



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

## **ENFORCEMENT ACTION**

**The Central Bank of Ireland**

**and**

**RSA Insurance Ireland DAC**

### **The Central Bank of Ireland imposes a fine of €3,500,000 on RSA Insurance Ireland DAC for regulatory breaches relating to large loss claims and accounting irregularities**

On the 18 December 2018, the Central Bank of Ireland (the “**Central Bank**”) reprimanded and fined RSA Insurance Ireland DAC (“**RSAIL**” or the “**Firm**”) €3,500,000 in respect of serious breaches relating to the following:

- Failure to establish and maintain Technical Reserves in respect of all underwriting liabilities assumed by it
- Failure to have administrative and accounting procedures and internal control mechanisms which are sound and adequate
- Failure to have robust governance arrangements

RSAIL has admitted these breaches.

The breaches arose from serious shortcomings in RSAIL’s internal controls and corporate governance frameworks enabling certain individuals within RSAIL to deliberately manipulate claim reserve estimates through the under-reserving of multiple large loss claims from 2009 until October 2013. This was done by recording claim reserve estimates on RSAIL’s claims database which were significantly lower than the claims handlers’ recommended reserve estimate, and/or significantly delaying the recording of recommended claim reserve estimate increases.

The Central Bank’s investigation also identified weaknesses in RSAIL’s accounting procedures and internal financial control mechanisms.

The extensive issues identified within RSAll's Claims and Finance functions led to an understatement of €78.2 million in the Firm's Technical Reserves as at 30 September 2013.

Furthermore, the investigation found that failures in RSAll's Corporate Governance framework, particularly in its internal reporting structures, allowed the under-reserving of large loss claims to go undiscovered and unchecked for several years.

The Central Bank's Director of Enforcement and Anti-Money Laundering, Seána Cunningham, said:

*"Insurance policyholders and the wider financial system are placed at significant risk when insurance entities fail to set aside sufficient reserves. Maintaining sufficient reserves to meet underwriting liabilities is the cornerstone of conducting business in all insurance entities.*

*Effective governance and robust internal controls are essential in mitigating the harm caused by inappropriate behaviours. Strong governance practices, systems and structures provide regulated entities with a framework through which they can embed appropriate behaviours throughout an organisation.*

*RSAll's failure to implement appropriately robust controls in respect of the reserving of large loss claims made it possible for certain individuals within RSAll to engage in a practice of deliberately manipulating claim reserve estimates over a number of years. This systematic under-reserving of large loss claims resulted in a material understatement of RSAll's liabilities and ultimately contributed to RSAll requiring a significant capital injection. The starkest example of the under-reserving practice uncovered by this investigation was a personal injuries claim with a recommended claim reserve estimate of €4,750,000 where the amount actually recorded on the Firm's claims database was €20,000.*

*The Central Bank will not tolerate conduct which poses a risk to the integrity and stability of the financial services market in Ireland. The Central Bank requires regulated entities to foster a culture of regulatory compliance through the promotion of principled and ethical behaviour at all levels in their organisation.*

*This enforcement action reflects the gravity of RSAll's failures and, demonstrates that where regulated entities fail to comply with their obligations, the Central Bank will use all available statutory powers to pursue enforcement action and hold regulated entities to account. The enforcement action against the Firm has now concluded. "*

## **BACKGROUND**

RSAll is an insurance undertaking authorised in Ireland to transact non-life insurance business. RSAll was authorised on 1 January 2009, incorporating the existing Europa General Insurance Company Ltd and the Irish branch of Royal and Sun Alliance Insurance plc, the UK subsidiary of the RSA Insurance Group plc.

As part of a scheduled supervisory engagement with RSAII, the Central Bank identified delays in increasing recommended claim reserve estimates on a sample of large loss claims. The Central Bank informed RSAII of this finding on 1 October 2013 and, subsequently, in the course of RSAII's Claims Reserving Processes and Controls Audit, RSAII identified an undocumented process involving the systematic underserving of large loss claims which had been in operation since 2009 and continued until its discovery in mid October 2013 (the "**Relevant Period**"). In response to this finding, the Central Bank commenced an investigation into suspected under-reserving practices at RSAII in 2014.

