BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

# FINAL NOTICE

To: **Millburn Insurance Company Limited (In Administration)**
**(FRN: 202177)**

Date: 1 February 2016

## 1. IMPOSITION OF PENALTY

1.1. Pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the PRA hereby imposes on Millburn Insurance Company Limited (In Administration) ("Millburn") a financial penalty of £2,863,066 for breaches of Principles 2 and 3 between 26 December 2010 and 18 September 2013 ("the Relevant Period").

1.2. Millburn agreed to settle at an early stage of the PRA's investigation and therefore qualified for a 30% (stage 1) discount under the PRA Settlement Policy. Were it not for this discount, the PRA would have imposed a financial penalty of £4,090,094 on Millburn.

## 2. SUMMARY OF THE GROUNDS FOR ACTION

2.1. The PRA imposed the financial penalty on Millburn because it failed to conduct its business with due skill, care and diligence, in breach of Principle 2 of the FSA's (and from 1 April 2013, the PRA's) Principles for Businesses. Millburn also failed to take reasonable care to organise and control its affairs, in breach of Principle 3 of the Principles for Businesses.

2.2. The breaches of Principle 2 result from Millburn's failure:

(a) to carry out adequate due diligence in respect of the reinsurer ("the Active Reinsurer") with whom Millburn placed its entire reinsurance programme for the portfolio it was actively underwriting ("the Reinsurance Treaties"); and

(b) to put in place prudent mitigation of Millburn's exposure to the Active Reinsurer and the resultant concentrated counterparty risk.

2.3. The breaches of Principle 3 result from Millburn's failure:

(c) to establish and implement appropriate systems and controls to monitor and control the nature of the business that its managing general agent ("the MGA") was writing on its behalf; and

(d) to establish and implement appropriate systems and controls to ensure that the activities of sub-delegatees under the MGA agreement were subject to effective control.

2.4. In so doing, during the Relevant Period, Millburn also breached a number of rules in the FSA (and from 1 April 2013, the PRA) Handbook, including rules in the Prudential Sourcebook for Insurers (INSPRU), the General Prudential Sourcebook for all authorised firms (GENPRU) and the Sourcebook on Senior Management Arrangements, Systems and Controls (SYSC). These breaches, and further explanations of the grounds for the PRA taking action against Millburn, are set out in more detail in Annex B.

2.5. These failings had a significant impact adverse impact on the safety and soundness of Millburn, and ultimately resulted in Millburn entering administration. They also meant that Millburn's policyholders did not receive the degree of protection to which they were reasonably entitled and that Millburn was unable to comply or verify its compliance with basic regulatory requirements to have adequate financial resources, capital and insight into its major sources of risk.

## 3. WHY THE PRA INVESTIGATED THIS MATTER

3.1. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA's role is to promote the safety and soundness of those firms, and, specifically for insurers, to contribute to securing an appropriate degree of protection for those who are or may become policyholders. The PRA is not responsible for ensuring that no insurer fails, but rather that all insurers have an appropriate degree of resilience, and that those that fail exit the market in an orderly fashion with their policyholders receiving appropriate protection.

3.2. Millburn's actions meant that it did not achieve the required degree of resilience to failure, and fell significantly short of the standards the PRA expects of PRA-authorised persons.

3.3. During the Relevant Period, Millburn's total gross written premium (GWP) was over £32.9 million. Millburn never held more than £2.7 million in capital during the Relevant Period. This was wholly insufficient to mitigate the risks of any non-payment by its Active Reinsurer. Of the 7,871 claims made by Millburn's policyholders (totalling over £16 million) during the Relevant Period, 914 claims remained outstanding prior to its administration, amounting to over £6.4 million. Millburn has incurred, and will continue to incur, liabilities to policyholders in respect of claims. The full extent of these claims, and of any resultant claims for Millburn under the Reinsurance Treaties, has not yet been ascertained. Without recoveries under the Reinsurance Treaties, there is little prospect that Millburn will be able to pay these claims in full, with the likely result that some losses will be borne by policyholders and/or the FSCS.

## 4. REASONS WHY THE PRA TOOK ACTION

4.1. The PRA considers that:

(1) adequate due diligence prior to arranging reinsurance and the effective management of reinsurer counterparty risk are integral parts of an insurer's safety and soundness. This is particularly important where insurers enter fully fronted schemes or place all their reinsurance with a single provider, but remains true in all cases;

(2) where an insurer is materially dependent on a reinsurer, it is essential that this risk is identified, mitigated and actively managed such that the insurer's total exposure to that counterparty remains prudent; and

(3) where firms of any type are authorised to write business on an insurer's behalf, insurers must put in place appropriate systems and controls to monitor and control the nature of such business in order to identify, measure, and control effectively the prudential risks that the insurer is, or might be, exposed to. Appropriate systems and controls must include appropriately-controlled sub-delegations within their scope and must ensure the provision of timely and reasonably accurate insurance risk data and management information.

