



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

The Rt Hon the Lord Willoughby de Broke  
House of Lords  
London SW1A 0PW

30 November 2010

*Dear Lord Willoughby de Broke,*

I am writing as a follow up to the Second Reading of the Equitable Life Bill on 24 November. As I noted at the time, there were a number of technical points I did not address in my closing speech, which I am writing to respond to now, as well as giving some further detail on points which I did address.

On the question of whether it is a general principle that those suffering from government maladministration can look for compensation, the Government is under no legal obligation to make compensation payments in consequence of regulatory maladministration. We have, of course, committed ourselves to compensate policyholders for their relative loss as a result of regulatory failure. However, that decision has to take into account the issue of fairness to the taxpayer and spending pressures on the public purse. Therefore £1.5 billion has been made available for the scheme.

Losses for With-Profits Annuitants (WPAs) have been calculated on a gross basis, and have been calculated up until December 2009. Unlike other policyholders, WPAs will receive their payments over time and we will not be paying any interest on those payments between the date of calculation and the date of receipt. Disregarding the payments for tax will offset the effect of this.

It is important to note that these payments are in respect of losses going back over almost two decades. It would be incredibly complex and burdensome to work out what the tax position for individuals would have been in the relevant time. This scheme needs to be simple and not unduly complex. In recognition of this, we have made the decision to make payments tax free. In the round, we do not believe that this will result in over-compensation for WPAs.

The Government's decision on whether to include WPAs who purchased their policies prior to 1 September 1992 in the scheme is based on the Ombudsman's findings. In her report, the Parliamentary Ombudsman recommended that the aim of the scheme should be *"to put those people who suffered a relative loss back into the position that they would have been in had maladministration not occurred"*. The only maladministration she found to have occurred prior to September 1992 was the "dual role" and the scrutiny of the 1990 and 1991 returns. The Ombudsman did not find that the dual role caused any injustice to policyholders. In relation to scrutiny of the returns, the Ombudsman was clear that payments should be made to those who suffered relative loss as a result of their reliance on regulatory returns which were inaccurate as a result of maladministration (Part 1 of her report, 12/99-100).

Until the 1991 returns, which investors would have seen only from September 1992 onwards, the returns of a properly-regulated Equitable Life would not have differed from the actual ones. Therefore WPAs who purchased their policies prior to 1 September 1992 did not rely upon regulatory returns which were inaccurate as a result of maladministration in making their decision to invest in Equitable Life. They would still have invested even if maladministration had not occurred and, once invested, were locked in. Putting them back into the position that they would have been in had maladministration not occurred therefore cannot involve compensation based on the assumption that they would never have invested in Equitable Life or would have moved their funds elsewhere. Accordingly, External Relative Loss can have no application to them.

Complying with the Ombudsman's approach therefore requires an assessment of the effect of maladministration on policyholders who remained invested in Equitable Life. Towers Watson and Sir John Chadwick did assess this, based on Internal Relative Loss figures. Internal Relative Loss is the only rational basis for assessing whether pre-September 1992 WPAs suffered loss, given that External Relative Loss is inapplicable for the reasons given above. Towers Watson's calculations showed that pre-September 1992 WPAs in fact received more from Equitable Life than they would have done in the absence of maladministration, due to the high bonuses they received in the early years. Accordingly they did not suffer a loss in respect of which they should be compensated.

This conclusion was not affected by Sir John Chadwick's restricted terms of reference. If anything, taking into account all the Ombudsman's finding of maladministration would increase the relative gain made by these WPAs, as it would cause bonuses in the early years to be lower than Towers Watson assumed in their calculation.

Towers Watson's analysis has shown that the reason WPAs are suffering a reduction in the level of annuity received is due to poor investment market

performance and the fact that early annuity payments were artificially high due to the structure of the product and over-bonusing.

Whilst regrettable, these are not examples of maladministration for which the Government was responsible and/or matters for which the taxpayer should compensate this group of WPAs.

It was also questioned whether there is an issue to be addressed in distinguishing between holders of indexed and level annuities when assessing relative loss and whether the payments to WPAs will be disregarded for pension credit. On the first matter, I can provide assurance that there is no issue to be addressed as the type of annuities being considered under this scheme are With-Profits Annuities. As for the second matter; the Government has decided that WPA payments will be treated as income for the purposes of pension credit and will not be disregarded. This is fair as it is an ongoing payment that reflects the structure of their policy.

Noble Lords questioned whether the proposals meet the terms of the EMAG pledge signed by many MPs. Many MPs did indeed sign up to the Equitable Members Action Group (EMAG) pledge and I think the proposals we have set out meet the commitment set out in the pledge. The pledge stated that:

*"I will support and vote for proper compensation for victims of the Equitable Life scandal and I will support and vote to set up a swift, simple, transparent and fair payment scheme – independent of government – as recommended by the Parliamentary Ombudsman."*

That is what we have done. We have moved swiftly by publishing the first bottom-up estimates of losses, established the Independent Commission on Equitable Life Payments and announced the amount of funding that will be made available for the scheme. We have been in dialogue with the Parliamentary Ombudsman, EMAG, and the Equitable Life Trapped Annuitants, in order to aid transparency and their understanding of the issue. We have also set out proposals that will allow for a simple scheme that does not unduly burden policyholders.

While there has been disappointment in the level of funding provided, I think it is important to note that the pledge did not state a figure and that the Ombudsman stated that "it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case." We believe the amount we have put forward is fair and I think MPs can be confident in saying that by supporting our proposals, they have met the terms of that pledge.

Lord McKenzie of Luton also asked for a comment on the assertions from the Equitable Members Action Group, that there is an error in the calculation due to non-contractual exit costs being deducted from the comparator.

In calculating relative loss, we are comparing the return from Equitable Life with the return that would have been received from investing elsewhere. The only fair way of doing that is to base the two returns on the actual value of the funds concerned, without the distortion introduced by smoothing.

This is done by the application, if necessary, of a Market Value Adjustment (MVA), which ensures that the payout is based on the actual value of the underlying assets at the point of withdrawal.

Equitable Life applied an MVA, to ensure that no single policyholder withdrew more than his share of the underlying assets was actually worth. Where the comparator's smoothed assets exceeded its actual underlying assets, it is necessary to apply an appropriate MVA to it too, to ensure that like is being compared with like.

I hope I have provided answers and clarification on the points raised during the debate. We will continue to work towards our ambition of starting payments to policyholders in the middle of next year. Policyholders have waited far too long for a resolution and the Government is committed to bringing an end to that wait.

I am writing in similar terms to all peers who spoke in the Equitable Life Bill Second Reading in the Lords.

*Yours sincerely*  
*James Sassoon*

**LORD SASSOON**