FIRST Report for Loss Event 8401/OpData Id 13839

Short Description

The US Federal Reserve, under the guidance of the Treasury Department, took control of American International Group (AIG) with an $85 billion bailout on September 16, 2008. The rescue left the US government holding 80% of the largest insurance company in the world until the company can be recapitalized. The recapitalization was expected to occur through a sale of the insurance company's assets. A significant portion of AIG's problems were attributed to credit derivative losses suffered by its financial products division. The firm was found to have taken on too much risk and to have not had the resources to meet calls for additional collateral when the value of reference CDOs that it had insured started plummeting. New York State Attorney General Andrew Cuomo is investigating payouts the firm made to a series of counterparties who demanded additional collateral. AIG's disclosure statements involving the collateral calls are also being investigated. AIG's underwriting businesses were deemed essentially healthy and believed to be of interest to a variety of possible acquirers. Hank Greenberg, the founder and former chief executive of AIG, was mentioned as a possible buyer for some of the company's assets. At least one pension fund sued AIG for "gross imprudent risk taking."

Organizations

Name:	Firm:	Country:
American International Group Inc.	AIG Financial Products Corp. (AIGFP)	North America\United States\New York

Details

Loss Amount:	85,000,000,000
Currency:	USD
Loss Amount Current:	82,970,888,144
Currency Original:	USD-United States Dollars
Original Currency Amount:	85,000,000,000
Status:	CLOSED
Geography:	North America\United States\New York
Created Date:	9/19/2008
Revision Date:	6/30/2009

Dates

Start Occurrence: 8/1/2007	End Occurrence: 9/16/2008	Settlement Date: 9/16/2008

Long Description

Event Summary

The US Federal Reserve, under the guidance of the Treasury Department, took control of American International Group (AIG) with an $85 billion bailout on September 16, 2008. The rescue left the US government holding 80% of the largest insurance company in the world until the company can be recapitalized. The recapitalization was expected to occur through a sale of the insurance company's assets. A significant portion of AIG's problems were attributed to credit derivative losses suffered by its financial products division. The firm was found to have taken on too much risk and to have not had the resources to meet calls for additional collateral when the value of reference CDOs that it had insured started plummeting. New York State Attorney General Andrew Cuomo is investigating payouts the firm made to a series of counterparties who demanded additional collateral. (see Goldman Sachs, events #9070). AIG's disclosure statements involving the collateral calls are also being investigated.

AIG's underwriting businesses were deemed essentially healthy and believed to be of interest to a variety of possible acquirers. Hank Greenberg, the founder and former chief executive of AIG, was mentioned as a possible buyer for some of the company's assets. At least one pension fund sued AIG for "gross imprudent risk taking."

Event Details

It is unprecedented for the US Federal Reserve to intervene in the rescue of an insurance company, but the decision reflects concern for how intertwined the company was with financial markets and the risk of an even larger systemic failure if the insurer was allowed to go under. Just days before the Federal Reserve stepped in to rescue AIG, it allowed Lehman Brothers to go under rather than provide financial backing. (see event #8392) The failure to rescue Lehman Brothers was surprising because the Federal Reserve earlier stepped in to rescue Bear Stearns (event #8025) in March 2008; circumstances changed since March and the US government came under political pressure to resist appearing to be saving Wall Street while Main Street (or Middle America) suffers from the economic downturn. In the case of AIG, the Federal Reserve said that a "disorderly failure of AIG could add to already significant levels of financial market fragility." AIG's takeover followed the September 7, 2008 government rescue of Freddie Mac and Fannie Mae. (see events #8397, 8396).

AIG's cash shortage, which became evident by the weekend of September 6, 2008, was attributed to its financial products division, which was exposed to credit default swap contracts, including those that insured mortgage backed securities. Credit default swaps provide investors with a type of credit insurance in the event of a default;

credit default swaps are triggered by credit events, including a bankruptcy filing. Besides AIG's importance as the largest insurer in the global markets, and its book of corporate and personal insurance policies, there was worry that if the company was allowed to file for bankruptcy a new round of credit protection contracts would have been triggered and a downward spiral would have been created if the entities that would have to honor contracts on AIG went under and triggered a new round of payouts. The New York Times (9/18/2008) reported that while the company's core business was underwriting insurance contracts and selling annuities, it was "deeply involved in the risky, opaque market for derivatives and other complicated financial instruments that operate largely outside regulation."

Unwinding AIG's portfolio of derivatives contracts is perhaps the largest task ahead for a senior management team that was facing many challenges. It was estimated that AIG provided $440 billion of credit insurance on debt products. Payouts on such transactions and requests for additional collateral dramatically increased since subprime mortgages, which underlie many of these complex debt securities, lost value following the market disruptions of August 2007. (See Goldman Sachs, event #9070.) AIG was a Counterparty to billions of dollars worth of other types of derivatives. There was also concern that if AIG filed for bankruptcy a series of credit default swaps tagged to its debt would have been triggered. For this reason, the government's description of the rescue used specific language that was designed to avoid triggering a credit event.

The Financial Times reported (9/18/2008) that AIG got caught in what was essentially a game of "regulatory arbitrage." Global banks were able to use credit default swaps to offset the amount of capital they had put aside to cover certain credit risks. The banks that entered into default contracts with AIG were able to claim that they were offsetting the risk that a certain underlying credit asset would default. They were allowed to hold less cash in reserve as a result of entering these contracts. The cost of these contracts was less than the cost of holding regulatory capital. AIG advertized the credit protection that it offered as a method for providing "regulatory capital relief rather than risk mitigation." As AIG's credit insurance business grew it also acquired a concentration of credit risk. The Financial Times wrote that as the market for credit default swaps grew, "dangerous levels of counterparty risk would accumulate in institutions willing, as AIGFP was, to write insurance on very attractive terms."

When AIG first approached the Federal Reserve for assistance, it was under the belief that it would need about $20 billion in order to continue operating. New York State allowed AIG to tap into available funds from its insurance subsidiaries in order to cover the shortfall – a comingling of funds which is usually prohibited. But it became evident after JP Morgan, Kohlberg Kravis and J.C. Flowers poured through AIG's books that it needed not $20 billion, but $40 billion and then $65 billion, and later, at least $80 billion in order to survive. AIG received a buyout offer of $10 billion from J.C. Flowers under the condition that it would have to retain its present credit rating. KKR and Texas-Pacific Group offered $20 billion for 50% of the company if the credit rating was maintained and additional funding was provided by Wall Street and the US government. A credit rating downgrade, however, was already planned for the insurance company. The major ratings firms announced on September 15, 2008 that they had downgraded the firm. A series of credit ratings downgrades meant that AIG was required by counterparties on its swaps contracts to post an additional $13.3 billion in collateral. This increased call for additional collateral is believed to have created a cash shortage at AIG and is under investigation by Attorney General Andrew Cuomo and federal regulators.

Also being investigated is the role Joseph Cassano played at the time the collateral calls were occurring. Mr. Cassano was head of AIG's ill-fated financial products division. He told AIG shareholders that "We have, from time to time, gotten collateral calls from people. Then we say to them, 'well, we don't agree with your numbers.'" He added that they then "go away." He made similar statements to his firm's auditors.

Documents received by CBS News (6/23/2009) belie Mr. Cassano's comments concerning the collateral calls; an internal memo documented 84 collateral calls received by late November 2007 totaling more than $4 billion. The same set of documents indicated that 38 calls were from Goldman Sachs, 18 margin calls were from Merrill Lynch and 25 such calls were received from Societe Generale. Despite the large number of collateral calls, CBS reported that during a December 5, 2007 conference call with investors, "AIG executives were silent about the specific number of collateral calls" and appeared to "gloss over any potential problems with its CDS portfolio." Former CEO Martin Sullivan commented on the firm's CDO portfolio during the call: "The probability that it will sustain an economic loss is close to zero." The US Justice Department is allegedly investigating this period in an effort to discern if AIG's senior executives misled investors and auditors about the health of its CDO business.

AIG was the tenth most popular stock holding in employee 401(k) plans. It was also widely held by pension funds. The City of New Orleans Employees' Retirement System announced on September 18, 2008 that it filed a lawsuit against AIG Chief Executive Robert Willumstad and the board of directors of AIG, accusing them of mismanagement and "grossly imprudent risk taking." The pension fund seeks return of all compensation that the firm's individual defendants earned from the company, in addition to other claims for recompense. It is also probable that the firm will be the target of additional shareholder lawsuits that will contend that it failed to properly report its true financial condition and risks. The investment banks that underwrote an AIG offering in May 2008 in an effort to raise cash are vulnerable to lawsuits alleging fiduciary breaches associated with their role as underwriters. This type of suit has already been filed against the underwriters who assisted Fannie Mae with raising funds, even though it was ordered to do so by its regulator.

AIG reported losses related to write-downs on credit default swaps linked partially to subprime mortgages in the fourth quarter of 2007. (see event #7998). The firm was also the subject of continual regulatory investigations over the last several years which were heightened when former New York State Attorney General Eliot Spitzer was in office. Some analysts traced the firm's troubles to the Spitzer regulatory regime which ultimately pushed out long-time CEO Maurice Greenberg. See events #5674, 5618, 5523, 5522, 5519, 5516, 5486, 5179, 5170, 4592.

