Equitable Life ex-gratia payment scheme

Representations and Comments

From

EQUITABLE LIFE TRAPPED ANNUITANTS (ELTA)

To

Equitable Life ex-gratia payment scheme

Interim report

October 2009

CONTENTS

1 - EXECUTIVE SUMMARY

Sir John Chadwick produced his Interim Report in August 2009 setting out his preliminary proposal on the approach to be adopted and the issues to be addressed, and inviting comments from interested parties with a view to refining his approach. He invited comments and submissions from me as the co-ordinator of the Equitable Life Trapped Annuitants (ELTA).

I am very grateful for the opportunity to be able to respond. I seek to do so not only for the potential benefit of the ELTA community, but also for all the With Profits Annuitants (WPAs).

Sir John has stated that he would favour what he calls a "Flexible Approach" and there is no doubt that this is a logical and pragmatic approach to the development of an ex-gratia payment scheme. As such, it is entirely to be welcomed and is a substantive improvement over the "Report-based Approach" as it should ensure that all policyholders will be potentially included in any ex-gratia payment scheme irrespective of when their policy started and how many of the Parliamentary Ombudsman's findings of injustice are accepted or otherwise by the Government.

At present, and perhaps inevitably at this stage, there are few details that set out the precise methodology that he envisages. Until those details are made available it is ***not*** possible to give an unqualified approval. Indeed in our opinion further reflection and clarification is required specifically on the choice and application of the comparator and the so-called end date for the determination of losses and the manner in which this date affects the WPAs.

It is our opinion that the only logical choice of a Comparator, both in respect of supplier and product, for the WPAs is the Prudential's own With Profits Annuity (not the ELAS annuity now transferred to and administered by the Prudential of course).

Further, the end date for annuitants when determining their losses is when they are expected to "die" as determined from the various and relevant age tables. The date of calculation should certainly be post transfer to the Prudential and the calculation should take into account actual bonus performance to date and anticipated future bonus performance with the Prudential. For this group, the manner in which the annuity has performed and will perform post transfer in contrast to the Prudential's "home-grown" With Profits Annuity is dictated by the maladministration, which had already taken place.

However, it is clear that nothing as yet is actually finalised and Sir John states that he might need to reconsider his entire approach.

In these circumstances, in light of the lack of precise detail and the possibility of future changes in detail, or indeed in the strategic approach, it is only just and reasonable that, in that event, Sir John ensures that we are given the opportunity and time to make further representations once further clarification on approach and detail is available.

It must however be emphasised that the WPAs are elderly, many living with illnesses, some in care homes, etc. As a result, it is vital that some form of payment must be made as soon as possible so that at least they have some additional financial resource for their remaining years.

Peter Scawen
Oct 12th 2009

2 - INTRODUCTION

Sir John's Interim Report is arguably two separate reports combined into one. He describes two approaches:

1. The Report Based Approach; and

2. The Flexible Approach.

Whilst it is clear that Sir John Chadwick favours the Flexible Approach he also states, or more precisely invites submissions on the questions, which he sets out in his Introduction:

> *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.*

See Appendix A for the full Introduction of Sir John's Interim Report

There is no doubt that the Flexible Approach has the potential to produce a much better solution for the WPAs and all other policyholders, but since this choice is at least open to debate and at worst open to be rejected by Sir John and/or the Government at a later date, I am left in the position of in essence being invited to produce two responses.

This on the face of it seems to be quite a cumbersome approach. I have therefore decided to respond **ONLY** on Sir John's preferred approach at present that is **the Flexible Approach.**

> **However if this approach is subsequently *not* used and/or rejected by the Government, then there must be an opportunity provided to produce further submissions in response to what will be a quite different set of conditions and assumptions.**

But having said that, I cannot emphasise enough that the Flexible Approach as adopted by Sir John is, in my opinion and those of my advisors, a much improved and more logical approach to the issue of providing ex gratia payments to the WPAs of Equitable Life (ELAS) (now with the Prudential) and indeed in my opinion for all policyholders. In contrast, the Report-based approach seems in essence undeliverable.

There are several key changes in approach to that adopted in Sir John Chadwick's document entitled "Proposals as to the approach, etc" all of which are to be welcomed. I sought further clarification on two issues, which have caused some confusion amongst various readers of the document by exchange of e-mails (see Appendix B).

In his reply of 11th September, Laurence Emmett, writing from Sir John's office, makes the following three points:

1) *"In relation to your point 1, it is correct that Sir John currently intends to advise that WPAs (including those who had taken annuities before July 1995) should not be excluded from the classes of policyholders who may have suffered relative losses. However, it is not correct to conclude from this that "all WPAs will be entitled to a share of any compensation".*

I think that is quite clear that not all WPAs will necessarily automatically qualify for any share of the ex gratia payments. An analysis will be required to ascertain that "relative loss" has in fact occurred.

2) *"As for point 2, the Interim Report contains no suggestion that calculation of relative losses under the flexible approach will be reduced proportionately to reflect the fact that the Government has not accepted all the Ombudsman's findings of mal-administration."*

This is quite significant as it is quite clear that Sir John does ***not*** intend to establish an ex-gratia payment scheme that reduces any payment on the basis that only three of the Parliamentary Ombudsman's findings were accepted by the Government. In fact, Sir John is stating that WPAs will receive 100% of any ex-gratia payment made within the limits set out elsewhere.

3) *"Nor does it contain any suggestion that Sir John currently intends to recommend that relative losses be assessed on a basis that would place policyholders in precisely the position they would have been in but for the accepted cases of mal-administration."*

I think that is quite clear that Sir John is saying that WPAs cannot expect to be put back precisely where they might have been but for the maladministration, but I would hope and expect that they can be put into the position (subject to any reasonable discount as to which I comment further below) which they would have been in with a suitable comparator.

3 - THE FLEXIBLE APPROACH

In essence the Flexible Approach, more or less, seeks to cut through many of the esoteric twists and turns discussed so far by Lord Penrose, the Parliamentary Ombudsman and the Treasury and to address the key underlying issue. Basically, in my wording, the approach is:

> "The Government accepts that the Policyholders of ELAS have lost money as a result of mal-administration by Government departments, and that I (Sir John) am going to devise, as best as I am able, a scheme which would allow the delivery of ex gratia payments that is fair and that is adaptable to meet public purse constraints."

Whether that is accepted as a basic premise by the Government is another matter, but it is an approach that I accept as being most likely to deliver ex gratia payments to annuitants both quickly and fairly, notwithstanding that policyholders are potentially being placed in the position of being penalised as a result of a hopefully temporary financial crisis, not of their making.

Sir John sets out four cogent reasons for adopting this approach, which require no further comment from me other than to note that in 2.41(iv) he states

> *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.*

This may be self-evident but it needs stating that if you compare the performance of a policyholder class with a similar class of policyholders in the so called "comparator" over any period, then such issues in respect of comparative bonuses will be taken into account in the calculation.

He goes on to state:

> *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.*

As I say above, I believe that this approach is the one most likely to deliver a fair and just scheme of ex gratia payments for the reasons that will become apparent in the following paragraphs.

Sir John poses three questions:

> *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.*

So far as the WPAs are concerned there are very few policies that started before 1990 and even for those their "losses" in this period may be non–existent. As a result the key issue here is the apparent lack of data. I am taking that to mean lack of data in digital form because I cannot conceive that ELAS does not have on file the contractual values data for annuitants, such as:

Policyholder's name
Spouse's name
Date of birth
Consideration Money
Start date of the policy
Choice of ABR etc

Given that digital data exists from 1992 onwards and that the above data are available, then it is perfectly possible to iterate backwards for the missing data values. This is significant as in this period the Overall Rate of Return declared by ELAS was very high and it is possible that in this period the WPAs would have received more income than they might have done with the so called "comparator" so in fairness these payments need to be incorporated into any loss calculation.

For many WPAs there is an additional complication.

a) Some annuitants, such as myself, purchased a With Profits Annuity from a fund that was established with another life company and transferred to ELAS using the Open Market Option. There can be no doubt in respect of these individuals that the start of the With Profits Annuity is the appropriate start date.

b) Others had built up their fund within the Society and then took the benefits in cash form under the Open Market Option and then authorised ELAS to apply that cash to their own With Profits Annuity. It follows logically that their calculations must:

i. Go back to the date the policyholder became "a member of the Society", not the inception date of the With Profits Annuity itself.

ii. Treat the two transactions, the investment process and the annuity, quite separately for the purposes of determining any losses and the associated ex gratia payments, if any.

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.

As always I am writing ONLY about the WPAs and with that premise, the above statement *"that it is not possible to say that any one single life office provides an appropriate comparator to Equitable Life's business"* is simply ***not*** correct. ELAS was the first life office to offer With-Profits Annuities, but The Prudential, Norwich Union (now Aviva) and Scottish Widows quickly followed it by offering similar products.

Self-evidently, the Prudential is a logical comparator, partly because its methodology is very similar to that of ELAS and partly because nearly all the With Profits Annuities have been transferred to the Prudential, which now is in effect the custodian of the complete database of annuitants.

I will discuss this issue in more detail below. The aspect, which concerns me most within the Interim Report, is the advice that Sir John Chadwick has received on the appropriate date of calculation for annuitants being the date of transfer. This is entirely misguided. Again, I expand on this below.

