

# The Office of Sir John Chadwick

Appointed by HM Government as independent adviser in relation to The Equitable Life ex-gratia payment scheme

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## Equitable Life ex-gratia payment scheme

### Interim report

August 2009



## 1 INTRODUCTION

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- 1.1 In January 2009 I was appointed by HM Treasury to advise on matters arising from the Government's Response (Cm 7538) to the Report of the Parliamentary and Health Service Ombudsman on her investigation into the prudential regulation of the Equitable Life Assurance Society. My Terms of Reference are at Annex A to the Response.
- 1.2 In June 2009 I set out Proposals as to the approach which I would adopt and the questions which I would need to address in carrying out that task. I invited comment on the Proposals. In response to that invitation policyholders and others have made representations to me, both orally and in writing. I have found the process of consultation constructive and helpful. To ensure there remains an open debate on the important issues that I am considering and to enable people to review this material, with the permission of those concerned, as part of this Interim Report I set out the formal representations I have received from groups or organisations, alongside any subsequent correspondence.
- 1.3 The representations which have been made to me – and further reflection in the light of those representations – have led me to the view that some aspects of the approach to the assessment of relative loss which I proposed in June should be revised. That approach (the "Report-based approach") had reflected closely the approach recommended by the Ombudsman in her Report, but taking account of the extent to which the Government has accepted her findings. The reasons which have led me to that view – and the more flexible approach to the assessment of relative loss which I am now minded to adopt ("the flexible approach") – are explained in this Interim Report.
- 1.4 Put shortly, the flexible approach has the potential to cover all those who were policyholders during the period affected by the maladministration which the Government has accepted. It will measure the relative losses suffered in respect of the accepted cases of maladministration by reference to the position that policyholders would have been in if all their investments in Equitable Life products had been made in a comparator.
- 1.5 The principal attraction of this flexible approach is that it will enable an assessment of relative loss to be made with much greater expedition and with much less burden on policyholders than the Report-based approach. In particular, as explained below, it will avoid any need to investigate difficult questions which would otherwise need to be addressed: for example, how Equitable Life's business would have been managed and when policyholders might have elected to withdraw funds from Equitable Life if there had been no maladministration. I consider the flexible approach to be no less fair to both policyholders and the Government than the Report-based approach which I had in mind when I made the Proposals. Rather, I think the flexible approach will produce a fairer overall result. I commend the flexible approach to all interested parties. It should not be rejected without a careful analysis of the reasons which I have found persuasive.
- 1.6 I have given careful consideration to the question whether, given my Terms of Reference and the Findings made by the Ombudsman in her Report, it is open to me to adopt the flexible

approach to the assessment of relative loss. My present, and provisional, view is that it is open to me to adopt the flexible approach. Ultimately it is, I think, for me to answer that question. But those who take a different view should have an opportunity to persuade me that their view is to be preferred. Publication of this interim report will provide that opportunity.

- 1.7 If I adopt the flexible approach to the assessment of relative loss, then the main issues that will remain for me to decide will be those relating to the development of an appropriate model of a notional comparator. These questions would have arisen on the Report-based approach and were identified in general terms in Section 4 of the Proposals. However, if I were to adopt the flexible approach, these questions will be of greater significance, because they would be relevant to the assessment of all relative loss by all policyholders. I would ask interested parties to give careful consideration to the question what would be the proper assumptions as to the characteristics of a notional comparator: I identify some of the issues at paragraphs 2.45-2.46 below.
- 1.8 If I were not to adopt the flexible approach, I shall need to consider the questions which were set out in a provisional list at Sections 4 to 7 of the Proposals. I received some comments as to that list; and the list has now been amended to incorporate those comments (where appropriate). The amended list, which I now hope to treat as definitive, is set out at the Appendix to this Interim Report.
- 1.9 Whatever approach is adopted to determining the characteristics of the notional comparator, there are a number of actuarial issues that will arise. My advisers have made significant progress in their analysis of those issues.
- 1.10 My task is not confined to advising on the extent of relative losses suffered by different classes of policyholder. In particular, I am required, also, to advise as to the proportion of those losses which it would be appropriate to apportion to the public bodies investigated by the Ombudsman. The principles which I should adopt in reaching a view as to the apportionment of losses are discussed at Section 3 of this Interim Report below. I welcome contributions to this discussion.
- 1.11 This interim report does not seek to identify those classes of policyholder who have suffered the greatest impact as a result of the maladministration which the Government has accepted; nor to identify factors, arising from my work, which the Government might wish to take into account when reaching a final view on whether disproportionate impact has been suffered. It would be premature to address those matters in advance of an assessment, at least in principle, of the extent of relative losses suffered by different classes of policyholder.
- 1.12 I welcome comment on matters in this interim report: in particular, I invite comments and representations on the following questions:
  - (i) Whether, given my Terms of Reference and the Findings made by the Ombudsman in her Report, it is open to me to adopt the flexible approach to the assessment of relative loss.
  - (ii) If it is open to me to adopt the flexible approach, the questions set out at 2.43–2.48.

- (iii) If it is not open to me to adopt the flexible approach, the questions set out in the Appendix.
  - (iv) Whether, in reaching a view as to the proportion of relative losses which it would be appropriate to apportion to the public bodies investigated by the Ombudsman, I should adopt the principles discussed in this Interim Report; and, if not, what principles should be adopted for that purpose.
- 1.13 Representations and comments in response to these proposals should be put in writing and sent by Friday 2 October 2009 to:
- The Office of Sir John Chadwick  
One Essex Court  
Temple  
London  
EC4Y 9AR  
Email: [info@chadwick-office.org](mailto:info@chadwick-office.org)
- 1.14 My Terms of Reference and the Proposals which were published in June 2009 – as well as other information about my office – can be found at [www.chadwick-office.org](http://www.chadwick-office.org).

A handwritten signature in black ink, appearing to read 'John Chadwick', with a long horizontal flourish extending to the right.

**The Right Honourable Sir John Chadwick**

## 2 ASSESSING RELATIVE LOSS

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### Introduction

- 2.1 I am required by my Terms of Reference to advise, in relation to “accepted cases of maladministration resulting in injustice” (the “accepted cases”), on

*“The extent of relative losses suffered by different classes of policyholder in respect of each case of maladministration, taking account of, among other things, wider market conditions during the period under consideration, and comparable insurance products available over the same period;”*

The accepted cases are summarised at Appendix 1 of the Government’s Response (Cm 7538). The Ombudsman’s findings of maladministration and injustice in relation to the accepted cases – and the terms in which those findings were accepted in the Response – are set out in section 2 of the Proposals.

- 2.2 In section 3 of the Proposals I set out the approach that I was then minded to adopt in reaching a view as to the basis on which the relative losses suffered by each class of policyholder should be determined in respect of each of the accepted cases. In particular, at paragraph 3.1, I identified two distinct heads of loss to which each of the Ombudsman’s Fourth and Sixth Findings could give rise. I described those as Head A and Head B loss. At paragraph 3.4, I raised the question whether I was precluded by the terms in which the Ombudsman had expressed her findings of injustice from considering any loss under Head B. I invited representations on that question; and, more generally, on the question whether I was permitted by my Terms of Reference to consider any loss beyond that which the Ombudsman has found to constitute injustice.
- 2.3 On consideration of the representations which have been made to me – and on further reflection – I have come to the view that, in the assessment of relative losses, it is unnecessary to distinguish between losses under Head A and Head B. The distinction assists in understanding the scope of the Ombudsman’s findings, but I do not intend to deploy it in the assessment of relative loss.
- 2.4 In addition to the distinction between losses under Head A and Head B, there is a distinction to which I did not refer in the Proposals: that is, the Ombudsman’s distinction between financial loss and lost opportunities. It is not clear whether the Ombudsman considered that that distinction should have a bearing on how relative loss should be quantified<sup>1</sup>, but once again it is important in understanding the scope of the Ombudsman’s findings of injustice.
- 2.5 I am not satisfied that I am yet in a position to answer the question whether I am permitted by my Terms of Reference to consider any loss beyond that which the Ombudsman has found to constitute injustice:

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<sup>1</sup> The Ombudsman has expressed the view at 1/14/140 (page 395) that assessing policyholders’ losses by reference to “relative loss” will “remedy any financial loss that has occurred and also the loss of opportunities to invest elsewhere than the Society”.

