

Executive Summary

Introduction and general conclusions

1. I have been asked by the Equitable Members Action Group ('EMAG') to review the nature of the service provided by the Financial Ombudsman Service ('FOS') to Equitable Life Assurance Society (EL) complainant policyholders.
2. The questions on which I am asked to advise are as follows:

Could policyholders reasonably conclude that the service provided by the FOS has fallen short of the standards which the policyholders were entitled to expect; and, if so, in what respects?
3. In answering these questions I have examined the complete correspondence relating to the cases of some 30 complainants who lodged claims with the FOS. I have also considered how it came about that a category of complaints (those with so-called 'Penrose-related' claims) had their cases dismissed by the Chief Ombudsman without any consideration of the merits of their claims. To ascertain the standards of performance to be expected of the FOS, I have looked first to the statutory provisions – the Financial Services and Markets Act 2000 (the 'FSMA' or 'the Act') and the rules made under the statute; but over and beyond the statutory provisions I have also taken account of statements made by the FOS in its published booklet 'your complaint and the ombudsman' and in FOS website communications as to the standards which it aims to meet.

4. My overall conclusions are:

- first, that the policyholders whose cases I have studied could reasonably conclude that the service provided by the Financial Ombudsman Service fell short of the standards which they were entitled to expect (these being standards which the Service had itself proclaimed and advertised);
- secondly, that the respects in which those expectations were disappointed are detailed in Appendix 2 and summarised and high-lighted in the Paragraphs of my Opinion commencing at Paragraph 151 onwards;
- and thirdly, that policyholders who had Penrose-related claims (concerning the allocation and payment of excessive bonuses) had good reason to be dismayed by the Chief Ombudsman's dismissal of their claims without considering their merits, both as regards the process by which he reached his decision and as to its content.

In these important respects, the FOS has left a significant class of complainants with an abiding and entirely justifiable sense of disillusionment, frustration and injustice.

5. My overall conclusions are set out in paragraph 4 above. My more detailed conclusions are as follows:

- (1) The impression gained by the complainants whose cases I have studied is that the FOS is not a body which holds the scales of justice evenly. It is a body which in many ways and in many instances has displayed partiality towards the financial firm, in this case EL.

- (2) The complainants did not expect to be treated with any special favour but they did believe that the FOS would be sensitive to the fact that they had suffered serious financial loss, and to the point that in nearly every case they were without any legal assistance.
- (3) The long delays in processing complaints had a corrosive effect. Complainants lost confidence in the system and began to feel that the FOS was stalling.
- (4) Many of the case studies reveal attitudes on the part of FOS officials which the complainants felt were unhelpful, unnecessarily argumentative, or even aggressive.
- (5) At worst the officials were seen as advocates for EL. In some instances, without any reference back to EL, they had come up with their own arguments to block the complainant.
- (6) There seems to have been a general feeling of outrage among complainants that Penrose-related complaints were not allowed to remain with the FOS for adjudication. Without knowing the legal niceties complainants as a whole thought that a Government Minister had in March 2004 pointed them firmly in the direction of the Chief Ombudsman. This was where complaints based on Lord Penrose were to be taken. Enormous disillusionment followed the Chief Ombudsman's decision a year later that he would not consider any of these complaints. Public cynicism being rampant, there arose at once the belief that the FOS had been 'leant upon'. An internal Treasury e-mail dated 18 June 2004 (disclosed under the Freedom

of Information Act on 25 January 2007 and quoted in paragraph 22 below) shows, at its lowest, that the FSA was seeking to “provide FOS with a basis for considering complaints relating to over-allocation” and that discussions to this end would take place between the FSA and the FOS in the week following 18 June 2004.

- (7) Those complainants who have succeeded through the FOS in establishing liability on the part of EL have been dismayed by the difficulties confronting them in ascertaining the amount of damages which they are entitled to claim. The attitude of detachment to this issue on the part of the FOS has led to repeated and strong protests by complainants. Many such protests are recorded here.
- (8) The general inefficiency of the FOS and the lack of concern with the special facts of individual cases (possibly exacerbated by the ‘lead case’ method) have caused complainants to form the view that their interests have not been well looked after.

Further details are given at paragraph 25 and following below.

Background – the Financial Ombudsman Service

- 6. The FOS’s board is appointed by the Financial Services Authority (FSA), the FSA sets the FOS’s annual budget and the two organisations’ working relationship is defined by a Memorandum of Understanding (July 2002). The essence of the FOS is a system, standing apart from the courts, for the

resolution of financial disputes fairly, reasonably, quickly, informally, independently and impartially. The Ombudsman is not bound by strict rules of law and hence is set free from legal precedents. It is for the Ombudsman to determine what award, if any, is in his opinion “fair and reasonable in all the circumstances of the case”. Though the strict rules of law and court procedure are displaced, the rules of natural justice or fairness nevertheless apply to the Ombudsman’s decision-making. So, each side will have the opportunity to comment on the totality of the other side’s case and the Ombudsman will not rely on material that he has not disclosed and circulated for comment by the parties. The Ombudsman will do his best to ensure that there is a level playing field and that the superior wealth and resources of one side do not give rise to an inequality of arms. Discretions vested in him will be exercised fairly and not arbitrarily or capriciously. As a pithy summary one may accept the Ombudsman’s own description – “Our aim is to resolve disputes fairly, reasonably, quickly and informally”; it is only necessary to add “and independently and impartially like a judge.”