Turning now to the issue of the so called “policy of full distribution”, Sir John states

> *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.*

I do not know how this conclusion “*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.”* was reached, but it flies in the face of common sense if nothing else.

I refer to the e-mail exchange at Appendix B and the series of references at Appendix E. The Ombudsman’s report does indeed state at 1/4/104 (page 60) that:

> “**104** The public bodies also said that **<u>it was not clear from</u>** where policyholders had derived a reasonable expectation that Equitable would set aside reserves for terminal bonuses, given the lack of a statutory requirement to do so and given the Society’s well publicised policy of full distribution. The public bodies submitted that, had Equitable set aside reserves, it would arguably have gone against the reasonable expectations of with-profits policyholders that there would be full distribution.”

However, I cannot reconcile that assertion and the assertions made by Lord Penrose with the findings of the Actuarial Disciplinary Committee quoted inter alia in the Ombudsman’s report at 1/12/157 (page 30) particularly at 1/12/157(i) and (ii). (See also Appendix E):.

> (i) *in implementing a stated philosophy of providing a full and fair return to policyholders, holding no estate apart from a revolving estate providing working capital, and treating policyholders as participating in a managed fund, the actuary had, over a long period of time, consistently failed to apply an appropriate smoothing policy, had failed to provide appropriate information to the Society’s board to enable proper consideration to be given to the consequences of his recommendations and had failed to maintain the publicised relationship between the investment reserve and total policy values notified annually to policyholders*;
>
> (ii) *in addition to the points above, the information provided to policyholders created a misleading impression of the Society’s financial strength. The Society’s board was provided with little information showing the relationship between the totality of the policy values including accrued terminal bonuses as notified to policyholders and the Society’s actual asset strength. No evidence was provided to the panel to indicate any proper degree of financial analysis undertaken by the Society during the period under examination*; [and]

I am not in a position to argue one way or the other but if after many years of research with full access to all the data, almost always internal and confidential, such bodies cannot reach a consensus it is quite unreasonable to expect the public to have reached informed decisions about this issue at the time.

It surely follows that WPAs could not reasonably be expected to know about and understand the so-called policy of full distribution and it would be equally unreasonable to place any reliance on such an assertion when assessing the approach to any ex-gratia payment and in making an adjustment to a comparator.

Lord Penrose's report includes at Chapter 17 paragraph 64 and Chapter 20 paragraph 5 the following: -

> "64. The statement was not entirely new: regulators had known for some considerable time that the Society's advertised policy was one of full distribution. **However, on the information communicated by the Society, the regulators would not have been in a position to challenge the statement that since 1986** "there had been times" when aggregate policyholders' asset shares exceeded the Society's assets. **There had in fact been no year-end at which that had not been the case."**
>
> "5. The gap between the representation of the Society's financial position in its published financial statements, for regulatory and Companies Act purposes, and its realistic financial position arose in large part from the absence of a coherent and consistently applied policy on bonus distribution and smoothing. The Society's frequently acclaimed principle of full distribution combined with its claim to ensure a smoothed return seem to have acted as an effective shield against a proper consideration by the regulators of Equitable's approach to bonus distribution."

I can only repeat what I have said earlier: if the regulators with all their professional expertise and access to data, unavailable to the public, failed to appreciate the true effect, it is quite unreasonable to expect WPAs to have understood the position and quite unreasonable to take this into consideration when holding the regulators to account and assessing ex gratia payments.

It is perhaps inevitable that the length and breadth of Lord Penrose's report mean that statements are made that are open to interpretation and sometimes appear contradictory. This in turn gives rise to the possibility that, depending on one's perspective, quotes that support one's arguments can be selectively chosen and used as the basis to justify actions or decisions.

As such the Penrose Report cannot be used in isolation without considerable care and without a full explanation of the rationale being used by any writer setting out why that particular quote is relevant to the point being made. In other words it is ***not*** enough to say "Lord Penrose says, etc." without putting the phrase into its precise context.

It should also be remembered that all of the ELAS's literature that it distributed to prospective WPAs talks about *reserves and smoothing policies*, which are of course completely incompatible with a policy of full distribution. I think it highly improbable that ANY WPA would have understood that, in fact, the Society had transferred the investment risk from itself to the WPAs by its policy of full distribution and by its calculation methodology whereby as much as 50% of the annuity was "un-guaranteed". In the absence of proper financial regulation, this converted what was supposed to be a secure retirement income into a product that makes "sub-prime lending" appear almost like a conservative financial policy! As a result, it would be unnecessarily penalizing annuitants to adjust a comparator to replicate in effect the errors that had been allowed to take place.

Since I am not aware of any other Life Office that practiced full distribution I am not clear how any model based on data from other life offices can possibly be constructed in any event. Indeed I can see no logic in this process since:

i. It is surely accepted by now that this financial strategy was deeply flawed and the primary reason for the failure of ELAS was that the regulators allowed such a flawed methodology to proceed in practice by means of poor financial scrutiny and regulation when in the circumstances proper regulation would have prevented that being the case; and

ii. The comparison should be with a Life Office or "basket" of life offices that acted in a manner that was properly regulated and therefore prudent and in the best traditions of this industry; that is one that did keep reserves, and did not adopt a policy of full distribution.

As a result, I cannot see that an adjustment of the comparator's model is justified. Such an approach would be to replicate the failings of regulation within that comparator which would appear to be to be nonsense.

Before I review the choice of a comparator there are some alternative possibilities:

i. An Alternative Transaction. I have discussed the so called Alternative Transaction in my first written submission to Sir John Chadwick and the conclusion that I reached was that whilst it gave the best solution in terms of allocating losses fairly across the WPA population, it was too complex and too intrusive and as a consequence was not practical.

ii. A replacement annuity. Many have argued that replacing the existing annuity with a guaranteed level annuity, based on any agreed loss as the consideration money, would be a possibility. This is unquestionably the easiest and quickest approach but it would ***not*** in my opinion deliver a fair allocation of ex gratia payments across WP policyholders. This flows from the above as a significant proportion WPAs would have chosen an Index Linked annuity or a 3% or 5% escalating annuity as their alternative transaction. These choices have a profound affect on the quantum of their loss calculations such that replacing the existing annuity with a guaranteed level annuity would leave some better off and others worse off relative to the majority. (I note in any event Sir John's rejection of a comparison against a non-with profits product.)

iii. An alternative Supplier, the so called, Comparator.

The only logical comparator for the WPAs is the Prudential for a number of reasons:

(1) The Prudential and ELAS were both perceived by investors as the 'quality' end of the market having apparently good With-Profits records and excellent reputations. The reality for ELAS was that this was illusory. As was evident from the experience of Mr T, see my first written submission to Sir John Chadwick, the Prudential would have been an alternative and this in itself makes the Prudential a powerful choice for a comparator.

(2) The Prudential placed policyholders whose policies had different terms and conditions into separate bonus series so that it is possible to match with the appropriate bonus series in the Prudential fund for the purpose of identifying any losses.

(3) The Prudential already has WPAs' details on their system and any other critical data can and must be provided by ELAS.

(4) Using a single fund as a proxy comparator avoids the complexity of agreeing and establishing a comparator from a basket of funds thus minimising delay before ex gratia payments can be paid.

Of course, the two policies had somewhat different conditions. There was no GIR offering with the Prudential and the method of calculation was somewhat different but the Prudential is the closest match that I am aware of.

Turning now to the issue of end date, Sir John states:

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.

It must be clear that, (*(ii) Where a policyholder has withdrawn funds from Equitable Life, it is appropriate to treat the date of withdrawal as the appropriate end date)* cannot and should not apply to the WPAs who were "sold" to the Prudential and consequently did not withdraw funds from ELAS. Further their future bonus prospects were dictated by the maladministration, which had gone before.

I believe I have covered this point (*(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.)* before in my first written submission. I stated at 4.3 "*(i) Where policyholders have died, then if spousal benefits and/or guarantees are part of the policy then of course they must be honoured. The problem arises where a policyholder dies in the period after the Government has offered in principle an ex-gratia payment and the date of a formal offer. I believe that the beneficiaries of these policyholders should receive the ex-gratia payment as if they were still alive."*

It is clear that each policyholder class has to be treated differently but the conclusion set out above, (*(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))* is based on flawed advice and is **simply wrong** for the following reasons:

i. The data post 2007 is available from the Prudential and indeed such data are essential in order to fairly calculate the losses for the WPAs. It is ***not*** correct to say such data are not available.

ii. The methodology used by the Prudential in calculating annuity payments for ex ELAS policyholders is EXACTLY the same as used by ELAS. (I shall call these policyholders ELAS/Prudential to distinguish them from the Prudential's home-grown WPAs.)

    All that has happened is that the share of the ELAS fund allocated to the WPAs is now managed by the Prudential with the benefit that its investment strategy is not so restricted and that it gives the possibility of a return to an increased Overall Rate of Return.

iii. These policyholders are in a ring fenced fund that isolates them from the general With-Profits fund of the Prudential and insulates the other Prudential policyholders and the shareholders from the risks associated with the ex ELAS annuities, other than that the General Fund can be used to make up any shortfalls with an interest bearing loan which has to be re-paid out of any “returns” made by the ex-ELAS fund.

It follows that the ELAS/Prudential With Profits will continue to see their incomes fall since:

i. The fund transferred to the Prudential arrived without reserves. In the transfer document the Prudential made it quite clear that it would wish to establish a reserve in line with its normal business practice.

