FINAL NOTICE

To: **The Underwriter Insurance Company Limited**

Of: **2 Minster Court**
Mincing Lane
London
EC3R 7YN

Date: **29 November 2004**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice of its decision to take the following action:

1. ACTION

1.1. The FSA gave you, The Underwriter Insurance Company Limited ("the firm"), a Decision Notice on 24 November 2004 which notified you that, pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a public censure on the firm.

1.2. The firm has agreed that it will not be referring this matter to the Financial Services and Markets Tribunal.

Accordingly, for the reasons set out below the FSA imposes a public censure on the firm.

2. THE STATEMENT OF PUBLIC CENSURE

2.1. The FSA has decided to impose a statement of public censure on the firm ("the public censure") in the following terms:-

"1 In the period 1 December 2001 to 26 March 2003, the firm breached Principle 11 of the FSA's Principles for Businesses by not being open and co-operative with the FSA by:

(a) taking steps at the year ends of 2001 and 2002 which had the effect of circumventing a regulatory requirement, namely the firm's Premium Income Limits ("PILs") set for 2001 and 2002; and

(b) not informing the FSA that it was considering taking, or had taken, those steps.

2 The firm did this by arranging to split the period of conventional 12 month insurance contracts so that part of the premium income relating to those contracts was deferred into the following accounting year.

3 The FSA views this breach as a serious failing because:

(a) a PIL is an important regulatory tool to protect consumers by limiting the underwriting risk to which an insurer may be exposed and the risk of the insurer becoming insolvent due to over expansion;

(b) PILs are imposed on insurers as limitations on their permissions to carry on regulated activities. A PIL requires an insurer to take all necessary steps not to exceed the stated limit on gross written premium income for the relevant year;

(c) as a result of the firm's decision to split insurance contracts, the gross written premium income that it reported to the FSA in its Annual Returns for 2001 and 2002 did not exceed the PIL, but did not accurately reflect the underwriting risks to which it had committed itself;

(d) the firm failed to inform the FSA, despite frequent contact with the FSA, about its policy to circumvent the PIL by splitting insurance contracts, particularly in the second half of 2002 when the firm was asked to confirm on a number of occasions that it was still writing below its PIL; and

(e) the firm's breaches occurred in 2001 and were repeated in 2002.

4 However, in deciding to issue a statement of public censure rather than impose an alternative disciplinary sanction, the FSA has taken account of the facts that:

(a) the breach relates solely to the firm's dealings and relationships with the FSA concerning its PILs and not to any other aspects of its business;

(b) the firm is now in run-off and is therefore not taking on any new business;

(c) the firm's board was not collectively aware of the relevant transactions;

(d) the firm's current senior management were not responsible for the firm committing the breaches;

(e) the firm conducted its own investigation into the splitting of the contracts and gave its findings to the FSA;

(f) *the firm was faced with an insurance market which was experiencing increasing premium rates, particularly so after 11 September 2001, which in turn put pressure on the firm's ability to comply with the PILs despite the fact that the firm had applied for increases in their PIL. The majority of the contracts were split at the year end, when pressure on the PILs was most acute;*

(g) *the monetary value of the breach which the firm avoided in 2001 by splitting insurance contracts was less than 1% of the PIL. In 2002 the figure was less than 3%;*

(h) *the firm implemented detailed underwriting guidelines designed to restrict the level of insurance business that it was writing;*

(i) *the firm cancelled some insurance contracts due for renewal and did stop writing new insurance business in the last quarters of 2001 and 2002;*

(j) *the firm applied to the FSA to increase it's 2002 PIL and appeared to be open and co-operative in its dealings, with the exception of informing the FSA of the split insurance contracts;*

(k) *no policy-holder has suffered any detriment as a result of the insurance contracts being split; and*

(l) *the firm has been open and co-operative with the FSA during the FSA's investigation."*

2.2. This statement will be published on or after 29 November 2004 and shall be published on the FSA's Public Register and website.

3. RELEVANT STATUTORY PROVISIONS RULES AND GUIDANCE

3.1. Section 205 of FSMA provides:

"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect."

FSA Principles for Businesses

3.2. FSA Principle 11 provides:

"A firm must deal with its regulators in an open and co-operative way, and must tell the FSA promptly anything relating to the firm of which the FSA would reasonably expect prompt notice."

Premium Income Limits

3.3. PILs are regulatory requirements that are placed on new insurance companies such as the firm to reduce the risk of them becoming over-exposed in the market compared to their business plans approved at authorisation. They set out limits on the total amount of business that a firm could transact in any given year.

3.4. The FSA expects firms to inform it if they are about to breach a PIL and to explain what remedial steps they propose to adopt to avoid a breach occurring. In the absence of exceptional circumstances, the FSA would expect a firm to plan so that these discussions would take place well in advance of any potential breach.

Facts and matters relied on

4. Background

4.1. The firm was authorised by the FSA, acting on behalf of HM Treasury, on 8 October 1999. At 1 December 2001 ("N2"), the firm was granted Part IV permission to carry on the regulated activities of effecting and carrying out contracts of general insurance.

