

NOTE: This is a very long and very well done article (published on the Rolling Stone web site) that explains what caused the 2007-2008+ recession and many of the factors leading up to it. I have added some extra missing information to beef it up and fill in some blanks. In any event this is the best article I have been able to find, to date, on the topic and it should be required reading for everyone going to high school or taking a college business and/or history class. My comments/info will be **added in <RED>**. I will also highlight many statements that one should pay particularly close attention too, in order to tie things together, **in BLUE**. Hopefully Matt won't mind me repeating his article here.

The Big Takeover

*The global economic crisis isn't about money - it's about **power**. How Wall Street insiders are using the bailout to stage a revolution*

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It's over — we're officially, royally fucked. No empire can survive being rendered a permanent laughingstock, which is what happened as of a few weeks ago, when the buffoons who have been running things in this country finally went one step too far. **It happened when Treasury Secretary Timothy Geithner was forced to admit that he was once again going to have to stuff billions of taxpayer dollars into a dying insurance giant called AIG,** itself a profound symbol of our national decline — a corporation that got rich insuring the concrete and steel of American industry in the country's heyday, only to destroy itself chasing phantom fortunes at the Wall Street card tables, like a dissolute nobleman gambling away the family estate in the waning days of the British Empire.

The latest bailout came as AIG admitted to having just posted the largest quarterly loss in American corporate history — some \$61.7 billion. In the final three months of last year, the company lost more than \$27 million *every hour*. **That's \$465,000 a minute,** a yearly income for a median American household every six seconds, roughly \$7,750 a second. And all this happened at the end of eight straight years that America devoted to frantically chasing the shadow of a terrorist threat to no avail, eight years spent stopping every citizen at every airport to search every purse, bag, crotch and briefcase for juice boxes and explosive tubes of toothpaste. Yet in the end, our government had no mechanism for searching the balance sheets of companies that held life-or-death power

over our society and was unable to spot holes in the national economy the size of Libya (whose entire GDP last year was smaller than AIG's 2008 losses).

So it's time to admit it: We're fools, protagonists in a kind of gruesome comedy about the marriage of greed and stupidity. And the worst part about it is that we're still in denial — we still think this is some kind of unfortunate accident, not something that was created by the group of psychopaths on Wall Street <and in Congress> whom we allowed to gang-rape the American Dream. When Geithner announced the new \$30 billion bailout, the party line was that poor AIG was just a victim of a lot of shitty luck — bad year for business, you know, what with the financial crisis and all. Edward Liddy, the company's CEO, actually compared it to catching a cold: "The marketplace is a pretty crummy place to be right now," he said. "When the world catches pneumonia, we get it too." In a pathetic attempt at name-dropping, he even whined that AIG was being "consumed by the same issues that are driving house prices down and 401K statements down and Warren Buffet's investment portfolio down."

Liddy made AIG sound like an orphan begging in a soup line, hungry and sick from being left out in someone else's financial weather. He conveniently forgot to mention that AIG had spent more than a decade systematically scheming to evade U.S. and international regulators, or that one of the causes of its "pneumonia" was making colossal, world-sinking \$500 billion bets with money it didn't have, in a toxic and completely unregulated derivatives market.

Nor did anyone mention that when AIG finally got up from its seat at the Wall Street casino, broke and busted in the after-dawn light, it owed money all over town — and that a huge chunk of your taxpayer dollars in this particular bailout scam will be going to pay off the other high rollers at its table. Or that this was a casino unique among all casinos, one where middle-class taxpayers cover the bets of billionaires.

People are pissed off about this financial crisis, and about this bailout, but they're not pissed off enough. The reality is that the worldwide economic meltdown and the bailout that followed were together a kind of revolution, a coup d'état. They cemented and formalized a political trend that has been snowballing for decades: the gradual takeover of the government by a small class of connected insiders <i.e. inside the beltway>, who used money to control elections, buy influence and systematically weaken financial regulations... <and many folks want you to think it was all single-handedly orchestrated by Republicans, and only Republicans, if you can believe that.>

The crisis was the coup de grâce: Given virtually free rein over the economy, these same insiders first wrecked the financial world, then cunningly granted themselves nearly unlimited emergency powers to clean up their own mess <by waiting too long to respond until after they got elected/re-elected to a sufficient number of House and Senate seats thus grabbing more power votes in the process>. And so the gambling-addict leaders of companies like AIG end up not penniless and in jail, but with an *Alien*-style death grip on the Treasury and the Federal Reserve — "our partners in the government," as Liddy put it with a shockingly casual matter-of-factness after the most recent bailout.

The mistake most people make in looking at the financial crisis is thinking of it in terms of *money*, a habit that might lead you to look at the unfolding mess as a huge bonus-killing downer for the Wall Street class. But if you look at it in purely Machiavellian terms, what you see is a colossal power grab that threatens to turn the federal government into a kind of giant Enron — a huge, impenetrable black box filled with self-dealing insiders whose scheme is the securing of individual profits at the expense of an ocean of unwitting involuntary shareholders, previously known as taxpayers.

I. PATIENT ZERO

The best way to understand the financial crisis is to understand the meltdown at AIG. AIG is what happens when short, bald managers of otherwise boring financial bureaucracies start seeing Brad Pitt in the mirror. This is a company that built a giant fortune across more than a century by betting on safety-conscious policyholders — people who wear seat belts and build houses on high ground — and then blew it all in a year or two by turning their entire balance sheet over to a guy who acted like making huge bets with other people's money would make his dick bigger.

