

THE FACTS SET OUT IN THIS DOCUMENT HAVE BEEN AGREED BETWEEN EXECUTIVE COUNSEL AND THE RESPONDENT. NO FINDINGS HAVE BEEN MADE, NOR SHOULD BE TAKEN TO HAVE BEEN MADE, AGAINST ANY OTHER PERSONS

IN THE MATTER OF:

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

- and -

MR JAMES RAKOW

FORMAL COMPLAINT

A: INTRODUCTION

1. The Financial Reporting Council ("FRC") is the independent disciplinary body for the actuarial profession in the UK. The FRC's rules and procedures relating to actuaries are set out in the Actuarial Scheme of 1 June 2014 (the "Actuarial Scheme").
2. Paragraph 7(11) of the Actuarial Scheme provides that if having reviewed any representations received for the purposes of paragraph 7(10) of the Scheme, the Executive Counsel to the FRC ("Executive Counsel") still considers that there is a realistic prospect that a Tribunal will make an Adverse Finding against a Member and that a hearing is desirable in the public interest, then the Executive Counsel shall deliver a Formal Complaint against the Member to the Conduct Committee.
3. This is the Executive Counsel's paragraph 7(11) Formal Complaint in respect of Mr James Rakow ("Mr Rakow"), an associate partner with Deloitte LLP ("Deloitte"), and member of the Institute and Faculty of Actuaries (the "IFoA"¹), in connection with the provision by him of actuarial services to Equity Syndicate Management Limited ("ESML"), and Syndicate 218 in respect of the financial years ending 31 December 2008 and 2009 ("the Relevant Years").

¹ References to the IFoA include where appropriate the Institute of Actuaries.

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B: THE RESPONDENT

Mr Rakow

4. Mr Rakow qualified as an actuary and was admitted to fellowship of the IFoA in 1989.
5. Mr Rakow was employed by Bacon & Woodrow, which was first engaged by ESML in around 1997 to provide actuarial services for Syndicate 218. Following Deloitte's merger with Bacon & Woodrow in 2001, ESML engaged Deloitte.
6. Mr Rakow was the individual signing actuary and worked extensively with ESML over the years of its engagements with both Bacon & Woodrow and Deloitte. Prior to the Relevant Years, Mr Rakow had therefore worked with ESML for a decade, and no complaint is made in respect of Mr Rakow's work in any of these ten prior years.
7. In each of the Relevant Years Mr Rakow provided the Statement of Actuarial Opinion ("SAO") required by Lloyd's in respect of Syndicate 218's technical provisions. Outstanding Claims Provisions included in the Syndicate Annual Accounts in each Relevant Year were derived from the 'best estimates' of technical provisions which Mr Rakow provided in the SAO.

C: BACKGROUND

i. Syndicate 218

8. At all material times, Syndicate 218 was a Lloyd's Syndicate writing primarily motor insurance. ESML was its managing agent. The Syndicate had historically focussed on particular areas of the motor insurance market (including taxis, fleet cars, motorcycles and classic cars) that were perceived to be more profitable than insuring private cars. However, during 2006 - 2007 the Syndicate increased its total volume of business and at the same time increased the proportion that involved insuring private cars.
9. In the period up until 2007, Syndicate 218 had maintained an unbroken profit record for many years, notwithstanding substantial changes to the market environment during that period.
10. In January 2007, Insurance Australia Group ("IAG") acquired Equity Group, the companies in which included ESML and Equity Red Star Limited ("ERSL"). Regarding each Relevant

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Year, IAG UK (through ERSL) provided the majority of the underwriting capacity for Syndicate 218, the balance being provided by Lloyd's "names".

11. In Syndicate 218, as in other Lloyd's Syndicates, each calendar year represented a separate business venture, with any profit or loss arising from insurance contracts written during the year falling on the participants in that year alone. However, for each underwriting year, or year of account ("YOA"), the final cost of all claims would not be known until all had been paid, generally many years after the end of the relevant year. In practice, and again in accordance with normal Lloyd's practice, each underwriting year 'closed' after three years and any outstanding liabilities were transferred into the next 'open' year. This process involved the calculation of a sum representing the total expected costs of unpaid claims, plus expenses, which would be paid by the closing year to the open year by way of a "Reinsurance to Close" ("RITC") premium. The amount of the RITC premium would be a significant factor in calculating the amount of profit or loss of the closing YOA.

ii. The SAO

12. In respect of each Relevant Year, Lloyd's syndicates were required for solvency purposes to obtain an SAO, to be addressed to Lloyd's, on the valuation of their underwriting liabilities, in accordance with the Lloyd's Valuation of Liability Rules in force at the material time. These rules were updated and reissued each year during the relevant period. The opinion required by Lloyd's was the same in each Relevant Year, i.e. that:

"the technical provisions...are no less than the [actuary's] best estimate of future liabilities".

The opinion had to be provided by the Syndicate Actuary, in this case Mr Rakow. The Rules also required that the technical provisions in the SAO be consistent with the provisions reported in the Syndicate Annual Accounts.

13. Prior to the issuance of the SAO, in each of the Relevant Years, ESML was required to provide the Syndicate Actuary (i.e. Mr Rakow), with a Data Accuracy Statement, which certified that the data provided to him in order for him to prepare the SAO was, in fact, complete and accurate. External actuaries rely on such assurances and the Data Accuracy Statement is therefore essential to the process of issuing the SAO.²

² See paragraph 5.11 of The Code for Managing Agents: Management of Reserving Risk (29 October 1998)

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14. Depending on the circumstances of the Syndicate and the results of the actuary's investigations, he could either:
- (1) Provide an "unqualified opinion", in the terms set out at paragraph 12 above.
 - (2) Provide an "unqualified opinion" with "Relevant Comments". The purpose of the comments is to highlight material issues, for example an unusually high degree of uncertainty, or that fact that the actuary has departed from accepted actuarial methodologies in reaching the opinion.
 - (3) Provide a "qualified opinion", i.e. an opinion highlighting that the actuarial methodology deployed and/or data available fail to deal with some or all aspects of the risks to which the Syndicate is exposed. An example of circumstances in which a "qualified opinion" would be appropriate is where deficiencies in data in a specific material area prevent the actuary from performing the necessary analysis.
 - (4) Decline to provide an opinion, on the basis that sufficient assurance regarding the technical provisions could not be obtained using accepted actuarial methods.

