q. Okay. And now I'm going to ask you to go to PTX 5354, and that's one of your slides. Just let me know when you're there.
A. Yes.
Q. Okay. So, you also have the AIG Annuity Insurance Company. Do you see that?
A. Yes.
Q. And how much -- and this is the slide where you say, well, if the -- if the insurance companies could get access to the PDCF, this is what they'd do, right?
A. Yes.
Q. And how much do you have AIG Annuity Insurance

Company getting from the PDCF in this chart?
A. 27 billion or so.
Q. Okay -- I'm sorry?
A. 27 billion or so.
Q. Okay. So, that's above the $20 billion limit that AIG Annuity Company faced in the internal AIG document we saw. Is that right?
A. Yes.
Q. And the -- the -- number 6 is the Lexington Insurance Company. Do you see that?
A. Yes.
Q. And they -- you've got them at $10 billion. Is that right?
A. Yes.
Q. And that's the $6 billion limit that we saw in the AIG document. Is that correct?
A. Yes.
Q. No further questions on that document, sir.
Now, if we could go to -- well, you know, so, on September 12th, AIG knew that the three major credit rating agencies were considering downgrading them. Is that right?
A. Yes.
Q. Potentially several notches.
A. Yes.

Q. What they didn't know on the 12th was what their liquidity needs would be if they were downgraded.

A. Certainly as they -- there were several sources of uncertainty. One was when and how much of a downgrade, and that would affect how the threshold amount on the CDS collateral provision would change, so that would be one source of uncertainty.

Then the other source of uncertainty would be whether there would be an impact on how counterparties' confidence in AIG changed and whether that would accelerate what was already the manifestation of a run at that -- at that stage.

And then the third source of uncertainty was, of course, the general economic conditions.

Q. But on September 12th, 13th, 14th, AIG didn't have a good handle on how much liquidity, how big its hole was, how much money it needed. Is that correct?

A. Yeah. It was changing because of those uncertainties.

Q. Well, those uncertainties didn't change. Those uncertainties were the same on the 12th, the 13th, and the 14th, right?

A. The manifestations of what that uncertainty was on an ex post basis was what would determine what the actual liquidity needs would be. That was uncertain.

Q. And the 13th and 14th, that's a weekend, right?
A. Um-hum.
Q. So, during September 13th and 14th, the markets were closed.
A. They're officially closed, but, I mean, as we all know, there were all kinds of things that were actually going on -- all kinds of marketing activity that was going on, but not trades, per se.
Q. And my only question, sir, is on September 12th, 13th, 14th -- and we can look at documents -- but on those dates, the AIG estimate of how much liquidity it would need continued to increase.
A. Yes.
Q. Is that -- okay.
And if AIG had had access to the primary dealer credit facility, even on September 12th, it still would have been downgraded, right?
A. I don't know.
Q. And even if AIG's counterparties had a little more confidence in AIG, they had the right -- the contractual right that if AIG was downgraded, to get collateral, correct?
A. Yes.
Q. Now, there were many causes to the financial crisis. True?

A. Yes.
Q. Some -- some were from the private market -- market and some were from the governmental. Is that right?
A. Yes.
Q. Securitization played a role in the financial crisis.
A. Yes.
Q. The contributing factors included a housing bubble and problems with the model of mortgage finance.
A. Yes.
Q. Banks contributed to the financial crisis to some extent, as did -- as did private actors -- I mean, as did other private actors.
A. Yes.
Q. And it's true that you can't pick out any one actor and say the financial crisis was that actor's or that industry's fault; it was -- it was systemwide.
A. I think it would be hard to do that, yes.
Q. The financial crisis affected more than just financial institutions, correct?
A. Yes.
Q. It affected small businesses and homeowners throughout the country.
A. Yes.

Q. It was -- and the financial crisis caused the bankruptcy of small businesses and homeowners throughout the country.

A. Yes.

Q. On September 16th, 2008, AIG could not pay its bills as they came due, correct?

A. What was the date again?

Q. September 16th, before they got assistance from the Government.

A. Well, when exactly that time was going to arise isn't entirely clear, but it was going to be in short order.

Q. The price for AIG's debt on September 15th and 16th reflected the possibility that AIG might enter bankruptcy.

A. Yes. I mean, I'm sorry, the -- when you say the price of its debt, in the secondary market.

Q. The price for AIG's equity on September 15th and 16th reflected the possibility that AIG might enter bankruptcy.

A. Yes.

Q. Government policy contributed to the United -- the U.S. recovery from the financial crisis.

A. Yes.

Q. The economic recovery has benefited most

households and firms, to some extent.
A. That sounds tautological, but yes.
Q. You talked about bank holding companies. AIG didn't own a commercial bank in 2008, did it?
A. No.
Q. And the parent company, the AIG parent, was not a depository institution.
A. Not the parent, no.
Q. For AIG to become a bank holding company, either it would have had to get a bank or the Board of Governors would have had to make an exception for them.
A. Yes.
Q. In fact, a Board of Governors vote would have been required for it to become a bank holding company.
A. I believe that is true, but I don't recall what the actual specific regulation is.
Q. The Federal Reserve never made Lehman a bank holding company.
A. Not that I recall.
Q. Making Lehman a bank holding company wouldn't have changed the outcome for Lehman.
A. I don't know.
Q. Secretary Geithner -- and you can tell me if you recall this -- testified that a condition of the bank holding company conversion was that Goldman Sachs and

Morgan Stanley raise private capital. Do you remember that?

A. I do remember him saying something like that.

Q. And they did each raise private capital within a very short time of them becoming bank holding companies.

A. Yes.

Q. Specifically, for Goldman Sachs, Warren Buffett invested $5 billion in Goldman Sachs in 2008.

A. Yes.

Q. And you told me in deposition -- I'd be happy to show it to you -- that he had leverage given Goldman's real liquidity problems and present need for liquidity.

A. Yes.

Q. The Warren Buffett loan that he made to Goldman Sachs in 2008 led to the dilution of Goldman Sachs' shareholders.

A. I'm not sure if that's true, but --

Q. Okay.

A. -- we can -- can we take a look at --

Q. Absolutely.

May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

BY MR. DINTZER:

Q. Sir, you have been handed what's been marked as

DX 2217. Do you understand that this is an article from Bloomberg?

A. It looks that way, yes.

Q. Okay. And the title is, "Berkshire to Pay Nothing to Be Among Top Goldman Sachs Holders." Do you see that?

A. Yes.

Q. And the date is March 26th, 2013. And it says -- now, you understand Berkshire Hathaway is owned at least in part and run by Warren Buffett. Is that right?

A. Yes.

Q. And the first sentence says, "Warren Buffett's Berkshire Hathaway, Inc. is poised to become one of Goldman Sachs Group's largest shareholders without paying anything after the companies agreed on a plan to settle warrants granted at the height of the 2008 financial crisis."

Do you see that?

A. Yes.

Q. And then it talks about how this is being done. I'm not going to read it into the record -- you are welcome to -- but I just wanted to draw your attention to the last sentence of the third paragraph.

"For Goldman Sachs, the fifth-biggest U.S. bank by assets, the plan seals Berkshire's participation as a shareholder in the company and reduces the dilution for other investors."

Do you see that?

A. Yes.

Q. And do you have any reason to doubt that Goldman Sachs' shareholders faced some dilution by Berkshire Hathaway's and Warren Buffett's investment in 2008?

A. That's what it says here.

Q. Okay. And you don't have any reason to doubt that.

A. As I say, that's what it says here, so --

Q. Right. And I'm just asking you, sir --

A. I don't -- I don't have any reason to -- to doubt that, you know, that the writer had some basis for his belief.

Q. Did you investigate that as part of your --

A. No.

Q. Okay. And the only thing I want to talk about is the fact that in 2008, a few weeks after AIG gets the 13(3) loan, Goldman Sachs and Morgan Stanley go out into the private market and raise funds. Is that right?

A. Yes.

Q. And they have to pay whatever is being charged in the private market. Is that right?

A. Yes.

Q. Okay. Now, if you could go to PTX 5351, sir, and just let me know -- that's one of your slides, and let me know when you get there.

A. Yes.

Q. And the heading here is "AIG Survived Longer Without Liquidity Support Than Other Financial Institutions." Do you see that?

A. Yes.

Q. And the word I am going to focus on is the word "survived."

A. Okay.

Q. Okay. So, this just shows how some of these other -- these institutions tapped -- is this the PDCF or what -- what is being shown in that first column?

A. Each of these columns is the sum of receipts that were received from the Federal Reserve and the Federal Home Loan Bank; so, from 13(3)-type lending as well as lending from the Home Loan Bank.

Q. Total lending?

A. Yes.

Q. Okay. And so this shows that, for example, on April 1st, 2008, Goldman Sachs had $7 billion in receipts from the FHLB. Is that right?

A. Well, it's from both 13(3) facilities --

Q. I see. So, from --

A. -- other Federal Reserve facilities and the Federal Home Loan Bank.

Q. So, a combination of all access to federal assistance.

A. The backstop liquidity support, yes.

Q. Okay. And my only question is, is that 7 billion that you show on April 1st, 2008, if Goldman Sachs didn't have access to that, have you done an analysis to see if it would have survived, if it could have found assistance elsewhere?

A. So, to understand your counterfactual, are you -- are you assuming that there is no -- there are no, for instance, 13(3) facilities that were created for the primary dealers and this other backstop liquidity support no longer exists? Is that the counterfactual?

Q. I'm just -- well, it's not even a counterfactual, sir; I'm just trying to understand the slide. When you say that AIG survived longer without liquidity support, you're not saying that without liquidity support, Goldman Sachs would not have survived April 1st, 2008, are you?

A. I am saying that without the facilities that were created to fund these -- to provide backstop liquidity support to these institutions, their survival -- well, everybody's survival, for that matter, would be, I think, very much threatened.

Q. Okay.

A. If you said what does the counterfactual world look like --

Q. No counterfactual.

A. -- the point is that AIG doesn't have backstop liquidity support like these other institutions until September.

Q. Okay. And so I just want to make sure, have you done an analysis on Goldman Sachs to say if they didn't have this $7 billion of access on April 1st, 2008, they would not have survived? Have you done that analysis?

A. No.

Q. Okay. And have you done the analysis for JPMorgan, that if they didn't have that $7 billion of access to backstop liquidity, they wouldn't have survived?

A. Not the way you're posing the question, no.

Q. Okay. And so in this chart, you are not offering the opinion that -- I mean, and we know a number of these companies ended up having some trouble and did need some assistance down the road, but you're not saying that just -- that the specific lending that you're identifying here was the reason that they survived that date, are you?

A. I think I answered that question earlier. I think I said Chairman Bernanke put it well, that 12 of 13 of these major institutions were at risk of failure in the month of September.

Q. Absolutely, and that's the point, sir. That's in the month of September, and that's -- and he's talking about sort of the middle to the end of September perhaps, but you start here in April, and then you also have September 1st. And so that's exactly what I'm getting at.

You're not saying that Goldman Sachs would have failed in -- on September 1st without the assistance that you listed here on PTX 5351, are you?

