

## **EQUI in the light of PO**

### **“Report on the Crisis of the Equitable Life Assurance Society” in the light of the Report by the UK Parliamentary Ombudsman “Equitable Life: a Decade of Regulatory Failure”.**

#### ***Introduction.***

In February 2006 the European Parliament established a Committee of Inquiry into the Crisis of the Equitable Life Assurance Society. The Committee published a report in May 2007 entitled “Report on the Crisis of the Equitable Life Assurance Society” which we refer to as EQUI-R. That report was subsequently adopted by the European Parliament in June 2007 with a majority of 611 votes to 11.

The UK Parliamentary Ombudsman conducted an inquiry into the Equitable Life Assurance Society and published a report in June 2003. After protests that that report was inadequate she decided to institute a further inquiry. That inquiry has resulted in a new report: “Equitable Life: a Decade of Regulatory Failure”, laid before Parliament on 16<sup>th</sup> July 2008 (we refer to it as PO-R). The Parliamentary Ombudsman has made it clear that her first report has now been withdrawn and is completely superseded by her second report.

The purpose of this paper is to draw attention to the support that PO-R gives to the findings of EQUI-R with some modifications. EQUI-R recognised the limited jurisdiction of the PO (vide p. 243) which only covers the question of whether there was maladministration leading to injustice by the UK regulators – the Treasury, the Financial Services Authority (FSA) and the Government Actuaries Department (GAD). PO-R’s findings are therefore based on a more limited remit but the final result is identical to EQUI-R in recommending that the UK parliament compensate those who have suffered loss through injustice arising from maladministration. The PO had the advantage of being able to compel witnesses and demand the production of documentary evidence.

However, whilst more limited in its remit and jurisdiction PO-R has revealed a vast amount of new evidence surrounding the Equitable Life Assurance Society (ELAS) affair. Much of this evidence relates to matters which were within the remit of the EQUI committee.

#### ***The findings of the Parliamentary Ombudsman’s report.***

The findings of the Parliamentary Ombudsman appear in Part one of PO-R but are summarised in Part five. The PO went through a process of first making finding of

facts, then deciding whether those facts amounted to maladministration and finally whether such maladministration led to injustice. She made ten determinations as to maladministration which appear in Section 6 of part five of PO-R. We summarise them, very briefly, as:

- (1). Failures by the regulators in respect of allowing the holding of the position of Chief Executive and Appointed Actuary by the same person.
- (2). As regards regulatory returns for 1990 to 1993 failure by GAD to question and seek to resolve questions concerning the valuation of liabilities and bonus declarations.
- (3). Failures by GAD regarding the Society's Differential Terminal Bonus Policy (DTBP) which was subsequently disallowed by the Hyman case.
- (4). Further failures by GAD concerning the regulatory returns from 1994 to 1996.
- (5). Further failures by GAD regarding the 1995 return.
- (6). Failure by the FSA in not seeking a concession under s.68 for the reinsurance treaty to be allowed in the 1998 return and failure to ensure that the credit taken for the same in the 1998, 1999 and 2000 returns was economically sound.
- (7). Failure by the FSA to ensure the disclosure in the 1998 and 1999 returns of the potential impact of losing the Hyman case.
- (8). Failure by the FSA to record their decision to allow ELAS to remain open to business after the loss of the Hyman case.
- (9). Failure by the FSA in allowing ELAS to remain open after the loss of the Hyman case.
- (10). Failure by the FSA in providing misleading information after the Society closed to new business in December 2000.

In respect of (1) EQUI-R made a similar finding at page 117. Findings (2) to (5) arise from the extremely detailed consideration of the regulatory returns and the regulators handling of them. These are issues involving much complex actuarial expertise which EQUI-R was not in a position to pursue other than briefly as appears on page 198 of EQUI-R. PO-R provides the detailed facts in support of the conclusions in EQUI-R. Finding (6) relates to the reinsurance treaty which is a story that has now come to light in long and dreadful detail to which we return. Failure (7) was part of the failure to recognise the GAR risks dealt with at page 199 of EQUI-R. Failure (8) to (10) confirm EQUI-R's conclusions about the Compromise Scheme on page 200.

