



House of Commons

Public Administration Select Committee

Equitable Life

Written Evidence

This is a volume of submissions, relevant to the inquiry into Equitable Life, which have been reported to the House but not yet approved for publication in final form. Any public use of, or reference to, the contents should make clear that it is not yet an approved final record of the written evidence received by the Committee.

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Memorandum from the Parliamentary and Health Service Ombudsman (EQL 02)

Equitable Life

1. On 16 July 2008, I laid the report of my investigation into the prudential regulation of The Equitable Life Assurance Society before both Houses of Parliament. My report, *Equitable Life: A Decade of Regulatory Failure*, was published the following day.
2. The publication of that report – which is the longest produced by my Office and is perhaps the most complex report we have published – led to significant parliamentary, public and press interest, all of which continues.
3. As the Committee knows, I made ten findings of maladministration and determined that this maladministration had led to injustice to those who had complained to me. That injustice took the form of financial loss, where that has occurred, lost opportunities to make informed savings and investment decisions, and a justifiable sense of outrage.
4. Where injustice has resulted from maladministration on the part of a body within my jurisdiction, my general practice – outlined in our Principles for Remedy – is to seek to restore people to the position they would have been in had no maladministration occurred. Where that is not possible, my approach is to recommend that appropriate compensation should be paid.
5. The Committee will know that I received submissions from those bodies whose actions had been investigated which sought to persuade me that I should not adopt my usual approach on this occasion. Those submissions, and my assessment of the rationale underlying them, are set out in full in Chapter 14 of Part 1 of my report.
6. The Committee takes a general interest in questions of remedy following our reports and in whether Ombudsmen should approach such questions in the same way as the courts. That Chapter of my report might therefore be of particular relevance to its deliberations.
7. I was not persuaded by the submissions of the public bodies and applied instead my usual approach to questions of remedy. I made two recommendations to government, namely:
 - (i) that, in recognition of the justifiable sense of outrage felt by those who have complained to me about the serial regulatory failure which my report identifies as maladministration, the public bodies should apologise to those people for that failure; and

- (ii) that the Government should establish and fund a compensation scheme, with a view to assessing individual cases and, where appropriate, providing compensation.
8. In making these recommendations, I recognised that it would not be appropriate for compensation to be paid merely for losses associated with the stock market or where no injustice had arisen from maladministration.
 9. Whether, and in what form, injustice has been sustained by a particular policyholder or annuitant could only be determined on an individual basis, not least because much depends on when, how, and how much an individual invested or saved with Equitable Life. Accordingly, my recommendation was that the aim of any such compensation scheme should be to restore anyone who had suffered a greater loss, relative to that which they would have suffered had they invested with another company, to the position they would have been in had no maladministration occurred.
 10. I also recognised that my recommendations raise issues related to the public interest and to the potential impact that acceptance of the recommendation to establish a compensation scheme might have on the public purse. Decisions as to whether such a scheme would be in the public interest and as to how public resources should be spent are matters for Parliament and Government and not for me. I therefore invited government and Parliament to consider further the issues that were raised by my report and by my recommendations.
 11. However, I gave guidance within my report as to the timescales within which I consider it would be reasonable to expect any such scheme both to be established and to conclude its work. I also set out some principles – independence, transparency, and simplicity – that should guide the operation of such a scheme.
 12. The Government has said that it will respond to my report in the Autumn. We have no further information about when that response will be forthcoming.
 13. The feedback we have received since publication of the report has largely been positive. Despite the time that it took to complete the investigation and to publish the final report, it would appear from the letters we have received that our general practice of involving complainants in all stages of investigations and of keeping them informed of developments as investigations progress was particularly welcomed on this occasion.

14. Other correspondence that we have received has sought to make connections between the subject matter of our report and the current position in world markets and with the ongoing discussions that have arisen about the role of financial regulation. We have had to explain that I have not investigated events which took place on or after 1 December 2001, that on that date the system of regulation changed fundamentally, that our knowledge in this area is limited to the specific case of Equitable Life in the earlier period, and that we have no basis on which we could speculate about current events.
15. However, that is not to say that I do not recognise the importance of the wider context in which the subject matter of my report is placed. Indeed, I have accepted an invitation to attend on 1 December 2008 a meeting of the Petitions Committee of the European Parliament, at which that Committee wishes to explore my report in the context of the report of that Parliament's special committee of inquiry into the Equitable Life affair.

October 2008

Memorandum from Equitable Life Assurance Society (EQL 03)

1 Introduction

- 1.1 Thank you for giving us the opportunity to give evidence to the Public Administration Select Committee's inquiry on this issue following the Parliamentary Ombudsman's report *Equitable Life: a decade of regulatory failure*. This note is Equitable Life's written submission ahead of giving oral evidence on 11 November 2008. We hope it helps further inform Committee members on this important issue.
- 1.2 We are happy that this submission be publicly available both before and after the oral evidence session on 11 November 2008.
- 1.3 We note that the Committee may wish us to submit further evidence after the oral session on 11 November 2008.

2 Executive summary and conclusion

- 2.1 We must emphasise that the Parliamentary Ombudsman's investigation was only concerned with public bodies and the Government Actuary's Department (GAD). It explicitly excluded investigation into the conduct of Equitable Life [Part 1 viii]. Where Equitable Life has been found wanting we have already paid redress in appropriate cases.
- 2.2 We fully support the Parliamentary Ombudsman's conclusions and her recommendations that where public bodies and GAD have been found guilty of maladministration resulting in injustice the Government should pay redress.
- 2.3 The regulator has protection from legal action, so we (and our policyholders) are wholly dependent on Parliament to provide redress for what this report has so clearly shown to have been injustice.
- 2.4 As a new Board in 2001 we have patiently worked through various lengthy processes including Lord Penrose's inquiry, to which we gave full assistance and which, after two and a half years, revealed evidence of maladministration even though there was no formal conclusion to that effect (see below). We then fully supported the Parliamentary Ombudsman who has, after four more years, very clearly concluded that there was serious regulatory maladministration leading to injustice for policyholders. She has also recommended government compensation.

- 2.5 We understand that the Treasury has been kept informed of the development of the report and seen drafts of it throughout and so little of the final report will have been new to Ministers and officials when it was published in July. It is certainly disappointing and some would say unconscionable that after a further three and a half months there is still no response.
- 2.6 The new Board of Equitable Life (with the help and support of its policyholders, but without government help) has stabilised the business and secured a future. During that time Equitable Life pursued those it could for any redress on behalf of policyholders. As Lord Penrose commented, Equitable Life, under its previous management, was the “author of its own misfortune”. We recognised that long before that report was published, Equitable Life identified where it should compensate policyholders and made appropriate payments amounting to hundreds of millions of pounds to hundreds of thousands of policyholders even though, as a mutual, such compensation is inevitably at the expense of other policyholders. All that work is essentially complete.
- 2.7 Eight years after the original crisis, the public bodies responsible for the prudential regulation of the Society and GAD have been shown conclusively to bear great responsibility for their failures. It is high time for the Government to accept that responsibility and to bear its share of the cost. Many policyholders and former policyholders are old and infirm. Indeed, many thousands have already died.
- 2.8 If the Government fails to respond positively to a report from Parliament’s own Ombudsman – a report which so thoroughly and unequivocally describes a ‘decade of regulatory failure’ - we will fail to understand and to explain to our policyholders what the point of the role of the Parliamentary Ombudsman is.
- 2.9 We understand the concern of the cost to the public purse, but we note particularly that the Ombudsman’s recommendation is limited to making good ‘relative loss’. That should exclude both market losses suffered by policyholders of all companies and any compensation already paid by Equitable Life itself.

3 **Background**

- 3.1 Equitable Life reached a crisis in July 2000 with the House of Lords ruling on the guaranteed annuity rates issue. The scale of the problems became apparent at the end of that year when the once highly respected company was unable to find a buyer at any price.

- 3.2 The former management and Board took responsibility for the problems and resigned. Consequently, in 2001 a new Board was brought in with a new chief executive. The role of the new Board and management was to try to sort out the mess and stabilise the business.
- 3.3 As you will be aware, the investment markets at the start of the new millennium were difficult and challenged some of the strongest insurers. For a company that was already struggling, the impact was almost catastrophic. The Society is now stable and secure, but because of the difficult economic climate it has taken many years longer to achieve that than any of us anticipated when we joined in 2001.

4 Culpability

- 4.1 Almost as soon as the new Board had been appointed we instigated an inquiry into whether there might be grounds for making claims against any parties who had had a hand in the events leading up to the closure of the Society.
- 4.2 We reported to policyholders at the end of 2001 that we had received advice back from the lawyers carrying out the investigation. As a result of that advice we commenced legal action against certain of the Society's former directors and former auditors. With regard to the role played by the regulators we were advised to wait for the outcome of the inquiry by Lord Penrose which had started in August 2001.
- 4.3 Legal action against the former directors and former auditors began in 2002 and was settled in 2005.

5 Policyholder claims

- 5.1 Just as we looked at culpability in former management, advisers and others, we also considered policyholders' position with regard to claims against Equitable Life.
- 5.2 Through a number of schemes and reviews and through the Financial Ombudsman's Service and the Courts we have settled over 100,000 individual claims made by policyholders against Equitable Life. It should be noted that as a mutual Equitable Life has no outside source of funds. Therefore the enormous compensation paid by Equitable Life to its policyholders or former policyholders has inevitably been at the expense of its current policyholders.
- 5.3 Perhaps most significant of these schemes was the Compromise Scheme which was sanctioned by the High Court in February 2002. Through that scheme

policyholders gave up their right to make claims against the Society (connected with the guaranteed annuity rate issue) in return for uplifts in their policy value. The description of the scheme made it clear that the value of the uplifts fell short of the potential maximum value of the claims policyholders might be giving up. However, policyholders compromised these claims because to pursue them they would be claiming against themselves. You will note that this is an example where in spite of claims against the Society being settled, policyholders may still have suffered a 'relative loss'.

- 5.4 A fuller note of past compensation settlements by Equitable Life is attached as an appendix to this note.

6 The Penrose Report

- 6.1 When Lord Penrose's report was published on 8 March 2004 he described a litany of failures by the regulatory regime and by former management.
- 6.2 Criticism of Equitable Life's former management was unsurprising – we were already involved in litigation against them.
- 6.3 As mentioned above, we were waiting for Lord Penrose's report in order to determine whether there could be a sustainable legal case against the regulators. However, regulators enjoy a very high level of protection from legal action – effectively, a case would need to show misfeasance, not simply negligence or incompetence. For that reason, in spite of the criticisms made by Lord Penrose, we were advised that we could not successfully pursue regulators through the Courts.
- 6.4 It is worth reiterating that although the then Financial Secretary, Ruth Kelly, spoke at length in the House in 2004 quoting criticisms made by Lord Penrose against Equitable Life, Lord Penrose also made many criticisms of regulators.

For example:

- “GAD's approach over this period seems to me to have been persistently naïve.” [Chap 17 para 78]
- “DTI Insurance division was ill-equipped to participate in the regulatory process. It had inadequate staff, and those involved at line supervisor level in particular were not qualified to make any significant contribution to the process.” [Chap 19 para 158]
- “The scrutiny process was slow, and its results emerged late relative to periods under review... Successive GAD actuaries did identify relevant issues, but consistently these were not followed through and were allowed to evaporate. No problem was considered so serious that it could not be left until next time.” [Chap 19 para 221]

- “There was challenge, but it was ineffective. Unsatisfactory answers were accepted without follow-up. Lines of inquiry were abandoned or postponed in the face of resistance.” [Chap 19 para 228]
- “There was a general failure on the part of the regulators and GAD to follow up issues that arose in the course of their regulation of the Society, and to mount effective challenge of the management.” [Chapter 19 Key findings para 240(11)]

6.5 It must be stressed again that the remit of Lord Penrose was limited and did not make it possible for him to reach a finding of fault or ‘maladministration’ against the regulators.