A. I -- well, I thought my testimony yesterday was clear that, you know, the Federal Reserve stepping in to create the Term Structure Lending Facility, the PDCF, the STOMO, those were critical to ensuring that the primary dealers were able to make it through the -- the liquidity crisis that was occurring in the March period. So, that was -- I thought I was clear about that.

Q. Okay. So, you have concluded that JPMorgan would have failed if they did not have access to the $7 billion of liquidity in the March period. You've reached that conclusion.

I need you to answer yes or no, sir.

A. No. I think -- I think I'm trying to make a more general point than the specific point that you're making. I'm trying to say that the focus of my analysis was on the impact of the Federal Reserve's programs. I then -- I didn't take it to the level of analysis that you're going, which is to say for this specific $7 billion that JPMorgan borrowed, for instance, but for that, would they have been put out of business. I didn't do that specific analysis.

Q. Okay. And so -- and you didn't do that for September 1st either, is that correct, on this chart at PTX 5351?

A. That's right. The interpretation I just gave stands for that date, also.

Q. And you didn't do that for any of these columns. Is that right?

A. For each of the cells in these columns, I didn't do that specific exercise that you're asking about.

Q. No further questions on that document, sir.

And you understand that the PDCF was to support the markets and not any one specific firm, correct?

A. Yeah. The motivation, I think, was to recognize that a run was occurring on the repo system, the triparty repo system, and that the repercussions from that were serious in that the Federal Reserve was trying to deal with the crisis of confidence that was coming out of that.

Q. And the Federal Reserve was trying to provide liquidity for the market, correct?

A. Yes.

Q. Now, AIG lost -- we talked about this. I wanted to get down the specific date. It lost its Aaa credit rating in March 2005. And I am not going to make this a memory test, sir. If you want, if you go to PTX 589, at page 36, we can nail that down.

A. I'm not sure whether March 2005 is going to be important for later, but if you think it is, then we can go check.

Q. Go ahead and check. Why don't we get that in the record.

A. Which of the binders is it in?

Q. It would be in the Government's binder, the white binder.

A. I'm sorry, you said PTX 589?

Q. Yes, sir. And if you can go ahead to page 36 -- and I am not going to read any of it into the record. I just want you to refresh your memory, sir, about when they were downgraded for the first time.

A. I'm having trouble finding it here. If you could point out what you want me to look at, that would be faster, I think.

Q. Sure.

A. Oh, here we go. I was looking at page 36. So, here, on the sixth line that says, "AIG lost its Aaa rating in March 2005."

Q. Okay. And so the -- now I'd like you to turn to your initial report at page 37 -- I'm sorry, at page 307. Just let me know when you're there, sir.

A. Yes.

Q. Okay. And so this is page 307 of your initial report, and you have a chart here. Is that right?

A. Yes.

Q. And what this chart shows is it shows AIG, its exposure with CDSs on insuring CDOs. Is that correct?

A. Yeah. The title says "Notional Volume of AIG's CDS on Super Senior Tranches of Multi-Sector CDOs."

Q. So, this would show the notional exposure that AIG had on its CDS program by quarter. Is that right?

A. It's the notional amount on which the CDS contracts were written.

Q. And "notional" just means par value. If, on the very first day, they all exploded, that would be how much it would have to pay?

A. That's how much it would pay the counterparties

to buy the securities.
Q. Okay. So, if we look at this chart, we just refreshed our memory that they lost the Aaa rating in March 2005, and we can see that after they lost it, they continued to increase their CDS exposure throughout -- basically in March 2007, and then it held steady. Is that right?
A. Yeah. That increased at a faster rate through the end of -- through -- a steady rate through the end of 2005 and then slowed off in the rest of 2006 as it was finishing off the business that it had committed itself to.
Q. And it -- and then there's that flat line, and the black part is subprime, and the portion above it is positions without subprime. Is that right?
A. That's right.
Q. And they continued to add CDS exposure to the nonsubprime, but they held the exposure to subprime flat. Is that right?
A. Yes.
Q. No further questions on that document, sir.
Now, you discussed the possibility of a guarantee during your direct testimony. Is that right?
A. Yes.
Q. And the idea of the guarantee that you discussed

was one where -- where the New York Fed provides a guarantee on AIG. Is that right?

A. No. I believe we were talking about -- I think we spoke actually about several versions of guarantees, but one that we spoke about was essentially the New York Fed novating the parent's position in the CDS contract. So, that was one version.

Q. Okay. So, let's --

A. Another version was to --

Q. -- let's just do them one at a time. So, here, we already talked about how AIG has a contract with its counterparties, and what you talked about was novating, basically stepping into the shoes of AIG on the contract with the counterparties.

A. Yeah. That would be a contractual way to do it.

Q. Okay. And I know you're not a lawyer. That could raise some contractual issues with the counterparties, right? I mean, they have a contract, and so they get to choose who their counterparty is, right?

A. Yes.

Q. And in the contract that they have set up, they have got some -- some -- some collateral posted that they -- that they're enjoying, right?

A. Yes.

Q. The counterparties.

A. The way I've described it is that AIG is effectively loaning money to the counterparties.

Q. As the collateral, as the posted collateral.

A. Well, the loan comes through the collateral. My point was that it exceeds the actual risk that the counterparty faces. So, it ends up being a loan.

Q. Okay. And all I'm saying, sir, is that these counterparties -- and I'm not asking you to step in their shoes or do any analysis -- these counterparties might decide that they might not want a novation -- and I'm not going to ask you a contractual question -- but there might be reasons that they might not want a novation. True?

A. True.

Q. Okay. Now, if AIG was going to give a guarantee, any guarantee that you've described, you -- and you can show me in your report if you have it -- you haven't figured out how AIG -- I mean, how the Fed would price the guarantee, have you?

A. I have not priced the guarantee, no.

Q. Okay. So, if the New York Fed took you up on your suggestion and went back in time, and instead of doing the deal that it did with AIG, instead if it was -- if it was legal, if it could do it and did that guarantee, you're not offering how much the New York Fed would charge for that.

A. I have not provided that opinion.

Q. Okay. And the -- you also haven't done the risk analysis of how much risk that guarantee would place on the New York Fed as compared to the risk that the credit facility -- the revolving credit facility placed, correct?

A. No. I described a variety of different guarantees that were considered in the various reports that are out there, and -- but I didn't --

Q. You don't have --

A. -- price them all and didn't do a comparison to the RCF.

Q. Okay. And so you didn't do a risk comparison on your -- the possible guarantees and the RCF, the credit agreement, correct?

A. That's right.

Q. Okay. Now -- and I don't know if you were in court when Professor Zingales was here and he mentioned a company called CIT. Are you familiar with it?

A. I was in -- I was in court that day. I'm not sure.

Q. He mentioned a company named CIT as a company that sought assistance and was denied. I don't mean to characterize his testimony.

A. Okay.

Q. But just to -- are you -- but you are not familiar with the company?

A. No. I know of other companies that sought assistance and were denied.

Q. Could you give me an example, sir?

A. LandAmerica.

Q. And when did it seek assistance from the Government?

A. In 2008.

Q. And what happened to LandAmerica?

A. They went bankrupt.

Q. What happened to their shareholders?

A. Well, it is still in bankruptcy, and they're still trying to resolve all the -- the various claims of the various estates. So, whether the shareholders get something out of that is still to be -- to be seen.

Q. Okay. And other than LandAmerica, who was the other -- what are the other companies you're thinking of that sought assistance and didn't get it?

A. That's just one that I know off the top of my head.

Q. Okay.

A. I mean, I know there -- there are a variety that did, so it's not --

Q. And it was a difficult time, wasn't it, sir?

A. Yes.

Q. And a number of --

A. You sound like you're starting some kind of Oliver Twist type store.

Q. Well, you know, it was the worst of times, sir.

And a number of companies went to the Fed to seek assistance and didn't get it. Is that correct?

A. Yes.

Q. And are you familiar with the company named Ambac?

A. Yes.

Q. And, in fact, you were an expert on a case regarding Ambac. Is that right?

A. Yes.

Q. And Ambac was a monoline, correct?

A. Yes.

Q. And a monoline is simply a type of insurer that just does one type of business, correct?

A. It specializes -- they specialize in -- in insuring municipal bonds.

Q. Okay. And basically they do the same type of insurance on municipal bonds that AIG -- not directly, but similar -- that AIG was doing to the CDOs.

A. Conceptually, yes.
Q. Okay.
A. And they had a different contract structure, typically, but...
Q. Right. And, in fact, the CDSs that the monolines were writing, they didn't have the -- they didn't have the capital posting provisions, right?
A. So, I had talked about yesterday that they typically use a pay-as-you-go contract.
Q. All right. And so...
So, they were writing CDS coverage on bonds without collateral posting, and in 2008, Ambac was one of the largest financial guarantee insurers in the country, correct?
A. Yes.
Q. And they got downgraded in January of 2008, correct?
A. Yes.
Q. And --
A. I think that's right. I mean, I have looked at, you know, the downgrades of the -- all the monolines. I just don't remember what the timing of each of them is, so...
Q. And I'd be happy to --
A. I'll just take your representation that it was

in January.
Q. Okay. And let me just make sure my representation is right. Just give me one second here, sir.
I'll withdraw the question on the date, because I don't see the exact date here, and I thought I had it.
The monoline insurers did not have access to backstop facilities, is that correct, before Lehman?
A. No.
Q. And -- no, it's not correct, or no --
A. No, I think that's correct.
Q. Okay. And just generally, insurance companies that wrote CDSs didn't have a right to receive 13(3) loans, correct?
A. Correct.
Q. And Ambac went bankrupt and its shareholders were wiped out, correct?
A. Yes. I don't remember what happened with the resolutions, but I expect that the shareholders didn't get anything.
Q. Okay. And I'd be happy to just --
May I approach, Your Honor?
THE COURT: Yes.
THE WITNESS: Thank you.
BY MR. DINTZER:

Q. Now, I've handed up DX 2209, and, sir, I'm just going to direct your attention -- this is a press release, "Ambac Emerges From Bankruptcy," and if you could just look at the last sentence of the second paragraph there and tell me if that refreshes your memory.

A. The second-to-last sentence here says, "All common stock of the Company in existence prior to Ambac's emergence from bankruptcy has been cancelled."

Q. And so does that refresh your memory also that the common stockholders of Ambac before it went bankrupt didn't get anything?

A. Yes.

Q. Okay. No further questions on that document.

Now, the credit rating agencies -- after the credit agreement was signed, the credit rating agencies expressed concern about AIG's continued exposure to losses from the CDS portfolio. Is that correct?

A. Yes.

Q. And the November restructuring was meant, in part, to address the credit rating agencies' concerns.

A. Yes.

Q. And it included TARP assistance. Is that correct?

A. Yes.

Q. And basically what was happening, ML III was -- it purchased the CDO tranches from AIG's counterparties. Is that right?

A. Yes.

Q. And ML III, whatever else you have to say about it, it resolved the rating agencies' concerns about AIG's continued exposure to the downgrades, correct?

