



Principles of compensation for Equitable Life sufferers

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PRINCIPLES OF COMPENSATION FOR EQUITABLE LIFE SUFFERERS

THE PARLIAMENTARY OMBUDSMAN'S REPORT

The Parliamentary Ombudsman ("the PO") recommended in July 2008 that the Government should establish and fund a compensation scheme to provide appropriate compensation. She went on to say that the aim of such a scheme should be to put those people who have suffered loss back into the position that they would have been in had maladministration not occurred. She recommended that such loss should be measured by comparison with investment elsewhere. She found that maladministration leading to injustice had occurred in respect of Equitable Life's regulatory returns for the years 1990 onwards. This set the start date for loss calculation at July 1991, when the first misleading return was filed for publication.

In Command Paper 7538 published in January 2009 the Treasury sought to undermine the PO's Findings and recommendations in three ways:

- a) It rejected various of the PO's Findings, which had the effect of significantly delaying the start date for maladministration and hence compensation.
- b) It proposed a reduction of compensation based upon the attribution of responsibility for some losses to Equitable Life and to other parties.
- c) It proposed to limit relief to an "ex gratia payment scheme" for those Equitable Life policyholders who have suffered a "disproportionate impact".

The Treasury appointed Sir John Chadwick to advise upon the extent of relative losses suffered by Equitable Life policyholders, upon the attribution of responsibility to non-regulators and upon "disproportionate impact".

Following the Judicial Review instigated by EMAG, the Court has held that the Treasury's rejection of the relevant PO's Findings was unlawful. The effect has been to reinstate the PO's start date for compensation.

EMAG continues its campaign for proper compensation and not an "ex gratia payment scheme". Compensation should benefit all policyholders who lost, not only those who have suffered "disproportionate impact".

THE CHADWICK PROCESS

The Parliamentary Ombudsman recommended:

- a) an independent tribunal with three members – one broadly representing the interests of citizens and one representing those of the relevant public bodies, with an independent chair
- b) that such tribunal should operate in a transparent manner
- c) that its process should be simple, not imposing undue burdens on policyholders
- d) that it should deliver the remedy as speedily as is possible

Such a tribunal would be answerable to Parliament.

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In its representation to the Public Administration Select Committee of January 2009 EMAG said:

“The ‘Chadwick Process’ falls a very long way short of the transparent and independent Tribunal recommended by the PO. Sir John Chadwick is a retired Appeal Court Judge, but in this instance he is merely acting as an advisor to the Treasury, itself found guilty, through its sub-contractor the FSA, of 5 counts of maladministration. Sir John owes no duty to Parliament and reports privately to the Treasury. He is not required to hear representations from interested parties. Parliament has no control over the timing of his work.”

EMAG’s views have not changed and it will continue to campaign for the establishment of the Tribunal recommended by the PO.

EVALUATION OF RELATIVE LOSS

Interpretation of PO’s Report

The Ombudsman’s Report forms the basis for the evaluation of loss. Particularly as regards matters of redress, it is a statement of broad principles aimed at securing justice for those who have been wronged. In EMAG’s view it should be interpreted in a spirit of fairness with the benefit of any doubt given in favour of policyholders. Treasury counsel’s attempt to interpret the PO’s Report in a legalistic and narrow manner failed in Court: this should be regarded as a precedent.

Inclusion

For the avoidance of doubt, the PO did not differentiate between types of policyholders in respect of loss evaluation: she made no attempt to categorise policyholders whatsoever. Although Equitable Life specialised in pension policies, the losses incurred by the holders of all types of with profits policies are to be included in loss evaluation, including life, endowment and investment policies. The Ombudsman specifically included the policies of those who are resident overseas. Also included are the policies of those who have died, those who have removed their investment from Equitable Life and those whose policies have been transferred to the Prudential.

In EMAG’s view, all with profit policies in existence during the period of maladministration should be eligible for evaluation of loss.

Transparency

In full accord with the PO’s recommendation for the conduct of the Tribunal, EMAG’s view is that it is vital that full details of whatever loss evaluation scheme is constructed are made public promptly, so that Members of Parliament, policyholders and their representatives can examine them. Furthermore, upon payment, individual loss calculations must be made available to policyholders in full. No information should be used from ‘confidential sources’ which might prevent this. Transparency is the key factor.

