

SHOW: MarketPlace Radio

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DAVID BROWN, anchor:

Shares in the world's largest insurer rallied for a second straight day. American International Group, AIG, has been caught up in a massive investigation of accounting irregularities. Investors are cheering word out of the New York attorney general's office. A resolution might be reached without criminal charges. For years, some analysts and reporters have wondered about the company's books, but commentator and business writer Tom Easton claims AIG's always had a little extra cover, courtesy of some well-heeled friends.

TOM EASTON:

The truth is that plenty of people knew AIG was a black hole, but they gave it a pass. The nicest explanation might be that Wall Street makes big money off AIG. AIG is a major player in aircraft leasing mergers and derivatives. Those are all money spinners for Wall Street firms. AIG is the world's biggest insurance company, so it gets a flood of insurance premiums. With that money AIG buys securities from Wall Street, and Wall Street considered Hank Greenberg, AIG's recently deposed head, a genius.

But a darker reason for AIG's free pass may have been that it was terrific at stifling criticism. Going up against AIG is not pleasant. Back in 2002, I wrote a story about AIG for The Economist, asking if it would continue its inscrutable ways. I noted the impenetrable accounting, the offshore entities, the bizarre controlling structure in Panama, and the slavish praise from Wall Street. An extremely clever securities analyst at Seabury Analytics, Timothy Freestone, provided me with the damning and prescient study. It said that if AIG was valued along the lines of the best in its industry, it would be worth about half of what it was trading at at the time. To justify that share price, it would have had to grow two-thirds faster than the best in the industry for 25 years. That would have been a remarkable feat.

AIG went ballistic. Most angry companies send a letter. AIG sent a private plane filled with executives, including a British lawyer, to The Economist headquarters in London to demand a retraction. AIG advertisements in The Economist and a sister publication disappeared. There were threats of lawsuits. A year ago after I questioned AIG's earnings, the company accused me of maligning it in a letter that reeked of potential litigation. It denied anything wrong with its numbers, a particularly ludicrous denial after the company's recent admission of misstated results going back more than a decade.

And AIG was even tougher on that smart analyst, Mr. Freestone. AIG executives showed up unannounced at his office demanding he sign a prewritten statement saying my story misconstrued his evaluation. He refused. AIG's lawyers called. He remained firm. A major Wall Street

bank issued a report belittling Mr. Freestone's work, but as stocks and other insurance companies have since jumped, AIG's has dropped by a third. Still, Wall Street won't say a critical word, and Wall Street firms aren't the only ones who have been oddly supportive. AIG's board is stuffed with the great and the good. Surely, they must have had concerns, if not because of a specific issue, then because of the difficulty of understanding the company. Laid out on a table, its organizational chart, let alone its financial picture, looks like a map of the human brain. But everybody, from financial houses to regulators, have their weaknesses, and I guess Hank Greenberg knows them all. With Mr. Spitzer ready to settle, what AIG still has to hide, we may never find out.

BROWN: The comments of Tom Easton, a New York correspondent for The Economist. He comes to us by special arrangement with that magazine.

Your thoughts: letters@marketplace.org.

Feb. 27, 2006 - 4:53 PM

Water Cooler

Tom Easton on Being the First to Smell a Rat at AIG

Mark R. Mitchell

American International Group, Inc. recently reached a \$1.6 billion settlement with the SEC and New York state authorities after a year-long investigation into accounting improprieties at the company. But while government officials take bows for their apparent success, it is worth remembering that it was a journalist who first sounded the alarm about AIG.

Writing in The Economist in February 2002, correspondent Tom Easton noted that "Enron's collapse...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."

CJR Daily spoke with Easton last week about the difficulties of going out on a limb, and the travails of taking on AIG and Hank Greenberg, the company's famously aggressive ex-CEO.

Mark Mitchell: When you published your first story pointing to problems at AIG, virtually everybody believed it was one of the most successful companies around. Yet you published a story comparing AIG to Enron. That seems pretty extreme. How did you conclude that AIG was like Enron?

Tom Easton: You had all these issues of obscurity and impenetrability that you had at Enron.. All the clips and all the research reports were flattering. But then I spent a vacation reading AIG's annual report and securities filings, and they were really hard to read. I looked at the proxy and tried to figure out what made this company so great, or even what Hank Greenberg's income was, but I found it all impenetrable.

I put [the Enron comparison] in because I thought if it was happening there, it could be happening [at AIG]. But I would've written the story even if Enron had never happened. It was just a rhetorical device, a way of saying, "Let me characterize where AIG stands in the pantheon of other things."

MM: Still, it was a bold call. How did you go about reporting the story?