A. Yes. It created concerns, but it resolved others.

Q. Okay. And you're welcome to tell me whatever concerns it created, but for my -- my question is, is the ML III structure resolved the rating agencies' concerns about the CDOs and AIG's exposure to them, correct?

A. Yes. It also created concerns related to crystallizing the losses related to those.

Q. The -- so, the CDOs were purchased at par value, correct?

A. Yes.

Q. And at the time AIG's counterparties had collateral already posted by AIG to protect against the risk of default, just like we've talked about. Is that right?

A. Yes.

Q. And the combination of collateral in their possession plus the CDO equaled the par value. Is that right?

A. No.

Q. Okay. I'm going to ask you, sir, to turn to PTX 549.

A. Okay.

Q. Oh, and I've been -- let me see if I can ask my question better.

The combination of the collateral plus the fair market value of the CDO equaled par. Is that correct?

A. We're going to argue about fair market value. So, why don't we just agree that the collateral plus whatever was paid was equal to par.

Q. Okay. If you could go to page 20. So, this is -- this is the SIGTARP report or one of the SIGTARP reports. Is that right?

A. Yes.

Q. And we're at PTX 549, and let's go to exhibit page 20, okay?

A. Yes.

Q. And you can confirm yourself, you can look at the previous page, it's talking about Maiden Lane III here. Is that right?

A. It looks that way, yes.

Q. And the last sentence on page 15 says, "According to an FRBNY senior vice president, the counterparties that FRBNY approached that resisted being paid anything less than the equivalent of par in exchange for terminating their CDS contracts cited several reasons for this."

Do you see that?

A. Yes.

Q. Including, "They had collateral already posted by AIG to protect against the risk of AIG default." That's true, correct? Right, sir?

A. That's what it says.

Q. And the people who had the CDS contracts, they did have collateral posted, right?

A. Yes.

Q. The next sentence is, "The combination of collateral in their possession plus the fair market value of the underlying CDOs also in their possession equaled the par value of the credit default swaps."

Do you agree with that?

A. No.

Q. The next sentence says, "Thus, from the counterparty's perspective, offering a concession would mean giving away value and voluntarily taking a loss, in contravention of their fiduciary duty to their shareholders."

Do you see that?
A. Yes.
Q. Do you agree that providing a concession by the CDO holders would have been voluntarily giving away value?
A. You know --
Q. From their point of view.
A. -- based upon the previous sentence and their view on fair market value, it would follow.
Q. So, this -- this paragraph -- this bullet point on page 20 is internally consistent; you just disagree with the fair market value portion. Is that fair?
A. Yes.
Q. Okay. No further questions on that document, sir.
You haven't sought to quantify what concessions from ML III counterparties would have looked like. Is that right?
A. Correct.
Q. And actually -- well, I guess we have already put it away.
So, let's turn to Citibank or Citigroup, sir, and if we could go to PTX 5368. And we're going to be talking about this, but you spent a fair amount of time talking about Citigroup. Is that right?

A. I'm not sure of the fraction of time, but we spoke about it.

Q. Okay. And you'll agree that both Citigroup and AIG are each complex financial institutions.

A. Yes.

Q. And they had -- they were -- had very different business mixes.

A. Yes.

Q. And they each --

A. At the point in time we're talking about.

Q. At the point -- in 2008.

A. Yeah. At one point Citigroup owned Travelers, so...

Q. In 2008, early 2009, Citigroup and AIG had very different business mixes.

A. Yes.

Q. Citigroup and AIG each faced different pressures at that time.

A. Yes.

Q. You didn't examine Citigroup's collateral and don't know how much postable collateral Citi had. Is that correct?

A. I'm not sure what the question means. I didn't -- yes, since I don't understand the question.

Q. Fair enough.

So, there -- are you familiar with the term "ring fencing"?
A. Yes.
Q. Was that the nickname given to what was provided for in Citibank -- in Citigroup?
A. Yes.
Q. Okay. If I use that term, "ring fencing," will you understand what I'm talking about?
A. Yes.
Q. Now, for the ring fencing proposal, do you have an understanding that Citigroup provided an initial proposal to the Government to sort -- that sort of got the discussion started?
A. I don't remember the full evolution of the history.
Q. Okay. So, let's go to PTX 2297. And just let me know when you have that document, sir.
A. Yes.
Q. Okay. So, this document is -- it's titled the "Extraordinary Financial Assistance Provided to Citigroup, Inc. " Do you see that?
A. Yes.
Q. And you rely on this in your report, is that right, or at least you cite it a number of times. Is that correct?

A. Yes.
Q. And I think you even quote it. Is that correct?
A. Yes.
Q. Okay. So, I'm going to ask you to turn to exhibit page 47 of the document, the page titled "Conclusions," and just let me know when you're there.
A. Yes.
Q. Okay. And the third paragraph down starts with the sentence, "SIGTARP found that the Government constructed a plan that not only achieved the primary goal of restoring market confidence in Citigroup, but also carefully controlled the overall risk of Government loss on the asset guarantee."
Do you see that?
A. Yes.
Q. Okay. So, then, the next sentence, "Citigroup's initial proposal, which would have had the Government guarantee 100% of $306 billion of troubled assets in return for $20 billion of preferred stock, was summarily rejected."
Do you see that?
A. Yes.
Q. And do you recall, sir, that sort of Citigroup got the ball rolling, saying we'd like to have $306 billion of troubled assets guaranteed, and we want you

to take on all the risk, Government?
A. I don't recall the -- as I said earlier, I don't recall the exact evolution of the -- of the deal, but that would be an opening offer which would explain going to the -- in the direction they did -- they went.
Q. Okay. And SIGTARP says in the next sentence -- actually in the rest of that sentence, because I left off before the comma, that it was "summarily rejected." Do you see that?
A. Yes.
Q. And then they said, "Instead, the Government made a take-it-or-leave-it proposal that required Citigroup to absorb the first $37 billion in losses in the asset pool as well as 10 percent of any losses in excess of that amount in return for approximately $7 billion in Citigroup preferred stock."
Do you see that?
A. Yes.
Q. So, Citigroup got a take-it-or-leave-it offer as well. Is that right?
A. Yes. That's what it says.
Q. And you don't have any reason to doubt that, do you, sir?
A. No.
Q. And so with its take-it-or-leave-it offer to

Citigroup, the Government drove a harder bargain than Citigroup asked for. Is that correct?

A. Sure.

Q. Okay. And now I'm going to take you to, sir, one of the documents that was in your binder from the Plaintiffs' counsel, PTX 2735. And just let me know when you have it.

A. Sorry. It's a big binder.

Q. It is a big binder, sir. Just let me know when you have it. No rush.

A. Yes.

Q. Okay. And so this document, which is already in evidence, Your Honor, is the "Summary of Terms of USG/Citigroup Loss-Sharing Program." Do you see that?

A. Yes.

Q. And did you rely on this as part of your analysis?

A. Yes.

Q. Okay. And so I just want to make it clear sort of the structure that they adopted in Citigroup. So, what happened was there was $301 billion of assets, according to this document, that ultimately got put into the ring fencing. Is that right?

A. Yes.

Q. Okay. And so -- and Citigroup had the first

loss position. Is that right?
A. Yes.
Q. And that meant that basically for the first -- well, it floats, but ultimately Citigroup ends up taking the $39.5 billion first loss position. Is that right?
A. Basically, yeah.
Q. Okay. And so -- so, in this pool of assets, basically a whole bunch of assets were put into this ring fence, right, bad assets, ones that might go bad, right?
A. Right.
Q. And the very first $39.5 billion of losses would be Citigroup's to eat, right?
A. Yes.
Q. And then there was a second loss position, and that was absorbed by Treasury. Is that right? Actually, it was absorbed 90 percent by Treasury and 10 percent by Citigroup.
A. Yes.
Q. So, that's the first loss. So, then, that's the second loss, and that's Citi plus Treasury. And then the third loss was borne by the FDIC, is that right, and Citi?
A. Yes.
Q. And that's $10 billion.

A. Yes. Well, it adds up to 11.1. So, if you think about, you know, the previous tranche, you've got Treasury absorbing 90 percent and Citi absorbing 10 percent, so that tranche is going to be 5.5, and then likewise, in the next tranche, it's going to be 11.1.

Q. So, we could basically take Citi out and increase the --

A. But you're basically getting -- I mean, save for the math, you're kind of getting it right.

Q. Okay. So, there's a first loss position, second loss position, third loss position, and then after that comes in the Federal Reserve, right, who are batting cleanup?

A. Yes.

Q. And what the Federal Reserve does is it offers a loan that would basically cover losses that exceed this amount. Is that right?

A. Yeah, 90 percent of the losses.

Q. Ninety percent. So, in the fourth loss position -- and I started too high down, so I'm going to have to put it up here -- but basically in the fourth loss position is the New York Fed plus Citi, and they covered 16.7 billion. Is that right?

A. No. So, it's -- after the layers that we just went through, any further losses are covered by a nonrecourse loan from Federal Reserve Bank of New York.

Q. So, if the losses exceed this, then basically the New York Fed will loan to cover these, and the New York Fed doesn't get paid back.

A. Yep.

Q. Okay. So, the New York Fed sat in the fourth loss position on Citi. Is that right?

A. Yes.

Q. So -- now, Citi had asked for 100 percent, so, in fact, the Fed would have sat in the first position, and it says -- and now I'm going to take you back to the SIGTARP report at 2297, and what they write, praising the Government, they write, "The Government's risk of loss, in other words, was dramatically less than it would have been under the Citigroup proposal. Indeed, based on various loss projections, the relevant government actors, Treasury, FDIC, and Federal Reserve Bank of New York, believed that Citigroup's initial loss position would render any government loss unlikely."

Do you see that?

A. Yes.

Q. Do you agree with that, that that position, ex ante, at that time rendered the loss by the Government unlikely?

A. I haven't done the -- the risk calculus that's necessary to determine that, but I presume the authors have.

Q. Okay. And then they write (as read): "In the end, Citigroup absorbed all of the losses among the guaranteed assets, which totaled $10.2 billion at the time of the termination of the guarantee..." Do you see that?

A. Yes.

Q. So, it turned out that this book of bad assets had about 11 billion go bad, Citigroup was in the first position, they ate all the losses of their own assets, and nobody else had to pay anything, right?

A. That's what it says, yes.

Q. And you don't have any reason to disagree with that.

A. No.

Q. And, in fact, the way that they described it was this was Citigroup's deductible, like we have a deductible on our car insurance. This was -- they were in the first loss position, and their deductible covered everything.

A. Right.

Q. Okay. Now, let's go to the next page, and it says that "the Government drove a particularly hard bargain on behalf of taxpayers was reflected in the reaction of many within Citigroup. Citigroup executives were concerned that the Government's terms were too expensive in light of the assistance provided, and some Citigroup insiders recommended against accepting the proposal."

Do you see that?

A. Yes.

Q. So, Citigroup's management, they didn't think it was such a sweet deal, right?

A. That's the summary here.

Q. And you don't have any reason to doubt that.

A. I haven't done that analysis.

Q. Okay. And then it says, "In the end, however, Citigroup accepted the deal, chiefly because of its expected impact on the market's perception of Citigroup's viability." Do you see that?

