You are in: Front Page > Business > World Business Review

WEBBER'S WEEKLY REVIEW

World Business Review

World Service Business Editor Martin Webber casts his eye over this week's main stories

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In this week's World Business Review we have an exclusive interview with the former boss of Equitable Life, once Britain's biggest pension provider that's now said to be facing a five billion dollar financial black hole. We'll ask whether politicians, judges and regulators are all to blame for the increasing failure of Britons to save for their retirement.

Britain's savings industry is in crisis.

The country's citizens should be putting aside more and more for retirement. Instead confidence in savings products like life insurance and pensions appears to be at an all time low.

What was once the country's most respected private pension provider, Equitable Life, is in turmoil - amid claims by some that a financial black hole exists there of around 6 billion dollars.

Equitable's former boss will be speaking to me in a moment and he's angry about the latest revelations that papers have been sent to Britain's Serious Fraud Office or SFO.

The UK savings industry has been under heavy fire in recent years, but it's easy to forget that it wasn't always like this. Back in the 1980s, the industry was often touted as the envy of the world....its institutions looked to be the next big export from Mrs Thatcher's Britain after privatisation and union reform.

However, the Conservative governments own policies seem to have played their part in the savings' industry's fall from grace.

The finance minister - Chancellor Nigel Lawson - in 1984, hit the savings industry by removing a tax concession called Life Insurance Premium Relief. This helped government finances, but meant that returns for savers were less attractive.

14 years later with New Labour now in power, Chancellor Gordon Brown then targeted the pension funds, making them pay tax on the income from their shareholdings for the first time. It was billions of dollars a year extra for the government. At that time, most funds were looking healthy as the internet bubble inflated - few commentators made a fuss.

But Britain's venerable financial institutions were

FTSE	4430.1	+27.4
Dow Jones	10593.03	+97.48
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cross. They'd won the confidence of the public for giving ordinary people with small sums of money a hugely better return than just putting their cash in the bank. The industry allowed people to share in the gains from economic growth reflected in the stock market, without the high risks involved in trying to pick individual company shares to buy.

Britain's oldest mutual insurer - that's one owned by its members - was Equitable Life. Founded in 1762, Equitable had a reputation for healthy payouts to its policyholders.

Increasingly as personal pensions were promoted in the 1990s, professionals like lawyers and accountants, flocked to the firm. Equitable used television advertising to build up its brand.

The success of these adverts went down badly with thousands of people known as Independent Financial Advisors. They were unable to cash in with commissions, as Equitable sold its policies direct to the public, without using middlemen. Equitable was losing friends, and was increasingly coming under attack.

Some of Equitable's policy holders began to challenge the fairness of the firm's payouts.

After various rulings, finally in the year 2000, the most senior court in Britain the Law Lords said Equitable had got its distribution to its policyholders wrong. The result was that cash was needed. The mutual put itself up for sale but failed to find a buyer. The company had to close to new business.

According to Martin Dickson a senior writer at London's Financial Times newspaper, it was just the latest of a series of blows to the savings' industry's reputation.

Martin Dickson
(Certainly the savings culture is not as strong, not nearly as strong, as it was say 20 years ago. The industry hasn't helped itself by a series of scandals over miss selling, which have severely dented consumer confidence in the industry. There's a sense, I think, out there that it's an industry selling duff products to dumb consumers.)

A report on the Equitable affair by a Scottish judge, Lord Penrose, is expected to be published soon. Leaked versions of the findings suggest Lord Penrose will blame misjudgements by former Equitable bosses and past regulators.

But the defenders of Equitable's past management say they were simply following the accepted rules of the time.

The roots of Equitable's trouble were complex. In previous decades, pension policies included a minimum percentage return for policy holders when they came to retire - these were called guaranteed annuity rates. At the time these guaranteed rates were so low, none expected them ever to apply.

But during the 1990s inflation and interest rates fell dramatically and far further than anyone had expected.

The result was the guaranteed rates were above the market rates - an expense for Equitable. But the society responded by cutting the bonuses paid out to those investors taking the valuable guaranteed rate. Equitable was confident that it was perfectly legitimate to dip into surplus cash that would otherwise have been sent as a bonus to the policyholder.

It meant a two tier bonus system for those with the guarantees and those without. But since bonuses were bonuses - in other words something over and above the return guaranteed in the policy - Equitable believed it had this discretion and was simply being fair to all its members.

It was this discretion that the Law Lords overturned in 2000. The Law Lords took the view that the guaranteed annuities had their own intrinsic value that couldn't be reduced by cutting bonuses. It was a hammer blow against Equitable and all other similar firms. But did the Law Lords get it right?

Michael Zander is a retired professor of Law at the London School of Economics, and one of Britain's foremost commentators on legal issues. He also had money in Equitable.

I asked Mr Zander if Britain's most senior judges had been right to rule against Equitable.

Michael Zander
(It seems to me that they got completely the wrong result, I think that it was an extremely foolish decision and it's extraordinary that highly intelligent people, highly respected people such as the law lords should ever have reached such decisions and unfortunately human beings make mistakes and sometimes the mistakes are very serious.)