- (i) On the one hand, there are powerful arguments which point to the conclusion that I am not so permitted. It would risk overloading this Interim Report if those arguments were set out in full.
  - (ii) On the other hand, it may be said that my Terms of Reference do not require me to confine my consideration to those policyholders who might have been included (in respect of the accepted cases) under the scheme which the Ombudsman recommended: in particular, that I have not been asked, in terms, to confine my consideration to those policyholders in respect of whom the Ombudsman made specific findings of injustice. It may be said that a payment scheme would not be fair if it excluded policyholders who, on analysis, can be seen to have suffered (or to be likely to have suffered) actual or potential losses in respect of the accepted cases of maladministration – even if the reason for their exclusion were that they would not have qualified for compensation under the scheme which the Ombudsman had in mind.
- 2.6 For reasons which I shall explain, the question is of particular importance to those policyholders who, by July 1995<sup>2</sup>, were no longer in a position to withdraw funds from Equitable Life under the terms of their policies. Those who had invested in with-profits annuities before that date (“trapped annuitants”) are an obvious example.
- 2.7 In that context, it is pertinent to recognise that one consequence of the Government’s decision not to accept all the Ombudsman’s findings of maladministration resulting in injustice is that that date (July 1995) is some four years later than the equivalent date (July 1991) which she would have had in mind in this context when she made her finding of injustice at paragraph 1/12/100: so the number of trapped annuitants (and, potentially, others) who would be excluded is substantially larger than she would have expected. Nevertheless, the issue would have arisen even if the Government had accepted all of the Ombudsman’s findings in full: by July 1991, a significant number of with-profits annuitants held policies with Equitable Life. There is a real question as to whether these persons fell within the scope of the Ombudsman’s findings.
- 2.8 However, it is unnecessary to answer this question at this stage of my work; and it seems to me that the better course is to leave it open for further consideration. I invite interested parties to make their views known to me. I should emphasise, however, that while this issue remains to be determined, it is not necessary to determine the question before I continue with other aspects of my work.
- 2.9 It is important to emphasise that there are matters that my Advice should not and cannot encompass:
- (i) None of the Ombudsman’s findings, accepted or otherwise, relate to mis-selling. There can be no question of an ex-gratia payment scheme placing policyholders in the position that they would have been in if they had invested in a different type of product from that in which they actually invested.
  - (ii) With-profits policies carry an inherent risk of disappointed expectations, in the event that markets fall. That risk has eventuated and policyholders across many life offices

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<sup>2</sup> This is the date by which the 1994 regulatory returns would have been publicly available.

have experienced cuts in the values of their policies. In the circumstances, it would not be right for Equitable Life's policyholders to be placed in a better position than those who held policies with those other life offices. In particular, it would be improper to calculate any payments on a basis that placed policyholders in the position that they would have been in if Equitable Life had not made the policy value cuts that it made in the early 2000s.<sup>3</sup>

### **Who suffered injustice according to the Ombudsman's findings?**

- 2.10 Those whom the Ombudsman found to have suffered injustice resulting from the accepted cases of maladministration are identified in paragraphs 1/12/100, 1/12/146 and 1/12/168 of the Report:

*"I find that injustice was sustained by any policyholder who relied on the information contained in the Society's returns for [1994]<sup>4</sup> to 1996 and who suffered either a financial loss or a lost opportunity to take an informed decision as a result of such reliance. Where a policyholder neither relied on this information nor suffered a loss of either type, I find that no injustice resulted from this maladministration." (1/12/100)*

*"I find 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." (1/12/146)*

*"I find that injustice resulted from maladministration to all those who can show that they relied on misleading information provided by the FSA, that such reliance was reasonable in the circumstances, and that it led to a financial or other loss. Where all this cannot be shown, I find that no injustice resulted from this maladministration." (1/12/168)*

- 2.11 It can be seen that the Ombudsman recognised that the nature of the injustice suffered could be either "financial loss" or "a lost opportunity to take an informed decision". She had already pointed out (at paragraph 1/12/7) that the concept of injustice was capable of covering both heads. That her findings of injustice were made under both heads is confirmed in the summary of her determinations at paragraphs 1/13/181 and 1/14/34.

### ***The finding of injustice in respect of the Sixth Finding of maladministration***

- 2.12 For reasons which will appear, the finding of injustice in paragraph 1/12/146 is the most significant and it is convenient to consider it first. This finding must be read with a recognition of the duality of financial loss and lost opportunities to which I have referred above.

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<sup>3</sup> The Ombudsman has also emphasised this point at, for example, paragraph 1/12/173.

<sup>4</sup> Given the Government's rejection of the Ombudsman's Second and Fifth Findings of maladministration leading to injustice, the date "1990" which appears in this paragraph must be read as "1994" in the present context.

- 2.13 The first sentence of paragraph 1/12/146 can only refer to those who fall within its terms – that is to say, to those who either joined Equitable Life after 1 May 1999 or who paid a non-contractual premium after that date.
- 2.14 Notwithstanding the word “also”, the second sentence must refer to all those who were members of the Society on and after 1 May 1999 and who lost the opportunity to withdraw. Once it is appreciated that “lost opportunities to take informed decisions about their financial affairs” includes the loss of the opportunity to withdraw – as paragraph 1/12/41 demonstrates<sup>5</sup> – it is plain that the Ombudsman could not have intended to confine the class within the second sentence to those who also fell within the first sentence. There could be no possible reason for such a restriction.
- 2.15 It is important to appreciate that the finding of injustice in the first sentence of paragraph 1/12/146 contains no requirement of reliance. In that respect, the finding in paragraph 1/12/146 differs from the findings in paragraphs 1/12/100 and 1/12/168.<sup>6</sup>
- 2.16 It seems to me, therefore, that the effect of the finding of injustice in paragraph 1/12/146 – which the Government has accepted – is that all those who joined Equitable Life after 1 May 1999 or who paid a non-contractual premium after that date and all those who, as members of Equitable Life on 1 May 1999, had the right to withdraw funds under the terms of their policies but did not do so (because they were denied the opportunity to make an informed decision whether or not to withdraw) are persons who, if they could demonstrate that they suffered relative loss, would have been within the scheme which the Ombudsman recommended. Those who had no right to withdraw funds on or after 1 May 1999 are not brought within that scheme by paragraph 1/12/146.

#### ***The finding of injustice in respect of the Fourth Finding of maladministration***

- 2.17 The Ombudsman’s finding of injustice, at paragraph 1/12/100 of the report, is referable not only to her Fourth Finding of maladministration, but also to her Second and Fifth Findings: see paragraphs 1/12/83 and 1/12/89 of the Report and paragraphs 4.29, 4.76 and 4.113 of the Response.

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<sup>5</sup> “A further consequence of the acts and omissions of the FSA was that the ongoing weakness of the Society’s financial position was hidden from public view in the Society’s published returns for 1999 and 2000. Those considering their options – whether to invest, to make further contributions to existing policies, to convert a policy into an annuity, or simply to stay – were given a misleading picture of the true position faced by the Society and of its solvency position.” (emphasis added) This makes clear that the range of opportunities included the decision to remain within Equitable Life.

<sup>6</sup> A reason for that distinction may be found at paragraphs 1/12/123 and 1/12/126-145. Put shortly, the Ombudsman took the view that a consequence of the maladministration which she had found in relation to the treatment of the financial reinsurance arrangement in the 1998 accounts would have led to the failure of Equitable Life to declare a bonus. She took the view that the effect on the Society would have been so serious that it would no longer have been seen as an attractive investment vehicle. She must have been persuaded that it was so obvious that those who did, in fact, join the Society after 1 May 1999 would not have done so in those circumstances that it was unnecessary to require them to show reliance on the 1998 regulatory returns.

- 2.18 The first sentence of paragraph 1/12/100 makes clear that those policyholders who satisfy two criteria – (i) that they relied on information contained in the relevant regulatory returns; and (ii) that they have suffered either a financial loss or a lost opportunity to take an informed decision as a result of such reliance – fall within the class of those who are found to have suffered injustice.
- 2.19 The second sentence of paragraph 1/12/100 identifies, in terms, those policyholders who are found *not* to have suffered injustice: they are those who neither (i) relied on the information in the relevant regulatory returns nor (ii) suffered a financial loss or a lost opportunity to take an informed decision. In short, those who satisfy the criteria under both (i) and (ii) in the first sentence have suffered injustice: those who satisfy neither of those criteria have not suffered injustice.
- 2.20 It is clear that not all policyholders can be said to have relied on information contained in the regulatory returns. Indeed, by the time the relevant regulatory returns were published, some policyholders (most obviously the “trapped annuitants”) had no choice as to what to do with their funds. Such policyholders, together with any other policyholders to whom the publication of the regulatory returns would not have made a material difference, would appear to fall outside the scope of the injustice found by the Ombudsman as expressed in this sentence.<sup>7</sup>
- 2.21 It has been suggested that if the true position regarding Equitable’s finances had been made known, some “trapped annuitants” and other policyholders who could not, in practice, have withdrawn their funds might have taken action to change the Society’s management. In all the circumstances, I do not consider this to be realistic. My understanding is that the Society’s members have not, even when organised into action groups in the early 2000s, managed to elect a board member other than those recommended by the existing board. In any event, it is not clear that a board chosen by a more active membership would in fact have managed Equitable Life any more prudently than the existing board during the 1990s. If the Ombudsman had had in mind such a complex sequence of events, then I would have expected her to say so.
- 2.22 I conclude that the finding of injustice in respect of the accepted cases within the Fourth Finding of maladministration includes only those who actually relied on the regulatory returns for 1994, 1995 and 1996 to which the finding of maladministration relates. It does not include those who did not, or could not, rely on those returns.

