House of Commons

Public Administration Select Committee

Justice denied? The Government's response to the Ombudsman's report on Equitable Life

Sixth Report of Session 2008–09

Report, together with formal minutes, oral and written evidence

Ordered by the House of Commons
to be printed 12 March 2009

HC 219
Published on 19 March 2009
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

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Summary

This Report contains our views on the Government's response to the Parliamentary Ombudsman's report on Equitable Life. It follows an earlier Report which we published in December 2008, before the Government's response was available. In essence, we are deeply disappointed with the response.

We are disappointed that the Government has chosen to act as judge on its own behalf by rejecting and qualifying a number of the Ombudsman's findings. It has done so for reasons which are not well explained in its published response, and which have therefore been difficult to assess.

We are disappointed that the Government has decided that compensation is not warranted, arguing that it is under no duty to put right, even in part, wrongs that it admits the State has caused. This may be a legally valid position, but we think that most people would consider it to be a morally unacceptable one. We also struggle to understand the logic behind this decision. The only potentially valid reason that the Government provides, namely that Parliament has considered that financial regulators should not normally be held liable in the courts for financial loss, was introduced late in the day in a way that we find to be shabby, constitutionally dubious and procedurally improper.

We are disappointed with the process that the Government has decided to follow for making ex gratia payments to policyholders. This process looks set to be complex, and therefore likely to be slow and onerous for all those involved. It does not take into account the difficult personal circumstances of many policyholders, for example, their age, their health, or the number of years that have passed since the relevant events. This represents a basic failure on the part of the Government to understand the problem which its scheme is supposed to address.

The Government's response has produced a strongly negative response not only from us, but also from the Ombudsman, from Equitable Life and from policyholder representatives. This should give the Government pause for thought.

Nonetheless, we accept that the scheme proposed by the Government could help to improve the lot of some policyholders. If this is the best scheme available, we want it to work as well as possible. This requires the Government to ensure that its scheme makes a tangible difference to policyholders as soon as possible. This is much more likely to be achieved through a scheme which is simple and clear. The Government has proposed a "disproportionate impact" test. This test is an unnecessary complication, but if it must remain, it needs to be workable and simple to implement, and should not rely on information which will be hard to access.

Individual policyholders have not been told when they can expect to find out if they qualify for a payment, or when they might receive it. This uncertainty is unsettling. An indicative timetable for the scheme needs to be made available as soon as possible. Many policyholders have already died; more will have died by the time a scheme is implemented. It would be deeply unfair if their surviving partners were denied the opportunity to benefit.

The Government has appointed Sir John Chadwick, a retired judge, to give it advice on the design of a scheme. His role is another potential factor for delay. There seems to be nothing improper about Sir John's appointment, despite claims to the contrary by policyholder representatives. It is, however, important for the Government to be clear and honest about which parts of the scheme's design are independent and which are not. It is important that Sir John's advice and the representations he receives should be published to show the extent to which the Government has followed his advice as well as how this advice may have been influenced.

We also give further thought to two wider issues on which we have previously reported.

It is to the Parliamentary Ombudsman's credit and to the credit of the Government that she achieves a satisfactory remedy in the vast majority of cases she investigates. However, she faces greater obstacles where her investigations find injustice which is likely to be very expensive to put right. We have previously called for comprehensive and fit for purpose investigations in such cases that stretch beyond the Ombudsman's remit, investigations that would be able both to look at the picture in the round and apportion responsibility. Until the Government embraces this kind of broader investigation, the Ombudsman system will remain the best option for holding public bodies to account for costly administrative failings.

Despite the numerous opportunities for the prudential regulators to learn lessons, the system of regulation has once again failed the taxpayer and the customers of financial institutions. Effective regulation requires honest and full learning from past mistakes, and this in turn requires regulators to be consistently and effectively accountable. A debate is now needed on how to achieve that kind of accountability.

1 Introduction

1. On 15 January 2009, the Chief Secretary to HM Treasury made a statement to the House[1] in response to the Parliamentary Ombudsman's report,[2] published in July 2008, into the prudential regulation of the Equitable Life Assurance Society (ELAS). Later that same day, the Government published its written response to the Ombudsman's report.[3]

2. In summary, the Government's response:

a) accepts some of the Ombudsman's findings of maladministration and injustice, although frequently with qualifications of the basis on which the Government is doing so;

b) rejects other findings of maladministration and injustice;

c) apologises for the findings the Government accepts; and

d) rejects the Ombudsman's recommendation for compensation as a remedy; but

e) proposes to establish an ex gratia scheme, after it has received advice from a former judge on certain issues.

3. This Report contains our considered reaction to the Government's response. It needs to be read in the context of our earlier Report, *Justice Delayed*, which we published on 15 December 2008.[4] We stand by the views we expressed in that Report. We repeat them here only as epigraphs to parts of this Report, and where sense demands it.

4. When we published our views in December, we stated:

> Whether we need to return to these issues in the New Year will depend on what the Government has to say—but if it gives us any cause for concern, we will not hesitate to do so.[5]

5. There can be no doubt that the Government's response has given others cause for concern. The Ombudsman has told us that "overall this is an unsatisfactory response",[6] ELAS that the response is "wholly inadequate",[7] and Equitable Members' Action Group (EMAG) that it is "totally unacceptable".[8] The issues they have raised with us relate to:

1 HC Deb 15 January 2009, cc 377–394

2 Parliamentary Ombudsman, *Equitable Life: A Decade of Regulatory Failure*, Fourth Report of Session 2007–08, HC 815 (henceforth 'Ombudsman's report')

3 HM Treasury, *The Prudential Regulation of the Equitable Life Assurance Society: the Government's response to the Report of the Parliamentary Ombudsman's Investigation*, Cm 7538 (henceforth 'Government response')

4 *Justice delayed: The Ombudsman's report on Equitable Life*, Second Report from the Select Committee on Public Administration, Session 2008–09, HC 41-I (henceforth 'Our earlier Report')

5 Our earlier Report, para 4

6 Q 1

7 Q 36 [Charles Thomson]

8 Q 64 [John Newman]

i. the Government's analysis of the Ombudsman's findings,

ii. the process of restitution that the Government now intends to follow, and

iii. what the outcome of this process will be for those who have suffered injustice as a result of the failings of the prudential regulators of Equitable Life.

6. We put these concerns to the Economic Secretary to the Treasury, Ian Pearson MP,[9] whose evidence we have also taken into account.

7. In this short Report, we tackle these issues in reverse order. We start by considering how the Government's proposals could be implemented so as to produce a positive outcome for at least some policyholders. We then make some broader comments on the way that the Government has approached the issue of redress in this case, and on how it has responded to the Ombudsman's findings. Finally, we ask what this case means more broadly for the Ombudsman and for the accountability of regulators.

9 Qq 96–171

2 Implementation of the Government's decision

> *the main priority must be prompt redress given that policyholders have already been waiting for almost a decade and substantial numbers have either died or are advancing in years. Justice further delayed will mean justice denied to even more people.*[10] *(paragraph 59)*

8. The Government's response is not what policyholders and others had hoped for, but the Minister has made clear that the Government has no intention of revisiting its decision.[11] We would be acting irresponsibly if we simply rejected the proposals out of hand.

9. We set out in subsequent parts of this Report the wide range of concerns that we have about the way the Government has responded to the Ombudsman's report and about its specific proposals to make payments to some Equitable Life policyholders. As we will show, **the scheme proposed by the Government is inadequate as a remedy for injustice. Nonetheless, it could help to improve the lot of some of those policyholders who have struggled to make ends meet since the closure of Equitable Life to new business, and on this basis, if the scheme is the best available, we want it to work as well as possible.**

10. The Government needs to focus on ensuring that policyholders start to receive money soon. At the same time, it has a duty to establish a scheme that is thought-through and workable in practice. The Ombudsman has made clear in the past the qualities that an effective ex gratia scheme needs to have, including:

- scheme rules that are clearly articulated and which directly reflect the policy intention behind the scheme; and
- systems and procedures in place to deliver the scheme which have been properly planned and tested.[12]

11. The Government's task is to ensure that the scheme is not "put together in haste", but that it is nonetheless put together at speed. Policyholders believe that the Government is using delay as a tactic to reduce the number of those who might qualify for payment under a scheme.[13] Unless the Government acts with urgency, there will be a stronger basis for this belief.

12. The Government has specified:

10 This and subsequent epigraphs are quotations from our earlier Report, *Justice Delayed: The Ombudsman's report on Equitable Life*, HC 41-I (2008–09).

11 Q 127

12 Parliamentary Ombudsman, *Put together in haste: 'Cod Wars' trawlermen's compensation scheme*, 2nd Report of Session 2006-07, HC 313, para 82

13 Q 87 [Paul Braithwaite]

a) that a scheme should make payments only to those who have suffered injustice resulting from maladministration where this has been accepted by the Government as having occurred;[14]

b) that payments should be reduced to take account of losses attributable to other factors, such as the conduct of Equitable itself;[15] and,

c) that payments should be made only where policyholders have suffered "disproportionate impact".[16]

13. **Confidence in the scheme will be fatally undermined if the net effect of the limiting factors specified by the Government is either:**

a) **to restrict payments to an excessively small number of policyholders,**

b) **to make unreasonable demands on policyholders to show that they qualify under the scheme, or**

c) **to cap the sums payable at a level that will make little or no real difference to policyholders' lives.**

14. **It is up to the Government to ensure that its scheme makes a tangible difference as soon as possible to policyholders who have, even by its own reckoning, suffered injustice including financial loss because of failures of the State. This is much more likely to be achieved through a scheme which is simple and clear, and which avoids making demands of policyholders wherever possible.**

"Disproportionate impact" test

15. An example of an unnecessary complication is the Government's proposal to make payments only where "disproportionate impact" has been suffered. It is all the more problematic, because it is unclear what it means. The Government is proceeding on the basis that some policyholders have suffered "disproportionate impact" according to representations it has received.[17] But it has no view as to what this impact might involve or how it should be taken into account.[18] When the Chief Secretary to the Treasury was questioned on this point in the House of Commons, she referred to the need for a "fair" ex gratia payment scheme to take account of people's "wider circumstances":[19]

> there is a difference, as I hope the House would recognise, between someone who relies on their Equitable Life pension for the majority of their income and has seen

14 Government response, para 5.22

15 Government response, para 5.23

16 Government response, para 5.22

17 Government response, para 5.22

18 Qq 136, 142

19 HC Deb 15 January 2009, c 389

significant reductions in it as a result and someone who might still be in work and has alternative ways in which they can invest.[20]

16. What this seemed to suggest was a form of hardship payment. It would only be possible to assess people's "wider circumstances" to judge whether they were or were not in hardship through access to personal financial information: this would only be held by them as individuals. Both Equitable Life and EMAG strongly opposed any suggestion of "means testing" of this kind[21]—as indeed we did in December.[22] When the Economic Secretary appeared before us, he told us in an apparent change of heart that the Treasury's "preferred option is for there not to be a means test"[23]—although this suggests that it has not been ruled out altogether.

17. We can see the attraction of targeting payments towards those who need them most, particularly for a Government which is treating these payments as a matter of charity, not of justice. However, we cannot see how this targeting could be achieved in practice without means testing: this would add to the complexity of the process, would be time-consuming and would discourage some of those most in need from participating in the process. These are not the only complications and sensitivities. Would a pensioner be refused a payment if he owned his home? If so, this implies that he might be required to sell it. Conversely, would a pensioner be denied a payment for having money in the bank from the sale of his home, perhaps before the scheme came into existence?

18. A further problem with the "disproportionate impact" test, however it is assessed, is that the scale of the impact of maladministration on individuals may not yet have become apparent. Those still in work may know that they face poverty in retirement, but suffer no hardship for now. We have heard from retired policyholders whose annuity payments have been gradually decreasing.[24] If impact this year is not judged to be disproportionate, it may yet become so next year or the year after. How is this to be taken into account?

19. There are more straightforward options for approaching disproportionate impact than looking at 'wider circumstances': for example, by looking at loss from an Equitable Life policy or annuity which is attributable to maladministration as a proportion of total loss suffered by that policy or annuity. Equitable Life has suggested that *de minimis* cases, where any loss has been marginal, could reasonably be excluded from a payment scheme.[25] We agree that it is sensible that they should.

20. Given this uncertainty and these complications, **our preference would be for the Government to make the scheme simpler by removing the disproportionate impact test altogether. If, however, the Government insists on the test, what matters most is that it should be simple to implement, relying so far as possible only on information held by**

20 HC Deb 15 January 2009, c 385

21 Qq 40 [Charles Thomson]; Our earlier Report, Volume II, Q 79 [Paul Braithwaite], 'Watchdog slams Treasury on Equitable', *Financial Times*, 29 January 2009

22 Our earlier Report, para 84

23 Q 128

24 eg Ev 59

25 Q 41 [Charles Thomson]

Equitable Life, and not placing a burden on policyholders or others to provide information.

21. **It is acutely disappointing that the personal circumstances of policyholders are not taken into account in any part of the Government's response, for example, their age, their health, or the number of years since the relevant events. Nowhere in the response does the Government take account of the need for simplicity in the design or operation of any scheme. This marks a basic failure to understand the problem which the Government's scheme is designed to address.**

Widows and widowers

22. The Government has not decided how the estates of those policyholders who have died should be treated.[26] **Those policyholders who have died, or will have died before a scheme is implemented, clearly cannot benefit personally from the payment scheme. But many will have surviving partners, who will have suffered worry and a diminished standard of living alongside them. It would be deeply unfair, and add to their justified outrage, if they were denied the opportunity to benefit.**

Judicial review

23. EMAG have been consulting their lawyers.[27] The most obvious option open to them if they decide to go to court is to seek a judicial review of the Government's decision in this case. If such a review were successful, the Government would need to make a fresh response, and we would need to revisit our comments in this part of the Report in the light of what this new response might say.

24. We do, however, have two thoughts on the prospect of judicial review: first, that it is likely to mean further delay; second, that, even if it were successful, it would not necessarily force the Government to provide a more generous compensation scheme. As the Ombudsman has suggested,[28] it is open to the Government to accept all of her findings, and yet refuse to pay any compensation whatsoever, for reasons of the state of the public purse. **A successful judicial review could result in a better process, but one with a worse outcome for policyholders.**

26 HC Deb 15 January 2009, c 386

27 EMAG website, www.emag.org.uk, 18/01/2009 – 'What next for EMAG?'

28 Q 1

3 The Government's approach to this case

> *Regulation is never an easy job and mistakes, even serious ones, will occasionally be made, but the real test for government is how it then responds. (paragraph 81)*

25. In this part of our Report, we consider the main elements of the Government's response: first, its decision to reinterpret and in some cases reject the Parliamentary Ombudsman's findings of maladministration and injustice; second its argument that injustice caused by maladministration by regulators does not lead as of right to the payment of compensation; and third, its decision to establish an ex gratia scheme on terms of its own devising.

26. We also have two general comments about the way in which the response was presented to Parliament and the public.

27. First, when the Chief Secretary to the Treasury made a statement to the House on 15 January, the extent to which the Government was departing from the Ombudsman's findings was not made clear. EMAG has noted the "disparity between the way it was presented to you, as MPs, in the statement and what was released later" in the form of the Government's written response:[29]

> Those attending and observing the debate might be forgiven for receiving the impression that all those who had been badly affected by the Equitable Life debacle could eventually expect at least some form of compensation … However, the details of the written response (only published hours after the Minister sat down) make it clear that this impression is far from the truth.[30]

28. Copies of the Chief Secretary's statement were distributed in the Chamber. Copies of the written response were not. Although they were available in the Vote Office, Members wishing to intervene to ask questions of the Chief Secretary following her statement would have had little or no opportunity to obtain a copy, as to do so would have meant leaving the Chamber and possibly losing the opportunity to speak. Copies of the written response also seem not to have been available to the public either in hard copy or via the Treasury's website until several hours after the statement was made.

29. While the Chief Secretary's statement to the House was not inaccurate, it nonetheless left Members and the public with an incomplete understanding of the Government's position. **Given the difficulties faced by Members and the public in obtaining timely copies of the Government's written response, the Chief Secretary should have been more explicit in her statement to the House about those findings made by the Ombudsman which the Government was rejecting or substantially qualifying.**

30. Second, we are deeply unimpressed by the way in which the Government has, in its own words, "taken account" in its response of our earlier Report on Equitable Life.[31] There

29 Q 87 [Paul Braithwaite]

30 Ev 41

31 Government response, para 5.9

are only two references to our Report in the Government's response. Both are quotes, taken out of context, and presented in support of the Government's position.

31. At paragraph 5.16, the Government quotes our statement that "The current board of Equitable Life and many others have acknowledged the legitimacy of Lord Penrose's conclusion; few people dispute that its former management were primarily to blame". Nowhere does the Government refer to the conclusion that follows:

> It would … be wrong for the Government to refuse compensation on the basis of Lord Penrose's conclusion that Equitable Life was "principally … the author of its own misfortunes". This often quoted phrase must not mask Lord Penrose's further conclusion that it was regulatory failure which permitted Equitable Life's management to carry on undermining the interests of its members for so long.[32]

32. At paragraph 5.18, the Government quotes our statement that "The decision to compensate must not … be the equivalent of signing a blank cheque on taxpayers' behalf", but fails to refer to our corresponding conclusion that:

> It is on this basis that we reject the suggestion that compensation would be the equivalent of turning the State into the guarantor of a failed business; in contrast it would be a case of the State making good its own serious failure.[33]

Instead, at paragraph 5.20, the Government restates the very argument we were countering in the remarks that it failed to use, namely that it would have "serious repercussions" if the taxpayer had to "provide a remedy for all losses whenever financial institutions fail and maladministration by the regulator was found". It does so without seeking to address or even to recognise the point we were making.

33. **In its response to the Ombudsman's report, the Government has taken a highly selective and partial approach to its representation of our views. It has not addressed our conclusions or analysed our arguments, but simply taken our words out of context to support arguments of its own in a way that gives an inaccurate impression of our views.**

Findings of maladministration: "judge on its own behalf"

> *we would be deeply concerned if the Government chose to act as judge on its own behalf by refusing to accept that maladministration took place. (paragraph 117)*

34. In her report, the Ombudsman made ten findings of maladministration, leading to five findings of injustice. The Government in its response accepts three of these findings of maladministration, with caveats, that it acknowledges led to some injustice. It also accepts several other findings of maladministration, but on the basis either that the Ombudsman's view was that these did not lead to injustice, or that it rejects the Ombudsman's view that they did lead to injustice. The Government rejects certain findings of maladministration altogether.

32 Our earlier Report, para 49

33 Our earlier Report, para 50

35. **The Ombudsman is not a judge, but a parliamentary investigator. The Government is not legally obliged to respect her findings as it would have to respect a judgement of the courts. It must, however, have compelling reasons for disagreeing with her.**

36. The Government has the legal right to disagree with the Ombudsman's findings of maladministration, as long as it has "cogent reasons" for doing so. It is for the courts to decide whether or not the Government's arguments are "cogent", a word defined by the Oxford English Dictionary as "argumentatively forcible, convincing".

37. The need for such "cogent reasons" makes moral sense in this context. The Ombudsman has conducted an impartial, painstaking and thorough investigation, and has found that the Government and public bodies were seriously at fault and that people have suffered because of that fault. For the Government to disagree with findings of this nature, reached in this way, is for the party at fault to substitute its own view for that of the independent arbiter. It should require compelling reasons for it to do so.

38. The Government's response itself fails to provide enough detail to enable a proper analysis of the validity of its reasons for rejecting and qualifying the Ombudsman's findings. As Charles Thomson of Equitable Life told us:

> What we have now got is less than 50 pages of which a very small part says Government disagrees with what the Ombudsman has found but gives very, very limited reasons. There may be cogent reasons behind that but it is not at all clear from what has been published so far.[34]

39. The Ombudsman has provided us with her detailed comments on the Government's response, providing specific examples of instances where she believes the Government has:

- addressed findings which she did not make;
- sought to reinterpret and/or limit the basis on which she made certain findings; and
- provided a partial or incomplete response to other findings.[35]

40. In her oral evidence to us, the Ombudsman commented that the Government's response was "strong on assertion, short on facts", and that it "fails to address the basis on which [she] came to several of [her] findings". As she put it to us:

> Perhaps another way of saying that is the response says that I said something different to what I actually said and then says it disagrees with something I did not say.[36]

The fact that the Ombudsman feels that she has been misunderstood and misrepresented is an indictment of the quality of the Government's arguments as presented to the public.

34 Q 48

35 Ev 31

36 Q 1

41. Shortly before considering this Report, we received further written evidence from the Economic Secretary, responding in some detail to the Ombudsman's comments. He has also made the following general observation:

> the response document … was not intended to cover every aspect of every topic set out in the Ombudsman's exhaustive and detailed report of July 2008. To have done so would have required a significantly longer and more detailed response, at the expense of the readability and accessibility of a document aimed at a general audience. Rather, the purpose of the document was to provide the Government's response to each of the specific findings reached, and recommendations made, by the Ombudsman.[37]

42. **In attempting to produce a response that was readable and accessible, the Government also produced one that prevented a proper analysis of the validity of its reasons for rejecting and qualifying the Ombudsman's findings. We do not think it was the right decision to sacrifice intelligibility for accessibility. Where the Government departs from the Ombudsman's findings, it has a duty to explain why it is doing so in enough detail to enable a proper examination of its reasoning.**

43. Certain detailed matters concerning the Government's response remain the subject of disagreement between the Government and the Ombudsman. We are not in a position to contribute further to that debate. We note that the Ombudsman is considering laying a further special report before Parliament on injustice that has not been, or will not be, remedied, under section 10(3) of the Parliamentary Commissioner Act. We encourage her to consider addressing these matters in any such report.

44. **We concluded in December 2008 that "we would be deeply concerned if the Government chose to act as judge on its own behalf"; yet this is precisely what it has done.** The warning of one of our previous witnesses, the former rail regulator Tom Winsor, appears to have been borne out:

> Justice at the discretion of ministers is not justice … There is a very high probability that justice will be denied simply because ministers do have that discretion.[38]

45. EMAG has claimed that the Government's rejection of a number of the Ombudsman's findings is also in effect a denial of responsibility for 90 per cent of the losses that might otherwise have been considered for compensation.[39] They have gone further, suggesting that the Government's aim in rejecting these findings was to reduce the bill to the taxpayer:

> They have said, '£', and then … tried to trim - the salami tactics - every policyholder out of the way.[40]

46. The Economic Secretary told us that the Government has departed from the Ombudsman's findings only where it believes it has cogent reasons for doing so, and not in

37 Ev 47

38 Our earlier Report, Volume II, Q 238

39 Q 65 [Colin Slater]

40 Q 69 [John Newman]

"an attempt, as some have suggested, by the Government to limit the number of classes of policy holders who may be eligible for ex gratia payments under the scheme that we establish".[41] Whatever the real rationale, the Government's rejection of some of the more potentially expensive of the Ombudsman's findings was always likely to provoke disquiet among policyholders.

Justice or charity?

> *the payment of compensation is not a matter of charity but a requirement of justice to redress a wrong. (paragraph 84)*

47. The Government has acknowledged, though on its own terms, that public bodies were responsible for maladministration and that some Equitable Life policyholders have suffered injustice including financial loss as a result of this maladministration. Yet it does not propose to pay these people compensation, but rather to establish an ex gratia (charitable) scheme. It gives three reasons for this:

- first, the primary responsibility of the former management of Equitable Life for policyholders' losses,
- second, the Government's responsibility to taxpayers generally to balance competing demands on the public purse, and
- third, that "Parliament has accepted that it is not generally appropriate to pay compensation even where there is regulatory failure".[42]

Primary responsibility of Equitable Life

> *It would … be wrong for the Government to refuse compensation on the basis of Lord Penrose's conclusion that Equitable Life was "principally … the author of its own misfortunes". (paragraph 49)*

48. The first of these reasons is, as the Ombudsman has put it, a "red herring".[43] If all that the Government was saying was that it should not be held liable for losses suffered as a result of mismanagement or for market losses, we would have no problem with that. Indeed, it would be in line with what we have already recommended.[44] But the Government seems to be going further than this, suggesting that another party's primary responsibility should mean that the injustice for which it has accepted responsibility should not trigger compensation at all. If this argument were followed to its logical conclusion, it would mean that a doctor who negligently failed to diagnose and treat a condition should not be liable because he did not cause the condition; or that a surveyor who negligently failed to identify that a wall was structurally unsound should not be liable when it collapses because he did not build the wall.

41 Q 96

42 Government response, paras 5.15–5.20

43 Q 1

44 Our earlier Report, paras 50, 69 and 78

49. **The injustice the Ombudsman found, and that part of it which the Government has accepted, were caused by the maladministration of public bodies, not by the former management of Equitable Life. Both we and EMAG have suggested that the fact that regulators were not primarily responsible for policyholders' losses warrants, as recognition of that fact, a discount on the amount of compensation payable. But this does not alter the fact that public bodies were responsible for injustice, and should not allow them to escape liability for that injustice altogether.**

Responsibility to taxpayers generally

> *The decision to compensate must not … be the equivalent of signing a blank cheque on taxpayers' behalf. It is essential that the public purse benefits from an appropriate measure of protection. In particular, the emphasis must be upon compensating individuals only for that loss that is fairly attributable to regulatory failure. (paragraph 50)*

50. The second of the Government's reasons has some strength as an argument for reducing the level of compensation payable. We took it into account in our last Report on this case, and the Ombudsman has since suggested that it might legitimately have been used to deny compensation altogether.[45] What we find impossible to understand is why it has any validity as an argument against making compensation payments as opposed to ex gratia payments; why it should allow the link to be broken between the Government's acceptance that it has caused injustice and the payment of money to put right at least part of that injustice.

51. Where maladministration by public bodies has caused injustice resulting in substantial financial losses, it will always be the case that the Government has a responsibility to taxpayers generally which will need to be balanced against the potential sum of its liability. **The Government uses its general responsibility to taxpayers as an argument for not establishing a compensation scheme. If this argument were carried to its logical conclusion, compensation would never be payable—even in part—where public bodies had been responsible for injustice resulting in substantial financial loss, but only where any financial loss was modest. Such a position would be patently absurd and unfair.**

Regulatory failure and compensation

> *the regulators were installed to promote confidence in us all to save for retirement. They were given extensive powers to carry out their task. Not only did the regulators fail, but they failed over a prolonged period and at a fundamental level. (paragraph 47)*

52. The third of the Government's arguments is the one that causes us most difficulty. Parliament has in recent years accepted that financial regulators should not be liable in the courts for damages caused by "anything done or omitted in the discharge of [their] regulatory functions", except where they have acted in bad faith or have breached obligations under the Human Rights Act.[46]

45 Qq 1 and 32

46 Financial Services and Markets Act 2000, Schedule 17, section 10

53. The Government is now effectively claiming that this statutory immunity should be understood as extending to compensation payments recommended by the Ombudsman.

54. The Ombudsman herself has disputed this strongly:

> if Parliament had indeed, as the Government says, always considered that regulatory failure should have no consequences in terms of remedy, or that regulators should always be immune from independent scrutiny or challenge, then why were the Prudential regulators in the period before 2001 not given statutory immunity or removed from the Ombudsman's jurisdiction before now? Why did the Government not say all of this much sooner either in its response to my consultation in 2004 when I consulted on whether to conduct a further investigation into Equitable Life, or in its very substantial response to the complaints at the beginning of the investigation. … If the Government had said these things at the outset, I might never have embarked on this investigation or at least we could have had the debate, and Parliament could have had the debate, much earlier.[47]

55. In 2004, the Ombudsman invited the views of interested parties on the question of whether she should begin a new investigation into Equitable Life. The Treasury provided a lengthy and detailed response, setting out numerous reasons why she should not.[48] There was, however, no suggestion at this time that compensation would not be an available remedy if she did conduct such an investigation. This argument began to emerge, by the Economic Secretary's own admission, only in 2007, when the Ombudsman's investigation was nearing completion.[49]

56. As we have already stated, the Ombudsman is Parliament's independent arbiter, not a court of law. This a fact that the Government is all too keen to take advantage of when it suits it. She conducted an investigation into areas within her remit, on the understanding that compensation would be an available remedy if injustice were found. This was not an unreasonable assumption: it is an available remedy in every other case she conducts, and the aim of providing a remedy is integral to her work. Several years into her investigation, and only when it became apparent what the outcome was likely to be, the Government began to argue that compensation should not be available in cases of this kind.

57. There is no dangerous precedent to set here. The Financial Services Authority is now outside the Ombudsman's remit, and has been since 2001. There are no other cases with the Ombudsman relating to financial regulation, and new cases relating to the FSA could not now be brought.

58. **We struggle to understand the logic behind the Government's decision to make payments to policyholders on an ex gratia basis rather than as compensation. It gives three reasons for this decision:**

47 Q 1

48 *A Further Investigation of the Prudential Regulation of Equitable Life?*, 3rd Report from the Parliamentary Ombudsman, Session 2003–04, HC 910, pp 33–36

49 Q 123

- **first, the primary responsibility of the former management of Equitable Life for policyholders' losses,**
- **second, the Government's responsibility to taxpayers generally to balance competing demands on the public purse, and**
- **third, that "Parliament has accepted that it is not generally appropriate to pay compensation even where there is regulatory failure".**

59. **The first two of these reasons had already been taken into account by others, including ourselves, and are in any case grounds for limiting compensation, not for denying it altogether. The third reason might have had some validity if made at the outset of the Ombudsman's investigation: this the Government had every opportunity to do. It was, however, shabby, constitutionally dubious and procedurally improper to introduce it as an argument at such a late stage in her work. In doing so, the Government undermined the purpose of the Ombudsman's investigation and the reasonable expectations of policyholders.**

60. **There is also a broader point of principle here. The Government has accepted that public bodies were responsible for maladministration which caused injustice to people. It is arguing at the same time that it is under no duty to put right these wrongs, even in part. This may be a legally valid position, but we think that most people would consider it to be a morally unacceptable one.**

Process for establishing the scheme

> *We endorse the Ombudsman's proposal for a compensation scheme that is independent, transparent and simple. (paragraph 53)*

61. The Government has not taken up the Ombudsman's proposal for an independent compensation tribunal, perhaps because it thought such a tribunal inappropriate in the context of its decision not to proceed with a compensation scheme. Instead, the Government has asked Rt Hon Sir John Chadwick, a former Lord Justice of Appeal, to advise it on a number of closely defined issues before it decides the criteria for its ex gratia payment scheme:

- Firstly, the extent of relative losses suffered by Equitable Life policyholders;
- Secondly, what proportion of those losses can be attributed to: (a) the maladministration accepted by the Government; and (b) the actions of Equitable Life and other parties;
- Thirdly, which classes of policyholder have suffered the greatest impact; and
- Fourthly, what factors arising from this work the Government might wish to take into account when reaching a final view on determining whether disproportionate impact has been suffered.[50]

50 Government response, para 5.26

62. Sir John's appointment has not been well received by EMAG, whose general secretary told us that its purpose was to give "a judicial veneer to what is really a very downmarket, back street process":

> In Sir John's court the accused is going to be giving the judge instructions. What sort of a court is that? The accused appointed the judge.[51]

EMAG has also received legal advice suggesting that Sir John's appointment contravenes the Judicial Code of Conduct and risks undermining the independence of the judiciary.