How did they come to that answer, what are the procedures do they hear from all the interested parties involved in such a complex issue?

Michael Zander
(The House of Lords always hears arguments from both sides as of course they did in this case, they had an elaborate argument from eminent lawyers.)

In other words 2 barristers - one on one side and one on the other.

Michael Zander
(Barristers yes on the two sides.)

Rather dependent then on one having an off day then isn't it?

Michael Zander
(Obviously different lawyers will put the case somewhat differently; equally different judges will look at it differently.)

Is this the right way to decide these complex financial issues though? Law lords with no specialist knowledge of how pension funds are run and coming to their own conclusions?

Michael Zander
(It's part of the great history of the common law that judges somehow manage to cope with areas of specialist knowledge with which they are not particular familiar or maybe not familiar at all.)

One interpretation of this ruling was that up until then society essentially trusted actuaries trusted the people running these pension funds to do the right thing for everyone. A very complex mathematical issue, who to pay, what, when and the judges came in and said they got it wrong, do you think that the judges realised that they were undermining that trust or reversing the trust that society had previously been given to the actuaries that used to work out these sums?

Michael Zander
(I don't believe that that would have played any part in their consideration, what also didn't play any part in their consideration and this I think is a real point of criticism, is that they simply didn't seem to understand the consequences for the company and all its members of their decision and if they had their decision again today, a second go as it were I am sure that they will decide the other way as they can now see the result of what they did and they will undoubtedly have felt in the interim "my God we did the wrong thing" if there is nothing to choose between the two legal technical arguments then of course they ought to give the decision to the side that what the lawyers call the merits in other words justice and if they ignore the merits simply pretend that all their own business to do is to decide technicalities, what is the law, the law is the law is the law without regard to the consequences, then the law often turns out to be an ass.)

Professor Michael Zander. Someone else who had money in Equitable was Liz Kwantes. She's formed an action group that now hopes taxpayer’s money will fund losses faced by those who lost out under the Law Lords ruling.

Liz Kwantes
(I actually blame the regulators for it, I mean I'm sure that the management must have done something incredibly wrong for it to have happened, but on the other hand somebody else didn't stop them doing it, we have regulators therefore what were they regulating? The government should actually give us compensation for the enormous amount of heartache that people have had to go through because of the Equitable.)

How big do you think that this financial black hole now is?

Liz Kwantes
(We worked out that it was about 3.2 billion.)

Pounds?

Liz Kwantes
(Pounds - quite a large amount.)

6 billion dollars, it's huge.

Liz Kwantes
(It is a huge amount but when you are talking about over a million people who were actually involved in it, one can understand why it is such a large amount of money.)

Do you not have any sympathy though with former directors people like Chris Headdon, who was the actuary and ran the company towards the end, because they all say they were simply paying out the money according to the rules at the time? If the law lords had confirmed that what they thought was confirming the whole principle of the way mutuals worked, then they would have done nothing wrong, Equitable would have carried on paying out the best returns in the industry.

Liz Kwantes
(No I don't think that is correct actually at all, I think that they were running an organisation, they should have been very much aware particularly in Chris Headdon’s case, he was an actuary so he did understand money and how the financial industry worked and life companies worked and he knew that there was a problem in the early 90's. I mean they had actually discussed the problem, he had even written a report on it, so I don't think that is any argument at all.)

A recent BBC television programme reported on many cases of people who argued they'd lost out under Equitable's old two tier bonus policy under Chris Headdon. In particular, one policy holder Linda Brown was used as an example.

Linda Brown was paid four thousand pounds a year under Equitable's rules in the year 2000, but the guaranteed annuity rate was said by some to be £5000.

Chris Headdon was chief executive at Equitable when Linda Brown was told by the firm that her pension was worth 4,000 pounds a year.

I asked Mr Headdon about the view that she should have been given £ 5,000 - had he robbed her of £ 1,000 a year that should have been hers.

Chris Headdon
(Absolutely not, this goes to the very essence of what the whole issue was about that we were

operating a bonus policy that was trying to provide benefits of fair value to each policy holder and the 4000 was the economic value of the pension that had built up in her fund.)

So 4000 was absolutely a fair return for her based on what she had paid in?

Chris Headdon
(Absolutely.)

So why do you think that she was so convinced that she should have had £5000 a year?

Chris Headdon
(Because people had created this expectation that the guaranteed annuity rate was some sort of additional benefit on top of the contract and you should get a windfall benefit through having it.)

So you are saying that the people who were portrayed in the 90's as the victims, the people who had been denied their rights to have the guaranteed annuity rate and the bonus, you are saying that what you gave them was full and fair?

Chris Headdon
(We thought that it was absolutely consistent with the full and fair approach that we tried to follow in all our business.)

So why then did the law lords rule against you and say it wasn't full and fair?

Chris Headdon
(Well I am not a lawyer; I mean other people have expressed views on the quality of the House of Lords judgement. Some people have said that it is a rather tortured attempt to find a justification for review, but I think that the Law Lords view frankly was irrational and cut across the principles of mutuality in the way that with profits business has been run in this country.)