## 5. OUTLINE FACTS AND MATTERS RELIED ON

5.1. Millburn is a UK insurance company based in London which had permission to underwrite insurance policies in the classes of Damage to Property, Fire and Natural Forces, Goods in Transit and Miscellaneous Financial Loss. Millburn is a very small firm but from late 2010 it had plans to grow. As a result, it embarked on a significant expansion. This was part of an agreement with a third party which would ultimately have led to a change in ownership.

5.2. In January 2011, in order to implement the plan, Millburn appointed a managing general agent (MGA) to underwrite business on its behalf and handle any resultant claims. Further delegations by the MGA to third parties were authorised by Millburn, including permission for the MGA to enter into binding authority agreements with authorised insurance intermediaries, thereby permitting third parties to accept proposals and issue policies and thus bind Millburn contractually.

5.3. The MGA agreement did not adequately specify the policy, premium and claims data or management information to which Millburn should have been entitled, nor did it provide details of the type of business Millburn wished the MGA to underwrite, on what terms and at what price. The MGA and third parties wrote business on behalf of Millburn but Millburn did not require the MGA to provide timely and reasonably accurate basic written policy, premium and claims data on that business. Millburn also did not require the MGA to provide adequate, timely insurance risk management information on the business. Consequently, Millburn was not able to monitor and control the prudential risks to which it was exposed.

5.4. Millburn also entered into three reinsurance treaties with the Active Reinsurer, covering the entirety of its business written during the Relevant Period, in the form of an overarching stop-loss treaty and two fully fronted schemes (whereby Millburn took on risks but reinsured them 100% to the Active Reinsurer). The first of these treaties was concluded on 26 December 2010. These treaties were the only reinsurance cover for the business underwritten during the Relevant Period and Millburn was materially dependent on them.

5.5. Initially, the Reinsurance Treaties performed as expected, but from a point in 2013, no further amounts were paid under the Treaties. This meant that Millburn became unable to meet its claims as they fell due.

5.6. Following engagement with the PRA, on 18 September 2013 Millburn voluntarily varied its permissions so as to cease writing new insurance business, and it voluntarily agreed to the imposition of asset requirements to protect policyholders. Millburn entered into administration on 9 December 2013. Millburn's administrators are unable, at this stage, to determine the quantum of the dividend to creditors as this is dependent on future recoveries from the Active Reinsurer and the final level of creditors' claims. It is possible that creditors will not be paid in full.

5.7. As a result of the events at Millburn, the PRA and the FCA each agreed to undertake an investigation into Millburn. The facts and matters relied on by the PRA in its decision-making process can be found in Annex A.

## 6. PRA POWER TO ACT

6.1. Millburn's breaches took place between 26 December 2010 (the date of the stop-loss reinsurance treaty) and 18 September 2013 (the date Millburn stopped writing new business).

6.2. On 1 April 2013, a new 'twin peaks' regulatory structure came into being under which the FSA was replaced by the FCA and the PRA. The effective date of that change, 1 April 2013, is known as the date of Legal Cutover (LCO). Following LCO, both the FCA and the PRA have an enforcement remit and are able to exercise a range of enforcement powers and impose sanctions under the Act.

6.3. Although the conduct to which this matter relates straddled LCO, Part 5 of the Financial Services Act 2012 (Transitional Provisions) (Enforcement) Order 2013 ("the Transitional Provisions Enforcement Order") permits the PRA to take action in relation to contraventions occurring prior to LCO and for which the PRA would have been the appropriate regulator had the contravention occurred on or after LCO. The PRA therefore has the ability to take action in relation to this matter.

6.4. Pursuant to Section 210(7) of the Financial Services and Markets Act 2000, the PRA must have regard to any statement published at the time when the contravention occurred when taking enforcement action. Since the Relevant Period commenced before LCO but continued after that date, pursuant to Article 11(6)(b) of the Transitional Provisions Enforcement Order, the PRA Penalty Policy is the relevant statement to which regard must be had in the imposition of

a financial penalty.

6.5. The PRA therefore imposed on Millburn a financial penalty of £4,090,094 (before Stage 1 discount) for breaching Principles 2 and 3. Millburn agreed to settle at an early stage of the PRA's investigation and therefore qualified for a 30% (Stage 1) discount under the PRA's Settlement Policy. The PRA therefore reduced the level of the penalty to £2,838,066. The PRA's penalty calculation is set out in Annex C.

## 7. PROCEDURAL MATTERS

7.1. The procedural matters set out in Annex D are important.

Robert Dedman
Chief Counsel, Regulatory Action Division
for and on behalf of the PRA

# Annex A

## 1. FACTS AND MATTERS RELIED UPON

### Background

1.1. Millburn is a UK insurance company based in London and was placed into administration on 9 December 2013. Its business included underwriting insurance policies in the classes of Damage to Property, Fire and Natural Forces, Goods in Transit and Miscellaneous Financial Loss.

1.2. Prior to the Relevant Period, Millburn was wholly owned by another company ("the Holding Company"). During that time, Millburn underwrote longer term insurance-backed guarantee policies and other policies relating to home improvement works carried out by contractors, with annual gross written premium below £500,000. This business was subsequently reinsured in full by another subsidiary of the Holding Company's group before commencement of the Relevant Period. As at 31 December 2010, Millburn held approximately £2 million of capital and its gross written premium for the year was £237,000.

