HIH inquiry seeks scapegoats for Australia’s biggest bankruptcy

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The year-long royal commission investigating the wreck of Australia’s second largest general insurer is slowly drawing to a close. The lengthy list of witnesses finished in December. The final report is due by February 28—nearly two years after HIH Insurance collapsed, affecting millions of small investors and policy holders.

On December 20, the commissioner, Justice Neville Owen, issued a “no publication” order on the concluding submissions, which are expected to recommend criminal charges against about 20 people.

HIH suddenly went into liquidation on March 15, 2001. In what has become Australia’s largest corporate failure, HIH left in its wake more than $A5 billion of losses, two million worthless insurance policies and about 1,000 former employees. The total damage bill is still not determined. Justice Owen refers to a $5.3 billion debt, but estimates range from $2 to $10 billion.

After initially refusing to conduct an inquiry, the Howard government reluctantly announced a royal commission, hoping to head off public anger. [See *Australian government forced to call royal commission into major insurance collapse*, www.wsws.org/articles/2001/may2001/hih-m22.] In his opening address to the inquiry, Owen stated: “The aim of the Commission, in each aspect of its work, will be to help redress the public disquiet to which the failure of HIH has understandably given rise.”

From the government’s standpoint, in order to restore investor confidence and deflect attention from its own role, some scapegoats were needed and it appears that the royal commission will provide an abundance. The inquiry’s central focus has been on the part played by a few individuals in HIH’s final days.

As with the Enron disaster in the United States and other corporate collapses around the world, HIH’s demise followed the deregulation of financial services, giving market forces a free rein. In 1996, Howard’s government commissioned leading businessman Stan Wallis to review the financial system and the regulation of banks, insurance companies, superannuation funds and credit unions.

As a result, in 1997 the government replaced the Insurance and Superannuation Commission, which supervised the capital adequacy of insurance and superannuation funds, with the Australian Prudential Regulatory Authority (APRA). The Australian Securities and Investment Commission (ASIC) replaced the Australian Securities Commission in reviewing sharemarket conduct, including disclosure and licensing. Treasurer Peter Costello described his “reform package” as a “landmark in the history of corporate and financial regulation”.

The royal commission heard evidence that staff at the newly established APRA were handed a one-page summary of each company for which they were responsible and given about six days of training. APRA’s intention was to appoint seven officers to oversee HIH. This never eventuated and by late 2000 the original three became one or two. APRA had about 400 staff to monitor the operations of about 85 percent of the Australian financial system.

According to a report by Canadian regulator John Palmer, filed with the commission, APRA ignored many warnings that HIH was in trouble. In 1999, actuaries within the HIH group advised APRA that HIH was insolvent. In June 2000, the Treasury Department told APRA there were problems at HIH. The following month, a senior HIH insider informed APRA of serious financial concerns. Around September 2000, APRA assessed HIH to be “high-risk” but apparently took no further action. Two state-based insurance authorities told APRA they intended to appoint inspectors to HIH, but APRA asked them not to.

In December 2000, APRA received a further disturbing report from Westpac, HIH’s bank, that supposedly was not read by anyone at APRA until March 2001. HIH missed the deadline for filing December 2000 quarter financial statistics, yet APRA gave the company an extension to March.

In the meantime, in line with the government’s “consultative” approach of minimal regulation, APRA worked with the management behind closed doors, helping it sell parts of its business to other major companies at rock bottom prices.

HIH’s demise can be traced back to the increasing globalisation of financial markets in the 1980s. In 1987, CE Heath International Holdings (as HIH was then known) began to diversify from its main areas of expertise, which were Australian workers compensation and professional liability insurance. It entered the California workers compensation market and by 1992 it was experiencing huge losses there that eventually totalled around $350 million.

In 1994, the company entered the high-risk Lloyd’s of London reinsurance market. Underwriting other insurance companies’ policies contributed around $150 million worth of loss. The Swiss insurance group Winterthur bought 48 percent of HIH in 1995 but sold its interest in 1998 when the share price began to fall after investments in Hollywood movies and marine insurance failed.

These losses, already known to industry insiders, were hidden from public view and the share price kept artificially high by adopting a business model of selling insurance policies in Australia at unprofitable premium rates (as much as 60 percent under-priced). HIH thus grabbed huge market share, but was under-reserved by $1 billion, especially in areas with “long-tail” claims that can arise many years down the track.

