EQUITABLE LIFE:
THE PARLIAMENTARY OMBUDSMAN'S SECOND REPORT: PARTURIENT MONTES- NASCETUR RIDICULUS MUS. (THE MOUNTAINS LABOUR, AND OUT POPS A SILLY WEE MOUSE.)

A critique by Michael Nassim with the initial collaboration of Michael Josephs, following up complaints submitted on behalf of the Investors Association, Equitable Late Contributors Action Group, and Equitable Life Trapped Annuitants.

Summary: **The Parliamentary Ombudsman's second Equitable Life Report is the latest in a protractedly disjointed series. Like all the rest it is limited in its powers, remit and scope. This situation the Ombudsman much regrets because it has led to justice delayed and denied, the like of which on such a scale she hopes will never be allowed to recur. Despite interim assurances that the interface between prudential and conduct of business regulation was within the scope of the Report, it has ended up rigidly restricted to the prudential regulators as well as by its already truncated time period. It is further limited by its pre-deterministic "Procrustean Bed" process, which addressed an initial set of specimen complaints rather than the whole array, and did not depart from its chosen course to address its own incidental new findings, some of which are of momentous import in the context of what is already known. These include a long list of episodes of reverse regulatory arbitrage (whereby the prudential regulators have in effect used their own rules contrary to the interests of those they should protect), many of which occurred at the conduct of business interface. This is compounded by the Report having adopted economical rather than exhaustive ruling, whereby individually important matters of fact or maladministration are made subordinate to others.**

Hence not all the separately relevant potential maladministrations and injustices have been assessed, let alone determined, irrespective of whether they might relate to the original specimen complaints or any others. Indeed some earlier draft ones have ended up deleted, probably for this reason. This is exacerbated by omitting to extend causal chains linking matters of fact or maladministration to later injustices occurring outside the Report's period of reference. And finally, both because of and despite many interactions, there are the customary British deficiencies in transparency and documentary trailing, which compare adversely with those abroad. All this has perforce limited the scope of maladministration that might have been determined, identifying those responsible for it, the true nature and extent of outrage or national concern, and properly constructed arguments as to quanta of necessary compensation.

Besides avoidance of accountability and blame, the net effect of reverse regulatory arbitrage has been to give unjustified assurances about the Society's solvency and situation throughout, to suppress, delay, discount or extinguish legally valid complaints, and to block or limit reasonable redress. It culminated in prudential regulators, the Financial Ombudsman Service, the Equitable itself and their legal staffs acting in concert through a single firm of accountants who had employed the Equitable's new Appointed Actuary. The members of this team have gone on to consolidate their positions in every subsequent development. It is within this overall context that the cumulative effects of

maladministrations, injustices, financial loss and outrage should be viewed. Equally importantly, the wider context embraces conflicts of interests too comfortably worn by regulators, professions or persons various and those regulated. Worse, there has been protracted pan-regulatory failure across the entire UK with-profits industry. Two common themes underlying the industry's resulting near demise are widespread opportunistic misappropriation of the traditionally accumulated free reserves of with-profits assurance offices on one hand, and over-reliance on future profits on the other in contradiction of the core with-profits assurance element. The collapse of the fiduciary, governance and professional ethos in this area has been spectacular, but is also darkly ominous for our wider future.

It is in this light we should view a Report that tells one quarter of the story at best, the limited findings of which even in its own area do not define appropriate redress. Its failure to tackle reverse arbitrage has left the collective position thereby established intact. That distils into the essence both of continuing injustice and the true nature of outrage. Moreover any indirect endorsement of pan-regulatory failure of the whole sector by using rescissionary alternative with-profits investment benchmarks, or market comparator assessments of relative loss, may well add insult to injury. Discounting liability and loss because of policyholders' reduced chance of gaining redress given what the regulators well knew and were withholding from them is another great evil. That the Report has not condemned such approaches should be deeply worrying.

Hence the main categories of financial loss have been revisited to find a surer reference standard. Next are identified five criteria for adequacy, namely incorporation of the report's new findings into the wider context, natural justice and common sense, rescission-based compensation, prompt sufficiency for closure, and simply robust implementation which minimises the individual burden of causal proof. Finally, the Society's policy values and story line ***as actively supported and engineered by the prudential regulators themselves*** **up to the critical points of loss are taken as having been true, following which rescissionary principles are applied to restore those losses. This procedure obviates most of the outstanding issues. Even so it remains necessary to give the adverse effects of residual inequities of guarantee, rights of the deceased, GAR/GIR rectification, loss of annuitants' with-profits mutual status, inconvenience or distress, and exemplary or aggravated damages special consideration.**

Regulatory failure and Government irresponsibility in the wider economy reinforce rather than gainsay this type of approach. Had the writer not followed up submissions and complaints previously published at EQUI, plus additional materials submitted to the Ombudsman's Investigation, he might not have arrived at his present position. He has also benefitted from the privilege of marginal participation in the Investigation and Report drafting process. The harsh conclusions of this review should not, therefore, detract from the very real advances and contributions made by the Second Report to our overall understanding of matters Equitable and the future. Even so, sweeping reforms of the UK regulatory milieu and Ombudsman system are an urgent and obvious necessity. Vested interests in the milieu itself are the greatest obstacle to change.

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Abbreviations and Definitions:

AA:	Appointed Actuary.
AH:	Alex Henney.
BWD:	Bacon Woodrow Deloitte.
CoB:	Conduct of Business.
DTBP:	Differential Terminal Bonus Policy.
ELAS:	Equitable Life Assurance Society.
ELTA:	Equitable Life Trapped Annuitants Association.
EMAG:	Equitable Members Action Group
EQUI:	European Parliament Temporary Committee Equitable Life Inquiry
FOS:	Financial Ombudsman Service.
FSA:	Financial Services Authority.
FSAVC:	Free Standing Additional Voluntary Contribution.
GAD:	Government Actuary's Department.
GAR:	Guaranteed Annuity Rate.
GIR:	Guaranteed Interest Rate.
IA:	Institute of Actuaries.
ISA:	Individual Savings Account.
LAUTRO:	Life Assurance and Unit Trusts Regulatory Organisation.
MJ:	Michael Josephs.
MN:	The writer.
MVA:	Market Value Adjuster.
OFT:	Office of Fair Trading.
PIA:	Personal Investment Authority.
PO:	Parliamentary and Health Service Ombudsman.
PRE:	Policyholders' Reasonable Expectations.
RMM:	Required Minimum Margin (of assets over liabilities for solvency).
RPI:	Retail Price Index.
RSP:	Recurrent Single Premium (as opposed to Regular Premium) business.
SFO:	Serious Fraud Office.
S & PM:	Sound and Prudent Management.
WPA:	With-Profits Annuitant.
WPWM:	With Profits Without Mystery (title of Ranson - Headdon paper in reference list).

Reverse regulatory arbitrage: Regulatory arbitrage is generally understood to be exploitation of the minutiae of statute, regulations, professional standards and guidelines in a manner contrary to their collective aim and spirit by regulated organisations or persons. Hence, when the regulator employs the same tactics against those it should protect it may be termed "reverse" arbitrage.

"Procrustean Bed" complaints handling: A process of aligning complaints under specified headings according to prior criteria, without due regard to significant new evidence which gainsays those criteria, or to material and relevant deviations from the headings to which the complaints have been assigned. It takes its name from the racking or hacking of the limbs of his guests by the mythical Procrustes so as to fit them in his bed.

Plaza-Toro Management is a general term for the ways in which senior and ultimately responsible persons arrange for junior persons or contractors to do or say things that they should not and could not do or say themselves. Moreover when challenged the responsible senior persons fail to support and endorse the action or statement in question, and yet commonly leave it un-retracted. Its name derives from a Gilbert and Sullivan song about the cowardly behaviour of a Duke of Plaza-Toro.

The Carltona Principle is that under which civil servants exercise power on behalf of Ministers. In some circumstances, persons in whom powers are vested can authorise other persons to exercise that power on their behalf. In that the other persons effectively become the *alter egos* of those in whom the original powers are vested, it is a question of authorisation as well as delegation. The Principle is named after the test case in which it was established, namely *Carltona Ltd v. Commissioner of Works 1943*. The contrast between the Carltona Principle and Plaza-Toro Management is instructive.

Introduction:

The reference platform for this critique is largely written and oral evidence at EQUI (European Parliament Equitable Life Inquiry). Also of note are Michael Nassim's (MN) paper dated March 31st 2007 on the UK Financial Ombudsman Service (FOS), *inter alia* submitted to the Parliamentary Ombudsman, and Michael Josephs' (MJ) ongoing Equitable numeric data base, which derives mainly from Regulatory and Companies Act returns, Annual Reports and reports such as Penrose. Particular attention is also drawn to MN's letter to Iain Ogilvie of June 30th 2005 published in EQUI written evidence item 33 (see ref), which outlines a framework of expectations concerning the Parliamentary Ombudsman's Investigation, and to the formal list of complaints drawn up by MN and MJ which was submitted to the Ombudsman and published in EQUI written evidence item 7 pages 31-5 inclusive which are the subject of Appendix 2. MN has also submitted two fully documented causal chains for specific injustices originating in some of the prudential regulatory acts and omissions which together make up the list of complaints. They introduce what will repeatedly be seen as a serious problem, namely how to deal with injustices occurring outside the Investigation's period of remit, but which are due to maladministrations within it. One details the several misrepresentations of the effects of the July 2001 total policy value cuts and the Compromise as they affected disenfranchised with-profits and FSAVC (Free Standing Additional Voluntary Contributions) annuitants, which culminated in the November 2002 annuity reductions shortly after completion of the mandatory AVC review. The other identifies the events which persuaded the Chief Financial Ombudsman to accept the official rationale for the Compromise Scheme of arrangement, the position outlined in the Society's unendorsed and demonstrably untrue Oct 2004 Fact Sheet, and to exclude "Penrose-related complaints". This allowed compensation to be limited to "late joiners" who commenced policies after March 20th 1998 (something that would not been possible in the first place without the intervention of the Equitable Life Late Joiners Action Group [ELJAG] and their successful class action against the Equitable), and legitimised the total policy value cuts of July 2001 *plus* the imposition of a market value adjuster as exemplified by the Ms. E Final Decision and award. On the basis of the belated and notorious Mr. & Mrs. K Final Decision (see MN paper on FOS stance), claims earlier than this were disallowed. In effect, therefore, the rump of 1988-98 Equitable with-profits members and policyholders were denied redress until the successful outcome of the Equitable Life Trapped Annuitants (ELTA) class action afforded a practical demonstration that the Mr. & Mrs. K decision could and should be overturned.

Two important aspect of this approach are that it made no assumptions as to the degree of documentary transparency that the Ombudsman's final Report might achieve, and that it makes plain the materials used to illustrate various observations on that Report. This has proved necessary in the event by the limited transparency of the outcome, and the disparity between what the writer has referred to and submitted as distinct from what the Report has acknowledged. The Investigation has also elected not to publish the Actuarial Review it commissioned, such that some critically important entries may not now be brought forward directly.

Achieving optimal transparency and documentary trailing during an Investigation and Report such as the PO's latest is a daunting task. The PO says in 4.51: "The fact that I have not quoted here from these or any other documents does not denote that I have had no regard to their contents. I have had regard to all the evidence submitted to me from whatever source." And yet, if what follows holds an acceptably true mirror to the entire process, there emerges the clear question as to how such regard might more accountably be brought forward and followed up in future.

Review of investigation and reporting process:

Briefly, the Parliamentary Ombudsman Investigation's approach has been to hold preliminary discussions with interested parties and action group representatives, and to receive their observations plus singular or multiple complaints arising. It has then bundled the complaints under 18 main heads designated A-R following recommendations by the Equitable Members Action Group (EMAG) as the largest interested party, with the observing participation of other parties and smaller action groups. 15 specimen "lead cases" were also selected from the many individual complainants nominated by Members of Parliament and action groups, or who wrote in directly. The 18 complaints were then assessed to ensure **firstly** that they were not misconceived because they fell outwith the Investigation's remit, and **secondly** to confirm they were soundly based in fact. **Thirdly** they were examined as to whether they were the result of deviations from European and UK statute, guideline, established principle or practice of sufficient moment to qualify as maladministration. **Fourthly and finally,** the Ombudsman has ruled as to what injustice if any flowed from the maladministration. It is also very important to note that, alongside this "bundling and winnowing of complaints", the Investigation has taken general expert advice. This might have permitted the Ombudsman to make certain findings of her own as to possible maladministrations unrelated to complaint heads A-R, or from which dependent injustice has not yet been pursued or determined. It is also curious to note that there has been little illustrative use of the Investigation's 15 lead cases, albeit that any wish for anonymity was to be respected.

Having thus defined which of the official complaints were valid according to the prevailing or contemporary statutory framework and powers, and after reviewing the responses to her draft report, the Ombudsman has made ten findings of fact. All these she has after due consideration of the relevant standards found to constitute maladministration. Between them they cover aspects of the following:

1. Allowing Roy Ranson's dual role.
2. Excessive valuation rates of interest to support liabilities.
3. Not holding explicit reserves for guarantees.
4. Failure to note, react to or warn on the emergence of the DTBP.
5. Affordability and sustainability of bonuses.
6. Users of returns led to misconstrue the Society's financial strength.
7. Failures connected with concessions for and appropriate assessments of the financial reinsurance arrangement over the years 1998-2000 (but not subsequently owing to regime change).
8. Not following up the possibility of losing *Hyman* in the 1998 & 99 returns.
9. FSA's failure to record decision to allow ELAS to accept new business after finally losing *Hyman.*
10. FSA's unsound basis for then letting ELAS stay open for new business.
11. FSA's misleading information about ELAS's solvency for the post-closure period only.

All in all the PO has made 10 findings of maladministration; 4 against the GAD, 1 against the DTI and 5 against the FSA. From these 5 major headings of injustice were held to follow. They comprise 3 elements, namely financial loss, lost opportunities of taking properly informed or alternative decisions, and outrage. We have later to ask whether these findings are sufficient for the public and the UK/EU Parliaments, and if they suffice to establish who qualifies for what quantum of redress.

At the draft report stage twelve headings of maladministration were made, which were more specific in their instances. But because the economical method of ruling (*vide infra*) allowed some of them to be made subordinate to others they did not themselves lead to determinations of injustice given how the Investigation had been structured. There was, however, one notable exception, the dependent consequences and injustices of which the writer had taken particular care to explain at EQUI and to the Investigation. It is mainly for this reason that the writer believes that, contrary to his wishes and representations, such matters were deleted as separate items of maladministration or reference points therein from the final Report. They dealt with aspects of guaranteed investment returns, guaranteed annuity rate issues, and PRE. It is of further interest to note that S & PM was not a maladministration finding or reference point in either the draft or final maladministration listings. These observations are consistent with the background to the preliminary considerations of maladministration and injustice given on pages 165-70 in part four of the Report

<u>Critique of process:</u>

The present Investigation has had three major limitations. **First** and most importantly, jurisdiction limitations dictated that it could only examine the conduct of prudential regulators, and **secondly** it has in practice mainly been confined to the period from 1988, including the official presentations of the WPWM (With Profits Without Mystery) business model to Dec 1st 2001, which marks the effective end of preparation for the Compromise Scheme of Arrangement. **Thirdly** and correctly, the actions of the regulators were not to be judged by hindsight, but by the successive statutes and guidelines prevailing at the time, of which more anon. The combined effect of these limitations is such that the Investigation has had to leave some major categories of observation and complaint unaddressed or unidentified. It is therefore encouraging to note that Sir Michael Buckley, the previous Parliamentary Ombudsman had expressed regret that the UK government did not institute an Investigation with powers and scope to address the whole affair from the start. He wrote: *"The root cause of the problem, in my view, is the failure of the authorities to establish at the outset a single investigation with terms of reference covering all aspects of the Equitable affair, including issues of possible personal injustice due to maladministration and redress for such injustice if it should be demonstrated".* Having compiled the "Anatomy of a Fraud" update for EQUI (MN written evidence item 33), and having further regard to matters mainly detailed in Annexe 2 of this paper, we have come to a distinctly jaundiced view as to how and why this came about. The most pressing consequence is, of course, that the Report may not fully satisfy the needs of the European Parliament, even though it may be more immediately acceptable in the UK. Moreover the Report's chronological account has revealed important interactions between conduct of business and prudential regulators, from which the prudential regulators in effect took important comforts as part of a general process of *reverse regulatory arbitrage* (see definition on page 4) to help maintain the Society's official solvency, the rationale for the Compromise and indeed all subsequent outcomes. As we shall also have occasion to see, the periods of delegation of Conduct of Business (CoB) regulation, firstly to LAUTRO (Life Assurance and Unit Trusts Regulatory Organisation) under ex-Equitable Appointed Actuary Barry Sherlock from 29th April 1988, secondly to the PIA (Personal Investments Authority) on 18th July 1994, and thirdly to the FSA (Financial Services Authority) under a Service Level Agreement as from June 1st 1998 have contributory significance in what follows. It is therefore disappointing that the Investigation and Report have not addressed the way in which the prudential regulators handled CoB interfacial matters with these various agencies, and the more so because they reveal much reverse regulatory arbitrage.

The consequences of economical as opposed to more exhaustive ruling, whether in the draft or final Report, are best exemplified by 12.148-50 and 154-6. They cover potential injustices in respect of the impact of losing the *Hyman* litigation and the basis on which the decision to allow the Society to remain open for new business was taken. No separate determinations of injustice were made, on the grounds that the matter was subordinate to the matter of financial reinsurance. From this it should follow that maladministrations in respect of the GAR issue on which *Hyman* was determined should also be subordinate, and that injustice could not have been determined in that instance either.

In the writer's view this raises two important issues. Firstly, the whole issue of reinsurance begs the question as to why it should have been necessary in the first place, to which of course the answer must be failure to explain, charge or reserve for the GAR option. Secondly it follows that maladministration in respect of the GAR ranks more highly in the causative sequence of events than the emergent DTBP which provoked *Hyman,* or the reinsurance issue which was dependent upon both the foregoing. In fact, however, the Report introduces a further discontinuity by professing inability to determine how individual or potential policyholders might have acted had things been managed differently and hence how much worse off they are now as opposed to themselves having acted differently, on which basis the dependent injustice becomes policyholders being deprived of the basis to take informed decisions rather than financial loss *per se* as expressed in 12.120-1. A similar logic underpins the decision not to rule on what injustices might have flowed from Roy Ranson's extended dual role (12.87-8). And yet all this begs a further question, namely that had policyholders decided not to invest or elected to transfer out they would not be in their present situation. What matters is not what people might have done, but their current predicament given what they actually did, which is one of loss. Moreover nobody now disputes that Roy Ranson's influence was baneful, from which it follows that what he actually did is the issue, and not what someone else might or might not have done, and preferably with competent guidance and support from the regulators at that.

From this it can be seen that economical ruling dissociates causal maladministrations from specific injustices, and secondly that, despite policyholders' very real predicament, injustice can further become dissociated from financial losses irrespective of whether they be absolute or relative. Adversely affected are:

- Primarily accurate explanation and understanding.
- Secondary forensic issues.
- The true nature of injustice.
- Causal attribution of financial loss to maladministration and injustice.
- Proper basis for precedent and remedy.
- Impaired ability to learn for the future.
- Difficulties in effecting any necessary reforms and disciplinary actions.

