Minster Court in the City of London, where Independent Insurance had its HQ

Case study:
Independent Insurance

When the truth won't do

It is a feature of the collapse of a major company due to fraud that when the end finally comes it is often so swift it takes the breath away. Frequently the outside world has had little idea that the company was living on the brink, or of how long it has been teetering there. But when that company is a major industry player of 15 years, and its larger-than-life chief executive has just been made the industry's new figurehead, then the shockwaves can last for a decade or more.

On 6 March 2001 the Independent Insurance Group published its 2000 results. Doubtless shareholders and other interested parties were all to some degree relieved. The previous year had been a bumpy one for the insurance industry. But here was 'Indy', the innovative and unorthodox brainchild of a man called Michael Bright, still showing decent returns. Group profits on ordinary activities (ie, minus short-term investment returns) had dropped to £22.2 million from £61.5 million the previous year, but this was still a reassuring performance in trying times.

Independent, now the ninth largest general insurer in the UK, had been built up from modest beginnings over more than 20 years by Bright and his long-time friend and partner Philip Condon. Their paths had first crossed in 1967 at Orion Insurance; Bright was 23-years-old and Condon just 18. Ten years later, when Bright took on a general management role, Condon became one of his senior field managers. They began to talk about what they would do differently if the show was theirs to run. Soon 'Brighty's' team, with Condon now his trusted No.2, was getting noticed. In 1982 the two men moved together to Lombard taking some 50 colleagues with them. In 1986, when venture capitalists bought out the UK business of US insurer Allstate Insurance, it was 42-year-old Bright they turned to to run what would become Independent Insurance. In 1993 Bright steered the company onto the stock market, in the first flotation of a general insurer since the war, and for seven years Independent could do no wrong – or so it appeared.

In 2000 the Chartered Insurance Institute made Bright its new president. His detractors noted that few previous presidents had been quite so eager to wear the chains of office. Big and hearty, radiating a brash certainty, and with his company's seemingly unstoppable rise to his credit, Bright, if not quite a living legend, certainly knew how to play the part.

In his 2000 CEO's review Bright wrote confidently: Independent was a *"quality operator, well-placed in an improving market"* whose unique and long-standing practice of having its reserves vetted by an independent firm of actuaries, Watson Wyatt, continued to provide *"a unique level of comfort to shareholders and policyholders"*.

But six weeks later and he was gone, removed by fellow directors who had lost confidence in him when reinsurance

irregularities came to light. The rapid unravelling had begun.

Finance director Dennis Lomas had worked closely with Bright and Condon for many years. With Bright gone he quickly prepared a document which would come to be known as 'schedule zero'. It carefully detailed a massive hole in Independent's reserves caused by claims data having been systematically withheld from the company's system over several years. It was the first chairman Garth Ramsay had heard of any of this. To survive, Independent now urgently needed something like £220 million of fresh capital. Stockbrokers Collins Stewart set about the fundraising challenge – Operation Kite – reportedly confident of success. But first they needed to be certain that everything was now out in the open. In particular they were concerned about a reinsurance deal, struck just before the 2000 figures were announced. It had provided a huge boost to the company's results but aspects of it had already been Bright's undoing. Ramsay wrote to Independent's long-time reinsurer, Luxembourg-based ERC, asking for details of all active contracts. The reply sealed Independent's fate. Revealed for the first time were four secret side contracts. These in effect negated the benefit of the reported reinsurance contracts which purported to boost the company profits by £100 million. The company's 2000 profits had been illusory; the balance sheet was a mess.

Emma Lindsay, case controller

On 11 June dealing in Independent shares was suspended. By the 14th, Operation Kite had failed completely and the company closed its books to new business. With their billion pound company now almost certainly worthless the Independent board met privately to accept the inevitable. Next morning, Independent was placed in the hands of provisional liquidators PricewaterhouseCoopers (PwC). As the company's 2,000 employees awaited news of their fate the press reported that the collapse had left 40,000 British companies without insurance cover. The debacle would end up costing the government's Financial Services Compensation Scheme almost £400 million.

"Insurance is a complex business and this was an extremely complex case"

Referral

The Financial Services Authority (FSA) had been monitoring the meltdown closely. On 15 June 2001, at the moment Independent became the first collapse of a UK general insurer for 30 years, the FSA's files were quickly passed to the SFO and a criminal investigation launched immediately.

"From the start this was obviously going to be a tough case," says Emma Lindsay who was involved in the case from the beginning and took over as case controller in January 2003. *"We are quite used to dealing with unfamiliar territory here, but this one had it in spades: reinsurance techniques and contracts; actuarial reserving techniques; such things are far from familiar turf even for our most experienced investigators. We knew this was*

going to be a tough test."

Assistant director Graham More joined the SFO in 2001. In 2004 he became head of the operational division responsible for the Independent prosecution. After 17 years as a commercial litigator, whose heavyweight City cases included some related to the collapse of Lloyd's in the mid-1990s, he understood precisely what his new colleagues had faced in those first few years: *"Insurance is a complex business and this was an extremely complex case. The investigation covered three main areas: insurance company reserves; reinsurance; and the third, which was dropped just before trial, related to the company's management accounts. Now you only need to mention those three topics to realise that they are not exactly jury-friendly. It was also tough for experienced investigators to get to grips with the technical detail underlying the case. That said, this was just the kind of high profile City case that the SFO was originally set up to do."*

First steps

When a serious fraud and a corporate collapse are revealed almost simultaneously the SFO must make an immediate decision about who will catalogue and control the company's documentation; the liquidator or the case team. There was no obvious security threat to the Independent evidence and so allowing the liquidator to catalogue the truly massive amounts of documentation generally worked well for both parties.

