Financial Services Authority

FINAL NOTICE

To: **Michael Bright**

Date: **11 April 2008**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the "FSA") gives you final notice about an order prohibiting you, Mr Michael Bright, from performing any function in relation to any regulated activity carried on by any authorised or exempt person or exempt professional firm on the grounds that you are not a fit and proper person.

1. THE ORDER

1.1 The FSA gave you, Mr Michael Bright, a decision notice dated 5 March 2008 which notified you that, for the reasons listed below and pursuant to section 56 of the Financial Services and Markets Act 2000 (the "Act"), the FSA had decided to make an order prohibiting you from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm ("the Prohibition Order") on the grounds that you are not a fit and proper person.

1.2 As you have not referred this matter to the Financial Services and Markets Tribunal, the FSA hereby makes the Prohibition Order against you.

2. REASONS FOR THE ORDER

Summary

2.1 The FSA, having had regard to the written representations made on your behalf that are summarised below, has concluded that you are not a fit and proper person to perform any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm and that it should make the Prohibition Order against you.

2.2 As is set out more fully below, the reasons for this action relate to the following:

2.2.1 From May 1997, until your resignation on 19 April 2001, you were the Chairman and Managing Director of the Independent Insurance Company Limited (the "Company"). During that period you knew that the Company had adopted and, on an increasing basis, was maintaining claims handling and reserving practices contrary to the Company's stated policies and good practice. As a result, you knew that the Company's booked reserves data was materially distorted and therefore that the Company's overall reserves were significantly understated. You also misled the Company's external actuaries.

2.2.2 You knew that certain reinsurers would only enter into reinsurance contracts that were required by and were prima facie favourable to the Company and Independent Insurance Group plc (the "Group"), if the Company and the Group also agreed to enter into certain prima facie unfavourable reinsurance contracts. On 2 March 2001, you signed four unfavourable reinsurance contracts and, as a result, the reinsurers agreed, on 5 March 2001, to enter into the favourable reinsurance contracts. You disclosed the favourable reinsurance contracts to the Group Board and to the Company and Group's auditors (the "Auditors"). You concealed the unfavourable reinsurance contracts from the Group Board and the Auditors and misrepresented the position to them.

2.2.3 You were convicted on 23 October 2007 of two offences of conspiracy to defraud arising out of these circumstances.[1]

2.3 On the basis of these findings the FSA has concluded that you are not fit and proper because you have failed to demonstrate appropriate standards of honesty and integrity.

3. RELEVANT STATUTORY PROVISIONS

3.1 The FSA is authorised by the Act to make a prohibition order in circumstances where it appears to the FSA that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by any authorised person, exempt person or exempt professional firm. A prohibition order may prohibit that individual from performing a specified function in relation to a specified regulated activity, any regulated activity falling within a specified description or all regulated activities (section 56 of the Act).

[1] The FSA agreed to postpone its consideration of whether to give a Decision Notice until the conclusion of the criminal proceedings.

4. RELEVANT GUIDANCE

4.1 In making this prohibition order, the FSA has had regard to guidance published in the FSA Handbook, in particular at FIT 2 and ENF 8:[2]

- FIT 2: the FSA has considered its guidance in relation to considering fitness and propriety. The FSA has serious concerns about your honesty, integrity and reputation[3].

- ENF 8: the FSA has considered its guidance in relation to the prohibition of individuals. Having considered the relevant factors set out at ENF 8 in relation to the prohibition of individuals who are not approved persons, the FSA has concluded that you are not fit and proper to perform any functions in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm and that a prohibition order is appropriate.

5. FACTS AND MATTERS RELIED ON IN THE WARNING NOTICE

Reserving

The Company's Stated Policies

5.1 As an insurance company, the Company was required to maintain reserves in relation to the claims for which it expected to make payments under the policies it had written.

5.2 The Company's reserves included components for (1) claims that had already been reported to the Company but had yet to be paid ("Outstanding Claims"); (2) claims in relation to insured events that had already occurred but had not yet been reported to the Company ("IBNR" or "Incurred But Not Reported"); and (3) claims that had not yet occurred but it was anticipated would arise out of future events during the currency of policies already written by the Company ("Unexpired Risks"). In the case of the Company, the component for Unexpired Risks was not significant.

