

Equitable Life: a decade of regulatory failure

Part five: guide to the main report and summary
of findings and recommendations



Parliamentary
and Health Service
Ombudsman

Equitable Life: a decade of regulatory failure

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findings and recommendations

Fourth report

Session 2007-2008

Presented to Parliament pursuant to

Section 10(4) of the Parliamentary Commissioner Act 1967

Ordered by

The House of Commons

to be printed on

16 July 2008

HC 815-V

London: The Stationery Office

£206.00

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Section 1: Introduction

- 1.1 This document provides a guide to the full report of my investigation into the prudential regulation of The Equitable Life Assurance Society (the Society) during the period prior to 1 December 2001. It also summarises the findings and recommendations of that report.
- 1.2 The guide sets out in summary form the conclusions which I have reached in that report. However, it does not aim to explain the full rationale for those conclusions or to set out every consideration that has been taken into account in reaching those conclusions.
- 1.3 This guide is not a substitute for reading Part 1 of my report, to which the reader is referred if they wish to understand the reasons for my findings and determinations or to see on what evidence I have based those findings and determinations. A glossary of terms used within my report is also set out in Part 1.
- 1.4 The investigation which led to my report centred on allegations of regulatory failure on the part of the public bodies responsible for the prudential regulation of insurance companies in the period prior to 1 December 2001, as those responsibilities were discharged in the case of the Society.
- 1.5 The full report of my investigation is in four Parts (or volumes):

Part 1 describes the background to my investigation, summarises the evidence and representations submitted to me by the parties to the complaints, explains the tests I have applied in determining those complaints, sets out my key findings of fact and contains my determinations as to whether maladministration occurred and, if so, whether it has resulted in any unremedied injustice. It concludes by setting out my

recommendations concerning questions of remedy.

Part 2 contains a factual description of the historical development of the regime that was relevant to the prudential regulation of life insurance companies during the period prior to 1 December 2001.

Part 3 contains a detailed chronology of events relating to the prudential regulation of the Society during the relevant period.

Part 4 contains some key primary and secondary documents, reproduced in full or in part, which I consider are either key to a full understanding of the matters that I have investigated or which help to place my determination of the relevant complaints in a wider context.

- 1.6 This document focuses on providing a summary of my findings. It therefore provides the reader principally with a guide to Part 1 of my full report. However, some Chapters of Part 1 are themselves a summary of more detailed evidence and documentation contained in Parts 2, 3 and 4.
- 1.7 So this document does not tell the full story and is not intended to do so. It is deliberately brief and focuses primarily on the complaints that I received and my determination of them.
- 1.8 I would encourage anyone who wishes to know more about the events which form the background to, and context for, this investigation, or about the detailed regime relevant to the prudential regulation of life insurance companies during the period in question, or who wishes to read a detailed account of the way in which the prudential regulation of the Society was undertaken, to read Part 1 in full.

The structure of Part 1

1.9 The structure of Part 1 of my report is as follows.

Chapter 1 is an introductory Chapter.

Chapter 2 sets the scene for the investigation I have conducted, focusing on the events which form the background to, and the context for, my investigation, and also on the other reviews, inquiries and litigation which have taken place (or which continue to take place) in respect of the Society.

Chapter 3 explains the involvement of my Office in respect of the events related to the Society and which led to my decision to conduct this investigation. It also outlines the legal and administrative framework for the investigation and describes the process that I have used to conduct it.

Chapter 4 sets out the general and detailed complaints that have been made to me about the prudential regulation of the Society. It also sets out the initial response to those complaints of the public bodies whose actions were the subject of complaint.

Chapter 5 sets out the basis for my determination of the complaints. It describes my general approach to investigating complaints of injustice sustained as a consequence of maladministration; and sets out both the general principles of good administration and public law and the specific legal and administrative framework of prudential regulation applicable to my consideration of those complaints. It concludes with a summary of the key obligations of the

prudential regulators and/or the Government Actuary's Department (GAD) which are relevant to this investigation.

Chapters 6, 7 and 8 set out a summary of the way in which the prudential regulation of the Society was undertaken in three time periods:

- the first period being prior to 20 June 1998;
- the second period being from 20 June 1998 to 8 December 2000, when the Society closed to new business;
- the third period being the post-closure period from 8 December 2000 to 1 December 2001, when my jurisdiction ends.

Chapter 9 contains the preliminary assessments which I have made in respect of disputed questions concerning what standard of regulation it would be appropriate to apply when reviewing the acts and omissions of those undertaking the prudential regulation of the Society, and what powers were available to those regulators.

Chapter 10 sets out the results of my review of the evidence I have obtained and contains my findings of fact.

Chapter 11 sets out my determinations as to whether the acts and omissions of the prudential regulators and/or GAD constitute maladministration.

Chapter 12 sets out my determinations as to whether any such maladministration has led to injustice to those who have complained to me.

Chapter 13 contains my disposal of each complaint within the terms of reference for the investigation, setting out which I have upheld in full, which I have upheld in part, and which I have dismissed.

Chapter 14 considers questions of remedy and contains my recommendations.

Chapter 15 contains my concluding remarks.

Section 2: The background

- 2.1 My report sets out my determinations of complaints which alleged that the regulators of insurance companies had failed properly to exercise their functions in relation to the Society for more than a decade.
- 2.2 The scope of that report was determined by the limits to my powers to conduct investigations into the actions of those bodies whose actions were the subject of those complaints.

The Equitable Life Assurance Society

- 2.3 My report does not make findings about the actions of the Society itself and is concerned instead with regulation. However, in Chapter 2 of Part 1 of my report, I set the scene for that regulation. This includes a description of the nature of the Society's business and of how the problems it faced came about.
- 2.4 The Society was founded in 1762 and it was incorporated in the United Kingdom as a private unlimited company in 1892. The Society is generally accepted to be the oldest surviving mutual life assurance company in the world.
- 2.5 As a mutual life insurance company, the Society has no shareholders and is owned by its with-profits policyholders. Those policyholders effectively stand in the position of proprietors, sharing in any profits made or losses incurred in running the Society's business.
- 2.6 On 8 December 2000, the Society announced that it would stop writing new business with immediate effect. Since then, the Society has undergone a difficult period and has implemented cuts in the policy values of its with-profits policies or the income derived from its with-profits annuities.
- 2.7 The announcement by the Society of its closure to new business was prompted by the withdrawal of the last potential bidder from a sales process that had been launched to seek a buyer to acquire the Society following a decision of the House of Lords.
- 2.8 The operation of the Society's differential terminal bonus policy in respect of a representative policy for which the default benefit was an annuity paid at a guaranteed rate had become the subject of legal proceedings once doubts arose as to the legality of that policy. The differential terminal bonus policy, which Equitable had adopted since January 1994, involved the paying of different levels of terminal bonus to policyholders exercising their right to take an annuity at the guaranteed rate than were paid to policyholders not exercising such a right.
- 2.9 The House of Lords held on 20 July 2000 – in *Equitable Life Assurance Society v Hyman* ([2002] 1 AC 408) – that the Society's differential terminal bonus policy was unlawful.
- 2.10 At the time, it was recognised that the Society was distinctive within the life insurance industry and also that this distinctiveness had played a part in the circumstances which had led the Society to close to new business.
- 2.11 The four central factors which were of importance to the Society's problems, recognised by the Treasury at the time of its closure, were:
- first, that the Society had for many years operated a policy of full distribution of any surplus through bonuses to its with-profits policyholders and a policy of not building up a free estate, leaving the Society with a comparatively low level of free assets;

- secondly, that the Society, being a mutual, had no access to additional, shareholder capital;
 - thirdly, that the Society had offered relatively generous and flexible guarantees on certain types of policy; and
 - finally, that the proportion of the Society's business to which those guarantees applied was much higher than was the case for other companies.
- 2.12 The closure of the Society to new business as a result of those problems set the scene for the complaints that I have received. While the actions of others, such as the Society itself or its former auditors, became also the subject of complaint to others, the complaints that were made to me concerned the role of the regulators of the Society.

Insurance regulation

- 2.13 Before 1 December 2001, there were two forms of insurance regulation in the United Kingdom – prudential regulation and conduct of business regulation.
- 2.14 Prudential regulation was governed by the provisions of the Insurance Companies Act 1982 and by the Regulations made under that Act. Such regulation primarily related to the supervision of the solvency of life insurance companies and their ability to meet and continue to meet their liabilities to policyholders and to fulfil the reasonable expectations of policyholders or potential policyholders.
- 2.15 Conduct of business regulation was governed by the provisions of the Financial Services Act 1986 and concerned the regulation of the conduct of

investment business, including the marketing activities of life insurance companies.

- 2.16 During the period prior to 5 January 1998, the prudential regulator was the Department of Trade and Industry (the DTI) and its predecessors; from 5 January 1998 to 1 December 2001, the prudential regulator was Her Majesty's Treasury (the Treasury).
- 2.17 From January 1999 until 1 December 2001 aspects of the day-to-day prudential supervision of insurance companies were contracted out to the Financial Services Authority (the FSA) – which, in this role, acted on behalf of the Treasury.
- 2.18 Furthermore, throughout the period relevant to this report legal advice to the prudential regulators was provided by in-house lawyers and, until 26 April 2001, actuarial advice was provided by GAD. Thereafter, actuarial advice was provided to the FSA by actuaries directly employed by the FSA, some of whom had previously worked for GAD.

My jurisdiction

- 2.19 I am only able to investigate certain action taken by or on behalf of those bodies which are within my jurisdiction.
- 2.20 Actions taken by all of the bodies which at the relevant time had statutory responsibility for prudential regulation are within my jurisdiction, where those actions are taken in the exercise of the administrative functions of such bodies. Thus the actions of the DTI and the Treasury are within my jurisdiction.
- 2.21 I am only able to conduct investigations in respect of the actions of GAD and the FSA on a limited basis. I have no power to conduct investigations in relation to conduct of business regulation.