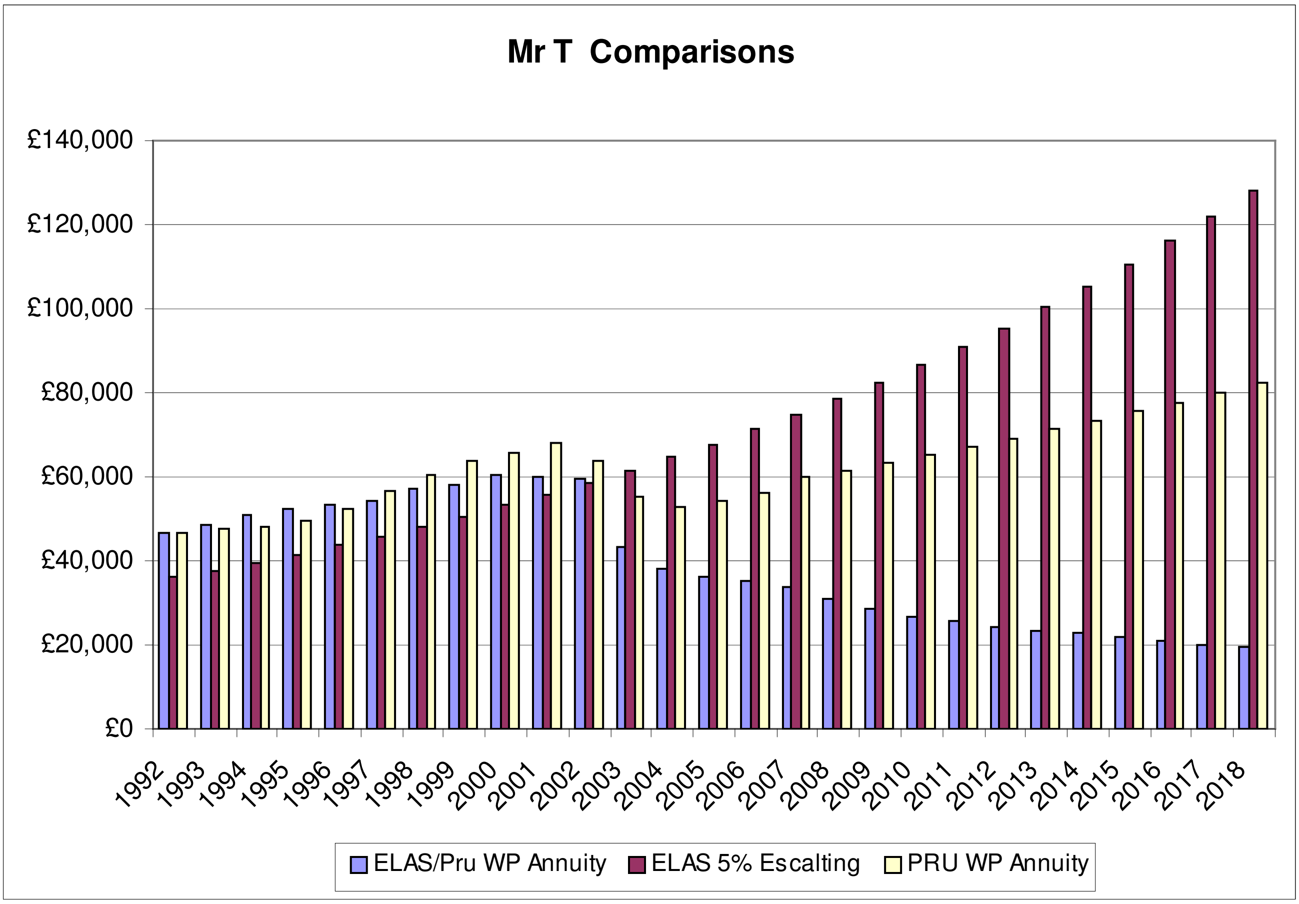
ii. In the short term, the Prudential stated that it would make up any shortfall with an interest-bearing loan, which had to be re-paid.

These two factors alone would have ensured that the Overall Rate of Return (ORR) declared by the Prudential for this class of its policyholders would not be enough to increase payments and indeed one would expect most annuity payments to decline.

This of course has been compounded such that for this year and next year the Prudential has announced that the ORR will be minus 5.5%, thus wiping out any part of the annuity income that was “not guaranteed” a re-run of the ELAS process that took place post 2002. This is entirely as a result of the issues associated with the regulation of ELAS. It is a direct and obvious consequence of the maladministration. To somehow apply a cut off to a continuing policy, which is behaving exactly as a result of the past maladministration, particularly when a comparator’s policies are continuing to behave differently would be entirely nonsensical.

Following an exchange of e-mails between Laurence Emmett and myself, it is now evident that the term end date as used in the Interim Report, potentially means the date at which Sir John’s stops using real historical data and relies on a forecast of future income for the WPAs until “they die” (or, pedantically, their age of death as determined from up to date age tables, adjusted for the current age of policyholders, sex, education and what used to be called “social class”) some time in the future. I comment further on this below but the vital element is that clearly it is preferable to use actual figures for as long as possible and only use assumptions at the latest possible point.
I covered this point in my first written submission but for ease of reading, I repeat the substance of the relevant section here below:

> By chance I happen to have a complete set of data for Mr T who considered buying a WPAnnuity from the Prudential in 1992 and what his alternative transaction was had he not bought a WPAnnuity from the Society. In fact he would have chosen a 5% escalating annuity.
>
> The chart below shows the effects projected forward to his 80th birthday. The numbers up to and including 2010 are hard but obviously from then until 2018 they are my best estimates. Of course the 5% escalating is a fixed number.



What it shows is:

i. The poor performance of the WPAnnuity from the Society compared to his alternative transaction.

ii. The disingenuous argument presented by the Government amongst others that the losses were entirely attributable to so called "market forces". As can be seen the Prudential WPAnnuity did in fact decline but has since recovered and there is every expectation that it will continue to do well. As I say elsewhere had the regulator acted promptly and forcibly this was one possible outcome for the Society.

iii. But most significantly it demonstrates how Mr T will continue to see his annuity income reduce relative to the Prudential's comparable product for the rest of his lifetime.

Two members of the ELTA community have provided additional data relating to the Performance of the Society, the Prudential and in addition Scottish Widows. They are particularly useful because the policyholders invested approximately the same amount of money at the same time with similar ABRs and thus provide an easy comparison. They illustrate some points of significance.

The details of Mr H's and Mr D's annuities can be found in Appendix D. In comparison to Mr T's, both Mr D's and Mr H's reductions are quite mild and this emphasises that "newer" policyholders have been less affected than ones that joined the Society many years ago. As a consequence the most severely affected are in general somewhat older and this reinforces the point that speed is of the essence.

These two examples provide clear evidence that whilst both annuities have been affected by market conditions, the Prudential and Scottish Widows have performed better. So the claim that the reductions were all down to market forces is clearly ***not*** true. It also emphasises the significant effects on those annuitants who purchased policies in the early to mid 1990's.

The point, of course, is that with the exception of ELAS, all the other pension providers survived the market conditions of the early 2000's and did not collapse, reflecting that they were managed prudently, and this once again emphasises that with prudent regulation ELAS could have survived.

As I have said before:

> **A) For those policyholders who "invested" in ELAS their losses essentially occurred in the past and are fixed.**
>
> **B) For the WPAs, whilst they have incurred losses to date, their losses occur mainly in the future and are not fixed and indeed will continue to increase.**

One of the major difficulties in determining future losses is the quantum of future bonus rates and future discount rates. They have a profound effect on the quantum of losses and are of course highly subjective. The recent and unexpected announcement by the Prudential that the Overall Rate of Return for 2009 and 2010 will be –5.5% (minus) will significantly impact the loss calculations and illustrates how difficult forecasts of such key data are.

In the recent litigation, now settled, Clarke Willmott appointed a number of technical witnesses, whose function was to provide their expertise in the support of our assessment of the losses. Clarke Willmott are willing to make the names of these experts available to Sir John to facilitate the calculation of losses for the WPAs.

I believe that it is:

i. Important to seek expert assistance direct from recognised experts on issues such as the appropriate choice of alternative transaction, the calculations used to determine losses, etc.

ii. Vital that the three interested parties, the Government, the Prudential and representatives of the WPAs have their views on the calculation of such claims canvassed and adjudicated so as to avoid any suggestion of impropriety.

Sir John concludes this section as follows:

> *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.*

I agree.

> *(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.*

I agree.

> *(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.*

This depends on how any ex-gratia payments are made:

i. If the payment is made as a lump sum AND is awarded free of tax, this effectively reduces the overall quantum of any payment. The downside is that the recipient has to advise Sir John of his/her tax rate or give enough information to Sir John so that the Inland Revenue can identify them. (Current tax codes may be available from the Prudential who are making annuity payments on the transferred policies.)

ii. If the payment is made as a lump sum and is NOT awarded free of tax, then any tax due will be recovered through the normal tax declaration and collection process. The only problem with this is for policyholders that might be pushed from one tax band into a higher band in the year of payment thus effectively penalizing them by excess tax.

iii. If the payment is made in the form of a new annuity, then taxation issues do not arise and of course this has the benefit that the cost to the public purse is spread out over a number of years.

