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The Office of Sir John Chadwick
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Equitable Life ex-gratia payment scheme – HM Treasury's response to Sir John Chadwick's proposals as to the approach to be adopted and the issues to be addressed

I write on behalf of the Treasury to provide representations as to Sir John's proposals concerning the issues to be addressed in order to reach a view as to the extent of the relative losses suffered by each relevant class of policyholder in respect of each of the findings accepted by the Government. These are set out in the document issued in June 2009 entitled "Equitable Life ex-gratia payments scheme, My proposals as to the approach to be adopted and the issues to be addressed" ("the Proposals document").

I deal with a few preliminary points before addressing the issues raised in that document.

Preliminary Points

The Treasury notes that Sir John does not, at this stage, invite representations as to:

- how those issues should be resolved;
- how (if at all) relative losses should be apportioned; or
- whether some classes of policyholder should be seen to have suffered disproportionate impact.

In order to ensure independence of decision-making regarding a payments scheme for Equitable Life policyholders, the Treasury has put in place arrangements ("a Chinese Wall") to separate on the one hand that part of the Treasury which responded to the Ombudsman's Report, and which is now responsible for making representations to Sir John's Office and, on the other, that part of Treasury which is working with Sir John while he advises the Treasury and which will, ultimately, be responsible for final decisions concerning the design and implementation of the ex-gratia payments scheme.

These representations, and any subsequently made to Sir John's Office in accordance with Sir John's procedures are being made by the Team within the Treasury which is responsible for making representations to Sir John.

These representations are being made on the basis and to the extent that Sir John has invited interested parties to do so. The Treasury recognises that, ultimately, it is for Sir John to decide how proceed to address the issues under his Terms of Reference, in light of the



comments and representations received from all interested parties. I confirm that the Treasury has no objections to these representations being published.

For ease of reference I adopt the paragraph numbers used in the Proposals document throughout. Representations are only made where the Treasury feel that it can contribute to Sir John's consideration of the issues raised.

Paragraph 2.7

Sir John's understanding is correct. Should Sir John feel that it is necessary to make a further finding of fact on the issue of whether the failure by GAD to question and seek to resolve whether the changes that Equitable Life made to its assumed retirement ages in its 1994 and 1996 regulatory returns did, in fact, lead to injustice then the Treasury is content with this course. However, the Treasury is mindful that there have been a number of investigations to date and should be grateful if Sir John would clarify the nature and extent of the investigation he considers necessary to make such a finding. As Sir John acknowledges at paragraph 3.8, his Terms of Reference underline a need for an expeditious process.

The Treasury would prefer, if possible, to avoid any investigation which would involve the gathering of formal evidence and representations from relevant parties. These would inevitably delay matters still further. The Treasury would ask whether Sir John can give thought to any process which could shorten any investigation, such as relying on published material already available as opposed to gathering on new evidence.

Paragraph 2.9

Sir John states that proposition (i) (that there was no Section 68 concession in place at 31 December 1998, without which Equitable Life should not have been permitted to take the reinsurance treaty into account in its 1998 return) does not add anything to (ii) (that on a true analysis of the reinsurance treaty, it should not have been taken into account in Equitable Life's returns at all). This is true if the economic value of the treaty was nil - in that case it does not matter whether or not Equitable was granted a concession to use it. However if the Ombudsman's point is that there was some economic value to the treaty (albeit less than assumed) then (i) would still be necessary in order for that economic value to be recognised in the returns. The Ombudsman does say, at 1/10/450, that the offset should have been nil, but this appears to be based on her view that it was not reinsurance rather than it having no economic value.

Paragraph 2.13

The Treasury takes this opportunity to clarify the position concerning Finding 6.

The Ombudsman's finding as to maladministration set out at 1/11/101, namely that "...the failure by the FSA, acting on behalf of the prudential regulators, (i) to ensure that the financial reinsurance arrangement was not taken into account within the Society's 1998 returns without an appropriate concession being given, and (ii) to ensure that the credit taken by the Society within its returns for 1998, 1999, and 2000 properly reflected the economic substance of that arrangement, constitutes maladministration" is accepted.