- 2.22 GAD were not within my jurisdiction until the beginning of this investigation. I may only investigate action taken by GAD on or before 26 April 2001 in the giving of advice concerning the exercise of administrative functions under Part II of the Insurance Companies Act 1982 or any other enactment concerned with the regulation of insurance companies.
- 2.23 The actions of the FSA are only within my jurisdiction in so far as those actions relate to the prudential regulation of insurance companies during the period from 1 January 1999 to 1 December 2001, when the FSA undertook that regulation on behalf of the Treasury.
- 2.24 Conduct of business regulation throughout this first period was delegated to a system of industry and practitioner-based, self-regulatory organisations under the supervision of a designated agency. None of those bodies with statutory responsibility for conduct of business regulation is or was within my jurisdiction.
- 2.25 All of this meant that the scope of my investigation was limited to the actions taken during the period prior to 1 December 2001 by the DTI and the Treasury as the prudential regulators of the Society and to the actions taken by the FSA and GAD on behalf of those regulators.

Section 3: The complaints that were made and the Government's initial response

The general and specific complaints

- 3.1 My investigation – undertaken after wide consultation with those affected – began in July 2004. It was conducted in accordance with the provisions of the Parliamentary Commissioner Act 1967.
- 3.2 I have received 898 complaints referred by MPs in respect of 1,008 people. I also received 1,309 direct representations from a further 1,480 individuals.
- 3.3 With the help of the various action groups representing complainants, fifteen people were selected to act as lead complainants. Those people epitomise the position of all the principal groups of current and former policyholders and annuitants who had complained to me. The lead complainants authorised members of the action groups to act as their personal representatives during the course of the investigation.
- 3.4 The general complaint made was that:
- ... the public bodies responsible for the prudential regulation of insurance companies... and the Government Actuary's Department 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.*
- 3.5 Eighteen detailed complaints were made. Those heads of complaint were labelled complaint A to complaint R and are set out in full in Annex A of this document. Those detailed complaints, together with the general complaint, formed the basis for my investigation.
- 3.6 All the complainants claimed that they had suffered financial and other injustice as a result of

alleged maladministration by the prudential regulators and sought full redress for that injustice.

The Government's initial response

- 3.7 I put those complaints to the Treasury, the FSA, and GAD. Their initial response, in summary, was that:
- (i) there had been no failure on the part of any of the prudential regulators or GAD properly to exercise their functions in respect of the Society. At all times those regulators and GAD had acted reasonably and properly, in the context of and having regard to the regulatory regime as it had been at the relevant time;
 - (ii) the nature and scope of that regime had been determined by legislation and by regulatory policies which informed and were adopted under the applicable legislation. At all times, the policies adopted had been proper ones and had been the result of choices which Parliament and Ministers had been fully entitled to make;
 - (iii) none of the complaints made by the complainants disclosed reasonable grounds for concluding that any of the public bodies responsible for the prudential regulation of the Society or GAD had been guilty of maladministration.
- 3.8 I was not satisfied that this response resolved the complaints which had been made to me and so I decided to continue my investigation.
- 3.9 I appointed an in-house team of investigators to conduct the investigation. I also appointed both legal and actuarial advisers to assist me and my investigation team. In addition, I arranged for the

actuarial advice I received to be peer reviewed. The advice of both sets of professional advisers has greatly informed (and is fully integrated into) my report.

Terms of reference

3.10 The terms of reference for the investigation were:

To determine whether individuals were caused an injustice through maladministration in the period prior to December 2001 on the part of the public bodies responsible for the prudential regulation of the Equitable Life Assurance Society and/or the Government Actuary's Department; and to recommend appropriate redress for any injustice so caused.

Conduct of the investigation

3.11 In carrying out the investigation, we have reviewed:

- the operational and policy files of the public bodies whose actions were under investigation;
- all the documentary evidence from other sources that was available to Lord Penrose when he conducted an inquiry into the events which led to the Society closing to new business, the report of which was published in 2004;
- transcripts of evidence given to the Penrose inquiry, to the Baird inquiry, an internal FSA inquiry in 2001 into their role in the relevant events, and to my first investigation by current and former officials and actuaries connected with the prudential regulation of the Society;

- the relevant working documents and emails of those officials and actuaries; and
- publicly available material (such as actuarial papers and discussions); and historical and other material held at the National Archives, the British Library, and the libraries of the DTI, the Institute of Actuaries, and the Institute of Chartered Accountants of England and Wales.

3.12 At the end of January 2007, I sent the public bodies a first draft of my provisional views on relevant facts, whether maladministration had occurred and, if so, whether it had resulted in any injustice to complainants. This followed the sharing of draft excerpts from the factual background Parts of this report with the parties to the complaints.

3.13 In March 2007, I disclosed the provisional report of my actuarial advisers to the public bodies. Those bodies, in April 2007, made substantial representations to me about my draft report and about the content of the professional advice that had informed that draft report. In the light of those representations, I agreed to conduct a fundamental review of my draft report and to seek further professional advice.

3.14 The revised draft report that was the result of that review was issued in February 2008 to all the interested parties. My final report takes into account all the responses I received to those drafts.

Section 4: The basis for my determination of the complaints

My approach

- 4.1 In simple terms, when determining complaints that injustice has been sustained in consequence of alleged maladministration, I generally begin by comparing what actually happened with what should have happened.
- 4.2 So, in addition to establishing the facts that are relevant to a complaint, I also need to establish a clear understanding of the standards, both general and specific, which applied at the time. I call this establishing the overall standard.
- 4.3 In Chapter 5 of Part 1 of my report, I set out the general standard relevant to the investigation, as derived from established principles of good administration and from public law principles. I then go on to set out the specific standard relevant to the investigation, i.e. the specific legal and administrative framework of prudential regulation.
- 4.4 Having established the overall standard, I then assess the facts in accordance with that standard. First, I assess whether an act or omission on the part of the body complained about constituted a departure from the applicable standard. If so, I then assess whether that act or omission was so unreasonable, or fell so far short of acceptable standards of good administration, as to constitute maladministration.
- The central place of the Appointed Actuary within the regulatory regime;
 - The protection of the ‘reasonable expectations’ of both policyholders and potential policyholders; and
 - The criteria of ‘sound and prudent management’.
- 4.6 Those cornerstones laid the foundations on which were built:
- the way in which regulation was undertaken – in which information provided through the regulatory returns and the role played by the Appointed Actuary in ensuring that this information was so provided were given a central place; and
 - the powers, duties and means conferred on the prudential regulators – which gave prominence to the protection of policyholders’ reasonable expectations and ensuring the fulfilment of the statutory criteria of sound and prudent management.
- 4.7 The statutory framework which governed this system of regulation had four chief component parts:
- European Directives concerning life assurance;
 - the Insurance Companies Act 1982;
 - secondary legislation made under the Insurance Companies Act 1982; and
 - certain other domestic statutory provisions related to the activity of insurance companies.

The regulatory regime

- 4.5 The regulatory regime which developed over time to deliver prudential regulation and which pertained at the time relevant to this report had four cornerstones:
- The concept of ‘freedom with publicity’;

- 4.8 The prudential regulation of insurance companies such as the Society was primarily undertaken through two mechanisms: the submission of regulatory returns and the scrutiny of those returns.
- 4.9 Each company was required to submit annual returns containing detailed information about the business and financial strength of the company in a prescribed format. Once checked by the prudential regulators for completeness, those returns were placed in the public domain at Companies House.
- 4.10 Scrutiny of those returns was undertaken by GAD on behalf of the prudential regulators until April 2001. The prime aims of this scrutiny were to ensure that the company had complied with the statutory and other obligations imposed on it, to verify the financial position of the company, and to check that the company was able to meet its liabilities and to fulfil the reasonable expectations of its policyholders and/or its potential policyholders.
- 4.11 The prudential regulators and GAD also obtained information through visits to, and meetings with, insurance companies and through information provided to them by such companies on an *ad hoc* basis. GAD also undertook industry-wide analysis, which informed their scrutiny of the returns.

The legal and administrative obligations of the prudential regulators and GAD

- 4.12 Chapter 5 of Part 1 of my report, supported by the relevant detail in Part 2, provides a detailed overview of the general and specific legal and administrative obligations which the prudential regulators and/or GAD had at the relevant time.

4.13 From that overview, I identified the following key legal and administrative obligations which I use in my consideration of the manner in which those regulators and/or GAD discharged their obligations. I also set out below what I would expect to have seen if the prudential regulators and/or GAD were fulfilling these obligations.

- (i) The prudential regulators were under statutory duties, imposed by the specific regime contained within the Insurance Companies Act 1982 and the Regulations made under it:

- to consider the regulatory returns with a view to ensuring that those returns were complete and accurate (in the sense of them being compliant with the applicable Regulations).

In complying with this duty, I would expect the prudential regulators to have considered the regulatory returns submitted by insurance companies and, if those returns appeared to be inaccurate or incomplete in any respect, to have communicated with the company with a view to the correction of any such inaccuracies and the supply of deficiencies.

- and to ensure that an insurance company valued its assets and determined its liabilities in accordance with the requirements that were imposed on it by the applicable Regulations.

In complying with this duty, I would expect the prudential regulators to have considered whether the way in which an insurance company valued its assets and determined its liabilities as set out within the regulatory returns had been

undertaken in accordance with the relevant requirements and, if it appeared that the company had used a valuation basis that was not compliant with those requirements, to have considered whether to take action to remedy the position.

- (ii) The prudential regulators were also under a general public law duty to give proper consideration to the use of their powers of intervention where the circumstances had or may have arisen which gave grounds for the use of such powers.