7 Parliamentary Ombudsman’s Inquiry

7.1 As mentioned above, Lord Penrose made many detailed and highly critical comments about the failures of the regulators. This was one of the reasons for the Parliamentary Ombudsman’s decision to re-open her inquiry in the light of 898 complaints referred by MPs and 1,309 direct representations. [Part 5 para 3.2] [Part 4 Section 2A para 48] We are grateful to those parliamentarians who ensured that she was able to include GAD in that inquiry.

7.2 We gave all possible assistance to the Parliamentary Ombudsman and her inquiry team.

7.3 We recognise and acknowledge the enormous amount of work put in by the inquiry team and the thorough and well argued case laid out in the report, which is over 2,800 pages long and took four years to complete.

7.4 The Government’s response in 2004 to Lord Penrose’s report was to emphasize that he made no finding of maladministration (although to do so would have been outside his terms of reference). On the other hand, the Parliamentary Ombudsman has found ten counts of maladministration.

7.5 The Parliamentary Ombudsman has found that the “prudential regulators, and no one else, were given the functions of scrutinising the returns that the Society submitted and of verifying its solvency position. Those regulators did this with advice and assistance from GAD. No other party can be said to be at fault because those regulators and/or GAD acted with maladministration.” (her emphasis). [Part 1, Ch 14 para 47]

7.6 Further, the Parliamentary Ombudsman has found that there is a sufficient link between the maladministration identified and any relative loss that is established. [Part 5 para 9.20]

8 Government's response

- 8.1 So far, the Government's response to parliamentary questions amounts to a re-run of its response to the Penrose report: namely, that Equitable Life was the 'author of its own misfortune'.
- 8.2 Of course, in part, it was. We have no dispute with that. As we have explained above, Equitable Life has included itself in its own search for culpability – former directors, former auditors – and it has compensated policyholders where they have had valid claims against it. But as the Parliamentary Ombudsman has made clear, the prudential regulators and GAD were solely responsible for scrutinising the Society's returns and for verifying its solvency (see above). The Parliamentary Ombudsman's findings in her report "show that the prudential regulation of the Society during the relevant period failed - and failed comprehensively. That was not a system failure, but a failure properly to implement in the particular case of the Society the system of regulation that Parliament had enacted." [Part 1 Chap 15 para 34]
- 8.3 A response made by the departments was also that the Parliamentary Ombudsman has been influenced by hindsight. This accusation is clearly rebutted by her and indeed the evidence within the report shows the lengths to which she went in order to ensure that she was measuring performance against the standards expected at the time. [Part 1 Ch 9 para 112]

Appendix: Past compensation settlements by Equitable Life

This note sets out the main categories of compensation payments made by Equitable Life to its policyholders since 2000.

1. Compromise scheme: non-GAR policyholders

The High Court sanctioned a compromise scheme (under s425 of the Companies Acts) in 2002. As part of the scheme we identified that policyholders could have potential claims against the Society relating to the guaranteed annuity rates (GARs) issue. In respect of non-GAR policyholders, the aggregate value of such potential claims was put at £850m. As part of the compromise, non-GAR policyholders gave up these potential GAR-related claims against the Society in exchange for uplifts in their policy values worth, in aggregate, £220m.

The compromise scheme covered all non-GAR policyholders with the Society at 8 February 2002 (with some minor exceptions). The value of the compensation accepted was below the estimated total value put on the potential claims to reflect various factors including litigation risk. Also, the Society's estimate of loss related to the guaranteed annuity rate issue only. Around 1 million people will have benefited from the uplifts in the compromise scheme referred to above. (A little under half that number will have been individual policyholders, the rest will have been beneficiaries under group pension schemes).

2. Compromise scheme: GAR policyholders

The compromise scheme also removed GAR policyholders' rights to GARs in exchange for uplifts in policy values. These rights (and the gross value of the related policy value uplifts) were valued in aggregate at £1.06 billion. There were around 90,000 GAR policyholders in this position.

3. Former non-GAR policyholders

Non-GAR policyholders who left the Society before the compromise scheme retained their potential claims against the Society. Many pursued their claims either directly, through the courts, or through the Financial Ombudsman's Service (FOS). We cannot disclose the actual cost of these because some are covered by confidentiality agreements, some are mixed with other sorts of claim and because of the different routes used. However, we published an estimate of the aggregate cost in 2002 at between £40m - £75m.

Former non-GAR policyholders who were 'late joiners' (after March 1998) were compensated on a relative basis which we published in 2002, or on a basis as adopted by FOS in 2005. Our basis limited the loss through a 'cap' because of the relevance of the GAR issue to the claim. For this scheme we invited holders of around 16,000 former non-GAR policies (the 'late joiners') to make claims. (This group is part of the aggregate cost estimate given above).

4. Former GAR policyholders

GAR policyholders who took benefits before the compromise scheme, but after the House of Lords' decision were normally able to take advantage of the valuable GARs in their policies. Consequently, we have not experienced many complaints regarding the benefits arising from this group.

Those who took benefits before the House of Lords ruling in July 2000 had the value of the GAR misstated by reason of the application of the differential bonus policy. However, we have reviewed all those cases (around 75,000) and where appropriate paid additional benefits. The cost of this compensation was a little over £100 million. We do not anticipate additional claims from this group.

5. Income drawdown (Managed Pension) review

In common with some other life companies the Society reviewed the suitability of a number of products including the Managed Pension (income drawdown) policies. Where an income drawdown policy was not found to be suitable appropriate compensation was offered. Although the suitability issue may not have related to the Society's financial position, if compensation was offered, it generally would have covered all losses. Around £45m was paid to policyholders or former policyholders through this scheme. The scheme covered all 20,000 policies.

October 2008

**Memorandum from The Equitable Members Action Group Limited (EMAG)
(EQL 04)**

INTRODUCTION

- 1 Equitable Members Action Group (EMAG) is the only substantial Equitable Life policyholder group, with a proper constitution, a money subscription and an elected Board of Directors. It has over 15,000 members.

We welcome the opportunity to give evidence to the Public Administration Select Committee on the prudential regulation of Equitable Life and the report of the Parliamentary Ombudsman ("the PO").

- 2 This memorandum draws attention to the financial costs of the compensation recommended by the PO in her report presented in July 2008. Most of the detailed computations have been prepared by Colin Slater FCA, partner in Burgess Hodgson, Chartered Accountants and a member of the Board of EMAG.
- 3 Colin Slater FCA with Paul Braithwaite (Secretary General and director of EMAG) and Ann Berry a with-profits annuitant will be giving oral evidence to the Select Committee.

EXECUTIVE SUMMARY

- 4 The Parliamentary Ombudsman (PO), made 10 findings of maladministration against the regulators amounting to 'serial regulatory failure' covering the period from 1991 to 2001. She recommended that compensation be based upon 'relative' losses incurred by comparison with investment 'elsewhere'. The PO made no estimate of the aggregate losses incurred or the cost to the public purse.
- 5 EMAG has undertaken such a comparison and estimates aggregate losses incurred by policyholders up to 2001 at about £4,800m. The basis of this calculation is the published results of the average competitor company; a similar calculation was undertaken by a firm of actuaries on behalf of the FSA in 2001 and arrived at nearly the same figure. We have added to this the costs incurred by policyholders in moving their funds elsewhere, increasing the losses to about £5,850m.
- 6 Many of the Parliamentary Ombudsman's findings refer to loss of opportunity. We have dealt with this in much the same way that the Courts deal with 'loss of a chance' cases. Effectively they apply a discount to allow for the possibility that the profit expected to derive from the chance might not have materialised.
- 7 We have also applied a discount for the fact that the Directors of Equitable Life were

primarily responsible. But the regulators allowed a problem with a small company with £5bn of assets to escalate over a decade to one with £30bn and more problems. Because they then adopted a tactic of cover-up and delay we have, on leading Counsel's advice, applied a small discount of 10%.

- 8 After discounts we estimate the loss for compensation at £3,316m and after adding interest to July 2008 the cost to the public purse becomes £4,666m. We stress that this is a simplified outline calculation derived from public information and using reasonable estimates. It could be improved and refined with access to Equitable Life and FSA information, which MPs could request.
- 9 It would greatly simplify and accelerate distribution if Parliament ordered that the aggregate amount of compensation, which it thought appropriate, should be paid to the proposed Compensation Tribunal. This would also cap that amount. That body would be under the control of Parliament and, if properly constituted, be responsible for effecting distribution amongst policyholders in a fair, transparent and speedy manner.
- 10 A claims system would be totally inappropriate. This would not recognise, those who have died, the age of the policyholders, their number and incidentally would lead to a windfall for professional advisers. Parliament could also arrange a simplified tax treatment
- 11 Lord Penrose found that 'principally, the Society was author of its own misfortunes'. However he also concluded that 'the standards of scrutiny [by the regulators] still impress me as complacent, lacking challenge, and hesitant in criticism and in following up on any criticism made', a view confirmed by the PO.

WHAT LOSSES DID POLICYHOLDERS INCUR AND HOW MUCH WILL COMPENSATION COST THE PUBLIC PURSE?

- 12 The PO's central recommendation regarding compensation is reproduced below:

9.27 My second – and central – recommendation is that the Government should establish and fund a compensation scheme, with a view to assessing the individual cases of those who have been affected by the events covered in this report and providing appropriate compensation.

9.28 The aim of such a scheme should be to put those people who have suffered a relative loss back into the position that they would have been in had maladministration not occurred.

9.29 I consider that addressing relative loss in this way would be the most appropriate remedy for the injustice that I have found resulted from maladministration. Such an approach would remedy any financial loss that has occurred and also the loss of

opportunities to invest elsewhere than the Society. It is thus not necessary to give further consideration to what additional remedy it would be appropriate to recommend to remedy the lost opportunities that have been sustained.'

- 13 It will be observed that the PO's recommended method is to compute 'relative' losses by comparison with investment 'elsewhere'. That is all she says on the matter. 'Elsewhere' may well mean a basket of competing policies. [For convenience, we refer to this as 'Elsewhere Life'] She regards the detailed computation as a matter for another day and for a different body, perhaps the proposed Compensation Tribunal.
- 14 The PO makes no estimate of the aggregate losses incurred or the cost to the public purse. EMAG addressed both these issues in its May 2008 submission to the PO, which is reproduced in her report and which is updated below in the light of her final report and her recommendations upon redress.

Investment Elsewhere

- 15 The published indications are that Elsewhere Life actually performed rather better than Equitable. Our information predominantly comes from Money Management. This is a widely read and respected trade magazine owned by the Financial Times. It performs twice yearly pension surveys and the results cover all the big players in the market, unfortunately excluding Equitable Life since its closure to new business.
- 16 The table on Appendix A shows the performance of £10,000 investments in Money Management's average fund at the beginning of each of the years 1990 to 2000 inclusive. Maturity is assumed at the beginning of each of the years 2000 to 2002. It also shows the results of a comparable Equitable Life policy and the relative loss for each year of investment and maturity.
- 17 The results for early 2000 maturities are significant in that the Equitable Life figures include the 1999 bonus, the last one before bonuses were distorted by the attempts to restore the position. Even then, the Society's past performance record was below the market average by about 1% p.a. compound. Its subsequent performance has been horrendous. Terminal bonuses were virtually eliminated by the 16% policy value cut of July 2001, which was back-dated to 31 December 2000, and the two smaller cuts (4% and 6%) in 2002.
- 18 The table below combines the relative losses shown at Jan/July 2001 per £10,000 of premium with our estimate of premiums remaining in force at that date and quantifies the aggregate loss at about £4,800m. [Column C = Column A x Column B/10,000]

Investment	Remaining Premiu m	Total Value £m	Losses to Jan- 01 per £10k premiu m	Loss from Jul 1991 £m	Loss from 1993 £m	Loss from 1988 £m
	A		B	C		
pre 1990	N/A	4,641				550
1991	470	1,154	8,692	204		408
1992	656	1,456	7,517	493		493
1993	868	1,733	6,254	543		543
1994	1,016	1,825	5,647	574	574	574
1995	1,406	2,302	4,782	672	672	672
1996	1,913	2,855	4,080	780	780	780
1997	2,437	3,274	2,548	621	621	621
1998	2,649	3,200	1,746	463	463	463
1999	2,581	2,819	1,120	289	289	289
2000	2,108	2,142	768	162	162	162
	<u>16,105</u>	<u>27,401</u>		<u>4,801</u>	<u>3,561</u>	<u>5,556</u>

- 19 Examination of the July 2001 chronology contained in the PO's Report reveals that the FSA itself commissioned a report from a firm of actuaries on the cost of the GAR claims. This was similarly based upon the assumption of investment in 'Elsewhere Life' in respect of premiums paid from 1988. The actuaries' report has not been reproduced, but the compensation figures it arrived at were quoted.

