

FROM: AP Barber, Secretary Lloyd's Disciplinary Tribunal
LOCATION: 86/G4
EXTENSION: 5530
DATE: 2 December 2002
REFERENCE: 034/2002
SUBJECT: **BALLANTYNE MCKEAN & SULLIVAN LIMITED**
MARLBOROUGH UNDERWRITING AGENCY LIMITED
SUBJECT AREA(S): Formal Disciplinary Proceedings –
Case No. LDB/ 0103/01 & LDB/0103/02
ATTACHMENTS: Notices of Censure
ACTION POINTS: **For information**
DEADLINE: **None**

Formal disciplinary proceedings were brought against the Lloyd's broker Ballantyne McKean & Sullivan Limited ("BMS") and the Lloyd's managing agent Marlborough Underwriting Agency Limited ("Marlborough"). These proceedings related to the fact that a South African firm, that was not a Lloyd's approved coverholder, was given authority to bind insurance risks on behalf of Lloyd's underwriters. Details are as set out in the attached Notices of Censure.

BMS

Following very strongly contested proceedings before a Lloyd's Disciplinary Tribunal BMS was found guilty of one charge of failing to take reasonable steps in connection with the business of insurance to avoid risk of harm to Lloyd's policyholders, the Society, its members or those doing business at Lloyd's. As a result of these proceedings BMS received the following penalties:

- i) a fine of £5,000; and
- ii) Censure in the terms of the attached Notice of Censure

The Disciplinary Tribunal made no order as to costs and BMS appealed to Lloyd's Appeal Tribunal against this aspect of the Disciplinary Tribunal's decision. The President of Lloyd's Appeal Tribunal dismissed the appeal. BMS is to pay costs in the amount of £14,000 arising from the unsuccessful appeal.

Copies of the full report of the disciplinary and appellate proceedings relating to the case against BMS are available from the Disciplinary Secretariat, telephone number 020 7327 5530.

Marlborough

Marlborough admitted one charge of failing to take reasonable steps in connection with the business of insurance to avoid the risk of harm to Lloyd's policyholders, the Society, its members, or those doing business at Lloyd's.

As a result of these disciplinary proceedings the following penalties were imposed:

- i) A fine of £9,000; and
- ii) Censure in the terms of the attached Notice of Censure

In addition, Marlborough is to pay the costs of Lloyd's of £6,500.

The case against Marlborough was determined by Lloyd's Disciplinary Board and its decision gives effect to a settlement of these proceedings agreed between Marlborough and the Council pursuant to paragraph 26.6 of Lloyd's Disciplinary Rules (schedule 2 of the Disciplinary Committees Byelaw (No. 31 of 1996) as amended).

This bulletin has been sent to all underwriting agents, Lloyd's brokers, corporate members, market associations, the ALM and recognised accountants.

AP Barber
Secretary to Lloyd's Disciplinary Board

IN THE MATTER OF DISCIPLINARY PROCEEDINGS UNDER LLOYD'S ACTS
1871-1982 AND LLOYD'S BYELAWS

BALLANTYNE, McKEAN & SULLIVAN LIMITED

NOTICE OF CENSURE

In proceedings before a Lloyd's Disciplinary Tribunal the Defendant Lloyd's broker, **Ballantyne, McKean & Sullivan Limited** ("BMS"), was the subject of two alternative charges of misconduct arising out of a slip which it drew up for a binding authority to operate in the South African market. The more serious charge was that BMS had been engaged in or associated with discreditable conduct; the lesser alternative charge was that BMS had failed to take reasonable steps in connection with the business of insurance to avoid the risk of harm to Lloyd's policyholders, the Society, its members or those doing business at Lloyd's. BMS contested both charges. The Tribunal dismissed the more serious of the two charges but found the lesser alternative charge of misconduct to have been established.

The background to the charges concerned the activities of a South African broker called SA Underwriters (Pty) Limited ("SAU"). Although it had for a number of years been involved in the generation of South African business for underwriters, SAU has never been an approved Lloyd's coverholder. Indeed, applications by SAU for coverholder approval had been refused. BMS decided to sponsor a fresh application by SAU for coverholder approval. In the meantime, in early February 1999 BMS drew up a binding authority slip under which the

coverholder was ostensibly Reach Out Insurance Brokers (Pty) Limited ("Reach Out").

Whilst the body of the slip named Reach Out as the coverholder and prohibited any sub-delegation of authority by Reach Out, at the same time BMS drew up an endorsement to the slip which was expressly to prevail over anything to the contrary in the body of the slip. The effect of the endorsement was to give to SAU the power to "market, bind and administer" insurances notwithstanding the fact that SAU was not a Lloyd's approved coverholder. Both the slip and the endorsement were presented by BMS to, and scratched by, underwriters. BMS also presented the slip to CABAC for approval and, given that Reach Out was indeed an approved coverholder, a CABAC stamp was duly applied adjacent to the slip's description of Reach Out as the coverholder. CABAC, as is common knowledge and was known to BMS, would not ordinarily examine or concern itself with the detail of any endorsements or appendices to a binding authority slip; and it did not do so in the present instance.

The vice of the arrangement, as reflected in the slip and endorsement drawn up by BMS, was that a firm which was not an approved coverholder, i.e. SAU, was given actual authority to bind insurance risks on behalf of underwriters. Such an arrangement undermines the whole purpose of a system for the prior vetting and approval by Lloyd's of those who are to act as coverholders under a binding authority. There is an obvious risk of harm if persons who are not approved coverholders are given the power to enter into binding commitments on behalf of underwriters.