In complying with this duty, I would expect the prudential regulators to have considered the use of their powers in the light of any information that they possessed – whether from the content of the regulatory returns, from contact with an insurance company, or from other sources – which gave rise to questions about the solvency position of that company, or about whether it was acting in line with the interests of its policyholders or in accordance with the reasonable expectations of those policyholders, or potential policyholders, or about whether it was acting soundly or prudently.

- (iii) The prudential regulators were also under a general public law duty to exercise their statutory powers in a right and proper way, in accordance with the presumed intention of the legislature which conferred those powers, in good faith, reasonably, for a proper purpose, and with procedural propriety.

In complying with this duty, I would expect the prudential regulators to have dealt appropriately with any regulatory issues

which arose in relation to any insurance company other than through the scrutiny process and to have acted in such a manner as to ensure the effective operation of the regulatory regime as Parliament had established it – informed as that regime was by the concepts of ‘freedom with publicity’, the protection of the reasonable expectations of policyholders and potential policyholders, and the fulfilment of the criteria of sound and prudent management.

- (iv) Both the prudential regulators and GAD were under an obligation generally to act in accordance with established principles of good administration.

In complying with this obligation, I would expect the prudential regulators and/or GAD:

- to have acted in accordance with their general and specific legal duties and powers;*
- to have acted in accordance with their own published and internal policy and guidance;*
- to have taken proper account of established good practice, including professional practice;*
- to have taken reasonable decisions based on all relevant considerations and ignoring irrelevant ones;*
- to have kept proper and appropriate records as evidence of their activities, including a record of the reasons for their decisions; and*

- *to have provided information, where it was appropriate to do so, which was clear, accurate, complete and not misleading.*

Section 5: Findings of fact

- 5.1 In Chapters 6, 7 and 8 of Part 1 of my report, supported by the relevant detail in Parts 3 and 4, I set out how the prudential regulation of the Society was undertaken during the period from when the Society's returns for 1990 were submitted to the prudential regulators until the end of my jurisdiction on 1 December 2001 – with the coming into force of the current regulatory regime.
- 5.2 As I explained in Section 4, my approach to determining complaints of maladministration leading to injustice is to assess the facts against the overall standard that I have established is relevant to the investigation.
- 5.3 First, I assess whether an act or omission by the body complained about constitutes a departure from the applicable standard. These are my findings of fact.
- 5.4 My review of all the evidence, submissions and other material and my application of the overall standard to that evidence have led me to make ten principal findings of fact.
- 5.5 conferred on the Appointed Actuary and to enable him or her to do so in line with the intention of Parliament when it had created the role in 1973.
- 5.7 If an Appointed Actuary was unable to secure or retain the necessary degree of operational independence, this would raise serious questions about the ability of the Appointed Actuary in those circumstances to perform the regulatory functions conferred on him or her.
- 5.8 **My first finding of fact** is that, in June 1991, the prudential regulators approved, when they should not have done, the appointment of a new Chief Executive without insisting that he should demit office as the Society's Appointed Actuary and without applying subsequently a closer degree of scrutiny of the Society's affairs.
- 5.9 Furthermore, for the next six years, those regulators failed to consider the use of their powers to seek the removal of that person from his 'dual role', despite the assurance that had been given at the time of his appointment that he would hold such a dual role for 18 months only. Yet the dual role existed from 1 July 1991 to 31 July 1997.

My first finding of fact

- 5.5 The role of the Appointed Actuary was, at the time relevant to this report, a central component of the system of prudential regulation of insurance companies.
- 5.6 Given this regulatory role, which was one cornerstone of the system of prudential regulation in the United Kingdom, an Appointed Actuary needed to ensure that he or she had sufficient independence from the executive management of a life insurance company to enable him or her to undertake effectively the responsibilities (to the company, to its policyholders, and to the prudential regulators and GAD) that were
- 5.10 After having considered the representations I had received, I concluded that the way in which the DTI, as prudential regulators, handled the creation and continued existence of the 'dual role' fell short of the standard that could reasonably be expected of such regulators.

My second finding of fact

- 5.11 Each year, the Society, like every other insurance company, was required to submit annual returns to the prudential regulators. Those returns set out a considerable amount of detail about the business of the Society, about its liabilities, about the assets

covering those liabilities, and about the solvency position of the Society.

5.12 As I have noted, the submission and scrutiny of those returns were the two prime mechanisms of prudential regulation during the period covered by this report.

5.13 The Society's returns for the years 1990 to 1993 raised certain issues about the approach that the Society was adopting to its business, which the scrutiny process was designed to highlight in order to enable the prudential regulators, acting with advice and assistance from GAD, to ascertain whether there was any need to raise and pursue those issues.

5.14 **My second finding of fact** is that, with regard to the scrutiny of the Society's annual regulatory returns for the year ends for 1990 to 1993, GAD, in providing advice to the prudential regulators, failed to satisfy themselves that the way in which the Society had determined its liabilities and had sought to demonstrate that it had sufficient assets to cover those liabilities accorded with the requirements of the applicable Regulations.

5.15 Accordingly, those regulators were unable to verify the solvency position of the Society as they were under a duty to do. The aspects in respect of which the Society's returns for these years raised questions which should have been identified, pursued and resolved were:

- the valuation rate of interest used to discount the liabilities, which appeared to be imprudent and/or impermissible (discounting liabilities well below the guaranteed face value of policies); and

- the affordability and sustainability of the bonuses previously declared by the Society, which appeared to raise the expectations of the Society's policyholders which might not be met.

5.16 On the information before GAD, the Society's approach to discounting meant that a significant amount of any future surplus would be required simply to fund current guaranteed benefits.

5.17 This occurred in a situation in which GAD knew that the Society had informed its policyholders that, subject to smoothing, the additional returns they would receive by way of future bonus declarations would reflect the future investment performance of the with-profits fund.

5.18 In addition, serious questions arose from the information within the returns about whether the Society could afford the level of bonus it was paying and whether it could continue to pay out at that level. This occurred in a situation in which, as GAD knew, the Society was unique in illustrating to its policyholders the full policy fund value, including terminal bonus.

5.19 From the information before GAD, it was not clear how the Society could fund guaranteed future bonuses (applying the guaranteed investment return) or manage to pay future discretionary bonuses, in line with the reasonable expectations of the Society's policyholders that such bonuses would continue to be paid.

5.20 Despite those questions, raising issues concerning the prudence of the Society's approach and whether the Society would be able to fulfil the reasonable expectations of its policyholders, no action was taken by GAD to seek to resolve those questions or to raise them with the prudential regulators.

5.21 After having considered the representations I had received, I concluded that the failures by GAD, as part of the scrutiny process, to raise and seek to resolve questions within the Society's regulatory returns for each year from 1990 to 1993, related to (i) the valuation rate of interest used to discount the Society's liabilities and (ii) to the affordability and sustainability of the Society's bonus declarations, fell short of what could reasonably be expected of GAD.

My third finding of fact

5.22 As is well known, the Society wrote policies containing guaranteed annuity rates. Those policies guaranteed the rate at which the proceeds available at retirement (based on the sum assured plus associated bonuses) would be converted to a pension – and thus the minimum amount of pension available at retirement.

5.23 The Society stopped providing guaranteed annuity rates on new policies from June 1988, although new members of some existing group schemes continued to be provided with policies containing guaranteed annuity rates until the early 1990s.

5.24 The Society's guaranteed annuity rates continued to apply to the benefits that would be purchased by any future premiums (including in relation to recurrent single premium policies) that might be paid in respect of policies which already enjoyed this guarantee.

5.25 Those guaranteed annuity rates were both more flexible, in that they applied over a wide range of ages without penalty, and potentially more widespread than was the case with similar guarantees provided by other companies. In addition, policyholders could pay future premium payments and still benefit from the same

guaranteed annuity rate at the same range of ages.

5.26 No new fund was established by the Society at the time of the changes it made to exclude guaranteed annuity rates and, subsequently, guaranteed investment returns from the policies it wrote. Thus the assets held in respect of the different classes of policy thereby created were held in one fund.

5.27 Nor was there a separate bonus series declared or any differentiation in treatment between the various classes of with-profits policyholders in terms of the level of bonuses declared by the Society, despite the changes in policy terms and the associated guarantees that had occurred.

5.28 In late 1993 and early 1994 and continuously from April 1995 onwards, the Society's guaranteed annuity rates became generally more favourable than then current annuity rates, due to lowering interest rates and improved mortality. This meant that the cost of providing the guaranteed annuity benefit exceeded the total policy fund, which was only sufficient to provide the lower benefit available at the current annuity rate.

5.29 In order to deal with this situation, the Society introduced what came to be known as the differential terminal bonus policy, by restricting the value of benefit paid to the amount of the total policy fund.

5.30 The Society said that this was done to enable it to continue to reflect the Society's philosophy of 'full and fair' distribution to all its policyholders in its bonus policy and to pay each policyholder just their share of the fund.

5.31 Under the Society's differential terminal bonus policy, the amount of final bonus payable when a policyholder took benefits would be dependent on the form in which those benefits were taken and

so, if the guaranteed annuity benefit was selected, the amount of the final bonus was reduced.

5.32 My third finding of fact is that GAD identified the introduction of a differential terminal bonus policy when scrutinising the Society's 1993 returns in October 1994, but failed to inform the prudential regulators, as GAD should have done, of that introduction or to raise the matter with the Society.

5.33 This failure by GAD to raise the matter occurred despite there having been full disclosure by the Society within its 1990 returns of the extent and level of the guaranteed annuity rates within its older policies and despite the Society referring to such guarantees when it disclosed the introduction of the differential terminal bonus policy in its 1993 returns. GAD also noted that this policy had the effect of reducing the final bonus payable to policyholders.

5.34 That failure also occurred despite GAD knowing, or having information before them which suggested, both that the Society had told its policyholders that the Society would only change bonus policy gradually and also that the Society's With-Profits Guides did not (at that time) inform its policyholders of the differential terminal bonus policy.