23/07/2001 [17:54] The Head of Actuarial Support says that 'If they [Equitable Life] are likely to incur mis-selling claims on all post-1993 policies, then the liability could be around £3-4 billion.... If the potential claims extend back to 1988 or even earlier, then the situation is clearly even worse.'

25/07/2001 [entry 8] FSA's Chairman told the Tripartite Standing Committee of the Treasury, the Bank of England and the FSA 'that something between £3[bn] and £5bn would [be needed to] make [Equitable] solvent.

- 20 The amounts for the post 1993 and post 1988 periods, using our estimates, are shown in the right hand columns and are compatible with those of the FSA's actuaries. Their report is referred to as having been dated 13 July 2001, 17/07/2001 [entry 3].

- 21 In EMAG's view, this is an important contemporaneous document, which the FSA should now publish for the guidance of Members of Parliament, policyholders and the

proposed Compensation Tribunal.

- 22 At this stage the Committee might reasonably ask how it was, if Equitable Life was paying bonuses that were too high, that its performance was worse than that of competitor companies. The answer is complex:
- a) Other companies either did not suffer the GAR problem, or suffered it in a much less extreme form than Equitable Life.
 - b) Over-bonusing related primarily to premiums paid before 1991, when the PO found that mal-administration commenced. Premiums paid after that time suffered because the Society tried to recover previous excesses from their bonuses. GAD's 1998 report on the life insurance industry noted a sharp fall in payouts over the 5 years then ended. [Chronology Page 404]
 - c) Competitors with stronger funds were able to invest more heavily in equities, which performed well.

Loss Mitigation Costs

- 23 The losses relative to investment in Elsewhere Life are calculated above upon the assumption of contractual departure in both cases. In practice, however, during the period from 2001 to 2004 something over half of policyholders by value moved their funds elsewhere and those that could not do so upon a contractual maturity date also suffered departure penalties. These took the form of Market Value Adjustments and deduction of the balance of the policy value cuts which could not be dealt with out of terminal bonuses. Many also incurred charges for re-investment in Elsewhere Life.
- 24 The vast majority of non-contractual leavers did not go for reasons of personal choice, for example because they were retiring or needed the cash for children's education or for moving house. They left to protect themselves from yet more financial pain to come. They took the view that such pain would be more costly than the various departure penalties. The Parliamentary Ombudsman's finding of serial regulatory failure strongly justifies their action.
- 25 Complainants have a legal duty to mitigate (minimise) their future losses and the costs of that mitigation are treated as part of the total loss, which is eligible for compensation.
- 26 Without access to the details of actual departures we cannot determine the precise cost to policyholders, but we would mention that:
- a) Over half the fund, perhaps £13,000m, was lost to departures over the 2001-2004 period.
 - b) About 45% of such departures (say) £5,800m are expected to have been non-contractual and have suffered the balance of the July cut and market value adjustments.
 - c) Most such monies would have suffered charges for re-investment elsewhere.

We estimate the aggregate of loss mitigation costs to have been of the order of £1,050m.

Loss of Opportunity

- 27 Many of the Parliamentary Ombudsman's findings refer to loss of opportunity. In particular the PO considers that the maladministration of allowing misleading returns to have been published lost policyholders the opportunity to have invested elsewhere. In short, if policyholders, advisers and commentators had known the true weakness of Equitable Life's finances, then a large proportion of subsequent premiums and in some cases the existing fund would have been invested elsewhere.
- 28 We understand that the PO intends 'loss of opportunity' to be interpreted in much the same way that the Courts deal with 'loss of a chance' cases. Effectively they apply a discount to allow for the possibility that the profit expected to derive from the chance or opportunity might not have actually materialised. In this case the factors affecting the expected profit are:
- a) Whether policyholders, had they known the true state of Equitable Life's finances would have actually taken the opportunity to invest elsewhere.
 - b) The possibility that the alternative investment could have performed worse.
- 29 Estimating the discount is by no means an exact science. Detailed examination of a sample of individual cases would be one approach to arriving at an estimate. Indeed the PO attempted such an approach by looking at the percentage of cases dealt with by the Financial Ombudsman Service which generated a loss. In the two samples she looked at 60% and 78% were found to have suffered a relative loss.
- 30 Although EMAG in no way accepts the FOS's methodology, this research supports our view that about 70% of cases would have taken the opportunity to invest elsewhere, indicating an appropriate discount of 30%. We have applied a further 7% discount to allow for the possibility of Elsewhere Life performing more badly.

The Public Purse / Regulatory Contribution

- 31 PO recognised the magnitude of the scale of compensation, which she recommended, but left it to Parliament to decide how to deal with it.

'9.37 I recognise that the public interest is a relevant consideration and that it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case.

9.38 Furthermore, I am acutely conscious of the potential scale of what I have recommended and that acceptance of my central recommendation might entail opportunity costs elsewhere through the diversion of resources.

9.39 In that context, I invite Parliament to consider the issues that have been raised in this

report and the recommendations that I have made and to further reflect on what its response to my report should be.’

- 32 EMAG is advised that in cases of maladministration it is traditional for those found guilty to meet the whole cost of the loss, even though others were partly responsible. However, in a case such as that of Equitable Life where the amounts are very substantial indeed and where the primary responsibility for the Society’s demise rested with its directors, the matter of whether it is reasonable for the public purse to bear the whole cost does need to be considered.
- 33 Lord Penrose demonstrated that in the early 1990s the directors voted bonuses substantially out of proportion to the Society’s profits and assets. This was done in order to maintain the Society’s marketing advantage. The responsibility for this must lie primarily with the directors. It must, however, also be pointed out that at this stage the Society was relatively small in size and with total funds of about £5 billion.
- 34 The financial weakness that excess bonuses created made it difficult for the Society to show the necessary degree of financial strength on its regulatory returns. The PO has found that the regulators were mal-administrative in failing to identify the devices used to conceal that weakness from public knowledge. This failure was not just an isolated incident, but as the PO’s report shows, continued for a decade.
- 35 The initial regulatory failure enabled the Society to carry on expanding its with profit business based upon imprudent bonuses and a fictitious marketing track record. The regulators carried on failing to deal properly with the Society’s Returns in the following years, during which time its size expanded six fold from £5 billion to £30 billion. During this time it drew in 500,000 individual and one million group investors, mostly people saving for their retirement.
- 36 The regulators cannot reasonably claim that they didn’t know what was going on. Both Lord Penrose and the PO demonstrate that they were well aware that bonuses were too high and the Society had insufficient assets to support them. They had opportunity after opportunity to take a stronger line but failed to do so. In EMAG’s view, the Treasury and the FSA’s approval of the worthless financial reinsurance contract as an asset valued at £800 - £1,000 million amounted to connivance with Equitable Life to cover up its appalling financial state.
- 37 In EMAG’s view, supported by Counsel, the thousands of millions of pounds involved, the time over which the fault was allowed to continue, their connivance with the cover up and subsequent delaying action require that the regulators should bear a heavy percentage of the blame and an appropriate discount is 10%.

Interest

- 38 The PO in her publication ‘Principles for Remedy’ requires simple interest to be added at

a reasonable rate to the date of payment. EMAG believes that because of the nature of the loss, the amounts involved and the long Treasury inspired delay, compound interest would be more appropriate. We suggest a rate of 5%.

Computation of Loss and Cost to the Public Purse

39 Below is our outline computation of the losses incurred and the cost to the public purse:

		£m
Relative Loss		4,800
Loss Mitigation Costs		1,050
Policyholders losses to 2001		<u>5,850</u>
Less: Discount for those who would not have invested in / moved to another provider, even if they had known Equitable Life's true state and for the chance that the alternative provider could have done even more badly	37%	<u>2,165</u>
		3,685
Less: Discount for the fact that Roy Ranson and the Directors were primarily responsible. However the regulators allowed a problem with a small company to escalate six-fold over a decade, then adopted cover-up and delay.	10%	369
		<u>3,316</u>
Compound Interest at say 5%	7 years	<u>1,350</u>
Cost to the Public Purse		<u><u>4,666</u></u>

40 Interest should continue to accrue until payment. Administration and distribution costs should be borne by the Treasury, not the compensation fund. 90% of Equitable Life's business related to pensions. In due course such compensation will manifest itself as additional pension income, from which the public purse will recover income tax, and save tax credit payments to those policyholders who would otherwise be in poverty.

41 We stress that this is a simplified outline. There are special cases, particularly those of late contributors and with profit annuitants, which require investigation. They represent about 13% and 14% of 2001 policy values respectively. Furthermore it is derived from public information and using reasonable estimates. It could undoubtedly be improved and refined with access to Equitable Life and FSA information, which MPs could request to be made available.

Distribution - 'NO CLAIMS' Basis

42 It would greatly simplify and accelerate distribution if Parliament ordered that the

aggregate amount of compensation, which it thought appropriate, should be paid to the proposed Compensation Tribunal. This would be a fixed sum which would then not balloon out of control. The tribunal would then be responsible for effecting distribution amongst policyholders. The cost of the exercise would be borne by the Treasury.

- 43 The categorisation and calculation of policyholders and the amounts payable to each could be done based upon the information existing on Equitable Life's computers. In view of the substantial age of the individuals, the fact that many have died, and the long delays that have already occurred, it would be quite wrong to require policyholders to submit claims. Most would be unable to complete a claim form document and would have to employ financial consultants. We do not want this exercise to present a windfall for such advisers and unduly prolong the payment of compensation.

Recipients and Tax

- 44 As regards compensation payments in cash to individuals or their beneficiaries, we recommend that some notional tax be deducted on an average basis and that the resulting compensation be made tax free. Elderly and much wronged Equitable Life policyholders should not be burdened with future battles with HM Revenue & Customs.

LORD PENROSE AND THE PARLIAMENTARY OMBUDSMAN

- 45 Lord Penrose, whose report was published in 2004, found that 'principally, the Society was author of its own misfortunes'. However he also concluded that 'the standards of scrutiny [by the regulators] still impress me as complacent, lacking challenge, and hesitant in criticism and in following up on any criticism made'. In short, he reported that the regulators knew what was going on, but took no effective action.
- 46 The PO's function was very different from that of Lord Penrose. Her job was to scrutinise the activities of the regulators, decide whether they were guilty of maladministration, to decide whether this maladministration led to injustice and to recommend redress. Her focus was on the regulators, whereas Lord Penrose's was mostly on the directors. One area of common interest was Equitable Life's use and the regulators condoning of 'practices of dubious actuarial merit'. Given the differences in objective, scope and focus between the two investigations, we find them to be remarkably compatible.