### ***The finding of injustice in respect of the Tenth Finding of maladministration***

- 2.23 The injustice flowing from the Tenth Finding of maladministration is set out at paragraph 1/12/168. It seems likely that most of those affected by this finding would already fall within the finding in paragraph 1/12/146; which encompasses all who joined Equitable or made a non-obligatory payment after 1 May 1999. The only persons whose position might materially

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<sup>7</sup> To the extent that they shed light on paragraph 1/12/100, the preceding paragraphs (1/12/89-99) would tend to suggest that the Ombudsman did not intend to include such persons within the scope of this finding.

be affected by the finding in paragraph 1/12/168 are those who relied on information provided by the FSA in deciding to leave their funds invested in Equitable Life.

### *Reliance*

2.24 The Ombudsman contemplated that the question whether an individual relied on the information in the 1994 to 1996 regulatory returns – or on the information received from the FSA – would be determined on an individual basis.<sup>8</sup> In my view it would not be possible, either in principle or in practice (within an acceptable time frame), to administer a payment scheme under which claimants were required to establish reliance on the 1994 to 1996 regulatory returns (in respect of accepted cases within the Fourth Finding) or on the information provided by the FSA post closure, on an individual basis.

### New money investment decisions

2.25 The Ombudsman has pointed out (1/12/96) that an individual policyholder could not be expected, so long after the relevant events, to produce copies of the information or advice on which he relied in taking a decision to join Equitable Life or to pay further non-contractual premiums (a “new money decision”); and that it was unlikely – I would add, most unlikely – that the principal means through which policyholders would have been influenced by the information in the Society’s regulatory returns was through reading those returns at Companies House. She observed (1/12/97) that reliance was more likely to have been indirect: through exposure to comparative analyses of life insurance companies, company profiles, ratings produced by agencies or advice derived by actuarial consultants, IFAs or others from their examination of the returns.

2.26 It might, I think, be said that reliance could also be founded on the absence of press comment. Had there been no maladministration, it may be expected that there would have been adverse comment on Equitable Life’s solvency position in the financial press as early as July 1995 or (at latest) by July 1997; and that such adverse comment would have been likely to have come to the attention of some who could not show that they received or relied upon any specific information. They might well have believed Equitable Life to be a safe investment simply because it was being regulated; and might well have believed that, if the regulators had identified any cause for concern, they would have addressed that concern. Are those policyholders to be excluded from a payment scheme because they cannot demonstrate reliance on specific information? And, if they are not to be excluded for that reason, how are they to establish that, had there been adverse press comment, it would have come to their attention and they would have acted upon it? I do not see how those questions could be determined fairly, even if policyholders were all given a chance to be heard individually.

2.27 Even if it were possible, in principle, to carry out a factual investigation into the question whether individual policyholders relied on the regulatory returns, it would be impossible to do so within an acceptable time frame. I am driven to that conclusion after taking account of the following matters:

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<sup>8</sup> See paragraph 1/12/99 of the Report.

- (i) It would be improper for the Government to pay public money to every person who claimed to have relied on the regulatory returns without submitting those claims to some kind of scrutiny.
  - (ii) The proper scrutiny of claims would take a long time and involve substantial resources. I am advised that the number of new money investment decisions made between 1 July 1995 and 1 May 1999 exceeded 30 million, each of which could give rise to a claim and the need for individual scrutiny.
  - (iii) The process for scrutinising claims would impose burdens on claimants. They would need to search records, assemble documentary evidence (so far as available to them) and complete and submit claim forms. They might wish to attend a hearing to make oral representations. That might lead some to incur the expense of instructing lawyers.
  - (iv) The outcome of a factual investigation would, inevitably, leave some claimants dissatisfied – in that some who did, in fact, rely on the regulatory returns would be unable to establish this reliance to the requisite standard.<sup>9</sup>
- 2.28 An alternative methodology in respect of claimants who made new money investment decisions would be to make a general assessment of the likelihood that policyholders of the same class who made such investment decisions at or about the same time did rely on the regulatory returns; and to apply an appropriate factor (to reflect the degree of likelihood) to all such policyholders. This was the approach recommended to the Public Administration Select Committee (the “PASC”) by some of those who made representations to that Committee. The PASC did not, itself, express a view on this approach; but it seems to have been sympathetic to some of the difficulties involved in requiring policyholders to prove reliance<sup>10</sup> and it may be thought to have found this approach attractive. But, because the impact that the maladministration had on the contents of the regulatory returns changed over time, it would be necessary to make a series of assessments: that is to say, it would be necessary not only to make a number of class based assessments at any given time but also to make such assessments at different times.
- 2.29 An approach to reliance which adopted this methodology would, I think, be preferable to the approach which the Ombudsman had in mind – that is to say, determination of reliance on an individual basis – but it would remain unsatisfactory in at least two respects: (i) it would involve what could be said to be a subjective view as to the likelihood that policyholders of the same class who made new investment decisions at or about the same time did (or did not) rely on the regulatory returns; and (ii) it would necessarily lead to a result in which policyholders who did, in fact, rely on the returns were under-paid and those who did not, in fact, rely on the returns were paid wrongly.

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<sup>9</sup> Any determination as to whether a policyholder relied on the regulatory returns would presumably be made on a “balance of probabilities” test. However, there is a strong element of artificiality in applying this test in relation to the question what a person would have done some ten to fifteen years ago: it is hard to justify the sharp distinction that would need to be drawn between those who just surmount the hurdle and those who just fail to do so.

<sup>10</sup> See paragraphs 60-63 of the PASC’s Report, “Justice Delayed” dated 11 December 2008.

## No-withdrawal investment decisions and lost opportunities

2.30 In the preceding paragraphs I have addressed the need of those who made new money investment decisions to establish reliance on the information in the 1994 to 1996 regulatory returns; or on the information received from the FSA. I turn now to those – perhaps not many in number – who did, in fact, make decisions not to withdraw funds from Equitable Life (“no-withdrawal investment decisions”) in circumstances where they had the right to do so under the terms of their policies; and to those – more numerous – who might have made a decision to withdraw funds (having the right to do so) had different information been available to them (lost opportunities).

2.31 For a policyholder to establish a claim in relation to a no-withdrawal investment decision, he would need to demonstrate:

- (i) that he made a positive decision not to withdraw funds from Equitable Life at a time when he had a right to do so;
- (ii) that, in a case where he made that decision before 1 May 1999, he relied on the information that was in the public domain;
- (iii) that, if there had been no maladministration, he would have received different information about Equitable Life’s financial position at a relevant time; and
- (iv) that, on the basis of that different information, he would have decided to withdraw funds that were at that time held within an Equitable Life policy.

The position is less clear if the no-withdrawal investment decision was made after 1 May 1999. No-withdrawal investment decisions do not fall within the first sentence of the finding of injustice in paragraph 1/12/146 of the Report. They could fall within the second sentence of that paragraph; but I have not yet reached a firm view as to whether or not the Ombudsman intended that those within the second sentence of paragraph 1/12/146 would need to demonstrate reliance on the 1998 returns.

2.32 The position is different again for a policyholder who did not, in fact, make a no-withdrawal decision, but who might have made a decision to withdraw funds from Equitable Life had different information been available to him (assuming that he had the right to do so). Such a policyholder was denied an opportunity to make a relevant decision as a result of maladministration. To establish a claim such a policyholder would need to demonstrate the matters to which I have referred under (iii) and (iv) in the previous paragraph; or (at the least) to demonstrate that, on the basis of the different information about Equitable Life’s financial position which he would have received from time to time, he *might* have decided to withdraw funds.

