

## Chapter Five

### Description of the conduct of business regulation of Equitable Life

#### 5.1 Introduction

- 5.1.1 The Terms of Reference require the Report to cover the PIA's discharge of its functions. As set out in **Chapter 2**, with effect from 1 June 1998, the PIA delegated the task of monitoring compliance with PIA Rules by its member firms to the FSA and agreed to provide staff for the purposes of carrying out other regulatory functions, including enforcing compliance with the Rules (under the PIA SLA). Accordingly, this Chapter focuses on the teams within the FSA who were involved in the regulation of Equitable Life on behalf of the PIA.
- 5.1.2 The Terms of Reference also state that the Report will:
- (a) describe the background and events leading up to the FSA's assumption of responsibility for the prudential regulation of the Equitable Life on 1 January 1999; and
  - (b) describe the course of supervisory work from then until the Society's closure to new business on 8 December 2000.
- 5.1.3 In contrast with the prudential regulator, the FSA (on behalf of the PIA) was tasked with conduct of business regulation from 1 June 1998. Accordingly, this Chapter tells the story of conduct of business regulation from the point, after 1 June 1998, when the relevant teams within the FSA first became aware of GAO-related issues. These teams are explained in **Chapter 2**.
- 5.1.4 The conduct of business narrative chronicles the consideration of various issues arising in connection with GAOs which were considered on different occasions by different teams within the FSA. To deal with each issue as it arises in chronological sequence, but in a way which makes it easier to follow, the Chapter makes use of headings to denote where consideration of particular issues begins and ends.
- 5.1.5 The following paragraphs seek to introduce the issues that arose to be considered by the conduct of business regulator.

#### 5.2 Issues arising for the conduct of business regulator

- 5.2.1 There were two classes of customer of Equitable Life which were of particular significance during the Review Period:
- (a) GAR policyholders; and
  - (b) Investors in the with-profits fund.
- 5.2.2 In relation to GAR policyholders, the Review Team accepts that there was nothing that the conduct of business regulator could have done, prior to the House of Lords' judgment, to pre-empt that decision and its potential adverse implications on existing GAR policyholders. (In fact as it turned out, there were no such adverse repercussions; indeed quite the reverse.) In relation to these policyholders, therefore, the focus of the Review Team's attention has been on the process by which IBD and IB-PIA assessed the issues as they arose. The principal issue concerned the advice and information given to GAR policyholders either:
- (a) at the point of sale of the GAO policy; or

- (b) when, during the lifetime of the GAO policy, incremental payments (“top-ups”) were made; or
- (c) when, on maturity of the policy (also referred to as “vesting”), a GAR policyholder purchased an annuity or “switched” from a GAO policy to another product without a GAR, such as a PFW (described in **Chapter 3**).

5.2.3 In relation to investors, the issue for the conduct of business regulator to consider was the impact of GAO issues on the advice and information that should be given to those who were considering investing in Equitable Life’s with-profits fund (including not only by way of a new sale but also top-up business).

5.2.4 For both GAR and non-GAR policyholders as well as potential investors, the decision of the House of Lords was a watershed in that it represented the moment at which doubts about Equitable Life’s terminal bonus practice were finally resolved and the GAOs acquired a value which had not previously been recognised. In this Chapter therefore we deal with these issues by reference to the period before and after the judgment of the House of Lords as different considerations apply.

### **5.3 When did IBD first become aware of GAO issues?**

5.3.1 In 1998, IBD became aware of different GAO-related issues at a number of levels:

- (a) referral of PFWs to Enforcement;
- (b) IB-Policy;
- (c) IBD; and
- (d) IB-PIA.

### **5.4 Referral of PFWs to Enforcement**

5.4.1 In June and July 1998, IB-PIA conducted a series of “pension-focused” visits to regulated firms to examine records in relation to the sales of a number of pension products, including PFWs. These visits were the first “themed” visits conducted by IB-PIA.

5.4.2 One of the issues identified by IB-PIA was that, as a result of the poor quality of some firms’ records of PFW business, no definite conclusions could be reached on whether or not firms were providing an adequate explanation to investors of the inherent risks of opting for withdrawals rather than an annuity or other options available. The issues arising from the visits were subsequently reported to the PIA Board and, in March 1999, were referred to Enforcement.

### **5.5 Awareness of GAOs: IB-Policy**

5.5.1 In August 1998, an article appeared in the *Sunday Times* making reference to GAO policies that had been sold up to 1988, and in some cases until 1993, and stating that, since some insurers might not be able to identify which policies contained a guarantee and as policyholders might not be aware of their entitlement, some policyholders might have received pension incomes lower than their due. The article included the following comment:

“Pensioners out of pocket could have problems seeking redress. The Personal Investment Authority (PIA), the industry watchdog, said, ‘Pension plans taken

out before 1988 do not come under our remit as the sales occurred before the Financial Services Act came into force.”

- 5.5.2 On 28 August 1998, IB-Policy prepared a memorandum that was copied to the FSA’s Media Relations Department (“**Media Relations**”) and to IFSD referring to numerous press enquiries relating to GAOs and attaching, as an example, a copy of the *Sunday Times* article. The memorandum stated that Media Relations had received several enquiries asking what the PIA or the FSA were doing about this issue and that IB-Policy had advised Media Relations that the issue related to policies sold “before our time” and to “after sale administration” which was outside the PIA’s scope. IB-Policy expressed the view in the memorandum that, at the extreme, it could breach the principles of fair dealing or high standards of market conduct but that “we would be most unlikely to want to invoke those rules”.
- 5.5.3 The memorandum states:
- “If we were to issue guidance, the most we might do would be to remind product provider firms about their responsibilities and the need to check each maturing policy itself. It seems almost unbelievable that firms do not know what they have guaranteed. This probably stems from the remote prospect (or so it seemed back in the 60’s when these guaranteed rates were set) that the guarantee could ever be called into use.”
- 5.5.4 The memorandum concludes by noting that, as the subject of GARs raised the question of solvency, HMT-ID was also investigating.
- 5.5.5 There is no evidence that IB-Policy copied this memorandum to IBD or IB-PIA or that the FSA took any steps at this stage to investigate whether any policies were sold after “A” Day<sup>1</sup> or that any further consideration was given to reminding product providers of the need to check policyholders’ entitlement to a GAO.

## **5.6 Awareness of GAOs: IBD**

- 5.6.1 On 3 September 1998, HMT-ID sent a memorandum to Michael Foot which was copied to IBD, amongst others, and which referred to a survey of all the Appointed Actuaries of all UK life offices carried out by GAD in relation to reserving for annuity guarantees. HMT-ID stated that it was copying the memorandum to IBD on the basis that IBD would no doubt have an interest in some aspects of the issue such as:
- “the extent to which companies are informing policyholders of the existence of a guarantee at the time when they come to make choices about annuities on retirement.”
- 5.6.2 The memorandum also noted that this was:
- “an example of an issue on which we will need to work closely together to ensure a seamless regulatory approach.”
- 5.6.3 There is no evidence that a copy of this memorandum was passed to IB-PIA. Furthermore, IBD did not request a copy of the GAD survey on reserving for annuity guarantees or take any other action in response. Equitable Life’s response to the GAD survey on reserving for annuity guarantees had stated that Equitable Life did not advise GAR policyholders when they reached retirement of the existence of a

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<sup>1</sup> “A” Day is 29 April 1988, the day on which the relevant provisions of the FSAct 1986 came into force.

GAO (see **Chapter 4, Part 1**). We have been told that no one within IB-PIA can recall having been aware of the GAD survey.

- 5.6.4 On 5 November 1998, HMT-ID sent a second memorandum to Michael Foot copied to, amongst others, IBD which attached draft guidance to companies about how to meet PRE in dealing with guarantees. The memorandum noted that HMT-ID's preliminary view was that Equitable Life's terminal bonus practice was permissible but that it was seeking further information to test the position further. It referred to a concern about the company's ability to reserve adequately for these guarantees and reported that the information that had been received to date was unconvincing. It also raised serious questions about the company's solvency. IBD did not follow up on this memorandum or copy it to IB-PIA.

## **5.7 Awareness of GAOs: IB-PIA**

- 5.7.1 In September 1998, IB-PIA began to receive complaints about Equitable Life's treatment of GAOs. The stance adopted by IB-PIA in a letter to a complainant dated 22 October 1998 was that:

“The FSA does not become involved in the application of final bonuses to policies due to the fact that these bonuses are not guaranteed, therefore the company can apply these as appropriate.”

- 5.7.2 On 2 December 1998 IB-PIA (Advertising) (apparently on its own initiative) prepared an internal memorandum regarding GAOs to IB-PIA management, copied to the Head of IB-PIA. The memorandum made reference to recent press articles about Equitable Life and other firms who had offered GAOs and noted that this “may well become a big issue, affecting a large number of Firms”. The memorandum referred to one suggestion that the industry could be looking at an overall bill of £7billion to £10billion and to speculation in the press about the ability of mutual companies to survive if they had to honour the guarantees which might, in turn, lead to speculation about take-over bids.
- 5.7.3 The memorandum explained that the GARs offered in the late 1980s were thought to be substantially higher than the annuity rates available now. However, it appeared that Equitable Life was “not upholding the Guarantee and including the maximum amount of terminal bonus allocated to the policies”, but, instead, offering two options: a GAR policyholder could either forgo the GAR and receive a full terminal bonus, or opt for the GAR and have a lower terminal bonus.
- 5.7.4 The memorandum also stated that IB-PIA (Advertising) had received some queries regarding the past performance figures used by Equitable Life in its advertising and whether the performance figures were acceptable, bearing in mind that the full terminal bonus was not payable in some circumstances.
- 5.7.5 It is clear from the memorandum that IB-PIA (Advertising) had also been in contact with HMT-ID and that HMT-ID was looking at the situation, particularly with regard to Equitable Life's solvency “if the guarantees are enforceable”. HMT-ID also intended to look at the literature used by Equitable Life when the policies were issued and the wording used on bonus notices and other documents issued during the term of the policy, in order to form a view on what reasonable expectations a policyholder might have had from reading the literature. The memorandum records that IB-PIA (Advertising) had offered to assist HMT-ID in reviewing the literature, and requested to be kept informed of further developments. IB-PIA (Advertising) also noted that HMT-ID had sent a “Dear Managing Director” letter to companies authorised to carry on long-term business, outlining its views on the interpretation of GAOs in the light of PRE.

5.7.6 The memorandum commented on the difference in approach between prudential regulation, which focused on a firm's ability to stay in business, and conduct of business which looked at what the firm had promised investors in their marketing literature and whether the firm should be "liable to pay the maximum figures".