That guy — the Patient Zero of the global economic meltdown — was one Joseph Cassano, the head of a tiny, 400-person unit within the company called **AIG Financial Products** <hiding out at AIG's elite weapons of mass economic destruction lab>, or AIGFP. Cassano, a pudgy, balding Brooklyn College grad with beady eyes and way too much forehead, cut his teeth in the Eighties working for Mike Milken, the granddaddy of modern Wall Street debt alchemists. Milken, who pioneered the creative use of junk bonds, relied on messianic genius and a whole array of insider schemes to evade detection while wreaking financial disaster. Cassano, by contrast, was just a greedy little turd with a knack for selective accounting who ran his scam right out in the open, thanks to Washington's deregulation of the Wall Street casino. "It's all about the regulatory environment," says a government source involved with the AIG bailout. "These guys look for holes in the system, for ways they can do trades without government interference.

Whatever is unregulated, all the action is going to pile into that." <So, regulation, apparently, is not the answer either?>

The mess Cassano created had its roots in an investment boom fueled in part by a relatively new type of financial instrument called a collateralized-debt obligation. A CDO is like a box full of diced-up assets. They can be anything: mortgages, corporate loans, aircraft loans, credit-card loans, even other CDOs. So as X mortgage holder pays his bill, and Y corporate debtor pays his bill, and Z credit-card debtor pays *his* bill, money flows into the box.

The key idea behind a CDO is that there will always be at least some money in the box, regardless of how dicey the individual assets inside it are. No matter how you look at a single unemployed ex-con trying to pay the note on a six-bedroom house, he looks like a bad investment. But dump his loan in a box with a smorgasbord of auto loans, credit-card debt, corporate bonds and other crap, and you can be reasonably sure that *somebody* is going to pay up. Say \$100 is supposed to come into the box every month. Even in an apocalypse, when \$90 in payments might default, you'll still get \$10. What the inventors of the CDO did is divide up the box into groups of investors and put that \$10 into its own level, or "tranche." They then convinced ratings agencies like Moody's and S&P to give that top tranche the highest AAA rating — meaning it has close to zero credit risk.

Suddenly, thanks to this financial seal of approval, banks had a way to turn their shittiest mortgages and other financial waste into investment-grade paper and sell them to institutional investors like pensions and insurance companies, which were forced by regulators to keep their portfolios as safe as possible. Because CDOs offered higher rates of return than truly safe products like Treasury bills, it was a win-win: Banks made a fortune selling CDOs, and big investors made much more holding them.

The problem was, none of this was based on reality. "The banks knew they were selling crap," says a London-based trader from one of the bailed-out companies. To get AAA ratings, the CDOs relied not on their actual underlying assets but on crazy mathematical formulas that the banks cooked up to make the investments look safer than they really were. "They had some back room somewhere where a bunch of Indian guys who'd been doing nothing but math for God knows how many years would come up with some kind of model saying that this or that combination of debtors would only default once every 10,000 years," says one young trader who sold CDOs for a major investment bank. "It was nuts."

Now that even the crappiest mortgages could be sold to conservative investors, the CDOs spurred a massive explosion of irresponsible and predatory lending. In fact, there was such a crush to underwrite CDOs that it became hard to find enough subprime mortgages — read: enough unemployed meth dealers willing to buy million-dollar homes for no money down — to fill them all. As banks and investors of all kinds took on more and more in CDOs and similar instruments, they needed some way to hedge their massive bets — some kind of insurance policy, in case the housing bubble burst and all that debt went south at the same time. This was particularly true for investment banks, many of which got stuck holding or "warehousing" CDOs when they wrote more than they could sell. And that's where Joe Cassano came in.

Known for his boldness and arrogance, Cassano took over as chief of AIGFP in 2001. He was the favorite of Maurice "Hank" Greenberg <to this date a major interested stockholder of AIG>, the head of AIG, who admired the younger man's hard-driving ways, even if neither he nor his successors fully understood exactly what it was that Cassano did. According to a source familiar with AIG's internal operations, Cassano basically told senior management, "You know insurance, I know investments, so you do what you do, and I'll do what I do — leave me alone." Given a free hand within the company, Cassano set out from his offices in London to sell a lucrative form of "insurance" to all those investors holding lots of CDOs. His tool of choice was another new financial instrument known as a credit-default swap, or CDS.

The CDS was popularized by J.P. Morgan, in particular by a group of young, creative bankers who would later become known as the "Morgan Mafia," as many of them would go on to assume influential positions in the finance world. In 1994, in between booze and games of tennis at a resort in Boca Raton, Florida, the Morgan gang plotted a way to help boost the bank's returns. One of their goals was to find a way to lend more money, while working around regulations that required them to keep a set amount of cash in reserve to back those loans. What they came up with was an early version of the credit-default swap.

In its simplest form, a CDS is just a bet on an outcome. Say Bank A writes a million-dollar mortgage to the Pope for a town house in the West Village. Bank A wants to hedge its mortgage risk in case the Pope can't make his monthly payments, so it buys CDS protection from Bank B, wherein it agrees to pay Bank B a premium of \$1,000 a month for five years. In return, Bank B agrees to pay Bank A the full million-dollar value of the Pope's mortgage if he defaults. In theory, Bank A is covered if the Pope goes on a meth binge and loses his job.

When Morgan presented their plans for credit swaps to **regulators** in the **late Nineties** <...keep in mind this is a history lesson so tie the dates together as we go along... (Note: This scheme was cooked up and brought to life with approval by CLINTON's administration... i.e. regulators. It was used all over town by the time Bush began dealing with the 9/11 fallout...)>, they argued that if they bought CDS protection for enough of the investments in their portfolio, they had effectively moved the risk off their books. Therefore, they argued, they should be allowed to lend more, without keeping more cash in reserve. A whole host of regulators — from the Federal Reserve to the Office of the Comptroller of the Currency — **accepted the argument**, and Morgan was allowed to put more money on the street.