### Millburn's change in business plan

1.3. In late 2010, Millburn changed its business strategy so that it could be actively marketed for sale to a potential investor. On 1 November 2010, an Investor Company entered into an agreement with Millburn and its shareholders for the purchase, in four stages, of Millburn's entire share capital, from 31 March 2011 and completing on 31 December 2013.

1.4. As part of the sale process, Millburn approved an expansion plan. This committed Millburn to commence underwriting a wider range of insurance policies, for which Millburn had appropriate permissions, and their sale through intermediaries, in order to expand Millburn's balance sheet.

1.5. On 31 December 2010, a company connected to the Investor Company purchased 9.9% of Millburn's shares. This was the only share purchase to take place.

**Appointment of the MGA**

1.6. As part of the expansion plan, on 1 December 2010 Millburn entered into an appointed representative agreement ("the AR Agreement") with the MGA, whereby the MGA became Millburn's appointed representative.

1.7. The terms of the AR Agreement provided that Millburn was responsible for the MGA in respect of insurance mediation activities relating to policies underwritten by Millburn.

1.8. Subsequently, on 26 January 2011, an MGA agreement was concluded between Millburn and the MGA. As Millburn's managing general agent, the MGA was granted authority to:

(1) negotiate and enter into binding authority agreements with authorised insurance intermediaries on behalf of Millburn for the sale and fulfilment of Millburn insurance policies;

(2) negotiate and enter into agreements with authorised insurance intermediaries on behalf of Millburn for the sale and fulfilment of Millburn insurance policies;

(3) accept and issue Millburn insurance policies to individual customers; and

(4) undertake financial accounting services on Millburn's behalf.

1.9. Under that agreement, no further delegations of authority by the MGA were permitted without Millburn's consent.

1.10. Also on 26 January 2011, Millburn approved the appointment of sub-delegatees under the MGA Agreement, thereby granting sub-delegatees authority to:

(1) enter into binding authority agreements with authorised insurance intermediaries for the sale and fulfilment of Millburn insurance policies;

(2) directly accept proposals and issue policies on Millburn's standard policy wording and/or on amended wording otherwise agreed by Millburn; and

(3) issue policies of insurance and other documents agreed by Millburn to evidence cover issued pursuant to the MGA Agreement.

1.11. No contractual restrictions were imposed on the type, quality or price of the business that could be underwritten on Millburn's behalf either in the MGA Agreement or the sub-delegations under it. No contractual requirements were

imposed in the MGA agreement on the policy, premium and claims data and management information which the MGA would provide or to which Millburn would be entitled. A cap on gross annual premium was included in the contract and was the only ostensible financial control.

**Millburn's insurance arrangements**

1.12. Millburn, via the MGA, entered into a number of binding authority agreements with third parties during the Relevant Period, which are summarised below.

Schools' Staff Absence

1.13. On 9 March 2011, a sub-delegatee of the MGA entered into an agreement with a coverholder, in respect of schools' staff absence insurance in the United Kingdom from 1 February 2011. The total gross written premium in respect of this business was approximately £1.86 million, for 308 policies issued during the Relevant Period. A total of 252 claims were made by policyholders prior to Millburn's administration, with a value of over £850,000.

Motorsport

1.14. On 16 May 2011, a sub-delegatee of the MGA entered into an agreement with another coverholder in respect of race, rally and motorbike on event/on track insurance worldwide, excluding the United States of America and Canada, from 1 September 2011. The total gross written premium in respect of this business was approximately £5.57 million during the Relevant Period. The number of policies issued has yet to be ascertained precisely. A total of 356 claims had been made by policyholders prior to Millburn's administration, with a value of over £4.8 million.

Other lines of business

1.15. During the Relevant Period, the MGA entered into a number of other agreements with various coverholders within the classes of Damage to Property, Fire and Natural Forces, Goods in Transit and Miscellaneous Financial Loss. Gross written premium received during the Relevant Period in respect of these various policies amounted to almost £26 million. The number of policies has yet to be ascertained precisely. A total of 7,263 claims had been made by policyholders prior to Millburn's administration, with a value of over £10 million.

**Millburn's reinsurance arrangements with the Active Reinsurer**

1.16. Millburn entered into the Reinsurance Treaties with the Active Reinsurer. These comprised:

(1) General Polices Reinsurance, dated on or around 26 December 2010, under which the Active Reinsurer provided Millburn with stop-loss cover in respect of all insurance policies issued by Millburn from 1 November 2010 via the MGA and/or under binding authority agreements issued by Millburn, with a limit of £25 million in excess of actual premium earned in any one year. The General Policies Reinsurance covered worldwide policies issued in classes of Damage to Property, Fire and Natural Forces, Goods in Transit and Miscellaneous Financial Loss. This treaty was Millburn's principal source of protection for its underwriting expansion;

(2) Schools' Staff Absence Reinsurance, dated 19 December 2011, providing for 100% reinsurance of UK staff absence insurance for schools underwritten by Millburn from 1 January 2011 issued by the MGA under the binding authority agreement referred to at paragraph 1.13 above, with a limit of £5 million; and

(3) Motorsport Reinsurance, dated 19 January 2012, under which the Active Reinsurer provided Millburn with 100% reinsurance in respect of worldwide (excluding the USA and Canada) race, rally and motorbike on event/on track insurance underwritten by Millburn from 1 September 2011 issued under the binding authority agreement referred to at paragraph 1.14 above, with a limit of £10 million.