63. Responding to these concerns, the Economic Secretary made clear to us that Sir John is not being asked for legal advice, and explained that his appointment had been approved by the Lord Chief Justice:

> We are not aware at all of any irregularity in the appointment or any reason at all why Sir John cannot very satisfactorily perform the remit that we have asked him to do, which is to provide independent and objective advice – but not to provide legal advice.[52]

64. The Economic Secretary also explained why Sir John had been appointed to this task…

> We believe that we need independent advice and I think Sir John will be an excellent person to give us independent, impartial objective advice and to give these complex questions that we are asking him in terms of his remit a forensic examination. So I have every confidence that he will be able to fulfil his remit in an efficient and excellent manner.[53]

…and he elaborated on why it had been decided specifically to appoint a former judge:

> It could have been somebody who was not a judge but I think that the independence that comes with appointing a member of the judiciary is something that I would expect the Committee to welcome.[54]

65. We also decided to ask the Lord Chief Justice's office directly about EMAG's concerns, and received the following reply:

> I can confirm that the Lord Chief Justice [LCJ] was asked, by the Ministry of Justice on behalf of the Treasury, to nominate a retired member of the judiciary to take on this work. He was sent a copy of the (near-final) draft terms of reference. The LCJ was satisfied, for a number of reasons, that it would be appropriate to nominate a retired member of the judiciary. These included the importance of the issues raised, the requirement for apportionment of responsibility and the need for public confidence in the advice to be provided. The LCJ's view was that Sir John Chadwick's professional and judicial experience, together with his personal qualities, made him eminently suitable for this appointment.

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51 Q 81 [Colin Slater]

52 Q 102

53 Q 151

54 Q 151

> The LCJ has since considered the issue further, in the light of the concerns raised by the Equitable Members Action Group. He remains content that there is no difficulty in, or impediment to, Sir John acting in accordance with the invitation extended to him.[55]

Given that the Lord Chief Justice has in effect approved Sir John Chadwick's appointment and has considered and rejected the concerns subsequently raised by Equitable Members' Action Group, it seems almost inconceivable that there could be any legal or procedural irregularity with the appointment.

Sir John Chadwick's role

66. Sir John Chadwick will not be carrying out his task alone. We have been told that he will be procuring his own legal, policy, operational and actuarial support "in line with his independent status".[56] He is being paid at a standard rate.[57]

67. We have heard no suggestion that Sir John is anything other than an independent-minded person, who will carry out the task he has been asked to perform without fear or favour. Our main concern is not with Sir John as a person, nor with the task that he is being asked to carry out, but rather with the combination of the two. Sir John can only apply "the independence that comes with appointing a member of the judiciary" to the task that he has been asked to carry out. In particular, we are concerned that people may reasonably suspect that his personal independence is being used to make the wider process of constructing a scheme, beyond the specifics of his role, appear more independent than in fact it is.

68. As the Ombudsman told us,

> I have absolutely no reason to suggest that Sir John's advice will be anything other than independent but he is in an advisory capacity; he is not the decision maker.[58]

Charles Thomson of Equitable Life added his concern:

> that Sir John will do the best job he can within his terms of reference but that is unlikely to produce a scheme that is fair, it will not be transparent and it will not give compensation to many people who deserve it. He has to ignore the findings of the Ombudsman which Government does not agree with so he has such a limited starting position.[59]

69. The Economic Secretary mentioned Sir John's personal independence and the independence of his role no fewer than nine times in his oral evidence to us.[60] But it is important to remember that Sir John's "advisory capacity" is strictly limited to four closely

55 Ev 51

56 Ev 51

57 Q 165

58 Q 14

59 Q 59

60 Qq 99, 102, 128, 151 (three times), 153, 166 and 167

defined tasks, the bulk of which appear to be about establishing the facts rather than applying independence of mind.

70. This does little to weaken the impression that the Government is creating an independent process of very limited scope in an attempt to enhance the public and parliamentary view of the broader course of action it has chosen to follow. If there is any truth in this impression, it makes us doubt the wisdom of involving a former member of the judiciary in a task of this kind. **The Government has designed Sir John Chadwick's remit to be of limited scope. When his work is complete, the Government, not Sir John, will decide who receives payments and on what scale. It is of constitutional importance that a government should not use the reputation of the judiciary to make a process appear more independent or more far-reaching than in fact it is. The Government should take care not to give the impression that the independence that Sir John brings to his remit extends more widely to those parts of the process which remain in the hands of Ministers.**

Speed

> *the main priority must be prompt redress …. (paragraph 59)*

71. The Government has asked Sir John Chadwick to work

> 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.[61]

72. The emphasis on speed is important and welcome. The Chief Secretary has, however, suggested to the House that work on establishing an ex gratia scheme and completing payments is likely to take "considerably longer" than the two and a half years envisaged by the Ombudsman for the more burdensome option of a full-fledged compensation tribunal.[62] Sir John has not been asked to work to a specific timescale. The most the Economic Secretary was able to tell us was that Sir John "expects that interim reports would give a likely view on timescales".[63]

73. **The Government needs to understand that uncertainty about the design of the scheme and the timescale for making payments is unsettling to say the least for those who do not know if or to what extent they will benefit from those payments. We are disappointed that the Government has not made it a priority to establish a simple process for determining payments that can then be implemented swiftly. While it has asked Sir John Chadwick to advise it as quickly as he is able, the nature of the task he has been given seems likely to mean that payments will be made more slowly—possibly much more slowly—than policyholders have a right to expect. We urge Sir John to establish and make public as soon as possible an estimated date for his final report, and to take explicitly into account in the advice he gives the Government the speed and ease with which different possible scheme criteria could be implemented. We urge the**

61 Government response, para 5.31

62 HC Deb 15 January 2009, c 386

63 Q 145

Government to provide an indicative timetable for making payments under the scheme as soon as Sir John's interim findings allow.

Interim payments

> *there is scope to reduce the financial pressure on those who are struggling the most, including the eldest and those in ill-health. Specifically, we recommend that priority or interim payments are made to individuals in those circumstances. (paragraph 84)*

74. The Government's reaction has been lukewarm at best to the idea of making interim payments to those policyholders who are struggling the most. The Chief Secretary told the House that "we would not want to set up an interim payment scheme that ended up being so complicated that it delayed the main payment scheme".[64] It seems to us that the more likely risk is that the main payment scheme will be so complicated that many of those most in need will either continue to struggle for years to come, or will die before any payment is forthcoming. **The Government's failure to set a timescale for payments, together with its indication that a scheme may not be completed for considerably longer than two and a half years, make it in our view all the more important that it finds a way of making interim payments considerably sooner than this to those who need them most.**

Transparency

75. The Economic Secretary told us that it was his expectation "that Sir John's final report will be published".[65] This begs the question of whether other information about Sir John's work will also be published: representations Sir John might receive in the course of his work, including those made by the Government; and Sir John's own interim updates and conclusions. **The Government is not obliged to follow Sir John Chadwick's advice. The benefit of transparency would be to show to what extent it had done so, as well as the extent to which Sir John's advice had been influenced by the representations he had received. We recommend that Sir John's interim reports, and any representations he receives, should therefore be published expeditiously.**

76. A further issue concerns the extent to which Sir John is able to access those who might be useful to his work. His terms of reference state simply that he may "if he deems it necessary, seek written representations as appropriate from interested parties".[66] We were concerned that this seemed to exclude the possibility of holding face-to-face interviews—except with the Government itself, which had reserved the right to make representations to Sir John.[67] We are therefore reassured to learn from the Government that Sir John's terms of reference do "not fetter his discretion to talk to interested parties" and that "Sir John has indicated that he will be inviting representations".[68] **We encourage Sir John Chadwick to invite and to receive representations in person from a range of those who have suffered loss through their involvement in Equitable Life, as well as from other relevant parties.**

64 HC Deb 15 January 2008, c 390

65 Q 170

66 Government response, p 46

67 Government response, para 1.14

68 Ev 51

It is important that he should not be kept at a remove from the human dimension of what has happened.

Conclusion

77. We regret the process the Government has chosen to adopt in its response to the Ombudsman's report. The best that can be said is that it is a process that may eventually produce a beneficial outcome for some of those people who have suffered loss as a result of regulatory failure. But the Government could have chosen to arrive at a similar outcome by more proper means. As the Ombudsman told us, the Government could have done this differently:

> It might have said 'We do not see this in the same way as the Ombudsman sees it, but out of respect for the constitutional position of her office, we will accept her findings of maladministration and injustice.' The Government could then have gone on to consider the question of remedy. It could then have brought into play legitimate considerations of public policy and public purse.[69]

78. Equitable Life too has made clear that its policyholders understand the realities of the public purse: "if they got half of what they believed they were entitled to then that would be a great deal better than nothing. If that is all the public purse can afford then I think people would understand".[70] The Government may be offering less than half—but the principle still holds true.

79. EMAG is clearly incensed by the Government's response; it may be that they would have found any proposal unacceptable short of substantial compensation, but the terms of the Government's response and the way it has been presented—'spun' would not be too strong a word—give policyholders good reason to be angry.

80. **The Government's response has provoked a strongly negative reaction from the Ombudsman, from Equitable Life, from policyholders, and now from us. This should give the Government pause for thought. There are two sets of lessons to be learned: not only from the serious failings of the prudential regulators of Equitable Life, but also from the Government's approach to the Ombudsman's findings and to providing a remedy for those who have suffered injustice.**

69 Q 1

70 Q 43 [Charles Thomson]

4 Wider issues

81. We reported in December on wider issues arising from this particular case.[71] Most of those findings remain valid and require no further comment. There are, however, two issues which deserve further thought in light of the Government's response.

Ombudsman's role

> *The Government must review the way in which serious failures of this kind are investigated in the future. In the meantime, the Government has reason to apologise not only for the maladministration identified by the Ombudsman, but also for the delay and frustration caused by its piecemeal approach. (paragraph 93)*

82. The first is the role of the Parliamentary Ombudsman in investigating cases where it is alleged that administrative failings have caused injustice to large numbers of people which are likely to be very expensive to put right.

83. Overall, the Ombudsman has an excellent record of achieving a remedy for people who have suffered injustice as a result of maladministration. She investigates thousands of complaints each year, a large proportion of which are upheld in full or in part. Where she recommends compensation for individuals, it is almost unheard of for the public body not to comply. The record is much more mixed for cases where very large amounts of public money have been at stake. Following the recent occupational pensions investigation and the Barlow Clowes case in the 1980s, the Government eventually provided a substantial part of the financial remedy recommended by the Ombudsman, despite refusing to accept the Ombudsman's findings of maladministration.[72] In this case, despite accepting some findings of maladministration, it seems clear that much of the financial remedy recommended by the Ombudsman will not be funded from the public purse.

84. Given the Government's record in cases of this kind and the Ombudsman's lack of enforcement powers, we have to ask if it is worth the Ombudsman conducting lengthy investigations on this kind of scale. Her office dedicates substantial human and financial resource to this work, and a report recommending compensation which may not be provided is bound to raise, perhaps unfairly, the expectations of those who have complained to her.

85. In the end, this must be a matter for the Ombudsman of the day to decide. Our firm view, however, is that, **so long as there is no better alternative for dealing with grievances of this kind, the Ombudsman should continue to consider investigating cases such as this, irrespective of the likelihood of a remedy being provided.** We have already stated that in this case, there should have been a "comprehensive and fit for purpose investigation", able to look at the picture in the round and apportion responsibility.[73]

71 Our earlier Report, paras 90–113

72 *Pensions Bill: Government Undertakings relating to the Financial Assistance Scheme*, Fifth Report from the Select Committee on Public Administration, Session 2006–07, HC 523, para 11; *Annual Report for 1989*, Third Report of the Parliamentary Commissioner for Administration, Session 1989–90, HC 353, paras 65–66

73 Our earlier Report, para 93

Perhaps it is unrealistic to expect a government to establish truly independent and wide-ranging investigations of this kind, which may find, even while it still in office, that the Government itself shared a part of the blame. If this is the case, then the Ombudsman system, albeit that it can only ever look at a part of the picture, will remain the best option available to those wishing to hold public bodies to account for their administrative failings.

Accountability

> *there is a need for reflection upon whether more could be done in Government, Parliament, and the National Audit Office to maintain an overview of regulators as a way of mitigating the risk of serious regulatory failure in the future. (paragraph 110)*

86. This leads us to a wider question about the accountability of regulators. How would the prudential regulators be held to account today if there were another disaster on the scale of Equitable Life?

87. This is of course scarcely a hypothetical question in the context of the current economic crisis. The Government has characterised the regulatory system in the years leading up to the closure of Equitable Life to new business as "reactive and unintrusive".[74] From the Ombudsman's perspective, it was not the system that had these characteristics, but rather the way in which it was operated.[75] The Chairman of the Financial Services Authority told our colleagues on the Treasury Committee in February 2009 that the Authority had failed to ask enough questions about strategy at banks, or the products they dealt in because of:

> a philosophy of how regulation was done … rooted in particular political assumptions at the time, … which suggested that the key priority in regulation was to keep it light rather than to ask ever more searching questions.[76]

All of this sits uneasily with the Economic Secretary's comments to us only several weeks earlier that "the regulatory regime that is in place now is very different to the regulatory regime that we are talking about when we come to the Ombudsman's report".[77] It seems that the philosophy of operating a "reactive and unintrusive" system remained unchanged.

88. In the context of the Ombudsman's findings in relation to Equitable Life, the admitted failures of the regulators in anticipating the current economic crisis seem to us to beg a crucial question: Are rigorous systems of prudential regulation devised at times of crisis, only to be operated with a 'light touch' as soon as the crisis abates—until the next crisis arrives and a new and even more rigorous system is proposed? This question is one that the Treasury Committee is better placed to answer than we are, but **it is vital to ensure that lessons from crises such as Equitable Life and the recent near-collapse of the banking system are not forgotten as soon as the good times return. Prudential regulation needs to be implemented consistently in the interests of the taxpayer and the**

74 Government response, para 1.12

75 Ombudsman's report, Part 1, Ch 15, paras 32 to 33

76 Uncorrected transcript of oral evidence taken before the Treasury Select Committee on 25 February 2009, HC 144-ix, Qq 2158–2160

77 Q 169

customers of financial institutions, not just in the short-term interests of those institutions.

89. Accountability is key to ensuring that the prudential regulators do their jobs effectively. We asked in our last Report on this subject:

> can we be assured that if an investor is failed by the Financial Services Authority in the future that it will be held accountable, to enable lessons to be learned and, if appropriate, any loss to be made good? If not, the time may have come to reconsider how our key regulators are held to account.[78]

90. Parliament has shown that through its Select Committees it can hold individual regulators to account for their actions; but these Committees have no power of sanction. Indeed, there has been a notable absence of any sanction against those responsible, principally or secondarily, for leaving millions of people to face a bleaker retirement than they had been reasonably led to expect.

91. **Despite the years that have passed since the closure of Equitable Life to new business, and despite the numerous opportunities to learn lessons, the system of prudential regulation has once again failed the taxpayer and the customers of financial institutions. What is needed is effective regulation. We are concerned that without an honest and full appraisal of what went wrong, both in the regulation of Equitable Life and more recently of the banking system, there will be failures again in the future—failures which could otherwise have been avoided.**

92. **Effective accountability needs to be an important part of effective regulation. The way that industry regulators are held to account currently is inconsistent and piecemeal. We called in December for reflection upon whether more could be done in Government, Parliament, and the National Audit Office to maintain an overview of regulators as a way of mitigating the risk of serious regulatory failure in the future. Our view now is that the question is no longer whether, but how.**

78 Our earlier Report, para 110

Conclusions and recommendations

Implementation of the Government's decision

1. The scheme proposed by the Government is inadequate as a remedy for injustice. Nonetheless, it could help to improve the lot of some of those policyholders who have struggled to make ends meet since the closure of Equitable Life to new business, and on this basis, if the scheme is the best available, we want it to work as well as possible. (Paragraph 9)

2. Confidence in the scheme will be fatally undermined if the net effect of the limiting factors specified by the Government is either:

a) to restrict payments to an excessively small number of policyholders,

b) to make unreasonable demands on policyholders to show that they qualify under the scheme, or

c) to cap the sums payable at a level that will make little or no real difference to policyholders' lives. (Paragraph 13)

3. It is up to the Government to ensure that its scheme makes a tangible difference as soon as possible to policyholders who have, even by its own reckoning, suffered injustice including financial loss because of failures of the State. This is much more likely to be achieved through a scheme which is simple and clear, and which avoids making demands of policyholders wherever possible. (Paragraph 14)

4. Our preference would be for the Government to make the scheme simpler by removing the disproportionate impact test altogether. If, however, the Government insists on the test, what matters most is that it should be simple to implement, relying so far as possible only on information held by Equitable Life, and not placing a burden on policyholders or others to provide information. (Paragraph 20)

5. It is acutely disappointing that the personal circumstances of policyholders are not taken into account in any part of the Government's response, for example, their age, their health, or the number of years since the relevant events. Nowhere in the response does the Government take account of the need for simplicity in the design or operation of any scheme. This marks a basic failure to understand the problem which the Government's scheme is designed to address. (Paragraph 21)

6. Those policyholders who have died, or will have died before a scheme is implemented, clearly cannot benefit personally from the payment scheme. But many will have surviving partners, who will have suffered worry and a diminished standard of living alongside them. It would be deeply unfair, and add to their justified outrage, if they were denied the opportunity to benefit. (Paragraph 22)

7. A successful judicial review could result in a better process, but one with a worse outcome for policyholders. (Paragraph 24)

The Government's approach to this case

8. Given the difficulties faced by Members and the public in obtaining timely copies of the Government's written response, the Chief Secretary should have been more explicit in her statement to the House about those findings made by the Ombudsman which the Government was rejecting or substantially qualifying. (Paragraph 29)

9. In its response to the Ombudsman's report, the Government has taken a highly selective and partial approach to its representation of our views. It has not addressed our conclusions or analysed our arguments, but simply taken our words out of context to support arguments of its own in a way that gives an inaccurate impression of our views. (Paragraph 33)

10. The Ombudsman is not a judge, but a parliamentary investigator. The Government is not legally obliged to respect her findings as it would have to respect a judgement of the courts. It must, however, have compelling reasons for disagreeing with her. (Paragraph 35)

11. The fact that the Ombudsman feels that she has been misunderstood and misrepresented is an indictment of the quality of the Government's arguments as presented to the public. (Paragraph 0)

12. In attempting to produce a response that was readable and accessible, the Government also produced one that prevented a proper analysis of the validity of its reasons for rejecting and qualifying the Ombudsman's findings. We do not think it was the right decision to sacrifice intelligibility for accessibility. Where the Government departs from the Ombudsman's findings, it has a duty to explain why it is doing so in enough detail to enable a proper examination of its reasoning. (Paragraph 42)

13. We concluded in December 2008 that "we would be deeply concerned if the Government chose to act as judge on its own behalf"; yet this is precisely what it has done. (Paragraph 44)

14. The injustice the Ombudsman found, and that part of it which the Government has accepted, were caused by the maladministration of public bodies, not by the former management of Equitable Life. Both we and EMAG have suggested that the fact that regulators were not primarily responsible for policyholders' losses warrants, as recognition of that fact, a discount on the amount of compensation payable. But this does not alter the fact that public bodies were responsible for injustice, and should not allow them to escape liability for that injustice altogether. (Paragraph 49)

15. The Government uses its general responsibility to taxpayers as an argument for not establishing a compensation scheme. If this argument were carried to its logical conclusion, compensation would never be payable—even in part—where public bodies had been responsible for injustice resulting in substantial financial loss, but only where any financial loss was modest. Such a position would be patently absurd and unfair. (Paragraph 51)

16. We struggle to understand the logic behind the Government's decision to make payments to policyholders on an ex gratia basis rather than as compensation. It gives three reasons for this decision:

a) first, the primary responsibility of the former management of Equitable Life for policyholders' losses,

b) second, the Government's responsibility to taxpayers generally to balance competing demands on the public purse, and

c) third, that "Parliament has accepted that it is not generally appropriate to pay compensation even where there is regulatory failure". (Paragraph 58)

17. The first two of these reasons had already been taken into account by others, including ourselves, and are in any case grounds for limiting compensation, not for denying it altogether. The third reason might have had some validity if made at the outset of the Ombudsman's investigation: this the Government had every opportunity to do. It was, however, shabby, constitutionally dubious and procedurally improper to introduce it as an argument at such a late stage in her work. In doing so, the Government undermined the purpose of the Ombudsman's investigation and the reasonable expectations of policyholders. (Paragraph 59)

18. There is also a broader point of principle here. The Government has accepted that public bodies were responsible for maladministration which caused injustice to people. It is arguing at the same time that it is under no duty to put right these wrongs, even in part. This may be a legally valid position, but we think that most people would consider it to be a morally unacceptable one. (Paragraph 60)

19. Given that the Lord Chief Justice has in effect approved Sir John Chadwick's appointment and has considered and rejected the concerns subsequently raised by Equitable Members' Action Group, it seems almost inconceivable that there could be any legal or procedural irregularity with the appointment. (Paragraph 65)

20. The Government has designed Sir John Chadwick's remit to be of limited scope. When his work is complete, the Government, not Sir John, will decide who receives payments and on what scale. It is of constitutional importance that a government should not use the reputation of the judiciary to make a process appear more independent or more far-reaching than in fact it is. The Government should take care not to give the impression that the independence that Sir John brings to his remit extends more widely to those parts of the process which remain in the hands of Ministers. (Paragraph 70)

21. The Government needs to understand that uncertainty about the design of the scheme and the timescale for making payments is unsettling to say the least for those who do not know if or to what extent they will benefit from those payments. We are disappointed that the Government has not made it a priority to establish a simple process for determining payments that can then be implemented swiftly. While it has asked Sir John Chadwick to advise it as quickly as he is able, the nature of the task he has been given seems likely to mean that payments will be made more slowly—possibly much more slowly—than policyholders have a right to expect. We urge Sir

John to establish and make public as soon as possible an estimated date for his final report, and to take explicitly into account in the advice he gives the Government the speed and ease with which different possible scheme criteria could be implemented. We urge the Government to provide an indicative timetable for making payments under the scheme as soon as Sir John's interim findings allow. (Paragraph 73)

22. The Government's failure to set a timescale for payments, together with its indication that a scheme may not be completed for considerably longer than two and a half years, make it in our view all the more important that it finds a way of making interim payments considerably sooner than this to those who need them most. (Paragraph 74)

23. The Government is not obliged to follow Sir John Chadwick's advice. The benefit of transparency would be to show to what extent it had done so, as well as the extent to which Sir John's advice had been influenced by the representations he had received. We recommend that Sir John's interim reports, and any representations he receives, should therefore be published expeditiously. (Paragraph 75)

24. We encourage Sir John Chadwick to invite and to receive representations in person from a range of those who have suffered loss through their involvement in Equitable Life, as well as from other relevant parties. It is important that he should not be kept at a remove from the human dimension of what has happened. (Paragraph 76)

25. The Government's response has provoked a strongly negative reaction from the Ombudsman, from Equitable Life, from policyholders, and now from us. This should give the Government pause for thought. There are two sets of lessons to be learned: not only from the serious failings of the prudential regulators of Equitable Life, but also from the Government's approach to the Ombudsman's findings and to providing a remedy for those who have suffered injustice. (Paragraph 80)

Wider lessons

26. So long as there is no better alternative for dealing with grievances of this kind, the Ombudsman should continue to consider investigating cases such as this, irrespective of the likelihood of a remedy being provided. (Paragraph 85)

27. It is vital to ensure that lessons from crises such as Equitable Life and the recent near-collapse of the banking system are not forgotten as soon as the good times return. Prudential regulation needs to be implemented consistently in the interests of the taxpayer and the customers of financial institutions, not just in the short-term interests of those institutions. (Paragraph 88)

28. Despite the years that have passed since the closure of Equitable Life to new business, and despite the numerous opportunities to learn lessons, the system of prudential regulation has once again failed the taxpayer and the customers of financial institutions. What is needed is effective regulation. We are concerned that without an honest and full appraisal of what went wrong, both in the regulation of Equitable Life and more recently of the banking system, there will be failures again in the future—failures which could otherwise have been avoided. (Paragraph 91)

29. Effective accountability needs to be an important part of effective regulation. The way that industry regulators are held to account currently is inconsistent and piecemeal. We called in December for reflection upon whether more could be done in Government, Parliament, and the National Audit Office to maintain an overview of regulators as a way of mitigating the risk of serious regulatory failure in the future. Our view now is that the question is no longer whether, but how. (Paragraph 92)

Formal Minutes

Thursday 12 March 2009

Members present:

Dr Tony Wright, in the Chair

Paul Flynn	Mr Ian Liddell-Grainger
David Heyes	Mr Gordon Prentice
Kelvin Hopkins	Mr Charles Walker

Draft Report (Justice denied? The Government's response to the Ombudsman's report on Equitable Life), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 92 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report , together with written evidence reported and ordered to be published on 29 January, 10 February and 11 February.

Written evidence was ordered to be reported to the House for placing in the Library and Parliamentary Archives.

[Adjourned till Thursday 19 March at 9.45 am

Witnesses

Thursday 29 January 2009

Wednesday 11 February 2009

List of written evidence

List of unprinted evidence

The following memorandum has been reported to the House, but to save printing costs it has not been printed and copies have been placed in the House of Commons Library, where it may be inspected by Members. Other copies are in the Parliamentary Archives, and are available to the public for inspection. Requests for inspection should be addressed to The Parliamentary Archives, Houses of Parliament, London SW1A 0PW (tel. 020 7219 3074). Opening hours are from 9.30 am to 5.00 pm on Mondays to Fridays.

Letter from Mr and Mrs Williams

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2008-09

First Report	Lobbying: Access and Influence in Whitehall	HC 36
Second Report	Justice Delayed: The Ombudsman's Report on Equitable Life	HC 41
Third Report	Ethics and Standards: Further Report	HC 43
Fourth Report	Work of the Committee in 2007-08	HC 42
Fifth Report	Response to White Paper: "An Elected Second Chamber"	HC 137

Session 2007–08

First Report	Machinery of Government Changes: A follow-up Report	HC 160 (*HC 514*)
Second Report	Propriety and Peerages	HC 153 (*Cm 7374*)
Third Report	Parliament and public appointments: Pre-appointment hearings by select committees	HC 152 (*HC 515*)
Fourth Report	Work of the Committee in 2007	HC 236 (*HC 458*)
Fifth Report	When Citizens Complain	HC 409 *(HC 997)*
Sixth Report	User Involvement in Public Services	HC 410 *(HC 998)*
Seventh Report	Investigating the Conduct of Ministers	HC 381 *(HC 1056)*
Eighth Report	Machinery of Government Changes: Further Report	HC 514
Ninth Report	Parliamentary Commissions of Inquiry	HC 473 *(HC 1060)*
Tenth Report	Constitutional Renewal: Draft Bill and White Paper	HC 499
Eleventh Report	Public Services and the Third Sector: Rhetoric and Reality	HC 112 *(HC 1209)*
Twelfth Report	From Citizen's Charter to Public Service Guarantees: Entitlement to Public Services	HC 411 *(HC 1147)*
Thirteenth Report	Selection of a new Chair of the House of Lords Appointments Commission	HC 985
Fourteenth Report	Mandarins Unpeeled: Memoirs and Commentary by Former Ministers and Civil Servants	HC 664

Session 2006–07

First Report	The Work of the Committee in 2005–06	HC 258
Second Report	Governing the Future	HC 123 (C*m 7154*)
Third Report	Politics and Administration: Ministers and Civil Servants	HC 122 *(HC 1057 Session 2007–08)*
Fourth Report	Ethics and Standards: The Regulation of Conduct in Public Life	HC 121 *(HC 88 Session 2007–08)*
Fifth Report	Pensions Bill: Government Undertakings relating to the Financial Assistance Scheme	HC 523 (*HC 922*)
Sixth Report	The Business Appointment Rules	HC 651 *(HC 1087)*

Seventh Report	Machinery of Government Changes	HC 672 *(HC 90, Session 2007–08)*
Eighth Report	The Pensions Bill and the FAS: An Update, Including the Government Response to the Fifth Report of Session 2006–07	HC 922 *(HC 1048)*
Ninth Report	Skills for Government	HC 93 *(HC 89)*
First Special Report	The Governance of Britain	HC 901

Session 2005–06

First Report	A Debt of Honour	HC 735 (Cm 1020)
Second Report	Tax Credits: putting things right	HC 577 (*HC 1076)*
Third Report	Legislative and Regulatory Reform Bill	HC 1033 *(HC 1205)*
Fourth Report	Propriety and Honours: Interim Findings	HC 1119 *(Cm 7374)*
Fifth Report	Whitehall Confidential? The Publication of Political Memoirs	HC 689 *(HC 91, Session 2007–08)*

Oral evidence

Taken before the Public Administration Committee

on Thursday 29 January 2009

Members present

Dr Tony Wright, in the Chair

Kelvin Hopkins	Julie Morgan
David Heyes	Mr Gordon Prentice
Mr Ian Liddell-Grainger	Mr Charles Walker

Witnesses: **Ms Ann Abraham**, Parliamentary and Health Service Ombudsman and **Mr Iain Ogilvie**, Investigation Manager, gave evidence.

Q1 Chairman: Let me welcome Ann Abraham, the Parliamentary and Health Service Ombudsman, and Iain Ogilvie, the Investigation Manager at the Ombudsman's office. It is a great pleasure to have you along. We had hoped not to see you again on the Equitable Life issue, and I am sure you hoped not to be here again, but here we are. We are now in the position of responding to what the Government has said in response to your report. Do you want to say something to kick us off?

Ms Abraham: If I may. I do not usually go into lengthy opening remarks but if the Committee would bear with me I would like to say something to start off. I have given you a memorandum,[1] not a hugely lengthy one, and I am happy to add to that if that would be helpful either today or in due course. The memorandum I have given you tries to do three things: to summarise the Government's response very, very briefly, to set out some initial observations from me, and to highlight some issues which, it seemed to me, the Committee might be interested to pursue. I am not going to read the memorandum but I would like to try and pull out the issues as I see them and then make some observations. If I could start with the issues, it seems to me there are three issues arising from the Government's response which the Committee might be interested to pursue. The first is that the Government has rejected findings of maladministration and injustice by the Ombudsman. The second issue is the question of whether the Government has given cogent reasons for that rejection. I am not persuaded that it has and there are a number of reasons why I say that. I think the Government's response provides insufficient support for the rejection of my findings. It is strong on assertion, short on facts. I think the response fails to address the basis on which I came to several of my findings. Perhaps another way of saying that is the response says that I said something different to what I actually said, and then says it disagrees with something I did not say. It also begs a rather larger question as to what the purpose of prudential regulation was supposed to be. The Government appears to be suggesting that whatever the regulators had done it would have made no difference to the events which followed. Frankly, I find that astonishing. The third of the issues, as I see it, all relate to this alternative proposal. It seems to me the alternative proposal to the one that I made about how to provide remedy in relation to a compensation scheme has a number of issues in it to be resolved. I identified four, and I go into more detail in the memorandum: there is no detailed timetable; there is independent advice but no independent decision maker; there is no definition of this phrase "disproportionate impact"; and then there is this requirement for Sir John Chadwick to assess what proportion of the losses I have identified, and the Government has accepted, could be attributed to the actions of the Society. I will come back to that in a moment. If those are the issues, what are my observations about the Government's response? First, I must say that I welcome the acceptance of some maladministration leading to some injustice and the Government will take some action. I welcome the fact that they have apologised; apologies are important. That said, it seems to me that overall this is an unsatisfactory response. I am disappointed to see the Government picking over and re-interpreting my findings of maladministration and injustice, re-arranging the evidence, re-doing the analysis and acting as judge on its own behalf. We have been here before and, as you say Chairman, I had hoped not to be here again. It seems to me the Government did not need to do that. It might have said "We do not see this in the same way as the Ombudsman sees it, but out of respect for the constitutional position of her office, we will accept her findings of maladministration and injustice." The Government could then have gone on to consider the question of remedy. It could then have brought into play legitimate considerations of public policy and public purse. Can I move on, as I conclude, by saying what I think are, and are not legitimate considerations? First, affordability, the cost to the public purse, seems to me to be a perfectly legitimate consideration. What is not legitimate is to create a self-standing concept of disproportionate impact. Secondly, the question of whether the taxpayer should ever pick up the tab for the consequences of regulatory failure seems to me a perfectly proper debate to have. What I find more

[1] EQP 01

difficult to understand is if Parliament had indeed, as the Government says, always considered that regulatory failure should have no consequences in terms of remedy, or that regulators should always be immune from independent scrutiny or challenge, then why were the prudential regulators in the period before 2001 not given statutory immunity or removed from the Ombudsman's jurisdiction before now? Why did the Government not say all of this much sooner, either in its response to my consultation in 2004 when I consulted on whether to conduct a further investigation into Equitable Life, or in its very substantial response to the complaints at the beginning of the investigation. All of that is published in the report itself in Part 4. If the Government had said these things at the outset, I might never have embarked on this investigation or at least we could have had the debate, and Parliament could have had the debate, much earlier. The last thing I want to say is what I believe is a complete red herring in the Government's response, and that is the task which Sir John Chadwick has been given to assess the proportion of losses which can be attributed to the maladministration accepted by the Government, the actions of Equitable Life and its advisers. As far as the injustice or, if you like, losses, which I have identified in my report is concerned, assigning relative culpability between maladministration and the actions of others is unnecessary. The remedy I recommended was for injustice resulting from maladministration and not for anything else. Relative loss, as I explained in my report, already excludes other causes and the Society cannot be held responsible for the failures of the regulators. I can help Sir John with that part of his task. The answer is that none of the injustice which I have found can be attributed to the actions of Equitable and its advisers; they were not the subject of my investigation. I could say more, if you wish, about Lord Penrose's Report and the extent to which it is relevant to any of this debate but I will leave it there for now and Iain and I will be happy to answer any questions.