November 2008

Appendix A – to follow

Memorandum from Equitable life Trapped Annuitants (ELTA) (EQL 05)

1) Executive Summary

- 1) The purpose of compulsory annuity purchase is to require individuals to secure a safe and reliable income for retirement when, crucially, they will be unable to supplement their income from alternative sources. Since this is a key statutory requirement that an individual **MUST** buy an annuity, it follows that the regulating authorities have an ***absolute*** obligation to ensure that the products offered on the market can meet that statutory objective. Any failure to do so must inevitably result in a justified claim for mal-administration.
- 2) The With-Profits annuity (“WPA”) was a particularly complex financial product, poorly understood by the annuitants who purchased it and many of Equitable’s representatives who sold it. It was predicated on the belief that the Equitable Life Assurance Society was a properly regulated, blue chip, institution of sound financial standing. Annuitants would not have purchased the product had they believed otherwise. More than any other product the Equitable’s finances were key. Without its apparent financial strength, the product could not have been sold.
- 3) Three core issues differentiate with-profits annuitants:
 - a. Their inability to surrender the policy or transfer it to another provider;
 - b. The importance of the purchase in the context of providing a safe and reliable income, when the individual’s abilities to find replacement income were increasingly remote; and
 - c. The increase of their losses as they get older because of the central role of the increasing, but un-guaranteed terminal bonus that was required to maintain their retirement income.
- 4) The WPA was deeply flawed as a source of retirement income. Probably it could never have delivered what it promised. The risk annuitants were invited to accept was the risk of the market, hedged by Equitable’s (allegedly) superior financial management and adequate reserves to support a smoothing policy. In fact there were no reserves to cover terminal bonus policy, no smoothing policy and Equitable was managed incompetently. The ever-increasing gap between the “guaranteed” annuity and the total annuity was not covered by

reserves, nor did it feature as a liability in the accounts and statutory returns. It could therefore only be met either by an ever increasing sales effort, so that new investments were required to meet the obligations of the old, or, as occurred from November 2002, by not paying it. In effect, Equitable created a pyramid scheme.

- 5) There was a significant failure of regulation. It was the responsibility of the regulator to ensure that the products on the market were in fact capable of delivering what they were offering, since annuitants are reliant on the regulator to carry out the sort of tests that lie beyond the competence of the general public.
- 6) The Ombudsman's three critical findings that the information on financial standing was incomplete, that liabilities were understated, and that the solvency position was not appropriately verified leading to a misleading picture of the financial health of Equitable, mean that the clear injustice sustained by With-Profits Annuitants was the purchase of a product, which, **without this mal-administration**, they would not have purchased.

2) Introduction

I was an Equitable with profits annuitant.

I have been **involved in this matter for 5 years**. I developed the original computer model, which disclosed to the public for the first time the characteristics of the WPA, its features, limitations and risk factors.

I established ELTA (Equitable Life Trapped Annuitants), which has some 2,500 policyholders and subsequently became the Chairman of ECL (ELTA Claims Ltd), a single purpose company established to manage the recent litigation against Equitable Life on behalf of some 400 annuitants and in conjunction with Clarke Willmott (CW) acting for the plaintiffs.

The model has been substantially enhanced as a result of the recent litigation, as a consequence of which I have discussed, argued, pondered and considered it from every angle imaginable with considerable input from fellow directors of ECL, many With-Profits Annuitants, lawyers, leading QCs and actuaries. Arguably I, and Paul Chapman (of CW) are probably the most knowledgeable (non-actuarial) people there are on the subject of WPAs.

Broadly speaking the actuarial experts to the litigation on both sides were in agreement as to the mechanism of the WPA and nobody, so far as I am aware,

has disputed the arithmetic basis of the model that I developed and on which this analysis is based.

Further, both sides broadly accepted the actuarial calculations that established the quantum of losses for the plaintiffs, though some of the numbers, such as future discount and bonus rates were not. These would have been resolved at trial although, as is well known, a settlement was reached between the two parties prior to the court hearing on confidential terms. It is on the basis of those quantum calculations that we have estimated the losses for With-Profits Annuitants illustrated in Section 6.

Outside of Equitable Life, probably nobody else has that expertise and these issues affect directly not only how With-Profits Annuitants should be compensated but, more importantly, the quantum of any compensation.

9 3) Annuity Basics

Ordinarily, pension annuities are purchased between the ages of 50 and 75. Broadly, it is compulsory to use the pension funds to purchase an annuity. Self evidently, as individuals get older, their earning capacity diminishes. Therefore, the purpose of compulsory annuity purchase is to require individuals to secure a safe and reliable income for retirement when, crucially, they will be unable to supplement their income from alternative sources.

It may be stating the obvious, but since it is a key statutory requirement that an individual **MUST** buy an annuity, it follows that the regulating authorities have an ***absolute*** obligation to ensure that the products offered on the market can meet that statutory objective. Any failure to do so must inevitably result in a justified claim for mal-administration.

It is not widely appreciated that a life company writing a conventional non-profit annuity calculates with the aid of its actuaries, etc, the size of “the fund” based on its forecast for likely investment returns and the personal characteristics of the annuitant, (sex, age, social class, education, geography, etc). When an annuitant gives a lump sum, the consideration money, to the Society, in effect what the Society does, is perform a calculation whereby the money is invested in a spread of products, Equities, Gilts, etc, makes a judgement of future returns over the lifetime of the annuitant, deducts expenses, profits and sets aside a small reserve, and converts the remainder (“the fund”) into a series of payments. This is true whether the annuity is a level, RPI linked, or escalating at a fixed rate. The consequence is that the same amount of money from “the fund” will be distributed, just in different ways.

So, irrespective of what type of annuity chosen, the total amount of money received in annuity payments will be more or less exactly the same. All that happens is that the payments are staged differently over time. In theory, if the starting conditions remained the same throughout the duration of the annuity and the annuitant died exactly as forecast in the actuarial life tables then, on the day the annuitant died, “the fund” would become zero.

Obviously if an annuitant dies early, the life company makes a “profit” and if the annuitant lives longer than planned then the life company makes a “loss”. If the provider gets it right, the losses are matched by the profits. And of course, starting conditions do NOT remain the same.

However, in the case of fixed escalating or RPI-Linked Annuities the starting income for the annuity is substantially lower than the benchmark annuity—the fixed level annuity. This was a major marketing deterrent, which the Equitable WPA was designed to overcome. The WPA at its inception provided an income equal to, or in some cases, above the fixed level annuity. This feature, plus the “promise” of additional growth, made them a very attractive product for potential annuitants. It achieved this by allowing the annuitant to anticipate future growth, so that effectively receiving tomorrow’s bonus today. This exercise, however, was dependent on the Equitable having a culture of sound management and adequate reserves, so that it could withstand dips in the investment market without reducing the annuity income. (Without that, it was doomed to failure and at some point drastic drops in the payments received, but with no chance that the annuitant could surrender the contract.)

Annuitants understand that if you invest in a product that relies on investment to produce growth, then your returns will be dependent in part at least on the markets, be they investment in Equities, Gilts, Cash, Property, or any other investment mechanism. What they could not understand was the “provider risk” represented by the finances of Equitable itself, rather than the markets.

Every annuity type involves some form of risk judgement that the annuitant has to make:-

- With a Fixed Level Annuity, the risk relates to inflation. Even a modest 3.5% rate of inflation means that your money more or less halves in value over 20 years, a relatively short time-span in today's world, where people retire at 55 and hope to live well into their 80's.
- With an Escalating Annuity, growing at some fixed rate, then the annuity starts low, but steadily increases so that late on in the annuity the payments are very high. In this case, the risk relates to your longevity.

- With an Index Linked Annuity, the risk relates to the future performance of that index, as well as longevity for the same reasons above.
- With a with-profits annuity the risk relates not only to the markets, but also to the “provider risk” that the life company will not, or will not be able to, declare bonus. In Equitable's case, the “provider risk” was extreme, but hidden by the regulatory mal-administration, which took place.

The pension provider has a statutory obligation to ensure that it has set aside and reserved funds in its balance sheets to meet future guaranteed obligations. But a with-profits annuity does not have to be covered in full by reserves, as a proportion (and, as demonstrated below, an increasing proportion) of the income is not guaranteed.

This is the fundamental difference between the various types of conventional annuities and With-Profits Annuities.

4) The ELAS With-Profits Annuities

The Equitable WPA was a very complex product, inadequately described in the product literature. The literature made the calculations of the annuity payment inaccessible to the annuitant.

Essentially, the Total Annuity, that is the amount paid, is calculated as a function of the Anticipated Bonus Rate (ABR), chosen by the annuitant at the outset of the contract and the Overall Rate of Return (ORR) declared by the Equitable each year. In effect, in order to choose the ABR the annuitant was asked to guess the average rate of return likely to be achieved by the Equitable over the lifetime of the annuity, maybe 20 to 25 years in the future, this without any actuarial assistance that might have helped.

As a result, in making this judgement as to ABR, the annuitant was heavily dependent on the advice of the salesman and the reputation of Equitable. The Ombudsman has found that Equitable’s public image was distorted through the rating agencies due to the misleading picture from its returns. Equitable’s management failed to inform its sales force as to its risk, and belittled such criticisms as there were from independent financial advisers, on the grounds that such adverse opinions were commission based. So the public had a misleading impression of the “provider risk” represented by Equitable. Consequently the choice of ABR, as well as the choice of a WPA in the first place, was informed by an inadequate appreciation of the risk.

(In my case, I chose a rate of 7% being approximately half of the “average” growth in the stock market over the previous 15 to 20 years. It seemed a cautious

number at the time and indeed in general Insurance and Pension funds have consistently exceeded that number. But I was unaware of the way the annuity really worked, and the true state of Equitable's finances.)

The way it works

Simply put, if in any one year the ORR was greater than the ABR, the pension, the Total Annuity, went up, or, conversely, if the ORR was less than the ABR, it went down.

However, the Guaranteed Part of the annuity was calculated as a function of the ABR and the Declared Bonus Rate ("DBR"), which was selected each year by the Equitable. As with the Total Annuity, if the DBR was greater than the ABR, the guaranteed part of the annuity went up and if not then it went down.

The difference between the Guaranteed Part of the annuity and the Total Annuity is called the Final Bonus Annuity. The Equitable Life literature describes the Final Bonus Annuity totally inadequately. There are various formulations. One of which is as follows,

"A final (non-guaranteed) bonus may be added and that will bring the actual level of annuity payable for the year up to that determined by the overall rate of return, after allowing for the anticipated return"

This is a critical statement since it suggests the following about the Final Bonus Annuity that it is:

- a) An insignificant part of the annuity; and
- b) "added" to the guaranteed part.

The first statement is misleading to say the least and the second statement is simply not true.

Chart 1 below, illustrates what was expected to happen to my Total Annuity payments, though at the time, February 1997, I did not understand the significance of the Final Bonus Annuity. This model assumes the basic starting conditions apply throughout the first 20 years of the lifetime of the annuity.

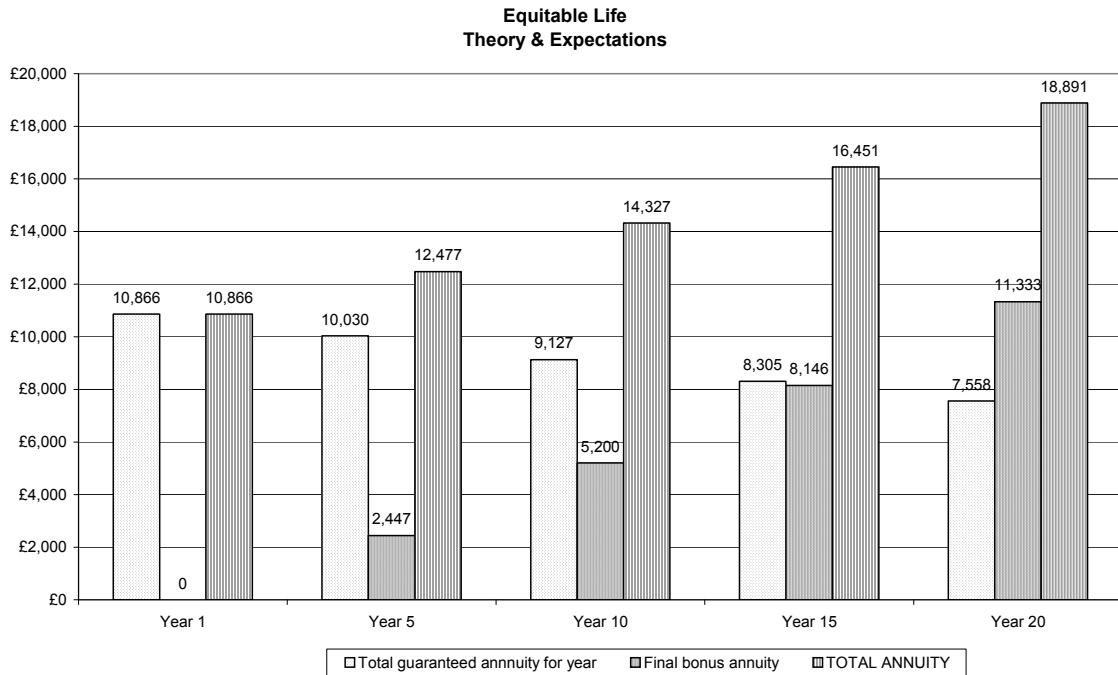


CHART 1

As can be seen:

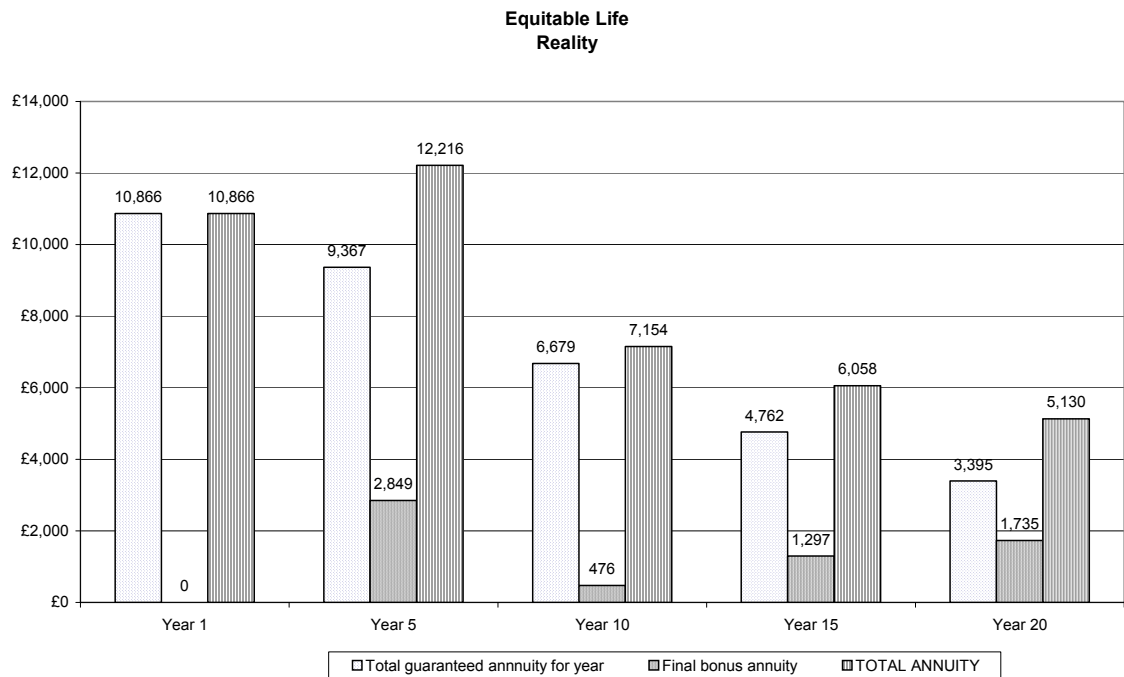
- a) The Total Annuity steadily increases
- b) BUT the guaranteed part of the annuity payment steadily decreases
- c) The Final Bonus Annuity, **the part that is NOT guaranteed**, steadily increases so that by year 15 (in my case 2012) it represents approx 50% of the annuity and by year 20, it represents approx 60% of the annuity!

Bear in mind that it is this part of the annuity that we NOW know can be removed by the Equitable at any time it chooses. The first time that was fully understood by the annuitants was when Equitable actually removed the Final Bonus Annuity in November 2002.

It begs the question, would any annuitant have bought such a risky product that truly understood this point?

Chart 2 sets out what would have happened to my annuity and the potentially disastrous consequences to my income. (As it happens I have other annuities so the effect on me would have been less than it might have been but others that I know personally were entirely reliant on the annuity income from Equitable Life.)

CHART 2



BUT shocking though these figures and statements are, they do not represent the real scandal, which arises out of the true state of Equitable’s with-profits fund.

A) The purchase price of a WPA goes into the global with profits fund. This was represented in the product literature as a sort of unit trust with gilts, property, equities and cash investment. Doubtless the actuaries calculated how much they needed to invest to cover the guaranteed part of the annuity, and bought gilts to match. But the guaranteed part declines every year. As to the rest of the income, it came from bonuses awarded on the with-profits fund. There were other calls on this. In particular the with-profits annuitants were in competition with investing policyholders for bonus, and with all the other insurance obligations of an insurer, management expenses, etc. In fact, although presented as investing in a diversified fund, the with-profits annuitant was investing in one company. We know, from Equitable’s own proceedings against its old board and from the decision of the Disciplinary Tribunal of the Institute of Actuaries, as well as from The Ombudsman, Equitable was an incompetently managed company. Its with-profits fund was therefore the capital base of an incompetently run company. On this annuitants

were supposed to rely for the rest of their lives, without any hope of being able to switch out once the incompetence became exposed.

B) But we NOW know that a substantial part of the total annuity payment was not guaranteed, and had to be earned afresh each year. In the case of WPAs the Equitable ONLY needs to set aside and reserve for future “guaranteed” payments, or approximately half the income that they are expecting. The money that in the case of other annuities would have to be put aside in reserves can now be used for pay higher bonuses on other policies or for any other purpose designated by the board of directors of the Equitable.

It therefore follows that over time the WPA either must decline in value in absolute terms, or be subsidised from new business or other policyholders’ funds.

This has the major components of a pyramid scheme.

Without realising the With-Profits Annuitant had exchanged the certainty of a guaranteed income for the illusion of an annuity that in reality could not deliver a higher income but certainly exposed the annuitant to what is very high risk investment, quite unsuited to the requirement of establishing a future reliable pension income. And of course, ultimately that same money was used to meet the obligations of the Society to its investors at the expense of the future security of the With-Profits Annuitants.

For other annuity types, Equitable was obliged to reserve for all future payments which as has been said would have been broadly the same over the full lifetime of the annuity. But Equitable did **NOT** do this for the With-Profits Annuity, save for the “guaranteed part”, which released the income it was STILL expecting to be used for other purposes as stated above.

This explains the phrase by the board of Equitable Life, that the With-Profits Annuity was “technically efficient” since it was able to use the “income” derived from the consideration money of the annuitants for purposes other than was their intention, understanding or consent.

The WPA was deeply flawed for many reasons and arguably could never have delivered what it promised. Annuitants were being invited to “take a risk” in the market, which arguably policyholders might have understood, but were also exposed to the provider risk - the financial status of “the Society” - which clearly they could never have understood. It was a risk posed by an incompetently run life assurance company. That exposure increased as time went by, not just because the Equitable was becoming more and more precarious, but also

because an ever increasing amount of the total annuity was “not guaranteed”, and could be, and indeed was, removed.

It is clear that it was the responsibility of the regulator to ensure that the products on the market were in fact capable of delivering what they were offering, since annuitants were reliant on the regulator to carry out the sort of tests that the above logic requires, and which lie quite beyond the competence of the general public.

In summary, the Equitable WPA was quite unsuitable for the consumer trying to create a lifetime’s income so as not to become dependent on the state—the whole objective of the “compulsory purchase” requirement. In light of Equitable’s finances and approach, this product should never have been allowed or offered to the market place.

5) With Profits Annuitants

The people that ELTA represents are uniquely different from other policyholders. All are retired, with an average age in the mid 70’s, some relative youngsters, active both physically and mentally, and others reaching the end of their lives with all the associated problems of memory and physical, and intellectual frailty that comes with the ageing process.

Two illustrations tell the story. An annuitant phoned up to advise me of his new address. When asked what it was, there was silence and he said, sadly, “I have forgotten, I will go and check!” Another annuitant phoned me and said he was sorry for not doing more but he already had one leg amputated, was going into hospital for a tumour and in all probability would need his other leg amputated as well! These are the people who need our active support and assistance.

We see the world differently from others. Within broad constraints, we know our income for the rest of our lives. It is fixed, or at best inflation linked. We have no future job prospects, no promotions in sight, no career moves, just the same income year in and year out. Accordingly, pensioners become very conservative about costs and budget very carefully to ensure that their expenses and incomes remain in balance. We live within our means, so if our income changes radically, as in the case of our Equitable WPAs, this poses some very real problems.

And it makes no difference whether we have a large or small annuity: that money forms part of our plans for our lifestyle and once it is removed then we have lost out with no opportunity to recover the situation.

We also come from a generation that reached political awareness at the end of the pre-war depression, survived the war, or grew up in the years of austerity

following 1945. We learnt to survive, so whilst our incomes have been reduced and many have had to sell their properties in order to create funds to meet their liabilities, most of us just “tighten our belts”, travel less and reduce our non-essential spending. Others rely on their families or the various income support schemes available to UK citizens from Social Services. This was NOT our objective when we spent our lives saving money so that we could live more comfortably without money worries during our retirement when at last we would have the time to simply spend more time with our families, or to explore new horizons, be they intellectual, travel or cultural.

I have already made clear that we, the with-profits annuitants, are different from all other classes of policyholders because:

1. Our income is already significantly reduced and it looks as if such reductions will continue for the rest of the annuitants’ lives. The transfer of the With-Profits Annuitants to The Prudential does NOT negate this statement
2. With-profits annuitants (WPAs) believed they were buying an annuity that would increase at least broadly in line with inflation. This was the advice of the Equitable’s tied representatives. Whilst we all understood there would be temporary variances from time to time as a function of the financial markets, it was never explained that nearly 50% of our annuity would NOT be guaranteed and could, and indeed has, been removed by the Equitable in order, we believe, to meet its obligations to other policyholders, who of course can take their investments elsewhere.

I quote from an e-mail that I received recently. *“Just to reinforce the point I met a friend recently who had his money invested with ELAS and he eventually withdrew it (£850K) less 16% and stuck the money into a risk free high interest account. After 3 years he has now recovered his capital and is a relieved and happy bunny.”*

These policies were presented as being as secure as the so-called Blue Chip investments by a financial institution that had the highest reputation for probity in the UK and whose clients included many workers in state industries and service providers, civil servants and indeed MP’s.

6) Loss and Quantum Calculations

This is obviously a complex area and I am reliant on advice offered by Clarke Willmott and the actuaries that acted for the group of annuitants in the recent

litigation. These numbers are not set in concrete, but whilst they may seem high, it is likely now that they could be higher.

A) Loss Calculations

Clearly there are Equitable Life policyholders who have suffered no financial loss during the relevant period. Conventional annuitants, who have been transferred to Canada Life, generally received competitive annuity rates and have not suffered cuts in their income as a result of the financial difficulties. Again, policyholders that invested and left the company before the policy cuts in July 2001 are normally unaffected.

Other policyholders have generally sustained some financial loss. Ordinarily, in respect of most policyholders, their loss can be calculated by comparing their original investment, together with a notional investment return against the surrender value of their policy proceeds, plus interest from the surrender date. Accordingly, for instance, if an individual invested £100,000 in 1997, it could perhaps have been expected to realise a 4.5% compound return after tax. By 2002, it could therefore be expected to have reached a value of say £125,000. That policy may instead have had a value of £90,000 with a resulting loss of £35,000. The variables and assumptions are relatively finite and it is relatively straightforward to determine assumptions. Each individual had the option to crystallise any loss by surrendering or transferring the policy (or otherwise made a conscious decision to leave the policy with Equitable).

The actual amounts invested and on surrender or transfer are clearly capable of being ascertained. The only issue is the alternative investment return, which would have been obtained.

In respect of With-Profits Annuitants, the position is more complicated. As stated above, but for the mal-administration, there can be no question that these policyholders would not have purchased this product. This is a situation where Equitable's financial standing was absolutely key to their decision.

Most individuals had reached the point where they had decided to retire and call upon their pension funds. As stated, it was compulsory for them to do so between the ages of 50 and 75. By far the most frequent decision in those circumstances is to purchase an annuity. Ordinarily people purchase level annuities. The advantage of such a purchase is that it maximises the starting income. The disadvantage is that it does not provide any safeguard against inflation. In order to provide some protection against inflation, the alternative conventional choices are

either fixed escalating annuities, or RPI-linked annuities. The starting level of the annuity and their views in respect of inflation most frequently influenced individual decisions in the choice of annuity.

