
FINAL NOTICE

To: **Mr Keith John Rutter**

Of: **c/o Jones Day
21 Tudor Street
London
EC4Y 0DJ**

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 about a requirement to pay a financial penalty:

1. The Penalty

- 1.1. The FSA gave you, Keith John Rutter ("Mr Rutter"), a Decision Notice on 24 November 2004 which notified you that, pursuant to section 66 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty of £20,000 on you.
- 1.2. You have agreed that you will not be referring this matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below the FSA imposes a financial penalty of £20,000 on you.

2. REASONS FOR THE ACTION

Introduction

- 2.1. In the periods 1 December 2001 to January 2002 and September 2002 to December 2002, Mr Rutter breached Statement of Principle 1 of the FSA's Statements of Principle for Approved Persons, in respect of his dealings and relationship with the FSA.
- 2.2. Mr Rutter breached Statement of Principle 1 in carrying out his controlled functions at The Underwriter Insurance Company Limited ("the firm"), by taking steps to circumvent regulatory requirements placed on the firm, namely the Premium Income Limits ("PILs") set for 2001 and 2002.
- 2.3. In addition, in the period 1 December 2001 to 7 March 2003, Mr Rutter breached Statement of Principle 4 of the FSA's Statements of Principle for Approved Persons by failing to inform the FSA of the steps taken to circumvent the firm's PILs, despite the frequent contact between the FSA and Mr Rutter during this period.
- 2.4. The FSA views these failings in respect of Mr Rutter's dealings and relationship with the FSA as serious because:
 - (1) 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;
 - (2) although others were involved, Mr Rutter was both closely involved in, and ultimately responsible for, the decision to split insurance contracts in order to enable the firm to circumvent the PILs imposed by the FSA;
 - (3) FSA approved persons must ensure they do not prevent an authorised person from complying with a limitation such as a PIL included in the authorised person's Part IV permission;
 - (4) as a result of the decision to split insurance contracts, the gross written premium income reported by the firm in the FSA Annual Returns for 2001 and 2002 did not accurately reflect the underwriting risks to which it had committed itself;
 - (5) despite the frequent contact between Mr Rutter and the FSA, especially in 2002 when Mr Rutter confirmed on a number of occasions that the firm was still writing below the PIL, Mr Rutter failed to draw the FSA's attention to the split insurance contracts, or the impact that they would have on the reported gross written premium income; and
 - (6) Mr Rutter's breaches occurred in 2001 and were repeated in 2002.
- 2.5. In deciding on the level of penalty to be imposed, the FSA has also taken account of the fact that Mr Rutter has suffered financial loss as a result of leaving the firm.

2.6. However, the FSA considers that these failings have been mitigated by the following factors:

- (1) Mr Rutter was ultimately responsible for overseeing the implementation of detailed underwriting guidelines designed to restrict the level of insurance business that the firm was writing;
- (2) Mr Rutter was ultimately responsible for the cancellation of insurance contracts due for renewal and the decision to stop writing new insurance business in the last quarters of 2001 and 2002;
- (3) 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;
- (4) the majority of the contracts were split at the year end, when pressure on the PILs was most acute;
- (5) 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%;
- (6) Mr Rutter applied to the FSA to increase the firm's 2002 PIL and appeared to be open and co-operative in his dealings, with the exception of informing the FSA of the split insurance contracts;
- (7) No policy-holder has suffered any detriment by reason of Mr Rutter's actions in relation to the insurance contracts being split;
- (8) Mr Rutter made no personal gain in respect of the split premiums; and
- (9) Mr Rutter has been open and co-operative with the FSA's investigation into these matters.

2.7. As a result, Mr Rutter has received considerable credit for these actions and without this evidence of acting responsibly and degree of co-operation the sanction proposed would have been more severe.

3. RELEVANT STATUTORY PROVISIONS RULES AND GUIDANCE

3.1. Section 66 of FSMA provides:

- “(1) The Authority may take action against a person under this section if—*
- (a) it appears to the Authority that he is guilty of misconduct; and*
 - (b) the Authority is satisfied that it is appropriate in all the circumstances to take action against him.*
- (2) A person is guilty of misconduct if, while an approved person—*
- (a) he has failed to comply with a statement of principle issued under section 64; or*
 - (b) he has been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under this Act.”*

FSA Statement of Principles for Approved Persons

- 3.2. FSA Statements of Principle 1 provides:

"An approved person must act with integrity in carrying out his controlled function."

- 3.3. FSA Statements of Principle 4 provides:

"An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice."

Premium Income Limits

- 3.4. 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.
- 3.5. 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 of the firm

- 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. Background of Mr Rutter

- 5.1. Mr Rutter was employed by the firm as CEO from its inception until he resigned on 7 March 2003. Mr Rutter was also the principal underwriter for the same period of time.
- 5.2. Mr Rutter was an Approved Person of the firm from 1 December 2001 to 7 March 2003 with the Controlled Functions CF1 (Director), CF3 (Chief Executive) and CF8

(Apportionment and Oversight)¹. As CEO, Mr Rutter was ultimately responsible for the conduct of the firm.