Equitable Life policyholders have strong reasons to be very wary of the activities of actuaries, especially those appointed and instructed by the Treasury and its subcontractors. Indeed in Court there was judicial criticism of the conduct of such

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actuarial advisers and those instructing them. It is essential that all actuarial reports used in the compensation process should be published promptly, together with the relevant instructions.

Methodology

In its estimates of aggregate relative loss submitted to the PO and to PASC, EMAG compared the results of representative premiums paid into Equitable Life over the maladministration period found by the PO with the average published results of the same premiums invested in competitor companies. This was our interpretation of the “relative loss” doctrine recommended by the PO. In principle, the loss evaluation methodology now proposed by Sir John Chadwick is identical to that used by EMAG.

Choice of Comparator - General

The selection of an appropriate comparator or yardstick is essential in evaluating relative loss. For practical reasons, EMAG’s estimates of loss used the average published results of competitor companies. Now that detailed premium information has been made available to Sir John, the selection of comparator can be refined.

As Sir John has been advised, the Society was unique. If its true financial position had been exposed, then policyholders would have chosen to buy the policies offered by competitors. The comparator should therefore be based upon the actual published results of those companies, with whom policyholders would most likely have invested. We would suggest a combination of the “top ten” with profit offices (weighted by market share) in the marketplace during the 1990s.

EMAG considers it inappropriate to try to create an “Equitable Life Lookalike” as comparator, since none existed. We also consider that it would be inappropriate to introduce an element of hindsight by selecting comparators based upon subsequent performance.

Comparator – With Profits Annuities

As regards with profit annuities, our researches show that the average investment was about £47,000. In EMAG’s view, if those buying lifetime annuities with funds of this order had purchased the products of competitor companies, then they would have been sold conventional fixed annuities, not with profits ones.

Firstly, this is a matter of practicality. Only a handful of companies sold with-profits annuities, whereas many sold conventional annuities.

Secondly, this is a matter of suitability. £47,000 would only purchase a small annual income and for such investors the security of that income is of paramount importance. If they had gone anywhere other than Equitable Life, then they would almost certainly have been sold a conventional annuity upon these grounds. The Financial Ombudsman Service maintains a library of historical annuity rates to calculate the compensation payable by those advisors who sell unduly sophisticated products to such investors. In EMAG’s view, for most with profits annuitants a conventional annuity is the appropriate comparator.

As regards those with larger retirement funds (say) in excess of £250,000, we accept that a with-profits annuity might have been a suitable investment. In such cases we suggest, that because there were few companies that offered this product and for practical purposes apart from Equitable there was only one company which

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dominated the market, the with-profits annuity offered by the Prudential should be the appropriate comparator.

Start Date

In estimating losses, EMAG used the PO's start date for maladministration of 1 July 1991. Sir John Chadwick proposes to use 1 January 1990. Either is acceptable. The vast majority of Equitable Life sufferers paid their premiums during the 1990s and for them the appropriate start date is the day when they paid their first with profits premium to the Society. The start date chosen for loss evaluation is consequently only of relevance to the minority who paid premiums before that date. We suggest that they be treated as having paid a notional premium equivalent to the accumulated value of the relevant policy upon that start date.

End Date

In estimating aggregate losses, EMAG selected an end date immediately following the 16% policy value cut of 16th July 2001, which was backdated to 31 December 2000. This was a practical expedient in the absence of detailed information upon the numerous subsequent departures.

For the purposes of calculating relative loss in respect of policies which have ceased, the date of that departure represents an appropriate end date. This includes those who have, subsequent to the closure of the Society to new business, converted pension policies into annuities and those that have died.

As regards continuing policies, in principle EMAG believes that the appropriate end date should be as close as possible to the payment date of compensation. This is vital for the computation of the losses of with profit annuitants, transferred to the Prudential in 2007, a substantial part of whose losses are still in the future.

Exit Penalties

In assessing loss, the comparator proceeds should be based upon a contractual exit i.e. without any penalties or charges of a notional nature. Many thousands of Equitable Life policyholders took non-contractual exits after closure and thus knowingly suffered various penalties. In the vast majority of such cases this action was taken in recognition that Equitable Life could no longer operate as a with profit office and to minimise their future losses. It would be quite inappropriate to assume that a similar non-contractual exit would have been required if funds had been invested in a comparator. In short, Equitable Life exit penalties should be included in relative losses.

