



The FIRST Database Focuses on Asia

We completed the spring round of user group meetings last month in Frankfurt, New York, and London. The user groups are primarily held to bring our ever-growing user community together to discuss present and future developments and how the content in the database is being deployed in a variety of creative ways by our user base. We also use the sessions as an opportunity to make sure our priorities and focus are in alignment with those of our users. We listened when our users told us during the last round of sessions that they wanted more coverage of events that occurred in Asia.

As a result we have assigned one of our researchers to focus on Asian events. Observant users of the database may have noticed this new development. We added or revised 115 events during the month of May; of this amount, almost half occurred in Asia, with the others primarily in North America and Europe. We are also reviewing our coverage of Latin America and hope to have an exciting new announcement next month concerning coverage of this geography.

This month we have selected a handful of cases from the region of Asia that we believe are representative of some of the issues we see in the database: fraud hazards associated with outsourcing in the region; complicated political issues that become entangled with operational risks; market and credit risk events with underpinnings of corporate governance; and operational risk issues and data privacy.

We also provide coverage this month of the unfolding AIG event. Eliot Spitzer and the New York Insurance Commissioner released their complaint against the company during the later part of May. It is a document worth reading, including the voluminous exhibits. For those in other industries, the document provides an introduction to the insurance industry, how it books its revenue, and the important difference between reporting underwriting vs. investment losses.

LATE BREAKING NEWS: ELIOT SPITZER AND THE NEW YORK STATE INSURANCE SUPERINTENDENT FILE A COMPLAINT AGAINST AIG, MAURICE GREENBERG AND FORMER CFO HOWARD SMITH

The Attorney General's Office of the State of New York, under the guidance of Eliot Spitzer, and State Insurance Superintendent Howard Mills announced on May 26, 2005 that they had lodged a suit against AIG and two former senior executives: ex-CEO and Chairman Maurice R. Greenberg and former Chief Financial Officer Howard I. Smith. The suit is the culmination of a series of investigations undertaken by Eliot Spitzer, the New York State Insurance Office, and the Securities and Exchange Commission. The present suit also opens a new investigation into the activities at AIG involving how the insurer booked worker's compensation premiums. AIG has previously announced plans to restate over \$2 billion of its reported earnings.

The lawsuit lodged against AIG attributed specific improprieties directly to Maurice Greenberg and relies heavily on email correspondence to corroborate its case. The Attorney General's complaint, through a series of published emails, paints a portrait of Greenberg who was personally involved in almost every detail of the company and was particularly preoccupied with the company's share price. The complaint presents evidence that Greenberg directed staff members to take actions that would directly prop-up the company's share price or improve its earnings through the use of offshore transactions and finite insurance.

The improper transactions cited in the complaint include: the transfer of losses experienced by an auto warranty unit to an offshore entity; the improper linkage of another set of losses to a Taiwanese subsidiary despite their occurrence within a Brazilian unit; the reporting of false underwriting income through the purchase of life insurance policies; and repeated balance sheet deception through ties to offshore entities. The suit also mentions a newly uncovered scheme involving improperly booked worker's compensation premiums. According to the complaint, this allowed the company to book revenue in such a way that its tax burden was reduced.

The complaint portrays a culture within AIG where it was the norm to shift losses around – primarily to offshore entities – so that they were not under the immediate microscope of regulators, investors and analysts. In general, underwriting losses receive more scrutiny than investment losses, because they suggest there are problems with the insurer's business and actuarial models. Hence, AIG is alleged to have created a number of guises in order to present actual underwriting losses as investment losses, such as creating an offshore reinsurance company to cover up \$210 million in losses associated with its auto warranty policies. It created the offshore entity, dumped the losses into it and then let it fail so that it could write it off as an investment loss.

Eliot Spitzer commented on the complaint: "The irony of this case is that AIG was a well-run and profitable company that didn't need to cheat. And yet, the former top management routinely and persistently resorted to deception and fraud in an apparent effort to improve the company's financial results." (see event #5674 for the complete case study.)

There are a number of investigations currently underway into the corporate structure, use of reinsurance and alternative insurance products, stock manipulation, offshore entities, and compensation at AIG. The following provides an overview of recent AIG cases covering these issues from the FIRST database:

Event #5618: Eliot Spitzer and the New York State Attorney General's Office are investigating whether AIG's former CEO and Chairman, Maurice Greenberg, illegally manipulated his company's share price through the purchase of shares during his final days of leadership.