What Cassano did was to transform the credit swaps that Morgan popularized into the world's largest bet on the housing boom. In theory, at least, there's nothing wrong with buying a CDS to insure your investments. Investors paid a premium to AIGFP, and in return the company promised to pick up the tab if the mortgage-backed CDOs went bust. But as Cassano went on a selling spree, the deals he made differed from traditional insurance in several significant ways. First, **the party selling CDS protection didn't have to post any money upfront**. When a \$100 corporate bond is sold, for example, someone has to show 100 actual dollars. But **when you sell a \$100 CDS guarantee, you don't have to show a dime**. So Cassano could sell investment banks **billions in guarantees without having any single asset to back it up**.

Secondly, Cassano was selling so-called "naked" CDS deals. In a "naked" CDS, neither party actually holds the underlying loan. In other words, **Bank B not only sells CDS protection to Bank A for its mortgage on the Pope — it turns around and sells protection to Bank C for the very same mortgage**. This could go on ad nauseam: You could have Banks D through Z also betting on Bank A's mortgage. Unlike traditional insurance, **Cassano was offering investors an opportunity to bet that *someone else's* house would burn down, or take out a term life policy on the guy with AIDS down the street**. It was no different from gambling, the Wall Street version of a bunch of frat brothers betting on Jay Feely to make a field goal. **Cassano was taking book for every bank that bet short on the housing market, but he didn't have the cash to pay off if the kick went wide**.

In a span of only seven years <2001-2007+>, Cassano sold some \$500 billion worth of CDS protection, with at least \$64 billion of that tied to the subprime mortgage market. **AIG didn't have even a fraction of that amount of cash on hand to cover its bets, but neither did it expect it would ever need any reserves**. So long as defaults on the underlying securities remained a highly unlikely proposition, AIG was essentially collecting huge and **steadily climbing premiums by selling insurance for the disaster it**

thought would never come. <By the way, that's what ALL insurance companies do to ALL OF US ALL THE TIME... Insurance is the biggest Ponzi scheme mankind has ever cooked up... starting with Social Security.>

Initially, at least, the revenues were enormous: AIGFP's returns went from \$737 million in 1999 to \$3.2 billion in 2005. Over the past seven years, the subsidiary's 400 employees were paid a total of \$3.5 billion; Cassano himself pocketed at least \$280 million in compensation. Everyone made their money — and then it all went to shit.

II. THE REGULATORS

<As you read what follows keep in mind that the 106th U.S. Congress was composed of 54 Republicans and 46 Democrats in the Senate, with VP Al Gore (D) having the tie breaker vote, and that there were 223 Republicans, 211 Democrats and 1 Independent in the House... plus President Clinton (D) who had the veto power over any passed legislation (power was fairly equal during these times)...>

Cassano's outrageous gamble wouldn't have been possible had he not had the good fortune to take over AIGFP just as Sen. Phil Gramm — a grinning, *laissez-faire* ideologue from Texas — had finished engineering the most dramatic deregulation of the financial industry since Emperor Hien Tsung invented paper money in 806 A.D. For years, Washington had kept a watchful eye on the nation's banks. Ever since the Great Depression, commercial banks — those that kept money on deposit for individuals and businesses — had not been allowed to double as investment banks, which raise money by issuing and selling securities. The Glass-Steagall Act, passed during the Depression, also prevented banks of any kind from getting into the insurance business.

But in the late Nineties, a few years before Cassano took over AIGFP, all that changed. The **Democrats**, tired of getting slaughtered in the **fundraising** arena by Republicans, decided to throw off their old reliance on unions and interest groups and become more "**business-friendly**". Wall Street responded by flooding Washington with money, buying allies in **both parties**. In the 10-year period **beginning in 1998**, financial companies spent \$1.7 billion on federal campaign contributions and another \$3.4 billion on lobbyists. They quickly got what they paid for. **In 1999, Gramm co-sponsored a bill that repealed key aspects of the Glass-Steagall Act** <(...the final version of Public Law 106-102 passed both houses of Congress by votes of 90-8 in the Senate and 362-57 in the house. Clinton signed it... without using the veto. It thus had a majority of both parties in favor of it at the time... not just Gramm (R) as one might think...)>, smoothing the way for the creation of financial megafirms like Citigroup. The move did away with the built-in

protections afforded by smaller banks. In the old days, a local banker knew the people whose loans were on his balance sheet: He wasn't going to give a million-dollar mortgage to a homeless meth addict, since he would have to keep that loan on his books. **But a giant merged bank might write that loan and then sell it off to some fool in China, and who cared?**

The very next year, Gramm compounded the problem **by writing** a sweeping new law called the **Commodity Futures Modernization Act** <(...which was piggybacked on the HR 4577 spending bill. Clinton signed this one also, no questions ask, on **Dec 21, 2000**. It effectively was rammed through Congress before Christmas recess. Had Clinton vetoed the budget it may have been viewed as closing shop under protest, thus harming the Democrats, until after the upcoming election. Still 157 Democrats and 133 Republicans voted for it and 9 Democrats and 51 Republicans voted against it.)> that made it impossible to regulate credit swaps as either gambling or securities. **Commercial banks** — which, thanks to Gramm, **were now competing directly with investment banks for customers** — were **driven to buy credit swaps** to loosen capital in search of higher yields. "By ruling that credit-default swaps were not gaming and not a security, the way was cleared for the growth of the market," said Eric Dinallo, head of the New York State Insurance Department. **<Fact is CDS's are NOT gambling or stock (securities). They ARE insurance policies... like it or not.>**

The blanket exemption meant that Joe Cassano could now sell as many CDS contracts as he wanted, building up as huge a position as he wanted, without anyone in government saying a word. "You have to remember, investment banks aren't in the business of making huge directional bets," says the government source involved in the AIG bailout. When investment banks write CDS deals, they hedge them. But insurance companies don't have to hedge. And that's what AIG did. "They just bet massively long on the housing market," says the source. "Billions and billions."

