HIH Case Study on Corporate Governance

Round 1
20 August 2000
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The primary objective of this case study is to assess the state of corporate governance at HIH before its collapse; to analyze the warning signals, if any, that were provided by the information that was available to the supervisory authority; and to determine what actions, if any, would be appropriate for an authority in the face of such information.

Your position is general manager of a branch within the Diversified Institutions Division (DID). DID is responsible for supervising all (approximately 350) systemically significant institutions and financial conglomerates, including HIH. Many of the institutions supervised by DID are significantly larger than HIH. The division is divided into four branches, one of which (yours) has sole supervisory oversight of HIH, along with 4 very large conglomerates and another 20 smaller institutions. DID’s total supervisory staff has about 50 members, of which your branch has 8.

Attached is a briefing note prepared by the senior manager of your branch responsible for HIH. Your tasks for the first round are to:

- Assess the information provided
- Identify any issues of concern in relation to the governance or control structure of HIH
- Prepare a strategy for addressing these concerns with HIH, with specifics about any information you wish to receive from HIH or other sources.
MEMORANDUM FOR GENERAL MANAGER
BRIEFING NOTE ON HIH INSURANCE LIMITED

20 August 2000

You will be aware that there has been a great deal of media attention on the governance of HIH over the past few months, focusing on the management and board performance of the company. Governance issues were also uncovered during the recent on-site visit by our asset risk team. These, together with our ongoing concerns about the accuracy of HIH’s financial returns, suggest that we need to focus some attention on the governance of HIH. In particular, the asset risk visit to HIH in July revealed that, in addition to taking on inappropriate levels of asset risk, HIH also suffers from some possibly serious breakdowns in internal controls.

I have attached the following for your information:

- Attachment 1 – Biographies of the directors, senior management and auditors of HIH;
- Attachment 2 – Corporate chart of HIH;
- Attachment 3 - Relevant extracts from a briefing note prepared in March for APRA’s first prudential visit to HIH;
- Attachment 4 - A file note prepared in July by the head of the specialist asset risk team. The team inspected a sample of loan files, conducted interviews with both junior and senior management at HIH;
- Attachment 5 - A briefing note prepared by the analyst responsible for HIH in relation to the accuracy of quarterly reporting;
- Attachment 6 - A summary of the corporate governance regulatory framework; and
- Attachment 7 - A sample of relevant media clippings referring to HIH. You will note from recent press that Mr Adler has been building up his stake in HIH to become one of the four largest shareholders (including family interests). Mr Adler’s role in the company is therefore an interesting mix of non-executive director, major shareholder and, according to industry rumor, a businessman using his connections to further his own personal business interests.

I would appreciate an opportunity to discuss the strategy we should be adopting to address these concerns.

Senior Manager
HIH Board of Directors

GEORGE ARTHUR COHEN AM

NON-EXECUTIVE CHAIRMAN
(AGED 66) APPOINTED 20/1/1992

Chairman of Audit, Human Resources and Investment Committees. Mr Cohen has an extensive background in corporate financial management and was formerly a senior partner of Arthur Andersen. Mr Cohen's directorships include Foster's Brewing Group Limited and Diversified United Investment Limited.

RAYMOND REGINALD WILLIAMS AM

DEPUTY CHAIRMAN AND CHIEF EXECUTIVE
(AGED 64) APPOINTED 2/12/1988

In 1968 Mr Williams, together with Mr Michael Payne, founded the Company that ultimately became HIH Insurance in Australia. He has held senior executive positions in the insurance industry for 40 years and is currently a Board Member of the Insurance Council of Australia Limited. Within the HIH Group Mr Williams is also a director of HIH Underwriting, HIH Casualty, HIH U&A, CIC, WMGI, FAI, FAI General, FAI Traders, FAI Reinsurance, FAI Finance, FAI Investments, FAI Leasing, FAI Overseas, Lanlex, United Body Works.

CHARLES PERCY ABBOTT

NON-EXECUTIVE DIRECTOR
(AGED 61) APPOINTED 30/8/1995

Member of Audit Committee. Mr Abbott, a former partner and now consultant to the major law firm Blake Dawson Waldron, is also a director of a number of other companies including Flinders Capital Ltd and Bass Capital Ltd.
RODNEY STEPHEN ADLER AM

NON-EXECUTIVE DIRECTOR
(AGED 41)
APPOINTED 16/4/1999
(FAI FROM 11/1/1988)

Member of Investment Committee. Mr Adler is Chairman and Chief executive of Adler Corporation Pty. Limited. He is a Fellow of the Institute of Chartered Accountants in Australia. Mr Adler is a Governor of the Sydney Institute, and Adjunct Professor in the Faculty of Business at the University of Technology, Sydney, and is a director of other companies including Anaconda Nickel Limited, One-Tel Limited, and a director and major shareholder of Abaca Funds Management Limited, Pacific Capital Partners Pty. Limited and Pacific Mentor Pty Ltd. He is chairman of Medicine Quantale Limited and Home Security International, and joint chairman of Juvenile Diabetes Australia.

(Note: Mr Adler came onto the HIH Board when HIH took over FAI Insurance Ltd, a company dominated by Adler family interests.)

JUSTIN HERBERT GARDENER

NON-EXECUTIVE DIRECTOR
(AGED 64) APPOINTED 2/12/1998

Member of the Audit and Human Resources Committees. Mr Gardener had been a partner in Arthur Andersen since 1972 and ultimately was a Managing Practice Director with responsibility for the Asia Pacific Region over which he has developed a high level of expertise. He is chairman of Ashton Mining Limited and his other directorships include Austar United Communications Limited, Combined Communications Network Ltd, Hillgrove Gold NL and Hutchinson Telecomm (Aust) Ltd.

ROBERT REGINALD STITT Q.C.

NON-EXECUTIVE DIRECTOR
(AGED 59)
APPOINTED 20/1/1992

Member of the Audit and Human Resources Committees. Mr Stitt has practiced as a barrister extensively since 1968 and was appointed a Queen's Counsel in 1983. Mr Stitt has been a legal adviser to the Company since it commenced business in Australia.
HERMANN FRANZ RANDOLPH WEIN

CHIEF EXECUTIVE, ASIA
(AGED 47)
APPOINTED 13/7/1995

Member of Reinsurance Committee. Mr Wein is an attorney-at-law and has had 20 years operational experience in the insurance industry, a substantial part of which is in the Asia Pacific area. Before joining the Company, he had been a senior executive of Winterthur Swiss Insurance Company for 8 years, with the last 4 as its Regional Chief Executive, Asia Pacific.

