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Head of Financial Supervision

10 JUN 2010

Mr Matthew Elderfield  
Financial Regulator  
Dublin

9<sup>th</sup> June 2010

International Green Institutions

15 JUN 2010

FINANCIAL REGULATOR

Dear Mr Elderfield

I trust that an individual may, on his own behalf, convey his views in response to your recently published consultation paper CP 41. Since my own full time career was served within the non life insurance industry, I confine my comments thereto.

Unequivocally and wholeheartedly I support your intentions to ensure that the regulatory regime here in Ireland will be improved to the highest standards, and is maintained as among the best internationally.

My personal involvement and history in financial services began when I was admitted a member of the institute of chartered accountants in England and Wales. I started with Commercial Union (CU), working in London. Subsequently I was transferred to Dublin as comptroller of Hibernian Insurance, owned by CU. I remained with this employer until retirement in 1995, after being their CEO for the previous 18 years.

The regulatory environment during the period from the 1970 's onwards, was influenced by the combination of various companies acts, by the then department of industry and commerce, and by the political influences of the day. The board which I joined in the early seventies in Hibernian included such luminaries as the CU board chairman, their UK CEO, and a group of inner establishment figures from the influential companies of the time, here in Ireland. One was a baronet, an Oxford cricket Blue in the thirties, another was the first CEO in the then fledgling aer lingus, another owned Waterford crystal etc. Blue blooded wasn't in it, and I was in awe of them all, as a mere mortal reporting cash flows to the weekly board.

However Ireland then had a small amount of people involved in its commercial life. When Ireland joined the EU, with Britain, in 1973, the gross written premium of its domestic market was about £75 million. By the end of the seventies it was over £700 million. Further significant changes were about to commence. One of these was the emergence of the concept of "all finance", providing one - stop shopping for all financial services.

I was then one of the lone voices raised against this concept., since, in my opinion there is no commonality between insurance and banking. Their respective risk profiles are opposites. In insurance, you get paid the risk premium up front. In addition when

notified of claims, one has sometimes a number of years before the claim is paid, thus enabling the insurer to claw back any losses through increased renewal premiums

In banking, the risk is immediate once the loan is approved and the cash amount is paid out. Even the management thinking behind the respective businesses is opposite in many fundamental operating respects.

However in the eighties two large general insurers went into administration, one in October 1983 and the other in 1985. The former was controlled by one individual, the latter had been under government control until a few years earlier. In around 1996 the government gave a licence to underwrite general insurance, and this new company allegedly controlled by one individual. That was just 13 years after a similarly controlled insurer had to go into administration, yet government seemed impervious to any risks that might arise., and nobody complained, especially, possibly, as another green flag was raised.

In my own career, I observed, in the seventies, the vigorous and successful contribution to the local market by an experienced insurance man who was provided as general manager by CU. In two years he changed the operating and control culture of the then Hibernian (now Aviva) and instituted changes to the management structure. He ensured that the culture of risk recognition and its acceptance into all aspects of underwriting was imprinted indelibly in all the departmental operating procedures.

He was promoted back to the UK, and then succeeded by a similarly – minded and authentic insurance trained person, also. I followed next and continued the serious recognition of endemic risk associated with the general insurance business. We recognised and implemented principles of risk in our investment policy, recognising this should be risk averse, whilst managing the dangers inherent in insurance and reinsurance. Thus the investment policy which we implemented was represented by 80 % of all funds being invested in a combination of cash deposits and short dated government bonds with a life of twenty four months. The balance of 20 % was invested between staff mortgages, property and equities. Thus solvency was never at risk of serious impairment, when occasional crashes in stock markets occurred. I recall once when working on an audit for CU in Paris, France, back in the sixties, that general insurance company investment policy was dictated by French law, and was a no risk strategy.

During my many years, I look back on one other achievement, where in 1981 we caused surprise by recruiting the first actuary to be appointed directly onto the staff. Initially this was prompted by worries about calculating and monitoring claims settlements, and was quickly overtaken by the recognition that in fact rate setting was his principal responsibility.



We worked diligently at ensuring that staff welfare and remuneration were fair, relative and competitive in our market. It was a huge surprise when, in Forbes November 1993 edition, we found our company name listed as among the 100 best in the world, on the basis of consistent high return on capital employed, in the category of annual sales under US \$ 500 million pa. What pleased us was that this recognition was earned through the pursuit of a very prudent and cautious, no risk, investment strategy.

We had been granted a stock market listing in July 1986, at which stage every single member of staff was entitled to participate in a share option scheme.

Operating procedures included continuous conduct, internally, of audits over all main functions in the company. Thus the commercial property manager would control all audits under his remit, similarly the motor manager, the liability manager, the claims manager, likewise finance, investments, IT and personnel. In addition there was a strong internal audit ethos. ( In fact I started my career in audit department of CU, where I spent over two years travelling throughout the UK ), and, occasionally in Europe. There was a self imposed stricture on the CEO, whereby he never interfered in the technical managerial decisions, unless invited to give an opinion thereon. It is the essence of qualitative management decision making, that it is shared by all those whose peer group accept them as such

There was also considerable amount of continuity at all levels, both in terms of staff turnover, under 4 % pa, and especially in the orderly management of change. This was particularly relevant in flattening out the management structures, and achieving the benefits derived from empowerment of individuals. This is an important contributor to the orderly and successful management of all companies.