5.35 After having considered the representations I had received, I concluded that the failures by GAD, when they identified the introduction of the Society's differential terminal bonus policy as part of their scrutiny of the 1993 returns, (i) to inform the prudential regulators about the policy, (ii) to raise the matter with the Society, or (iii) to seek to identify what the rationale was for the introduction of the policy and how it was being communicated to policyholders, fell short of the standard that could reasonably be expected of GAD.

My fourth finding of fact

5.36 As noted above, the Society submitted annual returns to the prudential regulators. Further issues arose in respect of the Society's returns for 1994 to 1996.

5.37 My fourth finding of fact is that, in carrying out the scrutiny of the Society's annual regulatory returns for each year from 1994 to 1996, GAD, in providing advice to the prudential regulators, failed to satisfy themselves that the way in which the Society had determined its liabilities and had sought to demonstrate that it had sufficient assets to cover those liabilities accorded with the requirements of the applicable Regulations. Those regulators were thus unable to verify the solvency position of the Society.

5.38 The matters arising from the Society's returns which GAD failed to address and resolve to a satisfactory conclusion were:

- the continuation of the two issues which had arisen within the returns for 1990 to 1993 (questions concerning discounting through the use of imprudent and/or impermissible valuation interest rates and the affordability and sustainability of the Society's bonus declarations);
- what appeared to be arbitrary changes to the assumed retirement age for personal pension policies, contrary to European Directives and the applicable domestic Regulations;
- the absence of explicit reserves for prospective liabilities for capital gains tax and for pensions review mis-selling costs, stating instead that such liabilities were covered by implicit margins in the valuation basis; and

- the absence of reserves in respect of guaranteed annuity rates, which by then GAD should have known were ‘biting’ and should therefore have been provided for.

5.39 GAD failed to identify all of those matters, to pursue them with the Society, or to seek to resolve the issues that they raised.

5.40 After having considered the representations I had received, I concluded that the failure by GAD, as part of the scrutiny process, to question and seek to resolve questions within the Society’s regulatory returns for each year from 1994 to 1996, related to (i) the valuation rate of interest, (ii) the affordability and sustainability of bonus declarations, (iii) apparently arbitrary changes to the assumed retirement ages, and (iv) the holding of no explicit reserves for the liabilities associated with prospective liabilities for capital gains tax, for pensions mis-selling costs, and for guaranteed annuity rates, fell short of what could reasonably be expected of GAD.

My fifth finding of fact

5.41 Most insurance companies used the valuation method and basis set out in the applicable Regulations to calculate their Mathematical Reserves.

5.42 However, throughout the period covered by this report, insurance companies were entitled to use an approach which differed from the statutory minimum basis, so long as the alternative method that was used produced Mathematical Reserves that were at least as high as that which would have been produced using the statutory minimum basis.

5.43 During the period covered by this report, the Society always used an alternative valuation method within its returns.

5.44 In order to seek to demonstrate compliance with the Regulations, the Society set out information about the amount of its Mathematical Reserves using a basis that its Appointed Actuary considered was compatible with the method set out in the Regulations. This was done in an appendix at the end of Schedule 4 of the Society’s returns.

5.45 **My fifth finding of fact** is that GAD failed in certain respects to act, when they should have acted, to question the Society’s practice of producing two valuations within the regulatory returns but omitting crucial information from one of those valuations. After 1996, the Society continued to produce two valuations but published the missing information.

5.46 That information was the amount of the resilience reserves required in the Society’s appendix valuation, produced to demonstrate compliance with the Regulations. That omission meant that the Society appeared financially stronger than it was and that its solvency position was capable of being misconstrued.

5.47 While GAD asked the Society for the missing information in all but one year, GAD did not take steps to ensure that a reader of the returns had that information.

5.48 Even though the Society was not in breach of any of the applicable Regulations by presenting its valuations in the way that the Society did, GAD recognised at the time that this position meant that the Society’s returns, which were the main mechanism through which ‘freedom with publicity’ was delivered, might mislead those who read them.

5.49 Although the Society was permitted to produce an alternative valuation from that specified in the applicable Regulations, it was required, by those Regulations, to demonstrate that its chosen

alternative valuation was at least as strong as that specified in those Regulations.

- 5.50 GAD considered that such demonstration was provided through the provision by the Society to GAD – but not through the returns – of the amount of the reserves omitted from the Society’s alternative valuation. However, GAD failed to ask for this information in November 1996 when conducting their scrutiny of the Society’s 1995 returns. GAD were therefore unable to verify whether those returns had complied with the applicable Regulations.
- 5.51 In addition, from November 1993 onwards GAD had possessed information, in the form of ratings of the Society produced by Standard & Poor’s – an expert ratings agency, which showed that the position was not only capable of being misconstrued but also that it was being misconstrued.
- 5.52 Standard & Poor’s erroneously concluded that the Society was stronger than it really was. This was as a direct result of the information which GAD knew was missing from the returns. Those ratings were also provided to GAD by the Society and retained on GAD’s files and were used by the prudential regulators as part of briefing for Ministers and in other ways.
- 5.53 GAD took no action to raise or to seek to resolve these issues.
- 5.54 After having considered the representations I had received, I concluded that the failures by GAD (i) to ask for the information they needed in respect of the Society’s 1995 returns to enable them to be sure that the Society had produced a valuation that was at least as strong as the minimum required by the applicable Regulations, and (ii) to pursue the information before them that the omitted information had led to the users of the returns

misconstruing the financial strength of the Society, fell short of what it was reasonable to expect from GAD.

My sixth finding of fact

- 5.55 During 1998, the prudential regulators and GAD became aware that the Society had not made provision for the liabilities arising from guaranteed annuity rates contained within certain of its policies and those regulators required that the Society should do so within its 1998 returns.
- 5.56 That requirement had led to an immediate increase of £1,600 million in the amount of reserves required to be shown as at 31 December 1998, as well as additional associated resilience reserves. As a result, the Society investigated means whereby those additional liabilities could be offset in order not to disclose a much weaker financial position in those returns.
- 5.57 Had such offsetting action not been taken, the 1998 regulatory returns would have shown such a weak financial position that the Society’s future as an independent mutual would have been threatened and its continued ability to write new business and declare bonuses would have been in doubt.
- 5.58 The prudential regulators told the Society in December 1998 that they would take action if they considered that the 1998 bonus declaration made by the Society was imprudent. The Society therefore needed to take urgent action to either raise capital or to reduce its Mathematical Reserves.
- 5.59 The Society did this through a financial reinsurance arrangement. Within its published returns for 1998, 1999, and 2000, the Society took

credit for the arrangement that it had entered into with IRECO.

- 5.60 The amount of the credit taken for those years was, respectively, £809 million, £1,098 million, and £808 million. The Society's Mathematical Reserves were reduced by more than those amounts, however, as the resilience reserves it was required to hold were also reduced. The prudential regulators permitted those credits to be taken.
- 5.61 The Society's published returns for 1998 showed that it had excess available assets and implicit items of £1,516 million over the required minimum margin, the returns for 1999 showed the excess asset figure as £2,747 million, and those for 2000 showed a figure of £411 million.
- 5.62 **My sixth finding of fact** is that the FSA permitted the Society, when they should not have done so, to take credit within its 1998 returns, which were submitted on 30 March 1999 and which were available to the public by 1 May 1999, for a financial reinsurance arrangement which had not been concluded either at the valuation date or at the date that those returns were submitted. This was done without an appropriate reporting concession being given.
- 5.63 Moreover, even leaving that aside, the FSA permitted the Society within its returns for 1998, 1999, and 2000 to take credit for the financial reinsurance arrangement that did not reflect the economic substance of that arrangement.
- 5.64 This was despite the fact that GAD had identified the potential problems with the proposed financial reinsurance arrangement and had informed the FSA of those problems, recognising that this arrangement had little or no value for the purposes of the determination of the Society's solvency position.

- 5.65 After having considered the representations I had received, I concluded that the failure by the FSA, acting on behalf of the prudential regulators, to (i) ensure that the financial reinsurance arrangement was not taken into account within the Society's 1998 returns without an appropriate concession being given, and (ii) ensure that the credit taken by the Society within its returns for 1998, 1999, and 2000 properly reflected the economic substance of that arrangement, fell short of the standard that could reasonably be expected of such regulators.

My seventh finding of fact

- 5.66 As is well known, the Society sought clarity as to the validity of its differential terminal bonus policy through seeking the view of the Courts. While that litigation was proceeding through the Courts, the Society – and the prudential regulators – undertook scenario planning to consider the likely impact of a range of possible outcomes to that litigation.
- 5.67 Consideration was given to what those scenarios would mean for the financial position of the Society and for its freedom to maintain the policies it had adopted to manage its affairs, and what other consequences the possible outcomes of the *Hyman* case could have for the Society and its members.
- 5.68 Even assuming that the financial reinsurance arrangement which the Society had entered into, and for which it proposed to take a substantial offset within its 1998 regulatory returns, entitled the Society so to do, the continuation of that arrangement was contingent on the Society being able to continue to apply its differential terminal bonus policy. Yet that ability was precisely the issue at stake in the *Hyman* proceedings.