In addition to the above, 3 other members of the HIH executive, George Sturesteps, Terrence Cassidy, and Dominic Fodera served on the Board, as did an ex-employee, Michael Payne.

Brief Biographies of Key Management and Auditors

HIH MANAGEMENT

George Sturesteps

- HIH Deputy Chief Executive and Managing Director, International (1995 – 2001)
- Executive Director of HIH from 2/12/1988 to 12/9/2000, Member of Reinsurance Committee (1995 – 1999)
- Employed by HIH since its inception in 1968

Terence Cassidy


- Employed by HIH since 1972

**Dominic Fodera**

- Joined HIH in 1995 as Chief Financial Officer

**William Howard**

- General Manager, Financial Services/Investments for HIH (1999–2001)
- Director of FAI Finance (from 31/1/2001)

**Frederick Lo**

- Joined HIH in 1987 and focused exclusively on secretarial function since 1995

**Ray Gosling**

- Group Reinsurance Manager for HIH (1995–2001)
- Employed by HIH since 1989
John Clarke

- General Manager, Public Affairs for HIH (1984–2001)

Paul Abela

- Group Tax Counsel for HIH (1999–2001)
- Employed by HIH since 1994

William Ballhausen

- HIH General Manager Investments (1992–2001)
- Employed by HIH since 1982, Investment Manager since 1985

Greg Waters

- HIH General Manager, Internal Audit (1995–2001)
- Internal audit function within HIH since 1988

Auditors – Arthur Andersen

Alan Davies

- Partner of Arthur Andersen (since 1980)

John Buttle

- Partner of Arthur Andersen (since 1999)
- Associate of Institute of Chartered Accountants of Australia (1977)
- Formally partner of KPMG, Chartered Accountants
- Lead engagement partner in audit of HIH Group 2000
Jonathan Pye

- Partner of Arthur Andersen (since 1/9/1999)
- Bachelor of Economics (1988), Associate of Institute of Chartered Accountants of Australia (1990), Associate Member of the Securities Institute of Australia
- Employed by Andersen since December 1987 (involved in audits of HIH Group companies from 1988–2000)
- Day to day management responsibility for the 1999 and 2000 audits of the HIH Group

John Fanning

- Manager of Assurance Business Advisory Group of Arthur Andersen
- Member of Institute of Chartered Accountants of Ireland (1996)
- Employed by Andersen Ireland since 1992 and Arthur Andersen Australia since 1998 (involved in 1999 and 2000 audit of HIH Group as senior manager)
MEMORANDUM

Relevant Extracts from Briefing Note on HIH Insurance Limited for First Prudential Visit (Scheduled for 9 March)

7 March 2000

Introduction

HIH Insurance (known then as CE Heath) listed on the ASX in 1992 as a specialized liability insurer sourcing most of its business from local and international insurance brokers. With 90% of the company's portfolio comprised of commercial classes of business, and commercial premium rates on the decline, the company embarked on a strategy to change its business profile from the mid 1990s. Acquisitions of CIC Insurance Limited (1995), Colonial Mutual and General Insurance Limited (1997) and FAI Insurances Limited (1998/99) substantially changed the group's business profile, with commercial lines declining to 47% of total business by June 1999 (35% Inside Australia).

HIH Insurance is currently the second largest General Insurance group in Australia, after NRMA/RACV (in terms of Inside Australia business). It has approximately 13% market share by Gross Earned Premium and 15% market share by Total Assets. The group currently includes the following companies:

- HIH Insurance Group companies authorized to carry on general insurance business in Australia:
  - HIH Casualty and General Insurance Limited
  - FAI General Insurance Company Limited
  - CIC Insurance Limited
  - World Marine and General Insurance Ltd (purchased and FSSA approved on 17 December 1999)
  - FAI Traders Insurances Company Pty Limited (Run-off)
  - FAI Reinsurances Pty Limited (Run-off)
  - HIH Underwriting and Insurance (Australia) Limited (Run-off)

HIH Insurance Limited changed its financial year-end from 31 December to 30 June and the reporting period to June 1999 is therefore an 18-month period. APRA and ASIC both approved the above changes.
Acquisitions

A number of acquisitions took place in the 1998/1999 financial year. The most important was the takeover of FAI Insurance, which was completed in January 1999. A more recent local acquisition took place in December 1999, when HIH took over World Marine General Insurance Company Limited (previously 70% owned by BHP). The WMG acquisition added approximately $25 million in premium income and $60 million in assets.

There have also been some substantial overseas acquisitions. The April 1998 acquisition of Cotesworth Group in the London market facilitated direct participation in the Lloyd’s market. There has been a trend towards increased corporate capital participation in Lloyd’s and HIH decided that it wanted to be part of that potential area.

Asian initiatives included the purchase of a 24.46% stake in listed Thai insurer Nam Seng Insurance Plc in February 1998, acquisition of a 49% stake in Insular of the Philippines in mid-1999 and the conclusion of the takeover of Forex Insurance Company (Macau) Limited. In addition, Bank of China granted HIH an approval to open a representative office in Beijing. HIH is also applying for a permission to open a representative office in Taiwan.

Other acquisitions include takeover of Great States Insurance Company, which is a US based WC underwriter (mostly Arizona). This was done to dilute a large exposure to the California WC market.

The other major development was the sale of its 51.1% interest in HIH by Winterthur, which was finalized in June 1999. Winterthur continues to hold a 4.96% stake in the company (they also hold 53.83% of the Convertible Notes on issue). Subsequently to this HIH Winterthur International Holdings Limited changed its name to HIH Insurance Limited on 21 October 1998.

Strategy

The takeover of FAI confirmed HIH’s strategies to secure a major market share position in Australia, change its business mix and to diversify distribution into every available distribution channel. As noted above, HIH Insurance Group is now the second largest General Insurance Group in Australia. The exposure to personal lines rose substantially as a result of the FAI takeover (see premiums) with commercial lines now representing only 47% of total business and 35% of Inside-Australia business. The rationale behind the takeover was to restructure the business in order to provide lower volatility and more resilient long-term earnings. There is a view in the marketplace that commercial and personal insurance cycles have low correlations and thus there are opportunities to diversify some business risk and reduce volatility of earnings. HIH claims to have the most diverse distribution mix of any Australian general insurer. This is a central element of the company’s strategy to reduce volatility and to improve earnings. The distri-
bution channels include direct business through FAI (both through the call centers and Internet), business agencies, brokers and agents, affinity groups, strategic alliances with financial institutions (eg NAB, ANZ and Colonial) and electronic distribution.