Having made her findings of maladministration the PO then goes on to determine whether they caused injustice in Section 7 on page 31 of Part five of PO-R and she so determines in respect of all 10 findings concluding that they caused financial loss, loss of opportunities and a justifiable sense of outrage. On this basis the PO recommends an apology by the regulators. Secondly she recommends that the Government should

establish and fund a compensation scheme. Those who are to be compensated are those who relied on any of the returns from 1990 onwards and in particular those who paid money to the Society after 1<sup>st</sup> May 1999. Thus this is a comprehensive recommendation very similar to that made by EQUI-R. It must be borne in mind though that this is purely a recommendation which the UK government is not bound by.

For a more detailed overview and commentary on PO-R we would recommend reading a paper prepared by Messrs Burgess Hodgson which deals with the complex actuarial aspects and the regulatory returns. It is available at ??????????

### ***Two important modifications to the story.***

Firstly contrary to what EQUI-R found, PO-R says that the regulators were at all times adequately resourced.

Secondly PO-R makes it clear that it was not the Hyman case decision in the House of Lords that was the key event but the failure of ELAS to reserve for the costs of the Guaranteed Annuity Rights (GARs). This was an issue that arose in 1998 and the regulators insisted that ELAS make reserves of some £1.6 billion in respect of the GARs. Essentially the regulators were requiring ELAS to reserve for the cost that would arise if a policyholder with a Guaranteed Annuity Right were to choose such on the basis of their fund including guaranteed bonuses but not in respect of non-guaranteed or final bonuses. The House of Lord decided in the Hyman case that a policyholder with a GAR was entitled to have it based not only on his fund including guaranteed bonuses but also in respect of non-guaranteed or final bonuses which could not be cut arbitrarily depending upon whether the policyholder, ex post facto, opted for the GAR or not. Thus ELAS was undoubtedly insolvent from the end of 1998 onwards and the Hyman case in July 2000 merely added a few hundred millions to the pre-existing £1.6 billion. But the Hyman case had the effect of publicising the whole problem which had existed from 1998 but had been deliberately hidden as we go on to explain.

### ***The Reinsurance Treaty and Collusion.***

A great deal of new evidence has come to light about the reinsurance treaty from December 1998 onwards. Up to that point there had been maladministration leading to injustice by the regulators. However with the reassurance treaty there is now evidence to show that this continuing maladministration turned to collusion by the regulators with ELAS to mislead and deceive policyholders and the world at large about the true state of ELAS's finances.

At the end of 1998 the regulators (the Treasury, FSA and GAD) were insisting that ELAS find assets to cover the liability for the Guaranteed Annuity Rights amounting to £1.6 billion. GAD (Government Actuaries Department) suggested financial reinsurance. In January 1999 ELAS produced terms of such a treaty for financial reinsurance which simply said that if a claim arose nothing would be paid in respect

of such claims. When shown to the GAD, the GAD said to the FSA (Financial Services Authority) that the treaty did **“not achieve the intended reserving effect for a number of reasons”**. What exactly did they mean by that statement? Were they saying that it was a complete fiddle and should not be allowed or were they saying that it was a fiddle that needed **“window-dressing”**? Examination of the Chronology (part three) in PO-R tends to suggest the latter interpretation. During the early months of 1999 the GAD entered into talks with ELAS to modify amend and lengthen the agreement, finally agreeing to it. The Treasury, the FSA and the GAD in their response to the PO say that that version of events was entirely correct. The GAD fathered the treaty and acted as midwife in bringing it to birth.

Nobody, in their right minds, looking at the tiny premium payable or the terms of the treaty could have thought that it secured cover for £1.6 billion. The Parliamentary Ombudsman said that the acceptance of the treaty by the Regulators **resulted in the true financial position of the Society being concealed and misrepresented through the publication of returns which contained a misleading picture of the Society’s solvency position**. She found maladministration leading to injustice as a result. That was the limit of her function as Ombudsman. However does this connivance and assisting in **window-dressing** by the regulators leading to concealment and misrepresentation not raise much more serious questions than just maladministration? According to the PO the acceptance of the reinsurance treaty was a **“critical juncture”** in the whole story. It can fairly be said that up to that point there was regulatory failure – maladministration – but here we move into more serious delicts to be followed by a litany of attempts to hide the truth, prevaricate and further the injustices done to the policyholders. To what extent the Ministers, then in charge of those departments, were aware of what was going is not clear; however an explanation and acceptance of responsibility from them is mandated.