HIH then purchased FAI Insurances in 1998 for $300 million, without conducting the standard due diligence or the pre-purchase inspection of books. Sydney multi-millionaire Rodney Adler had inherited FAI from his father. Some financial analysts suggest that both FAI and HIH were insolvent at the time, yet $275 million of the purchase price represented the goodwill of FAI. HIH wrote off $400 million in FAI bad debts within a year while still claiming $438 million worth of FAI goodwill as an “asset” on its books.

Throughout this period, Arthur Andersen & Co., were HIH’s auditors. Senior personnel from Arthur Andersen (Dominic Fodera, HIH’s chief financial officer, Geoffrey Cohen, chairman, Justin Gardner, non-executive director) became board members and executives of HIH, just as Andersen executives did at Enron.

Despite the long-term, systemic and officially-sanctioned nature of these dubious operations, the royal commission has concentrated on the role of certain individuals in the transfer of company funds just prior to its collapse.

HIH CEO Ray Williams shifted hundreds of thousands of dollars around the world into and out of HIH accounts in Hong Kong and personal accounts in the UK, Guernsey and the Isle of Man. Williams testified that he had “no idea” that the HIH board would announce an $800 million loss four months after he resigned as CEO. ASIC has already banned him from acting as a company director for 10 years.

Williams and Adler allegedly used HIH company funds to buy $10 million worth of its own shares. For this and other misdeeds, Adler has been banned from being a company director for 20 years. He is also defending criminal charges of manipulation of the stock market and making false and misleading statements.

According to documents tendered to the commission, Brad Cooper and Ben Tilley received more than $16 million from HIH in its final six months, including $2 million just the day before the company went into liquidation. The sum was an “introduction” fee for proposing to Kerry Packer, Australia’s richest individual, an investment with HIH that did not materialise.

As sordid as these transactions were, they were hardly the underlying cause of the HIH debacle. As insurance analyst Ben Zehnwirth, the managing director of Insureware, commented: “Payments made to Brad Cooper, gifts showered on Ray Williams’ staff and monies spent on award-winning Christmas parties are not even items in the $5.3 billion loss calculation.”

And the cover-up of HIH’s losses began far earlier. HIH CEO Randolph Wein gave evidence last September that accounting firm Ernst & Young expressed concerns that the reserves held by HIH were insufficient as early as 1995 and that accounts prepared by Arthur Andersen were less than adequate.

Three weeks after he testified, Wein died in a hit-and-run accident in Hong Kong on October 8, when a truck collided with his motorcycle. He was working in Hong Kong as a consultant assisting HIH’s liquidator, Tony McGrath of KPMG. Hong Kong press reports suggested that Wein may have been murdered.

Originally scheduled to report by June 30 last year, the royal commission has so far cost around $40 million, $10 million over budget. If one includes fees paid by witnesses to their own lawyers, the cost is probably in the order of $100 million. Yet, none of the victims of the crash will be compensated and little is expected to change as a result of the inquiry.

While the commissioner has devoted considerable resources to reviewing individual misdeeds, he has barely examined other important areas. Little attention has been paid to the failure of the US and British ventures—executives and auditors of those businesses were either not called or released after brief statements.

Owen’s terms of reference excluded any examination of the government’s responsibility. Part of his official task was to examine “the adequacy and appropriateness of arrangements for the regulation and prudential supervision of general insurance at Commonwealth, State and Territory level,” but in his opening address he made it plain that he would not call into question the government’s free market policies or the domination of the profit system.

“Any recommendations that are made for changes to the regulatory regime must be commercially and morally practical, realistic and effective,” he declared.

Owen may make recommendations aimed at avoiding future corporate collapses in the future, but they are likely to be cosmetic. Already, the government has introduced new regulations that still allow general insurers to operate at greater risk than life insurers. No actuary is required to determine the adequacy of reserves to cover potential losses. APRA’s new standards are based on a 90 percent probability that at least one company will fail in the next three years.

Moreover, in mid-November Howard announced another inquiry into the powers and conduct of federal regulators, to be conducted by John Uhrig, former CRA and Westpac chairman. This review is expected to address big business concerns that the regulatory authorities are too intrusive. The Business Council of Australia welcomed Uhrig’s inquiry and is expected to play a significant role.