My experience when a cross-section of Equitable annuitants were supplied with the starting levels of the alternatives and asked to consider the alternative product they would have purchased is that – 57% would have chosen a level; 23% a 3% escalating annuity; 8% a 5% escalating annuity; and 12% an RPI-linked annuity.

The importance of the choice is that it is a key variable in establishing the financial loss that has been suffered. It is only when the alternative transaction is known that a quantification of loss can be made. The income from the WPA to date should be capable of being ascertained. (See below regarding future income.) This must be compared to the income from the alternative transaction.

The starting point is the starting level of that annuity. That will depend upon a number of factors – the annuitant's age at purchase; his spouse's age; any spousal benefits; the frequency of the annuity and whether its in arrears or in advance; any guarantee period; and of course, the purchase price.

In addition, going forward, the likely income under the alternative annuity will depend upon whether the annuitant and/or his spouse is still alive, the spousal annuity, any guarantee period, the mortality assumptions based on the relevant current tables and the individuals' current ages and, of course, the nature of the alternative annuity (level, escalating, etc.).

Against that amount must be offset the income received to date under the WPA and the anticipated income going forward. Again this will be dependent upon the same factors as above, but also crucially the exact current make-up of the constituent parts of the WPA, the assumed bonus rate of the annuity (and any guaranteed investment return) and assumptions in respect of future bonus rates. The constituent parts are the underlying annuity, declared bonus annuity and final bonus annuity referred to above – together with the notional annuity (which is a figure in the calculations, if there is no final bonus, and the current level of the annuity is dependent upon being maintained by the current underlying annuity and declared bonus annuity).

The assumptions on future bonus rates are not only the overall rate of return, but also the declared bonus rate and interim bonus rate. The calculations are then dependent upon the exact anniversary in

comparison to the date when bonuses are normally awarded. In reality, there will be no declared bonus going forward and the overall rate of return and interim rate of return figures can be assumed to be the same.

The transfer to the Prudential is no saviour for the With-Profits Annuitants. Future overall rates of return were considered unlikely to exceed 5% per annum, despite the greater investment freedom following transfer to the Prudential and the limited provisions for support from the other Prudential funds on solvency. The reality however is likely to be far worse. WPAs have already been cut very severely below the levels of the alternative guaranteed annuities, which would have been chosen if the Equitable's financial standing had not been misrepresented.

B) Quantum Calculations

Based on the Equitable's 2006 press releases concerning the transfer of with-profits annuities to the Prudential, I believe that there were then about 62,000 policies transferred. There were about 400,000 policyholders in total so it follows that with-profits annuitants represented about 15% or less of the policyholder body. The press releases said they got assets representing 20% of the fund.

From this it is possible to infer that with-profits policyholders:

- i. On average had a bigger share of the fund than the investing policyholder, and
- ii. That with-profits annuitants are a very small proportion of the policyholder body as a whole.

I calculate that the total loss figure for the with-profits annuitants amounts to £6.287 billion (on a net basis) a figure reached by multiplying 62,000 by an annuitant's average loss figure as calculated by the claimants' actuary. (This calculation is based on the actuary's loss figures. I stress that the settlement terms are the subject of a confidentiality agreement reached at Equitable's request and acceded to by us so as to bring an early conclusion to the litigation.) Of course, this also depends on the litigants being representative of the general with-profits annuitant population. However, in light of the spread of dates and amounts, this seems to be reasonably likely.

(It might be assumed that the actual settlement figure following the litigation and which is confidential can be derived from the data in the preceding paragraph. But as the above calculations contain factors that are NOT described, that is NOT possible.)

Furthermore there is a strong argument that future bonus rates will need to be revisited in light of recent events in the financial markets. The loss figure was based on a future bonus rate of 4.5%; I am advised that currently Clarke Willmott and the actuary are considering a more likely outcome because of significant equity falls and the timing of the likely equity purchase following transfer to the Prudential to be 0% until 2014, and 4.5% thereafter.

7) Financial Redress

There are many possible methods by which the With Profits Annuitants might be compensated. Most of these ideas were developed on the work done for the 400 claimants, but it must be recognised that dealing with 62,000 policies would be an enormous undertaking involving a great deal of cost and long delays before payment. For example, the actuary administering the settlement in the recent litigation required 4 man months work for 400 annuitants, which is the equivalent of 620 man months, or approx 51 man years of actuarial effort for a community of 62,000 with-profits annuitants. However, given the age profile of most with-profits annuitants, it is essential that speed is of the essence and if that means a simpler but less accurate settlement method, then that may be an over-riding criterion.

There is no simple solution but possibilities include:

- a) The existing annuity is replaced with an annuity that reflects the original intent of the annuitant. Where a cumulative loss to date has been incurred a lump sum payment will be made and where there has been no loss to date, then the new annuity is reduced until the “over-payment” has been paid off. (The chance of any policies still being in credit is remote. They would certainly be exceptional.) This would return everyone to the status quo ante, but the problem arises in collecting data from all the policyholders, often not easily available. It has the attraction that there would not be a lump-sum payout, save for the balancing payment to date, as repayment would be made over time.
- b) Once the loss for the individual policyholder is calculated, a new annuity could be created that would compensate for that calculated loss over the lifetime of the annuitant.
- c) The policyholder receives a one off lump sum payment for the losses incurred to date and in the future.
- d) A simpler approach would be to set up parameters based on a “typical” WPA (say with assumptions on ages at purchase – say 60 for

the annuitant and 58 for the spouse, spousal benefits – say two-thirds, guarantees - say 5 years, etc) and compare it to a similar alternative level annuity product – based on the fact that conventional level annuity purchase is by far the most frequent retirement strategy adopted.

The actual variation is difficult to produce without very detailed calculation but the type of variation, which could be expected in such a comparison of net loss over time is as follows:

9.1.1.1.1. <u>Date of transaction</u>	<u>Level of loss</u>
1990 purchase	100% of initial purchase price
1992 purchase	85% of initial purchase price
1994 purchase	65% of initial purchase price
1996 purchase	50% of initial purchase price
1998 purchase	30% of initial purchase price
2000 purchase	20% of initial purchase price

In addition, there are other significant issues such as taxation, how to deal with annuitants who have already received partial settlement of their claims, etc.

Conclusion

The 62,000 with-profits annuitants are individuals who during their working lives took care to put aside funds for their retirement. When they invested in the Equitable WPA, they believed they were creating a guaranteed income for life administered by a mutual society whose probity was unquestioned. Many are now old and frail, and are struggling to exist on an ever-diminishing income. Most have also suffered, and continue to suffer, considerable emotional distress as they watch their life savings quite literally dwindle away. We hope that the Public Administration Select Committee will understand from the foregoing presentation how this group has suffered serious financial loss as a result of inadequate regulation and the urgency with which that loss needs to be redressed.

November 2008

Memorandum from Paul Braithwaite, secretary general of EMAG (EQL 06)

“My expectation of the regulators is that they should not connive at the dishonest behaviour of those being regulated nor should they indulge in a cover up. The regulators helped Equitable to arrange a reinsurance treaty which was entirely worthless. If they had not suggested this bogus treaty, Equitable would have been finished in early 1999. Instead, we have continued with dishonest regulators leading to a whole host of other chickens coming home to roost. If anyone doubts this, read the chronology (Part 3 of the PO’s report) from December 1998 onwards.”

Nicolas Bellord, retired trust solicitor and EMAG director.

1. I have been actively involved since the formation of EMAG more than eight years ago. But the Treasury’s involvement began even earlier, when it took on responsibility for prudential regulation for the calendar year of 1998, before subcontracting that responsibility to the FSA (on the Treasury’s behalf) until the FSA became self-policing in December 2001.
2. The PO’s report was remitted to look at prudential regulation, only up until December 2001. It could not and did not look at any mis-selling by the Society or at conduct of business regulation.
3. EMAG’s separate formal submission addresses quantifying compensation for the losses springing solely from the PO’s ten findings of maladministration. Those losses were incurred not just by the with-profits annuitants, who are the most visible, but by hundreds of thousands of others just as deserving whose pensions savings were damaged by regulators not performing their statutory duties. These core 500,000 largest pension savers had an average investment of just £45,000 – hardly fat cat.

Outrage, seven years on

4. It is astounding that, more than seven years after the losses resulting from maladministration were crystalised, there is still such a widespread and deep sense of outrage. This is manifest in the many letters that most MPs have received since the PO reported. EMAG still has more than 15,000 paid-up members and hundreds of them have attended the half dozen regional meetings that EMAG’s regional groups have organised recently.

5. The sense of injustice has been fuelled of late by talk of tax hand-outs and the array of government bail outs. Northern Rock was bad enough but more recently Bradford and Bingley, the big British banks and, most inflammatory of all, Icesave. There, vulnerable investments in a higher-risk, higher-return foreign internet bank have been addressed and transferred out within days with all of individuals' savings 100% guaranteed without limit.

6. The chancellor explained to the Treasury Select Committee on 3rd November that Equitable is not a bank and its problems happened long ago. But the numerous delays have all been of this Government's making and why should time excuse the Government's moral duty? Like the banks, Equitable Life had a business model that was flawed. It was run by questionable management who were the primary authors of their own downfall and they too were subject to the incompetent "light touch" regulation of the FSA. The only difference is that in the case of Equitable there have also been damning findings on 10 counts of maladministration by Parliament's Ombudsman.

7. I was present in the hall in Manchester on 23rd September when the Prime Minister made his admirable Conference speech. It had 41 references to "fair" and "a fairer society". Equitable sufferers are understandably confounded and wonder when it will begin for them. This has become an outstanding debt of honour.

8. However, there is an encouraging precedent: In the case of failed occupational pension schemes, PASC gave the PO its full backing and at Christmas 2007 Peter Hain, as secretary of state at the DWP, agreed to a compensation package for 150,000 victims totalling (over time) £7 billion.

A strategy of delay and dissembling

9. The PO's report was laid before Parliament on 16th July and the then Treasury Minister's statement explained that, because it is a complex report, the Government will respond in the autumn. But the regulators received this report in draft - which has remained largely unchanged - more than 20 months ago.

10. It is my conviction that the Treasury realised the depth of Equitable Life's unique black hole, which was far broader than the GAR guarantees issue, during 1998 and it laid down then a policy of delay and dissembling which has prevailed to this day.

11. Ann Abraham has observed that it would have been far better to have commissioned one comprehensive report back in 2001. But that would inevitably have revealed what the Treasury already knew - that the regulators were profoundly culpable. And so it was in December 2001, immediately after the closure of the Equitable Life, that the economic secretary to the Treasury (Melanie Griffiths) asked the FSA to look into its own role in the debacle - but not to look back. As with Northern Rock, after the event the FSA produced a fair report, published in October

2001 which was highly self-critical. It is regrettable that the lessons that should have been learned then in 2001 remained unaddressed throughout Callum McCarthy's disastrous FSA regime until summer 2007 when exactly the same set of seismic fault lines were again revealed in the failed supervision of Northern Rock.

12. To date there have been no fewer than 13 different reports precipitated by Equitable Life. But the PO's is the very first report to have the authority to recommend compensation, which was explicitly excluded from Lord Penrose's remit.

13. No other Life Company, no matter how disastrous (e.g Standard Life 2001 – 2005) has been the subject of any study. Equitable Life is the ONLY one that is the subject of credible claims of injustice for a very good reason – it IS unique. But the Treasury has consistently sought to obfuscate to avoid any admission of culpability or liability to compensate.

14. For example, maturing policy comparative performance figures for 20 and 25 year terms have been spun by the Treasury as showing similar returns to other companies, thus deliberately muddying the water. But these are irrelevant because the regulatory failures found by the PO hurt savers who made the bulk of their investment after the mid-1990s and not in the '80s.