Control Failings and Contributory Factors

Corporate/Market Condition: AIG was heavily exposed to asset backed securities that had subprime mortgages as their underlying instruments through the credit derivatives market. The appetite for mortgage-backed securities dissipated after the market events of August 2007 when it became evident that subprime mortgages exposed financial markets to a great deal of credit, market and operational risk.

Strategy Flaw: AIG was unique among insurance firms in that it took on so much capital markets related risk and expanded aggressively into non-core businesses, such as offering a form of credit insurance through the significant role it played in credit default swap transactions. A large part of this exposure was through offering protection for bonds linked to mortgage-backed securities. Internal memos that emerged later suggested there were problems with how these contracts were structured. The documents suggested that AIG failed to include reliable thresholds before collateral calls would be triggered; thresholds determine by what percentage reference CDOs would have to decline before the seller of protection is required to post additional collateral. The memos indicate that some of AIG's CDO contracts included no threshold and others were as low as 4%. This offered little protection against the counterparty calls for additional collateral that has been mentioned as a contributory factor to the firm's liquidity crisis in September 2008.

Failure to Disclose: Evidence presented by CBS News suggests that AIG had knowledge that its CDO portfolio might be trouble before a meeting that it held with investors on December 5, 2007. This knowledge may have been reflected in the number of collateral calls it received on the portfolio during the period before the meeting. However, during what the news service called "a crucial meeting," the firm's senior management commented to investors that there was no probability that the portfolio would sustain losses.

Undertook Excessive Risk: A business model that allowed one non-core division within AIG to put the rest of the firm at risk was a high risk-taking strategy. AIG's losses resulting from its credit derivatives exposure reflects the high and very opaque risk inherent in credit default swap transactions. It also represents how concentrated this type of risk became within the firm; in its core insurance underwriting businesses it is unlikely that AIG would have allowed its risk exposure to become so concentrated. The risk associated with credit default swaps can rapidly expand during volatile market conditions, when default triggers exponentially kick-in. A lawsuit filed by a New Orleans pension fund specifically targeted AIG's "grossly imprudent risk taking."

Corrective Actions and Management Response

The terms of the rescue plan call for the issuance of a two-year bridge loan of $85 billion to AIG; in return the US government takes ownership of a 79.9 percent stake in AIG. The bridge loan was granted at the high interest rate of 8.5 percentage points above LIBOR, as a deterrent to any possible moral hazard. It is in AIG's interest to retire the loan as soon as possible through the sale of assets. Assuming ownership through the issuance of equity warrants was a method deployed by the government in order to prohibit shareholders from benefiting directly from the rescue of the company, which was deemed another example of potential moral hazard.

The terms of the rescue called for replacement of the firm's CEO. Edward Liddy replaced Bob Willumstad as the firm's chief executive. Mr. Liddy agreed to receive a salary of $1. Mr. Liddy, the former CEO of Allstate, indicated that he had no intention of shutting down AIG in a letter to employees: "My intention is not to liquidate the company. Insurance operations are solid, capitalized and well funded." He also assured the markets when he said that "the mess we're in is solvable." He announced on May 21, 2008 that he was resigning his position and would remain on the job only until a replacement could be found.

The estimate for AIG's breakup value was in the range of $150 billion. A number of names were mentioned as potential acquirers of AIG's businesses, including Prudential Financial, Prudential PLC, Aviva, Berkshire Hathaway, Munich Re and Allianz. The senior management of AIG's profitable aircraft leasing business was attempting to put together financing for a management buyout.

AIG's Board of Directors issued the following statement on September 16, 2008: "The AIG Board has approved this transaction based on its determination that this is the best alternative for all of AIG's constituencies, including policyholders, customers, creditors, counterparties, employees and shareholders. AIG is a solid company with over $1 trillion in assets and substantial equity, but it has been recently experiencing serious liquidity issues. We believe the loan, which is backed by profitable, well-capitalized operating subsidiaries with substantial value, will protect all AIG policyholders, address rating agency concerns and give AIG the time necessary to conduct asset sales on an orderly basis. We expect that the proceeds of these sales will be sufficient to repay the loan in full and enable AIG's businesses to continue as substantial participants in their respective markets. In return for providing this essential support, American taxpayers will receive a substantial majority ownership interest in AIG."

Lessons Learned

The rescue of AIG led to the inevitable concern for associated moral hazard. The US treasury department and Federal Reserve were also under pressure to explain why they would extend emergency financing to an insurance company when just a day earlier they failed to extend a lifeline to Lehman Brothers. The issue at the crux of the decision is how intertwined the firm is in the overall economy, and how much systemic risk it poses. The decision was made that AIG was too big to fail and too intertwined in world markets. This was the result of the fact that it is one of the widest held stocks in portfolios of many pension funds, mutual funds and by a large number of retail investors, heavily bound into both sides of credit default transactions, and the role it plays as the largest insurer in many markets around the world. By contrast, the failure of Lehman Brothers was predicted to be more contained.

The Federal Reserve's role in stabilizing AIG represented a shift in the regulatory landscape. The Federal Reserve morphed seemingly overnight from an entity that was primarily concerned with the stability and capitalization of the monetary and banking systems to the steward of the overall economy. Some overseas analysts commented that the series of rescues that have occurred during the last few months represents a shift away from a pure free market economy. Whilst maintaining that they understand why the Federal Reserve stepped in to save Fannie Mae, Freddie Mac and AIG, they also commented that hypocrisy was possible because the US government and the World Bank have in the past criticized foreign governments in growth countries that attempted to stabilize ailing private entities.

Keywords

Entity Type	FINANCIAL SERVICES\INSURANCE COMPANY
Business Unit Type	OTHER -- (BUSINESS SERVICES)\INSURANCE SERVICES
Service/Product Offering Type	DERIVATIVES, STRUCTURED PRODUCTS AND COMMODITIES\DERIVATIVE PRODUCTS\CREDIT DERIVATIVES
Contributory/Control Factors	CORPORATE/MARKET CONDITIONS\CORPORATE & MARKET CONDITIONS,MANAGEMENT ACTION/INACTION\UNDERTOOK EXCESSIVE RISKS,STRATEGY FLAW\STRATEGIC FLAW,LACK OF CONTROL\FAILURE TO DISCLOSE
Loss Type:	Known
Loss Impact	INDIRECT LOSS\RELATED STRATEGIC RISK LOSSES,INDIRECT LOSS\RELATED CREDIT RISK LOSSES,INDIRECT LOSS\RATINGS AGENCY DOWNGRADE/RATINGS WATCH,INDIRECT LOSS\MANAGEMENT REMEDIATION,DIRECT LOSS\WRITE-DOWN (BIS)\GENERAL MONETARY LOSS,INDIRECT LOSS\SHARE PRICE
Loss Detection Sources	OTHER LOSS DETECTION SOURCES\LOSS SURFACED
Market Focus	INSTITUTIONAL SERVICES
Event Trigger	PROCESS RISK CLASS\BUSINESS & STRATEGIC RISK\LIQUIDITY RISK
Basel Levels I & II	OTHER (NON BIS)
Basel Business Line	Others\Insurance (Non-BIS)\Insurance - Property & Casualty (Non-BIS)
Industry Event	Credit Crisis

Ratings

Ratings Action	Ratings Code	Effective Date	Ratings Watch/Outlook
Affirmed	AA	2008-01-15	Rating Outlook Stable
Rating Watch On	AA	2008-02-11	Rating Watch Negative
Downgrade	AA-	2008-05-08	Rating Watch Negative
Affirmed	AA-	2008-05-22	Rating Outlook Negative
Rating Watch On	AA-	2008-08-22	Rating Watch Negative
Downgrade	A	2008-09-15	Rating Watch Negative
Revision Implication Watch	A	2008-09-17	Rating Watch Evolving
Affirmed	A	2008-11-10	Rating Outlook Stable
Affirmed	A	2009-03-02	Rating Outlook Stable
9 Ratings found.			

Source

2008-September-16: AIG Press Release, “AIG statement on announcement by Federal Reserve Board of $85 billion secured revolving credit facility.”
2008-September-16: Board of Governors of the Federal Reserve System Press Release, “On AIG.”