Additionally informing the whole we have:

1. Original list of maladministrations and injustices.
2. List of maladministrations and injustices actually made.
3. Findings of maladministration and injustice that could have been made using exhaustive ruling.

-to which must also be added:

4. Findings of maladministration and injustice that could reasonably have been made using the wider range of complaints submitted and/or relevant facts directly or incidentally discovered.

This last item is of the greatest importance, because the Investigation's process closely resembles the heavily criticised "Procrustean Bed" approach taken by the UK Financial Ombudsman Service (see definition on page 4 and MN paper), in that it has rigidly strict if less arbitrary limitations, groups complaints together under specified headings, and purports to have followed specimen lead cases. However, unlike the FOS process, advance determinations on selected lead cases have not enshrined precedent and hence decisions on all further action. That said, the outcome has in many ways proved similar, because both processes have been non-iterative, in the Investigation's case up the draft report stage. In the FOS case this was deliberate, in order to avoid the admission of any evidence that might undermine or gainsay the rationale and *bona fides* of the Compromise Scheme of Arrangement, and so it is ironic that the origins of the FOS stance and how it was brokered are to be found in the Chronology of the present Report. But in the Parliamentary Ombudsman's (PO) case it means that the opportunity to take new actions and revisit original complaints in the light of new evidence the Investigation has itself brought to light has been neglected. This becomes embarrassing where and when the Report comes to conclusions that are not fully consistent with its own evidence. For example, the Compromise Scheme rationale and the FOS position, burying the *scienter*/liability trail for fraudulent misrepresentation and mis-selling and the deliberate misleading of the public involved throughout were the culmination of a long series of comforts and reverse arbitrage by the regulators as revealed in the chronological section of PO's report, and which as yet remains unaddressed. We therefore find it odd, or even perverse that the Report in effect excuses or praises the regulators for their efforts to save the Society by means such as these. This situation is hardly permissible on account of later events being technically outside the Investigation's jurisdiction. *One must therefore submit that this has had a profoundly limiting effect on the range of* *and scope for maladministrations and injustices the Report has identified.* And as will be enlarged upon later, any last minute escape of the regulators from the Policyholders' Reasonable Expectations (PRE) era into "fairness" with the implementation of the Financial Services and Markets Act on Dec 1st 2001 neither legitimises nor excuses it.

The Investigation has nevertheless professed to follow through on two simply expressed and hallowed principles, which are, however, easier to formulate and understand than they are precisely to define. The first of these is the concept of PRE, attributed to actuary Ronald Skerman following his1966 paper (see ref) concerning principles of valuation that are highly relevant to the present Investigation, as they are also to the essential nature of with-profits business so central to its remit, and to the fiduciary choice of net premium valuation methods properly applied as opposed to the gross premium or bonus reserve valuation method. All these aspects of PRE have been overlooked. Subsequently PRE was officially expressed and incorporated in the 1973 Insurance Companies Act. The second is that of Sound and Prudent Management (S & PM) as expressed in the European Third Life Directive of 1993, which was incorporated into UK Law in July 1994. *As will become evident, the essential nature of with profits business in contrast to Society's business model or regulatory culture and ethos is a matter to which we shall have to return repeatedly in connection with these two principles, because the Report has not followed through on their overall significance in pursuit of its findings. Largely as a result of this the two principles themselves, rather like the lead cases, have been introduced but to a considerable extent left hanging in the air, and no adverse findings, maladministrations or injustices have been made in respect of them.* MJ has chosen to explain this further in a separate submission. More immediately we should note that PRE has become something of an embarrassment to the UK regulators, such that the Financial Services Authority (FSA) has sought to end its official life, and replace it with "fairness". Furthermore this policy change both falls within the time period of the present investigation and is highly pertinent to it Hence the following extract from the Minutes of evidence taken before the Treasury Select Committee Tue 30th Oct 2001, Paras 42-3:

(*Kali Mountford*) "You did not mention though any definition of PRE. It has no legal basis at all, does it? Do you think it should have? (*Sir Howard Davies*) Policyholders' reasonable expectations, as this report I think makes clear, has a somewhat chequered history and is lacking in clarity and definition. The phrase "PRE" will not be part of the new regime. We have tried to replace it with the concept of treating customers fairly and we have published a paper on what we think that means in future in terms of the information that should be provided to policyholders and the information particularly about the way in which companies will exercise their discretion. We are working on that in the context of our review of with-profits polices and we aim to produce a more comprehensive definition of what we mean by treating customers fairly in the spring of next year, but I agree that the concept has been-I will not go so far as to say unhelpful-not as clear as it should have been.

So are you saying that it is a concept that has had its day?
(*Sir Howard Davies*) Yes, and it has only got a month to live".

By these means it was hoped to supplant an external standard with a more flexible quality of operating procedure not necessarily informed by or corresponding to the aim of the original standard. That stated, reasonable expectations were limited to policyholders rather than clients generally. The general concept of reasonable expectation is, however, enduringly valid, and is entirely compatible with "fairness". So why supplant something inherently useful rather than extend it? Again, fairness is only compatible with justice when reasonable expectations have been followed. It is by no means always compatible with justice when reasonable expectations have been failed. For example, it is not just but fair that, if the granary guard has embezzled half the village supplies, all should share the loss. That aside, now that one can now so much more intimately understand Sir Howard's personal embarrassment over PRE matters, one is correspondingly better entitled to ask whether this is in fact a change for the better, and indeed whether it should be accepted uncritically. Practically and tactically, however, the S & PM and PRE era governed conduct of the regulator throughout the critical period of the Investigation. Moreover S & PM remains a tenet of EU legislation. Perhaps in response to representations the final Report has made some consideration of PRE with respect to maladministration and partially upheld some of the official complaints on account of it. Even so we should anticipate that the European Parliament could decide that there has been insufficient consideration of PRE and S & PM overall.

With this in mind, we now address two issues. MJ and the writer have each previously analysed the Society's business model as selectively and partially disclosed in two presentations of "With Profits Without Mystery" made within this Report's reference period, and have also explained how this translates into something fundamentally antithetical both to received actuarial wisdoms and the fiduciary heart of the with-profits assurance concept as originated at the Equitable itself. We have also explained why the absence of an estate, Ponzi expansion and taking allowances against future profits are in their different ways all diametrically opposed to the central ethos of with-profits assurance. What we had not anticipated, however, was the ease with which future premiums dependent items (i.e. Equitable's now well aired quasi-Zillmer) could be re-classified as future profits implicit items under Section 68 orders as revealed by the present Report. In essence, therefore, something inappropriate was switched to something alien to good faith, the essence of the with-profits concept, PRE and S &PM at the stroke of a pen. We are also mindful of what outgoing Insurance Directorate Actuary George Newton had to say generally on this subject in his memoranda of 21st Sept 1987 and 8th July 1988 as laid out in Penrose 13 Paras 107-112, and which we have specifically drawn to the attention of the present Investigation. In his letter of June 30th 2005 to the Investigation leader, MN hoped that the Investigation would give Newton's observations due weight, not only because they was current, timely and hence part of the contemporary skill set, nor simply because they emanated from an office of the regulator itself, but also because they were made in the light of both PRE and what was to become S & PM under the UK implementation of the 3rd Life Directive in July 1994. EMAG also alluded to it (Report chapter 3.46). Furthermore, Newton was one of the immediate predecessors of the GAD/FSA Directing Actuary whose decisions and actions feature so prominently in the draft Report. For these reasons Lord Penrose's abridged version has been reproduced in Appendix 3.

Prior to that, there are Government Actuary E.A. Johnston's concerns as expressed in discussion of the vulnerabilities and limitations exposed by the Report of the Maturity Guarantees Working Party as far back as 1980 (see references). How Johnston's and Newton's successors allowed this situation to run on unchecked through and then even beyond the later Guaranteed Annuity Rate Working Party impasse of 1997 (see references) is not pleasant to contemplate. More interestingly still, the Directing Actuary who was one of Newton's immediate successors and the Equitable's Christopher Headdon were fellow members of a working party whose report was entitled: "Proposals for the Statutory Basis of Valuation of the Liabilities of Linked Long Term Insurance Business" published in 1988 (see references), which was the year before Ranson and Headdon's traducing manifesto paper "With Profits Without Mystery" (WPWM) made its appearance (see references). More ironically still, much of the report was taken up with resilience testing and mismatching. Hence this must now be incorporated into our understanding of what Headdon must always have known about how resilience reserve hypothecation and presentation should have been handled by the Equitable, while also being privy to why and how in fact they were. Equally we must try to understand the very mixed feelings that the Directing Actuary may have experienced when the significance of the resilience reserve issue in the Equitable's returns was finally appreciated. It would be surprising if a growing mutual appreciation of all this did not colour the working relationship between these two men.

Now we may turn to Appendix 1, which *inter alia* shows how these particular considerations surfaced in our list of observations and complaints to the Investigation, and our deductions as to how they have been bundled up and dealt with. Note for example that our complaint B (f) has been ignored, and bundled into one with an essentially opposite meaning. *For surely the general point is not that the regulators failed to keep pace with developments, but that they did not follow the fruits of their own extensive experience, participation and advice.* And given what the chronology reveals about successive comforts taken and arbitrage by the regulators against their own rules, this must be a matter more of good or bad faith than of relative competence. EMAG put it thus:

"The PO has found that the FSA acted in good faith in all matters, which we understand means that in her view it did not act in "bad faith". This may be true, but what is very clear is that it put the regulators, the Government and the Industry's interests ahead of policyholders by concealing financial weaknesses arising from overbonusing and ineffective regulation of the industry in general and of Equitable Life in particular". One surmises that, while such an outcome might accord with the Government's notion of "Financial Stability", it certainly does not match PRE let alone "Fairness." As a result it is hard to see why complaints based on PRE, the Society's business model and S & PM have not been more comprehensively upheld.

Such considerations invite a further question. How is it that comprehensive failure of the regulatory system and the general complaint have been established only up to the closure of the Society to new business, and not throughout? Given all the active reverse arbitrage, the "misleading" finding for the post-closure period should perhaps not have been left as open as it still is. Somehow implicit in the present position is that sins of omission amount to failure, whereas acts of commission are not sins and do not. And so the question we are left with can be rephrased as: Are wrong acts of commission more or less serious than regulatory failure? It will at once be apparent to the more intimately knowledgeable that the fate of the entire collective Establishment defensive position depends on the answer. It is an answer which, had the emergent issue of reverse regulatory arbitrage been factored into the original question, might well have been provided.

In conclusion, Appendix 1 shows the fate of the ELTA and ELJAG complaints in relation to the determinations of the PO in illustration of this overall description and review of her Investigation process. Its similarities to FOS procedures may be judged from MN's FOS paper which has been widely circulated and is available on request.

<u>Nature and import of new evidence in the Report:</u>

This leads naturally into matters revealed by reading through the earlier draft chronological digests prepared for the Investigation as summarised and presented to it by MN on Sept 20th 2007 which opens Appendix 2. It has been gathered intact as Appendix 2 in order to preserve its contemporary flavour, but rendered anonymous and with date and time entries added so that the various editions of the Report Chronology may if later judged necessary be consulted or compared once due authority has been obtained. Suffice it in this narrative to say that the items group into three main categories of adverse findings resulting from reverse arbitrage by the prudential regulators as earlier defined.

These three categories are:

1. An extensive series of devices and comforts taken by the regulators over several years, which helped ELAS to maintain a public position of official solvency.
2. At the prudential/CoB interface, suppressing, discounting and dismissing evidence of *scienter*, systematic deceit and misrepresentation, and consequent liability. The consequences of this were, and continue to be, both grave and material.
3. In the course of reverse arbitrage, ending up in positions of falseness and ambiguity.

Category 1, insofar as it has been considered by the Report, appears to have been construed as worthy efforts by the regulator to save the Society for the good of each and all. But the pattern of constructive intent which emerges makes such a view very hard to accept. Despite repeated requests to the Investigation, **Category 2** reverse arbitrage has not been addressed in the Report. But given all the extensive knowledge that already exists in the area in respect of the Society's business model and methods, S & PM or PRE, this omission is incongruous. *Though substantial out of court settlements have been paid by the Society in these regards both to" late joiners" and more recently ELTA annuitants,, the effect of Category 2 reverse arbitrage has been to support the official mathematics of the Compromise and FOS stance, and to deny adequate justice or recompense to ordinary citizens.* As yet, however, there is no logical route to compensation in the draft report under this head. **Category 3** has been touched upon indirectly by the Investigation, and has surfaced in a finding of the regulatory stance being potentially misleading. Otherwise it appears to have been regarded as a positive feature by the Report, in that the general complaint of serial regulatory failure has been upheld for the pre-closure period only. We fail to understand this, unless it relates to the Compromise and FOS stance being out of the Ombudsman's bounds. This may also partly explain why causal chains from maladministrations within the time period of reference to subsequent well known later injustices have not been picked up or followed through.

That explained, we introduce some additional items from the Report. These extend the list of comforts taken, so further describing the pattern of reverse arbitrage that took place. The result is to reinforce the earlier appraisal of what its overall constructive intent must therefore have been, and hence what injustices must have followed from it. Thus, to the Appendix 2 list of comforts designated from 2(a) to (s) now we add:

t) Allowing the Society to take credit for the reinsurance treaty in the year before it was signed. This is analogous to comfort 2(q).

u) Turning a blind eye to the all the consequences of the July 2001 cuts, and postponing making a formal request to the Society to take steps to restore itself to a sound financial condition until they had been effected. The net effect of this inaction and reversed procedure was to create the main slack for first bribing and buying out the GARs in the Compromise Scheme that followed. Once that had been ratified and implemented, further cuts for provisions that the prudential regulators knew had not been made or described under the Scheme could thereafter be imposed with impunity. *We submit that this preparatory position, and all that we now know the prudential regulators did to facilitate it, falls within PO's rights of observation and jurisdiction.*

v) As opened up in Appendix 2 but not then fully appreciated, in effect delaying answering Noel's Nov 16th 2001 letter as to how much credit could be taken for the reinsurance treaty until *after* *** (actuarial review paragraph 19.47). In the author's view, that is both a significant comfort and a further example of reverse arbitrage. It is also a fine example of the Janus (two faced) style of memorandum so frequently encountered in the Chronology.

w) The Compromise Scheme was agreed by the court. Hence ELAS's 2001 returns were prepared on the basis that *** (Actuarial Review paragraph 19.47 as above-period outside the Report's jurisdiction.)

u) From EMAG's draft comments to the Investigation we add their observation that at the time the Compromise Offer went out to policyholders the Society's assets were insufficient to cover the proposed 2.5% uplift to non-GARs-hence the later 4% cut. As a result EMAG concludes that the FSA should have insisted that the Compromise Document should contain a 'Statement of Affairs' showing all assets and liabilities made up to a recent date, as is routinely included in commercial compromise proposals. This would have shown the deficiency. This point was made by the FSA's own insolvency expert: "This calls for another pro-forma balance sheet which necessarily will not be in a Companies Act format, and it should show the position before and after the proposed deal." -31/07/2001 [14:08].

In reviewing this long succession of comforts, one wonders why all the losses were not pulled together fully into one really big hit in July 2001. Everything yet to come was pretty much all up in lights after incoming ELAS AA Peter Nowell's valuation. Perhaps ongoing uncertainties about how to deal with mis-selling liabilities and details of the lead into the Compromise clouded some of the issues. But more significantly, announcement of the full scale loss could have provoked uproar, and more pressing questions into insolvency. If so, this would have been a potent deterrent from so doing. However there is another interesting aspect of the July 2001 cuts in that they seem to have had little effect on monthly Required Minimum Margin for solvency (RMM) presentations in the draft report. Cutting total policy values maintains the ratio of what is guaranteed to what is not, but might ordinarily have been expected to also improve the mathematical reserves and hence the RMM. However, the incoming AA may well have felt the need to rebalance the liabilities and re-state the resilience reserve consistently with a new and future convention in conformance with statutes and guidelines.

No immediately useful purpose would be served by rehearsing and discussing the minutiae of all the various comforts, suppressions of the public *scienter*/liability trail and false positions which comprise the entire process of reverse arbitrage listed in Appendix 2 and as supplemented above. That would require an inappropriately long narrative account over and above the listing already provided, and so it is fortunate that ex-EMAG Chairman Alex Henney (AH) has prepared one which covers a lot of this material (see references). Quite simply, we had not expected to emerge so troubled and oppressed by its magnitude and extent, let alone its clear relevance to matters already raised. Whether individually or in combination, these actions or inactions have resulted in gross and obvious injustice. *The Investigation has itself unearthed them, and it is a matter of the utmost concern that the Report has been obliged to leave the whole matter aside despite due notice and representations that it be considered..*

Significant breakdowns of process resulting from defects in implementation and ignorance of new findings:

It is now appropriate to summarise the more important breakdowns that, *from the perspective of our own complaints* we deem to have occurred. Some of these appear bizarrely unsound, and therefore objectionable.

- Bundled complaint D : Roy Ranson's dual role. Given Ranson's baneful influence, and the fact that that he eventually cause virtually irremediable damage which could hardly have been remedied by his successors irrespective of whether they were complicit or like minded, we find that the disparities between the report's own findings and subsequent reasoning on injustice are so wide as to be unsustainable. The dual role period was from 1991 until Ranson's retirement in 1997, and so included a further period of substantial over-allocation leading to such fateful changes as introduction of the quasi-zillmer, implementation of the GAR and GIR differential bonus policies, not advising his board on PRE matters as noted by Lord Penrose, and arranging subordinated loans which are antithetical to with-profits aim and ethos. Any or all of this might have been prevented by a reasonably competent President had the offices not been combined. We further maintain that, though it admits some hindsight, the prudential, statutory and guideline aspects of the Actuarial Disciplinary Tribunal findings against Roy Ranson are material and relevant to this issue. Moreover the Tribunal's findings necessarily reflect the professional standards expected of regulators as well as Appointed Actuaries. The Report opinion is summarised in Chapter 13.41-3.