Q2 Chairman: Can I pick up one thing you said there? You said if the Government had said certain things years ago you might never have embarked upon your investigation. Say again, what things might they have said which would have prevented you from embarking on the investigation?
Ms Abraham: They could have said, and indeed Parliament could have said and indeed as is now argued in the Government's response, that regulatory failure should never result in the taxpayer having to pick up a bill for maladministration. They could have said that in law, because they could actually have taken regulators generally, or these regulators, out of my jurisdiction. Parliament could have done that years ago and these issues have been running for some years.

Q3 Chairman: That was the point they put to you in the course of your investigation which you looked at and rejected.
Ms Abraham: Because Parliament has never made that decision I am saying that it is a perfectly legitimate decision for Parliament to make, but it has not made it and therefore we are where we are in terms of bodies in my jurisdiction. What I am saying, in response to a view that whether or not those bodies are in my jurisdiction, there is a certain category of injustice flowing from maladministration, when that maladministration is regulatory failure, that the Government will never pay compensation. If they had said that when I said "Shall I do an investigation into these issues?", I would have said what would be the point then if I were to find injustice flowing from maladministration. The Government has already said there will be no remedy, so the only point would have been for me to do the investigation and put the facts into the Parliamentary and public domain. It would have been a factor in my consideration is what I am saying.

Q4 Chairman: In a sense this is not where we are at, is it? The Government has not said, as it tried to say during the course of your inquiry when responding to some of your emerging findings, what you just said "We do not compensate for regulatory failure. That is what the courts say, that is what Parliament intended and we do not do it." In fact in this case they have said that is the position but in this particular case, because of what the Ombudsman has said, we will have some sort of scheme so it is not quite like that, is it?
Ms Abraham: I am not entirely sure whether it is like that. That argument about the special nature of regulation and remedy for regulatory failure is still sitting there as an argument that should be, and will be, called into play. I think much of the argument that was made in the course of the investigation was much more around the way the courts have viewed these issues than Parliament has viewed these issues and I dealt with that in my report. I am not sure I share your confidence, but I could be wrong, that the Government has said that Parliament has said this about remedy for regulatory failure but actually we put that to one side now as Sir John Chadwick goes forward and does his work.

Q5 Chairman: This is a more complicated response than the last big issue we had with the Government, which was the occupational pensions issue, and you were rightly incensed by the fact that the moment your report appeared, the Government instantly dismissed it without any serious set of reasoning. In this case you have had a period of consideration producing a rather detailed Command Paper that, whatever else you might say, does justice to what you said. We are in different territory here, are we not?
Ms Abraham: I am not sure. We are in different territory and I think it is entirely right, and I welcome the fact, that there has been, I believe, proper consideration of the report. I think the tone of the response is respectful but I am not so sure the content of the response is respectful.

Q6 Chairman: You touched on this in your remarks. Could the Government have said the things it said now in its response to you at a much earlier stage when it saw what you were recommending? At that point it challenged this question that we have talked about, which is the whole business about compensating for regulatory failure. Presumably it would have been possible, would it not, for it to have gone through each of your sets of findings and recommendations and interrogated them in the way that it does now in its mature response?
Ms Abraham: What I would say is I think the Government did do that in the course of investigation but they just said different things then to what they are saying now.
Mr Ogilvie: They did, at the end of the investigation, seek to persuade us that in respect to each of the ten findings there was no basis for any of them and they gave reasons, 500 pages of reasons, for their view on that. They take a slightly different view now on whether maladministration occurred so they are saying something different to us now but there is a similar approach they have taken.

Q7 Chairman: When they produced their response, in a sense, you had had these arguments with them anyway.
Mr Ogilvie: We had assessed their response and in Chapter 10 of Part 1 we set our response to their response.

Q8 Chairman: I wanted to get on to this because this matters in terms of the position of the Ombudsman and the relationship to Parliament and everything as you say in your memorandum. There are some fundamental issues here and you mentioned this in what you have just said. Because this has now been tested in the courts, we are in a slightly different position than perhaps we were before in that we now know that it is possible for governments not to accept what the Ombudsman says as long as they do it for cogent reasons. Indeed, Sir John Chadwick himself by one of these quirks is part the man who made the pronouncement. That is the territory we are in. Of course the question then is you may disagree with what the Government said, you may take a different judgment—and there are judgments to be made here, which you concede in your memorandum, that no one knows what would have happened if what did happen did not happen, if you see what I mean—but as long as the Government provides a kind of cogent set of arguments in relation to the various findings, even if you do not agree with them, does that not meet the cogency test?
Ms Abraham: I do not think it is as simple as that and I do not think that is what Sir John or the Court of Appeal Judges said in their judgment on the occupational pensions' case. It seems to me that the Government's speculation as to what would have happened cannot simply be substituted for, if you like to call it, my speculation or my view on the balance of probabilities about the consequences of this maladministration. It is not simply a question of the Government rejecting my view and preferring its own. I was looking up the quote in the judgment itself: "The Secretary of State acting rationally is entitled to reject a finding of maladministration and prefer his own view but it is not enough that the Secretary of State has reached his own view on rational grounds. It is necessary that his decision to reject the Ombudsman's findings in favour of his own view is itself not irrational having regard to the legislative intention which underlies the 1967 Act. To put the point another way, it is not enough for a Minister who decides to reject the Ombudsman's finding of maladministration simply to assert he had a choice. He must have a reason for rejecting the finding which the Ombudsman has made after an investigation under the powers conferred by the Act. The question then is not whether the Government body itself considers that there was maladministration but whether in the circumstances the rejection of the Ombudsman's finding to this effect was based on cogent reasons." I have talked about re-arranging the evidence and re-doing the analysis but I am not persuaded by that. I have now had time to look at it so I do not think it is just about can he construct an argument; it is can he construct an argument in the constitutional context that we have here, which is the Ombudsman has done a four-year investigation and these are the conclusions that she has reached. As you know, I have far less difficulty with the Government taking a different view about an appropriate recommendation for remedy. As I said in my introductory remarks, it was absolutely open to the Government, it seemed to me in these circumstances, to recognise that we were probably never going to agree about findings of maladministration and injustice but it is the Ombudsman's role to do that on behalf of Parliament, and then to move on to the whole question of remedy. I proposed a remedy. The Government could have proposed a different remedy with those public policy considerations actually as the backdrop to that. That seems entirely cogent and entirely reasonable but it is the picking over the findings that I have trouble with.

Q9 Chairman: We have talked about this before but I am doing it openly. We have to think our way through in a somewhat altered context in which we have this conversation than we once did. In view of what has happened it is harder to make a case that the finding should automatically be accepted by government that that is indeed the constitutional position. Now we probably have to amend it and say the presumption should be that the findings are accepted because of an independent investigation set up by Parliament, but it is not incumbent on the Government if they can find cogent reasons why they should accept. Their argument would be in this case we have gone to considerable lengths to look at each of these findings and in a rather elaborate way we have tried to distinguish those where we think there was maladministration and accept that and those where think there was additionally injustice and accept those. Whether you think that is good enough or not, and obviously you do not because otherwise you would not have made the report you did, but I suspect this Committee, if it wanted to,

could assemble a little panel of external commentators who are quite happy to say that they thought the Government's reading of these things was probably right; indeed we have had some distinguished people already saying something of this kind. The idea that these are not cogent reasons is quite hard to sustain. If it passes the cogency test, although we may dissent from them, I am trying to elucidate where we think we are in terms of this constitutional position.

Ms Abraham: I had hoped and expected that you would not want me today to go into a huge amount of detail pouring over the individual findings and the individual responses. We can do that at another time and we can send you whatever material you need. For me there are a number of things which go to the cogency question. One of them seems to me to be if what you do is re-present the finding to say something different to what I said and then you disagree with it then that is a flawed approach. There are, I think I can safely say, several examples of where we believe that is what is done here. It seems to me that actually there are very, very complex and detailed arguments that could be had about this which I think all of us had hoped would not find themselves in a court of law. I do not know what any of the parties here feel about the cogency of the arguments. What I am saying is I do not think it is as simple as you present it and I do not think it is simply a matter that the Government has made some cogent arguments and that is it.

Chairman: As you said, that is quite a fundamental issue we have to think our way through. We are now going ask more particular issues.

Q10 Mr Walker: You obviously feel very strongly about this and rightly so. Do you feel that the Government's response has undermined the position of the Ombudsman and your position?

Ms Abraham: I have heard this said and it would be easy to say of course to that but actually, in a strange sort of way, I do not believe that to be so. I suppose it is about the extent to which this one case weighs against the hundreds and thousands of cases that we are dealing with every day where the Government and the public bodies and the National Health Service are saying "Yes, of course, Ombudsman, absolutely. How do I provide the remedy?" I, and my office, have to balance this against the fact that in 99.9 % of cases the Ombudsman's findings of maladministration and injustice are accepted and our recommendations for remedy are complied with. If that were not the case, then I would be seriously concerned. In the wider Ombudsman community, and I talk to older and wiser heads than mine who have been around this world a long time, what they say is if you always make recommendations that bodies in jurisdiction comply with you are probably not doing your job properly. There is something about a recognition that from time to time there are going to be big cases which raise big issues where there are big battles. I have been doing this job for over six years now and there have been some big battles but there have been a huge number of cases which have gone through with no controversy whatsoever.

Q11 Mr Walker: There is a difference in the use of language between the Government disagreeing with you, which is perfectly legitimate, and then a government reinterpreting your findings which sounds far more malign and malevolent.

Ms Abraham: I do not think it is malign or malevolent. I would say genuinely that my engagement with the public bodies, and with the Treasury in particular, throughout this investigation has been courteous and respectful of the role. I have not detected any malevolence whatsoever. I have not detected any intention to undermine the role of the Ombudsman. There has been a recognition that this is a very difficult case which raises very big issues and that has been clear in the Government's response. They have engaged with us. They have not made it easy but it is not their job to make it easy. They have argued their case and they have done it with respect for the office. I would agree with what the Chairman said previously that this is a very, very different sort of dialogue to the one we had over occupational pensions. The dialogue we had over occupational pensions took us to a different place. I am not saying it is a satisfactory place but I am certainly not saying that I feel that there is any attempt to undermine my office.

Q12 Mr Walker: Where to from here? You gave a very strong and powerful opening statement. You are clearly in disagreement with the Government's position on this. Where does Ann Abraham and her group of staff go from here?

Ms Abraham: In terms of the investigation and the report, our job is done. As I have said in my memorandum at the end I talk about next steps. I have said I am happy to provide further evidence and assistance to the Committee on these matters. We will continue to do what we can to assist those of the Society's current and former policyholders who complain to us although we now have a limited role and may not be able to help them further. If Sir John Chadwick would find it helpful, we can provide what assistance we can to him. What I have said is it did seem to me, and I do not know to what extent it was noted at the time, but the report I laid in July was not laid under my powers under Section 10(3) of the Parliamentary Commissioner Act because I did not know at that time whether I had found injustice which I did not consider would be remedied. It did seem to me that I needed to reflect now on whether I should do a short follow-up report now I have the Government's response just making it clear, in more detail than I have been able to do this morning, that it does now appear to me that injustice has been caused in consequence of maladministration and that this injustice has not been, or will not be, remedied in terms of the Act. That would then give the Committee and Parliament the detail to support what I have said this morning.

Q13 Julie Morgan: I wanted to go on to more of the details of what the Government is actually proposing. Do you think it is possible to identify groups of policyholders who have suffered disproportionately?
Ms Abraham: It may be possible; I just do not think that is how it should be done.

Q14 Julie Morgan: What do you think about the Government appointing Sir John Chadwick in this sort of way?
Ms Abraham: As I said in my opening remarks, I made a very specific proposal for what the characteristics of a compensation scheme should be, how that should be administered and the timescale for it. I said specifically that there should be independent decision making. I have absolutely no reason to suggest that Sir John's advice will be anything other than independent but he is in an advisory capacity; he is not the decision maker.

Q15 Julie Morgan: You mentioned a timescale. I think you said in your report that it should be done within two years.
Ms Abraham: I said that a compensation scheme should be set up within six months of a decision to set it up and it should complete its work within two years.

Q16 Julie Morgan: What estimate could you make of a timescale now?
Ms Abraham: I cannot make an estimate of the timescale; I simply cannot.

Q17 Julie Morgan: You have not heard any indication from the Government about any possible timescale.
Ms Abraham: I have not heard anything the Committee has not heard and I suspect the Committee may have heard more than I have.

Q18 Julie Morgan: Do you feel that the policyholders are really in limbo at the moment?
Ms Abraham: I would not say that. Sir John has been given terms of reference. I have identified in my memorandum and in my opening remarks the issues that, it seems to me, need to be resolved in order for him to be able to get on and do his work, but I would not say in limbo.

Q19 Kelvin Hopkins: What is your view of the Government's repeated argument that the failure of financial regulators should never or not give rise to an entitlement to receive compensation?
Ms Abraham: I do not have a view on the substantive issue. I think that is absolutely properly a matter for Parliament to debate and entirely legitimate for government and Parliament to have a view on. What I am saying is that does not sit with the jurisdiction that I had in relation to this investigation and indeed I do have in relation to a number of regulatory bodies that are within my jurisdiction now. That would be something that Parliament might well have a view on and is entitled to have a view on. If I had a view it would be a personal one and all I could do is assist Parliament in that debate from my evidential experience.

Q20 Kelvin Hopkins: I am a Member of Parliament and I have a very strong view that if a regulator is not ultimately responsible financially as a financial regulator then possibly regulation is not worth the paper it is written on. Is that not a fair view?
Ms Abraham: I suppose I would broaden it out and say if there are no sanctions or no redress for public service failure then the drivers that would improve public service failures seem to be significantly weakened by that. That applies to regulation as much as it does to the work of the Child Support Agency or the National Health Service.

Q21 Kelvin Hopkins: If the Government is morally, if not legally, responsible for financial compensation, then they put pressure on their regulators to do a very good job to make sure that the organisations do their job. If that pressure is taken away, the regulators could play golf and say the Government is not that bothered and that with "light touch" regulation they will not pay out any money anyway, so we will just play golf instead. Clearly the regulator did not do the job and that is why they are in the dock now. Is that not fair?
Ms Abraham: I am not sure about the golf. I would turn it around and say, which I have said before to this Committee in the autumn when we were discussing these issues, that it has been argued that if the Government has to pick up the tab for regulatory failure then actually that will play against good regulation but I would say very strongly that it plays in the other direction because it seems to me that regulation, like any other public administrative task or public service, should work well and there should be clarity about what people can expect. It goes to my principles of good administration. Some of this is around what people can expect from a regulator but much of the Equitable investigation was around what the law required the regulator to do. I have said again we have set the bar pretty high here. There is a debate to be had is all I am saying. If I were a Member of Parliament, which I am not, I probably might be more inclined to your point of view than the other.

Q22 Kelvin Hopkins: The Government moved the regulation of Equitable Life from the DTI to the Treasury and then to the FSA. The FSA was specifically removed from your purview and not made legally accountable. Was that not the Government saying we are going to have regulation in name but not in practice? They got out from under because they possibly knew things were going to go wrong and they did not want to have shoulder responsibility. But for much of the period we are talking about regulation was a fairly direct government responsibility.

Ms Abraham: I was not around at the time of that debate. It seems to me there was a proper debate about the immunity that was brought in under the new arrangements and that was argued through and debated in Parliament and that is what Parliament decided. I do not think it was a question of getting out from under. I think it was thought through in terms of what was appropriate in relation to this new body. Not everybody is within my jurisdiction but I know there are debates about whether the Parliamentary Ombudsman should have complete jurisdiction for every public body. Those are matters for Parliament to decide and they are not for me. I do not think it was a question of somehow seeing that things were looking bad and trying to get out from under. I have seen no evidence that was the case.

Q23 Chairman: On Kelvin's question, there were two underlying strands to the Government's position: one is the one they put to you as your report was being done, which is the one you have been discussing now, which is that the public interest is in not compensating for regulatory failure which they argued strongly and said was the legal position. In their report, responding to your report, that argument seems to have fallen away; it is given as an assumption but it is no longer the real basis on which they are objecting to what you say. The second strand is the one that is now adopted, which is at the time the regulatory environment in which we lived, which is the one you are examining, was, in their words, "reactive and non-intrusive". That seems to be the philosophical basis for the whole of their reply and you have to understand that was the context so that even if you explore liability in the sense of a period before immunity had kicked in it was such a lax passive regime that, in a sense, you should not have expected more of it.
Ms Abraham: If that is the Government's position then it is a self-defeating one because it completely endorses what my report says. We have talked again about this: was this a failure of the system or a failure to operate the system? What I have said is it was the latter because actually the law required the regulators not to be reactive and passive and complacent. The law required considerably more than that and the regulators failed to operate the system as they were required to do. Again, and I think I have said it in this room before now, one of the exchanges that I had with the public bodies in the course of this investigation was I was being told that the regulatory regime, as I had articulated it, would not be recognised anywhere in the world. My response to that was that may be so but it is the law. If the argument is that actually it was a reactive and non-intrusive regulatory activity that was going on here, I do not disagree with that, the problem is that was not what the law required; indeed it was not how, at the time, they said they would operate the system.

Q24 Mr Prentice: We all despair that a line cannot be drawn under this business but, on the constitutional points that Charles raised, you told us that in your dealing with the Government they showed respect for the Office, they were polite, as they would be, but in your memorandum, which is pretty trenchant, you say there is no common understanding between the Government, the Ombudsman's position and presumably what Parliament intended when they set up your office. That must concern you.
Ms Abraham: I am trying to remind myself what I did say.
Chairman: Something very similar to what Gordon has just said.

Q25 Mr Prentice: "The system will only work if the Parliamentary Ombudsman and government departments share a broad common understanding of what maladministration might be and who should properly identify it. The Government's response indicates that they do not share such a common understanding."
Ms Abraham: Without being flippant, I was quoting the Committee and agreeing with it so we are in agreement.

Q26 Mr Prentice: When you said in your memorandum the Government's response is partial and you said there is no mention of EC Directives, are there other instances where the Government just did not address issues raised in your report?
Ms Abraham: Yes.

Q27 Mr Prentice: Lots of them?
Ms Abraham: Yes.

Q28 Mr Prentice: On the question of disproportionate impact, and that is means testing I suppose, is this completely novel or are there other examples in the past where the remedy offered would involve means testing and people would be compensated on the basis of disproportionate impact? Do you understand?
Ms Abraham: I understand the question. I am trying to think if I have ever come across this in another case and I think I have to say I have not.

Q29 David Heyes: Starting with the point in your memorandum, you say that you would be happy to explore with the Committee and provide further written evidence about the more detailed analysis. We are expecting to get the Minister in front of the Committee fairly soon. Will it be possible for us to have some of that in time for our evidence session with the Minister? It is clear these questions that are in your mind, this unhappiness that you have described, we need to be putting that to the Minister and we need more from you. Can that be done?
Ms Abraham: Certainly that can be done.[2]

Q30 David Heyes: Can you help us to have a flavour now? You have referred several times to the Government re-interpreting your report and then disagreeing with the re-interpretation and you have talked about points which the report does not

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address. I do not want you to give us chapter and verse now but can you give some illustrations of why you say that?
Ms Abraham: Perhaps I can bring Iain in to give one or two illustrations.
Mr Ogilvie: The clearest one is in relation to the decision to let the Society remain open after the House of the Lords' judgment in the Hyman case. The Government's response says that the Ombudsman did not say it was the wrong decision, it was just the why they took the decision that was faulty and, therefore, nothing really would have changed because the decision would have been the same and would just have been taken in a different way. That is not what we said. We said that they failed to take into account the interests of all policyholders. They had misunderstood their powers. They had come to a decision based on a wholly partial view of the relevant facts and the relevant law. What we did say is nobody now, ten years later, can say what would have happened had all of that not been the case but we certainly did not say the decision was right. From that they then said no injustice had flowed from that and therefore there should be no remedy for that. Had they actually addressed what we said they may have come up with a different view as to whether there was injustice and a rationale for a remedy.

Q31 David Heyes: Can I prompt a further example?
Mr Ogilvie: The information given by the FSA in the post-closure period we found to be misleading and inaccurate in places. They then go on to say in their view that while the information might have been misleading nobody really was misled. They have given no basis for that. That is not what we have said. What we said was individual policyholders were all in different positions and some of them may have had regard to that information and some of them may not and it would depend on the circumstances of each case. They have interpreted that as saying nobody suffered any injustice.
David Heyes: That helps to make the point that we need a lot more from you if we are to do our job in relation to holding the Minister to account. We look forward to some more detail on that.

Q32 Chairman: Can I come back to one area before we end, and we look forward to further evidence that you will give us in writing, and it is the sort of conversation we had before in other issues. I have a sense that you would be happier if the Government had said "We accept what the Ombudsman has said. We accept in all respects what she said about maladministration and in all respects what she said about injustice but I am afraid for public purse reasons we can do nothing about it." In a sense you gave them the option of saying that because you opened up the fact that there was a public purse consideration. Am I right in thinking that you would feel that would be a happier position to be in from your point of view?
Ms Abraham: From my point of view, yes, but I say that in the full knowledge that from the complainants' point of view clearly not. What I have found so difficult in the Government's response is this seems to me to be a rather roundabout way of getting to the same place and perhaps a less direct, less straightforward, way of getting to the same place. I have said that I have found maladministration leading to an injustice pie which is so big and that is how big it is. That is the injustice I have identified as flowing from this maladministration and that is my view. Instead of saying "This is your job. You have done a four-year investigation. We have had lots of debate about this. This is the conclusion you have reached, and we respect that, but there are public purse considerations and the Government cannot afford something this big." Government and Parliament can have that debate. No doubt there would be very strong views expressed but it is a legitimate debate. I see them, first of all, saying actually the maladministration was that not big and the injustice was smaller and then there is this disproportionate impact thing.

Q33 Chairman: Put slightly differently, the Government does refer frequently to your public purse observations. It could say, given its assessment of your report, given what it accepts and what it does not accept and given the fact it is persuaded in this case to have some kind of *ex gratia* scheme, that having a scheme of disproportionate impact is their way of responding to your public purse consideration. Is that not a logical argument?
Ms Abraham: I agree with you. I said the thing I find that is not legitimate is a self-standing concept of disproportionate impact. This may feel like a rather arid debate for the people who have had these losses but it seems to me it is more logical to say actually the taxpayer and the country cannot afford something that big, and therefore we have to find a way, and we need to find some criteria, to allocate what we can afford and, therefore, we will take a disproportionate impact criteria. What it does not disturb is the rationale which says the injustice is this big and therefore the remedy should match the injustice. If you then say we cannot afford that much and we have to find a way of dealing with that, that seems to me be more rational, more straightforward and easier for me to understand.

Q34 Mr Prentice: I do not know why I am laughing but it may produce a further injustice going down the disproportionate impact road because you have to do all this complicated means testing involving the company going through all those records, and your initial timetable, the timetable you wanted, is going to fly out the window and we could be here in eight years time.
Ms Abraham: I am not saying for a moment that I think that is the right criteria.

Q35 Chairman: That is the final thing I was going to ask. If you were Sir John Chadwick would you know what you had taken on? Would you have taken on something that you thought was understandable and doable?

Ms Abraham: I am not Sir John Chadwick and I find it hard to put myself in his place even having sat in his courtroom for three days. Presumably he does know what he has taken on because he is a very able man. He has a very difficult task and I do not envy him.

Chairman: Thank you very much for that. I suspect we will have further communication about all this but thank you for your evidence this morning.

Witnesses: **Mr Charles Thomson**, Chief Executive, and **Mr Simon Skinner**, Director Corporate Services, Equitable Life Assurance Society, gave evidence.

Q36 Chairman: Let me welcome and thank Charles Thomson, Chief Executive of Equitable Life, and Simon Skinner, the Director Corporate Services, for helping us. Mr Thomson, you were here before a little while ago. We now know more than we knew then when you could not help us very much. I wonder if you can help us any more today.
Mr Thomson: I will try. I wonder if I might take a minute before we begin. On behalf our policyholders I would like to thank the Committee for the support it gave to the Ombudsman's recommendations. You said in your report that regulation is never an easy job and mistakes, even serious ones, will occasionally be made. The real test for government is how it then responds. You asked the Government not to act as the judge on its own behalf but that is exactly what they have done. They have accepted fewer than half of the Ombudsman's detailed findings on injustice. You asked the Government not to address the issue as charity or financial hardship. You said compensation should be a matter of duty not of choice but they have decided on an *ex gratia* payment for hardship. You asked the Government to set up a scheme that is independent, transparent and simple but what they have actually done is to ask a judge to advise them privately on something, as yet undefined, which they call disproportionate impact and they have instructed him to ignore the Ombudsman's findings which the Government has rejected. In summary, we believe the Government's response is wholly inadequate. On behalf of our policyholders we are keen to give all possible assistance to this Committee. We seem to have a lot of common ground with you and we are pleased to be given the opportunity to speak again. We think that Parliament should not accept the Government's response to the Ombudsman's report and we hope that Parliament can find a way to influence Government.

Q37 Chairman: We understand what you say and it is helpful but the fact is we now do have a government position and some response to that position has to be worked through. What I would like to know from you is when Sir John Chadwick comes and knocks on your door, and I suspect yours will be the first door that he knocks on, and seeks to carry his brief forward what are you going to be able to say to him?
Mr Thomson: We will do whatever we can to help him in his work but our concern is his terms of reference will constrain what he can do in quite a serious way.

Q38 Chairman: He is charged with making sense of this disproportionate impact criteria and he comes to you and wants to know which of your policyholders have suffered a disproportionate impact. That is his terms of reference. He cannot go back and interrogate the argument between the Ombudsman and the Government. He has been told that he has to accept that his parameters are what the Government has said about what they accept. He has to find out who are the policyholders who have suffered disproportionate impact and he comes to ask you about that.
Mr Thomson: We will have considerable difficulty in helping him. We have the details of our policyholders. We know the policies they took out and when. We will have some other information but we do not know which of our policyholders are wealthy and which are poor. We have very many policyholders, more than half are in pension schemes and they include many people who are not wealthy, people who work for the NHS, people who work for the Post Office, and we do not have information about their private means.

Q39 Chairman: What are you going to do?
Mr Thomson: We can give Sir John the data we have but if he is interested in people's wealth then he will have to go directly to them.

Q40 Mr Walker: That is going to be fairly obscene, is it not? He may have to have the HMRC get involved. People who, through no fault of their own, have suffered significant loss as a result of this Equitable Life failing will have to list perhaps the value of their property, the value of their savings, the value of their chattels. This is really pretty unpleasant, personal, intrusive stuff, is it not? It is personal and very intrusive.
Mr Thomson: We cannot support any method that effectively is means testing for a compensation scheme that is supposed to be there to right a wrong.

Q41 Chairman: Means testing is one version of what this could mean. Part of the difficulty is we do not know what it means. It will be possible presumably to think of disproportionate impact in a way that did not involve means testing but simply involved looking at categories of your policyholders to see, in a sense, who had taken the greatest hit.
Mr Thomson: Indeed. If this was to remove the *de minimus* cases then that would not be something we would particularly object to because any scheme will be a complex and expensive thing and there is no

great value in spending a lot of administrative money in order to give somebody compensation of £5. At that end we would have some sympathy for it but until we have defined what the relative loss caused by maladministration is, so that we can work through that with the policy records we have got, we would be struggling to actually identify which group was most likely to be affected.

Q42 Kelvin Hopkins: A simpler approach would be if the Government hinted at a ball park figure for the amount of compensation they might pay and this was just divided up proportionately according to the losses. If I lost £10 pounds I get 1p. If someone has lost £1 million they get 1,000th of that in a simple proportionate way. That would be quick and it would be sort of fair. It would not be means tested and would not require the collection of all that detailed information which would be a nightmare. Is that not another possible approach?
Mr Thomson: That could be done. I was asked when I was here last did I think the six month period to construct a scheme was realistic. I still believe that is realistic. Someone needs to define what the relative losses due to maladministration are and how is that to be approached? What sort of methodology is going to be used about comparison of this company's results with other company's results? What proportion of that difference is market-related falls that are not related to maladministration? What are the impacts of the maladministration? What bits should be compensated? Design that scheme and then apply that to the data base but until that is done then the overall cost is unknown. That overall cost might not be beyond the public purse. If it is beyond the public purse then we might not be pleased but we would understand why a government then said that it should be restricted. The problem we have at the moment is, as the Ombudsman said earlier today, it seems to be being chipped away at in a variety of different ways and it seems most unlikely that ends up in a fair scheme.

Q43 Kelvin Hopkins: I would not say for a moment it should be as little as 1,000th. If it was 50% that would be more reasonable.
Mr Thomson: Our policyholders have waited a very long time for compensation and if they got half of what they believed they were entitled to then that would be a great deal better than nothing. If that is the all the public purse can afford then I think people would understand. At this stage I feel we are arguing about something that is unknown. The public purse may well be able to compensate fully.

Q44 Kelvin Hopkins: It could be quick.
Mr Thomson: I would like to see this being done quickly. The Ombudsman's original timetable seemed to be one that was challenging but possible.

Q45 Mr Prentice: We are having difficulty here. You said in your letter, and you may have said it earlier, that we do not know what the Minister meant by disproportionate impact. I am struggling to remember if ministers at any stage said that people of modest incomes or poorer people or elderly people should be treated more favourably than others. Can you help me here?
Mr Thomson: I do not think I can. I heard the same as you. I heard the Minister in the House and I heard the debate after that. Having heard that debate I was very unclear as to precisely what was meant. Members in the House did say means testing, and the Minister did not say this is not means testing.

Q46 Mr Prentice: The Chief Secretary, Yvette Cooper, when she spoke in the House a week or two ago said "We would expect that interpretation of disproportionate impact would include consideration of the extent of somebody's losses and how great they were as a proportion of their income, that is whether they were relying on that income or had other sources of income." That is the Government's position because it has been said on the floor of the House.
Mr Thomson: We cannot help with that.

