LLOYD'S

MARKET BULLETIN

REF: Y4682

Title	Equity Syndicate Management Limited – Mr Douglas Morgan & Mr John Josiah
Purpose	To provide information relating to proceedings before the Enforcement Tribunal relating to Mr Douglas Morgan and Mr John Josiah
Type	Event
From	Katie Dorling, Secretary to the Lloyd's Enforcement Tribunal
Date	14 March 2013
Deadline	N/A
Related links	[T&C]

In proceedings before the Lloyd's Enforcement Tribunal, Mr Morgan and Mr Josiah have each accepted two charges of detrimental conduct.

During the period relevant to these proceedings Mr Morgan was the Finance Director of Equity Syndicate Management Limited ("Equity"). Mr Josiah was the active underwriter of Syndicate 218 which was managed by Equity. Syndicate 218 specialises in the provision of motor insurance.

In October 2011 two charges of misconduct were brought against each of Mr Morgan and Mr Josiah. The charges related to the fact that as Finance Director and Active Underwriter respectively, Mr Morgan and Mr Josiah were each responsible for ensuring that adequate systems and controls were in place in respect of the areas of the business for which they were responsible, including certain aspects of the Syndicate's reserving processes, and their failure to ensure that these standards were met in the specific instances as set out in the attached Notices of Censure.

Details of the events giving rise to these proceedings and of the charges accepted are set out in the attached Notices of Censure.

The Enforcement Tribunal has approved the following settlement terms in respect of Mr Morgan–

1 That Mr Morgan be censured in the terms of the attached Notice of Censure;

2 That Mr Morgan undertakes not to apply for a position as a director of a Lloyd's firm (underwriting agent, run-off company, Lloyd's broker or corporate member of the Society) for three years.

The Enforcement Tribunal has approved the following settlement terms in respect of Mr Josiah–

1 That Mr Josiah be censured in the terms of the attached Notice of Censure;
2 That Mr Josiah undertakes not to apply for a position as a director of a Lloyd's firm (underwriting agent, run-off company, Lloyd's broker or corporate member of the Society) for two years.

In addition Mr Morgan and Mr Josiah have each agreed to pay contributions of £145,000 towards Lloyd's costs in respect of these proceedings.

These proceedings were determined by the Lloyd's Enforcement Tribunal and its decision gives effect to the settlement of these proceedings agreed between Mr Morgan, Mr Josiah and the Council of Lloyd's.

This bulletin concludes Lloyd's enforcement action in relation to this matter. (Lloyd's has previously published details of related enforcement cases in Lloyd's bulletins Y4550 and Y4675).

The proceedings demonstrate the importance that Lloyd's attaches to the establishment and maintenance of sufficient systems and controls relating to claims reserving and the importance of the proper use of management information. Market participants should refer to the revised Claims Management Principles and Minimum Standards effective from 1 January 2012 (Market Bulletin Y4479 dated 31 March 2011) which includes detailed guidance in relation to claims reserving and related documentation.

Katie Dorling
Secretary to the Lloyd's Enforcement Tribunal

Notice of Censure - Douglas Morgan

Douglas Morgan was the Finance Director (“FD”) of Equity Syndicate Management Limited (“Equity”) from 27 September 2006 until 30 March 2010. Mr Morgan was appointed as Commercial Director responsible for commercial investments at the group level in the UK including Equity from 1 June 2009 to 30 September 2010. At all material times Equity was the managing agent of Syndicate 218 (“the Syndicate”) that underwrote business at Lloyd’s, specialising in the provision of motor insurance.

Case summary

Enforcement proceedings were brought against Mr Morgan in relation to two charges of detrimental conduct.