## **PRESCRIBED CONTRAVENTIONS**

The Central Bank's investigation identified the following contraventions:

### **1. Failure to maintain Technical Reserves**

RSAll breached Article 13(1)(a) of the European Communities (Non-Life Insurance) Framework Regulations 1994, S.I. No. 359 of 1994 (the "**1994 Regulations**"), which requires an insurance undertaking to maintain sufficient levels of Technical Reserves.

Technical Reserves are the amount set aside by an insurance company to cover its liability for claims. Technical Reserves comprise an aggregate of Outstanding Claims Reserve, Unearned Premium Reserve and Unexpired Risk Reserve.

RSAll was required to submit regulatory returns to the Central Bank on a quarterly basis. The Firm's final Q3 regulatory return (for the period ending 30 September 2013) revealed that the Firm was required to address a significant shortfall in its Technical Reserves resulting from the under-reserving of large loss claims and other accounting irregularities. The understatement of Technical Reserves also resulted in the artificial inflation of the Firm's reported profits for 2012.

### **Deliberate manipulation of large loss claim reserve estimates ("the Under-Reserving Process")**

The Central Bank's investigation found that certain individuals within RSAII were manipulating claim reserve estimates by recording claim reserve estimates which were significantly lower than that recommended by the claim handlers and/or significantly delaying the recording of the claim reserve estimate increases recommended by the claims handlers in relation to certain large loss claims.

Ordinarily, experienced claims handlers within RSAII would assess individual claims and calculate the recommended claim reserve estimate to be recorded in order to meet the Firm's liability for each claim. The operation of the Under-Reserving Process effectively prevented the

claims handlers from recording their recommended claim reserve estimates on the Firm's claims database.

In order to manage the large loss claims subject to the Under-Reserving Process, a list, informally referred to within RSAII as the "NAMA List", was maintained throughout the Relevant Period. The NAMA List detailed, amongst other things, the existing claim reserve estimate recorded on the Firm's claims database, as well as the claims handlers' recommended claim reserve estimate.

During the Relevant Period, frequent, undocumented meetings were held between those individuals involved in the Under-Reserving Process to discuss the large loss claims on the NAMA List.

The Firm's failure to ensure the accurate recording of all large loss claim reserve estimates on its claims database resulted in incomplete and inaccurate information being relied upon in the calculation of the Firm's Technical Reserves.

Ultimately, as a result of the Under-Reserving Process, the Firm was required to increase its Technical Reserves as at 30 September 2013 to take account of 17 under-reserved large loss claims. The details of these claims are set out in the table below.

	<b>Claims Handlers Recommended Claim Reserve Estimate €</b>	<b>Claim Reserve Estimate recorded on RSAII's claims database €</b>	<b>Amount by which Claim was under-reserved €</b>	<b>% Difference</b>
<b>Claim 1</b>	2,500,000	1,248,570	1,251,430	100.23%
<b>Claim 2</b>	4,750,000	20,001	4,729,999	23,648.81%
<b>Claim 3</b>	2,500,000	350,000	2,150,000	614.29%
<b>Claim 4</b>	2,000,000	20,001	1,979,999	9,899.50%
<b>Claim 5</b>	2,000,000	19,001	1,980,999	10,425.76%
<b>Claim 6</b>	2,700,000	20,001	2,679,999	13,399.33%
<b>Claim 7</b>	1,300,000	7,356	1,292,644	17,572.65%
<b>Claim 8</b>	2,000,000	250,000	1,750,000	700.00%
<b>Claim 9</b>	5,000,000	800,000	4,200,000	525.00%
<b>Claim 10</b>	1,000,000	10,000	990,000	9,900.00%
<b>Claim 11</b>	4,700,000	2,700,000	2,000,000	74.07%
<b>Claim 12</b>	1,000,000	600,000	400,000	66.67%
<b>Claim 13</b>	2,225,000	225,000	2,000,000	888.89%
<b>Claim 14</b>	500,000	100,000	400,000	400.00%
<b>Claim 15</b>	500,000	50,000	450,000	900.00%
<b>Claim 16</b>	500,000	230,000	270,000	117.39%
<b>Claim 17</b>	1,006,828	231,828	775,000	334.30%
<b>Total</b>	<b>36,181,828</b>	<b>6,881,758</b>	<b>29,300,070</b>	

