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SCHIFF'S

October 15, 2004
Volume 16 • Number 12

INSURANCE OBSERVER

Spitzer Sues Marsh: Bid Rigging, Fraud, Collusion

Two AIG Execs Plead Guilty to Criminal Charges

New York State attorney general Eliot Spitzer filed a lawsuit against Marsh & McLennan yesterday, alleging that the company cheated its clients by engaging in fraud, manipulating the insurance market, rigging bids, providing fake insurance-company quotes, colluding with insurers to increase premiums, encouraging insurance companies to provide higher quotes, and steering business to insurers in return for special payments.

The complaint, *The People of the State of New York v. Marsh & McLennan Companies, Inc. and Marsh Inc.*, filed in state supreme court, is on the Attorney General's website at http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf. It's not a pretty document.

Yesterday, Spitzer announced that he wouldn't try to negotiate with Marsh's current management because his office had been "misled by the highest levels of the company."

The complaint also alleges that "AIG, ACE, Hartford, and others" conspired with Marsh to restrain trade. Two executives at American Home, a subsidiary of AIG, pled guilty to criminal charges in connection with the allegations in the lawsuit. The Attorney General's office expects them to testify in future cases.

Spitzer plans to pursue his investigation of the insurance industry. "This is day one," he said.

Six hours after Spitzer's press conference, Marsh's independent directors swung into crisis mode and issued a press release stating that an "independent review" was underway, that the directors had "full confidence in the company's leadership," and that Marsh's board "will take all appropriate action in the interests of our shareholders, employees and our clients" when the review is concluded.

Before yesterday's announcement of the lawsuit and the criminal pleas, Spitzer's investigation was viewed by many as having little financial impact on the industry. That viewpoint has been shattered. On the NYSE, Marsh's shares fell 24% to $34.85, lopping $6 billion off the company's market cap, and AIG's stock fell $6.99 to $60—a decline of $18 billion.

Until yesterday, *Schiff's* had no opinion about how Spitzer's investigation might play out. Now it's obvious this is a huge story that won't go away soon. It has all the elements necessary for a big scandal: money, greed, widespread corruption, damning emails, and an industry that's despised by most. And then there's the fact that major companies involved—Marsh, AIG, and ACE—are run by Hank Greenberg, Jeff Greenberg, and Evan Greenberg, respectively. A decade ago no one would have dreamed that three of the largest property-casualty businesses could be run by members of the same family

Hank Greenberg is widely admired…and widely disliked. There's an almost palpable sense of schadenfreude in the air. We know many who would love to see AIG get its comeuppance. Hank is a great businessman with an exceptional record, but in the last few years his prickly defiance and unwillingness to acknowledge mistakes has sent a message of a man who is slightly out of synch with the changes in corporate governance. There's something kind of sad about Hank's behavior—the complaints about lack of underwriting discipline, the railing against trial lawyers, the endless angling for "tort reform," and the criticism of SEC regulations meant to prevent corporate abuses. None of this looks particularly good in the light of Spitzer's allegations, the criminal acts of AIG employees, and AIG's ongoing tangle with the SEC and the Justice Department. Hank, who is in the twilight of an illustrious career (it's a long twilight), is now awfully close to what will almost surely be the biggest property-casualty scandal in generations.

Jeff Greenberg, a fine, smart, honest man, is at the epicenter of the scandal. Marsh has a long history as the biggest and best insurance brokerage in the world, but unless Spitzer's allegations are way off base it will be embroiled in litigation. Marsh's basic insurance broking business should perform fine in any market or economic climate. That's the nature of a well run brokerage business. But how will it fare if its clients believe that it cheated them? (Two factors going in its favor: its large clients don't have many other large brokers to turn to, and the other brokers may treat their clients the same way Marsh does.)

Marsh has a public-relations nightmare on its hands, and it's conceivable that this could result in Jeff, and others, being forced out. When scandal hits, companies may dig in at first, but often decide that people are expendable if it brings about some sort of closure. If Marsh cheated its clients as Spitzer alleges, the stench will rise towards the top. When the late-trading and market-timing scandals at mutual funds blew up last year as a result of Spitzer's investigations, Putnam's longtime CEO Louis Lasser was quickly ousted. (Marsh & McLennan owns Putnam.)

If Spitzer's allegations are on the money it also raises another question: why didn't Marsh do something? Why did the board wait until a lawsuit was filed before announcing an independent review? Why didn't it uncover the problems and announce them itself, along with solutions?

Yesterday *Schiff's* received numerous calls from reporters who wanted to know if the insurance business is corrupt. *Schiff's* editor, who worked in the insurance business and on Wall Street before becoming a fulltime muckraker, leapt to the insurance industry's defense. "It's nowhere near as crooked as the investment business," he said

The insurance business is going to be under intense scrutiny. Some regulators will take a renewed interest in market conduct. ("This certainly plays to the adage that where there's smoke, there fire," said New York insurance commissioner Greg Serio, whose department participated in the joint investigation.) Class-action lawsuits will be filed. Records will be pored over. Clients will be wary. Risk managers—who are wined and dined by brokers—may feel pressure to bite the hands that feed them.

The press will be all over this story, and you can imagine how it will be framed: It's almost high noon and sheriff Eliot Spitzer, the man who took on Wall Street and will run for governor of New York in 2006, is now taking on the insurance industry, especially the three Greenbergs, whose power, wealth, and influence is unparalleled in the insurance business.

There are so many questions to be asked and issues to be raised. How widespread is the fraud? How much will this cost insurance brokers and insurance companies? Can Spitzer force a management change at Marsh? How much restitution might Marsh have to pay? How large could the punitive damages be? How will those who pled guilty testify? What names will they name? Who else will plead guilty? Who will be convicted? Will some authority take a *much* closer look at AIG?

Finally, what are the investment ramifications of yesterday's news? In our September 11 issue we wrote that insurance stocks were "priced with a great deal of optimism built in," and that insurance investors didn't envision the industry's "return to adversity." In other words, because the stocks weren't priced with a satisfactory margin of safety, they were susceptible to bad news. Certainly, the news is much worse for Marsh than for AIG. The allegations involve Marsh's core business whereas they only touch part of AIG's business. Furthermore, AIG is seven to ten times larger than Marsh (depending on how you choose to measure), so the impact is likely to be less severe.

But bad news is likely to linger, and we won't hazard a guess about its effect on the companies' stocks prices. Suffice it to say that if Marsh and AIG happen to go down fifteen or twenty percent, we'd be inclined to be buyers. As we write this (4:30 Friday morning), the high $20s seems like a good price for Marsh, and the low $50s seems like a good price for AIG.

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