UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

ROBERT L. SCHULZ,	)	
	)	
Plaintiff	)	
	)	
-against-	)	**No.**
	)	
UNITED STATES FEDERAL RESERVE SYSTEM, BEN S. BERNANKI, Chairman of the United States Federal Reserve System, UNITED STATES DEPARTMENT OF THE TREASURY, HENRY M. PAULSON, JR., Secretary of the United States Department of the Treasury, and UNITED STATES	)	
	)	
Defendants	)	

DECLARATION #1 BY ROBERT L. SCHULZ IN SUPPORT OF SHOW CAUSE ORDER

Robert L. Schulz, under penalty of perjury, declares:

1. I am a Plaintiff in the matter captioned above and I make this affidavit in support of the Show Cause Order for temporary and preliminary injunctive relief.

2. On Wednesday, September 17, 2008, I downloaded from the New York Times website the following articles:

   a. "Fed's $85 Billion Loan Rescues Insurer." See Exhibit A attached hereto.
   b. "A.I.G Is Still Profitable, With a Wide Array of Enterprises." Exhibit B.

3. On Thursday, September 18, 2008, I downloaded from the New York Times website the following articles:

   c. "A New Role for the Fed: Investor of Last Resort." Exhibit C.
   d. "Abroad, Bailout Is Seen as a Free Market Detour." Exhibit D.

Dated: September 18, 2008

ROBERT L. SCHULZ
2458 Ridge Road
Queensbury, NY 12804

The New York Times
nytimes.com

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September 17, 2008

Fed's $85 Billion Loan Rescues Insurer

By EDMUND L. ANDREWS, MICHAEL J. de la MERCED and MARY WILLIAMS WALSH

This article was reported by Edmund L. Andrews, Michael J. de la Merced and Mary Williams Walsh and written by Mr. Andrews.

WASHINGTON — Fearing a financial crisis worldwide, the Federal Reserve reversed course on Tuesday and agreed to an $85 billion bailout that would give the government control of the troubled insurance giant American International Group.

The decision, only two weeks after the Treasury took over the federally chartered mortgage finance companies Fannie Mae and Freddie Mac, is the most radical intervention in private business in the central bank's history.

With time running out after A.I.G. failed to get a bank loan to avoid bankruptcy, Treasury Secretary Henry M. Paulson Jr. and the Fed chairman, Ben S. Bernanke, convened a meeting with House and Senate leaders on Capitol Hill about 6:30 p.m. Tuesday to explain the rescue plan. They emerged just after 7:30 p.m. with Mr. Paulson and Mr. Bernanke looking grim, but with top lawmakers initially expressing support for the plan. But the bailout is likely to prove controversial, because it effectively puts taxpayer money at risk while protecting bad investments made by A.I.G. and other institutions it does business with.

What frightened Fed and Treasury officials was not simply the prospect of another giant corporate bankruptcy, but A.I.G.'s role as an enormous provider of esoteric financial insurance contracts to investors who bought complex debt securities. They effectively required A.I.G. to cover losses suffered by the buyers in the event the securities defaulted. It meant A.I.G. was potentially on the hook for billions of dollars' worth of risky securities that were once considered safe.

If A.I.G. had collapsed — and been unable to pay all of its insurance claims — institutional investors around the world would have been instantly forced to reappraise the value of those securities, and that in turn would have reduced their own capital and the value of their own debt. Small investors, including anyone who owned money market funds with A.I.G. securities, could have been hurt, too. And some insurance policy holders were worried, even though they have some protections.

“It would have been a chain reaction,” said Uwe Reinhardt, a professor of economics at Princeton University. “The spillover effects could have been incredible.”

Financial markets, which on Monday had plunged over worries about A.I.G.’s possible collapse and the bankruptcy of Lehman Brothers, reacted with relief to the news of the bailout. In anticipation of a deal, stocks rose about 1 percent in the United States on Tuesday. Asian stock markets opened with strong gains on Wednesday morning, but the rally lost steam as worries returned about the extent of harm to the global financial system.

Still, the move will likely start an intense political debate during the presidential election campaign over who is to blame for the financial crisis that prompted the rescue.