5.7.7 This memorandum was subsequently forwarded by the Head of IB-PIA to IBD together with a covering memorandum dated 8 December 1998. The covering memorandum noted that:

"As far as we know, these annuities were all sold before the 1986 Financial Services Act came into force and so are not "caught" by PIA rules (although we cannot be certain of this without some sort of survey of the firms concerned)."

We have been told that it was a well established policy that pre "A" Day business was not covered by PIA Rules.

5.7.8 Attention was drawn in the covering memorandum to the IFA queries regarding the impact of the GAO issue on past performance figures used by Equitable Life to promote current products. The memorandum explained that the issue here was that, if Equitable Life should have made provision for paying the GAR and the full terminal bonus but failed to do so, it may have been able to offer other investors greater returns in recent years than it would otherwise have been able to do, enabling it to 'inflate' its past performance figures. IB-PIA commented:

"this all depends on whether or not the Equitable are within their rights to interpret their obligations under these contracts in the way that they are; and if they are not, it would require a fairly forensic historical analysis of what assumptions and provisions they made, and how and when they made them."

5.7.9 IB-PIA therefore concluded that it would be necessary to await the outcome of HMT-ID's review of how Equitable Life was interpreting its obligations against the test of PRE, before deciding whether to take action and what action to take. The memorandum concluded that, if action should be taken, it would be necessary to work very closely with HMT-ID. No further consideration was given to the issue of past performance figures during the Review Period.

## **5.8 IB-PIA's initial assessment of jurisdiction**

5.8.1 In January 1999, IB-PIA (Advertising) prepared two memoranda dated 18 and 20 January 1999 respectively. It appears from the first memorandum that the Head of IB-PIA had asked IB-PIA (Advertising) to produce a note exploring the GAO issues as far as the PIA was concerned. The memorandum records that, given the size of the problem, IB-PIA had decided that it was obliged to look closely at the subject of GAOs to check whether any of the activities of the life companies fell within the PIA's jurisdiction. It was noted that IB-PIA might find that the companies had not done anything since 1998 which might fall within the PIA's "selling and marketing" jurisdiction but that, on the other hand, they might find something which they felt obliged to pursue as part of "our general brief to protect investors".

5.8.2 Concern was also expressed about the fact that the guidance which had recently been issued by HMT-ID represented the position of one part of the FSA, when other parts had not had opportunity to consider the matter properly.<sup>2</sup> It was remarked that this

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<sup>2</sup> The evidence suggests that the memorandum was referring to the guidance on reserving issued by the Government Actuary as opposed to the guidance on charging for GAO's issued by HMT-ID in December 1998.

was particularly relevant when, as on this occasion, the position of IB-PIA may differ from that of HMT-ID and that:

“My instinct from a ‘selling and marketing’ point of view is to find out how these guarantees were promoted to investors and, if appropriate, to require firms to honour their promises.”

5.8.3 The memorandum expressed the view that the approach adopted by HMT-ID was to preserve the financial soundness of insurance companies by agreeing that bonus rates could be reduced to GAR policyholders and that this created “a clear conflict between conduct of business regulation and prudential supervision”. IB-PIA (Advertising) commented that this was particularly relevant to the wording of the press release about the guidance, which stated that the FSA was taking this action “in the interests of protecting policyholders”. In this respect the memorandum commented:

“I think this is a bit unfortunate - I would hate to have to explain to a policyholder how we are protecting him by agreeing that the insurer can pay him a substantially less pension than he was expecting.”

5.8.4 The memorandum concluded with the comment:

“Presumably there is some mechanism within FSA to co-ordinate regulatory activity. Should we be noting our interest in the subject at a higher level?”

5.8.5 The second memorandum dated 20 January 1999, considered what action IB-PIA could be taking in relation to GAOs. It was noted that the view to date was that the problem seemed to be with policies sold before “A” Day and therefore IB-PIA probably lacked jurisdiction. However, it was also noted that, as the subject was attracting increased attention in the media, it seemed sensible to consider the issues raised by Equitable Life’s treatment of GAOs in a bit more detail to see whether there was anything that IB-PIA should be doing in order to fulfil its regulatory obligations, or at least to justify its stance of non-involvement.

5.8.6 IB-PIA (Advertising) identified various sources of information available to IB-PIA (namely, press cuttings; a file of papers from IB-Policy; information from HMT-ID and liaison with the PIA Ombudsman). It also identified various activities after April 1988 which might fall within PIA’s jurisdiction as follows:

- (a) sales of, and top-ups to, GAO policies;
- (b) investors being “switched” out of GAO policies into new products without the benefit of a GAR; and
- (c) how the GAO was being presented on maturity.

5.8.7 In relation to sales and top-ups of GAO policies, the memorandum stated:

“The obvious first step is to seek to establish whether any pension guarantees were offered on pension sales made after April 1988. It has been suggested that these guarantees died out with the introduction of personal pensions in July 1988 - that leaves a couple of months business which we might cover - although I recall that not all the rules came into force immediately in 1988. [IB-PIA (Advertising)] has researched this further with the Insurance Directorate and it appears that at least some firms were selling this type of policy during 1988 and afterwards. There may in addition be incremental or top-up business which may

count as “new business” in terms of the rules and which may have generated regulated product disclosure material.”

- 5.8.8 In relation to switching, it was noted that there were rumours that firms had avoided liability by switching clients out of policies containing GAOs. If this was done after “A” Day, it might well fall within the PIA’s jurisdiction as “selling and marketing” and IB-PIA would be able to look at the presentation of the offer to switch contracts and whether the investor was provided with a balanced picture including the rights he or she was giving up.
- 5.8.9 In relation to advice at vesting, the possibility of looking at the “options on maturity” form was raised since this could fall within the “selling and marketing” jurisdiction if part of the purpose of the form was to generate sales in an alternative policy such as an annuity and IB-PIA could look at the way the GAO was presented.
- 5.8.10 IB-PIA (Advertising) made a number of suggestions about sources of information that could be explored if it was decided that the issues should be pursued, including the following:
- (a) “as a first stage we should certainly talk to the Insurance Directorate”;
  - (b) “alternatively, or in addition, we could send a questionnaire to firms” (although IB-PIA noted the possibility that some companies could not identify which policyholders had GAOs attached to their contracts and that there might also be difficulties ascertaining the number of policyholders who switched from GAO policies to other pension contracts and in obtaining documents such as instructions to switch and options at maturity forms going back possibly as much as 10 years); and
  - (c) “one way of addressing this may be through complaints” (IB-PIA had already contacted the PIA Ombudsman and had ascertained that eighteen complaints had been received against Equitable Life so far and that complainants might have retained documentation which could build up a picture of what insurers had been doing over the years. The PIA Ombudsman had confirmed that it would have no objection to doing a trawl through its records for such information).
- 5.8.11 In connection with the PIA Ombudsman, the memorandum also made reference to reports in the press about the complaints against Equitable Life and explained that Equitable Life’s solicitors had asked that these cases should be dealt with by legal proceedings rather than by the PIA Ombudsman.
- 5.8.12 The concern regarding the potential conflict between the obligations of IB-PIA and IFSD that had been identified in the memorandum of 18 January 1999 was repeated. In this context, it was also noted that IFSD had interpreted the PRE requirement to mean that GAR policyholders could reasonably expect to pay something for the benefit of the GAR in the form of reduced bonus rates.
- 5.8.13 In conclusion the second memorandum posed the question: “Is there at least enough for a meeting on the above?” There is no evidence that a meeting took place to consider the suggestions outlined in the memorandum but we have been told that the issues were probably discussed at an internal group managers meeting.
- 5.8.14 Of the three sources of information identified in the memorandum, only the PIA Ombudsman option was pursued at this stage. The advice which was being given to policyholders on maturity was not investigated. We were told that the reason for this was that, where there is a possible emerging problem, IB-PIA would not conduct an investigation unless it was satisfied that there was sufficient evidence to provide

grounds for dedicating resources. We were told that, in the event that an investigation was warranted, consideration would be given to the most easily accessible sources of information. Whilst a review of complaints made to the PIA Ombudsman was a relatively quick and easy avenue to explore, a survey of the number of policies sold post “A” Day was not necessarily straightforward due to the lapse of time and the difficulty of establishing the numbers of policies sold where the firm’s record keeping was poor.

## **5.9 Visit to the PIA Ombudsman**

5.9.1 On 9 March 1999, a meeting took place between IB-PIA (Advertising) and the PIA Ombudsman. In a memorandum dated 22 March 1999, prepared after the visit, IB-PIA noted, for the first time, that a case would be brought in the High Court and that, at that stage, around thirty cases relating to Equitable Life GAOs were being dealt with by the PIA Ombudsman.

5.9.2 In relation to “switching”, IB-PIA stated that it understood from the PIA Ombudsman that cases which involved investors who were originally sold GAO policies and were subsequently persuaded to transfer into a non-GAO policy were being “settled separately” by Equitable Life. We have not been able to determine what was meant by this.

5.9.3 As to the marketing of GAO policies, IB-PIA stated that one of its objectives in visiting the PIA Ombudsman was to review the literature that had been provided to policyholders in relation to GAOs after “A” Day in order to assess whether there was anything in the description of the policies that might be pursued with Equitable Life. However, apparently very few of the complaints received by the PIA Ombudsman (if any) related to sales (or “variations” to policies) made after “A” Day and IB-PIA was not in a position, therefore, to pursue Equitable Life regarding the descriptions of the policies and what an investor might have expected to receive.

5.9.4 IB-PIA’s memorandum concluded by querying whether it should be looking more closely at what Equitable Life was doing (given that it was the only company with a significant number of complaints lodged with the PIA Ombudsman). It was noted that:

“The difficulty with taking this forward is that we would be basing any action on hearsay and reports read in the press, and not on any hard evidence. However, this is a significant issue and we are probably obliged to contact Equitable Life about this.”

5.9.5 It appears, however, that IB-PIA never did contact Equitable Life in relation to any of the issues identified. We were told in interview that it was thought appropriate to wait for clarification on the legal position before applying significant supervisory resource to the situation. A memorandum from IB-PIA to IB-Policy dated 29 April 1999 which referred to the visit to the PIA Ombudsman noted that most, if not all, of the complaints related to pre “A” Day policies and so there was little action IB-PIA could take. The memorandum stated that, according to press reports, the case in the High Court was likely to be heard in the late summer and concluded:

“For the moment, the view here seems to be that there is little to be done from a supervision angle.”

## **5.10 Handling of complaints**

5.10.1 Prior to the commencement of the Review Period, IB-PIA’s response to one particular complaint about Equitable Life’s treatment of GAR policyholders was that

the application of terminal bonuses was not a matter for the PIA because these bonuses were not guaranteed and therefore the company could apply them as appropriate.