5.3 The Company's stated policy in respect of reserving for Outstanding Claims was set out in a Claims Handling Guide (the "Guide"). The Guide stated, amongst other things:

"We have a distinctive reserving philosophy which is a major pillar of our claims philosophy P.A.M (Proactivity, Accurate Reserving and Management). Our technical reserves at any given time must realistically reflect the total of our claims liabilities at

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[2] The Enforcement Manual was in force until 27 August 2007.

[3] FIT 2.1 & ENF8.5.2G(1)(a). *Honesty, integrity and reputation* is a phrase which encompasses a wide range of potential factors. The FSA's assessment of an individual's conduct may have regard to any one, or to any combination, of the three individual elements.

that time. There cannot be any deficiencies or surpluses in our technical reserves which would ultimately affect the Company's profitability.

As a result, accuracy of reserve is imperative at all times and should be based upon the anticipated result in negotiation. The reserves should be realistic and reflect the most probable settlement figure of the claim along with a provision for fees…. As the claim progresses, the reserve should be carefully reviewed and altered if required.…

"Whenever new information warrants either an increase or a reduction in reserve, this should be acted upon immediately."

5.4 The Company's stated policy therefore was to maintain an estimate of what each of the Outstanding Claims was ultimately likely to cost the Company (known collectively as "Case Estimates"), to review Case Estimates on an ongoing basis and to alter Case Estimates where appropriate.

5.5 From 1994, the Company's overall level of reserves was subject to review by an independent firm of actuaries (the "Actuaries"). The Actuaries prepared a certificate, which the Group included within its published accounts, attesting to the adequacy of the Company's reserves. Each year during the relevant period, the Actuaries' report to the Company, which formed the basis for that certificate, included the following statement:

"Reported Claims

[The Company] aims to identify and pay claims quickly. All reported claims are reserved on a case estimate basis. The case estimates are based on all known information and updated as and when new information becomes available."

<u>The Company's Actual Practice</u>

5.6 From about May 1997, and on an increasing basis from about July 1999, until it entered provisional liquidation in June 2001, the Company did not follow the policies set out in the Guide and which the Actuaries believed that the Company was following. The Company did not update its Case Estimates *"as and when new information [became] available"*.

5.7 Instead, in addition to the Case Estimates that were recorded on the Company's computer system (the "System"), the Company developed lists where other information was recorded but not input onto the System (the "Off-Claims System Lists"). These Off-Claims System Lists comprised:

5.7.1 **Reserve Increase Lists** – These lists contained details of cases in which the estimate of the cost of the claim, and therefore its contribution to the Case Estimates, had increased. The required increases to Case Estimates detailed on these lists were not input onto the System in a timely manner or at all. Further, as part of the drive to reduce the Company's Case Estimates, audits (known as "1-4-1 Audits") were used to identify reductions in Case Estimates. Following a 1-4-1 Audit, decreases to Case Estimates were input onto the System, but

increases were not. Instead, the increases were added to the Reserve Increase Lists; and

5.7.2 **Whiteboards** – The Whiteboards held details of new cases with large potential losses. The Case Estimates required for these cases were not input onto the System in a timely manner or at all.

5.8 By 12 April 2001, the total amount of the increases to Case Estimates that were held on Reserve Increase Lists but which had not been input onto the System was £35.312 million and the total amount of Case Estimates that were held on Whiteboards but which had not been input onto the System was £42.498 million.

5.9 When the Company calculated its overall reserves each year, it based its calculations on the Case Estimates that were contained on the System but did not take into account the Reserve Increase Lists or the Whiteboards.

5.10 When the Actuaries reported on and certified the adequacy of the Company's overall reserves, they did not take into account the Reserve Increase Lists or the Whiteboards, because they were not told about them.

5.11 As set out above, the Company's overall reserves included (1) the total of the Case Estimates; and (2) a provision for IBNR. That provision for IBNR was calculated by means of an extrapolation exercise conducted by reference to, amongst other things, the Company's Case Estimates. Thus, any understatement in the Company's Case Estimates, that was not compensated for, affected the IBNR calculation and resulted in both of these components of the Company's overall reserves being understated.

5.12 The practices set out above resulted in the certificates provided by the Actuaries in relation to the Company's reserves, and included in the Group's published accounts for at least the years 1999 and 2000, being made on a false basis because the Company's Case Estimates were not, as the Actuaries believed them to be, updated as and when new information became available.