In summary, the charges related to (i) Mr Morgan’s alleged failure to take reasonable steps to ensure that there were sufficient systems and controls including the maintenance of an adequate standard of documentation in relation to certain aspects of the Syndicate’s reserving processes; and (ii) Mr Morgan’s alleged failure, in part as a result of these same systems and controls failures, to put himself into a position, as the director with responsibility for the 2009 year-end process and as the signatory of the relevant Data Accuracy Statement, to be able to ensure that accurate and complete information had been provided to the Syndicate’s external actuaries in respect of two reports prepared as at year end 2009.

Mr Morgan has agreed to settle these proceedings and has admitted two Charges of detrimental conduct in a settlement considered and approved by the Enforcement Tribunal.

Charge 1

Historically the Syndicate has had a sustained track record of consistently reporting profits and of prudent initial case reserving. During the course of its business, Equity, in common with other insurers, conducted reviews of claims files in order to release redundancy in case reserves. No criticism has been or is made by Lloyd’s of the principle of reviewing and adjusting case estimates in order to address conservatism in those estimates.

Specifically, Equity had in place the following processes to establish, maintain, and, where considered appropriate, to release case reserves in respect of claims: case reviews and rolling and annual reviews. “Virtual” file reviews, which did not in fact result in an alteration to the case estimate, also took place to check levels of redundancy and provide further information for Actuarial reviews.

In addition to those methods of setting and reviewing case estimates, Equity adopted a practice which for the purposes of this Notice shall be termed the “reserve reviews”. This process targeted the reserves at or after month 33, because, by the third year of development, uncertainty surrounding claims estimates would often have significantly reduced.

The reserve review process was a longstanding practice which had been in operation within Equity for many years before Mr Morgan took over as FD. Mr Morgan was aware that reserve reviews were undertaken in order to review and, if there was surplus reserve, to remove redundancy.

During the period relevant to this case the annual reserve review process was operated with the following characteristics:

1. From 2007, a reserve review was added in respect of the 30 June accounting year end to tie-in with parent company reporting;

2. A team of five senior claims handlers carried out a review of a selection of the largest claims (chosen by size of estimate) in respect of a selected YOA in order to identify and remove redundancy by reducing the case estimate on the file;

3. It was generally the case that in years that were anticipated to be likely to lead to poorer syndicate results, the amount of redundancy that the handlers removed was greater than those years when results were expected to be better; and

4. Unlike other types of reviews, the reserve reviews were based on an instructed level of intensity that varied from review to review and year of account. In 2007 – 2009 those conducting the reserve reviews were given a target figure.

The instructions to carry out these reserve reviews, including the targets to be achieved, came from Mr Morgan (along with another executive director).

As a result of these reserve reviews in 2008 and 2009, reserve releases of £76.2m (in 2008) and £100m (in 2009) were made. This was, in part, due to an exercise to bring case reserves on older years (2004 and prior) to or close to a best estimate level. They included substantial reserves being released from some YOAs and releases from YOAs in their early years of development. For example, the first reserve review in 2009 released £13.5m from the 2008 YOA (which was 8.7% of the total held reserves as at May 2009 of £155m or 6.8% out of total required reserves (outstanding plus IBNR) for that YOA of £197.2m as at May 2010) when that YOA was 14-17 months into the 36 month accounting period.

Whilst a reduction in a case estimate arising out of a reserve review was recorded against that case file's individual entry on Equity's computerised claims system no separate or adequate aggregate written records of the reserve reviews, including the level of redundancy released, were maintained by Equity. An accurate aggregate record of the outcome of the reserve review process would have eliminated the risk that the impact of the reserve reviews, was obfuscated by other claims activity and avoided any potential impact on the technical reserve setting process, for which the Board was responsible.

The Board of Equity was not provided with sufficient details about the reserve reviews or about the results of any specific reserve reviews during 2008 and 2009.

Mr Morgan was at all material times the director of Equity responsible for the 2009 year-end process for Equity and the related regulatory filings. The reserve review process was organised, directed and overseen by Mr Morgan with another executive director, who together had executive and Board-level responsibility for reserving, including the reserve reviews. Whilst Mr Morgan, as FD, was responsible for overseeing the executive functions of the finance department, he did not have a role in the day to day conduct of the reserve reviews.