In particular the PO found that as the treaty was not signed until October 1999 a reporting concession under s.68 ICA 1982 should have been sought if the treaty was to be used in the regulatory return made as at 31<sup>st</sup> December 1998 i.e. the previous year. No such concession was sought by the regulators. EQUI-R criticised s.68 as being incompatible with the Third Life Directive (3LD) – page 116 on the grounds that it gave too much power to waive the application of prudential regulation. EQUI-R at page 66 mentions the excessive use of s.68 to approve the use of future profits. Why was no concession sought in respect of the reinsurance treaty? One can only speculate. Did the regulators not want to implicate the Secretary of State in this collusion? Was it something that they preferred to keep hidden? Did they think that even with the UK’s egregious s.68 this was a step too far? These are questions which the Secretary of State should respond to in order to clarify just who was responsible for this episode of collusion.

For a detailed account of the negotiation of the reinsurance treaty based upon the Chronology in PO-R we attach a paper entitled: **The Reassurance Treaty** prepared for EMAG.

### ***The Cover-up***

Once the Rubicon had been crossed from mere maladministration to actual collusion by the regulators with ELAS it became necessary to try and cover-up the failures of

the Regulators at all costs. The insurance industry was not going to assist in any bailout of ELAS as they regarded it as the regulators fault and if the Government were to bail them out one needs to look at the words of the Chairman of the FSA, Howard Davies, who *said if the government put money into the company, it would be interpreted as a problem with the past regulatory regime.* See the entry for 25/07/2001 in PO-R Part three – Chronology.

Whilst EQUI-R at page 200 had found no evidence of such collusion by the regulators with ELAS this Chronology in PO-R now provides ample evidence of such a collusive cover-up. The Chronology reveals a disturbing litany of attempts to conceal and cover-up; a reading of the Chronology suggests:

**1. That the regulators repeatedly claimed that the Society was solvent when it was not.**

Anyone reading the Chronology for 2001 will soon realise that there were doubts about regulatory solvency throughout that year. In July 2001 matters came to a head when there was a requirement to pay interest on a loan in August 2001 which would mean that ELAS was insolvent for Companies Act purposes let alone regulatory purposes. The slow realisation that they could no longer pretend that the reinsurance treaty was other than worthless coupled with legal advice that policyholders had valid claims for mis-selling which could amount to £5 billion led to a crisis at the end of July when the Society was within hours of going into administration. The only reason for its not doing so was an assertion that the Society was solvent by the Chairman, Vanni Treves. What figures he had to justify that assertion are not explained. The FSA said they had no figures to challenge his figures which was not surprising considering there were no figures. Yet all along the regulators were telling the world at large that ELAS was solvent in every way. They even told the Minister, Ruth Kelly, that in fact they based their view on solvency in July on the “latest figures” – their “latest figures” related to the previous March i.e. were already four months out of date.

It is notable that several witnesses informed the EQUI committee that ELAS was always solvent:

Pages 76 & 110: David Strachan of the FSA: “Equitable has always been solvent”.

Page 110: Alan Beverley of the Commission had evidently been misled on this “Equitable did not become insolvent”.

Page 169: Maxwell of the UK Treasury “the society did not go insolvent”.

Page 169: Strachan of the FSA dismissed: “*any misperception that Equitable Life has in some sense ‘collapsed’ or ‘failed’ in solvency terms ... at all times the company has remained solvent”.*

Page 249: “ELAS rejects these allegations, stating that the fund has never been ‘technically insolvent’. Mr DAYKIN (of GAD) and Mr STRACHAN also emphasised that the company had always been solvent ... MR THOMSON (of ELAS) ... “*I still believe that it was never insolvent at any point of time*”.

Those statements are now seen to have been clearly untrue. Just to take one example from the Chronology of Events when everyone in the regulators thought that ELAS was about to go into administration because of insolvency:

26/07/2001 [16:59] :

*3. They [ELAS] were clearer now (but still not crystal clear) that 1st August was the date by which irrevocable instructions had to be issued to make the payment due on 6 August. Thomson thought that it might be helpful if by that date, FSA had not received firm advice on the likely quantum of misselling liability.*

Effectively this was a suggestion by Charles Thomson that they should ignore the fact that they had had legal advice suggesting a liability of up to £5 billion. This is what they largely did in their subsequent pretence that they were solvent.

[An interesting sideline in view of recent events is that Halifax (a subsidiary of HBOS) on that same day was refused a line of credit unless they could put up \$5 million collateral. This was because of the rumours surrounding ELAS's solvency; the insurance industry was beginning to panic. HBOS (Halifax Bank of Scotland) has had to be rescued by the UK in recent weeks.]