- Bundled complaint E: Failure of regulators to keep abreast of developments. We naturally expected this complaint (which was not ours) to be rejected as not soundly based, but not that it would effectively reverse the meaning of our complaint (f) as previously explained. The consequence of so doing in the context of extensive reverse arbitrage are now plain, and no more need be said.
- Bundled complaint H: Reliance on the emergence of future surplus. Also as explained, the author wished this to be revisited after further general deliberation on what the particular ethos of with-profits funds as opposed to life policies in general was, or indeed should have been. More specifically, the author wished the Report to express an opinion as to the propriety of the new finding that confusion of future premiums dependent items with future profits dependent items allowed the regulators and hence the Society to take significant comfort under Section 68 regulations. We further submit that PRE under the bonus reserve versus the net premium valuation as originally formulated by Skerman (1966), the quasi-Zillmer/resilience reserve hypothecation issue and the ethics of loans or debts run up against the future in with-profits business are material and relevant factors. The Report has limited the issue as explained in 13. 60-67, but which does not answer any of these points
- Bundled complaint L: The Society's business model. The Investigation has ruled this to be partially misconceived as explained in Chapter 13 paras 91-101 inclusive. In essence the reasoning employed is based on the regulator's failure to spot the symptoms of the malady rather than the more stringent requirement of being required to diagnose and treat the malady itself. To the writer this is unsatisfactory for the following reasons:
    - MN and MJ have had occasion throughout their previous publications to distinguish between "freedom with disclosure" and the form of selective partial disclosure that the Society actually used in both prudential and CoB matters. Frankly, with all the information at their disposal, the regulators should also have been similarly aware, as in fact overall they were. That, and the fact that the Society was not compliant in the matter and manner of its returns, gave them the necessary powers of intervention.
    - While it may not have been for the regulators to function as "shadow directors" of the Society, it was certainly their role to be "shadow customers" and hence real regulators under both PRE and S & PM.
    - We have extensively analysed the relevance and consequences of the WPWM manifesto paper and discussions plus George Newton's memoranda to this complaint. So had the actuarial discussants of the WPWM model at both its presentations in 1989/90 Frankly, the prudential regulators must have known or should have deduced much of all this for themselves. What is more, if George Newton was the immediate predecessor to the Directing Actuary who assumed his position in 1988/9 and who features in the Chronology, Newton's valedictory advice should have been carried over. It all reinforces the contention that, given what the prudential regulators had early on

deduced about over-allocation and its relevance to the Society's protractedly precarious financial position they should have acted accordingly.
    - Rather than do this, we now know that the prudential regulators took a series of comforts and indulged in reverse arbitrage, which in or by the end they hoped would extend and cover the position prior to passing it back to policyholders.
    - The neglected issue as to what constitutes the aim and ethos of with-profits business plus what has already been said about the emergence of future surplus are once again material and relevant.
- <u>Bundled complaint M, N and O: Policy values in excess of assets and the decision to monitor PRE only through returns.</u> This complaint has now been upheld in part, which is gratifying to those who subscribe to the fundamental importance of PRE in relation to ultimate good faith. It has been considered partially misconceived in that the obligations of the prudential regulators were more secondary and reactive than primarily pro-active. But once clear departures had occurred which had PRE implications the regulators might reasonably be expected to have followed them up. The writer wished the Investigation to revisit this if only because of its relevance complaint L above. And to the extent that policy values and/or liabilities in excess of assets was an industry-wide problem which in due course led to the Actuarial Guaranteed Annuity Rates Working Party impasse of 1997, in effect it extends the General Complaint- a subject is enlarged upon later. Hence the wave of demutualisations, refinancing or passing on "zombie" funds to re-insurers is symptomatic of gross, chronic and general regulatory failure. Very probably, too, the affected offices were already giving the prudential regulators a serious headache. That the Equitable was the most severely affected office supports rather than detracts from this observation. Hence too it should not be in dispute that policy values in excess of assets must carry serious implications for PRE, of which even a prudential actuarial examiner should be aware. That should ordinarily prompt some necessary cross-checking of an office's reports and literature, if necessary in association with the CoB regulator. In the Equitable's case that would have led to the difference between the realistic position and the solvency position being duly exposed and addressed. So in effect PRE was not even monitored. However, that seems to be the current minimal position
- <u>Bundled complaints Q & R: Bonus declarations and policy value cuts.</u> We note Report p194-5 and Chapter 13 paras 127-36 on this subject, which further amplifies and is material to what has just been said under complaint L. Again the issue is cast as a matter of being proactive and reactive, and the issue of reverse arbitrage has not been taken into consideration. Para 136 concludes: **"To the extent alone that maladministration was a contributory factor in the creation of the situation in which the policy value cuts were made, I uphold these heads of complaint in part".** The contributory maladministrations (for surely there are more than one) are not specified- and indeed one might have expected more of these to be identified and added. We are obliged to dispute this conclusion and the form in which it is expressed, because it is of crucial and general import. A great deal of further thought on it is required by all parties, but suffice it now to state:

- Regardless of the general situation of with-profits offices, Equitable was so far worse than the others as to constitute a class of its own.
- We repeat that the prudential regulators had ample reason to know, and to a considerable extent did know, that the Society's business model was inherently unsound, and hence not conformant with UK/EU statute or actuarial guidelines under either S & PM or PRE.
- The regulators knew, or ought to have known, that the Society's over-allocation was both chronic and fundamentally inequitable.
- Despite this, the prudential regulators never gave it Category 1 priority.
- It is essential to view the July 2001 cuts **and** their inbuilt sequelae in the context of all three categories of reverse arbitrage that the prudential regulator indulged in.
- Had the prudential regulator not had recourse to all these, the Society would have had to be declared insolvent and liquidated irrespective of the July 2001 cuts. Hence too the regulators must have or at least ought to have known that there was no reasonable prospect of the Society finding a buyer in the latter half of 2000.
- Because the cuts included the guaranteed moiety of polices they were *de facto* an admission of insolvency. We continue to be astounded by this, and are correspondingly concerned given all the other devices the regulator was employing to maintain the official and public state of the Society's "solvency".
- In whatever other light one regards it, the regulators not admitting that the Equitable was insolvent, which would have required them to deal with this uncomfortable fact in a suitably prescribed manner, is a gross deviation from statute, guideline, professional duty and ethos.
- The Equitable was the **only** life office to a) become insolvent, and b) have its insolvency dealt with in this manner.
- To attribute the cuts to falls to the market, impose them on in all force policies, and then charge Market Value Adjusters (MVAs) on top of that for distressed non-contractual withdrawals is unethically illogical on the one hand, and flagrant double billing on the other. Besides, as others have maintained, market falls were not then sufficiently established to make this explanation credible. MVAs alone should have been sufficient, and under circumstances where emergency distress withdrawals would have been superfluous. That remained the position for all other Life Offices.
- The above is inherently material and relevant to injustices sustained during the genesis and emergence both of the Compromise and the FOS stance that are covered by the present Investigation.
- ---- of GAD's euphemistic concept of "solvent" run-off (modified in final Chronology) became the essence of the Compromise Scheme. At least it sounds marginally more realistic than the phrase "profitable" run-off which has appeared in other accounts)
- We now know what else the prudential regulator knowingly allowed to remain largely un-provisioned and carried over into the Compromise Scheme, largely but not exclusively because the July 2001 cuts were in effect not fully implemented beforehand.

  - As explained, the enabling cuts were effected in advance of a formal request to the Society to restore itself to a sound financial position being made. That is strange indeed.

We are astonished that this situation remains unrecognised despite many representations to the Investigation by several parties, and are correspondingly disappointed that it has not been addressed in a suitably searching way.

<u>An obstinate wrinkle: The nature and effects of residual inequities of guarantee:</u>

The writer has had occasion repeatedly to draw attention to the fact that the Guaranteed Interest Rate (GIR) Differential Bonus policy emerged simultaneously under essentially the same circumstances as the Guaranteed Annuity Rate (GAR) one. With that in mind, any omissions to reserve for the GIR or indeed the GAR are of obvious relevance. It has repeatedly been explained what the GIR issues are, and the Investigation has been kept fully informed as to how they continue to blight the prospects of GIR annuitants who have been transferred to the Prudential Assurance Company. Hence the matter was illustrated in another way, by paraphrasing some earlier observations commissioned by the Investigation in the Actuarial Report (not published- hence paraphrase withdrawn).

In the event, the writer respectfully asked that the Investigation revisit this area in respect of the following:

- The issue of unequal guarantees and how they would be explained or charged for, *and indeed how the expert audience expected them to be addressed and policyholders duly informed*, had surfaced in the WPWM discussions.
- The GIR DTBP text emerged at the same time, in the same footnotes and under the same circumstances as the GAR DTBP, i.e. in Feb 1994 which was **before** GIR policies ceased to be issued.
- We therefore submit that the effect this had was largely to neutralise the GIR in essentially the same manner as the GAR.
- Hence, by the time the non-GIRs were sold, the GIR had little value and there was not as much difference between GIR and the new non-GIR policies.
- At or around Feb 1994 the Society also commenced to add the value of the GIR to the hurdle rate of overall return ensuring a level annuity to GIR with-profits annuitants. This had the effect of turning the GIR from a guarantee into a fixed penalty for the great majority of years in which the rate of overall return was greater than the GIR. The problem is that most GIR annuitants remain unaware of this or its significance.
- Peter Scawen of ELTA has quantified the effect of this device, and made tabular projections on how it adversely affects GIR annuitants under the Prudential deal. MN has also drawn this to the Investigation's attention.
- In ELTA's Commentary on the PO's Report Peter again explains and exemplifies this. He also accounts for how the proportion of un-guaranteed annuity in WP annuities increases over time (p 4). However the hidden 3.5% GIR charge is levied on the whole annuity and not merely the guaranteed portion, such that both decrease at an accelerated rate.

From this it seems clear enough that the Society did in the end recover substantially more than the GIR was worth, in a manner of which policyholders were generally unaware, and which accords with the Investigation's earlier observations. We also trust this explains the significance of not reserving for the GIR. Moreover all this took place within the Investigation's remit, and the parallels with virtually every aspect of the GAR issue are starkly obvious. The writer therefore respectfully requested appropriate determinations on failure to follow through on any omission to reserve for the GIR, because it was symptomatic of the Society's underlying need to offset it and for essentially the same reasons as the GAR. As earlier explained the necessary determinations did not materialise.

<u>Discussion:</u>

This review has identified a number of issues for consideration. In recapitulation they are:

- A reprise of how appropriate and effective the complaints process has been, given the limitations of the PO's remit and process.
- An explanation of how far the Investigation's remit has allowed the PO to make observations and findings of her own, or interpret additional evidence that the Investigation has amassed as opposed to matters initially complained of. In this connection we were informed that Conduct of Business interfacial matters were within the Investigation's remit- but obviously did not presume that any resulting observations would be empowered as fully as those on prudential matters. Given the representations made by AH and the writer to the Investigation, ignoring and failing to refer to the matter in the Report must be of material concern.
- Significance and consequences of…. (draft Report findings of maladministration withdrawn from final).
- Reasoned approaches for review and extension of potential areas of maladministration and/or injustice: Overbonusing, loss of estate-associated security and earnings and incurring further debt in relation to the core fiduciary aspects of mutual with-profits funds, the resilience reserve and its hypothecation issue in relation to the seamless shuffle of zillmerisation allowances to future profits implicit allowances under Section 68 orders, the full consequences of ….(finding of maladministration withdrawn), injustice in respect of Roy Ranson's unconscionably prolonged dual role, turning a blind eye to everything hidden in and the pre-Compromise preparatory slack created by the July 2001 insolvency devaluations, and gross reverse arbitrage by the prudential regulators over matters including mis-selling liabilities, the rationale and cost of the Compromise, the plight of the disenfranchised annuitants, and genesis of the equivalent FOS stance.
- It is also worth considering the consequence of the Report's pragmatic approach of not determining specific maladministrations and injustices where these can be made subordinate to another determination. Though economical of means, it cannot be an adequate basis for establishing precedent, let alone for learning comprehensive lessons or for demonstrating clear rationales for remedy and recompense. It also invites the question as to whether the economical method is not unduly order or category dependent. If this turns

out to be sufficiently important, then a more exhaustive approach to ruling may be required. What is more, comparison of the economical and exhaustive approaches could be both interesting and fruitful.

- These problems are compounded by the fact that the Investigation considers itself precluded from addressing causal chains of events from maladministrations within its period of reference to those outside it. The consequences of this limitation are self-evident, and of particular relevance where later losses result which plainly merit compensation. One might therefore hope that, even if the later losses are outside the Ombudsman's formal jurisdiction, due regard might be given them during any logical approach to rescission. The writer's response to this problem is to use a model for rescission which goes back far enough to pre-empt or cut the damaging causal chains at or even above their source if possible. To be successful, however, this has to be done in an evidence-based manner. To that end he supplied the Investigation with the necessary supporting materials.

These reservations having been expressed, we move on to the essential nature of the Investigation's underlying approach. Having compared it with that of Lord Penrose earlier, with its emphasis on what the Society, its officers and directors did, EMAG put it thus:

"The PO has taken the view that, by concentrating on the regulations for preparing and scrutinising annual Returns and the way the regulators failed to apply them, she stands a better chance of proving her point and making it stand up than by adopting Lord Penrose's approach of comparing assets with policy values, including terminal bonuses. The PO's view has been arrived at as a result of 3 year's (sic) immensely detailed research and a year's argument with the Treasury and FSA."

EMAG's representation overlooks the fact that, while the compliance-based approach is in effect demanded by the authorities and is therefore necessary, it is not of itself sufficient. We should also be aware of just how many and deep the pitfalls attending this restricted approach can be. The following actual occurrence illustrates not merely this, but also the importance of the human dimension which is so highly pertinent to the current Investigation. No further inferences should be drawn from the tale itself, because the ethical climate and local research site senior management group responsible for it are mercifully long gone.

Clinical Research and Development staff at an R & D site attended a training course in Standard Operating Procedures and report preparation. At the end they were divided into three teams, and given a specimen report to assess. The chosen report described a formally protocolled trial which had passed scientific and ethical review, had been duly analysed by the project statistician before being written up, and then checked by Quality Assessment for compliance. After further revision and review it had been accepted as part of a New Drug regulatory submission. For the purposes of the exercise the report was altered, and a series of deliberate errors and compliance deviations were introduced. Now the three teams were competing to find as many of them as they could.

It happened that a member of the second placed team also read the report for content. It was thereby apparent that what had started out as an experiment to assess the statistical power of a method to distinguish a specified difference between two treatments had degenerated into a regulatory support demonstration that the larger dose of a new therapeutic agent worked better than the smaller. This degeneration also had the effect of accelerating the main project's wishful thinking. So what had started as trial of a method ended up with a changed objective only attainable by use of the untried method itself. The protocol author, the statistician and the medical report writer must therefore have been working at cross purposes, with the crucial result that the wrong statistical methods had been employed. The immediate result was a round of critical discussion, which included an attack on the box ticking mindset by the Head of the Regulatory Department who was also attending, and acute embarrassment mixed with hostility on the part of the training team. Sensitivity of the issue was increased because the team was headed by the responsible report writer and included the project statistician, who for the purposes of the exercise had been given the pseudonym "Dun Wong Sum". The situation was later explained to the medically qualified Head of Department who had devised and supervised the trial, and who had signed the report off. He elected to do nothing, and let the report pass unaltered into the regulatory dossier. That inaction might be thought impossible unless some prior enabling arrangement had been agreed.

This example shows how individual or group loyalties and interests in a culture deficient in professional rigour and ethos can completely subvert proper operational standards and procedures, even when the latter are meticulously observed. Furthermore, there was such a pressure of expectation fuelled by senior research management's need for credibility and their vested interest in the new drug, that there was a whole series of crucial scientific, clinical safety, and hence ethical flaws in the programme. In essence, despite the notice of a well publicised parallel example, unit dose selection of the drug had been made to favour it against competitors in comparator trials at the potential expense of increased side effects and/or exhaustion of beneficial effect. The unhappy story ended with immediate closure of the project, and the abrupt resignation of the clinical programme leader when the problems finally surfaced. In short then, culture and milieu are of supreme importance. Not to labour the point, but the Investigation's own evidence is strongly indicative of something similar in the UK governance and regulatory environment. It only remains to say so.

Our story introduces another problem with the compliance and box ticking approach, which is that of itself it produces no overview or insight. It is as though a team of archaeological excavators, busily uncovering and cleaning the individual pieces of an ancient mosaic floor, never stand up to ease their backs and look around, or take the chance to see what the whole represents. If the whole is an abstract pattern, the omission matters less than if it is a subject that explains the culture, customs and religious observances of the civilisation whose legacy it was.

Thus in their different ways the specimen story and mosaic metaphor show us that quality assurance and compliance based investigations are particularly poor instruments for detecting all-important driving influences. Looking further ahead, should it become more widely accepted that similar influences were at work on both sides of the regulatory fence, it may indicate a common cultural drift of no small importance.

This returns us naturally to what should have governed code and conduct during the course of the Investigation, namely S & PM and PRE, and not "Treating Customers Fairly". Technically, of course, the Compromise Scheme of Arrangement and its preliminary legal ratification both fall within the later Fairness era. But if the Compromise itself is beyond the Investigation's remit, how it was prepared for and represented beforehand most definitely are not. *To hope or pretend otherwise would entail regulatory gerrymandering on a grand scale, over and above the long succession of reverse arbitrage already identified.* Ultimately this may prove to be more important in the EU than the UK. A minute's further reflection will show that this again relates to what has been said above, to the effect that one is morally obliged to apply rescissive principles in a way that cuts off long trains of ensuing evils. This is addressed in the next section.

Implications for redress proposals:

The writer makes no apologies for opening this section with an abridged extract from his EQUI Anatomy of a Fraud update paper, in order to remind readers of how extensive are the misdeeds that they might reasonably have expected the regulators to forestall, and hence the magnitude of overall loss that resulted for which they might now expect recompense. If that be so, then it provides a reference measure of public expectation of what is required. Any departure in necessary appreciation, reform or redress from this ideal can therefore be termed an *expectation gap*. That gap neither acknowledges nor distinguishes the differences between prudential or conduct of business regulatory failure. Nevertheless, if this prudentially based investigation leaves an unacceptably large expectation gap unclosed, the practical outcome is likely to be demands for yet wider ranging investigations and further compensation, either in the UK or Europe. Quite simply, the issue will not go away.

"…….. it is only by looking at the separate classes of over-allocation and where they broadly went, as well as the sum total, that it can be seen precisely why the Equitable was so far ahead, and in a class of its own. Then we must look for the McGuffin, which is what crime writers call the central thing on which the plot hinges. In this case the McGuffin is the Society's estate, together with the whys and wherefores of its disappearance, and secondarily why all the subsequent over-allocations were channelled in the same overall direction at later (inequitably disadvantaged) policyholders' expense.
The sum total of inequitably misdirected over-allocation comprises:

1. Loss of the estate a) at 1982 value and b) notional peak fund expansion value.
2. Size of GAR claw-back a) £1.6 billion at 50% uptake or b) £3 billion for 100%.
3. Size of a) unadvertised GIR-related bonus deductions during contribution years and b) hidden excessive charges on annuities in payment.
4. Total of loans and adjustments against future premium/other income (£1.3 billion).
5. Various devices to alter hypothecation and boost contemporary regulatory solvency.

The amount will vary according to censoring date, the standards of regulatory solvency then in force, and whether maximum or conservative estimates of categories 1-3 are used. It is therefore very important to agree on both categorisation and time of estimate. For example the Compromise Scheme arrangement, the Penrose Report and Burgess Hodgson have all omitted the estate in their various assessments of the total deficit……….. Meanwhile, at least we can now all see why the GIR entitlement nowadays entails hidden penalties greater than the advantages stated in policy documents.