In the biggest joke of all, Cassano's wheeling and dealing was **regulated** by the **Office of Thrift Supervision** <which, by the way, is directly paid for (funded) by "assessments" (taxes/fees ?) levied on the banks when it was created by Congress in 1989 (and which made it possible for AIG to operate from the EU without oversight there)>, an agency that would prove to be defiantly **uninterested in keeping watch over his operations**. How a behemoth like AIG came to be regulated by the little-known and relatively small OTS is yet another triumph of the deregulatory instinct. Under another law passed in **1999**, certain kinds of holding companies could choose the OTS as their regulator, provided they owned one or more thrifts (better known as savings-and-loans). Because the OTS was viewed as more compliant than the Fed or the Securities and Exchange Commission,

companies rushed to reclassify themselves as thrifts. In **1999**, AIG purchased a thrift in Delaware and managed to get approval for **OTS regulation** of its entire operation.

<Thus they could go ahead and set up AIGFP in Europe.>

Making matters even more hilarious, AIGFP — a London-based subsidiary of an American insurance company — ought to have been regulated by one of Europe's more stringent regulators, like Britain's Financial Services Authority. But the OTS managed to convince the Europeans that it had the muscle to regulate these giant companies. **By 2007, the EU had conferred legitimacy to OTS supervision of three mammoth firms — GE, AIG and Ameriprise.** <Now we can thanks the EU, who would prefer not to accept any blame, for helping out too...2007 is the beginning of the end...>

That same year, as the subprime crisis was exploding, the **Government Accountability Office** <an arm of the 110th Congress (majority Democrats) at the time> criticized the OTS <but did little>, noting a "disparity between the size of the agency and the diverse firms it oversees." Among other things, the GAO report noted that the **entire OTS had only one insurance specialist on staff** — and this despite the fact that it was the primary regulator for the world's largest insurer!

"There's this notion that the regulators couldn't do anything to stop AIG," says a government official who was present during the bailout. "That's bullshit. What you have to understand is that these **regulators have ultimate power**. They can send you a letter and say, 'You don't exist anymore,' and that's basically that. They don't even really need due process. The OTS could have said, 'We're going to pull your charter; we're going to pull your license; we're going to sue you.' And getting sued by your primary regulator is the kiss of death." <So, AIG was regulated, just never regulated via any sort of enforcement.>

When AIG finally blew up, the OTS regulator ostensibly in charge of overseeing the insurance giant — a guy named **C.K. Lee** — **basically admitted that he had blown it**. His mistake, Lee said, was that he believed all those credit swaps in Cassano's portfolio were "fairly benign products." Why? Because the company told him so. "The judgment the company was making was that there was no big credit risk," he explained. (Lee now works as Midwest region director of the OTS; the agency declined to make him available for an interview.)

In early March <2009>, after the latest bailout of AIG, Treasury Secretary **Timothy Geithner** took what seemed to be a thinly veiled shot at the OTS, calling AIG a "huge, complex global insurance company attached to a very complicated investment

bank/hedge fund that was allowed to build up without any adult supervision." But even without that "adult supervision," [AIG might have been OK had it not been for a complete lack of internal controls](#). For six months before its meltdown, according to insiders, the company had been searching for a full-time chief financial officer and a chief risk-assessment officer, but never got around to hiring either. That meant that the 18th-largest company in the world had no one checking to make sure its balance sheet was safe and no one keeping track of how much cash and assets the firm had on hand. The situation was so bad that when outside consultants were called in a few weeks before the bailout, senior executives were unable to answer even the most basic questions about their company — like, for instance, how much exposure the firm had to the residential-mortgage market. [<By now the Democrats, with plenty of purchased voting power they can use to "change" the planet, had been elected and can finally TRY to save us all... by tax and spending plans adding up to \\$10 TRILLION to date and counting.>](#)

III. THE CRASH

Ironically, when reality finally caught up to Cassano, it wasn't because the housing market crapped but because of AIG itself. Before 2005, the company's debt was rated triple-A, meaning he didn't need to post much cash to sell CDS protection: The solid creditworthiness of AIG's name was guarantee enough. But the company's crummy accounting practices eventually caused its credit rating to be [downgraded, triggering clauses in the CDS contracts that forced Cassano to post substantially more collateral to back his deals](#). [<...i.e. market regulated vs. government regulated.>](#)

By the fall of 2007, it was evident that AIGFP's portfolio had turned poisonous, but like every good Wall Street huckster, Cassano schemed to keep his insane, Earth-swallowing gamble hidden from public view. That August, balls bulging, he announced to investors on a conference call that "it is hard for us, without being flippant, to even see a scenario within any kind of realm of reason that would see us losing \$1 in any of those transactions." As he spoke, his CDS portfolio was racking up \$352 million in losses. When the growing credit crunch prompted senior AIG executives to re-examine its liabilities, [a company accountant named Joseph St. Denis became "gravely concerned" about the CDS deals and their potential for mass destruction. Cassano responded by personally forcing the poor sap out of the firm](#), telling him he was "deliberately excluded" from the financial review for fear that he might "pollute the process."

The following February, when AIG posted \$11.5 billion in annual losses, it announced the resignation of Cassano as head of AIGFP, saying an auditor had found a "material weakness" in the CDS portfolio. But amazingly, the company not only allowed Cassano to

keep \$34 million in bonuses, it kept him on as a consultant for \$1 million a month. In fact, Cassano remained on the payroll and kept collecting his monthly million through the end of September 2008, even after taxpayers had been forced to hand AIG \$85 billion to patch up his fuck-ups. When asked in October why the company still retained Cassano at his \$1 million-a-month rate despite his role in the probable downfall of Western civilization, CEO Martin Sullivan told Congress with a straight face that AIG wanted to "retain the 20-year knowledge that Mr. Cassano had." (Cassano, who is apparently hiding out in his lavish town house near Harrods in London, could not be reached for comment.)