Event #5523: A group of regulators are presently investigating whether AIG inappropriately used finite reinsurance contracts – issued by two alleged affiliates – as tools for hiding losses, managing earnings and qualifying for special insurance accounting treatments.

Event #5522: Evidence emerged following AIG's acquisition of American General in 2001 that Maurice Greenberg may have pressured the CEO of the New York Stock Exchange to maintain AIG's stock price within a narrow price range, in order to limit the cost of the acquisition.

Event #5519: Eliot Spitzer is in the process of considering reopening an investigation, closed by Delaware regulators in the mid-1990s, that was looking into AIG's relationship with Coral Reinsurance – an entity set up in the mid-1980s to assist with AIG's need for excess capacity.

Event #5516: Regulators and shareholders are scrutinizing AIG private entities, C.V. Starr and Starr International, for improper market practice activities, self-dealing and related-party transactions.

Event #5486: AIG announced in mid-February 2005 that it had received subpoenas from the US Securities and Exchange Commission and the New York Attorney General's Office regarding two finite insurance contracts it had entered into in 2001 with Berkshire Hathaway's subsidiary, General Re.

Event #5179: Eliot Spitzer announced on October 14, 2004 that he had launched an investigation against insurance broker, Marsh & McLennan Companies, into an alleged conflict of interest related to contingent commissions. The insurance broker is accused of steering insurance business to preferred underwriters, including AIG, in exchange for millions of dollars in what the Attorney General has characterized as "kickbacks." Several AIG executives have been arrested in this case and pled guilty.

Event #5170: AIG announced on November 23, 2004 that it had agreed to pay \$126,366,000 in order to settle allegations that it had assisted two companies with committing alleged accounting fraud.

Event #4592: In a case that presents an insurance model for "roundtrip" transactions and accounting irregularities, the Securities and Exchange Commission announced on September 11, 2003 an enforcement action against AIG. AIG consented to the SEC's finding of securities fraud related to a nontraditional policy that it crafted for Brightpoint Inc. and agreed to pay a \$10 million fine.

AND NOW ON TO ASIA...

STANDARD CHARTERED BANK

Standard Chartered found itself in the center of an employment related case that included allegations of money laundering and unlawful sale of securities in the Philippines. The case ultimately led the Philippines' National Labor Relations Committee to order the bank to pay an ex-executive P16.2 million (USD \$299,556) in back pay and benefits; the bank settled charges of unlawful selling of unregistered global mutual fund shares with the country's Securities and Exchange Commission for P7 million (USD \$126,720).

This case originally unfolded in 2003 when senior executive Manuel Baviera accused the bank of selling unregistered dollar-denominated mutual funds; the allegations led to a settlement with the Philippines Securities and Exchange Commission (PSEC) for P7 million in January 2004. The settlement followed a cease and desist order by the PSEC in December 2003 that included a ban on the further sale of Third Party Global Mutual Funds (TPGMF) that are not registered with the SEC.

Manuel Baviera originally brought the sale of the unregistered mutual funds to the attention of Philippines regulators; the bank had already been ordered to “exclude investments in global mutual funds issues abroad in its trust investment portfolio unless the same is registered with the SEC.” At least 600 investors bought shares in the unregistered global mutual funds as of February 2001. Mr. Bariera also alleged that the bank had engaged in illegal money laundering. His charges led to the PSEC lodging a formal cease and desist order against the bank and the filing of charges against a host of senior officials located in London and Asia.

In its own defense, the bank claimed that it was simply a “passive order taker” of buy orders for shares in the unregistered global funds. The SEC, however, countered that employees of the bank had sales quotas to meet and were encouraged to actively market the funds to the public. Standard Chartered fired executive Manuel Baviera after it determined that he had breached the bank’s code of confidentiality; it further stated that Mr. Baviera had violated his duty of trust to the bank when he used confidential documents for the purpose of furthering his own personal gain.

This complicated case led to a decision of the National Labor Relations Committee to treat Mr. Baviera as a “whistle-blower” and for Standard Chartered to reinstate the former executive to his previous position “without loss of seniority, right, privileges and benefits.” In a 35-page decision, the labor committee determined that Standard Chartered employed a “retaliatory act of termination” after Mr. Baviera “refused to be intimidated.”