4.2. The firm was established to carry on non-life insurance business within the UK, underwriting insurance risks through insurance intermediaries, predominantly from commercial operations.

4.3. On 10 July 2003, the FSA granted an application by the firm to vary its permission by removing the regulated activity of effecting contracts of insurance as principal.

4.4. On 11 July 2003, the firm ceased to write new business and was placed into run-off. By being placed into run-off, the firm is no longer effecting new contracts of general insurance, but is carrying out existing contracts of general insurance.

5. The firm's PIL

5.1. As a newly authorised general insurer, the FSA imposed PILs on the firm for the years ended 1999, 2000, 2001 and 2002. The FSA did this by a Notice of Requirements under section 47 of the Insurance Companies Act 1982. The firm was originally subject to a PIL of £51.5m in 2001 and £70m in 2002.

5.2. Post N2, the firm's Part IV permission included limitations to give continued effect to the PILs.

6. Application and approval of PIL increases

6.1. On 19 October 2000, following an application to increase its PIL, the FSA approved increases in the firm's PILs for 2000, 2001 and 2002 of £60m, £80m and £105m, respectively[1]. During 2001, the firm contacted the FSA to seek a further increase in the PIL for 2001, to accommodate the uplift in premium rates that the market was experiencing and to allow for further growth in the firm's business.

6.2. On 24 July 2001, the FSA increased the firm's 2001 PIL to £105m, although the PIL for 2002 remained unchanged at £105m. Pressure on the PIL increased in 2001/2002, particularly so after 11 September 2001.

7. Splitting insurance contracts

7.1. The firm faced increasing pressure on its PIL in 2001 and 2002. To address this situation the firm took unilateral steps to circumvent the PIL both in 2001 and 2002 by splitting insurance contracts to defer premium income into the following year. Despite frequent contact with the FSA about its PIL, the firm failed to discuss this approach with the FSA.

7.2. The methods by which the insurance contracts were split by the firm were as follows:

[1] Variation of Requirements dated 19 October 2000.

(a) an existing 12 month contract that had already been renewed, for example on 1 October 2001, was subsequently amended to expire on 31 December 2001, with the remaining period of the contract incepting on 1 January 2002 and expiring on 30 September 2002;

(b) at the date of renewal, for example 1 October 2001, instead of renewing the contract for 12 months, two shorter term contracts were written, the first incepting on 1 October 2001 and expiring on 31 December 2001, and the second incepting on 1 January 2002 and expiring on 30 September 2002;

(c) at the date of renewal, for example 1 October 2001, an expiring 12 month contract was extended until 31 December 2001, and then renewed to incept on 1 January 2002 and expire on 30 September 2002; and

(d) for some contracts the period of risk was unchanged, for example a contract was renewed for 12 months on 1 October 2001, but the *allocation* of the premium income in relation to that contract was changed so as to *allocate* the premium for the first three months in 2001 and the second nine months in 2002.

7.3. The steps taken by the firm to split insurance contracts in 2001 and 2002 enabled the firm to remain below its PILs, which it would otherwise have breached by £0.5m and £2.4m respectively. As a result of the firm's decision to split insurance contracts, the gross written premium income reported to the FSA in the firm's Annual Returns for 2001 and 2002 did not accurately reflect the underwriting risks to which it had committed itself.

8. RELEVANT GUIDANCE ON PUBLIC CENSURES

8.1. The purpose of the imposition of a public censures is to promote high standards of regulatory conduct and help the FSA achieve its regulatory objectives. The FSA seeks to do this by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.

8.2. The FSA's policy on the imposition of public censure is set out in Chapter 12 of the Enforcement manual ("ENF 12") which forms part of the FSA Handbook. This states out that where the FSA considers that formal disciplinary action is appropriate, public censure may be an alternative to financial penalties.

8.3. Section ENF 12.3 sets out the factors that may be of particular relevance in determining whether it is appropriate to issue a public censure rather than impose a financial penalty. The criteria listed in the manual at paragraph ENF 12.3.3 are not exhaustive and all relevant circumstances of the case will be taken into consideration.

8.4. ENF 12.3.3(6) provides:

"[I]f the firm or approved person has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach or misconduct would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it would only be in an exceptional case that the FSA would be prepared to agree to impose a public statement rather than a financial penalty, if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include:

(a) [Omitted]; and

(b) verifiable evidence that the firm would be unable to meet other regulatory requirements, particularly financial resource requirements, if the FSA imposed a financial penalty at an appropriate level."

8.5. As the firm is currently failing to meet the FSA's financial resources requirement the application of ENF 12.3.3(6)(b) means that a public censure is a more appropriate disciplinary sanction in the circumstances than a financial penalty.

9. DECISION MAKER

The decision which gave rise to the obligation to give this Decision Notice was made by the Regulatory Decisions Committee.

10. IMPORTANT

This Final Notice is given to you in accordance with section 390 of the Act. The following statutory rights are important.

Publicity

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under these provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to the firm or prejudicial to the interests of consumers.

The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

For more information concerning this matter generally, you should contact Richard Peat at the FSA (direct line: 020 7066 1268 /fax: 020 7066 1269).

Ian Mason
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FSA Enforcement Division