Please note

The telephone numbers of the Parliamentary and Health Service Ombudsman changed on 15 March 2009.

The new contact details are:
Helpline: 0345 015 4033
Fax: 0300 061 4000

Responses from those representing complainants

Equitable Members Action Group (EMAG)

Excerpts from EMAG's response to the report

EXECUTIVE SUMMARY

Equitable Life
Equitable Life Assurance Society is the world's oldest life assurance company and was famous for not paying commission, low operating costs and (it claimed) fair distribution of profits. The Government Actuary recommended it for public servants including health workers and judges.

However, it made no provision for the guarantees against low interest rates contained in all policies issued before 1986 (the guaranteed annuity rate or GAR) and it declared bonuses out of all proportion to profits and assets, so far out, that the Institute of Actuaries has (in 2007) expelled its Appointed Actuary for it.

Over the 1990s its with-profit fund expanded six fold to £27,000m involving more than one and a half million people.

Equitable Life's attempt to renege upon its guarantees failed in the House of Lords in July 2000 at an estimated cost of £1,500 million. But the Society had been so weakened by over-bonusing that it could not pay. Indeed it was so weak that no-one would buy its with-profit business at any price. It closed its doors in December 2000 and its directors resigned.

In July 2001 the new board of directors slashed policy values by 16% (about £4,000 million) and proceeded to affect a compromise scheme to deal with the GAR problem. More cuts followed. However Equitable Life's problems were too deep-seated. The Society is now being both run down and broken up.

Treasury Cover-up
EMAG has no doubt whatever that Equitable Life policyholders have been the subject of a cover up and delaying action by the Treasury/FSA. It was not until July 2004 that the matter was finally taken up by the Parliamentary Ombudsman with power to rule on maladministration and to recommend redress. The Treasury/FSA delaying tactics continued. They will claim that they have co-operated fully, but observers can draw their own conclusions from the seven years that have elapsed from the time that Equitable Life Members' policy values were slashed to the publication of the PO's Report.

Policyholders
Nine tenths of policyholders were saving for their retirement or had retired. As a result of the Treasury/FSA cover-up and delaying action, most of those who suffered the big policy value cuts are now in their sixties and many in their seventies and eighties, many are infirm and some have died. The 500,000 direct savers had an average investment of £46,000 in Equitable Life, the million people whose retirement investment was via group schemes had an average of only £4,000.

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The principal complaint

'That the public bodies responsible for the prudential regulation of insurance companies (successively the Department of Trade and Industry, Her Majesty's Treasury and the Financial Services Authority...) and the Government Actuary's Department (GAD) failed for considerably longer than a decade properly to exercise their regulatory functions in respect of the Equitable Life Assurance Society and were therefore guilty of maladministration.'

Losses & Compensation

EMAG calculates losses incurred by policyholders investing after 1990 at £3.2bn if they would have remained with Equitable or £4.6bn if they would have invested elsewhere.

Elderly policyholders, having suffered 'outrageous' treatment at the hands of the Treasury, deserve a redress package that is rapid in payment, simple to administer, is not administered by either the Treasury, the FSA or any of their offshoots or by Equitable Life and does not require a complicated claims system. EMAG has explained how such a package could be constructed. Its estimate of the Compensation 'Pot' including interest to date is £4.5bn.

As EMAG's Actuary has pointed out, an FSA-style compensation scheme, such as applied to various forms of mis-selling, could take another eight years. In eight years most Equitable Life policyholders will be beyond caring. They need and deserve, having suffered 'outrageous' treatment at the hands of the Treasury and the regulators, a redress package that:

1. Is rapid in payment.

2. Is simple to administer.

3 Is not administered by either the Treasury, or the FSA or any of their offshoots or by Equitable Life.

4. Does not require an extensive and complicated claims system.

Fat Cats

Nine tenths of policyholders were saving for their retirement or had retired. The 500,000 direct savers had an average investment of £46,000 in Equitable Life, the million people whose retirement investment was via group schemes had an average of only £4,000. The story that Equitable Life was a place where 'fat cats' risked their money to get above average returns is not supported by the facts.