A. I do.

Q. Now, I'd like to turn -- so, this is what Citigroup got, but Citigroup paid for this insurance that it turned out it never needed; I mean, this loss protection, it never took advantage of them, never had to have those paid, but it paid for this loan, right?

A. Yes.

Q. And it paid 66.5 million shares of Citibank, is that right -- Citigroup, and $7 billion in preferred equity with an 8 percent dividend?

A. I have in my slide that the equity was 7.059 billion in TARP perpetual preferred shares that paid an 8 percent annual dividend; and then warrants to purchase 66.5 million shares of common stock at a price of 10.61 per share.

Q. And I'm just going to take you -- and maybe we're saying the same thing. I'm taking you to your report at Section 100. I just want to make sure the record is right on this. Just let me know when you get there, sir.

A. What page did you want me to go to?

Q. Page 61 or Section 100, whichever way you want to look at it, sir.

A. Yes.

Q. Okay. And in that section you're talking about the Citigroup guarantee. Do you see that?

A. Yes.

Q. "The Federal Reserve issued a $300 billion guarantee," then you go on. "The terms of the guarantee" -- and if I'm wrong, sir, maybe I'm misreading it -- "The terms of the guarantee included payment in the form of warrants to purchase 66.5 million shares of Citi at a strike price," and then it lists it, "and $7 billion in preferred equity with an 8 percent dividend."

Do you see that?

A. Yes. That's exactly what I just said.

Q. Okay. Maybe I misunderstood.

A. The report and PTX 5368 are identical.

Q. Okay. Then I apologize, sir. I didn't suss that out.

Now, in December 2010, the Treasury Department completed its sale of 2.4 billion shares of common stock in Citi. Is that right?

A. I don't recall.

Q. You do know that they ended up -- they ended up with a lot of shares of Citi, didn't they?

A. Yes.

Q. And they ultimately sold those shares for a lot of money, correct?

A. A lot of shares, a lot of money, okay.

Q. Okay. And ultimately Treasury exited from its Citi investment with a $12.3 billion gain. Is that correct?

A. I haven't done the math.

Q. Okay.

May I approach, Your Honor?

THE COURT: Yes.

THE WITNESS: Thank you.

MR. DINTZER: Your Honor, I have handed out DX 2208.

THE WITNESS: It looks like it's right across the street.

BY MR. DINTZER:

Q. Very close by.

Are you familiar with this document?

A. Yes.

Q. And what is it?

A. It's titled "Three Year Anniversary Report of TARP."

Q. Okay. If I could direct your attention to page 9, actual page 9 of the document, the one with the heading "Repayments" at the top and "Citigroup" underneath. Do you see that?

A. Yes.

Q. And sort of at the bottom of the "Citigroup" section, it says, "Treasury has now exited from all TARP investments in Citi with a realized gain of $12.3 billion on the $45 billion invested in the institution."

Do you see that?

A. Yes.

Q. And you don't have any reason to doubt that.

A. No.

MR. DINTZER: And, Your Honor, we would like to -- well...

BY MR. DINTZER:

Q. And have you read Secretary Geithner's book?

A. Yes.

Q. Cover to cover?

A. I don't remember if I've read every word, but I've read a lot of it.

Q. Okay. I'm just going to hand up a portion.

May I approach, Your Honor?

THE COURT: Yes.

BY MR. DINTZER:

Q. And I'm going to take your attention to page 502 of the exhibit. I'm sorry, page 526 of the exhibit, page 502 of the book, at the very bottom of that page.

A. Yes.

Q. He writes, "Through TARP and the stress test, major banks were diluted in proportion to the risks they took. The more capital they needed, the more their shareholders saw their stakes in those firms reduced. An investor or an executive who owned 1 percent of Citigroup's stock before the crisis would have owned 0.16 percent of the firm by the end of the crisis."

Do you see that?

A. Yes.

Q. Have you done an analysis of whether that

dilution analysis is correct?
A. I haven't.
Q. You don't have any reason to doubt it one way or the other?
A. That particular calculation, no.
Q. Okay. No further questions on that document, sir.
If you could go to PTX 5376.
A. Which binder is that?
Q. That's one of your slides, sir.
A. Oh, yes.
Q. And so you talked with Plaintiffs' counsel about your -- I am just going to read the heading -- "Defendant's Attempt to Justify the Punitive Terms." Do you see that?
A. Yes.
Q. And so -- and you say that, "as Necessary to Avoid 'Moral Hazard' Does Not Make Economic Sense." Do you see that?
A. Yes.
Q. My question is -- I mean, I understand that you don't think that there was a moral hazard concern or however you want to phrase it, but my only question is, is this: Are you offering an opinion that back in 2008, in September, around the 14th through the 16th, are you

offering an opinion that the people in charge of making this decision, people we have heard from in this Court, President Geithner, Chairman Bernanke, the other people, that they didn't actually have a moral hazard concern? Are you offering that opinion?

A. Well --

Q. I'm not asking you for an --

A. No, no, I understand that.

Q. It's a yes or no question.

A. I'm trying to think. Let me put it this way. An hour and a half or so before the decision that Mr. Bernanke made, he had said at the FOMC meeting, regarding the question of moral hazard, that I'm confused and muddled about this concept.

I take away from that statement, as well as other contemporaneous statements, that the issue of moral hazard and how they thought about it truly was confused and muddled.

Q. Okay. And I've got you on confused and I've got you on muddled, but that's not really my question. My question is, is are you offering the opinion as an expert in economics that their intent, their concern about moral hazard wasn't genuine from September 14th to September 16th?

Forget about whether they were right or not. We can have that discussion in a bit. I just want to know, are you offering that opinion, that they didn't actually genuinely have that concern?

A. I don't know what you mean by genuinely concerned. I think, as I said very early on in my testimony, I think they were genuinely worried about a lot of things and --

Q. And one of them --

A. -- and I think they were genuinely dealing with enormous pressure, and I think the circumstances they were involved in were enormously difficult. So, you know, in terms of, you know, them -- their genuine feelings and so on about them, I think it's very hard to know what they actually felt and were specifically thinking.

But when you look back through the record, looking at both the contemporaneous and the after-the-fact explanations, I -- this moral hazard explanation, I just don't see it as an economically rational explanation of the Government taking an 80 percent equity stake in AIG. It just doesn't -- it just doesn't make sense.

Q. I completely -- I understand that that's your position. You understand the term "ex ante," don't you?

A. Yes.

Q. That means their feelings at the time and not afterwards, right?

A. Well, specifically, it's before.

Q. Before. So, my only question is, sir -- and I think you answered it -- you are offering an opinion, as an expert, that -- that they really didn't have a moral hazard concern; genuinely, that they really didn't say, "Oh, boy, this is going to create moral hazard, I'm really worried about this," that they didn't actually have that particular -- forget about how valid it was, that they didn't actually have that concern on September 14th to September 16th. You're offering that as an expert, correct?

A. I'm offering the opinion that you cannot link the 80 percent taking of equity to a moral hazard justification as a matter of economics.

Q. Okay.

A. Just -- they're -- you cannot, in my view, rationalize that behavior that way.

Q. And that's not my question, okay? I understand that, but what I'm asking you is something -- and if you're not offering this opinion, that's fine. We just need to know, okay?

Are you offering an opinion -- not now does it add up, okay, you've given your opinion whatever it is, but the question is, is back then -- and I can show you quotes from them, I can show you documents that say "moral hazard" from back then.

And so my question is, is back then, are you saying these people, who you acknowledge were under pressure and facing a difficult time, making a difficult decision, that one of their concerns in making that decision wasn't the possibility that the AIG loan would create moral hazard? Are you saying that? Yes or no, sir.

MR. BOIES: Object to the form of the question, Your Honor.

MR. DINTZER: Your Honor, we need to get an answer on this.

THE COURT: It got awfully complicated there as you were putting in your conditions and qualifiers.

MR. DINTZER: Okay, I will try again.

THE COURT: Why don't you simplify it.

MR. DINTZER: Fair enough, Your Honor.

BY MR. DINTZER:

Q. Are you saying, not now as an economic justification, but back then, as they stood between September 14th and September 16th, that they did not have a genuine concern, that they believed was a genuine concern, about moral hazard? Are you saying that? Yes

or no, sir.
A. I don't know what their genuine concern was.
Q. So, you are not offering an opinion on that.
A. I am not offering an opinion on their emotional state.
Q. I'm not -- okay. And so you're not offering an opinion that Chairman Bernanke and Secretary Geithner did not really believe that there was a moral hazard concern between September 14th and September 16th, are you?
A. When you ask "really believe," I don't know what they really believed.
Q. So, you are not offering that opinion.
A. You'd need a psychologist for that.
Q. So, you are not offering that opinion.
A. Right.
Q. Okay.
I'm happy to go to the next subject, but I sense --
THE COURT: Let's take a break. We'll come back at 3:35.
(Court in recess.)
THE COURT: Thank you. Please be seated.
Please go ahead.
MR. DINTZER: Thank you, Your Honor.

BY MR. DINTZER:
Q. Sir, if you could turn to PTX 5371, and that's one of your slides.
A. Yes.
Q. And, sir, this slide lists how long it took to sell AIG's major assets and how much they got, correct?
A. It lists the sale date, the assets that were sold, and the proceeds from that sale.
Q. And I think we addressed this a little bit, but if not, just to close the loop on it, they were waiting for the most opportune time to make these sales so they -- I mean, to get the best value, that it took sometimes one, two, or three years to maximize the money on these. Is that right?
A. I can't tell you what the trade-off between the time until the date they decided to sell and the relationship between that being the maximal amount. I mean, I think there's a variety of things that went into the decision about the trade-off between price and sale date.
Q. Okay.
A. I just don't -- I don't -- I didn't analyze the specifics of each sale.
Q. Okay. And so now I'm going to go back to the issue of collateral, and so -- so, the -- the New York

Fed lent, as we know, an $85 billion facility, and it was collateralized by AIG's subs, not all of them necessarily, but their -- a lot of their insurance subs, right, the equity in those insurance subs, right?

A. Yes.

Q. Okay. And if AIG -- so, AIG got access to 85 billion, and if AIG hadn't paid it back, then the idea was that these insurance subs -- that the equity in these insurance subs would pass through the ownership of the New York Fed. Is that right?

A. Yes.

Q. I mean, that's the way collateral works. That's what you get in exchange for the loan if they can't pay back the loan.

A. Roughly speaking, yes.

Q. Now, do you understand -- and I'm not going to ask you a legal question -- do you understand that the Plaintiffs are suing saying that the New York Fed could not hold equity, roughly? Do you understand that that's one of their claims?