Representative Barney Frank, Democrat of Massachusetts and chairman of the House Financial Services Committee, said Mr. Paulson and Mr. Bernanke had not requested any new legislative authority for the bailout at Tuesday night’s meeting. “The secretary and the chairman of the Fed, two Bush appointees, came down here and said, ‘We’re from the government, we’re here to help them,’ ” Mr. Frank said. “I mean this is one more affirmation that the lack of regulation has caused serious problems. That the private market screwed itself up and they need the government to come help them unscrew it.”

House Speaker Nancy Pelosi quickly criticized the rescue, calling the $85 billion a "staggering sum." Ms. Pelosi said the bailout was "just too enormous for the American people to guarantee." Her comments suggested that the Bush administration and the Fed would face sharp questioning in Congressional hearings. President Bush was briefed earlier in the afternoon.

A major concern is that the A.I.G. rescue won’t be the last. At Tuesday night’s meeting. lawmakers asked if there was any way of knowing if this would be the final major government intervention. Mr. Bernanke and Mr. Paulson said there was not. Indeed, the markets remain worried about the financial condition of major regional banks as well as that of Washington Mutual, the nation’s largest thrift.

The decision was a remarkable turnaround by the Bush administration and Mr. Paulson, who had flatly refused over the weekend to risk taxpayer money to prevent the collapse of Lehman Brothers or the distressed sale of Merrill Lynch to Bank of America. Earlier this year, the government bailed out another investment bank, Bear Stearns, by engineering a sale to JPMorgan Chase that left taxpayers on the hook for up to $29 billion of bad investments by

Bear Stearns. The government hoped at the time that this unusual step would both calm markets and lead to a recovery by the financial system. But critics warned at the time that it would only encourage others to seek bailouts, and the eventual costs to the government would be staggering.

The decision to rescue A.I.G. came on the same day that the Fed decided to leave its benchmark interest rate unchanged at 2 percent, turning aside hopes by many on Wall Street that the Fed would try to shore up confidence by cutting rates once again.

Fed and Treasury officials initially turned a cold shoulder to A.I.G. when company executives pleaded on Sunday night for the Fed to provide a $40 billion bridge loan to stave off a crippling downgrade of its credit ratings as a result of investment losses that totalled tens of billions of dollars.

But government officials reluctantly backed away from their tough-minded approach after a failed attempt to line up private financing with help from JPMorgan Chase and Goldman Sachs, which told federal officials they simply could not raise the money given both the general turmoil in credit markets and the specific fears of problems with A.I.G. The complexity of A.I.G.’s business, and the fact that it does business with thousands of companies around the globe, make its survival crucial at a time when there is stress throughout the financial system worldwide.

“It’s the interconnectedness and the fear of the unknown,” said Roger Altman, a former Treasury official under President Bill Clinton. “The prospect of the world’s largest insurer failing, together with the interconnectedness and the uncertainty about the collateral damage — that’s why it’s scaring people so much.”

Under the plan, the Fed will make a two-year loan to A.I.G. of up to $85 billion and, in return, will receive warrants that can be converted into common stock giving the government nearly 80 percent ownership of the insurer, if the existing shareholders approve. All of the company’s assets are being pledged to secure the loan. Existing stockholders have already seen the value of their stock drop more than 90 percent in the last year. Now they will suffer even more, although they will not be totally wiped out. The Fed was advised by Morgan Stanley, and A.I.G. by the Blackstone Group.

Fed staffers said that they expected A.I.G. would repay the loan before it comes due in two years, either through the sales of assets or through operations.

Asked why Lehman was allowed to fail, but A.I.G. was not, a Fed staffer said the markets were more prepared for the failure of an investment bank. Robert B. Willumstad, who became A.I.G.’s chief executive in June, will be succeeded by Edward M. Liddy, the former chairman of the Allstate Corporation. Under the terms of his employment contract with A.I.G., Mr. Willumstad could receive an exit package worth as much as $8.7 million if his removal is determined to be “without cause,” according to an analysis by James F. Reda and Associates.

A.I.G. is a sprawling empire built by Maurice R. Greenberg, who acquired hundreds of businesses all over the world until he was ousted amid an accounting scandal in 2005. Many of A.I.G.’s subsidiaries wrote insurance of various types. Others made home loans and leased aircraft. The diverse array of companies were more valuable under a single corporate parent like A.I.G., because their business cycles offset each other, giving A.I.G. a relatively smooth stream of revenue and income.

