American International Group

Shine a light

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Can the world's biggest insurer continue with its old, inscrutable ways?

HE MAY remain chief executive of AIG for the rest of this year—and quite possibly next year, the one after, and the one after that. Even Maurice ("Hank") Greenberg, at 76, would admit, though, that actuarial tables point to a shorter career in front of him than behind. Rumours about Mr Greenberg's health raced through the insurance world last week, in true Kremlin-watching style, after he failed to make a rare scheduled appearance at an insurers' annual get-together in Bermuda. His absence, said his deputies, was merely a case of the flu, but worried investors sent AIG's share price down. Even after a tanned and rested Mr Greenberg was hauled before analysts and hacks for a body check on February 25th—he was not ill, he insisted, but merely contemptuous of the Bermuda get-together's intellectual content—the share price barely recovered. As it happens, the old king has failed publicly to anoint a successor.

Concern about Mr Greenberg comes at an awkward time for AIG. It has the largest share of America's commercial market and 85,000 employees, in 300 divisions, working around the world. September 11th created new levels of uncertainty for the group, even though in the long run it should help to boost demand for insurance. Then came Enron's collapse, which raised a whole raft of concerns about corporate America: conflicts of interest on Wall Street, impenetrable accounting, the offshore registration of corporate vehicles, large financial exposures, unhealthy deference given to celebrity chief executives, and high share valuations. Every one of these concerns is germane to AIG.

AIG has a stockmarket valuation of $190 billion, making it second among financial companies only to Citigroup's $225 billion. Some 17 years of rising profits have earned the company respect from investors. Now caution is creeping in. Can AIG perform in a more volatile world as well as it has in the past? Is there a cohesive picture of what AIG does? Do Wall Street analysts offer an impartial picture of AIG's prospects, given that their banks take in and invest billions of dollars in insurance premiums from the company?

The insurer certainly uses its muscle to shape how markets perceive it. Ask somebody in the insurance world for his candid view of AIG, and he looks palpably uncomfortable. Mr Greenberg's charm often disarms, but he can terrify too. Share analysts foolish enough to issue a critical comment about AIG get a blistering phone call. If they are unlucky, they hear the criticism second-hand, from their irate boss. Mr Greenberg says he complains only when the facts are wrong, but he cannot recall a critical report where the facts were right. The company's share price has fallen by 30% since late 2000, yet no analyst, according to First Call, has rated it a “sell”.

On valuation grounds alone, the faith placed by investors in AIG invites scepticism. Consider some analysis done for *The Economist* by Seabury Insurance Capital, a financial-advisory firm in New York. It looked at each of AIG's main businesses: life insurance, property-and-casualty insurance, asset management and a catch-all called financial products, which includes the world's biggest aircraft-leasing business. Each business was compared with the best in its field, or, in the case of financial products, with a hybrid of various top competitors. A composite valuation was then reached. (Click here to download Seabury's full analysis.)

The result: if AIG were valued in line with its best competitors, its stockmarket capitalisation would be almost $100 billion lower than it is. If AIG were compared with insurers of similar size and financial strength, the disparity would be even greater: $120 billion. For that to be justified, AIG's profits would have to grow almost two-thirds faster each year than similar companies, for at least the next 25 years.

To justify such investor confidence, you might also assume that unusual clarity prevails about AIG's operations, accounting and prospects. The opposite is true. Few large companies are more inscrutable than Mr Greenberg's.

Black hole at the heart

On the face of it, AIG appears a quintessential American corporation. A skyscraper in lower Manhattan serves as its headquarters. Its board is stuffed with the great and good who have represented America abroad: Barber Conable, former congressman and president of the World Bank, Carla Hills, a former trade representative, and Richard Holbrooke, recently United Nations ambassador. The company's interests are often advanced by the White House itself, most recently in China, whose accession to the World Trade Organisation was complicated at the last minute by European resentment of AIG's uniquely granted right to have a wholly-owned subsidiary there.

In another way, it is not clear that AIG is an American company at all. On top of many subsidiaries in countries where the company sells insurance, more than 50 AIG entities, many with global reach, are registered in Bermuda. A principle of America's securities law is disclosure, including of corporate control and executive pay. According to AIG's proxy statement, the only block of shares of more than 5% of the company is a 14% stake, worth $26 billion, the ownership of which is impenetrable. This stake plays a crucial role at AIG in both compensation and control.

The owner of the block is recorded as Starr International, a private company named after Cornelius Vander Starr, who in 1919 founded the group in Shanghai. Starr International is a private company funded, in what Mr Greenberg calls an unprecedented act of generosity, by the eight shareholders who owned AIG when it went public in 1970. They put up $120m in AIG shares—the difference between their book value and the offer price.

King Hank, fit and rested

Some 800 AIG managers now own Starr. AIG's proxy gives its home as a Bermuda post-office box, yet according to the company's thin file in Bermuda's registry, the true home is another box, this time in Panama. In other words, the ownership structure of America's second-largest financial institution is, for all practical purposes, immune to many aspects of American law and taxation.

