



HM TREASURY

The Prudential Regulation of the Equitable Life Assurance Society:

the Government's response to the Report
of the Parliamentary Ombudsman's
Investigation



The Prudential Regulation of the Equitable Life Assurance Society: The Government's response to the Report of the Parliamentary Ombudsman's Investigation

Presented to Parliament by
The Exchequer Secretary to the
Treasury
by Command of Her Majesty

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1

Introduction

1.1 In January 2009 Sir John Chadwick was appointed by HM Treasury to advise on matters arising from the Government's response (Cm 7538) to the Parliamentary Ombudsman's investigation into the prudential regulation of the Equitable Life Assurance Society. His Terms of Reference were set out in Annex A to that response.

1.2 In the light of the judgment of the Divisional Court handed down on 15 October 2009 in judicial review proceedings, the Government has decided to accept additional findings made by the Ombudsman. In addition to the five findings of maladministration and the four cases of maladministration resulting in injustice which are referred to in those original Terms of Reference, the Government now accepts:

- in relation to findings 2 and 4 in the Ombudsman's Report, the finding of injustice arising from the failure by GAD to ask questions of Equitable about the affordability and sustainability of bonuses and the valuation interest rate which it used for the returns in each of the years for 1990 to 1993 and for 1994 to 1996;
- in relation to finding 5, the finding of maladministration arising from GAD's failure to pursue information before them which suggested that users of the returns (principally Standard & Poor's) were misconstruing the financial strength of Equitable by reason of material that was omitted from the returns; and
- the finding of injustice resulting from the fifth finding of maladministration.

1.3 As a result, the Government has added to Sir John Chadwick's original Terms of Reference. The revised Terms of Reference are set out in Annex A, attached. They supersede and replace in full the original Terms of Reference as set out in the Government's response (Cm 7538).

A Revised Terms of Reference for the Rt Hon Sir John Chadwick

Sir John Chadwick (“Sir John”) is appointed by HM Treasury to advise on matters arising from the Government’s response to the Parliamentary Ombudsman’s investigation into the prudential regulation of the Equitable Life Assurance Society.

The Government accepts seven findings of maladministration in full, two findings in part, and rejects one finding. Within those findings 9 cases of maladministration resulting in injustice are accepted, as set out at Appendix 1.

In relation to those accepted cases of maladministration resulting in injustice, Sir John will advise HM Treasury on:

- The extent of relative losses suffered by different classes of policyholder in respect of each case of maladministration, taking account of, among other things, wider market conditions during the period under consideration, and comparable insurance products available over the same period;
- The proportion of those losses which it would be appropriate to apportion to the public bodies investigated by the Ombudsman, as opposed to the actions of Equitable Life and other parties;
- The classes of policyholders which have suffered the greatest impact as a result of maladministration;
- Factors, arising from this work, which the Government might wish to take into account when reaching a final view on determining whether disproportionate impact has been suffered; and
- The nature and extent of the finding of maladministration and injustice in relation to Finding 5 and the nature and extent of the finding of injustice in relation to Findings 2 & 4 so far as those Findings are now accepted.

Assumptions and evidence

Sir John will:

- 1 Accept as correct and be able to consider all of the Ombudsman’s findings of both maladministration and injustice in so far as those findings are accepted by the Government, but disregard findings which are not accepted;
- 2 Accept as definitive the Ombudsman’s account of the events at Equitable Life, as set out in the narrative sections of Part 1 of her Report and in Part 3;
- 3 Make such other findings of fact (if any) as he may think necessary in the light of the evidence contained in the publicly available reports produced to date, including the Penrose Report, the Ombudsman’s Report and the Government’s response to that report;
- 4 Review additional evidence should this be necessary to fulfil the terms of reference, but having regard to the need, so far as possible, for an expeditious process;

- 5 If he deems it necessary, seek written representations as appropriate from interested parties.

Sir John will advise as quickly as he is able, including providing interim updates and conclusions on a continuing basis so that work can progress on the practical issues in parallel without waiting unnecessarily for all his work to be concluded.

Appendix 1: Summary of Government's Response to the Ombudsman's Findings

The Government's response to the Ombudsman's findings is detailed in Chapter 4 of the Government's written response [Cm 7538]. Summarised below are those instances where the Government accepts, in its response or in the light of the judgment of the Divisional Court, that maladministration has led to injustice.

Finding 2 (scrutiny of Equitable Life's returns for 1990 – 1993)

Valuation Interest Rates and Affordability and Sustainability of Bonuses

The Government accepts findings of maladministration in relation to the valuation interest rate used by Equitable Life and the affordability and sustainability of its bonus declarations in relation to the regulatory returns in each of the years for 1990 to 1993 as set out in Chapter 4.