The National Labor Relations Commission tried to bring the case to a conclusion in March 2005 when it ordered the bank to pay Mr. Baviera P16.2 million, which included full back wages and benefits that had accumulated from the time of his dismissal to the present. Standard Chartered publicly announced that it would challenge the employment commission’s decision and that it intended to take action to “rectify the errors.” A representative with the bank said that he hoped “the facts will prevail and that this initial decision will be overturned.”

Although this event appears to be a “messy embarrassment” for Standard Chartered, unless new evidence is uncovered it appears to

be primarily a compliance-related case that has already been settled with regulators for a relatively modest amount. Regardless of Mr. Baviera’s motives in suing the bank, the largest impact of the incident may be on the Philippines itself, which could be viewed as an inhospitable and difficult country for foreign banks to operate in. Standard Chartered is the oldest foreign bank in the country, and the difficulties it is experiencing could cause other future entrants to be scared off by the dramatic headlines and charges of money laundering. (See event #5635 for the complete case study.)

MICHINOKU BANK LTD

In what represents the most severe data loss case for a Japanese institution to date, Michinoku Bank Ltd. announced that it lost three CD-ROM disks containing confidential information on 1.31 million of its individual and corporate customers, or almost its entire client base. On April 20, 2005, Michinoku Bank reported that the three CD-ROMs containing private information including names, addresses, telephone numbers, ages, dates of birth and loan/deposit amounts of clients were missing.

While bank officials are unsure as to exactly how the CD-ROMs were misplaced, some executives suspect that they were mistakenly discarded within the bank. The disks were delivered to the bank’s operation center in Aomori, Japan on April 12, 2005. However, eight days later the disks were nowhere to be found.

While Michinoku Bank suspects that the likelihood of a data leak is “quite low” due to the security safeguards on the CD-ROMs themselves, officials have said that the bank will discontinue its practice of sending data from its center to departments located elsewhere. Japan’s regulator, the Financial Services Agency (FSA), has also urged the bank to draft a report of the event and adopt stricter measures to ensure that this type of breach does not happen again.

In Japan, there have been a number of losses of data at financial institutions that have caused alarm for bank customers and regulators alike. In an environment where technology is used to safeguard customer confidentiality and prevent identity theft, events such as these are having a negative impact on customer confidence. And there is enough anecdotal evidence to support their concerns. In Asia, Aozora Bank lost data on 26,000 of its customers (event #5623); Mizuho Bank lost microfilm containing information on 270,000 account holders (event #5538); and Citibank Japan lost a magnetic tape containing information on 120,000 customers (event #4862).

As a measure to reduce the frequency of these types of events, Japan's Personal Information Protection Act of 2003, which originally applied only to the government, came into force for private sector entities effective April 1, 2005. The implication for financial institutions is that they are now subject to the provisions of the Act as well as the penalties for violating it.

In late May 2005, financial authorities instructed Michinoku Bank to improve the security measures it uses to safeguard customer data. It is the first such order issued by financial authorities under the newly expanded Personal Information Protection Act. Michinoku Bank received two similar orders in previous years: one in June 2002, following its failure to identify dubious money transfers to Chile (see event #5633), and another in September 2003 after a bank employee embezzled a customer's deposits (see event #5622 for the complete discussion of this case).

CITIBANK

In an event highlighting the risk of off-shoring services, four Citibank customers were defrauded out of approximately \$425,000 by call center employees in India. Authorities allege that several former and current employees of Mphasis BFL Ltd., an outsourcing firm used by Citigroup for customer service support, obtained personal account information including PIN numbers of Citibank customers which were then used to conduct a number of unauthorized fund transfers.

Indian authorities arrested three former call center employees and thirteen of their associates on April 9, 2005 over allegations that they misused confidential financial information and illegally withdrew money from the accounts of four New York-based Citibank customers. The conspirators had reportedly persuaded Citibank customers who called the help center to disclose information that would make their accounts accessible. Funds were then siphoned from these accounts via the international wire transfer system.

