SEC slaps Greenberg on AIG accounting

Nanette Byrnes

Former AIG CEO Hank Greenberg will have to pay $15 million in penalties for 2000-2005 infractions at the insurance giant.

It's another black eye for ailing insurance giant American International Group (AIG). On Aug. 6, the Securities & Exchange Commission charged that former Chief Executive Maurice "Hank" Greenberg and former Chief Financial Officer Howard Smith were involved in numerous improper accounting moves between 2000 and 2005. The two men settled without admitting or denying guilt. Greenberg will pay a penalty of $15 million; Smith, $1.5 million.

The SEC's complaint paints a picture of two executives creatively focused on managing Wall Street analysts' expectations and the value of AIG's share price. Each maneuver was made to create the impression that the company was consistently meeting or exceeding key earnings and growth targets. Similar charges were filed earlier in the week by the SEC against General Electric (GE), though in that case the alleged infractions were quite different.

"Corporate leaders cannot avoid the truth and consequences of their companies' performance by using improper accounting gimmicks and signing off on distorted financial reports," said Robert Khuzami, director of the SEC's Enforcement Div., in a statement.

A pattern of dubious stock bolstering

At issue at AIG, according to the complaint filed in U.S. District Court for the Southern District of New York, were: "sham" reinsurance transactions designed to make it appear that the insurer had increased its loss reserves, when it had not; a deal with an offshore shell entity that seems to have concealed underwriting losses from AIG's auto-warranty insurance business; and other transactions that juiced the company's investment income and allowed it to improperly recognize capital gains.

Greenberg had often boasted of AIG's consistent double-digit growth in key financial performance measures, a record that helped award its stock a high price compared with competitors'. When faced with circumstances that imperiled that record, the complaint asserts, Greenberg pursued complicated transactions.

In one example, the SEC says that in 2000, after analysts criticized AIG for its declining loss reserves and the stock dropped in value, Greenberg initiated two reinsurance transactions with a foreign subsidiary of General Re. By accounting for them improperly as real reinsurance, AIG falsely reported increases to both its loss reserves, a hot-button issue with analysts, and its premiums written. The move violated accounting rules, according to the SEC and "had no economic substance, amounting to a round trip of cash." Without the phony loss reserves on its balance sheet, the complaint alleges, AIG's reported loss reserves would have been $250 million lower in the fourth quarter of 2000 and an additional $250 million lower in the following quarter, the first quarter of 2001.

The SEC also accuses Greenberg of trying to cover up problems in AIG's core underwriting business, particularly its auto warranty line. Faced with projected losses of $210 million, Greenberg chose not to report them, instead initiating a reinsurance transaction with an offshore shell company funded and controlled by AIG, to inaccurately depict those operating losses as capital losses. Capital losses were less troublesome to investors, the SEC says, because they viewed them as not relating to AIG's core business.

Greenberg disavows responsibility

In 2005, after Greenberg was forced out by the board, the company restated many of its prior transactions. The company later settled SEC charges over the same matters for $800 million in fines and disgorgement. More recently, AIG has become a poster child for the risky excesses of the financial system; it was only kept from bankruptcy by $173 billion in federal loans and guarantees.

A former AIG affiliate, C.V. Starr—which Greenberg, 84, still runs—put out a statement on his behalf saying that after a four-and-a-half-year investigation he was pleased not to be charged with fraud. It continued: "Mr. Greenberg has consistently made clear that he personally never engaged in any fraud whatsoever and that the vast majority of AIG's Restatement was unnecessary and concerned accounting issues for which he had no responsibility."

Smith's attorney, Andrew M. Lawler, said in an e-mail: "Some of the transactions in the Complaint filed by the SEC today are almost ten years old. Although Mr. Smith was originally inclined to litigate this matter, resolving the SEC matter allows him to move forward with his life without the added legal costs and distraction of this lawsuit."

New powers for SEC

The AIG indictment continued a busy week for the SEC, which has settled charges over accounting fraud with GE, charged two options traders and their broker-dealers with violations of the commission's rules to prevent abusive "naked" short-selling, and exacted a $33 million penalty from Bank of America (BAC) over its communication with investors about billions of dollars in bonuses that were being paid to Merrill Lynch executives at the time of BofA's acquisition of that firm.

There may be more to come. On Aug. 5, SEC Enforcement Director Khuzami announced his division will now be allowed to subpoena documents and compel testimony without the approval of the agency's five commissioners, important new powers that are likely to add to the pace of investigations.

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