Mr Morgan accepts that as FD and as the director who organised and directed the reserve review process he had responsibility for ensuring adequate systems and controls were in place in relation to Equity's reserving processes and that he did not take sufficient steps to ensure:

1. that certain aspects of the reserve review process and the results of each reserve review were properly documented by those charged with those tasks; and

2. that the Board and the Syndicate's external actuaries were kept properly informed as to the reserve review process and the results of each reserve review.

Mr Morgan has therefore admitted the charge of detrimental conduct (pursuant to 3(b) of the Enforcement Byelaw) in respect of the above.

Charge 2

Lloyd's Valuation of Liabilities Rules require managing agents to provide its syndicate actuary with appropriate assurance as to the accuracy and completeness of the data provided for the purposes of obtaining a "Statement of Actuarial Opinion" ("SAO") in respect of the year-end reserving position of each syndicate under its management. This is achieved through the provision of a "Data Accuracy Statement".

The Syndicate's external actuaries produced two reports as at the end of 2009, one entitled 'Valuation as at 31 December 2009' dated 24 February 2010 and the other, being the 2009 Year End Report, dated 14 April 2010.

Mr Morgan was the director responsible for the 2009 year-end process and was the signatory of the relevant Data Accuracy Statement. He had responsibility for ensuring that accurate and complete information was provided to the Board and the Syndicate's external actuaries.

Due in part to the governance issues over the reserve review process set out above in respect of Charge 1, Mr Morgan was not able to satisfy himself that accurate and complete information regarding the reserve review process was provided to the external actuary.

Mr Morgan accepts that he then did not read either of the reports identified above and consequently was not in a position to correct any errors that they may have contained.

Mr Morgan has therefore admitted one charge of detrimental conduct (pursuant to 3(b) of the Enforcement Byelaw) in respect of the above.

Settlement terms

As a result of the above admissions, the following agreed terms have been approved by the Enforcement Tribunal:

1 Mr Morgan shall be censured in the terms of this Notice of Censure; and

2 Mr Morgan has undertaken not to apply for a position as a director of a Lloyd's firm (underwriting agent, run-off company, Lloyd's broker or corporate member of the Society) for three years.

The sanctions being imposed reflect the very specific circumstances of Mr Morgan.

In addition, Mr Morgan shall pay a contribution of £145,000 towards the costs of Lloyd's in respect of these proceedings.

Mitigation

In assessing these penalties in respect of Mr Morgan, the Enforcement Tribunal has taken account of the following factors:

(a) Mr Morgan has cooperated fully with the Lloyd's investigation into the relevant matters and has settled these proceedings without the need for a hearing.

(b) Mr Morgan has accepted two charges of detrimental conduct which is the least serious of the two forms of "epithet" misconduct under the Lloyd's Enforcement Byelaw

(c) It can now be seen that during the relevant period, the motor insurance market, in which Syndicate 218 largely specialised, experienced unprecedentedly difficult market conditions, caused by an increase in activity by claims farmers, an increasing number of fraudulent claims, and an increase in injury claims. The FSA has since noted in a "Dear CEO letter" dated 2011 that these factors, in conjunction with the challenging general economic climate, had created "pressure on actuarial practices". These pressures increased the need for boards of insurers to scrutinise their reserving practices.

(d) There was in place a number of systems and controls over the reserving function which included:

    (i) an experienced claims team;

    (ii) a computer system that recorded all changes in the reserves; and

    (iii) open access by the external actuary to the claims team and the data produced by them and the Equity computer system.

(e) There is no suggestion that Mr Morgan deliberately misled or withheld information from the Syndicate's external actuaries.

(f) The report entitled 'Valuation as at 31 December 2009' dated 24 February 2010 was instigated by the parent company of Equity and was outside the range of Mr Morgan's direct responsibilities.