Where a Syndicate was unable to obtain an unqualified opinion, its technical provisions would be set by the Lloyd's Actuary.

iii. Claims reserving at ESML

15. ESML, in common with all general insurance businesses, operated a claims reserving process, the aim of which was to recognise the extent of future claims liabilities that were expected to arise, in relation to business already contracted. An effective reserving process is important so as to effectively manage and minimise risk. The ability of the insurer to have confidence in the reserve figure is largely dependent upon the systems of internal controls which surround the reserve-setting process.
16. A reliable quantification of case reserves is necessary in order for the insurer to be able to properly assess, and present, its financial position. It has a direct and significant impact on the profitability of the company as reported through its accounts. It is also highly material to the provision of management information for the purposes of accurate underwriting, determining the appropriate reinsurance strategy, and, given its materiality, the general management of the business.

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17. At all material times, claims handlers within Syndicate 218 would be expected to place an initial reserve on each notified claim (a "case reserve" or "case estimate"). This could be a standard reserve for the particular type of claim or a specific reserve based on information received about the likely cost to settle the claim. Estimates would be expected to be adjusted as further information regarding the claim was received, for example an engineer's report giving details of repair costs, or medical reports detailing the extent of injuries suffered by an accident victim. In the simplest cases, the claim might be resolved, with the value agreed and all payments made, in a matter of weeks. In complicated cases, particularly those involving serious injuries and where the claim ultimately resulted in litigation, the claim could remain active, and the reserve continue to be adjusted for changing circumstances, for several years. In those types of cases some liabilities might be agreed and paid during the early stages of the claim whilst others would not be settled until much later. At any given time, therefore, ESML's systems would record, for each claim, and in aggregate, amounts already paid out ("paid claims") and the case handlers' estimates of further amounts that would ultimately need to be paid to settle the claim ("outstanding claims"). The sum of these two amounts is known as "incurred claims".
18. At all material times, the Syndicate Accounts included amounts of Syndicate 218's Outstanding Claims Provisions. At all times ESML had responsibility for setting these provisions. Deloitte's actuarial estimates, derived from the aggregate reserves recorded in ESML's systems, and calculated using data representing the historical pattern of claims development in prior years, assisted ESML in setting these provisions.
19. As noted above, in each Relevant Year, ESML engaged Deloitte to provide actuarial services, including providing a "best estimate" of technical provisions as at the relevant accounting date, in accordance with the SAO requirements. In the past, ESML had generally added a modest "risk margin" to the "best estimate" when calculating the provisions for inclusion in the Syndicate Accounts. The margin applied differed for each YOA and in each Relevant Year, and diminished as a proportion of the total reserves figure from 2007 - 2009.
20. The actuarial analysis of claims experience, and extrapolation of that claims experience into the future, would generally be carried out on the aggregated data relating to either paid or incurred claims, or more often both. The former has the benefit of objectivity - it relates to sums actually paid out to settle claims - but the disadvantage of susceptibility to possible fluctuations in, for example, claims settlement rates from year to year, as well as not

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including any information about current estimates of future liabilities. The latter has the benefit of incorporating additional data about estimated future liabilities but is inherently subjective, and vulnerable to changes in or inconsistencies between the standards and practices of claims reserve estimation over the years.

21. A further provision normally recognised by insurers represents an estimate of additional claims liability not captured in the incurred claims. Typically known as Incurred but not Reported ("IBNR"), it is a figure calculated in respect of insurance claims where liability has arisen but the claim has not yet been reported to the insurer, or it has been reported but there is insufficient information to reliably estimate the ultimate cost. A negative IBNR figure indicates a position where, notwithstanding these potential additional claims, it is believed that the aggregate reserves exceed the ultimate liability that will arise from all claims
22. Prior to 2007, the Syndicate appeared to have a long-standing practice of very prudent reserving, as evidenced by the fact that, as the final costs of claims for each underwriting year became apparent, there tended to be a level of redundancy in the aggregate case reserves recorded in its internal systems. It was believed that the initial individual case reserves set by claims handlers within ESML would be set towards the higher end of a range of possible settlement values. Claims handlers would also habitually leave redundant claims reserves on files where the claim had been settled.
23. This permitted the building up of a reserve surplus during profitable years, which could be released during years of reduced returns. ESML had for many years followed a policy of thus "smoothing" the underwriting cycle to which the UK motor insurance market is exposed, whereby a number of profitable years are followed by years of deteriorating profits. There was, however, no formal policy in force at the Syndicate which either mandated or encouraged such very prudent reserving.
24. As a result of the matters referred to in the above paragraph, the Syndicate tended to show a negative IBNR figure in its accounts, which reduced the over-prudent levels of recorded reserves to the best estimate of the likely amount required to settle the overall outstanding claims. The managers of the Syndicate assumed and Mr Rakow believed on the basis of his work, that the pattern of redundant reserves and consequently the inclusion of a negative IBNR in the Syndicate Accounts, would continue in the Relevant Years.

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iv. Market factors relevant to actuarial analyses at Syndicate 218

25. At or around the period with which this Formal Complaint is concerned, there were a number of factors that had a significant effect on markets in which Syndicate 218 operated. These factors would, albeit potentially at different times, have impacted on appropriate actuarial methodologies.
26. For an actuary reviewing a Lloyd's syndicate such as Syndicate 218 in the Relevant Years the reserving cycle would have been a significant relevant consideration because:
- (1) there was increasing evidence in the market generally that reserves followed the underwriting cycle in terms both of quantum (reserves went down when premium rates went down) and timing (the cycles in respect of both reserves and premium rates were closely linked);
 - (2) there was a concern among the actuarial profession working in general insurance reserving that as the underwriting cycle reached its low point actuaries might reduce their estimates of ultimate claims liability accordingly;
 - (3) It might reasonably be expected that the underwriting cycles for different motor insurance classes would be of different lengths and/or intensity, and be out of phase, making identification of trends more difficult.
27. Other relevant factors in the market, affecting Syndicate 218's business, included:
- (1) the emergence and growth of aggregators (such as comparison websites) which reduced the level of renewals and increased purely price driven competition;
 - (2) changed settlement patterns and legal costs as a result of civil justice reforms;
 - (3) the emergence of "no win no fee" litigation resulting in a rapid increase in low value bodily injury claims and/or reduction in settlement of claims at nil value;
 - (4) changes in legislation to permit periodic payment orders ("PPOs"), which exposed syndicates to claims to ongoing payments (and thus the effect of inflation) over a long period rather than lump sum payments;
 - (5) the emergence of insurance fraud on a potentially larger scale than previously.

