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Inside the AIG Proxy Statement

The Audit-Committee Report

AIG IS ARGUABLY THE greatest insurance organization in the world. As such, it deserves more scrutiny than other companies.

In its reports for the years ending 2001 and 2000, AIG's audit committee disclaimed virtually all responsibility for AIG's accounting, internal controls, and financial statements. It also said that it could not assure that AIG's independent accountants were actually "independent." (*Schiff's* raised this issue last year and created a bit of a stir.) The language didn't sit well with investors, especially those whose eyes had been opened by a new wave of reform in corporate governance and accountability.

As we reported last August, AIG said it would change its 2003 audit-committee so that it was not merely a disclaimer of any responsibility for AIG's financials. (Remarkably, we were the only ones to report this.)

On Friday, AIG released its 2003 proxy statement, which includes a new and improved audit-committee report. The broadly evasive language is gone, as is the equivocal twaddle that had rendered the report meaningless. It has been replaced by something better, but not as good as it could be. "The [audit] committee has considered and discussed both the audited financial statements as well as the unaudited quarterly financial statements with management and the independent accountants," says AIG's audit-committee report. The report says that the committee discussed various mandated requirements with the auditors, considered whether the auditors are "independent," and recommended that the audited financial statements be included in AIG's annual report.

For what it's worth, we'll contrast AIG's audit-committee report with Coca-Cola's. We picked Coca-Cola for one reason: its audit-committee is the only one in the world that Warren Buffett is a member of. While it's debatable whether Coca-Cola uses better accounting than AIG, it does have a better audit-committee report. (The language used by Coca-Cola's audit committee may even reduce the committee's potential liability.) Here's an important excerpt from Coca-Cola's report:

> Management has reviewed the audited financial statements in the annual report with the audit committee including a discussion *of the quality, not just the acceptability*, of the accounting principles, the reasonableness of significant accounting judgments and estimates, and the clarity of disclosures in the financial statements...Members of the audit committee have expressed to both management and auditors their *general preference for conservative policies* when a range of accounting options is available. [Emphasis added.]
>
> In its meetings with representatives of the independent auditors, the committee asks... 1) Are there any significant accounting judgments or estimates made by management...that would have been made differently [by] the auditors?

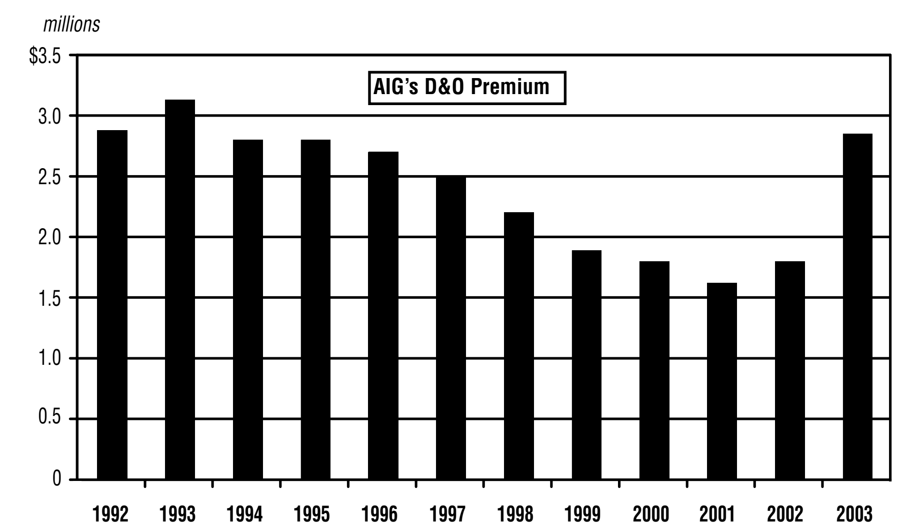
We believe that AIG, its shareholders, and the public would be better served if AIG's audit committee adopted language similar to Coca-Cola's. We'll have to wait until next year to see if it does.