RELIANCE UPON RETURNS

EMAG represented to both the PO and PASC that it would be impractical and unfair to base entitlement to compensation on the ability of individuals, many years after the event, to prove reliance upon the Returns. Instead we suggested an appropriate percentage deduction from all compensation. While accepting that this approach has some rough edges, it has the considerable advantage of enabling compensation to be calculated mechanically, without input from individual policyholders, thus considerably speeding up the process. We note that Sir John seems to have adopted our suggestion.

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Sir John suggests that no one percentage would be appropriate and that a series of different percentages be applied to the losses in respect of premiums paid at different times, to reflect the changing likelihood that those premiums would have been invested elsewhere. EMAG sees merit in this approach, but would comment that no such deduction should be applied to premiums paid after 1 May 1999, when but for flagrant maladministration by the FSA, the true awfulness of the Society's finances would have been made public. This is of particular importance to those who invested capital sums after that date. Furthermore any deduction made in respect of earlier premiums should be separately quantified on both an individual and aggregate basis.

As regards suitable percentages, we suggest that Sir John takes note of the view expressed by the PO in her 20th August letter to him:

"In essence the view expressed in my report is that, absent the serial maladministration I had determined occurred from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period instead of going to another life insurance company".

INTEREST

The PO in her publication 'Principles for Remedy' requires simple interest to be added at a reasonable rate from each end date of loss evaluation to the date of payment. EMAG believes that because of the nature of the loss, the amounts involved and the long Treasury-inspired delay, compound interest would be more appropriate. EMAG suggests the rate of interest charged by HMRC on unpaid taxes or the rate charged by the Courts.

TAXATION

Sir John may be aware that the taxation of compensation is one of the most complex aspects of UK tax law. EMAG suggests that:

- a) Losses should be calculated ignoring taxation.
- b) Taxation should be estimated, where appropriate, and the loss should be reduced by that notional charge to give the amount of compensation.
- c) All compensation payments should be made free of tax.
- d) An appropriate section should be included in a future Finance Act to eliminate the risk that HMRC may not agree.

RESPONSIBILITY

EMAG generally supports the PO's view that compensation should not be reduced by the notional contributions of non-regulators to the loss. EMAG's counsel advised that some small deduction might be acceptable, but this would not be appropriate in addition to deductions for "non-disproportionate impact" or for "public purse considerations".

As regards the former auditors, Sir John should take steps to ascertain the decision of the Tribunal of the Joint Disciplinary Scheme from that body or the Financial Services Authority even though it is, apparently, under appeal. If then he considers that Ernst & Young were partially responsible, EMAG believes that the appropriate action is for policyholders to be paid in full and for the Treasury to recover what it can from Ernst & Young.

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DISPROPORTIONATE IMPACT

The concept of “disproportionate impact” is unclear to EMAG, especially as ‘clarified’ by the statements of various Treasury ministers, but not as yet by Sir John. EMAG reserves the right to comment as matters progress. It will continue to campaign for proper compensation.

SCHEME ADMINISTRATION

The PO found the Treasury’s subcontractors guilty of ‘outrageous’ conduct over an extended period. The Court found that Treasury ministers unlawfully rejected some of the PO’s Findings of Injustice. It would be inappropriate for the Treasury to supervise or administer any scheme. In EMAG’s view supervision should be the responsibility of the PO’s Tribunal and day-to-day work should be outsourced to an organisation specialising in insurance policy administration.

SCHEDULES

Schedule A shows the compensation methodology EMAG suggested to the PO in May 2008 and the PO’s response. It should be observed that the PO happily countenanced EMAG’s broad brush approach to the speedy distribution of compensation. She did not envisage reviewing 30 million investment decisions by 2 million people, as misleadingly claimed by the Chief Secretary to the Treasury in Parliament on 21st October 2009.

Schedule B shows EMAG’s responses to the questions raised by Sir John Chadwick in his August 2009 paper.

Schedule C comments upon some statements contained in Sir John Chadwick’s August 2009 paper.