Although Syndicate 218 did not write the usual motor market business (i.e. it wrote a lower proportion of private motor insurance), each of these factors still had the potential to distort

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traditional actuarial measures including numbers of claims, claim cost inflation and the speed of payment of claims, and also to reduce the overall profitability of many areas of insurance business.

28. In the circumstances referred to above, a reasonably competent actuary reviewing the provisions of a Lloyd's syndicate such as Syndicate 218 in the Relevant Years would have:
- (1) regarded the period as one of significant change;
 - (2) regarded as crucial to actuarial estimates the receipt of robust and detailed data from the syndicate concerning both premiums and particularly claims, albeit would have been entitled to rely on the Data Accuracy Statement provided by the Syndicate as to its accuracy and completeness;
 - (3) taken into account the market factors referred to above in determining appropriate methodologies;
 - (4) recognised the potential for changes in the frequency, severity, and speed of payment of claims, and the need to investigate them;
 - (5) recognised that these developments might impact both on the data required in order to carry out appropriate actuarial analysis, and the methodologies that needed to be adopted. Additional data that might have been requested in these circumstances would include (insofar as was available) claims data split between different classes of business and heads of loss, and data relating to specific risks or issues e.g. the prevalence of PPOs, or any increase in fraudulent claims.

v. Data and processes at Syndicate 218

29. During the Relevant Years, Syndicate 218 suffered from serious weaknesses in its ability to provide management with claims data at a sufficient level of detail, and further weaknesses in the process of claims management, which in turn impacted on the reliability of that data that was available. Claims data was split by class of business but not by different 'heads' of loss e.g. repairs, medical expenses, loss of earnings, legal fees.
30. These weaknesses in the available data were recognised both by ESML and Mr Rakow and, at the suggestion of Mr Rakow, ESML had undertaken significant steps to improve the quality of the data it collected and tracked, however, these improvements had not been

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- fully realised in the Relevant Years. As a result, even the split between the broad heads of property damage and personal injury claims was only available for the most recent underwriting years, so historic development patterns could not be observed.
31. Further, there was no reliable process for ensuring that case reserving was carried out on a consistent and systematic basis from year to year and, in particular, there was no process for reviewing the accuracy of reserves on a regular basis. Mr Morgan oversaw a process of ad-hoc case reviews to check case reserves and remove any redundancy. The building up and subsequent release of redundant reserves, as described at paragraphs 22 and 23 above, served to obscure the real trends in changing claim costs.
32. In proceedings before the Lloyd's Enforcement Tribunal³ ('the Lloyd's Proceedings'), Mr Morgan accepted charges of detrimental conduct. In particular, Mr Morgan accepted that as the Finance Director and the director who organised and directed the reserve review process that he had responsibility for ensuring adequate systems and controls were in place in relation to ESML'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 documented by those charged with those tasks; and
 - (2) that Mr Rakow, as ESML's external actuary, was kept properly informed as to the reserve review process and the results of each reserve review.
33. As a consequence of the reserve review process set out above, it would not have been possible for an external actuary such as Mr Rakow to track the development of individual case reserves or identify the processes adopted. Mr Rakow was therefore compelled to place undue reliance on Mr Morgan's own representations as to the claims reserving process. As a result, inconsistencies within the incurred claims data could not be identified and challenged or rectified by an external actuary such as Mr Rakow and there was a risk that the impact of the reserve reviews would be obscured by other claims activity.
34. Lloyd's Valuation of Liabilities Rules require managing agents to provide its syndicate actuary (i.e. Mr Rakow) with appropriate assurance as to the accuracy and completeness of the data provided for the purposes of obtaining a SAO in respect of year-end reserving position of each syndicate under its management. This is achieved through the provision

³ Lloyd's Market Bulletin REF: Y4682 'Equity Syndicate Management Limited – Mr Douglas Morgan & Mr John Josiah' dated 14 March 2013

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of a Data Accuracy Statement. Mr Morgan was the director responsible for the year end processes in the Relevant Years and was the signatory of the Data Accuracy Statement. He had responsibility for ensuring that accurate and complete information was provided to Mr Rakow.

35. Due in part to the governance issues over the reserve process set out above, Mr Morgan was not able to satisfy himself that accurate and complete information regarding the reserve review process was provided to the Mr Rakow.
36. In the Data Accuracy Statement for the Relevant Years, Mr Morgan affirmed that the data and information provided to Mr Rakow was “prepared under [his] direction and, to the best of [his] knowledge and belief, are accurate and complete”.
37. The SAO stated in the ‘Scope’ section that Mr Rakow had relied upon the data prepared by ESML and, further, “[t]hese data have not been checked by me, although [ESML] has confirmed that the data supplied to me are accurate...”.
38. In the Lloyd’s Proceedings Mr Morgan accepted that he did not read any of the reports produced by Mr Rakow in respect of year end 2009 and consequently was not in a position to correct any errors that they may have contained.

vi. Syndicate 218's financial statements and deteriorating profits for the Relevant Years

39. Prior to 2007, Syndicate 218 had consistently reported profits for many years. In the following years, Syndicate 218 reported decreasing profits, and eventually a significant multi-million £ loss in 2010. In summary:

Table 2.a

SAA Year	Gross Premium £m	Profit £m
2007	569	25
2008	555	7
2009	635	15
2010	527	(499)

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Table 2.b

SUYA (underwriting year)	Gross Premium £m	Profit £m
2007 (2005)	535	63
2008 (2006)	514	22
2009 (2007)	580	0.2
2010 (2008)	511	(238) unclosed run-off year