## Accounting Irregularities

In addition to the identification of the Under-Reserving Process, the investigation found numerous unsubstantiated manual adjustments in the Firm's calculation of its Technical Reserves. These included unearned premium adjustments relating to non-refundable premiums, claims expense provisions and pre-payments. The Central Bank's investigation established that the accounting irregularities detailed below contributed to the Firm's failure to maintain its Technical Reserves.

- Unearned Premium

In 2010, RSAII introduced a legitimate Non-Refundable Premium ("NRP") component into some of its business lines. These policies included a NRP clause in the policy wording. The impact of the NRP component increased the Firm's premium revenues, while reducing the Firm's Provision for Unearned Premium Reserve.

This accounting treatment was subsequently extended to additional lines of business in 2011 and 2012. However, the necessary NRP clause was not included in the affected policies. In the absence of the required contractual terms, the extension of this accounting treatment should not have been accounted for in the Firm's Unearned Premium Reserve.

Details of the amounts relating to the NRP element of the Firm's Provision for Unearned Premium Reserve can be found in the table below.

Business Line	2011	2012	2013	Total
Business Line 1	4,450,000	5,120,000	3,433,000	13,003,000
Business Line 2		3,618,000	2,431,000	6,048,000
Business Line 3			3,268,000	3,268,000
Business Line 4		4,100,000		4,100,000
NRP element	4,450,000	12,838,000	9,132,000	26,419,000

- Outstanding Claims Reserve

Prior to 30 September 2013, a manual adjustment of €9.2 million was included in the Firm's Provision for Outstanding Claims Reserve to reduce the liability. This adjustment related to anticipated claims savings as a result of claims initiatives. In addition, the Central Bank's investigation identified a number of unsupported manual adjustments relating to the claims reserve reconciliation were included in the Firm's Outstanding Claims Reserve as at 30 September 2013 in the amount of €5.6 million.

- Pre-payments

As at 30 September 2013 a pre-payment balance of €1.9 million was being incorrectly carried in the Firm's Technical Reserves relating to a particular levy balance. When the Firm recorded its 2012 expense for the levy, a proportion was carried forward into the 2013 financial year as a pre-payment, rather than being fully expensed in 2012. The portion of the 2012 expense carried forward in 2013 was being amortised over the financial year.

- Pipeline Premium

As at 30 September 2013 the Firm were incorrectly accounting for pipeline premium on policies which were not in force at the time of recognition<sup>1</sup>. The amount recorded for this pipeline premium at that time was €5.8 million.

## 2. Inadequate Internal Controls

RSAll breached Article 10(3) of the 1994 Regulations. The Firm failed to have administrative and accounting procedures and internal control mechanisms which are sound and adequate.

### Claims Function Control Mechanisms

The Central Bank's investigation found that RSAll failed to have adequate internal control mechanisms in respect of its large loss claims handling process to enable it to either detect or prevent the deliberate manipulation of large loss claims estimates.

Certain individuals within the Claims function had authority to approve large loss claim reserve estimates (the "**Licence Authority**") at varying thresholds up to €5 million. Licence Authority limits for claim estimation purposes were a key control in RSAll's Claims function. However, the operation of the Under-Reserving Process effectively prevented the claims handlers from recording their recommended claim reserve estimates on the Firm's claims database, rendering the control ineffective.

