

# Corporate Governance --o0o-- Background & Session Outline

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IAAust BIENNIAL CONVENTION 2003

## IAAust Actions

- ASX Corporate Governance Council
- HIH Royal Commission Taskforce
- Corporate Governance Taskforce

## CG Taskforce actions to date

- Analyse and discuss alternatives
- Member input at September 2002 Horizons meetings
- Develop draft recommendations

## Session Outline

### First Hour

- Overview of global issues (A Doble)
- Overview of HIH RC report (A Coleman)
- Outline draft recommendations (C White)

### Second Hour

- Delegates' questions and comments

## Steps after this Convention

- Second Draft of Recommendations
- Discuss with Council in late June
- Further Horizons Meetings in July
- Final Recommendations in late July
- Final Report to Council in August
- Recommend necessary changes  
Code of Conduct, Standards, Guidance Notes, etc
- Due process for approval by members

# Corporate Governance --o0o-- Global issues

Alan Doble

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## Corporate Governance Overview

- Governance failures around the world
- Considerable public concern
  - => Numerous Enquiries
  - => Country Specific Responses
  - => Remedial Actions Commenced



## USA

- Failures = Enron, WorldCom
- Cause = Inaccurate financial reporting
- Response = Sarbanes-Oxley Act
  - Highly prescriptive
  - More independence of boards
  - Board statements of compliance
  - Certification of internal controls



## UK

- Higgs Report: Governance of Boards
- Actuarial interest: failures in Insurance
  - Pensions mis-selling
  - Guaranteed annuity options (Equitable)
- Review of role of Appointed Actuary
  - Stronger oversight of 'with profit' funds



## Canada

- Canadian Institute of Actuaries
- Strong regime of compliance
- Well developed peer review process



## Australia

- Failures – Ansett, One.Tel, HIH
- Several Enquiries
  - Ramsay: Independence of Auditors
  - CLERP 9: Corporate Disclosure
  - HIH: Royal Commission



## Australian Corporate Governance Standards

- IFSA Blue Book (updated 12/2002)
- Corporate Governance Council (21 bodies)
- ASX 10 Principles (March 2003)
- Addressing similar issues to USA & UK
  - ... mainly on governance of Boards



## **ASX – A Company Should:**

1. Lay solid foundations for management & oversight
2. Structure the Board to add value
3. Promote ethical & responsible decision making
4. Safeguard integrity in financial reporting
5. Make timely & balanced disclosure



## **ASX – A Company Should:**

6. Respect the rights of shareholders
7. Recognise & manage risk
8. Encourage enhanced performance
9. Remunerate fairly & responsibly
10. Recognise the legitimate interests of stakeholders



## **IAAust Response**

- Let others address conduct of Boards ... since that is already well covered
- Concentrate on Actuarial Governance





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## HIH Royal Commission Taskforce Report

*Tony Coleman*

## Introduction

- HIHRC Report Released 17 April 2003
- 61 Policy Recommendations
- 56 Referrals to ASIC and/or DPP – No actuaries amongst these

## Introduction

- Found HIH collapsed due to persistent under-reserving of claims liabilities (and associated underpricing of business)
- Positively received by Federal Government-formal response due mid-May

## Introduction

- 13 members of IAAust gave evidence to HIHRC. 10 gave evidence in person. 3 of these gave expert evidence on actuarial matters based upon work completed after the collapse of HIH
- Members of IAAust may read the HIHRC report and relevant evidence on HIHRC website ([www.hihroyalcom.gov.au](http://www.hihroyalcom.gov.au)).

## Introduction

- HIHRC report raises issues for the actuarial profession that need considered response
- Provides an important opportunity for the profession to contribute to sound management practices in the broader financial services industry and the corporate sector generally

## Approach of IAAust

- IAAust established a HIH Royal Commission Taskforce (the “Taskforce”) in 2001
- Two formal submissions to HIHRC on behalf of IAAust in July and December 2002
- Consultation meetings with the Commissioner and staff of HIHRC at the request of the HIHRC.