40. Syndicate 218's reported underwriting profits thus declined during the period 2007-2009.
41. In the SUYA for 2011, it was confirmed that the final loss of the 2008 underwriting year amounted to £248 million, of which £143 million was attributable to the business reinsured into the 2008 underwriting year from the 2007 underwriting year. It is therefore clear that, despite the declared profits, severe losses had in fact been suffered in the 2007 and (in all likelihood) earlier underwriting years.
42. These substantial losses were probably caused by many different factors, including changes in the insurance market caused by the emergence of aggregator websites, which put downward pressure on premiums, changes in litigation practices, the increase in 'whiplash' claims, the activities of 'claims farmers', which increased costs, and changes to the mix of business written by the Syndicate, including the substantial increase in the volume of private car business, which was more exposed to these changes than the Syndicate's traditional area of business.
43. ESML were aware during the Relevant Years that claims costs appeared to be increasing, both in open years and older years that had closed at an apparent profit. Financial information provided by ESML to Deloitte and KPMG clearly demonstrated that from 2006 onwards the levels of both paid and incurred claims for each underwriting year were significantly higher than for earlier years at the same point of development.

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44. However, it was maintained by Mr Morgan and other senior executives that the Syndicate had remained profitable, and that a large proportion of the observed increase in claims costs could be explained by two phenomena:
- (1) the paying of claims more quickly than had been the case in the past (claims "acceleration"); and
 - (2) paying more for each claim than would, or could, have been the case if more time and care had been exercised, as in previous years (claims "leakage").
45. The cause of both of these factors was believed to be changes in claims handling processes that had been introduced by ██████████ a new Claims Director who had been recruited by ESML in 2006. He had overseen changes intended to speed up the settlement of simple, low value claims, in the belief that this would reduce overall costs. This explanation for the apparent increase in claims costs was essentially accepted by the ESML board, and in due course by both Mr Rakow and KPMG, although some ESML staff (notably ██████████ himself) remained unpersuaded.
46. This was a crucial judgment; it led ESML to proceed on the basis that its underwriting approach continued to be profitable, its claims reserving practices were essentially effective, and that future costs could be controlled, and indeed reduced, by reverting to the claims handling processes that had been in place prior to the arrival of ██████████. However, the evidence to support the judgment was sparse. A report prepared by PwC for ESML in 2007 found some evidence of both acceleration and leakage, but also identified genuine increases in overall claims costs, and cautioned that their findings remained subject to a high degree of uncertainty. The reserve process set out in section iii and v above, which, by reducing reserves also reduced the aggregate incurred claims, played a key role in disguising the adverse claims trends which developed during the Relevant Years, making such a judgment appear plausible, despite its thin evidential basis.
47. In these circumstances, it was particularly important for a competent actuary to challenge any assumptions that were not clearly supported by the available data, and to obtain further data as necessary to carry out investigations to substantiate them.

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D: THE RESPONDENT'S WORK

Mr Rakow's actuarial work - an overview

48. Mr Rakow prepared and signed the SAO, addressed to Lloyd's, for Syndicate 218 in each of the Relevant Years. He was assisted by a team from Deloitte who requested and obtained data from ESML, and prepared calculations and projections based on that data. The SAO was accompanied in each year by a formal report ("the Valuation Report") setting out details of the data relied on, the methodologies used for different YOAs, classes of business and cohorts of claims, and the results of the analysis in terms of best estimates for provisions for each year. The Valuation Report was not finalised in each Relevant Year until some weeks after the SAO was signed.
49. The SAO in each year was unqualified and did not contain any Relevant Comments other than comments regarding uncertainty as regards bodily injury claims.

E: THE RELEVANT STANDARDS

50. The standards of conduct reasonably to be expected of the Respondent during the Relevant Years included:
 - (1) Standards set and guidance provided by the Board for Actuarial Standards ("BAS"). Such standards and guidance include in particular the Professional Conduct Standards ("PCS"), the Actuaries Code ("TAC"), and the Guidance Notes ("GN") referred to below.
 - (2) Generally accepted, albeit undocumented, actuarial practice consistently applied among the actuarial profession ("Generally Accepted Practice").
51. The relevant standards derived from these sources are set out below
 - i. **Relevant provisions of the PCS and TAC**
52. The PCS were issued by BAS, and in force at all material times until 1 October 2009 when they were replaced by TAC.
53. At all material times prior to 1 October 2009, the Respondent was subject to the following requirements under the PCC, compliance with which was mandatory:
 - (1) By PCS paragraph 1.2 (Professional Judgment):

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"Each member must comply with standards of behaviour, integrity, competence and professional judgment which other members or the public might reasonably expect of a member. Failure to meet such standards is misconduct, as defined in the disciplinary schemes".

- (2) By PCS paragraph 1.4 (Comply with Spirit and Letter):

"It is the professional responsibility of each member to be conversant with PCS. In the course of carrying out their professional duties or otherwise all members must comply in both the spirit and the letter [with PCS]. This also applies even where a member is also subject to the standards of another professional body."

- (3) By PCS paragraph 3.4 (Data is Sufficiently Accurate and Complete):

"A member must consider the extent to which it is appropriate to carry out investigations to assess whether the data is sufficiently accurate and complete for the purpose for which it is being used. The advice should include an explanation or qualification if the member has any material reservations about the data."

- (4) By PCS paragraph 3.5 (Results of Member's Investigations):

"Advice must include sufficient information and discussion about each relevant factor and about the results of the member's investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them, including where the advice relates to an insurance company, [or] a Lloyd's syndicate... any material implications for the policyholders of the insurance company or syndicate..."

54. At all material times from 1 October 2009, the Respondent was subject to the following requirements under TAC, compliance with which was mandatory:

- (1) By TAC paragraph 2.4 (Appropriate Advice):

"Members will take care that the advice or services they deliver are appropriate to the instructions and needs of the client, including the legal and other rules that may govern the matter, having due regard to others, such as policyholders of an insurer, members of a pension scheme, or any analogous persons whose interests are affected by the work of the member".

- (2) By TAC paragraph 4.1 (Improper Action):

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"Members will speak up to their clients or to their employers, or both, if they believe, or reasonably ought to believe, that a course of action is unlawful, unethical, or improper."