A critical matter which the Disciplinary Tribunal had to consider was whether there was a deliberate attempt by anyone at BMS to conceal from the Lloyd's regulatory authorities the true role of SAU. Having heard the evidence of, in particular, the broker at BMS who drafted the slip and endorsement the Tribunal concluded that there was no intent at BMS either to

deceive or that any byelaw should be contravened. BMS' behaviour was not "discreditable" within the meaning of the Misconduct and Penalties Byelaw. Nevertheless, the Tribunal was satisfied that there was misconduct within Paragraph 3(e) of that Byelaw. The employee at BMS who drafted the slip and endorsement, which were certainly not in standard form, had been rightly and properly concerned about the use of the word 'bind' in the endorsement. However, he neither exercised any independent judgment nor made any check of any sort about its appropriateness. He simply drafted the documentation in the way he was asked to do by SAU itself in accordance with what he understood from SAU to have been a form of words and structure used in previous years by other brokers.

Whilst the Tribunal was satisfied that there had been misconduct, it was also satisfied that there was powerful mitigation in the particular circumstances of the present case. Most notably, BMS was at least in broad terms doing no more than continuing a state of affairs vis-à-vis SAU which had existed for a number of years under the auspices of other brokers. The previous arrangements had provoked some regulatory investigation, but no disciplinary proceedings had in fact resulted. Moreover, whilst BMS' conduct created a risk of harm there was no evidence before the Tribunal of any harm having in the event actually resulted from SAU having been given the power to bind underwriters to risks. BMS has never before been the subject of any disciplinary action. It undoubtedly, and deservedly, enjoys a high reputation within the Lloyd's community. The Tribunal viewed the present case as an isolated lapse.

As far as penalty is concerned, the Tribunal considered that the misconduct merited rather more than censure but should, nevertheless, include the penalty of censure as it is important that the Lloyd's community be aware of the need for the rules about binding authorities to be

complied with. In the light of the exceptional mitigating circumstances the Tribunal concluded that the misconduct should be marked by a modest fine of £5,000 together with the publication of this Notice of Censure. The Tribunal made no order as to costs. In taking this course the Tribunal recognised that, in consequence of the disciplinary proceedings, BMS had incurred very heavy expenditure on its own legal costs.

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Robert Englehart Q.C. (Chairman)

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Mrs A Follis

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The Hon. JJT Mackay

NOTICE OF CENSURE

MARLBOROUGH UNDERWRITING AGENCY LIMITED

Marlborough Underwriting Agency Limited ("Marlborough") has admitted a charge of failing to take reasonable steps in connection with the business of insurance to avoid the risk of harm to Lloyd's policyholders, the Society, its members, or those doing business at Lloyd's in accordance with paragraph 3 (e) of the Misconduct and Penalties Byelaw (No. 30 of 1996).

Marlborough was at all material times the managing agent for syndicate 1242.

On 10 February 1999 a Lloyd's broker broked a binding authority facility to syndicate 1242. By this facility evidenced by a slip on that date, the syndicate approved a South African coverholder ("the coverholder") to bind the syndicate in respect of household, motor and personal accident cover.

On the same date that the syndicate signed the slip it also scratched an endorsement to the slip. That endorsement, which was prepared by the Lloyd's broker, permitted the coverholder to appoint "managers" to bind insurance. The endorsement also recorded the approval of a non-Lloyd's approved entity to act as such a manager ("the third party"). The effect of the endorsement was unlawfully to delegate underwriters' authority to the third party. This was in contravention of the terms of the Binding Authorities Byelaw (No. 9 of 1990).

As a result of this delegation of authority to the third party, the third party issued, in limited circumstances documents known as "confirmations of insurance" and in so doing held itself out as agent for underwriters at Lloyd's. Those documents, being evidence of cover, should only have been issued by the approved coverholder. It also issued claims settlement proposals which again held the third party out as being the agents of underwriters at Lloyd's.

In addition, by the third party rather than the coverholder, taking claims decisions the terms of the endorsement itself were also breached, as it had specifically provided that only the coverholder was to take claims decisions.

After the facility had been continuing for approximately seven months, Marlborough carried out an audit of the activities of the third party. That inspection identified that employees of the third party were carrying out underwriting functions and taking claims decisions purportedly on behalf of Lloyd's underwriters.

In the circumstances, at the time that the facility was set up and at all times thereafter Marlborough ought to have but failed to appreciate that the activities of the third party were in breach of the Binding Authorities Byelaw and its associated rules.

The following penalties have been imposed on Marlborough in relation to this matter:

- 1) A fine of £9,000
- 2) Notice of Censure in the terms of this Notice.

Marlborough has agreed to pay Lloyd's costs in the amount of £6,500 arising from these proceedings.

In assessing these penalties account has been taken of the fact that the relevant events occurred prior to the acquisition of Marlborough by Resolute Management Inc in December 2000 and the current management of Marlborough was not involved in managing the syndicate at the relevant time. Account was also taken of the fact that the binding authority was broked to the syndicate by an approved Lloyd's broker. In addition, Marlborough has co-operated at all times with the Lloyd's inquiry and has accepted the charge of misconduct thereby avoiding the costs of a contested hearing before a Disciplinary Tribunal.

Lloyd's Disciplinary Board