What sank AIG in the end was another credit downgrade <...i.e. market regulated vs. government regulated.>. Cassano had written so many CDS deals that when the company was facing another downgrade to its credit rating last September, from AA to A, it needed to post billions in collateral — not only more cash than it had on its balance sheet but more cash than it could raise even if it sold off every single one of its liquid assets. Even so, management dithered for days, not believing the company was in serious trouble. AIG was a dried-up prune, sapped of any real value, and its top executives didn't even know it.

On the weekend of September 13th, AIG's senior leaders were summoned to the offices of the New York Federal Reserve. Regulators from Dinallo's insurance office were there, as was Geithner, then chief of the New York Fed. Treasury Secretary Hank Paulson, who spent most of the weekend preoccupied with the collapse of Lehman Brothers, came in and out. Also present, for reasons that would emerge later, was Lloyd Blankfein, CEO of Goldman Sachs. The only relevant government office that wasn't represented was the regulator that should have been there all along: the OTS.

"We sat down with Paulson, Geithner and Dinallo," says a person present at the negotiations. "I didn't see the OTS even once."

On September 14th, according to another person present, Treasury officials presented Blankfein and other bankers in attendance with an absurd proposal: "They basically asked them to spend a day and check to see if they could raise the money privately." The laughably short time span to complete the mammoth task made the answer a foregone conclusion. At the end of the day, the bankers came back and told the government officials, gee, we checked, but we can't raise that much. And the bailout was on. <...after begging Pelois and Reid for HELP!!>

A short time later, it came out that AIG was planning to pay some \$90 million in deferred compensation to former executives, and to accelerate the payout of \$277 million in

bonuses to others — a move the company insisted was necessary to "retain key employees." When Congress balked, AIG canceled the \$90 million in payments.

<Congress and Geithner knew.>

Then, in January 2009, the company did it again. After all those years letting Cassano run wild, and after already getting caught paying out insane bonuses while on the public till, AIG decided to pay out another \$450 million in bonuses. And to whom? To the 400 or so employees in Cassano's old unit, AIGFP, which is due to go out of business shortly! Yes, that's right, an average of [\\$1.1 million in taxpayer-backed money apiece](#), to the very people who spent the past decade or so punching a hole in the fabric of the universe!

"We, uh, needed to keep these *highly expert* people in their seats," AIG spokeswoman Christina Pretto says to me in early February.

"But didn't these 'highly expert people' basically destroy your company?" I ask.

Pretto protests, says this isn't fair. The employees at AIGFP have already taken pay cuts, she says. Not retaining them would dilute the value of the company even further, make it harder to wrap up the unit's operations in an orderly fashion.

The bonuses are a nice comic touch highlighting one of the more outrageous tangents of the bailout age, namely the fact that, even with the planet in flames, some members of the Wall Street class can't even get used to the tragedy of having to fly coach. "These people need their trips to Baja, their spa treatments, their hand jobs," says an official involved in the AIG bailout, a serious look on his face, apparently not even half-kidding. "They don't function well without them."

IV. THE POWER GRAB

So that's the first step in wall street's [<and Congress's> power grab](#): making up things like credit-default swaps and collateralized-debt obligations, financial products so complex and inscrutable that ordinary American dumb people — to say nothing of federal regulators and even the CEOs of major corporations like AIG — are too intimidated to even try to understand them. That, combined with wise political investments, enabled the nation's top bankers to effectively scrap any meaningful oversight of the financial industry. [In 1997 and 1998, the years leading up to the passage of Phil Gramm's fateful act that gutted Glass-Steagall](#), the banking, brokerage and insurance industries spent \$350 million on political contributions and lobbying. [Gramm alone — then the chairman of the Senate Banking Committee — collected \\$2.6 million in only five years.](#) The law

passed 90-8 in the Senate, with the support of 38 Democrats, including some names that might surprise you: Joe Biden <our new VP>, John Kerry, Tom Daschle <Senate leader before Reid>, Dick Durbin, even John Edwards. <...and Dodd, Murray (WA), Kennedy, Wyden (OR), Reid (NV), Feinstein (CA), Lieberman and Pelosi (CA) now leader of the House... before H Clinton's and B Obama's time, so they could not vote yet.>

The act helped create the too-big-to-fail financial behemoths like Citigroup, AIG and Bank of America — and in turn helped those companies slowly crush their smaller competitors, leaving the major Wall Street firms with even more money and power to lobby for further deregulatory measures. "We're moving to an oligopolistic situation," Kenneth Guenther, a top executive with the Independent Community Bankers of America, lamented after the Gramm measure was passed.

The situation worsened in 2004, in an extraordinary move toward deregulation that never even got to a vote. At the time, the European Union was threatening to more strictly regulate the foreign operations of America's big investment banks if the U.S. didn't strengthen its own oversight. So the top five investment banks got together on April 28th of that year and — with the helpful assistance of then-Goldman Sachs<, one of Bear Stearn's competitors,> chief and future Treasury Secretary Hank Paulson — made a pitch to George Bush's SEC chief at the time, William Donaldson, himself a former investment banker. The banks generously volunteered to submit to new rules restricting them from engaging in excessively risky activity. In exchange, they asked to be released from any lending restrictions. The discussion about the new rules lasted just 55 minutes, and there was not a single representative of a major media outlet there to record the fateful decision.

Donaldson OK'd the proposal, and the new rules were enough to get the EU to drop its threat to regulate the five firms. The only catch was, neither Donaldson nor his successor, Christopher Cox, actually did any regulating of the banks. They named a commission of seven people to oversee the five companies, whose combined assets came to total more than \$4 trillion. But in the last year and a half of Cox's tenure, the group had no director and did not complete a single inspection. Great deal for the banks, which originally complained about being regulated by both Europe and the SEC, and ended up being regulated by no one.