Loss of the security and good faith inherent in an estate is unfortunate in itself, but it also betokens forfeiture of with-profits status. And so in the Equitable's case it could only lead to crucial misrepresentations. The principal categories of misrepresentation were:

1. Inequitable and selective over-distribution masquerading as historical "full and fair" distribution over many years.
2. Enviable performance figures, ostensibly based on mutual status plus sales and administrative efficiency, but in reality firstly on an unrepeatable and inequitable dispersal of the estate and subsequently by further over-allocations once it had gone.
3. Limited smoothing "inherent in the Society's with-profits business" rather than the cushion of an estate, but actually based on accumulating policy values (and therefore risks) rather than yearly earnings, and maintained by Ponzi payouts of total policy values until default.
4. Omission of GAR, GIR and other inequities or retrospectively imposed adjustments in primary source policy documents, updates/amendments and sales material.
5. Contrary to all the above realities, maintaining that ELAS with-profits based investments were at the lower end of accepted categories of risk- typically 3 on a score of 0 - 10.
6. An overall, longstanding and consistent misrepresentation that the Society's new paradigm was a continuation of its past honourable and honest practices.

Five of the six relate directly to the loss of the estate, and the fourth relates to it historically, in that it comprises *post hoc* and undisclosed contingency plans to claw back some of the over-distribution, but then in the main not until as much premium as possible had been taken in before policies matured. The essential logical device in these misrepresentations was, **and irresponsibly continues to be under the New "Plaza-Toro*" Board (for definition see p4),** an intentionally misleading selective partial disclosure rather than total non-disclosure, which was also used with devastating effect across the Society's three separate sets of accounts….. Precisely how intentionally misleading these partial disclosures and misrepresentations were depends upon who knew and concealed what the real situation was at any specified time, while then causing, facilitating and/or permitting their utterance (i.e. *scienter* and non-disclosure of the true essentials). **This applies to the underlying situation, and any misrepresentations of it, by either Board of Directors, and at any time before or since the Compromise Scheme of Arrangement."**

Sadly, the Investigation's new evidence unambiguously indicates that the prudential regulators consciously facilitated and enabled this overall situation. To the extent that they have also concealed, obfuscated or delayed recognition of this uncomfortable fact as for example EMAG and AH contend, they have also magnified the harm and injustice that has followed.

Having now quoted this passage and explained the expectations gap, one can also see in more detail how far the Investigation's findings, whether in their present or subsequently revised form, may suffice to address the grand sum of matters arising. Technically too, the position is much more comprehensive than what is implicit in the Investigation's **official selection** of complaints. The passage also serves to introduce a traditional difference in forensic approach between EMAG and the writer, namely that EMAG have historically concentrated on overbonusing, whereas the writer has focused on traducement of the Equitable's with-profits ethos and the central fiduciary importance of an estate of free reserves for a with-profits fund to function adequately, prudently, equitably and ethically. If so, overbonusing becomes one part of a much wider problem.

More to the point, the Treasury Select Committee's recent parallel deliberations on the two and a half century old topic of inherited estates have also been highly relevant, although the Equitable Life scandal was not mentioned in its terms of reference and received only passing mention. It was also disappointing that actuary

David Forfar, who tackled this subject head on for the Myners Review, but who ultimately felt compelled to withdraw from developing and extending his position for EQUI, did not make a further submission. But with regard to the regulatory milieu and reverse arbitrage a most illuminating identity of opposites informs much of its discussion, namely the AXA with-profits estate raid legitimised by the courts despite representations by the Consumers Association, and the Equitable negative estate liability and future profits complications legitimised by the Compromise which received no mention. The Consumers' Association made it plain that, both at the time and with hindsight the FSA's permissive stance to AXA was inappropriate, such that it was very sceptical about ex-mutual Norwich Union's reattribution of its inherited estate. At the same time the Prudential, which had not distributed its estate in or the aftermath of the 1973 energy and market crisis and instead used it to invest in and turn the market, has decided not to reattribute its estate. Once again the Prudential is likely to be right.

Again at the same time as the enlightening contrast in AXA's and the Equitable's fortunes was developing, other with-profits offices were of concern to the regulators, mainly because of past over-distributions combined with annuity guarantees, to which both the Report Chronology and a contemporary actuarial working party on with-profits bonds (see references) bear witness. As we have previously seen, these were problems that the prudential regulators had seen coming for a very long time, and yet had done nothing about them. The with-profits mortgage endowment issue, burned out "zombie" funds and opportunistic consolidating fund buyouts are all part and parcel with the same. Worse still, when these problems all came to a head around the time that the technology market bubble burst, the regulators panicked and forced Standard Life to move from equities into bonds, such that it had to demutualise. And all this is highly consistent with well over a decade of persistent regulatory failure of the Equitable. It hardly describes a regulatory climate of distinction, unless it be of the wrong sort.

The PO puts it more tactfully:

"I am of course aware that the basis of the complaints which were made to me was that the Society operated a uniquely flawed business model which was always going to, and did, cause the Society to fail.

However, I also recognise that a view could be taken that, in a context in which the smoothing implicit in with-profits business meant that policies would typically receive more than their unsmoothed asset share, a particular sequence of financial conditions let most with-profits offices, including the Society, to pay out more than unsmoothed asset share throughout much of the 1990s."

Whether one or the other view [or indeed both- MN] is the right one is not a matter for me to determine and I have no power to do so. My focus is on the acts and omissions of the prudential regulators and/or GAD (Report Chapter 10.198-200)." In either or both cases these situations were allowed to develop on the regulators' watch.

And still with either or both cases in mind, let us see how the FSA would reply to correspondents after the July 2001 cuts:

"Equitable Life, like many companies, is having to cope with extremely difficult investment decisions. The position is that policies have been growing in value at an annualised interim rate of 8 per cent. However, because of the current investment climate, the returns on the with-profits fund over the last couple of years have been minimal. The notional increase in policy values has therefore been eating away at the company's free assets. The board has therefore decided it is time to act to bring policies back into line with the value of the assets that back them, and to reset the interim rate of return to a sustainable level. The guaranteed elements of any policy values will not be affected (Report chapter 8.129)".

It is therefore a big mistake to propose, let alone allow, that UK with-profits market comparators should be used in order to determine relative losses rather than absolute ones. Of course market falls have been widely touted as justifying the relative loss market comparator approach, most notably by BWD and the FOS, but the idea does not under the circumstances bear examination. It brings us right back to sector losses as distinct from average losses, wherein lies the very problem everyone seems to have been hoping we might not have noticed. And besides, as EMAG have pointed out in their submission, contemporary market falls are not a convincing explanation for the various policy value cuts or MVA charges made. Moreover, it condones and even exonerates an environment of chronic pan-regulatory failure. We should therefore have none of it.

In discussion of the situation then prevailing with the Investigation team two matters were put to MJ and MN. Firstly, the Reinsurance Treaty maladministration finding could serve as a catch-all for picking up many of the items of loss. As previously demonstrated this is a consequence of the economical method of ruling, but EMAG also support this stance. Secondly, Lord Penrose's mantra that fundamentally "The Society was the author of its own misfortunes" was repeated, such that a proportion of blame would always attach to the Society as its ultimate originator. Hence maladministration must always be contributory only, and could be factorised with a range of, say 25-75 per cent of the actual loss sustained.

Having considered this position, the writer returned the view that it is inherently unsatisfactory. Unless very great care is exercised the first stratagem is inherently unlikely to address the needs of each separate class of policyholder, to which question we later return. The second fails because it assumes that matters only and always relate to events upstream in the causal chain of events. Leaving aside for a moment the irony that the Investigation itself elected to ignore the downstream effects, this approach does not allow for specific dependencies arising because of the temporal succession of events. At its most bluntly simple, the Equitable scandal reduces to a tale of five chapters, successively entitled "Carve Up, Cock Up, Wake Up, Cover Up and Stitch Up". We must allow what we have previously explained: that a particular generation of officers and policyholders improperly and deceitfully awarded themselves all the Society's traditional assets and more in Chapter 1. And yet, if the Report has itself not addressed what the regulators should have been doing in Chapter 1 throughout, it should not claim the right to reintroduce it at the end. Moreover Chapters 2-5, which begin with the overextension and guarantee liabilities being transferred to a million or so unsuspecting future policyholders as covered in the Warren opinion, are exclusively due to regulatory actions or inactions. From 1988 onwards the prudential regulators had a number of milestone opportunities to halt this progressive entrapment, but at every stage failed to do so. And all this happened before we are forced additionally to contemplate a whole succession of new horrors in Chapters 4 and 5. They culminate in all the catastrophic effects of delaying, overlaying and neutralising the Warren opinion as itemised and partially summarised in Appendix 2 of this paper or described by AH. What, then, should we say of an Investigation and Report which only finds itself able to read the largely prudential bits of chapters 2 and 3? Meanwhile the uncomfortable fact remains: policyholders' losses from regulatory failure were individual and absolute rather than proportional.

There is, however, a further argument for factorisation. It is based on the supposition that not every policyholder or their advisers, if any, would have received, understood or taken heed of the regulators' proper actions or advice even had these been made and disseminated effectively. In the context of the present Report, this argument is disconcertingly reminiscent of the pseudo-statistical ones deployed by the insolvency expert and Directing Actuary to the effect that, because individual policyholders and their legal advisers were ignorant of what they themselves knew, mis-selling liabilities could be factorised according the their limited likelihood of success in the courts, or that court actions would even be mounted on the more limited evidence publicly available. And as we have seen, a similar style of thinking may have persuaded the Ombudsman not to make certain findings of injustice. In the first place, therefore, both arguments are morally jejune, and for identical reasons. Secondly, the burden of proof that a significant proportion of policyholders or their advisers would press on regardless rests with the regulator, not policyholders, and surely not with the Investigation. It also neglects the dependent likelihood that, once the press and grapevine had picked it up, the heedless proportion would become vanishingly small. Moreover and again, the point was long ago reached when the burden of proof that there was no mis-selling transferred to the regulators- and now that we can begin to discern and unravel everything that the prudential regulators did to suppress the mis-selling avenue at the CoB interface, the presumptions against factorisation of any sort are formidable (See AH paper).

Having set out the reasoning for our observations on the draft report, the writer now wishes to proceed via EMAG's proposals in this area to the broad context of existing knowledge before explaining his approach to redress. EMAG have drafted the official complaints list, and have made their response to the draft report in strict accordance with its own limitations, rules and procedures. As a result they have not had occasion to follow their complaints list through in the same manner as herein. It may further transpire that, because their more general forensic inquiries have traditionally been centred on overbonusing rather than how and why dispersal of the Society's estate eventually caused its with-profits model to be come the antithesis of its former self, they may form a different overall opinion on the import of the pattern of reverse arbitrage that has been identified. But because we all now know how and why the arbitrage occurred we should maintain that the present position leaves too much to discretion, and hence to chance. In the present UK moral climate of governance we believe that this is unwise and, if matters Equitable miscarry even further as a result, the nation and European Parliaments ultimately may take a very dim view of it all.

The writer endorses EMAG's request that the compensation process be rapid, transparently simple to administer, should not involve an extensive and complicated claims system, and that it should not be administered by any of the discredited parties. Moreover it should also be transparent, and if possible easy to comprehend. It is for reasons such as these that we think a conventional and detailed attempt at making a whole series of interlinked subordinate estimates supporting whatever quantum of recompense is due under them and to whom is doomed to break down in protracted argument. The writer also fails to see how it can succeed if the terms of reference exclude forensic elements published at EQUI, or elects not to address the CoB regulatory interfacial matters introduced earlier. EMAG have also drawn attention to the manifold pitfalls attending the principle of causation, and in view of the Report's own difficulties in this area it is best to sidestep this as effectively as possible.

This is a truly Gordian knot, in which case a special knife must be forged to cut it. The billet for the proposed knife is an alloy of five parts. Of these the first and largest is that **the report should acknowledge the gravity and significance of its own new findings**, and incorporate them into the received wider context. The second is **natural justice and common sense**. The third is **restorative rescission**, as embodied in the Parliamentary Ombudsman's "Principles for remedy". Fourthly and dependently, rescission demands that **compensation should be timely and adequate**, and be awarded in such a manner that residual forensic and conduct of business matters become irrelevant. Last but not least, there must be **automaticity and robustness of process**, which eliminates or minimises the need for individual policyholders to establish causation.

From this alloy a sufficiently strong knife can be forged, and then shaped to suit. The first forging blow assumes that *policyholders should now be in the position where they would have been had the official story line put out by the regulators and the Society been true*. That defines the rescissionary benchmark. By the second blow it follows that *the real losses that should be restored are those arising from any material departure or default from this official position.* As may already be clear to many readers, the critical points of departure and default are distressed penal and non-contractual MVAs following the House of Lords GAR Decision and losses sustained in the extraordinary July 2001 insolvency devaluations, including further deficits undeclared and buried in the run up to the Compromise.

The third and final blow creates a *virtuous rescission scenario* under which everything the prudential regulator and the Society represented as true at the time was indeed true. Under it the WPWM paradigm has been scrutinised by the regulators and proved successful. Time has thus also proved ex-GAD Insurance Directorate actuary George Newton's caveats and FIA President Marshall Field's earlier warnings to be without foundation. Accordingly with-profits funds with negative estates, compromised future profits, a relentless overhang of overbonusing, with all regulatory slack hauled in and every successive comfort taken on both sides are formally regarded as able to support the total policyholder values given to the public under the foreseeably great majority of conditions, would by statute, guideline and definition be soundly and prudently managed, and would satisfy policyholders' reasonable expectations as to future viability and sustainability of returns. Under those circumstances, there being no estate, the Compromise Scheme would have been financed entirely by a nominal transfer of 1.6 billion pounds of funds from non-GARs to GARs, which the withholding of 7 months bonus in the latter part of 2000 would with comfort have achieved. Any preceding and preparatory insolvency cuts would moreover have been superfluous. The only hiccup in this smooth process would have been the inaccurate Nash Feb 2000 letter, which would have been promptly and graciously retracted after representations by the Society's Appointed Actuary, who had previously been warned not to do something similar himself, in conjunction with the prudential regulators who had warned him (See Appendix 2). Moreover, even assuming that it were then in fact necessary, the Society would have had the choice of raising capital by demutualisation or sale to another office, or might have been able to resume business in its own right.

Furthermore, there would have been no impediment to GAR rectification, no necessity for the succession of post-Compromise WPA cuts, and the FSAVC review would have been properly reserved for. As a result of ongoing background representations made by the new Chairman and Board of the Society in conjunction with policyholder groups into how the regulators had allowed the GAR (and GIR) problems to develop unnoticed, an Investigation could have been launched. The eventual result would have been a contribution by Government to appropriate policyholders' funds, such that the financial GAR losses imposed by the Compromise were mitigated, even eliminated.

To lend perspective to this scenario, which is relatively easy to construct because it is based on the public face value official position, it is not without interest to consider virtuous scenarios based on what ought to have happened at various critical stages, as opposed to what actually did. By definition there must be many more degrees of freedom inherent in this approach, but the scenarios can be reduced into several main variations, of which the four most relevant are despoiling, traducement and fraudulent transition prevention scenarios, GAR/GIR differential bonus revocation scenarios, 2001 insolvency cut scenarios and, most relevantly of all in view of the incidental findings of the Investigation (see Appendix 2), Warren opinion implementation scenarios. Here follows a Warren one which supposes the recognition that pre-1988 GAR policyholders would have to foot a £4.5 billion mis-selling bill, against which the non-GARs would have had to concede around £3 billion for surrender of GAR rights based on 90% uptake. The net result would have been the official transfer of £1.5 billion from GARs to non-GARs in a restructured Compromise, instead of the inherently unfair and unjust converse as actually occurred. The incidental benefit of this transfer would have been a rebalancing by the recovery of £1.5 billion of previous overbonusing to the GARs, which would have put the Society on a much stronger with-profits footing for the future.

The major advantage of the face value virtuous rescission scenario is that it largely bypasses quantitative subsidiary arguments about the separate contributory headings of loss. Because it necessarily envisages an office in competitive equilibrium with its properly regulated peers, market comparator adjustments are also irrelevant. It also obviates a whole medley of problems in implementing more orthodox rescission objectives based on restoring a very heterogeneous group of victims to notional positions they would or might have been in had the injustices not occurred. It also removes or at least reduces the need to construct models and scales to correct for who were relatively over-bonused and who were under-bonused. *Likewise and in natural justice it also entails that, however they later represent matters to the general taxpayer and public, the authorities will have been obliged to write off everything that they chose officially to conceal, deny, ignore and otherwise represent* (In any event the general taxpayer should be told how and why the resulting liability has been incurred). But as we have seen, because all the reverse arbitrage meant that matters were anything but face value, there are ongoing rescissionary elements relating to the ideal of equitably mutual with profits status which have been removed, and which continue to blight the futures of certain classes of policyholder. These must be picked up and dealt with. Besides, it is not as though the FSA/Bacon Woodrow Deloitte (BWD/ELAS/Lovells team, who have "overseen" every disposition from the Compromise onwards, are unaware of them. For example, loss of estate-backed with-profits status was the rationale advanced by Chairman Treves for the Prudential deal. Of course this difficulty was inherent in the Compromise from the start, which is yet one more matter that the prudential regulators had not then addressed, or required to be explained.