2.33 If I were to assume that the claim of a policyholder who did, in fact, make a no-withdrawal decision could be determined on an individual basis, the difficulties to which I have already referred (in the context of new money investment decisions) would apply with no less force. But that assumption cannot be made in the case of a lost opportunities claim. In such a case it is not possible to address the matters to which I have referred under (iii) and (iv) in paragraph 2.31 on an individual basis: in particular it is not possible to say, with any degree of certainty, how an individual policyholder who did not, in fact, consider withdrawing funds from

Equitable Life would have acted (and when) in response to information about Equitable Life's financial position which would, or might, have come into the public domain from time to time if there had been no maladministration.

- 2.34 A further difficulty that would arise in relation to claims of this nature is that *if* a large number of policyholders had attempted to withdraw funds simultaneously (that is, there was a "run" on Equitable Life), it is likely that the Society would not have been able to meet their demands without reducing policy values. I would need to decide whether policyholders' losses should be assessed with reference to the reduction that would have had to be made in those circumstances.

## Summary

- 2.35 To summarise, the difficulties of applying a Report-based approach to different classes of policyholders are as follows:
- (i) In the case of policyholders who did, in fact, make relevant new money investment decisions, the principal difficulty with making determinations on an individual basis as contemplated by the Ombudsman is how properly to determine (within an acceptable time frame or at all) whether an individual actually relied on the information which was available to him.
  - (ii) In the case of policyholders who did, in fact, make no-withdrawal investment decisions, that difficulty is compounded by the further difficulty as to how properly to determine what an individual would have done at the relevant time if different information had been available to him.
  - (iii) In the case of policyholders who can claim only on the basis of lost opportunities, those difficulties are further compounded by the difficulty as to how properly to determine what an individual would or might have done if (from time to time) different information had been available to him. By way of example: how can an individual policyholder be expected, now, to give a credible answer to the question what he or she would have done if, say, there had been a series of negative articles about Equitable Life in the press in 1996?

## Assessment of loss on the basis of the Ombudsman's findings of injustice

- 2.36 If, notwithstanding the difficulties associated with the need to establish reliance, I were to seek to assess relative loss on the basis contemplated in the Report – and on the basis of the Ombudsman's findings of injustice – I would need to make the following determinations:
- (i) In the case of a new money investment decision and a no-withdrawal investment decision, a determination of the difference between (a) the value that the sum paid to Equitable Life – or left invested in Equitable Life (as the case may be) – pursuant to each relevant investment decision would have had at an appropriate end date if that sum had been invested in an appropriate comparator and (b) the value that such sum paid to (or left invested in) Equitable Life actually did have in the hands of the policyholder at

the end date<sup>11</sup>. For convenience, I will call that difference in the case of each relevant investment decision 'X' and the aggregate in respect of each policyholder 'ΣX'; so that:

$$\sum_{i=1}^n X_i = X_1 + X_2 + \dots + X_n$$

where 'n' is the total number of relevant investment decisions made by the policyholder during the period in question.

- (ii) If I were to adopt what I have described as an alternative methodology in those cases where it was necessary to establish reliance, a determination of the appropriate factor (x) – or factors (x<sub>1</sub>, x<sub>2</sub> . . . x<sub>n</sub>) – to reflect the likelihood that policyholders in the relevant class would in fact have relied on the regulatory return at the relevant time. The computation of relative loss would be:

$$\sum_{i=1}^n X_i \cdot x_i = X_1 \cdot x_1 + X_2 \cdot x_2 + \dots + X_n \cdot x_n$$

- (iii) In the case of lost opportunities, a determination of the appropriate discount (y) to reflect the chance that the policyholder who, in fact, took no relevant investment decision would, if different information had been available to him, have decided to withdraw. As I have said, in such cases, the difficulty lies in ascertaining the date (or dates) on which, had there been no maladministration, the policy holder would or might have decided to withdraw funds from Equitable Life and invest elsewhere. The terms of his policy may well have entitled him to make that decision at any time; but it is likely to be possible to say that there are a limited number of temporal windows during which, had there been no maladministration, consideration would actually have been given to making a decision to withdraw or not to withdraw. Periods shortly after the publication of the 1996 regulatory returns and the publication of the 1998 regulatory returns are obvious examples. On the basis of assumptions founded on a limited number of temporal windows identified by reference to the publication of regulatory returns, lost opportunities could be assessed (in the manner described above) by reference to a series of notional no withdrawal investment decisions. The computation of overall loss would be:

$$\sum_{i=1}^n X_i \cdot y_i = X_1 \cdot y_1 + X_2 \cdot y_2 + \dots + X_n \cdot y_n$$

- 2.37 If I were to adopt the Report-based approach, I would need to address the questions that are set out in the Appendix to this Interim Report. Those questions would be relevant to determining the likelihood of policyholders making relevant investment decisions (that is, in the terms set out above, to determining the values for x and y).

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<sup>11</sup> In the case of with-profits annuitants, some additional matters will need to be taken into account.

## **A more flexible approach**

- 2.38 For reasons that will have become apparent, my present view is that an attempt to follow a Report-based approach to the assessment of loss would be at best unsatisfactory and more likely impossible.
- 2.39 Accordingly, I have found it necessary to consider whether there is an approach which avoids the difficulties which I have identified, while at the same time providing a fair and expeditious basis for a payment scheme. I am satisfied that these requirements can be met by an approach under which relative loss is calculated on a basis that would place all Equitable Life policyholders in the position that they would have been in at the end date if, from an appropriate start date – which, subject to the considerations discussed below, would be the date on which each policyholder first invested in Equitable Life – they had invested in an appropriate comparator.
- 2.40 I consider, first, whether I should adopt this more flexible approach, which departs from that canvassed in the Proposals; and second, if so, how I should give effect to this approach.

### ***Should I adopt the flexible approach?***

- 2.41 There are four reasons which lead me to the view that I should adopt the flexible approach (rather than some other approach which is not Report-based).
- (i) This approach avoids excluding those who did not rely, or who could not prove that they relied, on the relevant regulatory returns when taking investment decisions.
  - (ii) This approach avoids the need for the subjective determinations which would be involved in assessing relative losses under the Report-based approach.
  - (iii) This approach avoids the need to deal separately with financial loss (in the sense of loss actually suffered by reason of the investment in an Equitable Life product) and loss of opportunities (in the sense of loss suffered by being denied the opportunity of investing elsewhere). It is based on the assumption that, if Equitable Life had been properly regulated, it would have performed as an appropriate comparator would have performed.
  - (iv) This approach takes account of the possibility that some policyholders may have received excessive bonuses during the period covered by the Ombudsman's investigation. It does so by placing all policyholders in the position they would have been in if, from the start date, they had invested in an appropriate comparator. If bonuses declared by Equitable Life during the period covered by the Ombudsman's investigation exceeded those declared by other life offices at that time, then this will be taken into account in the comparison.
- 2.42 In my view the flexible approach is fairer, quicker and more certain than the approach outlined in the Proposals, which closely followed that suggested in the Report. I invite comment on this view.

### *How should I give effect to the flexible approach?*

- 2.43 The flexible approach gives rise to three matters for determination:
- (i) What is the appropriate start date for each class of policyholders?
  - (ii) How should an appropriate comparator be determined in respect of each class of policyholders?
  - (iii) What is the appropriate end date in respect of each class of policyholders?
- 2.44 The natural start date for each policyholder is the date on which he first invested in Equitable Life. In the case of those policyholders who first invested before 1 January 1990, that date (rather than the date of first investment) may be the appropriate start date because it is the beginning of the period covered by the Ombudsman's investigation. There are practical difficulties with this date, in that the necessary data is not readily available before 1992 (and even later, in some cases). My actuarial advisers are currently considering this issue, and hope to be able to make any necessary reconstructions.
- 2.45 I am advised that it is not possible to say that any one single life office provides an appropriate comparator to Equitable Life's business. It will therefore be necessary for my actuarial advisers to create a model comparator with reference to market data from the relevant period. It will be necessary to give careful consideration to what assumptions should be made as to the characteristics of the comparator. I invite comment as to what those assumptions should be.
- 2.46 One major consideration that I have identified is whether the appropriate comparator should be modelled by reference to the best, median or most poorly performing life offices over the period. This consideration is likely to be influenced by the fact that Equitable Life's business was carried on pursuant to a policy of full distribution. This fact was known to all policyholders, or would have been known to any who made the most rudimentary inquiry into the life assurance industry. In creating a model based on data from other life offices, it seems to me that it may be appropriate to assume that the comparator would have adopted a similar policy of full distribution. I currently take the view that if a life office were to operate a policy of full distribution responsibly, it would adopt a conservative approach to investments. That would be reflected in the assumptions to be made as to yield and growth of the fund. I invite comment on these points.
- 2.47 The appropriate end date is likely to vary in respect of different categories of policyholder. My current view is that the following dates are appropriate:
- (i) Where none of the special considerations below are involved, an appropriate end date would be 30 June 2008 (provided this is practicable by reference to the existing data). This is the nearest half-year-end to the date on which the Ombudsman published her Report. Recent market volatility makes the quantum of any payment very sensitive to the choice of end date. I am advised that 30 June 2008 represents neither a high point nor a low point of British stock market indicators during the past two years.
  - (ii) Where a policyholder has withdrawn funds from Equitable Life, it is appropriate to treat the date of withdrawal as the appropriate end date.

