Up the Insurance Department

The Love Song of Maurice "Hank" Greenberg

It isn't often that an insurance department singles out an insurance executive as a genius, but that's what happened recently. In October, the Delaware Insurance Department issued its long-awaited "Report on Examination" of the Lexington Insurance Company, an AIG subsidiary. The report was of greater than usual interest because of rumors that Delaware had been looking into AIG's transactions with Coral Re, a thinly-capitalized Barbados reinsurer that AIG had formed to reinsure certain classes of its business. Coral was of particular interest, because despite negligible capital—$15 million—it had received $1.6 billion in reinsurance premiums from AIG. (For more on Coral, see the March and July 1996 issues of *Emerson, Reid's Insurance Observer*.)

The Delaware examination report provides a glowing description of Hank Greenberg, AIG's boss. Although it is unusual for an insurance department to heap praise upon an individual, that's what Delaware has done, albeit inadvertently. After reviewing Lexington's business, the examination report goes on:

> Maurice "Hank" Greenberg, AIG's chairman, may, if he so chooses, bend the law to fit his company's needs. Mr. Greenberg is not required to comply with insurance-department requests that he deems irrelevant. It is up to Mr. Greenberg—not the Department—to decide whether a company is controlled by or affiliated with AIG. The Department apologizes to Mr. Greenberg for wasting his time with stupid regulations.

Actually, these words, or words close to these, do not appear. The report is, in fact, as dry and straightforward as the Bonneville Salt Flats. But the sentiment—that Greenberg is the proverbial 900-pound gorilla who sits wherever he wants to sit, is etched in the negative space between each line of text. Although the implication was clear that Coral Re was actually an AIG affiliate and that AIG had accounted for its reinsurance transactions with Coral improperly, AIG was not fined, ordered to restate its financials, suspended, punished, or tarred, feathered, and run out of town on a rail. The Delaware Department merely gave AIG a dirty look and said don't do this again.

The report recounts how AIG helped set up Coral Re, arranged for no-risk non-recourse loans to Coral's "investors," and ceded $1.6 billion of premiums to Coral on terms that allowed virtually no profit for Coral. The effect of these transactions was to shift liabilities off AIG's balance sheet. In little over a year, AIG had a $1 billion of reinsurance recoverable from Coral.

The Delaware Insurance Department lays out facts to support the contention that AIG "controls" or is "affiliated" with Coral. These facts are set forth in a manner that makes it difficult to believe that AIG's dealings with Coral were on an arm's-length basis. Little doubt is left that Greenberg and AIG pulled the strings.

AIG, however, *denies everything*. Backing up its assertion that Coral is not controlled by or affiliated with AIG, is a letter from the law firm Cahill Gordon & Reindel giving an opinion that AIG "does not control Coral Re within the meaning of the New York Insurance Law." The issue of whether AIG controls Coral Re within the meaning of *Delaware* law is apparently not addressed. Putting the law aside for a moment, consider this: if you and Hank were knocking back a few beers at the Blarney Stone and you looked him in the eye and asked him whether he—wink, wink, nod, nod—controlled Coral Re, we'd bet he couldn't say "no" with a straight face.

But getting Greenberg to admit something to the regulators is as difficult as housebreaking an elephant. Greenberg could probably get a law firm to write an opinion that he isn't affiliated with his wife. A case in point: even though AIG is the largest shareholder of Transatlantic Re, with a 49% interest, and Greenberg is Transatlantic's chairman, AIG claims that Transatlantic is not an affiliate.

It is a testament to Greenberg's savviness and power that the only action Delaware took was to whip AIG with a feather. "In order to alleviate the Department's concerns regarding the close relationship of the AIG companies to Coral Re," says the report, "[AIG] has agreed to stop ceding any business to Coral Re and commute $100 million of the reinsurance credits currently being taken. [AIG] has also agreed to report any reinsurer that has the previously mentioned characteristics as an affiliated reinsurer in future filings with the state insurance regulators." AIG also agreed to run off all of the Coral Re treaties.

That the matter ended with a whimper rather than a bang was no surprise. Greenberg, armed with the best lawyers in the world, is not about to be outfoxed by a bunch of low-paid, understaffed civil servants—even if they're right and he's wrong. You can bet on that.

As for the meaning of the Coral Re affair, Howard Smith, AIG's chief financial officer, termed it "much ado about nothing." But he didn't leave it at that. He rubbed Delaware's nose in the dirt, adding that the only reason AIG wouldn't place business with Coral and would cancel most existing business was *that it suited AIG to do so*.

Hank Greenberg may have dreamed up Coral, arranged for its investors to receive non-recourse loans, seen to it that Coral's board approved of everything he wanted, set the terms on the reinsurance ceded to Coral, arranged for Coral's retrocessions, and done everything else that the owner of the company would normally do. But Hank Greenberg is not now—nor has he ever been—affiliated with Coral Re.

Don't you forget it. ■

Small Change

OVER THE LAST EIGHT YEARS, A.M. Best has tinkered with the definitions of its ratings many times. Sometimes the changes have had the effect of upgrading a rating (making it more positive); other times the effect has been a downgrade. The B+ rating, for example, holds the record for the most permutations; it has been changed four times.

In 1996, Best quietly revised the definition of its B and B- ratings, making this the third year in a row that the definition has changed. Last year, B and B- companies were said to "*generally* have an adequate ability to meet their obligations," this year, the equivocal "*generally*" has been deleted, upgrading the category (which had been downgraded last year). The C++ and C+ rating went through similar changes, as well.

Larry Mayewski, Best's senior v.p. in charge of life/health ratings, told us that the changes were meant to clarify the ratings, and that "the process we went through to place a company in a rating hasn't changed from last year to this year."

Although Best has significantly improved its service in the last few years, and is, in the words of the great V. J. Dowling, "the de facto regulator" of the insurance industry, its ratings are still a bit vague. This can be solved by adopting a rating structure similar to that used by Standard & Poor's, Moody's, and Duff & Phelps (e.g., AAA, AA+, AA, etc.). This would increase clarity by providing Best with a greater range of categories to distinguish insurance companies' financial strength. (The other raters have nine categories of "secure" ratings whereas Best only has six.)

Although Best presently has no plans to do this, we think the odds are strong that it will come around in a few years.