Two Audit-Committee Members

ALTHOUGH AIG'S CHAIRMAN and CEO, Hank Greenberg, has dominated AIG for decades, he does not control the audit

American International Group's D&O Premium: A Study in Cycles

AIG maintains a Directors & Officers policy for itself, its directors and officers, its subsidiaries, and their directors and officers. Although AIG has made several acquisitions since 1992 and is a much larger company today, its D&O premium is the same as it was in 1992. AIG has not disclosed the terms and conditions of its policies, or the limits and deductibles.



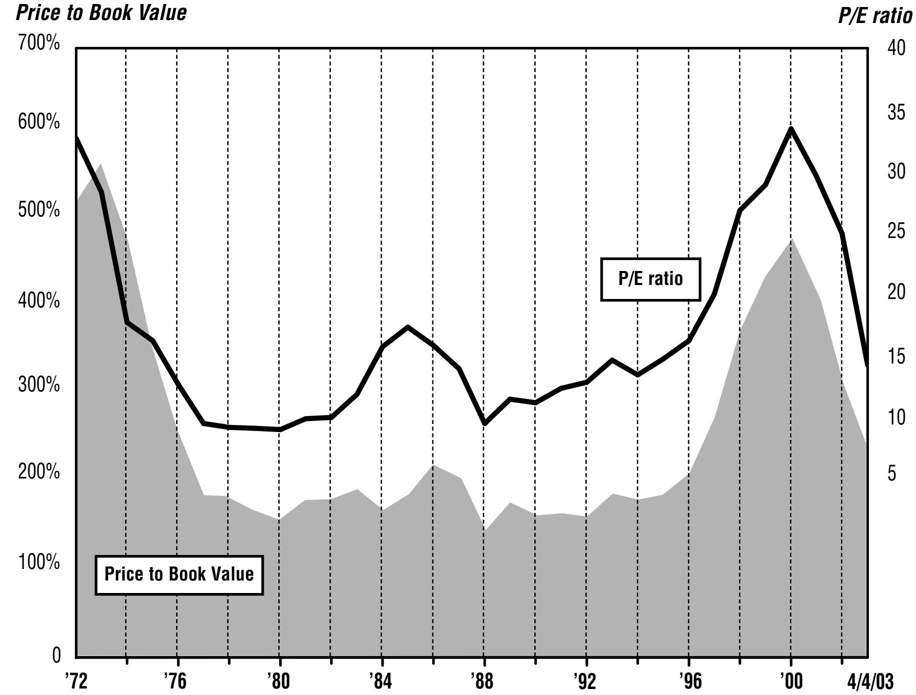
committee (at least in theory). It is made up of directors who are "independent" according to the current standards of the New York Stock Exchange. (Greenberg, for the record, is a member of the NYSE's Corporate Accountability & Listing Standards Committee.) We don't know why some members of the audit committee didn't insist on a better audit-committee report initially.

For example, Frank Zarb, senior advisor to Hellman & Friedman, was previously head of the NASD. In 1999, while at the NASD, he co-chaired a "blue-ribbon panel" that came up with "far-ranging recommendations intended to empower audit committees." The recommendations were good, but not all were adopted. (Some of the recommendations were *too* good.) Zarb is highly knowledgeable about financial matters *and insurance*. (He was CEO of Alexander & Alexander from 1994 to 1997.) His behavior on AIG's audit committee, however, seems to have been far more passive than the behavior he recommended for audit-committee members when he was running the NASD.

Carla Hills, CEO of Hills & Company, is also on the audit committee. (Like Zarb, she is on AIG's executive committee, as well.) She has had a distinguished career. She was an assistant U.S. attorney general, U.S. Secretary of Housing and Urban Development during Gerald Ford's administration, and the U.S. Trade Representative under George Bush. We have long been skeptical of her, however. She was a director of Henley Group, run by sleazy wheeler-dealer Mike Dingman. During her tenure on the board, Henley engaged in dirty accounting, and its board permitted Dingman to concoct a variety of dubious, self-enriching asset shuffles with affiliated companies. (See "The Henley Maneuver—It Helps the Rich Get Richer," *Barron's*, December 19, 1988, by David Schiff.) Hills is also a member of the infamous Time-Warner board that approved the merger with AOL—perhaps the worst deal of all time.