Financial investigator Kay Rogers joined the case on her very first day at the SFO. She would spend the next nine months based at Independent's prestigious City headquarters in Minster Court: *"The liquidator produced a massive inventory of documents which was very helpful for the executive area. It made it easy to discard files which were patently not relevant and then to concentrate on everything else."*

But investigators occasionally became frustrated by having to work through the liquidator's team which was now acting as *de facto* gatekeepers of the primary evidence. Kay Rogers is herself a qualified insolvency practitioner. She understood the problem perfectly: *"When we are trying to get a real feel for an investigation we need to handle, organise and process the materials in our own way. Frequently this means leaving everything in situ until we have catalogued it in detail. Even the location of an item can make a crucial difference to its evidential value. But liquidators need to act quickly to minimise expenditure. For Independent that meant closing offices and shedding leases. So while we wanted things to stay put, the liquidators wanted them boxed up and shipped out."*

Not surprisingly, the liquidators also from time to time expressed frustration at the amount of time and effort spent by them assisting the SFO.

Reconstructing accounts

Meanwhile, strenuous efforts were being made to get to grips with Independent's surprisingly arcane computer systems.

David Harris spent 15 years on the stock exchange, first as a broker, then as a dealer, and finally as a compliance officer for four years. Having joined the SFO in 1991, and cut his investigatory teeth on the collapse of BCCI, he is now one of the organisation's most experienced financial investigators: *"From very early on we knew that claims data had been withheld from the central system.*

Graham More, assistant director

Experience told us that we would need to be able to show how these operational shortcomings had distorted the final accounts. Being such a large company this was going to be a big task."

Inside insurance

To understand what went wrong at Independent, investigators had to get under the skin of how insurance companies work in detail. No small challenge.

Consulting actuary and Deloitte partner Lis Gibson would not be asked to join the case team until the investigation phase was over and preparations for the trial were already well underway. But when she did, she found that investigators had acquired an impressive command of this difficult material: *"I have a great deal of respect for the individuals at the SFO; for how they can turn their hands to somebody else's discipline and become competent so quickly. I've spent my entire career doing this one thing and they were able to come up to a very good level of competence to be able to prosecute this case successfully."*

Much of the complexity of insurance business springs from one simple fact: whilst an insurance company can readily tot up its revenues (premiums), it can't be certain of costs until policyholders have submitted every relevant claim and the company has settled them all. Even in general insurance this takes time. But in the case of liability insurance – in which Independent specialised – it can take a very long time; five or even ten years. Think of an industrial injury, a case of medical negligence, a plane crash, a natural disaster, or any big claim involving lawyers and with millions of pounds at stake; you have a formula for many years of delay (25-40 in the case of asbestosis claims) before a final figure for the insurer's costs emerges. This is what insurance insiders mean when they talk about 'long-tailed business'.

To accommodate this uncertainty about claims costs insurers are required to maintain reserves. At first these are estimates based mostly on how claims stacked up in previous years. Then, as the underwriting year wears on, real claims data can be drip-fed into the calculations. How the real data compares with the historic trend provides insurers with one of their more tricky conundrums. If claims are down – no problem. But if claims are up, the insurer must decide if this is a harmless blip or a completely new trend which will require extra reserves to be set aside immediately.

IBNR

At any point an insurer's current data is made up of claims which have already been settled and those which are negotiating their way towards settlement. Actuaries (technical specialists who use advanced mathematical techniques to make sophisticated predictions about insurers' future claims costs) use these two sources of information to estimate a third; claims which past experience suggests are likely to be made, but news of which has not yet reached the insurer. These are known as 'incurred but not reported'; IBNR to their friends.

Since the quality of any IBNR calculation rests crucially on the accuracy and completeness of the historical data and case estimates, every insurance company maintains a system which allows the shifting assessment of claims handlers (i.e. individual case reserves) to be fed accurately into the actuarial calculations which underlie the company's *aggregate* reserving decisions.

So reserving is very much more than just a cash-flow challenge thrown up by the particularities of the insurance business. Because an insurance company's reserves are a surrogate for future costs unknown, every pound to reserves is a pound off profits. In other words, since reserving decisions feed straight into an insurer's bottom line, the opinions of claims handling staff can, and should, have a direct effect on profits.

Caught by the tail

This tension between reserves and profits lies at the heart of all insurance businesses. It was a famous Bright boast, one that won him few friends around the City, that only Independent got the balance absolutely right. But did it? Ever? Many in the City had long been far from convinced, and not without good reason.

Right from the start Michael Bright had insisted that Independent would concentrate on niche markets where large and hard to quantify risks promised very substantial profit potential. Independent insured such exotic risks as Formula One racing teams, coal mines, game parks and the homes of celebrities. *"The rewards for a well-run insurance company are huge,"* Bright told journalists.

But 'long tail' liability business can sometimes flatter to deceive. Early cash flow tends to be strong, meaning that even an inefficient insurer can appear profitable by using revenues from new business to comfortably cover early claims (which are likely, as is the nature of these things, to be disproportionately small and straightforward).

Bright had also made 'accurate' reserving a point of honour at Independent. Claims

"The rewards for a well-run insurance company are huge," Bright told journalists

Kay Rogers, financial investigator

handling staff were constantly urged to reduce their estimates. The company's in-house staff guidance was almost strident on the subject: 'There cannot be any deficiencies or surpluses in our technical reserves which would ultimately affect the Company's profitability' it said.