**2. That when a new Board was being appointed the regulators did everything to prevent any genuine representative of the policyholders from being appointed.**

The Chronology tells us:

02/04/2001 [no time]

*FSA supervisors and management meet to discuss Equitable (and another insurance company [Axa]). They note that policyholder action groups may wish to nominate candidates for Equitable's Board (the appointments were to be voted for at the annual general meeting on 23 May 2001).*

*It is agreed that FSA will consider whether they would wish to use their intervention powers to prevent such candidates from being appointed.*

The regulators even considered putting ELAS into liquidation if "unsuitable" members of action groups got onto the Board. See 11/04/2001[14:30]. Perhaps they feared such "unsuitable" people might have learnt the truth?

At one point the Chronology reads:

12/04/2001 [09:45] Whittaker - Director of FSA's General Counsel Division writes to Ford about FSA's meeting with Equitable on 04/04/2001 [11:00]. He raises four queries about the note including, in relation to Board appointments, he says:

*'I do not know Jeremy Lever QC, but it sounds very odd to regard him as of insufficient calibre. This sounds like just an excuse to keep action group members off the Board.'*

Sir Jeremy Lever QC is a fellow of All Souls, Oxford. It would be difficult to find anyone of greater academic and legal eminence.

**3. That the regulators endeavoured to suppress legal advice that anybody joining the Society since 1988 had substantial mis-selling claims against the Society.**

When ELAS and the regulators received legal advice in the summer of 2001 that there were possible mis-selling liabilities of up to £5 billion the regulators tried to suppress publication of that advice. At one point – 01/08/2001[entry 1] – the FSA drafted an order under s.45 of the Insurance Companies Act 1982 to prevent publication.

**4. That the regulators allowed misleading and out-of-date financial information to be used in the Compromise proceedings thereby deliberately deceiving the Court.**

This relates to the tenth finding of maladministration in PO-R and we expand further on this when dealing with the Compromise.

**5. That the regulators allowed the Society to conceal the date of the Court hearing from the policyholder action groups so as to interfere with the course of justice.**

Again this relates to the Compromise which we deal with later.

**6. That the regulators persuaded the PIA (who were responsible for the conduct of business by the Society) not to take action against the Society.**

The PIA (Personal Investment Authority) argued strongly for action against the Society on behalf of policyholders who were complaining but the regulators persuaded them to take little or no action.

**7. The Office of Fair Trading was protesting strongly about the treatment of the Society's policyholders. Under the Financial Services and Markets Act 2000 the regulators were able to take over these complaints and promptly binned them.**

Again the Chronology explains how complainants to the Office of Fair Trading had their complaints ignored and buried at the instigation of the FSA.

**8. The regulators used their influence over the Financial Ombudsman Service to ensure that anybody who complained had their claim thrown out or minimised.**

There is further evidence of interference with the Financial Ombudsman Service. Effectively the FOS were being asked to “buy in” to the cover-up by the FSA.

For example see the entry in the Chronology for **30/08/2001 [12:41]** where the PIA suggest to the FSA:

*If, on the other hand we take the view that such fairness and reasonableness is dependent upon maximising the opportunities for non-GAR policyholders to get the maximum compensation, then manifestly we can only advise that they should leave their options open. To head this one off we would have to get the [Financial Ombudsman Service] to sign up to our position (which I would have thought they could do without compromising their freedom to look at each case individually). That would leave the courts as the only alternative avenue still open.*

*The attached could be laced with more explicit warnings that the society can/could stand only so much financial strain before insolvency beckoned, including as a result of any “better deal” from the [Financial Ombudsman Service]. The problem here is that attention could turn to an industry (or even Government) bail out.*

*We can only decide what to say and how far to go once we have [crystallised] the outcome we want from the compromise agreement and whether or not we have a chance of getting the [Financial Ombudsman Service] to buy-in to our position as set out in the attached.*

The whole story of how ill-served the policyholders were by the regulators has been set out in greater detail in a paper by Alex Henney:

### ***The Compromise.***

The form and documentation of the Compromise scheme was the subject of constant discussion between the FSA and ELAS from January 2001 onwards. It was seen as necessary to remove the Guaranteed Annuity Rights of the GAR in exchange for an uplift. The industry were not prepared to bail out ELAS as they regarded the regulators as having been at fault. The Government were not going to bail out ELAS because to do so would be admitting regulatory failure. The Government were not prepared to admit regulatory failure because the conduct of the regulators had gone much further than mere maladministration but ended up in a deceitful misrepresentation by means of a valueless Reinsurance Treaty.