- (iii) Where a policyholder has died, it is appropriate to use the date of death (assuming payment is to be made to the policyholder's estate) as the end date.
  - (iv) I am advised that due to the availability of data, the appropriate end date for with-profits annuitants is 31 December 2007 (the date on which all such policies were transferred from Equitable Life to the Prudential).
  - (v) Whatever end date is chosen, it will be necessary to consider an appropriate rate of interest from that end date to the date of payment.
- 2.48 In addition to the matters above, there are some further matters that will need to be considered:
- (i) It will be necessary to consider whether policyholders who were beneficiaries under group schemes should be treated differently from other policyholders. My current view is that there is no reason for this.
  - (ii) Some policyholders will have experienced a relative gain under one policy, but a relative loss under another. My current view, on which I invite comment, is that these two figures should be netted off against one another.
  - (iii) It will be necessary to take account of the tax that policyholders (and particularly with-profits annuitants) would have paid on any additional income that they would have received if invested in a comparator. I invite representations as to how this should be addressed.

### 3 PROPOSED APPROACH TO APPORTIONMENT

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*[References in the form “Penrose X/Y” are to chapter X, paragraph Y of the Penrose Report].*

3.1 I turn now to the second matter on which I am required by my Terms of Reference to advise:

*“the proportion of [the relative losses suffered by different classes of policyholder in relation to the accepted cases of maladministration] which it would be appropriate to apportion to the public bodies investigated by the Ombudsman, as opposed to the actions of Equitable Life and other parties”*

3.2 In carrying out that task I am required to accept as definitive the Ombudsman’s account of the events at Equitable Life, as set out in the narrative sections of Part 1 of her Report and in Part 3. I may make such other findings of fact (if any) as I may think necessary in the light of the evidence contained in the publicly available reports produced to date, including the Penrose Report, the Ombudsman’s Report and the Government’s Response to that Report; and I may review additional evidence should this be necessary, but having regard to the need, so far as possible, for an expeditious process.

#### **Principles to be applied in making an apportionment**

3.3 I understand that at law the rule that would apply as between joint wrongdoers is that of “joint and several liability”: that is to say, where two or more persons are jointly liable for the same wrong, each of them is separately liable to pay the victim of the wrongdoing the whole amount of any damages awarded by the court. But a wrongdoer who makes a payment to the victim is entitled to seek a “contribution” from the other wrongdoers; so as to bear only whatever proportion of his payment the court considers appropriate.

3.4 It is important to have in mind, as a starting point, that none of the public bodies investigated by the Ombudsman has been found to have breached a legal duty to Equitable Life’s policyholders. Further, it is clear that I cannot reach any view as to whether any other persons were liable in law for causing the losses that policyholders have suffered. If there were such liability, the proper course for those affected would be to bring a claim or claims through the courts (as some have done). If I were to seek to apply the legal principle of “joint and several liability” to the losses suffered by policyholders in relation to the accepted cases of maladministration, then I could make no apportionment between the public bodies and other parties. The fact that I have been asked to consider apportionment is indication enough that I am not expected to apply legal concepts; save, perhaps, by analogy.

3.5 I do not understand myself to be limited by my Terms of Reference to a consideration of those matters that could be taken into account in any analogous exercise in apportionment between joint wrongdoers in legal proceedings. I have been asked to advise on what apportionment is “appropriate”. I take that to confer a wide discretion as to what matters I may take into account.

3.6 I am fortified in this view by the Law Commission’s Consultation Paper no. 187, “Administrative Redress”, which includes a recommendation that a system of legal redress be

instituted for individuals who have suffered loss due to substandard administrative action. One feature of this recommendation is that, where a public body is found to have been negligent in respect of an action that is “truly public”<sup>12</sup>, the court should have the discretion to disregard the principle of joint and several liability and to determine liability proportionately, based on the extent of the public body’s responsibility for the claimant’s loss.<sup>13</sup> The Law Commission recommended that “responsibility” in such context should be assessed according to both the degree of the public body’s fault and the extent to which it contributed to the damage.<sup>14</sup>

- 3.7 It is my present, and provisional, view that I should only consider a notional apportionment of losses suffered by policyholders in relation to the accepted cases of maladministration where some party (not being a public body) has acted in breach of a regulatory or professional obligation. Plainly, I ought not to restrict notional apportionment to cases where there has been the commission of a wrong directly actionable at the suit of Equitable Life or its policyholders – even if it were within the scope of my remit to decide whether an actionable wrong had been committed – but, as it seems to me, I do need to find something more than mere improvidence or mismanagement. I invite representations as to this approach.

### **Whose conduct should give rise to a notional apportionment?**

- 3.8 My starting point is the Penrose Report. In its Response<sup>15</sup>, the Government referred to Lord Penrose’s observations that the Society was the author of its own misfortunes. Lord Penrose had said this (Penrose 20/83-84):

*“83. As for the regulatory system, I do believe that it has failed policyholders in this case. This is not, in general, because of individual failures. I do not pin that blame on individuals, who in the main have operated in good faith and to the best of their abilities within the system as they found it. But I do take the view that the system itself was not overseen, and in particular was not kept up-to-date, and operated in an ineffective manner.*

*84. The deficiencies are not so obvious as some are inclined (or wish) to believe. And, it is seldom enough, and it is not enough in this case, to infer from the coincidence of systems deficiencies and loss that one caused or contributed to the other. Principally, the Society was author of its own misfortunes. Regulatory system failures were secondary factors. The jurisdiction to adjudicate on regulatory failure in duty is not mine. Even less is it for me to comment on how government should respond if it were to acknowledge that there had been regulatory failure. But it may be appropriate to comment that the practices of the*

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<sup>12</sup> The Law Commission’s provisional views as to what should constitute a “truly public” action are set out at paragraphs 4.110-4.115 of the Consultation Paper.

<sup>13</sup> See paragraphs 4.190-4.195 of the Consultation Paper.

<sup>14</sup> See footnote 159 to paragraph 4.190 of the Consultation Paper, referring to *Downs v Chappell* [1997] 1 WLR 426.

<sup>15</sup> See the Executive Summary at page 3 and paragraph 2.9 of the Response.

*Society's management could not have been sustained over a material part of the 1990s had there been in place an appropriate regulatory structure adapted to the requirements of a changing industry that happened to manifest themselves in an extreme form in the case of Equitable Life."* [Emphasis added]

- 3.9 The Penrose Report was critical of those who were responsible for managing Equitable Life throughout the period covered by the Ombudsman's Report in a number of respects; and, in particular, critical of the Board (see the summary of conclusions at Penrose 19/83-115) and of the Executives (see the summary of conclusions at Penrose 19/116-137).
- 3.10 In the light of that criticism it is not difficult to see why some (perhaps, many) would consider it appropriate to apportion policyholders' losses as between the regulators and (effectively) Equitable Life's former management. Some suggestions as to the basis on which this might be done were made to the PASC in 2008, as recorded in paragraphs 70-78 of its Report, "Justice delayed: the Ombudsman's report on *Equitable Life*".
- 3.11 In deciding whether it would be appropriate, in the present case, to make a notional apportionment of loss between the public bodies and regulators and Equitable Life's former management, it seems to me that I need to give weight to the following matters.
- (i) There has been substantial investigation of the relevant events since the Penrose Inquiry. In particular, Equitable Life has brought proceedings against its former directors (and auditors). These proceedings came to a halt shortly before oral closing submissions were to be made, and after extensive evidence had been heard. I understand that the proceedings were settled on terms under which Equitable Life recovered nothing; and paid a contribution to some of the defendants' costs. In these circumstances, I cannot assume that those responsible for managing Equitable Life during the 1990s were culpable on the basis of the matters set out in the Penrose Report.<sup>16</sup> To reach a fair view on the issue of culpability would require me to examine in detail many of the issues raised during the litigation; and to examine extensive documentation, including some documents that may be covered by legal advice privilege. I do not consider this to be compatible with the need for an expeditious process.
  - (ii) There is a difficult question as to how far it can be said that potential mismanagement by Equitable Life itself was responsible for policyholders' losses, if those losses are to be assessed on a relative basis. To the extent that Equitable Life declared excessively generous bonuses in the early 1990s (if this occurred), this would be taken into account if I adopt the more flexible approach of assessing all policyholders' losses by reference to the date on which they first joined the Society (or the appropriate start date if this is different). Moreover, if the performance of Equitable Life's funds is to be measured by reference to a notional comparator modelled on the assumption of, say, a lower quartile investment return (as to which I have invited representations), it may well be said that there is already, effectively, a discount applied to take account of the fact that

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<sup>16</sup> In this respect, I respectfully differ from the view expressed by the PASC at paragraphs 70-78 of its Report. It may well be that if the PASC's attention had been directed to the outcome of the litigation against Equitable Life's former officers, it would not have expressed this view in quite the form it did.

