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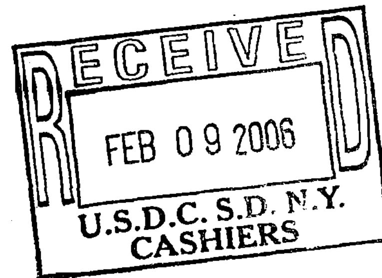

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	06 CV 1000
Plaintiff,	
-against-	06 Civ. ______ ( ) ECF CASE
AMERICAN INTERNATIONAL GROUP, INC.,	
Defendant.	COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission"), for its Complaint against Defendant American International Group, Inc. ("AIG"), alleges as follows:

SUMMARY OF ALLEGATIONS

1. In this case, the Commission alleges that from at least 2000 until 2005, AIG materially falsified its financial statements through a variety of sham transactions and entities whose purpose was to paint a falsely rosy picture of AIG's financial results to analysts and investors.

2. Among other things, AIG structured two sham reinsurance transactions with General Re Corporation ("Gen Re"). The purpose of the transactions was to add a total of $500 million in phony loss reserves to AIG's balance sheet in the fourth quarter of 2000 and the first

quarter of 2001. The transactions were initiated by AIG to quell criticism by analysts concerning a reduction in AIG's loss reserves in the third quarter of 2000. The transactions had no economic substance, amounting to a round trip of cash, but they were designed to, and did, have a specific and false accounting effect.

3. Shortly after receiving the Commission's subpoena in February 2005 specifically directed to the Gen Re transaction, AIG commenced an internal investigation that ultimately led to a restatement of its prior accounting for approximately 66 transactions or items.

4. In its restatement, AIG admitted not only that its accounting for certain transactions had been improper, but also that the purpose behind those transactions had been to improve financial results that AIG had believed to be important to the market.

5. AIG also conceded in its restatement that certain transactions may have "involved documentation that did not accurately reflect the true nature of the arrangements ... [and] misrepresentations to members of management, regulators and AIG's independent auditors."

6. AIG further admitted that "there was insufficient risk transfer to qualify for insurance accounting for certain transactions where AIG subsidiaries either wrote direct insurance or assumed or ceded reinsurance."

7. In a May 31, 2005 press release announcing the restatement, AIG said that the restatement would reduce AIG's consolidated shareholders' equity at December 31, 2004 by approximately $2.26 billion (or 2.7%).

8. During the period of the fraud, AIG distributed its stock in a stock-for-stock corporate acquisition.

9. AIG's admission of these extensive accounting irregularities came on the heels of two prior Commission actions against AIG alleging violations of the federal securities laws.

10. In the first case, in September 2003, the Commission charged AIG with securities fraud for fashioning and selling a sham "insurance" product to Brightpoint, Inc. for the sole purpose of enabling Brightpoint to report false and misleading financial information to the public. AIG settled that action with the payment of a $10 million civil penalty. *See SEC v. Brightpoint, Inc., et al.*, Litig. Rel. No. 18340 (Sept. 11, 2003).

11. In the second case, in November 2004, the Commission again charged AIG with securities fraud for developing, marketing, and entering into transactions that enabled another public company, PNC Financial Services Group, Inc., to remove fraudulently certain volatile, troubled, or underperforming loans and other assets from its balance sheet. AIG settled that action and related criminal charges by paying $126 million in disgorgement and penalties and retaining an independent consultant to, among other things, review certain other transactions to which AIG had been a party. *See SEC v. American Int'l Group, Inc.*, Litig. Rel. No. 18985 (Nov. 30, 2004).

12. In connection with the conduct alleged in this Complaint, AIG employed devices, schemes, and artifices to defraud that AIG deliberately designed to have a materially false and misleading impact on AIG's financial statements, that did have such an impact, and that operated as a fraud.

13. In the offer and sale and in connection with the purchase and sale of its securities, AIG made material misrepresentations and omissions of material fact in annual and other periodic reports filed with the Commission, other Commission filings, and press releases.

VIOLATIONS

14. By virtue of the foregoing conduct, AIG, directly or indirectly, singly or in concert, has engaged in acts, practices and courses of business that constitute violations of

Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77q(a)(1), 77q(a)(2), 77q(a)(3)], Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78j(b), 78m(a), 78(m)(b)(2)(A), 78(m)(b)(2)(B), and 78(m)(b)(5)] and Rules 10b-5(a), 10b-5(b), 10b-5(c), 12b-20, 13a-1, 13a-13, and 13b2-1 [17 C.F.R. §§ 240.10b-5(a), 240.10b-5(b), 240.10b-5(c), 240.12b-20, 13a-1, 13a-13, and 13b2-1].