In May 2001 the whole compromise looked like being upset because of the opinion of Nicholas Warren Q.C. that there was a mis-selling liability in respect of the non-GAR policyholders which could amount to as much as £5 billion – far in excess of the £1.6 billion which was considered necessary to transfer from the non-GARs to the GARs to cancel the GAR rights.

The FSA decided they should get:

1. An independent financial report on the state of ELAS.
2. An independent actuarial report on the size of the mis-selling claims.

The FSA got neither as ELAS’s Appointed Actuary, Peter Nowell, and the Chief Executive, Charles Thomson, threatened to resign if they did request such independent reports.

Instead the FSA agreed to accept reports prepared by Deloitte who were instructed by ELAS to carry out the reports. Deloitte, at the same time, were telling their public sectors to get out of ELAS as fast as possible.

Due to falls in the stock market ELAS became regulatory insolvent and was on the brink of Companies Act insolvency as a payment of interest was due on 3<sup>rd</sup> August 2001 which would mean they could not cover their guaranteed liabilities. Neither the industry nor the Government were prepared to bail out ELAS but the latter were prepared to change the law to allow ELAS to be put into administration which was seen as the best option. But then the Chairman of ELAS, Vanni Treves announced they were solvent on all counts but produced no figures to support this.

Shortly after this the reinsurance treaty started to unravel and this made the solvency position even more questionable.

Deloitte's presented the financial report on ELAS but made no mention of mis-selling claims or any doubts about the reinsurance treaty. Discussion continued about the mis-selling liability and it was seen to be necessary to nobble the Financial Ombudsman so that he did not make bigger rewards than what the policyholders might receive in the Compromise.

The FSA received a draft of the Actuarial Report from Deloitte which indicates considerable mis-selling liability. FSA lose the draft. When they get the final report they lose that as well and agree with ELAS to use a different much lower estimate of mis-selling liabilities whereby the £5 billion originally estimated is reduced to £220 million.

The consultation papers for the compromise were sent out on 20<sup>th</sup> September 2001 to policyholders despite ELAS having told FSA of a side-letter which cast severe doubts over the value of the reinsurance treaty.

FSA thought that policy values were still well above available assets and they might have to be cut immediately after the compromise so wiping out the 2.5% on offer to the non-GARs. They told no one.

The FSA then connived with ELAS in hiding the date of the first court hearing of the Compromise so that nobody else could be properly represented. At the same time they were advised by Counsel that the reinsurance treaty was worthless but they still put out a press statement that the side-letter was of no importance as the treaty had been renegotiated so the treaty was quite alright. ELAS repeated this misrepresentation of the position in the Scheme Documents sent out in December.

Two days after sending out this press statement, the FSA finally admitted that the reinsurance treaty was worthless making ELAS regulatory insolvent. They told no one except ELAS who disagreed.

The FSA allowed the compromise to go forward:

1. Knowing that the financial information – balance sheet at 30<sup>th</sup> June 2001 – was now out of date and misleading because the company was regulatory insolvent.

2. Knowing that the uplift for the non-GARs was probably illusory and that the policyholders should at least be warned about this.
3. Knowing that the reinsurance treaty was worthless
4. Having connived at hiding the date of the convening hearing.

In view of their statutory obligations to protect policyholders were they not allowing the court to be misled? The Parliamentary Ombudsman found maladministration in that the regulators were guilty of misinformation but it does appear again that their behaviour went far beyond maladministration.

### ***Conclusion.***

Overall PO-R gives a very detailed account which supports the finding of EQUI-R that the British Government should compensate the policyholders. However the facts now revealed by the UK Parliamentary Ombudsman now show a much more reprehensible picture of what the regulatory authorities did which goes much further than just bad administration. The UK PO speaks of outrage and recommends an apology and the setting up of a mechanism for compensation. Four months after PO-R and over two years since EQUI-R the Government has yet to respond.

Quite apart from anything else it is felt that if the UK Government had tackled the shortcomings of the UK regulatory system back in 2001 some of the problems that have arisen in 2008 might have been avoided.

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