- 5.69 Furthermore, if the Society were found not to have been able to apply its differential terminal bonus policy, the question would arise as to how to remedy the position of those policyholders with policies which contained guaranteed annuity rates who had retired since 1 January 1994, but who had not been provided with the option of taking benefits without the reduction in terminal bonus applied under the Society's differential terminal bonus policy. The question of compensating such policyholders would thus arise if the Society lost the *Hyman* case.
- 5.70 **My seventh finding of fact** is that the FSA failed to pursue the failure by the Society to include contingent liability notes within its regulatory returns for 1998 and 1999 regarding the potential impact of losing the *Hyman* litigation. This failure to check why the Society had not included any such disclosure in those returns occurred despite the reminders by the prudential regulators that the Society should do so, reminders given prior to the submission of the Society's 1998 returns.
- 5.71 No action was taken to seek to ensure that the Society had a sound basis for not publicly disclosing the fact that the outcome of the litigation could have profound effects, including for the operation of its differential terminal bonus policy (and hence its reserving practices) – effects which would have a significant impact on the solvency position of the Society and on the amount of money available to meet the liabilities it had to its policyholders and the future bonus expectations of those policyholders.
- 5.72 This failure by the FSA to act also occurred in relation to the Society's 1999 returns in a context in which the FSA knew that the Society had informed its policyholders that no significant costs would be imposed on the Society if it lost the *Hyman* case.
- 5.73 After having considered the representations I had received, I concluded that the failure of the FSA, acting on behalf of the prudential regulators, to pursue the issue of the proper disclosure, within the Society's regulatory returns for 1998 and 1999, of the potential impact on the Society of it losing the *Hyman* litigation fell short of the standard that could reasonably be expected of such regulators.

My eighth and ninth findings of fact

- 5.74 Following the decision of the House of Lords in the *Hyman* case, the Society had been faced with an extremely serious situation. That decision had profound effects.
- 5.75 The financial reinsurance arrangement that the Society had entered into was, as a result of the ending of the Society's differential terminal bonus policy, to lapse. Without the credit that had been taken for that arrangement, a serious question arose as to whether the Society could or would continue to meet its required solvency margin.
- 5.76 The Society was immediately faced with a significant reduction in what the Society regarded as the assets available to meet the costs in respect of those policyholders who chose to take benefits calculated with regard to guaranteed annuity rates. Those costs had to be shared, almost certainly by benefit reductions, across all policyholders – as any 'ring-fencing' of policyholders with annuity guarantees had been declared unlawful by the House of Lords.
- 5.77 This gave rise to inbuilt conflicts between the interests of different classes of policyholders that, in the circumstances facing the Society at the time, could not be resolved using the normal mechanisms available to life insurance companies and which meant that the Society's situation was inherently unstable.

5.78 In that context, the Society decided to put itself up for sale. The question arose as to what the regulatory response to that decision should be. The FSA decided not to intervene to require the Society to close to new business whilst it sought a buyer.

5.79 I make two findings of fact concerning the decision to permit the Society to remain open to new business following the decision of the House of Lords in the *Hyman* case.

5.80 **My eighth finding of fact** is that the FSA failed to record that decision. No contemporaneous record was made of that decision or of the factors and evidence which were taken into account by the FSA when they took it, or what alternative options, if any, the FSA had considered. That decision was highly significant for the interests both of existing and potential policyholders.

5.81 **My ninth finding of fact** is that, having established from those involved the basis on which the FSA took that decision, the decision to permit the Society to remain open at that time was not grounded in a sound factual or legal basis.

5.82 Relevant considerations – such as the nature of the Society’s business, which meant that it was not just new policyholders who were potentially affected by the decision – were not taken into account. No proper consideration was given to the use of the full range of powers that the prudential regulators possessed.

5.83 After having considered the representations I had received, I concluded that the failure by the FSA, acting on behalf of the prudential regulators, to record their decision to permit the Society to remain open to new business, following its loss of the *Hyman* litigation fell short of the standard that could reasonably be expected of such regulators.

5.84 I also concluded that the basis on which the decision was taken by the FSA, acting on behalf of the prudential regulators, to permit the Society to remain open to new business was unsound, not taking into account all relevant considerations and not having a proper legal and factual basis and that this fell short of the standard that could reasonably be expected of such regulators.

My tenth finding of fact

5.85 In the period between the Society’s closure to new business on 8 December 2000 and the end of my jurisdiction in relation to relevant events on 1 December 2001, the FSA, acting on behalf of the Treasury as the prudential regulators of insurance companies, were contacted by many hundreds of the Society’s policyholders who were concerned about the position that the Society was in and about their own future options.

5.86 The FSA during this period also issued general information relating to the Society through updates, website material, and factsheets.

5.87 As the Society prepared proposals for a scheme of arrangement under the Companies Act 1985, to compromise the competing claims of the Society’s policyholders, the FSA were also contacted by policyholders about the Society’s proposals and about the attitude of the FSA to those proposals.

5.88 **My final finding of fact** is that the information provided by the FSA in the post-closure period was misleading and unbalanced, with assurances being provided that the Society was solvent, when that was in considerable doubt and was not the view that was always held within the FSA, who, on behalf of the prudential regulators, had exercised formal intervention powers on the grounds that the

Society was likely to be in breach of its regulatory solvency requirements.

5.89 Nor were the assurances given by the FSA that the Society was at that time fulfilling and always had fulfilled all of its other regulatory requirements appropriate, when the FSA knew that this was not the case.

5.90 After having considered the representations I had received, I concluded that the misleading information, about the Society's solvency position and its record of compliance with other regulatory requirements, that was produced by the FSA, acting on behalf of the prudential regulators, during the period after the Society closed to new business fell short of the standard that could reasonably be expected of such regulators.

Section 6: Determinations of maladministration

- 6.1 In section 5, I set out the ten findings I have made that the acts or omissions of the prudential regulators and/or GAD fell short of the standard that could reasonably be expected of them.
- 6.2 Having done so, I then go on to assess whether those acts or omissions were so unreasonable, or fell so far short of acceptable standards of good administration, as to constitute maladministration. The assessments that I have made on these questions are set out in Chapter 11 of Part 1 of my report.
- 6.3 I have made ten determinations of maladministration – one against the DTI, four against GAD, and five against the FSA. I have done so because I am satisfied that the departures that each finding represent were unreasonable in the circumstances and/or fell far short of acceptable standards of good administration.
- 6.4 Those determinations are:
- that the failures (i) to insist, when approving the appointment in June 1991 of a new Chief Executive, that he should demit office as the Society's Appointed Actuary, and (ii) during the period from 1 July 1991 to 31 July 1997, to consider the use of their powers to seek to remove that person from such a 'dual role' constitutes maladministration by the DTI;
 - that the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1990 to 1993, related to (i) the valuation rate of interest used to discount the Society's liabilities and (ii) to the affordability and sustainability of the Society's bonus declarations, constitutes maladministration by GAD;
 - that the failures, when the introduction of the Society's differential terminal bonus policy was identified as part of the scrutiny of the 1993 returns, (i) to inform the prudential regulators about the policy, (ii) to raise the matter with the Society, or (iii) to seek to identify what the rationale was for the introduction of the policy and how it was being communicated to policyholders, constitutes maladministration by GAD;
 - that the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1994 to 1996, related to (i) the valuation rate of interest, (ii) the affordability and sustainability of bonus declarations, (iii) apparently arbitrary changes to the assumed retirement ages, and (iv) the holding of no explicit reserves for the liabilities associated with prospective liabilities for capital gains tax, for pensions mis-selling costs, and for guaranteed annuity rates, constitutes maladministration by GAD;
 - that the failures (i) to ask for the information GAD needed in respect of the Society's 1995 returns to enable them, as part of the scrutiny process, to be sure that the Society had produced a valuation that was at least as strong as the minimum required by the applicable Regulations, and (ii) to pursue the information before them that the omitted information had led to the users of the returns misconstruing the financial strength of the Society constitutes maladministration by GAD;
 - that the failures (i) to ensure that the financial reinsurance arrangement was not taken into account within the Society's 1998 returns without an appropriate concession being given, and (ii) to ensure that the credit taken by the

Society within its returns for 1998, 1999, and 2000 properly reflected the economic substance of that arrangement constitutes maladministration by the FSA;

- that the failure to pursue the issue of the proper disclosure, within the Society's regulatory returns for 1998 and 1999, of the potential impact on the Society of it losing the *Hyman* litigation constitutes maladministration by the FSA;
- that the failure to record their decision to permit the Society to remain open to new business, following its loss of the *Hyman* litigation constitutes maladministration by the FSA;
- that the unsound basis on which the decision was taken to permit the Society to remain open to new business, following its loss of the *Hyman* litigation constitutes maladministration by the FSA; and
- that the misleading information, about the Society's solvency position and its record of compliance with other regulatory requirements, that they produced during the period after the Society closed to new business constitutes maladministration by the FSA.

Section 7: Determinations of injustice

- 7.1 When determining in general terms whether or not any maladministration which I have found to have occurred has resulted in injustice to those who have complained to me, I first identify what were the consequences of that maladministration and then I assess whether those consequences constitute an injustice for which no or no sufficient remedy has been provided.
- 7.2 The **consequences of my first finding of maladministration**, related to the ‘dual role’ were, first, that the prudential regulators and GAD became overly reliant on the information provided by one person within the Society – through his completion of the returns and through the meetings that those regulators and GAD often had with only that person. The Society was also not prompted and/or invited by the prudential regulators to address the unsatisfactory nature of the ‘dual role’.
- 7.3 A further – and important – consequence of this failure was that the system of prudential regulation, designed on the basis that the Appointed Actuary (with operational independence from the executive management of a life insurance company) would play a central role, operated in a dysfunctional manner during this period in respect of the Society.
- 7.4 The maladministration which I have found to have occurred resulted in the effective operation of the system of prudential regulation in respect of the Society, and the governance of the Society, becoming compromised. There was effectively no ‘whistle-blower’ during this period within the Society, to the detriment of the proper governance of the Society and of the prudential regulation of the Society.
- 7.5 The **consequences of my second finding of maladministration**, related to the scrutiny of the Society’s regulatory returns for each year from 1990 to 1993 were, first, that the prudential regulators and GAD could not be satisfied that the Society was acting prudently and with proper regard to the reasonable expectations of its policyholders. Another consequence of this failure is that the Society was never asked to justify whether it could afford its bonus declarations or how it proposed to sustain the level of bonus that it declared.
- 7.6 A further consequence was that the impression was given to existing and potential policyholders that the Society was financially sound and able to pay generous bonuses, when the prudential regulators and GAD could not have been sure that either was the case.
- 7.7 The maladministration which I have found to have occurred led to lost opportunities to seek further understanding as to whether the Society’s business model was inherently prudent or whether that model exposed the Society’s members to unnecessary risks.
- 7.8 The **consequences of my third finding of maladministration**, related to the intimation of the Society’s differential terminal bonus policy were, first, that the prudential regulators were disabled from discharging their duties.
- 7.9 Another consequence of that failure was that the Society was not asked by the prudential regulators and/or GAD to justify its approach in the light of the reasonable expectations of its existing policyholders and/or of the contents of its advertising, which did not draw to the attention of potential policyholders (or existing policyholders, especially those considering making further contributions to policies which did not contain guaranteed annuity rates) that such a policy existed.