**Equitable Members Action Group
17 November 2009**

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SCHEDULE A – EXTRACT FROM EMAG’S REPRESENTATIONS TO THE PO (submitted May 2008, see pages 378 and 379 of Part 1 of PO’s Report)

“Approach to Redress

It will be appreciated... that there are issues upon which it would be unreasonable to expect policyholders to prove their individual case, e.g. whether they were influenced by the returns and whether, if they had known Equitable Life’s true financial position, they would have removed their investment or invested elsewhere.

It would also be unreasonable to inflict the sort of compensation scheme traditionally applied by the FSA to mis-selling, which could take another 8 years, to policyholders who are now in their 60s, 70s and 80s and who have already suffered ‘outrageous’ treatment at the hands of the Treasury and the regulators.

The approach EMAG suggests to the PO is as follows:

1. Take the areas where she has found maladministration leading to injustice and make a broad brush estimate of the total loss arising to policyholders at 16 July 2001.
2. Add an estimate of the ‘removal costs’ in respect of those that have subsequently moved their funds elsewhere. This would include Market Value Adjustments, other penalties and re-investment charges.
3. Apply a series of appropriate discounts for things like the proportion who were not influenced by published data and those who would not have invested elsewhere and apply those percentages to the total to arrive at a compensation sub-total as at that date.
4. Add something for outrage and interest to the resulting sum to arrive at a current compensation ‘pot’, which the Treasury should pay immediately to an appropriate independent scheme administrator.
5. Distribute that compensation ‘pot’ upon a policy by policy basis in accordance with a sliding scale based upon values immediately before the big cut of the 16 July 2001.

The benefit of this approach is that once the compensation pot is agreed and transferred to the scheme administrators, calculation could be handled mechanically from the information held upon Equitable Life’s computers, now in the possession of Halifax Financial Services. The downside is a lack of sophistication to deal with all possibilities.

EMAG sees it as vital for the fair treatment of Equitable Life policy holders as a whole that compensation can be calculated, apportioned and distributed without undue delay, even if it involves the acceptance of some rough edges to the calculations.”

The Ombudsman commented: “The principles that EMAG set out do not seem to me to be controversial. If it is decided to establish a compensation scheme, given the length of time that it has taken to determine the relevant complaints and the history of this case, it seems to me that it would be fair, just and reasonable for such a scheme to operate independently, flexibly, openly, and speedily – and with the acceptance of some ‘rough edges’.”

SCHEDULE B – EMAG’s replies to the Questions raised by Sir John Chadwick

Ref.	Question	EMAG’s Response
1.12 (i)	<p>Whether, given my Terms of Reference and the Findings made by the Ombudsman in her Report, it is open to me to adopt the flexible approach to the assessment of relative loss.</p> <p>[The “flexible approach” does not seem to be defined in the August Paper. It is described in Paragraph 2.39 as: an approach under which relative loss is calculated on a basis that would place all Equitable Life policyholders in the position that they would have been in at the end date if, from an appropriate start date — which, subject to the considerations discussed below, would be the date on which each policyholder first invested in Equitable Life — they had invested in an appropriate comparator.”</p> <p>A further feature is described in Paragraph 2.28: “An alternative methodology in respect of claimants who made new money investment decisions would be to make a general assessment of the likelihood that policyholders of the same class who made such investment decisions at or about the same time did rely on the regulatory returns; and to apply an appropriate factor (to reflect the degree of likelihood) to all such policyholders. This was the approach recommended to the Public Administration Select Committee (the "PASC") by some of those who made representations to that Committee. The PASC did not, itself, express a view on this approach; but it seems to have been sympathetic to some of the difficulties involved in requiring policyholders to prove reliance and it may be</p>	<p>EMAG’s comments are based upon the assumption that revised instructions to Sir John Chadwick will be issued in the near future, which are satisfactory to the Court; in short, ones that remove the Treasury’s unlawful rejection of the PO’s relevant Findings and reinstate the PO’s original start date for maladministration leading to injustice at July 1991.</p> <p>As regards the two main features of the “flexible approach”;</p> <p>In principle, the valuation methodology is identical to that used by EMAG in its estimates of aggregate relative loss submitted to the PO and to PASC. We compared the results of representative premiums paid into Equitable Life over the maladministration period found by the PO with the average published results of the same premiums invested in competitor companies. This was our interpretation of the “relative loss” doctrine recommended by the PO. This method of calculation should fall well within Sir John’s instructions, as amended following the Judicial Review.</p> <p>EMAG represented to both the PO and PASC that it would be impractical and unfair to base entitlement to compensation on the ability of individuals, many years after the event, to prove reliance upon the Returns. Instead we suggested an appropriate percentage deduction from all compensation. While accepting that this approach has some rough edges, it has the considerable advantage of enabling compensation to be calculated mechanically, without input from individual policyholders, thus considerably speeding up the process. We note that Sir John seems to have adopted our suggestion.</p>