Q47 Mr Prentice: It goes back to Revenue and Customs.
Mr Skinner: Part of our difficulty is that definition, or attempt at a clearer definition, is not within the Command Paper which is the thing against which we have to respond to which is why we have written to the Minister in the way we have trying to reserve our position. We do not know what they mean by that definition. This is something that he may be asked to consider but we do not know that is the case.

Q48 Mr Prentice: The other point that the Ombudsman made earlier about being a red herring, sorting out maladministration from market movements, that is another next to impossible job.
Mr Thomson: Yes. We have an element of surprise that the Command Paper is almost 50 pages long. Government, having seen the Ombudsman's drafts earlier on, produced a 500 page response as to why they disagreed, with a lot of where the Ombudsman was going and the Ombudsman dealt with that. What we have now got is less than 50 pages of which a very small part says Government disagrees with what the Ombudsman has found but gives very, very limited reasons. There may be cogent reasons behind that but it is not at all clear from what has been published so far. I would be very grateful if the Committee would question the Minister as to what those reasons are in detail so that we can see whether they are cogent or whether they are irrational.

Q49 Mr Prentice: That is why you said in the company's press release that the Society deplored—this is strong language—the Government's rejection of the Parliamentary Ombudsman's recommendation for those very reasons. You have been passed a ball and you cannot really run with it; you do not know in which direction you are going.
Mr Thomson: Indeed, our policyholders have waited at least eight years for something and at the end of the day, when the Ombudsman has recommended a scheme that looked open, transparent and fair the

Government is saying "No, we will not give you that. We will give something that we will decide what it is and it is very likely to be a lot less." Nobody knows what it is.

Q50 David Heyes: You said that you would do everything possible to help in this situation. That was one of your opening comments. Having heard the conversation since then I am finding it hard to discover what that might be other than providing names and addresses and perhaps some policy details. That would seem to be it.
Mr Thomson: That is a fair point. The help we can give is limited. We have access to data that relates to our policyholders and we can help. The Ombudsman envisaged that a scheme would be independent and, therefore, it is arguable that we can have a very limited part in trying to produce the solution for this. In so far as we can help then we stand ready to do so.

Q51 Mr Prentice: Has Sir John spoken to you yet?
Mr Thomson: No.

Q52 David Heyes: You are obviously expecting that to happen.
Mr Thomson: I would expect that fairly soon.

Q53 Mr Prentice: Any idea when?
Mr Thomson: No, I have no idea.

Q54 Chairman: If you were simply asked a question about which of your policyholders had suffered disproportionate impact, leaving aside means testing issues, is that a question you can answer?
Mr Thomson: I do not think it is a question I can get close to answering. It depends entirely on how you see the relative loss caused by maladministration. That would then perhaps identify groups of policyholders who have suffered more than other groups and then you would have a group of policyholders that you who might look at. How you would pick individuals out of that group I have no idea.
Mr Skinner: It is worth bearing in mind that a large proportion of our policyholders who will be affected by this moved away to different organisations such as the Prudential, Swiss Re and others. We only hold a snapshot of those policyholders at that time so as to their income now we would not even begin to be able to identify that.

Q55 Chairman: You have had no conversation at all yet with Sir John about these issues.
Mr Thomson: We have not heard from Sir John yet. We have not yet approached him.

Q56 Chairman: If I was him I would come and knock on your door pretty smartly to find out what brief he has taken on and whether it can be done or not. You are saying, as far as you understand it, it is impenetrable at the moment.
Mr Skinner: He will have to take actuarial advice about what has been ruled in and what has been ruled out. If you look at what he has been asked to look at, he cannot get into the detail unless he has read considerably into Penrose which led to this report and then try to take actuarial advice. We cannot provide that actuarial advice to him if he is to be independent, I would not have thought. The only thing we can provide is the data set.
Mr Thomson: To be fair to him, the volume of reading that can be involved in this, when you consider not simply the Ombudsman's report and its many pages but the backing material, runs certainly to three figures of lever-arch files.
Mr Prentice: I am sure he is a speed reader.

Q57 Chairman: He is locked in a dark room somewhere.
Mr Thomson: I am not sure. We have not approached Sir John. I would probably regard it as appropriate for me to approach him fairly soon.

Q58 Mr Prentice: I do not want to labour the point but I want to get this on the record. There was a debate in Westminster Hall only two days ago and the Exchequer Secretary to the Treasury, Angela Eagle, said this: "I reassure members that it is only with access to Equitable's data that we can assess which classes of policyholder will receive payment under this scheme." That is complete baloney, is it not?
Mr Thomson: It seems difficult to reconcile that with some of the other statements.

Q59 Mr Walker: I would just say that the Chief Secretary came to the House a few weeks ago to announce the scheme. We are discovering that it is a very complex scheme which requires a lot of background financial checking and would take a huge amount of time and be hugely expensive. You are a man of some financial experience. If you were in the Treasury you would say "Please do not go ahead and do this because you are creating a rod for your own back." Do you think common sense may well prevail and actually the Treasury Minister may come back to the House and say "We have looked at this in greater detail and we feel there is a better way of actually compensating policyholders than the one we originally thought we were going to go with."
Mr Thomson: I hope that the Treasury will decide that there are better ways than this one. I think my concern is that Sir John will do the best job he can within his terms of reference but that is unlikely to produce a scheme that is fair, it will not be transparent and it will not give compensation to many people who deserve it. He has to ignore the findings of the Ombudsman which Government does not agree with so he has such a limited starting position.

Q60 Mr Walker: You strike me as a very sober gentleman, Mr Thomson, and that is a fairly devastating review of the scheme currently before Parliament.
Mr Thomson: We struggle to know precisely what the scheme is. We have the Command Paper and in so far as it goes, we struggle to follow the reasoning for the rejection of the Ombudsman's findings and,

therefore, the reasoning behind the creation of this scheme. We believe the Treasury would be wise to consider whether a different approach is better.

Q61 Chairman: The difficulty is you talk about the scheme but in fact there is not a scheme: there is a rather vague maybe stated principle and the hope that our judge is going to convert that into a scheme. It seems to us to be a pretty mammoth task.
Mr Thomson: Indeed, and there is no timetable set for Sir John so this could be a further delay that simply means policyholders have to wait again.

Q62 David Heyes: You seem to be envisaging an in-depth renegotiation of the proposal and the way forward. That is not what I have seen here. The Government have said that this will be done independently. We will take data from you and someone else will do it. I am not sure why you seem to envisage this role where you can get involved in want might be lengthy renegotiation with the Government.

Mr Thomson: I do not expect we will get involved. I see this simply as the Ombudsman, as the Officer of Parliament, has produced her report. Parliament has that report and Government has said despite that report we intend to do such and such and I now see this as an issue between Parliament and Government as to whether that approach is accepted or not. What I am saying is that on behalf of our policyholders, I hope that Parliament will not accept the Government's approach because I do not think it will result in a fair result.

Q63 David Heyes: But you see a role for yourselves.
Mr Thomson: Our role is simply to provide any help we can for Sir John or whoever is involved in producing this. We have data that we will want to share with someone who is trying to produce restitution but our role will be quite limited in that.
Chairman: That is probably as far as we can go today. You have been as helpful as you can and have said some very interesting things. We are grateful to you for coming along and we may have further contact.

Witnesses: **Mr Paul Braithwaite**, **Mr John Newman** and **Mr Colin Slater**, Equitable Life Members' Action Group, gave evidence.

Q64 Chairman: Again let me welcome the representatives of Equitable Members' Action Group, EMAG. We had a conversation before with you on what the Government was going to say and we wanted to hear from you afterwards. I know that you have done a paper, we are grateful for that. Do any of you want to say anything by way of short introduction?

Mr Newman: I would like to start by thanking you and thanking PASC for the task of producing such a cogent, compelling report in December and so expeditiously. I thank you again on behalf of our members and myself. I was extraordinarily impressed. Of course, I did not agree with everything but that is life. Again, the Government is employing salami tactics on us. There is a big problem out there like a salami and they are cutting it into very, very small and little pieces to digest it and, I am afraid, I find it totally unacceptable. Personally, I have written to the Minister to reject the apology and to say it is totally inadequate. Today I would like not to try to shoot you as the messengers because you are not, you have been so helpful to us. I would like to hand over to my colleague, Colin Slater, to talk through some of the numbers of the issue. I want to pick up one point. There was a reference going to HM Revenue & Customs to find out means of individuals. This would be a totally irrational response because most pensioners and most of the pensioners involved in this disaster do not file tax returns because they have not got enough income. We are dealing with hardship, we do want to rectify that. They want justice, but recourse to HM Revenue & Customs would not work.

Mr Slater: Good morning. I think the best thing I can do this morning is try to provide some guidance for the Committee on the cash effects of what the Government has responded. I will try and keep my comments fairly short.

Q65 Chairman: If you would, please.
Mr Slater: First, I would like to mention the rate of growth of Equitable Life. In 1990 it was a very small insurance company with assets of about £5 billion. Over the decade of the Parliamentary Ombudsman's review it expanded its business aggressively. We now know it did so on the back of numbers that were extremely dubious and which were approved maladministratively by the regulators. By the time we get to 2000 that £5 billion has grown to £30 billion, so it was quite a large insurance company. In short, during that decade the company expanded its business six times, that is a huge rate of growth. In doing so it encouraged about one and a half million people to invest their money, mostly pension money, into Equitable Life's with-profit policies. Those are the important figures: there are one and a half million people and £30 billion. The Parliamentary Ombudsman made ten findings of maladministration against various regulators. However, as I am sure you know, maladministration on its own is not enough to justify the payment of compensation. For compensation to arise the Ombudsman also has to determine that the maladministration led to injustice. From a practical point of view, for compensation to be substantial that injustice needs to apply to the majority of policyholders, not just occasional ones here and there. Once you eliminate the matters that do not

lead to injustice, or do not lead to injustice to substantial numbers of people, you boil down to four issues, what we call the "money findings". The first three we can take conveniently together because these are the question of discounting the Society's mainstream pension business by something like half from 1990 onwards, the second one is the lack of any provision for guaranteed annuity rate liabilities from 1993 onwards and then there is the matter of Standard & Poor's mistaken AA rating of the Society from 1995 onwards, which the regulators knew about but did not do anything. The Parliamentary Ombudsman's cumulative findings in relation to those three matters mean the Society's regulatory returns were grossly misleading from 1990 onwards. Therefore, the Ombudsman puts a start date for injustice at 1 July 1991 which was when the Society's 1990 regulatory return was filed. In doing so she includes as potential subjects for compensation all those million-plus savers who entrusted their money, mostly pension money, to Equitable Life after 1 July 1991. The dates are important. The fourth finding relates to the dreadful business of the financial reinsurance contract where the directors of the Financial Services Authority simply lied to allow Equitable Life to declare its 1998 bonus and to carry on in business. In this instance the Parliamentary Ombudsman found maladministration leading to injustice in respect of all of those who joined the Society or paid a premium that was not required under contract from 1 May 1999. That is another important date, 1999. If you look closely at the Government's written response to the Parliamentary Ombudsman's report, then you will see that, while it has accepted all the findings of maladministration relating to those four issues, it has rejected the findings of injustice in respect of the first three, the earlier ones from 1990, 1993 and 1995. The effect of that is to move the start date for eligibility for compensation from 1 July 1991 to 1 May 1999, so we are talking about almost eight years. Under the Treasury's response only those who made contributions after 1999 and before, of course, the Society closed for business on 8 December 2000 will be eligible for compensation. It is this movement of the start date by eight years out of the possible ten that excludes most policyholders from receiving any benefit. You do not need to be an actuary to see that if you take eight years out of ten from the possible compensation period, you make a very big hole in the numbers. We have done the sums and we reckon that reduces the compensation by 90 %.

Q66 Chairman: I would quite like to hold you at that point, do you mind?
Mr Slater: Please.

Q67 Chairman: This is all extremely helpful, but some of it is written down in detail in this memorandum you have given to us. That is extremely helpful to us, but I think the conclusion you have arrived at now is probably the one we would like to talk to you about unless you have got anything else that really bears on that?

Mr Slater: Yes, I am nearly finished. As far as Sir John Chadwick's review is concerned, as certainly Charles Thomson and the Parliamentary Ombudsman have said, he is very firmly instructed to consider only those findings that the Government has accepted, and they have not accepted the expensive ones. When he comes to do his calculations on relative loss, appropriate proportion, the State of the public purse and the disproportionate effect, whatever that may mean, he is only going to be talking about 10 % of the money.

Q68 Chairman: I think what is interesting is that it was only EMAG which was giving us some sort of hard-ish figures before we had the Government's response. What I am interested in is the exercise you have done by identifying what you call the "money findings" and then comparing what the implications of the Ombudsman's money findings are with what the Government has said.
Mr Newman: Chairman, to come and talk about monies, in paragraph 519 of the Command Paper the Treasury say, "We haven't been able to estimate the cost". Any simpleton will say, "You have got to ask", and the Treasury has not asked either the company or us what the cost is or done an adequate investigation in the six-month period. That is not reasonable. We have done an estimate, and Colin will talk it through, of course we have, but it is not reasonable of the Treasury and the Government not to ask the question.

Q69 Chairman: What I am identifying, and you are being extremely helpful on this, is we have just had a conversation with the company when they were not able to help us in a way that you have been able to do. You have told us that going through this money-finding exercise, comparing the Ombudsman with what the Government has said, because you have identified this problem about start dates and therefore the exclusions that come in because of that, you know on the basis of having done that exercise that 90 % of policyholders are going to be excluded.
Mr Newman: Chairman, the cogent reason from the Treasury is to try to exclude most policyholders. Colin, would you like to add?
Mr Slater: I think that is pretty clear.
Mr Newman: It is a cogent reason. They have said, "£", and then it has tried to trim—the salami tactics—every policyholder out of the way.

Q70 Chairman: I am sorry to keep on at this, but this is interesting for us. If I say to you—which I have tried to ask other people—"Can you tell me who the 10 % of people are going to be?", if you were Sir John Chadwick and had been told to go away, apply the principle, do your exercise and find only 10 % of people, you would be able to do this quite readily.
Mr Slater: The only finding of maladministration leading to injustice which has real money attached to it, is the financial reinsurance and the start date for that is 1 May 1999, that is what the Parliamentary Ombudsman says. She says anybody who invested after that date who was not required to do so should be considered for compensation. That is the only

period that Sir John will have to look at. It is only a year and two-thirds over the whole saga of Equitable Life in which the Parliamentary Ombudsman found maladministration over a decade.

Q71 Chairman: Ironically, although I have been suggesting to witnesses that Sir John's task was going to be difficult and elusive, if not impossible, you are saying, "Actually, it is very straightforward".
Mr Slater: I think as far as identifying the potential claimants it is very straightforward indeed. I am sure Mr Thomson could give you a list of people who invested money after 1 May 1999. I am not saying Sir John's task is easy, quite the reverse. How on earth he is going to take into account the requirements of the public purse I really do not know. Like the Parliamentary Ombudsman, I thought that was the Government's job or Parliament's job. As far as the disproportionate effect is concerned, I think it is barmy, not to put too fine a point on it. In this country we have one system of dealing with people who fall on hard times, it is called social security. We have another system for dealing with people who make too much money, it is called income tax. Income tax has been going for 200 years, it has been developed over that length of time and it is an enormously complex system. The same can be said of social security, about a hundred years. We have had hundreds of years' worth of experience to develop those systems and the Government has said to Sir John Chadwick, "Here is Equitable Life. Go away and develop a system of income tax and social security just for Equitable Life", it is nuts.

Q72 Chairman: You are saying it is barmy but doable.
Mr Slater: No, I just said it was barmy. I certainly did not say it was doable.

Q73 Chairman: I thought your analysis had brought us to the conclusion that you could identify the categories.
Mr Slater: You could if you spend 200 years running it like income tax.

Q74 Mr Walker: Chairman, I am sorry, I have got to go very shortly but I want to get something off my chest for the record; I am not sure it is going to advance the discussion very far. Ultimately, this is about justice and justice being seen to be done and justice actually being done. What concerns me is that we now have a banking sector that is largely owned by the State, but many of the main players within that sector are still going to receive salaries, supported by the taxpayer, in excess of seven figures this year, next year and the year after. Surely, as Parliamentarians, if we are interested in natural justice we must ensure that policyholders in Equitable Life who have been disadvantaged by the regulatory system are compensated for their losses because, as you have so eloquently put over the time that I have got to know you, we are not talking about multimillionaires in the main here. We are talking about people who were professional and put money aside so they would not be a burden on the State in their retirement. That is the case in reality, is it not?
Mr Newman: Yes, I think it is. Could I add one thing here. One of the things about the rejection of the apology is to focus on the Civil Service. Not one person has been disciplined within the Civil Service for their maladministration to the best of my knowledge and belief. The Financial Services Authority: we had Sir Howard Davis here as a witness before Christmas who has made no comment or apology for his maladministration on the issue of misleading information. Now they are not suffering a pay cut, they are still receiving six-figure salaries. I think we have got to have a fundamental look at the morality of our pay policy in the private sector and the public sector when there has been maladministration and proven maladministration as such.
Mr Slater: Could I also say something. I agree with what you say as regards the policyholders of Equitable Life. We are talking about a million people in group schemes whose average fund was £4,000. That is not a lot of money, certainly not for a pension fund. We are talking about 500,000 people who invested directly whose average investment was £46,000. We are not talking about fat cats. The Treasury spin doctors would like you to talk about fat cats, but we are not talking about that.

Q75 Mr Walker: Actually, even if you do have the odd fat cat, they are entitled to justice as well.
Mr Slater: Absolutely, quite so.
Mr Newman: We do not discriminate.

Q76 Mr Walker: I know you do not, but it is important.
Mr Slater: Also, politicians love to talk about hard-working family people. Equitable Life policyholders are hard-working family people and they are mostly hard-working family people who have worked for 40 years. Because of their age they have done their working lifetime and the Government is now treating them very badly.
Mr Newman: Could I add on to the map the dead and the infirm, and the infirmity because of old age. The Treasury says at paragraph 5.7 that they had received representations and our meeting should not be claims-based and an assessment of losses should be on a collective rather than individual basis. I think the impact of that paper is totally unreasonable. It does not discuss or consider the rationale for dismissing these views, it does not consider it any further. It just does nothing. It does not inform. Sir John has got no instructions about how to deal with those 30,000 claimants who have died. It has not thought through the fact that a lot of the claimants or potential claimants will not be able to claim because they are infirm or old and they cannot do the claim. I think that is just totally unreasonable of the Government's response.

Q77 Mr Walker: A final thing. I have to say that I was very impressed by the observations of my colleague, Kelvin Hopkins. I think it would be so

much easier to say, "These are the policyholders, what they have lost. This is what we can afford to give them and we are just going to give them that money. We are not going to have intrusive investigations into their financial wherewithal. We are just going to do the right thing and we are going to do it quickly. We are not going to be able to give everyone every penny that they feel they are owed, but at least we can have a system that is fair and quickly executed for the benefit of those people".
Mr Slater: This is precisely what EMAG recommended to the Parliamentary Ombudsman. We said, "We understand about the public purse, we understand about responsibilities". If, in its wisdom, Parliament said, "We can only afford X", then for goodness sake say, "X is what we can afford", give it to the tribunal which the Parliamentary Ombudsman has recommended be set up and let them divvy it up between the policyholders. That is perfectly doable within two years. What the Government has suggested is not doable at all.

Q78 Mr Prentice: A lot is riding on Sir John Chadwick and let me read back to you what you said in your memorandum to us: "Sir John owes no duty to Parliament and reports privately to the Treasury. He is not required to hear representations from interested parties. Parliament has no control over the timing of his work". That is kind of—my words—open-ended, but ministers have told us that they will report back to Parliament on Sir John's work. Are you going to make representations directly to Sir John? You are not?
Mr Newman: We have not been approached by Sir John. We are in exactly the same position as Charles Thomson of Equitable. We have not heard anything. Our telephone lines and letterboxes are open. I would like to be invited to make representations and, if invited, I would indeed.

Q79 Mr Prentice: With all this paperwork I cannot find a reference to it but, given that ministers have promised to give regular progress reports to Parliament on what Sir John is up to, you could get in touch with Sir John and you could say that you would find it useful if Sir John were to report back on A, B, C and D when invited by ministers to.
Mr Slater: I think what we need to do is to compare what I call the "Chadwick process" with what your Committee recommended. Your Committee followed what the Parliamentary Ombudsman said and what she said was that the process should be—

Q80 Mr Prentice: Transparent and independent.
Mr Slater: Transparent, independent and so on, and it is not any of those things.

Q81 Mr Prentice: We are where we are. No, I understand that. That is why I am asking the question.
Mr Slater: Our first response to Sir John Chadwick will be to tell him to think again about whether it is an appropriate job for him to do. He is acting as the Treasury's hired hand. The Treasury is perfectly entitled to have an adviser of great eminence, but it is not entitled to present an ex-Appeal Court judge to give it a judicial veneer to what is really a very downmarket, back street process. In Sir John's court the accused is going to be giving the judge instructions. What sort of a court is that? The accused appointed the judge.

Q82 Mr Prentice: There is a headline in there somewhere, I know. We understand the process, that Sir John has been invited by Government, it is purely advisory, Sir John is going to make his recommendations to ministers and ministers are going to decide, there is no secret about that. I am not going to labour the point.
Mr Slater: That is the point we want to make. The point we want to make very much is the Treasury has been convicted on five counts of maladministration. Now it has appointed its own judge to hear its appeal in private at a time and place and in a manner of its own choosing. Please quote me on that one.

Q83 Chairman: In a sense we had the conversation with the Ombudsman about whether she would have preferred to have had all her findings accepted but for the Government to say, "I am afraid there is no money in the kitty. We can't do anything about it". Your perspective is different.
Mr Slater: Not very different. We understand that the public purse is not entirely open-ended. If the Government of the day says, "We can't afford this", that is something it can say, but it ought to do it openly and honestly, not in some backstairs alleged court.

Q84 Chairman: The point of the question is to say that the Government could have said, "We accept what the Ombudsman says, but the public purse is such that we cannot set up any kind of compensation scheme". In a sense they have done better than that, have they not? They have said, "Well, we do accept that there is the basis for some kind of compensation scheme. We need to take some advice on exactly what it means and we would like to help those people who have been disproportionately impacted by what happened". That is not a contemptible position, is it? It is better than it might have been if they had dismissed it out of hand or would you have preferred that?
Mr Slater: I think we would rather that the Government had been honest about it and stood up and said, "We are not going to pay", because in those circumstances in not a very long time the voters will be able to express their view on this Government.

Q85 Chairman: You would rather have had no scheme at all than a limited scheme?
Mr Slater: I did not say no scheme. I said that I would rather the Government stood up and said how much it was prepared to pay.

Q86 Chairman: In terms of this question, the choice was between whether you wanted the Government to say, "We accept what has been said, but we can't fund any kind of compensation scheme, I am afraid,

and that is the public policy and public purse position". They have said, "We will try and set up a scheme but it has to be a scheme that is limited in its impact".

Mr Newman: Also, Chairman, we look to Parliament to protect us. We look to this Committee and Members of Parliament to protect us and to right the wrong, so the Government has to set the process in Parliament. I hate to tell people what their job is; I think Parliament should actually see the wrong and try to right it. It is Parliament's prerogative to do that and that is where we are appealing to.

Q87 Chairman: Mr Braithwaite?

Mr Braithwaite: You used the word "compensation". I think you will find from the record of 15 January that Yvette Cooper did not use the word "compensation". Command Paper 7538 does not use the word "compensation", very carefully. I have a perspective on this which is that the Parliamentary Ombudsman was a wonderful invention 40 years ago and I think it is very regrettable how far we have come from that concept—such that this document had to be written in legalese and we have moved away from natural justice. I was horrified when I sat through the adjournment debate on Tuesday to hear MPs say, "EMAG must bring a judicial review". She is your Parliament and, really, you have to stand up for her. I thought that she displayed an amazing cerebral evenness when she said that she did not think the Government had been malevolent. I am rather partisan in this, though I would not ever be a prospective recipient of any payment, but I have been at this coalface for eight years, so forgive me if I do seem partisan: Yes, I do think there has been malevolence. There was a disparity between the way it was presented to you, as MPs, in the statement and what was released later. It is quite apparent that this has been delayed over and over again by the Government. This surfaced as a problem in 2001 and now everybody seems to be accepting: "Oh, we haven't got any money at the moment", but we had money for the banks and we had money a couple of years ago for the occupational pensioners—there were only 125,000 of those. We have ten times as many people here, yet we are pleading public purse and poverty. Having attended all of these evidence sessions, I was most impressed by Tom Windsor who said: "Justice at the discretion of ministers is not justice. There is a very high probability that justice will be denied here simply because ministers do have the discretion. A right without a remedy is not a right at all, it is just a statement of honourable intent". Yes, I am rather passionate about MPs' need to stand up against the "Chadwick process" and to make the Government think again and honour the extremely sensible proposal of the tribunal.

Q88 Chairman: Is the conclusion from that you think people should simply walk away from the process that has been described?

Mr Braithwaite: Yes.

Q89 Chairman: Is that going to be EMAG's position?

Mr Newman: We await this Committee's consideration. We are asking you to continue the work you have done and we would like to see what happens on that one. After that there are time limits, there are steps we will take, but we will go on. This is wrong and it needs righting.

Q90 Chairman: I am trying to find out what your take is on where we are at because obviously the Ombudsman made a report, we examined the Ombudsman's report and made our report. The Government has produced a response which accepts some things and does not accept others and says there will be a limited compensation scheme. Gordon said we are where we are. I am trying to find out whether you think the priority is to overthrow what the Government has now said is to be the process or to engage with that process and try and make some sense of it.

Mr Newman: The answer is very simple. The response made in the House of Commons is inadequate. They need to think again. It is unreasonable and inadequate. If you like, I can go through plenty more reasons why I consider it unreasonable and the Command Paper in itself is unreasonable.

Q91 Chairman: I think we understand that.

Mr Braithwaite: The Ombudsman made the point to you that she is considering issuing a subsequent report under 10(3) of the Parliamentary Commissioner Act. Looking back at this, that has only happened four times in the entire history of the Ombudsman. Two of them have been under your regime: the Japanese interned and the second was the occupational pensioners. It seems to me indicative that in a 40-year history in the first 35 years there were only two necessary times for a 10(3) report to be written and we are now looking at the possibility of a third such in four years, which says to me that this Government is seemingly contemptuous and seeking to undermine the role of the Ombudsman. We have spent four years working with the Ombudsman. Our reason was to seek compensation. We have lives that we could have been getting on with. To turn around and say: "Oh, well, we don't think there should be any compensation ever for negligence or failure in regulation", is *caveat emptor*. I do wish I had known that ten or 20 years ago. As the Ombudsman herself said, the actual regulatory regime, particularly post-July 1994 when we were the first European state to adopt the Third Life Directive, the requirements under statutory duties on our regulators were very arduous. There were no defects in the powers that they could and should have proactively used.

Q92 David Heyes: I think we have probably exhausted it, I was going to ask questions about really where does EMAG go from here. That has been answered more or less. Clearly, there is further

life in the Parliamentary process, but not much. There are things that might flow from the report that this Committee produces that might bring additional pressure to bear on the Government, but it seems to me that we are probably very near the end of the line as far as what Parliament can achieve to bring about a drastic change of mind on the part of the Government. If that is the case, if that pessimistic view is right, then the focus is back on EMAG for what you do next. Can you expand on that? The possibility of legal action must be on your agenda.
Mr Braithwaite: The ball is in your court! It should not be down to us to invoke expensive British legal systems. That is why the Ombudsman system was set up—as an alternative dispute resolution mechanism.
Mr Newman: When the whistle is blown at half-time we will go into the changing room and have a discussion, we will wait and then we are going to go for the second half.

Q93 David Heyes: You are keeping your powder dry.
Mr Newman: The manager and other people, whoever it is, will talk to us and we will come back and we are going to win the second half. If we can go to more popular psychology, the apology was a Jonathan Ross apology.

Q94 Chairman: I think we might retire to the dressing room at this point. I think we have illuminated the issue enough and you have been very, very helpful. Mr Slater, your analysis of the implications of what has been said was extremely helpful to us.
Mr Slater: Thank you.
Mr Newman: Could we thank you again.

Q95 Chairman: We operate in an environment where we spend a lot of our time trying to persuade the Government of things. On this front, as on other fronts, the Government does not always listen to us. Our job, I think, in this case is, yes, to revisit the basis upon which the Government has said what it has said, but also in fairness to try to interrogate what it has said about what will now happen and see if we can bring more light to bear on that. I think on both those fronts we should have something more to say, but thank you very much for coming along again this morning.
Mr Newman: Thank you.

Wednesday 11 February 2009

Members present

Dr Tony Wright, in the Chair

Mr David Burrowes
Paul Flynn
David Heyes
Kelvin Hopkins
Mr Ian Liddell-Grainger
Julie Morgan
Mr Gordon Prentice
Paul Rowen
Mr Charles Walker

Ms Ann Abraham, Parliamentary and Health Service Ombudsman, gave evidence.

Witnesses: **Ian Pearson MP,** Economic Secretary to the Treasury and **Mr Stephen Parker**, Head of Legal Advisers, HM Treasury, gave evidence.

Q96 Chairman: Good morning, Ian; good morning Mr Parker, I am glad you are able to join us. We have a limited session in a way because we have to finish before 12 o'clock, so that should focus our minds and make the questioning fairly brisk and I hope the answering fairly brisk as well, so that we can get through it. We are delighted to welcome Ian Pearson, who is the Economic Secretary to the Treasury and Mr Parker, the Head of Legal Advisers at the Treasury; thank you very much for coming along. Ian, we saw you before the Government had given its reply to the Ombudsman's Report on Equitable Life and you said very readily that you would want to come back and talk to us after the reply had been done, which has now happened and that is why we are having the session with you now; so thank you very much for doing that. Do you want to say anything else at all just by way of introduction?

Ian Pearson: Very briefly if I may, Chairman, just to make a few opening remarks. Obviously the Government's response to the Ombudsman's Report into the prudential regulation of Equitable Life has, understandably, generated a great deal of interest and I think a key aspect of our response has generated significant interest surrounding the Government's decision not to accept certain of the Ombudsman's findings. The Ombudsman herself talked about this at your previous hearing and at your invitation has supplied the Committee with further details about why she considers the Government's response has, in certain respects, misunderstood or misrepresented the findings she made in her report, and I am sorry she considers that to be the case. The Government will carefully consider the Ombudsman's memorandum and, if it would assist the Committee, we will supply our detailed comments on the points she makes in due course. I am sure you will appreciate that in the time available it has not been possible to give the memorandum detailed consideration and I will not therefore attempt today to deal with the technical issues and points of detail raised in the Ombudsman's paper; but I note that the Ombudsman asked Iain Ogilvie during the course of the previous hearing to give some details and two examples where she thought that there had been misrepresentation; so I thought it appropriate to bring along Stephen Parker to address some of those issues. For the avoidance of doubt let me repeat what I have said previously, and put on record that the Government has great respect for the Office of the Parliamentary Ombudsman and the Ombudsman has made a thorough and extensive consideration of all the issues involved. The fact that we have not accepted some of her findings should not in any way be taken as a criticism of her investigation; nor, let me be clear, does it represent an attempt, as some have suggested, by the Government to limit the number of classes of policy holders who may be eligible for *ex gratia* payments under the scheme that we establish. We have departed from the Ombudsman's findings only where we believe we have cogent reasons for doing so, applying the legal principles established in the *Bradley* case, which we discussed when I previously appeared before you. I think we would rightly be criticised if we accepted findings that we did not think that we should, and we have sought to comply at all times with the scheme of the 1967 Act as interpreted by the Court of Appeal. Let me very briefly say something about the other area of great interest, which has been how Sir John Chadwick will carry out his work and what form an *ex gratia* scheme will take when he has provided his advice to the Government. A lot of the questions that naturally arise can only be answered after Sir John has completed his work and has provided his advice, but we understand and acknowledge the intense public interest in this area. You will appreciate that I cannot second guess the outcome of key elements of his work today; I cannot predict at this stage how much those who have suffered a disproportionate impact might be paid, but within the constraints I am very happy to assist the Committee in any way that I can today.

