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## EQUITABLE LIFE - A DECADE OF REGULATORY FAILURE

In a report published today, Ann Abraham, the Parliamentary Ombudsman, has called on the Government to apologise to Equitable Life policyholders and to establish and fund a compensation scheme for those policyholders.

In her report *Equitable Life: a decade of regulatory failure* (HC 815), the Ombudsman makes ten determinations of maladministration on the part of the former Department of Trade and Industry, the Government Actuary's Department, and the Financial Services Authority, in relation to their regulation of Equitable in the period before 1 December 2001.

In addition to upholding several specific complaints, the Ombudsman has upheld a general complaint about the period before Equitable closed to new business on 8 December 2000, namely 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 Equitable Life.*

Finding that injustice resulted from maladministration, the Ombudsman has recommended that a compensation scheme should be established to assess the individual cases of Equitable's current and former policyholders, with a view to paying compensation to remedy any financial losses which would not have been suffered had those people invested elsewhere than with Equitable.

The Ombudsman has suggested that such a scheme should be established within six months of any decision by Government and Parliament to do so and, once operational, should complete its work within two years. The scheme should be independent, transparent, and simple to administer.

The Ombudsman has also recommended that the Government should apologise to policyholders for what her report describes as the '*serial regulatory failure*' that she has identified.

The Ombudsman recognises that her findings and recommendations will raise questions as to the public interest and may have a substantial cost to the public purse. She has therefore invited Parliament and Government to consider the issues raised in her report and the recommendations made within it, and to reflect further on what the response to her report should be.

In her report, the Ombudsman also:

- informs Parliament that the conclusions set out in her first report on the prudential regulation of Equitable, published on 30 June 2003, '*can no longer be regarded as having any validity*' and are superseded by this report;
- expresses her view that the failure by the Government to establish a single inquiry in 2001 not hampered by questions of jurisdiction or limited terms of reference was '*iniquitous and unfair*';
- expresses regret at the time that it has taken to complete the investigation and publish her report; and
- dismisses the Government's argument that she must adopt the approach of the Courts to questions of the remedies available for the failures of financial regulators.

The Ombudsman said:

*"The failings I have identified in this case were not failures of the system of regulation that was in place at the relevant time. The aim of that system was the protection of the interests and reasonable expectations of policyholders and potential policyholders. Parliament gave those operating that system robust and wide-ranging powers, which the regulators were under a duty to consider using where appropriate. The regulators at the time said that they would deliver regulation in a proactive and vigorous way. That singularly failed to happen in the case of Equitable."*

Ann Abraham also said:

*"The case of Equitable Life, which echoes earlier cases such as Vehicle & General in the 1970s and shares some similarities with the current example of Northern Rock, illustrates the need for absolute clarity as to what can and cannot be expected from financial regulation and the development of shared understandings as to the limits to the protection that such regulation offers to investors both before and after problems arise, as they inevitably will. Key, however, is that*

*those responsible for undertaking financial regulation should act in a way that is compatible with the duties and powers which Parliament has conferred on them. Those responsible for the prudential regulation of Equitable Life failed to do so throughout the period covered in my report."*

The Ombudsman also said:

*"I have alerted Parliament to the injustice which I have found in this case resulted from serial maladministration on the part of the former Department of Trade and Industry, the Government Actuary's Department and the Financial Services Authority. I recognise that my recommendations raise questions which are now properly ones for Parliament and Government together to consider. I stand willing to assist in their consideration of the issues raised by my report and of the recommendations which I have made."*

**Notes to editors:**

1. Ann Abraham holds the post of UK Parliamentary Ombudsman and is also Health Service Ombudsman for England. She is appointed by the Crown and is completely independent of Government and the NHS. Her role is to provide a service to the public by undertaking independent investigations into complaints that government departments, a range of other public bodies in the UK, and the NHS in England, have not acted properly or fairly or have provided a poor service. There is no charge for using the Ombudsman's services.
2. For media enquiries please contact: PHSO Press Office on 020 7217 4996 or 020 7217 4077. Out of Office Hours contact: 020 7217 4225.
3. If you would like a copy of the report, please contact 020 7217 3904 or [equitable.investigation@ombudsman.org.uk](mailto:equitable.investigation@ombudsman.org.uk) . Please note that, from 17 July 2008, the report will be available on the Ombudsman's website at: <http://www.ombudsman.org.uk>
4. The annex to this notice provides an overview of the Ombudsman's findings.

### Overview of the Ombudsman's findings

Part 5 of the Ombudsman's report contains a guide to the main report and a summary of the Ombudsman's findings and recommendations. You are encouraged to read that. A short overview of the principal findings, determinations, and recommendations is given below.

#### *Findings: the build-up to the crisis - before July 1998*

The Ombudsman concludes in her report that, during the period before July 1998, when the problems which were eventually to force Equitable to close to new business were developing, the bodies regulating Equitable - the former Department of Trade and Industry and the Government Actuary's Department - undertook that regulation in a '*passive, reactive, and complacent*' manner.

The regulators during this period:

- permitted one person to hold simultaneously the roles both of Chief Executive and Appointed Actuary for more than six years, thus neutralising the ability of the regulators to rely on the Appointed Actuary, who held a central role as a 'whistle-blower' in the system of prudential regulation;
- failed to question or to seek to resolve issues arising within the annual regulatory returns submitted by Equitable concerning the way in which the solvency position of the company had been calculated and as to the affordability and sustainability of the bonuses that it was declaring;
- identified that Equitable had introduced the differential terminal bonus policy, which was later to cause significant problems, but failed to consider the implications of the introduction of that policy, even though Equitable had fully disclosed in its earlier regulatory returns the nature and extent of the guaranteed annuity rates within its older business which the policy was designed to address;
- failed to resolve apparent issues of non-compliance within Equitable's regulatory returns; and
- did nothing to raise or resolve the issue of omitted information in Equitable's regulatory returns, which led the reader of those returns to assume incorrectly that Equitable was more financially sound than it was, even when the regulators had information before them that industry rating agencies were misconstruing the company's financial strength.