HIH continues to adopt the strategy of selling non-core assets inherited from FAI following its recent takeover of that company. It sold FAI Life Limited and its controlled entities to Tower Life on 28 April 1999. The price received exceeded the NTA of FAI Life by $26 million. Oceanic Coal Australia Limited was sold on 2 July 1999 for a $50 million loss. Recent media reports about its intention to sell its interest in the St Moritz Hotel in New York have been confirmed on the 2nd of March, when HIH announced a deal to sell 50% of its stake in the property for US $65 million and lease the other 50% on a 75-year lease.

Geographic diversification and overseas growth opportunities are being explored further. A program of structured development based on acquisitions, joint ventures and strategic alliances is now being pursued in some Asian countries including Hong Kong, China, Thailand, Philippines, Indonesia, Singapore and Malaysia. Some opportunities are also being explored in South Korea, Taiwan and Japan. Diversification out of the unprofitable California WC market is also being pursued with 40% of the US WC business now sourced from outside California. The recent acquisition of Cotesworth in the UK should have two benefits to HIH, direct involvement in Lloyd's market and generation of economies of scale by integrating the back office functions with the existing UK operations.

Investment strategy is based on the premise that the Group's business risk should not be compounded by investment risk. HIH’s preferred strategy is to hold a large proportion of cash and fixed interest assets, the cashflows of which are matched with the expected cashflows of its liabilities.

**Overseas Business**

Australia is by far the largest component of the activities of HIH Insurance Group. USA and UK follow Australia, both with significant contributions in terms of revenue and assets. In terms of return on assets, Workers' Compensation business in Argentina and activities in New Zealand performed exceptionally well with 11.2% and 8.4% ROA respectively. Australia's performance was solid. Other regions (USA, UK and Asia) performed very poorly. The results in the USA have been affected by the poor conditions in the US Worker's Compensation market (California in particular), which is the only class of business written in the US. UK results suffered from the worst catastrophe year in history (reinsurance business is written from the London office).
Management & Board of Directors

There are twelve directors on the Board. The five Executive Directors are the CEO, the deputy CEO (also Managing Director International), the Managing Director Australia, the Finance Director and the CEO, Asia.

Mr Ray Williams is the CEO of HIH. In 1968 Mr Williams together with Mr Michael Payne (Non-Executive Director and Chairman of Reinsurance Committee) founded the company that ultimately became HIH Insurance. The remaining executive and non-executive directors have a wealth of experience in insurance, reinsurance, accounting and corporate finance and law.

Outlook

A number of events took place in recent months which should translate into a more positive outlook for HIH in terms of profitability. The recent rise in interest rates (and bond yields) and any further rises will have a positive effect on the group. A recent fall in the value of the bond portfolio was and will be offset by a similar fall in the OCP, as the group matches its assets and liabilities. Any new cash inflows will be invested at higher yields, and should thereby have a positive effect on operating results.

Diversification of the US worker’s compensation business out of California and rising premium rates in California will have a strong positive effect on the performance of the region. Performance in the UK market should also improve with reductions of net retentions on the catastrophe account and the unlikely scenario of continued frequency and severity catastrophes in the world.

The profit smoothing agreement with Swiss Re will reduce the volatility of earnings over the next few years. The most likely scenario is that HIH Insurance will report higher (than actual) earnings in the first two years of the agreement (i.e. 1999/2000 and 2000/2001) and lower (than actual) earnings in the remaining years. The expected strong rise in premium rates over the two to three years is expected to neutralize the effect of reduced earnings in the later years of the agreement.

There are a number of threats to HIH which have the potential to significantly affect its results in the future. Rising reinsurance premiums will undoubtedly have a large

<table>
<thead>
<tr>
<th>Country (1998/99)</th>
<th>Revenue ($5bn)</th>
<th>Assets ($7.7bn)</th>
<th>ROA(%)</th>
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</thead>
<tbody>
<tr>
<td>Australia</td>
<td>64.2%</td>
<td>78.1%</td>
<td>1.3%</td>
</tr>
<tr>
<td>USA</td>
<td>14.8%</td>
<td>9.5%</td>
<td>-2.8%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3.8%</td>
<td>2.7%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Asia</td>
<td>3%</td>
<td>1.2%</td>
<td>-5.9%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>13.3%</td>
<td>8.1%</td>
<td>-3.5%</td>
</tr>
<tr>
<td>Argentina</td>
<td>0.85%</td>
<td>0.4%</td>
<td>11.2%</td>
</tr>
</tbody>
</table>
impact, especially for a company that cedes almost a third of its premiums. HIH will either have to increase its retentions (as they have indicated they might do with the first catastrophe layer – increasing event retentions to $20 million) or pay higher reinsurance premiums. Both strategies have disadvantages.

The introduction of the new GST system of indirect taxes will also test HIH’s computer systems. The ability of computer systems to cope will be tested as will the adequacy of provisions raised to cope with the tax liability. The last and probably most significant threat is the possibility of a property and sharemarket correction in the future. The fall in property prices in Sydney would have a strong effect on the profit and loss statement as would a fall in stock prices. HIH has a significant exposure to the property market. The group has a hedging program in place for its equity book, but this might prove not to be enough.

Overall the outlook for HIH Insurance Group is strong and, provided no extraordinary event like a large market correction or another Sydney hailstorm occurs, the group should see improved results in the future.

Senior Analyst
Note for File        APRA

Ref: HIH Asset Risk Visit
15 August 2000

Notes from HIH Asset Risk Visit July 2000

Focus of the Visit

The focus of this visit was the investment of shareholder and policyholder funds and the identification, assessment and monitoring of asset risk issues that arise as a consequence.

The Asset Risk Management Framework at HIH

The HIH Investment Strategy is based on the premise that the Group's main business risks arising from underwriting performance and its reinsurance policies should not be compounded by asset risk.

To ensure the neutral impact of investment outcomes on the group's overall risk profile, the HIH Board has approved the Investment Guidelines (dated August 1999) under which the Investment Committee formulates strategic asset allocation recommendations. The current guidelines (modified only slightly), which include limits and exclusions on various asset classes, were approved after the takeover of FAI.

The Investment Committee meets formally each quarter and reviews current asset allocations. Their objective is to ensure that the HIH Board's risk tolerance is properly reflected in the investment portfolio. HIH asset allocations are handled on a group basis from Australia and are not considered separately for each individual licensed insurer within the group. Thus there is only one Investment Committee for the group worldwide.

HIH also has an Investment Management Group that meets monthly and whose role is to monitor at more frequent intervals asset allocations and investment performances and advise the Committee accordingly.