Q97 Chairman: Thank you very much for that. I am interested that you say the Government is going to produce further cogent reasons beyond the cogent reasons that it says that it has offered already on these areas of dispute.

Ian Pearson: What I did say was that as a government we would respond, if the Committee felt it was appropriate, to the further memorandum that had been issued by the Office of the Ombudsman. I do believe that we have provided cogent reasons in our Command Paper as to each and every finding of injustice and maladministration where they occurred; but we are happy, if the Ombudsman suggests that there have been areas where there has been misunderstanding, to provide further information to the Committee but only if you wish.

Q98 Chairman: We have had the Ombudsman telling us this but we also had the Chief Executive of Equitable Life itself telling us that it thought that the grounds given by the Government were really too thin to make sense of it in some respect.
Ian Pearson: They would say that, would they not? I understand that they have an interest in this and would no doubt come to the views that they have. We are very happy as a government to defend our position, to defend the Command Paper that we have issued. We believe that it is a strong response to the Ombudsman's recommendations and we have accepted her recommendations where, in our view, those recommendations are appropriate; but where we have had cogent reasons for not accepting them I do not think that anybody would suggest that we should be agreeing to something when we profoundly thought that it was not right and there were reasons to depart from it.

Q99 Chairman: That leads me to the question that I have because, as you say, we are not going into the details of these because we do not have time now, but the Ombudsman has said that she thinks—and I quote her latest memorandum to us—"That the Government has in certain respects misunderstood or misrepresented the findings I had made in that report." So there are clearly issues at stake here which will be dealt with in detail, that is why I am interested in what you said about giving further reasons. But here we have a situation where, in some respects, you have the Government at issue with the Ombudsman on whether those reasons that are the grounds for dispute are cogent or not, and you invented Sir John Chadwick, the man who knows about cogent reasons, because he was the judge in the *Bradley* Case, who announced the doctrine of cogent reasons. So what I am quite puzzled by is why not have him as umpire; why not ask him, as he is going to do all the work, to decide whether these reasons are cogent or not? Instead of that, what you have said to him—and it is a curious brief for a judge—is, "We are going to tell you which evidence you can look at."
Ian Pearson: Let me be clear, we have not invented Sir John Chadwick and we have all along been at great pains to consider thoroughly each and every finding of the Ombudsman and to make an assessment about the extent to which we agree with it, and where we thought we had cogent reasons for disagreeing with the Ombudsman we have done so. When it comes to appointing Sir John Chadwick to conduct the work and the remit that is detailed in the Command Paper, I want to be very clear that we are not asking Sir John Chadwick for legal advice; what we have asked him to do is a piece of work for us that would provide an independent and objective assessment according to the remit that the Committee seeks.

Q100 Chairman: But he is a distinguished former judge and he knows the territory—
Ian Pearson: Absolutely.

Q101 Chairman: . . . and therefore is extremely expert on all this and will become more expert on it. If he, going through the whole stuff again, were to conclude that on some of these crucial areas he thought that the Ombudsman's argument was better than the Government's he would not, under his terms of reference, be able to say that, would he?
Ian Pearson: It is not in Sir John's remit to provide legal advice or commentary on this; he has a very clear remit. I really do think, Chairman, with all respect, that while there are points of detail where the Ombudsman suggests that we have misunderstood or misinterpreted what she has said that people need to realise the Government has made a considered decision and that considered decision is reflected in our response to the Ombudsman's Report. The priority for me now, frankly, is to get on with this and to focus on implementation; to make sure that Sir John Chadwick gets the resources he needs to do the work that he needs to do, and at the same time to make sure that the Treasury in parallel does work deciding a scheme so that *ex gratia* payments can be made. So I really do think that at some time we need to draw the line here and say, "Let us get on with this and let us implement a scheme."

Q102 Mr Walker: I have two questions. First of all, did you take advice before appointing Sir John Chadwick because the Guide to Judicial Conduct, March 2008, says—and I will be very brief—"The conditions of appointment to judicial office provide that judges accept appointment on the understanding that following the termination of their appointment they will not return to private practice as a barrister or a solicitor and will not provide services, on whatever basis, as an advocate in any court or tribunal in England and Wales or elsewhere, including any international court or tribunal, in return for remuneration of any kind, or offer or provide legal advice to any person." You have a former judge, who will by many still be regarded as being heavily involved in the legal field, involved in what could end up being a legal matter if complainants decide to take it further and go to court on this matter. Do you think that could be jeopardising the Government's position?
Ian Pearson: What we did is follow the usual channels when it comes to the appointment of Sir John. The usual channels in this case are not the Whips' Offices but the Ministry of Justice and the Lord Chief Justice. We are not aware at all of any irregularity in the appointment or any reason at all why Sir John cannot very satisfactorily perform the

remit that we have asked him to do, which is to provide independent and objective advice—but not to provide legal advice.

Q103 Mr Walker: But if this goes to court, as it might well do, you will have a judge giving opinion—
Ian Pearson: I do not want to speculate about what will happen if this goes to court.

Q104 Mr Walker: But you should speculate, Minister—you should speculate—because this may go to court—
Ian Pearson: You can if you want to, but I am not going to.
Mr Walker: This may go to court and you have appointed a judge to conduct the review. Did you take legal advice from your solicitors before making this appointment because you may well find that you are in breach of the Judicial Code of Conduct and that could bring this whole thing into question? Mr Parker, you are a solicitor.

Q105 Chairman: Mr Parker, you help us with this.
Mr Parker: Yes, we did advise that it was okay. As the Minister said, we went through the usual channels, through the Ministry of Justice and the Lord Chief Justice's Office. The Government is aware of no irregularity in Sir John's appointment and will be responding to the letter from Messrs Bindmans in due course.

Q106 Mr Walker: So you will be publishing the advice that you received for all of us to look at, just to make sure we are comfortable that you followed the right procedures in doing this? You will publish the advice you receive?
Ian Pearson: It is not our practice as a government to publish details of particular advice, as you know, Charles—you have been in the House long enough to know this.

Q107 Mr Walker: You will get a Freedom of Information request.
Ian Pearson: I really do think that you ought to consider whether you are advocating the position of Geoffrey Bindman and Solicitors and whether that is an appropriate thing for you to do in this Committee.
Mr Walker: I am operating from the briefing that I have received. We are here to hold the Government to account and that is what we are doing; I am sorry if you two gentlemen have a problem with that, but that is what this Committee does.

Q108 Chairman: Charles was asking you if you considered these matters before you made the appointment; that is all I think he is asking.
Ian Pearson: The answer that we have given is yes and we will obviously reply to the Geoffrey Bindman letter in due course.

Q109 Mr Walker: The very final point is that yesterday we had a group of bankers before another Committee. Regardless of what they have done to this economy many bankers are going to receive billions of pounds worth of bonuses this year—they might not be the usual size of bonuses but they will still receive substantial bonuses largely funded by the taxpayer. Is it not obscene that while these billions are being paid out this year we cannot come up with a billion or two to look after the poor pensioners of Equitable Life who have been failed so miserably by the FSA and others?
Ian Pearson: I am sure that there is more to be said about bonuses and you will all be aware of what the Government has previously said, when we have been very clear that we should not be awarding bonuses for failure. We have, when it comes to Equitable Life and the *ex gratia* payment scheme upon which we have made a decision, not come to conclusions about how much money should be allocated to that scheme. It is simply not possible to do that at this point in time without being able to understand further information in terms of the relative losses. Sir John's work and the actuarial advice that he receives as well will help him to do that. What I can say to you, Charles, is that we do not as a government, as you appreciate, normally provide any redress when it comes to regulatory failure in terms of compensation. We have said in this case that we are prepared to make *ex gratia* payments, recognising the disproportionate impact that the regulatory failure of Equitable Life has had on individuals. That is a big step forward for us as a government and, as I say, I think the key thing now really is to focus on how we implement that decision.

Q110 Julie Morgan: Ian, what do you think is the response of the policy holders to what the Government has said so far?
Ian Pearson: Obviously we have had numbers of representations from EMAG directly and from the individuals about the Government's response. Clearly there are a number of policy holders that believe they should have full compensation for all losses. What we have to do as a government is to try and strike a balance between the interests of the taxpayer and the interests of policy holders that have suffered loss that is directly attributable to maladministration. Again, I think the key point to stress here is that it is important to make a distinction between where loss occurred as a result of regulatory failure and loss and losses can come about as a result of market losses; they can come about as a result of failings in the company management; as well as a result of failure of regulation. Again, this is an area where we need advice from Sir John on this matter. But we think it is right and fair that the taxpayer should only be looking at making *ex gratia* payments where there is loss attributable to maladministration, not where there is loss attributable to the actions of the company or to market conditions.

Q111 Julie Morgan: This Committee recommended that any scheme should be speedy and simple. Do you think that is what you have come up with?

Ian Pearson: Yes, I do believe that there is ability for the scheme that we want to design to make *ex gratia* payments to be speedy. I know that in the Ombudsman's Report she talked about a two, two and a half year period before this could be settled. It will be up to Sir John Chadwick to advise us as soon as he feels able in terms of the factors to be considered and the areas that are in his remit. As Yvette made very clear in the Commons when she made the statement, we do want to get on with this; we do not want there to be any undue delay. As I say, my priority has been to focus on ensuring that we can move forward quickly.

Q112 Julie Morgan: Surely this is the most complicated way of addressing the situation that you could use, because to determine whether people have been disproportionately affected and I do not think we are sure of what that means at all. Surely you are going to have to look at all the individual circumstances and that is something that is going to delay it enormously.
Ian Pearson: We have asked Sir John to advise us on the factors that need to be taken into account when considering disproportionate impact, and again the Chief Secretary indicated what some of those factors might be in the statement and the questions that followed when she made the statement. I do not want to get into the detail of that because that is naturally Sir John's remit, but I do think that we need to try and take swift action and if there are ways in which we can do this I am sure that Sir John will be advising us in this matter. Again, to get back to a basic point here, there does need to be some distinction made between losses that are attributable to maladministration as opposed to losses that are attributable to failings in company management or market losses as well. So there is inevitably some complexity in this.

Q113 Mr Burrowes: But that very distinction was made by the Ombudsman who focused on the maladministration of the regulatory authorities and not the Society. So if you in your *ex gratia* payments are recognising that it should be focused on those failings of the regulatory bodies, why do you not follow through with the Ombudsman's Report which has made those very recommendations due to those failings?
Ian Pearson: As I outlined earlier, we have accepted a significant number of the Ombudsman's findings when it comes to maladministration. The Ombudsman can speak for herself but my understanding of her position is that she recognises that not all the losses by Equitable policy holders were attributable to maladministration—some were attributable to other circumstances. I do not think that you would expect the UK taxpayer to pay out for a maladministration on losses that were not as a result of maladministration.

Q114 Mr Burrowes: I am not asking that; I am asking about the Ombudsman's Report which concerned maladministration of those regulatory authorities, and do you accept the principle that compensation should follow from a finding of maladministration which is focused on regulatory failures?
Ian Pearson: We do not accept the general principle that the taxpayer should underwrite regulatory failure; that has not been normal practice of successive governments. There has been a scheme with regard to Barlow Clowes but there cannot be a taxpayer guarantee for every example of regulatory failure.

Q115 Mr Burrowes: Is it normal not to accept findings of not just regulatory failure but regulatory maladministration and not to compensate following those failures? Is it normal of a government not to accept, through Parliament, the Ombudsman's findings of regulatory maladministration?***Ian Pearson:*** In the vast majority of cases, government will accept the findings of the Parliamentary Ombudsman, but you would expect—and I think the general public would expect—that when it comes to complicated areas where there are detailed findings and where we as a government take issue with some of them because we have good reason to do so, then it would not be fair on the taxpayer to say, "We will agree with the Ombudsman" even if we do not think the Ombudsman is right in this case, and we have good reasons for believing that the Ombudsman is not right.

Q116 Mr Burrowes: Aside from the complications, did cost have anything to do with rejecting some of the Ombudsman's findings?
Ian Pearson: No.

Q117 Mr Burrowes: When you made your assessment that the *ex gratia* payments should be based on disproportionate impact, did you make any assessment of the costs?
Ian Pearson: When we came to conclude our policy stance on this—and, as I say, we considered very thoroughly all the findings of the Ombudsman's Report—cost was not an issue when we were deciding whether we agreed with the findings of the Parliamentary Ombudsman's Report or not.

Q118 Mr Burrowes: Your response to go down the disproportionate impact focus of *ex gratia* payments, did cost have an influence on that decision?
Ian Pearson: Let me explain how we came to this. Our starting principle is that we do not believe that the Government should automatically compensate for regulatory failure and, as I have said, it has been the practice of successive governments that that is not something that we do—you cannot have a taxpayer underwritten guarantee. What we did believe when we looked at the Equitable Life situation was that we recognised that there are some people who have suffered as a result of the regulatory failure that is documented in the Ombudsman's Report and we thought it right to help those that were hardest hit; that is why we came to the view that the best way by which we could determine that is by

looking at those who were disproportionately impacted, and that is why we announced the scheme in the way that we have.

Q119 Mr Burrowes: In that assessment of those who suffered most, in percentage terms who would that involve of the Equitable Life policy holders who have suffered most?
Ian Pearson: We do not actually have that information, David, and that is one of the problems in all this area in the sense that the data that will be required, as the Ombudsman again I think admitted in her report, has not been available. That is again the reason why we need Sir John Chadwick to carry out his work.

Q120 Mr Burrowes: So where are the cogent reasons for going down that line to disproportionate impact if you do not have the data now? How can that be a cogent reason for rejecting the Ombudsman's findings and recommendations on compensation?
Ian Pearson: We have explained all the way through the Command Paper on each and every finding—and I am sure you have read the report—the reasoning behind why we either accept or reject the findings—

Q121 Mr Burrowes: You do not have the data.
Ian Pearson: . . . of maladministration or injustice. What you are talking about is something different.

Q122 Mr Burrowes: No. You have rejected, by implication, the Ombudsman's recommendations.
Ian Pearson: Neither we nor the Ombudsman has the full data here and cogent reasons apply to the findings of the Ombudsman—they do not apply to the data itself. As I say, what we need to do now is to determine, after having received Sir John's advice, those policy holders who have been disproportionately impacted.

Q123 Chairman: In terms of what you have just said there—and the Ombudsman has said this to us and it is a good question—if this doctrine that you are now announcing, which is that the Government never compensates for regulatory failure, had been said to the Ombudsman back in 2004 when she was discussing with the Treasury about whether a further investigation should be done, many arguments were put by the Treasury to the Ombudsman as to whether any investigation was worthwhile doing or not. But what was not put was this doctrine that "we never compensate for regulatory failure" because, as she said to us, "If this had been told to me in those terms I might never have done the investigation or at least Parliament could have discussed this doctrine."
Ian Pearson: I tried to check some of the history of this and certainly there is evidence that the Government's views on compensation were made known to the Ombudsman in 2007 and certainly in 2008.

Q124 Chairman: Yes, but that is when the investigation has been running for several years.
Ian Pearson: Can I just say, with respect to people, ever since Barlow Clowes, the views of government have been pretty clear about their normal practice when it comes to the issue of regulation and whether compensation should be paid or not. I do not think that any government would want to say that there would be an automatic right for compensation in the case of regulatory failure. No government previously has done that and it has not been the practice of this one either, and that has been pretty well known.

Q125 Kelvin Hopkins: On this point about compensation or not compensation for regulatory failure, should there not be a clear distinction between errors of judgment where regulators do what they think is right and it turns out to be wrong, and culpable errors where regulators neglect their duties—I have suggested go off to play golf—look the other way and fail to understand their powers, as we have been told has happened in this case? There is a clear distinction between doing their best and getting it wrong and clearly not doing their best and getting it very badly wrong, as happened in this case.
Ian Pearson: I agree that that is a clear distinction, yes. The issue then is what conclusions you draw from it in policy terms.

Q126 Kelvin Hopkins: The Government keeps on using this general statement that the Government will not guarantee to compensate in cases of regulatory failure, but there are these clear categories of regulatory failure: one which is nobody's fault really, they might not be as skilled as they might be but they have done their best; and then clearly people who have just not done the job. I said it at our previous meeting, that in an era where government has been engendering and driving forward a spirit of deregulation and at best light touch regulation some of these people can say, "The Government is not that bothered, let us play golf in any case."
Ian Pearson: There is part of the point that you are making with regard to negligence and maybe Stephen wants to say something about that because it does touch on legal issues.
Mr Parker: The first point is that there other forms of accountability besides compensation for maladministration and defective regulation than mere process. And going back to the point about the Ombudsman's jurisdiction that the Ombudsman has actually undertaken the investigation and established, and the Government has agreed, that there was maladministration leading to injustice in the case of some of her findings, is a form of accountability from which lessons can be learned from in the future. In terms of the legal position, the Committee may be aware that the Law Commission at the moment is considering the extent to which government bodies and other public bodies should be liable for negligence, but the basic position at the moment is that they are not liable for a number of public policy reasons, including the fact that such accountability would lead to very defensive regulation, which would not be in the public interest;

and also issues about diversion of scarce public resources. The Law Commission is consulting on various ways in which the law could be moved forward; and I think the Law Commission is suggesting an approach which is based upon a higher standard of negligence akin to the test which the European Court has established and applies in the case of defective implementation of community law.
Chairman: I do not want to go too wide on this at the moment.

Q127 Mr Liddell-Grainger: Paul Flynn asked you on 9 December about compensation and you said, "I do not wish to comment on it at this stage". Somebody, Ian, is going to have to start making decisions on this, are they not?
Ian Pearson: We have made a decision and we announced in our statement that we made earlier this year that we were going to set up an *ex gratia* payment scheme and we have asked Sir John to advise us on the factors that need to be taken into account, as has been made clear. What I am trying to suggest to you, Ian, is that we have made a decision and what we need to do now is to implement this decision rather than continually revisit it.

Q128 Mr Liddell-Grainger: One of the other parts he mentioned was what are the figures? You still do not know how many people are affected. Is it going to be means tested?
Ian Pearson: Certainly our preferred option is for there not to be a means test. I want to be clear that we are not asking Sir John Chadwick to advise us on whether or not there should be a means test. What we have in mind—and we have discussed this with Sir John—is that as part of his wider role in assessing the extent of losses suffered by different groups of Equitable policy holders we believe that we will inevitably form views on the different ways in which different policy holder classes were affected in different ways. So we did not seek Sir John's advice on the factors as significantly adding to his significant workload, but we think he would be best placed to let us have his views on the extent of the impact on policy holders from the independent perspective. It is not our preferred option to consider means testing, but we need to really consider Sir John's advice; then we need to consider issues of the public purse because we are talking about taxpayers' money here. But we hope that Sir John will be able to give us advice and that it will not be necessary to undertake means testing.

Q129 Mr Liddell-Grainger: What you have just said is a highly complicated scheme. Sir John is not an expert in that field—none of us are. You are looking at possibly means testing parts of policy holders—who have been most affected. Surely you have to bring more into this than just to say that this is going to work or it is not going to work here.
Ian Pearson: You have just said we were talking about a means tested regime and what I said to you was that that is not our preferred option and that is not what we want to do and it is not what we have asked Sir John to do.
Chairman: But when the Chief Secretary made her statement to the House she did explicitly refer to taking account of what she called the wider circumstances of policy holders and she went on to talk about those who were basically rich and those who were poor.
Mr Liddell-Grainger: Which is means testing.

Q130 Chairman: And that has led everyone to think, quite naturally, including Equitable Life itself, that they were going to be asked to find out information about the personal circumstances of policy holders; but you are saying now that this is not part of any scheme?
Ian Pearson: What I am saying to you is that it is not part of Sir John's remit to advise us on means testing. As a Treasury, we will consider this as one of the options when it comes to designing the scheme, but our preferred option would be that we do not have to engage in means testing.

Q131 Mr Liddell-Grainger: I am still not clear; I am sorry.
Ian Pearson: What is unclear about that then, Ian?

Q132 Mr Liddell-Grainger: I will tell you exactly what is unclear about this. In the House of Commons then Ruth Kelly said, "This is what we are going to do," and you have now said, "We are not going to have a remit on this; we might look at it but we are not actually going to do that."
Ian Pearson: It was not Ruth Kelly; it was her predecessor.

Q133 Mr Liddell-Grainger: And now you are saying, "Maybe we are not going to go down this route." Why do you not give him the remit to look at it? Why not just bypass all this and say, "Look, just have a look at this and see what you think"?
Ian Pearson: I think it is rightly the job of government to decide how much money to allocate to any *ex gratia* payment scheme, and it is also the judgment that governments need to make in terms of whether that should be means tested in the future. We need to be clear about what is the role of government and what is the role we are asking Sir John to perform and we are very clear that Sir John's remit is to advise us in terms of disproportionate impact and the other elements of his remit that have been published and are available.

Q134 Mr Liddell-Grainger: Given what the Ombudsman has said about this whole situation I do not have a lot of faith in this; I am sorry. The Ombudsman has been very clear about what has gone on in the past and where we have got to.
Ian Pearson: You can say that, Ian, and I know we have been criticised for the length of time it has taken for a decision to be taken, but I would hope that at least you would want to welcome the fact that we have taken a decision; we have appointed a very eminent judge to advise on the factors that need to be taken into consideration when determining

disproportionate impact. We are working in parallel to look at options and to design a scheme; so we are moving forward.
Chairman: We are trying to understand what it is that you have announced.
Mr Liddell-Grainger: Exactly.

Q135 Chairman: I say that quite seriously, Ian. Let me put this gently: I am not sure that the Government quite knows what it has announced—
Ian Pearson: I am very clear what we have announced. What we cannot announce, Tony, is how much policy holders are going to get because we simply do not have that information. What we do not know is what differential losses policy holders have suffered as a result of maladministration as opposed to other factors, so what we have announced is a process where we can get advice from Sir John in terms of the factors that we need to take into account. But we have clearly announced the fact that we have made a decision that we are going to have an *ex gratia* payment scheme, and we have announced that as a government we are going to get on with it, and I think that really is a step forward given the previous period.

Q136 Chairman: The Command Paper that you issued says: "The Government recognises that there has been maladministration and the representations it has received suggest that there has been a disproportionate impact on some Equitable Life policy holders." This is where the doctrine of disproportionate impact emerged. So the Government presumably knows—otherwise it would not have said this—that there has been a disproportionate impact on some policy holders. So we would ask which policy holders has it had a disproportionate impact on, otherwise you would not have made that statement, would you?
Ian Pearson: We have had sufficient representations for the Government to come to a view that we think there have been losses and that some policy holders have suffered a disproportionate impact, but I do not think it would be right for me today to prejudge Sir John's work because Sir John is going to advise us on those factors, having had a thorough examination of all the circumstances.

Q137 Mr Liddell-Grainger: But he is not; he is not being appointed to do that. You said that that is not part of his remit on the means testing.
Ian Pearson: He is not advising us on means testing.

Q138 Mr Liddell-Grainger: He should, should he not?
Ian Pearson: He is advising us on the factors that need to be taken into account. If you read the terms of reference I think they are very clear.

Q139 Mr Liddell-Grainger: I think Charles is saying exactly the right thing; we are still not getting to the bottom of this because who is going to make the decisions, who is actually going to look at means testing? The Government has been found wanting in this—we will not go back over history—and surely it should get somebody else to look at this?
Ian Pearson: The Government overall makes the final decisions on the detail of the scheme and that is absolutely right—we are talking about taxpayers' money here and we should never forget that. We have said that we have taken a decision in terms of wanting to introduce an *ex gratia* payment scheme. We have asked for advice from Sir John, particularly on disproportionate impact as I have outlined the way that his remit has been set, and we are looking at designing an *ex gratia* payment scheme. But it has to be government that takes the final decisions in this area, and we need to balance interests and to do what we think is right and fair to the taxpayer as well as right and fair to policy holders who have suffered a disproportionate impact.

Q140 Chairman: You have said you are not going to compensate everybody and we know that—that is clear, you are not going to compensate everybody—
Ian Pearson: I would be very surprised if Sir John came back to us and said that everybody had suffered a disproportionate impact.

Q141 Chairman: It would have been possible to compensate everybody who had suffered a loss, a loss arising from regulatory failure as demonstrated by the Ombudsman—that would have been a proposition, but that proposition you have rejected and you are not going to do that; you are going to compensate some people on an *ex gratia* basis and those people are in this category of disproportionate impact. What I am trying to find out is, given all that, whether you know, whether the Treasury knows what that category is because we have had difficulty in identifying this as we have been going along.
Ian Pearson: If we knew the answer we would not ask Sir John to do the work.

Q142 Chairman: No, but you have said that there is a category and presumably you have had enough evidence to suggest that there is a category otherwise you would not have announced it.
Ian Pearson: What we have said is that there are a number of factors that need to be taken into account when discussing whether disproportionate impact might have occurred and we need Sir John to look at those and to advise us.

Q143 Chairman: He might say that you have crafted your reply and selected what to accept and what to reject in the Ombudsman's findings to make sure that 90% of policy holders are excluded and therefore the coverage of any scheme is going to be necessarily limited.
Ian Pearson: With respect to EMAG, I do not agree with that and I do not recognise the 90% figure. I would be very interested if you had any views on where that came from. What we have done is taken each finding in turn and subjected it to a thorough analysis. If you look at some of the details of this you will look at, for instance, the fact that in finding 4, there were two cases of injustice that were recognised

and accepted by the Government; that one of the key findings of injustice was to do with the Reinsurance Treaty, and I know that EMAG members feel very strongly that that was one of the major contributors to losses. That finding of injustice has been accepted by the Government.

Q144 David Heyes: You mentioned in reply to Ian's question earlier that Sir John's workload would be "significant"—and that was the word you used.
Ian Pearson: Yes.

Q145 David Heyes: Does that mean you have quantified it? Have you put a timescale on it? Is there a budget for it?
Ian Pearson: I was talking to Sir John yesterday about his role and obviously he is reading into his brief at the moment and, as we are all aware, there is a substantial amount to read when it comes to these matters. I am looking to push ahead in terms of making sure that he has all the support that he needs. He was telling me that he will be looking to produce a work plan and he expects that interim reports would give a likely view on timescales; but until he has actually read into his brief and can produce a work plan then I do not think it is possible to give indications on the likely timescale in terms of the question you were asking.

Q146 David Heyes: In the conversation that you had with Sir John yesterday—he is the expert on cogent reasons, he invented it—did that topic come up as part of your conversation?
Ian Pearson: We were both clear that we are not asking Sir John as part of his remit to offer us legal advice.

Q147 David Heyes: Did it come up in your conversation?
Ian Pearson: We both agreed that his remit was not to offer legal advice and it certainly is not to arbitrate between the Ombudsman and the Government where we have departed from the Ombudsman's findings.

Q148 David Heyes: Let me try again. It is hard to imagine that the country's top expert on cogent reasons, which is absolutely at the heart of what he is being asked to look at and is very constrained by the brief you have given him, that that did not feature in conversation with him at all. Are you saying that it did not feature at all in your conversation with him?
Ian Pearson: I think you are missing the point here, David.

Q149 David Heyes: I do not think so!
Ian Pearson: Because in my experience of dealing with lawyers they are very clear about what their brief is and what their brief is not, and we have been very clear in terms of our terms of reference with Sir John, which we have published. At the risk of repeating myself again, we have been very clear that we are not asking Sir John for legal advice.

Q150 David Heyes: It is almost going to become rude if I keep pressing the question—you still have not answered it. Did the issue of cogent reasons feature at all in the conversation that you had with Sir John yesterday?
Ian Pearson: Cogent reasons no. I think the conversation probably went something like, "Yes, John, we are quite clear that you are not offering us legal advice" and he says, "Yes, that is certainly my view."

Q151 Mr Walker: Then why do you appoint a judge? If you do not want legal advice why appoint a judge? What was unique about him?
Ian Pearson: We believe that we need independent advice and I think Sir John will be an excellent person to give us independent, impartial objective advice and to give these complex questions that we are asking him in terms of his remit a forensic examination. So I have every confidence that he will be able to fulfil his remit in an efficient and excellent manner. It could have been somebody who was not a judge but I think that the independence that comes with appointing a member of the judiciary is something that I would expect the Committee to welcome.

Q152 David Heyes: Can we take it, then, that Sir John, from your conversation yesterday, is entirely comfortable with the brief that you have given him?
Ian Pearson: Yes, Sir John is happy with the brief.

Q153 David Heyes: He did not question it or challenge it in any way?
Ian Pearson: No, he is happy with the brief. He was very clear to me that he is going to be his own man and completely independent and objective and I would expect nothing less—that is exactly what we want to see.

Q154 Chairman: One of our witnesses said that it would give a "judicial veneer" to the exercise and I know from conversations we had some years ago with Chief Justice Woolf at that time that he is very concerned about judges—and I suspect retired judges too—being used to give judicial veneers to administrative exercises.
Ian Pearson: I think that is an uncharitable and unworthy comment to suggest that for somebody to be honest—
Mr Walker: That is not a good enough response, Minister; it is in the Code of Conduct. It is not uncharitable; it is in the legal Code of Conduct about how judges and former judges should behave.

Q155 Chairman: I am not in any way being disparaging; I am sure he is absolutely excellently qualified in all kinds of ways, but there is that issue which has been raised not just by me but by distinguished judges in the past.
Ian Pearson: Firstly, Charles, I think you are being pathetic and I think we could do with a little bit less of the schoolboy behaviour and more of looking at this seriously.

Q156 Mr Walker: Minister, you are a Minister of the Crown and you are really—
Ian Pearson: And you are a Member of Parliament and you ought to act like one.

Q157 Mr Walker: . . . diminishing your position right now.
Ian Pearson: You are diminishing your role as a Member of Parliament.
Mr Walker: And you are coming out of this far worse than I am.
Chairman: Order! Could I say to both of you that we have limited time—at most we have about seven minutes left and we do not want to waste it on this kind of stuff.

Q158 Paul Rowen: How many staff do you propose that Sir John will have working with him?
Ian Pearson: Sir John has an assistant at the moment who is working with him and reading through papers at the same time. We are discussing with him what resources he will need. He will obviously need actuarial support but we want to make sure that he has an office and the support is sufficient to enable him to do the job in a speedy and effective manner.

Q159 Paul Rowen: Presumably to arrive at a definition of disproportionate every one of the policy holders of actual policies is going to have to be looked at. If you have not already decided what is disproportionate how do you envisage that process to operate?
Ian Pearson: I do not think it is necessarily the case that you would have to look at each individual policy holder's circumstances; I think it is probably possible that you can look at classes of policy holders, but that is going to be a matter for Sir John to decide how he wants to approach this.

Q160 Paul Rowen: How can you do that if you cannot tell us what is disproportionate? How, without having a proper review of every policy holder's case, can you arrive at a decision, unless your disproportionate has already been decided and it is not a definition that anybody else can sign up to?
Ian Pearson: Sir John believes that the remit that we have given him is clear and that he can perform the role that is required of him within that remit. He is going to advise us on the factors that need to be taken into consideration when considering disproportionate impact.

Q161 Paul Rowen: How can he determine those factors without looking at the cases, unless you have already determined what will be pertinent and what will be allowed or not?
Ian Pearson: As I suggested, Paul, he may well decide that he wants to consider classes of policy holders rather than each and every individual case and I think a number of people have suggested that that might be a sensible way forward—

Q162 Paul Rowen: How many classes would you envisage for doing that?
Ian Pearson: . . . but it will be a matter for him to decide that. As I say, I do not want to prejudge what Sir John is going to do and how he is going to do it; I think these are matters that are rightly left to him.