There is another approach, which has some attractions for the WPAs and would be very simple to implement.

The Government could pay a considerable sum to Prudential, which would be used exclusively to increase the fund for the ELAS annuitants so that the income of the WPAs at least no longer declines and in fact hopefully increases as the markets improve and under the management of the Prudential with its greater investment policy flexibility.

Further it places the entire administrative burden onto the Prudential (but without adding to its cost because they would be taking no steps which they would not otherwise be doing in any event), deals with tax and ensures that everyone gets their fair share of the ex gratia payments without having to determine individual calculations.

This approach has much to be said in its favour, but needs to be considered in the context that: -

i. The small number of WPAs who have already received some compensation through the courts might be overcompensated if a full payment is made to make up the full deficit – of course, there is considerable scope for argument in any event whether the compensation actually relates to the same failings, or whether the compensation actually received did compensate in full;

ii. It might compensate any annuitant who for whatever reason Sir John determines should not receive any ex-gratia payment; and

iii. This method must be adapted to take into account policyholders who have died in the circumstances described earlier in the submission. It may well be that a simple pro-rata cash payment to their dependants would be the easiest solution as evidently an annuity is most cases will not be appropriate or even feasible.

Almost without exception the ELTA members who commented were wholly supportive of this approach.

But most importantly it must be absolutely ensured that any payment of this type to the Prudential must be on condition that this money is used solely and exclusively for the ELAS WPAs and not for distribution to other policyholders or the shareholders by way of profits.

It also has two additional advantages.

1) Such an approach can be implemented **very quickly**--something that is of vital importance for a community that is elderly, often suffering illnesses and increasingly impoverished. Speed must be of the essence.

2) Any such payment could be in the form of a loan (interest bearing or not) to the ring-fenced WPAs' fund, repayable from the residue of the fund after the demise of all the WPAs. This should surely be of more interest to the government and the Treasury, since in some respects this eases the question of funding the ex-gratia payments for the annuitants.

4 - PROPOSED APPROACH TO APPORTIONMENT

It seems to me that there are two key issues to be considered:

1) The Penrose Report

> *3.8 My starting point is the Penrose Report. In its Response15, 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 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."*

It seems to me that Lord Penrose says on the one hand *"the Society was author of its own misfortunes"* and *"the regulatory system failures were secondary"* and then goes on to state "*But it may be appropriate to comment that the practices of the 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."*

Maybe I misunderstand, but that makes two contradictory statements which can only be reconciled if it is accepted that with proper regulation, ELAS would have been unable to be the "author of its own misfortunes". In any event in my view it is quite irrelevant for the purposes of a proper ex gratia payment scheme:

> 1) It is a statement of the obvious that the Society was author of its own misfortunes, who else was or could have been managing the Society, but the point is that "the practices of the Society's management could not have been sustained over a material part of the 1990s had there been in place an appropriate regulatory structure".
>
> 2) This statement was made many years ago and prior to the various legal actions that ultimately resulted in the second enquiry by the Ombudsman and her report and findings of mal-administration, accepted at least in part by the Government, and the primary driver in the establishment of Sir John's task to establish an "Ex-Gratia Payment Scheme".

The ex gratia payment scheme has been established to deal with the **accepted** failures of the regulatory system. It simply does not matter what created those failures or why or when or by who **only that they occurred.**

2) Sir John raises questions, with regard to apportionment, about the actions of:

a) Mr Headdon, (3.13 through 3.16) which remains an open question whilst Sir John conducts further research.
b) Ernst & Young, (3.17 through 3.20) which also remains open pending the result of the findings of the disciplinary committee, plus a potential appeal.

I cannot reconcile Sir John's requirement for a speedy end to this whole process with the need to wait on events in a) and particularly b) above given that at least in the case of the auditors this might result in a delay of some years.

However, Sir John also states in 3.3 that:

> *"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."*

In such circumstances it would have been logical to derive the ex gratia payment scheme, make the appropriate payments and for the Government to recover any liability assigned to Mr Headdon and Ernst & Young through the courts, which would ensure prompt payments to the all the policyholders of ELAS. Clearly this is not practical (or indeed possible) because of the actual lack of availability of this mechanism.

In fact that Sir John states at paragraph 3.7 of his Interim Report that he does not intend to restrict apportionment to wrongs, which would give ELAS policyholders a legal cause of action does not affect my view. I could understand a basis whereby an apportionment was made IF policyholders had a route to recover the balance of losses for which the Government was responsible but in the absence of such a route either because it is neither practical or indeed there is not a mechanism to do so or because such an apportionment derives from facts which in any event would not have given rise to a route for recovery seems to me entirely wrong.

In these circumstances it would be quite unjust for a policyholder to have their ex-gratia payment reduced based on some notional apportionment but at the same time leave the policyholder unable to recover that part of their losses.

As a result, this reinforces my view that NO actual apportionment should be undertaken.

However, I confirm in response to the questions posed by Sir John in 3.22, the correct answers in my view are:

> 3.22 (i) Yes
> 3.22 (ii) Yes
> 3.22 (iii) There should be no discount or apportionment. Any attempt to engage in such an exercise or identify further individuals or bodies would be misplaced.

The issue of approach to apportionment thereafter is NOT directly addressed in the Interim Report, other than to pose questions, so we do NOT have any information on such approach on which we can comment.

However we can make some logical deductions:

> 1) No matter what method is used to determine the loss for each WPA, all the losses must be aggregated to derive the total quantum of the claim for the WPAs.
>
> There will of course be a similar, though different in detail, process that has to be followed for each of all the other policyholder classes. The aggregate of all the losses for all policyholder classes then represents the total quantum of losses and with that, the ex gratia

payments made available by the Government can be easily distributed to each relevant individual policyholder in a just, fair and transparent manner. More importantly this lessens the prospect of any court challenge by any particular policyholder group.

2) Sir John has to determine the apportionment between the various bodies that he describes.

3) Sir John also has to determine which policyholders or indeed policyholder classes do not meet the definition of Disproportionate Impact.

I note from the e-mail exchanges between Laurence Emmett and me that:

> In relation to your point 1, it is correct that Sir John currently intends to advise that WPAs (including those who had taken annuities before July 1995) should not be excluded from the classes of policyholders who may have suffered relative losses. **However, it is not correct to conclude from this that "all WPAs will be entitled to a share of any compensation".**

This statement by Sir John may simply be a matter of judicial prudence, but I cannot conceive of a combination of circumstance when some WPAs can qualify for compensation and others not qualify.

> Third, it is **not certain at this stage that all WPAs will have suffered relative losses as assessed under the flexible approach set out in the Interim Report.** While it may turn out to be the case that all have done so, it would be wrong to pre-judge the issue.

For perfectly practical reasons, neither of the two processes above at 2) & 3) have yet been described, then it seems to me to be mandatory that when Sir John is ready he repeats the process that he has adopted so far and give the policyholders and the various groups an opportunity to comment and make representations on those processes.

Once that process is complete, then presumably Sir John will present his report to the Treasury for their further consideration and implementation. Again I would expect that policyholders and the various groups be provided with an opportunity to comment and make representations at that stage.

5 – ACKNOWLEDGEMENTS

This document is a result of the collaboration between the ELTA advisory committee and myself with assistance from Clarke Willmott.

As previously Clarke Willmott and Paul Chapman in particular have given many hours of time to assisting in the development of this submission and as previously on a pro bono basis. The ELTA community is indebted to their contributions.

The office of Sir John Chadwick, notably Laurence Emmett, agreed to comment on the draft version of this document simply to identify any misunderstandings that I had made without in any way supporting or commenting on its content. However, I must stress that the arguments and opinions expressed in this submission are mine, and those of my collaborators and do not necessarily reflect the opinions and beliefs of Sir John Chadwick or his office. The exchange of e-mails is included mainly as an audit trail in the development of this document and which can be found in Appendix B
The entire ELTA community was invited to read and comment on this document in its DRAFT form before it was finally submitted to Sir John Chadwick and their comments, slightly edited and where appropriate have been incorporated into the main body of text. Approximately 170 members provided input by e-mail, phone call or letter and have helped to identify paragraphs that were ambiguous and made suggestions for additional points. A selection of their input can be found in Appendix C.

Appendix A

The Introduction to Sir John Chadwick's Interim Report

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 mal-administration, which the Government has accepted. It will measure the relative losses suffered in respect of the accepted cases of mal-administration 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 mal-administration. 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 mal-administration 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.

Appendix B

E-Mail exchange with Sir John Chadwick's office

This is an exchange of e-mails between Sir John Chadwick's office and me, slightly edited for the purposes of clarity, but changing nothing of substance.

From: Eltaorg [mailto:eltaorg@orange.fr]
Sent: 05 September 2009 10:44
To: Laurence Emmett
Cc: John Chadwick; Simon Bor
Subject: Interim Report

Dear Mr Emmett

I wish to clarify so far as is possible two issues before I make my submission and as always I write about the With-Profits Annuitants of ELAS and now with the Pru.

1) The Interim Report appears to say that Sir John is now of the opinion that all, emphasize all, WPAs will be "entitled" to a share of any compensation that is awarded by the Government based on the final report submitted to the Treasury by Sir John.

Can you please confirm that I have interpreted this part of the interim report correctly?