As a matter of policy, HIH uses external fund managers for individual asset selection, to allow the Investment Committee to concentrate on overall asset allocation issues.
General Assessment

It was clear from our visit that many investments exceed Board approved guidelines and limits and that they have done so continuously, especially since the acquisition of FAI. Indeed, since the FAI acquisition, HIH’s Asset Risk became significantly higher than it was previously and continues to remain so. There was no documentation of any internally agreed framework for dealing with these breaches of guidelines. At best, there are broad statements about exiting these exposures and not renewing certain types of business.

HIH’s current level of asset risk could not be described as risk neutral vis-à-vis the level of business risk, as stated and documented in the risk strategy/appetite of the Board of Directors.

It is our assessment that HIH’s asset risks are being further compounded through inadequate identification, analysis and evaluation of the asset risks arising from its current investment portfolio.

Responsibilities for the Current Risk Management Framework

HIH management stated that the effectiveness and appropriateness of the risk management framework is the responsibility of divisional managing directors within the group.

Within the various divisions there are compliance officers but, from our initial discussions, it appears that compliance is focused on statutory and other legal requirements but not on investments and portfolio management issues.

Our visit highlighted that the acquisition and integration of FAI has impacted on and continues to impact on HIH’s risk management framework, its processes and the effectiveness of controls. This conclusion should not surprise, as there have been a number of warning signs over the past year, for example:

- High levels of FAI staff turnover, particularly with respect to accounting and reporting functions. We have the clear impression that HIH has not yet replicated the lost skills and knowledge.
- The ownership of land in Tucson, Arizona, was reported in the September 1999 investment report as “no details available”. (It is now stated in the books at $1.1 million.)
- Their lack of knowledge about a number of FAI’s equity holdings, particularly those listed overseas and those that have been subject to restricted trading rights. These holdings were and remain outside approved investment guidelines.
- Their lack of understanding of the chain of ownership for the St Moritz Hotel. This, we understand, still appears not to be fully resolved despite the proposed partial sale of the Hotel.
• The decision to create an HIH strategic fund whose main asset of shares in
high-tech stock One.Tel represents an exposure that breaches the investment
guidelines for maximum exposure to a single equity investment. This breach
continues.

Because the FAI investment portfolio and its style of management appears to be
significantly different from what had been in place at HIH, the acquisition of FAI should
have involved a complete analysis of the additional risks it presented to HIH. One of
the issues arising from the visit is that, under HIH’s risk management structure, it is not
clear where in the organization responsibility for such an analysis would reside.

It is significant that in the presentations given to us, the approval process for new
products/asset classes requires the Investment Committee to consider issues of risk/ret-
turn analysis and appropriate performance benchmarks. It is clear that, in practice, this
did not occur either before or after the FAI acquisition.

**The Role of Internal Audit**

The role of internal audit can be many and varied. It usually covers some or all of the
following:

• The adequacy of the control framework in place to manage risks across the
  Group
• The integrity of financial and other information
• Compliance with Board policies and management directives
• Compliance with regulatory and prudential obligations
• The economic and efficient use of resources
• The effectiveness of operations undertaken by the Group

Our discussion with HIH’s internal audit made it clear that they do not see their
role in the above terms. Rather, they see themselves as having a “bottom line” and op-
erational focus rather than assessing compliance with risk management controls. They
do not appear to be involved with approvals of breaches of investment guidelines.

As part of our pre-visit reading material, we were provided with two internal audit reports:

• Western Australia Workers Compensation, dated 29 February 2000 - rated sat-
sisfactory
• HIH America, dated 29 February 2000 - also rated satisfactory
Section 3.1 of the HIH America internal audit review, makes reference to the correction of incorrect elimination entries in August 1999 that are described as “having been generated some considerable time ago”.

The information provided in the report shows a decline in shareholders’ funds between June and December of just over USD 60 million and a decline in investments in subsidiaries of nearly USD 45 million.

We were unable to obtain any information about the circumstances surrounding this write-down and the impact if any on HIH’s retained earnings and shareholders’ funds. No-one we spoke with was able to confirm whether or not the write-down would have a direct impact on reported earnings for the current financial year.

**Policy Exceptions and Shortcomings**

**Exceptions in the 31 March 2000 return to APRA**

- The exposure to St George Bank (15 September, 2003 Bonds Coupon 7.5%) appears to be outside investment guidelines. This was not identified as an exception to policy.
- The exposure to the AMP Infrastructure Trust, which we understand is unrated, exceeds the guideline limits on exposures to unrated securities.
- The FAI exposures to unlisted equities outside Australia ($18 million) and to foreign shares reported inside Australia ($68 million) are both outside policies which limit individual equity holdings to securities listed on the ASX or IPOs likely to be listed within 6 months. These breaches are known within HIH but do not appear to have been addressed by the Investment Committee.
- The acquisition of FAI has also led to the size of the HIH’s internally managed funds falling well outside the investment guideline limit of $100 million as signed off by the Board in August 1999. While the issue of fund size appears to have been addressed through a change in policy:
  - the policy change does not appear to limit in any way the purchase of new securities in the internally managed funds until such time as the $100 million cap is met;
  - the holding of internally managed funds appears to be at odds with the description of the role and functions of the Investment Committee whose focus is supposed to be on asset allocation rather than on trying to manage holding of individual securities; and
  - the Investment Committee finds itself having to act as an active equities manager in potentially illiquid small cap stocks and other unlisted securities at the same time that it has been told that the portfolio’s underweight position
in News Corp represented “the greatest risk to relative benchmark performance”. (18 July 2000 Investment Management Group Report, page 4.)

- Policy limits the exposure to growth assets to no more than 40% of the portfolio. Growth assets are defined as including equities, property, and unlisted investments. While not determinable from the APRA returns, the March and June quarter HIH Investment Committee reports show the holdings of equities, property, property loans, and unlisted investments to have been well in excess of 40% of the portfolio. We understand that a narrower definition of “property” to that suggested by the guidelines is being used internally.

A basic tenet of APRA’s supervision approach and of good risk management practice is that documented policies must reflect actual practice and must address the risks of the business. HIH was unable to provide any evidence of a systematic approach to risk identification and analysis.