7. A significant advantage of the system is that complainants are firmly told in the literature that they will not need to hire a lawyer (or any other expert, such as an accountant or actuary) to assist them. The FOS will make up for this and see to it that complainants are not disadvantaged by lack of legal advice. Indeed complainants are warned that if they do instruct a lawyer they will generally be unable to obtain reimbursement of the fees incurred.

Background – the Equitable Life and Lord Penrose’s report

8. The background to my investigation is well-known, but it may be helpful to summarise it briefly.
9. Equitable Life was a long-established insurance company with a fine reputation. By the year 2000 some 1.5 million people had taken out pension and annuity policies with EL. Policyholders placed implicit trust in EL to conduct its business prudently and to ensure that the reasonable expectations of all policyholders were met. It hardly needs to be stated that pensioners conducted their lives on the footing that they would receive in full the pension which they believed they had been promised and had paid for.
10. EL was significantly weakened when, in July 2000, it lost a case in the House of Lords about the extent of its obligations to a significant block of policyholders. Thereafter the business was put up for sale but, having failed to find a buyer, EL closed its doors to new business. It cut policy values by 16% in July 2001 and by a further 10% the following year.
11. Large numbers of aggrieved policyholders sought compensation from EL. Many of those claims were wiped out by a Compromise Scheme, promoted by EL, which the High Court approved in February 2002.
12. In August 2001, the Government invited Lord Penrose, a distinguished Scottish judge, to investigate what had gone wrong. His report, published on 8 March 2004, revealed that a

significant cause of EL's collapse was that for at least a decade (the 1990s) EL had been following a policy of so-called 'over-bonusing', that is to say, announcing annually bonuses which would be attached to policies for which there was no adequate asset backing. Not only were excessive bonus allocations made to policyholders but £1.8 billion pounds of actual excess payments out were made to those who left before July 2001.

13. Aggrieved policyholders could have brought actions in the courts. But the costs risks in bringing a law suit which may fail are an absolute bar to most claims. It is for precisely this reason that the Government had thought it prudent to provide for an alternative avenue of redress for financial services complainants. The Financial Services and Markets Act 2000 therefore established the FOS bringing several pre-existing ombudsman schemes together into one.
14. Ruth Kelly MP (the then Financial Secretary to the Treasury) made a Commons statement about the Penrose Report on 8 March 2004, the day of its publication. Dealing with the question of redress for aggrieved policyholders, she repeatedly assured MPs that the FOS was standing ready to handle complaints based on the Penrose Report and had the necessary resources to do so. The Government would assist if more was required.
15. However, on 16 March 2004, in the Treasury Select Committee, Ms. Kelly raised the possibility – in one short sentence in response to a question – that the Chief Ombudsman might exercise his discretion to decline to deal

with the complaints, though, in subsequent Commons answers, she returned to her original commendation of the FOS as the tribunal to which complainants should take their cases based on Penrose. However, the FOS relied on the 16 March answer when it reported to the European Parliament's Committee of Inquiry into the Collapse of the Equitable Life Assurance Society ("EQUI").

16. It was with a sense of shock that policyholders learned that the Chief Ombudsman had decided on 22 March 2005 to exercise his discretionary power to dismiss, without considering on their merits, all complaints which could be described as Penrose-related. At one stroke the facilities of the FOS were thus removed from a large number of potential complainants.

The decision of the Chief Ombudsman (22 March 2005)

17. Because of its devastating effect I have given careful consideration to the Chief Ombudsman's decision to summarily dismiss all Penrose-related complaints. Although in form his decision related only to the 50 complaints which had reached the FOS, it effectively prevented thousands of other EL policyholders from referring their complaints to the FOS at all. The FSA had waived EL's obligation to deal with them for some eight months, and without a final decision from EL, these complainants could not progress to the FOS.
18. This dismissal followed a process in which the Chief Ombudsman sent to the 50 complainants for comment a letter from EL urging him to exercise certain powers to dismiss. The

vast majority of complainants who received this letter had no lawyer advising them. As a matter of fairness, he should have clearly identified to them the powers whose exercise he was considering. Only in this way could complainants have addressed their comments to the preconditions for the exercise of the powers.