So, when Bright, Condon and Lomas began to realise that a very large amount of Independent's pre-1997 liability business was in fact loss-making, and that it would cost the company very much more than had been provided for, it was never very likely that Independent's reserves carried much fat.

Nonetheless, Bright continued to argue that reserves were too low, using a flawed analysis of something called gross case development (GCD) to justify an increasingly bullying approach.

David Harris: *"Put simply, GCD was a set of statistics showing how current claims were developing. When this data started to tell Bright bad news he took the view that it was the data that was wrong. Instead of accepting the signals, and attacking the root cause, he set about manipulating the numbers so they showed something more positive."*

Others tried to explain the GCD error to Bright but the best concession they managed to extract from him was a promise of a thorough investigation into the statistical confusion; in the meantime it was business as usual. Doubtless other insurers have found themselves in similar difficulties. But at Independent the market had come to rely on Watson Wyatt's very public annual endorsement. If Watsons now found out how bad things really were they might withdraw their certificate and plunge the company into even deeper crisis. Independent's proudest boast – its Watson Wyatt certificate – had become its Achilles' heel.

During mid-1998 the three men stood at a fork in the road. *"At that point they could have come clean,"* says Harris. *"They could have explained the risk and reserving errors; faced the embarrassment; but then got on with sorting out the problem which was probably not yet big enough to destroy the company."* Or they could attempt to hush the whole thing up and try to find some secret way out. There was, of course, only one proper and legal course.

The slippery slope

As investigators' confidence with the detailed technicalities of insurance and actuarial science grew, they began to assemble a clear picture of how the dishonest behaviour of Bright, Condon and Lomas had steadily and inexorably stoked the coming crisis.

Having decided not to come clean, Bright's immediate problem was quite simple; since a sufficient legitimate boost to reserves was out of the question, the claims data had to be manipulated to keep them broadly in line with what limited reserves Independent actually had. At first this was not as hard as it might have been; claims handlers were used to being pressurised into keeping reserving estimates as low as possible. But soon Bright had to raise the stakes and, from some point in 1998, claims handlers were prevented from putting certain new claims on to the system without the permission of either Bright, Condon or Lomas.

Whiteboard

If a claims handler has no idea what a claim might end up costing, he or she might write it up on a 'whiteboard' (nowadays more likely a spreadsheet) until enough is known for a proper case estimate to be registered on the central system. At Independent, Bright now used his personal crusade for reserving

accuracy as a cover for keeping claims on the whiteboard long after they were ready for proper registration.

The effect was potentially catastrophic, which a man of Bright's experience must have known. *"Because whiteboard claims are not yet registered on the system, they are not automatically incorporated into reserve calculations,"* explains Harris. *"Once a claim can be estimated it should be moved immediately to the core system. Any delay has the dangerous side-effect of distorting reserving calculations; because the system is under-recording the known likely cost of current claims, it will also tend to under-estimate future claims costs, or IBNR."*

The total value of cases held over inappropriately on Independent's whiteboard snowballed rapidly: approximately £400,000 in December 1997; £5 million in 1998; £18 million in 1999; and £25 million by the end of 2000, the last full year of trading.

Delegated authorities

Given the scale of the problem Bright was trying to conceal it is no surprise that he soon hit upon a second mechanism for suppressing and manipulating claims data.

Like many insurance companies, Independent sometimes authorised certain brokers, solicitors and other agents to issue policies and manage claims on its behalf. Under cover of a perfectly genuine and long-running disagreement about the case reserves being estimated by these 'delegated authorities', the reserves actually allocated to them in the central system were systematically depressed to the point where they were utterly inadequate. By the end of 2000 this shortfall had reached £12 million.

David Harris, financial investigator

Reserve lists

And then there were the 'reserve lists'. Through 1999 Bright began insisting that claims handlers needed permission not only to register new claims, but also to register updated figures for existing claims. Deeply concerned claims managers began keeping their own records of the amounts withheld. The first reserve list was not created until 1999, but, again, the totals grew rapidly thereafter. Harris: *"The reserve lists grew out of a concern among staff that they were not being allowed to do their jobs properly. The lists showed the true figures, while the computer system showed only what Bright, Condon and Lomas wanted it to show. In the early days there was not much difference between the two. But by the end of 2000 it had reached £16 million, having trebled in just twelve months."*

> the reserves allocated in the central system were systematically depressed to the point where they were utterly inadequate

By the time the year-end 2000 accounts were drawn up a total of £50 million of claims data was being withheld from Independent's main system and, therefore, from Watson Wyatt. In other words Independent had no reserves to cover very nearly a third of all its current claims and the independent actuaries who publicly verified the reserves each year

had no idea. The basic figure for withheld data turned the company's year-2000 £22 million profit into a £28 million loss. But such a simple calculation reveals nothing about what the withheld data would have told Watson Wyatt about the reserves Independent needed to cover future claims. Once that £50 million was built into a recalculation of IBNR the shortfall was shown, in the view of the SFO, to be a bare minimum of £150 million, and possibly as much as £250 million, turning that small putative profit into a real loss of at least £128 million.

The reinsurance investigation

During the final months of Independent's operations Bright and Lomas made one desperate, last ditch attempt to shore up the company's crumbling finances. A mysterious reinsurance package – which many observers thought too good to be true – was negotiated just a day or so before the 2000 accounts were published.