Once the capital requirements were gone, those top five banks went hog-wild, jumping ass-first into the then-raging housing bubble. One of those was Bear Stearns, which used its freedom to drown itself in bad mortgage loans. In the short period between the 2004 change and Bear's collapse, the firm's debt-to-equity ratio soared from 12-1 to an insane

33-1. Another culprit was Goldman Sachs, which also had the good fortune, around then, to see its CEO, a bald-headed Frankensteinian goon named Hank Paulson (who received an estimated \$200 million tax deferral by joining the government), ascend to Treasury secretary.

Freed from all capital restraints, sitting pretty with its man running the Treasury, Goldman jumped into the housing craze just like everyone else on Wall Street. Although it famously scored an \$11 billion coup in 2007 when one of its trading units [smartly shorted the housing market](#), the move didn't tell the whole story. [In truth, Goldman still had a huge exposure come that fateful summer of 2008 — to none other than Joe Cassano.](#)

[Goldman Sachs, it turns out, was Cassano's biggest customer](#), with \$20 billion of exposure in Cassano's CDS book. Which [might explain why Goldman chief Lloyd Blankfein was in the room with ex-Goldmanite Hank Paulson that weekend of September 13th, when the federal government was supposedly bailing out AIG.](#)

When asked why Blankfein was there, one of the government officials who was in the meeting shrugs. "One might say that it's because Goldman had so much exposure to AIGFP's portfolio," he says. "You'll never prove that, but one might suppose."

Market analyst Eric Salzman is more blunt. ["If AIG went down," he says, "there was a good chance Goldman would not be able to collect."](#) The AIG bailout, in effect, was [Goldman bailing out Goldman.](#)

Eventually, Paulson went a step further, elevating another [ex-Goldmanite named Edward Liddy to run AIG](#) — a company whose bailout money would be coming, in part, [from the newly created TARP program](#), administered by another Goldman banker named Neel Kashkari.

V. REPO MEN

[There are plenty of people who have noticed, in recent years, that when they lost their homes to foreclosure <\(most due to the total lack of buyers due to no access to loans and fear of dropping house values and a slow to act Congress chasing their tails\)> or were forced into bankruptcy because of crippling credit-card debt, no one in the government was there to rescue them.](#) But when Goldman Sachs — a company whose average employee still made more than \$350,000 last year, even in the midst of a depression — was suddenly faced with the possibility of losing money on the unregulated

insurance deals it bought for its insane housing bets, the government was there in an instant to patch the hole. [That's the essence of the bailout: rich bankers bailing out rich bankers, using the taxpayers' credit card.](#)

The people who have spent their lives cloistered in this Wall Street community aren't much for sharing information with the great unwashed. [Because all of this shit is complicated, because most of us mortals don't know what the hell LIBOR is or how a REIT works or how to use the word "zero coupon bond" in a sentence without sounding stupid — well, then, the people who do speak this idiotic language cannot under any circumstances be bothered to explain it to us and instead spend a lot of time rolling their eyes and asking us to trust them.](#)

That roll of the eyes is a key part of the psychology of Paulsonism. The state is now being asked not just to call off its regulators or give tax breaks or funnel a few contracts to connected companies; it is intervening directly in the economy, for the sole purpose of preserving the influence of the megafirms. In essence, Paulson used [the bailout to transform the government into a giant bureaucracy of entitled assholedom](#), one that would socialize "toxic" risks but keep both the profits and the management of the bailed-out firms in private hands. Moreover, this whole process would be [done in secret](#), away from the prying eyes of NASCAR dads, broke-ass liberals who read translations of French novels, subprime mortgage holders and other such financial losers.

[<OK. Now comes the good part. Pay attention here. No more red ink. Just READ...>](#)

Some aspects of the bailout were secretive to the point of absurdity. In fact, if you look closely at just a few lines in the Federal Reserve's weekly public disclosures, [you can literally see the moment where a big chunk of your money disappeared for good](#). The [H.4.1 or H4 report](#) (called "Factors Affecting Reserve Balances") summarizes the activities of the Fed each week. You can find it online, and it's pretty much the only thing the Fed ever tells the world about what it does. For the week ending February 18th, the number under the heading "Repurchase Agreements" on the table is zero. It's a significant number.

Why? In the pre-crisis days, the Fed used to manage the money supply by periodically buying and selling securities on the open market through so-called [Repurchase Agreements, or Repos](#). The Fed would typically dump \$25 billion or so in cash onto the market every week, buying up Treasury bills, U.S. securities and even mortgage-backed securities from institutions like Goldman Sachs and J.P. Morgan, who would then "repurchase" them in a short period of time, usually one to seven days. This was the

Fed's primary mechanism for controlling interest rates: Buying up securities gives banks more money to lend, which makes interest rates go down. Selling the securities back to the banks reduces the money available for lending, which makes interest rates go up.

If you look at the weekly H4 reports going back to the summer of 2007, you start to notice something alarming. At the start of the credit crunch, around August of that year, you see the Fed buying a few more Repos than usual — \$33 billion or so. By November, as private-bank reserves were dwindling to alarmingly low levels, the Fed started injecting even more cash than usual into the economy: \$48 billion. By late December, the number was up to \$58 billion; by the following March, around the time of the Bear Stearns rescue, the Repo number had jumped to \$77 billion. In the week of May 1st, 2008, the number was \$115 billion — "out of control now," according to one congressional aide. For the rest of 2008, the numbers remained similarly in the stratosphere, the Fed pumping as much as \$125 billion of these short-term loans into the economy — until suddenly, at the start of this year, the number drops to nothing. **Zero.**

The reason the number has dropped to nothing is that the Fed had simply stopped using relatively transparent devices like repurchase agreements to pump its money into the hands of private companies. By **early 2009**, a whole series of new government operations had been **invented** to inject cash into the economy, most all of them completely secretive and with names you've never heard of. There is the Term Auction Facility, the Term Securities Lending Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility and a monster called the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (boasting the chat-room horror-show acronym ABCPMMMFLF). For good measure, there's also something called a Money Market Investor Funding Facility, plus three facilities called Maiden Lane I, II and III to aid bailout recipients like Bear Stearns and AIG.