2009-July-7: Fortune, “DERIVATIVES: THE RISK THAT STILL WON'T GO AWAY,” by Carol J Loomis.
2009-June-23: CBS News, “Internal doc reveal company silent about dozens of collateral calls,” by Armen Keteyian.
2009-June-23: The Washington Post, “AIG Trading Partners Got Funds Before Bailout,” by Hugh Son and Richard Teitelbaum.
2009-June-22: Bloomberg.com, “AIG trading partners squeeze insurer before bailout,” by Hugh Son and Richard Teitelbaum.
2009-April-7: BusinessWeek.com. “AIG's CDS Hoard: The Great Unraveling; The process of unwinding AIG's credit default swaps isn't rocket science, but it is messy and expensive.”
2009-March-28: International Herald Tribune, “Lawmakers seek details on A.I.G. bank payouts,” By Mary Williams Walsh.
2009-March-28: National Post, “BMO caught up in AIG bailout probe; Could lead to U. S. attempts to claw back funds,” by Eoin Callan.
2009-March-26: Reuters News, “UPDATE 2-New York AG subpoenaes AIG on CDS contracts – sources.”
2009-March-25: Associated Press, “AIG rescue allowed insurer to pay off banks, others at home and abroad,” By GREG KELLER.
2009-March-19: Reuters News, “UPDATE 1-Goldman to respond to coverage of AIG bailout.”
2009-March-19: Los Angeles Times, “Scrutiny of AIG aid broadens; It isn't just about bonuses anymore, as critics question federal officials' longtime ties to bailout recipients,” by Tom Hamburger and Janet Hook.
2009-March-18: BusinessWeek.com, “Who's Who on AIG's List of Counterparties; Among the financial behemoths on the list are Goldman Sachs, Merrill Lynch, and several European banks,” by Nanette Byrnes.
2009-March-17: Dow Jones News, “DJ AIG, Maiden Lane Paid $62B To Settle Derivatives >AIG.”
2009-March-17: USA Today, “Billions of AIG's federal aid went to foreign banks; Some ask why other nations didn't pitch in; others say that'd be bad,” by Pallavi Gogoi; Barbara Hagenbaugh.
2009-March-17: International Herald Tribune, “Banks got part of A.I.G. rescue funds List is released as Obama fights backlash on bonuses.”
2009-March-17: International Herald Tribune, “A.I.G. lists beneficiaries as fears of a backlash rise European banks among recipients of rescue money,” By Mary Williams Walsh.
2009-March-16: The Washington Post, “AIG Discloses $75 Billion in Bailout Payments; Insurer Reveals List of Taxpayer Funds Doled Out to Settle Debts With Companies, Municipalities,” by Brady Dennis.
2009-March-16: The Wall Street Journal, “AIG Faces Growing Wrath Over Payouts,” By Liam Pleven, Serena Ng and Sudeep Reddy.
2009-March-16: International Herald Tribune, “Looking for A.I.G.'s money trail Fair Game,” By Gretchen Morgenson.
2009-March-16: Dow Jones Business News, “AIG Reveals Over $100 Billion Of Payments To Banks, U.S. States,” By Simon Kennedy.
2009-March-16: Los Angeles Times, “AIG names firms that got bailout cash; The disclosure, long sought, doesn't drown out the topic of the day: outrage over employee bonuses,” by E. Scott Reckard and Tom Petruno.
2009-March-16: Reuters News, “AIG developments since bad bets forced U.S. rescue.”
2009-March-15: Reuters News, “FACTBOX-Top 10 largest recipients of AIG money.”
2009-March-15: Associated Press Newswires, “AIG says it spent some bailout money paying banks.”
2009-March-9: The Wall Street Journal Europe, ‘Banks in EU, U.S. got $50 billion in AIG aid --- Deutsche, Goldman each got $6 billion; political hot potato,” By Serena Ng and Carrick Mollenkamp.
2008-September-18: The Wall Street Journal, “The financial crisis: AIG deal assuages some Asian investors,” by Patricia Kowsmann.
2008-September-18: The Wall Street Journal, “The financial crisis: Insurers see garage sale of AIG lines,” by Liam Plevan.
2008-September-18: The Wall Street Journal, “Dow falls 449.36 as AIG rescue rattles investors,” by E.S. Browning.
2008-September-18: The Wall Street Journal, “Bad bets and cash crunch pushed ailing AIG to brink,” by Monica Langley.
2008-September-18: The Wall Street Journal, “The financial crisis: Congress vows action on markets, but after election – lawmakers irked at being left out of AIG rescue plan,” by Sarah Lueck.
2008-September-18: The Wall Street Journal, “Bad accounting rules helped sink AIG,” by Zachary Karebell.
2008-September-18: The Wall Street Journal, “Bailout of AIG fails to calm fears as Wall Street plunges,” by Matthew Karnitschnig.
2008-September-18: The Wall Street Journal, “AIG’s plane-leasing unit in play,” by J. Lynn Lunsford.
2008-September-18: The Wall Street Journal, “Lawmakers seems resigned to AIG bailout,” by Damain Paletta.
2008-September-18: The Wall Street Journal, “Asians reassured on AIG,” by Patricia Kowsmann.
2008-September-18: The Wall Street Journal, “As AIG teetered, Greenberg got the cold shoulder,” by Liam Plevan.
2008-September-18: The Financial Times, “Rescue kickstarts sale of AIG assets.”
2008-September-18: The Financial Times, “Changing the rules of the game; Saving AIG was right, but what is the state’s role to be.”
2008-September-18: Bloomberg, “AIG’s Liddy plans to keep company in business, not liquidate.”
2008-September-18: Bloomberg, “Buffett, Greenberg may find AIG rummage-sale bargains,” by Andrew Frye.
2008-September-18: Reuters, “AIG board accused of mismanagement by pension fund,” by Martha Graybow.
2008-September-18: The Washington Post, “Stocks plunge as investor fears deepen,” by Will Andrews.
2008-September-18: The New York Times, “Abroad, this bailout is a shocker,” by Nelson D. Schwartz.

2008-September-18: The New York Times, “With Fed’s $85 billion loan, AIG starts to calculate a measured sell-off,” by Mary Williams Walsh.
2008-September-18: The New York Times, “Credit markets suffer, and borrowing costs threaten businesses,” by Vikas Bajaj.
2008-September-18: The New York Times, “A new role for the Fed: Investor of last resort,” by Edmund L. Andrews.
2008-September-18: The New York Times, “In Washington, financial furor is a first-rate chance to assess blame,” by Jackie Calmes.
2008-September-18: The New York Times, “Throwing a lifeline to a troubled giant,” by Eric Dash.
2008-September-17: BusinessWeek, “AIG’s huge federal rescue.”
2008-September-17: The New York Times, “Fed in an $85 billion rescue of an insurer near failure,” by Edmund L. Andrews.
2008-September-17: The New York Times, “AIG’s sunny side,” by Jonathan D. Glater.
2008-September-17: The Financial Times, “Fed in $85bn AIG rescue deal.”
2008-September-17: The Financial Times, “Capital Hill divided on AIG intervention.”
2008-September-16: The New York Times, “A race for cash at AIG,” by Mary Williams Walsh.”
2008-September-16: BusinessWeek, “Federal Reserve Statement on AIG.”
2008-September-16: BusinessWeek, “The unraveling of AIG,” by Nanette Brynes.

Claimant

Claimant Name:	
Claimant Type:	

Scaling Data

Scaling Date	Employees	Total Assets(USD $M)	Total Equity(USD $M)	Total Deposits(USD $M)	Total Revenue(USD $M)
N/A	N/A	N/A	N/A	N/A	N/A

Supporting Material

a note about loss amount: In the case of rescues by government entities, we use the amount that the government invests to stabilize the company as a proxy for loss amount; in this case it is $85 billion.

Timeline
1919: AIG is founded in Shanghai by Cornelius Vander Starr.
1960: Maurice Greenberg joins AIG.
March 15, 2005: Martin Sullivan is appointed chief executive of AIG after Maurice "Hank" Greenberg was implicated in an alleged scheme to inflate the company's financial figures; AIG loses its AAA ratings on the same day that Mr. Sullivan is appointed. (see event #5674).
November 1, 2006: Bob Willumstad named new chairman of AIG.
August 8, 2007: AIG posts second-quarter profit that is 34 per cent higher and the company says that it is “comfortable” with its subprime exposure.
November 2007: AIG’s third-quarter earnings fall nearly 27 per cent. Mr Sullivan concedes that the “US residential mortgage and credit market conditions adversely affected results.”
December 5, 2007: AIG warns that it could face total write-downs of about $1 billion for losses associated with its credit default swap portfolio.
February 11, 2008: AIG announces that the value of its mortgage-backed securities portfolio declined by $5bn in October and November 2007.
February 28, 2008: AIG announces a fourth-quarter net loss of over $5bn. (see event #7998)
May 8, 2008: IG announces its biggest-ever quarterly net loss of $7.8bn and says it will need to raise $12.5bn in new capital to strengthen its balance sheet.
May 20, 2008: AIG says it will raise about $20bn in new capital to protect its balance sheet, 60 per cent more than originally planned.
June 6, 2008: AIG says it is being investigated by regulators over its valuation of subprime-related derivatives.
June 15, 2008: After an emergency board meeting, AIG decides to replace Mr Sullivan with Mr Willumstad, who will retain the title of chairman.
March 16, 2008: Bear Stearns Cos. is bought by JPMorgan Chase & Co. in a deal orchestrated by the US Federal Reserve (see event #8025).
September 7, 2008: The US Federal Reserve takes of Fannie Mae and Freddie Mac. (see events #8397, 8396).
September 14, 2008: Bank of America Corp announces that it will acquire Lehman Brothers. Against this backdrop is the expectation that the bank would have acquired failing Lehman Brothers.
September 15, 2008: Lehman Brothers declares bankruptcy, the largest ever in the United States. (event #8392). AIG is downgraded by the major credit agencies. Its share price falls 60 percent.
September 16, 2008: The U.S. government announces an $85 billion emergency loan to rescue AIG, saying a failure of the insurer would lead to too much systemic risk.
September 19, 2008: President Bush and Treasury Secretary Henry Paulson outline a plan to buyback troubled assets from the financial system and say that the effort is likely to cost hundreds of billions of dollars.