If this consistency does not apply, then it makes it extremely difficult to nurture the quality of the business environment within a company, especially a large and complex one where inter dependency and continuous training are considered essential. There was no outsourcing at all, in those days. Nowadays I look askance at the apparent acceptance that outsourcing is effective and efficient, when arguably the price to be paid is an unbalanced and uncoordinated insurance underwriting entity

One always felt committed without question to fulfilling all compliance and regulatory requirements, as a matter of course. Rules are rules, and there are many who are brought up to accept and respect rules, and behave always with integrity and basic and transparent honesty. Others, sadly, find this difficult, because they do not have respect, for rules, or even anybody else but themselves. There have been occasions where one has to be resigned to accepting corporate diminution, in deciding to abide by the rules

The existence of a fiercely competitive spirit within markets is given little attention. indeed little prominence by those who have not been exposed to the deep realities of



the private sector. It, ie competitiveness, is the greatest single difference in the actualities of public and private sectors.

Competitiveness is the main reason why rules are broken, indeed oftentimes justified, because they signal between winning and dying, as an entity. It has been said, about the Fortune 500 greatest companies in the world, that over each ten year cycle, one third of these no longer exist in their original form. This rate of attrition is unknown in the public sector.

So how can regulation, per se, affect or influence the conduct of the companies and managements in the private sector. Yes it can, of course, and yes, it cannot also. Where there is a conflict herein, the rules of survival, or the rules of greed, will tend to gain the uppermost. However this is a discussion for another chapter in the development of a regulatory controlled environment. Let no one think that a conclusion has been achieved.

So, on how many levels can the regulatory environment be taught and explained. Certainly, as a concept, it needs to be taught to students, to teachers, to professors, to business establishments. It is the modern – day equivalent to the ten commandments. The business leaders of tomorrow are the students, junior managers of today. They will develop and grow their careers and become the business leaders of the next generations.

Once established, the regulatory framework will need to be established, over time, in tandem, and through dialogue, with those institutions to be regulated. Different rules will apply to different industries, i.e. between banks, insurance companies, credit unions, pension funds, and other institutions. Between large ones and small ones. Between those which are full captives, and co managed with parent companies, those that are plc 's, those that are mutual, those that are differently owned and controlled.

The shifts in influence in boards of directors can be profound, and this can mean that the expected checks and balances are not obtained. There is a tendency in boards for certain individuals to dominate, or exert greater influence or time, and thus adversely affect the balance and decision making independence which regulation is expected to achieve.

The existence of so many and so varied companies being regulated itself poses the question as to whether it is possible to formulate, in advance, a regulatory regime which is effective. One size does not fit all. It will take time and patience to deal in a practical and effective way with the individuality of the requisite requirements, before a final and comprehensive regulatory regime can be said to be in place.

In my experience, there is an important distinction between the domestic and IFSC type general insurance companies operating in Ireland. The former are mainly



operating in a local market, and the latter's operational areas are overseas. Since the late nineties I have served as a non executive director in companies as diverse as HSBC insurance Ireland, Hannover Reinsurance companies Ireland, other insurers owned by Italian, French and British and American institutions. Also I served on ABN AMRO Ireland board. ( I thought that the tragic consequences of the subsequent take over of that company was an issue that should have been avoided, if regulations had been in existence, whereby all sizeable takeovers had to be subject to wider supervisory powers ,additional to those of the financial regulator ).

I recall some of my observations, for example, one company's policy was to never appoint two friends as directors, another was not to appoint two at the same time, since it created a perceived bond between them. Another company, now one of the richest in the world, had a costs policy whereby executives travelled Ryanair and stayed in hotels with a maximum 3 stars. In my experience, there is a lot of serious intent surrounding these companies, and they are very choosy about whom they appoint as non executive directors. I believe that it is quality rather than quantity of directors that is the important issue. Furthermore, in all sizeable regulated companies, the financial regulator ought have statutory rights to attend at least one board meeting each year. This is by way of audit of the board and assessment of its conformity to the highest principles of regulation, in word and spirit.

The diminution in Irish ownership of domestic companies means that fewer locals hold positions of senior management authority. Where they do, their experience is limited to general insurance , with no exposure to reinsurance. When these senior managers retire, their background experience may be less attractive to foreign owned IFSC – type companies, looking for Irish non executive directors.

My experience over recent years, is that the Irish – domiciled IFSC-originated insurers are managed very firmly, and with an iron grip exercised by the overseas owner, on all management activity. Invariably too, the foreign owner provides the chairman, and key directors. Since the raison d'etre of these companies is mainly to maximise profits in a low tax area, this alone provides an effective focus. I must say too, that in those instances where authorised insurance management companies are providing their services, they are managed very well and provide an excellent service.

These service providers are very supportive of the developing regulatory legislation, and hold related seminars for their list of non executive directors. I am very impressed with the sincerity and honesty of purpose being exercised by them , in support of regulation, and full compliance.

The foregoing includes the main responses which occur to me, in relation to CP 41. It remains for me to thank you and colleagues for the inestimable service that you provide to the Irish economy, in the vital work upon which you are engaged

*yours sincerely,*  
*Eamon Walsh.*