

Dear APPG member

In advance of tomorrow afternoon's debate on Equitable Life, please find below briefings from EMAG on:

- 1) how policyholders have been failed and denied justice over the years; and
- 2) how the Chadwick process is yet another charade.

A new perspective on the Equitable scandal

Few people know more about the Equitable Life scandal than the EMAG board. Regrettably, there's been a long trail of ten short-lived Treasury ministers, none of whom have got on top of this complex brief save Ruth Kelly, who perpetrated the biggest deception to the House (along with Yvette Cooper on 15 January, 2009). It is EMAG's view that Treasury civil servants have driven this cover-up since 2001, determined to diminish any payouts and delay them for as long as possible.

It was Ruth Kelly who appointed Lord Penrose in August 2001, with a brief not to address blame but to write a history book. When Ms Kelly subsequently presented his excellent 900-page Report to Parliament she crowed that he had not recommended compensation, yet she had specifically excluded any recommendation on compensation from his remit! Further, she hid behind one half of a sentence of his, that Equitable had been "the author of its own misfortunes...".

Were not the boards of Northern Rock, Icesave, RBS and Lloyds similarly responsible, yet consumers were protected and compensated from loss? The lay investor cannot understand the government's explanation: "But they were banks which presented a systemic risk", when pension savers trust the life companies and regulators with their lifetime's saving for their retirement years. Equitable's policyholders have been left to twist in the wind for a decade waiting for justice, with incalculable damage to trust in regulators and devastating damage to any faith in pensions savings.

A brief history of regulators

This really has been going on for more than a decade.

In February 2000, after the Appeal Court found against it, Equitable's chief executive wrote to all policyholders to say: "We must go to the House of Lords but, no worries, the maximum cost will be £50m." The FSA stood idly by, satisfied that – worst case scenario - Equitable was "99% sure of selling itself to a rival", solving the problem and even providing a windfall for members. How arrogant and wrong the FSA was.

In July 2000 the Lords ruled against Equitable. It was put up for sale and four months later, after 23 rival life assurance companies had run a slide rule over the prospectus and walked away, Equitable was forced to close its doors to new business on 8 December 2000.

The Tripartite system

In that first week of December 2000, Gordon Brown's new creation, the Tripartite regulatory body, met to determine what to do about Equitable. They did nothing. The FSA and its subcontractor, the Government's Actuary Department, knew by then there was a multi-billion pound black hole and that the industry would refuse to bail out through the Financial Services Compensation Scheme. The FSA decided to

duck below the parapet, hoping that the market would move ever upward to fill the gaping hole. But closure to new business and the collapse of the stockmarket from an all time high in December 2000 combined to seal the fate of the victims.

This was a spectacular failure of the Tripartite system of regulation, set up by Gordon Brown. Sadly it was followed much later by Northern Rock and the banking crisis. Clearly, lessons were not learnt. The fundamental weakness of "light-touch regulation was evident in the FSA's response to the draconian cuts to all Equitable policy values in July 2001. At a meeting with Gordon Brown later that same month, the chairman and chief executive of the FSA revealed that in the event of administration the cost of a bailout of Equitable Life would be around £5billion.

The FSA

The FSA failed to protect consumers, kept silent and maintained that Equitable was solvent, and conspired with the Equitable's board to patch together a legally binding compromise agreement based on a false prospectus which was foisted – with considerable pressure to agree – on the half million voting members in February 2002. Yet in the PO's report in 2008 it was revealed that Equitable was solvent in only one year during the 1990s, and that regulators could and should have known that.

Every attempt by EMAG to engage the FSA and the Treasury Select Committee from 2004 to date to take an active interest in Equitable as a case warranting intervention has been blanked. John McFall has acted as a loyal backstop for Gordon Brown and has taken the Nelson line of: "I see no ship", rendering the normal proper functioning of TreasCom void.

Now the soon-to-depart FSA boss, Hector Sants, admits that the consumer has been poorly served, thereby implicating its "light-touch regulation", "the Tiner reforms" and the "risk-based assessments" of previous heads of the FSA Sir Howard Davis, John Tiner and Sir Callum McCarthy (Sir Callum is now a non-executive director of the Treasury). Since it is the financial services industry that funds the annual FSA cost of £450million, it is not surprising that when the FSA's two objectives – preserving confidence in the industry and protecting consumers – are in conflict, it's always the consumer who loses out.