19. This he did not do: he did not identify and explain to the complainants all the powers on which he ultimately relied; and he did not tell them certain key facts that would drive his decision that a 'stalemate' between the FOS and the FSA would ensue were he to uphold the 50 Penrose-related complaints which had already been lodged with him.
20. In these circumstances the complainants never had a fair opportunity to address the case against them. Indeed, many did not even realise that EL had made what lawyers would call an application to strike out their cases.
21. In my Opinion I voice criticisms of the reasoning underlying the Chief Ombudsman's decision to dismiss the Penrose-related complaints. Though possibly impregnable as a matter of law because of the very great margin of discretion accorded to the Chief Ombudsman by the courts, the decision could reasonably be regarded by policyholders as one dictated to the FOS by the FSA and as one with disastrous financial consequences for thousands of ordinary people who were waiting upon his ruling.
22. Documents obtained from the Treasury on 25 January 2007 under the Freedom of Information Act suggest that the

dominance of the FSA's view was not fortuitous. In particular an internal Treasury e-mail dated 18 June 2004 records:

“The FSA appear to have decided that they will not publish the reports prepared for them (a report by an independent actuary and counsel's opinion). They propose in due course publishing some sort of statement setting out the overall conclusions of the work – this will not happen until after they have discussed the content of any such statement with the FOS (the main purpose of the statement would be to provide FOS with a basis for considering complaints relating to overallocation). I understand that initial discussions with FOS will be held early next week.”

23. The decision removed an avenue of free recourse, leaving complainants only with the high cost, high risk option of instituting legal proceedings against EL.
24. Many complainants regarded the decision as (a) negating the very purpose for which the FOS had been established; and (b) wholly inconsistent with the clear assurance which they understood the Minister to have given to MPs that this avenue would be open to complainants.

The Individual complaints

25. I have endeavoured to extract themes which are common to many of the 30 cases which I have studied.

Lack of impartiality

26. Nearly all complainants felt that in their dealings with the FOS they were arguing with an advocate for EL rather than dealing with an impartial judge.

Lack of independence

27. This is a theme closely connected to lack of impartiality. Complainants regarded the Chief Ombudsman's decision to dismiss the Penrose-related complaints as one which he reached not on his own, but because the FSA had publicly stated that Penrose-related claims were likely to fail in the courts and had further stated (but from no identified source) that an FOS finding for the Penrose complainants would require a scheme of fund rearrangement with which it (the FSA) would not cooperate.

Breach of natural justice

28. While the case studies give examples of the failure by the FOS to give particular complainants the chance to comment on adverse material, the major instance where a breach of natural justice is identified is in relation to the Chief Ombudsman's decision.

Delay

29. Many of the cases examined have involved unacceptable delay on the part of the FOS in reaching a final decision, with some going on for more than five years. The FOS has recently reported to the EQUI Inquiry that many cases remain unresolved.

Obscurity of the financial awards

30. Many complainants described the difficulty – if not the impossibility – of understanding how awards are calculated.

This problem has arisen on account of the complexity and sophistication of the system designed by accountants Deloitte on the instructions of EL to give effect to the Chief Ombudsman's Decision in the pivotal lead case of Ms E.

31. Many complainants cannot rework the figures because the necessary raw data has been withheld from them. A widely held view among complainants is that it is completely unfair to leave them in a position where they cannot verify what is asserted by EL to be the 'correct' figure.
32. Those who have complained to the FOS about this have been told that the FOS does not provide a checking service and that it is for the complainants to come up with evidence (in one case "conclusive evidence") as to why the award is inaccurate and then themselves confront EL. This involves an extraordinary reversal of the burden of proof.
33. No court would allow a litigant in person to be left in such a position of ignorance in relation to the calculation of an award made in his or her favour. Nor would any court fail to police its own awards in the manner in which the FOS does.
34. An additional point is that some complainants have plausibly argued that the Deloitte system does not in fact give effect to the order made in Ms. E's case. It certainly is not accompanied by the clear explanations which the Chief Ombudsman called for.

Unlevel playing field

35. It is widely perceived that the FOS tends to allow much more latitude to EL than it does to complainants. Examples cited are (a) the generous time accorded to EL to deal with some issues as contrasted with the short time limits imposed upon complainants; and (b) the willingness of the FOS to resolve disputed issues in favour of EL even where the complainant relies on attested fact and EL replies with conjectures as to what would/must have happened. One complainant voiced his frustration in these forthright terms:

Your “playing field” is, in reality, a precipice with Equitable Life policyholders at the bottom being bombarded with rocks hurled down on them by the FOS and others.”

Inequality of arms

36. The fundamental assumption underpinning the FOS scheme is that complainants will be able to present their cases on their own, without the need for expensive lawyers, accountants or actuaries and that they will suffer no disadvantage by acting in this manner. However, that has not been the experience in the EL disputes. Learned opinions from leading counsel have been procured by EL that are apt to overwhelm the average complainant; and complaints frequently raise serious evidentiary issues, that are difficult for lay complainants to address. The FOS has done little to redress the imbalance.

Unfair conditions attached to offers

37. A grievance voiced by some complainants is that instead of making awards itself, the FOS has put pressure on EL to make an offer. This has enabled EL to impose conditions which are designed wholly for its own advantage. Frequent examples cited are “This offer is made without admission of liability” and “Save as required by law, the existence and terms of their settlement shall be, and remain, confidential to the parties and their professional advisers”. Complainants say that they derive no benefit from these conditions and that they would not feature at all if the FOS made the awards itself.

Miscellaneous

38. The report identifies a number of other miscellaneous complaints not falling under the above heads, which could be classified as incompetence or negligence.