Tripartite system – early failures

15. Possibly the first stress-test for the Tripartite regulatory arrangement was in December 2000 when it met and decided to do nothing about Equitable Life, ostensibly because there was no panic. A lot of Equitable Life sufferers subsequently moved their savings into Northern Rock and many of them were in the queues that formed outside branches. Having learned their lesson they panicked - to immediate successful effect. Equitable Life stands as THE defining cause of the breakdown in trust in the regulators.

16. Equitable Life was also the subject of the Tripartite regulators being convened in July 2001. Once again Equitable's investors were failed. It chose not to intercede because the Association of British Insurers (ABI) made clear that the industry would resist any and all demands for it to bail out Equitable. In consequence, sophistry well-evidenced in the PO's chronology in July 2001 was perpetrated against Equitable's investors. It took the Northern Rock crisis a year ago for it to be recognised that, because the FSA was dysfunctional, the Tripartite system could not work.

Europe

17. The powers of and obligations on the prudential regulators provided by the series of Insurance Companies Acts were considerably enhanced by the European Third Life Directive, which was incorporated into UK law in the summer of 1994. Thereafter, the UK regulator had arduous proactive statutory duties, not only to UK savers but to

the citizens across Europe for all products sold by the UK's financial services industry. There is no doubt that, in the case of Equitable Life, the UK regulators persistently breached the Third Life Directive.

18. After various successful diversionary and delaying tactics by the Treasury, the FSA and the FOS in response to Lord Penrose's report in March 2004, it became clear that Equitable sufferers were being subjected to a well orchestrated cover-up. For this reason, I myself and another EMAG director, Tom Lake, petitioned directly to the European Parliament for justice.

19. In January 2006 the first EU special committee of enquiry in a decade was set up with 22 MEPs to investigate Equitable Life – named EQUI. In total it conducted 11 three-hour long evidence sessions with 50 witnesses taking part over a 15-month period. The EQUI report was debated in the Parliament's full Plenary in Strasbourg in June 2007. The report and its recommendations were adopted by 611 MEP votes in favour, with just 11 votes against. Seventeen months on and the UK Treasury has thus far refused to comment at all on the EQUI report, despite the majority of its remit not overlapping in any way with that of the PO. It is worth re-stating three of the EQUI's recommendations:

EQUI report remedies (extract)

20. (Remedy 9) In view of the UK Government's failure to comply with the requirements of the Third Life Directive and given the absence either of accessible legal redress through the courts or of effective alternative means of redress, the committee **firmly** believes that the UK Government is under an obligation to assume responsibility. The Committee therefore strongly recommends that the UK Government devise and implement an appropriate scheme with a view to compensating Equitable Life policyholders both within the UK and abroad.

21. (Remedy 10) The committee urges the UK Government to accept and implement any recommendations the UK Parliamentary Ombudsman may make with regard to Equitable Life.

22. (Remedy 11) Although the FOS can be considered as one of the more advanced out-of-court dispute settlement schemes in Europe in terms of competences and powers, the committee believes that the Equitable Life case has revealed a number of serious shortcomings in its operation. The Committee therefore **demand**s that the UK Government urgently address these shortcomings, strengthen the FOS's capacities and ensure that it is truly independent from the FSA.

Why the European dimension is important

23. For a decade the UK has told European governments that our industry-funded single regulator, the FSA, is the ideal paradigm that they should replicate. But post

EQUI, Northern Rock and the bail-outs of the UK's leading banks the credibility of the FSA is now rock bottom in Europe. The financial services industry is one of our most important export industries and it is vital that we retain our pivotal role in the development of revised European regulation in negotiating both Solvency II and Basel III.

24. The FSA has not succeeded in squaring the circle of preserving confidence in the industry AND protecting the investing public. The industry funds it and thus preserving confidence in the industry always prevail when stress-tested.

The office of the PO

25. The office of the PO performs a very valuable function in our constitution, for MPs and citizens alike. It is a laudable creation of Dick Crossman MP, in that it is an alternative to the ludicrously expensive court costs of proceedings against any public body. It is a free alternative disputes resolution (ADR) mechanism that is truly independent and seeks to dispense natural justice. Its sole function is to determine whether a public body has been maladministrative. If so, whether it is sufficiently serious to warrant a recommendation to Parliament that compensation be paid. That is the only reason that EMAG and 3,000 complainants wrote to the PO in May 2004 to encourage a thorough investigation into the prudential regulation of Equitable Life. EMAG has spent four years and hundreds of thousands of pounds of its members' contributions in informing the PO's investigation team as professionally as we are able.

26. This particular report must be the finest, most rigorous and thoroughly tested one that the PO's office has ever produced. If Parliament chooses to ignore the unequivocal recommendation or it pleads poverty and short-changes the sufferers then what is the point of the PO? We will have wasted our and Ann Abraham's time to no purpose and the office of the Parliamentary Commissioner will be damaged and devalued.

November 2008

Memorandum from Liz Kwantes (EQL 07)

1. I should like to thank the PASC for allowing my colleagues and myself to act as witnesses for the review of Equitable Life yesterday. After our session I stayed on for the evidence of Equitable Life's management and I was concerned, to say the least, by the obfuscation of the situation. I also felt that there was a comparison of apples and pears being made, as I was none too sure as to whether the 'hundreds of millions' paid to 'hundreds of thousands' of policyholders related to mis-selling or to something else. I was also not sure if the 'hundreds of thousands' were real recipients of compensation. The impression was given that the Equitable management were trying to talk down compensation for some incomprehensible and unapparent reason, certainly not supporting the demonstrably legitimate case for compensating both past and present members of their mutual.

2. Secondly I have worked in the computer industry for many years and the suggestion of using a computer system suggested by Gordon Prentice MP to calculate loss based on either the EMAG calculations or some other one decided upon, should not be onerous using various macros based on certain policyholder criteria. I understand that all necessary policyholder data is still available to do this, including the majority who have left the Society, who will also need to be included. Since the board has declared that it intends to sell off the remainder of the Society, it is important that this is done at the earliest opportunity.

3. Over the last eight years I have received many thousands of e-mails from distraught and worried policyholders, who have been largely ignored up until now, so a speedy resolution would be very much appreciated. As was mentioned, if a proper inquiry had been made in 2001, it could possibly have ensured a stronger form of regulation in the ensuing years and we would not have had such recent cases as Northern Rock. The current parlous state of the economy is not, therefore, a fair factor for the hundreds of thousands of Equitable sufferers who should have been addressed when this situation came to light. The timing is entirely of the Treasury's own making.

November 2008

Memorandum from Anthony Wilson (EQL 08)

I see that the Select Committee on Public Administration will be considering the Parliamentary Ombudsman's report on Equitable Life's travails, and I write as one of those immediately affected. I took out a with-profits policy in 1993 which I expected to yield about £1400 per month by now: instead, I am receiving £540 p.m. before tax.

I find myself ambivalent how the Government should respond to our situation. On the one hand, I did what both Tory and Labour administrations told me to do: save hard (I took out AVCs) as the state pension would not provide the necessary. I assumed that regulation was sufficiently effective to protect me, and deliberately chose to rely on a mutual provider rather than a privatised company. So I feel entitled to a measure of compensation... And Treasury ducking and weaving rather than engage in open debate on difficult issues reduces its credibility for dealing justly, and adds to our sense of being hardly done by.

On the other hand, does *caveat emptor* apply here (though how could I have found out that Equitable was insubstantial?) And people depending on the state pension who are facing rising fuel and food bills must have a higher priority than private investors on the public purse. Would 'compensation' create a precedent which could cause endless problems for years ahead?

I suppose I have a couple of comments, for what they might be worth. Is the situation in which we Equitable Life beneficiaries find ourselves a unique one-off, where general considerations of compensation should apply? And in a broader context: the political decision to effectively run down the state pension is a poor capitulation to low-tax ideology, which needs to be challenged in the larger public interest.

Thanks for reading this far, as I can't have made your role any easier.

September 2008

**Supplementary memorandum from the Parliamentary and Health Service
Ombudsman (EQL 21)**

Introduction

1. This supplementary Memorandum is submitted to the Public Administration Select Committee in order to assist the Committee in its deliberations on my recent report, *Equitable Life: a decade of regulatory failure*. It deals with issues arising from the evidence given by others to the Committee on 11 November 2008 and on 13 November 2008.
2. In particular, this Memorandum responds to evidence given by Sir Howard Davies, former Chairman of the Financial Services Authority (FSA), which questioned the fairness of the investigation process which led to the publication of my report.
3. It also deals briefly with certain issues which have arisen from the other evidence which I understand that the Committee has received in those sessions.

Sir Howard's evidence as to the fairness of my investigation process

4. In his evidence, given on 13 November 2008 as part of a panel of witnesses of industry and expert commentators, Sir Howard expressed the general view that the investigation which led to my report was '*flawed*' in certain respects and that those flaws had led to the production of a report which did not fairly characterise '*the mindset, the attitudes, and the dilemmas faced by the regulators at the time*'.
5. Sir Howard also gave particular evidence to the effect:
 - (i) that he had written to me offering to give evidence as part of my investigation;
 - (ii) that, after receiving a copy of the draft of my report, Sir Howard and two of his former colleagues had met me to express their surprise that '*the whole process had been undertaken without any interviews [with] the regulatory staff*' – and that, at or before this meeting, I had agreed with Sir Howard that such a meeting '*could not in any way cure the fault*' said to be inherent within the investigation process;
 - (iii) that, although Sir Howard had not been a party to discussions between the FSA (and the other public bodies concerned) and my Office throughout the investigation process nor had he had any contact with the FSA on these matters since 2003, he nevertheless understood that

the FSA were *'very clear'* that it was not the case, as I had informed him at our meeting, that those public bodies had requested at the outset of my investigation that we should not interview current and former regulatory staff; and

(iv) that it was *'surprising'* that, whether in my report or else in subsequent evidence to the Committee, I should *'seek to characterise the state of mind of people and say that they were reluctant or frozen in the headlights or whatever phrase she has used'* when I had not interviewed those people.

6. Notwithstanding these purported criticisms of the investigation process we used, I note that Sir Howard also informed the Committee that he was *'not saying that she has made an illegitimate decision, because I believe it is for the Ombudsman to decide how she carries out her investigation'*.

My response to Sir Howard's evidence

7. Nothing that Sir Howard has said to the Committee about the fairness of our process is new or unresolved, has or had any merit, or affects in any way the robustness of my report and the integrity of the investigation which led to it.

8. As I explained in the Foreword to my report, I was satisfied that the process I adopted was entirely fair and gave those complained about ample opportunity to respond to the allegations made against them, to submit evidence, and to respond to my emerging findings. I remain of that view and believe that the facts fully support my view.

Preliminary observation

9. For the benefit of the Committee, I will address the merits of Sir Howard's evidence in detail below. Before doing so, I should draw the Committee's attention, as a preliminary matter, to the facts that his criticisms are not new and that I considered them, reflected on their merits, and responded to them during the investigation.

10. The criticisms now made by Sir Howard were also put to me by him (and by two of his former colleagues) in April 2007 in their joint response to the first draft of my report, which had been provided to the FSA (and the other public bodies) in January 2007, more than nineteen months before my final report was published.

11. I reflected carefully on his allegations and addressed them in correspondence with Sir Howard towards the end of 2007 and also within my published report.

I did this within the context of the whole investigation process which had been undertaken. That process had included regular liaison meetings with the FSA and with the other public bodies.

12. Chapter 3 of Part 1 of my report sets out the process which we used to conduct the investigation. That Chapter details the numerous occasions on which the public bodies were invited to give evidence to the investigation, were asked to comment on early drafts of the factual parts of the emerging report, were asked to clarify specific matters which arose from the available evidence, and were provided with formal opportunities to respond to more than one full draft of the report setting out the provisional results of my investigation.
13. I would invite the Committee to examine that Chapter of my report again very carefully. In the Foreword to the report, on page vii, I explained that I had considered the representations I had received about the fairness of this investigation process and said that I had responded to those representations. I remain certain that what I said there remains true, namely that:

... the process I have adopted has been fair and has given those complained about ample opportunity to respond to the allegations made against them, to submit evidence and to respond to my emerging findings.