1.17. Prior to entering into the Reinsurance Treaties with the Active Reinsurer, Millburn received and reviewed the Active Reinsurer's financial statements. Millburn did not conduct any further due diligence in relation to the Active Reinsurer, either prior to or during the term of the Reinsurance Treaties. Consequently, Millburn did not discover that the Active Reinsurer is the subject of cease and desist orders in relation to insurance sales in a province in Canada and certain states in the United States of America which pre-date the Reinsurance Treaties with Millburn. Millburn did not consider using another reinsurer or carry out and record a risk assessment in respect of its exposure to the Active Reinsurer, and the resultant concentrated counterparty risk, at any point during the Relevant Period. Millburn failed to mitigate its exposure to reinsurance counterparty risk in any way, and did not monitor its exposure to the Active Reinsurer with a view to assessing whether total exposure remained prudent, whether risk mitigation

techniques should subsequently be put in place or whether risk concentration limits had been reached which triggered reporting obligations to the PRA.

**Oversight of the MGA's activities**

Data

1.18. Millburn did not put in place a contractual entitlement in the MGA agreement to receive reasonably accurate, timely, written data on policies, premiums and claims. Millburn also did not establish practical appropriate systems and controls to ensure that it was in fact provided with such data. Consequently, Millburn relied on limited written data and some oral explanation by the MGA. This was insufficient for Millburn to be able to verify compliance with its regulatory obligations in relation to capital, risk management and accounting. Because of these limitations, Millburn's gross written premium for the Relevant Period was still subject to material revision in July 2015.

Underwriting guidelines

1.19. Following commencement of the MGA Agreement, Millburn did not put in place underwriting guidelines for the MGA, despite such guidelines being envisaged by the wording of the risk provisions in the MGA Agreement. In November 2012, a recommendation was made at a Millburn/MGA management meeting that underwriting guidelines should be put in place. However, these were not implemented until around April 2013, by which time the MGA had already entered into a number of sub-delegations under which a substantial volume of business had been underwritten.

Management Information

1.20. Millburn received management information through different routes and with varying frequencies as the Relevant Period progressed. However, at all times the written management information was insufficient in isolation for Millburn to be able to assess or have appropriate insight into the prudential risk it was exposed to. Millburn was consequently reliant on verbal explanations provided by the MGA but this remained insufficient to provide insight into Millburn's prudential risk.

**Oversight and control over sub-delegatees**

1.21. Millburn permitted sub-delegations under the MGA agreement despite knowing that adequate systems and controls were not in place to ensure effective control of the MGA. By lengthening the delegation chain in this way, Millburn exacerbated the risk resulting from its original failures in its systems and controls.

**Millburn's administration**

1.22. The PRA became concerned about Millburn in May 2013 and obtained information from Millburn. As a result of that information, the PRA identified concerns in relation to Millburn's solvency and management.

1.23. On 18 September 2013, following the involvement of the PRA, Millburn voluntarily varied its permission so as to cease writing new insurance business, and it voluntarily agreed to the imposition of asset requirements to protect policyholders. Millburn went into administration on 9 December 2013. As a result of its administration, Millburn was declared in default by the FSCS.

**Millburn's capital position**

1.24. During the Relevant Period, Millburn never held more than £2.7 million capital on its balance sheet. This was wholly insufficient to mitigate the effects of any non-payment by the Active Reinsurer.

# Annex B

## 1. BREACHES AND FAILINGS

### Principle 2

1.1. Principle 2 states that a firm must conduct its business with due skill, care and diligence.

Due diligence failures

1.2. The underlying cause of Millburn's administration was Millburn's inability to continue paying claims without also receiving recoveries under the Reinsurance Treaties.

1.3. As set out above, Millburn arranged for all business written during the Relevant Period to be reinsured by the Active Reinsurer, by way of an overarching stop-loss reinsurance treaty and two fully fronted schemes (whereby Millburn took on risks but reinsured them 100% to the Active Reinsurer). These arrangements provided for Millburn to pass to the Active Reinsurer material but varying percentages of the premiums received from policyholders. Millburn also incurred coverholder commissions which were paid from premiums.

1.4. Millburn was therefore exposed to the risk that, if the Active Reinsurer did not pay certain amounts under Millburn's reinsurance, Millburn would be liable to its policyholders for the payment of claims, but would not be in a position to meet those claims if it did not have sufficient capital resources to pay claims itself. Millburn's capital resources were limited, and insufficient to mitigate default by the Active Reinsurer. Default in this context means a delay in performing contractual obligations as well as the non-performance of those obligations, either in whole or part.