Q163 Chairman: How long has he been employed for?
Ian Pearson: We have not put a timescale, as you know, on Sir John's appointment. We do not want this to be a "Bloody Sunday" inquiry; Sir John does not want it to be either. He wants to get on with the job and we are keen for him to do that and we want him to be able to advise us as soon as he feels able to do so.

Q164 Chairman: Are you paying him on a daily basis or are you paying him for the whole job?
Ian Pearson: I am not sure of the detail of the remuneration.

Q165 Chairman: I bet he is!
Ian Pearson: I am told that he is paid on a fees basis.
Mr Parker: It is standard rate, so it is for the whole exercise; he is paid on—I do not know whether it is daily or hourly off the top of my head.

Q166 Chairman: It is going to run up to quite a figure, is it not?
Ian Pearson: We will have to see what the final figure is. What I would want to say to the Committee, however, is that we believe it is the right approach to have this independent and objective advice and if it is going to cost some money to do that then I think that is needed.

Q167 Paul Flynn: Do you think a retired judge would attract more public trust than, say, a retired banker, a retired estate agent or a retired MP?
Ian Pearson: It is a good point. Sir John is a person of enormous experience and integrity and I think that people can feel confident that he will approach his task in an independent and objective manner and I think that that is one of the factors that we wanted to take into consideration when we were deciding who to appoint. I tend to agree with you that certainly at the moment a retired banker would not be high on the list of people's choices for doing this sort of work.

Q168 Paul Flynn: I should repeat my own interest in this; I have a financial interest, as do two other members of the Committee. One of the criticisms made by a journalist we invited here, but unfortunately he could not attend, was that the public perception of those who are clients of Equitable Life is that they represented a rich segment of society in general terms. Was this an element in your decision? Would you agree with that; is there any evidence of that; and was it an element of the decision to go for groups of people, one presumes, who are suffering financial hardship now?
Ian Pearson: There may be some public perception that that is the case but certainly from looking in detail at the people who have written to me as a

Minister and as a Member of Parliament there are certainly many people who you would not regard as being rich at all and who have found themselves in very straitened circumstances as a result of having a policy with Equitable Life.

Q169 Paul Flynn: A final, brief one: what effect do you think it will have on regulation in future, with this change of policy that you have announced that the Government will accept that they should compensate in cases of failure of regulation, on the conduct of the regulators? Will they be excessively cautious in future if they know they are going to cost the country, the taxpayer billions of pounds if they take a decision? The case I have in point, there was one point in this where there was a possibility of Equitable Life being bought out or continuing and the regulator allowed them to continue into the market. He might have been right, he might have been wrong, but with hindsight we know that the regulator was wrong. Do you think that the regulation in future would be poorer because they will not be able to take a balanced decision, they will be excessively taking decisions that are cautious?
Ian Pearson: There are two points I want to make in response to that. Firstly, we have been very clear that this is an exceptional case and it is not normal practice for government to provide redress for regulatory failure through a payment scheme—there are other means, as Stephen has outlined already. I suppose the second point I would like to make is the broader point about regulation and to stress the fact that the regulatory regime that is in place now is very different to the regulatory regime that we are talking about when we come to the Ombudsman's Report on a Decade of Regulatory Failure. There were substantial changes that had taken place. That is not to say that there are not further lessons to be learned in terms of strengthening regulation, but we do believe that it is important to recognise the fact that things have moved on substantially in terms of regulation since the period of time that we are talking about.

Q170 Chairman: Thank you for that. Just as we end, can you confirm that Sir John's advice to the Government, even when you find that advice unhelpful, will be published and that the representations the Government makes to Sir John will also be published?
Ian Pearson: Certainly it is our expectation that Sir John's final report will be published. We have said that we want to produce interim updates and we remain committed to doing that. So I hope that that provides you with the assurances that you seek in that matter.

Q171 Chairman: Textual analysis will reveal whether it does or not. Despite the moment of excitement, we have had an enjoyable and interesting session with you and we are grateful to you for coming along; thank you very much.
Ian Pearson: Thank you.
Chairman: Thank you, Mr Parker.

Written evidence

Memorandum from the Parliamentary and Health Service Ombudsman

THE GOVERNMENT'S RESPONSE TO EQUITABLE LIFE: A DECADE OF REGULATORY FAILURE INITIAL OBSERVATIONS

Introduction

1. This Memorandum sets out my initial observations on the Government's response to my July 2008 report, *Equitable Life: a decade of regulatory failure* (HC 815).

2. The Memorandum is not intended to be a detailed critique of, or comprehensive response to, the Government's document *The Prudential Regulation of the Equitable Life Assurance Society: the Government's response to the Report of the Parliamentary Ombudsman's Investigation* (Cm 7538). It focuses instead on the main high-level issues prompted by the Government's response and my initial reaction to those issues.

3. The Memorandum is submitted in advance of my appearance before the Committee on 29 January 2009. At that evidence session, or perhaps subsequently, I would be happy to assist the Committee by providing a more detailed reaction to the content of the Government's response to my report if that would be helpful.

Background—the Government's Response

4. As the Committee knows, the Government provided its response to my report by way of an oral statement to both Houses of Parliament on 15 January 2009. Later that day, the Treasury published the above Command Paper which contained the detailed response of the Government to my report.

5. Ministers told the House that the Government accepted some, but not all, of my findings and apologised to the policyholders of The Equitable Life Assurance Society for the maladministration which the Government accepted had occurred.

6. In the published response, Ministers said that they had given careful consideration to my central recommendation—that the Government should establish and fund an independent, transparent, and speedy compensation scheme which would restore those relative losses sustained by policyholders—but that they had decided not to accept that recommendation.

7. The Government set out what they described as an "*alternative proposal*". This alternative was said to be founded on three factors—the need to take into account:

- the degree of responsibility of the Society when designing a compensation scheme;
- the public purse and the wider public interest; and
- that "*Parliament has accepted that it is not generally appropriate to pay compensation even where there is regulatory failure*".

8. The Command Paper explained that the Government believed that action on their part was warranted and that, in the circumstances of the case in which it was said that some people had suffered "*disproportionate impact*", some ex gratia payments should be made. The Government then set out its decision to ask Sir John Chadwick, a former judge of the Court of Appeal of England and Wales, to advise the Government on four issues.

9. Those issues were:

- first, the extent of relative losses suffered by Equitable Life policyholders;
- secondly, what proportion of those losses could be attributed to the maladministration accepted by the Government and what to the actions of the Society and of other parties;
- thirdly, which classes of policyholder have suffered the greatest impact; and
- finally:

> *. . . what factors arising from this work the Government might wish to take into account when reaching a final view on determining whether disproportionate impact has been suffered. The Government will consider Sir John's advice on the relevant factors before setting the criteria for the payment scheme.*

10. The Command Paper published the Terms of Reference within which Sir John will undertake this work. Sir John was required:

- to accept as correct and consider my findings only in so far as those findings had been accepted by the Government and to disregard findings which had not been accepted;

— to accept as definitive my account of the events as those were recited in the narrative sections of Part 1 of my report and as set out in the detailed chronology of events in Part 3;

— to 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, my report and the Government's response;

— to 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*"; and

— to seek written representations as appropriate from interested parties, but only "*if he deems it necessary*".

11. The Command Paper contains no timetable for the completion of this work, although it is said that Sir John will produce his final advice as soon as he is able to do so and will provide interim reports to the Government on an ongoing basis.

My Initial Observations on the Government's Response

12. It is disappointing that the Government has decided not to accept all my findings and has rejected my central recommendation that it should establish and fund an independent compensation scheme. However, there are certain things about the Government's response that should be welcomed.

13. First, I welcome the fact that, for the first time, the Government has accepted that maladministration occurred in the prudential regulation of the Society during the period covered in my report—and that this maladministration led to injustice to the Society's policyholders.

14. I also welcome the fact that the Government has accepted that at least some people have been adversely affected by such regulatory failure and that action on the part of Government to seek a fair remedy, including financial redress, is warranted. Those are positive developments, if not a fully satisfactory response to my report.

15. It is also a positive development that the response of the Government to my report was not provided immediately and that my findings and recommendations appear to have been given careful consideration, which has not always been the case on previous occasions in recent history. I welcome the measured and respectful tone in which the Government's response to my report was provided to the House.

16. However, the Government's published response raises a number of issues, many of them fundamental, which are of concern to me—and which I believe should also concern the Committee and Parliament more generally. Those issues relate to:

— the rejection of findings of maladministration and injustice;

— the basis on which those rejections were made; and

— the alternative approach taken by the Government to the questions of remedy and redress.

Rejection of findings

17. Once again, the Government has thought fit to reject findings made by the Ombudsman after a lengthy, detailed, complex, and rigorous investigation. This scenario was one considered by the Committee in its report *Justice delayed: The Ombudsman's report on Equitable Life*, published in December 2008:

> *We urge the Government to act without further delay and to accept the Ombudsman's findings of maladministration. She is Parliament's Ombudsman and it is imperative that the Government respects her conclusions. There are valid arguments to be had about the scale of compensation and the way that such cases should be handled in the future, but we would be deeply concerned if the Government chose to act as judge on its own behalf by refusing to accept that maladministration took place. This would undermine the ability to learn lessons from the Equitable Life affair.*

18. The Government has only accepted four instances of injustice resulting from maladministration from the ten findings of maladministration and five findings of injustice that were set out in my report. Even those acceptances have been qualified by commentary within the published response, which appears to limit the basis on which I made the relevant findings.

19. That the Government has, through its response, again sought "*to act as judge on its own behalf*" raises questions about whether it is prepared to accept independent judgments about the actions of Government bodies. It also raises questions about whether citizens can rely on the implementation of independent adjudications of their complaints.

20. Those are serious questions which go to the heart of the effectiveness of the Ombudsman system and the ability of Parliament to hold the Executive to account using the work that we produce.

21. As the Committee itself has said, in another but similar context, the system "*will only work if the Parliamentary Ombudsman, the Government and Parliament share a broad common understanding of what maladministration might be and who should properly identify it*". The Government's response indicates that they do not share such a common understanding.

22. It is a matter of general consensus that Government (with the consent of Parliament) must retain the power to decide what should be done to put matters right, including by way of the provision of remedies, when maladministration leads to injustice.

23. However, it does not seem to me consistent with the intention of Parliament when it established my Office that Government bodies should, before such questions of remedy arise, reject my judgments on maladministration and injustice on the grounds merely that they disagree with those judgments or simply have a different view.

24. Indeed, as the Committee knows, the proper approach to be taken to responses to my reports became the subject of legal proceedings in relation to my report into the role of Government bodies in the security of final salary occupational pension schemes.

25. The Court of Appeal held—with Sir John giving the leading judgment—that, in the words of paragraph 51 of the judgment:

> *The Secretary of State, acting rationally, is entitled to reject a finding of maladministration and prefer his own view. But . . . it is not enough that the Secretary of State has reached his own view on rational grounds: it is necessary that his decision to reject the Ombudsman's findings in favour of his own view is, itself, not irrational having regard to the legislative intention which underlies the 1967 Act. To put the point another way, it is not enough for a Minister who decides to reject the Ombudsman's finding of maladministration simply to assert that he had a choice: he must have a reason for rejecting the finding which the Ombudsman has made after an investigation under the powers conferred by the Act.*

26. The judgment then set out, in paragraph 72, the Court's agreement with the proposition that "*the question is not whether the [Government body itself] considers that there was maladministration, but whether in the circumstances the rejection of the Ombudsman's finding to this effect was based on cogent reasons*".

27. The Committee will doubtless wish to explore not only what the Government's response means in constitutional terms for the Ombudsman system, but also whether that response—and the rejection of my findings in particular—was founded on cogent reasons.

The basis for the rejection of findings

28. This brings me to the basis on which the Government has rejected many of my findings.

29. I have not set out in this Memorandum detailed analysis of each of the responses provided by the Government to each finding of maladministration or to each finding of injustice resulting from maladministration. I would, however, be happy to explore this with the Committee or to provide further written evidence which provides such analysis.

30. However, put as briefly as possible, I would make the following three initial observations about the basis on which the Government has rejected those of my findings it has not accepted:

— *First, the Government's response provides insufficient support for the rejection of those findings.*

For example, the response includes only a very brief statement setting out the Government's view on the regulatory regime which applied at the time relevant to my report.

The standard applied in my report was grounded in a detailed analysis of the historical development of the applicable regime and of the law as it stood at the relevant time (see Chapter 5 of Part 1 and the whole of Part 2). I addressed more limited assertions about the nature of the regulatory regime in Chapter 9 of Part 1 of my report.

The principal basis for the Government's view seems to be such an assertion—that the regime was "*reactive and unintrusive*". Many of the subsequent rejections of my findings appear to be based on this inadequate view as to what the duties and powers of the prudential regulators at the time were.

The Government's response is partial—making, for example, no mention of the EC Directives in which that regime was grounded—and is not evidenced—failing to provide any support for the Government's limited view.

— *Secondly, the Government's response also fails to address the basis on which I came to several of my findings when rejecting those findings.*

On a number of occasions, my findings of maladministration were predicated on failures by the prudential regulators and those acting on their behalf to consider the use of their powers or to take appropriate action.
In rejecting findings of maladministration which are founded on those failures, the Government sets out now—with the benefit of hindsight—its analysis of why certain courses of action would not have been appropriate or were, in its view, not available to the prudential regulators within the limited view of the relevant regime that the Government now asserts.

But that analysis was not done at the time. The Government's approach thus fails to address the basis on which I came to those findings. That the Government is able now to set out its view regarding the courses of action or the use of powers that I found should have been considered in

the 1990s is irrelevant: this does not adequately explain why those courses of action or the use of those powers were *not considered at the time*. The maladministration I found has therefore not been properly addressed.

Equally, on occasion my findings were that injustice in the form of lost opportunities had occurred.

In rejecting findings of injustice in the form of those lost opportunities, the Government merely states that it is not convinced by what it says are my assessments of what might have happened had maladministration not occurred—pointing to other possible outcomes. That is an insufficient basis on which to reject findings of injustice in the form in which I made them.

It is a matter of common ground that what the end result would have been, absent maladministration, is necessarily a matter of some speculation and would be made on the balance of probabilities. In rejecting such findings of injustice, the Government seeks to suggest that its view of what might have happened is preferable to the findings set out in my report. That appears to be a return to an argument that it is permissible for those investigated merely to prefer their own view over an independent judgment of their actions.

Whatever the case may be as to that, the Government's response has provided no basis that reasonably could question the undeniable fact that maladministration led to the *loss of opportunities* that are set out in some detail in Chapter 12 of Part 1 of my report, instead addressing findings—that injustice is predicated only on a particular outcome transpiring—that I have not made. Injustice in the form of the lost opportunities has thus not properly been addressed.

— *Thirdly, the Government's response begs the question as to what the purpose of regulation was supposed to be.*

In particular, when considering findings of injustice resulting from maladministration, the Government appears to suggest that, whatever the regulators had done, it would have made no or little difference to events.

If it were truly the case that the relevant regulators, acting without maladministration and operating the regulatory system as Parliament intended it should be operated, could have made no difference to the events covered in my report, then that would be astonishing.

Indeed, without further support for these assertions and in the absence of consideration of the European dimension to regulation, the basis on which the Government have responded to my findings raises more questions about the responsibilities of regulators than it addresses.

The Government's alternative approach

31. This brings me to the Government's alternative approach, outlined at the beginning of this Memorandum. I understand that a debate in Westminster Hall will be held on the Government's response. Others have called for a full debate on the floor of the House. It is of course Parliament's role and not mine to consider the nature of the proposals for action put forward by the Government in its response and to scrutinise those proposals. However, the Committee might find the following five observations about those proposals helpful.

32. First, I am concerned that no detailed timetable has been set for the work to be done by Sir John Chadwick. Both my report and the Committee's report highlighted the fact that the resolution of the complaints made about the regulation of the Society has been a protracted process, a process vitiated by the failure of Government to establish a comprehensive and fit-for-purpose inquiry at the outset. The Government's response has not addressed this. I recognise that the relevant issues are complex, but it seems to me unfortunate that it has not been felt possible to set any form of timetable for the completion of Sir John's work, let alone for the establishment and operation of any resultant scheme.

33. This brings me to my second point. It is clear that Sir John will act only in an advisory capacity and that final decisions will be taken by Ministers. It also appears that Sir John will only solicit evidence from those directly affected and from other interested parties if he considers that necessary to fulfil his remit. This raises issues of both public confidence in the process and the degree of Parliamentary or other external scrutiny which will take place. These issues should be resolved.

34. Thirdly, even in relation to findings which have been accepted by the Government it is not clear on what basis Sir John will be able to take those into account. Will he act on the findings accepted by the Government as those findings were set out in my report? Or is he only to take those findings into account as they have been re-interpreted or limited by the Government in the commentary provided within its published response? The answer to those questions is likely to have a profound impact on the outcome of his work and on the scope of any compensation to be provided—and should thus be clarified.

35. Fourthly, no definition has been provided of the concept of "*disproportionate impact*" which has been introduced by the Government in its response to my report. Given the centrality of it to the work now to be done, I am surprised that no attempt has been made to give a clearer picture to those affected as to the basis on which Sir John will undertake his work. That should be remedied.

36. Finally, I should comment on the requirement imposed on Sir John that he must assess what proportion of losses could be attributed to the actions of the Society and of other parties. This fails to recognise that I have found *injustice* resulting from *maladministration on the part of the prudential regulators*. There is no basis for suggesting that any such injustice was caused by the actions of anyone other than those regulators and those acting on their behalf. There is thus no basis on which to assign blame for maladministration on the part of a public body to anyone else; a remedy for injustice resulting from maladministration should be forthcoming from those alone who acted with that maladministration.

Next Steps

37. As indicated above, I am happy to provide further evidence and assistance to the Committee on these matters if that would be helpful. We will continue to do what we can to assist those of the Society's current and former policyholders who complained to us, although we now have a limited role and may not be able to help them further. If Sir John would find it helpful, we will also provide what assistance we can to him.

38. As the Committee knows, section 10(3) of the Parliamentary Commissioner Act 1967 provides that if, after conducting an investigation, it appears to me that injustice has been caused in consequence of maladministration and that this injustice has not been, or will not be, remedied, I may, if I think fit, lay before each House of Parliament a special report upon the case.

39. It is clear to me that the nature of the Government's response to my report means that the injustice I have found resulted from maladministration will not in every case be remedied—nor in any case will it be remedied fully.

40. That being so, I am giving consideration as to whether it would be appropriate for me to lay a further report before both Houses of Parliament. I will keep the Committee informed as to my thinking on that.

January 2009

Further memorandum from the Parliamentary and Health Service Ombudsman

Background

1. We gave oral evidence to the Committee on 29 January 2009 concerning the Government's response to my report on the prudential regulation of The Equitable Life Assurance Society. That response was published on 15 January 2009.

2. In that evidence, I expressed the view that the Government, when making its response, had in certain respects misunderstood or misrepresented the findings I had made in that report, which was published in July 2008.

3. We gave two examples of this in our oral evidence. Those related to maladministration associated with the decision by those acting for the prudential regulators to permit the Society to remain open to new business after the decision of the House of Lords in the *Hyman* litigation—and to injustice resulting from the misleading information provided during the post-closure period.

4. During the evidence session, Committee members asked me to provide further examples in advance of their session on 11 February 2009, at which Ian Pearson MP, Financial Secretary to the Treasury, will give evidence on the Government's response to my report.

5. This Memorandum provides such further examples. Those examples relate to times on which the Government's response has:

- addressed findings which I did not make;
- sought to reinterpret and/or limit the basis on which I made certain findings; and
- provided a partial or incomplete response to other findings.

6. I give below three main further examples to illustrate these points, although there are other such examples within the Government's published response to my report.

Findings which I Did Not Make

7. One example—although it is relevant to more than one particular finding—will suffice of a response by the Government which addresses findings which I did not make. This is with respect to those findings of injustice which relate to the unreliability of the regulatory returns produced by the Society in respect of the years from 1990 to 1996, returns published after scrutiny by the Government Actuary's Department (GAD) acting on behalf of the prudential regulators.

8. Throughout the Government's response to my findings in relation to the scrutiny by GAD of those returns, it is asserted that my findings of injustice consequent on those of maladministration can be rejected now because the relevant maladministration, in the Government's view expressed some years later, would not "*have resulted in any changes to the contents of Equitable Life's regulatory returns in the relevant years*". [See, for example, paragraphs 4.35, 4.39, 4.43, 4.46, and 4.99 of the Government's response].

9. Leaving aside the fact that no sufficient evidence is provided for such assertions, such a rejection does not address the basis on which my findings of injustice resulting from maladministration in the scrutiny of the contents of the relevant returns were made.

10. The consequences of the various failures of GAD in respect of their scrutiny of the Society's regulatory returns during the relevant period were that those returns, as published following such scrutiny, were *unreliable*. In that context, I found injustice in the form of *lost opportunities* on the part of existing and potential policyholders to make informed decisions about important financial matters.

11. The Government's response has not addressed the issue of those lost opportunities, nor has it explained how—even if the doubts expressed in my report can much later be proved groundless—a finding that the relevant regulatory returns were not reliable can be rejected.

12. By focusing on whether those returns would necessarily have been different, the Government has failed to address the basis—a lost opportunity—on which I criticised those responsible for the scrutiny of those returns.

13. Other examples of this type include:

— the assertion (in paragraph 4.70 of the Government's response) that my conclusions in respect of the way in which GAD handled the intimation within the Society's returns for 1993 of the introduction of its new differential terminal bonus policy were predicated on a view that proper action by GAD "*would have led to any change in policy*" by the Society. In fact, my finding was that the failure by GAD to address that introduction led to lost opportunities on the part of the regulators and the Society to discuss the issues which had led to that introduction and to consider whether policyholders needed to be informed of it; and

— the assertion that I made findings that the Society had failed to hold certain reserves (see paragraphs 4.85 and 4.90 of the Government's response). In fact, I addressed the question as to whether those scrutinising the relevant regulatory returns submitted by the Society had done enough to verify the financial position of the Society in those respects. I made no—and could not have made any—findings as to the actions of the Society.

The Reinterpretation or Limitation of my Findings

14. One example will suffice of a response by the Government to my findings which sought to reinterpret or limit the basis on which I made those findings. This relates to my finding concerning financial reinsurance (see paragraphs 4.135 to 4.140 of the Government response).

15. The Government in this section of its response claims that I "*found that, had credit for the reinsurance treaty not been permitted, Equitable Life would have been unlikely to have declared a bonus in 1999 and earlier closure to new business would have followed*".

16. The response then goes on to explain the Government's view as to what else might have transpired in the absence of the maladministration as regards the handling by the regulators of this reinsurance arrangement that it has accepted took place.

17. From this interpretation of my finding, it is suggested—although this is an example of commentary which has an unclear status as regards the work of Sir John Chadwick—that the damage to the resultant published financial position of the Society might have been limited.

18. This is an attempt to reinterpret what I found and to limit the necessary consequences of that finding. I did not find that earlier closure to new business in formal terms would necessarily have followed proper action by the prudential regulators in relation to the credit that they permitted the Society to take for the reinsurance arrangement within the relevant regulatory returns.

19. What I found was that, absent maladministration, the true and published solvency position of the Society would have deterred potential investors from placing money with the Society, would have led to those considering converting their policy into an annuity to understand the true risks of such a course of action, and would have led to those not required to make further contributions to existing policies reconsidering the benefits of doing so.

20. Nor did I fail to address in my report the options said to be available to the Society and which are now put forward by the Government in its response as a potential means of limiting the direct consequences of the maladministration regarding the credit which the regulators permitted the Society to take and which hid the company's true financial position. Those options and (the lack of) their viability were addressed in paragraphs 122 to 147 of Chapter 12 of my report.

21. It is clear from the detailed chronology of events in Part 3 of my report that those options were not seen by the regulators at the time as being viable. I also addressed later submissions, now echoed in the Government's response, within Chapter 10 of my report.

22. Given the extensive treatment of those questions within my report, not now addressed in any form by the Government in its response to that report, there is no basis on which such considerations can now be used to limit the consequences of the relevant finding.

23. Other examples of this type include those given to the Committee in oral evidence on 29 January 2009.

Partial or Incomplete Responses

24. One example will suffice of a response by the Government to my findings which are partial or incomplete. This is in respect of my first finding of maladministration, which relates to the "dual role"—the holding simultaneously by one person for more than six years of the posts of Chief Executive and Appointed Actuary within the Society. This, of course, is the only finding of maladministration I made in my report which the Government has rejected in full.

25. In relation to the dual role (see Chapter 11: paragraphs 12–27), I found maladministration on the part of the prudential regulators in the form of failures by those regulators:

— to insist, when approving the appointment of a new Chief Executive, that he should demit office as the Society's Appointed Actuary; and

— during the subsequent period to consider the use of their powers to seek to remove that person from such a "dual role".

26. The Government rejected that finding of maladministration in sections 4.5 to 4.26 of its published response. The basis of that rejection was the assessment provided in 2009 by the Government as to whether the various options which might have been open to the prudential regulators were in fact open to those regulators—or as to whether such options, if considered and exercised, might have been successful.

27. The Government's response fails to address the whole of the finding that I made. It is irrelevant that, when addressing a finding that one public body failed to consider the use of its powers at a given moment, another public body is able, many years later, to give such consideration—and to provide its view as to what the outcome of any such consideration might have been had it been given many years previously.

28. The Government's response has failed to explain why such consideration was not given at the relevant time (that is, in 1991 when the appointment which led to the dual role was approved by the regulators—or in the six years subsequent to that approval).

29. The Government's view now as to the end result of any such consideration might be relevant to any finding of injustice but such a finding was not made in this case.

30. Moreover, it cannot in any case explain away maladministration in the form of a failure to consider the use of powers—not least in the factual environment that the report details, in which the regulators recognised the potential conflict of interest which existed and in which the relevant individual had drawn the existence of such powers to the attention of those regulators.

31. Other examples of this type include:

— the failure in the Government's response to address the full basis on which I found that the prudential regulators and GAD should have considered action in relation to the presentation by Equitable Life of two valuations—not dealing with why GAD and others used the ratings by Standard & Poor's—which they should have realised were inaccurate—to brief Ministers or to address policyholder enquiries and complaints; and

— the failure in the Government's response to address the full basis on which I found that the prudential regulators should have considered the taking of action in relation to the disclosure of the possible impact of the Hyman litigation on the Society—not dealing with why the FSA failed to consider whether action was appropriate in respect of the information provided privately to it by the Society concerning the potential costs of mis-selling, which was inconsistent with the information that the FSA knew that the Society's regulatory returns and letters to policyholders contained (which stated that those costs were considerably less).

Conclusion

32. I hope that the above is helpful to the Committee. I remain happy to assist in any way that I can in the further deliberations that the Committee may engage in regarding the issues raised by my report and by the Government's response to it.

February 2009

Memorandum from Equitable life Assurance Society

It may be helpful if we sum up our thoughts following our review of Command Paper 7538.

Naturally, we welcome the Government's acceptance of maladministration leading to injustice and the apology given to policyholders. We also welcome the Government's acceptance that they should establish a payment scheme to compensate policyholders.

However, we also have a number of serious concerns.

Early in her statement, the Minister noted that regulatory maladministration does not automatically lead to compensation. However, I think most (if not all) those giving evidence to your committee last year agreed that compensation should be paid in egregious cases. That is certainly our view. It is not clear whether the Government believes regulatory maladministration should never result in compensation, or whether "a decade of regulatory failure" does not constitute an egregious case.

The Government has chosen to reject a number of the Ombudsman's findings of maladministration. This appears to be the Government acting "as judge on its own behalf" to quote from your earlier report.

The Government has also introduced a new concept of "disproportionate impact" which appears to mean that the Government will decide who might be worthy of an ex gratia charity payment, rather than righting a wrong as a matter of justice.

We also disagree with the Government's decision to seek to reduce compensation because of the responsibilities of third parties. The Parliamentary Ombudsman has made it clear that her recommendation is to put people in to the position they would have been in had regulatory maladministration not occurred. She also makes clear that the regulators and no one else are responsible for their maladministration. Equitable Life is not responsible for regulatory maladministration. We do not see how Sir John, or anyone else, can allocate a proportion of regulatory losses to third parties.

I attach a copy of our letter to the Minister setting out our concerns.

The Parliamentary Ombudsman is an Officer of Parliament and has reported to Parliament. In our view the Government's response to that report is inadequate. In the interests of our long suffering policyholders, we would like to do anything we can to help Parliament to support its Ombudsman.

January 2009

APPENDIX

LETTER FROM CHARLES THOMSON, CHIEF EXECUTIVE, EQUITABLE LIFE ASSURANCE SOCIETY, TO YVETTE COOPER, CHIEF SECRETARY TO THE TREASURY, 26 JANUARY 2009

GOVERNMENT RESPONSE TO PARLIAMENTARY OMBUDSMAN'S REPORT ON THE PRUDENTIAL REGULATION OF THE EQUITABLE LIFE ASSURANCE SOCIETY DATED 17 JULY 2008

We have now had the opportunity to consider your statement made to the House of Commons on Thursday 15 January 2009, which responded to the Parliamentary Ombudsman's Report into the prudential regulation of the Equitable Life Assurance Society ("ELAS") in the period prior to December 2001. We have also considered the Government's written response to that same Report contained in Command Paper 7538. We refer hereafter to your statement to the House and the Command Paper together as "the Government's Response".

We very much welcome the acceptance in the Government's Response that there were failures by the public bodies and successive governments responsible for the prudential regulation of ELAS which amounted to maladministration, and which caused injustice to ELAS policyholders. We are also pleased that the Government has in the circumstances apologised to ELAS policyholders for the significant distress they have suffered.

We also welcome the Government's acceptance that, in the circumstances, Government action is justified in the form of a payment scheme which is intended to compensate at least some ELAS policyholders in respect of the loss they have suffered.

The Government's Response does, however, give rise to a number of serious concerns. In particular, we note that in its Response the Government has not accepted that it would be appropriate to establish a compensation scheme in accordance with the Parliamentary Ombudsman's recommendations. Rather, so far as we are able to ascertain from the Government's Response, the intention appears to be to limit (perhaps significantly) both the number of current and former ELAS policyholders who are likely to benefit from any compensation payment, and the level of such compensation. We do not accept that any such limitations, if applied, would be fair or reasonable.

The Government has chosen to reject a number of the Parliamentary Ombudsman's findings of maladministration, and has indicated that any compensation payments will be limited to loss attributable to those instances of maladministration which the Government has accepted. Whilst we are still in the process of reviewing the Government's reasoning for its rejection of some of the Parliamentary Ombudsman's findings, we seriously question the reasonableness of the Government's decision, in circumstances where the Parliamentary Ombudsman's findings were reached after an extremely full and vigorous investigation lasting some four years, and which included due consideration of the Government's own submissions. We reserve our position to challenge the Government on this point.

We also note from the Government's Response that the Government's intention may also be to limit compensation payments further by restricting these to policyholders who have suffered a "disproportionate impact". The Government's Response gives no indication as to the likely criteria the Government will use to determine whether disproportionate impact has been suffered (and this is in fact a matter which has been put to Sir John Chadwick for advice).

In any event, we do not consider that, in all the circumstances, it would be appropriate (or legal) to depart from the Ombudsman's recommendation that the aim of a compensation scheme should be to restore all those who have suffered a relative financial loss (as defined in her Report) to the position they would have been in had the maladministration not occurred. Further, the adoption of criteria which would have the effect of excluding groups of affected policyholders from any compensation scheme (for example, criteria which excluded a section of policyholders that were perceived to be "better off") would be inequitable and unreasonable. As the Public Administration Select Committee ("PASC") concluded, "It would not be appropriate to compensate only those policyholders and annuitants who are experiencing financial hardship; the payment of compensation is not a matter of charity but a requirement of justice to redress a wrong".[1] Accordingly ELAS reserves its position to take appropriate action to challenge the criteria once the full details of the Government's compensation scheme are known.