Equitable Life may not have been as well managed as other life offices in the market at the time.

- (iii) The purpose of regulation was to serve as a check upon the actions of Equitable Life (including its directors and Appointed Actuary): that is, (a) to ensure that certain information concerning Equitable Life's financial position that was in the public domain was reliable and (b) to prevent policyholders suffering loss as a result of certain improvident actions by the Society and its officers. Therefore, losses of the kind that have been found by the Ombudsman could be said to be losses of the very kind that the system of regulation was in place to prevent. This, it seems to me, is the primary principle that I should have in mind in considering whether or not notionally to apportion some of the losses experienced to the Society itself.
- 3.12 I recognise, however, there will be circumstances in which it would be right to depart from the primary principle identified at sub-paragraph (iii) above. The system of regulation in place at the time relevant to the accepted cases of maladministration was based on the expectation that the regulated body would deal with the regulator in good faith. In a case where there has been a significant departure from that expectation, there is no longer a proper basis for the application of the principle.
- 3.13 I have considered whether this may be so in the present case in light of the findings of the Disciplinary Tribunal of the Institute of Actuaries against Mr Christopher Headdon (who was at the relevant time the Appointed Actuary of Equitable Life) in relation to his failure to disclose a side-letter to the reinsurance treaty to which the Ombudsman's Sixth Finding related. The Disciplinary Tribunal concluded that:
- "Mr Headdon should have disclosed the [side letter] to the FSA and it was plainly wrong of him not to have done so ... The system of the Appointed Actuary is heavily dependent upon open disclosure and dialogue with the Regulator and any material departure from complete openness and candour brings discredit to the profession."*<sup>17</sup>
- 3.14 My current view is that this finding is significant and may be sufficient to take the case outside the primary principle to which I have referred. If Mr Headdon *had* revealed the existence of the side-letter to GAD, then it seems to me that GAD would have been almost bound to decide that the reinsurance treaty had no value; and so would have refused to allow Equitable Life to rely on it in its 1998 regulatory returns. If this view is correct, then it follows that Mr Headdon's lack of openness and candour was one of the causes of the losses flowing from the Ombudsman's Sixth Finding. It may well be appropriate to make a notional apportionment to reflect this.
- 3.15 I am conscious that the Ombudsman has expressed the view (1/10/478) that the side-letter did not have *"any impact on the amount of offset that the Society could take for the [reinsurance treaty] within its regulatory returns"*, and has stated that she disregarded the

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<sup>17</sup> See paragraph 203 of the Decision of the Panel of the Disciplinary Tribunal of the Institute of Actuaries in the matter of The Equitable Life Assurance Society dated 30 January 2007. The Decision is available on-line at [http://www.actuaries.org.uk/data/assets/pdf\\_file/0005/27788/tribunal\\_rep\\_elas.pdf](http://www.actuaries.org.uk/data/assets/pdf_file/0005/27788/tribunal_rep_elas.pdf), with an executive summary at: [http://www.actuaries.org.uk/data/assets/pdf\\_file/0011/27767/tribunal\\_rep\\_elas\\_summary.pdf](http://www.actuaries.org.uk/data/assets/pdf_file/0011/27767/tribunal_rep_elas_summary.pdf).

existence and terms of the side-letter in reaching her conclusions. This informed her view that GAD committed maladministration even on the basis of the limited and uncandid disclosure made by Equitable Life: a view which, of course, the Government has accepted. But that finding does not dislodge the conclusion that Equitable Life (in the person of Mr Headdon) causally contributed to the losses suffered by Equitable Life's policyholders.

- 3.16 I note, also, that the investigating committee of the Institute of Actuaries had initially brought charges against Mr Headdon in relation to Equitable Life's regulatory returns, but that these charges were withdrawn following consideration of his written defence.<sup>18</sup> I need to reach a better understanding as to how closely those charges corresponded with the Ombudsman's findings in relation to Equitable Life's regulatory returns before I can reach a conclusion on whether to make an apportionment on the basis of Mr Headdon's conduct in relation to the side letter.
- 3.17 The second party whose conduct might be said to give rise to a notional apportionment of loss is the auditors. The audit was covered by the Penrose Inquiry, although Lord Penrose stressed that it was not part of his remit to express any views on the auditors' performance of their contractual or professional duties.<sup>19</sup> For this reason (as well as the collapse of Equitable Life's case against the auditors in the court proceedings), I would not consider it appropriate to make a notional apportionment to reflect the auditors' conduct on the basis of the Penrose Report.
- 3.18 But I am aware that disciplinary proceedings against Ernst & Young in respect of the audit of Equitable Life have been brought under the Joint Disciplinary Scheme of the Institute of Chartered Accountants of England and Wales; and that those proceedings are now close to a conclusion. The nature of the charges, and the report of the Tribunal which decided the proceedings based upon them, have not yet been made public: they remain subject to a non-disclosure order pending an appeal by Ernst & Young.
- 3.19 It does not seem to me that a notional apportionment in respect of the auditors' conduct could be subject to the objection that it impinged upon the primary principle to which I have referred earlier. Unlike the Society itself, the auditors were in the position of being fellow "watchdogs" with the regulators. The auditors, like the regulators, had responsibilities in relation to information concerning Equitable Life's financial position that was in the public domain; and the regulators had no responsibility to ensure that the auditors performed their task properly.
- 3.20 My present intention, therefore, is to wait until the findings in the disciplinary proceedings against Ernst & Young are published (following appeal) before expressing a view as to whether those findings provide a basis for a notional apportionment of some policyholders' losses on the basis of the auditors' conduct. If they do not do so, I am not, at present, minded to make a notional apportionment of loss on the basis of any alleged failings by the auditors.

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<sup>18</sup> See pages 2-3 of the executive summary of the Disciplinary Tribunal's findings, cited above.

<sup>19</sup> See Penrose 19/138-148 (summary); and Penrose 12 for a more detailed narrative of the audit of the Society during the period covered by Lord Penrose's Inquiry.

## Conclusions

- 3.21 At paragraph 3.8(ii) of the Proposals, I expressed the view that I should seek, so far as possible, to avoid the need for any form of “maxwellisation”, on the ground that that could result in substantial delay in giving advice under my Terms of Reference, which would be inconsistent with the need for expedition. There was no substantial objection to this approach, and I intend to adopt it.
- 3.22 With this in mind, I invite representations as to whether I am correct to proceed in the manner set out above. In particular, I would be assisted by representations directed to the following questions:
- (i) Subject to the matter of the side letter, would it be right to make no apportionment of losses in respect of the actions of the former Equitable Life management?
  - (ii) Would I be correct, in relation to the auditors, to limit myself to the findings made in the disciplinary proceedings?
  - (iii) Are there persons other than Equitable Life and its auditors (and if so whom) in relation to whose conduct policyholders’ relative losses might properly be apportioned?