JURISDICTION AND VENUE

15. The Commission brings this action pursuant to the authority conferred upon it by Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)] and Section 21(d)(1) of the Exchange Act [15 U.S.C. § 78u(d)(1)] seeking a final judgment: (i) restraining and permanently enjoining AIG from violating certain specified provisions of the federal securities laws; (ii) requiring AIG to disgorge any ill-gotten gains; and (iii) imposing civil money penalties against AIG pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

16. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa].

17. AIG, directly or indirectly, singly or in concert, has made use of the means and instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices and courses of business alleged herein.

18. Venue lies in the Southern District of New York, pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa]. AIG's principal corporate offices are located in New York, New York.

THE DEFENDANT

19. AIG, a Delaware corporation, is a holding company that, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad. AIG's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

20. During the period of the fraud, AIG distributed its stock in connection with its August 29, 2001 acquisition of American General Corporation ("American General") to American General stockholders.

OTHER RELEVANT ENTITIES

21. Gen Re is a Connecticut corporation with its principal corporate offices located in Stamford, Connecticut. Gen Re is a holding company for global reinsurance and related risk assessment, risk transfer, and risk management operations. Gen Re became a wholly owned subsidiary of Berkshire Hathaway Inc. on December 21, 1998. Berkshire Hathaway's Class A and Class B common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is traded on the New York Stock Exchange.

22. Capco Reinsurance Company Ltd. ("Capco") was a Barbados company that was a subsidiary of Western General Insurance Ltd. until 2000. Capco was liquidated in 2002.

23. Union Excess Reinsurance Company Ltd. ("Union Excess") is a Barbados reinsurer used by AIG for the purpose of reinsuring certain insurance contracts entered into by AIG.

FACTS

24. In 2000 and 2001, AIG falsely increased its loss reserves, and falsely reported these increases in its financial statements, through two sham transactions whose purpose was to

quell analyst criticism about AIG's declining loss reserves. In addition, AIG entered into at least two other transactions that resulted in misrepresentations in AIG's financial statements.

A. AIG's Internal Review and Restatement

25. On February 10, 2005, the Commission issued a subpoena to AIG in connection with an investigation. The subpoena prompted AIG to commence its own internal investigation.

26. From approximately March through May 2005, AIG conducted an internal review under the direction of its current senior management and with the oversight of AIG's audit committee.

27. On March 14, 2005, AIG announced that its Board of Directors had implemented a management succession plan with the selection of a new president and CEO, who would succeed AIG's then-chairman and CEO. AIG also announced that a new CFO had been selected and would succeed its then-CFO, who had taken a leave of absence. On approximately March 28, 2005, AIG's CEO retired.

28. On March 30, 2005, AIG announced that the filing of its 2004 Form 10-K would be delayed in order to complete an internal review of AIG's books and records that included issues arising from pending regulatory investigations.

29. On May 31, 2005, AIG announced that it had completed its internal review and filed its 2004 Form 10-K. The Form 10-K included a restatement of its financial statements for the years ended December 31, 2000, 2001, 2002 and 2003, and selected quarterly information for the quarters ended March 31, June 30 and September 30, 2003 and 2004, and the quarter ended December 31, 2003. In connection with the restatement, AIG amended its periodic quarterly filings on Form 10-Q for the periods ended March 31, 2003 and 2004 in a 10-Q/A filed on June 28, 2005; for the periods ended June 30, 2003 and 2004 on a 10-Q/A filed on August 9, 2005; and for the period ended September 30, 2004 in a 10-Q filed on November 14, 2005.

30. The restatement resulted in a reduction of consolidated shareholders' equity of $2.26 billion at December 31, 2004.

31. AIG's restatement disclosed the following with respect to certain transactions:

> In many cases these transactions or entries appear to have had the purpose of achieving an accounting result that would enhance measures believed to be important to the financial community and may have involved documentation that did not accurately reflect the true nature of the arrangements. In certain instances, these transactions or entries may also have involved misrepresentations to members of management, regulators and AIG's independent auditors.

32. The restatement summarized several transactions that were accounted for improperly. Among these were two sham reinsurance transactions with Gen Re designed to improperly increase loss reserves.

33. The restatement also briefly addressed several other transactions that resulted in misstatements in AIG's financial statements, including transactions involving Capco and Union Excess.

B. <u>The Sham Gen Re Transactions</u>

34. As a result of analysts' concerns regarding a reduction in AIG's loss reserves in the third quarter of 2000, AIG and Gen Re structured two sham reinsurance transactions. The transactions had as their purpose to provide apparent support for AIG to add a total of $500 million in phony loss reserves to its balance sheet in the fourth quarter of 2000 and the first quarter of 2001.

35. In actuality, the two transactions entailed Gen Re paying $500 million in reinsurance "premiums" in return for AIG's reinsuring a $500 million risk. In other words, the transactions had no economic substance, amounting to a roundtrip of cash, but were designed to

look like genuine reinsurance with the required element of risk transfer, in order to achieve a specific, and false, accounting effect.