- 7.10 A further consequence of this failure was that the Society took its decisions, such as not to consider ring-fencing new entrants into a different fund, rejecting certain approaches that it received from those interested in acquiring the Society's business, and/or as to the validity of its general practices, in a context in which the Society could reasonably believe that it had secured regulatory approval – albeit tacit approval – for its new bonus policy and associated practices.
- 7.11 The maladministration I have found to have occurred resulted in the loss of a number of critical opportunities. Such opportunities included those to test the appropriateness of the differential terminal bonus policy and to ensure that the illustrations and advertisements provided to existing and potential policyholders explained the Society's policy and practice.
- 7.12 Opportunities were also lost to take decisions about the future direction of the Society in full knowledge of the reserving requirements to which it was subject and to which the prudential regulators and GAD would eventually draw attention. The Society lost the option to make provision gradually over time for the costs arising each year from those requirements as those costs accumulated.
- 7.13 The maladministration which I have found also resulted in the problems which caused the Society eventually to close to new business being obscured until July 1998 and to the loss of opportunities for the Society and for the prudential regulators and/or GAD to begin to address those issues much earlier than they all eventually did.
- 7.14 The **consequences of my fourth finding of maladministration**, related to scrutiny of the Society's regulatory returns for each year from 1994 to 1996 were, first, that an early opportunity was lost to address the issue of the Society's practice as to reserving for guaranteed annuity rates. Another consequence was that the Society's liabilities were considerably understated.
- 7.15 The maladministration which I have found to have occurred reinforced that which I have found in relation to the introduction of the differential terminal bonus policy, in that the problems which caused the Society eventually to close to new business were further obscured and opportunities were lost to address those issues earlier.
- 7.16 The **consequences of my fifth finding of maladministration**, related to the presentation of the Society's two valuation results were, first, that those reading the Society's returns during this period were capable of being misled as to the strength of the Society's true financial position.
- 7.17 Another consequence was that those who used the information and conclusions drawn from the returns by rating agencies and other third parties – including financial advisers, industry publications, and those briefing Ministers – were enabled to rely on information that did not contain a complete and accurate assessment of the Society's true position. They were thus actively misled.
- 7.18 A further consequence was that GAD were unable, with respect to the Society's 1995 returns, to verify the financial position of the Society, as they were not able on that occasion reasonably to be satisfied that the Society's chosen valuation method had produced a result at least as strong as the minimum prescribed in the Regulations as they lacked the information needed to be so satisfied.
- 7.19 The maladministration which I have found to have occurred resulted in the reader of the returns not having the information that was before GAD and

which, arguably, should have been available to all readers of the Society's published returns.

- 7.20 No action was taken when it was clear that those readers were misconstruing the information that was provided. Maladministration also resulted in those who expressed concerns about the Society's solvency being reassured on grounds which were not sustainable.
- 7.21 The **consequences of my sixth finding of maladministration**, related to financial reinsurance were, first, that the Society was permitted to declare a bonus in March 1999. Had the Society not done so, a warning would have been given to those considering investing in the Society for the first time or to those considering making further contributions to existing policies that the Society was in significant financial difficulty.
- 7.22 Another consequence of those acts and omissions was that the solvency position of the Society, as published by 1 May 1999 within its 1998 returns, was misrepresented. Those reading the Society's published 1998 returns would have been misled as to the strength of the Society's financial position. That reinforced the misleading message of the strength of the financial position of the Society which had been given by the declaration of a bonus a month earlier.
- 7.23 A further consequence of the acts and omissions of the prudential regulators and GAD was that the ongoing weakness of the Society's financial position was hidden from public view in the Society's published returns for 1999 and 2000. Those considering their options – whether to invest, to make further contributions to existing policies, to convert a policy into an annuity, or simply to stay – were given a wholly misleading picture of the true position faced by the Society and of its solvency position due to the unreasonable credit taken for the reinsurance arrangement.
- 7.24 The maladministration which I have found to have occurred resulted in the true financial position of the Society being concealed and misrepresented through the publication of returns which contained a misleading picture of the Society's solvency position.
- 7.25 That maladministration also resulted in existing and potential policyholders making highly important decisions – some of which were irreversible – about their financial affairs without the benefit of information which the system of prudential regulation was designed to provide to them, in order to enable them to make informed choices.
- 7.26 The **consequences of my seventh finding of maladministration**, related to the potential impact of the *Hyman* litigation on the Society were, first, that the prudential regulators and GAD could not be certain that the Society's policyholders and those potential policyholders considering investing or continuing to invest in the Society were being given complete and accurate information about what were the extent and nature of the possible effects should the House of Lords deliver a judgment that was adverse to the Society.
- 7.27 Existing and potential policyholders were thus denied information about their potential exposure to significant risk, which was an integral part of informed decision-making as to their financial options.
- 7.28 Another consequence of those acts and omissions was that the Society and the prudential regulators and GAD lost an opportunity to consider, either separately or together, whether the scenario planning and other work they had undertaken as preparation for managing the possible outcomes of the *Hyman*

litigation was sufficient to address the full range of factors which had exposed the Society to the range of problems which it faced during that period.

7.29 The maladministration which I have found to have occurred meant that the prudential regulators could not have been certain that the reality that an adverse judgment would crystallise for the Society was not being distorted.

7.30 Any such distorted reality might inform the published returns and the other publications that the Society produced during that period. The prudential regulators could not have been sure that existing and potential policyholders had the full information necessary to take informed decisions.

7.31 The **consequence of my eighth finding of maladministration**, related to the failure to record the decision to permit the Society to remain open to new business was that no proper and contemporaneous record exists as to the basis for that decision. The maladministration which I have found resulted in an absence of documentary evidence to support the basis for an important decision taken by the FSA.

7.32 The **consequences of my ninth finding of maladministration**, related to the basis on which the decision was taken to permit the Society to remain open to new business were, first, that policyholders lost any opportunity to receive the benefit of the sound and robust exercise of the discretionary powers that Parliament had conferred on the prudential regulators in order to protect the interests of such policyholders.

7.33 Another consequence of this failure was that those who invested for the first time during this period – which could not have occurred had certain intervention action such as the withdrawal

or suspension of the Society's authorisation to write new business been taken – or who bought annuities, or who made further contributions to existing policies where there was no contractual requirement to do so, made those decisions in an environment in which accurate and complete information about the financial position of the Society was not available to them.

7.34 No warning had been given by the prudential regulators, as would have been provided by the exercise of intervention powers such as the withdrawal of authorisation, of the seriousness of the financial position that the Society was in.

7.35 A further consequence of this failure was that compensation for mis-selling, if any were provided, became an additional liability falling to be met by those existing policyholders.

7.36 The maladministration which I have found to have occurred resulted in those 'late joiners' and certain other existing policyholders making decisions about their financial affairs without the accurate and complete information necessary to make those decisions on an informed basis.

7.37 The **consequence of my final finding of maladministration**, related to the information provided by the FSA after closure was that reassurance was given to those who contacted the FSA to enquire about the financial position of the Society when that reassurance was not soundly based. Those who had regard to the information provided by the FSA made decisions about their financial affairs having regard to the incomplete and inaccurate information that was provided.

7.38 The maladministration which I have found to have occurred resulted in misleading information about the position of the Society being provided to existing policyholders, in a situation in which

those policyholders were entitled to have regard to that information because of its source.

7.39 All of the above specific consequences of the determinations of maladministration that I have made also had three general consequences:

- that the Society's published returns were unreliable;
- that there were lost opportunities to address critical issues earlier; and
- that regulatory decisions were taken on a basis which had insufficient regard to the range of powers that the prudential regulators possessed.

7.40 I considered whether the consequences which I have determined flowed from the maladministration I have found to have occurred constitute injustice to those who have complained to me. Having done so, I make five findings of injustice, being:

- first, **financial loss**, where that has occurred, and/or **lost opportunities** to take informed decisions as a result of reliance on the information contained in the Society's returns for 1990 to 1996;
- secondly, the **loss of opportunities** in the period between July 1991 and April 1999 to take informed decisions in full knowledge of the exposure of the Society to guaranteed annuity rates and of the risks that such exposure generated;
- thirdly, **financial loss**, where that has occurred, to anyone who joined the Society or who paid a further premium that was not contractually

required in the period after 1 May 1999 and/or **lost opportunities** to take those decisions on an informed basis;

- fourthly, **financial loss**, where that has occurred, and/or the **loss of opportunities** to take informed decisions to those individuals who can show, having regard to their particular circumstances, that they relied on deficient information provided by the FSA in the post-closure period, that such reliance was reasonable in the circumstances, and that it led to any such losses; and
- finally, a justifiable sense of **outrage** on the part of all those who complained to me at the failings of those operating the regulatory system during the period prior to the Society's closure to new business.