After Mr. Greenberg’s departure, A.I.G. restated its books over a five-year period and instituted conservative new accounting policies. But before the company could really rebuild itself, it became embroiled in the mortgage crisis. Some of its insurance companies ended up with mortgage-backed securities on their books, but the real trouble involved the insurance that its financial products unit offered investors for complex debt securities.

Its stock tumbled faster this year as first the debt securities lost value, and then the insurance contracts, called credit default swaps, came under a cloud.

The Fed’s extraordinary rescue of A.I.G. underscores how much fear remains about the destructive potential of the complex financial instruments, like credit default swaps, that brought A.I.G. to its knees. The market for such instruments has exploded in recent years, but it is almost entirely unregulated. When A.I.G. began to teeter in the last few days, it became clear that if it defaulted on its commitments under the swaps, it could set off a devastating chain reaction through the financial system.

“We are witnessing a rather unique event in the history of the United States,” said Suresh Sundaresan, the Chase Manhattan Bank professor of economics and finance at Columbia University. He thought the near brush with catastrophe would bring about an acceleration of efforts within the Treasury and the Fed to put safety controls on the use of credit default swaps.

“They’re going to tighten the screws and say, ‘We want some safeguards on this market,’ ” he said of the Fed and the Treasury.

The swaps are not securities and are not regulated by the Securities and Exchange Commission. And while they perform the same function as an insurance policy, they are not insurance in the conventional sense, so insurance regulators do not monitor them either.

That situation set the stage for deep losses for all the countless investors and other entities that had entered into A.I.G.'s swap contracts. Of the $441 billion in credit default swaps that A.I.G. listed at midyear, more than three-quarters were held by European banks.

"Suddenly banks would be holding a lot of bondlike instruments that were no longer insured," Mr. Sundaresan said. "They would have to mark them down. And when they marked them down, they would require more capital. And then they would have to go out and raise capital in these markets, which is very difficult."

Mr. Sundaresan said that for a new market arrangement to succeed, it would have to create a clearinghouse to track swaps trading, and daily requirements to post collateral, so that a huge counterparty would not suddenly find itself having to come up with billions of dollars overnight, the way A.I.G. did.

Edmund L. Andrews reported from Washington. Michael J. de la Merced and Mary Williams Walsh reported from New York. David M. Herszenhorn contributed reporting from Washington and Eric Dash from New York..

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September 17, 2008

A.I.G. Is Still Profitable, With a Wide Array of Enterprises

By JONATHAN D. GLATER and HEATHER TIMMONS

American International Group and its assortment of businesses run the gamut from aircraft leasing to life insurance for Indians to retirement plans for elementary schoolteachers. Parts of the company have been battered by the credit crisis.

But many of its operations may put up for sale — as the Federal Reserve signaled they would be when it announced its rescue of the company Tuesday night — and they could prove attractive to prospective investors and competitors. The main insurance unit has remained profitable, as has the aircraft leasing arm.

The great assortment of assets reflects the determination of the man who built A.I.G., Maurice R. Greenberg, to create an global empire operating in complementary businesses. Not even the company's annual reports to shareholders or its regulatory filings offer a chart of its complex corporate structure.

Though its name is American, the company is rooted in Asia. According to company lore, its founder, Cornelius Vander Starr, a World War I veteran, traveled to Asia with only 300 Japanese yen (less than $3 by today's exchange rates) in his pocket and started the firm in Shanghai in 1919.

With a partner, he sold marine and fire insurance and expanded rapidly throughout the Philippines, Indonesia and China by hiring locals as agents and managers, a business strategy A.I.G. uses today. Nearly half of A.I.G.'s 116,000 direct employees — about 62,000 people — are in Asia.

In 1960, Mr. Greenberg joined the company, following his mentor, an executive at Continental Casualty Company in Chicago. Mr. Greenberg focused on making giant commercial deals, increasing its share of the life insurance business and writing what were, decades ago, unusual types of coverage, like insurance against kidnapping and protection from suits against a company's officers and directors.