Another effect of following the virtuous rescission scenario is that, within the period of reference of the present Investigation, the major critical downstream damage done by the FSA/BWD/ELAS/Lovells team is cut off at source, and hence also largely neutralised. This team, which initially included the FOS, was formed and tried in adversity, and has had a decisive influence on subsequent events. Hence its false pre-Compromise platform has been consolidated in virtually every event or disposition since. Predictably, the team has also been earmarked to handle disposal of the rump of remaining with-profits policyholders. For these reasons, the Investigation has been kept up to date with the consolidation process, even though it lies outside the reference period. And though the downstream events are outwith the Parliamentary Ombudsman's jurisdiction it is obviously highly desirable that further investigative, exemplary, or even disciplinary measures should now be taken with regard to this team. *Meanwhile, one must respectfully ask that consideration be given to additional redress for all the harm and distress that this particular causal chain has, and indeed continues to cause.*

This specific example leads naturally into the general point that, although this process restores much of what is implicit in the upheld General Complaint, it does not make additions for "outrage" in the shape of distress, loss of opportunity, intermediate hardship, time-consuming effort and expense in strivings for Justice, qualities of life denied, or their aggravation by the authorities over successive years (cf. examples in "Principles for Remedy"). If so, this topic may be regarded as a "discretionary" or "additional" item rather than an "algorithmic" or "intrinsic" part of the main compensation process. Be that as it may, the suppressive subversion of the Warren opinion was so utterly perverse and corrupting in its effects that not only Justice, but every wholesome aspiration of regulation itself, were thereby toppled and stood on their heads. By this one climactic act every consideration has been moved far beyond the bounds even of total regulatory failure. Unquestionably it epitomises, as indeed it largely defines, the true nature of outrage for the purpose of this Investigation. That being so, *an exemplary or aggravated damage award for outrage is appropriate.*

Detailed Redress Proposals:

The process is as follows:

1) *Take all ELAS's total policy values, accounts and approved regulatory returns at face value up to the critical point of loss. This defines the rescission benchmark.* It assumes that policyholders were broadly content with their lot and reasonable expectations until then. The benchmark sidesteps nearly all the arguments about fraud, traducement of the with-profits concept, improper dispersal of the traditional estate, how much there should have been, who were overbonused and when, etc., earnings expectations backed only by phantom assets, expert and insider round tripping bonus consolidations and topping up, special exit favours, what policyholders should have been told, and what **any** regulator should have done about it. Notably and in particular, it has the effect of obviating the evil sequels to the FOS's Mr & Mrs. K Final Decision. <u>It is also the pre-loss position that we can now see the prudential regulators themselves actively supported, did little to modify, deliberately blocked effective legal redress against or for, and knowingly allowed the nation at large to persist in believing.</u>
2) *The critical points at which real losses began for individual policyholders were the House of Lords judgement*, which resulted in penal MVAs for distressed non-contractual escapees, and the series of cuts successively affecting various classes of policyholder and announced between July 2001 and November 2002.* Full rescission for these losses defines the base quantum of compensation for individuals and in sum. Because all successive cuts were dependent upon how the July 2001 cuts were explained and implemented, the whole matter can be said to fall within the PO's jurisdiction. (*It could, however, be argued on account of how we know the MVA issue was handled by the prudential regulators from around the OFT transfer onwards (see Appendix 2), that an earlier MVA rescission date might be imposed. For example the official FOS date after which the Society was deemed to know that it could well lose the HoL case in the Mr G view could be used.)
3) *We support EMAG's contention that compound rather than simple interest be applied to all rescissionary payments.* The compound rate should be that which crosses over the customary linear rate of interest of 8% simple originating at July 2001. The proposed crossover date is March 22nd 2005, namely the date when the FOS Ms E Final Decision and FSA/ELAS/BWD/FOS compensation formula crystallised the official form and amount of late joiners' losses with knowingly inadequate levels of compensation, legitimisation of MVAs and no allowance for reinvestment costs. *This requires a compound annual rate of approximately 7.5%.* Compound interest with a crossover point already passed also lends poetically just urgency to the compensation process.
4) *It follows that any distressed non-contractual MVA and pro rata reinvestment charges after the HoL decision should also be refunded, plus interest..* Among other things, this compensates for the FSA/ELAS/BWD/FOS Ms. E compensation formula having legitimised MVAs and not recognised reinvestment costs.
5) *The amount of any prior compensation, whether awarded by the FOS or gained elsewhere, is then deducted from the final sum.* We imagine that the

FOS, Clarke Willmott and others or the Equitable will have no difficulty in providing the necessary figures and paperwork.

6) *Since this mechanism of compensation is based on taking the FSA and ELAS's explanations about the basis for the Compromise at face value and in good faith it could claimed that, if it is adopted, then the nominal cost of the Scheme might also be accepted.* But as indicated in the rescission scenario, face value motivations might well have led to the Society' new Chairman to call for an investigation into possible maladministration by the regulators with the full support of policyholders. That would eventually have led to recovery of the *face value* cost of the Compromise. *So let us have the nominal £1.6 billion restored.*
7) *With profits annuitants need special consideration.* Beside their losses in asset share and resultant annuity cuts, which were deliberately postponed with the regulators' knowledge until the AVC review was completed and implemented, they have incurred additional charges due to loss of with-profits status and mutuality, and now have to pay a premium to enjoy estate-linked investment freedoms and safety. <u>It follows that these and continuing losses should first be restored plus interest, and that all future charges levied by the Prudential Assurance Company under these heads be met by Government.</u> These losses include the tithe of estate earnings forfeited annually by ex-mutual annuitants to Prudential shareholders under the 90/10 rule.
8) *Similar arguments about loss of equitable or mutual with profits status currently apply to the Society's remaining with profits policyholders.* How this may ultimately need to be restored depends upon whether they remain with the rump of the Society, or are moved elsewhere, in which case consideration analogous to those affecting the Prudential transfer should apply. Meanwhile, as previously advanced in the finale of "Anatomy of a Fraud", consideration should be given to funding the security and advantages of virtual estate participation on their behalf
9) *As explained in the text, there is an need to reassess the question of residual inequities of guarantee, notably including the GIR differential bonus adjustment commencing in Feb 1994 and ongoing annuity charges e.g. as quantified by Peter Scawen at ELTA.* Until this position has properly and publicly clarified the mechanism of any recompense will not be transparent, and in particular the ongoing plight of GIR annuitants will remain unaddressed.
10) *The GAR rectification scheme as originally conceived in the Compromise Scheme should be funded and implemented without further delay, plus any interest bearing compensation due for delayed implementation back to the date of the Compromise itself.* The regulators knew this question would arise, and should have ensured that funds were set aside to support it. But like the uncut annuitant policy values and AVC review issues or 2.5% non GAR policy uplift bribe in the Compromise Scheme, they may have allowed no effective provision to be made for it.
11) *The rights of deceased policyholders, their joint survivors, relicts and kindred should be acknowledged, and appropriate redress variations made.* What follows is not comprehensive, but might include:
    a. Payment of redress calculated up to the date of death to relicts, or for distribution according to wills, or directly to next of kin, if any, in the absence of a will.

b. For joint survivor policies, redress in full to the survivor(s).
c. Fractional survivor payment policies are paid redress in full up to the date of death, and *pro rata* up to settlement. This comprises the percentage increase of further payments under the policy from then on.

12) *Tax considerations:* If rescissive principles are strictly applied under taxation rules they may require that capital loss and income loss be treated differently. Then also would arise the further complication at to how sometimes substantial awards should in fairness be handled in the tax year in which they are made. Unfairness on the income side could be avoided if the award is made under Individual Savings Account (ISA) regulations. Capital awards could be treated similarly, or failing that as applicable for taper relief given the period over which they would have arisen. Beyond that, awards to the deceased might have to be added to the probate value of their estates. There is also the nice point as to whether annuitants or their survivors should be given a cash award outside their policies, or whether awards should be added to ongoing policies at the Prudential, again in strict pursuit of virtuous rescission. *The obvious and simple way out of these complications and difficulties is to make all cash or annuitant policy value and lost earnings awards tax free in some compensation for outrage, inconvenience and distress, protracted delay and opportunity cost.*

All this detail reduces to something inherently simple. Anyone who suffered a penal MVA once ELAS knew it could lose the GAR case in the House of Lords gets compensation. So does anyone who had a with-profits policy or annuity with the Society and suffered seven months loss of bonus in 2000 and/or the series of cuts commencing in July 2001. Some policyholders will be eligible for compensation on all three counts. ELAS identifies all these persons and their total policy value asset shares from its records, such that the total loss plus interest can be returned to policyholders, their estates or relicts. Any awards by the FOS or through the courts are subtracted from these totals. If ELAS has no funds for rectification as originally and legally prescribed in the Compromise, and which the prudential regulator should have ensured were there, the necessary monies are advanced for speedy resolution. WPAs need separate consideration: The full FSAVC review increase is also added where appropriate, and backdated plus interest. Depending on resolution of the GIR issue, further monies may be due. That done, the Treasury pays the ongoing extra charges and tithe on earnings incurred by WPAs who have been transferred to the Prudential. A watching brief is meanwhile maintained on the rump of ELAS policyholders until their future is decided. Because of the nature and importance of outrage in this instance, all awards are tax free.

The main differences in redress proposals outlined with an eye to the future:

EMAG endorse the conventional security of the box-ticking approach. They would like overbonusing and valuation rate of interest issues to be strengthened and extended. EMAG currently rely on the re-insurance maladministration as a catch-all to compensate anyone investing after 1 May 1999. Presumably that comprises both new policies and further premiums to existing ones. Though they do not challenge the Report's findings on the big cuts, they similarly identify the July 2001 cuts as a critical loss point, but rather than use actual total policy values at that point to compute the true sum, are content that an approximate "pot" be decided in advance and then distributed *pro rata* according to policy values immediately before the cut. It is thus crucial that the initial pot is not underbid. The use of a sliding scale makes it easy to factorise in the downward adjustments rejected by ELTA and the author, and by an upward broad brush allowance in substitution for actual MVA's and removal costs where appropriate, plus a discretionary token addition for outrage. This currently results in a round factorised pot amount of £3.2 billion, with a further 1.3 billion of interest accrued since the cuts at around 5% p.a. EMAG acknowledge that with-profits annuitants are a special case, and at this stage seem to be indicating that the July 2001 cuts are an appropriate surrogate starting point for their pro rata rather than actual losses in a manner similar to their standard approach to everyone else.

ELTA reject proportionate responsibility or reduction in liability on account of ignorance or subsequent free choice, since annuitants had none of the latter. They do not accept the Report's findings over the July 2001 cuts, and point out that no other office needed to do this. Nor do they accept a rigid division between prudential and conduct of business regulation, for the simple reason that the basis of what was misrepresented as opposed to how it was misrepresented was always prudential. In the successful Clarke Willmott action annuitants were each required to say what other choice they might have made at the time of purchase of their annuity, and this served as the base point for rescissionary calculation. With this method "-in order to capture past as well as future losses, it becomes necessary to consider assumptions for both the accumulation of losses and gains and the discount of future losses (as well as the future inflation rate for RPI-linked alternative annuities). In addition, of course, on the basis that any compensation will not be taxable, there are issues in ascertaining the net loss as individuals' tax situations vary and it is the differential between the respective net incomes, which is important." Furthermore, the pricing of annuities has varied considerably over the rescission option period covered. So, because annuity pricing has become more expensive, "-older policies have the greatest losses, and because of relative pricing between 3% and 5% escalating annuities and level annuities, those policies have higher losses than level annuities (RPI-linked annuities have varied in pricing terms more significantly."

As ELTA go on to explain, the resulting calculations are laborious. "What is the quantum? This is a very complex calculation, but there is good reason and logic to argue that the With-Profits annuitants have a case to claim for compensation for a sum of between £6 and £10 billion".

ELTA's quantum estimate for WPA annuitants alone is roughly double that of EMAG for everyone else. One presumes interest is factored into it. However the ELTA estimate must differ materially from EMAG's in order to factor in future losses, on the assumption that a one-off payment is to be made.

In comparison with EMAG the writer's approach is more radical. Moreover it is based on real rather than notional loss, because it sums from actual individual losses. Thus also it avoids potential abuse, protracted argument and delay. Assuming that all the cuts on or after July 2001 amounted to a starting sum somewhat in excess of the mis-selling total in the Warren opinion or the deficit identified by Lord Penrose at closure, a base minimum of some £5 billion is required, which with 7 years of interest at 7.5% compound as previously explained gives a current figure of around 9 billion pounds. Perhaps unlike EMAG's more modest figure, it also includes the approximate losses sustained by WPAs up to the present. Future ongoing WPA loss of status and expectations compensation costs would thereafter be met annually, as explained previously.

A rough idea of total future costs probably scales similarly to ELTA's future cost fraction of their total. For example a figure of £2 billion to 50,000 annuitants gives rise to future expectations of £40,000 on average *per capita* spread over the remainder of annuitants' lives, which is not out of order. On top of that, the nature and severity of outrage requires an exemplary or aggravated damage award as previously shown. Also as yet, there are no allowances for GAR and GIR rectification. On this initial basis some 10 billion pounds are now accrued, with perhaps 3 billion further to come over the succeeding years.

The writer's method differs from both EMAG and ELTA in that it makes as few assumptions as possible by using actual policy values and individual deviations from official face value statements. Like ELTA it rejects factorisation, and unlike EMAG or ELTA it requires exemplary or aggravated damage for outrage. In this regard, and to simplify matters generally it is proposed that all compensation be made tax free. His method also necessarily differs from ELTA's "one stop" payment which allows for the future, because it envisages successive annual contractual compensation contributions for the ongoing adverse situation in which annuitants now find themselves. Precisely how much immediate relief this might afford the authorities is not yet clear.

MJ has not made specific redress proposals, but if we refer to the figures in his paper, the cost of the 16% cuts was approximately 6 Billions, the subsequent further cuts about 3.5 Billion and sundry MVAs about 1.5 Billion making a total of 11 Billion. To this needs to be added the additional amount required to restore the premium pool of the WPAs which was depleted as they joined and without their knowledge. The cost of this would be perhaps 2 Billion giving a compensation sum of 13 Billion. In comparison MJ suggests that around 15 Billion in year 2000 terms would be required.

In rounding off the writer wishes to enter the caveat that the EMAG team currently appear significantly short on their opening bid in comparison with previous authoritative estimates, and that their deference to process rather than content now gives them little further room for manoeuvre. Succinctly put, their opening bid is also their final bid. Strange as it may seem, the writer wishes to reserve an amending position for EMAG as a whole on this matter, even though he is not an EMAG member! Moreover at a time when Government profligacy has been cruelly exposed by a recurrent threat of thermodynamically induced 1973-style inflation, this time complicated by a credit crisis and consumer debt overhangs plus tight food and commodity supplies generally, the customary Government reluctance to acknowledge Equitable sufferers' plight is likely to harden. If resolve weakens and monetary policy is relaxed, the return of hyperinflation could make 7.5% compound interest look trivial. Let us all hope this figure does not have to be adjusted further upwards by the time a final decision on compensation is made.

Beyond all this it seems likely that whatever individual or miscellaneous approach is used, logistic simplicity and practicality will weigh heavily in the decision. *And as* *previously explained, everyone must hope that the final result will come close to the wider public expectation.* If so, taking the lowest bid and then whittling it down further will not suffice. That aside, the various parties have been so preoccupied with their own ideas that they might be thought to have had no regard any others. Furthermore, in view of all the considerations expressed in this paper, any detailed opinions of the Society, its auditors past and present and the prudential regulators should be highly entertaining. With the possible exception of Ernst and Young they can hardly depart from their common and indeed collectively established position. But as we have seen, they will thereby continue all the injustice that still needs to be captured under the General Complaint

It might be thought that such a consideration of suggestions for redress is superfluous to this paper. In fact none of it persuaded the Parliamentary Ombudsman, who has gone on to exemplify the EMAG approach and the Ms. E Final Decision, in all likelihood plus its dependent FSA/ELAS/FOS/BWD redress formula with all its reverse arbitrage baggage, as possible approaches to redress. So why persist with it now? Sadly and simply, not to do so could leave the parties hostages to fortune, from which they might not be able to recover themselves without being accused of hindsight. Time and again during the long succession of events in the Equitable saga this has proved to be a wise, indeed an essential precaution.

Conclusion:

One must echo the previous Parliamentary Ombudsman's words:
"The root cause of the problem, in my view, is the failure of the authorities to establish at the outset a single investigation with terms of reference covering all aspects of the Equitable affair, including issues of possible personal injustice due to maladministration and redress for such injustice if it should be demonstrated. " This situation and the protracted delays it has led to is something that the PO hopes will never again recur.

For all the reasons given some of us wished the Investigation to review the effectiveness of its complaints bundling and winnowing process, and that it should work in relevant or new findings as considered appropriate. Outstanding among these are the ethical wood rather than the narrowly regulatory/compliance trees of the with-profits concept, or not quite analogously the familiar "spirit rather than the letter", and the entire pattern of reverse regulatory arbitrage as itemised and explained in Appendix 2 or AH's narrative. Also of importance is adoption of economical rather than exhaustive ruling, which the writer maintains to have produced conspicuous oddities and difficulties in the rationale for determining maladministration, injustice and remedy. With regard to the underlying history discernible from the Chronology, we could not fail to notice that the Directing Actuary/Head of Department at the GAD was a prime mover and shaker in much of what occurred, and that his involvement extended to the FSA's period of responsibility. It raises the obvious questions as to what reporting relationship the Directing Actuary had to the person of the Government Actuary on the one hand, and the Chairman of the FSA on the other. Beyond that, the Carltona Principle attributes actions by authorised persons to those in whom the powers are vested, i.e. ministers (definition p4). The Carltona Principle thus does not admit the Plaza-Toro Management Device as employed at the Equitable, whereby senior persons delegate actions to others which they themselves could not and should not promote, endorse or support, and on subsequent challenge decline to do so (definition p4).

Carltona versus Plaza-Toro is thus a highly pertinent factor in any future discussion of matters Equitable. Suffice it to add that, if conclusions about the entire regulatory ethos can no longer be avoided, we must also return to the axiom that: "No regulatory apparatus can function any better than the milieu in which it operates". Since that milieu so notably includes the present Government, the dangers of leaving too much to chance are obvious. *Yet irrespective of the fortunes of Government, root and branch regulatory reform is both urgent and imperative.*

The governance and regulatory world is relatively small, and highly inbred. Because of this conflicts of loyalty and other vested interests, not to mention interchanges between financial businesses and the regulatory milieu are critically important. They are best illustrated by some recent career changes:

Sir Howard Davies: FSA Chairman to board of "vulture capital" buyout group Paternoster.
John Tiner: FSA Chief Executive to CEO of refloated "vulture capital" buyout group Resolution.
Sir James Crosby: HBOS-Halifax Equitable to Deputy Chairman, FSA.
Adair Turner: Pensions Review/Paternoster to Chairman of the FSA.
Ron Sandler: Lloyd's of London, Retail Financial Products Report, Paternoster Chairman to head Granite/Northern Rock.
Paul Myners: Equitable Corporate Governance Report, Bradford and Bingley short-selling CLG Hedge Fund board to Minister for the City.
Sir Christopher Kelly: FOS "Defending" Chairman Jan 2005 to Chairman of Committee of Standards in Public Life in December 2007, succeeding Lord Neill who had been highly critical of the FOS at EQUI in February of that year (see refs)- a potentially ominous development from Equitable sufferers' point of view.

The poachers and gamekeepers issue apart, there is something distinctly incongruous in senior FSA personnel changing roles to exploit what can very reasonably be construed as the windfalls of their own failures. Moreover the relevance of this list to the Equitable saga is plain. Thus good reasons abound to suggest that it is this inbred environment that needs reform rather than the regulations themselves. But if so, the very environment is likely to be the biggest obstacle to useful change and practical reform. Alternatively the financial columnist Jeff Randall has commented that there is a need for more appropriate regulation rather than more or less *per se*. Meanwhile these considerations may be held to underlie and inform the PO's polite comments on the very wide gap between the aims and powers of statutes and regulations, and the regulator's conception of their own responsible duties in carrying them out.

For these reasons too the Investigation has had to contend with formidable difficulties, a significant number of which it has manifestly failed to surmount. The result is that much good labour has been expended with too little effect- hence the well known Latin subtitle of this paper. Nevertheless the importance of all the underlying effort is gratefully acknowledged. It would be a great pity if, as a result of privileged participation and criticisms, transparency and complainant participation were to be compromised in future rather than extended as perhaps they should be. The critical reception of the results of the Hutton Enquiry into the origins of the Second Iraq War, which would not have been possible without unprecedented transparency of process, is in these respects a comparable example. Moreover Lord Neill's earlier account of the FOS's manner of dealing with Equitable complainants and the writer's systematic review of the underlying FOS position together indicate that reform of the Ombudsman system is also required. This is of added relevance because the Parliamentary Ombudsman's own Investigation has obvious similarities with FOS procedures.