36. The only economic benefit to either party was a $5 million fee paid by AIG to Gen Re for putting the deal together – a side deal not reflected in the contracts. The "premiums" due AIG under the terms of the contracts were merely window dressing and were in fact prefunded by AIG to Gen Re in an undisclosed side agreement.

37. Although AIG initiated the transactions, AIG, with Gen Re's assistance, created a phony paper trail to make it appear as though Gen Re had solicited the reinsurance when the parties knew that AIG sought the deal to manipulate its financial statements.

38. As AIG conceded in its restatement, the Gen Re transactions were "done to accomplish a desired accounting result and did not entail sufficient qualifying risk transfer. As a result, AIG has determined that the transaction[s] should not have been recorded as insurance."

39. In its restatement, AIG recharacterized the Gen Re transactions as a deposit instead of as insurance.

1. <u>The Purpose: The False Appearance of Increased Loss Reserves</u>

40. Prior to the Gen Re transactions, on October 26, 2000, AIG issued its third quarter earnings release showing an approximate $59 million decline in general insurance reserves.

41. This reduction in general insurance reserves drew criticism from certain analysts. One analyst wrote: "One concern over the past several quarters has been reserve growth, which has been minimal or even has declined in certain quarters. There has been concern that AIG is releasing reserves to make its numbers." Other analysts voiced similar concerns.

42. At least two analysts downgraded AIG after the earnings release.

43. Following AIG's third quarter 2000 earnings release, issued on October 26, 2000, AIG's stock price dropped 6%.

44. Just a few days later, on approximately October 31, 2000, AIG's then-CEO called Gen Re's then-CEO to propose a transaction whereby Gen Re would transfer $200 million to $500 million of loss reserves to AIG by year-end.

45. In conversations regarding this proposed transaction, AIG's CEO made it clear to Gen Re's CEO that he wanted a transaction involving no risk to AIG. A real transfer of loss reserves to AIG would necessarily have involved AIG's assumption of some risk. However, AIG was one of Gen Re's largest clients and Gen Re wanted to accommodate AIG.

46. Gen Re's CEO turned to several Gen Re senior executives, including Gen Re's then-CFO, to work out the details of the transaction.

47. AIG's CEO turned to an AIG senior executive to act as the AIG point person in structuring the deal.

48. On November 1, 2000, a Gen Re executive sent an email to Gen Re officials confirming that he spoke with the AIG senior executive assigned to the deal and that AIG "only want[s] reserve impact" from the deal "to address the criticism [AIG] received from the analysts" in the third quarter of 2000. In subsequent communications, AIG and Gen Re executives further discussed the fundamental elements of the deal.

49. AIG and Gen Re then fashioned two contracts between National Union Fire Insurance Company of Pittsburgh, PA ("National Union"), an AIG subsidiary, and Cologne Re Dublin ("CRD"), a Dublin, Ireland-based subsidiary of a Gen Re subsidiary. These purportedly were retrocession contracts, or contracts in which a reinsurer cedes to another reinsurer all or part of a reinsured risk it previously assumed – in other words, reinsurance of reinsurance.

50. Under the terms of the contracts, National Union purportedly reinsured CRD for up to $600 million in losses ($300 million per contract). In consideration for the reinsurance from National Union, CRD was obligated to pay $500 million in premiums ($250 million per contract). In actuality, both parties had agreed that AIG would not have to pay any losses under the contracts, even though the contracts were written to appear as if AIG could incur $100 million in losses.

51. These sham contracts became the vehicle for adding loss reserves to AIG's financial statements. Without the phony loss reserves added to AIG's balance sheet and touted in its earnings releases, AIG's earnings releases would have shown continued reductions in loss reserves for the fourth quarter of 2000 and the first quarter of 2001, instead of $500 million of additional loss reserves.

2. <u>Reinsurance Accounting Principles</u>

52. The sole purpose of these transactions was to make it appear as though Gen Re was purchasing reinsurance from AIG so that AIG could record loss reserves associated with the reinsurance contracts.

53. Had this been real reinsurance involving a real transfer of risk, AIG would have been entitled to record reserves in the amount of the loss that was probable and reasonably estimable under generally accepted accounting principles ("GAAP"). Under Statement of Financial Accounting Standards ("FAS") No. 113, a reinsurer may record a loss reserve pertaining to a reinsurance contract only when the reinsurer is assuming significant insurance risk (underwriting and timing risk) and it is reasonably possible that the reinsurer may realize a significant loss for the transaction.

54. When there is insufficient risk transfer, a transaction may not be treated as insurance for GAAP purposes, but rather must be accounted for using the deposit method, which has no effect on loss reserves. Deposit accounting simply reflects that one party owes funds to another party.