1.5. Millburn should have been particularly careful to assess, monitor and mitigate reinsurance default risk given that the Active Reinsurer:

(1) was the only provider of reinsurance to Millburn for its active portfolio;

(2) was the subject of cease and desist orders in a province in Canada and in certain states in the United States of America in respect of carrying out

unlicensed insurance business;

(3) had not been subject to independent scrutiny from a ratings agency and so had no rating; and

(4) was not required by Millburn to provide any form of security against default.

1.6. Despite the significant prudential risk to Millburn of placing all of its reinsurance cover with the Active Reinsurer in respect of policies underwritten during the Relevant Period, Millburn failed to carry out adequate due diligence in respect of the Active Reinsurer prior to entering the Reinsurance Treaties. In particular, Millburn:

(1) reviewed financial statements for the Active Reinsurer but took no further steps to assess the financial standing and repute of the Active Reinsurer, either prior to or during the term of the Reinsurance Treaties. Millburn therefore failed to establish clearly at any time whether the Active Reinsurer had sufficient financial and other resources to provide reinsurance in accordance with the Reinsurance Treaties;

(2) failed to give consideration to placing business with any other reinsurer as it considered entering into the Reinsurance Treaties with the Active Reinsurer to be an integral part of its expansion plan;

(3) failed to carry out and record a risk assessment of the Active Reinsurer at any stage in the reinsurance relationship;

(4) failed to put in place prudent mitigation of Millburn's exposure to the Active Reinsurer and the resultant concentrated counterparty risk. Prudent mitigation could have taken a variety of forms, including a decision by Millburn to hold more capital; and

(5) failed to monitor its reinsurance concentration risk, and therefore failed to consider during the course of the Reinsurance Treaties whether mitigation techniques should be employed, whether total exposure remained at prudent levels, and whether reporting obligations to the PRA were triggered.

Consequences of failures

1.7. Millburn's failures with respect to its reinsurance meant that it breached the following rules in the PRA Handbook:

(1) the requirement in INSPRU 2.1.8 to ensure that counterparty exposures are kept within prudent levels;

(2) the requirement in INSPRU 2.1.23 to report to the PRA as soon as a firm becomes aware that its exposure to a reinsurer is reasonably likely to exceed 100% of its capital resources; and

(3) the requirement in INSPRU 2.1.24 to explain to the PRA when making notification under INSPRU 2.1.23 how prudent provision has been made for exposures exceeding 100% or why such provision is unnecessary, and to explain how the reinsurance exposure is being safely managed.

1.8. Millburn's degree of exposure to the Active Reinsurer was not prudent because the Active Reinsurer was a concentrated source of credit risk for Millburn, which if realised would inevitably lead to Millburn being unable to meet policyholder claims. No steps were taken to quantify, manage or mitigate this concentrated source of risk, though a variety of techniques for this were available to Millburn. Millburn's failure to monitor its reinsurance credit risk meant that it was unable to make the necessary reports to the PRA or consider whether risk mitigation techniques should be employed. Its material dependence on the Active Reinsurer (on whom it had not carried out adequate due diligence and on whom it did not carry out appropriate monitoring) meant that there was a significant risk that Millburn would not be able to meet its liabilities as they fell due. The number and seriousness of the breaches of the PRA's rules demonstrate that Millburn did not conduct its business with due skill, care and diligence.

**Principle 3**

1.9. Principle 3 states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Millburn's failure to monitor and control the MGA

1.10. From the date of its appointment, the MGA was authorised to write insurance business on Millburn's behalf. Millburn failed to establish and implement appropriate systems and controls for the provision of basic, timely data on policies, premiums and claims. Millburn further failed to establish and implement appropriate systems and controls for the provision of timely management information which could have enabled Millburn to assess the prudential risks to which it was exposed.

1.11. In particular, Millburn failed to:

(1) establish a sufficiently clear contractual definition of the policy, premium and claims data to which it was entitled;

(2) implement a system which was effective in practice for reporting that basic data accurately, on a timely basis and in a written form which was capable of interrogation by Millburn;

(3) establish and implement underwriting guidelines for the MGA that set out in detail the nature of business acceptable to Millburn, the terms on which it could be written and the rates to be applied. Such guidelines, which were envisaged by the wording of the risk provisions contained in the MGA Agreement, would have mitigated the prudential risks associated with allowing the MGA to bind Millburn to contracts of insurance, by making Millburn's risk appetite clear to the MGA; and

(4) establish and implement systems and controls which stipulated the scope and quality of management information that Millburn required from the MGA. As a result, the MGA did not prepare adequate MI to enable Millburn to identify, measure, and control effectively the prudential risks that Millburn was, or might be, exposed to as a result of the MGA's activities.

Millburn's failures in relation to sub-delegatees under the MGA agreement

1.12. Millburn failed to establish and implement appropriate systems and controls to ensure that the activities of sub-delegatees under the MGA agreement were subject to effective control.

1.13. In particular, Millburn permitted sub-delegations to be made despite the lack of effective systems and controls in relation to the MGA agreement. Further, once sub-delegations had been agreed, Millburn was not able adequately to identify, measure or control effectively the prudential risks resulting from those sub-delegations as the sub-delegations were subject to all the same reporting weaknesses as the original appointment of the MGA.