Last but not least is the important question of how and where the Report and its conclusions will be perceived as fitting into the larger corpus of established knowledge and wisdom. It has been shown that, because of a time-limited, prudential and compliance-based remit that has not yet been pushed to its full limits, and which also leads to difficulties of causation and dependency, the Investigation seems strangely ill at ease in its surroundings. The overall impression gained is somewhat paradoxical, in that the Report emerges as rather too safe to be sound. It may be that the paradox centres on the postulate that the underlying truth is a necessary antecedent to justice. Or, in the same way as ex-FOS Chairman Andreas Whittam Smith recently wrote, the Penrose Report was "highly revealing", some might wish to add: "-rather than directly explanatory". Meanwhile, if the Investigation's complaint bundling and winnowing process has produced more indigestible chaff than loaf, all we can be certain of is yet more methane-charged debate. And so, unless the Report can be used to bridge the current gap in public expectation, another cloud of home grown Equitable "Le Pong" seems destined for Europe. And as variously alluded to, the EU Parliament may yet consider that outstanding issues remain under the EU Life directives. All of which goes to show that Justice, like its poor substitute Revenge, is these days nearly always cold and seldom sweet. And all the while Justice delayed is Justice denied, and to none more than the ever increasing number of the frail, the dying and the relicts of the deceased.

Dr Michael Nassim. October 12th 2008.

(Version 2 contains corrections to main title and FOS Chairmanship status made on Dec 1st 2008).

Acknowledgements:

On this occasion the writer is thrice indebted. What he owes to the steadily accruing wisdoms of his principal collaborators Michael Josephs, Peter Scawen, Paul Weir and others has increased steadily and greatly over an inordinately long time. He wishes especially to express gratitude to the Parliamentary Ombudsman and her team for the privilege of participation at various points in the current Investigation. He wants it to be generally recognised that the often daunting and thankless task of reconciling so many different opinions and sometimes formidable interests over so much longer than originally envisaged must have placed unimaginable strains on her Office and the Investigation team headed by Iain Ogilvie. For all this they deserve something more than thanks and praise from everyone.

The writer's most significant obligation on this occasion must, however, be to Nicholas Warren QC. His subject matter and the comprehensive clarity of his opinions reach the very heart of almost everything on both sides of the regulatory fence: the deeply harmful things the Society had done wrong on one side, and the catastrophic general failure of the regulators on the other which in the end required them first to suppress and then neutralise his unacceptably truthful view. That view has, moreover, been amply confirmed directly or corroborated indirectly by almost everyone and everything since.

Caveat.

This paper takes its form from the unpublished response made by the writer to the draft Report. That response was subject to peer review. Circumstances have dictated that later additions and amendments have not been reviewed. And so, while every reasonable care has been taken to track the Report changes, or to check the smaller items of fact and reference within the time available, any errors must be the writer's. Nevertheless it is hoped that any such will not materially detract from the overall truthfulness and good faith to which the paper aspires.

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APPENDIX 1
Complaints submitted to the Investigation by MN and MJ and published in MN's Anatomy of a Fraud paper- How they stood the test, and how the Investigation indirectly addressed them as summarised in Chapter 13 and Report Guide Annex B.

Regulatory Failure II: Prudential.

The evidence presented in the different sections of this paper is here brought together to support the itemisation of prudential regulatory failure which now follows. Much of it has also been submitted by ELTA and ELCAG (Equitable Late Contributors Action Group) to the Parliamentary Ombudsman's second investigation. It is instructive to compare the list with the Official Statement of Complaint which has appeared on the PO's (Parliamentary Ombudsman's) and EMAG's websites. Much credit is due to EMAG for the latter, because in the second round of negotiations with the PO's office they reformulated much of what had transpired in the first round in a publicly and politically acceptable format for the PO's second Investigation. However, such considerations are secondary in a paper of this sort.

The authorities responsible for the prudential regulation of insurance companies (successively the Department of Trade and Industry, Her Majesty's Treasury, the Security and Investments Board, the Personal Investment Authority and the Financial Services Authority, collectively referred to in the rest of this section as 'the regulators') failed properly to exercise their regulatory functions in respect of the Equitable Life Assurance Society (ELAS).

The Primary Failures

a. It must be noted that the normal situation of Regulation, is that it oversees and checks upon actions already taken by the management of life assurance companies. Where harm occurs to policyholders, actual or potential, the harm is caused by companies themselves and that harm is then compounded by the failure(s) of the Regulator. The evidence gathered and set out in Penrose, and subsequently extended in this paper and elsewhere, indicates that the primary causes of the claimants' losses were inequitable dispersal of the Society's traditional estate followed by deliberate over-bonusing over the years 1982-1986/7 which progressively increased contemporary realistic liabilities from a situation where they were in some degree of balance to one where those liabilities totalled £4.5-5.0 Billion, against assets of £3.0 Billion.

Corroborated in Chronology: Estate and overbonusing issues not specifically investigated. Overbonusing not upheld.

b. The Regulators did not intervene in any effective way, although they should have known that such over-bonusing would have the following inevitable effects:

- Early claimants would take substantially more than their fair asset share from the WP Fund;
- Those benefiting from the over-bonusing would retain a larger claim on the WP Fund than their asset share would justify;
- Those early claimants would drain capital from the Society, where that capital was properly required to service remaining policyholders and to maintain solvency;
- Remaining policyholders would be deprived of their fair asset share;
- The size of the effective asset shortage would increase in line with the allocated 'investment growth' of the Fund, unless steps were taken to negate the over-bonusing in one way or another. In effect, therefore, a permanent rather than intermittent or temporary strain on the Society's finances was allowed to accumulate.

In other words, the Regulator, by inaction, allowed the Society to be put in grave solvency peril, both in immediate terms (for example see Penrose on the situation in 1990-92 although not covered here), and in constructive terms by giving new cohorts of policyholders valid grounds of claim against the Society.

Not fully investigated because bundled into complaint L , originally ruled misconceived although now upheld in part. Confirmed by Actuarial Review. Ethical, S & PM, PRE and EU aspects ignored. See also Appendix 3.

c. With each passing year, a greater volume of losses was crystallised in claims, until by the end of 2000, such losses probably exceeded £8 Billion. On any reasonably informed analysis it was these losses and the resulting capital shortage which prevented the sale of the Society as a going concern.

Not specifically investigated. Insider round tripping,

and top- up aspects ignored by SFO and PO.

d. As a further consequence, new policyholders were recruited on a basis where they shared in a substantial undisclosed deficit sufficient to undermine the viability of the Society, and they thereby received substantially less than their proper investment growth. However, this deficit was concealed until the Society's Ponzi operation effectively collapsed with the total policy value cuts of 16 July 2001, whereupon the entire deficit fell upon the shoulders of those policyholders who were still with the Society on or after that date.

First part not investigated as generally above. Second part complaint R not upheld originally, but now partially so. Maladministration considered to be one factor among many affecting the insolvency devaluations.

e. In conclusion: The claimants' losses flowed primarily from reckless behaviour by the Society's management which over the period 1973-1987 had critical consequences. This behaviour was of a kind which fell squarely within the scope of the Regulator's duties and powers to monitor, warn and compel retraction. The Regulator took no action or no effective action and allowed actuarial etiquette to guide its conduct instead of statutory duty. As a result the Prudential Regulator became equally responsible for the losses in question.

Loss of estate outside the reference period, but the overbonusing, topping up and round tripping that helped cause it continued into it. Resulting WPWM model not investigated. Regulatory inaction corroborated and upheld under the General Complaint from which outrage is the only injustice deemed to follow.

A. Organisational issues

a. The regulators were not always sufficiently resourced, and did not all possess the necessary skills, to make an effective contribution to the regulatory process and responsibly exercise discretionary powers as intended by Parliament from 1973 onwards. As a consequence they did not properly undertake their functions.

"Sanity check" item from PO's original specimen draft of complaints not introduced by us. Not substantiated. Complaint A not upheld.

b. The prudential regulators failed to communicate effectively with those responsible for the regulation of the conduct of business by insurance companies, particularly in relation to ELAS' published actuarial and insurance business paradigm, or to advise the Conduct of Business Regulators that the realistic position rather than the Solvency position was the primary reference for potential customers, or in regard to changes in policy forms and the guarantees provided in accordance with this or annual statements and letters to members.

Different aspects bundled into Complaints B, L & O. B dismissed but L and O now upheld in part. Realistic position ignored. Notionally linked to PRE, but not S &PM or essential ethos of with-profits. Gross reverse regulatory arbitrage against policyholders at the Conduct of Business interface (Annexe 2) entirely overlooked.

c. Although ELAS were aware of the significance of non-guaranteed bonuses and showed them in their 'Office Account', the Regulators did not give the matter proper attention despite its importance for policyholders and for the financial viability of the Society

Corroborated by chronology. Not specifically addressed.

d. The regulators and GAD allowed successive chief executives/managing directors of ELAS also to hold the post of appointed actuary, despite a recognition of the potential for conflict of interest in this position, and the fact that it completely undermined the basis of the regulatory process which was founded on the separation of powers between the AA and the rest of the Executive.

Complaint D substantiated but no material injustice ruled as following. Given Mr Ranson's baneful influence, EMAG's request for this to be re-examined was supported, but in vain.

B. Operational issues

As a general point, the regulators spent over-much time debating the circumstances under which they might use their discretionary powers, and in the event never used them when the overall situation required them to do so. As a result they did not recognise or react to any of the important successive stages in the development of that position, which were:

Partially bundled into light touch complaint C, ruled misconceived and dismissed, and the General Complaint which was upheld. Ignores discretionary elements of S&PM and PRE which are the subject of Appendix 3.

a) From 1973 onwards the regulators failed to react to ELAS making no explicit reservation for its increasingly dominant bonus form (terminal bonus), and did not examine the position from the realistic aspect required under a proper or reasonable interpretation of PRE.

Corroborated by chronology. Not investigated. PRE aspect bundled into Complaints N & O both originally deemed to be misconceived but now partially upheld. Again see Appendix 3.

b) When in 1987/8 ELAS carried over into new policy forms a bonus record enhanced by the prior dispersal of its estate which had no prospect of continuing, it began trading on a false basis. Regulators could and should have recognised this at the time, because the Society had also moved into over-allocation. More seriously from the prudential aspect, the over allocation to the pre-87 policies was of such magnitude as to drain capital required for solvency within a few short years. Nevertheless the Regulator did not intervene.

1987 outside main reference period, but not 1988. Over-allocation identified by regulators very early on, but not followed up. Causal chain linking fraudulent origins to later consequences never investigated by any party. See MN's letter to IO dated June 30th 2005 in Anatomy of a Fraud update (EQUI written evidence item 33).

c) Despite contemporary informed actuarial comment the regulators failed to scrutinise the "With Profits Without Mystery" actuarial and insurance paradigm. Had they done so, they would necessarily have discovered that it was in essence a post hoc sophistry-laden rationalisation for dispersal of its assets, and running a with-profits fund on an intermittently negative technical solvency gap. Under the WPWM paradigm and/or given the Society's underlying situation there was no prudently equitable assurance, or real prospect of fulfilling policyholders' reasonable expectations.

Bundled into Complaint L and originally classified as misconceived, but now upheld in part. Despite assurances, WPWM not specifically investigated, or indeed evaluated in light of WP concept, S&PM, PRE or the 1987/8 Newton memoranda.

d) From 1987 onwards the regulators allowed a with-profits fund to operate on a mostly negative technical solvency gap which betokened liability for present and future policyholders rather than profit.

Corroborated by chronology; not investigated. See c) above. Failure to appreciate basic aspects of the WP concept? Compensatory overbonusing aspects, but not the underlying loss of free reserves, also highlighted by EMAG.

e) The regulators generally failed to appreciate the effects of conflicts of interest between the Society's private and corporate/institutional clients, and the GAD's position in recommending the Society as a civil service institutional pension scheme provider.

Bundled into Complaint F: deemed not soundly based & dismissed. Implies that all Chinese Walls were sound throughout. Needs further thought by all parties.

f) Despite helping to develop joint "net premium" and "gross premium" actuarial methods to probe ambiguities in hypothecation of assets and liabilities under different accounting and regulatory return conventions, the regulators did not use them on ELAS's returns. Had they done so, the fundamental weakness in ELAS's position would have been exposed by 1996/7 at the latest.

Bundled into complaint E which has an essentially opposite meaning, and which was deemed not soundly based and hence dismissed. Failure to distinguish between future premiums and future profits implicit items is a related and grave issue bundled into complaint H deemed misconceived and hence dismissed.

g) Having turned a blind eye to gross solvency risks in 1990-92, the Regulator adopted thereafter a self-protective policy of denial, to conceal the maladministration that had taken place in previous years, and to absolve itself of responsibility when the collapse of the WP Fund eventually manifested itself. It colluded throughout the period 1996-2002 in attributing the circumstances leading to the closure of the WP Fund to problems with Annuity Guarantees, rather than the earlier and far more serious over-bonusing of 1982-87.

Corroborated by chronology, and substantiated by evidence supporting gross regulatory reverse arbitrage. Bad faith, maladministration and injustice not ruled despite advance notice of this.

h) The regulators failed to follow up disclosure of the Differential Terminal Bonus Policy on Nov 30th 1993, or assess its implications for regulatory solvency and PRE. Had they been sufficiently diligent to trace the origins of the DTBP at that time, they would necessarily have concluded that its prior non-disclosure was fraudulent.

First part bundled into complaint G and upheld. Fraudulent origin and relationship to WPWM, S & PM and PRE not investigated.

i) The regulators failed to question why the Society inappropriately extended its chronic over-allocation by using inappropriate quasi-Zillmer adjustments and subordinated loans which anticipated future premium income and impacted adversely upon future profits. As a result they failed to digest the prudential and PRE implications.

Essentially Complaint H, ruled misconceived and dismissed. PO considers Lord Penrose's observations on inappropriateness for RSP business made with little regard to contemporary standards. Again, failure to distinguish between premiums and future profits implicit items in context of WP business.

j) Understandably, the regulators could not detect that the reinsurance arrangements made to cover the Hyman position were a show treaty without substance. The regulators did not, however, examine ELAS's public statement in Feb 2000 that losing Hyman would cost members no more than £50 million, when reinsurance to the tune of £800 million was nominally being sought to cover the same situation. At the same time the Society's actuaries were valuing a "worst case" scenario based on 100% GAR uptake at over £3 billion. These disparities demanded rigorous investigation.

Bundled into Complaint P and partially upheld, but subordinated to reinsurance treaty aspects of Complaint J with no further findings being made. Implications of deceitful Feb 2000 Nash letter neither mentioned nor investigated in this or any other regard.

k) Despite external representations and their own evidence to the contrary, the Treasury, judiciary and regulators, and in particular the FSA, supported ELAS's position that there was no generic mis-selling of policies in respect of the GAR liability, and that ELAS's problems were solely due to the GAR liability. On this public position the Compromise Scheme of arrangement was carried through to the detriment of members and with forfeiture of their legal rights.

Amply corroborated by chronology, and evidence supporting gross regulatory reverse arbitrage including suppression/ alteration of the PIA report culminating in the Warren episode. Bundled into complaint P and watered down into a finding that the FSA's pronouncements after ELAS closure were misleading. No specific injustice deemed to have occurred.

l) In so doing, Treasury and the regulators necessarily permitted carry over of ELAS's discredited WPWM fund paradigm and structure by the New Board under circumstances in which with-profits fund status was irretrievably lost. They also allowed cuts in policy values well in excess of the nominal GAR liability without questioning their rationale, and without requiring any action to undo the over-bonus on outstanding GAR policies dating back to the 1982-86 era, which had become ever more substantial with the passage of time. Furthermore, if the Regulator had insisted on truly prudent action at that time or earlier, all final (i.e. discretionary) bonus would have been suspended indefinitely until the financial condition of the Society could be fully established, thereby retaining a vital £2 billion of capital which was subsequently lost.

Corroborated by chronology, but not investigated. Regulatory equivocation around the 1999 bonus declaration was, however, a focus of investigation. Policy value cuts complaint R initially rejected, but partially upheld in final Report as mentioned in (d) above.

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m) After the Compromise and despite forewarning, the FSA allowed the Society first to raise FSAVC's in compliance with FSAVC review procedures, and then cut them again immediately afterwards along with deferred cuts in all other annuities. In effect, therefore, the FSA permitted the Society to make post-Compromise upward revision of FSAVC's which it knew the Society had no intention of honouring.

Corroborated by chronology showing regulators well aware of the uncut annuitant policy values overhang pre-Compromise, and that the AVC review had not been reserved for at the time (although the FOS have pointed out that Penrose 5.119 refers to a specific FSAVC reserve of £6 million on Jan 24th 2001, albeit that it was inadequate in the event). Dependent causal chain of injustice supplied to Investigation by MN. Not investigated- final injustice outside reference period?

In sum, therefore, there is sufficient evidence to maintain that operational regulatory failure was total over an extended period, and that in the later stages it was deliberate, such that it had the effect of extinguishing many just claims without opportunity of recompense. Had the regulators halted this progression, an eventually fraudulent position would have been averted, which effectively they condoned by allowing the Compromise Scheme to take place. The writer is moreover confident that total operational failure of this ultimate kind can only be due to an overall deficiency in ethically responsible attitude. Others have wished further to maintain that, over and above organisational and operational deficiencies, regulatory failure must also have been collusive.

In effect bundled into the General Complaint, and upheld for PO's reference period. Bad faith or defective ethos not identified. Regulators in effect excused or praised for their comforts, arbitrage and misrepresentations as attempts to save the Society.

C. Payment of excess bonuses

a. Over a period of many years the regulators and the Government Actuary's Department (GAD) permitted ELAS to declare bonuses in excess of available assets, while at the same time operating without a significant estate. This was a major contributory factor in the Society's demise and in the losses incurred by all those who held policies on 16 July 2001.

Not investigated and not linked to S & PM, PRE or essential with-profits ethos. PO initially not persuaded that madadministration contributed to July 2001 cuts, but has now conceded that it was one of many underlying factors. Injustice element not determined. Overbonusing aspects supported by EMAG.

b. Over this same period, the regulators allowed ELAS to publish financial results and projections that were misleading in that they did not reflect the Society's true position.

In effect bundled into complaint C (ruled misconceived, and dismissed) and complaint I partially upheld..

D. Issues relating to regulatory solvency

a. From about 1990 onwards the regulators and GAD failed to give sufficient consideration to the fact that a number of the various measures used to bolster ELAS' solvency position were predicated on the emergence of a future surplus (for details see operational factors above). As a consequence, they did not properly assess the overall impact and adequacy of those measures.

Not investigated, perhaps partly because of confusion over source of surplus (profits versus premiums). WP ethical, S &PM and PRE implications largely ignored.

b. During the same period, the regulators and GAD failed to act when ELAS adopted what Lord Penrose described as practices of 'dubious actuarial merit'. These included valuing future liabilities at an inappropriate rate of interest between 1990 and 1996; treating selling costs as an asset; making no provision for guaranteed annuity rates until much too late; valuing a financial re-insurance policy which proved to be useless, at over £800 million; and taking on a subordinated loan which was not counted as a liability.

Essentially complaint J: upheld for valuation rates of interest in some years only, and for subordinated loan. Reinsurance treaty maladministration the dominant finding as per PO's economical method of ruling

c. On several specific occasions the regulators and GAD ignored or failed to action information that might have led to regulatory action against ELAS.

