

INTRODUCTION

This paper is EMAG’s response to Sir John Chadwick’s Second Interim Report.

THE EFFECTS OF SERIAL REGULATORY FAILURE

Sir John has made it clear that he would like to use his ‘flexible approach’. Essentially this involves:

- a) Calculating all policyholder losses during the maladministration period relative to what the money would have bought elsewhere.

- b) Applying a factor to the result, reflecting the probability of that money being so re-directed.

Sir John, rightly in EMAG’s view, has rejected what he calls the ‘report-based approach’, primarily because:

- a) It is not practical to compute losses based upon particular items of maladministration. As the PO has said, the maladministration pervaded the exercise of regulatory functions for a decade and individual failures had a cumulative effect.

- b) It is impossible to say at this stage what decisions individual policyholders might have taken many years ago, if proper regulation had made better information available. The best that can be done is to deal with all losses on a balance of probability basis.

In spite of the Court finding that the Minister’s decision to mutilate the PO’s report was unlawful, the Treasury continues to cling to the idea that it can minimise compensation by playing down the effects of maladministration. Practical examples are its refusal to support Sir John’s ‘flexible approach’ and its insistence

that he must consider the effect of proper regulation upon policyholders, without (apparently) authorising expenditure upon appropriate professional advice.

Repeated claims by Ministers that Sir John is working as quickly as possible ring very hollow when compared to the steps, which the Treasury is taking to slow him down.

This Treasury attitude also makes it essential that EMAG responds to Sir John’s request for representations as to how competent regulators would have dealt with the FO’s findings, which the Treasury has been forced to re-instate as a result of EMAG’s successful Court action. These comprise:

- a) Equitable Life’s weak financial position, which it sought to cover up by undervaluing its main liabilities.
- b) Equitable Life’s failure to make any provision at all for its Guaranteed Annuity Rate liability until it had grown to £1.6bn
- c) Standard & Poor’s AA Excellent rating of the Society, based upon its mistaken interpretation of the Society’s convoluted way of presenting its finances.

We have provided a detailed analysis, based upon the PO’s report, of the strenuous steps which competent regulators should have taken to deal with these matters and the likely reaction of policyholders. This amply justifies the PO’s view that *“from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period - going instead to another life insurance company.”*

CONCEPTUAL ALLOCATION OF LOSSES

As requested by Sir John Chadwick, EMAG has supplied a detailed conceptual analysis, extending his classification of losses under Heads A and B, which includes a quantification of classes of loss by premiums paid.

Sir John indicates his interest in using, as a practical measure, a single computation method for both Heads. EMAG indicates how this can be achieved as regards fully 94% of affected premiums.

CHOICE OF COMPARATOR

We note that Sir John continues to search for a suitable comparator upon which to base relative loss evaluation. EMAG’s view is that the appropriate comparator for all forms of Equitable Life policies, except with-profits annuities, is the market weighted average of the results of its leading with-profits competitors during the maladministration period. EMAG’s research demonstrates that these comprised a group of ‘household name’ companies, such as Prudential, Standard Life, Legal & General and Norwich Union. As regards with-profits annuitants, EMAG’s view is that the appropriate comparator is either a conventional annuity or a Prudential with-profits one, depending upon size, for the reasons explained in our Principles of Compensation paper.

END DATE

EMAG is surprised that Sir John is considering limiting relief for losses incurred after July 2001, on the spurious (probably Treasury-inspired) grounds that policyholders then had sufficient information to decide that it was in their best interests to move their funds elsewhere. This is in conflict with the PO’s findings that the FSA consistently

misled policyholders between 1999 and 2001, encouraging them to stay with Equitable.

He should be aware that the FSA exerted considerable pressure upon Independent Financial Advisers during 2001 and 2002 to prevent funds being transferred elsewhere. As late as April 2002, the FSA threatened the committee of EMAG with criminal sanctions, when it worked with an IFA to offer an escape route to Equitable Life sufferers.

WITH PROFITS ANNUITANTS

Consideration of Sir John’s report, suggests to EMAG that he has only reached a disappointingly early stage in the major task of evaluating the losses of with-profits annuitants. This is the group identified by Parliament as having been particularly badly affected by maladministration [Commons motion of 21 Oct 2009].

In spite of the crocodile tears shed by Ministers over the plight of with-profits annuitants, EMAG sees no instruction from Treasury Ministers or civil servants to prioritise this group. EMAG’s impression is that they will be left until last.

This lack of progress indicates an urgent need for an early payment on account to relieve immediate suffering and we shall be pleased to indicate how this may be done.

THE CHADWICK PROCESS

EMAG has always had grave doubts about the Treasury, whose sub-contractors committed the maladministration, running the process to evaluate losses and devise a scheme of compensation. However fair-minded Sir John Chadwick may try to be, the fact that he is appointed, instructed, assisted and paid by the Treasury inevitably makes this a one-sided process. It allows the guilty party the chance to re-try the case and minimise the sentence, when Parliament’s own independent Ombudsman has already ruled on both issue.

EMAG calls upon Treasury Ministers to:

- a) Instruct their civil servants to abandon attempts to minimise and to delay compensation by treating particular episodes of maladministration separately, rather than cumulatively, as part of the serial regulatory failure which the PO found.
- b) Authorise Sir John to adopt his ‘flexible approach’.
- c) Instruct him to treat those that have died and those that live overseas in the same way as other policyholders.
- d) Instruct him and/or the Treasury to publish his instructions to his actuaries and their unedited reports. Transparency is essential in this complicated area.
- e) Instruct Sir John to recommend an immediate payment on account to with-profit annuitants, so as to relieve their suffering, until their losses are properly evaluated.