- 5.3. As principal underwriter, Mr Rutter wrote a substantial part of the firm's business. In 2002, Mr Rutter wrote approximately 40% of the firm's business.

6. The firm's PIL

- 6.1. 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.
- 6.2. Post N2, the firm's Part IV permission included limitations to give continued effect to the PILs.

7. Application and granting of PIL increases

- 7.1. On 19 October 2000, following an application to increase its PIL, the FSA granted increases in the firm's PILs for 2000, 2001 and 2002 of £60m, £80m and £105m, respectively². 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.
- 7.2. 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.

8. Splitting insurance contracts

- 8.1. 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.
- 8.2. The methods by which the insurance contracts were split by the firm were as follows:
- (1) 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;
 - (2) 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;

¹ Mr Rutter was an approved person with the Controlled Function CF2 (Non Executive Director) for the period 1 December 2001 to 11 September 2003.

² Variation of Requirements dated 19 October 2000.

- (3) 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 inception on 1 January 2002 and expires on 30 September 2002; and
 - (4) 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.
- 8.3. 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.
- 8.4. 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.

9. RELEVANT GUIDANCE ON PENALTY

- 9.1. The principal purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct. The FSA seeks to do this by deterring approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other approved persons from committing contraventions and demonstrating generally to approved persons the benefit of compliant behaviour.
- 9.2. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement manual ("ENF 13") which forms part of the FSA Handbook. Paragraph 13.3 of the Enforcement manual sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty.
- 9.3. The criteria listed at ENF 13.3.4 are not exhaustive and all relevant circumstances of the case will be taken into consideration.
- 9.4. In determining whether a financial penalty is appropriate and its level, the FSA is required therefore to consider all the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case:

The seriousness of the misconduct or contravention.

- 9.5. The FSA has had regard to the seriousness of the contraventions, including but not limited to the nature of the requirements breached, the number and duration of the breaches, the identification of the contraventions by the firm's senior management and the extent to which problems were systemic. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. Details of the breaches identified in this case are set out above. For the reasons detailed at paragraph 2.4 above, the FSA considers that the breaches identified in this case are of a serious nature. However it has also had regard to the factors set out in mitigation at paragraph 2.6 above.

The extent to which the contravention is deliberate or misconduct was deliberate or reckless

9.6. Although deliberate steps were taken to split insurance contracts there is no evidence that Mr Rutter knowingly contravened FSA Statements of Principles. However, the fact that Mr Rutter failed to give due attention to:

- (1) the FSA's approach relating to limitations such as the PIL in the firm's Part IV permission; and
- (2) the possibility that given the underlying importance of PILs to the FSA that he could unilaterally circumvent the PIL without discussing the issue first with the FSA;

are serious aggravating factors, whether or not Mr Rutter's behaviour and misconduct is classified as reckless.

The financial circumstances of the individual

9.7. The FSA only has limited information surrounding Mr Rutter's financial circumstances but Mr Rutter has stated that he has suffered the following financial impact:

- (1) as a result of the FSA's investigation, the firm ceased making stage payments under the Compromise Agreement between Mr Rutter and the firm which has resulted in Mr Rutter suffering severe financial loss by not receiving the substantial payments which had been due under that Compromise Agreement;
- (2) the existence of the investigation is known in the market place and this has severely restricted Mr Rutter's ability to secure a suitable alternative position; and
- (3) following the firm going into run-off, Mr Rutter paid up the balance of the subscription price for his shares in The Underwriter Group Limited, the firm's parent company, pursuant to a call for such amount made in accordance with that company's Articles of Association. Mr Rutter has invested in the share capital of the firm's parent company, The Underwriter Group Limited, and is unlikely to receive some or all of it back until completion of the firm's run-off which, depending on the circumstances of the run-off, could take many years.

Conduct following the contravention

9.8. The FSA has also considered Mr Rutter's full co-operation with the FSA's investigation into these matters.

Disciplinary record

9.9. Mr Rutter has not been subject to any previous disciplinary action.

Previous action by the FSA and other regulatory authorities in relation to similar failings

9.10. In deciding on the level of penalty, the FSA has taken into account penalties levied by previous regulators and by the FSA in relation to similar behaviour by other approved persons.

10. **DECISION MAKER**

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

11. **IMPORTANT**

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

Financial penalty: manner of payment

Mr Rutter must pay the Penalty to the FSA in full.

Time for payment

The Penalty must be paid by Mr Rutter to the FSA within 14 days beginning with the date on which the notice is given to him.

Time for payment

If all or any of the Penalty is outstanding after 14 days, the FSA may recover the outstanding amounts as a debt owed by Mr Rutter due to the FSA.

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.

Third Party Rights

The FSA gave a copy of the Decision Notice to the firm. Accordingly, the FSA must also give a copy of this notice to the firm.

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
Head of Deposit Taking, Insurance and Financial Crime
FSA Enforcement Division