Revision Comments

6/30/2009: Updated description to include additional details on CDO business; added "failure to disclose" keyword and associated discussion in Control Failings section of record.

Copyright Information

FIRST
RISK CASE STUDIES

FIRST Report for Loss Event 7949/OpData Id 13568

Short Description

From October 2007 to October 2008, UBS AG announced a series of writedowns on US securities backed by mortgages or other assets. The writedowns included $18.7 billion for the financial year 2007 and another $19 billion in the first quarter of 2008. Further losses in the second and third quarters of 2008 brought UBS' writedowns to $48.1 billion. The losses led to changes in UBS' board, an internal review of risk-management practices, and a sharp downsizing of its investment banking unit. The bank has raised new capital and on October 16, 2008 announced that it had raised CHF 6 billion ($5.2 billion from an issue of convertible notes placed with the Swiss Confederation. UBS will also transfer from $49 billion to $60 billion in risky assets into a special purpose entity controlled by the Swiss National Bank.

Organizations

Name:	Firm:	Country:
UBS AG	UBS AG-No Firm Available	Europe\Switzerland

Details

Loss Amount:	48,100,000,000
Currency:	USD
Loss Amount Current:	47,016,786,496
Currency Original:	USD-United States Dollars
Original Currency Amount:	48,100,000,000
Status:	CLOSED
Geography:	North America\United States\New York
Created Date:	1/25/2008
Revision Date:	10/27/2008

Dates

Start Occurrence: 3/13/2007	End Occurrence: 9/30/2008	Settlement Date: 10/16/2008

Long Description

Event Summary

From October 2007 to October 2008, UBS AG announced a series of writedowns on US securities backed by mortgages or other assets. The writedowns included $18.7 billion for the financial year 2007 and another $19 billion in the first quarter of 2008. Further losses in the second and third quarters of 2008 brought UBS' writedowns to $48.1 billion. The losses led to changes in UBS' board, an internal review of risk-management practices, and a sharp downsizing of its investment banking unit. The bank has raised new capital and on October 16, 2008 announced that it had raised CHF 6 billion ($5.2 billion from an issue of convertible notes placed with the Swiss Confederation. UBS will also transfer from $49 billion to $60 billion in risky assets into a special purpose entity controlled by the Swiss National Bank.

Event Detail

On October 30, 2007, UBS announced its financial results for the third quarter of 2007. The results included an estimated writedown of $3.4 billion in revalued collateralized debt obligations (CDOs). The company said that the losses were "mainly due to the substantial losses and writedowns in trading positions related to the US sub-prime residential mortgage-backed securities market, leading to revenues of negative CHF 4.2 billion in the investment bank's fixed income, currencies and commodities business." The press release also said: "Markets remain uncertain, but based on current information, UBS should return to profitability at Group level in the fourth quarter 2007."

On December 10, 2007 UBS announced that a further writedown of around $10 billion was needed for its subprime-related positions. The company described the affected holdings as "primarily on CDO and super senior holdings (i.e. senior AAA tranches)." The stock declined to $48.78 per share, which represented a 26% decline since March 13 2007.

In mid-January 2008, UBS remained unable to ascertain whether it would suffer further writedowns on securities backed by residential mortgages. A key section of UBS Management's January 11, 2008 letter to investors read: "We cannot, at this time, accurately predict the future development of US residential mortgage markets and therefore the ultimate impact on our positions in sub-prime mortgage related securities." The letter to investors was signed by chairman Marcel Ospel and chief executive Marcel Rohner.

The bank's subprime-related writedowns for FY 2007 totaled $18.7 billion, after an upward revision of $4 billion announced on January 31, 2008. According to the UBS Shareholder Report (see below) disclosing the results of an internal investigation, UBS had kept on acquiring risky securities despite warnings from its own analysts of a deterioration in the CDO market. For example, in the second quarter of 2007, UBS said it acquired “further substantial mezzanine residential MBS” even after the CDO desk expressed a “relatively pessimistic” outlook for the CDO market. According to the UBS Shareholder Report, the bank held $50 billion in “super senior” rated CDO debt at the end of 2007 of which $20.8 billion was bought from third parties. The debt was hedged, but only against a relatively small (2 to 4%) decline in value. This level of hedging, which was entirely based on “statistical analyses of historical price movements that indicated that such protection was sufficient” proved to be too small.

UBS’ losses continued to mount during the first three quarters of 2008. The largest was a $19 billion writedown relating to subprime-related securities for the quarter ending on March 31, 2008. On August 12, 2008, UBS’ second-quarter results included further “realized and unrealized losses of $ 5.1 billion on risk positions, “mainly on exposures related to US residential real estate and other credit positions.” It also booked a provision of USD 900 million (CHF 919 million) related to auction rate securities (ARS). Third quarter estimated results for UBS include a provision for $4.4 billion of writedowns and losses “on disclosed positions recorded in the Investment Bank's Fixed Income, Currencies and Commodities (FICC) business.” (UBS, October 16, 2008)

At least four lawsuits litigation have been filed against UBS in relation to the losses. Two suits were filed on December 13, 2007. One suit (Wesner et al v UBS AG et al.) was filed in the Southern District of New York on behalf of all shareholders who purchased UBS stock between March 13, 2007 and December 11, 2007. The same day, a second suit was filed under the Employee Retirement Income Security Act (ERISA) representing UBS employees who purchased stock in their 401(k) plans.

In addition, UBS faces a suit was filed by the German regional bank HSH Nordbank in New York in February 2008, alleging “breach of contract, fraud, negligent misrepresentation and breach of fiduciary duty” by UBS over the sale of $500 million in North Street 2002-4, a CDO portfolio linked to subprime loans. The case is HSH Nordbank AG, v. UBS AG and UBS Securities, LLC, 600562/2008, New York Supreme Court (Manhattan).

Another suit was filed in Connecticut Superior Court on March 5 2008 by Pursuit Partners, a hedge fund based in Stamford CT, alleging "fraudulent concealment" of material information regarding CDOs that the plaintiff bought from UBS.

Control Failings and Contributory Factors

General Corporate Governance Issues: The UBS Shareholder Report of April 21, 2008 found failures of governance, both at the group and the investment–bank levels. The report found that senior management had failed to “demand a holistic risk assessment” and had not been aware made of the exposure to super senior CDO tranches until August 2007. “Risks were siloed within the risk functions, without presenting a holistic picture of the risk situation of a particular business.” (p. 39). The UBS Shareholder Report also further found that senior management “relied on the assurances of others ... rather than obtaining all of the facts and analytically reviewing the situation.” (p. 35). The report specifically faulted senior management of the investment bank where groups “did not sufficiently challenge each other in relation to the development of their various businesses.” (p. 36). The former head of investment banking was criticized as being ineffectual and distracted during the unfolding of the credit crisis.

Undertook Excessive Risk: The UBS Shareholder Report found that the fixed-income division was focused on “revenue maximization, regardless of risk, with no limits on balance-sheet usage.” The report also said that “inappropriate risk metrics were used” and that the Market Risk Control unit did not “develop a comprehensive risk framework to ensure the subprime portfolio would be contained.”

Market/Corporate Conditions: UBS, like other large financial companies, found itself having to mark down CDOs. “In light of continued deterioration in the sub-prime market, valuations of UBS's remaining sub-prime positions reflect the extreme loss projections implied by the prices achieved in the very limited number of observable market transactions in US sub-prime related securities and indices up to the end of November,” the company stated.

Failure to Disclose: According to the shareholder lawsuit filed in December 2007, statements made by UBS AG “were materially false and misleading because they failed to disclose the company’s failure to timely write-down impaired securities containing subprime debt.”

Lack of Internal Controls: The UBS Shareholder Report targeted specific failures of risk management, including gaps in risk-management expertise among top managers, failures to respond to wider industry concerns as the subprime market deteriorated, and the absence of limits on front-desk personnel.

Failure to Test for Data Accuracy: Generally, the UBS Shareholder Report found “insufficiently robust” and ineffective risk controls. There was overreliance on time-series data, which failed to account for the dynamics of the US housing market and a lack of research into statistical shocks to existing portfolios. The report faulted the businesses’ overreliance on value-at-risk (VaR) time series, on credit ratings, and a “lack of recognition of idiosyncratic risk” that led units to conclude that their positions were adequately hedged.

Failure to escalate: The UBS Shareholder Report states that although research teams had issued reports to risk management on the deterioration of subprime mortgage-related debt as early as March 2007, “there appears not to have been sufficient discussions of, or actions upon, concerns. […] This seems to have arisen largely from the belief that deterioration in the subprime market would not impact AAA assets.”

Staff Compensation: Employee compensation and bonus incentives were misaligned with the firm’s longer-term interests: “Bonuses were paid regardless of the damage done to the UBS franchise long term,” the UBS Shareholder report said.

Inadequate Technology Planning: Without describing the failing in detail, the UBS Shareholder said that the bank was “unable to obtain a portfolio view” of risks relating to certain products, due to “infrastructure issues.”

Corrective Actions and Management Response

Switzerland's Federal Banking Commission (EBK) announced on December 24, 2007 that it would “uncover” the circumstance of UBS’ losses. Alain Bichsel, an EBK spokesman, later praised UBS’ response to its losses and said the regulator’s first priority was to help UBS address any problems: “It's not an investigation in the legal sense.”