- 5.10.2 In February and April 1999, IB-PIA received copy correspondence relating to further complaints regarding Equitable Life's treatment of GAOs from the FSA's Public Enquiries Department ("**Public Enquiries**"). Public Enquiries responded to the February complainant stating that there were no PIA Rules banning a change of policy on annuity guarantees although investors might point to the terms of their particular agreement if they believed it prevented a variation. In such a case they could either pursue the matter through the courts or activate the company's complaints procedure. At this stage, IB-PIA noted that the issue was "hotting up" and that it would need to be monitored.
- 5.10.3 In relation to the April complaint, Public Enquiries asked IB-PIA to assist in drafting a response. Public Enquiries also requested assistance from IB-Policy, IFSD and the PIA Ombudsman and asked IFSD to suggest a "FSA line" for Public Enquiries and other staff at the FSA who might receive telephone calls on this subject.
- 5.10.4 As a result:
- (a) on 5 May 1999, IFSD agreed with IB-PIA that IFSD would take responsibility for the handling of queries in relation to GAOs and the acceptability of insurers cutting terminal bonuses payable to those who exercised a GAO (on the grounds that it was largely a PRE issue) subject to calling on IB-PIA to advise on PIA issues raised by particular cases;
  - (b) on 11 May 1999, IFSD produced a draft response to the complaint incorporating:
    - (i) a suggested response from the PIA Ombudsman to the effect that no investigation was being made by the PIA Ombudsman in respect of GAO complaints pending a decision by the High Court in the Equitable Life proceedings; and
    - (ii) a reference to the guidance issued in December 1998 about meeting the costs of GAOs; and
  - (c) in July 1999, IFSD produced FSA press lines in connection with the Court case (see below).
- 5.10.5 A hand-written note prepared by IB-PIA in June 1999, indicated that IB-PIA's view was that:
- (a) GAOs were broadly a prudential issue to be dealt with by IFSD;
  - (b) PIA issues related to marketing after "A" Day;
  - (c) complainants should receive letters similar to the draft response produced on 11 May 1999 (to be dealt with by Public Enquiries); and
  - (d) IB-PIA would await the outcome of the test case.
- 5.10.6 Also in June 1999, IB-PIA prepared a hand-written note headed "Action Plan" summarising issues that might be addressed with Equitable Life. The action points include reference to the guaranteed annuities position, how Equitable Life was dealing with complaints relating to GAOs, Equitable Life's assessment of regulatory

issues surrounding GAOs (such as marketing) and when GAOs ceased to be sold. It was also noted that IB-PIA should be alert to the outcome of the Court case.<sup>3</sup>

## **5.11 Query received in relation to advice at vesting**

- 5.11.1 On 28 May 1999, IB-PIA (Advertising) was contacted by IFSD in relation to general concern (not restricted to Equitable Life) raised by the Consumers' Association that, on vesting, policyholders were not being told that their policy contained a GAO and so may end up buying a lower value market annuity. IB-PIA initially informed IFSD that concealing information from policyholders was within the PIA's jurisdiction and would probably be addressed as part of IB-PIA's usual supervision visits. It was suggested by IB-PIA (Advertising) that IB-PIA management "nominate someone to take this forward if you think this is appropriate" and the IFSD contact was identified.
- 5.11.2 There followed an e-mail exchange within IB-PIA (also involving IB-Policy) regarding the application of PIA Rules to cases involving GAO policies taken out before "A" Day where, on maturity, an investor was not told that his or her policy contains a GAO. During this exchange, some uncertainty was expressed as to the application of PIA Rules to this situation. One view was that the answer depended on a number of factors such as whether the GAO policy was sold before or after "A" Day, and whether the sale was advised or not.
- 5.11.3 As a result of this uncertainty regarding the application of PIA Rules to such a situation, on 2 June 1999, IB-PIA sought the advice of GCD by "posing a couple of queries". It was also noted that IB-PIA would want to be clear about its stance on the issues before any meeting with the Consumers' Association. We have not been able to verify the nature of the advice sought from GCD as it is believed that the request was sent by e-mail and no copy has been retained.
- 5.11.4 On 14 June 1999, IB-PIA and IFSD attended a meeting with the Consumers' Association to discuss GAOs in general. The note of the meeting records that, amongst other things, it was explained that, shortly before a policy was due to vest, the insurer would inform the policyholder of the value of the annuity that was available under the policy and the cash fund value that was available as an alternative. Only if the GAO provided the "highest value annuity" would the rate it offered be quoted, although it might not be indicated that the rate offered was pursuant to the terms of a GAO. If a policyholder sought advice about the purchase of an annuity, PIA Rules required advisors to consider the merits of any GAO against the other alternatives. Any policyholders who were not correctly advised would be entitled to compensation. The particular circumstances of Equitable Life GAR policyholders were not discussed.
- 5.11.5 On 15 June 1999, GCD responded to IB-PIA's request for advice in relation to the specific query raised by the Consumers' Association. GCD noted that the concern was that GAR policyholders were not being told that their policy contained a GAO that would probably provide a larger pension than the current annuity rate offered by the insurer. Without this information, policyholders might purchase a lower value market annuity, either in the open market or with their existing life company.
- 5.11.6 GCD advised that the application of the relevant conduct of business rules depended on the date on which the advice was given or withheld. Accordingly, advice given on the taking up or purchase of an annuity post "A" Day would fall to be regulated

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<sup>3</sup> We have been told that the next meeting that was held between IB-PIA and Equitable Life was on 25 May 2000 (see below) but we have not been provided with any documentary evidence of this meeting.

even if the policy was sold before “A” Day. If a life company was advising its representatives to withhold information about rights to GAOs on maturity, or failing to ensure its representatives were providing adequate advice, PIA Principles would “undoubtedly have been breached”.

5.11.7 It appears from the response from GCD that IB-PIA did not request an opinion from GCD dealing specifically with the nature of the advice, if any, that should be given to Equitable Life GAR policyholders where, generally speaking, the value of a GAO was being negated by the company’s terminal bonus practice. Having addressed the Consumers’ Association query, IB-PIA took no further action to clarify the position regarding advice that should be given to Equitable Life GAR policyholders on maturity of their policy.

5.11.8 The memorandum from GCD was circulated within IFSD and copied to GAD with a comment by IFSD:

“As you can see, PIA have concluded their rules cover information provided to policyholders at vesting irrespective of when the policy was taken out.”

## **5.12 Query received in relation to bonus notices**

5.12.1 On 24 June 1999, IFSD contacted IB-PIA (Supervision) stating that IFSD had concerns about the format of certain bonus notices issued by Equitable Life because it was thought that the presentation of the terminal bonus was potentially misleading. IFSD’s concern was that:

“A figure is quoted for terminal bonus and this is then added to the guaranteed benefits under the policy to give a total benefits number. You have to read the notes over the page to appreciate that terminal bonus is not guaranteed.”

IFSD considered that it was arguable that the format of the notice may have encouraged a policyholder to believe that the GAR applied to the full fund including terminal bonus. IFSD queried whether the PIA had any relevant powers to require Equitable Life to change their bonus notices.

5.12.2 There followed an e-mail exchange within IBD regarding the bonus notices during which uncertainty was expressed regarding the application of the PIA Rules to these documents. One view was that, although the notices were not advertisements (because they did not have a sales purpose), they might be caught by Rule 4.1 (which requires information provided to policyholders to be clear, fair and not misleading).<sup>4</sup> Another view was that the notices were not within the scope of the rules because they related to the administration of existing business but that, where the notice contained additional information such as past performance information, the regulator had taken action in the past in relation to elements of the notice that could be regarded as an investment advertisement, particularly where the firm included a “mailer” for new business.

5.12.3 IB-PIA (Supervision) responded to IFSD also on 24 June 1999 concluding that it was worth looking at the current bonus notice. Later that day, IFSD replied stating that it would provide examples of the 1996 and 1997 bonus notices and that it would obtain a copy of the 1998 notice from Equitable Life the following week. IFSD further commented that the 1998 notice was expected to include a more clearly drafted note

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<sup>4</sup> Although it was noted that Rule 4.1 would only apply to notices issued since 18 July 1994 when Equitable Life became a PIA member (as Lautro did not have an equivalent “catch all” rule).

explaining that different levels of terminal bonus may be available depending on whether or not the GAO was exercised.

### **5.13 The Court case**

5.13.1 Prior to the First Instance judgment, IB-PIA attended the following bilateral meetings with IFSD at which the case was discussed:

- (a) On 17 June 1999, in relation to guaranteed annuities it was noted that IFSD was awaiting the 1998 regulatory returns to review the basis of firms' reserving for this product and that IB-PIA had received a legal opinion in relation to the pre versus post "A" Day debate. It was also noted that the key milestone would be the Court case on 5 July and its implications for PRE.
- (b) On 11 August 1999, IFSD reported that judgment was due on 9 September 1999, that a summary of the transcripts had been prepared and that the evidence suggested that the case could go either way.

5.13.2 In addition, IB-PIA was copied into the following documents relating to the case:

- (a) an internal IFSD memorandum dated 5 July 1999;
- (b) an internal IFSD memorandum dated 12 August 1999; and
- (c) a memorandum from GCD to IFSD dated 10 September 1999.

5.13.3 We will deal with each of these in turn.

### **5.14 Internal IFSD memorandum dated 5 July 1999**

5.14.1 This memorandum explained that the case was due to commence and that IFSD had undertaken some simple scenario planning in order to be ready to react to the outcome of the case. This memorandum is described in **Chapter 4, Part 2** but, amongst other things, it recorded that:

- (a) IFSD would need to monitor the impact of the judgment on the company's financial position and IFSD might need to intervene to ensure that Equitable Life's approach was consistent with PRE; and
- (b) IB-PIA was considering the presentation of Equitable Life's bonus notices which appeared to IFSD to be potentially "misleading to policyholders because of the emphasis they place on the projected total fund value which includes terminal bonus although it is not guaranteed".

5.14.2 The memorandum attached press lines for dealing with queries regarding the case which included consideration of the implications for Equitable Life if the company was to lose the case and stated that it would not be appropriate for IFSD to speculate or comment on individual companies' positions but that IFSD "would not expect the judgment to have a significant impact on the level of reserves the company needs to hold to cover its liabilities to policyholders".

5.14.3 Also attached to the memorandum was a "scenario planning" document (see **Chapter 4, Part 2**) which was of some relevance to the conduct of business regulator:

- (a) Under the heading "Implications for FSA" in respect of scenarios 1 and 2 it was, amongst other things, noted that, even if Equitable Life won the case, the PIA

Ombudsman would still need to resolve complaints by individual GAR policyholders.

