3 PROPOSED APPROACH TO APPORTIONMENT

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

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

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

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

Principles to be applied in making an apportionment

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

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

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

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

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

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

Whose conduct should give rise to a notional apportionment?

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

> "*83. As for the regulatory system, I do believe that it has failed policyholders in this case. This is not, in general, because of individual failures. I do not pin that blame on individuals, who in the main have operated in good faith and to the best of their abilities within the system as they found it. But I do take the view that the system itself was not overseen, and in particular was not kept up-to-date, and operated in an ineffective manner.*
>
> *84. The deficiencies are not so obvious as some are inclined (or wish) to believe. And, it is seldom enough, and it is not enough in this case, to infer from the coincidence of systems deficiencies and loss that one caused or contributed to the other. Principally, the Society was author of its own misfortunes. Regulatory system failures were secondary factors. The jurisdiction to adjudicate on regulatory failure in duty is not mine. Even less is it for me to comment on how government should respond if it were to acknowledge that there had been regulatory failure. But it may be appropriate to comment that the practices of the*

[12] The Law Commission's provisional views as to what should constitute a "truly public" action are set out at paragraphs 4.110-4.115 of the Consultation Paper.

[13] See paragraphs 4.190-4.195 of the Consultation Paper.

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

[15] See the Executive Summary at page 3 and paragraph 2.9 of the Response.

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

3.9 The Penrose Report was critical of those who were responsible for managing Equitable Life throughout the period covered by the Ombudsman's Report in a number of respects; and, in particular, critical of the Board (see the summary of conclusions at Penrose 19/83-115) and of the Executives (see the summary of conclusions at Penrose 19/116-137).

3.10 In the light of that criticism it is not difficult to see why some (perhaps, many) would consider it appropriate to apportion policyholders' losses as between the regulators and (effectively) Equitable Life's former management. Some suggestions as to the basis on which this might be done were made to the PASC in 2008, as recorded in paragraphs 70-78 of its Report, "Justice delayed: the Ombudsman's report on *Equitable Life*".

3.11 In deciding whether it would be appropriate, in the present case, to make a notional apportionment of loss between the public bodies and regulators and Equitable Life's former management, it seems to me that I need to give weight to the following matters.

(i) There has been substantial investigation of the relevant events since the Penrose Inquiry. In particular, Equitable Life has brought proceedings against its former directors (and auditors). These proceedings came to a halt shortly before oral closing submissions were to be made, and after extensive evidence had been heard. I understand that the proceedings were settled on terms under which Equitable Life recovered nothing; and paid a contribution to some of the defendants' costs. In these circumstances, I cannot assume that those responsible for managing Equitable Life during the 1990s were culpable on the basis of the matters set out in the Penrose Report.[16] To reach a fair view on the issue of culpability would require me to examine in detail many of the issues raised during the litigation; and to examine extensive documentation, including some documents that may be covered by legal advice privilege. I do not consider this to be compatible with the need for an expeditious process.

(ii) There is a difficult question as to how far it can be said that potential mismanagement by Equitable Life itself was responsible for policyholders' losses, if those losses are to be assessed on a relative basis. To the extent that Equitable Life declared excessively generous bonuses in the early 1990s (if this occurred), this would be taken into account if I adopt the more flexible approach of assessing all policyholders' losses by reference to the date on which they first joined the Society (or the appropriate start date if this is different). Moreover, if the performance of Equitable Life's funds is to be measured by reference to a notional comparator modelled on the assumption of, say, a lower quartile investment return (as to which I have invited representations), it may well be said that there is already, effectively, a discount applied to take account of the fact that

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

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

(iii) The purpose of regulation was to serve as a check upon the actions of Equitable Life (including its directors and Appointed Actuary): that is, (a) to ensure that certain information concerning Equitable Life's financial position that was in the public domain was reliable and (b) to prevent policyholders suffering loss as a result of certain improvident actions by the Society and its officers. Therefore, losses of the kind that have been found by the Ombudsman could be said to be losses of the very kind that the system of regulation was in place to prevent. This, it seems to me, is the primary principle that I should have in mind in considering whether or not notionally to apportion some of the losses experienced to the Society itself.

3.12 I recognise, however, there will be circumstances in which it would be right to depart from the primary principle identified at sub-paragraph (iii) above. The system of regulation in place at the time relevant to the accepted cases of maladministration was based on the expectation that the regulated body would deal with the regulator in good faith. In a case where there has been a significant departure from that expectation, there is no longer a proper basis for the application of the principle.

