

# MARKET BULLETIN

REF: Y4795

<b>Title</b>	<b>Enforcement Proceedings – Framework for Enforcement Sanctions and Costs</b>
<b>Purpose</b>	To inform the market about the new framework for setting sanctions and costs orders in Lloyd's enforcement proceedings
<b>Type</b>	Xxxxxxxx
<b>From</b>	Paul Brady Manager, Enforcement & Governance Lloyd's Legal & Compliance
<b>Date</b>	12 May 2014
<b>Deadline</b>	xxxx
<b>Related links</b>	<a href="#">The Underwriting Requirements</a>

## Background and Purpose

Lloyd's may bring enforcement proceedings in respect of misconduct against those who are subject to Lloyd's enforcement jurisdiction. Lloyd's has previously set out in Market Bulletin Y4202 its "Principles of Enforcement" to give guidance as to the type of cases that may result in enforcement action.

Where enforcement proceedings are brought, Lloyd's and the defendant may agree settlement terms to seek to resolve the case without the need for a contested hearing. The settlement terms will include the appropriate sanctions to be imposed on the defendant.

The sanctions to be offered to a defendant for settlement purposes are determined by the Lloyd's Market Supervision and Review Committee ("MSARC"). MSARC has therefore prepared the attached framework to set out MSARC's approach for establishing the appropriate level of sanctions Lloyd's will seek going forward. The framework includes specific discounts for early settlement. It also refers to Lloyd's approach to costs recovery.

In preparing this framework regard has been had to the approach taken by both the Financial Conduct Authority and the Prudential Regulatory Authority in determining the level of penalties in their enforcement proceedings. Whilst MSARC has adopted a similar approach to the FCA/PRA process, MSARC's framework takes into account the specifics of

Lloyd's enforcement objectives. This includes the emphasis Lloyd's places on suspension from the market as being a key enforcement sanction.

The new framework is intended to provide greater transparency regarding the sanctions in Lloyd's enforcement cases. It is also likely that the adoption of this new framework will result in higher sanctions being sought in the future. MSARC believes that this is right to ensure that Lloyd's enforcement process continues to be robust and promote high standards of regulatory and market conduct.

It should be noted that any settlement agreed between the parties is subject to the independent consideration of the independent Lloyd's Enforcement Board, which may confirm, reject or propose modifications to the terms of a settlement.

Any queries in respect of the application of this new framework should be addressed in the first instance to:

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The attached framework has been included as Schedule 7 to the Enforcement Requirements (Chapter 5 of the Underwriting Requirements) where all Lloyd's requirements and guidance regarding the Lloyd's enforcement process can be found.

## Schedule 7 (to the Enforcement Requirements)

### MSARC framework for the imposition of sanctions

#### Introduction

1. The Market Supervision and Review Committee ("MSARC") is the Lloyd's committee responsible for bringing enforcement proceedings against those subject to Lloyd's enforcement jurisdiction. In Lloyd's Market Bulletin Y4202 MSARC set its "Principles of enforcement" which indicate the types of conduct that are likely to result in MSARC bringing enforcement proceedings against a firm or individual<sup>1</sup>.
2. Where MSARC decides to bring proceedings then, under the terms of the Enforcement Byelaw, the parties to enforcement proceedings may agree settlement terms in order to resolve the case without the need for a contested hearing before an Enforcement Tribunal. The terms (ie the sanctions) to be offered to a defendant for settlement are determined by MSARC and will then be negotiated by the Representative of the Council (on behalf of Lloyd's) with the defendant.
3. Any settlement agreed between the Council of Lloyd's and a defendant is then subject to the independent consideration of the Enforcement Board, which may confirm, reject or propose modifications to the terms of a settlement.
4. The purpose of this note is to set out MSARC's approach in establishing the appropriate level of sanctions when prosecuting enforcement cases. This framework will be used to –
  - a. establish the proposed sanctions to be offered for settlement purposes.
  - b. in the event that settlement cannot be reached, to inform Lloyd's when making submissions as to sanctions to the Enforcement Tribunal hearing the case.

This framework includes specific discounts for early settlement. The framework also refers to Lloyd's approach to costs recovery.

It should be stressed that it is for guidance only and in individual cases MSARC may consider it appropriate to vary the application of this framework.