55. AIG's contracts with Gen Re, through their subsidiaries National Union and CRD, were not real reinsurance contracts, because AIG assumed no risk. The only economic benefit to either party was a $5 million fee that AIG paid to Gen Re for putting the sham transactions together.

56. Because the transactions had no substance, AIG should not have increased its reserves at all. At best, AIG should have recorded the transactions as deposits on its books – *i.e.*, as money owed to Gen Re – which would have had no effect on AIG's reserves.

57. By accounting for the transactions as if they were genuine reinsurance contracts, AIG inflated its reserves for losses and loss expense by $500 million and its premiums and other considerations by $500 million in total.

3. <u>The Structure of the No Risk Deal</u>

58. The transactions consisted of two contracts. The first contract had an effective date of December 1, 2000. The second contract had an effective date of March 31, 2001.

59. Under these contracts, National Union purportedly reinsured CRD for up to $600 million in losses ($300 million per contract). In consideration for the reinsurance from National Union, CRD was obligated to pay $500 million in premiums ($250 million per contract).

60. The contracts did not reflect the actual arrangement. As the AIG and Gen Re executives who were involved understood, this was to be a riskless transaction for both AIG and Gen Re.

61. Although on the face of the contracts National Union appeared to assume $100 million of risk over and above the $500 million in premiums CRD was obligated to pay, this extra $100 million of risk was pure fiction added to make it appear that the contracts transferred risk to National Union, as AIG understood.

62. In fact, National Union assumed no risk and CRD incurred no premium liability. Of the $500 million in premiums set forth in the contracts, $490 million was on a "funds withheld" basis (*i.e.*, the money was never paid to National Union but was retained by CRD). CRD was supposed to pay the remaining $10 million to National Union according to the contracts, but AIG "prefunded" this portion of the contractual premium amount in a side deal that was not reflected in the contracts.

63. Hence, neither AIG nor Gen Re could profit or lose from the transactions except for the $5 million fee AIG agreed to pay Gen Re for its trouble.

4. <u>AIG and Gen Re Concealed Payments Through Undisclosed Side Agreements</u>

64. AIG concealed undisclosed side agreements that revealed the true nature of the transaction.

65. Gen Re did not want to give National Union $10 million in purported premiums until AIG prefunded that amount to Gen Re, plus Gen Re's fee for doing the deal. The AIG executive assigned to the transaction proposed a solution to this problem to Gen Re: AIG and Gen Re would enter into a purportedly unrelated transaction to conceal the payment by AIG.

66. The unrelated transaction, which was finalized by the AIG senior executive in December 2001, involved an existing reinsurance contract between Gen Re and another AIG subsidiary, Hartford Steam Boiler Inspection and Insurance Company ("HSB").

67. Gen Re held over $30 million in an account that would be owed to HSB if that unrelated reinsurance contract were commuted, which is insurance parlance for "terminated."

68. The AIG senior executive proposed that the parties use the HSB money to prefund the $10 million premium and pay the $5 million transaction fee for the Gen Re transactions.

69. AIG and Gen Re decided to commute the HSB contract and distribute approximately $15 million from the account to Gen Re, $10 million of which would be later paid to National Union by CRD as premiums, with the remaining $5 million to compensate Gen Re for doing the deal. In other words, an AIG subsidiary, HSB, in effect paid another AIG subsidiary, National Union, the $10 million in premiums purportedly owed by CRD under the contracts between CRD and National Union.

70. AIG and Gen Re, through senior officers of each company, developed three additional sham contracts to effect the transfers of the funds in the HSB account and mask the funding for the AIG/Gen Re transactions.

71. First, HSB and Gen Re executed a commutation agreement on December 21, 2001. Under the agreement, Gen Re was expressly obligated to pay $7.5 million to HSB (compared to the over $30 million HSB otherwise would have been entitled to receive).

72. Second, National Union and Gen Re executed a retrocession agreement on December 27, 2001. Under its terms, National Union agreed to reinsure Gen Re for any losses Gen Re became obligated to pay under its reinsurance contract with HSB. This was the very reinsurance contract that Gen Re and HSB had commuted just a few days earlier, eliminating the possibility that Gen Re could incur any losses under it. Nevertheless, Gen Re paid National Union approximately $9.1 million in "premiums" under their meaningless reinsurance contract,

thus concealing the true reason for the transfer of the $9.1 million and obscuring that their source was the HSB account.

73. Third, Gen Re and CRD entered into a sham reinsurance contract whereby CRD would pay $400,000 in purported premiums to Gen Re for $13 million in supposed reinsurance coverage. This sham contract was intended to mask the purpose of the transfer of $12.6 million from the HSB account from Gen Re to CRD, $10 million to prefund the premiums that CRD would pay to National Union plus approximately $2.6 million for CRD's portion of the fee Gen Re charged for putting the transaction together ($5 million as originally agreed plus $200,000 characterized as interest), for the two original agreements with National Union. On December 28, 2001 Gen Re paid $12.6 million to CRD as "loss payments" due under this newly created reinsurance contract. Gen Re kept the remaining approximately $2.6 million as its share of the transaction fee. That same day, CRD transferred $10 million to National Union for the premium supposedly due under the agreements.