**Shortcomings of Documented Policies**

- Despite the statement in the investment guidelines that loans secured by mortgage on real property are to be run-off, the policy provides no clear guidelines as to how existing loans are to be reviewed and subject to ongoing monitoring and how provisions, if necessary, are to be assessed and authorised.
- There is no authorized listing of dealing counterparties.
- Despite the high level of investment in property investment and project development, there appears to be no authorized panel of property valuers.
- There is no mention of hybrid securities in the investment guidelines. FAI has investments in convertible notes, preference shares, and listed equity options. It is not clear how these hybrids are analyzed within the context of exposure limits to individual securities or the size of the portfolio in total.
- The various benchmarks used for externally-managed equity portfolios lack detail. During the visit we were told that the mandates given include a margin over various ASX indices but the investment reports do not show such a margin in the assessment of managers’ performances.
- The investment reports show that the current investment allocations for Hong Kong and New Zealand involve the holding of asset classes outside of current investment guidelines.
- Holdings of unlisted investments lie outside policy guidelines. Policy guidelines for valuing such exposures in these circumstances do not appear to have been established.
• There is no policy on asset revaluations. A number of FAI equity holdings with restricted trading rights and listed in illiquid markets appear to need revaluation.
• There are moves within HIH to address this issue of revaluing illiquid assets, but the current incremental approach carries with it the risk of mixing assets that are valued on different bases. It is also contrary to the Australian accounting standards, which seek to avoid the possibility of selective revaluations within an asset class.
• The FAI equity portfolio includes a large number of “dot.com companies” whose price volatility is much greater than the various ASX benchmarks used by HIH. We were advised during the visit that stop-loss limits have not been established on these holdings and no special reporting limits have been established to cover any significant price movements for individual stocks.
• Whilst we understand that some price sensitivity analysis is being conducted, our copies of the investment reports do not show there to be any reporting of this in the investment reports.

OTHER ISSUES

• There appear to be many classification and reporting issues in the APRA quarterly returns that must be addressed.
• As at 31 March 2000 as reported to APRA, FAI held 853,000 shares in an OTC Bulletin Board listed company Piranha Inc (i.e. it is not listed or traded on the Nasdaq or other US national securities exchange).

We understand that Piranha’s securities listings include many infrequently traded and thinly capitalized securities. It has been subject to problems of fraud in recent years. Many of these types of stocks are not obliged to meet normal reporting requirements. The FAI holding exceeds normally monthly trading volumes in Piranha.

From our discussions it appears that the FAI holding has been restricted as to its tradability and had not been listed on the electronic quotation service for subscribing members. Resolution of these issues has occurred but it seems that banking arrangements for receiving USD funds on sale of securities had not been fully established.

Analysis of Files

We had expected HIH to have what was described earlier as a “traditional investment book”. As such we had not intended to look at files except to review some of the investment mandates.
Accordingly, our analysis of particular investment files was brief in terms of time spent and number of files reviewed. Nevertheless, it raised several significant issues.

**Property – Direct Holdings**

63 Exhibition Street, Melbourne - The file shows that this property was last independently valued in December 1996. This is in conflict with the group’s investment guidelines and various corporate and accounting requirements that refer to formal revaluation occurring every three years.

55 Clarence Street, Sydney - This is currently held in HIH’s books with a valuation of $64.3 million (from an independent December 1997 valuation). However, consideration is currently being given to selling this property. Market contacts are suggesting a realisable sale price (excluding GST) somewhere in the order of $56 million – as per the Investment Committee Report for 31 May 2000. This reassessment of value has not been brought to book, notwithstanding that it is a material fluctuation in value.

**Property – Joint Venture Developments**

The Forum, St Leonards - We found this file difficult to following in terms of being able to reference actual exposure levels at any point in time to the limits approved by the Investment Committee. Usually such a summary sheet is kept at the top of a file together with a copy of the latest Investment Committee decision for ease of reference.

Contrary to policy, there was no revaluation of the property this year.

We also found it difficult to reconcile the information on the file with what was being reported to the Investment Committee as the market value of the exposure. As at 31 March the file appeared to show HIH’s property exposure to this development as totalling $110.4 million, including guarantees of $47.5 million. In contrast the Investment Management Group report shows the exposure to be $82 million as at 31 March 2000. This suggests that HIH may not be treating guarantees as exposures in calculating risk.

**Property – Emu Brewery**

The original site was acquired as mortgagee in possession from Alan Bond some years ago. The basis of the current valuation is the “audited value 30/6/99” of $87.1 million. This is then further described as the “value transferred to HIH books from FAI’s audited accounts”. This is not an independent valuation of the exposure.
**Property Loans**

Three property loan files were selected for review from a population as reported to APRA of 58 loans as at 31 March 2000. All three loans are reported as assets of FAI General Insurance (ADP 84(2)):

- First Phoenix Consolidated Ltd (reported in the March return to APRA as a loan amount of $3.103 million)
- Fretwood P/L (reported as a loan amount of $2.533 million)
- Dr R. Baume (reported as a loan amount of $1.230 million)

Each of these files contained inadequate documentation as to how the lending decisions were reached. There was an absence of legal documentation, an absence of analysis of the debt servicing capability of the borrower, and a lack of confirmation of the existence and value of any security offered in support of the debts.

We were not able to reconcile the principal sums to the loan amounts reported in the March returns to APRA. Even more importantly, the First Phoenix and Fretwood exposures, the files included printouts that showed material amounts of capitalised interest attaching to these exposures:

- First Phoenix – the capitalised interest was shown as $21.09 million (and the principal as $3.8 million) as at 28 April 2000.
- Fretwood P/L – the capitalised interest was shown as $1.701 million (and the principal as $2.273 million) as at May 2000.

In both these cases the loans are well past due and the capitalised interest is being charged at penalty interest rates. In our opinion, the limited information on file suggests that these exposures should be written off. The information on file suggests this was also the case at the time the loans were acquired from FAI.

**Inter-company Investments**

Each of the three major authorised entities (HIH, C&G, CIC, and FAI) have investments in, or loans to, subsidiary entities the carrying value of which was either overstated or questionable, as lodged in the quarterly returns provided to APRA as at 31 March 2000.

We were informed that the investment value was adjusted to reflect the net asset values of the subsidiaries but that this was done only once per year. We have since been informed that these carrying values would now be reviewed twice per year.

However, based on the information provided and discussions held with management it is apparent that, as at 30 June 1999, the write down of investment values, while
supposedly done for consolidation purposes, was not booked at the entity level. Consequently, these carrying values have been overstated for the last annual and past three quarterly returns. The impact of this is made worse as the amounts involved are material and have been approved for solvency purposes under Section 30 of the Insurance Act.

A list of the investments in question is tabled below. It should be noted that not all investments were subject to review.

<table>
<thead>
<tr>
<th>Authorized Entity</th>
<th>Investment</th>
<th>Carrying Value March 2000 $’000</th>
<th>Net Assets per Subsidiary $’000</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIH C&amp;G</td>
<td>CIC General Insurance Holdings</td>
<td>107,171</td>
<td>68,265</td>
<td>$39 m overstatement – majority of assets of subsidiaries are inter-company receivables</td>
</tr>
<tr>
<td>CIC Insurance</td>
<td>CIC Investments</td>
<td>19,827</td>
<td>11,232</td>
<td>$8 m overstatement - majority of assets of subsidiaries are inter-company receivables</td>
</tr>
<tr>
<td>FAI</td>
<td>FAI Car Owners Mutual</td>
<td>25,878</td>
<td>25,878</td>
<td>75% of assets of subsidiary are inter-company receivables</td>
</tr>
</tbody>
</table>

Many of the Section 30 approvals were granted many years ago. Further, some were granted due to the nature of the subsidiary being a regulated entity in itself. Since the time of the approval the nature of the companies appears to have changed significantly and, as such, the status of the approved asset may be subject to review.