The routine public filings that AIG posts with American regulators are widely considered to be unfathomable. When challenged, AIG notes that it provides abundant disclosure, including 40 pages of densely written footnotes in its most recent annual report, as well as extraordinarily detailed statements with the Securities and Exchange Commission. But while the company provides great gobs of information, it is all but impossible to put them together. While AIG boasts of its dominance in various business lines and countries, it discloses only the broadest loss ratios. A source of its resilience is a willingness to reinsure about one-quarter of its underwriting, so spreading risk, but no outsider knows what business it keeps and what it cedes. Plenty of opportunity exists, if not for creative accounting, then certainly for inscrutability.

Part of the recent fall in AIG's share price can presumably be explained by suspicions about sophisticated but opaque forms of financial engineering. The insurer was hit with a $69m loss linked to Enron, and it is now at the centre of a dispute over off-balance-sheet partnerships held by PNC Financial, a regional American bank. AIG is a large and growing participant in complex derivatives markets. It says that derivatives play an important part in reducing the company's overall risk. From the outside, all that is clear is that AIG's credit exposure to derivatives is rising, from $17 billion in 1999 to $33 billion in 2000, according to the most recent annual report. Gross exposure has grown from $435 billion to $544 billion.

Any cracks in the confidence that AIG knows what it is doing in derivatives would be highly damaging. The company has a triple-A rating from Standard & Poor's, in part because a conventional analysis of its balance sheet shows AIG to be well-capitalised. A top-notch credit rating counts for much, particularly in skittish markets like Japan, where local insurers are chronically weak. A good rating gives AIG a low cost of funding. So it is a concern that recent volatility in AIG's share price probably lowers other, quantitative ratings that rely more on market data.

Brand values

So how does AIG make money? If it has a brand identity, it is one better known among investors than customers. Indeed, AIG operates under a welter of names: Lexington, National Union, Audubon Indemnity, United Guaranty, Société Anonyme d'Intermédiares Luxembourgeois, and so on.

The common thread is an aggressive approach. AIG is known as an intense meritocracy, filled with people who come in early and leave late. Base pay is low, but bonuses are tied to the company's share price, which everybody at AIG seems to know at any time of the day. Every department must present an annual budget to Mr Greenberg himself. The scrutiny is brutal. Managers have been known to ask for lower spending limits—in the hope of making planned returns—only to have their requests rejected. Corporate intelligence, too, is viewed as high art. Mr Greenberg himself calls employees at every level to keep tabs on his own company. Often, AIG appears to have better information about the workings of other companies than the companies have themselves.

Prized employees are tied in with compensation agreements that pay out chiefly at career's end. Millionaires among senior management are commonplace; there are billionaires as well. Corporate notions of loyalty to staff are strong. Stories circulate of Mr Greenberg's own aircraft being sent to bring sick employees for care at New York-Presbyterian hospital (home to the Greenberg wing), and of his secretary evacuated from Lebanon in the midst of war. Headhunters say that AIG employees are reluctant to get in touch, partly for fear of being fingered as disloyal.

For some, nothing can compensate for Mr Greenberg's demands. Among those who have left are his sons, Jeffrey, now chairman of Marsh & McLennan, a giant insurance broker, and Evan, in charge of reinsurance for Ace, a fast-growing company based in Bermuda. Both were, at different times, considered Mr Greenberg's heir-apparent. Mr Greenberg says only that there is a plan for a successor; that he prefers him to be an insider; and that people should stop asking questions.

It is a heated environment, in which opportunities are grabbed quickly. AIG sells all the common insurance products, but it is best known for specialised insurance, including policies for corporate directors and executives, for political risk and for oil rigs—the difficult markets, in other words, that Lloyd's of London once dominated. Its response to disasters puts competitors to shame. The destruction of the World Trade Centre cost AIG more than $800m in claims. Within days, however, it had arranged a $500m insurance line for foreign airlines that desperately needed coverage if they were to continue to fly. As well as being fast, AIG is efficient, with operating costs a quarter below the industry average. That allows it to make what few other underwriters can: a profit before adding investment income.

The flipside of AIG's reputation is the firm's sharp edge, most evident in its treatment of claims. Many insurance brokers contend that good customers justifiably pay more to buy insurance elsewhere. Fighting AIG is not easy. Almost all the big law firms count the company as a valuable client, and so cannot easily represent plaintiffs. Mr Greenberg rebuts the criticism. “We would not be the biggest if we failed to pay,” he says.

Playing hardball often works in insurance, but it has drawbacks elsewhere. Last year AIG escaped paying out on a financial guarantee, worth $182m, for a series of Hollywood films, a decision that caused one of the rare defaults of a security rated triple-A. The convention in the world of financial guarantees, just as for bank letters of credit, is to pay first, and sue later. As a result, says a participant, AIG is largely locked out of these markets.

At least for now. AIG is hardly inflexible: just look at Mr Greenberg's swift response to the rumours about his own impending demise. Now, AIG promises quarterly conference calls, between Mr Greenberg and analysts and investors, to discuss profits and give more detail on each of the insurance operations, rather than just issue brief releases. Investors will get a day each year to meet managers at AIG.

Reassurances, sure. However, AIG has yet publicly to anoint a successor, clear up its overseas registrations, find a way to provide confidence in accounting for derivatives, and persuade investors it is properly scrutinised by regulators. In short, it has yet to give up being AIG.