- (3) By TAC paragraph 4.4 (Report Material Breach):

"Members will promptly report any matter which appears to constitute misconduct or a material breach of any relevant legal, regulatory or professional requirements including Actuarial Professional Standards and Technical Actuarial Standards issued by the Board for Actuarial Standards, for consideration under the relevant disciplinary schemes. To the extent that the consent a third party is required for this purpose in order to disclose information, members must take all reasonable steps to obtain that consent."

- (4) By TAC paragraph 5.2 (Consideration):

"Members will take such steps as are sufficient and available to them to ensure that any communication with which they are associated is accurate and not misleading, and contains sufficient information to enable its subject matter to be put in proper context."

ii. Relevant provisions of the GNs

55. At all material times the Respondent was subject to the following requirements under the GNs, compliance with which was mandatory:

- (1) By GN 50 (General Insurance Principles and Practice), paragraph 2.1.4 (Not Sufficiently Up to Date):

"The member must exercise care in providing advice in circumstances where the underlying information upon which the advice is provided is not sufficiently up to date."

- (2) By GN 50 (General Insurance Principles and Practice), paragraph 2.5.2 (Appropriate Methodology and Key Assumptions):

"The member must ensure that, when considered together, the methodology and key assumptions selected are appropriate for the purpose."

- (3) By GN 12 (General Insurance Business: Actuarial Reports), paragraph 1.2 (When Formal Report Required):

"The member must exercise professional judgement when deciding whether work requires a formal report, paying regard to:

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- I. *the principles of practicality and proportionality;*
- II. *the terms of reference; and*
- III. *the need to communicate effectively in accordance with GN 50.*

Subject to these considerations, a formal report is required:

....

- IV. *for work that is to be used in compiling statutory accounts or submissions to regulators;*
- V. *if under the terms of reference, an independent third party may rely on the results; or*
- VI. *if the advice given is likely to have a material financial impact on the recipient."*

(4) By GN 12 (General Insurance Business: Actuarial Reports), paragraph 3.2 (Data):

"The report should normally contain or make reference to and address issues arising out of... (i) The nature, accuracy and interpretation of the data... If the report does not address [each of the points] above the report should justify why the point has not been addressed."

(5) By GN 20 (Actuarial Reporting under Lloyd's Valuation of Liabilities Rules), paragraph 6.3 (Unreliable Data):

"Should the data prove to be incomplete, inaccurate, unreliable, or not as appropriate as desired, the member must consider whether the use of such imperfect data may produce material biases in the results of the investigation and make appropriate allowances. If the data are so inadequate that they cannot be used to carry out work necessary for the SAO, even on a very conservative basis, the member must decline to provide an SAO."

(6) By GN 20 (Actuarial Reporting under Lloyd's Valuation of Liabilities Rules), paragraph 7.10 (Generally Accepted Actuarial Methods):

"If, for some or all of the elements of the technical provisions, the member has adopted methodology that is materially different from generally accepted actuarial methods, then reference should be made to this in the "Relevant Comments" section of the SAO and in the report."

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iii. Generally Accepted Practice

56. In addition to the above standards, for the Syndicate Actuary providing an SAO for Syndicate 218, in the Relevant Years, it was Generally Accepted Practice, albeit not formally documented, that such actuary would:

- (1) Request and review data from the Syndicate in sufficient detail broken down historically, by class and by reinsurance level, for premiums and for claims, on both paid and incurred bases.
- (2) Request and review from the Syndicate additional contract, premium and claim information, particularly the breakdown of claims by heads of claim.
- (3) Arrange discussions with management of the Syndicate (and in particular those responsible for finance, underwriting, claims and reinsurance) to understand the Syndicate's operations (including procedures and manuals) and any changes, delays or updates as well as new or unusual risks insured by the Syndicate plus actions taken in response to major internal or external developments, premium and claim movements or the equivalent comparison of "actual versus expected" where prior year analysis is available.
- (4) Engage in a dialogue with the auditor of the Syndicate's accounts including as regards the quality of the data and of operations at the Syndicate, plus a discussion on uncertainty of outcomes.
- (5) Consider ways to project the claims experience at the Syndicate and select a methodology which involves several methods, set reasonable and appropriate assumptions and prepare an initial set of projections for discussion with the Managing Agent of the Syndicate.

F: THE RESPONDENT'S MISCONDUCT

57. Paragraph 2(1) of the Actuarial Scheme provides that an Adverse Finding is a finding by a Disciplinary Tribunal that a Member or Member Firm has committed "Misconduct", i.e.: *"an act or omission or series of acts or omissions, by a Member in the course of his professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the*

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standards reasonably to be expected of a Member or has brought, or is likely to bring, discredit to the Member or to the actuarial profession" (Scheme, paragraph 2(1))."

58. As set out more particularly below, the allegations of Misconduct set out in this Formal Complaint relate to Mr Rakow's role in carrying out the actuarial engagement leading to the signing of the SAO in each Relevant Year.

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ALLEGATIONS

ALLEGATION 1:

THE 2008 SAO

In respect of SAO engagement for the year ending 31 December 2008, Mr Rakow's conduct fell significantly short of the standards reasonably to be expected of a Member in that he failed:

- (1) to adequately explain in the Valuation Report the limitations of the data;
- (2) to adopt reasonable and/or appropriate methodology and assumptions;
- (3) to communicate adequately to ESML and the Syndicate the results of such work and the level of uncertainty involved;

and that as a consequence he was not in a position to sign, and therefore ought not to have signed, the SAO.

Particulars

59. The work carried out in respect of the 2008 SAO in respect of the communication of data limitations and uncertainty, and methodology and assumptions adopted failed to meet the applicable professional standards in each of the following areas:

- (1) The nature and completeness of data requested and obtained;
- (2) The calculation of 'Focus Motor' provisions;
- (3) The treatment of the paid claim acceleration assumption;
- (4) The calculation of gross provisions and reinsurance recoveries;
- (5) The adoption of a loss ratio roll forward method for the 2008 YOA;
- (6) The change in methodology for 2006 and prior YOAs;
- (7) The change in methodology for the 2007 YOA.