74. The AIG and Gen Re executives who had proposed and developed the structure of these sham contracts understood that these contractual contortions were intended merely to mask the real reason for the transfer of funds between AIG and Gen Re.

5. <u>AIG Knew the Gen Re Transactions Conveyed No Risk</u>

75. From its inception, AIG's deal with Gen Re was designed to convey no risk. As AIG's then-CEO and as its senior executives working on the transactions understood, the transactions did not constitute genuine reinsurance that would have allowed AIG to add loss reserves to its financial statements.

76. AIG's CEO made it clear to Gen Re's CEO that he was seeking a transfer of loss reserves in a risk-free transaction.

77. Furthermore, AIG and Gen Re entered into side agreements under which neither AIG nor Gen Re could profit or lose except for the $5 million fee AIG agreed to pay Gen Re for its trouble.

78. Contrary to what a company reinsuring losses would have done if the deal were legitimate, AIG did not perform any due diligence regarding the underlying losses it was supposedly reinsuring, did not seek or receive any claims or reports on loss activity during the course of the contracts, and did not even maintain an underwriting file for the two contracts with CRD.

79. The AIG and Gen Re executives involved in the transaction also understood that the accounting for the transaction would not be "symmetrical," that is, that AIG and Gen Re would account for it differently. AIG planned to account for the transactions using reinsurance accounting principles to improperly add loss reserves to AIG's balance sheet. AIG understood that Gen Re planned to use deposit accounting, because no risk was conveyed.

7. **The Sham Paper Trail**

80. In another effort to conceal a key aspect of the transaction, AIG and Gen Re deliberately created a sham paper trail suggesting that Gen Re, not AIG, had initiated the transaction.

81. The paper trail was designed to make it look as though Gen Re had solicited the contracts, when, in fact, AIG solicited the deal to manipulate its loss reserves.

82. The paper trail idea was first raised in a December 8, 2000 email in which a senior Gen Re executive wondered: "Do we need to produce a paper trail offering the transaction to the client?"

83. Another Gen Re senior executive and the AIG executive assigned to the deal discussed the idea later that day. AIG decided that it wanted a paper trail, according to another Gen Re email dated December 8, 2000.

84. As part of the paper trail, Gen Re faxed AIG an offer letter and draft contract on December 18, 2000. The offer letter falsely suggested that CRD was asking for AIG's "help" and "support."

85. Later, on December 27, 2000, Gen Re emailed another cover letter for the paper trail that made it appear as if CRD had solicited the transaction. Once again, this letter falsely indicated that CRD was asking AIG to "provide us with cover" and "to support the cover."

86. In a recorded telephone conversation with two senior Gen Re executives on December 28, 2000, the AIG executive assigned to the deal confirmed receipt of Gen Re's December 27, 2000 letter. He told them he expected to send a reply email that day accepting the proposal.

87. In the same conversation, the AIG executive said that he did not need any further documentation by year-end to book the transaction as a year 2000 transaction, and that once he sent his reply email accepting the offer, the "paper trail" would be complete.

88. The AIG executive sent his reply email completing the paper trail later that evening.

8. AIG Improperly Added Loss Reserves to Its Financial Statements

89. AIG accounted for the agreements between National Union and CRD as if they were real reinsurance contracts that transferred risk from Gen Re to AIG. In fact, AIG, through its senior executives involved in the transactions, knew that there was no such risk transfer and that the transactions in reality had no economic substance and provided no up- or downside to

either party (other than the undisclosed $5 million fee AIG paid to Gen Re to create the sham transactions).

90. By accounting for the contracts as if they were real reinsurance (*i.e.*, not shams), AIG falsely inflated its Reserves for Losses and Loss Expense by $250 million and its Premiums and Other Considerations by $250 million in the financial statements contained in the Form 10-K for the year ended December 31, 2000, which AIG filed with the Commission on April 2, 2001. Similarly, AIG falsely inflated its Reserves for Losses and Loss Expense by an additional $250 million and its Premiums and Other Considerations by $250 million in the financial statements contained in the Form 10-Q for the quarter ended March 31, 2001, which AIG filed with the Commission on May 15, 2001. AIG also falsely inflated its Reserves for Losses and Loss Expense by $500 million and its Premiums and Other Considerations by $500 million in total in the financial statements contained in the Form 10-K for the year ended December 31, 2001, which AIG filed with the Commission on April 1, 2002.

91. In connection with its acquisition of American General and its distribution of shares to American General shareholders, AIG filed a registration statement on Form S-4 on June 8, 2001, which incorporated by reference AIG's Form 10-K for 2000 and its Form 10-Q for the first quarter of 2001.

