# MARKET BULLETIN

REF: Y4550

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| **Title** | Equity Syndicate Management Limited |
| **Purpose** | To provide information relating to proceedings before the Enforcement Board relating to Equity Syndicate Management Limited |
| **Type** | Event |
| **From** | Katie Dorling, Secretary to the Lloyd's Enforcement Board |
| **Date** | 3 January 2012 |
| **Deadline** | N/A |
| **Related links** | [T&C] |

In proceedings before the Lloyd's Enforcement Board, Equity Syndicate Management Limited ("Equity") has admitted two charges of detrimental conduct.

Equity is the managing agent of Syndicate 218 ("the Syndicate") that underwrites insurance business at Lloyd's, specialising in the provision of motor insurance.

On 7 May 2010, as a result of its concerns as to the reliability of the Syndicate's reserving position, Equity instructed an independent actuarial review of the Syndicate's reserving. As a result of that review, which was finalised on 2 June 2010, Equity reported a deterioration of £311m (central estimate) in respect of net ultimate claims for the 2009 and prior Years of Account ("YOAs"). As a result Lloyd's announced at its 2011 AGM that it was conducting an investigation into matters relating to Equity's reserving procedures. Following that investigation, the Council of Lloyd's decided to bring enforcement proceedings against Equity in relation to two charges of detrimental conduct.

The first charge relates to issues around Equity's oversight and documentation in respect of certain of its processes in reviewing its case reserves. The second charge relates to the provision of management information and data by Equity to its Board regarding the adverse development of claims payments. Details of the events giving rise to these proceedings and of the charges admitted are set out in the attached Notice of Censure.

In bringing these proceedings the Council of Lloyd's has worked closely with the Financial Services Authority who have confirmed their agreement to the actions taken by Lloyd's to address these issues.

The Enforcement Board has approved the following settlement terms –

1 That Equity be censured in the terms of the attached Notice of Censure;
2 That Equity pays a contribution of £95,000 towards the external costs of Lloyd’s in these proceedings.

As is made clear in the attached Notice of Censure, but for the mitigating facts in this case, including the fact that Equity has settled these proceedings without the need for a contested case, it would be expected that a fine of at least £1 million would have been imposed.

These proceedings were determined by the Lloyd’s Enforcement Board and its decision gives effect to the settlement of these proceedings agreed between Equity and the Council of Lloyd’s.

Katie Dorling
Secretary to the Lloyd’s Enforcement Board

**Notice of Censure**

**Equity Syndicate Management Limited**

At all material times Equity Syndicate Management Limited ("Equity") was the managing agent of Syndicate 218 ("the Syndicate") that underwrote insurance business at Lloyd's, specialising in the provision of motor insurance.

## Case summary

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

In summary, the charges related to (i) Equity's failure to comply with Lloyd's requirements for the maintenance of systems and controls procedures, and/or for the maintenance of a high standard of documentation in relation to its reserving processes; and (ii) Equity's failure to ensure that its Board was provided with, and the Board's failure to insist upon, sufficiently comprehensive management information and data regarding the adverse development of claims payments.

## Charge 1

Historically the Syndicate has had a sustained track record of consistently reporting profits and of prudent initial case reserving. Equity had in place various processes to establish, maintain and release its generally initially conservative case reserves in respect of the Syndicate's claims.

These processes included an annual file review process employed as part of the annual close procedure. These annual reviews typically adjusted case reserves downwards to remove surplus reserves (known as "redundancy"). This process targeted the reserves at month 33 immediately before the Year of Account ("YOA") was due to close because by the third year of development uncertainty surrounding claims estimates would often have significantly reduced.

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.

However, during the period relevant to this case, the annual file review process came to be operated with certain different characteristics and became known to certain individuals at Equity as "strategic claims reviews" (hereinafter referred to as "reserve reviews"). These reserve reviews had the following characteristics:

1. From 2007, a reserve review was added in respect of the 30 June accounting year-end;

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. As a general rule, 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 in those years when results were expected to be better; and

4. Unlike the other types of reviews, the reserve reviews were based upon a target figure or an instructed level of intensity (that included designations such as “heavy” or “light”) that varied from review to review.

As a result of these reserve reviews in 2008 and 2009, reserve releases of £76.2m (in 2008) and £100m (in 2009) were made. They included very 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 when that YOA was only 14-17 months into the 36 month accounting period even though it was not Equity’s usual practice for a YOA to be reviewed before it reached its third year of development (when uncertainty surrounding estimated claims would have significantly reduced).

No adequate written records of the reserve reviews, including of the level of redundancy released, were maintained by Equity. The need to record properly the reserve review process was significant given its potential impact on the technical reserve setting process, for which the Board was responsible.

No formal audit, whether internal or external, was carried out on the reserve reviews themselves or on the results of any individual reserve review until 2010.

The Board of Equity was not provided with details about the reserve reviews or about the results of any specific reserve reviews undertaken during 2008 and 2009 with the consequence that:-

a) Equity, through its Board, was not able to monitor or control its reserving position or the processes involved in setting its technical reserves; and

b) Equity, through its Board, was not in a position sufficiently to assess the impact that the release of reserves might be having on the Syndicate’s claims development patterns and performance.