There was also an issue concerning our request for information re the trial balances for certain subsidiaries. Investments in these subsidiaries have been approved for section 30 purposes. From our visit we understand that these investments are being valued on a net tangible asset basis without consideration of earnings or growth of earnings.

**Loan Exposures – Intra-Group Funding**

The exposures in the table on the following page appear to have been reported to APRA as loans to private trading companies, whereas they should have been reported as intra-group funding. These exposures are not apparent from the information provided in the March statistical information provided to APRA.

When considered in the context of the follow-up trial balance information HIH has provided to APRA, it is clear that the FAI balance sheet is one of great complexity with respect to the flow of funds between related entities. At the same time, HIH appears to lack a central treasury co-ordinating function to monitor and approve these flows.

Head of Asset Risk
<table>
<thead>
<tr>
<th>Borrower</th>
<th>Debt $</th>
<th>Maturity</th>
<th>Security</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAI Finance Corp. Loan No.1</td>
<td>15,806,803</td>
<td>31/12/02</td>
<td>Second ranking fixed and floating charge</td>
<td>Not provided</td>
</tr>
<tr>
<td>FAI Finance Corp. Loan No.2</td>
<td>15,843,040</td>
<td>31/12/02</td>
<td>Second ranking fixed and floating charge</td>
<td>Not provided</td>
</tr>
<tr>
<td>FAI Finance Corp. Loan No.3</td>
<td>500,000</td>
<td>On 90-days demand</td>
<td>nil</td>
<td>Not provided</td>
</tr>
<tr>
<td>FAI Finance Corp. Loan No.4</td>
<td>900,000</td>
<td>On 90-days demand</td>
<td>nil</td>
<td>Not provided</td>
</tr>
<tr>
<td>FAI Home Security</td>
<td>7,781,529</td>
<td>31/12/02</td>
<td>Mortgage over shareholding in FAI Finance Corp.</td>
<td>Repayment due 31/12/99 deferred to 12/00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Repay $4</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>31/12/00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Repay $2 m</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>31/12/01</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Balance on maturity</td>
</tr>
</tbody>
</table>
Note for File        APRA

Ref: HIH Quarterly Returns
30 July 2000

Accuracy of HIH Group Quarterly Returns

APRA received the March 2000 quarterly return for FAI on 25 May 2000. However, I am of the view that the return is compromised by the information which has come to light from the Asset Risk visit earlier this month. The returns have been found to contain material errors, in particular in relation to the carrying value of many loans in the portfolio. In addition, the carrying value of many of the previously approved section 30 assets which, from subsequent information, may have been materially overstated.

Section 30 of the Act defines a series of assets not allowable for solvency purposes and gives scope for approval of some classes of those assets to be included in the solvency calculation. For example, RBC (related body corporate) assets are excluded from the solvency calculation unless approved under section 30.

When reviewing the December 1999 quarterly return for FAI, it was noted that the company had reported only a net figure for RBC loans (that is, loans to RBCs were reported net of loans from RBCs) therefore overstating the solvency position. The error was apparent from the inclusion of negative numbers in the relevant attachment. A manual adjustment of $91.8 million was made by the analyst in arriving at the adjusted NTA. The March returns revealed netting of RBC assets and liabilities to the extent of $210m.

Other issues cast further doubt on the accuracy of the quarterly and annual returns. These include:

- Unexplained or unusual data in quarterly returns such as the very large re-insurance expense reported in the 30 June 1999 return of HIH C&G, and an unexplained increase in shareholders’ equity in the FAI General return at 30 September 1999.
- The information coming out of the March 2000 Prudential Consultation that the Group managed itself on a business line rather than an entity basis, raising some concerns about the attention the authorized legal entities were receiving. This had obvious implications for the integrity of data relating to those legal entities.
- Large discrepancies between the quarterly and annual returns, as noted in the annual review of HIH C&G for the year ended 30 June 1999.
• The large number of issues arising out of the Asset Risk Review, including the netting issue, related body assets apparently misclassified as unlisted securities and overvalued and approved related body assets.

In a telephone conversation with Mr Abela from HIH, I was informed that all annual adjustments would be reflected in the June quarterly returns and that the returns would be corrected for the disclosure issues identified in the Asset Risk visit and, for these reasons, the June quarterly returns would be late. HIH has assured us that procedures would be tightened to ensure that future returns are accurate.

It has been decided that rather than revising the March returns, priority is to be placed on a review of the quarterly returns for June.

The due dates for future returns are as follows:

• June quarterly return – 15 August 2000
• June annual return – 31 October 2000
• September quarterly return – 15 November 2000

Junior Analyst
**Corporate Governance Regulatory Framework**

The general insurance industry is subject to regulation at a number of levels. The broadest level of regulation is provided by the Australian Securities and Investments Commission (ASIC). Among other things, ASIC administers those provisions of the Corporations Act dealing with the conduct and disclosure obligations of financial service providers, including general insurers.

In addition, corporations listed on the Australian Stock Exchange must also comply with the business and Listing Rules made under the Corporations Act.

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**The Corporations Law**

A national system of law and regulation for corporations and the securities market was introduced by the Commonwealth, with effect from 1991; it replaced the previous cooperative Commonwealth–State scheme and arrangements. The new Corporations Law regulates the operation and market conduct of corporate entities, and the Australian Securities Commission was established with regulatory powers.

The Corporations Law—now the *Corporations Act 2001*—underwent a number of amendments during the 1990s, as a result of various review processes. Following the Wallis report, the corporate regulator, the Australian Securities Commission, became the Australian Securities and Investments Commission (ASIC) from 1 July 1998. ASIC was given additional responsibility for the consumer protection–related functions of all banks, insurance companies and other prudentially regulated financial institutions.

ASIC is required under its legislation to monitor and promote market integrity and consumer protection across the financial system. It is also responsible for the registration of auditors and liquidators and the regulation of financial services organisations and professionals who deal in and provide advice on investments, superannuation, insurance, and deposit-taking and credit services.