92. The sham loss reserves remained on AIG's financial statements filed with the Commission, improperly boosting AIG's loss reserves by $500 million, until the first contract was commuted in November 2004 (AIG's loss reserves were then decreased by $250 million) and until AIG restated its accounting for the transaction on May 31, 2005 (at which time the $500 million were restated as deposits). On August 1, 2005, Gen Re notified AIG that it cancelled the second contract.

9. AIG's Materially False Earnings Releases

93. On February 8, 2001, AIG issued its fourth quarter 2000 earnings release. The release reflected the impact of the first Gen Re contract.

94. The earnings release quoted AIG's then-CEO, who touted the increased loss reserves: "AIG had a very good quarter and year.... We added $106 million to AIG's general insurance net loss and loss adjustment reserves for the quarter, and together with the acquisition of HSB Group, Inc., increased the total of those reserves to $25.0 billion at year-end 2000."

95. Analysts reacted favorably to the added reserves. A February 9, 2001 analyst report opined: "We think this quarter was a good example of AIG doing what it does best: growing fast and making the numbers.... As important was the change in reserves: AIG added $106 million to reserves and the paid/incurred ratio fell to 97.1%, the lowest level since the first quarter of 1999."

96. On April 26, 2001, AIG issued its first quarter 2001 earnings release. The release reflected the impact of the second Gen Re contract.

97. AIG's then-CEO again touted AIG's additions to its loss reserves in this release: "AIG had a solid first quarter.... We added $63 million to AIG's general insurance net loss and loss adjustment reserves for the quarter, bringing the total of those reserves to $25.0 billion at March 31, 2001."

98. Once again, analysts appeared to be pleased with the added reserves.

99. Without the phony loss reserves, AIG's reported loss reserves would have been $250 million lower in the fourth quarter of 2000 and $500 million less in the first quarter 2001.

100. Because the loss reserves added to AIG's balance sheet were phony, the $106 million increase to reserves touted in AIG's fourth quarter 2000 earnings release in reality

was a $144 million decrease in reserves, and the $63 million increase in reserves touted in AIG's first quarter 2001 earnings release was in reality a $187 million decrease in reserves.

C. Other Accounting Misrepresentations

101. AIG's restatement reflects 65 other items, the accounting for which AIG determined was incorrect and required restatement. Among other things, these instances of improper accounting include the Capco and Union Excess transactions and five additional categories. The improper accounting has led to additional restatements and the necessity of ongoing remediation activities by AIG.

1. The Capco Transaction

102. In 2000, AIG concocted a scheme to conceal approximately $200 million in underwriting losses in its general insurance business by improperly converting them to capital (or investment) losses that were not in AIG's general insurance business and therefore would be less embarrassing to AIG.

103. AIG structured a sham transaction designed to convert underwriting losses to investment losses by moving them to an off-shore entity, Capco, a Barbados reinsurer. Capco's preferred shareholder was an AIG subsidiary, American International Reinsurance Company, Ltd. ("AIRCO"). Capco also had nominally independent common shareholders. AIG funded the contributions of certain of these shareholders.

104. AIG ceded underwriting losses to Capco, through another AIG subsidiary, depleting Capco's capital. In turn, AIRCO recognized capital losses on its investment in Capco.

105. AIG did not consolidate Capco's results in AIG's financial statements; consolidation would have eliminated the effect of the fraud.

106. In its restatement, AIG admitted that the transactions "involved an improper structure created to recharacterize underwriting losses relating to auto warranty business as

capital losses. That structure ... appears to have not been properly disclosed to appropriate AIG personnel or its independent auditors."

107. In addition, AIG conceded that its internal controls:

> were not effective to prevent certain members of senior management, including the former Chief Executive Officer and former Chief Financial Officer from having the ability, which in certain instances was utilized, to override certain controls and effect certain transactions and accounting entries. In certain of these instances, such transactions and accounting entries appear to have been largely motivated to achieve desired accounting results and were not properly accounted for in accordance with GAAP....Specifically, this control deficiency permitted the following [including]:
>
> Creation of Capco, a special purpose entity used to effect transactions that were recorded to convert, improperly, underwriting losses to investment losses and that were not correctly accounted for in accordance with GAAP, resulting in a misstatement of premiums and other considerations, realized capital gains (losses), incurred policy losses and benefits and related balance sheet accounts.

108. The Capco scheme was an improper effort to convert underwriting losses to capital losses in violation of GAAP and without disclosure to AIG's auditors, as the restatement acknowledged.

2. **The Union Excess Transactions**

109. In 1991, AIG established Union Excess, an offshore reinsurer, to which it ultimately ceded approximately 50 reinsurance contracts for its own benefit.