A. Yes.

Q. Okay. So, if that happens to be the case and it turns out they couldn't hold equity, my only question for you as an economist is this: Did AIG have enough assets that were not equity to secure an $85 billion

loan? And if you don't know, then that's fine.
A. Well, AIG had a trillion dollars' worth of assets on its balance sheet.
Q. Right. So, I'm just asking you. If they couldn't pledge the equity, do you know if they had enough -- given that the market value was whatever it was, do you know if they had enough other assets that weren't equity -- didn't belong in the equity, that weren't equity -- that they could pledge?
A. Well, I just described to you, you know, the assets they had on their balance sheet, you know, the -- the combined balance sheet. I had also done calculations and have presented those, the types of assets that could have been pledged to the PDCF or PDCF-like facility, which were ultimately done in October.
Q. But -- okay. So, it had --
A. So, in terms of providing security for liquidity, there's certainly other ways to have done this besides the way that was chosen.
Q. Okay. So, we know that it has all these subs, right?
A. Yes.
Q. And that was the equity that was pledged, right?
A. Yes.

Q. And the subs have a lot of assets, right? I mean, that's -- they have all those things that they have to -- you have to keep in reserve for policyholders, right?

A. Yes.

Q. Do you know if -- that if those assets could have been pledged to secure the $85 billion, the specific assets of the subs for a loan to the parent?

A. I showed you calculations of how to do that.

Q. Right. But do you know if the insurance regulators would have allowed that, to secure the 85 billion, not a PDCF where the money comes to the subs, but the loan to the parent?

A. So, what I described in my calculations was how each of the subsidiaries could have financed their share of the securities lending portfolio. I further described how, on top of that, the Dinallo or Patterson plan could have been implemented to upstream another $20 billion to the parent, and I've further described how the parent through, again, a PDCF-type repo-type structure, an additional 12 billion or so could have been raised. That would have gone a long way to resolving the two primary liquidity issues that concerned the rating agencies and the markets at the time.

Q. And that doesn't -- and I understand, sir, and that doesn't answer my question.

My question is, is if AIG was going to get the exact same loan, the $85 billion credit agreement, okay, not some -- some of these other ways of doing it -- I understand you have already said all that, but if they were going to get the exact same loan but couldn't pledge equity, do you know -- and if you haven't done the analysis, just tell me -- but do you know if there was other things that AIG owned directly that could have been pledged for its own $85 billion loan to the New York Fed? Do you know that?

A. I don't understand your question. I mean, I tried to answer it as best I can.

Q. Okay. Well, let me try one more time, sir.

There's this $85 billion loan, and it's secured by equity in subs, right?

A. Yes.

Q. Okay. If it turns out that the equity in the subs can't secure this loan -- and I'm not talking -- so, I'm not talking about some other loan, just this same loan -- do you know if AIG had other assets that could have secured the credit facility, the revolving credit facility?

A. Well, it -- it -- it strikes me your question is assume away all of AIG's assets, do they have other assets to pledge -- you know, to secure the loan? That's why I don't understand the question, because the question is -- the answer to your question is self-evidently no, because you've assumed away all the assets.

Q. Well, I've just assumed away the equity in the insurance subs, because if we enter a world where the New York Fed can't hold equity, and so I'm just asking, if you assume away the equity in the insurance subs, do you know of or have you done any analysis that could -- the 85 billion could be supported, that specific loan, by other holdings of AIG?

A. Well, I'm still confused. AIG in your diagram, I think, is a holding company --

Q. Yes.

A. -- and --

Q. As it is in the real world.

A. Right, and its assets -- its primary assets are in the insurance companies.

Q. The equity in the insurance companies.

A. Right.

Q. Right, okay.

A. And so if --

Q. If you can't pledge those --

A. -- you look at the three little nodules that are dangling there, I don't know what they are in your mind, but I think you've assumed those don't exist.

Q. Well, actually, no, I'm asking what those are. Other than the equity in the insurance subs, I'm asking -- I'm actually -- that is my question. Other than the equity in the insurance subs, does AIG own anything else -- and equity in, say, airplane leasing -- does AIG own anything else that it could pledge for the 85 billion? That's my question.

A. I mean, there's real estate, as I identified. There was, you know, on the order of another 12 billion it could have pledged.

Q. That AIG could have --

A. I haven't done -- I -- so, those are some other assets that could have been pledged if you assume away the existence of the insurance subsidiaries.

Q. And do you know if those would have been enough to cover an $85 billion loan?

A. I don't think so.

Q. Okay.

With that, Your Honor, we pass the witness.

THE COURT: All right. Thank you, Mr. Dintzer.

Mr. Boies, do you have a question or two?

MR. BOIES: I do, Your Honor. I do,

unfortunately.

THE WITNESS: Well, it's Halloween tomorrow.

REDIRECT EXAMINATION

BY MR. BOIES:

Q. Good afternoon, Dr. Cragg.

A. Good afternoon.

Q. I'd like to begin where counsel for the United States left off, and he was asking you about the collateral that had been pledged by AIG.

A. Yes.

Q. And in the course of your investigation, did you ascertain whether, in fact, AIG did pledge the equity -- the shares in its insurance companies?

A. Yes.

Q. And did anyone at the Federal Reserve, insofar as you are aware, say that they could not pledge that collateral as collateral for the loan?

A. No.

Q. Are you aware of anyone, prior to the questions this afternoon by the Government, that ever suggested that the Fed could not take as collateral equity in subsidiaries of a borrower?

A. No.

Q. As a matter of economics, do you understand whether or not there is any difference between a lender taking collateral that is returned after the loan is paid off and taking equity in the borrower that the lender keeps even after the loan is paid off?

MR. DINTZER: Objection, Your Honor. I think that crosses the leading line. So, we object.

THE COURT: All right. Maybe he can rephrase.

BY MR. BOIES:

Q. As a matter of economics, do you understand whether or not there is any difference between a lender taking collateral that is returned after the loan is paid off, on the one hand, or on the other hand, taking equity in the borrower that the lender keeps even after the loan is paid off?

A. No. I think they are economically equivalent.

Q. I need to pursue that, because I'm not sure that I was clear or if I -- if I -- if I --

A. I mean, I agree that it was a complex question, so...

Q. Yeah. And perhaps counsel for the Government was trying to save me from myself.

But I asked you earlier whether you were aware of anyone that had ever suggested that the Fed could not take collateral equity in subsidiaries of a borrower, and you said no. Do you recall that?

A. Yes.

Q. Are you aware -- and you may not be -- but are you aware, because counsel for the Defendant asked you about this, that in this case there is a contention that the Fed could not take borrower -- borrower's equity, not the equity in the subsidiaries, but AIG's parent equity --

A. Yes.

Q. -- not as collateral, but to keep, even after the loan was paid off?

A. I do understand that.

Q. And what -- I'm first trying to draw a distinction and then I want to ask you whether there's an economic significance to the distinction. The distinction I'm trying to draw is between somebody, a lender, that takes something as collateral for a loan that gets returned after the loan's paid back, and a lender taking equity in the borrower that is not returned after the loan is paid back.

Do you understand the distinction?

A. Oh, yes. So, one is you take an ownership stake as an equityholder, and the other is you lend against collateral?

Q. Yes.

A. Yes, there is a difference.

Q. And is there an economic difference?

A. Yes.
Q. What is the economic difference?
A. Well, in the one case where you're lending, you know, you've provided funds, you're paid, you know, a rate of interest, and in the event that you repay the principal and loan -- and interest on the loan, your collateral is returned. The collateral just acts as security in the event that you don't perform on the loan.
In the other you've taken an ownership stake in the asset, and the value that you have changes with the underlying value of the asset, as well as -- you know, whatever other rights come with you being an equityholder also inure to you.
Q. Now, counsel asked you whether economists and the Federal Reserve had narrowed the Bagehot principles. Do you recall that?
A. Yes.
MR. DINTZER: Objection, Your Honor. I think he's mischaracterizing, and I -- obviously, he's welcome to ask the witness anything, but not to restate what I said, and I don't believe that that's a completely accurate characterization.
THE COURT: Often that sort of thing is an introduction to what we're going to talk about next.

MR. DINTZER: Which I fully expect at this point --

THE COURT: You can always say, "We're going to talk about the Bagehot principle now," then go right into it.

MR. DINTZER: We would appreciate that, Your Honor.

BY MR. BOIES:

Q. Let's talk about the Bagehot principle. Do you recall that counsel for the United States directed your attention to a question and answer in your deposition about the Bagehot principle?

A. Vaguely. It's been a while now, so...

Q. Do you still have that section of your deposition up there?

A. I'm sure I do have it. I just have to find it.

MR. BOIES: In fact, did you give him the entire deposition?

MR. DINTZER: Yes.

BY MR. BOIES:

Q. You probably have the entire deposition up there.

A. Yes.

Q. And if you would turn to page 173 of that deposition, and he directed your attention to the question and answer on page 173 at line 5 through 9. Do you see that?

A. Yes.

Q. And this is a -- no, I apologize. I'm referring to the rough transcript that he handed out that was referring to your deposition. The -- the question and answer is at page 173 of yesterday's transcript where he is quoting your deposition. The deposition is -- starts on page 155.

A. Oh, okay.

MR. DINTZER: If we could just ask, Your Honor, Counsel, are you directing us to the transcript -- I mean, to the trial transcript or to the deposition transcript?

MR. BOIES: Let me begin by directing your attention to the trial transcript.

MR. DINTZER: If we could just ask for a moment, then, because I don't know if we have that -- we're getting it.

MR. BOIES: And I'm going to be going to page 172 of the trial transcript.

MR. DINTZER: Okay. If Your Honor wants one, we have an extra copy.

THE COURT: That's all right. I'll just listen, and I think we're going to the deposition soon anyway, which I have.

MR. BOIES: Yes.

BY MR. BOIES:

Q. And do you see on page -- oh, okay.

If you want a copy, this is the rough transcript, Your Honor.

THE COURT: All right, thank you.

MR. BOIES: One of us is determined to do it.

BY MR. BOIES:

Q. So, at page 172 of yesterday's rough transcript, counsel for Defendant directs your attention to page 155 of your deposition and, in particular, at line 17 to a statement where you, in your deposition, said:

"So, he" -- referring to Mr. Bagehot -- "had a very broad view of what that could be. Generally the economics profession as well as central bankers have taken a narrower view of what that lender of last resort's role is."

Do you recall that?

A. Yes.

Q. Now, I'd like you to go now to your deposition at page 155.

A. Yes.

Q. And I'd like to direct your attention to the question to which, what counsel for the United States directed your attention to, was one paragraph. The question was:

"QUESTION: Does Bagehot speak to whether a central bank should provide funding to the small businesses and the homeowners, or is Bagehot really talking about financial institutions?

"ANSWER: Well, Bagehot's writing recognizes that a panic can hurt any institution, and he espouses the view that, in general, it makes sense to correct the negative externalities caused by panic, regardless of what they affect.

"So he made the broad observation that there is essentially a destruction of social value that the government, or lender of last resort, can avoid.

"So he had a very broad view of what that could be. Generally, the economics profession as well as central bank customers have taken a narrow view on what the lender of last resort's role is.

"It's changed because during the depression, a lot of the Federal Reserve Act was actually targeted towards getting credit for people who otherwise couldn't get credit. So, that was a lot of the motivation for the way it was written.

"But as well, there was the -- it was written in a way that it also provided the Fed with the ability to provide liquidity. They are different concepts. Generally, at this point in time, most people consider that the role was to provide liquidity and not credit."

Do you see that?