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REDRESS

The With Profit Fund
We estimate that the With Profit fund at 31 December 2000 comprised:

With Profit Fund at 31 Dec 2000	Regulatory Returns £m	Estimated Total Value £m	% of Fund
Pension Investment Policies			
GAR Pensions	5,030	7,085	25.9%
Non GAR Group Pensions	3,341	4,074	14.9%
Non-GAR Individual & Personal Pensions	5,730	6,988	25.5%
	14,101	18,147	66.2%
Pensions in Payment Policies			
Drawdown Policies	1,860	2,268	8.3%
With Profit Annuities	3,222	3,929	14.3%
			88.8%
Life & Investment Policies	2,524	3,057	11.2%
	21,707	**27,401**	**100%**

It will be observed that two thirds of the fund was represented by the Society's mainstream Pension Policies and after adding Drawdown and WP annuities, almost 90% of the fund was represented by some form of pension policy.

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Below is our estimate of the make up of the fund, by premium year.

Investment	**Remaining Premium £m**	**Contractual Value £m**	**Terminal Bonus £m**	**Total Value £m**
Pre 1990	N/A	1,682	2,959	4,641
1991	470	864	290	1,154
1992	656	1,112	344	1,456
1993	868	1,357	376	1,733
1994	1,016	1,472	353	1,825
1995	1,406	1,896	406	2,302
1996	1,913	2,402	453	2,855
1997	2,437	2,861	413	3,274
1998	2,649	2,944	256	3,200
1999	2,581	2,734	85	2,819
2000	2,109	2,144	-2	2,142
	16,105	**21,468**	**5,933**	**27,401**

Although the above figures are derived from the Regulatory Returns and Accounts the division of total value and the allocation between premium years has been estimated by EMAG's accountants. Actual figures should be available from the Society and we recommend that the PO obtains them.

Approach to Redress

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

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

The approach EMAG suggests to the PO is as follows:

1. Take the areas where she has found maladministration leading to injustice and make a broad brush estimate of the total loss arising to policyholders at 16 July 2001.

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2. Add an estimate of the 'removal costs' in respect of those that have subsequently moved their funds elsewhere. This would include Market Value Adjustments, other penalties and re-investment charges.

3. Apply a series of appropriate discounts for things like the proportion who were not influenced by published data and those who would not have invested elsewhere and apply those percentages to the total to arrive at a compensation sub-total as at that date.

4. Add something for outrage and interest to the resulting sum to arrive at a current compensation 'pot', which the Treasury should pay immediately to an appropriate independent scheme administrator.

5. Distribute that compensation 'pot' upon a policy by policy basis in accordance with a sliding scale based upon values immediately before the big cut of the 16 July 2001.

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

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

The Amounts

The table below illustrates the principle of calculating the 'pot'.

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	Financial Loss Staying with Equitable		**Opportunity Loss** Not moving to a competitor	
	£m	£m	£m	£m
The loss incurred through staying with Equitable was crystallised with the 16% policy value cut on 16 July 2001 on the then fund of about £24bn		3,846		
Part could not be recovered by the Society as relating to Contractual Values		(570)		
Part related to excessive bonuses voted in the early 1990s but still reflected in continuing policy values		(1,100)		
		2,176		
A rough estimate of the loss in investment value to 2001 of not moving to a competitor might be				3,600
Removal Costs				
Loss of 16% policy value cut from contractual values	400			
Re-investment costs on about £15bn at say 4%	650			
		1,050		1,050
Losses Incurred by policyholders		3,226		4,650
Discounts				
For those not being influenced in any way by the Returns, Accounts, Newspaper reports etc	5%	(161)		
For those who would not have invested in / moved to another provider, even if they had known Equitable Life's true state			30%	(1,395)
				3,255
For the difficulty in proving that the alternative provider would have done better			10%	(326)
		3,065		2,929
Most Losses relate to Lost Opportunities – take an intermediate figure (say)		3,000		
Discount for the fact that [redacted] and the Directors were primarily responsible. However the regulators allowed a problem with a small company to escalate six-fold over a decade, then adopted cover-up and delay.	10%	(300)		
		2,700		
		500		
Outrage – at say £500 for individual policyholders and £250 for group scheme members.		3,200		
Interest		1,300		
Compensation 'Pot'		**4,500**		