Also accepted is the Ombudsman's finding as to injustice, set out at 1/12/146, that "...in respect of all those who joined the Society or paid a further premium that was not contractually required in the period after 1 May 1999, any financial loss that they have sustained constitutes injustice in consequence of maladministration. Those affected by that maladministration have also suffered injustice in the form of lost opportunities to take informed decisions about their financial affairs."

This is clearly stated at paragraph 4.132 of the Government's Response. The Government's response does not seek to engage with each statement made by the Ombudsman in her Report. It is accepted that the Society's Returns for the relevant years would have been different, but just how different is a matter of conjecture. The Government's observations at paragraphs 4.136 to 4.140 go to the issue of just how materially different those returns would have been.

In this respect the position is that the Government has not qualified its acceptance of the finding of maladministration causing injustice. Rather the observations made in paragraphs 4.136 to 4.140 of the Response are matters that may be relevant to the work undertaken by Sir John and, in turn, to the Government when determining the precise details of any ex-gratia scheme it adopts. The Government must decide as a matter of public policy the details of the ex-gratia scheme. The Government may determine that such a scheme should seek to reflect, inter alia, (i) the extent of relative losses suffered by policyholders, (ii) an assessment of the proportion of those losses that are properly attributable to the maladministration accepted by the Government, (iii) which classes of policyholder have suffered the greatest impact, and (iv) the factors the Government might wish to take into account when reaching a view on whether disproportionate impact has been suffered. If and to the extent that the basis on which the Government has accepted the findings of maladministration and/or injustice in relation to Finding 6 is considered to be qualified, it is qualified as described. Sir John should note that this issue has been raised in the judicial review proceedings in Folio No CO/3455/2009 and so the Court may make a determination on this point.

Paragraph 2.18

Again the Treasury welcomes to opportunity to clarify the extent of the acceptance of the Ombudsman's findings. The Government's acceptance of the Ombudsman's findings in relation to Finding 10 is qualified in that it has accepted that information provided in the post closure period in relation to the solvency position of the Society involved maladministration but on the basis that the statement made in October 2001 (namely that the Society remained solvent but continued to face fundamental uncertainties following the House of Lords' judgement in Hyman) had the potential to mislead policyholders and others reading it. In particular, "Greater thought should have been given to making clear that there had been a change in the FSA's understanding of Equitable Life's state of financial health so that policyholders and others could easily understand the difference between its statement that Equitable Life met "regulatory solvency margin requirements" (made in August 2001) and its statement that Equitable Life was "solvent" (made in October 2001)" (Response, para 4.179). The Government believes that prior to October, the FSA's statements were correct and not maladministration. The Government accepted the finding of injustice on the basis set out in the Response at paragraphs 4.180 to 4.187.

Paragraphs 3.1-3.3



The Treasury notes Sir John's proposed Head A / Head B approach to the calculation of relative loss. The Treasury is conscious that the Ombudsman frequently made findings focussing on the content of the Society's returns and the effect that any maladministration would have had upon the content of those returns. The Treasury suggests that considering the practical impact of the maladministration would be the most logical way of proceeding, but the issue of the Heads of relative loss is a matter for Sir John and the Treasury would not wish to fetter Sir John's investigation where it remains within his Terms of Reference.

In relation to 3.1 (ii) the Treasury would ask Sir John to clarify whether the market comparison he intends to make would be over the same time frame as the investment. This could possibly lead to relative gains under Head A. The Treasury assumes that this is taken into account under para 4.7 but would ask Sir John to confirm.

Paragraph 3.4

Sir John has specifically asked for representations on the point he raises in this paragraph. For the avoidance of doubt the Treasury agrees that he should not consider any loss beyond that which the Ombudsman has found to constitute injustice.