A. Yes.

Q. And when you referred to "the role," what were you referring to?

A. That's the role of the Federal Reserve or the lender of last resort.

Q. And when you were distinguishing between providing liquidity and providing credit, what were you referring to?

A. That the -- the concept is, as lender of last resort, to provide -- for solvent institutions that face a liquidity shortage because of market circumstances due to some interruption, like a panic, for the lender of last resort to step in and correct that market dysfunction that's caused a negative externality to -- it can cause a negative externality to anybody.

Q. And do you believe that economists or central banks have taken a narrower view of their role or of the Bagehot principle with respect to the provision of liquidity, not the provision of credit, but the provision of liquidity?

A. I think conceptually they have looked at the general proposition that we're talking about in terms of providing liquidity to solvent institutions that face problems due to market failures. That's a -- you know, I think a guiding principle in general for government institutions, which is to create market failure -- to correct market failures. That principle is generally accepted and -- because of the destruction of social value.

I think there's a variation across both economists and central bankers as to how they think about whether this principle should be limited and when it should be limited, but in general, the limitations are merely to -- well, I shouldn't say merely. Ultimately, the objective is always the same, which is to reestablish confidence so the market doesn't fail institutions that are solvent but suffering from a lack of liquidity because of a market disruption.

Q. Let me hand up a binder that has some additional materials.

A. Thank you.

MR. BOIES: I apologize to the Court, because these materials are materials that we have given the Court several times, but in order to have it in a binder for the witness, we're presenting them again.

BY MR. BOIES:

Q. What I want to do is direct your attention to a number of documents about the Bagehot principle and about the view of the Federal Reserve and, to some extent, economists concerning whether the Bagehot principle is or is not still applicable.

A. Yes.

Q. And first let me direct your attention behind Tab 1 to Plaintiffs' Trial Exhibit 15, which is a May 13th, 2008, address by Chairman Bernanke.

A. Yes.

Q. And this is in evidence.

And in the second paragraph, do you see where he says, "In my remarks today, I will begin by reviewing the principles that should guide central banks' actions to support market liquidity."

Do you see that?

A. Yes.

Q. And then under the heading "The Principles Behind Central Bank Liquidity Provisions," do you see that?

A. Yes.

Q. Mr. Bernanke says, "The notion that a central bank should provide liquidity to the banking system in a crisis has a long intellectual lineage. Walter Bagehot's Lombard Street, published in 1873, remains one of the classic treatments of the role of the central bank in the management of financial crises."

Do you see that?

A. Yes.

Q. And is that consistent with your views?

A. Yes.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 537, which is a Board of Governors publication of an address by Brian Madigan, who was director of monetary affairs at the Federal Reserve Bank of Kansas City.

A. Yes. He's presenting this at the Jacksonville Conference, which is done annually in August. So, this is a year after the financial crisis.

Q. And it's dated August 21, 2009. Is that correct?

A. Yes.

MR. BOIES: I would offer Plaintiffs' Trial Exhibit 537.

MR. DINTZER: No objection, Your Honor.

THE COURT: Plaintiffs' Trial Exhibit 537 is admitted.

(Plaintiffs' Exhibit Number 537 was admitted into evidence.)

BY MR. BOIES:

Q. Let me ask you to look at the first paragraph and the first sentence. Mr. Madigan talks about the appropriate scope of central bank policy actions in a crisis and notes that it's a matter of significant public discussion.

A. Yes.

Q. In the next sentence, he says, "For central bankers, however, the essential principles guiding their actions are long-standing and well established. In considering the appropriate central bank response to a financial crisis, monetary economists have long appealed to the insights that Walter Bagehot set forth in Lombard Street. Paul Tucker, for example, recently summarized Bagehot's dictum as follows: 'To avert panic, central banks should lend early and freely (i.e. without limit), to solvent firms, against good collateral, and at 'high rates.'" Do you see that?

A. Yes. Paul Tucker is the head of the Bank of England.

Q. And does that inform your view as to whether or not Bagehot's principles are still accepted by central bankers?

A. Well, it accords with my view. There are many -- there are many places where you'll find similar quotes and applications of these principles in public discourse by central bankers.

Q. The next paragraph begins, "Bagehot's dictum is well founded..." Do you see that?

A. Yes.

Q. "...by lending freely, the central bank may be able to quell powerful panic-driven demands for liquidity and their potentially untoward effects on the economy."

A. Yes.

Q. And he goes on to say, "Providing a virtually unlimited source of liquidity to institutions can avert the fire sales that can lead to decreases in asset values, reductions in wealth, and ultimately to a costly contraction in economic activity."

Do you see that?

A. Yes. That's the liquidity cycle that I have tried to describe.

Q. That's what I was going to ask. How, if at all, does that relate to your liquidity cycle?

A. Well, the cycle is one where, when somebody can't -- they're solvent but they can't get liquidity to fund their business or their investment or whatever it is, in that instance, if they're forced to sell -- and there are many people who are starting to do that, because panic is developing -- that can lead to fire sales that bring asset prices down below their long-run value, which then harms everybody else's ability to borrow against assets.

And then, as that cycle begins to become self-reinforcing, fear sets in and people with liquidity are no longer willing to extend that liquidity and instead hoard that liquidity, and that creates a big contraction simply because of emotional concerns as opposed to, you know, sound, kind of rational economic ones.

Q. Jumping down to the third paragraph, it says, "At the same time, Bagehot's dictum can be viewed as having a sound foundation in microeconomics -- one directed at promoting the efficient allocation of resources. By lending only to solvent firms, by lending only against good collateral, and by charging a penalty rate, central banks can limit the moral hazard and other distortionary effects of government intervention in private financial markets that can impair the efficiency of the economy."

Do you see that?

A. Yes.

Q. And, first, do you agree with that proposition?

A. I do. And Mr. Madigan goes on to develop conceptually what he means over the remainder of that paragraph.

Q. What significance, if any, did what Mr. Madigan says here have to your conclusions about whether or not the moral hazard issue is something that would be related to the taking of equity as opposed to a charging of an interest rate?

A. Well, the -- in general, the -- the use of a penalty rate is designed to encourage firms from only using the lender of last resort in times of real need. So, when circumstances return back to normal, the penalty rate is above the normal rate, and it forces firms to wean themselves of that.

In terms of the type of moral hazard created where institutions incorporate the presence of -- the automatic presence of backstop liquidity into their decision-making, which can lead them to take excess risk, Mr. Madigan and, you know, any central banker, any economist would say that the way to deal with that is through prudential supervision.

Q. Let me ask you to look at one more document. This is behind --

A. Which is, by the way, Bagehot, also. I think I cited Bagehot's views on that earlier, too.

Q. Would you explain what you mean.

A. Well, Mr. Bagehot -- and actually, I think in this previous lecture by Mr. Bernanke, he speaks to that the time of dealing with, you know, moral hazard -- of course, you know, Bagehot doesn't call it moral hazard, but he uses some more contemporary term, like -- I can't remember how he phrases it, but he's basically saying for those who have not acted well or have taken, you know, excess risk, that you don't deal with them in a moment of crisis. You either announce beforehand what you're going to do and use rules or afterwards you put in place essentially, you know, prudential oversight.

Q. Let me ask you to look -- I said a moment ago one, but it's actually two additional documents. One is Plaintiffs' Trial Exhibit 682 that is behind Tab 5.

A. Yeah.

Q. And this is a speech dated November 8, 2013, by Chairman Bernanke.

A. Yes.

MR. BOIES: I would offer this exhibit.

MR. DINTZER: No objection, Your Honor.

THE COURT: Plaintiffs' Trial Exhibit 682 is admitted.

(Plaintiffs' Exhibit Number 682 was admitted into evidence.)

BY MR. BOIES:

Q. If I could direct your attention to page 2, the paragraph at the bottom, where Chairman Bernanke says, "When the financial system teetered near collapse in 2008 and 2009, we responded as 19th century essayist Walter Bagehot advised, by serving as liquidity provider of last resort to stressed financial firms and markets."

Do you see that?

A. Actually, did you say you were on page 2?

Q. Page 2 of Plaintiffs' Trial Exhibit 684.

A. Oh, 684. I'm sorry.

THE COURT: No, 682 I think it is.

MR. BOIES: I apologize. Your Honor, I -- I said 682, I meant 682, and I turned to 684, where there was another good quote.

THE WITNESS: By the way, while we're creating disorder, the -- when I was talking about Mr. Bernanke citing to Bagehot regarding moral hazard being in tab number 1 here, he speaks to that on page 6 of 7 of PTX 15, if you're interested in reading it at some point.

BY MR. BOIES:

Q. Let me just -- we don't have to necessarily read it right now, but what page did you say it was?

A. Page 6 of 7 of PTX 15.

Q. And just so we're sure we know what you're referring to, is it in the last paragraph, the second sentence?

A. Yes. It starts, "Recall Bagehot's advice: The time for economy and for accumulation is before. A good banker will have accumulated in ordinary times a reserve he is to make use of in extraordinary times." And then he --

MR. DINTZER: Your Honor, I don't mean to -- I appreciate counsel's efforts to move things along, but he's not asking questions. The witness is just paging through and testifying, and it doesn't actually allow me to do anything, because I can't object if he's asking -- depending on what he's asking.

So, we would ask -- obviously we don't want to interfere, but we would ask that they resume the sort of question and answer format.

THE COURT: Yes. I think the question and answer format would be preferred.

MR. DINTZER: Thank you, Your Honor.

BY MR. BOIES:

Q. As my next question, let me direct your attention to the quote that I read that was not the quote I had referenced in Plaintiffs' Trial Exhibit 682, but in Plaintiffs' Trial Exhibit 684.

THE COURT: When you offered Exhibit --

MR. BOIES: I meant to offer 682, and that was actually the -- that was the document I wanted to direct the witness' attention to. I thought that when I turned the page, I was turning to the second page of 682, which is behind Tab 5, but I, in fact, turned to the second page of 684, which is behind Tab 6, and seeing this quote, which was similar to the one I had planned to use in 682, I just assumed that I was in the right document, and I wasn't.

THE COURT: So, where are we now?

MR. BOIES: Plaintiffs' Trial Exhibit 684.

MR. DINTZER: And not to sow confusion at all, but we have binder -- more than one -- we have at least one binder, apparently a binder left over from Zingales, but the one that you handed us, where at least one of them has highlighting in it. And having been the perpetrators of that accident ourselves, we understand that that can happen, but we just want to make sure.

It's Exhibit -- it's Tab 5, PTX 682. I don't know if that's the one we moved. I'm getting a little behind here. I don't know if that's the one we moved into evidence.

MR. BOIES: 682 is the one we moved into evidence.

MR. DINTZER: Okay. So, 682, the one we moved into evidence, at least one of our versions has highlighting, and I don't know if the Court and the witness have those as well.

MR. BOIES: May I approach, Your Honor?

THE WITNESS: I have no highlighting, but...

THE COURT: I have no highlighting.

MR. DINTZER: No highlighting? It's not a problem with us, Your Honor. We understand these things happen, but I just wanted to make sure that we were on the same highlighted page, or not.