	<p>thought to have found this approach attractive. But, because the impact that the maladministration had on the contents of the regulatory returns changed over time, it would be necessary to make a series of assessments: that is to say, it would be necessary not only to make a number of class based assessments at any given time but also to make such assessments at different times.</p> <p>2.29 An approach to reliance which adopted this methodology would, I think, be preferable to the approach which the Ombudsman had in mind — that is to say, determination of reliance on an individual basis”</p>	<p>In these circumstances EMAG must welcome what we understand to be the main features of the “flexible approach”. As always, much will depend upon the detailed implementation of these principles</p> <p>As regards the suitable percentage, we suggest that Sir John takes note of the view expressed by the PO in her 20th August letter to him: “In essence the view expressed in my report is that, absent the serial mal-administration I had determined occurred from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period instead of going to another life insurance company”.</p>
1.12 (ii)	If it is open to me to adopt the flexible approach, the questions set out at 2.43-2.48.	See Below.
2.43	<p>The flexible approach gives rise to three matters for determination:</p> <p>(i) What is the appropriate start date for each class of policyholders?</p> <p>(ii) How should an appropriate comparator be determined in respect of each class of policyholders?</p> <p>(iii) What is the appropriate end date in respect of each class of policyholders?</p>	See Below.
2.44	The natural start date for each policyholder is the date on which he first invested in Equitable Life. In the case of those policyholders who first invested before 1 January 1990, that date (rather than the date of first investment) may be the appropriate start date because it is the beginning of the period covered by the Ombudsman's investigation. There are practical difficulties with this date, in that the necessary data is not readily available before 1992 (and even later, in some cases). My actuarial	Agreed.

	advisers are currently considering this issue, and hope to be able to make any necessary reconstructions.	
2.45	I am advised that it is not possible to say that any one single life office provides an appropriate comparator to Equitable Life's business. It will therefore be necessary for my actuarial advisers to create a model comparator with reference to market data from the relevant period. It will be necessary to give careful consideration to what assumptions should be made as to the characteristics of the comparator. I invite comment as to what those assumptions should be.	In our view the comparator should be based upon the actual published results of those companies, with whom policyholders would have most likely invested. We would suggest the "top ten" with profit offices (by market share) in the market place during the 1990s.
2.46	One major consideration that I have identified is whether the appropriate comparator should be modelled by reference to the best, median or most poorly performing life offices over the period. This consideration is likely to be influenced by the fact that Equitable Life's business was carried on pursuant to a policy of full distribution. This fact was known to all policyholders, or would have been known to any who made the most rudimentary inquiry into the life assurance industry. In creating a model based on data from other life offices, it seems to me that it may be appropriate to assume that the comparator would have adopted a similar policy of full distribution. I currently take the view that if a life office were to operate a policy of full distribution responsibly, it would adopt a conservative approach to investments. That would be reflected in the assumptions to be made as to yield and growth of the fund. I invite comment on these points.	<p>We consider that it would be inappropriate to introduce an element of hindsight by selecting comparators based upon subsequent performance.</p> <p>We also consider it inappropriate to try to create an "Equitable Life Lookalike" as comparator. As Sir John has been advised, the Society was unique. If its true financial position had been exposed, then policyholders would simply have bought the policies offered by its competitors.</p> <p>EMAG's view is that it is vital that full details of whatever comparator is constructed are published so that Members of Parliament, policyholders and their representatives can examine it. Furthermore, upon payment, individual loss calculations must be made available to policyholders in full. No information should be used from 'confidential sources' which might prevent this. Transparency is the key factor.</p>
2.47	The appropriate end date is likely to vary in respect of different categories of policyholder. My current view is that the following dates are appropriate:	