Two general points

14. Before dealing with the merits of each specific point arising from Sir Howard's evidence, I should also draw the Committee's attention to two further general points.
15. The first general point to make is that Sir Howard's criticisms are fundamentally misconceived. It is a long-standing convention between my Office and the public bodies whose actions are subject to investigation that my Office deals during investigations with the principal officers of such bodies – that is, with their Permanent Secretaries, Chief Executives, or Chairmen - and with any liaison officers appointed by those principal officers to engage with a particular investigation. Indeed, in certain respects, I am required to do so.
16. I am also required by the Parliamentary Commissioner Act 1967, where I propose to conduct an investigation, to invite the initial comments of those bodies and individuals whose actions are the subject of the complaints which have been made. In addition, we often ask public bodies for further evidence during an investigation.

17. It is a further long-standing convention that, in both circumstances, the onus is placed on the relevant public body to ensure that all their current or former staff whose actions may be subject to criticism are given an opportunity to comment on any allegations made in the complaints about their actions and, in addition to answering any queries that my Office might have about the facts of a particular case, to enable those staff to contribute to the investigation process in any other way that those individuals might wish so to do.
18. Both those conventions are set out in more detail in the Government's own public guidance on handling Ombudsman investigations¹. In this case, at all times we acted in line with both the statutory requirements imposed on me and with the well-developed conventions that the Government themselves recognise.
19. We engaged in very comprehensive liaison with the FSA (and the other public bodies) at every stage of the investigation. The FSA (and the other public bodies) submitted extensive evidence to us throughout the process.
20. According to his evidence, it would appear that Sir Howard feels that he should have been given earlier or more frequent opportunities to contribute personally to the FSA's input to my investigation. However, that this did not occur is a matter for the FSA, whose responsibility it was both to protect his interests and to enable him to make any contribution to the investigation process in whatever form that he wished to make such a contribution.
21. The second general point to make is that, as Sir Howard will know from his time at the Audit Commission, there is no general legal obligation or requirement in fairness on public bodies conducting inquisitorial processes to conduct interviews or to seek oral testimony in other ways².
22. It is nevertheless my own general practice to conduct interviews:
 - (i) where I receive a request from someone whose acts or omissions might be subject to criticism - or from someone whose actions are directly relevant to a determination of a complaint - that such an interview should be carried out; or

¹ Available at

http://www.cabinetoffice.gov.uk/propriety_and_ethics/parliamentary_ombudsman/handling.aspx

² The leading case law on this matter relates to the Audit Commission's work: see, for example, *Lloyd & Ors v McMahon* (1987) AC 625.

- (ii) where the available evidence – in whatever form - is incomplete and there is a need to pursue issues on which conclusions could not otherwise be drawn; or
 - (iii) where the very nature of the complaint – for example, that a civil servant was rude in an oral exchange with a customer – might mean that no contemporaneous evidence exists and that an interview is the only possible means of obtaining any understanding as to what transpired.
23. As will be clear from what follows in relation to the specific points made by Sir Howard, this investigation met none of these criteria and there was no other reason to conduct interviews in the particular circumstances of the case.

Response to particular points made by Sir Howard

24. First, and for the avoidance of any doubt, Sir Howard did not, at any time during my investigation, write to me to seek an interview or to offer to give evidence as part of the investigation process. I note, however, that he did write to Lord Penrose in such terms.
25. Had he written to me requesting an interview or asking to participate in other ways in the investigation process, we would have interviewed him or otherwise enabled his participation independently from that of the FSA. Yet at no time prior to the issue to the public bodies of the first draft of my report at the end of January 2007 did Sir Howard (or his two former colleagues) contact me, request that an interview with him (or them) should be conducted, or seek to assist the investigation in other ways.
26. I received correspondence from Sir Howard some months after the issue of the draft report, which contained representations on my provisional findings. As Sir Howard said before the Committee, some of those findings were adverse to the FSA. Sir Howard's correspondence included the criticisms of the investigation process which he has now made before the Committee. The general thrust of those representations sought to challenge, by way of procedural issues, the substance of my provisional views. Despite this, as explained above, I considered those representations carefully and responded to them at that time.

27. I was also very surprised to receive those representations – not least because of the public position taken by Sir Howard, of which we were aware, that he had nothing to add to the evidence that the FSA could provide³.
28. In the absence of any request from Sir Howard, and in the absence of any indication whatsoever from the FSA at any time during the investigation that any of their current or former staff wished to be involved in the investigation process in the particular way that Sir Howard asserts was necessary, I do not believe that there was any unfairness in our process.
29. Secondly, contrary to what Sir Howard asserted in his evidence to the Committee, I have never accepted the contention that a failure to conduct an interview with Sir Howard or his former colleagues constituted a ‘*fault*’ which needed a ‘*cure*’.
30. Indeed, as he knows from my correspondence with him, I rejected at the time – and continue to reject - the assertion that our investigation was deficient in the way alleged by Sir Howard.
31. I am satisfied that our process was entirely fair and afforded the FSA (and, through them, their current and former staff) ample opportunities to contribute to the investigation and to explain and defend their position(s). I would also note that Sir Howard has been entirely unable – then or now – to point to any specific ‘*flaw*’ in the findings set out in my published report.
32. Thirdly, Sir Howard said in his evidence that he had not been party to the discussions between my Office and the FSA following the criticisms he had made of our investigation process. He also said that he had not been in contact with the FSA about Equitable Life since 2003. However, despite that, he also said that he understood that the FSA were ‘*very clear*’ that they disputed our account of exchanges between the public bodies and my Office in 2004 about what particular form of investigation process should be undertaken.
33. Our contemporaneous notes indicate (and our clear recollection is) that the public bodies made a request at the beginning of the investigation that we should only interview current and former staff if that proved absolutely necessary. The rationale for this request was that those staff had been subject

³ See the letter dated 7 November 2006 from Sir Howard to the Chair of the European Parliament’s Committee of Inquiry, available at http://www.europarl.europa.eu/comparl/tempcom/equi/written_evidence/response_davies_en.pdf

to a series of inquiries and investigations on the same matters and that to interview them yet again might be oppressive.

34. However, it is true that the FSA now only accept that they '*expressed a hope*' that this would be the case. Whether an expression of a hope constitutes a request is perhaps a matter only of semantics. What is more important, I am sure, to the Committee is the context in which that expression or request was made and how we subsequently acted on it.
35. The Committee will be aware from Chapter 3 of Part 1 of my report that we had available to us all the witness statements of all the relevant regulatory officials that were provided to investigations and inquiries into the same matters. Those inquiries and investigations were conducted much nearer in time to the events covered in my report. We also had available to us the agreed transcripts of interviews that had been conducted with those officials - and also their responses to the criticisms of their actions that those earlier investigations and inquiries proposed to make regarding the issues and events covered in my report.
36. In addition, as Part 3 of my report demonstrates, we had access to a huge amount of contemporaneous documentary evidence setting out the relevant events, in relation to which, particularly in the later period relating to the FSA's actions, there were few, if any, gaps.
37. We thus had access to a considerable amount of evidence, derived from the files of the regulatory bodies but also from the records of the oral and other evidence that they and their staff had given regarding the relevant events nearer the time that those events had occurred.
38. In each of the regular liaison meetings that my officers had with the officials representing the public bodies, we informed them that, while we hoped not to have to conduct interviews, we could not promise not to do so if any issues arose which might require us to seek further evidence from their staff. Throughout the investigation, we kept the public bodies informed as to our developing thinking on whether this might be necessary.
39. Given the very comprehensive evidence we had reviewed, which is set out in the report, and the identification - by us then or by Sir Howard now - of no specific issue on which further oral evidence was necessary, we came to the view that no further interviews were necessary. We informed the public bodies of that decision and proceeded to provide to the public bodies (and, through

them, to their staff) the extensive opportunities to comment on the emerging report to which I have referred above.

40. At no time until I received Sir Howard's letter in April 2007 – that is, after my proposed adverse findings were made known to them - did the public bodies or anyone associated with them raise with us any issues concerning any alleged unfairness in our process.
41. Finally, in questioning before the Committee, Sir Howard criticised my characterisation of the regulators as '*mesmerised*' because, in his view, it was impossible to come to a view as to the state of mind of a regulator unless they were interviewed.
42. I do not accept the general proposition that an interview many years after the relevant events is necessary in order to come to a view as to the state of mind of someone – especially when, as here, more contemporaneous evidence exists on that very question. However, that does not seem to me to matter on this occasion.
43. That is because Sir Howard appears to have misunderstood my evidence on this point given to the Committee on 30 October 2008. As is clear from the transcript of that evidence, my reference to the regulators being '*mesmerised*' was patently made in relation to the period before the FSA – and thus Sir Howard – were responsible for the prudential regulation of Equitable Life. Those comments therefore have no bearing on my assessment of the discharge by the FSA of (or the state of mind of any of their staff regarding) their responsibilities.
44. For completeness, I would add that none of the five findings of maladministration made against the FSA – the failure to record the decision to permit the Society to remain open, the basis of that decision (as that was explained to me by the FSA during the investigation and subsequently confirmed by Sir Howard and his former colleagues), a failure to follow-up on requests made in correspondence regarding the Society's 1998 regulatory returns, the credit permitted to be taken for a reinsurance arrangement that the Government Actuary's Department had advised the FSA was in fact worthless, and the corporate information produced by the FSA during the post-closure period – relate to, or are dependent on, the state of mind of any individual.

Other matters

45. There are three other matters arising from the other evidence given to the Committee on which I would like briefly to comment.
46. The first point concerns the evidence given by Sir Howard on 13 November 2008 concerning the decision taken by the FSA to permit the Society to remain open to new business following the decision of the House of Lords in the *Hyman* litigation.
47. I would invite the Committee to consider Sir Howard's evidence on this point carefully, after revisiting the section of my report which deals with this finding. The relevant sections in Part 1 of my report are paragraphs 523 to 614 of Chapter 10 and paragraphs 124 to 142 of Chapter 11.
48. I addressed there the mistaken premise, now repeated again, that the FSA had only two options available to them – either to close the Society immediately to new business or to do nothing and permit people to pay into the Society not fully aware of the potential risks they faced. Given that it is clear that the regulator had a range of other powers that were never considered, I would respectfully suggest that Sir Howard's evidence on this point reinforces the finding of maladministration that I made regarding the basis for the FSA's decision.
49. The second point concerns the remarks made by the Committee Chairman in the session on 11 November 2008, during his questioning of representatives of those who complained to me, which suggested that I had said in my oral evidence on 30 October 2008 that any compensation might only be paid on the basis of proven hardship.
50. I have looked at the transcript of the evidence that I gave on that occasion and can find no reference to such a suggestion. Indeed, I would consider that it would be a novel and worrying development, should it be accepted as a matter of principle, that redress for injustice resulting from maladministration should only be forthcoming to those who can pass a subjective test that they were 'deserving'. That does not mean that interim payments to alleviate immediate hardship might not be made by any scheme, prior to final settlements being determined. Indeed, that seems perfectly viable and, given the passage of time since the complaints of those affected arose, entirely reasonable.
51. I also have some sympathy with the point made by one of the policyholder witnesses in reply that it might cost more than would be dispensed to administer any scheme that was based on assessing everyone against a

hardship test, in addition to considering and measuring the scope of the injustice sustained in each case or group of cases.

52. The third point concerns the possibility, explored during the broader evidence given by the panel of industry and expert commentators on 13 November 2008, that an alternative remedy exists by way of litigation for misfeasance in public office.
53. Leaving aside the undesirability of forcing citizens to litigate in circumstances where an Ombudsman remedy exists, the Committee may wish, in the light of normal limitation periods of six years, to reflect on whether the alternative of litigation for misfeasance in public office is an option still open to complainants, given that the events recounted in my report *ended* on 1 December 2001, approximately seven years ago.
54. I would be happy to assist the Committee further in their consideration of the issues raised by my report, either by way of further oral evidence or by responding to any written questions that the Committee might have.

November 2008