A.I.G.'s general insurance business, which accounted for nearly half its $110 billion in revenue last year, has held up well. A.I.G. claims that its companies are the largest underwriters of commercial and industrial insurance in the United States. Its policies cover everything from environmental liability for companies to auto insurance.

A.I.G.'s asset management group — it includes a private banking subsidiary for the wealthy, a broker dealer and another unit that manages mutual funds — has had losses, but it is not a unit that pushed the company to the brink. That group reported its first loss in years in the last quarter of 2007; in the second quarter of this year, it reported an operating loss of $314 million, which is modest these days.

Then there is the aircraft leasing business, which owns more than 900 planes and is part of the company's financial services group. The company stated in its annual filing with regulators that the leasing unit would buy 73 new aircraft this year. That unit is profitable, according to the most recent report for the quarter ended June 30.

A.I.G.'s problems rest in the company's London-based financial products unit, part of its financial services group, which is exposed to securities tied to the value of home loans — the same kind of securities that forced Lehman Brothers into Chapter 11 bankruptcy proceedings on Monday. The financial products group sold credit-default swaps, complex financial contracts allowing buyers to insure securities backed by mortgages. Many of the buyers were European banks. As home values have fallen, the value of the underlying mortgages has declined, and A.I.G. has had to reduce the value of the securities on its books.

The company has other forms of real estate exposure. One subsidiary, American General Finance, makes home loans and has suffered along with the housing market. Another subsidiary, the United Guaranty Corporation, provides mortgage guarantee insurance. Still other units buy mortgage-backed securities directly.

"We've always been opportunistic," Mr. Greenberg said, responding to a question about whether the company would buy other insurers struggling in the wake of the Sept. 11 terrorist attacks. "When we see opportunities, we will never change. At A.I.G., it's part of our culture."

Geographically, A.I.G. is sprawling. One of its life insurance companies operates in 50 countries and other units offers other products, like health insurance and retirement services, in countries like Japan and the United States. It claims to be the largest life insurance company in the Philippines. Its private bank is based in Zurich.

A.I.G. 's Asian asset management business has $115 billion in assets, and the company peddles mutual funds in the Philippines, Hong Kong and Singapore and investment trusts in Taiwan.

The company is a sizable investor in Asian development projects, from toll roads in the Philippines to Seoul's international finance center. It is also a major investor in the Taiwan government. As of February, A.I.G. held $14.2 billion in Taiwan government bonds, 13.1 percent of Taiwan's total issued government bonds.

Though he left the company a few years ago after an accounting scandal, Mr. Greenberg's fortune remains locked up with A.I.G., in which he has a stake of about 11 percent through various holdings, according to Bloomberg News.

Early in 2005, questions arose about financial transactions that had the effect of making the company's earnings look better. Mr. Greenberg resigned as chief executive after regulators sent a wave of subpoenas to the company; eventually A.I.G. restated earnings covering a five-year period. His successor tried to restore confidence in the company but his efforts did not meet with investor approval and he was replaced this summer, after the company announced that it lost $7.8 billion in the first quarter of the year, the biggest loss in its history. In August it announced that it had lost another $5.3 billion in the second quarter.

Heather Timmons reported from New Delhi.

The New York Times
nytimes.com

September 18, 2008

A New Role for the Fed: Investor of Last Resort

By EDMUND L. ANDREWS

WASHINGTON — The mighty Federal Reserve is being stretched to its limits, both in the range of problems it is being asked to fix and in its financial firepower.

The central bank has also transformed itself almost overnight into the Fed Inc. by essentially taking over American International Group after already taking on hundreds of billions of dollars in mortgage securities to help ailing financial institutions.

Instead of just setting monetary policy in its Ivory Tower-like setting, the Fed now must wear several hats — that of insurance conglomerate, investment banker and even hedge fund manager.

“This is unique, and the Fed has never done something like this before,” said Allan Meltzer, a professor of economics at Carnegie-Mellon University and author of a sweeping history of the Federal Reserve. “If you go all the way back to 1921, when farms were failing and Congress was leaning on the Fed to bail them out, the Fed always said ‘It’s not our business.’ It never regarded itself as an all-purpose agency.”

The Fed has often been described as the nation’s lender of last resort — the one institution that would lend money when everything else had failed. But by acquiring almost 80 percent of A.I.G. in exchange for lending it $85 billion, and holding $29 billion in securities once owned by Bear Stearns, the Fed is now becoming the investor of last resort as well.