	<p>(i) Where none of the special considerations below are involved, an appropriate end date would be 30 June 2008 (provided this is practicable by reference to the existing data). This is the nearest half-year-end to the date on which the Ombudsman published her Report. Recent market volatility makes the quantum of any payment very sensitive to the choice of end date. I am advised that 30 June 2008 represents neither a high point nor a low point of British stock market indicators during the past two years.</p> <p>(ii) Where a policyholder has withdrawn funds from Equitable Life, it is appropriate to treat the date of withdrawal as the appropriate end date.</p> <p>(iii) Where a policyholder has died, it is appropriate to use the date of death (assuming payment is to be made to the policyholder's estate) as the end date.</p> <p>(iv) I am advised that due to the availability of data, the appropriate end date for with-profits annuitants is 31 December 2007 (the date on which all such policies were transferred from Equitable Life to the Prudential).</p> <p>(v) Whatever end date is chosen, it will be necessary to consider an appropriate rate of interest from that end date to the date of payment.</p>	<p>(i) In principle EMAG believes that the appropriate end date should be as close as possible to the payment date of compensation. At the present rate of progress, with no payments likely to be made before 2011, 30 June 2008 strikes us as too early.</p> <p>(ii) Agreed, with the proviso that in assessing loss, the comparator proceeds should be based upon a contractual exit. Many thousands of Equitable Life policyholders took non-contractual exits from 2001 onwards and thus knowingly suffered various penalties. In the vast majority of such cases this action was taken in recognition that Equitable Life could no longer operate as a with profit office and to minimise their future losses. It would be quite inappropriate to assume that a similar non contractual exit would have been required if funds had been invested in a comparator.</p> <p>(iii) Agreed.</p> <p>(iv) As regards with profit annuitants, a substantial part of whose losses are still in the future, it is vital that computation should be carried out as close as possible to payment date. 31 December 2007 strikes us as much too early.</p> <p>(v) Agreed. EMAG suggests the rate of interest charged by HMRC on unpaid tax or the rates applied in Court judgements.</p>
2.48	<p>In addition to the matters above, there are some further matters that will need to be considered:</p> <p>(i) It will be necessary to consider whether policyholders who were beneficiaries under group schemes should be treated differently from other policyholders. My current</p>	<p>(i & ii) If the data is available, then EMAG agrees.</p> <p>(iii) Sir John may be aware that the taxation of compensation is one of the</p>

	<p>view is that there is no reason for this.</p> <p>(ii) Some policyholders will have experienced a relative gain under one policy, but a relative loss under another. My current view, on which I invite comment, is that these two figures should be netted off against one another.</p> <p>(iii) It will be necessary to take account of the tax that policyholders (and particularly with-profits annuitants) would have paid on any additional income that they would have received if invested in a comparator. I invite representations as to how this should be addressed.</p>	<p>most complex aspects of UK tax law. EMAG suggests that:</p> <ul style="list-style-type: none"> a) losses be calculated after deduction of estimated tax, where appropriate b) all compensation payments be made free of tax c) an appropriate section be included in a future Finance Act to eliminate the risk that HMRC may not agree
1.12 (iii)	If it is not open to me to adopt the flexible approach, the questions set out in the Appendix.	Not Applicable
1.12 (iv)	Whether, in reaching a view as to the proportion of relative losses which it would be appropriate to apportion to the public bodies investigated by the Ombudsman, I should adopt the principles discussed in this Interim Report; and, if not, what principles should be adopted for that purpose.	<p>EMAG generally supports the PO's view that compensation should not be reduced by the "contributions" of non-regulators to the loss. EMAG's Counsel's advice was that some small deduction might be acceptable, but this would not be appropriate in addition to deductions for "non-disproportionate impact" or for "public purse considerations".</p> <p>As regards the former auditors, if Sir John considers that they were partially responsible, then EMAG believes that the appropriate action is for policyholders to be paid in full and for the Treasury to recover what it can from Ernst & Young.</p>
2.5	<p>I am not satisfied that I am yet in a position to answer the question whether I am permitted by my Terms of Reference to consider any loss beyond that which the Ombudsman has found to constitute injustice:</p> <p>(i) On the one hand, there are powerful arguments which point to the conclusion that I am not so permitted. It would risk overloading this Interim Report if those arguments</p>	<p>The PO found that injustice was suffered by those who both suffered loss (or lost opportunity) and relied upon Returns published from July 1991 onwards. Sir John expressed the view that:</p> <p>"2.20 It is clear that not all policyholders can be said to have relied on information contained in the regulatory returns. Indeed, by the time the relevant regulatory returns were published, some policyholders (most</p>