Reinsurance is the insurance of insurance business. It can improve balance sheets because net liabilities are reduced when the value of the reinsured policies are removed from the schedule of liabilities to be replaced by the smaller figure of the reinsurance premium. Meanwhile, profits are boosted because the associated reserves can also be removed from costs. But to be sure what precise effects the new contracts had had on Independent's accounts, and whether these had been honestly stated, investigators would need to master a universe of arcane contractual relationships and staggeringly complex technical practices. Kay Rogers led this part of the investigation: *"Those first few months were mind-boggling – I can't think of a better word. At first you are not even sure what questions to ask, which is particularly unsettling when that is your raison d'être. It was a huge intellectual challenge to understand all of the different terms and conditions; how these interact and how the different types of policies affect companies and their accounts; and what these things mean in terms of this year, next year and onward years. Not to mention what the disclosure of these arrangements means and why it matters."*

Independent's long-standing relationship with its reinsurer ERC was based on a gentleman's agreement between Bright and Walter Copping, with whom Bright had worked for many years: ERC was guaranteed never to lose money on the relationship and Independent never had to pay full commercial premiums. But by the beginning of 2001 the gentlemen's agreement was under severe pressure. Things were deteriorating fast at Independent just as Copping's US bosses were taking a more active interest in a 'hardening' European market. This was no time for Bright to seek gentlemanly indulgences from his old friend. Rogers: *"In mid-2000, before they had any inkling of the true state of affairs, Watson Wyatt told Bright that the reserves were low and likely to be inadequate. As a result Bright took out £50 million of additional reinsurance cover for the loss-making London market policies written under the regime of former senior manager Keith Rutter. Bright told Copping that it was just a 'sleep-easy' for an over-cautious actuary, but by the end of the third quarter the facility was completely used up. Copping was not amused."*

At the end of October ERC was approached for an extra £30 million, but by the time Lomas met Copping in mid-January even that looked like a drop in a bucket.

Lis Gibson, consulting actuary

Lomas told the meeting he also needed £50 million of cover for the rest of the London market (i.e. 1998 and forward) and another £160 million for the other side of the business, 'the regions'.

The sheer size of the numbers told ERC all they needed to know. There would be no more business on the nod. ERC now required the protection of binding contracts and Bright had no choice but agree. By the beginning of March he had what he needed: three contracts covering £278 million of risk at a premium of £110 million; a total of £168 million worth of benefit to Independent's accounts, £110 million of which would accrue to the year 2000 figures due to be published any day.

But ERC wanted more; it wanted to be certain of making money on the deal and certain that it would not be left in the lurch should Independent go bust or its ownership change. In short, ERC wanted security and lots of it. The final package of contracts was fantastically complex and would challenge investigators to establish what was, and was not, in force at any given point. It included a group of contracts so disadvantageous to Independent that Bright had to conceal them from his fellow board members. Among them was a 'charge' over Independent's assets to ensure that ERC would be at the head of any future queue of creditors. The original three good contracts were endorsed to limit their effectiveness. There was an agreement dressed up as pukka reinsurance but under which no risk was transferred, so that ERC was guaranteed to make money. There was even a cast-iron, no-loss, 'wrap up' agreement under which Independent's own in-house reinsurer (Novi Re) agreed to cover ERC in such a way that it could simply dump any losses back on the Independent group.

But why would Bright and Lomas agree to such a deal if the bad contracts so comprehensively undid the benefit of the good? The answer came on 6 March when the £110 million benefit of the good contracts were incorporated into Independent's 2000 results – in effect turning a £70 million-plus loss into a small but acceptable profit – while no mention was made of the bad.

Interviewing

Unlike their cousins in the US, UK prosecutors must produce an agreed and signed statement for each witness. The whole process consumes enormous amounts of prosecution time, explains lead counsel Andrew Baillie QC, who joined the team when the case was less than a year old: *"The SFO has good powers for seizing documents and commanding answers to questions but it cannot command timely co-operation in turning that information into signed witness statements. If a witness was a senior employee or officer of a substantial commercial concern, then he will employ substantial commercial solicitors to make sure he doesn't say anything ill-advised. And that process of hawking drafts backwards and forwards until a big City law firm is satisfied can take a huge amount of time."*

> The final package included a group of contracts so disadvantageous to Independent that Bright had to conceal them

"All interviews, but particularly with suspects, are crucial for us," says David Harris who helps train and mentor less-experienced investigators in interview techniques. *"They are almost always long and complex and we will normally get only one shot. So we have to put a lot of work into the preparation."*

"The old saying 'don't ask a question in court to which you don't already know the answer' can't be true for us," adds Kay Rogers. *"We are conducting an investigation; there are lots of answers we can't know yet. Even so we need to have a gut feel for what the true answer should be, and for when we are being fobbed off, misled or simply misdirected."*

Lomas

By the middle of 2003 it was abundantly clear that Dennis Lomas had benefitted relatively little from Independent's continued trading – in 1999 Bright had received remuneration totalling £2.3 million; Condon £1.1 million; Lomas £336,912 – and there was a feeling that he might be about to co-operate. *"We chose to interview Lomas first thinking he was the most likely to assist us,"* explains David Harris, *"but it didn't turn out that way."* On 11 June 2003, Harris and Rogers spent the first of three very hot days in a small airless room listening to an otherwise subdued Dennis Lomas say *"no comment"* to their every question. Lomas's silence was a big disappointment for the case team. His defence strategy would remain a mystery right up to the trial, at which point it would be revealed as not merely a challenge to the prosecution but as a potent threat to the international credibility of the UK insurance industry as a whole.