Consequences of failures

1.14. Millburn's failures with respect to its systems and controls meant that it breached the following rules in the PRA Handbook:

(1) the requirement in INSPRU 1.1.12 for general insurers to maintain adequate technical provisions, the associated calculation rule in GENPRU 2.1.34 and the requirement in GENPRU 2.1.13 to ensure that capital is at least equal to the capital resource requirement at all times, as it would have been unable to establish with any certainty whether its technical provisions or capital satisfied these provisions;

(2) the requirement in GENPRU 1.2.30 to have sound, effective and complete processes, strategies and systems to identify and manage all major risk classes;

(3) the requirement in SYSC 3.1.1 to take reasonable care to establish and maintain appropriate systems and controls;

(4) the requirement in SYSC 14.1.18 to take reasonable steps to ensure the establishment and maintenance of appropriate systems for the management of prudential risk, and the associated requirement in SYSC 14.1.19 to document those systems and controls; and

(5) the requirement in SYSC 14.1.53 to regularly update records to show the firm's financial position and exposure to risk to a reasonable degree of accuracy.

1.15. Millburn's failure to ensure that it received reasonably accurate and timely data on the policies it underwrote, and the premiums and claims due on those policies, meant that it could not verify the accuracy of its technical provisions, as technical provisions depend among other things on premium and claims data. These failures with regard to data meant that Millburn was also unable to verify whether it was holding sufficient capital, as capital calculation also depends (among other things) on premium and claims data. They further meant that Millburn was unable to record its financial position to a reasonable degree of accuracy. These failures have complicated both Millburn's administration and the PRA's investigation, even in relation to the most basic metric insurers report, namely GWP. Without the ability to record GWP accurately, many other material elements in Millburn's financial position were by definition incorrectly recorded.

1.16. Millburn's reliance on verbal information from the MGA to gain insight into its exposure to insurance risk did not constitute a sound, effective and complete process to manage its exposure to insurance risk. Verbal information should supplement comprehensive, timely and accurate data and management

information, not attempt to act as a substitute for it.

1.17. Millburn's failure to establish underwriting guidelines and to clearly communicate its risk appetite to those authorised to bind it to contracts of insurance meant that a critical part of the system for controlling insurance risk was not in place. Millburn's failure to ensure that it received appropriate, timely management information meant that Millburn was unable to understand the prudential risks to which it was exposed.

1.18. The number and seriousness of the breaches of the PRA's rules demonstrate that Millburn did not take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Conclusion

1.19. The PRA considers Millburn's failings to be particularly serious because:

(1) its failure to manage the risks associated with its reinsurance arrangements with the Active Reinsurer was a significant causative factor in Millburn entering administration, and is likely to cause loss to its policyholders and/or the FSCS;

(2) its failure to put in place systems for basic data reporting meant that Millburn was never in a position to know whether it was meeting its regulatory obligations in relation to capital, risk management and accounting;

(3) its failure to put in place systems and controls to monitor and control the MGA resulted in prudential risk as Millburn was not fully aware of the parameters and levels of business that were being written by the MGA on Millburn's behalf and consequently could not manage its exposure to insurance risk; and

(4) its failure to ensure the activities of sub-delegatees were subject to effective control resulted in Millburn entering contracts of insurance of which it had insufficient knowledge and understanding.

# Annex C

## 1. PENALTY REGIME

1.1. The PRA took over prudential regulation of Millburn on 1 April 2013. Millburn's breaches occurred during the period 26 December 2010 to 18 September 2013 ("the Relevant Period") and therefore straddle that date.

1.2. Because the breaches continued after 1 April 2013, pursuant to article 11(6)(b) of the Transitional Provisions Enforcement Order, the PRA must apply its penalty regime set out in the PRA Penalty Policy.

### Single penalty calculation

1.3. The PRA considered whether to calculate separate penalties in respect of Millburn's breaches of Principles 2 and 3. However, as the systems and controls failures underpinning the misconduct in relation to both regulatory breaches are linked, the PRA concluded that a single penalty calculation is appropriate.

### Step 1: Disgorgement

1.4. Pursuant to paragraph 17 of the PRA Penalty Policy, at Step 1 the PRA seeks to deprive an individual of any economic benefits derived from or attributable to the breach of its requirements, where it is practicable to ascertain and quantify them.

1.5. The PRA has no evidence to suggest that Millburn derived any economic benefits from the breaches of Principles 2 and 3, given that it is in administration. The PRA therefore does not require the disgorgement of any sum from Millburn.

1.6. The Step 1 figure is therefore £0.

### Step 2: The seriousness of the breach

Relevant revenue

1.7. Pursuant to paragraph 18 of the PRA Penalty Policy, at Step 2 the PRA determines a starting point figure for a penalty having regard to the seriousness of the breach by the firm - including any threat it posed or continues to pose to the advancement of the PRA's statutory objectives - and the relevant revenue of

the firm.

1.8. Paragraph 19(b) of the PRA Penalty Policy defines "relevant revenue" as:

*'the firm's revenue during its last business year, that is, the financial year preceding the date when the breach ended'.*

1.9. Millburn's relevant revenue is therefore revenue during the financial year preceding 18 September 2013 (when the breaches ended) and is represented by its GWP. Based on information provided by Millburn to the PRA, Millburn's relevant revenue is £17,267,291.

