The AIG outrage

by Lawrence_Kudlow

This whole AIG fiasco â€” where the entire political class is suddenly screaming over bonuses paid to derivative traders in AIG's financial-products division â€” is just a complete farce. What it really shows is how the government has completely bungled the AIG takeover. Blame the Bush administration and the Obama administration. It also shows, once again, why the government shouldn't run anything, because it cannot run anything.

AIG should have been placed in bankruptcy last fall under some sort of government sponsorship. While in bankruptcy, all the salary contracts (and every other AIG contract) would have been nullified and voided. At the same time, there would have been an orderly liquidation and sale of AIG's assets and separate divisions.

But as things stand now, there still is no clear roadmap for the dissolution of AIG. There are ideas, but nothing is set in concrete.

And as for the $165 million or so in AIG bonus payments, the Obama administration â€” including the president, Treasury man Tim Geithner and economic adviser Larry Summers â€” knew all about them many months ago. They were undoubtedly informed of this during the White House transition.

So there's no big surprise. Nobody should be shocked. But President Obama is doing his best play-acting ever. He knows full well that the nationwide outcry against federal bailouts and takeovers is only going to get worse on his watch. His poll numbers are already falling, and this AIG episode is going to pull them down more.

Incidentally, has anybody asked Team Obama why it is more than willing to break mortgage contracts with a bankruptcy-judge cram-down, but won't cram down compensation agreements for AIG, despite the fact that the U.S. government owns the company? Kind of odd, don't you think?

The Wall Street Journal editors get it right when they ask: Who's in charge, and what's the game plan? The whole AIG story is an outrage.

What's more, AIG is acting as a conduit for taxpayer money that is being sent to dozens of derivative counterparties, including foreign banks and American banks like Goldman Sachs. If we're going to bail out all these other firms, why not bail them out in full taxpayer view? Why is the money being laundered furtively through AIG? And where exactly is the end game for AIG? How are the taxpayers going to be repaid?

And what is Treasury man Geithner's role in all this? He appears to be the biggest bungler in what has become a massive bungling. My CNBC friend and colleague Charlie Gasparino thinks Geithner can't survive this. I am inclined to agree.

Nevertheless, behind the furor over AIG, there is some good news to report on the banking front. This week's decision by the Federal Accounting Standards Board (FASB) to allow cash-flow accounting rather than distressed last-trade mark-to-market accounting will go a long way toward solving the banking and toxic-asset problem.

Many experts believe mortgage-backed securities and other toxic assets are being serviced in a timely cash-flow manner for at least 70 cents on the dollar. This is so important. Under mark-to-market, many of these assets were written down to 20 cents on the dollar, destroying bank profits and capital. But now banks can value these assets in economic terms based on positive cash flows, rather than in distressed markets that have virtually no meaning.

Actually, when the FASB rules are adopted in the next few weeks, it will be interesting to see if a pro forma re-estimate of the last year reveals that banks have been far more profitable and have much more capital than this crazy mark-to-market accounting would have us believe.

Sharp-eyed banking analyst Dick Bove has argued that most bank losses have been non-cash â€” i.e., mark-to-market write-downs. Take those fictitious write-downs away, and you are left with a much healthier banking picture. This is huge in terms of solving the credit crisis.

In a column last week, I suggested that not one more dime of government money is necessary for the banks. Instead, the marriage of the cash-flow valuation of bank assets and the upward-sloping Treasury yield curve will do the trick. Net interest margins are rising as banks purchase money for near-zero interest and loan it out at profitable rates. And the new mark-to-market reform will allow banks to hold their toxic assets for several more years and work them out â€” just as they did back in the 1990s.

We don't need more TARP. We don't need to take over more big banks. And we don't need to have the government run things it simply isn't capable of running.