Bundled into the General Complaint, and upheld: Outrage the only injustice identified. Again see Appendix 3.

d. The regulators and GAD further failed to assess whether the New Board's representation of ELAS's situation was full and fair in the run up to the Compromise, and in the light of their own expert knowledge whether that description was consistent with PRE.

Chronology paints a worse picture, in that the evidence for gross regulatory reverse arbitrage suggests that the regulators well knew, or ought to have known, that the Compromise was essentially an active misrepresentation. Regulators excused/praised for trying to save Society by these means. But see main report Chapter 10 paras 674-5. Otherwise bundled into Complaint P supporting late contributor injustice.

e. In July 2001 the regulators allowed the Society to boost regulatory solvency by making total policy value cuts that included the guaranteed portion of members' funds. *De facto* this denotes breach of guarantee and regulatory insolvency, and is also a flagrant violation of PRE. By any ordinary criteria regulatory approval of such a manoeuvre is astounding.

Corroborated by chronology. Bundled into complaint R and regulators' market falls representation not challenged. Story briefly related in Main Report p194-5 with no searching examination. Implications of guaranteed moiety cuts not investigated. Issue ignored- official platform for Compromise and Financial Ombudsman's subsequent stance thereby left intact.

APPENDIX 2.
Observations and comments on full Chronology:

Iain Ogilvie,
Leader, Parliamentary Ombudsman's 2nd EL Investigation,
Office of the Parliamentary and Health Services Ombudsman,
Millbank Tower,
London SW1P 4QP.

The Croft,
10, Chapel Lane,
Old Dalby,
Leics. LE14 3LA.
Sept 21st 2007

STRICTLY CONFIDENTIAL.

Dear Iain,

Re:
1) Confidential observations on your complete draft Equitable Life Chronology.
2) Causal chains of maladministration producing injustice.

I am embarrassed to find that a whole year has passed since I commented on the first part of your chronology, and that I have only now completed the second part. Since the new follows on from the old, I have run them both together for the convenience of you and the reading panel.
Having mulled things over for a day or two since, I think my so-called "EQUI Late Submission" of March 20th 2007 is the most concisely convenient document for explaining my personal appreciation of the various points arising. And so, though I know you have had that document previously, let me now enclose a signed copy of it for your records. What it says about the three main categories of grievance and their separate *scienter*/liability trails is, at least to me, of obvious relevance. It may also serve as a handy digest of the FOS's stance, the origins of which one can now see much more clearly from your chronology.
I have previously cited to you one complete causal chain of maladministration causing injustice to my wife and me over our Equitable Personal Investment Plans. Let me now add that the regulators knew that ELAS was not reserving for the pensions/FSAVC review in Part One of your chronology, and further that they also knew that uncut WPA annuities were being carried through into the Compromise from Part Two. In other words, it must have been plain to them that FSAVC WPAs like me were in for a post-Compromise hammering. My personal injustice apart, it surely adds a material further element of concern over the disenfranchisement of the WPAs in the Compromise.
Though as therein explained I acknowledge that my observations should be viewed as preliminary, I hope you will be able to tell the confidential reading panel if they are fundamentally in error in any important way. Granted total regulatory failure, we all must have known that the detailed story would be a bit of a shocker- but having now grasped it one trembles a tad at the scope and weight of defensive interest ranged against you. So if you think my summary of the story is badly wrong, please disabuse us all now.*

Yours sincerely,

Michael Nassim.

Enclosures: Observations and Comments on Chronology; EQUI Late Submission.
E-copies: Michael Josephs; Paul Weir; Peter Scawen; Colin Slater/EMAG panel.
* In the event, no material comments or qualifications were returned by any party.

This digest of salient points and comments follows on from MN's e-mail to Iain Ogilvie entitled " Fw: Confidential basis for joint view on chronology dated 20 September 2006 (sent 12:35). Attached was "Annex 2 – chronology to closure amended MAN170906..doc" which was the annotated electronic copy on which the e-mail was based. This stage of the review is hereafter called Part One.

With two exceptions this account is presented *verbatim* to preserve its contemporary flavour. The first exception is to make the account anonymous on the regulatory side so as to follow the convention of the second edition of the Chronology, and the second is the insertion of dates, times, and periods to reconcile various editions.

Part One Summary:

The high level provisional summary points were as follows:

- Ranson pulled a number of *en passant* fast ones in an informal setting [Zillmer 17/09/92, 06/11/92; GAR/GIR item 1 20/07/93, 30/11/1993 ; reinsurance/resilience testing/future profits implicit items, smoothing, solvency and other WPWM related items 09/12/94; euphemisms for MVAs arising on transfer because of no reserving for guarantees & policy values being less than assets 14/12/95; "instantaneous" terminal bonus funded from income 08/11/96; total bonus in policy value statements but guaranteed bit not in DTI returns 08/11/96; section68 orders & quasi-zillmer 18/04/97 not in final version]. Having done so, he briefed people like Headdon and Nash fully, and then used them as though they were formal agreements. But R, H and N couldn't use them openly because that would have blown their cover- they could only claim them in retrospect!
- Headdon and Nash both reveal this themselves in different ways, in a setting that shows that they too made use of the deceptions that followed [GAR, DTBP & terminal bonus 02/10/98; 24/11/98; 03/12/98; 18/12/98 entry 3; 16/11/00].
- In 1998 GAD stopped Headdon from pulling the trick that Nash later used in his Feb 2000 letter [30/10/98 & 03/11/98]. So why didn't either the regulators or Headdon stop Nash? [01/02/00; 11/08/00]?
- Headdon's remaining attempt at *bona fides* is now shot to bits.
- Regulatory culture rather than the system was the primary problem. On GAD's side the regulators kept up appearances but connived in maintaining the illusion of solvency at all times. Otherwise competent juniors* who had started to unravel tricky problems were probably reined in and warned off [inference from 20/08/98 A2 check].
- By the end regulators did everything they could to avoid having to admit that ELAS was insolvent. Despite dire problems it was never given urgency category 1, because then they would have had to do something [22/10/98 onwards; 05/11/98 solvency memo later leaked; 22/01/99; letter to the German Regulator on 07/07/00; 24/11/00].
- On the Treasury side of the fence it was a little different, in that the Treasury's staff did their best to make sure that Ministers didn't get associated with the tacky stuff- but things got difficult when treasury staff were seconded to FSA. They never managed to be good shepherds to the public because their primary feudal loyalty was to the Treasury.
- There's an additional FSAVC black hole- the regulators knew the Society weren't reserving for it and despite my best efforts they allowed it to be carried over and buried in the Compromise, with the results we all know about [29/03/00].
- It looks as though ---- with his euphemistic concept of "solvent" run off in the event of no sale, was the progenitor of the Compromise [changed to GAD in final 29/11/00 entry 3].

- It seems that the regulators were always provided with an alternative net (corr. from gross) premium valuation, which was always suspiciously in agreement with ELAS's gross premium one. They never ever questioned why, and so missed the quasi-Zillmer.
- There is no evidence that ANY of the regulators had read or properly understood WPWM or its implications.
- Though regulators regularly asked for and had policy documents etc, they never opened them to check fact, legality or PRE.
- The regulators did not rule on the basis of their considerable powers over matters that they abdicated to the Courts [e.g. 16/11/98; 01/12/98; 02/12/98 culminating in 19/06/99].
- Given proper leadership, the scrutinising actuaries on the GAD side were of a quality to have had ELAS on toast*. On the treasury side, the most experienced actuary was so unguarded as to be something of a liability; --- was in due course replaced by someone much more politically astute-but whose loyalties were clearly with the Treasury and not the public.
- Lord P is, as Brian Chase Grey remarked, a master of understatement. His use of indirect speech removes the valuable nuances present in the direct speech of the PO2 Chronology.
- Lord P's indulgence of the regulators is not supported by the text we now have.
- Though we are heavily dependent on what has been offered us by the PO2 team, it looks as though they have provided enough to take us as far forward as we can reasonably expect given their remit.
- The regulators well knew the overbonusing problem was going on in other companies, let alone ELAS, despite which they never did anything about it. [essentially throughout Chronology]

* e.g. ------ and -----------

Some suggestions arising were listed as follows:

1. Regulatory review documents over the crucial period of fraudulent transition being missing, why not look at the original regulatory returns themselves (which Lord P says are public documents) to see what was going on? Indeed the regulators may/should have done this already.
2. Was there REALLY no formal and appropriately responsible review of WPWM by any of the regulators? It seems most remarkable.
3. In view of observations on regulatory culture and mores, organograms, moves and promotion history info would be useful.
4. Form 9 presentations might help overall understanding of what was going on.
5. What influence on regulatory culture were the high level actuaries exerting, and what guidance were they giving their juniors? If so, what level of responsibility attaches to it all?
6. Given the interconnectedness of people and events which are material to the Nash Feb 2000 letter, may we please see the regulatory and Treasury reaction and responses to it?
7. Given the importance of conflicts of interest in actuarial relationships, plus some of the regulatory personnel being in retrospect a little too close to ELAS actuaries for comfort, may we please know who put RR up for his CBE in the first place? On the indirect evidence available, it looks as though it came from quite a high level in the Treasury, perhaps in association with RR's contacts elsewhere in the Civil Service-even Government (?) [see 11/04/95 entry 1; 01/08/95; 18/06/96- ironies in retrospect].

8. Given the heavy burden of responsibility that passed to the FSA Chairman on his being expressly and personally warned of prospective ELAS purchasers' concerns, some further knowledge of how he discharged this duty (especially vis-à-vis GAD, his own board and the public) is desirable [10/11/2000; 24/12/00].
9. Some more information on how the Directing Actuary's nascent proposals for the Compromise were debated, advanced and developed would be useful.

Introduction to Part Two.

The present account follows on from these previous lines of investigation. It is, however, less transparent because the electronic text version was write-protected, which has necessitated manual annotation of hard copy. Hence the supporting raw text and comments cannot be circulated on this occasion. And since there was roughly twice as much text to go through as previously, I have decided to use numbered paragraphs rather than bullet points to explain or carry forward matters of importance.

This time we have an organogram to explain the rank and position of the major players. There is also enough material in the entire chronology to assess the characteristic stances and preferred team roles of a number of the participants using standard industrial techniques. Of these the Belbin system is perhaps the most widely accepted and easy to use. I have often found it insightful for assessing individuals and hierarchies as well as teams. That said, characteristic personal stances and interactions are much more easily judged in meetings than by letters or memoranda. In my view the Directing Actuary emerges as the pivotally decisive and resourceful prime mover in this next stage, who has the characteristics of a "shaper" combined with a "plant". At the height of the insolvency/liability crisis he gets able support from ----------, an insolvency "plant/specialist" who works at the problem from the other end, and tests things to make them more robust. Not surprisingly, his services are retained for some time after they are strictly necessary. The Head of the Legal Department, so often the final arbiter of what goes or doesn't, is the group's "monitor-evaluator", a critical role she gradually abandons as she becomes caught up by the force and momentum of events. The FSA Chairman seems well suited to his official role as a "chairman/coordinator", but never seems to stand outside himself and ask what he should in competence and conscience be doing, so to guide his team and inform his Directors accordingly. Paradoxically this makes the reporting line of the Directing Actuary to the FSA Chairman more than usually important, albeit speculative at this stage. In remarkable contrast the Directing Actuary's previous boss the Government Actuary is almost invisible in the entire chronology- as shadowy as the Chancellor of the Exchequer if not the Economic Secretary to the Treasury, who is perforce more directly involved although usually careful not seen to be any more personally accountable than she has to be (the Permanent Insurance/Section 68 issue being a notable exception). Since the Government Actuary would have needed to maintain a close interest in everything that was going on, one must presume some "dotted line" reporting relationship between him and the Directing Actuary. Was the Government Actuary really as averse to committing himself to paper as his absence suggests? That does not absolve him from responsibility, not least because the nascent Compromise was formulated before the Directing Actuary transferred from GAD to the FSA, let alone the whole sorry story up to that point.

Separating out the personalities of those in more supportive, implementing and completing roles is rather more fragmented and difficult. -------, ------, ------ and even ----, ------- or ------ are therefore somewhat harder to distinguish and evaluate. ------- and ------ seem most often to toe and support the party line- and so perhaps they should be regarded as "team workers" rather than "completer/finishers". But irrespective of individuals and their roles, my abiding impression throughout this part of the Chronology is of considerable ability, tactical ingenuity, care and detailed legal or technical attention expended in the service of a collective purpose almost entirely destitute of any proper standards and ethos. Therein lies the bleakly hard heart of the problem.

Part Two Findings:

1. **Realisation and awareness:** Given the sometimes bewildering sequence of events and reactions, it is easier to summarise what made for the regulators' growing awareness of just how bad things really were, and what they did to contain the unwelcome findings individually and collectively. Having implicitly accepted the concept of "solvent" run-off without external support, their first priority was always to be able to say that ELAS was "solvent". This they achieved by a series of technical and legal comforts on one hand, and finding dubious ways of suppressing, discounting or dismissing liabilities for *scienter,* systematic deceit, misrepresentation and mis-selling on the other. But in the process they placed themselves in a falsely ambiguous position over the Compromise, compensation issues, the subservient FOS and the policyholders and public they purported to serve.
2. **The principal comforts taken were:**
   a. Persistent neglect of the necessity for free assets independently of working capital for the security and good faith of assurance business- and especially with-profits.[throughout Chronology]
   b. Reluctantly acknowledging but subsequently ignoring pre-1990 overbonusing, its overall effects on financial strength and unfairness to non-GARs in the Compromise (the Directing Actuary).
   c. Failing to take a firm line on how much reserving should be made to cover terminal bonus-specifically ELAS, but also more generally.
   d. Allowing ELAS more temporary comfort from the dubious reinsurance treaty over a prolonged period than was justified by the circumstances.
   e. Under cover of Section 68 orders, on discovery of the quasi-Zillmer/resilience reserve hypothecation switching trick, allowing future profits implicit items to be substituted for future premiums implicit items [November 16th 2000 entry 2 p461 para 3 and onwards].
   f. Ignoring the fundamental impropriety of loans against a with-profits fund. [from 1997 onwards]
   g. Being somewhat over-amenable and hasty in acceding to Crosby and Halifax's requests in order to gain their purchase contribution and boost confidence/"solvency" [29/01/2001-30/01/2001].
   h. Allowing the Article 4 situation to remain open and unresolved, over which extended time they could maintain that their assurances of solvency were ultimately justifiable [13/10/01-13:15 & 19:46hrs specific example deleted from final].

i. Discounting the GAR liability at different times by allowing and supporting the concept of percentage uptake rather than the whole.
j. Discounting mis-selling claims based on arbitrary notions of average claimants' likelihood of success in the courts- i.e. on the basis of the regulators' own failure to inform, advise and regulate![original suggestion made to the Directing Actuary by the insolvency expert on 28/07/01-12:34 hrs; then e.g. 02/10/01-10.00 hrs p972 last para]
k. Adopting less rigorous Companies Act solvency conventions.
l. Pretence of analysing and monitoring the imposition of and rationale for market value adjusters, which had the effect of deflecting the OFT and allowing the Society pretty much free rein (see 3c below).
m. Allowing ELAS to make optimistic use of valuation rates of interest, including "segmentation" of asset classes.
n. Allowing or even encouraging ELAS to cut total policy values in June 2001, while obviously ignoring that *de facto* this was an admission of absolute rather than merely technical insolvency.
o. Knowingly allowing the unreserved FSAVC review liability and WPA uncut policy values to be carried over undeclared and uncorrected in the Compromise Agreement [29/03/00 & 04/09/01 p741 last sentence].
p. Maintaining or allowing it to be put about that the Society's troubles and cost of the GAR were limited to and covered by the loss of 7 months bonus in year 2000.
q. Allowing credit to be taken for the sale of Permanent Insurance in returns for the year preceding its completion (*cf.* AIT and Carl Rigby).
r. Taking pains to avoid giving any personally signed approvals or confirmations of ELAS's solvency position and reinsurance credit (e.g. ------- to Crosby or the Directing Actuary to Nowell).
s. In effect concealing the nature and import of Peter Nowell's evaluation of the Society's affairs from policyholders and the public in the run up to the Compromise Agreement, and subsequently.

3. **The principal means of suppressing, discounting and dismissing *scienter*, fault and liabilities were:**
   a. Taking over all unfair trading and PIA issues in order first to gain control over them rather than treat them responsibly in due course.
   b. No PIA disciplinary action *re* income drawdown and pension review to placate Crosby [28/01/01-10:15 hrs, 29/01/01 17:20 hrs & 31/01/01 10:30 hrs].
   c. Heading off the OFT on the MVA issue [14/03/01 et seq. Cf. 16/10/01-09:25 hrs &16/07/01-16:49 hrs entries in draft Chronology only].
   d. Bullying the PIA into an almost complete *volte face* over the conclusions of their CoB/mis-selling report, and using specious logic in the process (the Directing Actuary) [18/04/01 15:06 hrs vs.21/05/01 & 05/06/01 19:40 hrs; 17/08/01; 28/08/01-13:58]
   e. In various ways seeking to delay, mitigate and suppress Equitable Counsel's assessment of misrepresentation and mis-selling. Overall this has the effect of reducing an estimated £4.5 billion overall liability to £50 million or so, and de-fusing the liquidation crisis. *Inter alia* this involves altering and suppressing the PIA report, followed by wilfully ignoring both WPWM and Warren's incontrovertible *scienter*/liability trail [as summed up by some crucial notes of a telephone call by Glick

and Snowden to the FSA on 06/07/01 and by minutes of an emergency meeting of the Tripartite Standing Committee on 25/07/01 and an extraordinary meeting on 31/07/01]. It also requires the Directing Actuary's pseudo-statistical whittling down of the probabilities of legal action success (2j above), and an insistence that all compensation must be "tort and/or fault based"[08/08/01-15:28hrs -only possible using the evidence already ignored or suppressed! It all takes much time and ingenuity by the Directing Actuary's team and their counsel Glick and Snowden. Meanwhile Vanni Treves in effect blackmails the FSA for a let out by pretending virtue, and seemingly wishing to publish Warren as soon as possible. *In the end, therefore, it is the regulator and not ELAS that has to take the responsibility for not letting the public know the full extent of ELAS's predicament.*

4. **The separate components of falseness and ambiguity were:**
   a. Following the "solvent" run off/Compromise concept, getting the Old Board, notably including the discredited Headdon, to start work on it before recruiting a New Board to implement it prior to resigning *en bloc*.
   b. Knowingly never complaining about Headdon, probably because they needed his services initially and feared his reaction thereafter [09/04/01 entry not in final; 11/04/01 13:54 hrs; 26/09/01-11:57].
   c. This committed them to an approach that had thereafter to be maintained almost regardless of circumstance. Loss of free reserves and overbonusing were longstanding background obstacles to it, but the PIA review and Warren later emerged as acutely large threats.
   d. As explained in 2e above, ending up in the paradoxical position of having to delay and de-fuse ELAS counsel's own report, ironically because it revealed the very information that a competent regulator should have uncovered or have prevented throughout!
   e. Seeking publicly to distance themselves from the instruments they had devised and were brokering, while giving no guidance to policyholders and financial advisers.
   f. In reality the regulators had their own monitor at ELAS Compromise meetings, and were using a single firm of accountants common to all participants (Nowell, FSA, ELAS and the FOS) to obtain a universally consistent view regardless of policyholder wellbeing or the differing responsibilities and interests of the various parties. They were also seeking to impose their own actuarial/statistical views on compensation policy and quantum (principally the Directing Actuary).
   g. This situation placed the accountants (BWD) in an improper position overall, which in conscience they should have declined. And *de facto* the regulator had ended up effectively conspiring against policyholder and public interest while acting in their name, and without their proper representation.
   h. Having got their solution in place, the FSA obtained Walter Merrick's and the FOS's assent to it all in advance [PIA –FSA 30/08/01-12:41 et seq- see also AH paper par 21 p11; 28/09/01-15:30 hrs ELAS suggestions for factorisation; also Charles Thomson to FSA 26/10/01-09:57 hrs p997 para 1; 30/11/2001 entry 7].

i. So in due course emerged the false Compromise accounting ("No problems other than GAR rights, which never amounted to more than 7 months withheld bonus", plus FSAVC and WPA problems undeclared), the FOS "Procrustean bed" of lead cases together with their fixed underlying assumptions, and the BWD/Ms. E compensation formula.

