

GIRO XXX 2003 Convention

14-17 October 2003
City Hall, Cardiff

The HIH Royal Commission Lessons from down under

q Alex Marcuson
q 15 October 2003

"ELIZABETH THE SECOND, by the Grace of God Queen of Australia and Her other
Realms and Territories, Head of the Commonwealth:
TO the Honourable Justice Neville John Owen
WHEREAS it is desired to have an inquiry into certain matters relating to the failure
of HIH Insurance Group ('HIH');
BY these Letters Patent issue in Our name by Our Governor-General of the
Commonwealth of Australia on the advice of the Federal Executive Council and
pursuant to the Constitution of the Commonwealth of Australia and the *Royal
Commissions Act 1902* ..."

Introduction

- What happened?
- Why a Royal Commission?
- How the HIH Royal Commission operated
- Policy recommendations
- Topics for discussion
 1. Insiders vs. outsiders
 2. The \$5bn question
 3. Dealing with auditors
 4. Lies, damned lies and reinsurance contracts

What happened?



What happened?

- 1992 - Listed on ASX
- 1995 – 1998 (June)
Winterthur the majority shareholder
- Sept 1998
–Purchase of FAI
- Late 1999 / early 2000
–APRA release drafts of new prudential standards
- Sept 2000
– Allianz joint venture
- Dec 2000 – Williams (CEO) resigns from board
- 6 March 2001 – QBE joint venture
- 15 March 2001 – provisional liquidation
- 27 August 2001 – official liquidation

Why a Royal Commission?

- Sudden demise
- 2nd largest insurer
- “Shouldn’t happen in a modern economy”
- Public suffering
- Ensure new APRA standards work
- General election ...

Royal Commissions:

What are they?

- Royal Commissions Act 1902
- Letters patent
- Nature of commission
- Evidence gathering

Royal Commissions:

How did this one work?

- Hearings
- Web-site
www.hihroyalcom.gov.au
- Parties and witnesses
- Technology

Recommendation Extracts

- 4 Support for IAS participation
- 8 Accounting standards amended to reflect new APRA standards
- 15 Mandatory certification of completeness and accuracy**
- 16 Approved actuary cannot belong to same organisation as approved auditor**
- 17 More detailed disclosure requirement from approved actuary of the "exercise, incidence and impact of subjective judgement and departure from historical experience"**
- 35 Publication of "Schedule P" loss-development data ...
- 35 Publication of a summary of the approved actuary's valuation, including methodologies and assumptions**
- 42 Insurance Act 1973 extend prudential regulation to cover all discretionary insurance-like products – to extent possible within constitutional limits
- 60 Tax relief to catastrophe reserves
- 61 Introduction of policyholder support scheme

Topics for discussion

- Insiders vs. outsiders
- The \$5m question
- Dealing with auditors
- Lies, damned lies and reinsurance contracts

Insiders vs. Outsiders

Situation:

- Internal actuary raises concern that external actuaries are underestimating reserves because they are not receiving complete or accurate data
- Receives instructions not to take matter further / assurances that others will take matters further

Issues:

- Management interest vs. public interest
- What additional reliance do you place on data if there is an internal actuary involved?
- When could / should / must you whistle-blow?
- What protection do you have?

The \$5bn question

How can a listed company with a BBB rating (or better), big-five auditors, internal and external actuaries ... “suddenly” have a \$5bn shortfall?

Dealing with auditors

- Who is responsible for data accuracy?
- Should an auditor's firm have any involvement in the actuarial estimation of reserves?
- What place have actuaries in an audit?
- How can the actuary and the auditor work together to avoid "dodgy data"?

Lies, damned lies and reinsurance

- A. Reinsurance in place of prudential margins
- B. Side letters negating the transfer of risk
- C. Backdating of documentation
- D. Inclusion of sections of cover not intended to be used
- E. Uses of unrealistic "triggers" for unrealistic cover
- F. Uses of letters of credit to transfer risk from reinsurer back to insurer
- G. Back-to-back reinsurance to make an ineligible parental guarantee "eligible" for UK solvency

Why did HIH fail?

- Systematic under-provisioning
- Weak governance / no clear strategy
- Conflicts of interest at board level
- Disastrous misadventures
- Dominant senior executive directors
- Poor management information

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