5. MSARC's policy regarding the imposition of fines on managing agents for late or incorrect submission of prescribed returns is separately set out in Market Bulletin Y4527).

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<sup>1</sup> The current principles of enforcement are set out in Schedule 5, Chapter 5 of the Underwriting Requirements

### The available sanctions

6. Under the Enforcement Byelaw (at Part G), the sanctions that may be imposed on a defendant include the following (although not all these sanctions will be available in respect of all defendants) –
  - a. the exclusion or suspension from membership of the Society;
  - b. the revocation or suspension of a firm's permission to act as an Underwriting Agent, Approved Run Off Company or Lloyd's Broker;
  - c. the revocation or suspension of a person's right to transact or be concerned or interested in the transaction of insurance business at Lloyd's;
  - d. the revocation or suspension of an individual's permission to enter the Underwriting Room;
  - e. a fine;
  - f. a notice of censure;
  - g. a declaration of an individual's unfitness or unsuitability to act as a director, partner or compliance officer;
  - h. an order of restitution.
7. In practice, the sanctions that have in previous cases (and will therefore in future) be most normally considered as part of the settlement of enforcement proceedings are c, d, e, f, g and h above. Accordingly, this note primarily relates to the approach to be taken in deciding the level of the sanctions to be sought under those heads.
8. It is likely that the application of this framework will lead in many cases to higher levels of fines or other sanctions than has previously been the case given that penalties will be based upon the defendant's "relevant income". However, each case will need to be considered on its merits.
9. In addition, Lloyd's will continue to seek reimbursement of its internal and external costs from defendants in respect of investigating and prosecuting enforcement proceedings<sup>2</sup>. This will apply in both contested cases and in cases that are settled.
10. In preparing this framework regard has been had to the "step approach" adopted by both the Financial Conduct Authority as set out in its Handbook (at DEPP) and the Prudential Regulatory Authority (in the Prudential Regulatory Authority's *Approach to enforcement - statutory statement of policies and procedures*).

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<sup>2</sup> See part K of the Enforcement Byelaw

## Overriding principles

11. In assessing the sanctions, MSARC has agreed that the following overriding principles will apply in all cases –
  - a. sanctions should promote high standards of regulatory and/or market conduct;
  - b. sanctions should promote confidence with members (capital providers) and policyholders;
  - c. sanctions should have a suitable deterrent effect (both on the specific firm/individual and on others in the market generally);
  - d. sanctions should be fair, proportionate and should reflect the individual facts of a case;
  - e. sanctions should take into account the previous conduct of the defendant and, in the case of an individual, should take into account their seniority or experience;
  - f. sanctions should ensure that policyholders, members and those that work in the market, are protected from firms or individuals who may cause them loss or detriment. The market generally needs to be protected from those that may damage its reputation. Accordingly Lloyd's sees suspension in appropriate circumstances as a primary enforcement tool;
12. Whilst account will be taken of any relevant previous Enforcement Tribunal decisions these should not be regarded as constituting binding precedents and the application of this framework may result in higher sanctions being sought. Account may also be taken of developments in financial services regulatory practice generally and specifically in applying this framework Lloyd's may take account of the rules and guidance contained in DEPP/the PRA's statutory statements.
13. As is described in more detail below, MSARC's approach, when considering the applicable sanctions will be to seek a public censure and also to consider whether an order of restitution should be made. MSARC will then determine which (if any) further sanctions should apply and in particular whether suspensions or fines should be sought.

## Public Censure

14. MSARC will seek a public censure in all cases of misconduct<sup>3</sup>. This is critical to ensure that the market is made aware of conduct that Lloyd's believes to be unacceptable and as a deterrent against further similar misconduct. The censure notice will aim to set out a clear summary of the facts and matters relating to the wrongdoing, the standards breached, the charges admitted and the sanctions imposed. Lloyd's recognises that censures will have a serious effect upon a defendant especially given that censures in respect of the most serious misconduct may remain on Lloyd's website indefinitely (for instance where the sanctions include an indefinite ban from the market).

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<sup>3</sup> Other than in the very limited circumstances set out in the Enforcement Requirements

### Restitution (“Disgorgement”)

15. Where the misconduct has led to the defendant accruing a specific profit and/or having caused a loss to an innocent third party then MSARC will always consider whether an order for restitution is appropriate and can be properly made. The financial position of the defendant will not ordinarily of itself be a reason not to make an order for restitution that would otherwise be made.