The nature and completeness of data requested, obtained and considered

60. During the 2008 SAO engagement, Mr Rakow failed to address the deficiencies in the data available to him, by prominently highlighting to ESML the risks associated with the data deficiencies although he had already advised ESML of the need to improve the capture,

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collation and presentation of clearly relevant data. He also failed to request further data that that might have assisted him to investigate more thoroughly the factors affecting the Syndicate during the Relevant Years.

61. One of the weaknesses in the data processes at the Syndicate was that records of third party claim costs were not split between costs relating to property damage and costs relating to personal injury claims other than for the most recent years. Mr Rakow advised ESML of the seriousness of this weakness and as a result the Syndicate had begun to collect this data although there was not yet sufficient history to provide a basis for actuarial analysis. Many of the external factors affecting the Syndicate's claim costs affected large, primarily personal injury claims, whilst the view of management was that changes in internal processes had impacted largely on small, property damage claims. Proper investigation of these matters was hampered by the absence of the appropriate data split.
62. In light of the weaknesses in the data relied on, greater prominence should have been given in the Valuation Report to those weaknesses and the consequent need for caution in relying on the results of the analysis conducted.
63. The general acceptance of incomplete data left Mr Rakow ill-equipped to challenge assumptions derived from ESML's view of the experience of the Syndicate, in circumstances where there was evidence of significant deterioration and hence the risks of adopting those assumptions were greater.
64. The conduct failed to meet the standards required by (i) paragraph 3.4 PCS in that the Valuation Report should include an explanation if the member has any material reservations about the data and (ii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 4.2 GN12 in that there was a failure to prominently highlight in the Valuation Report sufficient information about the weakness of data and the impact on results of analysis.

The calculation of 'Focus Motor' provisions

65. Mr Rakow used a number of different methodologies for different YOAs and in each case he calculated gross provisions using data triangles for the whole Focus Motor account. Whilst he did have regard to data split by class or claim type, this was not highlighted sufficiently in the Valuation Report. The methodology remained limited reflecting the level of data available but these limitations were not sufficiently explained.

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66. Adopting this methodology produced a result that was inconsistent with other evidence of deterioration in the account. This should have caused Mr Rakow to reconsider the appropriateness of his approach, or at least to highlight the uncertainty in his results in light of that evidence. The conduct failed to meet the standards required by (i) paragraph 3.4 PCS in that the Valuation Report should include an explanation or qualification if the member has any material reservations about the data and (ii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to highlight sufficiently to the Syndicate the limitations of the methodology adopted and the consequent uncertainty in the results.

The treatment of the paid claim acceleration assumption

67. In connection with SAO 2008, Mr Rakow modified paid claim patterns to reflect the assertion by ESML that there was accelerated payment of claims at Syndicate 218. In 2008 this reflected not just a claim acceleration due to external factors, but also claims by ESML that changes in internal claims processing practices had contributed to or exacerbated the issue. This latter issue should have been investigated by Mr Rakow and relevant information could have been expected to be available to enable him to do so. In the event, Mr Rakow did not carry out sufficient investigation around the available evidence to conclude as he did that the assumption was reasonable or appropriate.

68. The conduct failed to meet the standards required by (i) paragraph 3.4 PCS in that by not requesting data to enable him to test or challenge the acceleration assumption he relied on insufficient and/or incomplete data; (ii) paragraph 2.5.2 GN50 in that the methodology and key assumptions regarding paid claim acceleration were not appropriate for the purpose; (iii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to include in the Valuation Report sufficient explanation of the impact of the adjustments and the significant uncertainty attaching to the results; and (iv) paragraph 1.2 PCS in that, in light of all of these matters, the conduct did not comply with the standards of competence and professional judgment required.

The calculation of gross provisions and reinsurance recoveries

69. Mr Rakow identified uncertainties as to the exposure of Syndicate 218 to claims that might involve PPOs and changes in the discount rates in the Ogden Tables. However he did not

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explicitly quantify this uncertainty as, given the Syndicate's low reinsurance retention regardless of indexation considerations, he believed that the Syndicate's reinsurers would bear the costs and hence it would not impact the Syndicate's net position.

70. Mr Rakow was satisfied that these factors did not have a material effect on the gross provisions of the Syndicate and were already captured in the Very Large Loss allowance estimated. Mr Rakow obtained information concerning reinsurance cover which he considered to be adequate to satisfy himself that the impact of these factors did not have a material effect on the net provisions of the Syndicate.
71. The uncertainties were highlighted in the key uncertainties section of the Valuation Report and reference was made to "earlier work" to quantify the impact on Ogden however given the uncertainties on a gross basis in particular, further detail should have been provided within the Valuation Report and the uncertainties should have been explicitly quantified.
72. The conduct failed to meet the standards required by paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to highlight sufficiently the assumption and rationale that neither PPOs nor other changes would impact materially on gross provisions and the consequent uncertainty in the results.

The adoption of a loss ratio roll forward method for the 2008 YOA

73. Mr Rakow determined the provisions for the 2008 YOA by adjusting the 2007 YOA loss ratio. The adjustments made were stated to be on account of inflation, underwriting effect, and rate movements. The adjustments relating to underwriting effects were based on information from the Syndicate, accepted without sufficient challenge despite the increasing evidence of deterioration.
74. Consequently, the loss ratios which determined the provisions for the 2008 YOA was calculated without sufficient regard to the actual claims experience of the Syndicate during the year; that experience indicated significant deterioration. The need to adopt a methodology that took account of that experience was necessary.
75. Mr Rakow's conduct failed to meet the standards required by paragraph (i) paragraph 2.5.2 GN50 in that the loss ratio roll forward method as applied was inappropriate for the purpose; and (ii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in

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that there was a failure to include in the Valuation Report sufficient explanation of the weakness of the method and the consequent uncertainty in the results.