(g) Whilst Mr Morgan accepts that he was at all material times the director of Equity responsible for the 2009 year-end process the 2009 Year End Report dated 14 April 2010 was produced after the time that Mr Morgan was FD.

(h) Mr Morgan's behaviour was not deliberate, wilful or reckless and there is no suggestion that Mr Morgan behaved in a dishonest manner. Moreover, Mr Morgan has not previously been the subject of an adverse finding by Lloyd's.

(i) Mr Morgan has made no personal financial gain as a result of the facts and matters admitted by him.

(j) For the avoidance of doubt, it is not alleged by Lloyd's that the facts and matters admitted by Mr Morgan were the cause of the increase in claims notified to the Syndicate. Nor is it the case that any policyholders have suffered loss.

Lloyd's Enforcement Tribunal

Notice of Censure - John Josiah

John Josiah was joint active underwriter of Equity Syndicate Management Limited ("Equity") between 2006 and April 2007. From April 2007 to December 2010, Mr Josiah was the sole active underwriter. He was a director of Equity from 27 June 2005 to 1 December 2010. At all material times Equity was the managing agent of Syndicate 218 ("the Syndicate") that underwrote business at Lloyd's, specialising in the provision of motor insurance.

Case summary

Enforcement proceedings were brought against Mr Josiah in relation to two charges of detrimental conduct.

In summary, the charges related to (i) Mr Josiah's alleged failure to take reasonable steps to ensure that there were sufficient systems and controls including the maintenance of an adequate standard of documentation in relation to certain aspects of the Syndicate's reserving processes; and (ii) Mr Josiah's alleged failure to take reasonable steps to ensure that the Board of Equity was provided with sufficiently comprehensive management information and data regarding the adverse development of claims payments.

Mr Josiah has agreed to settle these proceedings and has admitted the charges of detrimental conduct in a settlement considered and approved by the Enforcement Tribunal.

Charge 1

Historically the Syndicate has had a sustained track record of consistently reporting profits and of prudent initial case reserving. During the course of its business, Equity, in common with other insurers, conducted reviews of claims files in order to release redundancy in case reserves. No criticism has been or is made by Lloyd's of the principle of reviewing and adjusting case estimates in order to address conservatism in those estimates.

Specifically, Equity had in place the following processes to establish, maintain, and, where considered appropriate, to release case reserves in respect of claims: case reviews and rolling reviews. In addition "virtual" file reviews, which did not result in an alteration to the case estimates, also took place to check levels of redundancy and provide further information for Actuarial reviews.

In addition to those methods of setting and reviewing case estimates, Equity had a long established practice which for the purposes of this Notice shall be termed the "reserve reviews". This process usually targeted the reserves at or after month 33 immediately before a Year of Account ("YOA") was due to close because, by the third year of development, uncertainty surrounding claims estimates would often have significantly reduced.

The reserve review process was a longstanding practice which had been in operation within Equity for many years before Mr Josiah joined the Board and before he became active underwriter. Mr Josiah, along with other members of the Board, was aware that reserve reviews were undertaken in order to review and, if there were surplus reserves, to remove redundancy.

During the period relevant to this case the annual reserve review process was operated with the following characteristics:

1. From 2007, a reserve review was added in respect of the 30 June accounting year end to tie-in with parent company reporting;

2. A team of five senior claims handlers carried out a review of a selection of the largest claims (chosen by size of estimate) in respect of a selected YOA in order to identify and remove redundancy by reducing the case estimate on the file;

3. It was generally the case that in years that were anticipated to be likely to lead to poorer syndicate results, the amount of redundancy that the handlers removed was greater than those years when results were expected to be better; and

4. Unlike other types of reviews, the reserve reviews were based on an instructed level of intensity that varied from review to review and YOA. In 2007 - 2009 those conducting the reserve reviews were given a target figure, though Mr Josiah did not formulate and was not aware of the specific target figure set or provide it to the claims handlers carrying out the reviews. Mr Josiah was however involved in the year-end discussions as to the nature of the reserve reviews to be carried out and on one occasion directly gave the instruction for a review to be carried out.