2) In the letter of 20th August from the Parliamentary Ombudsman Ann Abraham to Sir John, she carefully emphasized the cumulative effect of the mis-regulation - "that it would not be appropriate to take each matter in isolation" and went on to essentially say that there was a systemic failure of regulation.

I can understand why she adopted such an argument but that of course is somewhat undermined because though the PO made 10 findings the Government only accepted 3 of them and Sir John is restricted to considering a compensation scheme with only those 3 findings.

There are two, at least, interpretations of this issue with respect to compensation:

i) I murder 10 people, get convicted of only 3, but I can only be hung once!

ii) I exceed the speed limit 10 times, get convicted of only 3 and I lose points three times.

My interpretation (scenario i) is that Sir John has accepted that ALL WPA's have suffered a loss and that they are entitled to 100% of their loss - allocated fairly across all WPAs and other policyholders - irrespective of the number of accepted findings.

But I can see (scenario 2) that it might be argued that whilst ALL WPAs have suffered a loss, they are ONLY entitled to 30% (3/10) of their loss - allocated fairly across all WPAs and other policyholders - which is a function of the number of accepted findings of the whole.

Yes, the analogies are not that good but I hope the point I am making is clear.

Again I would appreciate some feedback on this question.

Thank you for your help and kind regards

Peter Scawen

From: Laurence Emmett
To: 'Eltaorg'
Cc: John Chadwick ; Simon Bor
Sent: Friday, September 11, 2009 7:47 PM
Subject: RE: Interim Report

Dear Mr Scawen,

Further to my message earlier this week, I have now had the opportunity to discuss your message with Sir John. He is grateful that you have considered the Interim Report carefully and discussed it with other interested parties.

In relation to your point 1, it is correct that Sir John currently intends to advise that WPAs (including those who had taken annuities before July 1995) should not be excluded from the classes of policyholders who may have suffered relative losses. However, it is not correct to conclude from this is that “all WPAs will be entitled to a share of any compensation”.

First, Sir John’s reason for setting out his current view in an Interim Report is to invite representations from interested parties. It may be that, in the light of the representations, which are received, he may be persuaded to take a different view.

Second, Sir John’s Terms of Reference do not require him to advise the Government on the payment of compensation, but rather on the establishment of a fair ex-gratia payment scheme. It follows that it is not within his remit to create any “entitlement” to payment. The Government may choose to reject the advice or any aspect of it.

Third, it is not certain at this stage that all WPAs will have suffered relative losses as assessed under the flexible approach set out in the Interim Report. While it may turn out to be the case that all have done so, it would be wrong to pre-judge the issue.

As for point 2, the Interim Report contains no suggestion that calculation of relative losses under the flexible approach will be reduced proportionately to reflect the fact that the Government has not accepted all the Ombudsman’s findings of maladministration resulting in injustice. Nor does it contain any suggestion that Sir John currently intends to recommend that relative losses be assessed on a basis that would place policyholders in precisely the position they would have been in but for the accepted cases of maladministration. For the reasons explained in the Interim Report, his current view is that it would be impracticable (and, probably, impossible) to seek to assess relative losses on that basis.

Sir John has confirmed that he would have no objection to your sharing this response with your members or other interested parties if you consider that this will assist you to prepare your comments on the Interim Report.

Kind regards,

Laurence Emmett

From: Laurence Emmett
To: 'Eltaorg' ; Simon Bor
Cc: John Chadwick
Sent: Monday, September 28, 2009 7:41 PM
Subject: RE: Interim Report

Dear Peter,

Thank you for sending the draft of your representations and comments in relation to Sir John's Interim Report. Although you directed your inquiry to Simon Bor, I hope you do not mind my responding. I have reviewed your document in consultation with Sir John and Simon, and there are a few matters which it may be helpful to clarify

First, you state on page 3 that, "Sir John has decided to adopt what he calls a 'Flexible Approach'". As I know you appreciate (not least because you say so on page 4), Sir John has not in fact yet reached a decision as to whether policyholders' relative losses will be quantified in such a way as potentially to include all WPAs. However, it would be helpful to ensure that this point is clearly stated at the beginning of your comments.

Secondly, it may assist your comments on the appropriate determination of an "End Date" to make clear that Sir John currently intends to quantify WPAs' relative losses (so far as included in the proposed payment scheme) as consisting of two elements. The first element is the difference between the income that the annuitant actually received from Equitable Life (and, if appropriate, the Pru) up to the End Date and the income that he would have received from an appropriate comparator during that period. The second element is the difference between the (notional) value, which the annuity actually held at the End Date, and the (notional) value which it would have held if it had originally been invested in an appropriate comparator. In this way, whatever End Date is identified, WPAs' relative losses as calculated will reflect both their loss of past income and their future expected losses.

Thirdly, you have indicated that you do not agree with the statement at paragraph 2.46 of the Interim Report, to the effect that it was widely known that Equitable Life operated a policy of full distribution. The statement in question is based, not least, on statements contained in the Ombudsman's Report and the Penrose Report.

I would draw your attention to the following, by way of example:

i. paragraphs 1/2/36-38 (pages 12-13), 1/2/56 (page 14), 1/2/157 (page 30 – quoting the Disciplinary Panel of the Institute of Actuaries, to the effect that Equitable Life operated a "stated philosophy of full and fair distribution"); 1/4/104 (page 60 – where the Ombudsman appears to accept the description of Equitable Life as having a "well-publicised policy of full distribution) and 1/12/68 (page 343) of the Ombudsman's Report; and

ii. paragraphs 4/139 (page 157), 5/62 (page 175), 14/2 (pages 481-482), 14/11 (page 484), 14/56 (page 496), 14/78 (page 502), 14/85 (page 505), 14/95 (page 508), 14/110 (page 512), 17/64 (page 623) and 20/5 (729) of the Penrose Report.

Fourthly, on page 15 you say that, "it would be logical … for the Government to recover any liability assigned to Mr Headdon and Ernst & Young through the courts". As Sir John stated at paragraph 3.7 of his Interim Report, he does not intend to restrict apportionment to wrongs which would give Equitable Life's policyholders a legal cause of action. If Sir John were to advise that there should be a notional apportionment, it would not necessarily follow that either the Government or policyholders would be in a position to make any further recovery through the courts.

I hope the above points are of some assistance. Please feel free to email again if I may assist further with any of the above points, or indeed with other matters in the Interim Report.

Kind regards,

Laurence

From: Eltaorg
To: Simon Bor ; Laurence Emmett
Cc: John Chadwick
Sent: Sunday, October 04, 2009 3:03 PM
Subject: Re: Interim Report

Dear Laurence

Thank you for your e-mail and our subsequent phone conversation which has provided food for thought and I will be reconsidering various passages in the draft submission and would add:

On the first issue, as discussed, I intend to amend the wording to record that this is Sir John's preference rather than a decision and I have no difficulty with that.

On the second issue, I am pleased to note that the intention is to include an element for future loss by calculating the residual value of the annuity as at the date of transfer and comparing this to a comparator value as at that date. Clearly, in calculating those values, you will be making an assumption on the performance of those respective annuities in the future (post-transfer). It would seem more logical to incorporate real data where you have the actual performance rather than use anticipated performance. You can then make the comparison to the point of anticipated death based on assumptions at the latest possible moment. Clearly, that should be a preferable approach particularly if the Prudential with-profits annuity is the actual comparator. As stated, surely it is better to use actual figures and only use assumptions at the latest point possible.

On the third issue, I have considered the passages to which you refer. A number of these such as 1/12/68 of the PO Report reinforce the point that I am making in my view. There is clearly a fundamental issue here as to whether prudently regulated such behaviour should have taken place. I intend to revisit the wording and may amend it to bolster the point. I note Sir John's interpretation of his instructions to take note of the various findings on such points.

On the fourth issue, I refer you to the second sentence of that paragraph which accepts that I accept this is neither practical nor possible but I note the point that it is not simply if there was legal responsibility that such an apportionment was being considered and will therefore explain in more detail the moral and practical reasons which reinforce my view that there should be no apportionment.

Kind regards and thank you for your help

Peter Scawen

From: Laurence Emmett
To: 'Eltaorg' ; Simon Bor
Cc: John Chadwick
Sent: Wednesday, October 07, 2009 3:44 PM
Subject: RE: Interim Report

Dear Peter,

Thank you for your email.

I make further brief points on the second and third issues below, which I hope will assist you in preparing your comments on Sir John's Interim Report.

As to the second issue, Sir John has not as yet expressed any view as to the basis on which any future element of WPAs' losses should be calculated; however, any comments you make on this question will be given consideration.

As to the third issue, I would remind you that Sir John's Terms of Reference limit him to considering those instances of maladministration leading to injustice which the Ombudsman found and the Government accepted.

Kind regards,

Laurence

Appendix C

E-mails from ELTA members

These are a selection of e-mails from a few of the members who responded to the copy of the draft submission to Sir John Chadwick. I have edited out their names and material that is not germane to this submission. The e-mails are intended to put some further substance and context to the issues raised in the main report.