TE: I just couldn't justify the filings with everyone saying the company was good. You want to know *why* it was good. What was its sustainable advantage? What unique qualities did it have that made it so much more successful than everyone else? Did it have a rare genius? A unique network that was nonduplicatable? I started expecting to write a positive story, but I couldn't write that story.

I began reading research reports in a different light. I thought, how do they know this company is doing so well? I thought they all must be really really smart, because I clearly did not get it. After I read all this stuff, I thought it was incredibly shallow. There was this general endorsement, but when I started calling these people and asking questions, their answers were incredibly unsatisfying.

I got *The Economist* to send me down to Bermuda to cover an insurance conference. The real reason I wanted to go to Bermuda was to check the filings for Star [International, a private offshore company owned by AIG managers]. I had to search through all these boxes of papers, and finally I found what I was looking for. And do you know what it said? It said, see Panama. I don't think anyone before that had ever heard that Star was in Panama. They didn't even allude to that in their U.S. filings.

The story took an incredible amount of time to write because it was confusing. I talked to more people than

you can imagine. I went down to the NY state insurance office to get filings I talked to insurance brokers, risk managers, other companies. I talked to headhunters to see why they hired from AIG, what sort of people worked there. I had heard that Star was so secretive that even divorce lawyers couldn't get access to it. Spouses [of AIG managers] wanted to know how much their husbands and wives were worth, but they couldn't get the information. So, strangely, I ended up talking to divorce lawyers too.

MM: Is it true that in all the interviews you did, you couldn't find even one person who was willing to say on the record that there was anything wrong with AIG? At the time your story came out, AIG's stock price had fallen something like 30%. So, clearly, someone must have seen a problem.

TE That's right, the stock price had gone down, but everyone was still saying buy. I think a lot of analysts were saying buy on the dip, or something stupid like that.

Some people were very nervous about talking. I mean *really* nervous. Nervous on a higher level [of] nervous. Ask why, and you'd find out that Hank would scream at them if they said anything critical even though they didn't feel critical about the company.

I did not speak to anyone who was short AIG until after the story was published. And I encourage short sellers to leak to me. Let me just say, leak to me please. Any leaker, please call me, give me your grudges. [laughter] But unfortunately, I didn't find any of those people until after I wrote the story.

Everyone really was positive at the time. My negative story went up on Yahoo! Finance for about a minute and half and some positive story by a competitor went up and stayed for weeks. I assume AIG had some kind of leverage to get that story off the Yahoo! Website.

MM: Are you saying that AIG told Yahoo! to remove your story?

TE: It was amazing how briefly my story stayed there. Who knows why a story goes on and off the Yahoo! site. There's new management now.

MM: At the time, you asked Seabury Insurance Capital to do a valuation of AIG, and as your article points out, the company concluded that AIG was overvalued. How did you know you could rely on that analysis, given that everyone else in the world was still saying that AIG was in good shape.

That was someone who came into my office for a different reason, and I asked them if they could do a breakout valuation...The analyst [from Seabury] had tremendous intellectual integrity He was absolutely solid. We talked about those numbers time and time again. It wasn't a flimsy number or a sales pitch.

MM: You ultimately managed to get an interview with Hank Greenberg...

TE: AIG wouldn't talk to me for a long time. It was the Panama [information] that got me the interview. Hank held a press conference to disclose that he wasn't dying or something, after there'd been reports that he wasn't well...I went up to him and asked, why is Star in Panama? And he went, "Oh, well, come in to see me. Whenever you have time. Like how about tomorrow." I mean, he really reacted quite strongly.

I like Hank. He is very smart. When people say he's the brightest guy in insurance, I believe that....He is [also] tough. AIG was [*The Economist's*] second largest advertiser, and [after the story came out] they canceled all our ads. It was very painful during a recession....AIG also sent a private plane with their executives to London to formally complain about the story...Even Henry Kissinger questioned the story when he came to talk about foreign policy. He was on [AIG's] advisory board, and he said "I just want you to know that Hank Greenberg has more integrity than any person I have ever known in my life. Who wrote that AIG piece?"

MM: Do you think the government would have investigated AIG if it weren't for your story?

TE We do not know what prompted the investigation. My assumption is that Hank would have died on the job, he would have left the company eventually. When he left, there would have been some huge write-off. Either it would have earned its way out of the problem, or there would have been some huge write-off and reconciliation. It might never have come to light. But ultimately, can you bury the truth forever?

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Comments

I think it's great to see this reporter get a little public recognition here for work that's really in the public service. And a chance to air the consequences that you get for attempting this kind of journalism! Great post.

Posted by: Noumenon  | March 1, 2006 11:25 AM

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