Your Knowledge

5.13 The use of Off-Claims System Lists as set out above was contrary to the Company's stated policies and good practice. The FSA has considered, in particular, the extent to which you (1) knew that Off-Claims System Lists were being maintained; and (2) knew that these Off-Claims System Lists were not being taken into account in calculating the Company's overall reserves and were not disclosed to the Actuaries.

5.14 The FSA has concluded that you were fully aware, from late 1997, and certainly from July 1999 until your resignation in April 2001, that Off-Claims System Lists were being maintained in that:

5.14.1 During the course of 1997, when Company staff informed you that reviews of Case Estimates, such as 1-4-1 Audits, had identified some Case Estimates where an increase was warranted, and some Case Estimates where a decrease was warranted, you would ask for the decreases to be input straight away onto the System but would question the validity of the increases.

5.14.2 On 7 August 1998, you were sent a memo from a senior Company employee which stated *"During the [1-4-1 Audit] [a senior Company employee] will provide regular reports which we will need to meet too [sic] discuss including how to manage the reserves through."*

5.14.3 On 1 September 1998, you were sent a memo by a senior Company employee which stated that *"no audit increases [in a certain class of business would] be input until further discussion in the 4th quarter."*

5.14.4 On 12 November 1998, you were sent a memo by a senior Company employee which stated that Company staff were *"keeping lists of increases which will not be processed and this will be 'managed' through in conjunction with [a senior Company employee] and [Mr Condon, the Company's Deputy Managing Director]."*

5.14.5 In July 1999, the process of Off-Claims System Lists became more formalised. On 21 July 1999, you received a memo from a senior Company employee which stated, in relation to certain categories of insurance claims, *"the following instructions have been issued:- … All reserve increases which are identified on pending claims (and do not relate to payments) will be put on a weekly spreadsheet and sent to me. Each week, I will, therefore, receive a list of all proposed reserve increases on pending claims and a separate summary of the audit activity. I will report to you on a weekly basis. I trust this is in order."*

5.14.6 You did not in any way disapprove of or criticise the proposal contained in the memo of 21 July 1999.

5.14.7 You were sent the first weekly report envisaged by the memo described in paragraph 5.14.5 above on 26 July 1999. The report clearly indicated that the Company staff's review had identified more Case Estimates where <u>increases</u> were required than Case Estimates where <u>decreases</u> were required. That report specifically stated that *"the savings have been input – the deficits are outstanding."*

5.14.8 From July 1999 onwards, you were regularly updated in relation to the extent of the Off-Claims System Lists. For example:

(a) On 24 October 2000, you were sent a memo stating that the outstanding Whiteboard claims in one area of the Company's business amounted to £36.188m.

(b) On 18 December 2000, you were sent a memo attaching the outstanding Whiteboard claims for one area of the Company's business showing that they amounted to £34.993 million.

(c) On 2 March 2001, you were sent an e-mail attaching a copy of the Whiteboard for one area of the Company's business showing that the outstanding Whiteboard cases in this area amounted to £28.725.

5.14.9 Throughout 1999 and 2000, you personally prevented Company employees from inputting Case Estimates held on the Off-Claims System Lists on to the System.

Your Concealment of the Company's Actual Practice and Misleading the Actuaries

5.15 The FSA has also concluded that you were fully aware from late 1997, and certainly from July 1999, until your resignation in April 2001, that the information contained in the Off-Claims System Lists was not being taken into account in calculating the Company's overall reserves and was not being disclosed to the Actuaries. In fact, you took positive steps to mislead the Actuaries and to conceal the existence of the Off-Claims System Lists from them in that:

5.15.1 On 24 March 2000, you signed a Letter of Representation that the Actuaries had asked you to provide. That letter represented, amongst other things, that *"appropriate case estimates had been applied to all reported claims which remained open at 31 December 1999."* You were aware that, as a result of the Off-Claims System Lists, appropriate estimates had not been applied to all reported claims and you made this statement knowing it to be untrue, and therefore made it dishonestly.