3.13 I have considered whether this may be so in the present case in light of the findings of the Disciplinary Tribunal of the Institute of Actuaries against Mr Christopher Headdon (who was at the relevant time the Appointed Actuary of Equitable Life) in relation to his failure to disclose a side-letter to the reinsurance treaty to which the Ombudsman's Sixth Finding related. The Disciplinary Tribunal concluded that:

> "*Mr Headdon should have disclosed the [side letter] to the FSA and it was plainly wrong of him not to have done so ... The system of the Appointed Actuary is heavily dependent upon open disclosure and dialogue with the Regulator and any material departure from complete openness and candour brings discredit to the profession.*"[17]

3.14 My current view is that this finding is significant and may be sufficient to take the case outside the primary principle to which I have referred. If Mr Headdon *had* revealed the existence of the side-letter to GAD, then it seems to me that GAD would have been almost bound to decide that the reinsurance treaty had no value; and so would have refused to allow Equitable Life to rely on it in its 1998 regulatory returns. If this view is correct, then it follows that Mr Headdon's lack of openness and candour was one of the causes of the losses flowing from the Ombudsman's Sixth Finding. It may well be appropriate to make a notional apportionment to reflect this.

3.15 I am conscious that the Ombudsman has expressed the view (1/10/478) that the side-letter did not have "*any impact on the amount of offset that the Society could take for the [reinsurance treaty] within its regulatory returns*", and has stated that she disregarded the

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

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

3.16 I note, also, that the investigating committee of the Institute of Actuaries had initially brought charges against Mr Headdon in relation to Equitable Life's regulatory returns, but that these charges were withdrawn following consideration of his written defence.[18] I need to reach a better understanding as to how closely those charges corresponded with the Ombudsman's findings in relation to Equitable Life's regulatory returns before I can reach a conclusion on whether to make an apportionment on the basis of Mr Headdon's conduct in relation to the side letter.

3.17 The second party whose conduct might be said to give rise to a notional apportionment of loss is the auditors. The audit was covered by the Penrose Inquiry, although Lord Penrose stressed that it was not part of his remit to express any views on the auditors' performance of their contractual or professional duties.[19] For this reason (as well as the collapse of Equitable Life's case against the auditors in the court proceedings), I would not consider it appropriate to make a notional apportionment to reflect the auditors' conduct on the basis of the Penrose Report.

3.18 But I am aware that disciplinary proceedings against Ernst & Young in respect of the audit of Equitable Life have been brought under the Joint Disciplinary Scheme of the Institute of Chartered Accountants of England and Wales; and that those proceedings are now close to a conclusion. The nature of the charges, and the report of the Tribunal which decided the proceedings based upon them, have not yet been made public: they remain subject to a non-disclosure order pending an appeal by Ernst & Young.

3.19 It does not seem to me that a notional apportionment in respect of the auditors' conduct could be subject to the objection that it impinged upon the primary principle to which I have referred earlier. Unlike the Society itself, the auditors were in the position of being fellow "watchdogs" with the regulators. The auditors, like the regulators, had responsibilities in relation to information concerning Equitable Life's financial position that was in the public domain; and the regulators had no responsibility to ensure that the auditors performed their task properly.

3.20 My present intention, therefore, is to wait until the findings in the disciplinary proceedings against Ernst & Young are published (following appeal) before expressing a view as to whether those findings provide a basis for a notional apportionment of some policyholders' losses on the basis of the auditors' conduct. If they do not do so, I am not, at present, minded to make a notional apportionment of loss on the basis of any alleged failings by the auditors.

[18] See pages 2-3 of the executive summary of the Disciplinary Tribunal's findings, cited above.

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

Conclusions

3.21 At paragraph 3.8(ii) of the Proposals, I expressed the view that I should seek, so far as possible, to avoid the need for any form of "maxwellisation", on the ground that that could result in substantial delay in giving advice under my Terms of Reference, which would be inconsistent with the need for expedition. There was no substantial objection to this approach, and I intend to adopt it.

3.22 With this in mind, I invite representations as to whether I am correct to proceed in the manner set out above. In particular, I would be assisted by representations directed to the following questions:

(i) Subject to the matter of the side letter, would it be right to make no apportionment of losses in respect of the actions of the former Equitable Life management?

(ii) Would I be correct, in relation to the auditors, to limit myself to the findings made in the disciplinary proceedings?

(iii) Are there persons other than Equitable Life and its auditors (and if so whom) in relation to whose conduct policyholders' relative losses might properly be apportioned?