Comment:

Once again note that this account is provisional, and may change in detail or emphasis when "PO2" appears and is reviewed. Because it is short, simple and provisional it is not properly transparent. Sometimes, too, the logic is compressed so much that properly reasonably inferences can be mistaken for harder facts. For all these shortcomings I apologise in advance. *So please, if the PO/ readership panel want to take issue over anything they think is important would they do so now than later?* That way future disagreements and confusion may be reduced, if not completely avoided.

Though to comment more formally, or even to criticise, is prematurely inappropriate, already one cannot escape the conclusion that our prudential and conduct of business regulatory climate and culture are fundamentally unfit for purpose. And though I have not been able to highlight them all on this occasion, there are just too many weaselly details, two-faced ("Janus") memoranda and irresponsible or exculpatory behaviours that are fundamentally objectionable- even inexcusable. But since regulatory failure has been so abjectly total, this is pretty much what we should all have expected.

At this stage it appears that the Directing Actuary has much to answer for. I surmise that, having come up with the essential idea for the Compromise while at GAD, he then had to deliver it as the senior responsible actuary at the FSA. He devised and initially led the attack on the PIA, played a crucial role in delaying and neutralising Warren, and having kicked the entire fraud/misrepresentation/conduct of business problem into the long grass could invent, refine and drive through the pseudo-statistical compensation and market fall arguments that were material both to the Compromise and the FOS's stance. And all the while he was the internal expert and arbiter on "solvency", the handling of which required much dexterity and determination. As an aside, he had two sticky personal moments. The first of these was when Headdon tried to pull a Ranson-style *en passant*, and claim personal indemnity by suggesting that the Directing Actuary had been told about the side letter and/or related issues [as revealed in a letter from Nowell to him on 07/08/01 entry 5; see also related events from 14/09/01 entry 5 - 25/09/01, including 20/09/01 entry 6; 28/09/01 15:30 hrs]. The Directing Actuary managed to evade --------'s fate, and ultimately it rebounded on Headdon, even though the Directing Actuary was careful not to "shop" him personally. Here again the Directing Actuary's instincts were probably right in that, if it is correct that Charles Thomson complained to the Institute of Actuaries about Headdon, Headdon may have got his revenge by revealing and complaining about the false Thomson reference. Hence what Headdon might have said about the GAD and FSA in reprisal must remain speculative! The Directing Actuary's second sticky moment was when Nowell wanted him to vouch for the reinsurance treaty being worth £600 million in the run up to the Compromise, which required much temporising by the rest of the team in order to avoid any commitment. (As discovered later, the story ends with entry 19.47 in the Actuarial Review already referred to, albeit that it is outside the Report's reference period- MN). How much responsibility for all this the Government Actuary and FSA Chairman should accept ultimately is pertinent, but not for detailed discussion now.

How properly to explain all this and put it right without undue opposition, disquiet and upheaval? And what exemplary actions should be taken? These are obviously major issues. But one thing has escaped most commentators' attention, and that is the Swiss approach to financial security and regulation presented at EQUI. Its philosophy is diametrically opposed to ours because it puts customer safety first, from which financial confidence and stability necessarily follow. Not only that, but Swiss regulatory procedures are in harmonisation with EU statutes and guidelines even though Switzerland is not an EU member. Almost certainly they implement the European Life directives better than we do. Moreover the Swiss regulator is consistently effective using limited means. It also acknowledges that failures might occur, but does not excuse them in advance. The English regulator puts confidence first, and protection comes a poor second. It makes its excuses first, to account for the unacceptably high number of lapses past, present and future. We might well benefit by following the Swiss example.

Michael Nassim.

September 20th 2007.

Circulation: Iain Ogilvie (PO2 leader); Michael Josephs (Investors Association); Paul Weir (ELCAG); Peter Scawen (ELTA); Colin Slater (EMAG) for circulation to the EMAG confidential readership panel.

APPENDIX 3:
The Newton Memorandum.
(Reproduction of Penrose Chap 13.105-12)

In Chapter 13 of his Report, Lord Penrose made a comprehensive historical approach to the concept of PRE, and the extent to which the issues surrounding it had been picked up by working parties, statute, guidelines, precedent and custom. The preface to this extract is that in 1988 Arthur Russell, Head of Insurance at DTI, had prepared a draft proposed submission to the Consumer Affairs Minister in guidance for a general policy position on PRE with regard to insurance matters. As will become clear, many of the considerations expressed in Lord Penrose's abridged exchange reproduced below are prophetic with regard to the Equitable, and anticipated the concept of S & PM as later expressed in the Third Life Directive. As a result it cannot be held that the DTI and GAD should not have been fully conversant with the issues. The question thus becomes why this approach was not applied later on, which is something that the Parliamentary Ombudsman's Second Report might have enlarged upon as requested. The Report does, however, make detailed reference to IA President Marshall Field's address "Risk and Expectations" (part two p91-2 para 429), which expressed many of the same concerns, although not so obviously from a regulatory viewpoint. The similarity between Field's and George Newton's approaches suggests that Newton may have paid considerable attention to Field's paper. Whatever, all these matters are now important from the European as well as the UK perspective. For the reader's convenience the more immediately relevant topics have been italicised.

------oOo------

GAD became involved. George Newton, who was directing actuary for the insurance directorate at GAD from 1982 to 1988, provided a copy of a memorandum he had written on 21 September 1987 on an argument that had surfaced that section 45(2) of the 1982Act inhibited the exercise of the Department's powers generally rather than solely in respect of investment management. On 8 July 1988 Newton wrote a long memorandum to Russell and others:

> "I doubt whether much purpose is served by going in any detail into the origins of the "reasonable expectations" provision… but I would do so at least in order to correct what I have now discovered is a distorted version of history which I have been instrumental in spreading around.
>
> GAD folklore has for long had it that the origin of the reference to "reasonable expectations in section 37 of the Act and in particular the reference to the legislation to enable the power to make regulations for valuing liabilities, introduced in the same Bill, *to go beyond provision for a company's contractual liabilities but to extend also to direct or indirect provision for future bonuses to with-profits policyholders.*
>
> It is certainly true that the Instructions to Parliamentary Counsel for the 1973 Bill did draw attention to *the desire to make regulations for valuing liabilities which included provision for making bonus expectations of with-profit*

policyholders and it was suggested that this extension of the concept of liabilities should be expressly spelt out in the Bill. However, a quite separate part of the Instructions on the Secretary of State's powers of intervention included the following:-

Principal power

The Department should have power to require a company to take such action as may appear appropriate to the Department to protect policyholders and potential policyholders of the company…. from the risk that the company may be unable to meet its liabilities or, in the case of its long term business to fulfil the reasonable expectations of policyholders or potential policyholders.

I In the event the wording of this part of the instructions was, unusually, carried forward virtually unaltered into the Bill in what are now sections 37 and 45 of the 1982 Act but, possibly because this was done, Counsel saw no need to expand on the way suggested the regulation-making powers in what is now Section 90 of the Act.

It is clear, therefore, that the ability to meet reasonable expectations was included in the 1973 Bill as grounds for the exercise of the powers of intervention in its own right and not merely as a peg on which to hang valuation of liability regulations which prescribe a standard above provision for a company's minimum contractual liabilities."

It appears equally clear from this insight in 1988 into the background into the Act that GAD had been proceeding for a material time on a false assumption about the scope of scrutiny that would have been appropriate. Regarding PRE as a peg for the valuation regulations would have led to the assumption that PRE was irrelevant except in so far as reflected in the valuation regulations.

108. Newton continued with helpful background observations:

"*Even if the "reasonable expectations" grounds had not been introduced in the 1973 Act as part of a package of measures designed to keep asset strippers away from the large free reserves held within life assurance companies (in particular to give teeth to what is now section 30), some such provision would sooner or later have become inevitable to match the changing structure of with-profits business.*

During the latter part of the 19th century and the early part of this century (the era reflected in the 1909 Act which effectively governed the conduct of life insurance business up to the 1973 amendment), the premium rates for with-profits contracts had been conventionally just 10% higher than for the corresponding non-profit contracts. Bonuses were distributed wholly in reversionary form so that the additional benefits were built up more or less uniformly over the term of the contract. In the circumstances the bonus loading could reasonably be regarded as a small equity interest in the insurance company and if during the course of the contract the company's treatment of its with-profit policyholders ceased to match up to their expectations, the policyholders were exposed only in regard to a very small part of their investment.

The margin between the with-profit and non-profit premium rates has gradually widened over the years but in the middle 1950s, the earliest date for which returns are to hand in GAD, the differential was still only of the order of 20% - 25% for a twenty year endowment assurance. For some years now, however, the corresponding differential has been 70%, with non profit savings contracts almost ceasing to be a significant class of business. *This has resulted from the effects of inflation which has taught policyholders the hard way not to rely on benefits fixed in monetary terms. The effect has been, however, wholly to change the character of a with-profits contract. I find it difficult to interpret a with-profit contract in current conditions as other than one where the policyholder entrusts the insurance company to do its best for him in the investment of his premiums and, in order to enable the company to invest heavily in assets such as property and equity shares which have performed well in the past but whose value at a future date is inherently uncertain, the policyholder accepts a guaranteed benefit representing less than half the return he can reasonably expect from his premiums.*

However, without any formula governing how the non guaranteed part of the return should be determined, there is clearly much scope for the inequitable treatment of policyholders, which is increased with the trend towards giving a very significant part of the return in the form of a terminal bonus when the policy matures.

On this general analysis of the nature of a with-profits contract, you will see that *we would fully support the view put forward in the draft submission that policyholders' reasonable expectations are to share in the success or otherwise of the company's investment policy, and in any other sources of profit or loss, and not to any particular rate of return on their investment. Clearly a primary application of the reasonable expectation concept will be in relation to the apportionment of the distributed profits between policyholders, as was originally intended."*

These observations would have been significant at any time during the 1980s as the allocation of surplus between reversionary and terminal bonus shifted. They have particular significance as one approaches the 1990s when that process accelerated. GAD in particular were clearly aware of the need for legislation and regulations to take account of changing industry practice.

109. Newton continued on the issue of competent and prudent management:

"We would also consider that the policyholder can reasonably expect that the company, and not just the funds, would be competently and prudently managed. In addition to the investment aspects, of which more below, this would cover the control of the expenses but should also include the company's rate of expansion where excessive investment in financing new business strain can lead to failure to meet reasonable expectations in regard to bonuses.

Whether this is happening or not in a particular case is difficult to judge from outside the company and, as elsewhere, the Department would presumable (sic) expect to intervene only in extreme cases and would be largely dependent on the company's Actuary.

In practice the concept of prudent and competent management when applied to investment will come down largely to what degree of risk is considered to what degree of risk is considered to be in keeping with policyholders' reasonable expectations… However, even if the investment of a high proportion of the assets in a well spread portfolio of equities is regarded as in keeping with policyholders' reasonable expectations the concentration of a large part of the investment in, say, a single industry would clearly give rise to a risk that policyholders' reasonable expectations could not be met. *However, quite apart from the problem of laying appropriate criteria, at present we do not even get the information to enable a situation which might not be in keeping with policyholders' reasonable expectations to be identified. In effect we rely on the AVRs and again on the role of the actuary within the company to control the situation."*

110. Newton then discussed the development of non-profit business *before noting that the draft submission did not deal with whether reasonable expectations should extend to surrender values.* He finished with a "general review which advised caution:

"Whilst we recognise the need for guide lines in regard to the policy to be applied in using the statutory powers of intervention on grounds of reasonable expectations, the particular situations to which I have drawn attention above do I believe illustrate the need for flexibility and the dangers in saying too much in public. There are a number of aspects where it would be difficult to maintain that reasonable expectations were not involved but where DTI in practice would presumably only wish to intervene in extreme cases. In some areas we do not at present have the necessary information and others where the powers could probably only be exercised if more formal responsibilities are put on the Appointed Actuary."

111. On 1 August Russell sent a revised draft of the submission to Newton. Newton again replied at length on 8 September. It is unnecessary to set out the terms of the paper in full. Russell's revised draft, at paragraph 13, had referred to problems associated with timings of receipts of relevant information and said:

"But we and GAD are giving thought as to how the chance of such situations occurring can be minimised by giving greater definition to the role of the Appointed Actuary, and a more robust attitude to discipline by the .. Institute of Actuaries…"

Newton commented:

"…as you may recall from Edward Johnston's notes and the discussion on 20th July, the exercise of disciplinary powers by the actuarial profession is a more complex problem than may appear at first sight…"

and proposed that the subject be left over for a later paper.

112. Newton also commented at length on a new topic:

"The situation in the paper on reasonable expectations in regard to the distribution of surplus is largely confined to the apportionment of profits between policyholders and shareholders, but issues of policyholders' reasonable expectations also arise in regard to the respective treatment of different classes of policyholders. Whilst I recognise that there is a limit to the aspects of the question that can, or indeed need to be referred to in detail in a submission to Mr Maude, while the subject is under active consideration by officials *I would draw attention to some of the main circumstances which may arise where the treatment of particular groups of policyholders may amount to failure to meet their reasonable expectations, particularly as the number of cases where the Department is asked to intervene on these grounds could increase significantly in the future.*

It is not suggested that DTI/GAD should become involved in vetting the equity of companies' bonus distributions as a matter of course. *However commercial pressures will always tend towards generosity in bonus distributions to those classes of policyholders where the company is competing most actively for new business and this may sometimes be carried so far as to prejudice the reasonable expectations of certain classes of existing policyholders.* This has been a major issue in Australia where a number of companies have ceased to write traditional with-profits policies and the Commissioner in successive annual reports has expressed his concern that surplus generated from the older types of contract is being applied to increasing the rates of dividend on the new deposit administration type of contracts that companies are currently marketing. The Australian Commissioner in one report went so far as to warn companies that if they did not mend their ways he might require the setting up of separate sub-funds in respect of the main classes of participating business.

The issue of policyholder's expectations may also be raised by changes to the form of bonus distributions. Although a particular bonus system, such as uniform reversionary bonuses may only do rough justice, it has generally been held in the industry that the method of distribution of surplus is part of the deal that the policyholder buys when he takes out his contract. Over the years virtually all the companies have come to supplement their reversionary bonuses with terminal bonuses which have gradually grown in importance with for some companies for longer term policies more than 50% of the total policy proceeds arising in this form.

The use of terminal bonuses to distribute a part of the surplus can certainly be justified as the only method by which policyholders can be given a full share of the unrealised capital appreciation on the assets in which their premiums have been invested. However, from the company's point of view there are other advantages in terminal bonuses in that compared with reversionary bonuses the time when surplus funds are converted into additional contractual liabilities to policyholders is deferred, thus increasing the company's capital resources available, for example, for financing expansion. Increasing pressure on capital resources for some companies in the future could well lead to a situation where profits came to be distributed largely in the form of terminal bonuses, but in the extreme cases this could raise the question of *policyholder's expectations. The manner in which terminal bonuses are currently operated amount almost to a tontine system with benefits accruing disproportionately to the minority of policyholders who maintain their policies in force to the maturity date.*

More generally, any sudden recasting of bonus scales can give rise to issues of policyholders' expectations. We have seen examples of increased (sic) in payouts on similar policies of the order of 30% or 40% as terminal bonuses have been introduced or greatly increased. Changes on this scale have certainly not added to the reputation of the industry or of the actuarial profession, since it is impossible to avoid the implication of very serious shortcomings in the basis for distribution of profits in the past, but there have generally been no actual losers and so far as we are aware the dissatisfaction that must be felt by policyholders whose contracts matured shortly before the increased (sic) has not been translated into formal complaints on grounds of reasonable expectation.

However in circumstances likely to rule in the foreseeable future, significant realignments of bonus scales are likely to involve losers as well as gainers and the Department has recently had a difficult case where a policyholder has complained about a significant reduction in the maturity benefit under his pension policy compared with an estimate given by the company a few months earlier for no reasons other than, as the policyholder sees it, an arbitrary decision by the company to revise the shape of its bonus scales. Fortunately in the present instance the company can show that the new scale is more soundly based than the one it replaced, but were this not so an awkward question of policyholders expectations not being met would be involved.

Whilst we fully share the sentiment expressed in para 19 of the draft submission that we should not be overzealous in the pursuit of possible unfairness, for the reasons I have indicated I fear that there might be many more complaints to DTI in regard to bonus distributions in the future than there have been in the past. It is very much in DTI/GAD's interests that the initiatives of the Institute of Actuaries, following the discussions last January that you attended, should be effective in bringing about a more structured and consistent approach to bonus distributions than has always been applied in the past."

POSTSCRIPT.

Source: The Motley Fool Equitable Life bulletin board.

Author: paulheinz57 **Number: 70000 of----**

Subject: Happy 70,000th birthday! **Date: 28/4/08 11:53**

When some of us started contributing to this Equitable Life Board in 2001, our focus was mainly on getting our money back from Equitable. At first it seemed that it was a matter of truth, timing and tactics.

Then it seemed that the Compromise would solve many of our problems. Then we realised we'd been conned and it wouldn't.

We believed the FSA was there to see fair play. That the FOS was impartial and that it would award proper compensation in cases where the mis-selling was blindingly obvious. We believed that the WP Annuitants would be protected from the privations meted out to the rest of us.

Then we started to realise that we were being sacrificed "for the greater good" – so-called confidence in the financial services sector.

Later we realised that the New Board of ELAS, the Treasury, the FSA, the FOS, the SFO and other areas of government were all working in concert to ensure that the Government did not have to pick up the bill for compensation.

Later still it became apparent that something very smelly was being covered up in high places to protect the culprits.

And now some of us have become less concerned with getting our money back and more worried about what this scandal tells us about the society in which we now live. It's not a pretty sight.

Seven years on and 70,000 posts later this board has provided an invaluable meeting place for those who want to do something about it. Many thanks to TMF for continuing to provide us with this opportunity.

Please forgive us if occasionally we appear too "political". It is the politicians who interfered with our pensions, not the other way round. I believe that history will show we were more than right to cry "foul".

Paul.