



HM TREASURY

# Equitable Life

**The Government response to the Public  
Administration Select Committee's Third  
Report of Session 2010-11**





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# Equitable Life

## The Government response to the Public Administration Select Committee's Third Report of Session 2010-11

Presented to Parliament by  
Financial Secretary to HM Treasury  
by Command of Her Majesty

October 2010

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# 1

# Equitable Life - the Government response

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## Introduction

**1.1** The Government would like to thank the Public Administration Select Committee for its enquiry and the speed with which it has produced its report on Equitable Life. This is a very complex issue and one to which a great deal of consideration must be given in order to reach a fair resolution, and the Government is grateful to PASC for the significant amount of work that it has undertaken over the years to bring this to a resolution.

**1.2** The conclusions and recommendations of the Committee are addressed below.

## Government's Approach to Resolving Equitable Life

**Recommendation 1:** The search for compensation for Equitable Life members has been heavy on inquiries but light on solutions. We welcome the Government's commitment to resolving matters speedily. It is no less than those involved deserve.

**Recommendation 11:** If the public is to have trust in its elected representatives, we must keep our promises. Expectations have been raised by many of those seeking election. The coalition should focus on how to meet the political commitment it has made.

**1.3** As the Committee acknowledges, there have been a number of inquiries into the events at Equitable Life. The Government is grateful for the contribution that their work and that of Parliament and its select committees has made to pursuing a just, fair and speedy resolution of this problem.

**1.4** The Programme for Government contains a pledge to "implement the Parliamentary Ombudsman's recommendation to make fair and transparent payments to Equitable Life policyholders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure." The Government's responsibility has been to find the best way to meet that pledge, while having due regard to the need to deliver a swift solution that is fair to policyholders and taxpayers. The announcement made today as part of the Spending Review meets that pledge.

**Recommendation 2:** We welcome the fact the Financial Secretary to the Treasury has made clear that the Government accepts all findings of maladministration made by the Ombudsman.

**1.5** At the hearing, the Financial Secretary to the Treasury once again reiterated the fact that the Government accepts all findings of maladministration made by the Ombudsman. This has been the Government's position since accepting the Ombudsman's report in July 2008 when in Opposition, and remains the position to this day. The issue the Government has had to address since being responsible for this matter is how best to translate the Ombudsman's principles and recommendations into a practical, workable scheme that delivers justice for policyholders.

**1.6** As the Ombudsman herself recognised, more work was needed to be done to her report into a workable scheme. In her report she writes "I am aware that there is more than one means

of calculating compensation in circumstance such as this”<sup>1</sup> and “I have no concluded view on the relative merits of such proposals, which are a matter for others to decide”.<sup>2</sup>

**Recommendation 4:** We regret that despite the Government’s commitment to meet the Ombudsman’s recommendations that it did not properly explore the possibility of amending Sir John’s terms of reference back in May. Had this change been made then it would not have significantly altered the timescale for delivering compensation.

**1.7** The Government notes that one of the criticisms of the Committee is in regards to the decision not to amend Sir John Chadwick’s terms of reference. While Sir John was not asked if a change to his terms of reference would significantly alter the timescales for delivering his work, a great deal of consideration was given to the matter and the Financial Secretary held discussions with officials on it. The Financial Secretary made the judgement that given the complexity of his analysis, re-opening Sir John’s terms of reference would considerably extend his timetable and would not be compatible with the Government’s aim of delivering swift justice to policyholders. The Government notes that the Equitable Members Action Group has stated on their website, on 15 October, that they would oppose Sir John being asked to revisit his report based on revised terms of reference.

**1.8** Furthermore, speed of resolution has been an important aspect of the Government’s approach. Policyholders have been waiting a decade for justice and the Government felt that it was important to make swift progress. There was already considerable discontent at the fact that Sir John had been allowed to delay his report until mid-July. For example, at the end of May, the Financial Secretary received a letter from the Chairman of EMAG asking that he “abandon” items from Sir John’s terms of reference and “take advantage of the reduced instructions to report in draft by the middle of June”.<sup>3</sup>

**1.9** The Government does not believe that this option is possible without causing significant delay to the payments start date. For example, the Independent Commission could not do its work on allocating funds amongst policyholders until the Government had set a final figure of what is affordable for the scheme. That would not be possible until the government knew what the final loss figures were. In turn, further work on finalising the operational aspects of the scheme could not be done until the Independent Commission completes its task.

## Calculation of Relative Loss

**Recommendation 3:** There is a fundamental incompatibility between the position of the Ombudsman and Sir John Chadwick’s approach. Sir John’s remit does not reflect all ten of the Ombudsman’s findings. Sir John and the Ombudsman may have reached different answers because they addressed different questions.