## Approach of IAAust

- Virtually all of the recommendations contained in the IAAust's submissions to the HIHRC are consistent with the equivalent recommendations set out in the report of the HIHRC
- Profession now needs to consider the recommendations of the HIHRC
- A public report by the Taskforce to members has been put on IAAust website



## Approach of IAAust

- The Taskforce report addresses:
  - a) expected future policy outcomes from the work of the HIHRC; and
  - b) elements of the work of the HIH RC that have reflected upon the conduct of various members of the actuarial profession
- Separate Taskforce letter to the President of IAAust specifically recommended that professional disciplinary inquiries be conducted by IAAust with respect to various matters considered by HIHRC concerning certain individual actuaries.



## Approach of IAAust

- The IAAust President has exercised his right to initiate such professional disciplinary inquiries
- The IAAust Constitution requires that the names of the actuaries concerned remain confidential at this stage of the professional disciplinary inquiry process.
- Taskforce has sought to preserve access to material available to HIHRC for use in IAAust professional disciplinary inquiries.



## Approach of the HIH RC

Royal Commissioner decided as a matter of policy not to make any referrals about individuals to either :

- (a) APRA (who have a power under Section 27 of the Insurance Act to direct an authorized entity to remove a director or senior manager from a position he or she holds), or
- (b) to any relevant professional disciplinary tribunal such as that of IAAust.



## Approach of the HIH RC

- "The tribunals are able to act according to their own constitutions; they will be in a position to make what they will of the evidence and findings reported here [in the HIHRC report]; and they are well positioned to form their own views on particular matters. In addition, some things relevant to the decision making processes of the tribunals have not been the subject of evidence or submissions to this inquiry." (Section 1.2.7, Vol 1, pp15-16, HIHRC report)



## Approach of Taskforce

- Taskforce needed to consider the applicability of the IAAust professional disciplinary scheme in these circumstances
- Taskforce considered the definition of "Actionable Conduct" under the Code of Conduct and Constitution of the IAAust
- Events investigated by HIHRC occurred while a different definition of Actionable Conduct was in place under the previous Constitution of IAAust from 1993 until December 2001



## HIH RC Policy Issues for Actuaries

### *Independence*

- Need to consider the merit of applying concepts recommended by HIHRC on Auditor independence to the role of the Approved Actuary and other similar statutory actuarial roles.
- Proposed test of independence is based on whether a reasonable person would perceive that independence might be impaired, considering all the circumstances surrounding the auditor's firm and their relationship with the insurer.

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## HIH RC Policy Issues for Actuaries

### *Independence*

- Non-audit work and the fees involved are to be disclosed, with an explanation of why independence is not thereby compromised. See Recommendations 9 to 12 & 17 of the HIHRC report.
- This is being separately addressed by the IAAust's Corporate Governance Taskforce.
- Royal Commissioner agreed with the IAAust submissions that the Approved Actuary could be an employee of the insurer.

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## HIH RC Policy Issues for Actuaries

### *Independence*

- Recommendation 17 specifically seeks to ensure the Approved Actuary is not an employee or partner of the organization to which the Approved Auditor belongs.
- Royal Commissioner also commented on the relationship between internal and external actuaries and between actuaries and auditors, concerning in particular the provision of complete and accurate data.

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## HIH RC Policy Issues for Actuaries

### *Peer Review*

- Royal Commissioner noted that peer review will often be a worthwhile exercise, but that "it may be an unnecessary impost which could be productive of delay".
- Royal Commissioner encouraged insurers and their auditors to consider carefully the need for actuarial input in the review of the actuarial advice received by the company, but he was not inclined to recommend that a formal process of peer review be made mandatory.

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## HIH RC Policy Issues for Actuaries

### *Peer Review*

- Acknowledged that where the auditor had access to actuarial advice within the same firm the process of peer review was effectively part of normal audit practice.
- The IAAust Corporate Governance Taskforce has been involved in a consultative process with members over the past six months on this issue

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## HIH RC Policy Issues for Actuaries

### *Regulation, Reporting & Accounting Issues*

- Several recommendations have the effect of increasing the regulatory role of the actuarial profession including Recommendations 8, 15, 16, 35 & 41 in particular.
- Twenty pages of the HIHRC report are devoted to suggested improvements to relevant accounting standards (AASB 1023 in particular) including various points raised in IAAust's submissions.