From: PS
To: Peter Scawen
Sent: Monday, October 05, 2009 6:17 AM
Subject: Follow Up Report

Dear Mr Scawen

One aspect I could not see in your letter was any reference to those who took out an annuity after the House of Lords' ruling. On this Penrose wrote the passage below. If appropriate please include it:

> 2004 - Penrose Report - Comment on the performance of the FSA Extract form the Penrose Report Page 678 paragraph 115, which comments on the FSA allowing the Equitable to continue to operate after the Law Lords June verdict.
>
> "It appears that the regulators proceeded on an assumption that, if anyone were disadvantaged by the decision, compensation would be available. No legal assurance was sought that this would be so, and there was no examination of the legal issues involved. There was no recognition recorded that, if compensation claims were sustained, those claims would be at the expense of the with-profits fund, nor any attempt to quantify the risks to which potential policyholders were exposed relative to the benefit claimed by management for continuing to trade. No consideration was given to measures that might have mitigated the potential for subsequent claims of misrepresentation. The Society was even permitted to continue it's advertising, and so those taking new or further policies with the Society did so by invitation and not as mere volunteers, without the risks of doing so being made known to them."

Thanks
PS

From: DS
To: Peter Scawen
Sent: Friday, October 02, 2009 6:32 PM
Subject: Follow Up Report

Peter,

In response to your 'follow up' report of September 25th, I would say that I fully agree with your verdict that there is much in the 'Interim report' which is positive for the WPAs.

I also agree that of the alternatives, the 'Flexible Approach' seems to offer the prospect of a better and fairer outcome.

The suggestion that Equitable's policyholders knew at any time that the company operated on a "Full Distribution" basis is of course nonsense. What sensible person would enter into a long term and non-reversible contract with a company, which openly admitted to having no reserves? It was always asserted that their generous bonus record reflected a low expense ratio because they did not have to remunerate independent intermediaries.

As one who has already received partial compensation, I assume that any further compensation from the Government would take that into account.

Finally I would thank you for your continuing efforts on behalf of us all.

Regards,

DS

From: RA
To: eltaorg@orange.fr
Sent: Saturday, October 03, 2009 12:16 PM
Subject: Third DRAFT submission to Sir John Chadwick

I have managed to read the draft submission and most of the previous ones and whilst I agree basically with the content I am disappointed to read that WPAs who have received some compensation will not be part of any compensation which may be agreed in the future. This seems unfair to me in that the WPAs who felt aggrieved enough to risk considerable sums of money by claiming from ELAS will not be entitled to compensation, if any, that the policyholders who sat back and did nothing will get. Furthermore any compensation received does not go nearly far enough to make up for past, current and future losses. Your graph shows the sums we would now be receiving had we invested with someone like Prudential, which are 3 times as much as we now get and this gap will continue to grow. I personally did not vote for the transfer to the Pru as I felt that ex ELAS members would be the poor relations and this has proved correct as we immediately get a drop in income of 11.5% although other Pru members get an increase and although they blame the current financial problems for this drop their profits and share price increase does not support this argument.

I thank you for the very significant time and effort you are putting in to this and hope that your health is standing up to it.

Yours sincerely,

RA

From: Eltaorg
To: RA
Sent: Saturday, October 03, 2009 1:33 PM
Subject: Re: Third DRAFT submission to Sir John Chadwick

Dear R

Thank you for your e-mail and some quick comments:

It is not true to say that you will definitely not get any compensation. Of course I have no control over what is paid and I am only trying to make submissions to ensure that Sir John understands the position and issues facing WPAs.

As regards the Prudential, I fully understand your frustration but you must understand that the Prudential is only managing the ELAS fund that was transferred without any reserves, as there were none. The Prudential specifically stated that the ELAS fund would be ring fenced to protect its existing policyholders from having to pay out for the failures of ELAS. However, at least there is an opportunity for the fund to grow now it is with the Prudential, not a possibility if it had remained with ELAS, though again I think it will be many years before you see a positive change.

From: BG

To: eltaorg@orange.fr
Sent: Saturday, October 03, 2009 10:26 AM
Subject: Equitable Life Trapped Annuitants

Attention Peter Scawen.

Dear Peter Scawen,

Thank you for keeping me in the loop, I have a With Profits Annuity taken out in 1993 and now administered by the Prudential on a reducing formula basis.

You deserve all Equitable Life policyholders' thanks and support for continuing to press for a just decision in this sad saga. I would hope that a high court judge would see justice is done despite this Government's efforts to keep the matter in the long grass thus reducing the sum of any ultimate compensation made for their admitted liability. This is in the light of a senior Treasury Office official declaring "A settlement is very unlikely since Gordon does not think these people are our people".

I would support any decision you decide to embark with but would comment as follows.

> I think that the aim should be to keep the approach simple in that all policyholders should participate and that the Prudential is the obvious and only vehicle best employed to administer it and be paid by the Government for doing so. Surely it must be possible using Prudential's expertise to establish a lump sum and negotiate on it with the Government, better to settle for a lesser figure than to get no settlement. This could be prorated to all policyholders across all the variations of policy the aim to keep it simple.

I expect my comments have already been made by many people, but that is what I think. I have been a broker all my life and a negotiated settlement is better then no settlement.

Kind Regards BG

From: KT
To: eltaorg@orange.fr
Sent: Friday, October 02, 2009 2:12 PM
Subject: Comments on the Draft Interim Report

Dear Mr Scawen (Written on behalf of her mother MG)

Comments on the Draft Interim Report

Many thanks for your letter of 25th September, I have been able to obtain an email of your proposed Interim Report – which, if I may say so, is very much a tour-de-force – and would make the following observations for your consideration: -

1) A most significant point of reference, for Sir John and his team of advisors, is the operation of the Pension Protection Fund (PPF) – where employees of failed company pension schemes are now automatically compensated by means of ex gratia payments (subject to a cap) and with absolutely no question of 'apportioning' blame. Furthermore, these employees are compensated for both their own and their company's contributions. What price the self-employed!

2) Regarding the appropriate end-date, this is very important. Whereas many of us are now left having eaten into our savings or, worse still, having built up debt – to go into the future, on our current pension level and on top of all our savings/debt problems would be absolutely appalling and would mean that any compensation received for the period up to being transferred to the Prudential would effectively have to be spent on trying to keep afloat until our eventual demise.

3) I believe it would help the Government very much, politically, if as much compensation as possible was spread out into the future – as is being done with the Pension Protection Fund. To this end, it should be possible for Sir John to determine a total annual level to which each WPA should be 'topped up' – and then pay the Prudential an annual sum representing the difference between the low levels of pension we are receiving now and the higher levels finally arrived at by Sir John.

4) I am decidedly nervous about the potential impact of a total cap being put by the Government on compensation payable to ELAS policy holders and WPAs and would just say that, in such circumstances, WPAs and others struggling on low incomes should not have to bear the burden of having their income cut back to the same degree as those who are better off – with the tax coding system being used to ensure those on no tax / low tax being cut back least.

5) Finally, I must confess to having been initially somewhat shocked by some of the (bad) advice being given to Sir John (especially regarding Equitable's so called 'full distribution' policy; and in regard to an 'end date', which is nearer to beginning than the end!) but I suspect that some of this 'advice' is really being put into the arena in order to draw out a suitably robust response from you!

May I personally thank you for all the effort that you and your team of advisors are putting in on our behalf.

Most sincerely

MG

From: AM
To: eltaorg@orange.fr
Sent: Wednesday, September 30, 2009 9:08 PM
Subject: Equitable life trapped annuitants

My mother has asked me to e-mail you the following message:

"Dear Mr Scawen

As an 87-year-old annuitant unless compensation is paid within the next year, preferably the next 6 months, I feel that I will have missed out completely. It is certainly time that all this was cleared up.
Yours sincerely
MC"

Many thanks
AM

From: DK
To: eltaorg@orange.fr
Sent: Tuesday, September 29, 2009 5:08 PM
Subject: elta

I have read your letter 25th September and looked at the latest submission to Sir John. The first thing that occurs to me is the terrible length of time being taken to resolve these matters. After all you know so many ELTA people have died. I am now 80 years old and had 2 with profits policies with Equitable which were paying me approximately £340 per month. I am now receiving less that half this amount about £143 per month; surely the answer to this is to push the government to a speedy solution.

Thank you for your efforts

SK

From: ST
To: eltaorg@orange.fr
Sent: Monday, September 28, 2009 10:39 PM
Subject: Submission from ELTA to Sir John Chadwick

Dear Mr Scawen,

I today received the ELTA communication of 25th September for which many thanks. As suggested I have read the draft submission to Sir John Chadwick's report. I need not tell you how complex these matters have become. Little did we know when we invested monies put aside to provide a comfortable pension for ourselves with what was then considered a 'blue chip' life assurance society that we would find ourselves many years later fighting for adequate compensation.

You seem to have covered all the points, which have occurred to me, at least for the moment. I am not at all confident that this or any future government will honour its responsibilities following the Ombudsman's Report and that of the Parliamentary Select Committee, although with a General Election in the offing some pressure may be brought to bear that way.

However, I would like to thank you and your colleagues for your continued efforts on behalf of WPAs.