Corporations Law is replete with mechanisms designed to detect danger signs and promote the financial health and longevity of commercial entities. The law imposes duties and responsibilities on corporate officers and others such as auditors to ensure that problems that may adversely affect the solvency of a commercial entity are detected at an early stage. When problems of this nature are detected, corporate officers have a responsibility to take action. Corporate officers must inform the regulators and the public of the company’s true financial position.
THE AUSTRALIAN STOCK EXCHANGE

The Australian Stock Exchange (ASX) operates Australia's primary national stock exchange for equities, derivatives and fixed interest securities. It also provides comprehensive market data and information to a range of users. As a recognised stock market under the Corporations Law, the Australian Stock Exchange is required to have adequate business rules for the conduct of trading on the market and adequate Listing Rules regulating the conduct and activities of entities listed on the exchange. Both the business rules and the Listing Rules are given the force of law.

The ASX has a particular focus on the disclosure practices of listed entities, including through the continuous disclosure regime. ASX Listing Rule 3.1 requires an entity to inform the ASX immediately of any information that a reasonable person would expect to have a material effect on the price or value of the entity’s securities, such as information about their financial position, performance or prospects. This is subject to several exceptions related to confidential information under rule 3.1A. These arrangements are designed to ensure that the market is well informed and efficient. Guidance Note 8 provides assistance to listed entities in their compliance with the disclosure obligations.

Listing Rule 4.10 requires disclosure within the annual report of the corporate governance practices that the company has in place during the reporting period. Further guidance on the matters to be addressed is provided in Guidance Note 9.

ACCOUNTING AND AUDITING STANDARDS

The Corporations Act lays down financial reporting requirements for companies; one such requirement concerns compliance with relevant accounting standards in the preparation of financial statements. The purpose of the accounting standards is to ensure that companies report financial information that is accurate, reliable and comparable (both between companies and over time) so that, among other things, people and organisations can assess the performance and financial position of the reporting entity. Responsibility for the development and promulgation of accounting standards lies with the Australian Accounting Standards Board.

It is the responsibility of the directors of a company to produce accounts that are in accordance with the requirements of the Corporations Act. This Act stipulates that companies must keep financial records that allow true and fair financial statements to be prepared and audited. The financial statements must comply with accounting standards and give a true and fair view of the financial position and performance of the entity.

The Act also imposes on most companies a requirement to have their financial statements audited by a registered auditor. This process involves the examination of records or financial accounts—to determine their accuracy and whether they comply
with relevant standards and give a true and fair view of the financial position of the company.

Auditing standards are set by the Auditing and Assurance Standards Board. Unlike the accounting standards, auditing standards do not have the force of law. Professional obligations include compliance with the auditing standards.

The auditing standards cover a number of issues and matters. Some deal more with the performance or process of the audit, whereas others deal more with ethical considerations and responsibilities of the auditor.

Internal auditing is a discipline, quite distinct from the external or statutory auditor, that addresses the risk management, control and governance processes of an organization. Internal auditors seek to improve organizational operations and promote the achievement of organizational objectives. They do this by the review of existing systems and analysis of proposed systems and providing advice on the controls they contain. The Auditing Standard AUS 604 (Considering the Work of Internal Auditing) requires auditors to satisfy themselves as to the scope and effectiveness of the operations, policies and procedures of the internal audit function prior to their reliance on the work performed by that function.

Auditor independence is a critical element going to the credibility and reliability of an auditor’s reports. Audited financial statements play a key role promoting the efficiency of capital markets and the independent auditor constitutes the principal external check on the integrity of financial statements.

The current regulation of audit independence derives from:

- the Corporations Act 2001; and
- professional standards and guidance issued by the professional accounting bodies.

The relevant requirements of the Corporations Act are concerned with such matters as indebtedness and employment relationships between a company and its auditor. The standards and guidance issued by the professional accounting bodies are more comprehensive. The enforcement of these requirements is generally undertaken by the professional bodies themselves.

**Director’s duties**

In addition to requirements relating to financial reporting and disclosure, the Corporations Act imposes other duties on directors such as:

- Duty to act with care and diligence and in good faith;
- Prohibition on the improper use of position or information for personal gain;
- Duty to disclose material personal interests;
- Role of shareholders in the making of company decisions.

The Corporations Act also imposes requirements in relation to the powers of directors, the appointment of directors, directors meetings, shareholder meetings and voting requirements.

The following are some relevant sections of the Corporations Act relating to the responsibilities of directors and officers of public companies:

**GENERAL DUTIES**

**180 CARE AND DILIGENCE**

*Care and diligence—directors and other officers*

(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

(a) were a director or officer of a corporation in the corporation's circumstances; and
(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

*Business judgment rule*

(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and
(b) do not have a material personal interest in the subject matter of the judgment; and
(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
(d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.
(3) In this section:

*business judgment* means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

**181 Good faith**

*Good faith—directors and other officers*

(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the best interests of the corporation; and
(b) for a proper purpose.

**182 Use of position—Civil obligations**

*Use of position—directors, other officers and employees*

(1) A director, secretary, other officer or employee of a corporation must not improperly use their position to:

(a) gain an advantage for themselves or someone else; or
(b) cause detriment to the corporation.

**Oppressive Conduct of Affairs**

**232 Grounds for Court order**

The Court may make an order under section 233 if:

(a) the conduct of a company’s affairs; or
(b) an actual or proposed act or omission by or on behalf of a company; or
(c) a resolution, or a proposed resolution, of members or a class of members of a company;

is either:

(d) contrary to the interests of the members as a whole; or
(e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.
Flailing HIH has only itself to blame

Mark Westfield

Ray Williams finds his HIH Insurance, once again, out of favour in the market as the group struggles to convince investors it has a strategy against a backdrop of a darkening earnings outlook.

HIH, however, must bear the additional burden of being perceived to be poorly run by an entrenched management team led by Williams. It has also failed to extract the potential synergies from its three acquisitions since it listed as CE Heath in 1992 and is still suffering from its over-payment for FAI Insurances early last year.

Time and again, the issue of most concern for analysts and fund managers is management.

Williams founded CE Heath in the 1970s and remains one of the industry’s survivors, growing his group through a string of acquisitions.

Yet the various systems of the insurers he has bought, starting with CIC (owned by the Swiss Winterthur group), then Colonial Mutual General Insurance and, finally, FAI, are not compatible. The group consists of four separate businesses.

Although HIH clearly paid too much when it acquired FAI for $300 million, it had to make a further $130 million in provisioning. After accounting for $275 million in goodwill, HIH holds an asset in FAI with negative net worth of $105 million.

Yet Williams has failed to use the well-known FAI brand name to push the group which is otherwise largely oriented to commercial lines, into the retail market.

HIH’s board is dominated by ex-partners of Arthur Andersen, HIH’s long-time auditor.