The change in methodology for 2006 and prior YOAs

76. The methodology adopted combined a savings factor approach for the 2000 and 2001 YOAs and an incurred link ratio for 2002-2006. This differed from the work carried out in respect of the 2007 SAO, when the 'Focus Model' had been used, which relied on paid claims data.
77. The savings factor approach relied on an assumption as to a level of redundancy in case reserves observed in earlier years persisting to the 2000 and 2001 YOAs. This assumption which was questionable in light of the indications of deteriorating claims experience, was not adequately documented in the Valuation Report.
78. The change to a method based on incurred claims for the 2002 - 2006 YOAs was explained on the basis that the previous method would overstate ultimate claims. This was attributed to claims process changes introduced in 2006, but there was not sufficient explanation of this analysis to support this conclusion.
79. Mr Rakow did not set out in the Valuation Report a clear and prominent explanation for the change in methodology for each of the relevant YOAs, nor sufficient information to highlight the effect of the changes on results.
80. The conduct failed to meet the standards required by (i) paragraph 3.5 PCS because there was insufficient information, analysis and discussion of the nature of the changes and their impact compared to the approach in the prior year and (ii) paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to adequately document sufficient reasoning for the adoption of the methodology in the Valuation Report.

The change in methodology for the 2007 YOA

81. The method for calculating ultimate claims for the 2007 YOA as at 31 December 2008 involved two differing approaches. The first, a "burning cost" method, involved calculating an average cost for a given number of vehicles insured from prior years, scaling up to the actual number of vehicles insured in 2007, and adjusting for inflation. The second, the "AD:TP ratio" method, involved deciding on a method to split 'accidental damage' and

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'third party' liabilities in prior years, determining an average ratio between these two cohorts of claims, and applying that ratio to an estimated 'accidental damage' total for the 2007 year.

82. The adoption of these methods represented a change from the approach adopted in the work carried out in respect of the 2007 SAO, without sufficient explanation as to why this method was likely to be more appropriate. The rationale for adopting the approach was that it was believed that the claims experience would differ to prior years; but this should have been further explained or analysed. The methodology and the change from the previous year were not appropriately explained in the Valuation Report. These methods took little if any account of the actual claims experience of the 2007 year, which suggested significant deterioration from prior years.
83. The conduct failed to meet the standards required by (i) paragraph 3.5 PCS because there was insufficient information, analysis and discussion of the nature of the changes and their impact compared to the approach in the prior year and (ii) paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to adequately document sufficient reasoning for the adoption of the methodology in the Valuation Report.

ALLEGATION 2:

THE 2009 SAO

In respect of SAO engagement for the year ending 31 December 2009, Mr Rakow's conduct fell significantly short of the standards reasonably to be expected of a Member in that he failed

- (1) to request, obtain and/or consider sufficient or appropriate data;**
- (2) to adopt reasonable and/or appropriate methodology and assumptions;**
- (3) to communicate adequately to ESML and the Syndicate the results of such work and the level of uncertainty involved;**

and that as a consequence he was not in a position to sign, and therefore ought not to have signed, the SAO.

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Particulars

84. The work carried out in respect of the 2009 SAO in respect of the communication of data limitations and uncertainty, and methodology and assumptions adopted failed to meet the applicable professional standards in each of the following areas:
- (1) The nature and completeness of data requested and obtained;
 - (2) The calculation of 'Focus Motor' provisions;
 - (3) The treatment of the paid claim acceleration assumption;
 - (4) The calculation of gross provisions and reinsurance recoveries;
 - (5) The adoption of a Loss ratio roll forward method for the 2008 and 2009 YOAs;
 - (6) The change in methodology for 2006 and prior YOAs.

The nature and completeness of data requested, obtained and considered

85. Although additional data was received, there was further evidence regarding deterioration in the Syndicate's claims experience, and consequently the risks arising from weaknesses in the data were greater than in 2008. In those circumstances Mr Rakow should have requested further data to enable him to investigate the extent and causes of that deterioration.
86. In light of the weaknesses in the data relied on, the Valuation Report should have given clear information about those weaknesses and the consequent need for caution in relying on the results of the analysis conducted.
87. The conduct failed to meet the standards required by (i) paragraph 6.3 GN20 in that Mr Rakow did not properly consider whether the use of such imperfect data might produce material biases and make appropriate allowances, or decline to provide an SAO (ii) paragraph 3.4 PCS in that the Valuation Report should include an explanation if the member has any material reservations about the data and (iii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 4.2 GN12 in that there was a failure to prominently highlight in the Valuation Report sufficient information about the weakness of data and the impact on results of analysis.

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The calculation of 'Focus Motor' provisions

88. Mr Rakow used a number of different methodologies for different YOAs and in each case he again calculated gross provisions using data triangles for the whole Focus Motor account. Whilst he did have regard to data split by class or claim type, this was not highlighted sufficiently in the Valuation Report. There was no explanation of how data split by class had been considered or whether, for example, estimates produced at a class level were consistent with the results of the methodology adopted. The methodology remained limited reflecting the level of data available but these limitations were not sufficiently explained.
89. Adopting this methodology produced a result that was inconsistent with other evidence of deterioration in the account. This should have caused Mr Rakow to reconsider the appropriateness of his approach, or at least to highlight the uncertainty in his results in light of that evidence. The conduct failed to meet the standards required by (i) paragraph 3.4 PCS in that the Valuation Report should include an explanation or qualification if the member has any material reservations about the data and (ii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to highlight sufficiently to the Syndicate the limitations of the methodology adopted and the consequent uncertainty in the results.

The calculation of gross provisions and reinsurance recoveries

90. Mr Rakow identified uncertainties as to the exposure of Syndicate 218 to claims that might involve PPOs and changes in the discount rates in the Ogden Tables, as in 2008. He again did not explicitly quantify this uncertainty as he continued to believe that the Syndicate's reinsurers would bear the costs and hence it would not impact the Syndicate's net position.
91. By 2009 the Syndicate had experienced one claim that settled as a PPO. The claim dated back to the 2004 YOA, thus indicating the potentially lengthy period it took for these to emerge, however, Mr Rakow did not consider it necessary to further explicitly quantify the potential impact on all subsequent YOAs on the basis of one settled PPO claim as he was satisfied an implicit allowance was already captured in the Very Large Loss estimates.
92. Mr Rakow continued to discuss the Syndicate's exposure to PPOs with ESML to satisfy himself that these factors did not have a material effect on the gross provisions of the

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Syndicate. The reinsurance cover in place did not change materially in 2009 therefore he continued to be satisfied that the impact of these factors did not have a material effect on the net provisions of the Syndicate.