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## HIH RC Policy Issues for Actuaries

### *Regulation, Reporting & Accounting Issues*

- Recommendation 8 calls for Accounting Standard AASB 1023 to be aligned with APRA's Prudential Standard on the valuation of general insurance liabilities and for increased disclosure.
- Additionally, the Commissioner recommends that Australia participates in the development of international accounting standards and that the membership of the AASB and the Urgent Issues Group (UIG) be broadened to include professionals beyond the accounting profession.

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## HIH RC Policy Issues for Actuaries

### *Regulation, Reporting & Accounting Issues*

- Recommendations 15 & 16, call for APRA and the IAAust to introduce compulsory certification of the completeness and accuracy of data, and a requirement for more detailed disclosure of the exercise, incidence and impact of subjective judgement and departure from historical experience.

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## HIH RC Policy Issues for Actuaries

### *Regulation, Reporting & Accounting Issues*

- Recommendation 35 seeks to have the general insurer publish claims development information and 'a summary of the Approved Actuary's valuation of the outstanding claims liabilities, including the methodologies and assumptions underlying that valuation.'
- In the public interest, the Commissioner has sought improvements in financial reporting and disclosure including the introduction of an annual 'financial condition report' prepared by the Approved Actuary for the insurer's board and APRA (Recommendation 41). He notes that:

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## HIH RC Policy Issues for Actuaries

### *Regulation, Reporting & Accounting Issues*

"...in the normal course of events I consider that such relevant information concerning the financial strength of a general insurer should be made public. However, the publication of the financial condition report might inhibit the willingness of the approved actuary to reveal all of his or her concerns. Full and frank disclosure might be better achieved by requiring dissemination of the report only to the insurer's board and to APRA. Over time, as the preparation of the report becomes an established feature consideration could be given to the question of wider publication of the report or an extract of it."

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## HIH RC Policy Issues for Actuaries

### *Actuarial Function*

- The Commissioner noted that the new prudential regime, brought about by amendments to the *Insurance Act 1973*, represented a substantial improvement upon the regime in place during HIH's time.
- He notes the broad support for, and recognizes the "crucial role which actuaries play in the accurate valuation of what will ordinarily be the largest single item on the insurer's balance sheet."

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## HIH RC Policy Issues for Actuaries

### *APRA Role & Expertise*

- There are various recommendations the Commissioner makes in relation to improvements in the prudential standards and in the role and function of the APRA. Of particular interest to the actuarial profession is the suggested establishment of an advisory board for the APRA and the need for improved skills development and training within the staff of APRA. These are areas where the profession through the IAAust may be able to provide appropriate support and representation.

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## Conclusions & Recommendations of the Taskforce

1. Based upon the report of the HIHRC and evidence and submissions provided to the HIHRC, the Taskforce considers that the conduct of a number of actuaries involved in matters investigated by the HIH Royal Commission MAY constitute Actionable Conduct under the IAAust Constitution and/or MAY constitute a breach of the IAAust Code of Conduct. Accordingly, the Taskforce recommended that IAAust should conduct relevant professional disciplinary hearings.

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## Conclusions & Recommendations of the Taskforce

2. IAAust should review its Code of Conduct and Professional Standards in the light of the ultimate findings of the professional disciplinary hearings conducted into HIH related matters and relevant findings and recommendations of the HIHRC.

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## Conclusions & Recommendations of the Taskforce

3. IAAust should prepare a guidance note to alert members to the options available to them if they believe they may be faced with circumstances that give rise to the possibility of a breach of an IAAust Professional Standard or the IAAust Code of Conduct including the use of legal options that may be available where the member may be concerned by the existence of confidentiality clauses in employment or consulting contracts.