In a number of instances, the Mphasis employees allegedly arranged for their associates to call from public telephones in order to authorize fund transfers. The fraud surfaced when Citibank customers complained about discrepancies in their accounts, and the activity was subsequently traced to a call centre in Pune, India.

Nine of the suspects have been detained by authorities and are being questioned for their role in the fraud and a further seven have been remanded to judicial custody. Meanwhile, Mphasis BFL Ltd, the Indian IT firm at the centre of the theft, defended its security procedures and branded the victims "gullible" and "careless" for handing over their PIN numbers. The company later disclosed that the fraud involved three of its former employees who had left the company at the end of December 2004, and a current employee.

In a press release issued on April 13, 2005, Mphasis stated that it was working closely with local authorities and Citibank to "ensure that employees, past or present, involved in this distressing episode are brought to justice." The company is also backing calls by Indian IT trade body Nasscom for better background checks for the 350,000 workers employed by the Indian business process outsourcing industry and for the Indian government to increase penalties for such crimes. (For the complete case study, see event #5575.)

CHINA EAGLE SECURITIES

The China Securities Regulatory Commission canceled the brokerage license of China Eagle Securities on January 24, 2004 over allegations that the brokerage had misused CNY1.65 billion (\$200 million) in client funds. The market regulator appointed another securities house, Changjiang Securities, to oversee China Eagle's brokerage operations and has urged creditors to file claims against China Eagle Securities.

China Eagle Securities has approximately 400,000 clients and is ranked 18th in size on the Shanghai Stock Exchange's list of more than a hundred brokers. A Shanghai court froze its accounts on December 13, 2004, citing a "huge financial risk." A report published in the state-run newspaper China Securities Journal said authorities were taking action to "protect the securities market and financial order and stability and to preserve investors' legal interests."

Official details of the difficulties at China Eagle Securities have yet to be disclosed, but several publications speculated that the CNY1.65 billion (\$200 million) shortfall in client funds was due to the brokerage being unable to repay client funds it had misappropriated to invest in the market. The shortfall amounts to nearly 90% of the broker's client settlement funds. China's 130 securities companies have experienced losses for the past three years in a row as the benchmark Shanghai composite index fell to little more than half its 2000 high.

The Chinese market regulator has appointed accountants to analyze the brokerage's accounts. Additionally, Changjiang Securities, majority owner of a \$72.5 million brokerage venture with BNP Paribas, has been appointed to take over daily operations at Eagle Securities.

The move comes as part of a wider effort to regulate an industry that has been plagued with allegations of corruption and misuse of investor funds. The China Securities Regulatory Commission ordered an audit of all the nation's brokerages in January 2005, requiring companies to submit detailed financial reports about their liabilities, profits and the use of the clients' assets together with concrete plans for further reforms by the end of April. The Commission also disclosed efforts to create a protection fund for securities investors to guarantee compensation in the event of the bankruptcy of securities companies. (See event 5406 for the complete case study.)