While the rest of America, and most of Congress, have been bugging out about the \$700 billion bailout program called TARP, all of these newly created organisms in the Federal Reserve zoo have quietly been pumping not billions but trillions of dollars into the hands of private companies (at least \$3 trillion so far in loans, with as much as \$5.7 trillion more in guarantees of private investments). Although this technically isn't taxpayer money, it still affects taxpayers directly, because the activities of the Fed impact the economy as a whole. And **this new, secretive activity by the Fed completely eclipses the TARP program in terms of its influence on the economy.**

No one knows who's getting that money or exactly how much of it is disappearing through these new holes in the hull of America's credit rating. Moreover, no one can

really be sure if these new institutions are even temporary at all — or whether they are being set up as permanent, state-aided crutches to Wall Street, designed to systematically suck bad investments off the ledgers of irresponsible lenders.

"They're supposed to be temporary," says Paul-Martin Foss, an aide to Rep. Ron Paul. "But we keep getting notices every six months or so that they're being renewed. They just sort of quietly announce it."

None other than disgraced senator Ted Stevens was the poor sap who made the unpleasant discovery that [if Congress didn't like the Fed handing trillions of dollars to banks without any oversight, Congress could apparently go fuck itself — or so said the law](#). When Stevens asked the GAO about [what authority Congress has to monitor the Fed](#), he got back a letter citing an obscure statute that nobody had ever heard of before: the [Accounting and Auditing Act of 1950](#). The relevant section, 31 USC 714(b), dictated that congressional audits of the Federal Reserve may not include "deliberations, decisions and actions on monetary policy matters." The exemption, as Foss notes, "basically includes everything." [According to the law, in other words, the Fed simply cannot be audited by Congress. Or by anyone else, for that matter.](#)

VI. WINNERS AND LOSERS

Stevens isn't the only person in Congress to be given the finger by the Fed. In January, when Rep. Alan Grayson of Florida asked Federal Reserve vice chairman Donald Kohn where all the money went — only \$1.2 trillion had vanished by then — Kohn gave Grayson a classic eye roll, saying he would be "very hesitant" to name names because it might discourage banks from taking the money.

"Has that ever happened?" Grayson asked. "Have people ever said, 'We will not take your \$100 billion because people will find out about it?'"

"Well, we said we would not publish the names of the borrowers, so we have no test of that," Kohn answered, visibly annoyed with Grayson's meddling.

Grayson pressed on, demanding to know on what terms the Fed was lending the money. Presumably it was buying assets and making loans, but no one knew how it was pricing those assets — in other words, no one knew what kind of deal it was striking on behalf of taxpayers. So when Grayson asked if the purchased assets were "marked to market" — a methodology that assigns a concrete value to assets, based on the market rate on the day they are traded — Kohn answered, mysteriously, ["The ones that have market values](#)

are marked to market." The implication was that the Fed was purchasing derivatives like credit swaps or other instruments that were basically impossible to value objectively — paying real money for God knows what.

"Well, how much of them don't have market values?" asked Grayson. "How much of them are worthless?"

"None are worthless," Kohn snapped.

"Then why don't you mark them to market?" Grayson demanded.

"Well," Kohn sighed, "we are marking the ones to market that have market values."

In essence, the Fed was telling Congress to lay off and let the experts handle things. "It's like buying a car in a used-car lot without opening the hood, and saying, 'I think it's fine,'" says Dan Fuss, an analyst with the investment firm Loomis Sayles. "The salesman says, 'Don't worry about it. Trust me.' It'll probably get us out of the lot, but how much farther? None of us knows."

When one considers the comparatively extensive system of congressional checks and balances that goes into the spending of every dollar in the budget via the normal appropriations process, what's happening in the Fed amounts to something truly revolutionary — a kind of shadow government with a budget many times the size of the normal federal outlay, administered dictatorially by one man, Fed chairman Ben Bernanke. **"We spend hours and hours and hours arguing over \$10 million amendments on the floor of the Senate, but there has been no discussion about who has been receiving this \$3 trillion," says Sen. Bernie Sanders (I). "It is beyond comprehension."**

Count Sanders among those who don't buy the argument that Wall Street firms shouldn't have to face being outed as recipients of public funds, that making this information public might cause investors to panic and dump their holdings in these firms. "I guess if we made that public, they'd go on strike or something," he muses.

And the Fed isn't the only arm of the bailout that has closed ranks. **The Treasury, too, has maintained incredible secrecy surrounding its implementation even of the TARP program, which was mandated by Congress. To this date, no one knows exactly what criteria the Treasury Department used to determine which banks received bailout funds**

and which didn't — particularly the first \$350 billion given out under Bush appointee Hank Paulson.

The situation with the first TARP payments grew so absurd that when the **Congressional Oversight Panel**, charged with monitoring the bailout money, sent a query to Paulson asking how he decided whom to give money to, Treasury responded — and this isn't a joke — by directing the panel to a copy of the **TARP application form on its website**. Elizabeth Warren, *the chair of the Congressional Oversight Panel*, was struck nearly speechless by the response. <This is probably the only funny part of this entire history lesson... just how dumb can a bunch of Congress members be for crying out loud?!>

"Do you believe that?" she says incredulously. "That's not what we had in mind." <Oh really? Hello... any one home in there?>

Another member of Congress, who asked not to be named, offers his own theory about the TARP process. "I think basically if you knew Hank Paulson, you got the money," he says.