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## Conclusions & Recommendations of the Taskforce

4. IAAust should develop, in consultation with APRA, a mandatory guidance note in response to HIHRC Recommendation 15 covering compulsory certification of the completeness and accuracy of data used by the actuary. This new mandatory guidance note would also need to consider the terms of the existing GN551 and the extent to which GN551 should be rewritten as a professional standard to cover issues that arose in part because of a lack of communications between the auditor and actuary of HIH.

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## Conclusions & Recommendations of the Taskforce

5. IAAust should develop, in consultation with APRA, a mandatory guidance note in response to HIHRC Recommendation 16 covering "more detailed disclosure of the exercise, incidence and impact of subjective judgment and departure from historical experience." This recommendation appears to be principally aimed at disclosure of key actuarial assumptions and the sensitivity of the result to relatively small changes in those assumptions and the extent to which the key assumptions can be justified by historical experience.

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## Conclusions & Recommendations of the Taskforce

6. In association with developing a response to HIHRC Recommendation 16, IAAust should consider the preparation of a guidance note on "Peer Review" of statutory actuarial roles. HIHRC considered, but did not recommend, mandatory peer review. It seems logical that if an actuary is providing a valuation where a significant assumption is not in accordance with historical experience (see Item 5 above) that it would be prudent to obtain a peer review report. In such cases, a guidance note on how this should be done would be useful.

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## Conclusions & Recommendations of the Taskforce

7. IAAust should develop a professional standard to respond to Recommendation 41 of the HIHRC that the Approved Actuary of a general insurer must prepare a Financial Condition Report at least annually for submission to the Board of the insurer and APRA. It is noted that a sub-committee of the IAAust's General Insurance Practice Committee has been convened with a mandate to develop a suitable Professional Standard for such reports using the existing PS200 as a guide.

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## Conclusions & Recommendations of the Taskforce

8. IAAust should consider developing a professional standard or guidance note to respond to the technical issues inherent in Recommendation 60 with respect to general insurers establishing catastrophe reserves for taxation purposes.

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# Corporate Governance --o0o-- Draft Recommendations

Chris White

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## Introductory Comments

- We DO want your input (today, July Horizons meetings, or email)
- The recommendations are DRAFTS
- We do not expect everyone will agree with everything we recommend...
- ...but we must have broad support
- However the issues are critical, and we must act decisively to be effective
- Ultimately Council will decide

## Education & CPD

- Need recognised - Professionalism Course upgraded
- Now time to strengthen initial education
- ... and extend to qualified members also

### Draft Recommendation 1

Corporate governance & ethics to be included in Part III subject 4, the Professionalism Course, and CPD

## Independent Peer Review

### Rationale

- strengthen & maintain confidence in profession
- assure quality of advice
- narrow range of practice
  - standards, GNs, methodology, assumptions
- educate & develop actuaries
- support actuaries under pressure
- ensure objectivity of advice
- reinforce role of signing actuary

## Independent Peer Review (cont)

Consistent with developments overseas

- Canada
- UK
- South Africa

Would have helped in past problem cases, e.g.

- HIH
- Equitable

**Conclusion: Independent peer review of statutory reports would enhance quality & status**

## Independent Peer Review (cont)

- Independence rules should be no less stringent than those for auditors
- Final content of independent peer review to be determined; taskforce view in Rec 2
- Peer review of other work to be encouraged

## Independent Peer Review (cont)

### Draft Recommendation 2

#### Independent Peer Review to be required for statutory reports & returns, including

- review of data, methodology, assumptions, control processes,
- any other matter material to users,
- review of primary actuary's compliance with profession's and legal requirements

Guidance Note to be produced



## Independent Peer Review (cont)

### Definition of independence:

#### Reviewing actuary must

- not be employed by *primary actuary*, his/her *employer*, or *client*,
- not be a substantial shareholder of *employer* or *client*,
- have not within last 3 years been materially associated with *primary actuary*, *employer* or *client*,
- and be free of interest or relationship which could (or reasonably be perceived to) materially interfere with his/her judgment in review process



## Independent Peer Review (cont)

### Definition of Independence (cont)

To avoid appearance of loss of independence, other services provided by reviewing actuary in preceding 3 years should not involve

significant decisions, significant influence on financial standing, internal communication, transactions, product pricing, maintenance of actuarial records, valuation systems, legal disputes or litigation, accounting services, or advice on material acquisitions

in relation to the client organisation.