- (b) In respect of Scenario 1 (a win for Equitable Life) it was noted that a GAR policyholder might argue that he or she had suffered loss due to reliance on a bonus notice about the value of the GAO and so had not made additional alternative retirement provisions.
- (c) In respect of Scenario 2 (a partial win for Equitable Life in that reducing terminal bonus was acceptable but that past practice was not) it was noted that the PIA Ombudsman would probably follow the Court judgment where complainants raised similar issues.
- (d) In respect of Scenario 3 (a loss for Equitable Life) it was noted that Equitable Life would need to pay compensation to policyholders who had exercised GAOs and suffered reduced terminal bonuses as a result (or establish reserves to meet that cost). It also noted that IFSD would need to determine the solvency position of Equitable Life. If there was a significant risk that the company would be unable to meet its liabilities to policyholders/PRE, IFSD would need to consider closing the company to new business or suspending its authorisation. A take-over bid was also contemplated and a fall in new business was expected therefore reducing the new business strain on the company and bolstering the company's short to medium term financial position. The final implication listed was:

“Potential for allegations that FSA/IFSD should have prevented Equitable writing new business earlier so that lapses could have been avoided.”

5.14.4 No input into the scenarios by IBD or IB-PIA was invited or given.

5.14.5 This memorandum was subsequently provided to a member of the PIA Board on 24 August 1999, when that member requested a brief run down of the PIA's assessment of the potential impact of the Court case on Equitable Life (despite the fact that IB-PIA had, by then, received a more recent note dated 12 August 1999 (see below)).

### **5.15 Internal IFSD memorandum dated 12 August 1999**

5.15.1 This memorandum reported on IFSD's review of the transcripts of the High Court hearing and is dealt with in **Chapter 4, Part 2**. Of particular relevance to the conduct of business regulator was the following comment on the likely outcome of the case:

“Overall my conclusion is that the case could go either way. However, the most likely outcome still looks to be a win for Equitable but with criticism that they did not make their bonus practice clear to policyholders.”

5.15.2 This memorandum was copied to IB-PIA without the attached summary of the hearing which contained a reference to the illustrations provided to policyholders at vesting and the clarity of the bonus notices for 1995 and 1997.

### **5.16 GCD memorandum dated 10 September 1999**

5.16.1 This memorandum summarising the High Court judgment is referred to in **Chapter 4, Part 2**. The following comments made by GCD were particularly relevant to the conduct of business regulator:

- (a) The Court had decided there was nothing in the contract to prevent Equitable Life adopting the practice of reducing terminal bonuses when GAOs were taken up. In this regard, GCD commented:

“This on its face seems right, but I understand that the FSA has some evidence that, on maturity and when options were being discussed with policyholders, [Equitable Life] did not tell policyholders in terms that terminal bonus was conditional. This is not a matter for IFSD however and is before the PIA.”

- (b) In relation to PRE, the Court had concluded that Equitable Life’s communications with policyholders up to 1994 (and perhaps for a while thereafter) did produce in GAR policyholders a reasonable expectation that the GAR would apply to the total fund including the full terminal bonus declared for all policyholders.
- (c) If the judgment was upheld, it was thought that IFSD would need to determine whether sufficient or due regard was had to PRE but the memorandum expressed the view that there would be real awkwardness in taking action against Equitable Life. GCD expressed the view that there was a “PIA ring” to the case (although GCD could not comment on the extent to which IB-PIA could or should get involved in light of the judgment or its appeal).

5.16.2 None of these notes was copied to those individuals within IB-PIA who were conducting a review of the bonus notices.

5.16.3 On 13 September 1999, receipt of the GCD memorandum dated 10 September 1999 prompted the conduct of business section of GCD to:

- (a) request a copy of the full transcript of the High Court hearing from the prudential section of GCD; and
- (b) send a copy of the GCD memorandum to IB-Policy.

5.16.4 In the covering memorandum to IB-Policy, GCD drew attention to the references to the PIA which had appeared in the GCD memorandum and suggested that it might be helpful to have a discussion given that GCD might be asked to advise at short notice.

5.16.5 We have been told that the reason for sending this memorandum to IB-Policy was that IB-Policy contained the actuarial resource within IBD and GCD thought it would be useful for the actuarial team to have the judgment and to consider it from a number of angles.

5.16.6 On 14 September 1999, IB-Policy responded by memorandum (copied to IBD and IB-PIA) stating that the issue was more for IB-PIA since the principal issue was whether the marketing literature of Equitable Life could be regarded as compliant with the rules in force at the time, including the Key Features, Product Particulars and With-Profits Guides (although it was noted that the PIA Rules do not cover bonus notices). IB-Policy expressed the view that failure to explain that a terminal bonus was conditional would seem to fall short of the expected standards.

## **5.17 Action taken by IB-PIA**

5.17.1 IBD was sent the GCD memorandum dated 10 September 1999 by IFSD by e-mail on 14 September 1999. On receipt, IBD forwarded the e-mail to IB-PIA expressing some puzzlement about GCD’s reference to the fact that the FSA had some evidence

that Equitable Life did not tell policyholders in terms on maturity that terminal bonus was conditional and that the PIA were aware of this. The e-mail states:

“my understanding is that the contracts which have been the subject of the litigation were sold pre-1988. And I am not clear whether PIA has any real standing in relation to post-1988 communications between Equitable and its policyholders in respect of such contracts.

But my speculations are so much chaff: would you please consult Enforcement and GCD and advise by the close on 20 September what if anything we should be advising PIA to do. If there is any point in our investigating I guess we should get ahead with that without necessarily waiting for the outcome of the appeal? None of the points at issue in the continuing litigation seem to bear on whether the company’s communications with policyholders were compliant.”

5.17.2 We have been told that the reference in the GCD memorandum that was queried by IBD was based on what had been reported at meetings between HMT-ID and Equitable Life in November 1998 at which Equitable Life had explained the practice that was followed for maturing policies. GCD understood that:

“At the point at which policies matured, policyholders were coming in for their discussions with the Equitable adviser and were being presented with options which didn't necessarily include the GAR option at all, on the basis that the sales adviser had already decided that this was not the sensible option for the policyholder in question; it would always be the sensible option to take the money in fund form instead.”

5.17.3 IFSD also knew that not all policyholders were advised about their entitlement to a GAO from Equitable Life’s response to the GAD survey on reserving for annuity guarantees in July 1998 and the further representations given to IFSD at the meeting on 13 October 1998.

5.17.4 This information was not passed on to IB-PIA, and we have been told that IB-PIA did not have any evidence that policyholders were being mis-advised.

5.17.5 IBD’s e-mail to IB-PIA was also copied to IFSD which responded by agreeing that it was important to review whether the judgment threw any light on the PIA’s interests and responsibilities and agreed that there was no reason why any analysis should wait until after the appeal and “indeed very good reasons why it should not”. However, IFSD also stated:

“That said I am keen that we should look at the issues from the perspective of all the FSA constituent bodies and we should consider any possible action in the same way. I think that will probably mean that we should not decide on, or initiate, any action until the appeal court’s decision is known. If the judgment is overturned, particularly if the actions of [Equitable Life's] directors are heavily criticised, it is possible that it would be appropriate for us to take action under the Insurance Companies Act. I would not wish to be in a position where our room for action had been constrained, or possibly prejudiced, by earlier action by others.

But we can, of course, consider this further in the light of the analysis which I think we are agreed should now be undertaken.”

5.17.6 As requested by IBD, IB-PIA sent a memorandum to Enforcement and to GCD (copied to IBD and IFSD) by e-mail dated 20 September 1999 which covered much the same ground as had been covered in January 1999, setting out the implications of

the judgment as far as PIA's Rules were concerned in order to determine what further action, if any, was required (the "September Memorandum"). The September Memorandum contained the following analysis:

- (a) Post "A" Day Sales: Notwithstanding the concerns which had been expressed about what may have been said to customers at the point of sale about GAOs and the impact they may have had on terminal bonuses, IB-PIA had been led to believe that most sales of GAO policies were made before "A" day and had concluded that there was little they could do because they were outside the PIA's jurisdiction. It was noted that there had been suggestions that some GAO policies had been sold after "A" Day but IB-PIA had received no evidence to confirm this, although the PIA Ombudsman and IFSD might have further information.
- (b) Advice at vesting: Following considerable internal discussion on the subject of advice at vesting, the conclusion was that the adviser was responsible for alerting a policyholder to any GAO which may apply. Equally, if the life company issuing the GAO was also advising the investor on their options at vesting, it too was obliged to set out all the available options and their consequences. IB-PIA had no evidence to suggest that clients were being mis-advised but it was suggested that they should check the current position with the PIA Ombudsman.
- (c) Switching: It had been suggested that some life companies had switched clients out of GAO policies into new products. If the life company did so without alerting them to what they were giving up they would be in breach of PIA Rules. It was said that IB-PIA had no evidence to support these assertions but it would be worthwhile carrying out some checks.<sup>5</sup>
- (d) Bonus notices: These might be caught by PIA Rule 4.1. However, it was noted that the bonus notices for 1997, 1998 and 1999 had been reviewed and it had been concluded that there was nothing seriously wrong with them.<sup>6</sup>

#### 5.17.7

The September Memorandum stated that further action was required to ascertain whether any investors had suffered as a result of misleading literature regarding GARs; incorrect advice at vesting; switches made without advice about a GAR or misleading bonus notices, and concluded with a recommendation that:

- (a) consideration be given to establishing a small team to:
  - (i) conduct a review of complaints received by the PIA Ombudsman, including identifying any emerging trends and identifying those companies that are generating the most complaints;<sup>7</sup>
  - (ii) undertake focused visits to firms known to have issued GAOs to review their records in relation to bonus notices, post "A" Day sales, switching and advice at vesting; and
  - (iii) obtain and review bonus notices issued by firms known to have issued GAOs (having checked that PIA Rules apply); and

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<sup>5</sup> No reference was made to switching being "settled separately" by Equitable Life as referred to in the memorandum dated 22 March 1999 prepared by IB-PIA (Advertising) following the visit to the PIA Ombudsman (see paragraph 5.9 above).

<sup>6</sup> The notices reviewed were for the years ending 31 December 1996, 1997 and 1998 but these notices were issued in 1997, 1998 and 1999 respectively.

<sup>7</sup> No reference was made to the earlier visit to the PIA Ombudsman and review of complaints in March 1999 (see paragraph 5.9).

- (b) that IB-PIA chair a meeting of representatives from Enforcement, IB-Policy and IFSD to discuss and agree next steps.

5.17.8 On 23 September 1999, GCD responded by e-mail with the following advice:

- (a) sales made prior to “A” Day did not fall within the PIA’s jurisdiction but could be raised with the PIA Ombudsman under his voluntary jurisdiction;
- (b) “You say that there is no evidence that, at vesting, clients are being mis-advised but this surely begs a question as to whether [Equitable Life] has the right to offset the value of the guarantee against the terminal bonus. This question has been determined in favour of Equitable at first instance but there is likely to be an appeal”; and
- (c) it would be an “uphill struggle” to bring the bonus notices within the PIA Rules which apply to “business which comprises marketing or business carried on in connection with marketing”. Accordingly IB-PIA would need to look at the context of the bonus notice statement to see “if a marketing point was present”.