2.6	<p>were set out in full.</p> <p>(ii) On the other hand, it may be said that my Terms of Reference do not require me to confine my consideration to those policyholders who might have been included (in respect of the accepted cases) under the scheme which the Ombudsman recommended: in particular, that I have not been asked, in terms, to confine my consideration to those policyholders in respect of whom the Ombudsman made specific findings of injustice. It may be said that a payment scheme would not be fair if it excluded policyholders who, on analysis, can be seen to have suffered (or to be likely to have suffered) actual or potential losses in respect of the accepted cases of maladministration — even if the reason for their exclusion were that they would not have qualified for compensation under the scheme which the Ombudsman had in mind.</p> <p>For reasons which I shall explain, the question is of particular importance to those policyholders who, by July 1995, were no longer in a position to withdraw funds from Equitable Life under the terms of their policies. Those who had invested in with-profits annuities before that date ("trapped annuitants") are an obvious example.</p>	<p>obviously the "trapped annuitants") had no choice as to what to do with their funds. Such policyholders, together with any other policyholders to whom the publication of the regulatory returns would not have made a material difference, would appear to fall outside the scope of the injustice found by the Ombudsman as expressed in this sentence."</p> <p>The argument seems to be that those who invested after the relevant date both suffered loss and relied upon the defective returns and are thus included within the scope of the POs finding of injustice. Those who invested before the relevant date, but who had the right to move their funds, but did not do so because of reliance upon the defective returns are also included. However, under Sir John's interpretation, With Profit annuitants, who invested before the relevant date and had no right to move their funds thereafter, could not be said to have relied upon the defective returns and are excluded from the finding of injustice.</p> <p>EMAG asks itself why the PO should seek to exclude from injustice (and compensation) a group, which almost certainly suffered significant loss, while having no power to avoid or minimise that loss in any way? Sir John's interpretation strikes EMAG as very unlikely to represent the PO's intention.</p> <p>In our view all policies in existence during the maladministration period should be eligible for compensation.</p>
2.9	<p>It is important to emphasise that there are matters that my Advice should not and cannot encompass:</p> <p>(i) None of the Ombudsman's findings, accepted or otherwise, relate to mis-selling. There can be no question of an ex-gratia payment scheme placing policyholders in the position that they would have been in if they had invested in a different type of product from that in which</p>	<p>As regards with profit annuities, our researches show that the average investment was about £47,000. In EMAG's view, if those buying lifetime annuities with funds of this order had purchased the products of competitor companies, then they would have been sold conventional fixed annuities, not with profits ones.</p>

	<p>they actually invested.</p>	<p>Firstly, this is a matter of practicality. Only a handful of companies sold with-profits annuities, whereas almost all sold conventional annuities.</p> <p>Secondly, this is a matter of suitability. £47,000 would only purchase a small annual income and for such investors the security of that income is of paramount importance. If they went anywhere other than Equitable Life, then they would almost certainly have been sold a conventional annuity upon these grounds. The Financial Ombudsman Service maintains a library of historical annuity rates to calculate the compensation payable by those advisors who sell unduly sophisticated products to such investors.</p> <p>In EMAG's view, for most With Profits annuitants a conventional annuity is the appropriate comparator.</p> <p>As regards those with larger retirement funds (say) £250,000 plus, we accept that a with-profits annuity might be a suitable investment. In such cases we suggest the Prudential's with-profits annuity as the appropriate comparator. We would expect an examination of market shares in respect of with profits annuity policies to confirm Prudential as the most likely alternative.</p>

SCHEDULE C - COMMENTS UPON SOME STATEMENTS IN SIR JOHN CHADWICK PAPER OF AUGUST 2009

EXTRACT FROM PAPER

“2.46 One major consideration that I have identified is whether the appropriate comparator should be modelled by reference to the best, median or most poorly performing life offices over the period. This consideration is likely to be influenced by the fact that Equitable Life's business was carried on pursuant to a policy of full distribution. This fact was known to all policyholders, or would have been known to any who made the most rudimentary inquiry into the life assurance industry. In creating a model based on data from other life offices, it seems to me that it may be appropriate to assume that the comparator would have adopted a similar policy of full distribution. I currently take the view that if a life office were to operate a policy of full distribution responsibly, it would adopt a conservative approach to investments. That would be reflected in the assumptions to be made as to yield and growth of the fund. I invite comment on these points.”