Condon

Condon, on the other hand, spent three days answering questions readily and, for the most part, constructively. Unsurprisingly, he denied almost everything without quite blaming Bright – except on one point. Investigators wanted to know more about several memos, attributed to Condon, which contained key

Andrew Ballie QC (seated) with James Pavry and Emily Radcliffe

instructions about keeping claims off the system. They were not his, they were Bright's, he said. Bright would later say *"He would say that, wouldn't he?"*, but a close reading of the style pointed to the truth of Condon's claim.

Bright

When the investigation first began Bright had said he was keen to help. Two-and-a-half years later his attitude was different. Just organising diary dates took an age. When at last the interview sessions began it quickly became clear that progress would be very slow indeed. Bright repeatedly asked to see more evidential documents and then requested more time to read them. A doctor's note asked that he be interviewed for no more than three hours at a time. The recording of Bright's interview filled 50 cassette tapes but, instead of the nine days that they would normally represent, Bright's were spread over 19 weeks.

The former CEO did not take kindly to being asked to account for his actions, recalls Harris: *"I think it was quite a culture shock for him. He didn't like being asked questions and, in replying, he tended to preach at us."* Bright's over-arching position was that he had been kept in the dark by others. In a key exchange, Harris read from an internal memo dated 12 November 1998 and sent to Bright by Stuart Pettet, a senior manager: 'they are keeping lists of increases which will not be processed and this will be managed through'. *"What does that mean?"* asked Harris. *"Don't know,"* replied Bright. *"Were you aware that at that time there were lists of increases ... which had not been processed?"*, asked Harris. *"No,"* replied Bright.

With regard to the reinsurance contracts, Bright denied any knowledge of the so-called 'bad' contracts, saying that he'd so trusted Terry Masters, his highly paid reinsurance advisor, that he'd signed without reading whatever Masters put in front of him.

Bright in denial

It is, of course, very far from uncommon for a defendant in an SFO case to do anything other than issue blanket protestations of innocence. But Bright's defence was genuinely mystifying. Its central plank was that Keith Rutter, not he, was to blame for the collapse of Independent because Rutter had written all that unprofitable business during 1995-97. But, as Emma Lindsay explains, no-one was being prosecuted for causing the collapse of Independent: *"We realised early on that Bright did not seem to be grasping the real allegations against him. The criminality lay in the concealing of claims data and the misrepresentation of the reinsurance contracts."* The persistence of the misunderstanding would dog the case team right through the pre-trial period.

Comic moments in Luxembourg

Diplomatic and procedural obstacles stopped Rogers taking her reinsurance investigation to Luxembourg until after all three defendants had been interviewed. Such visits must satisfy the Home Office here, and the courts there. The consent of the individuals concerned is also required. Finally, on 12 May 2004, after months of negotiations and delay, Rogers (accompanied by Brian Eager of the City of London Police) sat down with Walter Copping: *"I asked my questions in English. An interpreter then translated them into German, Copping's native tongue. And finally Copping answered me – but in perfect,*

unaccented English. Meanwhile a local police officer typed a simultaneous record in French and argued with the translator about what various English terms meant."

The strategic use of language aside, the meeting was very productive. Three months later a large bundle of ERC documents arrived. *"Buried in all that material was the hand-written letter from Bright to Copping, dated 31 January 2001, of which no copy existed at Independent,"* explains Rogers. *"It had been hand-delivered by Lomas, unopened, in a meeting on 2 February. In it Bright promised 'I will sign the slips'. The use of the term 'slip' was very important; it is a technical insurance term for precisely the kind of contract notes that Bright had denied any knowledge of. It was a real Eureka! moment."*

Preparing for trial

On 16 December 2005 Michael Bright, Philip Condon and Dennis Lomas were finally charged with conspiracy to defraud. But as the case team now began to shift its focus away from the investigation phase and towards formalising the prosecution case, its relationship with Independent's liquidator took another twist.

Graham More rang PwC's in-house actuary, who was involved in the civil case against Watson Wyatt, to discuss the possible effects the withheld data might have had on reserves: *"From the evidence available to us we had always believed that £50 million of withheld claims would have had an impact greater than £50 million on the overall reserves"*, says More. *"But the liquidator's actuary said 'no, that's not the case at all – there is not necessarily a gearing effect'. So I said 'but at least the reserving calculations would have been affected by the original £50 million?'. And he said 'no, that's not necessarily the case either – it might have had no impact whatsoever'. At that moment I realised that on a very, very technical basis an actuary could argue that the withholding of claims data would have made no actual difference to the overall reserves."*

As the trial loomed the case team remained nervous about the outcome; could a jury really understand this case?

Expert witnesses

The general wisdom among criminal prosecutors is to avoid using experts if possible; if there is a disagreement between prosecution and defence experts this can sow seeds of doubt in the minds of the jury about the case overall. Nonetheless, the case team had been debating this issue for some time and now their hand had been forced. More: *"We were very conscious that this interpretation suited PwC's civil case, but even so it led us to realise that on this point we might need expert input after all."*