5.17.9 Enforcement did not respond to the September Memorandum (but did attend the subsequent meeting to discuss the memorandum on 21 October 1999 (see below)).

5.17.10 Neither the September Memorandum nor the GCD response appears to have been copied to those individuals within IB-PIA who had been asked to review the bonus notices.

## **5.18 IB-PIA’s assessment of the bonus notices**

5.18.1 In the meantime, IB-PIA (Supervision) who, in June 1999, had been asked by IFSD to review Equitable Life’s bonus notices, had received from IFSD the bonus notices for 1996, 1997 and 1998 and, on 31 August 1999, had forwarded them internally to IB-PIA (Advertising) with a note seeking a view but stating:

“My view is that (a) it’s unlikely that we can do anything under the advertising rules; (b) the 1998 bonus notice is quite clear anyway.”

5.18.2 IB-PIA (Advertising)’s view, as expressed in a memorandum to IB-PIA (Supervision) dated 21 September 1999 was that:

- (a) whilst the bonus notices were probably not an advertisement, notices issued since July 1994 would presumably be subject to PIA Rule 4.1 as they are issued in the course of relevant business;
- (b) it was possible to quibble about how clear the 1998 notice was, but “overall all the relevant information seems to be there”;
- (c) whilst the note in the 1996 notice relating to the cost of guaranteed annuities might serve to alert policyholders to the possibility of having their fund value reduced, it did not do so in a clear and fair manner;
- (d) it had not been possible to draw any conclusions in relation to the 1997 notice because the 1997 document provided by IFSD did not relate to a GAO policy; and
- (e) it would be interesting to review earlier bonus notices issued since July 1994 to see how the guaranteed annuity factor had “gradually been worked into” the

bonus notices. However, it was noted that Rule 4.1 was not often used in disciplinary cases “probably because it is very non specific”.

5.18.3 Following the advice from IB-PIA (Advertising), IB-PIA (Supervision) reported back to IFSD by memorandum dated 23 September 1999 which stated:

“You may remember our earlier conversations about [Equitable Life’s] bonus notices. You kindly sent me some examples including the latest bonus notice (1998). We do not think that the bonus notice is poorly presented or inaccurate.”

5.18.4 We have been told by IB-PIA (Supervision) that this comment was intended to reflect its view on all the bonus notices (rather than just the 1998 notice). It was acknowledged in interview that IB-PIA (Supervision) had formed a different view of the 1996 notice to IB-PIA (Advertising), on the basis that the relevant information was included in the notice, and it was not unclear or unfair to such a degree that something needed to be done about it. In any event, the question from IFSD had been whether IB-PIA had powers to change the bonus notice and IB-PIA (Supervision) took this to refer to the current notice which had been changed by the time the notices were received and which was now compliant.

5.18.5 We have also been told by IFSD that IFSD was interested in all the notices and that IFSD understood the response from IB-PIA to relate to all the notices. IFSD explained that, if it thought that the PIA had powers to change the company’s bonus notices because they were misleading, IFSD would raise it with the company, although it would probably not take retrospective action. However, a conclusion that the 1996 bonus notice was misleading would have been relevant to PRE and, had there been a need to consider PRE further, IFSD would have gone back and asked IB-PIA for more information about why it had reached its conclusion. IFSD also said that it was more interested in IB-PIA’s reasoning and views of the bonus notices than whether there were grounds to intervene.

5.18.6 In any event, IB-PIA (Supervision) made it clear to IFSD that IB-PIA did not intend to pursue a breach of Rule 4.1. The memorandum concluded:

“We have not previously breached a firm on [Rule 4.1] in respect of documentation issued once the post sale information has been given. That is because our scope covers the activities of dealing, arranging deals in, managing and advising on certain types of investments. The ongoing servicing of policies does not seem to fit comfortably within these activities. And we would therefore have to have serious concerns about a document issued in the course of servicing a policy, to attempt to breach the firm concerned.”

5.18.7 We know that, at the same time, GCD was advising others within IB-PIA that it would be “an uphill struggle” to bring the bonus notices within PIA Rules (unless there was a marketing point present), but this was not copied to IFSD or those within IB-PIA who were reviewing the bonus notices.

## **5.19 The PFW investigation report**

5.19.1 In March 1999, the findings from the pension-focused visits that had been conducted in mid-1998 were reported to the PIA Board and the PFW issues were referred to Enforcement. Enforcement undertook an initial data gathering exercise in order to identify the most active seller of PFW contracts. This exercise established that, between 1 May 1995 and 31 December 1998, Equitable Life had sold over 14,000 PFWs (which was 93.7% of all PFWs sold directly by a company’s sales force (as opposed to through an IFA) and 35.4% of the total market). Enforcement had also confirmed that between 1 May 1995 and 31 May 1999 Equitable Life sold over

16,000 PFWs. Enforcement therefore restricted its investigation, as far as direct sales by companies were concerned, to Equitable Life and decided to review a 0.5% sample (which resulted in a sample of eighty one cases). The investigation had commenced on 22 June 1999 and had included a visit to the firm between 12 and 16 July 1999.

- 5.19.2 In October 1999, Enforcement produced an investigation report detailing its findings in relation to Equitable Life's sales of PFWs (the "October Report"). One of the issues in the October Report was whether Equitable Life failed to ensure that PFW contracts were suitable in relation to the investor's personal and financial circumstances. One of the concerns arising in relation to this issue from Enforcement's review of investor files was that there was insufficient evidence to show that an adequate investigation was made by the adviser as to the availability of a guaranteed annuity from the original provider prior to transferring funds to Equitable Life.
- 5.19.3 It is apparent from the October Report that the investigation into the availability of a guaranteed annuity prior to switching and buying a PFW was confined to those policyholders who transferred funds from another company. In other words, the investigation excluded investigation of this issue in respect of sales to existing Equitable Life GAR policyholders. Although the October Report found that, in twenty four cases where funds were transferred from another provider to Equitable Life for the purpose of effecting a PFW contract, there was no evidence that enquiries had been made as to whether a guaranteed annuity was available from the original provider, the investigation did not examine whether Equitable Life GAR policyholders were asked or advised about their GAO before they switched into a PFW.<sup>8</sup>
- 5.19.4 The October Report does not give any reason for this decision and there is no other documentary evidence about it. We have been told that Equitable Life's practice of paying differential terminal bonuses negated the effect of the GAO and so an Equitable Life GAR policyholder who bought a PFW using funds in an Equitable Life policy was not, at that time, giving up any value in relinquishing the GAO. Accordingly, he or she did not need to be advised about the loss of a GAO when buying a PFW. Enforcement was also aware that the position taken by Equitable Life was the subject of litigation and, to that extent, there would be uncertainty until the litigation was concluded. If the Court upheld Equitable Life's terminal bonus practice, there would be no issue.
- 5.19.5 The October Report recommended that further investigations be conducted including interviews with targeted investors. We have been told that consideration was given to interviewing Equitable Life representatives but interviews of investors was considered to be the most appropriate investigation method to obtain information about the suitability of PFW contracts for individual investors.
- 5.19.6 Enforcement did not provide IB-PIA with a copy of the October Report until requested to do so by e-mail on 14 January 2000 nor did it inform IB-PIA of the decision to confine the investigation of enquiries made about the availability of a GAO to GAR policyholders transferring from other companies.
- 5.19.7 We have been told that one of the ways in which IB-PIA is kept informed of the progress of all the cases which have been referred to Enforcement is by means of a document known as a "Key Case Update" which is circulated to IB-PIA. The Key

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<sup>8</sup> It is not known how many of the 16,000 PFW sales were to existing Equitable Life policyholders and how many involved transfers from other providers. However, of the seventy six cases which involved advice from an Equitable Life sales representative, thirty of these involved policyholders transferring from another provider (the remaining cases involving sales to existing Equitable Life policyholders).

Case Updates in January and December 1999 both include reference to the PFW investigation but neither mentions the GAO-related issues. We have also been told that Enforcement provided IB-PIA with oral updates on the progress of the Equitable Life PFW investigation at each monthly management interface meeting but that no minutes were kept of these meetings.

- 5.19.8 IB-PIA have told us that they were not aware of the detail of the investigation, including the decision to restrict the scope of the investigation as regards Equitable Life GAR policyholders and therefore did not make any connection between the PFW investigation and the switching issue.

## **5.20 Action taken by IB-PIA as a result of the September Memorandum**

- 5.20.1 On 11 October 1999, IB-PIA attended a routine bilateral meeting with IFSD at which IFSD reported on the implications of the High Court judgment for both IFSD and IB-PIA. It was noted that the main implication was for other firms which had issued GARs and their reactions to the judgment would need to be monitored. Although the judgment was in favour of Equitable Life, IFSD's view was that Equitable Life had failed to meet PRE and so there remained a possibility of intervention. In terms of conduct of business issues, it was noted that there may be misleading bonus notices supplied to investors or firms may have switched investors into new contracts without GAOs. It was noted that a paper on this had been prepared by IB-PIA (i.e. the September Memorandum) and that this paper would need to be discussed at a meeting chaired by IB-PIA.
- 5.20.2 On 21 October 1999, a meeting was held to discuss the September Memorandum and the need for regulatory action by IB-PIA in relation to GAO issues generally and Equitable Life in particular. Although no minutes of the meeting have been located, we have been told that the meeting was attended by IB-PIA, IFSD, IB-Policy, Enforcement and GCD (conduct of business section). After the meeting, IFSD sent an e-mail to GAD reporting on the meeting. This e-mail indicates that, as a result of the meeting, IFSD understood that:
- (a) in relation to sales and top-ups of Equitable Life GAO policies, IB-PIA wanted to investigate whether a material number of policies fell within its remit to justify an investigation;
  - (b) the bonus notices fell outside IB-PIA's remit (such remit being described by IFSD as "broadly marketing literature"); and
  - (c) IB-PIA was considering looking at the practices being adopted by companies other than Equitable Life in relation to advice and information at vesting and whether GAR policyholders were being switched into new policies so that they lost their entitlement to a guarantee. We have been told that the reason why these issues did not need to be investigated in relation to Equitable Life was that the advice given to GAR policyholders would depend on the outcome of the Court case (i.e. a GAO would only need to be drawn to the attention of a GAR policyholder if the decision attributed value to a GAO).
- 5.20.3 It was, however, resolved that IFSD would write to Equitable Life to enquire about the number of post "A" Day sales and top-ups after June 1988 (when Equitable Life stopped selling GAOs).<sup>9</sup>

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<sup>9</sup> In fact the significant date for top-ups was not June 1988 when Equitable Life stopped selling GAOs but "A" Day when top-ups fell within the FSAct 1986 regime. The letter subsequently sent to Equitable Life correctly made reference to post "A" Day top-ups and not to June 1988 (see below).