5.15.2 On 29 March 2000, you informed the Actuaries by letter, in response to certain concerns regarding the Case Estimates and the claims evaluation process, that you had *"put in place a complete review of [certain claims] with the objective that the IBNR reserve be added back to case reserves and for those to be re-evaluated ..."* Six months later, on 6 October 2000, you wrote to the Actuaries and reminded them that *"I undertook to react both urgently and thoroughly to investigate your concerns [about the pressure on claims staff] but also to take personal responsibility to ensure that any identified problems would be dealt with both thoroughly and with the agreed objective, that our case reserve positions were put back onto a basis that had been in position up until the previous year."* You stated that the review had been *"a hugely time consuming exercise"* and was *"now complete."* No such review had been undertaken and you did not have reasonable grounds to believe that any such review had been undertaken. You made this statement knowing it to be untrue and you therefore made it dishonestly.

5.15.3 On 5 March 2001, you provided a further Letter of Representation to the Actuaries in which you confirmed that *"specific measures have been taken to strengthen case reserves established by [the Company] as at 31 December 2000 by comparison with the case reserves established as at 31 December 1999. Appropriate case estimates had been applied to all reported claims which remained open as at 31 December 2000."* You knew that this statement was untrue and you therefore made it dishonestly.

5.16 In the circumstances, the FSA considers that, throughout a sustained period, you (1) knew that the Company's overall reserves were understated; and (2) dishonestly concealed material information from and positively misled the Actuaries, knowing

that this would result in the Actuaries' certificate as to the adequacy of the Company's overall reserves being provided on a false basis.

Reinsurance

5.17 In 2000, the Company entered into a reinsurance contract with certain reinsurers ("the Reinsurers") for a particular class of business in order to bridge the gap between the Actuaries' calculation of appropriate reserves and the reserves held at the time by the Company.

5.18 In 2001, the Company sought to extend that reinsurance protection for its reserves in other classes of business by entering into three further reinsurance contracts ("the Reserve Contracts").

5.19 However, during the course of negotiations that took place in January and February 2001, you became aware that the Reinsurers would not enter into the Reserve Contracts unless the Company also entered into other reinsurance contracts that constituted a "pay-back" arrangement to the Reinsurers.

5.20 On 2 March 2001, you signed four reinsurance contracts that formed part of this pay-back arrangement (the "Pay-Back Contracts"). You knew that if you did not do so the Reinsurers would not enter into the Reserve Contracts that the Company required. Two of the Pay-Back Contracts amended the terms of the Reserve Contracts, so that they were less favourable to the Company. One of the Pay-Back Contracts involved a fellow-Group company providing reinsurance to the Reinsurers and one, known as a "Wrap-Up Policy", was intended to ensure that, if the Reinsurers still suffered an overall loss under all the reinsurance contracts entered into between the Company and the Reinsurers when taken together (including the Reserve Contracts and the first three Pay-Back Contracts), the Company would reimburse the Reinsurers for those losses. In other words, the intention of the Wrap-Up Policy was to render the overall series of transactions between the Company and the Reinsurers entirely circular.

5.21 On 5 March 2001, you attended a meeting of the board of directors of the Group. You referred to the Reserve Contracts (but not the Pay-Back Contracts) and explained that the Company had been asked to provide a Letter of Representation to the Auditors which stated that the Reserve Contracts *"are final and there are no side agreements with reinsurers, or other terms in effect, which allow for the modifications of terms under the reinsurance arrangements."* Furthermore, you were questioned by a Group director about the nature of the reinsurance arrangements. You did not refer to the Pay-Back Contracts in your response. The Group Board subsequently approved the Letter of Representation and you signed it.

5.22 The Auditors were provided with the Letter of Representation and copies of the Reserve Contracts and, on 6 March 2001, the Auditors duly signed the Group accounts for the year ending 31 December 2000. The Company announced its preliminary results to the market on 6 March 2001.

5.23 The Group Board and the Auditors only discovered the existence of the Pay-Back Contracts on 14 May 2001. The Company did not become aware of the Wrap-Up Policy until after 17 June 2001 (on which date it entered into provisional liquidation).

5.24 In the circumstances, the FSA considers that you knowingly misled the Group Board and the Auditors as to the circumstances surrounding the making of the Reserve Contracts. You therefore acted dishonestly. Even if you were not aware of the precise terms of the Pay-Back Contracts you had signed, you were well aware, at the time that you represented that there were no side agreements to the Reserve Contracts, that this was not true because, in particular, you had personally signed four such side agreements three days earlier.

6. CONVICTION FOR CONSPIRACY TO DEFRAUD AND REPRESENTATIONS

Conviction for Conspiracy to Defraud

6.1 You were convicted on 23 October 2007 of conspiracy to defraud by dishonestly withholding claims data from the Company's actuaries and conspiracy to defraud by making incomplete disclosure of all actual or intended agreements between the Company and its reinsurers. These convictions arose out of the same circumstances as set out in the Warning Notice.