## APPENDIX: QUESTIONS TO BE ADDRESSED IF THE REPORT-BASED APPROACH IS ADOPTED

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*The paragraphs below substantially reproduce the questions identified at Sections 4-7 of the Proposals. Those questions have been amended to take account of comments and representations I received. As a result of analysis conducted by my actuarial advisers, I am already in a position to answer some of the questions below. Where that is the case, I provide an outline of the answer in bold and italics below the question.*

### Questions to be considered in assessing relative losses generally

- 4.1 By reference to what end date should relative losses be assessed?
- 4.2 What was the policyholder's position at the end date, with reference to:
- (a) the size of the fund<sup>20</sup> available to the policyholder; and
  - (b) any sums received by way of an annuity or other payment out of the fund?
- 4.3 What would have been the policyholder's position at the end date if, instead of investing in Equitable Life, the policyholder had invested the same amount in a comparable product offered by another life assurance or pensions provider?
- 4.4 What special provision, if any, should be made in respect of the following classes of policyholders:
- (i) policyholders who have died;
  - (ii) policyholders who have surrendered a policy;
  - (iii) policyholders whose policy has been transferred to another life assurance or pensions provider; and
  - (iv) policyholders who have policies under group schemes?
- Should the treatment of such policyholders differ as between policies in different classes?
- 4.5 In respect of each relevant policy, how is a comparable product to be identified? In particular, should regard be had to:
- (i) a basket of comparable products offered by other life assurance or pensions providers; or
  - (ii) the product whose terms were the most similar to those being offered by Equitable Life?

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<sup>20</sup> The term "fund" as used throughout these questions includes notional funds used to calculate payments made to annuitants.

- 4.6 What would have been the size of the fund available to the policyholder if there had been no relevant maladministration? Where relevant, what sums would the policyholder have received pursuant to an annuity policy?
- 4.7 What subsequent steps taken by policyholders should be taken into account in assessing relative losses? In particular, should regard be had to:
- (i) the surrender of an Equitable Life policy and withdrawal of a fund with penalties;
  - (ii) the transfer of a fund from Equitable Life to another life assurance or pensions providers; and
  - (iii) the conversion of an Equitable Life policy fund into an Equitable Life annuity?
- 4.8 To what extent should relative losses be netted off against relative gains (if any) that have accrued as a result of the accepted instances of maladministration? If gains should be netted off against losses, should that extend to gains and losses accrued in respect of different policies held by the same policyholder?
- 4.9 To what extent have those policyholders who have suffered relative loss already been compensated by other parties, including, in particular, compensation for mis-selling or other wrongs received from Equitable Life itself?
- 4.10 How should double counting in the assessment of relative loss be avoided?
- 4.11 How far, consistent with fairness, can the calculation of relative loss be simplified with a view to expediting payments?

## Questions to be considered under the Fourth Finding

### *Maladministration*

- 4.12 What questions (if any) should GAD have raised in respect of the retirement age assumptions in each of the 1994, 1995 and 1996 returns and when should it have done so? In particular, should GAD have raised questions as to:
- (i) whether the actual assumption made was prudent in the light of emerging experience; and
  - (ii) if so, what reason led to the change from the assumption used in earlier years?
- 4.13 If GAD had raised those questions that it should have raised concerning the retirement age assumptions, then in respect of each relevant set of returns:
- (i) What justification (if any) would Equitable Life have been able to provide for the changes from its assumption made in earlier years?
  - (ii) If so, by what date would this justification have been provided?
  - (iii) Would GAD have been acting reasonably if it had accepted that justification?

***My preliminary investigations suggest that the documents which would enable me to answer these questions may not be available. My present view is that if these questions cannot be answered with reference to any existing documents, or with reference to other***

***publicly available material, I should proceed on the basis that Equitable Life would not have been able to justify the changes to its retirement age assumptions and that it should therefore have continued to use an assumed retirement age of 50 for the 1994, 1995 and 1996 returns. If this approach is adopted, it will provide an answer to the relevant parts of questions 4.14-4.18 below.***

- 4.14 In respect of the 1994 return:
- (i) If Equitable Life's justification for the change in its retirement age assumption had not satisfied GAD (acting reasonably), was the effect of the change in the age assumption so material that GAD should have insisted that Equitable Life amend the relevant sections of the return?
  - (ii) If so, what amendment or amendments would Equitable Life have made and when would it have done so?
- 4.15 If GAD had raised the questions that it should have raised regarding the retirement age assumption in the 1994 return and whatever the outcome in relation to that return, would Equitable Life have submitted returns for 1995 and/or 1996 that differed materially from those which it actually submitted? If so, in what respects would those returns have differed?
- 4.16 In respect of the 1995 return:
- (i) What amendments (if any) should GAD/DTI have insisted that Equitable Life make in respect of (a) its retirement age assumption and/or (b) reserves for GARs? What constraint (if any) does Response paragraph 4.106 impose on the answer to this question in respect of GARs?
  - (ii) By what date should GAD/DTI have ensured that such amendments were made? Does the answer to this question differ in respect of amendments regarding (a) retirement age assumptions and (b) reserves for GARs?
- 4.17 If GAD had raised the questions that it should have raised in respect of retirement age assumptions and reserves for GAR liabilities in relation to the 1995 return and whatever the outcome in relation to that return, would Equitable Life have submitted a return for 1996 that differed materially from that which it actually submitted? If so, in what respects would that return have differed?
- 4.18 In respect of the 1996 return:
- (i) What amendments should GAD/DTI have ensured that Equitable Life make in respect of (a) its retirement age assumptions and/or (b) reserves for GARs?
  - (ii) By what date should GAD/DTI have ensured that such amendments be made? Is the answer to this question different for amendments in respect of (a) retirement age assumptions and (b) GARs?
- 4.19 If it is permissible to assess loss on an alternative basis, what assumptions (if any) should be made as to policyholders' reliance on material published by the FSA and the reasonableness of such reliance?

## Relative loss

- 4.20 How (if at all) would the information contained in the regulatory returns or revised regulatory returns have come to the attention of policyholders? In particular, should regard be had to:
- (i) the possibility (however remote) that individual policyholders would themselves examine and review regulatory returns;
  - (ii) reporting in the financial press;
  - (iii) information published in with-profits guides;
  - (iv) figures provided by Equitable Life in marketing and reporting documentation;
  - (v) reviews by other life assurance companies;
  - (vi) information published by rating agencies;
  - (vii) advice provided by IFAs; and/or
  - (viii) advice provided by consulting actuaries.
- 4.21 If Equitable Life had published different or revised regulatory returns would whatever information that policyholders (other than those who themselves examined and reviewed those returns) would have received, have differed from that which they did actually receive? If so, in what respects?
- 4.22 In respect of each of the 1994, 1995 and 1996 returns, to what extent would the publication of different or revised returns have made a material difference to policyholders' perception of Equitable Life in comparison with other life offices participating in the same market at that time?

***The actuarial advice I have received indicates that if Equitable Life had submitted regulatory returns for each of 1994, 1995 and 1996 which (i) assumed a retirement age of 50; and (ii) made reserves in respect of GAR liabilities in the figures referred to at paragraph 1/10/324 of the Report<sup>21</sup> (that is, in the sum of £275 million for 1995 and £325 for 1996 ), without making any other adjustments, then the impact on some key figures as shown in or derived from the regulatory returns would have been:***

	1994	1995	1996
<b><i>Increase in mathematical reserves due to GAR reserve</i></b>	<b><i>£0m</i></b>	<b><i>£275m</i></b>	<b><i>£325m</i></b>
<b><i>Increase in mathematical reserves due to retirement age assumption of 50</i></b>	<b><i>£125m</i></b>	<b><i>£106m</i></b>	<b><i>£419m</i></b>
<b><i>Total increase in mathematical reserves</i></b>	<b><i>£125m</i></b>	<b><i>£381m</i></b>	<b><i>£744m</i></b>
<b><i>Impact on solvency</i></b>	<b><i>-£125m</i></b>	<b><i>-£381m</i></b>	<b><i>-£744m</i></b>
<b><i>Free Asset Ratio deduced from published returns</i></b>	<b><i>8.6%</i></b>	<b><i>10.3%</i></b>	<b><i>9.1%</i></b>
<b><i>Free Asset Ratio after impact on solvency</i></b>	<b><i>7.7%</i></b>	<b><i>8.0%</i></b>	<b><i>5.2%</i></b>
<b><i>Decrease in Free Asset Ratio due to impact on solvency</i></b>	<b><i>-0.9%</i></b>	<b><i>-2.3%</i></b>	<b><i>-3.9%</i></b>

- 4.23 Which classes of policyholders would have been in a position to take steps in direct or indirect reliance on the regulatory returns?

<sup>21</sup> The figures referred to by the Ombudsman at paragraph 1/10/324 were provided to her by the Government. I do not consider myself to be bound to accept them as correct, but I use them here by way of indication.