MR. BOIES: The witness' binder is not highlighted.

MR. DINTZER: Okay. Then we don't have a problem with it, Your Honor.

BY MR. BOIES:

Q. Dr. Cragg, can I direct your attention to Plaintiffs' Trial Exhibit 684?

A. Yes.

Q. And the first sentence in the last paragraph, which we previously directed your attention to, "When the financial system teetered near collapse in 2008 and 2009, we responded as the 19th century British essayist Walter Bagehot advised, by serving as liquidity provider of last resort to stressed financial firms and markets."

Do you see that?

A. Yes.

Q. And what significance, if any, does that have to whether or not Bagehot is still recognized by economists and central bankers as providing guidance for how central banks should operate?

A. Well, it's another example of the support that a central banker is pointing to in explaining the way that they designed and dealt with the financial collapse in 2008 and 2009.

Q. If I could direct your attention to the next page of Plaintiffs' Trial Exhibit 684, to the second full sentence that begins, "Thus, the Fed lent not only to commercial banks but also extended its liquidity facilities to critical nonbank institutions and key financial markets, such as the commercial paper market."

Do you see that?

A. I do, yes.

Q. And what significance, if any, does that have to whether or not the role of the central bank in providing liquidity in terms of a crisis extends beyond banks?

A. Well, Bagehot and I think central bankers in general recognize that the problem in a financial crisis is one of confidence, and that confidence may manifest itself in other markets beyond just traditional commercial banks.

And as I tried to describe in my testimony yesterday, the new world that we live in relative to the world that Mr. Bagehot lived in is a different one where the parallel banking system plays a central role, but he was prescient enough to understand that confidence is a characteristic that affects any market where you're essentially exchanging assets between today and tomorrow.

And because there's that difference in timing between today and tomorrow, your willingness to make that interplay has to be based upon confidence. And so Mr. Bagehot and economists and central bankers, you know, fully understand that it's not just through banks that that inter -- that interplay between today and tomorrow occurs, but it can happen in many different places in the economy.

Q. Let me direct your attention now to Plaintiffs' Trial Exhibit 682, which I had previously offered, and to page 6, and at the top of the page, the third sentence --

A. Yes.

Q. -- which reads, "In the more recent crisis, the Federal Reserve fulfilled the role of liquidity provider, consistent with the classic prescriptions of Walter Bagehot."

Do you see that?

A. Yes.

Q. And then Mr. Bernanke goes on to say, "The Fed lent not only to banks, but, seeking to stem the panic in wholesale funding markets, it also extended its lender-of-last-resort facilities to support nonbank institutions, such as investment banks and money market funds, and key financial markets, such as those for commercial paper and asset-backed securities."

Do you see that?

A. Yes.

Q. And is that consistent with your opinion as to what the role of the central bank should be as a matter of economic theory?

A. Yes.

Q. Counsel for the United States asked you whether the Fed took Bagehot literally in the 1970s and the 1980s. Do you recall that?

A. Yes.

Q. Were there any 13(3) loans in the 1970s or the 1980s?

A. No.

Q. Let me turn to another subject, and that has to do with interest rates.

A. Yes.

Q. And counsel for the United States asked you whether the federal funds rate had any role in -- well, let me try to get the exact language, because it is a little bit complicated. It's on page 192 of the rough transcript that I handed out, and for context, at line 15, you were asked:

"QUESTION: And you used the term 'normal rate,' and I just want to make sure -- I'm not sure that that's been explained to the Court. The normal rate is the rate that might have been obtained had there not have been a financial crisis. Is that right?

"ANSWER: Yes.

"QUESTION: And so my only question is this, sir: If the penalty rate, you know, some amount above the federal funds rate, if that's lower than they could have gotten here, 11th and 12th in the private market, should the Fed let them, once they cross over this line, so there's no private funds available, should the Fed give them a rate, a loan at this lower rate or should the Fed try to mimic what's available in the private market so that there's no benefit to sort of jumping the line and not being able to raise money in the private market?"

And I am going to follow up on that question, but your answer, so that it's complete:

"ANSWER: Well, the Fed is trying to calm panic, and so in the case of AIG, you know, lending at a rate which is comparable to what others were borrowing at would be a sensible policy at that stage."

Now, going back to follow up on the question, to whom was the Fed funds rate given during the crisis?

A. Well, during the crisis, the Fed funds rate is -- I mean, it's a target rate. It's -- in that the Federal Reserve is trying to set that rate through its open market operations, and it's the interest that's paid on reserve deposits.

In terms of what was actually being charged for backstop liquidity support, that would have been the primary rate or the secondary rate, which differs from the federal funds rate by 25 basis points during the crisis. Typically, it differs by 50 basis points.

Q. So, during the crisis, the penalty rate is represented by what you called the primary credit rate, which was 25 basis points above the Fed funds rate?

A. Yes.

Q. And the secondary rate was how much above the primary rate?

A. Another 25 basis points --

Q. And --

A. -- during the crisis.

Q. During the crisis.

And during the crisis, what rate was charged for the PDCF borrowings, as an example?
A. The primary rate.
Q. And let me direct your attention to your Demonstrative Exhibit 5357.
A. Yes.
Q. And I do so just because this is a convenient way of directing your attention to Chairman Bernanke's testimony that you quote here.
"QUESTION: And a penalty rate is an interest rate that is slightly higher than the interest rate that would be charged under normal circumstances, correct?
"ANSWER: Yes, sir."
Do you see that?
A. Yes.
Q. And what did you understand or what do you understand the penalty rate being referred to here to be?
A. That would be the rate that would be charged to both commercial banks and primary dealers for their access to the discount window, and that discount window was given access through, you know, the primary dealer credit facility as well as the traditional access that commercial banks had.
Q. And what was that rate, as you've described it?

A. That's the federal funds rate plus 25 basis points.

Q. Otherwise known as the primary credit rate?

A. Yes, that's right.

Q. Let me direct your attention next to an exhibit that counsel for the United States showed you this afternoon, and that's Plaintiffs' Trial Exhibit 5371.

MR. DINTZER: Counsel, which binder?

MR. BOIES: This is the demonstrative binder.

MR. DINTZER: Okay. Thank you.

THE WITNESS: Oh, yes.

BY MR. BOIES:

Q. And counsel asked you whether this was a list of how long it took to sell these assets. Do you recall that?

A. Yes.

Q. And you had a discussion as to whether this was or was not the most opportune time to sell the assets. Do you recall that?

A. Right.

Q. In your analysis -- and I want to focus your attention to the two largest sales here, which was the sale of ALICO and the AIA common stock issuance.

A. Yes.

Q. And those two together comprise the substantial

majority of all of the asset proceeds, correct?
A. Yes.
Q. And these sales took place in October and November of 2010.
A. Yes.
Q. As part of your analysis, did you investigate or come to know whether or not there was an opportunity to sell these particular assets back in September of 2008?
A. Well, I was here when we heard the videotaped testimony from one of the AIG board of directors who was a member of Blackstone, who had spoken about interest from I guess the Chinese Government in acquiring these. That would be one example.
Q. Um-hum. And do you remember what price the Chinese Government put on the table back in September of 2008 for those assets?
A. His testimony was 50 billion.
Q. Let me ask you to turn to the subject of Goldman Sachs and the bank holding company status.
A. Yes.
Q. The -- counsel for the Department of Justice asked you this afternoon whether Goldman was required to raise funds in the private market and dilute their shareholders. Do you recall that?
A. Yes.

Q. First, was Goldman able, as you understood it from your analysis, to raise private capital prior to the time that it became a bank holding company?

A. My review of the facts suggests that the week prior to it becoming a bank holding company, the only access to liquidity that it had was through government facilities.

Q. And in the week before it became a bank holding company, what federal liquidity facilities did Goldman have to assist it?

A. It had the TSLF, the PDCF, STOMO. Those would have been the primary sources that it had at that point.

Q. And did you identify whether those facilities alone were sufficient to assure the survival of Goldman as of the end of that week?

A. I didn't do an analysis of their -- of their liquidity and balance sheet at that stage, but the -- the record shows that there was extreme concern about both Morgan Stanley and Goldman Sachs actually being able to make it through the weekend of the 20th and 21st of September.

Q. And were you here -- I simply don't remember -- when Mr. Geithner testified?

A. Yes.

Q. Did you hear what Mr. Geithner testified about that?

A. Yes. He reported on --

MR. DINTZER: Objection. Objection, Your Honor. The witness has said that he didn't do the analysis, and, I mean, I -- the transcript is what the transcript is, but to ask this witness simply what he remembers another witness said, I don't think that benefits the Court or -- I mean, it -- it's hearsay of trial testimony that's already in the record. We object as redundant and irrelevant.

THE COURT: Mr. Boies?

MR. BOIES: Could we just briefly excuse the witness before I say anything?

THE COURT: All right.

Could you step outside again, Dr. Cragg, just for a moment?

THE WITNESS: I may not come back.

THE COURT: That's the risk at this point.

(Witness excused.)

THE COURT: All right.

MR. BOIES: I don't want to -- I didn't want to speak in front of him and suggest what I think he's going to say, but I believe that what his testimony is, is that he did not do a balance sheet analysis himself, but he relied on what others had done, and he relied on what -- other documents that were in the record. And I think that that is exactly what experts often do, and I think it's entirely appropriate to ask him about that.

THE COURT: Mr. Dintzer?

MR. DINTZER: Your Honor, if he didn't do the balance sheet analysis, the materials that are in the record are already in the record, and so the -- there's nothing -- there's no gloss for him to add to it. I mean, it's in the record. So, we'd object to him regurgitating the facts that the Court's already heard.

THE COURT: Well, you know, I think it's going to be pretty limited and we're going to get through it quickly. I'm willing to let him say what he wants to say.

MR. DINTZER: Thank you, Your Honor.

THE COURT: All right.

(Witness present.)

THE COURT: I knew if we took less than a minute on this, you couldn't get too far.

THE WITNESS: The elevator didn't even make it.

MR. BOIES: Particularly with the marshals out there.

BY MR. BOIES:

Q. Dr. Cragg, I think you said that you have not done your own analysis of Goldman's balance sheet to make an independent determination of whether or not Goldman would have failed or when. Is that correct?

A. Yes.

Q. As part of your economic analysis, did you -- and if so, to what extent -- look at the record and try to make an economic judgment based on the work that others had done and what was in the record?

A. Yeah, I feel -- well, I have looked at very many documents, testimony, depositions, of the circumstances that surround the month of September and, in particular, the week of -- well, the -- you know, the two weeks of September, you know, 9th through the 24th or 25th.

Q. Let me ask you to look at your big binder, Plaintiffs' Trial Exhibits 174 and 175 that are in evidence.

A. Which numbers again? Sorry.

Q. 174 and 175.

A. You said Plaintiffs' Trial Exhibit's 174 and --

Q. Plaintiffs' Exhibits 174 and 175.

A. Yes.

Q. And is that part of what you've relied on in terms of reaching the conclusions that you have?

A. Yes. This is -- both of these are emails that I read and are a basis for the statement I made earlier about the likelihood of Morgan Stanley and Goldman Sachs making it through the weekend.