American International Group: Stock Bubble Bursts, Again

In 1972, AIG's shares traded at 518% of book value and 32 times earnings. From 1972 to 1974, AIG's stock fell 66%, as these inflated multiples shrank, even though AIG's earnings grew. In 2000, AIG's price-to-book-value and p/e ratios returned to their euphoric 1972 levels. AIG's stock is now down about 50% from its 2000 high. The price-to-book-value and p/e ratios are down significantly, too.



Primary source: Value Line

Some Notable Connections

MANY OF AIG'S DIRECTORS have close connections with AIG or Hank Greenberg (see the chart on page 3). Some have close *and* unusual connections. Marshall Cohen, for example, joined AIG's board in 1992, when he was president of The Molson Companies. Molson was a shareholder in Coral Re, a suspicious, curiously capitalized offshore reinsurance company that AIG ceded more than $1.5 billion in premiums to in the 1980s and early 1990s, making it one of AIG's largest reinsurers. Although Coral was formed to benefit AIG, AIG maintained—despite considerable evidence to the contrary—that Coral was not an affiliate. Coral's initial investors were offered a most unusual deal: they didn't have to put up a cent or risk money or collateral, yet they were *guaranteed* to make a profit. AIG's proxy statements did not mention the connections between Coral and Molson and Cohen, even though Cohen was on AIG's board.

AIG's 2002 proxy statement does not disclose—and perhaps is not required to disclose—that The Starr Foundation (which owns 56,957,340 shares of AIG, a 2.18% interest), gave more than $25 million to the American Museum of Natural History in 2001. (Greenberg is a trustee of the museum.) Seven past or present AIG directors were on The Starr Foundation's board at that time, and Hank Greenberg was, and still is, chairman. According to an IRS filing, he devoted 200 hours to The Starr Foundation in 2001 and received no compensation.

What makes The Starr Foundation's grant to the Museum of Natural History noteworthy, aside from its magnitude, is that Ellen Futter, the museum's president, was and still is on AIG's board, and served on its Stock Option and Compensation Committee until September 18, 2002. Setting Hank Greenberg's compensation is one of the committee's major responsibilities. Although Greenberg is very well paid, his compensation isn't particularly unusual compared to some of the ridiculous figures doled out to lesser CEOs these days. In 2002, he received $1,000,000 in salary and a $5,000,000 bonus. He also received 375,000 ten-year options to buy AIG shares at $61.30 per share. While there's no single correct way to value options, $6,000,000 seems like a reasonable valuation for this options grant, bringing Greenberg's total compensation for 2002 to $12,000,000.

In February 2003, AIG's compensation committee took unusual action. "In light of the decline in the market price of AIG common stock," says AIG's proxy statement, "the committee determined that *additional incentives were needed to retain and motivate employees*." [Emphasis added.] Instead of repricing the previously granted options, the committee granted Greenberg, who owns 45,167,862 AIG shares, 375,000 *additional* options. The proxy statement doesn't disclose whether these options carried a lower strike price than the previous options.

More Connections

THE CHART ON THIS PAGE, which does not purport to be complete, shows some of the connections between Hank Greenberg and AIG's directors. These connections are not listed in AIG's proxy statement and have been gathered from various sources. The chart does not show connections between other directors, or between directors, advisory board members, honorary directors, and AIG employees.

Four Directors Step Down

THREE AIG DIRECTORS ARE not standing for reelection this year. They are Eli Broad, Edward Matthews, and Thomas Tizzio, all of whom work or worked at AIG. Former director, Robert Crandall, the retired chairman of AMR and American Airlines, resigned from the board on October 9, 2002. AIG's board will have sixteen directors.

AIG's Important D&O Ad

ON FEBRUARY 3, AIG announced a $1.8-billion after-tax charge to increase loss reserves. About twenty-five percent of this charge was for directors and officers liability. Hank Greenberg subsequently attributed the charge to a "liability bubble" that could not have been foreseen.

In fact, AIG did foresee a difficult liability environment. What it didn't foresee was the precise magnitude of the so-called bubble. That D&O claims have surged is not just the result of a legal system run amuck; it has much to do with the grossly abusive behavior of corporate executives who have run amuck.