Do you think that the law lords really understood the consequences of what they were doing?

Chris Headdon
(Well I now think that they can't have because in a mutual fund - I mean we actually started our case in the House of Lords by saying that this whole issue is about how you fairly divided up the assets within the mutual fund between different groups of policy holders, but the Law Lords seem to have completely ignored the interests of all the policy holders without guaranteed annuity rates or indeed people with them who didn't want to make use of the guaranteed annuity rates.)

There was a risk growing in the 1990's, not given much publicity at the beginning but certainly was increasingly, that the Law Lords might not agree with you, that they might rule against you. Shouldn't you have prepared for that? Shouldn't you have put money aside in case you lost?

Chris Headdon
(Clearly one can run an organisation in a number of different ways and one can run it on what you might call a very safety first approach and consistently hold money back from each generation of policy holders so that you have created a contingency fund so that if something unexpected comes at you from leftfield you have created that fund of money to deal with it. Or you can try to operate in a more full distribution way and you cope with events as and when they arise. Now there are intellectual arguments in favour of each of those but it is not clear to me that one is not necessarily better than the other, under the former you may well pay people for generations and just build up assets that are never needed. We were very open about the fact that we were trying to run in a full distribution way and I don't see any evidence that we were out of line with the market in any way.)

If the House of Lords judgement hadn't gone against you would you still be in trouble? Or in worse trouble than anybody else?

Chris Headdon
(I have got no evidence for thinking so.)

There was nothing else in Equitable, the way you were running the fund, the things that you were investing in, there was nothing else that could be construed as mismanagement or imprudence?

Chris Headdon
(I believe not, I mean we clearly didn't have an extra buffer of assets compared to an office run on a different philosophy, so we may have needed to adjust our investment mix earlier than perhaps some other companies but I think that we would have come through the period in the same way that other people have.)

What do you say to the current Equitable management, your successors, who are now trying to sue you for behaving wrongly in the 90's?

Chris Headdon
(I am saddened by it and I find it difficult to understand the thinking behind it. There are 2 things in particular which have been said which I find difficult to understand. The one is that from the outset the current board have said that they would only pursue the litigation if it was economically sensible to do it. The costs that have already been run up alone would exceed the assets that they would recover from a significant number of the directors so I really don't understand any economic justification for spending more policy holders money than can possibly be recovered by the action. The other thing that I find curious is that Mr Treeves, the chairman, insistently says that they have had no choice but to do this because of the strengths of the legal advice that they have been given. Now as a lawyer I would have thought that legal advice was legal advice and you then took your own view on the basis of that and so I find this picture that they've

been pushed into by the lawyers really quite a difficult one to understand.)

How do you feel now when you see examples of Equitable policy holders who are not getting the same return anything like the return that they were expecting?

Chris Headdon
(I am saddened by it because I think that we had an institution that was extremely customer focused and for many years tried to do its very best to treat people fairly and offer the most attractive products in terms of flexibility and suitability to peoples life styles, while producing good returns and this guaranteed annuity rate issue has really wrecked 200 years of history.)

Do you think that journalists overall were reporting this story fairly?

Chris Headdon
(No I don't.)

And why do you think they're not?

Chris Headdon
(I think that throughout this issue it was a more attractive story that a large institution was doing down some group of policy holders, and you know, I think the then management must take some responsibility for failing to get the other message across and we tried very hard to explain the equity of the situation and look at the position of all the policy holders and despite the efforts we made that didn't happen and really I think that that theme has carried on ever since.)

The financial authorities say that they are referring parts of Lord Penrose's report to the serious fraud office, how do you feel about that?

Chris Headdon
(I find that very surprising. The current board have had a very experienced and say aggressive litigation looking at this for the last 2 years. They have consistently said that they have seen no evidence whatsoever of fraud and accepted from the outset that all the directors had acted honestly on what they had done. So I find that very surprising. I am actually quite angry about it. I think that some journalists have speculated that this is a somewhat cynical political manoeuvre by the treasury and the end result is that our reputations get smeared because there is left a lingering doubt that there was something fraudulent going on, its just that the SFO can't find enough evidence or don't think that it is worth taking on and I think that that is unfair. I also think that using the Penrose results in this way is an act of bad faith. As I said a number of us have participated very freely in that. We were told that Lord Penrose's brief was not to ascribe blame to people, that he was enquiring into the facts, not conducting a forensic examination of the behaviour of particular individuals and we participated on that

basis. We have had really no opportunity to see what he has concluded from what we have told him so whether we believe that he's interpreted what we've told him accurately or not and then to find that the results have been shipped off to the SFO, to me feels like at a minimum act of bad faith given the basis on which we were encouraged to participate with him.)

The mix of disastrous events of the past decade means few are convinced that savings are worthwhile. The savings crisis is set to deepen.

And that's it from this World Business Review

^^Back to top

Front Page

News | Sport | Business | Entertainment | Science/Nature
Technology | Talking Point | In depth
Learning English | Programmes | Schedules & Frequencies | Site Map

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