

THE SEMTEX IN THE AIG RETENTION CONTRACTS

Here's how I understand the white paper AIG just used to convince Tim Geithner that, while the US government can force car companies to cut the wages of line workers, the US government cannot force banksters to cut the wages of the thugs who broke the global financial system. There's a lot of mumbo jumbo about contract law, but that's not the real reason AIG is arguing Geithner can't strip the bonuses. It's the "business reasons" that amount to a deliberate threat:

For example, AIGFP is a party to derivative and structured transactions, guaranteed by AIG, that allow counterparties to terminate in the event of a "cross default" by AIGFP or AIG. A cross default in many of these transactions is defined as a failure by AIGFP to make one or more payments in an amount that exceeds a threshold of \$25 million.

In the event a counterparty elects to terminate a transaction early, such transaction will be terminated at its replacement value, less any previously posted collateral. Due to current market conditions, it is not possible to reliably estimate the replacement cost of these transactions. However, the size of the portfolio with these types of provisions is in the several hundreds of billions of dollars and a cross-default in this portfolio could trigger other cross-defaults over the entire portfolio of AIGFP.

Translated, I take that to mean that AIGFP is a party to a bunch of contracts insured by AIG the US government. And if AIGFP somehow does something that equates to a default on those

contracts, then ~~AIG~~ the US government is on the hook for hundreds of billions of dollars.

The white paper goes on to explain just one scenario that might trigger a default in terms of these contracts.

Departures also have regulatory ramifications. As an example, the resignation of the senior managers of AIGFP's Banque AIG subsidiary would allow the Commission Bancaire, the French banking regulator, to appoint its own designee to step in and manage Banque AIG. Such an appointment would constitute an event of default under Banque AIG's derivative and structured transactions, including the regulatory capital CDS book (\$234 billion notional amount as of December 31, 2008), and potentially cost tens of billions of dollars in unwind costs. Although it is difficult to assess the likelihood of such regulatory action, at a minimum the disruption associated with significant departures related to a failure to honor contractual obligations would require intensive interactions with regulators and other constituents (rating agencies, counterparties, etc.) to assure them of the ongoing viability of AIGFP as well its commitment to honoring counterparty contracts and claims.

I take this to mean that if a bunch of AIGFP managers quit because they didn't receive bonuses promised in their contracts, then France could, if it wanted, to appoint its own designee. And if that happened, then it would equate to a default and those contracts would kick in, at a cost to ~~AIG~~ the US government of at least tens of billions.

In other words, I take this to be a threat: "if you don't give us our bonuses, we'll trigger a default event that will cost ~~AIG~~ the US government tens of billions of dollars." It's

just a polite way of saying, "Pay us the \$100 million ransom or we start exploding the suicide bomber vests we're wearing."

Frankly, I have no idea whether this particular threat—France responding in a way that would set off a default—is real, or whether there are similar events that those AIGFP managers demanding their ransom could easily trigger.

But what they're doing is pointing to one relatively preventable area, noting that we might be able to defuse the explosion before it went off if we worked hard enough with the French, but saying that that, in general, is the kind of thing the AIGFP managers might contemplate if they don't get their bonuses.

AIG agreed to pay the guys whose gambling AIG the US government insures hundreds of millions of dollars in bonuses. And the gamblers are now saying they would be willing to blow their own gambles—ignite their semtex vests—if we refuse to pay up.