Section 8: Disposal of the complaints

- 8.1 Chapter 13 of Part 1 of my report sets out my disposal of each of the eighteen specific heads of complaint, and the general complaint, referred to in Section 4 above and detailed in Annex A.
- 8.2 I uphold the general complaint that the prudential regulators and GAD failed properly to exercise their regulatory functions in respect of the Society during the period prior to 8 December 2000. I do not uphold it for the period from 8 December 2000 to 1 December 2001.
- 8.3 Annex B shows how I have disposed of the eighteen specific heads of complaint.

Section 9: Remedy and recommendations

- 9.1 My approach to the provision of remedies for injustice or hardship resulting from maladministration is set out in my document, *Principles for Remedy*, published in October 2007. My underlying principle is to seek to ensure that the relevant public body restores someone to the position he or she would have been in, had the maladministration not occurred. If that is not possible, the relevant body should compensate them appropriately.
- 9.2 I received submissions from the public bodies which sought to persuade me that it would not be appropriate in the circumstances of this case to adopt my usual approach to questions of remedy. I was not persuaded by those submissions.
- 9.3 It is my normal practice, where someone has been inconvenienced or made to feel a justifiable sense of outrage at the way that they have been treated, to recommend that an apology is made and that consideration is given to whether that apology should be accompanied by a tangible recognition of such inconvenience or outrage.
- 9.4 Where financial loss is established, I would normally expect that, where appropriate, such a loss should be remedied in full, with payment of interest where that is relevant.
- 9.5 In that context, there are four questions that I need to address in this case before making any recommendations designed to remedy the injustice that I have found has been sustained on this occasion, namely:
- whether complainants have suffered a financial loss in absolute terms – that is, have they suffered an identifiable or quantifiable loss at all?;
 - if so, whether complainants have suffered a financial loss in relative terms – that is, have they suffered a loss that they would not otherwise have suffered had they invested or saved elsewhere than the Society?;
 - if so, whether there is a sufficient link between the acts and omissions of the bodies whose actions have been investigated and found to be deficient with that relative loss; and
 - if there is, what would be appropriate in all the circumstances of this case to recommend by way of a remedy?
- 9.6 If I were to find no financial loss, or were to conclude that any such loss sustained was not sufficiently linked to maladministration, or were to consider that it would not be appropriate to recommend a remedy for any such loss, I would then need to consider whether it would be appropriate to recommend a remedy for the opportunities that I have found were lost as a result of maladministration.
- 9.7 I also need to consider whether any injustice has already been remedied by other means. Where that is so, I would not expect a further remedy to be provided, as it is an important principle that any recommendation I make should not lead to a complainant making a profit or gaining an unreasonable advantage.
- 9.8 As for **absolute loss**, I am very far from concluding that everyone who has complained to me about the prudential regulation of the Society has suffered a financial loss. Still less do I conclude that everyone who has saved with, or invested in, the Society during the period covered in my report has suffered such a loss.
- 9.9 It seems to me that it is a natural and unavoidable consequence of one of the basic premises of the allegations underpinning the complaints that have

been made about the events covered in this report – namely, that distribution took place of the resources of the Society in what is said to be an imprudent manner which it could not afford – that some people have gained from their savings and investments with the Society more than they would have done had any such distribution not occurred.

- 9.10 However, there is no avoiding the fact that those who are, or were at the relevant time, members of the Society experienced the series of policy value and bonus cuts during the period after it closed to new business in December 2000. Details of those cuts are set out within Chapter 2 of Part 1 of my report.
- 9.11 That is sufficient evidence in my mind to persuade me to conclude that, for many people at least, financial loss has been sustained. In coming to that conclusion, I have also borne in mind the acceptance, which appears to be common ground among all the parties, that such losses were suffered across the with-profits industry at the relevant time. That loss generally occurred does not seem to be controversial.
- 9.12 That brings me to **relative loss**. Did those who have complained to me, and those in a similar position to those complainants, suffer a loss that they would not have suffered had they saved or invested elsewhere?
- 9.13 The Society has dealt with many types or categories of mis-selling complaints, or claims based on breach of contract. However, the most analogous category of complaint to the maladministration on the part of the prudential regulators and GAD is the complaints which were made due to the Society's failure to disclose the existence of guaranteed annuity rates.
- 9.14 I sought information from the Society as to what the outcome had been to the cases of those people who, not being caught by the effects of the Compromise Scheme, had complained to the Financial Ombudsman Service about such alleged mis-selling on the part of the Society. I understand that those cases were assessed using a comparative loss assessment using the performance of an average competitor of the Society as a comparator. That information shows that relative loss was established in approximately 60% of those cases concerning complaints of this type.
- 9.15 I understand that the cases dealt with by the Financial Ombudsman Service followed on from a review conducted by the Society, at the request of the FSA, of any mis-selling which related to the failure to disclose the existence of guaranteed annuity rates. In the course of that review, the Society also adopted an analogous comparative approach to assessing loss. Under that review, approximately 78% of those with mis-selling complaints of this type were found to have suffered a relative loss.
- 9.16 Those who have complained to me are in substantially the same circumstances as those who complained to the Society or to the Financial Ombudsman Service, with the exception that they were caught by the effects of the Compromise Scheme and thus could not pursue such complaints.
- 9.17 When the above information is considered together, it seems to me that this demonstrates that, for many of those covered by my recommendations, it could be established that a loss has been sustained, relative to what would have transpired had those individuals saved or invested with a comparable with-profits fund.

9.18 I therefore conclude that it would be difficult to sustain an argument that no person affected by ‘*the Equitable affair*’ had suffered a relative loss.

9.19 I also conclude that the individual circumstances of each complainant and other people similarly affected are key to establishing whether those people are in the category of those who have suffered relative loss. Accordingly, whether relative loss in a particular case has been sustained has to be determined at an individual level.

9.20 As for whether there is a **sufficient link** between the acts and omissions of the bodies whose actions have been investigated and found to be deficient with any relative loss that is established, I conclude that there was such a link.

9.21 The aim of the system of regulation was to protect the interests of policyholders through the supervision of the affairs of insurance companies, in the manner in which Parliament intended and using the means that Parliament provided.

9.22 In the light of my determinations, set out in this guide, I conclude that there is a direct link between the acts and omissions of the prudential regulators and the information that throughout the period covered by my report was before those people who were making savings and investment decisions regarding the Society.

9.23 Those acts and omissions are also directly linked to the knowledge about the solvency position of the Society that policyholders and potential policyholders possessed during the period on or after 1 May 1999.

9.24 The prudential regulators, and no-one else, were given the functions of scrutinising the returns that the Society submitted and of verifying its solvency position. No other party can be said to be at fault

because those regulators, acting with the advice and assistance of GAD, acted with maladministration.

9.25 I now turn to what I consider that it is **appropriate to recommend** as a remedy for the injustice that I have found resulted from maladministration on the part of the prudential regulators and GAD.

First recommendation

9.26 **My first recommendation is that, in recognition of the justifiable sense of outrage that those who have complained to me feel about the maladministration in the form of the serial regulatory failure that I have identified in this report, the public bodies should apologise to those people for that failure.**

Second recommendation

9.27 **My second – and central – recommendation is that the Government should establish and fund a compensation scheme, with a view to assessing the individual cases of those who have been affected by the events covered in this report and providing appropriate compensation.**

9.28 The aim of such a scheme should be to put those people who have suffered a relative loss back into the position that they would have been in had maladministration not occurred.

9.29 I consider that addressing relative loss in this way would be the most appropriate remedy for the injustice that I have found resulted from maladministration. Such an approach would remedy any financial loss that has occurred and also the loss of opportunities to invest elsewhere than the Society. It is thus not necessary to give

further consideration to what additional remedy it would be appropriate to recommend to remedy the lost opportunities that have been sustained.

9.30 The scope of such a scheme should cover all those who have suffered similar injustice to those who have complained to me. That should include not just residents of the United Kingdom but all those who have sustained the injustice that I have found resulted from maladministration.

9.31 I consider that it would be reasonable to expect such a scheme to be established within six months of any decision by Government and Parliament to do so.

9.32 I recognise that how best to establish and administer any compensation scheme is a matter for Government and Parliament to decide. However, I would offer, as a contribution to that debate, my view of the principles which should govern any such compensation scheme.

9.33 It seems to me that such a scheme:

- should be **independent** and constituted along the lines of a tribunal or adjudication panel, with three members – one representing broadly the interests of those affected and one representing those of the relevant public bodies, with an independent chair;
- should operate in a **transparent** manner, with the basis being made public of the decisions as to how compensation should be calculated, as to what procedure will govern the consideration of individual cases, and as to the criteria which will be taken into account when considering those cases. Those decisions should only be made after appropriate consultation is undertaken, including with those directly affected; and

- should be **simple**, not imposing undue burdens, whether evidential or procedural, on those making claims to the scheme.

9.34 The above principles would, I hope, be accepted widely as being an appropriate and effective mechanism of decision and delivery of the remedy that I have recommended should be provided.

9.35 I hope, also, that it would be accepted that this mechanism has to have, as its guiding principle, the need to deliver as speedy a remedy as is possible in the circumstances, while recognising the complex issues that would need to be addressed and resolved.

9.36 In my view, the scheme should take no longer than two years from the date of its establishment to complete its work.

9.37 I recognise that the public interest is a relevant consideration and that it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case.

9.38 Furthermore, I am acutely conscious of the potential scale of what I have recommended and that acceptance of my central recommendation might entail opportunity costs elsewhere through the diversion of resources.

9.39 In that context, **I invite Parliament to consider the issues that have been raised in this report and the recommendations that I have made and to further reflect on what its response to my report should be.**

9.40 Having alerted Parliament to the injustice that I have found was sustained in consequence of maladministration, I would be very happy to assist Parliament in its deliberations in any way that I can.