### Suspension and fines

16. After public censure, suspension and/or fines are likely to be the most usual sanctions sought.
17. In the context of Lloyd’s enforcement proceedings, the sanction of revocation or suspension of a person’s right to transact business in the Lloyd’s market is considered to be the primary enforcement sanction for the more serious forms of misconduct<sup>4</sup>. This is because exclusion or suspension from the market helps protect the market from the activities of the defendant. In the case of a time-limited suspension, the period of suspension will allow the defendant an opportunity to consider their misconduct, undergo any necessary remedial training and take steps to demonstrate that they have adequately rehabilitated themselves.
18. In other cases a fine will be considered an appropriate sanction without a suspension also being imposed. In suitable cases both a suspension and a fine will be considered appropriate.
19. In determining the level of suspension or fines to be offered for settlement purposes MSARC will adopt the following 5 step approach –

*Step 1: Consider the seriousness of the breach to set the applicable range of sanctions*

20. MSARC will first have regard to the seriousness of the alleged misconduct in assessing the range of the period of suspension (or whether a permanent suspension is appropriate) and also the starting level of a fine.

Sanctions against firms

21. In assessing the level of fine for a firm, MSARC will establish a fine based on the seriousness of the alleged misconduct. Where appropriate, in proceedings against a Lloyd’s managing agent, MSARC may determine a fine as a percentage of the firm’s “relevant revenue.” Relevant revenue means the amount of premium income generated by the managing agent from a particular product line, class or business area for the relevant underwriting year(s) of account during which the misconduct occurred<sup>5</sup>. However, MSARC recognises that there may be cases where premium income is not an appropriate indicator of the harm or potential harm that a firm’s misconduct may cause, and in those cases MSARC may use an appropriate alternative (such as the loss caused by the misconduct).

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<sup>4</sup> The sanction referred to at paragraph 6(c) above. In such cases Lloyd’s would also seek a sanction to prevent the individual having access to Lloyd’s premises (ie the sanction referred to at paragraph 6(d) above)

<sup>5</sup> Regard may be had to the percentages of “relevant revenue” see DEPP6.5A.2

22. In the most serious cases MSARC would consider whether the firm's approval as a managing or members' agent should be suspended or revoked<sup>6</sup>.

Sanctions against Individuals

23. In assessing the length of suspension for an individual, MSARC will have regard to the seriousness of the alleged misconduct in accordance with the table below.
24. In assessing the level of fine for an individual MSARC will deal with the assessment of the fine in accordance with the table below. This calculates the fine based on a percentage of the individual's "relevant income" depending on the seriousness of the alleged misconduct. ("Relevant income" is the gross amount of all benefits received by the individual from the employment or role in connection with which the misconduct occurred during the year or years in respect of which the misconduct occurred<sup>7</sup>. Relevant income shall include salary, bonus, pension contributions and any share options relating to such employment or role.)

Level of misconduct (including indicators)	Period of suspension from transacting Lloyd's business and from the Room	Starting level for benchmark of fine (% of "relevant income")	Public Censure?
1. Discreditable conduct (involving dishonesty or lack of good faith)	Total and permanent suspension	40%	Yes
2. Discreditable conduct (involving reckless misconduct)	Five years – permanent suspension	30%	Yes
3a. Discreditable conduct involving "gross" or very serious negligence  3b. Detrimental conduct (at the higher level of this charge)	3a. Two – five years suspension  3b. Zero – two years suspension  <u>and/or</u> a declaration of an individual's unfitness or unsuitability to act as a director, partner or compliance officer of a	20 %	Yes

<sup>6</sup> Enforcement proceedings may also be brought against a Lloyd's broker and the only sanction would be to revoke its registration as a Lloyd's broker

<sup>7</sup> In the case of a "one-off" act of misconduct the relevant income shall be for a period of 12 months

	Lloyd's firm (either indefinitely or for a set period)		
4. Detrimental conduct or other breach of Lloyd's requirements (not at the higher level of this charge)	Zero – 1 year	10%	Yes
5. Detrimental conduct or other breach of Lloyd's requirements (where misconduct committed inadvertently and no actual harm caused)	No suspension	0%	Yes

25. In the past Lloyd's has been prepared to accept public "undertakings" from individuals in lieu of the formal suspension sanctions imposed under the Enforcement Byelaw. Lloyd's will not generally agree to such undertakings as part of a settlement other than in exception cases. Suitable undertakings may in appropriate cases form part of a settlement with a firm. Undertakings will not be accepted in lieu of a fine.