Perhaps the best outcome for shareholders would be another merger, not by HIH this time, but with HIH being the target.

Two groups, one international and Queensland’s Suncorp-Metway, have attempted to have discussions with Williams, but he has rebuffed them in a situation similar to AMP’s rejection of National Australia Bank’s approach.

According to one funds manager, “Something will happen. It’s a question of price and time”.
Looks like HIH is in for stormy weather

Mark Westfield

HIH Insurance staged a weak recovery yesterday in response to a statement to the Australian Stock Exchange notable for containing no new information but the general insurer’s problems loom as large as ever.

It is essential, therefore, for HIH management under long-time chief executive Ray Williams to get the share price up, and very substantially.

Williams’ management style is an issue frequently raised by analysts and fund managers, yet there is no obvious successor, although former FAI Insurances chief executive and now HIH director, Rodney Adler, is being mentioned more often as a potential candidate.

Yesterday in a statement to the ASX attempting to clarify lingering concerns about HIH’s capital adequacy and earnings outlook, the company declared that it did not need to raise any fresh capital. It said too that its investment performance was “consistent with market” and that it would review its global operations, claiming that Australia was “sound”.

In an extraordinary admission, HIH said that its international businesses (apart from New Zealand) “will not be contributors to the bottom line this financial year”.

Adler buys into embattled HIH

Anthony Hughes

Businessman Mr Rodney Adler has emerged as a potential savior for besieged insurer HIH Insurance, buying close to $2 million worth of shares during last week’s plunge and saying he will buy more.

Mr Adler, an HIH director and former managing director and major shareholder of FAI Insurances, bought 1.87 million shares at $1.01 each on Thursday, the same day HIH issued a statement to the market aimed at quashing concern about its capital position. HIH closed slightly lower at $1.02 but dropped to new lows below $1 last week.

Mr Adler said yesterday he was an “ongoing buyer”, but would not comment on speculation about him playing a greater role in HIH’s future. The speculation has included that he might take over Mr Ray Williams’ position as managing director, though this is considered unlikely.
Mr Adler yesterday bought more shares and is expected to file another director’s interest notice today. “I am a non-executive director of HIH. It’s awfully hard to comment on speculation,” he said. “It would be wrong for me to say there are no problems because the share price has gone down so much.”

Mr Adler said the company’s long-term potential was strong given it had 2 million customers and 14 per cent of the general insurance market. “They have some serious fundamental strengths” he said.

**HIH holders seek change**

Sean Aylmer

Large shareholders in HIH are lobbying for wholesale management changes at the troubled general insurer, including the removal of chief executive Mr Ray Williams.

Shareholders yesterday said change was needed at HIH given the company’s poor share price performance. HIH shares rose 5 cents to $1.12 yesterday, but are still around half the level of 12 months ago.

One representative of a major shareholder said investors had been discussing possible changes at the top of the company to halt the debilitating slide in market capitalization. But he emphasized that Mr Williams should not carry all the burden of the poor share price performance, and other managers should also move on.

“No-one is really happy with Ray Williams’ performance ... but there are other senior managers also at fault. There has to be wholesale changes at the top of HIH.”

“The business has no clear strategy. It has had a poor overseas expansion policy and no real understanding of IT. And it’s not only investors that are concerned. Middle-level employees are also worried about where they can go in the company.”

“If you have good management you will have a good share price. Ray Williams has been an excellent MD...but now we need new management in HIH,” the representative said.

Another shareholder agreed, saying the comments about management were “close to the mark”.

A spokesman for the company last night declined to respond to investors’ comments.

The company’s four largest shareholders are Maple Brown Abbott with more than 8 per cent of shares on issue, Mercantile Mutual with close to 6 per cent, family interests associated with HIH director Mr Rodney Adler (around 5 per cent) and a group comprising of management and staff (also around 5 per cent).
The organization has several other large institutional shareholders with significant stakes. While some investors said they were unhappy with management, most declined to comment publicly, wanting to avoid a boardroom brawl.

When asked whether he was happy with Mr Williams' performance, Mr Adler yesterday said: “Absolutely. I am a very happy non-executive director. I am disappointed in the fall in the share price but I think it will bounce back. I know that management of the company is working hard.”

Mr Adler last week very publicly raised his family’s stake in HIH to around 5 per cent.

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**Adler bid may claim HIH prize**

Sean Aylmer

A boardroom stoush is brewing at beleaguered insurance company HIH, with board member Mr Rodney Adler positioning himself to take on chief executive, Mr Ray Williams, according to fund managers.

Mr Adler – who joined the board two years ago, when HIH purchased his company, FAI Insurance, for close to $300 million - was positioning himself to run the company, one major HIH shareholder said.

Another said Mr Adler had been moving behind the scenes to destabilize Mr Williams' position. The fund manager would support the removal of Mr Williams, but would not necessarily support Mr Adler if he made a bid to become chairman of HIH.

It is understood that most of the HIH board would support Mr Williams, the long-term incumbent, in any move to remove the chief executive.

Excluding Mr Williams and Mr Adler, the board has 10 members. Six worked or consulted for HIH or an associated company before joining the board.

Mr Adler would not confirm, or deny the speculation: “I'm a buyer of shares and a non-executive director and I've heard the rumors,” he said.

Mr Williams is also a major stakeholder in the company, holding 10.6 million shares. He was unavailable for comment.
HIH board, Chairman backs Williams

Sean Aylmer

HIH chairman Geoffrey Cohen yesterday stood by the company’s chief executive, Mr Ray Williams, saying he had the full support of the board.

The comments were a response to rumblings among fund managers that Mr Williams’ position was under attack from board member, Mr Rodney Adler.

“The position of the chief executive is not an issue. Ray Williams has always had, and continues to have, the full and unconditional support of the board,” Mr Cohen said.

It is understood that Mr Adler yesterday spoke to Mr Williams and re-affirmed his support. HIH shares closed 1c higher at $1.17.

Despite the comments, speculation about Mr Adler’s actions continued yesterday.

One fund manager said there was plenty of activity going on behind the scenes.

“The market view is HIH management have not delivered. They are long on promise and short on delivery. It’s a little bit autocratic and there needs to be a change before the market will accept it,” he said.

There has been some concern in the market-place about the independence of the board members. Of the 11 members of the board, five are executive directors. Two of the non-executive directors, Mr Michael Payne and Mr Robert Stitt QC, have previously undertaken work for HIH.

Mr Adler took his position on the board following HIH’s acquisition of FAI Insurance at the beginning of last year.

Share market analysts said the perception that the board would remain loyal to Mr Williams, no matter what, could be a concern.

“It does not have that air of independence that we would normally like to see,” one fund manager said.