The Firm's reserve review ("**RES**") process was another key control within the Claims function. The RES process involved a periodic review by claims handlers of all claims, the purpose of which was to ensure the accuracy and adequacy of the claim reserve estimates. The Central Bank's investigation found that the RES process was regularly circumvented by certain individuals within RSAll to avoid under-reserved claims appearing on any notification or review list.

The Claims function's Large Loss Advice ("**LLA**") process was intended to operate as an effective control in the approval of large loss claim reserve estimates. The LLA database design easily lent itself to deletion and overwriting of records and was not properly designed for record storage or version control. The LLA database was not connected to the Firm's claims database and, due to the lack of an effective reconciliation mechanism across the Firm's internal systems, the LLA process was not effective as a control mechanism.

Furthermore, as a result of the lack of effective reconciliation between the relevant databases, RSAll's reinsurance team was separately advised of the reserve estimates to be notified to the reinsurers by the claims handlers. For the under-reserved claims subject to reinsurance, the claim reserve estimates provided to the reinsurance team exceeded the amounts that had been recorded on the Firm's claims database and instead reflected the recommended reserve

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<sup>1</sup> Pipeline Premiums relate to premiums on underlying contracts of insurance written by intermediaries accepting business on the Firm's behalf where full details of the contracts may not have been notified to the insurer as at the reporting date but where the period of cover has commenced prior to the reporting date.

estimate. A reconciliation process, which highlighted this anomaly, could have enabled earlier detection of the Under-Reserving Process.

### Finance Function Control Mechanisms

RSAll failed to ensure that it had adequate administrative or accounting procedures or internal control mechanisms in place to identify or prevent the accounting irregularities in its Finance function during the Relevant Period.

The accounting irregularities arising from the manipulation of large loss claim estimates, the treatment of NRP and the manual adjustments detailed above, resulted in financial reporting misstatements in the Firm's Financial Statements for the years ending 2011 and 2012 and resulted in the provision of false financial information to the Central Bank<sup>2</sup>.

The Central Bank's investigation found that a large number of manually maintained spreadsheets were used in the financial reporting process which increased the risk of errors, omissions and manipulation of figures being reported by the Finance function.

RSAll's financial control mechanisms failed to prevent erroneous accounting treatment of pre-payments which were subject to manual adjustment. As at 30 September 2013, the Firm accounted for a €1.7 million prepayment relating to commission payments for two specific lines of business. However, this amount should already have been expensed in the records of the Firm, and it was subsequently reversed.

### 3. Corporate Governance failures

The Central Bank's investigation identified two breaches of the Corporate Governance Code for Credit Institutions and Insurance Undertakings 2010 (the "**Corporate Governance Code**"). RSAll breached Section 6.3 of the Corporate Governance Code which requires insurance entities to have in place robust governance and organisational arrangements.

The Central Bank's investigation found that RSAll failed to ensure that its governance arrangements were sufficiently robust to enable effective internal reporting and ensure that accurate and reliable information was provided to the necessary decision makers. It also found that RSAll did not have a clear organisational structure with well defined, transparent and consistent lines of responsibility nor did it have a sufficiently robust control framework to detect and prevent breaches and/or circumvention of the Firm's policies.

The Firm failed to ensure that reporting between key Control Functions, Senior Management, the Board and Committees, and RSA Group was accurate and reliable. The reporting to the Firm's Board and Executive Committees during the Relevant Period failed to allow them to

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<sup>2</sup> The Firm was required to produce a restatement of the Financial Statements as at 31 December 2012.

make informed decisions regarding risks to which the Firm was exposed in respect of its underwriting liabilities and compliance with regulatory obligations, in the following ways:

- The Reserving Committee was provided with inaccurate reserving information as a result of the Under-Reserving Process. Decisions made by the Reserving Committee impacted on reserving information provided to the Board for the purposes of establishing and maintaining the Firm's Technical Reserves;
- The Disclosures Committee was not provided with details of significant large loss claims (with a recommended reserve estimate greater than €1 million). As a result, details of the significant liabilities to which the Firm were exposed were not shared with the International Disclosure Committee;
- The Board Risk Committee and Executive Risk Committee were not provided with the details of the large loss claims which were subject to the Under-Reserving Process, which impacted on their ability to effectively address the risks to which the Firm was exposed; and
- The Whistleblowing Policy was not sufficiently robust and/or was not adequately implemented.