This cozy arrangement created yet another opportunity for big banks to devour market share at the expense of smaller regional lenders. While all the bigwigs at Citi and Goldman and Bank of America who had Paulson on speed-dial got bailed out right away — remember that TARP was originally passed because money had to be lent right now, that day, that minute, to stave off emergency <ring any bells> — many small banks are still waiting for help. Five months into the TARP program, some not only haven't received any funds, they haven't even gotten a call back about their applications.

"There's definitely a feeling among community bankers that no one up there cares much if they make it or not," says Tanya Wheelless, president of the Arizona Bankers Association.

Which, of course, is exactly the opposite of what should be happening, since small, regional banks are far less guilty of the kinds of predatory lending that sank the economy. "They're not giving out subprime loans or easy credit," says Wheelless. "At the community level, it's much more bread-and-butter banking."

Nonetheless, the lion's share of the bailout money has gone to the larger, so-called "systemically important" banks. "It's like Treasury is picking winners and losers," says one state banking official who asked not to be identified.

This itself is a hugely important political development. In essence, the bailout accelerated the decline of regional community lenders by boosting the political power of their giant national competitors.

Which, when you think about it, is insane: What had brought us to the brink of collapse in the first place was this relentless instinct for building ever-larger megacompanies, passing deregulatory measures to gradually feed all the little fish in the sea to an ever-shrinking pool of Bigger Fish. To fix this problem, the government should have slowly liquidated these monster, too-big-to-fail firms and broken them down to smaller, more manageable companies. Instead, federal regulators closed ranks and used an almost completely secret bailout process to double down on the same faulty, merger-happy thinking that got us here in the first place, creating a constellation of megafirms under government control that are even bigger, more unwieldy and more crammed to the gills with systemic risk.

In essence, Paulson and his cronies turned the federal government into one gigantic, half-opaque holding company, one whose balance sheet includes the world's most appallingly large and risky hedge fund, a controlling stake in a dying insurance giant, huge investments in a group of teetering megabanks, and shares here and there in various auto-finance companies, student loans, and other failing businesses. Like AIG, this new federal holding company is a firm that has no mechanism for auditing itself and is run by leaders who have very little grasp of the daily operations of its disparate subsidiary operations.

In other words, it's AIG's rip-roaringly shitty business model writ almost inconceivably massive — to echo Geithner, a huge, complex global company attached to a very complicated investment bank/hedge fund that's been allowed to build up without adult supervision. How much of what kinds of crap is actually on our balance sheet, and what did we pay for it? When exactly will the rent come due, when will the money run out? Does anyone know what the hell is going on? And on the linear spectrum of capitalism to socialism, where exactly are we now? Is there a dictionary word that even describes what we are now? It would be funny, if it weren't such a nightmare.

VII. YOU DON'T GET IT

The real question from here is whether the Obama administration is going to move to bring the financial system back to a place where sanity is restored and the general public can have a say in things or whether the new financial bureaucracy will remain obscure, secretive and hopelessly complex. It might not

bode well that Geithner, Obama's Treasury secretary, is one of the architects of the Paulson bailouts; as chief of the New York Fed, he helped orchestrate the Goldman-friendly AIG bailout and the secretive Maiden Lane facilities used to funnel funds to the dying company. Neither did it look good when Geithner — himself a protégé of notorious Goldman alum John Thain, the Merrill Lynch chief who paid out billions in bonuses after the state spent billions bailing out his firm — picked a former Goldman lobbyist named Mark Patterson to be his top aide.

In fact, most of Geithner's early moves reek strongly of Paulsonism. He has continually talked about partnering with private investors to create a so-called "bad bank" that would systemically relieve private lenders of bad assets — the kind of massive, opaque, quasi-private bureaucratic nightmare that Paulson specialized in. Geithner even refloated a Paulson proposal to use TALF, one of the Fed's new facilities, to essentially lend cheap money to hedge funds to invest in troubled banks while practically guaranteeing them enormous profits.

God knows exactly what this does for the taxpayer, but hedge-fund managers sure love the idea. "This is exactly what the financial system needs," said Andrew Feldstein, CEO of Blue Mountain Capital and one of the Morgan Mafia. Strangely, there aren't many people who don't run hedge funds who have expressed anything like that kind of enthusiasm for Geithner's ideas.

As complex as all the finances are, the politics aren't hard to follow. By creating an urgent crisis that can only be solved by those fluent in a language too complex for ordinary people to understand, the Wall Street crowd <and Congress> has turned the vast majority of Americans into non-participants in their own political future. There is a reason it used to be a crime in the Confederate states to teach a slave to read: **Literacy is power**. In the age of the CDS and CDO, **most of us are financial illiterates**. By making an already too-complex economy even more complex, Wall Street <and Congress> has used the crisis to effect a historic, revolutionary change in our political system — transforming a democracy into a two-tiered state, one with plugged-in financial bureaucrats above and clueless customers below.

The most galling thing about this financial crisis is that so many Wall Street types think they actually deserve not only their huge bonuses and lavish lifestyles but the **awesome political power** their own mistakes have left them in possession of. When challenged, they talk about how hard they work, the 90-hour weeks, the stress, the failed marriages, the hemorrhoids and gallstones they all get before they hit 40.

"But wait a minute," you say to them. "No one ever asked you to stay up all night eight days a week trying to get filthy rich shorting what's left of the American auto industry or selling \$600 billion in toxic, irredeemable mortgages to ex-strippers on work release and Taco Bell clerks. Actually, come to think of it, why are we even giving taxpayer money to you people? **Why are we not *throwing your ass in jail* instead?"**

But before you even finish saying that, **they're rolling their eyes, because You Don't Get It.** These people were never about anything except turning money into money, in order to get more money; **values-wise they <the pin heads in Congress and on Wall Street> are on par with crack addicts, or obsessive sexual deviants who burgle homes to steal panties.** Yet these are the people in whose hands our entire political future now rests.

Good luck with that, America. And enjoy tax season.