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The estimate of loss in investment value of £3,600m is derived from an examination of the published results of competitor companies by EMAG's accountants. A similar estimate produced by/for the FSA in 2001 produced an estimate of £5,000m. EMAG has found estimates based upon FSA internal information to be unsatisfactory, since they are always alleged to be 'confidential' and therefore cannot be independently scrutinised. The percentage discount in respect of the responsibility of [redacted] and the Directors is based upon EMAG's Counsel's opinion.

Special Cases

In view of the PO's strong findings on the Financial Re-insurance Contract, there are good grounds for adding back some of the discounts in respect of monies invested after 1 May 1999 (about £3,500m) and assuming a higher rate of interest.

With Profit annuitants have been particularly badly hit. They are not able to move their investments to other providers and have been stuck with Equitable Life until 2007. Their underlying funds were cut in July 2001 in the same way as other policyholders. This resulted in pension cuts in subsequent years. Also during those years the Equitable Life fund was invested in fixed interest stocks, which could not support the assumed growth rates. Finally they missed out on the Stock Market rise from 2003-2007 and have been transferred to the Prudential, which has Stock Market exposure, just in time for markets to fall. A special addition will be needed to reflect these matters.

Pivotal Date

The obvious date up to which to calculate compensation is 16 July 2001 when policy values were cut by about £4 billion. This was the action taken by the new board of directors to restore the balance between assets and policy values. It is the most convenient point at which to identify those who lost and to quantify by how much. The records of the policy values themselves, the terminal bonus element and the amount by which they were cut should be readily available from Halifax.

Lost Opportunities

It is imperative that whatever formula is used to assess losses from not moving to alternative providers should be based on public information, not from FSA confidential sources. EMAG members have suffered at the hands of the FOS and the FSA in producing computations of loss which cannot be checked.

Regulatory Contribution

EMAG is advised that in cases of maladministration it is traditional for those found guilty to meet the whole cost of the loss, even though others were partly responsible. However, in a case such as that of Equitable Life where the amounts are very substantial indeed and where the primary responsibility for the Society's demise rested with its actuaries, notably [redacted] and its directors, the matter of whether it is reasonable for the public purse to bear the whole cost does need to be considered.

Lord Penrose demonstrated that in the early 1990s the directors voted bonuses substantially out of

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proportion to the Society's profits and assets. This was done in order to maintain the Society's marketing advantage. The responsibility for this must lie primarily with [redacted] and the directors. It must, however, be pointed out that at this stage the Society was relatively small in size and with total funds of about £5 billion.

The financial weakness that excess bonuses created made it difficult for the Society to show the necessary degree of financial strength on its regulatory returns and accounts. The PO has found that the regulators were mal-administrative in failing to identify the devices used to conceal that weakness from public knowledge. This failure was not just an isolated incident, but as the PO's report shows, continued for the subsequent nine years.

The initial regulatory failure was taken by [redacted] as a green light to carry on expanding the Society's with profit business based upon imprudent bonuses and a fictitious marketing track record. The regulators carried on failing to deal properly with the Society's Returns for the following nine years, during which time its size expanded six fold from £5 billion to £30 billion. During this time it drew in 500,000 individual and one million group investors, mostly people saving for their retirement.