LARGE OPERATIONAL RISK LOSSES IN ASIA FROM THE FIRST DATABASE

Name	Loss Amount (USD)	Date	Short Description	Event ID	Country
Toyo Shinkin Bank	2,268,145,152	13-Aug-91	A bank manager with Toyo Shinkin Bank forged 19 deposit certificates with a face value of 416 billion yen. The value of the forged certificates was almost equal to that of the institutions's total deposits.	1791	Japan
Showa Shell Sekiyu KK-No Firm Available	1,500,000,000	1-Jan-93	Showa Shell Sekiyu KK sustained losses of 165 billion yen from forward currency transactions. The company's treasury department, expecting the U.S. dollar to rise against the yen, bought forward dollars on futures markets at around 145 yen. Unfortunately, the dollar decreased to 120 yen in 1993 causing huge exchange losses for the firm.	1628	Japan
Barings plc	1,300,000,000	27-Feb-95	Barings Plc suffered a USD \$1.3 billion unauthorized trading loss that was precipitated by a Singapore-based trader with a 'hotshot' reputation who eventually pled guilty to two counts of fraud and was sentenced to an six-year jail term.	251	Singapore
Carrion Group-No Firm Available	1,000,000,000	1-Jan-83	Carrion Group susained losses in the range of \$1 billion as a result of improper loans; the company was bribing banking officials to continue loaning it money without following any of the proper channels or procedures and using "\$2 firms" (a type of dummy company) as a cover.	2564	Hong Kong
Industrial and Commercial Bank of China Ltd.-No Firm Available	894,000,000	31-Aug-04	The Industrial and Commercial Bank of China was defrauded out of CNY 7.4 billion (\$894 million) over a four year period between 2000 and August 2004. A year-long investigation by Chinese authorities has implicated 233 bank employees and government officials in a scheme involving forged letters of credit.	5408	China
China Aviation Oil	550,000,000	30-Nov-04	China Aviation Oil (Singapore), which is 60 percent owned by China Aviation Oil Holdings of Beijing, sought court protection from creditors on November 29, 2004 after losing USD \$550 million as a result of speculative derivatives contracts. The firm had placed bets on options contracts that the price of jet fuel would fall. Instead, the price rose steadily, as did CAO's losses.	5311	Singapore
Bank of China-No Firm Available	500,000,000	1-Jan-02	The Bank of China announced in March 2002 that it was investigating an alleged fraud. The scheme resulted in the disappearance of an estimated USD \$500 million in funds from a provincial branch in Kaiping. The crime has been attributed to three senior officers of the branch, including its manager and chief accountant, who allegedly embezzled the \$500 million from 1991 through 1999.	4116	China
Union Carbide Corporation	470,000,000	1-Dec-84	In Bhopal, India, methyl isocyanate, hydrogen cyanide, monomethyl amine, carbon monoxide and possibly 20 other chemicals were released from the Union Carbide pesticide plant after an explosion. The gas leaks resulted in the death of 3000 people and the injury of 200,000. Safety devices proved inadequate or were not working.	1822	India
Itoman Corp.-No Firm Available	463,694,496	1-Sep-99	A real estate developer was accused of causing at least 49.3 billion in losses to Itoman, whose funds were allegedly used to buy paintings at unreasonably high prices and invested in golf course development projects deemed unlikely to materialize. The alleged fraud led to Itoman's collapse and absorption in 1993 by Sumikin Bussan Kaisha Ltd., a subsidiary of Sumitomo Metal Industries Ltd., ending Itoman's 110-year history.	2209	Japan
Bayerische LandesBank Girozentrale-No Firm Available	456,313,600	16-Jan-98	In January 1998, an operational risk incident was revealed by Bayerische Landesbank, when three managers in the institution's Singapore office were fired for extending improper loans to private banking clients.	3376	China

AMAN CAPITAL MANAGEMENT

In a market risk case that has components of operational risk (and hence, can be considered a "bridge event" between the two disciplines), Aman Capital Management, one of Singapore's largest hedge funds, announced in May 2005 that during the month of April 2005 its flagship fund had experienced an 18% decline in assets as a result of derivatives trading losses. The extraordinary loss led to an internal review by PWC and the fund's administrator. In total, Aman is estimated to have lost about USD \$43 million; its total assets are in the range of \$242 million.

The Aman Capital Global Fund allegedly suffered losses as a result of derivatives trades based on the Korean Composite Stock Price Index. The losses, which were revealed in May 2005, were incurred and according to the Financial Times, "has become the flagship of Singapore's fledgling hedge fund industry, which has pitted itself against Hong Kong, its larger rival."

The hedge fund has undertaken an independent review of its operations in a mission to determine what went wrong. It is also examining the role its service providers played – including its prime

broker, UBS. UBS distanced itself from the hedge fund's troubles by stating that it "should be noted that UBS had no discretion over the investment decisions of the fund, nor was UBS mandated to provide any risk oversight functions to the fund."

Some industry analysts have speculated that the losses suffered by Aman could contribute to a stymie of growth of the nascent hedge fund industry in Singapore. The Financial Times (5/9/2005), which first reported losses at the hedge fund, wrote that the Aman event is "likely to cast a pall over Singapore's fledgling hedge fund industry, which has seen a sharp rise in the number of start-ups in the past two years – a feat that has caught rivals Hong Kong and Tokyo off guard."

According to the Financial Times, Singapore has benefited from its lack of regulation; hedge funds are exempt from regulation as long as they service fewer than 30 "accredited" investors. Accredited investors are individuals with assets of more than USD \$5 million and companies with assets greater than USD \$10 million. (See event #5654 for the complete case study).

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