UBS undertook one round of recapitalization in December 2007, when it announced that Singapore’s Government Investment Corporation (GIC) had agreed to inject almost USD $10 billion into UBS’ balance sheet. The GIC cash infusion raised its stake in UBS AG to about 9 percent, as against 1.1 percent in 2006. UBS also said it was getting a further 2 billion Swiss francs from an undisclosed strategic investor in the Middle East. Both GIC and the unidentified investor agreed to subscribe to an issue of CHF 13 billion of mandatory convertible notes. The notes pay a coupon of 9% until conversion into ordinary shares, which must take place on or before a date approximately two years after issuance. The proceeds of the issue will count as Tier 1 capital for BIS capital adequacy purposes after shareholder approval.

On February 15, 2008, UBS's chief executive, Mark Rohner said the outlook for 2008 remained "very challenging." Rohmer said UBS had "ring-fenced" its mortgage-backed portfolio from the rest of the bank's operations. The losses led Swiss activist shareholder group Ethos to call for a special audit of the bank at an extraordinary general meeting called for February 27, 2008. Shareholders at an extraordinary general meeting on February 27, 2008 overwhelmingly approved the special issue of mandatory convertible notes valued at CHF 13 billion ($12 billion) to GIC and the still unidentified Middle-Eastern investor. Shareholders also rejected a motion by the shareholder group Ethos for a special audit of the books. The motion for a special audit won less than 45% of the votes.

On April 1, 2008, UBS disclosed that Marcel Ospel would not to seek re-election as chairman at the general meeting on April 23, 2008. Ospel was succeeded as UBS chairman by Peter Kurer, who said UBS would sharply reduce the size of its investment banking unit, leave the commodities business (other than precious metals), and substantially downsize its real estate, securitization and proprietary trading. Kurer obtained the resignation of four of the twelve members of the supervisory board of UBS in July 2008. New board members were duly elected at an extraordinary general meeting of shareholders on October 2, 2008.

However, despite these changes in governance and streamlining of the businesses, the bank's position remained insecure due to its holdings of illiquid securities. After several weeks of turmoil in credit and stock markets worldwide -- as well as injections of government capital into banks in the United States, United Kingdom, Europe and elsewhere -- UBS said on October 16, 2008 that it had raised CHF 6 billion in new capital through an issue of mandatory convertible notes placed with Swiss Confederation. UBS' release to investors on its deleveraging efforts added that "The Swiss National Bank (SNB) and UBS reached an agreement to transfer up to $60 billion of currently illiquid securities and other assets from UBS's balance sheet to a separate fund entity."

UBS said that the fund is to be capitalized with "up to $6 billion of equity capital provided by UBS, and a non-recourse loan in the maximum amount of $54 billion provided to the fund by the SNB. The entity will be controlled by the SNB."

Among the $49 billion in securities that UBS said it will transfer to the fund are:
--about USD 31 billion (valued at 30 September 2008) of primarily cash securities (US sub-prime; US Alt-A; US prime; US commercial real estate and mortgage-backed securities; US student loan auction rate certificates and other securities backed by student loans; and US reference-linked note program (RLN)).
-- about USD 18 billion in "mainly non-US debt instruments" from a wide range of securities backed by a variety of asset classes. UBS said the positions were included following the bank's "decision to downsize its securitization business and provides a better diversification of the fund's portfolio."

UBS said that the fund may also acquire at a later date further assets, including "up to $5 billion of student loan auction rate securities the bank may buy back from clients as part of the recent settlements" and "up to $3.5 billion of positions which may become unhedged in the event of commutation of the credit protection contracts with one or more monoline insurers." UBS has the option to buy back the equity of the entity, once the loan is fully repaid, by paying to SNB $1 billion plus 50% of the amount by which the equity value at the time of exercise exceeds that amount.

On October 18, UBS' chairman Peter Kurer announced he would forgo a bonus until the bank recovers from the huge losses incurred in the global financial crisis. Kurer, whose annual compensation is reported to be in the range of $2 million, will not request any bonus for 2007 and 2008.

Lessons Learned

UBS' publication of the "Shareholder Report on UBS Writedowns" on April 21st, 2008 included 14 pages discussing factors contributing to the record losses suffered by the bank; these are highlighted in the Control Failings and Contributory Factors section of this record. Along with issues of governance and structural risk-management and risk-control factors, the report is highly critical of the bank's employee compensation structure. According to UBS, the bank's bonus structure encouraged overinvestment in mezzanine CDOs and more generally created "asymmetric risk/reward compensation".

As to the distribution of losses by business unit, the UBS Shareholder Report found that only about 16% of UBS' subprime losses were attributable to the now-closed hedge fund unit Dillon Read Capital Management. The bulk of the bank's losses occurred within the fixed-income business of the investment bank, in CDO and asset-backed securities holdings. About two-thirds of the losses arose from UBS' CDO warehouse, particularly from "super-senior" CDO tranches, which proved riskier than expected. Within the CDO warehouse, "there were no aggregate notional limits on the sum of the CDO pipeline."

The UBS Report was highly critical of the bank's "lack of reaction to changing markets" prior to August 2007, and to the existence of compensation incentives which encouraged excessive risk-taking as well as overdependence on profitable carry trades. The report concluded that there should be more "healthy skepticism" in risk management.

The bailout package announced by UBS on October 16, 2008, will allow the bank to focus its strengths and areas of core competence. It was feared that without the creation of the taxpayer-backed SPV, depositors might shift their funds to banks in countries where governments have undertaken to guarantee domestic banks. UBS senior management is also undertaking governance reforms designed to realign compensation with the interests of shareholders.

Keywords

Entity Type	FINANCIAL SERVICES\BANKING\INVESTMENT BANK
Business Unit Type	CORPORATE FINANCE (BIS)\CORPORATE FINANCING
Service/Product Offering Type	DERIVATIVES, STRUCTURED PRODUCTS AND COMMODITIES\STRUCTURED PRODUCTS\COLLATERALIZED DEBT OBLIGATIONS
Contributory/Control Factors	LACK OF CONTROL\FAILURE TO DISCLOSE,STRATEGY FLAW\INADEQUATE TECHNOLOGY PLANNING,STAFF SELECTION/COMPENSATION\STAFF SELECTION & COMPENSATION,CORPORATE/MARKET CONDITIONS\CORPORATE & MARKET CONDITIONS,CORPORATE GOVERNANCE\GENERAL CORPORATE GOVERNANCE ISSUES,MANAGEMENT ACTION/INACTION\UNDERTOOK EXCESSIVE RISKS,MANAGEMENT ACTION/INACTION\LACK MANAGEMENT ESCALATION PROCESS,LACK OF CONTROL\FAILURE TO TEST FOR DATA ACCURACY,LACK OF CONTROL\LACK OF INTERNAL CONTROLS
Loss Type:	Known
Loss Impact	INDIRECT LOSS\RELATED CREDIT RISK LOSSES,DIRECT LOSS\WRITE-DOWN (BIS),DIRECT LOSS\LEGAL LIABILITY (BIS)\CLASS ACTION,INDIRECT LOSS\SHARE PRICE

Loss Detection Sources	WHISTLE BLOWING\SHAREHOLDER ORIGINATED
Market Focus	INSTITUTIONAL SERVICES
Event Trigger	PROCESS RISK CLASS\BUSINESS & STRATEGIC RISK\BANKRUPTCY/CREDIT RISK
Basel Levels I & II	OTHER (NON BIS)
Basel Business Line	Investment Banking \Corporate Finance \Corporate Finance
Industry Event	Credit Crisis

Ratings

Ratings Action	Ratings Code	Effective Date	Ratings Watch/Outlook
Affirmed	AA+	2006-10-31	Rating Outlook Stable
Revision Outlook	AA+	2007-09-17	Rating Outlook Negative
Downgrade	AA	2007-12-10	Rating Outlook Negative
Affirmed	AA	2008-01-30	Rating Outlook Negative
Downgrade	AA-	2008-04-01	Rating Outlook Negative
Affirmed	AA-	2008-07-09	Rating Outlook Negative
Downgrade	A+	2008-10-24	Rating Outlook Stable
Affirmed	A+	2009-01-21	Rating Outlook Stable
Affirmed	A+	2009-03-05	Rating Outlook Stable
9 Ratings found.			