Step 2 factors

1.10. In determining a percentage rate to apply to the firm's relevant revenue to produce a figure at Step 2 that properly reflects the nature, extent, scale, gravity and overall seriousness of the breach, the PRA may have regard to the factors set out at paragraph 21 of the PRA Penalty Policy.

1.11. The PRA considers the percentage rate of Millburn's relevant revenue should be 15%, for the following reasons:

(1) Millburn's breach had a significant adverse effect on the advancement of the PRA's statutory objectives, specifically the "safety and soundness" and "policyholder protection" objectives. In particular, Millburn's failure to conduct adequate due diligence in respect of its reinsurance arrangements compromised its safety and soundness, the effect of which, in this case, was Millburn entering into administration when its reinsurance did not perform, causing loss to its policyholders (PRA Penalty Policy, para. 21(a));

(2) the breaches occurred for a period of over two years and eight months (PRA Penalty Policy, para. 21(b));

(3) the breach was neither reckless nor deliberate (PRA Penalty Policy, para. 21(c));

(4) Millburn was directly responsible for its breaches, both in terms of lack of due diligence and failure to organise and control its affairs responsibly and effectively with adequate risk management controls (PRA Penalty Policy, para. 21(d)); and

(5) the breaches revealed serious and systemic weaknesses in Millburn's business model, financial strength, and governance and risk management systems (PRA Penalty Policy, para. 21(g)).

1.12. Therefore, the Step 2 figure is 15% of £17,267,291 = £2,590,094.

**Step 3: Adjustment for any aggravating, mitigating or other relevant factors**

1.13. Pursuant to paragraph 24 of the PRA Penalty Policy, at Step 3 the PRA may increase or decrease the Step 2 figure (excluding any amount to be disgorged pursuant to Step 1) to take account of any factors which may aggravate or mitigate the breach, or other factors which may be relevant to the breach or the appropriate level of penalty in respect of it.

1.14. The PRA considers that the following aggravating and mitigating factors are relevant:

(1) Millburn voluntarily agreed to a variation of its FCA and PRA permissions (PRA Penalty Policy, para. 25(b));

(2) Millburn is co-operating as the PRA would expect when under investigation (PRA Penalty Policy, para. 25(c));

(3) Millburn could reasonably have been expected to be aware of the breaches throughout the Relevant Period. Millburn failed to put in place prudent mitigation of the concentration of counterparty risk and failed to take reasonable steps to ensure that appropriate systems and controls were in place at Millburn to monitor and control the nature of the business that the MGA was writing on Millburn's behalf. However, despite knowledge of these sources of risk, no adequate or effective steps to address them were taken (PRA Penalty Policy, para. 25(d));

(4) Millburn has not had any previous disciplinary or compliance problems with the PRA or FCA (PRA Penalty Policy, para. 25(e)); and

(5) Millburn has not taken any compliance or training policy or programme or other remedial steps, since it is in administration (PRA Penalty Policy, para. 25(f)).

1.15. The PRA does not consider that these factors are sufficient to justify any deduction or increase of the Step 2 figure.

1.16. Therefore, the Step 3 figure is £2,590,094.

**Step 4: Adjustment for deterrence**

1.17. Pursuant to paragraph 27 of the PRA Penalty Policy, if the PRA considers the

penalty determined following Steps 2 and 3 is insufficient effectively to deter the person who committed the breach and/or others who are subject to the PRA's regulatory requirements from committing similar or other breaches, it may increase the penalty at Step 4 by making an appropriate adjustment to it.

1.18. The PRA considers that the Step 3 figure of £2,590,094 does not represent a sufficient deterrent. It therefore made an adjustment to the penalty at Step 4 of £1,500,000. Therefore, the Step 4 figure is £4,090,094.

**Step 5: Application of any applicable reductions for early settlement or serious financial hardship**

Settlement discount

1.19. Pursuant to paragraph 29 of the PRA Penalty Policy, the PRA and the firm on whom a penalty is to be imposed may seek to agree the amount of the penalty and any other appropriate settlement terms. The PRA Settlement Policy provides that the amount of the penalty which would otherwise have been payable will, subject to the stage at which a binding settlement agreement is reached, be reduced. Paragraph 26 of the PRA Settlement Policy provides that, where the PRA proposes to impose a financial penalty under the Act and a proposed settlement agreement is negotiated by the parties, approved by the PRA's settlement decision makers and concluded, the person concerned will be entitled to a reduction in the amount of the financial penalty (as set out at paragraph 28 of the PRA Settlement Policy).

1.20. The PRA and Millburn reached agreement at Stage 1, therefore a 30% discount applies to the Step 4 figure.

1.21. The Step 5 figure is therefore £2,863,066.

Serious financial hardship

1.22. Pursuant to the PRA Penalty Policy, the PRA will consider reducing the amount of a penalty if a firm will suffer serious financial hardship. In deciding whether it is appropriate to reduce the penalty, the PRA will have regard, amongst other things, to the firm's financial strength and viability.

