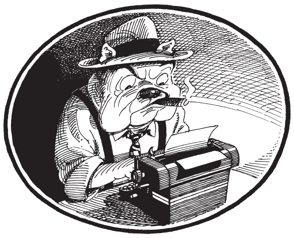

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AIG's Relationship with Three Starr Entities

Conflicts of Interest

AIG is an inherently complex corporation. Because of its unusual relationships with three affiliated entities—Starr International Company, Inc. (SICO), C.V. Starr & Co., Inc. (Starr), and the Starr Foundation—it is all the more complex. Each Starr entity is a significant shareholder of AIG stock (collectively, they own 412,409,172 shares worth approximately $23.5 billion), and each is majority-owned or controlled by retired AIG officers, with Hank Greenberg serving as chairman, president, or director. AIG does not own any of the Starr entities.

For decades, AIG's directors have not objected to AIG's transactions and relationships with the Starr entities. The existence of the three Starr entities has never been a secret, but much of what they do has not been disclosed to the public, nor have many intercompany conflicts of interest been disclosed to AIG's shareholders. Although the conflicts of interest are important, one cannot make a sweeping statement that *all* of them are detrimental to AIG and its shareholders. But they are problematic for a variety of reasons (which we will get to eventually). Here's an outline of the flow of money or business between AIG and the Starr entities:

SICO, which owns 11.94% of AIG, is a Panamanian company with headquarters in Bermuda. It is apparently used as a deferred-compensation program for about 700 of AIG's current and former employees. AIG's board of directors does not decide how SICO compensates AIG's employees. Greenberg oversees SICO and is a director of the company. SICO has also acted as a secret "finite" reinsurer of AIG business.

Starr, which owns 1.81% of AIG, is an underwriting manager that specializes in excess casualty, primarily for AIG's insurance companies. Starr is located in AIG's offices and shares employees with AIG. In 2003, it received $173 million (forty-seven percent of its revenues) from AIG. Starr is owned by AIG's most senior current and former employees. AIG's board of directors does not decide how Starr compensates AIG employees. Greenberg is Starr's president and CEO.

The Starr Foundation, which owns 2.05% of AIG, was created by C.V. Starr, who founded what is now AIG. Greenberg is chairman of the foundation. Its president, Florence Davis, was previously AIG's general counsel. All of the foundation's directors were once officers of AIG. The foundation makes about $220 million of charitable grants per year, including scholarships to children of AIG's employees throughout the world. It has also made significant grants to organizations run by AIG directors. (In 2003, *Schiff's* published an exposé about $36.5 million in grants that the foundation gave to the American Museum of Natural History shortly after the museum's president, Ellen Futter, joined AIG's board of directors. AIG never disclosed that Greenberg, through the Starr Foundation, was one of Futter's major benefactors.)

AIG
THE STARR FOUNDATION
C.V.STARR & Co.
Starr International Company, Inc.

The Starr entities are, to some extent, a legacy of AIG's predecessor companies, and their relationships with AIG date back to 1967, when AIG was incorporated. The fact that practices are longstanding, however, does not make them right for the present time. Since corporate America has finally entered the Age of Transparency, it's reasonable to assume that AIG's relationships with the Starr entities will change—probably soon.

On the following pages we will examine AIG's relationships with the three Starr entities and provide some of the history behind the relationships, as well as some history of AIG.

In 1919, Cornelius Vander Starr, an adventurous twenty-seven-year-old from Fort Bragg, California, formed an insurance agency in Shanghai called American Asiatic Underwriters. The business grew rapidly as a foreign underwriting manager for a pool of American and European insurance companies. Starr formed a life-insurance company in China and eventually expanded into Latin America and Europe, and, after World War II, into Japan and the Philippines, creating a loosely-knit amalgam of international life-insurance, reinsurance, underwriting, and brokerage operations under the aegis of C.V. Starr & Co. and American International Underwriters (AIU).

In 1952, Starr and his associates sold control of U.S. Life to Continental Casualty for about four million dollars. A few months later, Starr's Bermuda-based American International Reinsurance Company (AIRCO) bought control of the Globe & Rutgers Fire Insurance Company, which was merged into its subsidiary, American Home Assurance Company, three years later.

Starr was a hard worker who had a great grasp of his organization's details. He inspired loyalty in his employees, and made many of them partners in his businesses. He was also a world-traveling bon vivant who did things in grand style. He started an English-language newspaper in China, built up a ski resort in Vermont (Stowe), sent American skiers to the Olympics, put on a production of *Madame Butterfly* at the Metropolitan Opera, created a golf course by his house in Brewster, and paid for the college tuition of some of his employees' children. After his death, his estate went to the Starr Foundation.

In 1960, when he was sixty-eight, Starr hired thirty-five-year-old Hank Greenberg as vice president of C.V. Starr & Co. Although Starr's companies were filled with many long-tenured executives, Greenberg, who was younger than the others, quickly moved toward the top.

In 1967, AIRCO formed AIG as a holding company for its interests in the American Home and New Hampshire insurance companies, both of which were members of the AIU pool that Starr wrote business for. The following year, AIRCO transferred American Life Insurance Company (ALICO) to AIG. AIG also acquired a controlling interest in National Union (which was a member of the AIU pool).

During 1967 and 1968 there was a skirmish for control within Starr's organization. At that time the organization's key people included Houghton Freeman, Greenberg, Edwin Manton, Francis Mulderig, John Roberts, Ernest Stempel, K. K. Tse, Gordon Tweedy, and William Youngman. One faction wanted to sell out, and the other, led by Greenberg, wanted to expand. Starr, who was quite sick and would die at the end of 1968, is said to have chosen Greenberg as his successor, although there are those who say that Greenberg ultimately edged Starr out of the business.