As a result of these reserve reviews in 2008 and 2009, reserve releases of £76.2m (in 2008) and £100m (in 2009) were made. This was in part due to an exercise to bring case reserves on older years (2004 and prior) to or close to best estimate level. They included substantial reserves being released from some YOAs and releases from YOAs in their early years of development. For example, the first reserve review in 2009 released £13.5m from the 2008 YOA (which was 8.7% of the total held reserves as at May 2009 of £155m or 6.8% out of total required reserves (outstanding plus IBNR) for that YOA of £197.2m as at May 2010) when that YOA was 14-17 months into the 36 month accounting period.

Whilst a reduction in a case estimate arising out of a reserve review was recorded against that case file's individual entry on Equity's computerised claims system, there was no proper system for keeping a separate or adequate aggregate written record of the reserve reviews, including the level of redundancy released. Whilst movements in the data provided to the external actuary could indicate the occurrence of a reserve review an accurate aggregate record of the outcome of the reserve review process would have minimised the risk that the impact of the reserve reviews was obfuscated by other claims activity and avoided any potential impact on the technical reserve setting process, for which the Board was responsible. The Board of Equity was not provided with sufficient details about the reserve reviews or about the results of any specific reserve reviews during 2008 and 2009.

Mr Josiah accepts that as Active Underwriter he had responsibility for ensuring adequate systems and controls were in place in relation to Equity's reserving and claims processes and that he did not take sufficient steps to ensure that:

1. certain aspects of the reserve review process and the results of each reserve review were properly documented by those charged with those tasks; and

2. the Board was kept properly informed as to the reserve review process and the results of each reserve review.

Mr Josiah has therefore admitted one charge of detrimental conduct (pursuant to 3(b) of the Enforcement Byelaw) in respect of the above.

Charge 2

From around 2006, the motor insurance market in general (including the Syndicate) was experiencing increasingly significant claims deterioration (higher value and/or more claims being made) caused by a number of external factors. This trend was exacerbated with a large number of insurers, not just the Syndicate, having retrospectively to strengthen claims reserves. In accordance with that market development, Equity's financial results deteriorated.

From about 2007 the above market trend was noted by the Board and discussed at Board meetings, and the Board was concerned about Equity's adverse development of claims payments (the "adverse paid development"). In 2007 IAG UK commissioned a report by PwC to review claims handling within IAG UK, including Equity. Part of that review looked at the causes of adverse paid development. The report identified a large number of causes including acceleration in paid claims (a speeding up of the date when claims started to be paid and were subsequently settled) and claims inflation (an increase in the average claim's size over time), as well as underwriting and environmental factors. The report noted that changes in Equity's internal claims handling processes that had been introduced in 2006 by a new Director of Claims were a contributing factor. Those changes included a process driven approach to claims handling. The report was not tabled at a Board meeting and was not discussed in detail at a Board meeting. The report made numerous recommendations, the majority of which were implemented. Moreover most Board members attended a presentation by PwC about the report outside of a Board meeting.

In late 2008 and early 2009, the adverse paid development was continuing on some YOA and the new claims handling processes were reversed because the business considered that they were a major cause of the continued adverse paid development. In 2009 and early 2010, the executive directors with responsibility for claims and reserving, including Mr Josiah, explained to the Board that the adverse paid development would be temporary and would improve when the changes to the claims handling processes were fully reversed. This was not challenged by the external advisors. By the end of 2009 an improvement was showing in the paid development for some of the YOA. At the start of 2010 the paid development again showed deterioration but it was believed that this would be temporary and that there would be an improvement in the paid development when the changes to the claims handling processes had taken full effect.