1.23. Although the PRA acknowledges there is some uncertainty surrounding the position of Millburn's administration, there remains a prospect that there will be

sufficient funds to enable a distribution to unsecured creditors, albeit the quantum of any dividend is currently unknown and is dependent on future recoveries, and the final level of creditors' claims.

1.24. Whilst the imposition of a financial penalty may cause Millburn serious financial hardship, the PRA has not reduced the financial penalty to £nil in this case. Instead, the PRA has imposed a financial penalty (which will be a debt provable in Millburn's administration) but will keep under review whether to subordinate the Authority's claim in the administration in order that insurance creditors (including policyholders and the FSCS) are satisfied prior to any funds realised in the administration being used to pay some, or all, of the financial penalty. The PRA considers that this would best advance its insurance objective as set out in Section 2C of the Act.

**Conclusion**

1.25. The PRA has therefore imposed on Millburn a financial penalty of £4,090,094 (before the Stage 1 discount), reduced to £2,863,066 (after the Stage 1 discount) for its breaches of Principles 2 and 3.

# Annex D

## 1. PROCEDURAL MATTERS

### Decision maker

1.1. The settlement decision-makers made the decision which gave rise to the obligation to give this Notice.

This Final Notice is given under and in accordance with section 390 of the Act.

### Manner of and time for payment

1.2. The financial penalty must be paid in full by Millburn to the PRA no later than 14 days from the date of this Notice.

### If the financial penalty is not paid

1.3. If all or any of the financial penalty is outstanding on the day after the due date for payment, the PRA may recover the outstanding amount as a debt owed by Millburn and due to the PRA.

### Publicity

1.4. Sections 391(4), 391(6A) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the PRA must publish such information about the matter to which this Notice relates as the PRA considers appropriate. The information may be published in such manner as the PRA considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the PRA, be unfair to the person with respect to whom the action was taken, prejudicial to the safety and soundness of PRA-authorised persons or prejudicial to securing an appropriate degree of protection to policyholders.

### PRA contacts

1.5. For more information concerning this matter generally, contact John Cheesman at the PRA (direct line: 020 3461 7866, john.cheesman@bankofengland.co.uk).

# APPENDIX 1

**DEFINITIONS**

**1. THE DEFINITIONS BELOW ARE USED IN THIS FINAL NOTICE:**

1.1. "the Act" means the Financial Services and Markets Act 2000 (as amended);

1.2. "the Active Reinsurer" means the insurance company providing reinsurance to Millburn as described at paragraph 1.16 of Annex A;

1.3. "AR" means appointed representative, an exempt person under section 39 of the Act;

1.4. "the AR Agreement" means the Appointed Representative Agreement between Millburn, the MGA and another party commencing on 1 December 2010, as referred to in paragraph 1.6 of Annex A;

1.5. "Handbook" means the FSA (and after 1 April 2013, the PRA's) Handbook of Rules and Guidance;

1.6. "the Holding Company" means Millburn's majority shareholder, referred to at paragraph 1.2 of Annex A;

1.7. "the FCA" means the Financial Conduct Authority;

1.8. "the FSCS" means the Financial Services Compensation Scheme;

1.9. "the FSA" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

1.10. "the General Policies Reinsurance" means the agreement referred to at paragraph 1.16 of Annex A;

1.11. "the Investor Company" means the company referred to at paragraph 1.3 of Annex A;

1.12. "LCO" means Legal Cutover, as described at paragraph 6.2 of this Notice;

1.13. "the MGA" means Millburn's managing general agent;

1.14. "the MGA Agreement" means the managing general agency agreement entered into on 26 January 2011 by Millburn and the MGA, as referred to at paragraph 1.8 of Annex A;

1.15. "Millburn" means Millburn Insurance Company Limited (In Administration);

1.16. "Motorsport Reinsurance" means the agreement referred to at paragraph 1.16 of Annex A;

1.17. "Notice" means the PRA's Final notice;

1.18. "the PRA" means the Prudential Regulation Authority;

1.19. "the PRA Penalty Policy" means *'The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure April 2013 – Appendix 2 – Statement of the PRA's policy on the imposition and amount of financial penalties under the Act'*;

1.20. "the PRA Settlement Policy" means *'The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure April 2013 – Appendix 4 - Statement of the PRA's settlement decision-making procedure and policy for the determination and amount of penalties and the period of suspensions or restrictions in settled cases'*;

1.21. "Principle" means a principle included in the FSA's (and after 1 April 2013) the PRA's Statement of Principles for Businesses;

1.22. "the Reinsurance Treaties" means the General Policies Reinsurance, the Schools' Staff Absence Reinsurance and the Motorsport Reinsurance treaties between Millburn and the Active Reinsurer, as set out at paragraph 1.16 of Annex A;

1.23. "the Relevant Period" mean the period 26 December 2010 to 18 September 2013 in relation to Principle 2, and 26 January 2-11 to 18 September 2013 in relation to Principle 3;

1.24. "the Transition Provisions Order" means the Financial Services Act 2012 (Transitional Provisions) (Enforcement) Order 2013;

1.25. "the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).