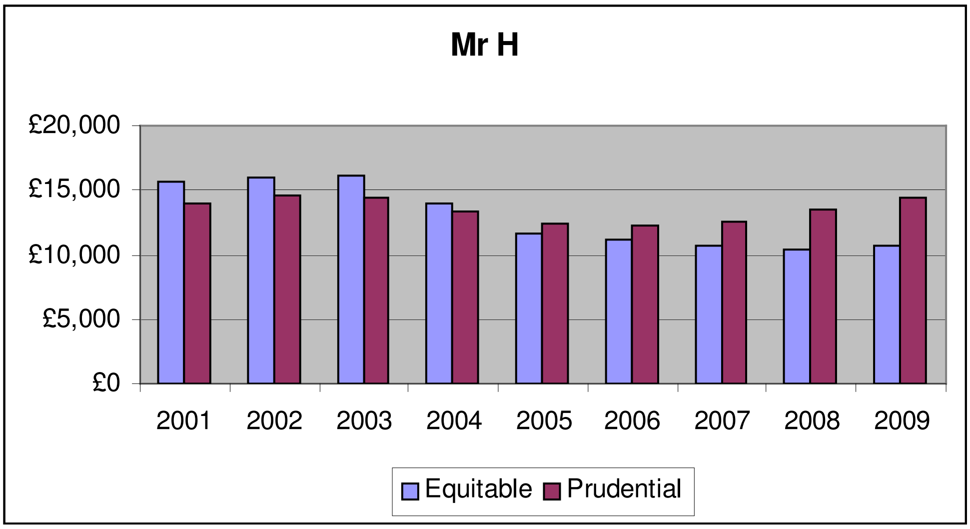
ST

Annuity provider comparisons

A) Mr H invested money in both Equitable Life and the Prudential at more or less the same time, with the same ABR and other conditions.

The original investment with the Equitable was £186,026 and the Prudential was £171,097

Both Pensions were in the 'With Profit Fund' of each provider with an anticipated Bonus Rate of 5% pa, guaranteed for 5 years with a 2/3rds Widows Pension if he died first. Annual Adjustments to the Annual Pensions were made on the anniversary in October each year.

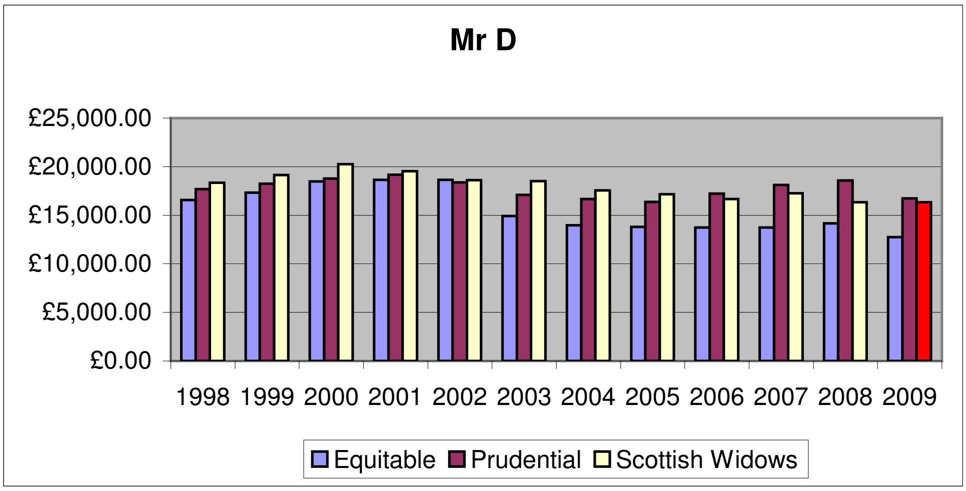


As can be seen, despite the original investment in Equitable being slightly higher over the same period, £186,026 and £171,097 respectively the Prudential has substantially outperformed the Equitable Life With Profits Annuity and is likely to do so for the foreseeable future.

It is worth noting that the 5.5% reduction in annuity payments has not yet come into affect, as Mr H's renewal date is October of each year.

B) **Mr D** invested in Equitable Life, the Prudential and Scottish Widows more or less at the same time with similar funds, £232,101, £245,474 and £262,939 respectively. His ABRs were also similar 5%, 5.5% and 5% respectively.

The conditions were the same with his wife receiving 100% of the annuity in the event that Mr D pre-deceases his wife.



As Mr D's ELAS policy has already been recalculated this year, you will note the substantive reduction in income for 2009 something that will be repeated in 2010.

Over the whole period, noting that I have made an estimate for the Scottish Widows payment for this year, both these annuities have paid Mr D approximately an extra £14K over the 12 year period compared to Equitable Life or £28,000 in total. As Mr D might reasonably expect to live another 10 years or so, it is evident that his ex-gratia payment should be significant.

Appendix E

Ombudsman Report Extracts

1/2/36-38 (pages 12-13)

"36 Another example of the Society's distinctiveness was its bonus policy introduced from 1989. Equitable stated that this reinforced their philosophy of providing a 'full and fair' return to policyholders. The Society treated its with-profits policyholders as participating in a managed fund, which allowed them to benefit from investments in a wide range of assets.

37 In the Society's accounts for 1992, its then President said: *In the Equitable we pride ourselves on allocating earnings from our investments across all classes and durations of contact in as fair and consistent a manner as possible. The fundamental philosophy is that each generation of policies should receive benefits commensurate with the earnings produced during its lifetime. Beyond the bounds of normal commercial prudence, it would be alien to our culture to hold back benefits from one generation to build reserves for a future generation.*

38 Equitable thus did not maintain an estate – that is, assets in excess of the amount needed to meet policyholder benefits, including terminal bonus. Apart from maintaining what was sometimes referred to as a 'revolving estate' to provide some working capital, the Society said that it made a full distribution to its participating policyholders."

1/2/56 (page 14)

"56 As a result, the application of a single growth rate to the total policy fund in respect of all policies would have meant that those policyholders whose policies contained guaranteed annuity rates could receive a greater proportion of the surpluses than was, in the Society's view, compatible with its stated approach to 'full and fair' distribution."

1/2/157 (page 30)

"157 The decisions made at the conclusion of that hearing were published in a written determination on 2 March 2007. The panel found in respect of the first actuary – Mr Roy Ranson, who had held the post of Appointed Actuary of the Society from 1982 to 1997 – that, in the words of the Executive Summary of the determination:

(i) *in implementing a stated philosophy of providing a full and fair return to policyholders, holding no estate apart from a revolving estate providing working capital, and treating policyholders as participating in a managed fund, the actuary had, over a long period of time, consistently failed to apply an appropriate smoothing policy, had failed to provide appropriate information to the Society's board to enable proper consideration to be given to the consequences of his recommendations and had failed to maintain the publicised relationship between the investment reserve and total policy values notified annually to policyholders*;

(ii) *in addition to the points above, the information provided to policyholders created a misleading impression of the Society's financial strength. The Society's board was provided with little information showing the relationship between the totality of the policy values including accrued terminal bonuses as notified to policyholders and the Society's actual asset strength. No evidence was provided to the panel to indicate any proper degree of financial analysis undertaken by the Society during the period under examination*; [and]

(iii) there had been '*a failure to properly distinguish, in spite of the significantly different terms and conditions, between the pension policies issued prior to 1988 and those subsequently issued, both in internal analyses of the financial performance and in communications to policyholders. The panel found this failure created the basis for the subsequent problems of the Society. This failure, compounded by the unresponsiveness of management to signals and questioning of the policy adopted, in the light of changing circumstances, was viewed by the* *panel as irresponsible. The introduction of the differential terminal bonus policy and its implications under different economic scenarios was not properly addressed either in the board or in the communications to policyholders*'.

1/4/104 (page 60)

"**104** The public bodies also said that it was not clear from where policyholders had derived a reasonable expectation that Equitable would set aside reserves for terminal bonuses, given the lack of a statutory requirement to do so and given the Society's well publicised policy of full distribution. The public bodies submitted that, had Equitable set aside reserves, it would arguably have gone against the reasonable expectations of with-profits policyholders that there would be full distribution."

1/12/68 (page 343)

"68 In relation to the widely accepted causes of the Society's closure to new business – a low free asset ratio, a policy of full distribution, a failure to reserve for generous and flexible guarantees, and the differential terminal bonus policy – these were all matters which the prudential regulators and/or GAD could have addressed through the scrutiny process in earlier years than 1998."

Penrose Report Extracts

Chapter 4 Paragraph 139

"139. In his statement to members in the 1996 annual report, the president highlighted three achievements for the Society during the year:

"Our new U.K, annual premium income, at over £400m, broke all previous records for the industry. Our total new premium income exceeded £2 billion for the first time, and included our highest ever single premiums at £1.59bn. Our expense ratio fell, for the eighth consecutive year, to the remarkably low level of 4.3%. We confidently expect this figure yet again to be the lowest in the industry. These achievements, together with many others over the years show that a well run mutual organisation can consistently produce outstanding performance."

In discussing mutuality, the president stated that throughout the Society's history it had tried to ensure that each generation of with-profits policyholder received the returns it had deserved on its investment with the Society. He said that the Society's distributions had been full and fair "i.e. equitable." Consequently the Society did not build up surplus assets in order to boost its free assets and as a result its free asset ratio was inevitably, and, in his view rightly, lower than those of its competitors. This attribute was regarded by the Society as a reflection of its full distribution policy and not an indication of financial weakness. The Standard and Poor's rating was relied upon as support for the Society's strength. The directors considered it appropriate to maintain declared bonus rates for 1996 at the same level as that declared in the prior year."

