Turning Up The Heat on AIG

What investigators are looking at now

BY JONATHAN R. LAING • It has been a bad week for insurance giant **American International Group**. Two AIG employees pleaded guilty to charges arising from New York Attorney General Eliot Spitzer's ongoing investigation of bid-rigging in the commercial-insurance market. These plea agreements raise to four the number of AIG employees caught up in the high-visibility Spitzer investigation of pricing and commission shenanigans at insurance broker **Marsh & McLennan.**

But of far greater moment, perhaps, was AIG's disclosure early last Monday that it had been served by a new set of subpoenas by both Spitzer and the SEC delving into AIG's accounting of certain "assumed reinsurance." We pointed out in a recent cover story ("Letting the Air Out," Jan. 31) that it would only be a matter of time before investigators turned their eye to the murky world of "finite-risk reinsurance" and probed how leading property and casualty insurance companies had used such transactions to burnish their own reported financial results. That appears to be the case, particularly with Spitzer's latest salvo of subpoenas leveled at AIG.

Company insiders were reportedly stunned at the specificity of the information requests, which centered on two reinsurance deals AIG reached with **Berkshire Hathaway**'s General Re unit in late 2000 and early 2001. Moreover, if any charges of wrongdoing emerge from the probe, AIG's 79-year-old chairman and CEO Hank Greenberg could be toppled from his executive perch at a company that he has sedulously built into a financial powerhouse over four decades. That's because top management at both AIG and General Re may have been involved in both transactions, according to an industry insider.

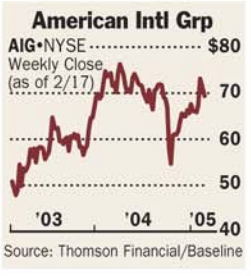
AIG declined to discuss any details of the supoenas. General Re has declined to comment on the reinsurance controversies.

Most thought that AIG's legal woes arising from claims of improper financial engineering were behind it until the latest subpoenas. For last November, the company settled investigations by the Department of Justice and the SEC into whether AIG had helped two clients outside the insurance industry—Pittsburgh banking firm **PNC Financial** and an Indiana cellphone distributor, **Brightpoint**, boost their earnings through AIG-confected financial schemes. AIG paid $126 million to settle the cases without admitting or denying any wrongdoing. The company also agreed to allow an independent monitor selected by the government to further scrutinize its books.

That monitor began working last week, so very likely any information giving rise to the latest subpoenas came from elsewhere.

Headed for a Fight? *Eliot Spitzer, left, is asking about certain reinsurance deals by Hank Greenberg's AIG.*

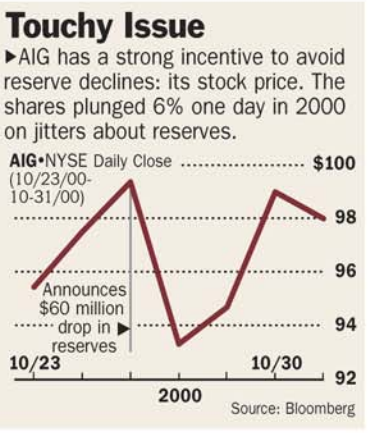
Among other things, the lastest probe of AIG apparently is homing in on whether AIG employed financial hot-sauce similar to what it offered PNC and Brightpoint to spice up its own financial results. Specifically, investigators are said to be looking at two reinsurance deals with General Re that allowed AIG to beef up its fourth-quarter 2000 and first-quarter 2001 reserves with a total of some $200 million in no-risk finite reinsurance transactions with Gen Re. In effect, investigators are looking at whether AIG borrowed the claims loss reserves from Gen Re, boosting the reserves carried on its balance sheet. AIG's offset, most likely a $200 million debit to some asset class, would be virtually undetectable in a balance sheet then boasting over $300 billion in assets.



The amount of the reserves boost may seem inconsequential to a company that at that time had nearly $25 billion in reserves against future claims losses. But at the time, security analysts following AIG were concerned that the company might be under-reserving against future claims in order to show greater-than-warranted earnings growth.

In fact, on Oct. 26, 2000, AIG's stock plummeted 6%, from around 99 to around 93 after its third quarter earnings release showed a trivial $60 million drop in reserve levels from the quarter before. The stock soon righted itself. However a powerful message had been delivered to AIG management: No more reserve declines, no matter how miniscule, would be tolerated.

As a consequence, fourth-quarter reserves that year jumped some $340 million, to $24.952 billion from $24.610 billion at the end of the third quarter. Only $106 million of that increase came from organic growth in reserves while the remainder came from AIG's acquisition of Hartford Steam Boiler that quarter. That was followed by a slim rise in reserves of $62.8 million in the first quarter of 2001, to $25.014 billion.



In fact, Wall Street fears of under-reserving at AIG were anything but misplaced. In early 2003, the stock plummeted again after AIG announced a $2.8 billion pre-tax charge against fourth-quarter 2002 results to boost the very same property and casualty reserves. And not all of this could be blamed on the impossible-to-anticipate claims losses of 9/11. The company had likely been skimping on reserves for some time.

The information giving rise to the latest AIG subpoenas was likely uncovered from the raft of information requests that the SEC and Spitzer has hit other companies with in recent months. General Re was one of the companies that had already received a subpoena, so one can perhaps surmise that the two reinsurance deals were sifted from its document dump.

A towering figure in the insurance industry by virtue of his longevity, aggressiveness and abilities, Hank Greenberg seems somewhat uncomfortable in the new post-Enron era of regulatory jihad against corporations. In the past, Greenberg has rolled over different state insurance commissioners like Patton's tank corp. In the mid-'Nineties, AIG was accused of creating out of whole-cloth a supposedly independent reinsurance company called Coral Re so that AIG could artificially increase its capacity to write more business in the then strong market. The company slapped down the complaints of several state commissioners with ease. In a recent conference call, Greenberg groused about the new regulatory environment in which a "foot fault" is treated as a "felony."

Interestingly, Greenberg laid low last week, not speaking as planned at a Merrill Lynch insurance conference on Monday or at an Executives' Club of Chicago meeting the following day. The company explained that Greenberg had a cold.

Perhaps an eventual confrontation between Greenberg and Spitzer is all but inevitable. Greenberg can't have liked how Spitzer humiliated his family by forcing the resignation of Greenberg's oldest son, Jeffrey, from the top spot at Marsh & McLennan in the wake of the recent scandal. Then there were the embarrassing guilty pleas at AIG arising from the same investigation.

These may be just preliminary bouts to a main event coming in the months ahead between Greenberg and Spitzer. It should be a hell of a fight. ■

Photographs: AP Photo/Gerald Herbert (left), Diane Bondareff/Bloomberg News (right); cover inset: AP Photo/Pablo Martinez Monsivais