The FOS, intended to provide a back-stop protection to individual investors, has served Equitable's victims no better. Walter Merricks, then Chief Financial Ombudsman, determined unilaterally in March 2005 that the FOS would refuse to investigate any complaints that were deemed to be "Penrose-related" – a term that was interpreted as all embracing.

Equitable has been the canary in the coal mine, the early warning of the systemic flaws, both deep and fundamental, with "light-touch regulation" and with the Tripartite regulatory system. But the warning was ignored, thereby failing to prevent further problems. The Treasury's decision to cover up Equitable's real problems has proved incalculably costly to public confidence in regulators, pensions and savings.

Post the PO

It took the government six months to contrive its device "The Chadwick Process" (see paper below), designed to further delay and minimise any Equitable Life payouts.

Since July 2009 the Chief Secretary to the Treasury, Liam Byrne, has claimed this process will be quicker than that originally proposed by the PO, which would have been completed this year.

On 21 October the Commons debated a Lib Dem motion to honour the PO's report, as defined in EDM 1423, signed by 351 MPs. On that day the government misled its own backbenchers into believing its timetable and process would be quicker and a three line whip ensured the government's amendment was carried. We now know that Sir John will not even report until May, after the election.

At the all-party meeting on Equitable on 24 February, Mr Byrne would not rule out means testing but, deplorably, has ruled out any interim payment on account to the worst hit with-profits annuitants – a compassionate proposal from EMAG which would have cost just over £200 million on account.

The Treasury currently has a team sitting on its hands waiting for its own dubious "Chadwick Process" to report before it announcing the details of its ex-gratia payment scheme. Remember that the Treasury itself, responsible as regulator in 1998 and legally thereafter for FSA regulation until 2002, was found culpable by the PO - so how can it possibly be the appropriate body to finalise a scheme that it has already specified should pay only to those "disproportionately impacted"?

The right thing to do is to discard the remit given to Sir John (although keeping the database developed by the Treasury's actuaries), establish the independent tribunal as recommended by the PO and commit to the compensation process that the PO proposed.

That is an urgent priority for the next Parliament.

Paul Braithwaite
For EMAG Ltd
15 March, 2010

The Chadwick Charade

1. The Parliamentary Ombudsman reported that there had been a decade of regulatory failure and recommended compensation – not ex-gratia charity – for the policyholders' relative losses. That was in July 2008 and by the time the election is over that will be two years ago. The Treasury, who were responsible for regulation that had been found maladministrative for part of the period (1998-2001), then took six months until January 2009 to appoint Sir John Chadwick to advise on an ex-gratia scheme for those "disproportionately impacted". Instructed not to deliver before May 2010, i.e. until after the election, Sir John Chadwick has behaved like the Grand Old Duke of York leading policyholders and action groups up to the top of the hill and then down again in a time-wasting merry-go-round while more and more policyholders die. EMAG always suspected Sir John's appointment as an advisor to the Treasury to be an attempt to give a veneer of judicial authority to a stitch-up.

2. Sir John in his first proposals in July 2009, his first interim report in August and his second interim in December appeared to be taking an independent line from the Treasury and led many to believe that he was adopting a fair and flexible approach, albeit without Treasury sanction. However, in his third interim report published in

March 2010 he has been firmly roped back down the hill by the Treasury. **Having earlier proposed a flexible approach which looked at the failures as a whole – a method endorsed by the PO – he now redefines his flexible approach to try and speculate on the results of each individual finding i.e. guesswork.**

3. The Treasury, in January 2009, rejected several of the findings by the Parliamentary Ombudsman but the Divisional Court, in a judicial review brought by EMAG, reinstated most of the findings. However, Sir John in his third interim report sets out to rewrite history at great length, effectively saying that these re-instated findings of regulatory failure are of no importance: That even if the regulators had taken action Equitable Life would still have been able to show such sound figures of solvency that nobody would have been deterred from investing or caused any loss. This is a travesty of what actually happened and is completely contrary to what Lord Penrose and the Parliamentary Ombudsman reported after their very extensive inquiries.