Source

2008 April 21: UBS AG “Shareholder Report on UBS Writedowns”
http://www.ubs.com/1/e/investors/agm.html

2008 October 26: Associated Press Newswires “Swiss mull UBS subprime prosecutions: report”

2008 October 18: Associated Press Newswires “UBS chairman to forgo bonus until the bank overcomes crisis”

2008 October 16: Bloomberg News "Swiss National Bank finances transfer of illiquid assets of UBS to a special purpose vehicle"

2008 October 16: UBS AG “UBS to raise CHF 6 billion of new capital through mandatory convertible notes, fully placed with Swiss Confederation”

2008 October 2: Associated Press Newswires “Swiss bank UBS expects return to "small" profit in 3rd quarter despite volatile market” by Onna Coray

2008 August 12: Associated Press Newswires “UBS posts Q2 losses, writedowns of $5.1B” by Ernst Abegg

2008 August 12: Reuters News “FACTBOX-Key events in subprime fallout at UBS”

2008 May 6: Associated Press Newswires “UBS reports 1Q net loss of US$11 billion, cuts 5,500 jobs” by Ernst Abegg

2008 April 23: Reuters “UBS to slash investment banking after crisis”

2008 April 22: Financial Times “Decision Not to Repackage CDOs Cost UBS Dollars 8 billion.”

2008 April 22: New York Times “Reckless Pursuit of Cash hurt UBS” by Uta Harnischfeger

2008 April 22: Wall Street Journal “UBS Raps Banker on losses” by Katharina Bart

2008 April 21: Agence France Presse “UBS Explains Huge Subprime Losses”

2008 April 1: UBS AG “Pre-announcement of first quarter 2008 estimated net loss of approximately CHF 12 billion” (press release)

2008 April 1: UBS AG “Marcel Ospel not to seek re-election at Annual General Meeting, to be succeeded as Chairman by Peter Kurer”

2008 March 6 HedgeWorld News/Reuters “UBS Shares Sink Anew on Write-down Fears”

2008 February 27 UBS AG “Extraordinary General Meeting of UBS AG” (press release)
http://www.ubs.com/1/e/about/news.html?newsId=136970

2008 February 27: Associated Press “UBS shareholders approve $12B investment in bank from Singapore, Mideast wealth funds” by Ernst Abegg

2008 February 27: Dow Jones International News “UBS Chairman Ospel: Cap Hike Will Put UBS On Solid Ground”

2008 February 26 Bloomberg “HSH Nordbank Sues UBS in New York to Recoup Subprime Losses”

2008 February 15: Wall Street Journal “UBS Picture Spells More Woe for Banks --- Swiss Titan Posts Loss, Confirms Write-Downs Exceeding $18 Billion” by Katharina Bart and Carrick Mollenkamp

2008 January 31 Wall Street Journal “UBS's Mortgage Woes Increase --- Swiss Bank Adds $4 Billion to Losses Seen in '07, Takes Third Write-Down; The Optimism From October Is Gone” by Carrick Mollenkamp and Katharina Bart

2008 January 30: Dow Jones International News “Writedowns by European Banks”

2007 December 13: US District Court, Southern District of New York “Wesner et al v UBS AG et al”

2008 January 12: The Times “UBS admits that it still cannot quantify its exposure to sub-prime crisis” by Miles Costello

2007 December 10: AFX International Focus “Singapore banks higher on GIC's cash infusion into UBS”

2007 December 10: UBS AG “UBS strengthens capital base and adjusts valuations” (press release)
http://www.ubs.com/1/e/about/news.html?newsId=133686

2007 November 29: Ottawa Citizen/Bloomberg News “UBS leaps to biggest gain since March 2003 after Credit Suisse raises recommendation” by “Elena Logutenkova

2007 October 30: UBS AG “UBS reports third quarter loss of CHF 726 million pre-tax, in line with announcement on 1 October 2007” (press release)
http://www.ubs.com/1/e/about/news.html?newsId=130754

Claimant

Claimant Name:	Wesner et al.,
Claimant Type:	EMPLOYEE,SHAREHOLDER,INVESTOR

Scaling Data

Scaling Date	Employees	Total Assets(USD $M)	Total Equity(USD $M)	Total Deposits(USD $M)	Total Revenue(USD $M)
Dec 31, 2008	73228	1,894,423.24	42,561.81	660,865.85	-19,288.33

Supporting Material

Loss Amount: $48.1 billion. This is total of writedowns for FY 2007 and first three quarters of 2008.

Loss Amount
$18.7 billion losses in FY 2007 due to subprime-mortgage-related writedowns
$19.0 billion writedown in 1Q 2008 due to subprime-mortgage-related securities;
$6 billion in 2Q 2008 ($5.1 billion losses in due to mortgage-related writedowns; $900 million related to student-loan ARS)
$4.4 billion writedowns in 3Q 2008 "on disclosed positions recorded in the Investment Bank's Fixed Income, Currencies and Commodities (FICC) business."

$48.1 billion: total CDO/ABS/ARS writedowns for 2007, plus first three quarters 2008

Timeline:
2007 October 30: Swiss banking giant UBS announces charges from exposure to the US housing and mortgage markets, although the group's third-quarter loss matches earlier guidance. In its October warning, UBS said it would take a net write-down of around $3.4b and cut 1,500 investment-banking jobs.

2007 November 29 Credit Suisse analysts estimate possible UBS writedowns of CHF 3.5 billion in the fourth quarter after CHF 4.4 billion in the third. That estimate "probably errs on the side of conservatism." and would result in an overall fourth-quarter loss of 138 million francs at Zurich-based UBS, they added.

2007 December 10: UBS announces writedowns of around $10 billion were necessary as a result of its subprime mortgage related positions. Also announces cash infusions by GIC of Singapore and an identified strategic investor in the Middle East.

2007 December 13: Securities lawsuit was filed NYC against UBS AG on behalf of all shareholders who purchased UBS stock between March 13, 2007 and December 11, 2007. A separate suit filed on behalf of UBS employees who suffered losses through their employers' stock in 401(k) plans.

2007 December 24: Switzerland's Federal Banking Commission (EBK) will investigate how UBS became one of the banking sector's worst victims of the credit crunch. The investigation is not a formal legal probe, an EBK spokesperson says.

2008 January 31: UBS warns of further $4 billion in MBS losses.

2008 February 15: UBS confirms total $18.7 billion in MBS losses.

2008 February 27: EGM ratifies convertible bond issue to GIC and an unidentified investor.

April 1 2008: UBS pre-announces first quarter results, incurring $19 billion in mortgage writedowns. Ospel to resign as chairman

April 21 UBS AG admits in a 50-page report to shareholders that a lack of risk control and ambitious plans to grow revenue led to its huge losses in the global credit crunch.

April 23 UBS' AGM held in Basel. UBS says it will put its investment banking arm on a shorter leash as it tries to overhaul its corporate governance. Shareholders approve a rights offer of about $15 billion at turbulent AGM.

2008 May 6: UBS says it will cut 5,500 jobs and sell billions of dollars of ailing assets in a bid to break free from the subprime crisis. The job cuts, coming on top of 1,500 already completed, would reduce the Swiss bank's workforce by an additional 7 percent. Bank also unveils a preliminary deal with US asset manager BlackRock Inc to sell for $15 billion a portfolio of subprime mortgages with a face value of $22 billion.

2008 July 1: UBS obtains resignation of four board members in a long-awaited shake-up of corporate governance. UBS will seek candidates with "substantial banking, finance and risk backgrounds" to replace a third of its 12-strong supervisory board. UBS shares hit a ten-year low.

2008 August 12: UBS announces a net loss of CHF 358m for the second quarter of 2008. New writedowns pushes UBS's total since the crisis started to $42bn. Bank will focus on wealth management.

2008 September 16: UBS it does not expect the total cost of closing out its exposures to Lehman Brothers to exceed $300m , net of hedges.

2008 October 2: At Extraordinary General Meeting, Kurer announces restructuring of company, governance reforms, reduction of investment banking activities.

2008 October 16: Swiss taxpayers will pay for a $59.2 billion bailout for UBS AG. UBS will get CHF 6 billion ($5.2 billion) from the government and put as much as $60 billion of risky assets into a special purpose vehicle backed by the central bank, UBS said. UBS estimates its investment bank's writedowns and losses in third quarter to be $4.4 billion.

2008 October 18: Chairman Peter Kurer said he would forgo a bonus until the bank has recovered from huge losses in the global financial crisis. Peter Kurer will not ask for any bonus for 2007 and 2008 and would only expect one when the bank had recovered and if the country had not lost out because of the crisis at UBS.

Revision Comments

10/27/2008: UBS announces Swiss National Bank bailout, creation of a special purpose entity for risky assets. UBS chairman will forego bonuses until bank recovers. Case expanded, loss amount increased to $48.1 billion.
04/23/2008: Case revised and updated to first-quarter 2008 writedown, departure of Marcel Ospel, UBS report to shareholders on writedowns. Loss amount increased from $18.4 billion to $37.7 billion
03/11/2008: Update UBS adds further $4bn to MBS writedowns; shareholders approve investment by Singapore GIC and unidentified investor of CHF 13 billion ($12 billion) in mandatory convertible notes. Loss amount increased to $18.4 billion

Copyright Information

FIRST Report for Loss Event 7896/OpData Id 13544

Short Description

On November 4 2007, Citigroup disclosed that it would take a write-down of $11 billion on losses in structured finance products held by seven proprietary special investment vehicles (SIVs), due to the ongoing crisis in the mortgage securities and credit markets. The unexpectedly large losses led to the departure of chairman-CEO Charles Prince and his replacement as CEO by Vikram Pandit in December 2007. Citigroup disclosed a larger writedown of $18.1 billion in the fourth quarter of 2007. In 2008, further writedowns and credit losses in the first three quarters of 2008 of ($14 billion, $7.2 billion and $13 billion) brought Citigroup's total losses to approximately $63.4 billion. To help deal with these unprecedented writedowns, Citigroup has reported raising at least $40 billion from investors, announced plans to sell assets, and reduced headcount by 23,000 in 2008.