**Recommendation 5:** We therefore recommend that the Government re-engages Sir John Chadwick to establish what conclusions he would reach under terms of reference which reflect all ten of the Ombudsman’s findings. We believe this work can be done in parallel with the Independent Commission’s work to design a compensation scheme. We think that this need not delay payment to policyholders. It would however leave open the extent of the Government’s liability in the spending review, but the timetable for the CSR should not be the driving factor. Alternatively the Government must find some other way of resolving the incompatibility between the Ombudsman’s findings and Sir John Chadwick’s existing terms of reference. If the

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<sup>1</sup> Equitable Life: a decade of regulatory failure – page 379, paragraph 21

<sup>2</sup> Equitable Life: a decade of regulatory failure – page 379, paragraph 22

<sup>3</sup> Letter from Chairman of EMAG, 28 May 2010

Government's proposals remain based on Sir John's existing terms of reference, we concur with the Ombudsman that they are, in principle, an "unsafe and unsound" basis on which to proceed.

**Recommendation 6:** We welcome the broad consensus on the quantum of relative loss around the provisional figures produced by Towers Watson of between £4 and 4.8 billion. EMAG are of the view that this is still a considerable understatement. The only way this disagreement can be resolved is if Towers Watson are instructed to recalculate their estimate in line with the Ombudsman's findings.

**1.10** The Government recognises the disparity between the Ombudsman's position and the advice proffered by Sir John. The Government's aim since the publication of Sir John's report has been to find a way to resolve that incompatibility. In pursuit of that aim, the Financial Secretary invited representations from interested parties and held meetings with the Parliamentary Ombudsman, the Equitable Members Action Group (EMAG), Equitable Life Trapped Annuitants (ELTA) and Equitable Life. The aim of this process was to build upon the parts of Sir John's work that are not incompatible with the Ombudsman, such as the 'alternative approach' to calculating losses and his work providing the comparators for calculating relative loss, and decide how best to build on those.

**1.11** The Government is aware that parts of Sir John's analysis are controversial, and have consistently said that representations from interested parties on his work would be considered alongside it. Government recognises this Committee's recommendation that Sir John's final findings could not be used in order to determine the payments due to policyholders as his terms of reference included only the findings of maladministration accepted by the previous Government. The Government has therefore decided to reject the final findings of Sir John's report, as the later parts of his methodology are dependent upon which of the Parliamentary Ombudsman's findings were included in his Terms of Reference, and which were not.

**1.12** The Government also welcomes the general consensus across the various parties involved as to the credibility of the £4 to £4.8 billion provisional estimate that Towers Watson gives for total relative losses sustained. The Ombudsman has called it "credible" and Equitable Life has said that it closely matches the relative loss described by the Ombudsman. We believe that accepting this number – now confirmed by Towers Watson to be £4.3 billion – resolves the incompatibility between the Ombudsman's findings and Sir John's terms of reference. We are grateful to PASC for its recommendation on this matter.

**1.13** However, as the Committee noted, EMAG are of the view that the provisional estimate of £4 to £4.8 billion is still a considerable understatement. The two principal disagreements that EMAG have with this calculation are the start date for payments and the Market Value Adjustment (MVA) on non-contractual exits.

**1.14** In respect of the start date, there are two substantial reasons for using the end of 1992 – one is an interpretation of the Ombudsman's findings, and the second is a practical consideration. As Sir John set out in his report, the information in the regulatory returns for the year 1991 that could influence policyholder behaviour "could not have come to the attention of policyholders and prospective policyholders before it was submitted at the end of June 1992".<sup>4</sup> Sir John proposes that as such, it is unlikely that they would have influenced policyholders much before 1 September 1992.

**1.15** The second reason is more pragmatic. The advice the Government has received from Equitable Life is that the early data is not available electronically (or is not reliable prior to these dates) because Equitable Life began to change its mainframe computer systems in December

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<sup>4</sup> Sir John Chadwick's Report – page 123, paragraph 4.49

1992. Equitable Life has searched and located some of this data but it is in a format that makes them prohibitively difficult and costly to access the tapes to even check their viability, let alone establish whether they are useful.

**1.16** Another area EMAG disagree with is the decision not to include MVAs non-contractual exits in the calculation of loss. As noted earlier, the Ombudsman stated in her report that she had no concluded view as to the means for calculating compensation.<sup>5</sup> The reason they are included in the calculations is a necessarily technical one.

**1.17** Guarantees that bite when policies are withdrawn contractually are based on the guaranteed value of the policy. These guarantees build up over the lifetime of the policy based on smoothed investment returns. On contractual exit the policyholder will receive the greater of the guaranteed value and the smoothed value of the underlying assets.

**1.18** An (MVA) or 'exit cost' adjusts the policy value on earlier exit to calculate the actual value of the underlying assets at the point of withdrawal, where asset values have reduced due to market movements.

**1.19** Applying an MVA means that no single policy holder can withdraw more than their assets are actually worth. This is the appropriate comparator to ensure that like is being compared with like between Equitable Life and the basket of comparators. Adjusting the value in this way avoids paying for investment performance whilst allowing for the effect of maladministration. If the impact of the MVA were removed from the calculation, policyholders would be compensated for investment performance.