In 1968, the American Home Assurance Company, an AIG subsidiary, ran a striking full-page ad in *The Wall Street Journal*. (AIG has always been an extremely effective and creative advertiser.) The ad showed a small

No Degrees of Separation: Hank Greenberg's Connections with American International Group's Directors

AIG's proxy statement provides very little information about the company's directors. The chart below—which does not purport to be complete—shows some of the non-AIG connections between Hank Greenberg and AIG's directors. These connections are not listed in AIG's proxy statement.

	M.R. Greenberg	Aidinoff	Chia	Cohen	Conable	Feldstein	Futter	Hills	Hoenemeyer	Holbrooke	Smith	Sullivan	Tse	Wintrob	Wisner	Zarb
American Museum of Natural History	Trustee				Director		President									
Business Council for International Understanding	Honorary Trustee														Vice Chairman	
Center for Strategic and International Studies	Former Vice Chairman							Member								
Coral Reinsurance	Secret Affiliate?			Shareholder												
Council on Foreign Relations	Former Vice Chairman	Member			Member	Director	Member	Vice Chairman		Director					Member	Member
Federal Reserve Bank of New York	Former Chairman					Board of Advisors	Former Chairman									
Institute for International Economics	Director							Director								
New York Stock Exchange	Director				Director											Former Director
Project Hope	Director												Advisory Board			
The Asia Society	Trustee		Trustee					Trustee		Trustee						
The Starr Foundation	Chairman										Director		Director			
Trilateral Commission	Member					Member		Member		Member						
US-ASEAN Business Council	Vice Chairman							Husband is Vice Chairman								
US-China Business Council	Director							Director								

photograph of a conservative-looking businessman beneath the headline, “I just might sue every company director reading this newspaper.” Here’s the text of the ad:

> I am not a madman.
>
> This is not a joke.
>
> If you are a director of a major company, I’ve got you where I want you.
>
> At my mercy. All I have to do is own a few shares in your corporation and I can sue you and every other director and officer in the company.
>
> What can I sue you for?
>
> I can sue you for sending me a dividend payment that I think is unwarranted.
>
> I can sue you because I think your salary is too high, or for conflict of interest or for missing a few director’s meetings. I can blame and sue you because of a misstatement in your company’s financial report—or should I say our company? I can’t begin to list all the reasons I can sue you for. And here’s the saddest part. I’m not alone. There are 24 million other people out here just like me. There are 24 million stockholders in the United States and that’s 24 million potential stockholder suits. And even if you should win a stockholder suit—you lose. When you take into consideration lawyers’ costs, wasted time etc. At this point, you must be feeling helpless. You’re not.
>
> There is a company that can help you. American Home Assurance Company. They didn’t invent stockholder suits, but they have come up with some interesting solutions to them. They feature a type of insurance that every director or officer in the United States should consider. Directors and Officers Liability Insurance. They have a booklet which tells all about Directors and Officers Liability Insurance for those that qualify. You can get it by writing to Dept. A-14, American Home Assurance Company, 102 Maiden Lane, New York, N.Y. 10005. Send for it and talk it over with your insurance agent or broker. He and American Home Assurance Company are good friends to have when you have 24 million potential enemies.

AIG’s ad, which pitted corporate bigwigs against their *shareholders* (“potential enemies”), generated a tremendous response from major corporations and insurance brokers. D&O coverage may have been unusual back then, but it’s ubiquitous now.

Perhaps some academic will analyze D&O lawsuits and figure out whether directors and officers were emboldened because they were able to buy coverage. Did the availability of insurance create moral hazards that led to greater abuses? Did AIG’s ad, unwittingly, awaken corporate directors and officers as well as shareholders and class-action lawyers?

In 1968, many public companies were not especially accountable to their shareholders—*their owners*. Although shareholders have gained some power, they’re still disenfranchised. When directors miss board meetings, act as rubber stamps, overpay their CEOs, have conflicts of interest, and permit their companies’ financial statements to be materially misstated, it’s not surprising that they’re sued.

Call it a liability bubble. Or call it a bubble in directors’ and officers’ malfeasance.

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