The Government's Response also contains a suggestion that compensation payments may also be adjusted to take account of the extent to which losses suffered by policyholders can be attributed to other factors including the conduct of ELAS itself. Again, no detail is given in the Government's Response as to how exactly this might be done and what exactly this would mean in terms of the numbers of policyholders who will receive compensation, or the level of those payments. However, we note that this is again a matter upon which Sir John has been asked to advise.

We fail to understand how, and on what basis, compensation payments designed to address loss resulting from regulatory maladministration can or should take into account other factors such as the conduct of ELAS. In any event, it would be entirely inappropriate to do so. As the Ombudsman made clear in her evidence to the PASC, "I think it is really important to remember that the wrongs done here and the injustice here described in this report, is the wrongs done to these people by the regulators; it is not the wrongs done by the company, it is not the wrongs done by the auditors. It is the wrongs done by the regulators and the remedy is very specifically addressing those failings".[2] Similarly, in her Report she concluded that where there are findings of maladministration leading to injustice (which the Government has accepted in its Response) "the 'primary wrongdoer' is the body or bodies which acted with such maladministration, not any third party".[3]

Again, therefore, we reserve our position to challenge any future attempt to adjust or apportion payments to policyholders to take account of other factors, including the conduct of ELAS itself.

Finally, we have considerable concerns as to the timing for the establishment and administration of the compensation payment scheme now proposed by the Government. In this regard, there appears to be no commitment to follow the Ombudsman's recommendation to establish a scheme within six months of deciding to do so, nor to complete its work within two years. Indeed, the proposed review by Sir John Chadwick, and any requirement to assess "disproportionate impact" will add yet further layers of complexity that will inevitably result in further delays. You will no doubt be aware of the Ombudsman's observation that "The adage 'justice delayed is justice denied' has rarely been far from my thoughts as publication of this report has drawn nearer", citing the lack of a comprehensive and fit for purpose inquiry as being "iniquitous and unfair".[4] We therefore urge the Government to act expediently in order to prevent a decade of regulatory failure being followed by a decade of delay, particularly in the current financial crisis in which savers and pensioners are likely to suffer most.

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1 PASC Report: "Justice delayed: The Ombudsman's report on Equitable Life" (HC 41-I) published on 15 December 2008.
2 Oral evidence of the Parliamentary Ombudsman, in response to Public Question 40, taken before the PASC on 30 October 2008.
3 Paragraph 122 of Chapter 14 of the Report.
4 Page xii of the Foreword to the Report.

Memorandum from Equitable Members' Action Group (EMAG)

Introduction

1. Equitable Members' Action Group (EMAG) is the only substantial Equitable Life policyholder group, with a proper constitution, a money subscription and an elected Board of Directors. It has over 20,000 members.

We welcome the opportunity to give further evidence to the Public Administration Select Committee on the prudential regulation of Equitable Life, the report of the Parliamentary Ombudsman ("the PO") and the Government's response to that report.

2. This submission examines the effect in money and public administration terms of the Government's written response (Command 7538). The detailed computations have been prepared by Colin Slater FCA, partner in Burgess Hodgson, Chartered Accountants and a member of the Board of EMAG.

3. Colin Slater FCA with John Newman MA FCA (Chairman) and Paul Braithwaite (General Secretary) will be giving oral evidence to the Select Committee.

Executive Summary

4. This memorandum comments briefly upon the Government's response to the Parliamentary Ombudsman's Report, concentrating upon the issues, which affect the quantum of loss and compensation and upon its public administration consequences.

5. Our previous submission estimated aggregate policyholder losses at about £4.8 billion and appropriate compensation, after adding exit penalties and interest and allowing various deductions, at £4.6 billion.

6. The really big loss/compensation money depends heavily upon the 1991–96 findings that Equitable Life's regulatory returns, mal-administratively approved by the regulators, were grossly misleading.

7. As regards the "money findings" the Government accepts virtually all the PO's findings of maladministration, but rejects virtually all her determinations that such maladministration led to injustice and where there is no injustice there is no compensation.

8. The Treasury proposes to appoint Sir John Chadwick to advise further, but has restricted his instructions so as to consider only those findings which the Government has accepted, eliminating at least 90% of policyholders' losses from his review.

9. However fair-minded Sir John Chadwick may be, the Treasury's instructions mean that the resulting compensation will be a very small fraction of the losses incurred by policyholders.

10. The "Chadwick Process" falls a very long way short of the transparent and independent Tribunal recommended by the PO. Sir John Chadwick is a retired Appeal Court Judge, but in this instance he is merely acting as an advisor to the Treasury, itself found guilty, through its sub-contractor the FSA, of 5 counts of maladministration. Sir John owes no duty to Parliament and reports privately to the Treasury. He is not required to hear representations from interested parties. Parliament has no control over the timing of his work. The Government's action is arguably an insult to the Parliamentary Ombudsman and to Parliament.

The PO's Findings

11. The Parliamentary Ombudsman ("PO") made 10 findings of maladministration, but, in order to lead to compensation, maladministration needs to result in "injustice". Furthermore, in order for loss/compensation to be substantial, the loss needs to be both significant and applicable to the generality of policyholders. Eliminating the findings which do not meet these criteria leaves what we regard as the PO's "money" findings:

Table 1

No	*Finding*	*Injustice*
2 & 4	**The unreliability of the Returns** GAD's failure to question and seek to resolve questions for each year from 1990 to 1993 (Finding 2) and from 1994 to 1996 (Finding 4), 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	Injustice found, in respect of lost opportunities to invest elsewhere as a result of the misleading returns from 1 July 1991 onwards

No	*Finding*	*Injustice*
3	GAD's failure, 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	
& 4	GAD's failure to question and seek to resolve questions . . . related to (iv) the holding of no explicit reserves for . . . guaranteed annuity rates	
5	GAD's failure . . . (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 [ie that Standard & Poor's "AA" rating of Equitable was based upon a misunderstanding of the two valuation methods used.]	
6	**Financial Re-Insurance** The FSA's failure (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	Injustice found, in respect of financial loss and lost opportunities to invest elsewhere for all those who joined the Society or paid a further premium that was not contractually required in the period after 1 May 1999

LOSS EVALUATION BASED UPON THE PO'S REPORT

12. Before considering the Government's response, it is important to note the general principle that the earlier findings relating to the unreliability of the Returns are much more valuable in terms of primary loss and compensation than the later ones. The table below shows the loss calculations made based upon the PO's "money" findings above:

Table 2

Investment	*Remaining Premium* £m *A*	*Total Value* £m	*Losses to Jan 2001 per £10k premium* *B*	*Loss from July 1991* £m *C*		*Division of Loss* £m *D*
pre 1990	N/A	4,641				
1991	470	1,154	8,692	204	}	
1992	656	1,456	7,517	493	}	
1993	868	1,733	6,254	543	}	
1994	1,016	1,825	5,647	574	}	
1995	1,406	2,302	4,782	672	}	4,446
1996	1,913	2,855	4,080	780	}	
1997	2,437	3,274	2,548	621	}	
1998	2,649	3,200	1,746	463	}	
Jan to Apr 1999	860	940	373	96	}	
May to Dec 1999	1,721	1,879	747	193	}	
2000	2,108	2,142	768	162	}	355
	16,105	27,401		4,801		4,801

13. It will be observed from column B that those who invested with Equitable Life instead of "elsewhere" in the earlier years lost much more than those who invested later. This is because "Elsewhere Life":

(a) Did not have Equitable Life's GAR problem.

(b) Was not trying to recover from incoming members excessive bonuses paid to outgoing ones.

(c) Performed better as a result of higher equity exposure.

14. It will also be seen that the biggest periods for loss (columns C and D) in money terms are those from 1 July 1991 to 30 April 1999. If findings in respect of those periods, relating to the unreliability of the Returns, were overturned, then the remaining loss, relating to the financial reinsurance finding (from 1 May 1999) would be relatively small, about £355 million out of £4,801 million or about $7\frac{1}{2}\%$.

15. In fairness it must be said that late contributors suffered more losses than others in terms of leaving penalties, but the really big loss/compensation money (more than 90%) depends heavily upon the 1991–96 findings.

The Government's Response

16. The table below concentrates upon the "money" findings, for which the PO found maladministration leading to injustice and which we have re-grouped under more convenient headings, showing the Government's response.

Table 3

No	*Subject*	*Government Maladministration?*	*Government Injustice?*
2 & 4	**Scrutiny of Equitable Life's returns for 1990–93 (Finding 2) and for 1994–96 (Finding 4)**		
	Valuation interest rates	Accept	Reject
	Affordability and sustainability of bonus declarations	Accept	Reject
3	**Differential terminal bonus policy (1993 Return)**	Accept in Part	Reject
4	Reserves for guaranteed annuity rates	Accept	Accept For 1995 and 1996 only
5	**Presentation of Equitable Life's two valuation results (misleading Standard & Poor's to rate Equitable "AA") (1995 Return)**	Accept in Part	Reject
6	**Financial Reinsurance (1998–2000 Returns)**	Accept	Accept subject to reservations

17. It will be observed that the Government accepts virtually all the PO's findings of maladministration, but rejects virtually all her determinations that such maladministration led to injustice. The above boils down to four issues:

(a) Valuation interest rates. Whether the rates used in the valuation of the Society's mainstream pension business in the returns from 1990 to 1996 inclusive were in accordance with the rules prevailing and whether those rates, if acceptable in themselves, cast material doubt over the sustainability of bonus declarations.

(b) GAR Problem. Whether the regulators should have identified the GAR problem in its examination of the 1993 Return and insisted upon the liability being provided against in that and subsequent returns.

(c) Two Valuations. Whether GAD's failure to take any action as regards its discovery that Standard & Poor's had been misled by the Society's two valuation methods resulted in loss/injustice to policyholders.

(d) Financial re-insurance. Whether the Government's acceptance of the PO's financial re-insurance findings is too limited to be significant.

18. The above issues, the PO's findings and the Government's responses are explained in the Schedules and are summarised in the table below.

Table 4

No	*PO's Finding*	*PO on Injustice*	*Government Response*	*Loss*
	The unreliability of the Returns	Injustice found, in respect of lost opportunities to invest elsewhere as a result of the misleading returns from July 1991 onwards.	The Government rejects the PO's findings of injustice. The Government maintains that, if GAD had asked the proper questions, then Equitable Life would have been able to justify its discounting of its mainstream pension business by up to one half and no change in the Returns and no injustice would have resulted.	£4,446 million
2 & 4	GAD's failure to question and seek to resolve questions for each year from 1990 to 1993 (Finding 2) and from 1994 to 1996 (Finding 4), 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			
3 & 4	GAD's failure, 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. GAD's failure to question and seek to resolve questions … related to (iv) the holding of no explicit reserves for … guaranteed annuity rates		The Government accepts that the regulators should have identified the GAR problem when examining the 1993 Return and that provision for this liability should have been made for 1995 and 1996. Its argument is that the amounts involved did not become sufficiently material to affect policyholders' perceptions until much later.	
5	GAD's failure . . . 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 [ie that Standard & Poor's "AA" rating of Equitable was based upon a misunderstanding]		The Government claims that GAD had no duty to inform S&P of their error. It does not explain why GAD continued to use S&P's ratings in its own examinations, its own presentations to Ministers and in replying to questions.	

No	*PO's Finding*	*PO on Injustice*	*Government Response*	*Loss*
	Financial Re-Insurance			
6	The FSA's failure (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.	Injustice found, in respect of financial loss and lost opportunities to invest elsewhere for all those who joined the Society or paid a further premium that was not contractually required in the period after 1 May 1999.	The Government accepts the PO's finding of injustice, but claims that Equitable Life had other options to allow it to declare a bonus for 1998, without showing an unacceptable solvency position.	£355 million

The Government's Verbal and Written Statements

19. In Parliament, on 15 January, the Minister provided a verbal apology to policyholders, which on the face of it was unequivocal. The Minister's statement and the brief debate which followed revolved around various issues.

(a) *Relative Losses.* The Minister claimed that Government had not been able to estimate the cost of the Ombudsman's recommendation, based upon the losses sustained by Equitable Life policyholders, relative to how they would have fared by investment elsewhere.

(b) *The appropriate proportion.* The Minister made much of Lord Penrose's statement that primarily the Society was the author of its own misfortunes. She sought to reduce the Government's contribution to any compensation package by reference to the proportion that the Society and others were to blame.

(c) *The state of public finances.* The Minister sought to distinguish (and minimise) much-delayed compensation for a decade of regulatory failure in respect of Equitable Life from the immediate full compensation paid to investors in foreign banks, notable Icesave.

(d) *Disproportionate effect.* The Minister acknowledged that some policyholders or groups had been disproportionately affected by the maladministration in respect of Equitable Life. The Minister indicated that any compensation scheme would attempt to provide relief for those disproportionately affected.

20. The Minister announced the appointment of Sir John Chadwick to consider and advise upon these matters with a view to creating a "fair ex gratia payment scheme" for those Equitable Life policyholders who have suffered a disproportionate impact. Those attending and observing the debate might be forgiven for receiving the impression that all those who had been badly affected by the Equitable Life debacle could eventually expect at least some form of compensation. Comment by Members of Parliament was mostly restricted to concerns about the timing of Sir John's advice.

21. However, the details of the written response (only published hours after the Minister sat down) make it clear that this impression is far from the truth. The paper, Command 7538, limits both the apology and Sir John Chadwick's consideration to:

> "Those failures identified in the Ombudsman's report which are accepted in the Government's response" (Apology)
>
> "Those accepted cases of maladministration resulting in injustice" (Sir John's instructions)

22. It will be observed from the above, that while the Government accepts the PO's findings of maladministration, it mostly rejects her findings of injustice. This eliminates the vast majority of policyholders and the bulk of their losses (not less than nine tenths) from both the apology and from Sir John's considerations.

23. Relative Losses and Appropriate Proportion have already been included in EMAG's loss computations. However the Government's descriptions of "Disproportionate Effect" and "Public Finances" are too vague to quantify. The best we can say at this stage is that compensation is unlikely to exceed one twentieth of policyholders' actual losses.

The Parliamentary Ombudsman

24. The Government's rejection of the "money" findings of injustice is not only a serious attack upon the quantum of policyholders' losses and compensation, but also an attack upon the person and institution of the Parliamentary Ombudsman. She and her team have spent 4 years proving beyond doubt that the Government's regulators failed Equitable Life's policyholders for more than a decade.

25. The Ombudsman is the mechanism set up by Parliament to investigate and if appropriate recommend redress for the constituents of Members, who have been harmed by maladministration. If the Government accepts her findings of maladministration, but rejects her findings of injustice and requires expert consideration of responsibility and loss computation, then surely its proper course is to refer these matters back to the PO?

26. Sir John Chadwick is a retired Appeal Court Judge, but in this instance he is merely acting as an adviser of the Treasury, itself found guilty through its sub-contractor the FSA, of 5 counts of maladministration. Sir John owes no duty to Parliament and reports privately to the Treasury. He is not required to hear representations from interested parties. Parliament has no control over the timing of his work. The "Chadwick Process" falls a very long way short of the transparent and independent Tribunal recommended by the PO. The Government's action is arguably an insult to the Parliamentary Ombudsman and to Parliament.

Conclusions

27. As regards the "money findings" the Government accepts virtually all the PO's findings of maladministration, but rejects virtually all her determinations that such maladministration led to injustice.

28. The Treasury seeks to appoint Sir John Chadwick to advise further, but has restricted his instructions so as to consider only those findings which the Government has accepted, eliminating at least 90% of policyholders' losses from his review.

29. However fair-minded Sir John Chadwick may be, the Treasury's instructions mean that the resulting compensation will be a very small fraction of the losses incurred by policyholders.

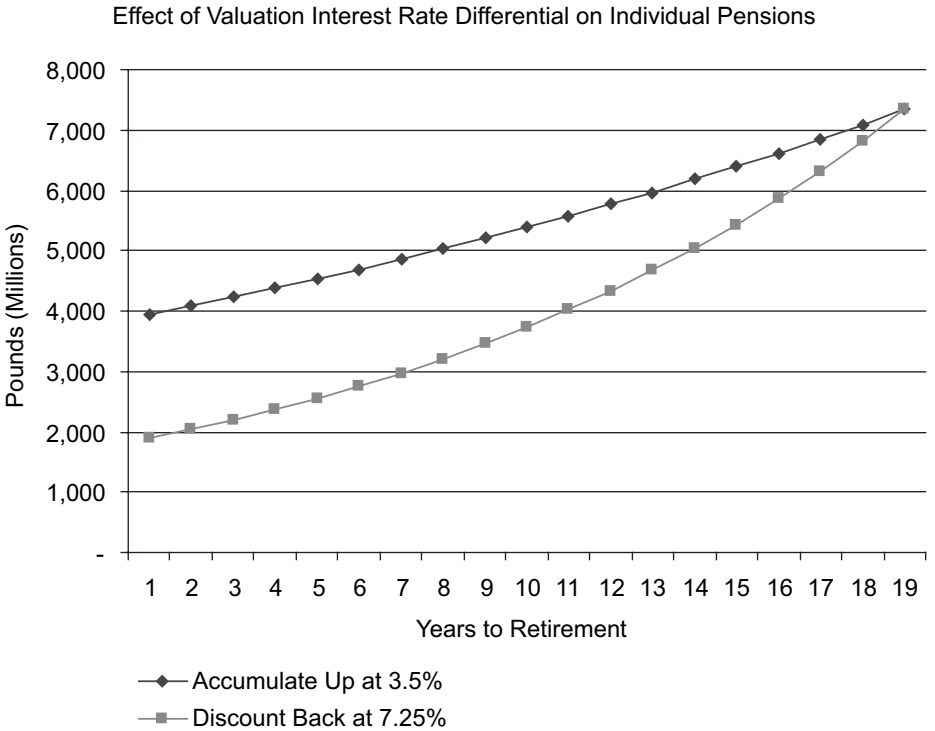
Schedule 1—Valuation Interest Rates

Equitable Life's main line of business, representing about 80% of the with-profit fund, was the pension investment policy, that is, the accumulation of premiums during the policyholder's working lifetime to buy an annuity upon retirement. How this line of business was valued was far and away the most important aspect of the annual valuation of liabilities for regulatory purposes. By comparison, other issues should have paled into insignificance.

Policyholders, who received an annual statement showing how much their policy was worth, might reasonably have expected the regulators to use the contractual value shown on those statements (called the "Guaranteed Policy Fund" or "GPF"). However this was not the case. Throughout the period 1988 to 1999, the regulators allowed Equitable Life's actuaries to value such policies at a discount from the GPF, sometimes to a very substantial extent.

The largest differential was applied in respect of 1990. The chart below shows, in very simplified form, how the differential of 3.75% per annum applied over 18 years to the average retirement date reduced aggregate guaranteed policy values of just under £4,000 million to liabilities for regulatory purposes of £1,900 million.

The effect was like telling a policyholder that his guaranteed fund was £4,000, but telling the regulators that the Society only needed assets of £1,900 to cover it.



The PO found that GAD had identified that there was a problem, but failed to ask sufficient questions concerning:

> The valuation rate of interest used to discount the liabilities, which appeared to be imprudent and/or impermissible (apparently discounting the liabilities well below the guaranteed face value of policies); and
>
> The affordability and sustainability of the bonuses declared by the Society during this period, which appeared to raise the expectations of the Society's policyholders which, it appeared, could not be met.

The Government accepts this finding of maladministration.

As regards injustice the PO said:

> One consequence of this failure was that the prudential regulators and GAD could not be satisfied that the Society was acting prudently and with proper regard to the interests and 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.

She concluded:

> I find that injustice was sustained by any policyholder who relied on the information contained in the Society's returns for 1990 to 1996 and who suffered either a financial loss or a lost opportunity to take an informed decision as a result of such reliance. Where a policyholder neither relied on this information nor suffered a loss of either type, I find that no injustice resulted from this maladministration.

The Government rejects the PO's determination of injustice. In general terms the Government claims:

(a) that the valuation rates used were within the range allowed by the regulations;

(b) that the use of an interest rate differential was allowed by the regulations; and

(c) that if GAD had raised the matter of sustainability of bonuses, then Equitable Life would have been able "to establish that its approach to future bonuses was sustainable and affordable".

Schedule 2—The GAR Problem

The Society attempted to deal with the Guaranteed Annuity Rate problem in 1993 by means of changing its terminal bonus policy, so that the burden fell mostly upon policyholders instead of on the Society. GAD's failure to follow up the disclosure of the differential terminal bonus policy in the Return for that year meant that it did not discover the extent of the Society's exposure to the GAR problem or the fact that it had made no provision for this liability in its Returns.

The PO found that "the failure by GAD, when the introduction of the Society's differential terminal bonus policy, intimated within the Society's 1993 returns, was identified by GAD as part of their scrutiny of those 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 constituted maladministration".

The Government only accepts part (i) of the PO's findings.

As regards injustice the PO said:

> "I consider that the loss of opportunities to take informed decisions about their financial affairs during the period from July 1994 to April 1999 in full knowledge of the exposure of the Society to guaranteed annuity rates and of the risks that such exposure generated constitutes injustice to policyholders and I consequently make a finding that policyholders suffered such injustice as a result of maladministration".

The Government rejects the PO's determination of injustice. In short, it contends that even if the regulators had raised the question of the GAR problem, none of the consequences envisaged by the PO would have actually transpired. These included, taking earlier legal advice, testing the policy earlier in the Court and making provision earlier in its Returns. The Government claims that in the absence of regulatory breaches, the influence of the regulators was limited.

As regards explicit reserves for the GAR cost in subsequent periods the PO found:

> "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 . . . (iv) the holding of no explicit reserves for the liabilities associated with prospective liabilities for …guaranteed annuity rates, constitutes maladministration by GAD;

As regards 1994, the Government believes interest rates were too low to justify making any reserve, but accepts this finding for 1995 and 1996.

The Government accepts that maladministration led to injustice, but claims that the amounts of the reserve were too small to have shown a significantly different picture. It does not say what, in its view, amounts of the GAR liability would have been.

EMAG's actuary has estimated the GAR liabilities for 1994, 1995 and 1996 as £346 million, £435 million and £483 million respectively.

SCHEDULE 3—THE TWO VALUATION METHODS

Equitable Life computed its actuarial liabilities (the value of policies in force) on a "gross premium" basis in its Published Returns. This was acceptable so long as it could demonstrate that these, in aggregate, showed a higher, more conservative, liability than was required by the "net premium" method required by the regulations. The Society submitted valuations using both methods, the regulatory version being shown in an Appendix. The resulting totals are shown below in lines A and C. This suggests that the published version was more conservative than the Appendix one by a substantial margin; what we describe below as the "Apparent Margin of Prudence". In fact this was almost entirely illusory, since the Appendix version required a Resilience Reserve, which was not revealed in Returns. Indeed the Returns contained a note which could be read as meaning that no such Reserve was required. After taking into account the Resilience Reserve, the real Margin of Prudence was trivial.

Comparison of Actuarial Liabilities		*1990*	*1991*	*1992*	*1993*	*1994*
Appendix version	**A**	4,868	6,453	8,079	11,116	12,077
Resilience Reserve (not revealed in Returns)		450	390	462	236	171
	B	5,318	6,843	8,541	1,352	12,248
Published Version	**C**	5,362	6,852	8,557	11,448	12,378
Apparent Margin of Prudence	**C-A**	494	399	478	332	301
Real Margin of Prudence	**C-B**	44	9	16	96	130

For the years 1990 to 1994, GAD asked Equitable to supply to it the Resilience Reserve figure, included in the table above. This meant that GAD could satisfy itself that the valuation method which the Society used was indeed more conservative than that required by the regulations, albeit not by much.

The effect of this charade was that GAD complied with the rules, but allowed Equitable to present to the outside world a misleading impression of conservatism, clearly against the spirit of the "freedom with publicity" policy advanced by Ministers.

The ratings agency, Standard & Poor's first considered Equitable in 1993, when the Society received an "AA (Excellent)" rating, which it continued to receive until May 1999. Companies which were given such a rating by Standard & Poor's were described as offering "excellent financial security".

It subsequently became clear to GAD that Standard & Poor's had been misled. The PO said:

> "[S&P's] ratings demonstrated that the Society's method of presenting the two valuations, but without including the figure for the resilience reserve, was being misconstrued.

GAD knew that, contrary to the information contained within Standard & Poor's ratings, Equitable did not adopt a conservative valuation approach—quite the opposite.

GAD also knew that, contrary to the information within those ratings, there was little difference between the results of the Society's alternative method of valuation and the minimum prescribed in the Regulations. In substance, there were no margins, as had been wrongly assumed, between the statutory minimum reserves and the results which the Society's alternative method had produced.

The way in which the Society presented its returns—and was permitted to present its returns—led directly to financial analysts misunderstanding the true financial condition of the Society and to misleading information being disseminated about the 'hidden' strengths of the Society's position. Yet GAD failed to take any action concerning this matter". Chapter 10, paragraphs 374–377.

She concluded:

> "While I accept that the prudential regulators and GAD were not responsible for the content of the ratings produced by such agencies, that does not explain why the Society's ratings—despite them containing assessments which GAD should have known were fundamentally flawed—were used by GAD and by the prudential regulators in a number of contexts—such as in scrutiny reports, as briefing for Ministers and to deal with enquiries as to the strength of the Society.
>
> I consider that GAD should have alerted the prudential regulators to the issue and should have recommended that those ratings should not be used as briefing material and to respond to enquiries". Chapter 10, paragraphs 393–395.

Her finding was that the failure:

> "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;

The Government does not accept that either GAD or the regulator was under any duty to act in response to the credit rating produced by Standard & Poor's.

As regards injustice the PO said:

> "That maladministration 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. No action was taken when it was clear that those readers [S&P] 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". Chapter 12, paragraphs 34–37.

The Government rejects that any injustice derived from this finding of maladministration. Its reasons are technical justifications for GAD's doing nothing when it ascertained that Standard & Poor's had made a mistake. It does not explain why GAD continued to use their ratings in its own examinations, in its own presentations to Ministers and in replying to questions.

Schedule 4—Financial Re-Insurance

This is the most blatant case of maladministration. The Treasury and the FSA bent over backwards to allow Equitable to take £800 million/£1,000 million credit for a reinsurance policy that they knew was worthless. The PO made a finding of maladministration against the FSA. The PO found that this injustice led directly to financial loss.

This finding applies to new policies taken out and new investments made after 1 May 1999. As the bulk of Equitable Life's business was of a single premium type, almost all subsequent premiums totalling about £3,500 million are covered by this finding.

This is of particular interest since those who invested after 1 May 1999 got back substantially less than they paid in. Their investments received hardly anything in bonuses (certainly nothing in terms of excess bonuses) and the 16% policy cut was applied to them regardless of that fact. Many suffered further penalties when they tried to mitigate their loss by removing their funds from Equitable.

The PO's finding in this regard has the happy effect of providing a compensation route for those who suffered from other areas of complaint over the same period eg the FSA's inaction in respect of the GAR litigation and its failure to demand special consideration for those who joined after the House of Lords decision.

The facts are relatively straightforward.

The Treasury took over prudential regulation from the DTI in 1998 and soon identified Equitable Life as a problem case, particularly as regards its, by that time, serious GAR liability, estimated at £1.6bn. It was clear that inclusion of such a liability in the 1998 Returns would threaten the Society's solvency to the point of putting at risk its 1998 bonus declaration, omission of which was recognised as commercial suicide. A meeting was held with the Society even before that year had ended at which this serious situation was discussed. Re-insurance was mentioned as a possible means of relief. The Treasury expressed its willingness to grant a concession allowing credit to be taken for such re-insurance, even if it could not be actually completed by 31 December 1998.

The FSA took over most aspects of prudential regulation as the Treasury's sub-contractor from January 1999.

The Society then arranged a form of re-insurance with an Irish company for a premium of (initially) £150,000. This was claimed by Equitable Life as an asset worth £800 million. GAD examined the transaction and found it insufficient to justify such a credit. Regardless of GAD's view, the FSA's Director of Insurance and Managing Director told their Board that satisfactory re-insurance cover had been arranged and the Society declared its 1998 bonus in March 1999 in the usual way.

The actual re-insurance treaty was not signed until October 1999 and the Treasury never issued any concession to allow back-dating to 1998. Credit for this treaty was allowed in the 1998 and subsequent returns of the order of £800–1,000 million.

The PO concluded:

> "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";

As regards injustice the PO said:

> "I consider that the maladministration relating to the acts and omissions of the FSA in permitting the Society to take the credit that it did for the financial reinsurance arrangement within the Society's 1998 regulatory returns, which were available to the public by 1 May 1999, constituted a significant turning point. Those acts and omissions represent, in my view, a critical juncture in the sequence of events which I have recounted in this report.
>
> That the Society was permitted by the FSA to take any credit within its 1998 returns, without the required concession, had significant consequences. That was reinforced by the fact that the credit that was taken with the permission of the FSA totalled £809 million—despite the fact that, had regard been had, as it should have been, to the economic substance of the arrangement, no credit would have been permissible at all.
>
> The Society's 1998 returns were available to the public by 1 May 1999. Had the FSA acted, as they should have done, they would have ensured that the financial reinsurance arrangement was given no credit within those returns, with all the ramifications that this would have had on the reported financial position of the Society.
>
> I consider that, in those circumstances and on the balance of probabilities, if the Society had sought to declare either a reversionary bonus or a terminal bonus in March 1999, the FSA would have taken action to prevent the declaration from taking effect, on the grounds that such a declaration would have adverse effects for the reasonable expectations of the Society's policyholders if it were later to be reduced.
>
> Any failure to make such a bonus declaration was recognised, at the time, to be 'commercial suicide' by both the regulatory bodies and the Society itself. Whether or not in fact the Society did declare a bonus, the Society's published regulatory solvency position would have been very weak at that point. This would have occurred in a context in which the Society's serious financial position was not yet generally known to the public.
>
> Once that financial position became known, I consider that many fewer new prospective policyholders, acting reasonably, would have taken out with-profits policies with the Society. The Society's financial position would have become known shortly after the Society announced, as it would have had to do, that it was not declaring a bonus. If in fact it did declare a bonus, its financial position would have become known by 1 May 1999, when the Society's 1998 returns were published. I also consider that many fewer existing policyholders would have taken out a with-profits annuity, from which there was no subsequent prospect of exit.
>
> Furthermore, I consider that many fewer existing policyholders would have made further contributions to existing policies in the circumstances which would have prevailed had this maladministration not occurred.

She concluded:

> I find that, in respect of all those who joined the Society or paid a further premium that was not contractually required in the period after 1 May 1999, any financial loss that they have sustained constitutes injustice in consequence of maladministration. Those affected by that maladministration have also suffered injustice in the form of lost opportunities to take informed decisions about their financial affairs. Chapter 12, paragraphs 133–146.
>
> The Government accepts the Ombudsman's findings of maladministration and injustice in relation to Equitable Life's use of reinsurance, but seeks to suggest that the consequences would not have been as serious as envisaged by the PO.
>
> The Government claims that Equitable Life had other options to allow it to declare a bonus for 1998, without showing an unacceptable solvency position. These include 'alternative reinsurance cover, adjustment of the margins in Equitable Life's regulatory returns, increased use of the future profits implicit item and reducing some of its equity exposure in favour of fixed interest assets'.
>
> These options would have impacted on Equitable Life's published solvency position to different degrees, depending on which were utilised and to what degree, and their availability should be taken into account when assessing the impact and nature of the injustice flowing from this finding of maladministration. Recourse to any of these options would also have impacted on Equitable Life's ability to justify to the regulator its ability to pay a bonus in 1999.
>
> This is an attempt to mitigate the financial consequences to the Treasury of the Government's acceptance of both maladministration and injustice in respect of the Financial Re-Insurance arrangement.