***I am advised that it is likely that holders of the following policies were in a position to take steps in reliance on the regulatory returns:***

- (i) ***policies that were issued after the returns were made available; and***
- (ii) ***with-profits policies that were in force at the time when the returns were made available and which gave the policyholder one or more of the following rights:***
  - (a) ***to surrender the policy for cash;***
  - (b) ***to transfer the policy to another provider;***
  - (c) ***to switch the benefits of the policy from with-profits to unit-linked;***
  - (d) ***to cease to make further payments; or***
  - (e) ***to cause the policy to vest and start drawing an annuity.***

4.24 What matters would have influenced the decisions of those policyholders who were able to take steps in direct or indirect reliance on the regulatory returns? In particular, to what extent would policyholders have been influenced by:

- (i) penalties (if any) payable for withdrawing funds or ceasing to make contributions; and/or
- (ii) the tax treatment of any steps taken at that stage?

4.25 Is it possible to identify classes of policyholders for whom, on the basis of information published in revised regulatory returns, it would have been:

- (i) obviously advantageous to invest in a comparative product offered by a life assurance or pensions provider other than Equitable Life or to move funds away from Equitable Life; and
- (ii) obviously not advantageous to invest other than with Equitable Life or to move funds away from Equitable Life?

On what basis should the relative loss suffered by those classes of policyholders who do not fall into either category be assessed?

4.26 In respect of each of the 1994, 1995 and 1996 returns, given the extent of the amendments required, what options would have been open to GAD /DTI if Equitable Life had refused to revise its regulatory returns as required by GAD/DTI?

4.27 What might Equitable Life have been expected to do if the DTI had threatened regulatory intervention following scrutiny of the returns for each of years 1994, 1995 and 1996?

- (i) Would Equitable Life have changed its approach to the conduct of its business? In particular, would it have taken any of the following steps (individually or in combination):
  - (a) taken out reinsurance and if so on what terms;
  - (b) declared different bonuses and if so what;
  - (c) taken credit for a larger future profits implicit item and if so in what sum;
  - (d) adopted a different investment strategy; and/or

- (e) started a new bonus series for new premiums, including new premiums on existing policies with GARs, subject to any constraints imposed by policy conditions?
  - (ii) Alternatively, would Equitable Life have chosen to leave the DTI with no alternative but to make a regulatory intervention?
- 4.28 If Equitable Life had left the DTI with no alternative but to make a regulatory intervention:
- (i) What form would that intervention have taken?
  - (ii) What consequences would have followed for existing policyholders? In particular:
    - (a) Would Equitable Life have been forced to close to new business earlier than it actually did? If so, when would it have closed to new business?
    - (b) Would Equitable Life have sought another commercial solution (including the sale of the business); and if so what solution?
    - (c) If Equitable Life would have been able to continue to write new business, would regulatory intervention nonetheless have had a material effect on existing policyholders?

## Questions to be considered under the Sixth Finding

### *Relative loss*

- 4.29 What would Equitable Life have done if the regulator had declined to allow it to take credit for the reinsurance treaty in its regulatory returns for 1998, 1999 and 2000? In particular, would Equitable Life have published different regulatory returns for 1998, 1999 and/or 2000 (including publishing returns with adjusted margins and/or increased use of the future profits implicit item)?
- 4.30 In assessing the financial position that would have been shown in the 1998 returns had no credit been taken for the reinsurance treaty, is it appropriate to take account of provisions (if any) in respect of GARs and any more prudent assumption as to retirement ages that should have been made in earlier returns – and in particular in the 1996 return?
- 4.31 If Equitable Life had not been permitted to take account of the reinsurance treaty in its 1998 return and if no other adjustments had been made, what would its published solvency position have been?

***The actuarial advice I have received indicates that if Equitable Life had submitted regulatory returns for 1998 which (i) took no credit for the reinsurance treaty, without making any other adjustments, and (ii) in addition, assumed a retirement age of 50 and made reserves in respect of GAR liabilities in the figures referred to at paragraph 1/10/324 of the Report, then the impact on some key figures as shown in or derived from the regulatory returns would have been:***

	<i>(i)</i>	<i>(ii)</i>
<b>Total increase in mathematical reserves</b>	<i>£1,011m</i>	<i>£1,290m</i>
<b>Impact on solvency</b>	<i>-£1,011m</i>	<i>-£1,290m</i>
<b>Free Asset Ratio deduced from published returns</b>	<i>8.9%</i>	<i>8.9%</i>
<b>Free Asset Ratio after impact on solvency</b>	<i>5.4%</i>	<i>4.4%</i>
<b>Decrease in Free Asset Ratio due to impact on solvency</b>	<i>-3.5%</i>	<i>-4.5%</i>

- 4.32 How (if at all) would the information contained in the regulatory returns have come to the attention of policyholders? In particular, should regard be had to:
- (i) the possibility (however remote) that individual policyholders would themselves examine and review regulatory returns;
  - (ii) reporting in the financial press;
  - (iii) information published in with-profits guides;
  - (iv) figures provided by Equitable Life in marketing and reporting documentation;
  - (v) reviews by other life assurance companies;
  - (vi) information published by rating agencies;
  - (vii) advice provided by IFAs; and/or
  - (viii) advice provided by consulting actuaries.
- 4.33 If Equitable Life had published different regulatory returns would whatever information that policyholders (other than those who themselves examined and reviewed those returns) would have received, have differed from that which they did actually receive? If so, in what respects?
- 4.34 To what extent would the publication of different regulatory returns have made a material difference to policyholders' perception of Equitable Life in comparison with other life offices participating in the same market at that time?
- 4.35 Which classes of policyholders would have been in a position to take steps in direct or indirect reliance on the regulatory returns?
- 4.36 What matters would have influenced the decisions of those policyholders who were able to take steps in direct or indirect reliance on the regulatory returns? In particular, to what extent would policyholders have been influenced by:
- (i) penalties (if any) payable for withdrawing funds or ceasing to make contributions; and/or
  - (ii) tax treatment of any steps taken at that stage?
- 4.37 Is it possible to identify classes of policyholders for whom, on the basis of information published in revised regulatory returns, it would have been:
- (i) obviously advantageous to invest in a comparative product offered by a life assurance or pensions provider other than Equitable Life or to move funds away from Equitable Life; and
  - (ii) obviously not advantageous to invest other than with Equitable Life or to move funds away from Equitable Life?

On what basis should the relative loss suffered by those classes of policyholders who do not fall into either category be assessed?

- 4.38 What would Equitable Life have done if the regulator had declined to allow it to take credit for the reinsurance treaty in its regulatory returns for 1998, 1999 and/or 2000? Specifically, would Equitable Life have changed its approach to the conduct of its business? In particular, would it have taken any of the following steps (individually or in combination):
- (i) renegotiated the terms of the reinsurance treaty with IRECO;
  - (ii) taken out alternative reinsurance cover (in which case, what alternative cover would have been permissible, and what impact would such a reinsurance treaty have had on the financial position of Equitable);
  - (iii) declared different bonuses and if so what;
  - (iv) taken credit for a larger future profits implicit item into account and if so in what sum;
  - (v) adopted a different investment strategy (including by reducing some of its equity exposure in favour of fixed interest assets);
  - (vi) applied market value adjusters; and/or
  - (vii) started a new bonus series for new premiums, including new premiums on existing policies with GARs, subject to any constraints imposed by policy conditions?
- 4.39 If Equitable Life had not been permitted to take account of the reinsurance treaty in its 1998 return and if no other adjustments were made:
- (i) Would Equitable Life have been able to declare (a) the bonus and (b) the increase in policy values that it in fact declared?
  - (ii) If not, (a) what bonus and (b) what increase in policy values would Equitable Life have in fact declared?
- 4.40 If Equitable Life had left the regulator with no alternative but to make a regulatory intervention:
- (i) What form would that intervention have taken?
  - (ii) What consequences would have followed for existing policyholders? In particular:
    - (a) Would Equitable Life have been forced to close to new business earlier than it actually did?
    - (b) Would Equitable Life have sought another commercial solution (including the sale of the business) and if so what solution?
    - (c) If Equitable Life would have been able to continue to write new business, would regulatory intervention nonetheless have had a material effect on existing policyholders'?

## Questions to be considered under the Tenth Finding

- 4.41 On the basis that:

- (i) the Ombudsman found at Report 1/12/167-168 (page 353) that no injustice resulted in cases where it could not be shown that a policyholder relied on misleading information provided by the FSA; that such reliance was reasonable in the circumstances; and that that could only be determined on an individual level; and
- (ii) the Government accepted at Response paragraph 4.178 (page 37) that the only way in which losses attributable to the Tenth Finding could be assessed was by looking at policyholders on an individual basis;

how can the extent of relative losses under the Tenth Finding be assessed consistently with the need to avoid imposing unrealistic burdens on claimants? Is there any alternative to requiring individuals to come forward and prove their cases?