LLOYD'S

MARKET BULLETIN

REF: Y4675

Title	Equity Syndicate Management Limited – Mr Neil Utley
Purpose	To provide information relating to proceedings before the Enforcement Tribunal relating to Mr Neil Utley
Type	Event
From	Katie Dorling, Secretary to the Lloyd's Enforcement Tribunal
Date	19 February 2013
Deadline	N/A
Related links	[T&C]

In proceedings before the Lloyd's Enforcement Tribunal, Mr Utley has accepted two charges of detrimental conduct.

Mr Utley was the Chief Executive and a director of Equity Syndicate Management Limited ("Equity") from 27 June 2005 to 30 September 2010. Equity is the managing agent of Syndicate 218 ("the Syndicate") that underwrites insurance business at Lloyd's, specialising in the provision of motor insurance.

In October 2011 enforcement proceedings were brought against Mr Utley in relation to two charges of detrimental conduct. The charges related to the fact that as CEO Mr Utley had overall responsibility for corporate governance and for overseeing the establishment of effective systems and controls within Equity and that he failed to take sufficient steps to ensure that these standards were met in the specific instances set out in the attached Notice of Censure. Details of the events giving rise to these proceedings and of the charges accepted are set out in the attached Notice of Censure.

The Enforcement Tribunal has approved the following settlement terms –

1 That Mr Utley be censured in the terms of the attached Notice of Censure;
2 That Mr Utley 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.

As is made clear in the attached Notice of Censure, the sanctions being imposed reflect the very specific circumstances of Mr Utley. In addition Mr Utley has agreed to pay a contribution of £95,000 towards the external costs of Lloyd’s and £35,000 towards Lloyd’s internal 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 Utley and the Council of Lloyd’s.

Katie Dorling
Secretary to the Lloyd’s Enforcement Board

Notice of Censure

Neil Utley

Neil Utley was the Chief Executive (“CEO”) and a director of Equity Syndicate Management Limited (“Equity”) from 27 June 2005 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 Utley in relation to two charges of detrimental conduct.

In summary, the charges related to (i) Mr Utley’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 its reserving processes; and (ii) Mr Utley’s alleged failure to take reasonable steps to ensure that the Board was provided with sufficiently comprehensive management information and data regarding the adverse development of claims payments.

Mr Utley 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 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.

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 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 Utley took over as CEO. Mr Utley 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, albeit Mr Utley was not aware of some of these characteristics or the details of others:

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 and, in 2007 - 2009, were based on a target figure (Mr Utley was not aware that a target figure was used).

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 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 adequate aggregate written records of the reserve reviews, including the level of redundancy released, were maintained by Equity. The need properly to record the reserve review process was significant given its 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.

The reserve review process was organised and directly overseen by other executive directors, who had executive and Board-level responsibility for reserving, including the reserve reviews. Whilst Mr Utley, as CEO, was responsible for overseeing the executive functions of the managing agency, he did not have a role in the day to day conduct of the reserve reviews or in the provision of information to Equity's external advisors either in respect of the reserve reviews or reserving more generally.

Mr Utley accepts that as CEO he had ultimate 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 overseen and documented by those charged with those tasks; and

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

Mr Utley 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 Mr Utley commissioned a report by PwC to investigate the causes of the adverse paid development at IAG UK including Equity. 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 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. Although the report itself was not tabled at a Board meeting and was not discussed in detail at a Board meeting, the report made numerous recommendations and these 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 years of account and the new claims handling processes were reversed because the business considered that they were causing the continued adverse paid development. In 2009 and early 2010, the generally understood explanation provided to the Board by the executive directors with responsibility for claims and reserving, which was not challenged by its external advisers, was that the adverse paid development would be temporary and would end when the changes to the claims handling processes were fully reversed.

However, from 2007 to June 2010 the Board was not provided with sufficiently detailed information 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. changes to its pricing models) were appropriate.

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, in part due to external factors, and, although detailed claims data was captured from the start of 2007, and the "data warehouse" was generating some reports in 2009, it did not become fully operational until during 2010.

Mr Utley accepts that as CEO with overall responsibility for corporate governance and for overseeing the establishment of effective systems and controls within Equity he failed to take reasonable steps to ensure that the "data warehouse" project was implemented within a reasonable time by those charged with that task and that the Board was provided with sufficiently detailed information by those charged with that task to enable it properly to consider all material factors that may have been affecting the Syndicate's performance.

Mr Utley 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 Utley shall be censured in the terms of this Notice of Censure; and
2 Mr Utley 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 Utley.

In addition Mr Utley shall pay a contribution of £95,000 towards the external costs of Lloyd's and £35,000 towards Lloyd's internal costs in respect of these proceedings.

Mitigation

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

(a) It was as a result of Equity's own concerns (at the time when Mr Utley was CEO) as to the reliability of the Syndicate's reserving position that Equity commissioned an independent actuary to conduct a review of the Syndicate reserving. Equity informed both the FSA and Lloyd's of the potential need to strengthen its reserves.

(b) Mr Utley, on behalf of IAG UK, commissioned reporting accountants to investigate the reasons for the adverse paid development at Equity and to examine all aspects of claims with a view to identifying problems and suggesting possible actions to remedy them. This was done in 2007.

(c) Mr Utley 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 Utley 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) During his tenure as CEO of Equity, Mr Utley was responsible for significant improvements in a number of its systems and controls within Equity and was responsible for substantially strengthening the Board and recruiting a number of people who performed important risk management roles.

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

(i) Mr Utley 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 Utley 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