Organizations

Name:	Firm:	Country:
Citigroup Inc.	Citigroup Inc.-No Firm Available	North America\United States\New York

Details

Loss Amount:	63,400,000,000
Currency:	USD
Loss Amount Current:	61,972,230,018
Currency Original:	USD-United States Dollars
Original Currency Amount:	63,400,000,000
Status:	CLOSED
Geography:	North America\United States\New York
Created Date:	12/28/2007
Revision Date:	11/7/2008

Dates

Start Occurrence: 6/30/2007	End Occurrence: 9/30/2008	Settlement Date: 10/17/2008

Long Description

Event Summary

On November 4 2007, Citigroup disclosed that it would take a write-down of $11 billion on losses in structured finance products held by seven proprietary special investment vehicles (SIVs), due to the ongoing crisis in the mortgage securities and credit markets. The unexpectedly large losses led to the departure of chairman-CEO Charles Prince and his replacement as CEO by Vikram Pandit in December 2007. Citigroup disclosed a larger writedown of $18.1 billion in the fourth quarter of 2007. In 2008, further writedowns and credit losses in the first three quarters of 2008 of ($14 billion, $7.2 billion and $13 billion) brought Citigroup's total losses to approximately $63.4 billion. To help deal with these unprecedented writedowns, Citigroup has reported raising at least $40 billion from investors, announced plans to sell assets, and reduced headcount by 23,000 in 2008.

Event Detail

During the third quarter 2007, many large banks and financial institutions began to face large losses due to the decline in value of securities that were backed by residential mortgages, including subprime loans in the United States. Citigroup was the advisor to seven proprietary "variable-interest entities" or special investment vehicles (SIVs), which had been kept off the bank's balance sheet. According to FASB, a bank is permitted to keep a SIV off its balance sheet if it is exposed to less than half of the entity's risk. Citigroup's variable interest in several of the SIVs rose when it was obliged to backstop them in the third quarter of 2007.

Citigroup was one of the largest investors in SIVs at the time. When a number of SIVs and so-called "SIV-lites" collapsed in the fall of 2007, Citigroup came under pressure to bring the structures back onto its balance-sheet or face reputational risk and the loss of investor confidence. The seven Citi-advised SIVs -- named Beta, Centauri, Dorada, Five, Sedna Vetra and Zela -- held $80 billion in various structured finance products, including collateralized debt obligations

On October 1, 2007, Citigroup estimated that its third-quarter profit would decline 60 percent to $2.2 billion, and that it expected to incur approximately $6 billion in credit costs and write-downs in the quarter. Citigroup increased this estimate to about $6.6 billion on October 15, 2007.

This estimate proved to be too small. On Sunday November 4, 2007, Citigroup held an emergency board meeting and filed a 10-Q announcing that it would take an additional "$8 billion to $11 billion" in write-downs in the fourth quarter on "direct exposure" to subprime debt valued at $55 billion on September 30th. The company also announced that Chairman-CEO Charles Prince, who had headed the company since October 2003, was resigning. Prince was replaced by Sir Win Bischoff as interim

CEO and former Treasury Secretary Robert Rubin was named Chairman. The search began for a permanent CEO. Vikram Pandit was named CEO on December 11, 2007.

On January 15, 2008, Citigroup announced its first-ever quarterly loss: for the fourth quarter it incurred a net loss of $9.83 billion, or $1.99 per share, and cut its dividend by 41 percent. The net loss was blamed on $18.1 billion in “pre-tax write-downs and credit costs on sub-prime related direct exposures in fixed income markets, and a $4.1 billion increase in credit costs in US consumer loans, primarily related to higher current and estimated losses on consumer loans.” The announcement coincided with similar massive losses at Merrill Lynch, and was accompanied by a fall in financial stocks.

In the first three quarters of 2008, Citigroup continued to experience smaller yet significant losses, although the writedowns were lower than many analysts had forecast. A large part of these writedowns were attributed to securitized mortgage loans and other asset-backed securities, although increasingly credit losses have been attributed to consumer loans.

On April 18, Citigroup posted a net loss of $5.11 billion, or $1.02 a share, on writedowns of $14 billion. These included $6 billion on CDOs; $7.6 on Alt-A mortgage loans; $3.1 billion on leveraged buyout (LBO) loans, and $1.5 billion on auction-rate securities. Citigroup also wrote down $212 million on the value of assets reabsorbed from SIVs, as well as marking down $1.5 billion tied to downgrades of key bond insurers. (On top of the writedowns, the bank also incurred $about $6 billion in increased credit costs.) The bank also agreed to offer investors a chance to seek redemptions from its Old Lane hedge funds, which CEO Pandit had sold to Citigroup in 2007 for more than $800 million.

On July 18, 2008, Citigroup said that it lost money for the third consecutive quarter after writing down $7.2 billion of investments primarily consisting of $4.4 billion in net credit losses and a $2.5 billion net charge to increase loan loss reserves. Net credit losses were “primarily driven by residential real estate lending in North America and Global Cards”. Citi’s net loss for the quarter was $2.5 billion, or $0.54 a share.

On October 16 2008, reporting a quarterly net loss of $23.8 billion, reported further writedowns of $13.2 billion. This was made up of $4.4 billion in investments, $4.9 billion in credit losses, and a $3.9 billion charge for consumer banking and credit card losses. Third quarter charges also included a $612 million charge relating to a regulatory settlement over auction-rate securities.

Control Failings and Contributory Factors

Corporate/Market Conditions: A rapid deterioration in the market for mortgage-backed securities and CDOs led Citigroup’s SIVs to be unable to obtain funding in July and August 2007. This in turn forced the bank find a way to consolidate the SIVs, bring them onto its balance sheet, or risk the appearance that its was concealing further losses.

Strategy Flaw: According to the Financial Times, Citigroup’s exposure to CDOs and other structured products was reported to have been exacerbated because in 2005 Citigroup began to create CDOs which raised money not only from investors but also from issuing commercial paper. According to the Financial Times, “Citi entered into a series of agreements which forced it to buy the CDOs’ commercial paper if no one else would.” When demand for the commercial paper began to dry up in summer of 2007 and it could no longer sell its commercial paper, the bank was obligated to buy the paper at par, leading to mark-to-market losses.

Corrective Actions and Management Response

Citigroup has raised capital from investors, and undertaken a series of reforms to offset the losses incurred in 2007 and 2008.

On November 27, 2007, Citigroup announced it had obtained $7.5 billion in a cash infusion from the Abu Dhabi Investment Authority. The ADIA will buy securities that convert to stock and yield 11 percent a year. The purchase of this 4.9 percent stake in Citigroup made Abu Dhabi the company’s largest shareholder.

On December 11 Citigroup named Vikram Pandit to be the new CEO of the company, replacing acting CEO Sir Win Bischoff, who in turn replaced Robert Rubin as chairman. The company was also able to reduce some of its exposure to the SIV’s holdings from $80 billion down to about $50 billion, while bringing the SIVs fully onto its balance sheet.

Citigroup said On January 15, 2008 that it had it had raised a further $14.5 billion, with $6.9 billion from Singapore’s Government Investment Corp (GIC), and cash from a number of private investors, including the Kuwait Investment Authority (KIA).

On April 22, 2008, Citigroup said it would raise a further $6 billion, four days after revealing a net quarterly loss of $5.1 billion. Citi will issue preference shares, adding to the $30 billion it raised in the past year. A variety of investors expressed dissatisfaction at $46bn in write-downs and charges Citigroup had taken since the summer of 2007.

Lessons Learned

Mr. Prince, Citigroup’s former CEO, famously said in an interview with the Financial Times on July 9 2007: “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing.” He was not unaware of the consequences of an end to the music of loose credit: “The depth of the pools of liquidity is so much larger than it used to be that a disruptive event now needs to be much more disruptive than it used to be. At some point, the disruptive event will be so significant that instead of liquidity filling in, the liquidity will go the other way. I don’t think we’re at that point.” One month later, a crisis hit the credit and equity markets in August 20007, causing the first failures of hedge funds due to illiquidity, and the drying up of markets for asset-backed commercial paper a few months later.

Mr. Prince will probably be long remembered just for that one line: “As long as the music is playing, you’ve got to get up and dance.” There may be no better expression of how banks continued to participate in risky lending and excessive leverage, even when could sense that a “disruptive event” was in the offing.

Keywords

Entity Type	FINANCIAL SERVICES\BANKING\COMMERCIAL/FULL SERVICE BANK
Business Unit Type	CORPORATE FINANCE (BIS)\CORPORATE FINANCING
Service/Product Offering Type	DERIVATIVES, STRUCTURED PRODUCTS AND COMMODITIES\STRUCTURED PRODUCTS\STRUCTURED PRODUCTS (MISC.)