That could put the central bank in an increasingly complicated and contradictory position. It will be responsible for stabilizing the financial system, but also for minimizing losses to taxpayers. Those responsibilities are likely to conflict even more than the traditional tension between the Fed’s dual mandate to keep inflation low and promote full employment.

The Fed’s balance sheet, moreover, is being stretched in ways that seemed unimaginable one year ago. As recently as last summer, the central bank’s entire vault of reserves — about $800 billion at the time — was in Treasury securities.

By last week, the Fed's holdings of unencumbered Treasuries had dwindled to just over $300 billion. Much of the rest of its assets were in the form of loans to banks and investment banks, which had pledged riskier securities as collateral.

In a sign of how short the Fed's available reserves had become, the Treasury Department sold tens of billions of dollars of special "supplementary" Treasury bills on Wednesday to provide the Fed with extra cash. The Treasury sold $40 billion of the new securities on Wednesday morning and will sell $60 billion more on Thursday. More money-raising is sure to follow.

"The Fed is very stretched, and that's why they've asked the Treasury to go ahead with these proposals," said Lou Crandall, chief economist at Wrightson ICAP and a longtime analyst of the Fed's market operations. "You don't want the market wondering whether the Fed has enough reserves to handle the next supplicant."

Indeed, the role of the Fed chairman, Ben S. Bernanke, almost seemed to unnerve a leading House Democrat.

"He can make any loan he wants under any terms to any entity or individual in America that he thinks is economically justified," said Representative Barney Frank, Democrat of Massachusetts and chairman of the House Financial Services Committee.

"I asked the chairman if he had $85 billion to bestow in this way. He said 'I have $800 billion.' "

"No one in a democracy unelected should have $800 billion to dispense as he sees fit," Mr. Frank said.

Fed officials contend that they have ample resources to handle all their new obligations. Unlike a company or a household, the Fed can raise as much cash as it wants by printing money and buying up Treasuries and other securities at will.

But in the last few months, the central bank has transformed itself from a regulator of the money supply to a white knight for troubled financial institutions.

The first step across the Rubicon occurred last March, when the Federal Reserve and Treasury Department prevented the bankruptcy of Bear Stearns by engineering its shotgun marriage to JPMorgan Chase.

To make the deal work, the Fed agreed to hold and manage a huge pool of hard-to-sell securities from Bear Stearns as the collateral for a $29 billion loan to JPMorgan. The Fed has disclosed little about the securities it is holding, but the pool is believed to include billions of dollars worth of securities backed by troubled subprime mortgages.

At the time, Fed officials hired the money-management firm BlackRock Inc. to oversee the Bear Stearns pool, which appears as “Maiden Lane L.L.C.” on the Fed’s balance sheet. But while Fed officials said their goal was to “maximize returns” on those assets, officials appear to have made no changes in the portfolio yet.

But the Maiden Lane portfolio will be small potatoes compared to the businesses owned by A.I.G.

The failed insurance conglomerate held countless billions of dollars in credit-default swaps, which are insurance contracts that protect bond holders from losses if a company defaults on its loans. It also holds vast amounts of real estate, which could have a depressing impact on property prices if the company’s new overseers decided to unload quickly.

Fed officials said on Tuesday that they did not plan to manage the A.I.G. holdings themselves. Instead, the Fed has a claim on just under 80 percent of the equity in A.I.G. as collateral to cover loans on which A.I.G. will have to pay a steep interest rate of about 12 percent.

Fed officials appear to be hoping that the high rate will encourage the company to pay off its loans as quickly as possible. But if the company’s new executive cannot fix its problems quickly, Fed officials might need to get more directly involved. That could make them tantamount to real estate investors and hedge fund managers at the same time.

Beyond its foray into corporate management with A.I.G., the Federal Reserve is becoming an increasingly important force in the market for risky debt securities.

Analysts say they believe that Lehman Brothers, the Wall Street firm that filed for bankruptcy on Monday, is borrowing tens of billions of dollars through the Fed’s six-month-old emergency loan program for big investment banks.