RSAll also breached Section 6.5 of the Corporate Governance Code as the weaknesses in RSAll's corporate governance structure also allowed certain individuals within the Firm to exercise unfettered powers of decision in respect of the recording of large loss claim reserve estimates on the Firm's claims database.

## **REMEDIATION**

The Central Bank is satisfied that RSAll has taken the necessary steps to rectify the deficiencies that gave rise to the breaches. Supervisors from the Central Bank's Insurance Supervision Division engaged extensively with RSAll for a two year period following the identification of the issues in October 2013 to ensure that all remedial steps were followed and actioned by the Firm in a timely manner. The Central Bank found no evidence of loss to policyholders.

## **PENALTY DECISION FACTORS**

In deciding the appropriate penalty to impose, the Central Bank considered the following matters:

- The seriousness with which the Central Bank views RSAll's failure to maintain adequate Technical Reserves to enable it to meet all underwriting liabilities assumed by it;
- The systemic nature of the weaknesses in RSAll's internal control and governance frameworks;
- The extended period of time over which the breaches occurred, spanning the period from 2009 to October 2013;
- The need for an effective deterrent impact on RSAll and other regulated entities;



- The potential impact of the breaches on the orderliness of the financial services market;  
and
- The co-operation of RSAII during the investigation.

## NOTES

1. The fine of €3,500,000 imposed by the Central Bank represents the maximum applicable penalty of €5,000,000 with a settlement discount of 30%. For further information on the discount scheme, see the Central Bank's "Outline of the Administrative Sanctions Procedure", which is [here](#).
2. The Central Bank's sanctioning powers were increased in 2013, pursuant to Section 68(b) of the Central Bank (Supervision and Enforcement) Act 2013. The maximum penalty which the Central Bank may now impose is €10,000,000, or an amount equal to 10% of the annual turnover of a regulated financial service provider, whichever is the greater.
3. This is the Central Bank's 126<sup>th</sup> settlement since 2006 under its Administrative Sanctions Procedure, bringing total fines imposed by the Central Bank to over €69 million.
4. Funds collected from penalties are included in the Central Bank's Surplus Income, which is payable directly to the Exchequer, following approval of the Statement of Accounts. The penalties are not included in general Central Bank revenue.
5. Article 13(1) of the 1994 Regulations required all insurance undertakings to establish and maintain technical reserves in respect of all underwriting liabilities assumed by it.
6. The Solvency II Directive was transposed into Irish Law as the European Union (Insurance and Reinsurance) Regulations 2015 (S.I. 485 of 2015) and the legislation entered into force on 1 January 2016. The Solvency II framework sets out strengthened requirements around capital, governance and risk management in all EU authorised (re)insurance undertakings. Solvency II also introduces increased regulatory reporting requirements and public disclosure requirements. The new requirements are intended to reduce the likelihood of an insurer failing and should also provide policyholders with increased protection. Further information on Solvency II can be found [here](#).
7. Article 10(1) of the 1994 Regulations required all insurance undertakings to have administrative and accounting procedures and internal control mechanisms which are sound and adequate.
8. Section 6.3 of the Corporate Governance Code required all institutions to have robust governance arrangements which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, adequate internal control mechanisms, including sound administrative and accounting procedures, IT systems and controls, remuneration policies and practices that are consistent with and promote sound and effective risk management both on a solo basis and at group level. The system of governance shall be subject to regular internal review.

9. Section 6.5 of the Corporate Governance Code required all institutions to ensure that no one individual had unfettered powers of decision.
10. The Corporate Governance Code 2010 has been amended and replaced. The current Corporate Governance Requirements for Insurance Undertakings 2015 can be found [here](#).