Contributory/Control Factors	CORPORATE/MARKET CONDITIONS\CORPORATE & MARKET CONDITIONS,STRATEGY FLAW\STRATEGIC FLAW
Loss Type:	Estimated
Loss Impact	INDIRECT LOSS\RELATED CREDIT RISK LOSSES,DIRECT LOSS\WRITE-DOWN (BIS)\WRITE-DOWNS
Loss Detection Sources	PERIODIC INTERNAL REVIEWS\AUDIT REVIEWS
Market Focus	INSTITUTIONAL SERVICES
Event Trigger	PROCESS RISK CLASS\BUSINESS & STRATEGIC RISK\MARKET RISK
Basel Levels I & II	OTHER (NON BIS)
Basel Business Line	Investment Banking \Corporate Finance \Corporate Finance
Industry Event	Credit Crisis

Ratings

Ratings Action	Ratings Code	Effective Date	Ratings Watch/Outlook
Affirmed	AA+	2007-06-12	Rating Outlook Stable
Affirmed	AA+	2007-10-01	Rating Outlook Stable
Downgrade	AA	2007-11-05	Rating Outlook Negative
Downgrade	AA	2007-11-05	Rating Outlook Stable
Rating Watch On	AA	2008-03-07	Rating Watch Negative
Downgrade	AA-	2008-04-18	Rating Outlook Negative
Rating Watch On	AA-	2008-09-29	Rating Watch Negative
Downgrade	A+	2008-11-24	Rating Outlook Stable
Affirmed	A+	2009-02-06	Rating Outlook Stable
Affirmed	A+	2009-02-27	Rating Outlook Stable
10 Ratings found.			

Source

2008 October 17: The Times “Citigroup's $13bn writedown raises fears of a crisis beyond Wall Street Banking crisis” by Tom Bawden

2008 October 16: Reuters “Citigroup posts 4th straight loss on write-downs”

2008 July 18 Dow Jones Business News “Citigroup swings to loss on $7.2 bln writedown” by Greg Morcroft

2008 June 27: The Independent “Citigroup will need to write down $9bn in second quarter, analyst predicts” by Nikhil Kumar

2008 April 18: Housing Wirew “Citi Posts $5.1 Billion Loss; Late Mortgages More than Double” by Paul Jackson

2008 April 18: Bloomberg News “Citigroup Reports Loss on Writedowns, Credit Costs” by Bradley Keoun

2008 January 15: Forbes “Citigroup's Write-Down Disaster” by Evelyn M. Rusli,

2007 December 21: Financial Times (FT.Com) “US banks scrap plans for SIV 'superfund'” by David Wighton and Bernard Simon

2007 December 15: The Times “Citigroup under more strain as SIVs worth $49bn put on balance sheet” by Tom Bawden

2007 December 13: Citigroup “Citi Commits Support Facility for Citi-Advised SIVs” (press release) http://www.citigroup.com/citigroup/press/2007/071213c.htm

2007 December 13 Citigroup “Additional Facts on the Citi-Advised SIVs” (press release)

2007 December 11: Associated Press “Citigroup names investment banking head Pandit as CEO, Bischoff as chairman” by Madlen Read

2007 November 27: The Oakland Tribune “Citigroup disavows fund bailout plans”

2007 November 27: Bloomberg “Citigroup to Raise $7.5 Billion From Abu Dhabi State” by Will McSheehy and Bradley Keoun

2007 November 21: Financial Times (FT.Com) “Liquidity Put” by Sam Jones

2007 November 16: Fortune “Citi's giant write-downs: What did it know, and when did it know it?” by Carol Loomis

2007 November 7 Financial Times (FT.Com) “10Q clue to Citigroup's financial headache” by Paul J Davies

2007 November 6: BusinessWeek Online “Citigroup Turns to Robert Rubin; In the wake of Charles Prince's departure, the former Treasury Secretary is named chairman. His first order of business: finding a new CEO” by Steve Rosenbush

2007 November 5: Associated Press “Citigroup CEO quits, is replaced” by Madlen Read

2007 October 23: Financial Times “Citigroup failing to stop SIV skeptics” by David Wighton

2007 October 15: Dow Jones Business News “CEO Calls Citi's Quarter 'Disappointing' As Net Drops 57%”

Claimant

Claimant Name:	
Claimant Type:	

Scaling Data

Scaling Date	Employees	Total Assets(USD $M)	Total Equity(USD $M)	Total Deposits(USD $M)	Total Revenue(USD $M)
Dec 31, 2008	323000	1,938,470.00	73,358.00	774,185.00	-27,684.00

Supporting Material

Loss Amount: $63.4 billion (approximately) in writedowns and credit losses, from 3Q 2007 through end of 3Q 2008.

3Q 2007: $11 billion in structured finance products & CDOs written down.
4Q 2007: $18.1 billion in writedowns; Net loss is $9.83 billion
1Q 2008: $14 billion in writedowns ($6 billion on CDOs; $7.6 on Alt-A mortgage loans; $3.1 billion on leveraged buyout (LBO) loans, and $1.5 billion on auction-rate securities. Citigroup also wrote down $212 million on the value of assets reabsorbed from SIVs, as well as marking down $1.5 billion tied to downgrades of key bond insurers; Net loss is $5.11 billion.
2Q 2008: $7.2 billion of writedowns on investments in mortgages and other loans; Net loss is $2.5 billion
3Q 2008 $13.2 billion in charges (includes writeoffs and credit losses); Net loss is $2.8 billion

New Capital:

November 2007: Raised $7.7 billion from Abu Dhabi Investment Authority.
January 2008: In January it said it would get a further $14.5 billion from investors, including the governments of Singapore and Kuwait.. Citigroup will get $6.9 billion from the Government of Singapore Investment Corp., in exchange for a 4% stake. Meanwhile, Citi also get cash from Capital Research Global Investors, Capital World Investors, the Kuwait Investment Authority, the New Jersey Division of Investment, Saudi Arabia Prince Alwaleed bin Talal, Sanford Weill, and a public sale of $2 billion in stock.
April 22, 2008: Citigroup will raise a further $6bn after revealing quarterly losses of $5.1bn last week. Citi will issue preference shares, adding to the $30bn it raised in the past year. “

Timeline

2007 October 1: Citigroup expects year-to-year drop of net income in third quarter of 60%. CEO Charles Prince says business expected to return to more normal levels in fourth quarter.

2007 October 15: Citigroup announces $6.5 billion write-downs in structured finance products and loan losses.

2007 Nov 4: Citigroup announces a further $8-11 billion of subprime-related writedowns and losses. Charles Prince resigns as Chairman and Chief Executive.

2007 Nov 5: SEC’s corporation finance division reported to be investigating Citigroup's accounting of its use of SIVs. Current and ex-employees file an ERISA lawsuit against Citigroup in the US District Court for the Southern District of New York. Plaintiffs are beneficiaries of Citigroup's 401(k) plan.

2007 Nov 14: Citigroup's capital-markets division lets go the two heads of the global credit-markets operations, following a decision to combine the equity and debt capital markets underwriting businesses into a new group called Capital Markets Origination.

2007 Nov 27: Citigroup announces it has secured a $7.5 billion investment from Abu Dhabi''s government-controlled investment authority in return for special interest-bearing stock convertible into a 4.9% stake.

2007 Nov 30: WSJ reports that “a prominent investment banker approached Citigroup Inc. about a merger with Bank of America Corp. during its recent travails.”

2007 Dec-13: Citigroup new CEO Vikram Pandit announces that the company will bail out its seven SIVs with assets worth $49 billion, superseding an earlier plan to create a “super SIV” known as the Master Liquidity Equity Conduit (M-LEC).

2007 December 26: Citigroup Inc. could write off as much as $18.7 billion in the fourth quarter, wrote Goldman analysts William F. Tanona, Betsy Miller and Neil C. Sanyal in a note to investors late Wednesday.

2008 January 15: Citigroup posts first ever quarterly loss since its creation in 1998, due to write-downs on exposure to subprime mortgages and other risky debt. The net loss for Citi totaled $9.83 billion, or $1.99 per share. Net income totaled $5.13 billion, or $1.03 per share, a year earlier. C would write down the value of certain assets by $18.1 billion.

2008 April 18: Citigroup loses $5.11bn in the first quarter, somewhat less than the $9.8bn loss reported in 4Q2007. The results included about $12bn of write-downs for sub-prime mortgages and other risky assets: $6 billion of writedowns and credit costs on subprime mortgages and bonds, $1.5 billion on leveraged buyout loans and $1.5 billion on ARS.

2008 April 22: Citigroup will raise a further $6bn. Citi will issue preference shares, adding to the $30bn it raised in the past year. A variety of investors expressed dissatisfaction at $46bn in write-downs and charges Citigroup has taken since last summer.

2008 June 12 2008: Citigroup will shut down Old Lane Partners, the hedge-fund group CEO Vikram Pandit co-founded and sold to the bank in 2007 for more than $800 million. Citigroup will buy most of Old Lane's assets. Clients can begin withdrawing their investments from July 31 onwards.

2008 July 18 (US) Citigroup said that it lost $2.5 billion in the second quarter. The loss was largely caused by $7.2 billion of write-downs of Citigroup's investments in mortgages and other loans and by a weakness in the consumer market, which cost Citigroup $4.4 billion in credit losses and $2.5 billion to increase reserves.

2008 October 17: Citigroup suffered a $2.8 billion loss in the third quarter, its fourth consecutive quarterly loss. The bank took more than $13.2 billion in charges in the third quarter, bringing the total amount of write-offs and credit losses since the credit crisis began last year to $64 billion.

Revision Comments

11/07/2008: Updated case to include Citigroup subprime writedowns through the third quarter of 2008. Loss Amount increased to $63.4 billion.

Copyright Information

Document generated at: Mon Oct 26 11:57:10 EST 2009