Summary of "Equitable Life: Penrose and Beyond – anatomy of a fraud" A paper by Dr Michael Nassim

1973

- Equitable's new sales drive was seriously affected by the 1973 oil crisis, which caused a market crash followed by prolonged and severe inflation which led into a sustained bull market. An unprecedented compensatory rise in interest rates followed. Over its course, Appointed Actuary Barry Sherlock and his deputy Roy Ranson used the estate as well as earnings to fund bonus allocations and boost the Society's competitive performance record.

- That year an un-guaranteed terminal bonus adjustment was introduced, and *as a matter of policy* it became the dominant bonus form. Fatally, the actuaries from then on repeatedly advised the Board that terminal bonus was cheap to service because it did not require statutory reserving. ***Since this could only be true if the Society was prepared to renege on terminal bonus, it was a lethal seed of bad faith.***

1983

- By 1983 virtually all the estate was consumed, and the remaining funds were all taken up by unconsolidated terminal bonus. The with-profits fund was now a null fund. To support new solvency requirements under the 1982 Insurance Companies Act, all remaining capital appreciation was brought onto the books. With no further reserves and interest rates falling, senior management formulated a retrospective claw-back Differential Terminal Bonus Policy (DTBP) to fund Guaranteed Interest Rate (GAR) annuities on maturity. ***The DTBP was in bad faith, and its non-disclosure was potentially, if not then actually, fraudulent.***

1987

- Having finally consumed all its 200 year's accumulation of traditional assets, the Society now moved into over-allocation of bonus to current members so as to continue boosting its performance figures and sales drive. ***But since the performance figures sprang from an unrepeatable distribution of assets, the Society was thereafter trading on a false basis.***

- In 1988 more flexible managed pensions were due to be introduced, and the Society hoped fully to discontinue its onerous GAR policies. The senior management team (which included executive directors) elected to mix the new policies with the old in what was now a ***with-liabilities*** fund, nominally in order to continue using the unrepeatable performance figures.

- There was, however, by any reasonable standard an **absolute requirement** to disclose the DTBP and inequities of benefit and guarantee to the full Board at this fateful point - and to minute the discussion. But equally, no competent non-executive director would have approved carrying over the now inequitable liabilities into an extended and over-allocated fund. ***Not only was this in continuing bad faith, but also the Society was finally embarked on a fraudulent course.***

- If the full Board was not informed, then nor could anyone else be. ***Hence, once the unknowing sales force commenced selling the new policies, the fraud became established, finally trapping over 1 million people.***

  Ironically, 1987 was also when outgoing Insurance Directorate Actuary George Newton drew particular attention to the need for prudential and conduct of business regulators to monitor the abilities of companies in Equitable-style predicaments to satisfy policyholders' reasonable expectations. Failure to follow the position up was disastrous.

1988

- In order to carry on boosting sales, over the years to 2001, over-allocation was extended by devices that eroded statutory solvency margins, and by inappropriate Zillmer adjustments and loans which depended upon future premium income such that the fund degenerated further into a Ponzi scheme. By the year 2001, 930,000 new policyholders had been drawn to the lure of the Society's now spurious performance figures.

- ***Unfortunately, pension scheme trustees now insisted on retaining GAR privileges for a further 5 years, which hazardous inequity private policyholders unknowingly funded.***

1989

- In 1989 and 1990 Ranson and his assistant Christopher Headdon delivered a manifesto paper entitled "With Profits Without Mystery" (WPWM). It was a *post hoc* rationalisation for disappearance of the estate and periodic over-allocation, and purported to justify using all the unconsolidated terminal bonus allocations to back the guaranteed portions of policies and finance the business in the absence of any free reserves. The paper also stated that since the Society's practice was to pay out policy values in full, it was of little importance whether bonus was guaranteed or not. The actuarial audience was sceptical.

- ***But since the Society was already over-allocated and falling interest rates meant that the covert DTBP terminal bonus claw-back would sooner or later become necessary, the entire exposition was integral with pre-existing and fraudulent bad faith.*** **And** despite whatever whispers there now were in actuarial circles, prudential regulators and the Government Actuary's Department did not react, or recall Newton's caveats.

1993

- Scheme GAR privileges having ended, the DTBP could at last be deployed. It was obscurely placed in board papers and mentioned *en passant* to the regulators. Only slowly did directors and regulators realise the significance of what had happened, but from now on retiring GAR policyholders encountered it, and as time went on they increased in anger and number.

1998-2001

- Eventually the Society had to fund the *Hyman* test case on legality of the DTBP. Full re-insurance of the potential liability was too expensive, and so Headdon entered into a show treaty which effectively he negated by means of a side-letter agreement. And as lately as Feb 2000 Managing Director Nash told policyholders by letter that losing *Hyman* would cost no more than £50 million, i.e. what the Society would pay only if it won, and had been officially held on the books as such.

- ***When the House of Lords eventually found for Hyman the GAR liability was valued at £1.6 billion. The now hugely expanded £32 billion fund was between £8 billion and £10 billion short of with-profits status, and over a million policyholders were involved.***

- At this point the regulators had failed totally for 30 years. They misread the long inflationary wave and its distorting effects on competitive pressures. They allowed a WP fund to disperse its estate inequitably, incur excessive new business strain and move into over-allocation, did not react to disquiet over the WPWM paradigm, did not probe ambiguities of hypothecation, allowed inappropriate gross premium valuation, and failed to react to the DTBP, subordinated loan and quasi-Zillmer adjustment. Their failure was in part systemic, but predominantly attitudinal and hence operational. Regulators engaged in sometimes self-absolving debate about the inches while the ship was off course by miles and headed for the rocks.

2002

- Despite energetic representations, the Society, Treasury, regulators and judiciary turned a deliberately blind eye to the surrounding irregularities, previous fraudulent non-disclosures, mis-selling, and regulatory failure. ***In February 2002 the S425 Compromise, which was thereby founded on a false prospectus, went through.*** Further trouble was now inevitable.

2002-2005

- Some regulators, and most notably the FSA, remain locked in denial in continuance of self-absolution. The FSA deliberately ignored the evidence for fraudulent mis-selling before the Compromise, since claiming to have investigated and rejected the case without revealing its grounds. Like the Society, the FSA has become its own antithesis, and is now an unaccountable public danger.

- Despite continuing denial, overwhelming contrary evidence has shifted the burden of proof to the FSA and the Society. They must now demonstrate that the With-Profits Fund did not lose its with-profits status on disappearance of its free assets; that it did not thereafter trade on a false basis by using unrepeatable performance figures, did not next become a with-liabilities fund under circumstances of chronic over-allocation complicated by the GAR/DTBP issue, and that at no time did it degenerate further into a Ponzi scheme implemented by an ignorant sales force. ***<u>If it could be demonstrated that none of the above happened, only then should we concede that there was no fraud.</u>***

7 February 2005