Step 2: Mitigating and aggravating factors

26. MSARC will then consider any relevant mitigating and aggravating factors that are relevant in order to establish whether to adjust the level of sanctions from step 1.

27. Factors to take into account at this step may include –

- a. whether there was any direct or indirect benefit to the defendant arising from the misconduct;
- b. whether the defendant cooperated during the investigation by Lloyd's;
- c. whether the defendant identified and reported the misconduct and took timely steps to mitigate its effect;
- d. whether the misconduct took place over a prolonged period, involved repeated activities of misconduct or was a "one-off" isolated act;
- e. whether the defendant was a director or held any other senior position or position of trust in the relevant firm;



- f. whether the defendant's actions involved or implicated other individuals especially more junior individuals (whether knowingly or not) in the commission of the misconduct;
  - g. whether the defendant's actions harmed or risked harming policyholders, members or others doing business at Lloyd's;
  - h. whether the action involved a breach of, or having caused or permitted a breach of, any applicable fiduciary duty;
  - i. whether the defendant has any previous regulatory or disciplinary convictions or relevant criminal convictions;
  - j. whether Lloyd's has previously issued guidance or previous cases regarding the conduct in question;
  - k. whether the defendant's actions harmed or risked harming the reputation, licences or brand of Lloyd's;
  - l. whether the misconduct harmed or risked harming the Lloyd's Central Fund;
  - m. the defendant's personal financial position (although this will not ordinarily be taken into account when considering an order of restitution).
28. MSARC will accordingly make any adjustments to the sanctions that were assessed under Step 1.

Step 3: Adjustment for deterrence

29. If MSARC considers the sanctions arrived at after Steps 1 and 2 are insufficient to act as a credible deterrent either against the defendant who committed the misconduct or others from committing other further or similar acts of misconduct, then MSARC may increase the length of suspension or the level of the fine.

Step 4: Consider whether both a suspension and a fine are appropriate

30. MSARC will in accordance with Steps 1 to 3 assess the applicable level of suspension and amount of any fine. MSARC will then consider whether it is appropriate to impose both a suspension and a fine. In doing so MSARC will decide whether the combined effect of both a suspension and a fine is likely to be disproportionate, in view of the nature of the misconduct.
31. In the event that MSARC considers that the overall impact of the sanctions would be disproportionate, it will decide whether the suspension and/or fine should be reduced or should not apply.

Step 5: Settlement discount

32. MSARC will consider what, if any, settlement discount should be offered to the defendant for settling at an early stage (in particular before any defence to the charges has been served).
33. In circumstances where the appropriate sanction includes a permanent suspension from the market, then no discount on that suspension will be offered (although any additional fine may be discounted).
34. In any other cases a reduction in the length of suspension or a reduction in the fine of up to 30 per cent may be agreed. In the event that a case settles after a defence has been served then the maximum discount available would be 10 per cent.

**Costs**

35. In addition to the sanctions that will be sought in a settlement, Lloyd's will also seek an order for costs.
36. Under the Enforcement Byelaw, costs may be sought against any person who was the subject of an inquiry. Costs may also be sought in respect of the Council's costs incurred in the investigation, preparation and presentation of an enforcement case. (In the event that a case is contested an order for costs may also include the costs of the Tribunal).<sup>8</sup>
37. MSARC is of the view that it is inappropriate for the Society to bear the costs associated with investigating and bringing proceedings against a defendant. Accordingly, Lloyd's will always seek, as part of any settlement an order for costs to recover the full amount properly and reasonably attributable to the specific defendant. This will include in-house costs, external legal costs and other reasonable disbursements.
38. Clearly early settlement will reduce the level of costs sought. Lloyd's may take into account evidence of hardship in determining the level of costs sought but for the avoidance of doubt Lloyd's will not reduce the level of costs as a consequence of the level of the fine.

**Review of this policy**

39. MSARC will keep this policy under review and may amend or replace this policy from time to time.

May 2014

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<sup>8</sup> Enforcement Byelaw, paragraphs 40 and 41