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## The Deal That Toppled A.I.G.'s Boss

**M**AURICE R. GREENBERG is a famously irascible executive. When he got a call on March 13 from Frank G. Zarb, [American International Group's](#) lead director, telling him that his 38 years as the company's chief executive were over, he was, well, enraged.

You can only imagine what he was thinking: Who were these directors to jettison the head of a triple-A-rated insurance company, one that had just reported \$100 billion in revenues? Who were they to dump an executive who met regularly on equal footing with world leaders, who was revered not only on Wall Street but around the world for producing predictable, steady earnings growth through years of insurance industry ups and downs?

Mr. Greenberg's fall from grace may seem to have been dizzyingly swift, but according to people who have worked for him, analyzed his business and dealt with him as either customer or competitor, the seeds of his ouster were probably sown earlier in his long tenure. Paradoxically, these people say, **Mr. Greenberg's ability to produce smooth and steady results in a hugely volatile and complex business was also responsible for his downfall.**

**Dozens of other A.I.G. transactions are now under scrutiny by investigators, though little is known about them. In a board meeting last Thursday, A.I.G. directors were advised that reversing questionable deals uncovered by the company could force it to restate results by approximately \$1 billion, according to a person briefed on the meeting, though the figure could change as the internal review continues.**

A.I.G. is struggling to file its annual report to regulators by Thursday. Its shares have lost 24 percent, or almost \$46 billion in market value, since it disclosed on Feb. 14 that it had received subpoenas from Eliot Spitzer, the New York attorney general, and the Securities and Exchange Commission.

Remarkably, it was a lone transaction, involving just \$500 million - a blip on A.I.G.'s screen - that took Mr. Greenberg down.

Memo to executives who still think it is O.K. to fudge financial results to keep your stock price high: This could happen to you.

The deal that undid Mr. Greenberg was struck in 2000 with Gen Re, a unit of [Berkshire Hathaway](#), the insurance company run by Warren E. Buffett. The stock market was crumbling and A.I.G.'s financial strength had been badly eroded by one of the longest downturns in the history of the property and casualty insurance market.

Although A.I.G. was financially strong, it clearly needed to reduce its dependence on the property and casualty market. The most efficient way to do that was to diversify, making big acquisitions of more stable businesses, like companies that sold life insurance and annuities. A.I.G. stock would be the currency for these deals; keeping A.I.G. shares high, therefore, became crucial to Mr. Greenberg's diversification plans.

But Mr. Greenberg had another reason to do what he could to maintain the stock's highflying status: a significant portion of his compensation and that of other top A.I.G. executives was generated by millions of A.I.G. shares sitting at two offshore companies, C. V. Starr and Starr International.

In late 2000, however, around the time of the Gen Re deal, several factors weighed on A.I.G. shares. The declining stock market was one, the unrelenting downturn in the property and casualty market another. A.I.G. shares hit their all-time high of \$103.69 on Dec. 8, 2000, but within two weeks they had lost 10 percent of their value.

Investors were growing increasingly concerned that A.I.G.'s reserves - the money set aside to pay future claims - were inadequate. During the third quarter of 2000, for example, A.I.G.'s reserves fell to \$24.6 billion from \$24.7 billion in the same period a year earlier, a worrisome decline. To bolster its reserves, A.I.G. might have needed to take an earnings hit.

A canny survivor of the industry's rolling cycles, Mr. Greenberg must have understood that the soft market that had devastated insurers since 1997 would soon morph into a more profitable environment. The deal with Gen Re may have looked like just what A.I.G. needed to propel itself through the downturn and to the other side.

According to regulators who have reviewed the deal, it enabled A.I.G. to bolster its reserves substantially, but in a way that was improper because no risk was transferred. The favorable accounting treatment assigned to insurance transactions is lost when risk is not transferred; then, the money that changes hands looks more like a loan and must be accounted for as such.

As the deal was structured, the company added \$250 million in the fourth quarter of 2000 and again in the first quarter of 2001. But that is not the story that investors were told. In February 2001, Mr. Greenberg said A.I.G. raised reserves by \$106 million in the last quarter of 2000. When results for the first quarter of 2001 were made public, reserves, he said, had risen by \$63 million.

Typically, when insurers raise reserves, they do so with company earnings. But A.I.G. disclosed no

deduction from earnings. Indeed, the company's first-quarter 2001 results beat the analysts' consensus earnings by a penny, the first upside surprise issued by the company in a year.

A.I.G. shares never again hit their 2000 high of \$103 - they traded in the \$70's and \$80's during the first quarter of 2001 - but they stayed high enough to finance a \$23 billion takeover of American General that was completed in August 2001. Intent on doing the deal because it promised to bring billions of dollars in stable life insurance revenue to the more volatile income statement of A.I.G., the company agreed to pay a \$600 million breakup fee to Prudential of Britain, which had bid for American General first.

UNDER the terms of the bid for American General, A.I.G.'s shares had to stay within a certain range, or the company would have to pay more. That gave A.I.G. an even greater incentive to keep its stock price up.

During this time, A.I.G. was reporting its results in a way that highlighted measurements that made its financial performance look better. For decades, it had reported its results using net income as the headline. But in 2000 and 2001, its headline number became "income, as adjusted" or "core income," both of which excluded the often-substantial capital losses A.I.G. had realized.

Then, in 2003, Mr. Greenberg returned to using net income to report results. Had the previous computation been used, A.I.G.'s gains would have been lower. In a 2004 report, David Schiff, editor of Schiff's Insurance Observer, noted the change in A.I.G.'s reporting and called it deceptive, misleading and a way to disguise unfavorable news.

Taken together with what we know of the Gen Re deal, a picture emerges of an executive determined to keep his stock price up and to produce improving results no matter what. Mr. Greenberg's lawyer did not return a phone call seeking comment. A spokesman for A.I.G. declined to comment.

To Mr. Schiff, historically one of Mr. Greenberg's biggest fans, the questionable reporting at A.I.G. that began in 2000 was a warning. In a prescient report dated Feb. 24, 2004, he wrote: "A.I.G. has long been respected and valued for the steadiness with which its earnings have grown. Beginning in 2000, A.I.G.'s earnings releases and annual reports have given the impression of greater growth and consistency than that which actually occurred. A.I.G. is a gigantic company and Hank Greenberg is a brilliant man. But people should be wary of companies that don't present their results fairly. A.I.G.'s manner of highlighting the most favorable figures and growth rates raises a sad question: Should A.I.G. be trusted?"

A year later, he got his answer.