5.20.4 Accordingly, on 29 October 1999, IFSD wrote to Equitable Life requesting details of the number of GAO policies sold and the number of top-ups made to GAO policies after “A” Day. Equitable Life’s preliminary response on 10 November 1999 was that Equitable Life would have no difficulty in establishing the number of individual GAO policies sold between 29 April and June 1988. However, Equitable Life requested a clearer definition of “top-ups” and explained that most “top-ups” would probably not have involved advice from an Equitable Life sales representative. IFSD forwarded this response to IB-PIA on 26 November 1999, stating that further consideration needed to be given to whether it would be helpful to have information on the number of top-ups given Equitable Life’s response that most would not have involved advice from an Equitable Life sales representative. IB-PIA did not respond to IFSD or Equitable Life on this.

## **5.21 The College Meeting and the OA-CSP**

5.21.1 In the meantime, in June 1999, IB-PIA and IFSD had agreed to pilot lead supervision for eleven firms including Equitable Life and preparations had begun for the first college meeting concerning Equitable Life. The college and the OA-CSP are explained in **Chapter 2**.

5.21.2 On 27 October 1999, IB-PIA provided IFSD by e-mail with the following information to be included in the draft OA-CSP:

- (a) that IB-PIA’s risk rating of Equitable Life was “Average”;
- (b) that the last visit had taken place in June 1998 and the next was planned for the second quarter of 2000; and
- (c) that the latest supervisory activity by IB-PIA was “tracking” the Court case.

5.21.3 In relation to the risk rating, the FSA has been unable to locate a copy of the score sheet for the July 1998 risk assessment of Equitable Life (prepared following the previous visit). However, we have been told that the fact that Equitable Life had brought a test case to assess its past payment practice was seen as being a responsible move and there was no indication that, if the judgment went against them, they would not act appropriately to review past practice. Accordingly, the Court case was not necessarily an adverse factor in the risk assessment.

5.21.4 The OA-CSP that was subsequently prepared by IFSD indicated that Equitable Life was graded medium to high by IFSD and high by IMRO. We have been told that IFSD’s risk rating was based on the fact that Equitable Life did not retain the levels of reserves that other companies may have done because of its low charging and high bonus distribution policy. IMRO’s assessment was based on a particular IMRO-related factor. We have also been told that IB-PIA reviewed its risk rating in light of the rating given by IMRO and IFSD but that it was not thought appropriate to change it.

5.21.5 In relation to the timing of the visit, we have been told that Equitable Life was a large firm with a large client bank and IB-PIA felt that a visit would enable IB-PIA to get to know the culture of the firm and the way it operated. In addition, we were told that IB-PIA was aware that Enforcement had concerns about PFWs and it was felt that it would be useful to assess the process by which policies were sold.

5.21.6 The college meeting was held on 26 November 1999 and attended by IFSD and IMRO but IB-PIA was unable to attend. Although this was regarded as unfortunate by IFSD and IB-PIA accepted that attendance would have been preferable, IB-PIA

did review the draft OA-CSP and provide comments on it to IFSD and also received a copy of the minutes of the meeting and amended OA-CSP.

- 5.21.7 The minutes record the fact that IFSD informed the college that the appeal against the High Court judgment would be heard at the end of November 1999, that recent supervisory activity had been concentrated on the GAO issue but that IFSD planned to fill in some of the gaps in its knowledge about Equitable Life as part of its 6 December 1999 visit.

## **5.22 Response received from Equitable Life regarding post “A” Day sales**

- 5.22.1 Equitable Life responded to IFSD’s request for information about the number of post “A” Day sales on 3 December 1999 stating that the company wrote 22,224 policies containing GAOs between “A” Day and 30 June 1988. Equitable Life explained that it was likely that most of the policies would have been purchased on clients’ own initiative rather than through Equitable Life’s sales force noting:

“At that time, exceptional levels of business were generated by the imminent withdrawal of the product. In the whole of the previous year, 1987, we sold 18,247 such policies in total.”

- 5.22.2 We have been told that the sudden rush to buy GAO contracts prior to their withdrawal cannot necessarily be attributed to any perceived value attaching to a GAO because (a) it appears that policyholders were not generally aware of the existence of GAOs; (b) most sales were probably not advised; and (c) investors may have wanted to take advantage of the opportunity to buy established policies rather than investing in the new personal pensions that were being introduced.

- 5.22.3 On 10 December 1999, a bilateral meeting took place between IFSD and IB-PIA. At the meeting reference was made to the meeting held on 21 October 1999 to discuss the need for further regulatory action in relation to GAO issues and to the fact that IFSD now had information on the number of GAO policies sold post “A” Day which would be passed to IB-PIA.

- 5.22.4 The information was provided to IB-PIA under cover of a memorandum to IB-PIA dated 12 January 2000 which attached a copy of Equitable Life’s response regarding post “A” Day sales. The covering memorandum stated that, in view of the fact that only a few of the sales would have been advised and it would be difficult to identify them, it was arguable that IB-PIA could justify not pursuing this further. It was noted that the query raised by Equitable Life in relation to the definition of a “top-up” remained outstanding and it would be necessary to reach a view on whether this issue was worth pursuing given that, again, only a small proportion of them were likely to have been advised sales.

- 5.22.5 Although IB-PIA accepted that 22,224 sales was quite a large number, IB-PIA did not take any action upon receipt of this information. We have been given two different reasons for this:

- (a) that there would have been a discussion about when the rules applied and that since the Lautro Rules may only have come into effect on 1 July 1988, the PIA might not have had jurisdiction over policies sold prior to that date<sup>10</sup>; and

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<sup>10</sup> This reason is not entirely correct; Lautro Rules came into force on 29 April 1988. Some rules were phased in and came into effect on 1 July 1988. These related to advertising and product disclosure. Although advertising might affect an investigation of how GAO policies were marketed, the best advice and general suitability requirements came into force on “A” Day and applied to policies sold between “A” Day and 1 July 1988.

- (b) that, although the response confirmed that there was some business that fell within IB-PIA's scope, IB-PIA could not act on the information until the outcome of the Court case was known.

### **5.23 The Judgment of the Court of Appeal**

- 5.23.1 On 21 January 2000, the Court of Appeal gave judgment against Equitable Life. On the same day, an e-mail was circulated within IB-PIA suggesting that IB-PIA should liaise with IFSD to obtain information to be discussed the following week.
- 5.23.2 Later that day, IFSD sent an e-mail to IB-PIA stating that the judgment was no cause for panic; Equitable Life had been given permission to maintain its payment practice pending an appeal to the House of Lords and the financial position of the company was "largely unaltered" by the judgment (although there was no way of knowing whether the decision might spark a hostile take-over bid).
- 5.23.3 In response, IB-PIA told IFSD that it would keep a "close eye" on how things progressed.
- 5.23.4 On 24 January 2000, IFSD sent an e-mail to the college stating:  
  
"Despite the armageddon scenario painted in some of the papers, we do not think that the judgment affects the statutory financial position greatly as [Equitable Life] already has to fully reserve in the Annual Returns for biting GAOs."
- 5.23.5 IB-PIA told us that the response from IFSD was seen as "placatory". Although the Court of Appeal judgment affected IB-PIA's view of the likely outcome of the case because it was an indication that "it was not a clear cut case that [Equitable Life's] past payment practice was appropriate", certainty had not yet been established and it was IB-PIA's understanding that the financial position of the company was unaltered.

### **5.24 The PFW investigation continued**

- 5.24.1 On 8 February 2000, having seen a reference to the PFW investigation in the monthly report from Enforcement to ExCo, IFSD requested, by e-mail, further information from Enforcement regarding the investigation and the potential implications for Equitable Life. This request was copied to IB-PIA which responded by e-mail setting out the background to the visit and stating:  
  
"My understanding is that Enforcement did not find too many problems (so discipline case unlikely)... . Apologies if IB-PIA has not kept you in the loop... ."
- 5.24.2 When IFSD responded to IB-PIA stating that Enforcement was going to provide it with an update, IB-PIA further commented:  
  
"my general feel is that Enforcement don't have an appetite for this one. As it was not the normal style of referral - i.e. we did not pass them a visit report with rule breaches etc. - this is probably why it was not mentioned before."
- 5.24.3 On 8 March 2000, Enforcement attended a meeting with IFSD to discuss the PFW investigation. The note of the meeting records that the issue of advice leading to the loss of a GAO was raised and that Enforcement had "left this to one side for the time being because of the uncertainty about companies' obligations as a result of the Equitable Court case". IB-PIA was not included in the meeting.

- 5.24.4 Following the meeting, on 9 March 2000, IFSD circulated the note of the meeting within IFSD (and to GAD) by e-mail stating that the investigation did not look too good but was not disastrous from a solvency perspective.
- 5.24.5 In March 2000, Enforcement prepared a further report on the PFW investigation summarising its findings in relation to Equitable Life's sales of PFWs (the "March Report"). The March Report included details of the sample investor interviews conducted since the October Report. Interviews had been conducted with twenty investors who had received advice from an Equitable Life sales representative and seven of those investors had transferred to Equitable Life from another company (the remaining thirteen cases involving sales to existing Equitable Life policyholders). When asked whether the representative had discussed the availability of a GAO only one of the seven investors answered "Yes". Three answered "No" and three were unsure. Enforcement had also ascertained that in 45% of the twenty four transfer cases (identified in the October Report), the policyholder was in fact entitled to a GAO. The March Report recommended a review of contracts where funds were transferred to Equitable Life as these might have contained guaranteed or beneficial terms. The purpose of the review would be to ascertain whether investors were informed about the option of a guaranteed annuity or other beneficial arrangement.
- 5.24.6 The March Report concluded with consideration of the wider implications of the investigation, namely the impact on other firms and the future impact of the House of Lords' judgment in the Equitable Life Court case, and stated:
- "If the House of Lords' decision is in [Equitable Life's] favour, then this could have an effect on the decisions of other product providers causing them to also reduce their terminal bonuses. The effect of this could potentially cause all investors who have the option of a guaranteed annuity in their contracts to lose the benefits of their guaranteed annuities. Therefore the investigation team considers that senior management should consider the wider implications before further work is undertaken."
- 5.24.7 The March Report did not consider the implications of an adverse judgment either for Equitable Life or for other companies and no further thought seems to have been given to this either before or after the House of Lords' judgment.