On August 19, 1968, four months before Starr died, *The New York Times* carried an article, "C.V. Starr & Co. Elects Leaders." Below the headline were two photographs: one of Gordon B. Tweedy and the other of Greenberg. "C.V. Starr & Co., Inc., international insurance managers, announced over the weekend the election of Gordon B. Tweedy as chairman and Maurice R. Greenberg as president," the article stated. "Mr. Tweedy succeeds Cornelius V. Starr, who started in the insurance business in China and whose subsidiaries are still active in 130 countries. Mr. Starr is retiring but will re-

continued on next page

main a director of the company... Mr. Greenberg succeeds William S. Youngman, who also retired."

At that time, AIG was little more than a shell holding company. On September 30, 1968, its balance sheet listed four significant assets—investments in American Home, New Hampshire, ALICO, and National Union, which were valued at $24.2 million, $6.1 million, $5.4 million, and $12.2 million, respectively. AIG's long-term debt totaled $12 million, leaving the company with shareholders' equity of $35.5 million. (So different was 1968 from today that AIG carried its investment in ALICO on a statutory—rather than GAAP—basis because there was no accepted method for adjusting the statements of life-insurance companies to GAAP.)

Although AIG didn't look like much, the concept of a publicly-traded holding company that could own insurance companies was a hot one.

In August 1967, Edward Netter, a thirty-four-year-old insurance analyst with Carter, Berlind & Weill, published a research report entitled "The Financial Services Holding Company." Netter had noted that many fire and casualty companies had a "capital redundancy" (also known as *surplus* surplus). When insurance companies' balance sheets were adjusted for their capital redundancies (i.e., capital that they didn't need for operations), their stocks were selling for almost nothing. If an insurance company was owned by a holding company, the capital redundancy could be put to use elsewhere, or leveraged at the holding-company level.

The sheer cheapness of insurance stocks did not go unnoticed by all. Within the next few years, many major insurance companies would be acquired. One deal was particularly noteworthy.

In May 1968, Leasco Data Processing Equipment Corp., a six-year-old computer-leasing company with total assets of $75 million, announced that it wanted to take over Reliance Insurance Company, which was 150 years old and had $750 million in assets and $250 of surplus. Reliance's management didn't want to be acquired—especially not by Leasco, whose chairman, Saul Steinberg, was a boyish-looking twenty-nine.

Although Leasco had little in the way of traditional assets and earnings, it made up for that with a stock that was selling for eighty times earnings. (Leasco's "earnings" would later prove to be illusory.)

The Reliance Insurance Company was the antithesis of a high flier. In fact, it was too solvent for its own good—at least in the eyes of "go-go" money managers. So out of favor were old-line insurance companies that Reliance's insurance business was valued at zero by the stock market. The assets offsetting its unearned premiums and loss reserves (i.e.,"float") were also valued at zero. One dollar of Reliance's net worth was not considered to be worth a dollar, either. At year-end 1966, Reliance's stock was trading at $32 per share—8.5 times earnings—and its market capitalization was $150 million, far below its $235 million book value.

By traditional measures, Reliance was grossly undervalued. Leasco's value, on the other hand, could not be measured by traditional methods. In order to justify its valuation, one had to use New Era rationalizations and make bold assumptions about its future performance.

People aren't always rational, and markets are reflections of people's behavior. Perhaps that's the simplest way of explaining how, within a few months, Leasco managed to take over Reliance, shelling out a mere $4.4 million in cash in the process. Leasco's acquisition currency—convertible preferred stock and warrants—was derisively referred to as "Chinese paper" or "funny money."

In early 1969, the Senate Judiciary Committee's Subcommittee on Antitrust and Monopoly held hearings on the insurance industry chaired by Senator Philip Hart of Michigan. The scope of the hearings was broad; it included solvency (and insolvency), auto insurance, non-renewal, and something that was then radically altering the financial landscape and insurance-companies' balance sheets: takeovers of insurance companies—especially by conglomerates and holding companies.

It was against this backdrop that AIG, which had $35 million of shareholders' equity, went public via an exchange offer for the 48.6% of American Home, 42.2% of National Union, and 87.6% of New Hampshire that it did not already own. In exchange for the common shares of these three insurance companies, AIG offered its common stock, convertible preferred stock, and convertible subordinated debentures. Upon completion of the exchange offer, AIG was transformed into a company with $600 million in assets and $120 million of shareholders' equity.

The April 21, 1969 prospectus for the exchange offer provided details about AIG's relationships with various Starr entities. For example, AIG's most senior officers did not devote their full time to AIG's business. Their primary positions were with C.V. Starr & Co., AIRCO, and AIU.

After the exchange offer, AIG was controlled by AIRCO, which owned about sixty-one percent of AIG's shares. (AIRCO's address was P.O. Box 152, Hamilton, Bermuda. Not coincidentally, that is also SICO's current address.) AIG's directors and officers owned 19.1% of AIRCO, and C.V. Starr's estate owned 14.9%. (Starr's shares would be transferred to the Starr Foundation, although the voting rights were held by C.V. Starr & Co. for twenty years.) AIG's officers and directors also controlled 95% of C.V. Starr & Co.'s common stock.

There were so many transactions between AIG, the Starr companies, and various officers, directors, and affiliates that three pages of the prospectus were needed to outline them all.

There were, apparently, tax reasons why AIRCO's AIG shares were not distributed to the senior people at Starr. But the AIRCO holdings also served another purpose: they prevented anyone from taking over AIG. At a time when conglomerates were swallowing up insurance companies, this was reassuring to Hank Greenberg, who had big plans for AIG and didn't want the company to be acquired. ■

To be continued soon

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