Section 10: Annex A

Terms of Reference and Statement of Complaint for the Equitable Life Investigation

December 2004

Investigation terms of reference

The terms of reference for the investigation are:

To determine whether individuals were caused an injustice through maladministration in the period prior to December 2001 on the part of the public bodies responsible for the prudential regulation of the Equitable Life Assurance Society and/or the Government Actuary's Department; and to recommend appropriate redress for any injustice so caused.

Statement of complaint

Summary of complaint

The complainants complain 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, collectively referred to in the rest of this statement as 'the regulators') 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 (ELAS) and were therefore guilty of maladministration.

Specific complaints

1 Organisational issues

- a. The regulators were not sufficiently resourced, and did not all possess the necessary skills, to contribute effectively to the overall regulatory process and to responsibly exercise their discretionary powers as intended by Parliament and by the European Community (now the European Union). Administrative decisions as to resourcing, priorities and methods contributed to a position in which the regulators did not properly undertake their functions as prudential regulator of ELAS.
- b. The regulators failed to liaise and to co-operate effectively with those responsible for the regulation of the conduct of business by insurance companies. In particular, they failed to ensure that proper assessments were made of ELAS's individual practices and its communications with policyholders, and of the expectations that these generated, in the light of the information that was, or should have been, known to the prudential regulators.

2 General operational issues

- c. The prudential regulators did not operate the regulatory regime as it was intended to be implemented by Parliament and in conformity with EC Directives. The regulators instead chose to regulate ELAS with a 'light touch' – a concept not evident from or provided for under the Insurance Companies Act 1982 and the EC Third Life Directive nor one consistent with these statutory provisions. The approach to the regulation of ELAS was exceptionally and unjustifiably lenient when compared to that adopted with other companies, with inadequate investigative site visits and lack of liaison with conduct of business regulators.

Much more rigorous standards of supervision and better co-operation with conduct of business regulators were adopted for smaller and unit-linked companies. This demonstrated that the regulators applied a two-tier standard of regulation.

- d. The regulators and GAD allowed successive chief executives or managing directors of ELAS also to hold the post of appointed actuary, despite recognising the potential for conflict of interest in this position. These decisions were not consistent with the basis of the regulatory regime.
 - e. The regulators and GAD failed to keep pace with developments in the pensions and life insurance industry and to assess and adapt their methods to reflect those developments. This was particularly critical in a situation in which narrow, technical interpretations of regulatory solvency were becoming an increasingly irrelevant measure of any insurer's realistic financial position as the industry moved more and more towards non-guaranteed bonus declarations.
 - f. GAD had recommended ELAS as a pension plan or additional voluntary contribution scheme provider in their advice to the administrators of the Principal Civil Service Pension Scheme and to other public sector pension schemes. This led to a lack of proper separation of their responsibilities and to a clear conflict of interest between GAD's role in providing advice to government bodies in relation to public sector pensions and in assisting the prudential regulators of ELAS. This conflict of interest compromised the proper discharge of GAD's regulatory functions.
- 3 Supervision of regulatory solvency
- g. From the mid 1980s until 1997, the regulators failed to evaluate the potential effect of Guaranteed Annuity Rates (GARs) on the solvency of ELAS in a context where current annuity rates were falling steadily, in line with the Bank of England's base rate, to below contracted GARs. The regulators learned explicitly in November 1993 of the degree of ELAS's exposure to risks associated both with the GAR issue and with ELAS's lack of prudent reserves. The regulators' failure to take action then or to impose reserving until 1999 played a direct part in the closure of ELAS to new business and to subsequent cuts in policy and annuity values. The regulators did not prepare a study on the extent of GARs in the industry until 1997: a decade too late.
 - h. From about 1990 onwards, the regulators and GAD failed to give sufficient consideration to the fact that some of the measures used to bolster ELAS's solvency position were predicated on the emergence of a future surplus. As a consequence, they did not properly assess the overall impact and adequacy of those measures. The regulators also allowed ELAS to mis-use the term 'surplus' and failed to consider the use of that word in the context of policyholders' reasonable expectations.
 - i. Over this same period, the regulators allowed ELAS to publish financial results and projections that were misleading in that they did not reflect the Society's true position. In particular, ELAS was allowed to habitually report growth rates alongside bonus rates, which gave the impression of a prudent margin for error, whereas the true position was that:

- assets were consistently less than policy values so that higher rates of growth were needed to cover any given rate of bonus; and
 - as part of the growth was needed to cover expenses and the contractual liability for conventional annuities, the growth available to meet with-profits bonuses was always materially less than the rate quoted in ELAS literature. This was never made clear.
- j. During this period, the regulators and GAD failed to act when ELAS adopted what Lord Penrose described as practices of ‘*dubious actuarial merit*’. These included valuing future liabilities at an inappropriate rate of interest between 1990 and 1996; treating selling costs as an asset; making no provision for GARs until much too late; valuing a financial re-insurance policy (which proved to be of no value) at over £800 million; allowing credit for ‘aspirational’ (i.e. effectively unrealisable) assets; responding too slowly to widely evidenced changes to mortality expectations; and the issuing of a subordinated debt worth £346 million which did not count as a liability.
- k. On several specific occasions, as set out in the Penrose report, the regulators and GAD ignored or failed to act on information that might have led to formal or informal regulatory action against ELAS, thus also failing to alert new investors to the risks of investing. These include when ELAS board papers were sent to GAD by the Appointed Actuary on 11 June 1991, and when information was provided to GAD on 10 September 1992 which showed that, for the years 1989 to 1991, the aggregate policy values very significantly exceeded the value of the underlying assets.
- 4 Payment of excess bonuses
- l. Over a period of many years the regulators and GAD permitted ELAS to operate an unsound business model, of which they were aware. ELAS had made public its policy of reliance on ‘goodwill’ in a 1989 actuarial paper *With Profits Without Mystery*, but the regulators never addressed the issue or challenged ELAS about it or about the consequences of the model. Instead, they allowed ELAS to operate the model, which entailed declaring bonuses in excess of admissible assets, while at the same time operating without a significant estate and with a smoothing fund persistently in deficit. These were major contributory factors to ELAS’s development of what Lord Penrose quantified as a £3 billion asset deficit at the time of closure to new business and to the losses incurred by all those who held policies on 16 July 2001.
- m. The regulators failed to ensure any satisfactory correlation between the total of declared policy values and ELAS’s admissible assets in a context where ELAS, uniquely in the industry, had declared total policy values that included terminal bonuses and had, without exception, always paid all claims (both contractual and non-contractual) in accordance with these declarations.
- 5 Policyholders’ reasonable expectations (PRE)
- n. Ministers and officials decided that regulatory activities in relation to safeguarding PRE should be based solely on the regulatory returns, but failed to put in place adequate procedures and Regulations to enable this to be achieved. This failure was particularly critical in respect of ELAS, which had unique practices that elicited PRE.

- o. As a result, the regulators and GAD failed over many years properly to monitor and assess ELAS's asset position and its practices in the light of PRE. The regulators and GAD did not properly determine PRE or act to protect them as intended by Parliament and to the standards set by EC Directives.
- p. During the course of the *Hyman* litigation, the regulators failed in their duty to all policyholders in respect of PRE and postponed consideration of issues related to assets and reasonable expectations, both for GAR and non-GAR policyholders, until after the House of Lords' judgment (20 July 2000). In addition, the regulators totally failed to assess properly either the impact or the scope of the judgment and to evaluate the range of scenarios for ELAS following it. They failed to take appropriate action to mitigate the adverse effect of the judgment on the majority, non-GAR policyholders, and on new investors into the same with-profits fund. Their judgement that there was a 99.9% probability that ELAS would be sold demonstrated that, despite the extensive information that they possessed, the regulators failed to understand the parlous state of ELAS which was apparent to all prospective bidders.
- q. In March 2001, the regulators permitted ELAS to declare a bonus for 2000 and an interim bonus for 2001 that were both inappropriate and unjustifiable given the then state of ELAS's finances, thus raising misleading expectations about the true state of ELAS just prior to significant across-the-board cuts that were imposed only four months later. Instead, ELAS's asset deficit of 13% at year-end 2000 in a closed fund should have precipitated regulatory intervention at that time.
- r. In July 2001, the regulators failed to protect PRE by permitting policy value adjustments worth more than £4,000 million in the form of an inequitable uniform percentage cut across all with-profits policies, rather than the fairer alternative of reducing policy values by cutting only non-guaranteed bonuses. The regulators also refused to comment meaningfully on this to policyholders while discouraging independent financial advisers from giving proper advice to policyholders.

Remedy sought

The complainants seek full financial redress for the losses they have incurred in consequence of the maladministration outlined above.

Section 10: Annex B

Disposal of the heads of complaint

Head of Complaint	Topic: the actions of the prudential regulators and/or GAD in relation to allegations concerning:	Disposal
A	Resourcing and skills	Dismissed
B	Liaison with the conduct of business regulators	Dismissed
C	Inconsistent approach to regulation	Dismissed
D	Dual role	Not determined
E	Failure to keep pace with developments	Dismissed
F	Conflict of interests	Dismissed
G	Guaranteed annuity rates	Upheld in full
H	Measures predicated on the emergence of future surplus ignored	Dismissed
I	Misleading financial results	Upheld in part
J	Practices of 'dubious actuarial merit'	Upheld in part
K	The use of the information before GAD and the papers disclosed to GAD	Upheld in part
L	Unsound business model	Upheld in part
M	Correlation between policy values and assets	Dismissed
N and O	PRE	Upheld in part
P	Preparation for House of Lords	Upheld in part
Q and R	Bonus and policy value cuts	Upheld in part
GENERAL COMPLAINT	General regulatory failure	Upheld for the period prior to 8 December 2000

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Please note

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

The new contact details are:

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Printed in the UK by The Stationery Office Limited
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5807928 07/08

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