110. Although AIG controlled Union Excess, it improperly failed to consolidate Union Excess's financial results with its own. AIG also took steps to conceal its control over Union Excess from its auditors and regulators.

111. As a result, AIG derived a number of advantageous but improper financial results from its reinsurance cessions to Union Excess. In particular, Union Excess was used to

"reinsure" certain AIG liabilities. It was treated as an independent entity, which enabled AIG to reduce, improperly and in material amounts, the amount of expense associated with the underlying insurance. These financial benefits would have evaporated if AIG had consolidated Union Excess's results.

112. AIG established Union Excess for an improper purpose, concealed the true nature of its relationship with Union Excess from auditors and regulators, and fraudulently improved its financial results by ceding reinsurance to Union Excess.

113. In its restatement, AIG admitted that, based on AIG's control over Union Excess and the lack of intent to transfer risk, the accounting for the transaction was improper. AIG should have consolidated Union Excess on its financial statements. The benefits of the Union Excess relationship would thus have been eliminated. AIG's restatement acknowledges that AIG controlled Union Excess.

114. Specifically, the restatement conceded that:

> AIG has concluded, based on documents and information identified during the course of the internal review, that reinsurance ceded to Union Excess Reinsurance Company, Ltd., a Barbados-domiciled reinsurer (Union Excess), did not result in risk transfer because of AIG's control over certain transactions undertaken directly or indirectly with Union Excess, including the timing and nature of certain commutations. Eliminating the cessions reduces reinsurance assets, effectively eliminates the inherent discount related to the loss reserves ceded under the contracts, and increases net premiums and losses. It should be noted that any income earned on the deposit assets in future periods would increase net investment income in those periods.
>
> In addition, as a result of certain facts and circumstances related to the formation of Union Excess, as well as certain relationships with Starr International Company, Inc. (SICO), Union Excess is now included in AIG's consolidated financial statements. The facts and

> circumstances surrounding SICO's involvement with Union Excess were not properly reflected in AIG's books and records, were not known to all relevant AIG financial reporting personnel and, AIG now believes, were not known to AIG's independent auditors. For example, a significant portion of the ownership interests of Union Excess shareholders are protected against loss under financial arrangements with SICO. Additionally, from its formation in 1991, Union Excess has reinsured risks emanating primarily or solely from AIG subsidiaries, both directly and indirectly. Further, it appears that the employees responsible for the reinsurance related to Union Excess managed that relationship to prevent significant losses or gains to Union Excess so that substantially all of the risks and rewards of the underlying reinsurance inured to AIG. This relationship allowed AIG to absorb substantially all the economic returns, which in turn caused Union Excess to be deemed a variable interest entity (VIE).

115. AIG's restatement consolidated Union Excess's financial results with its own.

3. Risk Transfer

116. AIG concluded that certain transactions – including but not limited to the Gen Re and Union Excess transactions – did not have the sufficient risk transfer necessary to qualify for reinsurance accounting. AIG has since restated the accounting for these transactions using deposit, rather than reinsurance, accounting.

4. Net Investment Income

117. AIG determined that certain transactions and investment strategies that were entered into in order to enhance net investment income had been accounted for incorrectly. The restatement admitted that certain transactions or strategies were "initiated to increase net investment income." In other cases, AIG accounting staff had incorrectly characterized transactions or reclassified certain items to increase net investment income or accrued net investment income on anticipated realizations of gains or carried interest. AIG reversed the accounting in its restatement.

5. Top-Level Adjustments

118. A number of accounting entries, originating at the parent company level and directed by former senior management, were unsupported and had the effect of reclassifying income statement items and changing the presentation of certain financial measures. In some cases, top-level entries were made at the parent level affecting subsidiaries without the knowledge of the subsidiaries' management. In other cases, management either was aware of the entries or the entries were subsequently "pushed-down" to the subsidiaries.

119. The effect of these entries included reclassifying capital gains to net investment income, increasing expense deferrals or reducing accruals, both having the effect of increasing reported earnings, and reducing and increasing reserves. The restatement reversed all unsupported "top-level" entries from January 1, 2000 through December 31, 2004.

6. Conversion of Underwriting Losses to Capital Losses

120. AIG's restatement identified certain transactions and entries that had the principal effect of improperly recharacterizing underwriting losses as capital losses, including but not limited to the Capco transactions. This category also included insurance and reinsurance transactions in which AIG's accounting resulted in errors relating to the timing and classification of income recognition and errors relating to the timing of premium recognition. AIG's restatement conceded that the improper accounting had an effect on underwriting losses in each year. The restatement reversed the accounting by converting the capital losses back into underwriting losses.

7. **Asset Realization**

121. AIG concluded that adjustments needed to be made to the value of certain assets on its consolidated balance sheet – for example, receivables for which certain doubtful accounts and other accruals were neither properly analyzed nor reconciled in prior periods and for which allowances were not properly recorded in AIG's consolidated financial statements. According to the restatement, certain of these items were known by members of former senior management but were not previously disclosed to AIG's independent auditors. The restatement made these adjustments to the value of the assets.