Q. And this was the weekend of when, sir?

A. This is September 20th and 21st.

Q. And was this after Goldman already had the benefit of the government assistance provided by the PDCF and certain other Federal Reserve credit facilities?

A. Yes.

Q. And you mentioned or I mentioned Mr. Geithner's testimony on this subject.

A. Yes. I mean, I believe he -- he -- well, I thought he looked at both of these emails, but maybe I'm just remembering that I would have liked to have shown them to him myself, but...

Q. He -- I think he was mentioned, certainly, in one of the emails. I believe --

A. Yes, exactly.

Q. -- I believe it was Plaintiffs' Trial Exhibit 175.

A. Yes.

Q. But in addition, do you recall that he testified about this subject in court?

A. Yes.

Q. And without going through that testimony because it's already part of the record, to what extent, if any, did that testimony inform your judgment?

A. Well, it affirmed the conclusion I had drawn that Morgan Stanley and Goldman Sachs being given bank holding -- bank holding company status, you know, with such rapidity on Sunday afternoon, that that was a critical step to their being able to gain market confidence and successfully open on Monday and beyond.

Q. Now, counsel for the Department of Justice also asked whether the capital raise that Goldman was able to do after becoming a bank holding company had diluted Goldman's shareholders, and you said it had, correct?

A. I -- I said I wasn't sure whether the terms of that capital raise -- you know, the extent to which they are dilutive.

Q. Exactly. And that's what I want to direct your attention to now. And Mr. Geithner wrote about this in his book that is Plaintiffs' Trial Exhibit 709.

I don't know whether the Court has its copy.

THE COURT: I took it upstairs, but if you want to just read it, I'll follow along.

MR. BOIES: Let me direct your attention -- and I'll give the witness a copy.

Do you have a copy of it, the book?

MR. DINTZER: Yes, Counsel, but if you could give us a minute to scare it up.

MR. BOIES: Sure.

I've got another copy just in case you want it. I'll take it back afterwards.

BY MR. BOIES:

Q. And this goes to the subject that we were talking about before in terms of what state Goldman was in that week, and I'd direct your attention to page 199, in particular, which you can see from page 198 is Mr. Geithner recounting what happened the morning of September 18th, 2008. Do you see that?

A. Yes.

Q. And would you just read the first few paragraphs on page 199 to yourself, and then I just want to ask you some questions about that.

THE COURT: Is this page 199 of the book?

MR. BOIES: This is page 199 of the book, and since we marked the book itself, I've been using the book page numbers, although I know that we have confused the record a little bit by having marked it as a xeroxed copy where we marked the cover page so that the page numbers are all off.

THE WITNESS: (Document review.) Yes.

BY MR. BOIES:

Q. Is that material that you relied on in forming your conclusions about what the state of Goldman was the

week of September 16th?
A. Yes. It's part of the materials that, you know, together confirmed and developed my view that Goldman, Morgan Stanley, and numerous other institutions were, you know, in crisis that week.
Q. I now want to direct your attention to Defendant's Exhibit 2217, which was a document that they handed up to you this afternoon.
A. I've got it here.
Q. Now, first, with respect to the dilution that the Goldman shareholders had, do you have an understanding as to whether or not that dilution came in the form of warrants that had an exercise price?
A. Yes.
Q. And does Defendant's Exhibit 2217, particularly the second paragraph, refresh your recollection as to what that exercise price was per share?
A. Yes. Here it states that the exercise price was $115.
Q. And with respect to the preferred shares that Mr. Buffett and his company received, did that have an interest rate associated with it?
A. I believe it did, but I just don't remember what it -- what it was.
Q. All right. Let me hand you Defendant's Exhibit

931.

A. You know, later in this article, by the way, it mentions, you know, the 5 billion in preferred stock with a 10 percent dividend.

Q. Ah, it does. So, we don't need Defendant's Exhibit 931, because I was going to give it to you only for the purpose of refreshing your recollection as to what the interest rate was.

Now, from an economic standpoint, how would you compare the interest rate and warrants that Goldman paid and gave to the interest rate and equity that AIG shareholders were required to provide?

A. Well, as I recall this warrant price, I believe that it was out of the money when they were issued, and, you know, obviously that wasn't the case with the way -- the 80 percent equity of AIG that was received by the Government. You know, ultimately there was no strike price for that.

And then the 10 percent dividend rate here is obviously lower than, you know, the interest that was charged to AIG.

Q. Also from an economic standpoint, can you compare what Goldman provided to Buffett for money in connection with this transaction and what Goldman provided to the Federal Reserve for the liquidity that the Federal Reserve provided to Goldman?

A. No. I mean, one is the provision of, you know, secured lending, and the other is, you know, an equity investment.

Q. With respect to the money that Goldman received pursuant to the PDCF, what was the interest rate that Goldman paid?

A. The primary rate.

Q. Did Goldman have to provide any equity?

A. No.

Q. I also now want to direct your attention to Plaintiffs' Trial Exhibit 5354, which counsel directed your attention to today. Do you have that up there?

A. Yes.

Q. And do you recall he showed you Plaintiffs' Trial Exhibit 1502?

A. Yes.

Q. I think he handed it up to you and he asked you to compare certain numbers derived from Plaintiffs' Trial Exhibit 1502 with the numbers that you had provided in 5354. Do you recall that?

A. I do, yes.

Q. Now, the data that you used in 5354, where did that data come from?

A. I've listed, you know, the spreadsheet for where that comes from, PTX -- I think it's PTX 1475 and then PTX 1469.

Q. And do you recall going over at least Plaintiffs' Trial Exhibit 1469 yesterday?

A. Yes.

Q. Let me turn to another subject. You were asked this afternoon whether, with respect to ML III, the counterparties might not want a novation. Do you recall that?

A. Yes.

Q. Was there any effort, insofar as you've been able to determine, by the Federal Reserve to determine whether the counterparties would or would not accept a novation?

A. I'm not aware of that, no.

Q. Let me turn now to Morgan Stanley, and you testified earlier that Morgan Stanley did, in fact, also become a bank holding company.

A. Yes.

Q. And what, as you understand it, was or was not the importance of becoming a bank holding company to Morgan Stanley?

A. Well, I think the importance of it is the Fed expressing a level of confidence in the institution by which the markets could also make a similar inference.

Q. And did you see any materials in the record in which representatives of Morgan Stanley made that assertion or stated that understanding?

A. I don't recall, you know, a specific document coming to mind right now.

MR. BOIES: Can I have just a moment, Your Honor?

(Pause in the proceedings.)

BY MR. BOIES:

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 203.

A. Thank you.

Q. Is this a document that you have considered or relied on in connection with the opinions that you have expressed?

A. Yes.

MR. BOIES: Your Honor, I would offer Plaintiffs' Trial Exhibit 203 for the limited purpose of illustrating the witness' testimony and the support for that testimony.

MR. DINTZER: No objection under 703, Your Honor.

THE COURT: All right. Plaintiffs' Trial Exhibit 203 is admitted with a Rule 703 restriction.

(Plaintiffs' Exhibit Number 203 was admitted into evidence.)

BY MR. BOIES:

Q. And did you understand that -- and I don't want to read this document particularly at this hour -- but did you understand that what's stated in this document reflected Morgan Stanley's view as to the importance of becoming a bank holding company?

A. Yes. The third paragraph, I think, states, you know, the importance of it, and then the quote from John Mack in the fourth, who's the CEO of Morgan Stanley, describes the importance that they perceived in becoming a bank holding company.

Q. Let me ask you to turn next to Plaintiffs' Trial Exhibit 624. It is in their binder. We have copies.

MR. DINTZER: It was handed up, Counsel.

MR. BOIES: Oh, it was handed up.

THE WITNESS: I've got pages 59 to -- oh, I've got --

BY MR. BOIES:

Q. Do you have page 391?

A. Pardon me?

Q. Did they give you 391?

A. No.

THE COURT: Folks, my suggestion is that maybe we should break for today and everybody can get reorganized and --

MR. DINTZER: Get some more binders, Your Honor?

THE COURT: -- and we can get Dr. Cragg on his way home tomorrow. We will reconvene at 9:30 a.m.

(Whereupon, at 4:59 p.m., the proceedings were adjourned.)

CERTIFICATE OF TRANSCRIBER

I, Susanne Bergling, court-approved transcriber, certify that the foregoing is a correct transcription from the official digital sound recording of the proceedings in the above-titled matter.

DATED: 10/31/2014 ______________________________

SUSANNE BERGLING, RMR-CRR-CLR

ADMITTED EXHIBITS

PX	PAGE	DESCRIPTION
203	5452	Morgan Stanley Press Release -Morgan Stanley Granted Federal Bank Holding Company Status By U.S. Federal Reserve Board of Governors: Provides Ongoing and Expanded Access to Federal Reserve Window and Other New Funding Opportunities (Sept. 21, 2008)
537	5422	Brian Madigan Speech at the Federal Reserve Bank of Kansas City's Annual Economic Symposium, "Bagehot's Dictum in Practice: Formulating and Implementing Policies to Combat the Financial Crisis" (Aug. 21, 2009)
682	5427	Ben S. Bernanke Remarks at the Fourteenth Jacques Polak Annual Research Conference, "The Crisis as a Classic Financial Panic" (Nov. 8, 2013)
1502	5352	AIG Draft Slide Deck - Securities Lending Liquidity Contingency Plan (September 5, 2008)

DX	PAGE	DESCRIPTION
126	5310	S&P GLOBAL CREDIT PORTAL RATINGS DIRECT REPORT RE: AMERICAN INTERNATIONAL GROUP RATING LOWERED TO 'AA-' FROM 'AA'; ALL RATINGS PUT ON WATCH NEG

130	5250	LETTER FROM MAURICE GREENBERG TO AIG BOARD OF DIRECTORS RE: CONCERN OVER DETERIORATION OF AIG
146	5264	EMAIL FROM ERIC LITZKY TO STEPHEN BOLLENBACH ET AL RE: LETTER TO THE BOARD OF DIRECTORS FROM MESSRS. BROAD, DAVIS AND MILLER, WITH ATTACHED LETTER TO BOARD OF DIRECTORS, JUNE 11, 2008
191	5315	MEMO TO MR. GREENBERG FROM HOWARD SMITH RE: AIG - 6/30/2008 10Q DISCLOSURE RE: SECURITIES LENDING PROGRAM
211	5318	MEMO FROM HOWIE, FOR YOUR MEETING WITH WILLEMSTAD, TO MAURICE R GREENBERG RE: AIG-CREDIT DEFAULT SWAPS AND SUBPRIME ISSUES, SEPTEMBER 2, 2008
567	5294	EMAIL FROM CHRISTOPHER SWIFT, TO JOSEPH COOK, ANTHONY VALOROSO, ROBERT GENDER, PHILIP JACOBS, STEVE BELCHER, CC ROBERT LEWIS, STEVEN BENSINGER, DAVID HERZOG, RE: FW DOCUMENT FOR BLACKROCK CALL, ATTACHMENT AIG SECURITY LENDING PORTFOLIO DISCUSSION, SEPTEMBER 25, 2008