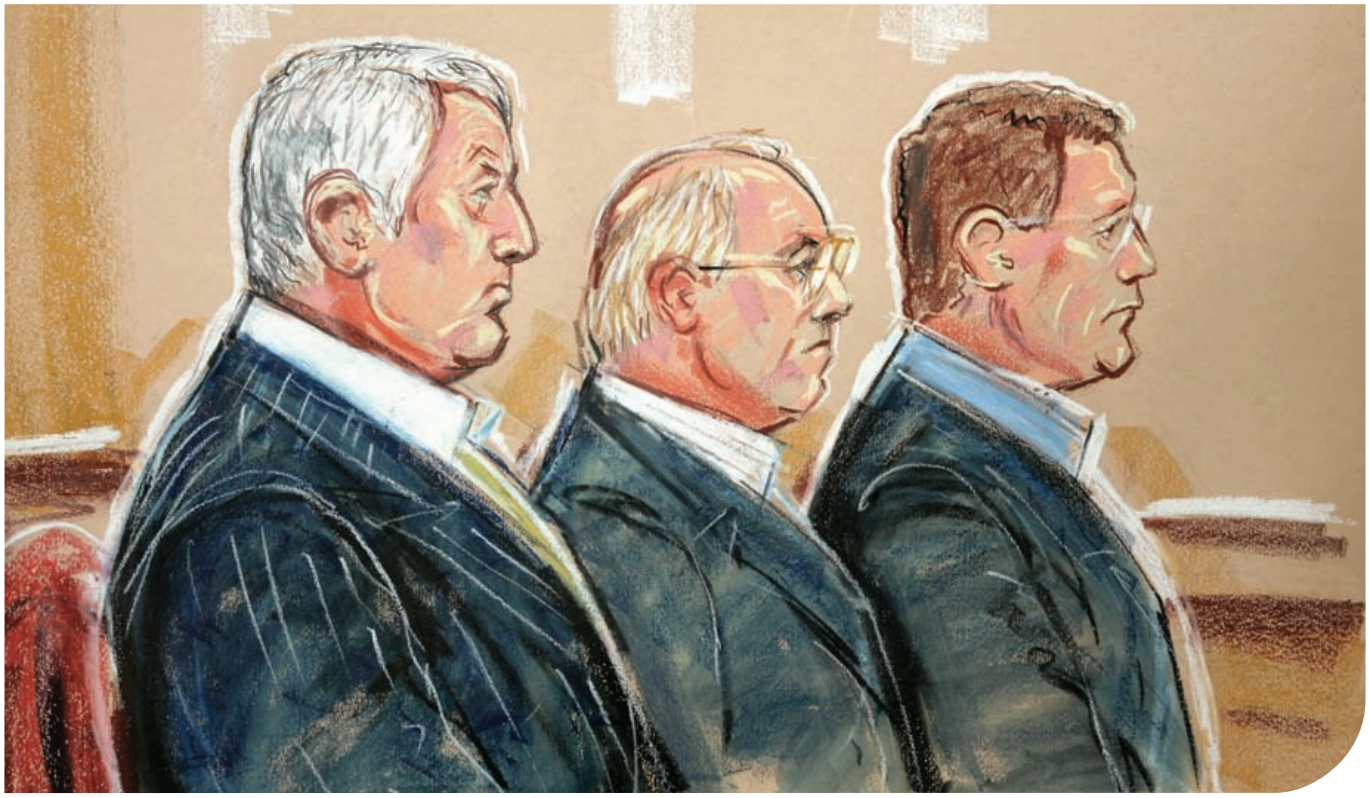
Lis Gibson, consulting actuary and partner in the global accounting firm Deloitte, joined the case team in June 2006, less than a year before the trial was due to open. She was sure she could quantify the impact of the withheld data without getting the court mired in expert disputation. *"An important part of my role was to help the SFO identify and focus on areas in which no two sensible actuaries would disagree,"* she says. In Gibson's view, quantifying the wider impact of the withheld data was just such an area. She was soon proved right. Gibson calculated that for 2000 the total damage to reserves fell within the range £150-£250 million. For the defence Stuart Shepley of Grant Thornton came up with a figure of £130-£230 million. *"Effectively the same answer,"* says Gibson now.

Disclosure

By the end of 2006, with a trial start date of 30 May 2007 now firmly set by Judge Rivlin, the next six months would be dominated by 'disclosure' – which had first commenced back in September 2005 – conducted under a new and, for the prosecution, considerably more burdensome regime.

After a long and complex fraud investigation the evidence the SFO intends to rely on in court is likely to make up only a small proportion of all the potential evidential material in its possession. Disclosure is the legal process by which the prosecution carefully sifts that unused material for anything that might either undermine its own case or assist the defence. For the Independent case team this was their first experience of the new rules and it was not a happy one.

If evidence which should have been disclosed to the defence before a trial opens comes to light later on the implications for an otherwise rigorous prosecution can be disastrous, explains Andrew Baillie: *"There are cases in which the jury never gets to hear the evidence because the prosecution has tripped up over the disclosure process and the case is stayed as an abuse of process."* Like other prosecutors the SFO traditionally protected itself against such slips by allowing defence teams free access to the unused evidence;



Left to right: Michael Bright, Philip Condon and Dennis Lomas

Illustration courtesy of Priscilla Coleman

'handing over the keys to the warehouse' as it was called. But government concern that this laissez-faire approach was costing the tax-payer dear (the whole disclosure process is paid for by legal aid) led the attorney general to introduce, in 2005, a stricter approach under which prosecutors micro-manage defence access.