Chapter 5 Paragraph 62

"62. There had been a decline in premium income in 1999 of 7%. The annuity guarantee controversy had affected the business. However, net assets had continued to grow, assisted by a high level of capital appreciation. The fund for future appropriations was increased by £1.8 billion. The president reported to members that the Society had achieved a relatively high return on investments. In relation to bonus he said:

"We have taken a disciplined approach to declared bonus levels in recent years and we were able to maintain our rates of declared bonus at last year's levels, for example, 5% p.a. for the current pension products. We increased the overall rate of return allotted to policies for 1999 to

12% p.a. for pension business and to 10.25% p.a. for life business, which is subject to a different tax regime.

I believe our bonus rates provide competitive policy results over a wide range and duration of policies and it is clear from our standing in surveys conducted by financial publications that this view is shared by objective commentators. At the heart of this performance is our commitment to the fair and full distribution of profits that is central to our approach to mutuality." He looked to a future in which the Society would continue to be committed to providing innovative, high-quality and value-for-money products, supported by excellent service and delivered through the channels that the Society's clients found most practical and convenient. These included web site and direct telephone sales channels. The accounting provision for the guaranteed annuity issue was maintained at £200m, which was said to be a prudent provision for any additional liabilities that might arise through clients choosing to exercise guaranteed annuity rights under their policies. It was a balanced, if somewhat unexciting, assessment of the current and immediately past two years."

Chapter 14 Paragraph 2

"2. Headdon's views provide a point of reference for discussion of the range and nature of the reasonable expectations that policyholders might have deduced, on an objective assessment, from the materials discussed in this chapter, and in particular from the actions and publications of the Society. Generally, any reasonably diligent policyholder would have developed reasonable expectations about the directors policies in relation to the pursuit of growth of business, the development of innovative products, the pursuit of a stated investment policy, the maximising of returns by investment in equities and properties, close control of expenses, full distribution and a range of other particular policies advertised from time to time."

Chapter 14 Paragraph 11

"11. A major change in policyholders reasonable expectations would have come about by the emphasis given to the managed fund approach to the definition of members interests. Professor Smith presented the information as established fact in his 1986 statement to members:

"It cannot be stressed too often that members participate in a fund of investments being managed on their behalf and that this fund provides the capital base for running the business. The members are the proprietors, and their interest is expressed in the form of bonus additions."

That formulation of the directors' approach appears to have superseded finally the policy advertised in Ford Geddes statement of 1970 justifying the holding of ample reserves to sustain the office's continuity: Equitable's justification for holding a form of inherited estate. By about this time, in 1986 or 1987, the Board's distribution policy during the period from 1982 had eroded the surplus brought forward by conservative distribution policies following the poor performance of the triennium 1974 to 1976. The managed fund approach reflected current realities. But the policy set the scene for an expectation of full distribution thereafter. The approach was given increased emphasis in 1987. But there was a change in the presentation of investment policy. The market collapse of October 1987.Black Monday resulted in a somewhat more sober statement, emphasising the need for diversification of risk within the portfolio, and balancing investment and bonus policies."

Chapter 14 Paragraph 56

"56. In the 1986 statutory accounts, Smith commented on the members' interest in a managed fund. and the current bonus system, distinguishing declared and final bonus. He explained:

"The final bonus added when the claim is paid ensures that the member gets a fair return overall covering the period of membership of the fund but, of course, the member has uncertainty about the amount which will be paid until the last moment.""

He said that implementation of bonus strategy required that as much as was prudent should take the form of declared bonuses. That required holding assets that were guaranteed, such as government stocks, which bore a proper relationship to the value of the guaranteed liabilities to be met in the future. Secondly, reserves should not be built beyond what was needed for the benefit of newcomers who had neither contributed to them nor taken the proprietors risk. The Board, advised by the Joint Actuary, would continue to ensure that bonuses allocated from time to time were fair, bearing in mind stock market volatility. The managed fund concept was strengthened and full distribution was advertised as a guiding principle. The implication was that the whole with-profits business was conceived in terms of a single fund. The bonus system expressed the members' interest in the business. The contractual effect of declaration was expressed strongly. Smith said that he believed that the Society was probably entering a period of lower investment returns and that bonuses, in particular declared bonuses, would have to reflect that."

Chapter 14 Paragraph 78

"78. Viewed in isolation from the other communications with policyholders at this stage, the statements in the published accounts expressing the accumulating fund characterisation of the policyholder's interest could have given rise to misunderstanding. But there were other documents in issue at the same time and it is necessary to have regard to the total range.

Sherlock's Dear policyholder letter of February 1990, relating to the 1989 bonus declaration, was one of those referred to by Corley at paragraph 56. It carried the process of defining the with-profits philosophy further. It set out the basic principles of with-profits business as practised by the Society. Full distribution was described. He stated:

"The Society's with-profits contracts contain a basic guaranteed level of benefits, expressed as, for example, a guaranteed amount of fund. A certain level of investment return is needed to cover the build-up of these guaranteed benefits. The return in excess of that basic level is available for distribution as bonuses.

... Part of that excess is translated each year into a 'declared bonus'. Such bonuses are additional, fully guaranteed, benefits and are added to all previously guaranteed benefits. In this way, the annual addition of declared bonuses provides an increasing underlying value below which the ultimate benefits cannot fall. The accumulated amount of the basic guaranteed benefits and declared bonuses represents the consolidated value of the policy benefits.

The balance of the overall return is carried forward unconsolidated but is credited immediately as final bonus when benefits become payable under the terms of the policy. The retention of part of the accumulated total policy value in unconsolidated form is a vital ingredient in the operation of with-profits business. In that way the Society retains the flexibility to manage its investments in a way compatible with achieving the best results it can for the with-profits policyholders.

It should be emphasised that, while both consolidated and unconsolidated benefits would be paid if they became due now, only the consolidated benefits are guaranteed for the future. The amount of final bonus ultimately paid will depend on the future experience of the Society; it could be lower as well as higher than the current amount.""

Chapter 14 Paragraph 85

"85. On 31 August 1990, the Society published a With-Profits Guide in accordance with LAUTRO rules. Chapter F of the guide dealt with "Recent bonus policy". It described the full distribution policy. It described the Society's approach to final bonus in apparently unambiguous terms:

"The approach to final bonus is that the investment reserve, which is the excess of assets over liabilities, is averaged over time and notionally apportioned amongst the with-profits policyholders in the fund at the current time in direct relation to the liabilities under their policies."

As discussed in chapter 6, this statement does not reflect the reality of bonus allocation practice as I have found it. But on its terms, the statement excluded anything of the nature of a differential final bonus policy. The liability to policyholders, as described by the Society, was a function of net premium investment, investment roll-up and declared bonuses. Notional apportionment in direct relation to liabilities was fundamentally incompatible with variation according to the form of benefits selected. Positively, this was a representation that the amounts of final bonus were directly related to the investment reserve, subject to averaging over time.”

Chapter 14 Paragraph 95

“95. In his statement in the 1992 Accounts the president commented on full distribution, and that it would be incompatible with the Society’s culture to hold back benefits from one generation to build up reserves for a future generation. He stated:

“As we say in our literature, for new policyholders future bonuses must depend primarily on the investment of new premiums. Any deliberate cross subsidies between generations would not be equitable. ”Cross subsidy could occur in either direction: over-distribution to a current generation at the expense of a future generation would imply that new policyholders would not receive the benefit of the investment of their new premiums. The reader would have been entitled to infer from the general condemnation of cross subsidies that the Society avoided both types of practice, subject to some degree of smoothing.”

Chapter 14 Paragraph 110

“110. The guide discussed recent bonus policy, giving emphasis to full distribution, the characteristics of the declared bonus, and the final bonus. It stated: “The approach to final bonus is that the investment reserve, which is the excess of assets over liabilities, is averaged over time and notionally apportioned amongst the with-profits policyholders in the fund at the current time in direct relation to the liabilities under their policies. The intention is to avoid too great a volatility in bonuses by smoothing and averaging. Whilst declared bonuses can be expected to be relatively stable, final bonuses may fluctuate rather more because they are the balancing item in the overall return.””

Chapter 17 Paragraph 64

“64. GAD then expressed the view that if the Society had not been mistaken in its interpretation of the regulations, it would not have made the bonus declarations it had. The minutes noted that:

“Questions were also raised regarding the prudence of trying to operate without an estate.”

GAD pointed out that a fair proportion of the previous year’s reversionary bonus had been paid out of “asset value gains”. In response:

“Mr Headdon argued that since 1986 reversionary bonus rates have been managed down although he did admit that it was possible that there had been times when the value of the accumulated policyholders. Asset shares had been greater than Equitable’s assets. Nevertheless he argued that he did not believe that it was in the interests of policyholders for the Equitable to build up a large estate.”

The statement was not entirely new: regulators had known for some considerable time that the Society’s advertised policy was one of full distribution. However, on the information communicated by the Society, the regulators would not have been in a position to challenge the statement that since 1986 “there had been times” when aggregate policyholders’ asset shares exceeded the Society’s assets. There had in fact been no year-end at which that had not been the case.”

Chapter 20 Paragraph 5

"5. The gap between the representation of the Society's financial position in its published financial statements, for regulatory and Companies Act purposes, and its realistic financial position arose in large part from the absence of a coherent and consistently applied policy on bonus distribution and smoothing. The Society's frequently acclaimed principle of full distribution combined with its claim to ensure a smoothed return seem to have acted as an effective shield against a proper consideration by the regulators of Equitable's approach to bonus distribution."