FIRST CLAIM FOR RELIEF
Violations of Section 17(a)(1) of the Securities Act

122. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

123. AIG, in the offer and sale of securities, by the use of the means and instruments of transportation and communication in interstate commerce or by the use of the mails, directly or indirectly, singly or in concert, has employed or is employing devices, schemes and artifices to defraud.

124. AIG knew or was reckless in not knowing of the activities described above. The knowledge and conduct of its senior officers are attributable to AIG.

125. By reason of the foregoing, AIG has violated, and unless enjoined will again violate, Section 17(a)(1) of the Securities Act [15 U.S.C. § 77q(a)(1)].

SECOND CLAIM FOR RELIEF
Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

126. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

127. AIG, in the offer and sale of securities, by the use of the means and instruments of transportation and communication in interstate commerce or by the use of the mails, directly or indirectly, singly or in concert, has obtained or is obtaining money and property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and has engaged or is engaging in transactions, practices or courses of business which have operated or would operate as a fraud and deceit upon investors.

128. By reason of the foregoing, AIG has violated, and unless enjoined will again violate, Sections 17(a)(2) and (3) of the Securities Act [15 U.S.C. §§ 77q(a)(2) and (3)].

<u>THIRD CLAIM FOR RELIEF</u>
Violations of Section 10(b) of the Exchange Act and Rules 10b-5(a), 10b-5(b), and 10b-5(c)

129. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

130. AIG, in connection with the purchase and sale of securities, by the use of the means and instrumentalities of interstate commerce or of the mails, directly or indirectly, singly or in concert, has employed or is employing devices, schemes and artifices to defraud; has made or is making untrue statements of material fact and has omitted or is omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and has engaged or is engaging in acts, practices and courses of business which have operated or would operate as a fraud and deceit upon investors.

131. AIG knew or was reckless in not knowing of the activities described above. The knowledge and conduct of its senior officers are attributable to AIG.

132. By reason of the activities herein described, AIG has violated, and unless enjoined will again violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5(a), (b) and (c) promulgated thereunder [17 C.F.R. § 240.10b-5(a), (b) and (c)].

FOURTH CLAIM FOR RELIEF
Violations of Rule 13b2-1 of the Exchange Act

133. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

134. AIG, directly or indirectly, singly or in concert, falsified or caused to be falsified its books, records and accounts that were subject to Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

135. By reason of the foregoing, AIG has violated, and unless enjoined will again violate, Rule 13b2-1 of the Exchange Act [17 C.F.R. § 240.13b2-1].

FIFTH CLAIM FOR RELIEF
Violations of Section 13(a) of the
Exchange Act and Rules 12b-20, 13a-1 and 13a-13

136. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

137. AIG did not file with the Commission such financial reports as the Commission has prescribed, and AIG did not include, in addition to the information expressly required to be stated in such reports, such further material information as was necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading, in violation of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1 and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1 and 240.13a-13].

138. By reason of the foregoing, AIG has violated, and unless enjoined will again violate, Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1 and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1 and 240.13a-13].

SIXTH CLAIM FOR RELIEF
Violations of Sections 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act

139. Paragraphs 1 through 121 are realleged and incorporated by reference as if set forth fully herein.

140. AIG did not:

a. make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected the transactions and dispositions of its assets; and

b. devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

i. transactions were executed in accordance with management's general or specific authorization;

ii. transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets;

iii. access to assets was permitted only in accordance with management's general or specific authorization; and

iv. the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

141. Furthermore, AIG knowingly circumvented or knowingly failed to implement a system of internal accounting controls and knowingly falsified books, records, and accounts described above.

142. By reason of the foregoing, AIG has violated, and unless enjoined will again violate, Sections 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B), and 78m(b)(5)].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests a Final Judgment:

I.

Permanently enjoining AIG, its agents, servants, employees and attorneys and all persons in active concert or participation with AIG who receive actual notice of the injunction by personal service or otherwise, and each of them, from future violations of Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(1), 77q(a)(2), 77q(a)(3)], Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act [15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A), 78m(b)(2)(B), and 78m(b)(5)] and Rules 10b-5(a), 10b-5(b), 10b-5(c), 12b-20, 13a-1, 13a-13, and 13b2-1 [17 C.F.R. §§ 240.10b-5(a), 240.10b-5(b), 240.10b-5(c), 12b-20, 13a-1, 13a-13, and 13b2-1].

II.

Ordering AIG to disgorge any ill-gotten gains from the conduct alleged herein.

III.

Ordering AIG to pay civil money penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

IV.

Granting such other and further relief as to this Court seems just and proper.

Dated: New York, New York
February 9, 2006

By: ______________________
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