Paragraph 3.6

Sir John has again specifically requested representations on the views expressed in this paragraph. The Treasury agrees with Sir John's view that double counting should be avoided. However the Treasury would suggest that, insofar as it is relevant to consider losses under Head B, then policyholders should have losses measured on the basis which, on the balance of probabilities, represents the most likely course of events. It would not be fair if losses were to be measured on an extremely advantageous basis if that basis were highly improbable.

Paragraph 3.7

The Treasury does not disagree with the proposals in this paragraph but would have the same concerns in relation to the exercise proposed as have been expressed in comments on paragraph 2.7 above. The Treasury considers that it will be unfortunate were Sir John's suggested approach to result in a further quasi-inquiry into the matter. It was in an effort to avoid such an investigation that it was suggested, in his Terms of Reference, that Sir John refer to the evidence contained in publicly available reports produced to date. Any detailed investigation would add significantly to Sir John's workload and to the time taken for him to complete his work.

Paragraph 3.8 (i)

The Treasury would welcome a solution which would reduce the requirement for policyholders to prove the basis on which they made decisions to invest. However this may prove difficult given the express terms of a number of the Ombudsman's findings on injustice where reliance is required in order to demonstrate financial loss. In this regard the Treasury would draw attention to 1/12/99; in the preceding paragraphs, in particular, paragraphs 95-98, the Ombudsman sets out what she considers "reliance" to be and that any such reliance was reasonable. In paragraph 99 the Ombudsman states: "the only questions, therefore, are whether an individual relied on the information and did so to their detriment. That can only be determined at an individual level."



The Treasury's concern therefore is that Sir John's suggested approach would run counter to the Ombudsman's findings and general approach to reliance being proven at an individual level. However, to adopt the approach the Ombudsman suggests may impose too great a burden on policyholders.

The Treasury would therefore suggest that, in order to alleviate such a burden whilst ensuring fairness to all parties, Sir John should consider various methods of approaching the issue in a broad-brush way, possibly applying a discount to reflect the broad nature of any assumptions made. This may speed up the process of establishing a claim without requiring the level of individual detail which the Ombudsman appears to have envisaged. All parties would, of course, have to accept that the consequence of this would be quicker but broader and less tailored to individual circumstances

Paragraph 3.8 (ii)

The Treasury agrees with the proposal at 3.8(ii).

Paragraph 3.9

The Treasury agrees with Sir John's view regarding excessive reversionary bonuses.

Paragraph 3.10

The Treasury agrees that Sir John is not required to engage in any form of means testing. It may be worth pointing out, for the sake of clarity that, in his evidence to the House of Commons Public Administration Select Committee on 11 February 2009, the Economic Secretary to the Treasury stated that the Government's preferred option is for there not be to a means test and that the Government was not asking Sir John to advise on whether or not there should be a means test. What the Government had in mind, and discussed with Sir John, is that part of his wider role will be to assess the extent of losses suffered by different groups of Equitable Life policyholders. The Economic Secretary confirmed to the Committee that Sir John is not advising Government on means testing.

Sections 5 and 6

The Treasury would also comment more generally on the issues raised in sections 5 and 6.

In relation to those parts where Sir John must make factual findings concerning the actions of organisations such as GAD or the Society itself, the Treasury repeats its concerns regarding the wish to avoid a further lengthy quasi-inquiry, set out in its responses to paragraphs 2.7 and 3.7 above. Where this is necessary the Treasury would strongly urge Sir John not to apply hindsight to determining the reasonableness of the decisions of those involved, but rather to assess their actions on what a reasonable person in their position would have done at the time.

Turning to the actuarial issues raised, the Treasury notes that the issues are, potentially, significant. Given the lapse of time it may not be possible to produce accurate answers. The Treasury would therefore again suggest that, wherever practical Sir John should consider a shortcut which may produce justice which may be broader but also quicker for policyholders.



Yours faithfully,

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