4. Essentially, the regulators were concerned first of all with regulatory solvency - which asked the question “Does Equitable Life have sufficient assets to cover the guarantees made to policyholders together with a margin to cover stock exchange volatility?”. Sir John has chosen to ignore previous actuarial advice. Instead Towers Watson, appointed and no doubt instructed by the Treasury, have produced highly disputable figures which claim to show that Equitable was indeed regulatorily solvent at all times, using dodgy devices as simply upping the amount of future profit stream it incorporates to achieve solvency through the Required Minimum Margin (RMM). To give a further phony veneer of independence, Towers Watson have been allowed to choose themselves three further colleague actuaries to review their sums. This just gives a bad name to the concept of peer reviews.

5. The regulators were, in the 1990s, also bound by Act of Parliament to take account of Policyholders Reasonable Expectations (PRE). This was to ensure that policyholders were not misled by promises which the company could not fulfil. Those promises took the form of an annual allocation of final bonus which, though not guaranteed, gave the impression that the company could ultimately pay them and was performing satisfactorily. In fact Equitable Life NEVER had any assets to cover this final bonus and the Institute of Actuaries expelled the Society's Appointed Actuary, Roy Ranson, for this failure. The regulators had known about this and did nothing. Sir John Chadwick's third interim report has no mention of this aspect which Lord Penrose, in particular, had commented upon at length. Effectively the guilty party, the Treasury, has rewritten history despite Lord Penrose, the European Parliament, the Parliamentary Ombudsman, the PASC select committee and the High Court having accepted the correct version.

6. Sir John's report sets out Higher and Lower Impact Scenario's in support of his contention. His Lower Scenario ignores one of the most crucial elements of Equitable's Ponzi scheme – the valuation of liabilities at about half of what they should have been - by discounting forward and then back at totally unjustifiably different interest rates to produce a plausibly understated liability. This is quite contrary to what the two Judges in the Judicial Review ruled.

7. Thus for the first eight years or so of regulatory failure the Treasury pretends that there was really no problem and any loss should be calculated by reference to a company or companies which was doing equally badly. Only when Sir John gets to 1999 does he admit that the fraudulent reinsurance treaty was so bad – leaving a £1.6 billion hole in the Society's finances – that he finally acknowledges nobody would have invested new money in the Society if they had known the true position.

Amazingly though he believes that no one would have removed their money from the Society! His belief is based on the idea that people were slow to leave the Society when it closed for business in 2001. He overlooks the fact that in 2001 the Treasury, the FSA and the GAD, having fathered and nursed the fraudulent reinsurance treaty were still ensuring that nobody knew the true state of the finances – a cover-up the Treasury is still trying to maintain nine years later.

8. In addition to minimising the failure of the regulators, the Treasury, through “The Chadwick Process”, is endeavouring to further salami-slice the amount of any ex-gratia payments. It still maintains that regulatory failure was partly down to the Society itself – despite the fact that there is no evidence of the Society providing the regulators with false figures. Also mentioned is the role of the accountants, Ernst & Young, who are the subject of yet another inquiry - the result of which is as yet unknown and which will bring no compensation to the beleaguered policyholders. Ex-gratia payments, it is proposed by the Treasury’s remit, will be further limited to only those who suffered “disproportionate impact” – now defined as With Profit Annuitants and those late-joiners who put in new money after 1998. A further torture that has explicitly not been ruled out by Liam Byrne is means testing.

9. In summary, “The Chadwick Process” has been a shameful charade to which EMAG is surprised that a retired Appeal Court Judge (albeit hand picked) has lent his name. The regulators allowed a Ponzi fraud to develop over nine years. The Treasury fathered and nursed a fraudulent reinsurance treaty when the crisis arose in 1999 and ever since has not failed to stoop to every kind of cover-up, delay and low trick to escape the full truth being revealed – it is not just the failure to pay any compensation after a further decade – but the hiding of disgraceful behaviour by a major Office of State.

And in the meantime policyholders die.

Nic Bellord
EMAG director
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