"Under the new regime we aim to give the defence only what they are strictly entitled to under the law," explains Graham More. *"We no longer give any kind of carte blanche access to the unused material. This necessarily places much greater pressure on our case teams who must ensure that they have looked through everything and disclosed anything that is genuinely relevant and disclosable in accordance with the law. If something gets overlooked there is no longer any 'safety net' for us."*

But what does that mean in practice for case controllers? Emma Lindsay explains: *"For us this was a two-stage process. Initially you must assess whether you are in possession of any material that may undermine your case – that's the comparatively easy part. On receipt of a defence case statement from each defendant you must, by reference to that statement, assess whether any item of unused material aids the defence. Over a period of months, a team of SFO people systematically reviews the unused material by reference to the defence case statements. Ultimately, material that meets the disclosure test is passed to the defence."* The extra workload is considerable and comes just as the case team is trying to get its own case into the best possible shape. Lindsay pays considerable tribute to her assistant lawyer at the time, Hannah Laming, who worked *"tirelessly to manage the disclosure process to the satisfaction of the parties and the judge".*

The trial

As 30 May 2007 loomed, the case team remained nervous about the outcome; could a jury really understand this case?

"The decision to charge had been a long and difficult process with Andrew Baillie producing papers on various issues and us seeking his views on various points of law," says Graham More. *"As time went on we became more and more convinced that we'd made the right decision, but we didn't really become confident of the outcome until the trial was well underway".*

But Andrew Baillie had a different perspective: *"I always thought it would be possible for the jury to know enough to understand the story and to then focus on who had been telling lies, what was the significance of those lies, and who knew what. These are not complex questions – they are not questions which only an actuary could answer. Once they understood the story it was a case for ordinary people to decide."*

So Baillie's opening speech sought not only to introduce the complex material about reserving and reinsurance but also to reassure jurors that this case was well within their competence. Their verdict would not depend

upon the quality of their understanding of 'incurred but not reported' claims, he told them. They would not need to pass exams in actuarial science. Getting to know the technical information that now seemed so daunting would be like getting to know London itself: an initial impression of *"a vast and impenetrable place"* would slowly give way to *"small clearings in the forest";* some of these then merge into larger areas until, after a while, whilst you do not know everything, and never will, you do know enough.

The rest of the case team are unanimous in their admiration for how Baillie made such a difficult case so accessible. *"An important part of getting the jury off on the right foot in a case as complex as Independent is to reassure them about the demands it will make on them. Andrew did this brilliantly,"* says Emma Lindsay.

Expert testimony

Lis Gibson entered the witness box on 20 August, the day before Michael Bright. Her evidence would now prove invaluable in helping Andrew Baillie explain to the court the crucial but very technical 'gearing' mechanism by which the withheld data came to cause a hole several times its own size in Independent's finances. It was a challenge she relished. Having tried out various explanations on the case team she had finally settled on a motoring analogy; a routine drive to work is hampered by unexpectedly heavy traffic (adverse claims development) and an unreliable timepiece (inaccurate claims data) so that the driver struggles to make an accurate prediction of her final arrival time (total reserves). But would the jury 'get it'? There was only one way to find out. "*The best fun I had during the whole case was explaining to the jury how actuarial reserving methods work,"* says Gibson. *"If you take it slowly enough, and break things down into pieces, these things can be understood. The car journey analogy is one we use with our trainees and it seemed to work very well with the jury too. The judge made a comment that he disliked the cartoon style, but he asked a question in the language of the analogy, so he certainly seemed to get it – and that's what matters."*

The SFO team cannot speak highly enough of Gibson's contribution, combining great technical expertise with a rare talent for explaining tricky material in a way that is clear and entertaining even for the uninitiated.

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Bright in the witness box

When Bright came to give his evidence in chief his counsel did all he could to paint the allegations against his client as absurd: as CEO, Bright was a broad brush man, uninvolved in detail; he showed his faith in Indy by buying shares as late as February 2001; in the collapse he'd lost his entire personal fortune and his reputation. It makes no sense to think of Bright as a fraudster, the defence insisted. Where's the benefit? Where's the motive?

"The main shape of the cross examination of Bright," says Baillie, *"was first to get him to acknowledge for the jury that his case was that he had not known about any of the three aspects of the dishonest system; then to go through a series of documents and show that he had known about each; then to get him to admit that that was the case; and finally to say that what he'd said at the beginning had not, therefore, been right."*

When Bright was interviewed by the SFO he had insisted he had no idea what senior staff like Patricia Clarkson and Stewart Pettet meant when they referred to 'lists of increases' being 'managed through'. During his evidence in chief he changed tack, trying instead to portray 'managing through' as simply part of his dogged determination to secure accuracy in reserving. *"Did you think they were being managed through?"* his counsel asked. *"Yes"* he replied. *"And not kept off the system?" "No".*

But during cross examination Andrew Baillie showed that this distinction, between 'managing through' and 'withholding', was a false one. In fact, he said, there was no innocent reason for keeping claims data off the system because the outcome was always the same; it caused the system severely to understate the situation and so to mislead anyone – actuary, auditor, analyst, investor – who relied on its information. What mattered, insisted Baillie, was the time the data spent off the system, not the reason: *"In the evidence in chief Bright and his lawyer between them treated the allegation that he was a party to keeping things off the system as if that meant keeping things off the system for ever. We weren't really saying that; sooner or later they had to pay each claim. What we were saying was that they kept things off the system when those things should have been on the system. I think that was quite deliberately done by the defence, but it put*

Lloyd's of London

Bright in a false position. Then it was easy to show that he did know about cases being kept temporarily off the system."

Regarding the reinsurance contracts, really Bright's case was hopeless, says Baillie. *"It was quite clear that he had had to know about what we called 'the bad contracts' and there were several reasons for that, in particular the hand-written letters, which he was never able to explain."*

Lomas's surprise defence

The press made much of Michael Bright's witness box display of tearful regrets on 23 August, but arguably the true moment of high drama presented itself less ostentatiously two weeks later.