In addition Equity’s reporting actuaries, Deloitte, were given incomplete and inaccurate information about the reserve reviews in 2009. In particular, Equity did not inform Deloitte that, contrary to its usual practice, a reserve review had been carried out on the 2008 YOA whilst only in its second year of development.

Equity accepts that it did not, in the conduct of its business, in all respects comply with Lloyd’s requirements for the maintenance of systems and controls procedures, and/or for the maintenance of a high standard of documentation in relation to its reserving processes. Specifically, Equity accepts that it did not ensure that:

1. the reserve review process and the results of each reserve review were properly overseen, documented, reported and audited;

2. the Board was kept adequately informed of the reserve reviews in general and the detail of each reserve review, to avoid increasing the risk that the Syndicate’s claims development patterns and performance could not be fully understood because of the lack of this information and the risk that it could not

satisfy itself that Equity held sufficient reserves; and

3. its external actuaries were provided with accurate and complete information about the operation and results of the reserve reviews conducted on the 2005, 2006 and 2008 YOAs in 2009.

Equity has therefore admitted one charge of detrimental conduct (pursuant to paragraph 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 has been exacerbated over the last three years 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.

The above deteriorating claims trend was noted by the Board and discussed at Board meetings. From about 2007 the Board was concerned about the adverse development of claims payments (the "adverse paid development") which, it considered, was occurring as a result of a combination of, an acceleration in paid claims (a speeding up of the date when claims start to be paid and are subsequently settled) and claims inflation (an increase in the average claim's size over time).

The principal explanation provided to the Board for the adverse paid development was that it had been caused by changes in internal claims handling processes that had been introduced in 2006 by a new Director of Claims. Those changes had included a process driven approach to claims handling so that each claims handler would only be responsible for certain types of claim and would no longer retain responsibility for a particular claims file throughout its currency. This explanation was unchallenged by the Board at this time.

In September 2007, a report was commissioned from PriceWaterhouseCoopers ("PwC") to investigate the causes of the adverse paid claims development across the Equity Group. The scope of this report included the Syndicate and the Equity Group's Gibraltar based insurance company, Advantage. The report confirmed that there was a significant number of factors that had contributed to the increase in paid claims. It was discussed on 5 November 2007 at a meeting attended by members of the senior management of Equity Group, which included some of the executive directors of Equity's Board, although there is no evidence that the report was discussed at a formal Board meeting.

No formal written report was tabled to the Board regarding external market factors and neither is there any record of any structured discussion in the Board minutes about such factors.

From 2006 onwards Equity planned to introduce a "data warehouse", a new electronic claims data processing and recording system that would have permitted more detailed and effective ways of processing and interrogating data, including claims development. There was significant delay in its introduction and it did not become operational until late 2010.

Accordingly, from 2007 to February 2010, the Board was not provided with adequate information either in advance of or at Board meetings in order to put itself in a position properly to consider all material factors that may have been affecting the Syndicate's performance.

Equity accepts that between 2007 and February 2010 it did not ensure that its Board was provided with, and the Board did not insist upon, sufficiently comprehensive management information and data regarding the adverse development of claims payments that could have enabled the Board better to identify and to analyse the possible causes of the adverse paid development (other than the internal claims handling process changes) which it had noted from 2007 onwards. Equity therefore accepts that it did not in the conduct of its business in all respects comply with Lloyd's requirements for the maintenance of systems and controls procedures, and/or for the maintenance of a high standard of documentation in relation to its processes.

Equity has therefore admitted one charge of detrimental conduct (pursuant to paragraph 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 Board:

1. Equity shall be censured in the terms of this Notice of Censure; and

2. Equity shall pay a contribution of £95,000 towards the external costs of Lloyd's in respect of these proceedings.

The sanctions being imposed reflect the very specific circumstances of Equity and but for the mitigating factors set out below, a fine of at least £1,000,000 would have been imposed.

**Mitigation**

In assessing these penalties in respect of Equity, the Enforcement Board has taken account of the following factors:

1. Equity has co-operated fully with the Lloyd's investigation into the relevant matters and has settled these proceedings at an early stage without the need for contested enforcement proceedings;

2. It was as a result of Equity's own concerns as to the reliability of the Syndicate's reserving position that Equity commissioned an independent actuary to conduct a review of the Syndicate's reserving. Equity informed both the FSA and Lloyd's of the potential need to strengthen its reserves and has since worked closely with Lloyd's to undertake remedial steps;

3. Since the above events Equity has taken major steps to improve its governance framework and operational aspects of its internal and reserving procedures, including strengthening its senior management and Board with a number of appointments, as highlighted in the 2010 Syndicate Annual Report and the appointment of a new external consulting actuary;

4. A review of the Syndicate's claims reserving practices has been completed including a review of all open claims to ensure optimum consistency in the Syndicate's case estimates;

5. Equity's parent company has already suffered significant financial detriment and has recapitalised its corporate member;

6. Any financial penalty would only serve to have a further detrimental effect on the current Equity business; and

7. For the avoidance of doubt, it is not alleged by Lloyd's that the facts and matters admitted by Equity in the charges were the cause of the increase in claims notified to the Syndicate. Nor is it the case that policyholders have suffered loss.

**Lloyd's Enforcement Board**