For months now, investment banks have shunned the Fed’s lending program because they feared being perceived as weak. But Mr. Crandall, of Wrightson ICAP, predicted that Lehman and other investment banks might have already tapped it for $50 billion since last weekend.

If they did, Fed officials will be holding collateral that is even riskier than what they already have.

The New York Times
nytimes.com

September 18, 2008

Abroad, Bailout Is Seen as a Free Market Detour

By NELSON D. SCHWARTZ

PARIS — Is the United States no longer the global beacon of unfettered, free-market capitalism?

In extending a last-minute $85 billion lifeline to American International Group, the troubled insurer, Washington has not only turned away from decades of rhetoric about the virtues of the free market and the dangers of government intervention, but it has also probably undercut future American efforts to promote such policies abroad.

“I fear the government has passed the point of no return,” said Ron Chernow, a leading American financial historian. “We have the irony of a free-market administration doing things that the most liberal Democratic administration would never have been doing in its wildest dreams.”

The bailout package for A.I.G., on top of earlier government support for Bear Stearns, Fannie Mae and Freddie Mac, has stunned even European policy makers accustomed to government intervention — even as they acknowledge the shock of the collapse of Lehman Brothers.

“For opponents of free markets in Europe and elsewhere, this is a wonderful opportunity to invoke the American example,” said Mario Monti, the former antitrust chief at the European Commission. “They will say that even the standard-bearer of the market economy, the United States, negates its fundamental principles in its behavior.”

Mr. Monti said that past financial crises in Asia, Russia and Mexico brought government to the fore, “but this is the first time it’s in the heart of capitalism, which is enormously more damaging in terms of the credibility of the market economy.”

In France, where the government has long supported the creation of “national champions” and worked actively to protect select companies from the threat of foreign takeover, politicians were quick to point out the paradox of what is essentially the nationalization of the largest American insurance company.

“Today the actions of American policy makers illustrate the need for economic patriotism,” said Bernard Carayon, a lawmaker of President Nicolas Sarkozy’s center-right governing party, UMP. “I congratulate them.”

For the “evangelists of the market, this is a painful lesson,” he added.

National economies are entering “an era where we have much more regulation and where the public and the private sector will mix much more.”

In parts of Asia, the bailouts stirred bitter memories of the different approach the United States and the International Monetary Fund adopted during the economic crises there a decade ago.

When the I.M.F. pledged $20 billion to help South Korea survive the Asian financial crisis of the late 1990s, one of the conditions it imposed was that the Korean government allow ailing banks and other companies to collapse rather than bail them out, recalled Yung Chul Park, a professor of economics at Korea University in Seoul, who was deeply involved in the negotiations with the I.M.F.

While Mr. Park says the current crisis is different — it is global rather than limited to one region — “Washington is following a different script this time.”

“I understand why they do it,” he added. “But they’ve lost credibility to some extent in pushing for opening up overseas markets to foreign competition and liberalizing economies.”

The ramifications of the rescue of A.I.G. will be felt for years within the United States, too.

A.I.G. was a different kind of company than Fannie Mae or Freddie Mac, which enjoyed government sponsorship, or Bear Stearns, which was regulated by the federal government.

“This was an insurance company that wasn’t federally regulated,” said Gary Gensler, who served as a top official in the Treasury Department during the Clinton administration. Nor did A.I.G. have access to Federal Reserve funds or deposit insurance, like a commercial bank.

“We’re in new territory,” Mr. Gensler added. “This is a paradigm shift.”

A.I.G. is also in a different league because of the breadth of its businesses and its extensive overseas operations, especially in Asia.

What’s more, it fell into something of a regulatory gap under the current rules.

While the company, based in New York, is better known for selling conventional products like insurance policies and annuities overseen by state regulators in the United States, it is also deeply involved in the risky, opaque market for derivatives and other complicated financial instruments that operate largely outside regulation.

Along with the threat to the plain-vanilla insurance policies held by millions of ordinary consumers, it was the threat posed by these arcane financial instruments that led Washington to bail out A.I.G.

So far that rescue has not steadied markets.

"It's pure crisis management," Mr. Chernow said. "It's the Treasury and the Federal Reserve lurching from crisis to crisis without a clear statement on how financial failures will be handled in the future. They're afraid to articulate such a policy. The safety net they are spreading seems to widen every day with no end in sight."