**Recommendation 7:** There is no dispute that the burden on the public purse must be taken into account in assessing the level of Compensation. It follows that there must be some reduction of the compensation awarded. The reduction must strike an appropriate balance between the interests of taxpayers and the interest of policyholders.

**Recommendation 9:** The Government should be open with Parliament and the policyholders. It must explain the basis for the final loss figure. It must also set out how it has determined what is affordable.

**Recommendation 10:** The Government should provide an early opportunity for Parliament to debate the announcement, and quantum, in government time.

**1.20** The Government's role is to make decisions about spending priorities by taking into consideration other pressures on the public purse, competing priorities and the opportunity costs involved. It will be a matter of judgment but the Government will ensure that it balances fairness between policyholders and taxpayers.

**1.21** In respect of these recommendations and recommendation 5, the Spending Review is really the only appropriate time to decide how much the Government can afford to allocate towards this scheme. Decisions are being made that will set out spending across the life of this Parliament and beyond. The decision on one area has an effect on another area. As such, it would not be appropriate to make an affordability decision on this scheme at another point, in isolation from other considerations. As the Ombudsman noted in her report, she was conscious that her recommendation "...might entail opportunity costs elsewhere through the diversion of resources."<sup>6</sup>

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<sup>5</sup> Equitable Life: a decade of regulatory failure – page 379, paragraph 21

<sup>6</sup> Equitable Life: a decade of regulatory failure – page 397, paragraph 152

**1.22** The Government has published a letter from Towers Watson setting out a detailed analysis of losses and the approach taken in their calculations, building on the earlier publication of their work on 22 July. This letter includes the first analysis of the distribution of losses amongst policyholders, and shows that over a quarter of eligible policyholders suffered no relative loss at all, and of those that did suffer losses, for 40 percent, this loss was less than £1000.

**1.23** There has already been an opportunity to debate Equitable Life at the second reading of the Equitable Life (Payments) Bill and there will be further opportunities at the Committee stage and at third reading. There will also be a general debate of Spending Review decisions on 28 October.

**Recommendation 8:** The Ombudsman's objection was to the challenge posed to her idea of injustice, not to the level of compensation that the Government finds to be affordable. The fact that the Government may not be able to afford to compensate fully for relative loss is a separate issue from how the relative loss is calculated.

**1.24** The Government is not seeking to challenge the Ombudsman's idea of injustice and the losses of £4.3 billion, accepted by Government as the figure representing relative loss suffered by policyholders, is reached by comparing Equitable Life to a basket of comparator companies from the end of 1992 onwards. It is not dependent on any individual finding of the Ombudsman and does not challenge her idea of injustice. The Ombudsman has stated that this is a credible figure. There is also broad agreement on the comparators used.

## **Independent Commission**

**Recommendation 13:** We welcome the appointment of the Independent Commission and endorse the Government's intention that it should work quickly and make the first payments in the early part of next year. We seek an assurance from the Government that the cost of administering the scheme should not come out of the total compensation sum.

**1.25** In its report, the Committee seeks an assurance from the Government that the cost of administering the scheme should not come out of the total compensation sum. The Government can provide that assurance. While in the interests of good practice and value for money, we shall strive for the best deal for administration costs; this will have no impact on the total sum provided for policyholders.

**Recommendation 14:** We endorse the principles that it should be transparent, fair, and independent as well as swift. We encourage the Commission to design a payment scheme which allocates compensation as fairly as possible and strikes a balance between speed and proper compensation to individual policyholders for their loss.

**1.26** The main objective of the Independent Commission on Equitable Life Payments is to:

- Recommend how best to fairly allocate funds provided for the Equitable Life Payments Scheme as part of the Autumn 2010 Spending Review to those persons found to have suffered relative losses as a result of accepted Government maladministration; and
- Advise on any groups/classes of persons that should be paid as a priority.

**1.27** It has been asked to have regard to practicalities of delivering the payment scheme; however it is not required to advise on the administration and operational mechanics of delivering payments to policyholders. It has been asked to provide its report by the end of January 2011.

**Recommendation 12:** Given the circumstance of this case, and that legislative changes mean that the FSA no longer falls within the Ombudsman's jurisdiction, it is important to note that the decisions that the Government makes cannot set a precedent for future cases.

1.28 The Government sees the present case as unique, and not itself a precedent for the future.

## **Conclusion**

1.29 The Government believes that the Committee hearing helped to highlight just how complex this issue is. As the Committee notes, due to the time frame associated with upcoming decisions, it did not consider Sir John's advice or the Towers Watson's supporting actuarial advice in detail in its report. With something as complex as this, the devil is in the details. At the Spending Review announcement on 20 October, the Government will clearly set out more detail which will provide policyholders and all interested parties with more clarity as to how this Government will resolve this important issue.



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Correspondence Team

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