The regulators cannot reasonably claim that they didn't know what was going on. Both Lord Penrose and the PO demonstrate that they were well aware that bonuses were too high and the Society had insufficient assets to support them. They had opportunity after opportunity to take a stronger line but failed to do so. In EMAG's view, the Treasury, the FSA and GAD's approval of the worthless financial reinsurance contract as an asset valued at £800 - £1,000 million amounted to connivance with Equitable Life to cover up its appalling financial state.

In EMAG's view, supported by Counsel, the thousands of millions of pounds involved, the time over which the fault was allowed to continue, their connivance with the cover up and subsequent delaying action require that the regulators should bear a heavy percentage of the blame and the cost.

Interest

The PO in her publication 'Principles for Remedy' requires simple interest to be added at a reasonable rate to the date of payment. EMAG believes that because of the nature of the loss, the amounts involved and the long Treasury inspired delay, compound interest would be more appropriate.

Computation of Compensation

a) Pension Investment Policies (two thirds of the WP Fund)

   The most accurate approach would be to apply a compensation factor to each premium paid since 1990. This however depends upon the availability of premium payment data. If this is not available or would involve undue delay, then the terminal bonus content of any policy provides a reasonable indication of the 'vintage' of policies generally and should be used.

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It is a feature of Equitable Life's bonus methodology that the policies with the largest terminal bonus content did best from the over-bonusing and those with the smallest suffered worst from the policy value cut. It would be possible to work out a sliding scale of compensation to counteract these effects. This could then be applied directly to each policy based on its value in July 2001 and its terminal bonus content.

b) Pensions in Payment Policies (about 23% of the WP Fund)

These were single premium policies made by policyholders upon their retirement, in order to provide a pension for life (or in the case of Drawdown) to age 75. The vast majority were taken out after 1990 and did not benefit from the over-bonusing. Compensation would be based upon the amount of that premium and the date of payment.

c) Investment Policies (most of the rest)

Compensation would be based upon the policy value before the big cut and the terminal bonus content, in a similar fashion to Pension Investment Policies

Distribution

The above would enable compensation to be apportioned and distributed primarily from the information available on Halifax's computers and without the need for anyone to make a particular claim and without policyholder input.

The main features of distribution should be:

a) The money and the administration should be in the hands of a suitable body, independent of the Treasury the FSA and Equitable Life.

b) The data required for apportionment between policies should be contained on Halifax's computers.

c) No claim or other input should be required of policyholders

d) The formula should be a simple arithmetic one, open to inspection.

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As regards payment, we suggest the following:

1) Continuing With Profit Annuities

   That part of the compensation representing lost income since 2001 should be paid to policyholders direct. The balance should be passed to Prudential for addition to the appropriate fund and policies.

2) Continuing Policies Generally

   The share of the compensation pot should be passed to Equitable Life for addition to the appropriate fund and policies.

3) Pension Policies transferred to other Providers

   The policyholder should have the option of having the relevant compensation share transferred to his new provider or paid to him as cash.

4) Encashed Policies, Deceased Investors

   The relevant compensation share should be paid to the policyholder or his estate as cash.

5) Group Schemes

   These should be dealt with on a group basis. Distribution to individual members should left to the respective trustees.

Recipients and Tax

Where compensation is paid into an ongoing pension fund there should be no question of tax being deducted or of any policy holder being able to claim tax relief in respect of the payment. Eventually the policy holder will benefit in the form of a higher pension and HMRC will of course assess tax thereon in the normal way.

As regards payments in cash to individuals or their beneficiaries, we recommend that some notional tax be deducted on an average basis and that the resulting compensation be made tax free.

The Treasury should ensure that any necessary changes to the tax laws are put in place to enable this to happen. Elderly and much wronged Equitable Life policyholders should not be burdened with future battles with the tax man.

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Conclusion

EMAG is pleased to approve the PO's Report generally and to acknowledge her courage and integrity and her team's industry and dedication.

EMAG believes that in view of the delays that have already occurred and the age of the complainants, any scheme for Redress needs to be open, simple and capable of rapid implementation from existing readily available information. Its proposals are designed to achieve this objective. It will be pleased to provide further details if required.