6.2 You were sentenced to seven years imprisonment for each count of conspiracy to defraud, to run concurrently, and you were disqualified as a director for twelve years.

6.3 In sentencing Judge Rivlin made the following observations in relation to your conduct:

"Michael Bright, you were undoubtedly the architect and driving force behind this fraud. I am prepared to accept that it began almost imperceptibly and in a relatively minor way. But by November 1998 you had determined on a course of dishonesty and thereafter into 1999, and under your clear instruction and with your full knowledge, it quickly steamrollered out of control.

"You have accepted in the face of overwhelming evidence that you introduced a fear factor into the working lives of your managers. It was against this background that the fraud which you devised was able to thrive. The truth is that you corrupted a lot of people along the way including, I believe, your co-defendants, and the breezy manner in which during the course of this trial you sought to blame some of your very able, decent and hard-working employees for dishonest practices that you had yourself introduced and put into operation has done little to confirm that you are truly sorry for what occurred."

"… the truly serious disease which so afflicted this Company and the lives of so many people connected with it was your initiation and close, hands-on direction and control of the dishonesty charged in this case, dishonesty which was taken to a new and exceedingly serious level when you played your leading role in the reinsurance aspect of the fraud."

"…the seriousness and huge scale of this offending is such that I believe that it goes beyond the scope of anything that Parliament can have had in mind when fixing the maximum sentence for this offence, possibly by a factor of several times."

Representations on the Warning Notice

6.4 The FSA was sent on 14 January 2008, on your behalf, copies of the closing speech made by your counsel in the criminal proceedings in which you were convicted, and of certain documents headed "admissions" from those proceedings. The FSA treated these materials as written representations responding to the Warning Notice.

6.5 The FSA considered that, in summary, the materials sought to make the following points on your behalf:

6.5.1 Any criminal conspiracy at Independent did not involve you.

6.5.2 Your actions during the relevant period were inconsistent with being dishonest and part of a criminal conspiracy, for example efforts to sort out the chaos of the "London Market" part of the business.

6.5.3 You could not have dishonestly operated/participated in a criminal conspiracy because what was alleged would have required the assistance of too many individuals who are said not to have been participants.

6.5.4 You were yourself, in fact, kept in the dark about key matters.

6.5.5 Your management style, single-mindedness and inability to delegate cost you everything. You considered that you had nothing to gain and did not gain from what was alleged.

7. CONCLUSIONS

7.1 The FSA has concluded that, in the light of the matters set out above you have demonstrated a failure to act with honesty and integrity in functions for which you would, under the Act, need approval to perform. The contents of the materials provided to the FSA in January 2008 do not persuade the FSA that its view, as set out in the Warning Notice, is incorrect in any way. Indeed the FSA notes that your conviction and the judge's sentencing remarks demonstrate that similar conclusions were reached in your criminal trial.

7.2 Consequently, the FSA has reached the conclusion that you lack honesty and integrity and are not, therefore, fit and proper to perform any function in relation to any regulated activity carried on by any authorised or exempt person or exempt professional firm and that a prohibition order is appropriate. In reaching this conclusion, the FSA has considered the fact that you were not an Approved Person when you were employed by the Company.

7.3 The FSA has also had regard to ENF 8. This indicates that in deciding whether to make a prohibition order, the FSA will consider the FSA's regulatory objectives and the provisions of FIT 2. The FSA has therefore had regard to the criteria for fitness and propriety set out at FIT 2 and the regulatory objectives of the FSA as set out in section 2 of the Act.

8. DECISION MAKER

8.1 The decision that gave rise to the obligation to give this Final Notice was made by the Regulatory Decisions Committee.

9. IMPORTANT

9.1 This Final Notice is given to you under section 56 and in accordance with section 390 of the Act. The following statutory rights and obligations are important.

Publicity

9.2 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under these provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

9.3 The FSA intends to publish this Final Notice and such information about the matter to which this Final Notice relates as it considers appropriate.

FSA Contacts

9.7 For more information concerning this matter generally, you should contact Helena Varney at the FSA (direct line: 020 7066 1294 / fax: 020 7066 1295).

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Tracey McDermott
Head of Department
FSA Enforcement Division