NB a lower quartile investment return is suggested elsewhere as an appropriate comparator.

EMAG COMMENTS

EMAG rejects the principle that the comparator should be an actuary-manufactured Equitable Life Lookalike. Some of the assumptions inherent in the creation of such a comparator are questioned below.

What evidence is there that Equitable Life's full distribution policy was known to policyholders, who invested during the maladministration period? Because this policy has been widely discussed in subsequent reports by Lord Penrose and the PO does not mean that most policyholders were aware of it from 1990. Certainly the full distribution policy became more widely known after the Society's problems started to attract media attention from about 1998, but policyholders generally were not aware of it before that.

What evidence is there that policyholders (even if they had known about it) were influenced in their investment choices by Equitable Life's full distribution policy? The Government Actuary's Department knew about it from 1989 and had good reason to be interested, but ignored it. Why should policyholders be expected to be more observant?

Even if policyholders were influenced by a full distribution policy why pick this policy out? What other relevant policies did Equitable have? The major policy we have identified from our own experience was “smoothing” where funds were purportedly set aside to deal with market volatility and to even out good years with the bad. “Smoothing” reserves were made purportedly before full distribution occurred. In fact no such reserves existed and “negative smoothing” was the Equitable's practice with, of course, the complicity of The Government Actuary's Department.

Why does full distribution necessarily imply a conservative approach to investments? Full distribution of profits and losses (on a daily basis) is a feature of Unit linked products. And

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yet they range from the ultra conservative to the downright dangerous. We cannot see how full distribution impinges upon investment approach.

What evidence is there that a conservative approach to investments would have produced a lower quartile investment return? There are times in the market cycle when conservatism can be the most profitable (or least unprofitable) approach.

Alternatively, what evidence is there that lower quartile results are produced by a conservative approach to investments? We suggest that poor returns are made by companies that got their investment position radically wrong.

EXTRACT FROM PAPER

3.11 (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."

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.

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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 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.

EMAG COMMENTS

EMAG rejects in principle the concept of reducing compensation based upon the notional responsibility of non-regulators. However we cannot let the inaccuracies in this section pass without comment.

Sir John seems to be under the misapprehension that GAD was misled by Mr Headdon into believing that the Re-Insurance Treaty had substantial economic value, and thereby into maladministration, in part by concealing the side-letter which confirmed that it did not. This is not what the PO found.

On pages 274 and 275 the PO recorded that GAD reviewed the Re-Insurance Treaty, found various shortcomings and advised the FSA that it "fails to achieve its intended reserving effect" (a credit of £700m-£800m)

At page 284 she said: "GAD at the time identified the issues which I have concluded meant that no offset was permissible and notified the FSA of those issues." She went on to say: "The concerns expressed by GAD were not resolved but the FSA, acting on behalf of the prudential regulators, nevertheless permitted the Society to take credit in its regulatory returns for the financial reinsurance arrangement with IRECO. The FSA were wrong to do so."

At page 325 she absolved GAD from responsibility – "I make no finding in this respect against GAD, as they raised with the FSA a number of concerns about the reserving effect of the proposed financial reinsurance arrangement."

Instead she found (page 326) "101 I consider that the failure by the FSA, acting on behalf of the prudential regulators, (i) to ensure that the financial reinsurance arrangement was not taken into account within the Society's 1998 returns without an appropriate concession being given, and (ii) to ensure that the credit taken by the Society within its returns for 1998, 1999, and 2000 properly reflected the economic substance of that arrangement, constitutes maladministration. I therefore make such a finding of maladministration against the FSA."

In short, GAD without the benefit of the side letter, found that the re-insurance treaty was of insufficient economic value and reported that to the FSA. The PO made the finding of maladministration against the FSA for allowing Equitable Life to take substantial credit for it, in spite of that advice.

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In the PO's view, the existence of the 'side-letter' had no impact on the amount of offset that the Society could take for the arrangement within its regulatory returns (page 284). It was worth nothing like the £809m credit allowed for it with or without the side letter. The views expressed in paragraphs 3.12 to 3.15 of Sir John's paper quoted above are misconceived. The side letter is a red herring.