The Ombudsman found that those failures constituted maladministration, as they represented departures from the standard that could reasonably be expected of the regulators which were unreasonable in the circumstances and fell far short of acceptable standards of good administration.

The report explains that the consequences of that maladministration were:

- that the regulators were, from 1991 to 1997, overly reliant on the information provided by one person;
- that the regulators failed to verify the financial position of Equitable over this period, although they were under a duty to do so;
- that the regulators failed to identify the problems which would in time cause the company to close to new business and that opportunities were lost to address those problems much earlier than eventually happened; and
- that the regulators permitted misleading information, based on a misunderstanding of Equitable's reported financial position, to be provided to policyholders and potential policyholders.

*Findings: the crisis period - July 1998 to December 2000*

The Ombudsman has also concluded that, in relation to the period between July 1998 and December 2000, during which time the regulators were aware of Equitable's growing problems and were in discussion with the company before it closed to new business, the regulators' actions were '*largely ineffective and often inappropriate*'.

While the regulators, by now the Financial Services Authority (acting on behalf of the Treasury) and the Government Actuary's Department, often initiated discussions appropriately with Equitable, those regulators:

- permitted Equitable to take credit within the regulatory returns for 1998 for a reinsurance arrangement which had not been concluded, without issuing the required reporting concession - and then permitted the company to take credit - of £809 million, £1,098 million, and £808 million for 1998, 1999, and 2000, respectively - for that arrangement, when it had no economic substance at all;
- failed to ensure that Equitable, in not disclosing the potentially serious financial impact on it of losing the *Hyman* litigation, had a proper basis for not so doing;
- did not record their decision to permit Equitable to remain open to new business or the reasons for that decision; and
- took their decision to permit Equitable to remain open on an unsound basis, ignoring relevant considerations such as the nature of the company's business - which meant that those exposed to risk by the regulators' decision were not as

limited as had simply been assumed by the regulators - and not taking into account the full range of powers available to the regulators.

The Ombudsman found that those failures constituted maladministration, as they represented departures from the standard that could reasonably be expected of the regulators which were unreasonable in the circumstances and fell far short of acceptable standards of good administration.

The report explains that the consequences of this maladministration were:

- that Equitable was permitted to declare a bonus in March 1999, when had it not done so the public would have been given a very clear warning as to the dire financial position that the company by then was in;
- that the true financial weakness of Equitable was further obscured by the publication by 1 May 1999 of misleading returns, which reported a solvency position which took substantial credit for a reinsurance arrangement which was worthless;
- that no warning of the potentially serious impact of the loss of the *Hyman* litigation was given to Equitable's policyholders until it was too late;
- that those making new or further investments with Equitable, or making other decisions such as whether to buy an annuity or to remain with the company, in all of the period from 1 May 1999 onwards, did so in an environment in which they did not have accurate and complete information about the company's true position; and
- Equitable's policyholders lost the opportunity for the exercise of robust and fair intervention powers to protect their interests and reasonable expectations.

*Findings: after closure to new business - December 2000 to December 2001*

The Ombudsman also established that, during the period covered by her report after Equitable closed to new business on 8 December 2000, the regulators undertook a large amount of work in relation to Equitable. She concluded that most of that was effective.

However, during this period the regulators provided misleading information to policyholders and the public, saying that Equitable had always been solvent for regulatory purposes. The regulators also gave assurances that the company had always met its other regulatory requirements. Neither was the case.

The Ombudsman found that the provision of this misleading information constituted maladministration, as it represented a departure from the standard that could reasonably be expected of the regulators which was unreasonable in the circumstances and fell far short of acceptable standards of good administration.

The consequence of the provision of misleading information was that those who looked to the regulators to provide them with accurate and balanced information were let down.

*Injustice and remedy*

The Ombudsman found that there were three further general consequences of these failings, being:

- that Equitable's regulatory returns were an unreliable source of information for existing and potential policyholders, financial advisers, industry commentators, and ratings agencies;
- both the regulators and Equitable lost opportunities to address at an earlier date issues which were eventually to become critical; and
- regulatory decisions were frequently taken on a basis which had insufficient regard to the powers which Parliament had given to those regulators.

The Ombudsman determined that all this represented injustice resulting from maladministration in the form of:

- any financial loss and/or lost opportunities to take informed decisions as a result of reliance on the information contained in Equitable's regulatory returns for 1990 to 1996;
- lost opportunities in the period between July 1991 and April 1999 to take informed decisions in full knowledge of the exposure of Equitable to guaranteed annuity rates and of the risks that such exposure generated;
- any financial loss incurred by anyone who joined Equitable 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;
- any financial loss 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 regulators in the post-closure period, that such reliance was reasonable in the circumstances, and that it led to any such losses; and
- a justifiable sense of outrage on the part of all those who complained to the Ombudsman at the failings of those operating the regulatory system during the period prior to Equitable's closure to new business.

The Ombudsman's general practice is, where injustice has resulted from maladministration, to seek to ensure that people are put back into the position they would have been in, had no maladministration occurred. Where that is not possible, appropriate compensation should be paid.

In this case, the Ombudsman has made two recommendations, saying:

*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 identified in this report, the public bodies should apologise to those people for that failure.*

...

*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.*