Lomas took the prosecution by surprise when, under cross examination, he tackled Gibson's expert evidence head on. Baillie asked Lomas whether he agreed with Gibson's calculation that the minimum consequence of the withheld data was a reserve shortfall of £130 million. Lomas replied *"I would challenge it."* *"As a matter of professional opinion?"* asked Baillie. *"Yes"* replied Lomas, adding that Watson Wyatt did not *"take into account in their calculations the full weakness* [of Independent's reserves] *and they should have been able to identify* [that] *in the data without any reference to the additional data."*

Lomas went on to say that he *had* deceived Watson Wyatt knowingly but that he'd been justified in so doing for three reasons: the actuaries had had enough data anyway; they were already allowing for inadequacies in the Independent data; and, finally, he believed that had Watson Wyatt been told the truth they would have over-reacted, causing the company to collapse needlessly.

"The Lomas defence was really important for the actuarial profession and the insurance industry in the UK," says Lis Gibson. *"If a finance director can legitimately choose to deceive his advisors and manipulate their opinions to mirror his own, just because he disagrees with them and thinks he is right, then the advisors' formal opinions no longer have any meaning."*

The next day Baillie probed Lomas's actuarial defence closely. It did not stand up well. The whole argument rested precariously on the notion that Lomas's opinion was more valuable than Watson Wyatt's, even though it was the actuaries' which the market relied upon. *"Have you ever had any formal training in being an actuary?"* Baillie asked. *"No,"* Lomas replied. *"Did you put pen to paper …[or] cursor to spreadsheet to make an analysis?" "No."*

Lomas's 'reasoning' had done him no favours. Andrew Baillie's close inspection had revealed it to be not much more than an admission of guilt by his own account.

The verdict

On 9 October 2007, with the closing speeches and Judge Rivlin's four-day summing up completed, the jury retired to consider its verdict.

The case that some had feared unprosecutable, and which many had assumed would drag on deep into 2008, was over in not much more than four months. After such a complex and long-running investigation the relative brevity of the trial was a credit to all involved, including the defence, says Emma Lindsay: *"The trial was quite focused, and the defence should share the credit for that; both sides worked well together in trying to have sensible discussions about admissibility and to limit the amount of*

evidence and areas of dispute. We always try to do that, but it doesn't always work."

Baillie agrees, but also emphasises the work that went into trial management by the prosecution: *"There was not one occasion when the jury had to retire for the judge to decide whether or not evidence was admissible. That is extremely rare. But we also went through a drastic pruning of documents and witnesses which, along with focusing the trial on two counts rather than three, meant that it was significantly quicker than it might have been. Of the several million documents collected during the course of the investigation the prosecution relied on 30,000 or so pages, but the documents eventually shown to the jury were whittled down to 1501 pages. That is a huge pruning. Similarly, 238 witness statements were taken from about 180 witnesses, but to avoid duplication only 23 were actually called to give evidence at trial. So there was very little time wasted during the trial, which not only saves public money, I'm sure it also helps the frame of mind of the jury if they think that their time is not being wasted."* As for the plaudits heaped upon him before and after the verdict, Baillie says simply that he was very ably assisted by his juniors, James Pavry and Emily Radcliffe, and that the Independent result was a real team effort.

Graham More agrees: *"This case proved that to succeed in a matter like this you must have a strong and effective team across the board. Without the stability of a strong core team – Emma (Lindsay), who was case controller for most of its life, Kay (Rogers) and David (Harris) who were in on day one – we might not have had the success we had."*

During a trial the logistics of daily life can get very complicated for SFO staff who are by then already working on other cases, says Emma Lindsay: *"I had a cracking team for the trial too. Our law clerk, Susan Johnson, and her assistant, Frances Davis, ran the courtroom with an iron rod, making sure counsel picked up their papers and witnesses were on time and happy. They did a sterling job. Susan was also our case secretary from early 2004 and she was fantastic throughout."*

The outcome was a great relief for the insurance industry too. Just before joining the case team Lis Gibson had been closely involved in rewriting the Institute of Actuaries' reserving guidance, in part to reflect the lessons learned from Independent's collapse. For the industry as a whole the outcome of the Independent trial could hardly have been more significant, she says: *"Ever since the rescue of Lloyd's in 1993 actuarial opinions have been a statutory requirement for Lloyd's under rules determined not only by UK regulators but also by the US. If it had become accepted that UK actuarial opinions aren't worth the paper they are written on, because the Independent trial result showed that UK finance directors are allowed to lie to their actuaries, it would have undermined the international system of confidence in the solvency of Lloyd's. In Europe too, the whole of the new EC regulatory regime, 'Solvency 2', which comes into effect in 2012, is predicated on actuaries giving assurances about the adequacy of provisions of insurance companies. So it would have had enormous consequences for UK insurance globally if the Independent defendants had been acquitted."*

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But they were not. On 22 October 2007, after seven days of deliberation, the jury found all three men guilty of conspiracy to defraud; Bright and Lomas on both the reserving and reinsurance counts, Condon on reserving only.

Two days later, as the three men stood in the dock, suited but with their ties, belts and shoelaces confiscated by warders, Judge Rivlin sentenced them all to significant terms of imprisonment: Michael Bright, seven years on each count (to run concurrently) – the maximum possible in the circumstances; Denis Lomas, four years on each count (concurrently); Philip Condon, three years. They were also disqualified as directors for twelve, ten and ten years respectively.