## **5.25 The June 2000 supervision visit**

- 5.25.1 Following the judgment of the Court of Appeal, the principal supervisory activity carried out by IB-PIA in relation to Equitable Life was a monitoring visit to Equitable Life in June 2000. This visit was a routine visit which was not triggered by the GAO issues. It had already been planned and recorded in the OA-CSP prepared in October 1999 (as set out at paragraph 5.21 above).
- 5.25.2 Prior to the visit, on 22 May 2000, IB-PIA contacted IFSD by e-mail to inform it of the visit and to ask whether there were any "sensitive issues" of which it should be aware. IFSD responded asking whether IB-PIA would like any background on the company's financial position before the visit. However, IFSD stated that there was no immediate prospect of the company becoming insolvent and asked whether there were any particular issues that IB-PIA wanted to address. IB-PIA did not follow up on IFSD's offer to provide background financial information.
- 5.25.3 We have been told that, on 25 May 2000, IB-PIA attended a meeting with Equitable Life. In June 1999, GAO issues had been identified as a subject for discussion with Equitable Life (see paragraph 5.10.6 above). However, we have been told that, although GAO issues were discussed at the meeting, it was agreed that the forthcoming supervision visit would not assess any aspects of supervision relating to

GAOs pending the outcome of the case. The supervision visit also refrained from looking at any PFW issues during the visit.

- 5.25.4 The supervision visit lasted from 12 June 2000 to 28 June 2000 and focused on a review of complaints and selling practices, in order to get a general picture of the company's compliance performance.
- 5.25.5 After the visit, on 29 June 2000, IB-PIA contacted IFSD to report that the visit had concentrated on selling practices and complaints and that, whilst there were "systemic issues" found in both areas, IB-PIA was confident that the issues arising could be resolved by maintaining a "close and regular working relationship through a period of change". The visit report indicates that the "systemic issues" related principally to deficiencies in record keeping (such as records of advice given to customers) and to the handling of complaints generally.

## **5.26 The Judgment of the House of Lords**

- 5.26.1 Following the House of Lords' judgment on 20 July 2000, IFSD circulated a number of e-mails regarding the outcome of the case to IB-PIA attaching FSA press lines and making reference to Equitable Life's press release. The conduct of business section of GCD also received copies of two notes relating to the judgment prepared by IFSD on 20 and 21 July 2000.
- 5.26.2 One particular e-mail dated 20 July 2000 which was sent by IFSD to the Equitable Life college and to Enforcement stated that the company was still solvent but that its asset base was weakened, which would affect the bonuses payable to with-profits policyholders, and that it had decided to put itself up for sale. IFSD also took the opportunity to ask for information from the college regarding future activity or visits in relation to Equitable Life and to ask Enforcement whether there was any update to report regarding the PFW investigation, stating "we are now even more sensitive to any financial implications that may come out of this". Enforcement did not provide a progress report in relation to the investigation until 1 September 2000.
- 5.26.3 On 21 July 2000, IB-PIA responded to IFSD stating that there were no issues arising from the June supervision visit that were expected to lead to discipline, but that IB-PIA would conduct quarterly visits to Equitable Life in the future combining short focused visits and continuing management dialogue. We have been told that this was a suggestion from IFSD to allow regular contact with Equitable Life and to enable the issues arising from the visit to be addressed.
- 5.26.4 IFSD subsequently prepared an "Action Plan" dated 24 July 2000 which indicated that the company's financial position was "tight". This was not provided to IB-PIA.
- 5.26.5 On 24 August 2000, IB-PIA attended a bilateral meeting with IFSD at which IFSD reported that the House of Lords' judgment against Equitable Life would have implications for the company and the industry more widely. The minutes of the meeting state:

"The process of finding a buyer for Equitable Life was underway and it was hoped that a preferred candidate would be identified by December. It was envisaged that demutualisation would take place by June 2001, how achievable this was would depend to some extent on what were the intentions of the purchaser and hence how complicated the transfer scheme became. In the meantime, [Equitable Life] was just covering its solvency margin. The company had renegotiated a reinsurance agreement the continuation of which had been dependent on the company winning the Court case and this had given the

company a bit more breathing space. However, the solvency position remained tight.”

5.26.6 In relation to this meeting, we have been told:

- (a) by IFSD, that the House of Lords’ judgment and its implications for Equitable Life were discussed at some length at the meeting; and
- (b) by IB-PIA, that, as a result of the meeting, IB-PIA received the impression that Equitable Life was continuing to meet its solvency margins (although the buffer was relatively thin) and, on the basis of information received, IB-PIA did not have any reason to believe that Equitable Life should be required to make specific disclosures to new policyholders.

5.26.7 Following this meeting, IB-PIA was not aware of the continuing review of Equitable Life’s position or subsequent meetings between IFSD and Equitable Life. For example, IFSD and GAD met with Equitable Life on 1 December 2000 and the note of the meeting (which was not shared with IB-PIA) indicates that there was only one realistic potential bidder and that the mode of sale proposed by that bidder caused concern both to Equitable Life and to the FSA. The meeting note also indicates that Equitable Life’s lawyers at that time were considering the effect of insolvency on its members, in the light of the fact that Equitable Life is an unlimited liability company. However, the note further states that Equitable Life had not considered whether, after the House of Lords, with-profits policyholders could be excessively disadvantaged in a closed fund (due to the preferential treatment of GAR policyholders).

## **5.27 Consideration of GAR policyholders: Post “A” Day sales**

5.27.1 No consideration was given to post “A” Day sales after the House of Lords’ judgment until 16 October 2000 when some misdirected DTI papers relating to Equitable Life (but apparently unrelated to GARs) prompted IB-PIA to consider whether any action was required in relation to these. An internal hand-written note dated 17 October 2000 reads:

“Is there anything we should now be doing on this? I know we were going to about a year ago (my delay) - has the time passed?”

5.27.2 The conclusion reached by IB-PIA was that no further action was necessary by IB-PIA to establish the population of clients sold GAO policies by Equitable Life after “A” Day and assess how they had been dealt with, given that GAR policyholders could now exercise their GAOs and receive the same bonuses as other with-profits policyholders. Accordingly, on 3 November 2000, IB-PIA informed IFSD that it did not propose to take this potential conduct of business issue any further.

## **5.28 Consideration of GAR policyholders: Vesting and switching**

5.28.1 No consideration was given by IB-PIA as to the impact of the House of Lords’ judgment on the other issues that had previously been identified by IB-PIA such as advice at vesting and switching. We were told that existing GAR policyholders who had been disadvantaged (in light of the House of Lords’ judgment) would be included in the GAR rectification scheme; that the liability for redress would total £200million for which Equitable Life had reserved; and that the total liability for GARs was estimated to be £1.5billion, which would be paid for by the retention of seven months bonus from existing policyholders and made good as a result of the sale.

5.28.2 We have also been told that IB-PIA assumed that IFSD was dealing with the implementation of the GAR rectification scheme for which Equitable Life was responsible and that IB-PIA did not contact Equitable Life during the Review Period to discuss or comment on the GAR rectification scheme.

## **5.29 The PFW investigation continued**

5.29.1 Following the House of Lords' judgment, Enforcement's continuing investigation into sales of PFWs proceeded on the same basis as before. In particular, the part of the investigation which related to whether enquiries had been made about the availability of a GAR continued to be confined to policyholders transferring to Equitable Life from another company. The position of Equitable Life GAR policyholders was not reconsidered.

## **5.30 Consideration of Equitable Life's new sales and advertising**

5.30.1 We have been told that IBD was not party to any discussions as to whether Equitable Life should be permitted to continue to write new business after the House of Lords' judgment because this was a matter essentially for the prudential regulator.

5.30.2 As for advertising, IB-PIA (Advertising) did not pay any special attention to Equitable Life's advertising after the House of Lords' judgment but, between the House of Lords' judgment and the closure to new business on 8 December 2000, certain complaints were forwarded to IB-PIA in connection with Equitable Life's advertising.

5.30.3 On 4 October 2000, Public Enquiries sent an internal memorandum to IB-PIA (Advertising) attaching a copy of a complaint letter that had been sent to Equitable Life about the fact that the company was spending money advertising products to new investors (when the "with-profits annuity is to remain at the same level as the previous year") and that advertisements made reference to the fact that Equitable Life had delivered consistently strong results since 1763. The memorandum from Public Enquiries stated that the letter had presumably been copied to the FSA for comment and asked IB-PIA to comment on whether Equitable Life's advertisements were misleading given the current situation of the company.

5.30.4 IB-PIA (Advertising) responded stating that, although it could see why the Equitable Life's advertising could cause annoyance to policyholders and may therefore be unwise, the company had all sorts of business activities of which guaranteed annuities was only one part:

"Over the years the company has achieved a record of success and has a good reputation. I don't think the annuity issue totally overshadows that. I have not seen the advertisement in question and it is always difficult commenting in the abstract. But it looks like the claims are based on the past rather than the current position ... ."

5.30.5 Public Enquiries subsequently drafted a response and sent it to IB-PIA by e-mail for comments. IB-PIA pointed out that the complaint letter had only been copied to the FSA (not addressed to the regulator) and stated:

"I guess we have a conflict between our general wish to be open and responsive and the practical issue that if we don't see a problem, we don't want to spend any time on it. ... I don't think we need opine on whether the advertisement is misleading - if we aren't asked the question, do we need to answer it?"

- 5.30.6 On 27 October 2000, Equitable Life sent a letter to one of its policyholders which appeared to be a response to a complaint about advertising. The letter pointed out that past performance figures were a matter of record, that the company was fully solvent and that “the temporary period for which bonuses were not allotted would be made good as a result of the sale of the Society”. The letter stated that it was Equitable Life’s intention and expectation, in negotiating the sale of the company, that the House of Lords’ judgment should not have any long-term adverse effect on the expectations of the policyholders (whether or not they held GAOs). The letter concluded by stating that Equitable Life was of the opinion that the advertisements complained of met the “relevant rules of the Financial Services Authority and the Advertising Standards Authority”. This reassured IB-PIA that Equitable Life was reviewing the content of its advertisements in the context of PIA Rules and considered them to be fully compliant.
- 5.30.7 On 3 November 2000, an internal IFSD e-mail referred to complaints received about recent press advertisements by Equitable Life, including allegations that the advertisements were misleading. At this stage, IFSD took the view that the company was solvent and so there was no reason why it should not advertise, so long as IFSD did not intend nor have any grounds to use intervention powers to stop the firm writing new business. The e-mail attached a draft letter in response to the complaints which explained that Equitable Life continued to maintain the required margin of solvency over its liabilities as required and that the FSA did not share the view that it should be prevented from marketing its products since this could be damaging to the business. The letter further stated that, given that there was “a realistic chance of a successful sale of the business”, newspaper advertisements inviting potential customers to request additional information from the company were not misleading.
- 5.30.8 The e-mail was copied to IB-PIA (including to IB-PIA (Advertising)) because of “the PIA interest in misleading advertising”. IB-PIA responded approving the draft letter. IB-PIA (Advertising) also commented that, although IB-PIA had received a few letters requesting that Equitable Life’s advertising campaign be curbed, it was not reasonable to seek to suspend legitimate advertising activity. However, the position could be affected if Equitable Life was believed to be in breach of its prudential requirements.
- 5.30.9 On 10 November 2000, IB-PIA concluded that it would “keep an eye on this issue” but that it did not believe it could act and agreed with the view expressed by IFSD.
- 5.30.10 On 13 November 2000, IB-PIA and IFSD were informed by Media Relations that newspapers had contacted the FSA about Equitable Life suggesting that there would need to be regulatory intervention if a buyer could not be found. The line that had been given by the FSA to the press was that, on present information, a profitable run-off was the worst that could happen and there was no disaster in the making.
- 5.30.11 In addition, Media Relations mentioned that the FSA had received several enquiries about how Equitable Life’s advertisements could be anything other than misleading when “they quote the wondrous past without mentioning the more difficult present”. However, Media Relations understood that Equitable Life had volunteered to withdraw its campaign. IB-PIA (Advertising) expressed surprise that Equitable Life was withdrawing its campaign and said that it was only aware of one complaint which had been forwarded to IFSD. IFSD responded confirming that it had not placed any pressure on Equitable Life to withdraw its campaign and stated “I don’t think we should show anything but disinterest in response to public enquiries - it is a matter for the company”. IFSD also approved the FSA line to be used if there was no successful bid stating “If we say anything else, we will simply be asked why we have not intervened already to protect policyholders in case a bid fails”.