## IAAust Standards & Processes

- IAAust needs to ensure standards & processes meet community expectations
- Need to ensure practising members keep up to date; CPD needs to be reviewed
- Need continuous review process for standards & processes



## IAAust Standards & Processes

### Draft Recommendation 3

Review professional standards in light of HIH RC, developments in legislation, corp governance, & community expectations

### Draft Recommendation 4

Review code of conduct in light of developments in corporate governance, community expectations, whistleblowing



## IAAust Standards & Processes

### Draft Recommendation 5

CPD etc to be strengthened for statutory roles; may lead to practice certificates or other recognition of competence

### Draft Recommendation 6

Institute proactive review process - corp governance, independent peer review, code of conduct, professional stds/GNs



## Whistleblowing

- Statutory actuaries have whistleblowing obligations under Life, General & Superannuation legislation
- Statutory whistleblowing will only work if calling regulator not “life or death” jump
- Differences between 3 Acts, especially as regards obligations, powers, protections

### Draft Recommendation 7

Produce whistleblowing reference GN



## Whistleblowing (cont)

- None of the 3 Acts provide any protection to whistleblower against retaliation
- CLERP 9 proposes qualified privilege to employee reporting to ASIC
- ASIC/APRA cannot give unconditional confidentiality, but APRA gives best endeavours to protect identity



## Whistleblowing (cont)

### Draft Recommendation 8

IAAust to press for consistent treatment of whistleblowers by APRA & ASIC:

- CLERP 9 ASIC protections to be duplicated by APRA
- ASIC to do best to protect identities of whistleblowers



## Whistleblowing (cont)

- Whistleblowing less likely to be an issue if regular communication between senior people at FI and regulator

### Recommendation 9

IAAust to encourage regular confidential one-to-one communication between APRA and nominated senior people at FI



## Whistleblowing (cont)

- Most FIs don't have stated protocols for w/b, relying rather on corporate culture
- Arguments in favour of stated protocol:
  - Internal people most likely to know/discover w/b best done internally, but will it happen if no stated protocol?
  - Stated protocol encourages frankness - esp. by employees unlikely to see audit committee
  - Adopting stated protocol good self-discipline on FI



## Whistleblowing (cont)

### Draft Recommendation 10

IAAust to encourage regulators to devise best practice whistleblowing guidelines for adoption by FIs



## Mentors

- Awareness of professional integrity & seeking experienced guidance where necessary should be fostered throughout
- Professional Guidance Committee only current source formally available - however advice is sought informally
- Arguably unsuitable for whistleblowing - small profession & commercial conflicts; recently retired actuaries a possibility



## Mentors (cont)

### Draft Recommendation 11

#### IAAust should

- require Part III students to nominate Fellow as mentor
- establish panels for each major practice area of 3 senior (recently retired?) actuaries for whistleblowing contact
- nominate legal advisor for each major practice area for w/b advice



## Employment Contracts

- Often contain confidentiality conditions which could inhibit actuaries clarifying, let alone fulfilling, w/b obligations



## Employment Contracts (cont)

### Draft Recommendation 12

IAAust to recommend standard wording of employment contracts for statutory actuaries, giving right to seek independent actuarial or legal advice on w/b obligations

### Draft Recommendation 13

IAAust to communicate standard employment contract as best practice



## Questions for Audit Committees to ask Actuaries

- Warren Buffett suggestions for audit committee questions to auditors suggest analogous questions to actuaries



## Questions for Audit Committees to ask Actuaries

### Draft Recommendation 14

- Would actuary have preferred different assumptions etc to those used?
- Is information provided likely to prevent or hinder APRA's understanding?
- Would actuary have used different data collection & verification procedures, etc?
- Is actuary aware of actions that changed reporting period of revenue or expenses?