93. The uncertainties were again highlighted in the key uncertainties section of the Valuation Report and reference was made to "earlier work" to quantify the impact on Ogden however given the uncertainties on a gross basis persisted, further detail should have been provided within the Valuation Report and the uncertainties should have been explicitly quantified.
94. The conduct failed to meet the standards required by paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to highlight sufficiently the assumption and rationale that neither PPOs nor other changes would impact materially on gross provisions and the consequent uncertainty in the results.

The change in methodology for 2006 and prior YOAs and the increased reliance on "savings factors"

95. The methodology adopted for the 2006 and prior YOAs was again changed from the prior year without sufficient explanation or sufficient analysis. The "savings factor" methodology was now applied to 2004 and all prior years. For the 2005 and 2006 YOAs a different methodology was adopted, but it also incorporated assumptions as to a significant level of redundancy in the case reserves. The evidence of claims development strongly suggested the contrary, including, in particular, the fact that the case estimates which had been used for the purposes of the 2008 Report had been heavily eroded on a paid basis which should have been investigated further.
96. For example, by November 2009, the implied savings factor for the Motor Focus reserve for the 2005 year had increased from 49% (at the end of 2008) to 71%. As a result of deterioration between November 2009 and December 2009 in the Syndicate's case estimates, it increased to 76%. Mr Rakow should have investigated or analysed this deterioration further but instead continued to deploy his pre-existing projection of the case estimates as at November 2009 for the purposes of his projections.
97. Further, the savings factors methodology involved assuming redundancy in case reserves in respect of the 1993 to 1999 YOAs that, at the end of 2008, had been considered by Mr Rakow to be fully developed, and treated the ultimate as equal to the incurred position i.e.

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no redundancy at all. This change was not justified by the information available and insufficient explanation was given in the Valuation Report for the rationale.

98. Mr Rakow's failure to conduct sufficient analyses led to a potential understatement of provisions.
99. His conduct failed to meet the standards required by (i) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to highlight sufficiently to the Syndicate the limitations of the methodology adopted and the consequent uncertainty in the results; (ii) paragraph 2.5.2 GN50 because the 'savings factor' method was not appropriate for the purpose; (iii) paragraph 5.2 TAC because the methodology was inappropriate and there was insufficient information, analysis and discussion of each of the relevant factors; and (iv) paragraph 1.2 PCS in that, in light of all of these matters, the conduct did not comply with the standards of competence and professional judgment required.

The treatment of claims leakage remediation and adjustments for file reviews

100. Mr Rakow made significant adjustments to his projections for the 2008 and 2009 YOAs in respect of claims 'leakage', and the Syndicate's purported and/or assumed remediation thereof. Mr Rakow reduced the loss ratio and hence the provisions required on the basis that, due to failures in internal process, claims handlers had settled cases for substantially more than the true liability. This issue should have been investigated by Mr Rakow and relevant information was available, in the form of internal reports, to enable him to do so. In the event, Mr Rakow did not carry out sufficient investigation around the available evidence to conclude as he did that the assumption was reasonable or appropriate.
101. The assumed figures for both the proportion of the deterioration that had resulted from leakage, and the effect of the remediation plan and was unsupported by proper evidence or analysis. As a result of the adoption of this method the effect of increasing claims payments on the calculation of ultimate liability was significantly reduced despite there being insufficient evidence to support this position, leading to a potential understatement of provisions.
102. Mr Rakow made adjustments to his projections for the 2005 and 2008 YOAs on the basis that file reviews had not taken place for these years, and had they taken place the incurred claims figures would have been substantially lower. These adjustments were supported

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by insufficient evidence or analysis. Mr Rakow should have insisted on receiving better data, including tracking and reconciliation of the strategic and virtual claims reviews carried out by the Syndicate with underlying records. As Mr Rakow did not do this he was unable to appreciate that:

- (1) The claims review process undertaken by the Syndicate under the direction of its Finance Director, Mr Douglas Morgan, was, and had for many years been, undisciplined, inconsistent and undertaken for the purpose of achieving a reduction in the level of overall case estimates, rather than maintaining a consistent and accurate approach to the Syndicate's case estimates.
 - (2) The information with which Mr Rakow had been provided by the Syndicate as to, in particular, the absence of claims reviews in late 2009 in respect of the Syndicate's 2005 - 2007 years of account (and which information Mr Rakow considered to be fundamental to the reliability of his projections) had been inaccurate.
103. The conduct failed to meet the standards required by (i) paragraph 3.4 PCS in that by not requesting data to enable him to test or challenge the assumptions about both claims leakage and the impact of file reviews he relied on insufficient and/or incomplete data; (ii) paragraph 2.5.2 GN50 in that the methodology and key assumptions for the treatment of claims leakage remediation and adjustments for file reviews were not appropriate for the purpose; (iii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to include in the Valuation Report sufficient explanation of the impact of the adjustments and the significant uncertainty attaching to results; and (iv) paragraph 1.2 PCS in that, in light of all of these matters, the conduct did not comply with the standards of competence and professional judgment required.

The adoption of a Loss ratio roll forward method for the 2008 and 2009 YOAs

104. Although up-to-date premium information was used, Mr Rakow continued to accept uncritically the Syndicate's view that underwriting performance had significantly improved, despite this being inconsistent with the actual claims experience observed. The reference year for the Ultimate Loss Ratio that was 'rolled forward' was still the 2007 YOA. Consequently, the loss ratios which determined the provisions for both 2008 and 2009 YOAs were calculated without sufficient regard to the actual claims experience of the Syndicate during those two years; that experience indicated continuing and more

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significant deterioration than in the prior year. The need to adopt a methodology that took account of that experience was necessary.

105. The conduct failed to meet the standards required by (i) paragraph 2.5.2 GN50 in that the loss ratio roll forward method as applied was inappropriate for the purpose; and (ii) paragraph 3.5 PCS, paragraph 3.2 GN12 and paragraph 6.5 GN12 in that there was a failure to include in the Valuation Report sufficient explanation of the weakness of the method and the consequent uncertainty in the results.