However, from 2007 to June 2010 the Board was not provided with sufficient data in order to put itself in a position properly to consider all material factors that may have been affecting the Syndicate's performance such as external market factors. Had it done so, the Board may have been able to consider if any further remedial steps (e.g. further changes to its pricing models) were appropriate.

In 2006 Equity commenced a project to implement new management information requirements for motor underwriting and claims, including a new data warehouse and a revised management reporting/business intelligence application. The project faced a number of challenges and there was significant delay in its introduction, in part due to external factors. The data warehouse generated some reports which were provided to the external actuary in 2009 but it did not become fully functional until during 2010.

Mr Josiah accepts that as active underwriter he failed to ensure that the Board was provided with sufficient data to enable it properly to consider all material factors that may have been affecting the Syndicate's performance and that there was a delay in implementing the data warehouse project within a reasonable time.

Mr Josiah has therefore admitted one charge of detrimental conduct (pursuant to 3(b) of the Enforcement Byelaw) in respect of the above.

Settlement terms

As a result of the above admissions, the following agreed terms have been approved by the Enforcement Tribunal:

1 Mr Josiah shall be censured in the terms of this Notice of Censure; and

2 Mr Josiah has undertaken not to apply for a position as a director of a Lloyd's firm (underwriting agent, run-off company, Lloyd's broker or corporate member of the Society) for two years.

The sanctions being imposed reflect the very specific circumstances of Mr Josiah.

In addition Mr Josiah shall pay a contribution of £145,000 towards Lloyd's costs in respect of these proceedings.

Mitigation

In assessing these penalties in respect of Mr Josiah, the Enforcement Tribunal has taken account of the following factors:

(a) Mr Josiah took over as owner of the data warehouse project in May 2007 and at that time identified certain problems with the scope of the work. He ensured these were addressed and it transpired that this meant the project had to be “re-initiated” in 2008.

(b) Mr Josiah implemented the recommendations made by PwC in their report in 2007 in respect of underwriting and from the time the Head of Claims reported to Mr

Josiah from the beginning of 2009, Mr Josiah ensured that significant progress was made on a number of the PwC recommendations in respect of claims.

(c) Mr Josiah has cooperated fully with the Lloyd's investigation into the relevant matters and has settled these proceedings without the need for a hearing.

(d) Mr Josiah has accepted two charges of detrimental conduct which is the least serious of the two forms of "epithet" misconduct under the Lloyd's Enforcement Byelaw.

(e) It can now be seen that during the relevant period, the motor insurance market, in which Syndicate 218 largely specialised, experienced unprecedentedly difficult market conditions, caused by an increase in activity by claims farmers, an increasing number of fraudulent claims, and an increase in injury claims. The FSA has since noted in a "Dear CEO letter" dated 2011 that these factors, in conjunction with the challenging general economic climate, had created "pressure on actuarial practices". These pressures increased the need for boards of insurers to scrutinise their reserving practices.

(f) There was in place a number of systems and controls over the reserving function which included:

(i) an experienced claims team;

(ii) a computer system that recorded all changes in the reserves; and

(iii) open access by the external actuary to the claims team and the data produced by them and the Equity computer system.

(g) There is no suggestion that Mr Josiah deliberately misled or withheld information from the Syndicate’s external actuary or the Board.

(h) Mr Josiah's behaviour was not deliberate, wilful or reckless and there is no suggestion that Mr Josiah behaved in a dishonest manner. Mr Josiah has not previously been the subject of an adverse finding by Lloyd's.

(i) Mr Josiah has made no personal financial gain as a result of the facts and matters admitted by him.

(j) For the avoidance of doubt, it is not alleged by Lloyd's that the facts and matters admitted by Mr Josiah were the cause of the increase in claims notified to the Syndicate. Nor is it the case that any policyholders have suffered loss.

Lloyd's Enforcement Tribunal