- 5.30.12 The following day, on 14 November 2000, Media Relations sent a further e-mail stating that the information regarding the withdrawal of Equitable Life's advertising campaign had been received from a journalist and so may not be accurate. IB-PIA (Advertising) suggested that the position should be checked with Equitable Life. IFSD subsequently checked the position and confirmed that the campaign had been dropped due to the negative publicity it was generating, but that this did not mean that Equitable Life had stopped advertising altogether. IFSD also reported that it had told Equitable Life that it had been giving a robust response to those who approached it, stating the company was solvent and continuing to trade so it was not a matter for the FSA to be concerned about. IFSD concluded by commenting that, hopefully, any future advertising would "recognise the sensitivities and be presented with a little more tact".
- 5.30.13 Later that day, IB-PIA (Advertising) confirmed to Media Relations and IFSD that the Equitable Life advertisements which had appeared in the "weekend papers" had been reviewed but that they contained nothing contentious, that Equitable Life's website was down for maintenance and that IB-PIA would take no further action. We have been told that, in accordance with standard practice, no copies of the particular advertisements reviewed have been retained.
- 5.30.14 On 23 November 2000 an internal IB-PIA e-mail indicated that, amongst other things, IB-PIA 'had its eye on' advertising issues regarding Equitable Life's "past performance and poor present".

### **5.31 Consideration of non-GAR investors**

- 5.31.1 On 17 November 2000, IB-PIA was contacted by IFSD regarding a query from one of the potential bidders for Equitable Life. IFSD explained that, if the bidder acquired Equitable Life, it would close the with-profits fund to new business which would mean that no new policies would be issued but that existing policyholders would be able to make additional payments to top-up their existing policies. This was likely to be an attractive option to GAR policyholders who might seek to pay in as much as possible in order to maximise the value of their GAR and IFSD commented:

"This is expected to shift the Equitable GAR liability significantly upwards although, according to [the bidder], a figure can't be put on this because there are too many unknown variables in the calculation. As things currently stand this means that other policyholders in the Equitable fund would have to meet these additional GAR costs. Therefore any additional payments to policies made by with-profits policyholders who don't have a GAR option are likely to end up subsidising those who do have GARs on their policies. The question that [the bidder is] asking is whether this would be regarded by FSA as mis-selling to those policyholders who don't have GARs."

- 5.31.2 IB-PIA referred this query to IB-Policy which advised, on 20 November 2000, (copied to IFSD) that this was difficult territory and it was not aware of the scope of Equitable Life's problem but that:

"If a firm has a series of GA and non-GAs so that future premiums must be accepted on the same basis and that the effect of paying for the liability for the GA is spread across all policyholders, then this will affect the reasonable expectations of future sales both GA and non-GA.

I think the key issue is whether the reasonable expectations for the new sales to existing policyholders is greater or less than asset share given that the firm knows about a possible strain on the funds. If it is less then the firm has serious

problems since, I would suggest, the minimum PRE is asset share. If it cannot “promise” asset share, then the warning that you could get back less must be disclosed and I suspect would make it unsellable.”

5.31.3 There was no apparent follow up with Equitable Life or with IFSD about this.

### **5.32 Reports and meetings**

5.32.1 An explanation of meetings and reports as they form part of the structure of regulation is provided in **Chapter 2**. Set out below is a description of meetings attended by IBD or IB-PIA during the Review Period at which Equitable Life was discussed and reports within the FSA which referred to Equitable Life.

### **5.33 Reports to the PIA Board**

5.33.1 In accordance with the PIA SLA, IB-PIA provided reports to the PIA Board. However, none of the reports which we have reviewed includes any mention of the issues arising in connection with GAOs either in general or in connection with Equitable Life.

5.33.2 As set out above, the only information that was provided to a member of the PIA Board about Equitable Life and GAOs was provided as a result of a request from that member on 23 August 1999. IB-PIA’s response to the request was to provide a copy of the memorandum prepared by IFSD dated 5 July 1999 (despite the fact that IB-PIA had received a more recent note dated 12 August 1999).

5.33.3 It is evident that discussions took place in March and May 1999 between IB-PIA and the PIA Board in relation to the issues that had arisen in connection with the sale of PFWs and that the PIA Board was consulted in relation to the referral to Enforcement. Enforcement did not thereafter make any interim reports on the progress or findings of the PFW investigation to the PIA Board. We have been told that it is not Enforcement’s role to report ongoing investigations to the PIA Board. The Board only receives reports when an investigation has been completed.

### **5.34 IBD Quarterly Reports (to ChairCo)**

5.34.1 IB-PIA also provided quarterly reports to the Board of the FSA. None of the reports that we have seen includes any mention, in the section which deals with regulatory issues, of GAO issues either in general or in connection with Equitable Life.

### **5.35 ExCo meetings**

5.35.1 At ExCo meetings, IFSD reported on developments concerning Equitable Life and the progress of the Court case as part of the “Tour de Table” and assumed responsibility for action points relating to Equitable Life. No similar report appears to have been made by IBD on any of the conduct of business issues.

### **5.36 IFSD / IB-PIA bilateral meetings**

5.36.1 These meetings were attended by the two heads of department and their managers. They were viewed as a chance to get together at managerial level “with an agenda of exchanging views on current issues” and were a means of improving the mutual understanding of what each other was each doing, at an informal level. GAO issues relating to Equitable Life were discussed at five meetings during the Review Period (in June, August, October and December 1999 and then in August 2000). These meetings are all dealt with, in context, above but the key points are summarised here:

- (a) In June 1999 IFSD reported that it was waiting for the end June regulatory returns to review the basis of reserving by firms against guaranteed annuities. IB-PIA reported it had received a legal opinion in respect of the PIA's jurisdiction over pre "A" Day sales.<sup>11</sup> It was noted that the key milestone would be the Court case and the implications for PRE.
- (b) On 11 August 1999, there was a very short reference to the expected judgment to be delivered on 9 September 1999 with a comment that the case could go either way.
- (c) On 11 October 1999, IFSD reported on the implications of the Equitable Life judgment. Notwithstanding the fact that the judgment was in favour of Equitable Life, IFSD reported that its current view was that Equitable Life had failed to meet PRE and so there was a possibility of intervention. Reference was also made to the fact that, in terms of conduct of business issues, there might, for example, be misleading bonus notices supplied to investors and firms may "have churned investors into new contracts without guarantees". It was noted that a memorandum on this had been prepared by IB-PIA and would be discussed at a meeting to be chaired by IB-PIA.<sup>12</sup>
- (d) On 10 December 1999, there was reference to the meeting which IB-PIA had held to discuss the Equitable Life GAO issue. IFSD now had information from Equitable Life regarding the number of GAO policies sold after "A" Day which would be passed to IB-PIA.
- (e) On 24 August 2000, IFSD reported that the House of Lords' judgment would have implications for the company and the industry more widely and that the process of finding a buyer for Equitable Life was underway. It was hoped that a buyer would be found by December. In the meantime, Equitable Life was "just covering" its solvency margin and had renegotiated the reinsurance agreement (which had given it a bit more "breathing space") but the solvency position "remained tight".

### **5.37 The FMC and the weekly notes**

- 5.37.1 The FSA has only been able to locate one weekly note during the Review Period which mentions Equitable Life. This note is dated 7 December 2000 and refers to revised guidance that IFSD was considering issuing in relation to GARs after the House of Lords' judgment.

### **5.38 The College meeting**

- 5.38.1 There was one college meeting during the Review Period, held on 26 November 1999 (referred to at paragraph 5.21 above). It was attended by IFSD and IMRO. IB-PIA was unable to attend. We have been told by IFSD that IB-PIA's non-attendance at this meeting was unfortunate. We have been told by IB-PIA that attendance at the college meeting would have been preferable but that IB-PIA commented on the OA-CSP and received a copy of the minutes.

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<sup>11</sup> This was a reference to the advice received from GCD in June 1999, following the query received from the Consumers' Association referred to at paragraphs 5.11.5 and 5.11.6 above.

<sup>12</sup> This was a reference to the September Memorandum dealt with at paragraph 5.17.6ff above and to the meeting on 21 October 1999 referred to at paragraph 5.20.2 above.

## **5.39 Enforcement**

- 5.39.1 In relation to communication between Enforcement and IB-PIA we have been told that, at the end of each month, a full print out of progress on cases being dealt with by Enforcement is provided to IB-PIA which forms the basis for the Enforcement/IB-PIA monthly management interface meetings. We have been told that Equitable Life was always the subject of an oral report at that meeting from Enforcement but the meetings were not minuted since they were internal liaison meetings which it was not considered justified to minute. As set out above, we have seen copies of two progress reports which include the PFW investigation (for December 1999 and January 2000). Neither document makes reference to any GAO related issues.
- 5.39.2 In relation to communication which involved IFSD, we have been told that it is for IB-PIA to update IFSD on the progress of Enforcement cases (unless there are special circumstances such as the possibility of using IFSD's powers to address a particular issue). We have also been told that there are no specific procedures for keeping IFSD informed in relation to matters referred to Enforcement but that college meetings and IB-PIA/IFSD bilateral meetings allowed for the exchange of relevant information and Enforcement also made a monthly report to ExCo. We note that, on 25 October 2000, a meeting was held between IFSD and Enforcement (but not attended by IB-PIA) to discuss the PFW investigation and that Enforcement did not attend IB-PIA/IFSD bilateral meetings or the college meetings held as part of lead supervision.