In relation to injustice, the Government accepts that the returns for 1990 to 1993 might have shown a different picture of the Society's solvency position if the maladministration accepted had not occurred.

The extent to which the regulatory returns in each of the years for 1990 to 1993 would have been different if the maladministration accepted by the Government had not occurred is the subject of a request for advice from Sir John.

Finding 4 (scrutiny of Equitable Life's returns for 1994 – 1996)

The Government accepts findings of maladministration in relation to (a) the valuation rate of interest; (b) the affordability and sustainability of Equitable Life's bonuses; and (c) apparently arbitrary changes to assumed retirement ages; and (d) the holding of no explicit reserves for liabilities for GARs constituted maladministration in relation to the regulatory returns in each of the years for 1994 to 1996 as set out in Chapter 4.

Changes to retirement ages

The Government accepts that Equitable Life's changes to retirement ages were significant and therefore should have prompted GAD to ask questions of the Society so that the regulator could be satisfied that the changes were justified.

In relation to injustice, it is accepted that the regulator ought to have satisfied itself that the changes to retirement ages were permissible. The Government accepts that Equitable Life might not have been able to justify their changes to retirement ages and that the regulatory returns might therefore have shown a different picture of the Society's solvency position.

Reserves for guaranteed annuity rates

The Government accepts that there was a requirement for Equitable Life to reserve for its GAR liabilities in circumstances in which the GARs were valuable to policyholders (when the current annuity rate fell below the guaranteed annuity rate). The Government accepts that GAD failed to confirm whether a GAR reserve was established in the 1995 returns.

In relation to injustice, the regulator should have required Equitable Life to establish explicit reserves for its GAR liability in the 1995 and 1996 returns. The Government therefore accepts that Equitable Life's returns would have shown a different picture of the Society's solvency position had no maladministration taken place.

Valuation Interest Rate and Affordability and Sustainability of Equitable Life's Bonuses

The Government accepts findings of maladministration in relation to the valuation interest rate used by Equitable Life and the affordability and sustainability of its bonus declarations in relation to the regulatory returns in each of the years for 1994 to 1996 as set out in Chapter 4.

In relation to injustice, the Government accepts that the returns for 1994 to 1996 might have shown a different picture of the Society's solvency position if the maladministration accepted had not occurred.

The extent to which the regulatory returns in each of the years for 1994 to 1996 would have been different if the maladministration accepted by the Government had not occurred is the subject of a request for advice from Sir John.

Finding 5 (presentation of Equitable Life's two valuation results)

The Government accepts that GAD's failure (a) to ask for information in relation to the 1995 regulatory returns (namely the figure for the resilience reserve in Equitable Life's appendix valuation) which was necessary to enable it, as part of the scrutiny process, to be sure that Equitable Life had produced a valuation that was at least as strong as the minimum required by the Regulations; and (b) to pursue information before it that the omitted information had led to users of the returns (specifically the credit rating agency Standard & Poor's) misconstruing Equitable Life's financial strength, constituted maladministration.

In relation to injustice, the Government accepts that the 1995 regulatory return might have shown a different picture of the Society's solvency position if the maladministration accepted had not occurred.

The extent to which the regulatory returns for 1995 would have been different if the maladministration accepted by the Government had not occurred is the subject of a request for advice from Sir John.

Finding 6 (financial reinsurance)

The Government accepts that the reinsurance Treaty was such as to raise questions which should have been resolved by the regulator before permitting credit to be taken for it in the regulatory returns.

In relation to the injustice resulting from Equitable Life's use of reinsurance, the Government accepts that, because the regulator permitted credit to be taken for the reinsurance treaty, Equitable Life's returns gave a materially misleading picture as to its solvency.

Finding 10 (information provided by the FSA in the post-closure period)

The Government accepts that the statement made in October 2001, namely that Equitable Life remained solvent, but continued to face fundamental uncertainties following the House of Lords' judgment in *Hyman*, had the potential to mislead policyholders and others reading it. Greater thought should have been given to making it clear that there had been a change in the FSA's understanding of Equitable Life's state of financial health so that policyholders and others could easily understand the difference between its statement that Equitable Life met "regulatory solvency margin requirements" (made in August 2001) and its statement that Equitable Life was "solvent" (made in October 2001). Furthermore, the FSA should have given further thought to its statement that Equitable continued to meet its regulatory solvency requirements.

The Government accepts the finding of injustice, although it believes that the number of policyholders who could show reasonable reliance solely on statements made by the FSA is likely to be relatively few, if any.



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