Memorandum from HM Treasury

EQUITABLE LIFE: THE GOVERNMENT'S COMMENTS ON THE MEMORANDUM BY THE PARLIAMENTARY AND HEALTH SERVICE OMBUDSMAN TO THE PUBLIC ADMINISTRATION SELECT COMMITTEE DATED 9 FEBRUARY 2009; AND FURTHER SUPPLEMENTARY INFORMATION

Introduction

1. At the Public Administration Select Committee ("the Committee") hearing on 11 February 2009, the Economic Secretary to the Treasury offered to provide detailed written comments giving the Government's response to the memorandum provided on 9 February 2009 to the Committee by the Parliamentary and Health Service Ombudsman ("the Ombudsman"). In the memorandum, the Ombudsman set out examples to illustrate her view that the Government, in its response to her report into the prudential regulation of Equitable Life published in July 2008, had in certain respects misunderstood or misrepresented the findings made in that report.

2. In addition, the Committee subsequently asked for clarification of several points in relation to the undertaking of the work that the Government has asked Sir John Chadwick to carry out prior to the establishment of an ex-gratia payments scheme for those Equitable Life policyholders who have suffered a disproportionate impact as a result of the maladministration the Government believes occurred.

The Ombudsman's comments on the Government's response

3. Following the Committee hearing on 29 January 2009, the Ombudsman provided a memorandum to the Committee, at its request, giving examples of instances where the Ombudsman felt that her findings had, in certain respects, been either misunderstood or misrepresented by the Government in its response to her report of July 2008. At the Committee's request the Government has reviewed the examples given both in oral evidence before the Committee on 29 January 2009 and in the memorandum dated 9 February 2009.

4. The Government's response is set out below. The headings used correspond to the examples given by the Ombudsman, with references to the relevant paragraphs in the Ombudsman's memorandum given where appropriate. In addition, this document addresses the examples provided to the Committee in oral evidence on 29 January 2009.

5. Before addressing the specific examples given by the Ombudsman, the Government would make the general observation that the response document it has published was not intended to cover every aspect of every topic set out in the Ombudsman's exhaustive and detailed report of July 2008. To have done so would have required a significantly longer and more detailed response, at the expense of the readability and accessibility of a document aimed at a general audience. Rather, the purpose of the document was to provide the Government's response to each of the specific findings reached, and recommendations made, by the Ombudsman.

Examples given in oral evidence

6. Two examples were given in the oral evidence session of 29 January.

7. In the first, regarding the Government's response to Finding 9 (the decision by the Financial Services Authority ("FSA") to allow the Society to stay open after the House of Lords' decision in the Hyman litigation), it was said that the Government was wrong to state that the Ombudsman's report suggested that this was not an incorrect decision, but just taken in the wrong way.

8. In the terms explained at the oral evidence session, the Ombudsman had in fact "said that they [FSA] failed to take into account the interests of all policyholders. They had misunderstood their powers. They had come to a decision based on a wholly partial view of the relevant facts and the relevant law. What we did say is nobody now, ten years later, can say what would have happened had all of that not been the case but we certainly did not say the decision was right." (Reference in quotes taken from the answer given to Question 30 in the uncorrected transcript of oral evidence for the session on 29 January published on the Committee's website.)

9. In response, the Government would observe that the Ombudsman's finding of maladministration was not that the FSA had necessarily made the wrong decision, but rather that in making that decision the FSA (a) had failed to take into account all relevant considerations; and (b) did not have a proper factual and legal basis for its decision (see Ombudsman's report, Part 1, Chapter 10, paragraph 614, page 300).

10. This criticism is specifically accepted in the Government's response to the extent that it is accepted that the FSA did not give full consideration to each of the powers available to it before reaching its decision to allow Equitable Life to remain open (see paragraph 4.168).

11. As to the merits of the decision itself, the Ombudsman specifically states in her report:

> "I am not suggesting that it was unreasonable for the prudential regulators to give the Society an opportunity to find a buyer."—(see Ombudsman's report, Part 1, Chapter 10, paragraph 570, page 294)

12. It was the FSA's concluded view that in the light of the proposed sale of the business there was no reasonable alternative to keeping Equitable Life open (see paragraph 4.171 of the Government's response). Indeed, any regulatory action against Equitable Life had the potential to affect the sale price.

13. The second example given in oral evidence, made in relation to the Government's response to Finding 10 (information from the FSA in the post-closure period was inaccurate), was that the Government's response claimed that no-one was misled by the information provided by the FSA and therefore implied that no-one could have suffered injustice.

14. The uncorrected transcript of the oral evidence for the session on 29 January, at the response to Question 31, states:

> "The information given by the FSA in the post-closure period we found to be misleading and inaccurate in places. They [HM Treasury] then go on to say in their view that while the information might have been misleading nobody really was misled. They have given no basis for that. That is not what we have said. What we said was individual policyholders were all in different positions and some of them may have had regard to that information and some of them may not and it would depend on the circumstances of each case. They have interpreted that as saying nobody suffered any injustice."

15. In fact, the Government has accepted the Ombudsman's findings of both maladministration and injustice in relation to Finding 10.

16. The Government's response on injustice is set out in paragraphs 4.180 to 4.187 of its response document. The Government does not claim that no-one was misled, nor does it rule out the possibility of policyholder reliance on the statements made by the FSA. This is reflected in its acceptance of the Ombudsman's finding of injustice.

17. However, quite properly, the Government's response does note that, during the post-closure period, there was a great deal of commentary in the media and elsewhere and that any statements made by the FSA would form only one element of information before the public. It then goes on to observe, within that context, 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."—(see paragraph 4.187)

18. This observation seeks to reflect the extent and tone of the media coverage at the time, the steps that the FSA did take and the information placed in the public domain by Equitable Life itself.

Ombudsman's Memorandum—examples given in the section headed "Findings which I did not make" (paragraphs 7—13)

19. Paragraphs 7—12 of the Ombudsman's memorandum address aspects of the Government's response with respect to Findings 2-5 (regulatory returns). The Ombudsman considers that the Government's response failed to address the finding of lost opportunities and failed to explain the rejection of findings that the regulatory returns were not reliable.

20. The Government has interpreted the Ombudsman's finding of injustice in the way which is stated in the Ombudsman's memorandum, ie that there was injustice arising from lost opportunities on the part of existing and potential policyholders to make informed decisions about important financial matters.

21. The Ombudsman criticises the Government for having failed to address the basis of this finding—namely her view that the returns in question were unreliable. However, the Government's position is that for the Ombudsman's finding of "lost opportunities" (resulting to policyholders) to be sustained, it remains necessary to identify whether, had the regulatory bodies dealt with the problems with Equitable Life's regulatory returns identified by the Ombudsman, the position as published in Equitable Life's returns would have been materially different.

22. In the Government's view, if, regardless of any action taken by the regulatory bodies on those identified issues, the returns would have been materially the same then it cannot be the case that policyholders sustained a lost opportunity. Thus, for example, the Government accepts that the Government Actuary's Department ("GAD") did not raise queries or resolve them as they should have done. However, whether raising such queries would have resulted in any material difference in the returns is a relevant consideration to the question of whether any injustice resulted from those accepted failures.

23. As set out in its response, it is the Government's view that in relation to some (but not all)[5] of the sub-findings relating to Equitable Life's regulatory returns for the period 1990 to 1996, action by the regulatory bodies in respect of the issues identified by the Ombudsman would not have led to those returns being materially different from the returns which Equitable Life in fact published.

[5] The Government only rejected the injustice said to arise from a) valuation interest rates 1990—1992 and 1994—1996; and b) affordability and sustainability of bonuses 1990—1992 and 1994—1996 (4 sub-findings in total) on grounds that no injustice resulted from the maladministration. Other injustice findings in relation to the 1990—1996 returns were rejected on the basis that the finding of maladministration was rejected.

24. It is for that reason that the Government's response does not accept that existing or potential policyholders could have suffered a lost opportunity (and therefore could not have suffered an injustice) as a result of the maladministration identified.

25. In paragraph 13 of the Ombudsman's memorandum, first bullet point, the Ombudsman refers to the Government's response with respect to Finding 3 (intimation of the differential terminal bonus policy). The Ombudsman says that the Government did not respond to the finding that failure by GAD to address the introduction of the differential terminal bonus policy led to lost opportunities on the part of regulators and Equitable Life.

26. The Government's response sought to consider the basis for the Ombudsman's finding of injustice, namely that there was a loss of opportunity on the part of policyholders to take informed decisions (see Part 1, chapter 12, paragraph 121, page 348).

27. The basis for this finding was the Ombudsman's finding that there were lost opportunities (resulting from the maladministration identified) on the part of the regulators and Equitable Life to discuss the issues arising from the introduction of the differential terminal bonus policy. The Government's response sought to address whether such a loss of opportunity did, in fact, gave rise to the injustice identified—namely the loss of opportunity on the part of policyholders as identified by the Ombudsman. This is set out at in the Government's response document from paragraph 4.65 onwards.

28. The Government outlined (at paragraph 4.70 of its response) the point that there is no basis to conclude that earlier discussions with Equitable Life about its differential terminal bonus policy would have led to any change in the policy. Accordingly, as explained in the Government's response document, the maladministration found in this respect cannot, in the Government's view, be said to give have given rise to any injustice (in the form of lost opportunities or otherwise) on the part of policyholders.

29. In the second bullet point of paragraph 13 of her memorandum, the Ombudsman refers to the Government's response to Finding 4 (returns for 1994-1996). The Ombudsman states that the Government asserts that she made findings that Equitable Life failed to hold certain reserves, whereas she made no findings as to the actions of Equitable Life.

30. The Ombudsman explicitly states that her investigation was not, and could not have been, focused on Equitable Life (see Part 1, Foreword, page viii, of her report). The Government agrees with the Ombudsman's assessment of her jurisdiction. Nevertheless, within the report the Ombudsman does make observations about the actions of Equitable Life. Whilst the Ombudsman's finding of maladministration was directed at the actions or failings of those scrutinising the relevant returns by Equitable Life, those findings were made in the context of observations made by the Ombudsman as to Equitable Life's actions.

31. In this context, the Government believes its interpretation, cross-referenced to the Ombudsman's text, is a fair reading of her report. The Ombudsman states:

> "The second issue that arose was the failure by the Society to hold explicit reserves for the prospective liabilities to tax on capital gains and pensions mis-selling costs" (Part 1, Chapter 10, paragraph 313, page 263).
>
> See also:
>
> "the failure by the Society to reserve for the liabilities associated with those policies which contained guaranteed annuity rates" (Part 1, chapter 10, paragraph 323, page 264).

32. The Government's response sought to address these underlying observations of the Ombudsman, some of which may have a bearing on any injustice said to arise from the acts of maladministration in question.

Ombudsman's memorandum—examples given in the section headed "The reinterpretation or limitation of my findings" (paragraphs 14—23)

33. In paragraphs 14—22 of her memorandum, the Ombudsman addresses the Government's response concerning Finding 6 (reinsurance treaty). The Ombudsman states that she did not find that earlier closure to new business in formal terms would necessarily have followed proper action by the prudential regulators.

34. Rather she found that, absent maladministration, the true and published solvency position of the Society would have deterred potential investors from placing money with the Society, would have led to those considering converting their policy into an annuity to understand the true risks of such a course of action, and would have led to those who were not required to make further contributions to existing policies reconsidering the benefits of doing so. Neither did the Ombudsman, in her view, fail to address in her report the options said to be available to the Society.

35. Regarding this example, the Government would observe that it has accepted the Ombudsman's findings of both maladministration and injustice in respect of the reinsurance treaty.

36. The Government agrees that the Ombudsman does not state explicitly that Equitable Life would have closed, but the Government believes that its reading of the relevant section of her report is fair. The Ombudsman states (Part 1, Chapter 12, paragraphs 126-127) that if credit for the reinsurance treaty had not

been permitted and Equitable Life had sought to declare either a reversionary or terminal bonus in March 1999, such a declaration would have been prevented by the FSA and that a failure to declare a bonus was recognised at the time to be "commercial suicide".

37. Similarly, the Ombudsman states (Part 1, Chapter 12, paragraph 140 of her report) that had no credit been permitted the Society ". . . would have been very publicly in such a parlous position that its ability to attract new investments would have been greatly constrained". It is also asserted that: ". . . the acts and omissions of the prudential regulators …played a central part in the ability of the Society to attract business after that date" (Part 1, Chapter 12, paragraph 144) indicating that, had the prudential regulators acted as she held they ought, the Society would not have been able to attract business.

38. As to the different options available to Equitable Life, the Government did not seek to suggest that these had not been addressed by the Ombudsman in her report. The Ombudsman states that it would, theoretically, have been possible to sell equities and buy into gilts such that the Society's reported position was improved to a reasonable degree (Part 1, Chapter 12, paragraph 137 of her report). The Government also considered the combination of possible options and the extent of their potential impact (see paragraph 4.137 et seq of the Government's response) and sought to highlight the fact that no definite conclusions could be drawn as to what would have happened had Equitable Life considered alternative options.

Ombudsman's memorandum—examples given in the section headed "Partial or incomplete responses" (paragraphs 24 –31)

39. Paragraphs 24 to 30 of the memorandum address the Government's response to Finding 1 (dual role). The Ombudsman says that the Government failed to explain why consideration was not given to powers to prevent the dual role appointment at the relevant time.

40. The Government noted, at paragraph 4.11 of its response, that the Ombudsman had summarised the steps that the regulators took to address the question of whether the appointment of the existing Appointed Actuary to the role of Chief Executive should be approved (Part 1, Chapter 10 paragraphs 47 to 57 of the Ombudsman's report).

41. The Government also explained, at paragraph 4.12 of its response, its view that there was no legal basis for the prudential regulator to withhold authorisation of the dual appointment. The regulator's actions must be assessed in this context. The regulator cannot fairly be criticised for failing to give express consideration to powers which were not available to it.

42. The remainder of the section of the Government's response concerning Finding 1 deals with the powers that the Ombudsman states should have been considered, and seeks to explain why these could not have been used, or would have been ineffective as a matter of law. As explained in the Government's response, there was no trigger for the regulator to consider each of the powers.

43. Furthermore, the Government does not agree with the criticism raised at paragraph 29 of the Ombudsman's memorandum that "the Government's view now as to the end result of any such consideration might be relevant to any finding of injustice but such a finding was not made in this case". The effectiveness of a course of action can, in the Government's view, be relevant to assessing an alleged failure to take that course (for instance where the allegation is that the regulator failed to pursue methods of non-statutory intervention).

44. In the first bullet point of paragraph 31 of her memorandum, the Ombudsman addresses the Government's response to Finding 5 (presentation of Equitable Life's two valuation results). She considers that the Government failed to address why GAD and others used ratings by Standard and Poors which they should have realised were inaccurate.

45. The Government believes that it has addressed the basis on which the Ombudsman made her finding. The Ombudsman's finding of maladministration (expressed in Chapter 10, paragraph 396, page 273) is that the failure by GAD (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, fell short of what it was reasonable to expect from GAD.

46. In her report the Ombudsman refers to the use made by GAD and others of the ratings produced by Standard and Poors. GAD is criticised for not alerting the prudential regulators to the way in which the Society presented its returns (Part 1, chapter 10, paragraph 394-395), although she concedes the returns were not contrary to the Regulations.

47. In the Government's view, GAD could not have been expected to investigate ratings produced by credit rating agencies. The reasons for this view are set out in that part of the Government's response dealing with the independence of the processes of credit rating agencies (see paragraphs 4.119—4.122). Credit rating agencies undertake their own research and reach their own conclusions; GAD could not have been expected to know how individual ratings were arrived at. The extent of the reliance placed by Standard & Poors'

rating on the Society's appendix valuation was a matter solely for the credit rating agency itself. There was no responsibility on GAD or the prudential regulator to monitor and seek to amend ratings produced by credit rating agencies.

48. The Ombudsman accepts that the prudential regulators and GAD were not responsible for the content of the rating produced by credit ratings agencies (Part 1, chapter 10, paragraph 393).

49. Given the circumstances described above, the use made by GAD or the prudential regulator of the ratings cannot fairly be criticised.

50. Paragraph 31 of the Ombudsman's memorandum, second bullet point, concerns the Government's response to Finding 7 (disclosure of the potential impact of the Hyman litigation). The Ombudsman states that the Government did not address why the FSA failed to consider whether action was appropriate concerning inconsistent information regarding the potential costs of mis-selling.

51. The Ombudsman's finding (Part 1, Chapter 11, paragraph 123, page 328) is that the FSA's failure to pursue the issue of proper disclosure within the regulatory returns for 1998 & 1999 of the potential impact of the Society losing the Hyman litigation constituted maladministration. This has been accepted by the Government. The Ombudsman made no specific finding of injustice.

52. Having accepted the finding of maladministration, the Government's comments in its response document did not seek to deal with every underpinning aspect of that finding.

Further information requested by the Committee in relation to the work of Sir John Chadwick

53. The Committee has asked for clarification of three points: what assistance does Sir John Chadwick have to carry out his work; who will be providing him with actuarial advice; and is he allowed to receive oral representations from interested parties?

Assistance being provided to Sir John Chadwick

54. The Government is liaising with Sir John Chadwick over his resourcing requirements to ensure he has access to, and can procure, all the expert advice he needs, including legal and actuarial input.

55. Sir John has recruited legal support from his Chambers, One Essex Court. Following a "reading in" period, he is now recruiting policy and operational support.

Actuarial support

56. In line with his independent status, Sir John will procure his own actuarial advice, using public sector procurement rules.

Oral representations

57. Sir John's terms of reference specify that, if he deems it necessary, he will seek written representations from interested parties. This does not fetter his discretion to talk to interested parties. The Government can confirm that Sir John has indicated that he will be inviting representations.

March 2009

Memorandum from the Private Secretary to the Lord Chief Justice

I can confirm that the Lord Chief Justice was asked, by the Ministry of Justice on behalf of the Treasury, to nominate a retired member of the judiciary to take on this work. He was sent a copy of the (near-final) draft terms of reference. The LCJ was satisfied, for a number of reasons, that it would be appropriate to nominate a retired member of the judiciary. These included the importance of the issues raised, the requirement for apportionment of responsibility and the need for public confidence in the advice to be provided. The LCJ's view was that Sir John Chadwick's professional and judicial experience, together with his personal qualities, made him eminently suitable for this appointment.

The LCJ has since considered the issue further, in the light of the concerns raised by the Equitable Members Action Group. He remains content that there is no difficulty in, or impediment to, Sir John acting in accordance with the invitation extended to him.

March 2009

Memorandum from Peter Scawen, Chairman, Equitable Life Trapped Annuitants (ELTA)

Firstly, I consider that it is deplorable that the Government has cherry picked between the findings of maladministration and injustice and set up the parameters of an ex gratia payment scheme both to restrict the categories of policyholders to whom payments are made and the amounts of those payments. I entirely endorse comments by EMAG that compensation should be universal in its application and fully delivered. Nothing in this additional submission should be read as diverting from that principle. I set out the position of annuitants solely as that is the group of policyholders where my experience lies.

Further, to the extent that the partial acceptance will result in groups of annuitants receiving no payment when they would otherwise have done so, as will be clear from my comments below, I consider that this would be a disgraceful outcome.

I note that Sir John Chadwick is instructed merely to advise and there is no confirmation that his conclusions will be accepted. Similarly there is no reference to a timeframe. Both issues are disturbing. As has been confirmed repeatedly, policyholders are dying every day. It is noteworthy that the Government reserves its right to make representations "relevant to disproportionate impact" and the issue of the fault that rests with Equitable Life or its advisors. However, the terms of reference state that only if it is deemed necessary, should Sir John Chadwick receive representations from the various classes of policyholders. Clearly, there needs to be even-handedness particularly as the Government has set up the terms of reference.

I find it disturbing that the Government's response fails to record how the with-profits annuity works and simply sets out the perspective of a savings product. The explanation of the categories of bonus reinforces the fact that HM Treasury seems unable to understand the issues arising from the with-profits annuity and the issues faced by policyholders making an irreversible purchase of a product to deliver income in their retirement.

With those comments in mind, my remaining comments are solely addressed to four headline terms of reference in so far as they apply to annuitants and to illustrate that further delay should not be permitted.

Relative Loss

The Government's definition of relative loss is "a loss which policyholders would not otherwise have suffered had they invested or saved elsewhere than Equitable Life". (Again, this reflects the lack of understanding of annuitants.) There is also a reference to "wider market conditions". With-profits annuitants would not have bought these annuities had they known the true state of the finances which would have been the case without the maladministration. In respect of annuity policies, the alternative products that would have been purchased maintained their value and would not have sustained market losses. (Indeed, those alternative annuities would have been similarly insulated by the ultimate protection in the event of insolvency of the provider by Financial Services Compensation Scheme protection.)

Apportionment of Losses

There is an attempted distinction between losses resulting from maladministration and other losses. This appears to stem from the much-quoted passage from Lord Penrose, which has been specifically isolated to magnify its effect. I contend that it is plainly irrelevant to annuitants. If the Society had been properly regulated, these individuals would not have purchased these policies. It is not the role of the Society that is being addressed here but the regulator. A proper acceptance of the Ombudsman's full findings should result in proper compensation for the full effect of its maladministration. That effect has been the purchase of policies, which would otherwise not have been purchased. It is not a piecemeal apportionment.

Greatest Impact

This is plainly an attempt to divide policyholders. As set out above, I have no intention of categorising with-profits annuitants as having suffered more or having a more deserving case. I simply comment on the impact that I know has been suffered. I know of very many annuitants who having retired are now suffering from the usual degenerative diseases of old age (cancer, Alzheimer's and dementia, arthritis etc). They are unable to work to replace income that they have irretrievably lost and which with future prospects will continue to decline. Most are in their seventies or are older.

Disproportionate Impact

As set out above, I do not seek to differentiate with-profits annuitants from other policyholders and there should be no differentiation between annuitants.

Some annuitants have theoretical capital reserves tied up in their properties but no other income. Some have other income but no capital reserves. Each of their individual circumstances differs. However, the key issue is that all have in fact suffered very significant cuts in their income in comparison to the alternative pensions that they would otherwise have secured. The guaranteed proportion of the annuity decreases as

time passes and this singular characteristic has caused so much hardship as the payments under the policies have themselves declined. All should be compensated for the resulting effect on their pension income. Means testing has already been very specifically rejected.

Additional Evidence

There is reference to the Penrose Report, the Ombudsman's Report and the Government's response. I am surprised that there is not reference to the European Parliament report dated 4 June 2007 (particularly on the issue of the Third Life Directive which is clearly relevant to the issues relating to the regulation of the Society) or the decision of the Actuarial Disciplinary Tribunal dated 30 January 2007 (particularly as it is a testament to the manner in which the Society was allowed to behave by the regulator).

Calculation of Losses

Those are my comments regarding the criteria in the terms of reference. However, there is a further issue on the calculation of loss for annuitants. The maladministration has plainly caused significant losses but how can the terms of reference be properly addressed in respect of impact without an understanding of the actual individual losses sustained. I note that Sir John Chadwick will have access to, subject to the co-operation of the Society, basic data of the annuitants. I presume that this will include:

- consideration;
- commencement date;
- anticipated bonus rate (anything between 0% and 7.5%);
- whether the guaranteed interest rate applied (policies pre-dating July 1996);
- spousal benefits (anything from 0% to 100%);
- initial guarantee period (anything from 0 to 10 years);
- dates of birth of policyholder and spouse; and
- the relevant annuity rate (unique to those circumstances).

If that data is not made available, clearly, it is unreasonable to expect elderly pensioners to provide it. In any event, he will also need:

- the alternative transaction and that annuity's details;
- expert evidence on future bonus rates; and
- expert evidence on future discount rates.

These are the starting blocks to determine the effect of the maladministration on individual annuitants and the potential losses that have been suffered.

Conclusion

I am disappointed that the Government has sought to restrict its acceptance of the findings of such a comprehensive and well-researched report. I have set out my consideration of the terms of reference where findings are accepted in the context of annuitants to illustrate how those terms of reference should not be allowed to further restrict the deserving cases of the policyholders that fall within the categories. The consideration of this individual group of policyholders in respect of whom I have experience strongly suggests that arguments with equal force can be made on behalf of all other policyholder groups. The piecemeal acceptance and the artificial restrictive terms of reference should not be allowed to further delay what is a most deserving case for full and proper compensation.

January 2009

Further memorandum from Peter Scawen, Chairman, Equitable Life Trapped Annuitants

Introduction

1. I have spent some five years looking into the issues facing the with-profits annuitants of Equitable Life (ELAS). During that time I have established two organisations, EQUITABLE LIFE TRAPPED ANNUITANTS (ELTA) with some 2,500 members, approximately 5% of the total annuitant community, and ELTA CLAIMS LTD (ECL) that represented the community of over 400 policyholders in the recent court case.

This has enabled me, in conjunction with the lawyers of Clarke Willmott, their associated counsel and actuaries, to acquire extensive knowledge and experience of not just the policies themselves but also the issues facing annuitants when trying to determine the quantum of compensation that each should receive for each policy.

2. I have made written submissions to the Parliamentary Ombudsman and to the EQUI enquiry in Brussels.

Incredible as it seems, it appears that the Government and Parliament is trying to develop a compensation scheme for the ELAS with-profits annuitants without any data and consequent statistical analysis of the issues.

This submission will try to address this point based on my experience to date and is offered in the hope and desire that an approach will be developed that treats all with-profits annuitants fairly with respect to each other (and I must stress again fairly to other policyholders with equal claims) but with due respect to their privacy and the personal issues that they are facing and not least with a sense of urgency before more of the people whose interests I represent die.

I was unable to attend the session held on Thursday 29th January, though I was able to submit my 3rd written submission beforehand and now offer this addition 4th written submission having read:

(A) UNCORRECTED TRANSCRIPT OF ORAL EVIDENCE
To be published as HC 219-i

(B) JUSTICE DELAYED: THE OMBUDSMANS'S REPORT ON EQUITABLE LIFE
Second report of session 2008–09 Volume II

These documents raise a number of issues that I consider need to be covered in more detail.

1. Executive Summary.
2. Points arising from the meeting of 29 January.
3. Financial Compensation.
4. A With-Profits Annuitant—Case study (Mr & Mrs F).
5. Caveat Emptor.

I would like to thank the committee for allowing me to make a further written submission and for their support of the policyholders' claim for compensation. We will not succeed in receiving justice save with them and through them save with the support of Parliament as a whole.

Executive Summary

1. The numbers and statistics we use unless specifically stated otherwise are derived from the community of with-profits annuitants that participated in the litigation with ELAS. It has been argued that this group may not be a typical sample and the analyses and projections are therefore skewed in some way. I think I can positively state that they are likely to be skewed but how and in what direction I have no idea.

We have stated that we estimate that the losses incurred by the annuitants are of the order of £6 billion + −20%, (see 2nd written submission), which itemised how the figures were determined. Colin Slater and I have discussed our respective figures and he is of the opinion that ELTA's are too high. I think EMAG's figure is too low because it fails to take into account the full losses sustained by annuitants. Again I think I can positively state that both figures are likely to be wrong but who is closer to the real figure only time and a lot of work will tell.

It is a sad reflection on the discussions that we are having and on the approach that the Government is trying to introduce, that the information provided by ELTA is THE ONLY source of reliable data about the annuitants. Clearly, the Treasury has been in a position to request information from ELAS (and indeed as far as is necessary the Prudential) for a very considerable period. Until we have reliable data then no compensation figure for any policy can be decided. Any scheme of payments introduced will be neither transparent nor fair nor just.

2. The personal circumstances of each individual with-profits annuitant vary so much that it is difficult to envisage a just and fair methodology that can be developed WITHOUT VERY INTRUSIVE ENQUIRIES into their financial affairs and that MUST inevitably involve inviting annuitants to make written submissions to Sir John Chadwick and in effect to set out their circumstances to him so that he can set out the criteria in respect of the issues raised by the Government. I regard such a process to be wholly unacceptable.

3. Any process that does not treat each policyholder strictly and demonstrably on the basis of their individual financial loss invites legal challenges to the whole process and from individuals or groups of individuals with all the consequent delay and costs.

4. When the detail of each individual's life and circumstances is considered, the concept of "disproportionate loss" simply does not and cannot work in any way that is fair and just. If Sir John Chadwick's brief cannot be changed, then Parliament must demand that he allows ELTA, and others such

as EMAG of course, full access so that we can assist him in making the distribution as fair as is possible. After all "disproportionate loss" does not by definition exclude each and every case being considered, deciding that all annuitants have been so affected and allocating money in a just methodology to all of them.

5. The only just methodology that ensures that this compensation process is not open to challenge in the courts, is to do the detailed research to determine individual losses, aggregate them and allocate the compensation on a pro-rata basis per policy for each and every policyholder class (see Financial Compensation below).

6. Having said all of that, I am most concerned currently by the very small proportion of policyholders that are in fact covered by the elements accepted in the Government's response. I regard such a conclusion to all the energy and work devoted to this issue by the Parliamentary Ombudsman, the thousands of policyholders who have complained to their MP's, Parliament itself with a loss of parliamentary time and the various pressure groups to be a disgraceful demonstration of the contempt that the Treasury apparently holds for the public.

1. Points Arising from the Meeting

(a) I entirely support the comments made by Ms Abraham and Mr Olgilvie, which are expressed so eloquently that there is nothing left to add, save perhaps that the Government's actions seem almost to invite a judicial review, further delaying the compensation process.

(b) Q42 Kelvin Hopkins. The mechanism described will work perfectly for the annuitants save that in order to allocate the money, one needs to know exactly what each policy has lost so that the compensation can be correctly allocated. The allocation process is trivial, collecting that data is a major task. I will address this in more detail below.

(c) Q46 Mr Prentice. The phrase "disproportionate impact" will come to haunt the Government, this enquiry and all policyholders. How do you distinguish between a person who has lost 50% of his income but owns two properties compared to someone who has no assets and an income that is ordinarily adequate to live on but not enough to pay for occasional items, new boiler, replacement car, etc? Or take Mr & Mrs F whose details are set out below who apart from losing 50% of their income now have to face the real possibility that Mrs F will have no income if Mr F dies soon?

Each policyholder will have grounds for arguing he/she has been "disproportionately impacted" depending on their personal circumstances. It would indeed be obscene if each of the 50,000 annuitants were required to justify their claim against other annuitants and policyholders and it beggars belief how anyone could develop a scheme of payments that was seen to be just and fair, without in effect Sir John Chadwick "trying each claim" and making a judgement on very individual criteria to determine the "classes of policyholders".

(d) Q56 Mr Skinner. Actuaries have already been engaged extensively by ELTA and ELAS in considering issues of loss and their details are a matter of public record.

(e) Q58 Mr Prentice. I am not sure why this is "baloney" as in fact whilst the "typical" relative loss for different types of policy can be determined without individual details the exact actual individual loss and therefore the proper aggregate amount cannot. Each policy must be evaluated, the loss determined and aggregated with all the other policies. The data that Equitable has is vital but it is not the only data that will be needed.

(f) Q68 Chairman. With respect ELTA has provided data values of its estimated claim based on our experience in court. They are robust figures derived by actuaries and whilst I accept the sample may be skewed, to date it is the only statistical sample available to the Committee regarding annuitants' losses.

2. Financial Compensation

No matter how "disproportionate loss" is finally expressed arithmetically, I cannot envisage any process other than investigating each and every policyholder's annuity in detail and determining their loss, and aggregating all their losses to determine the correct aggregate loss for annuitants.

It is only with this amount of data can Sir John allocate what funds that are made available by the Government in a fair, just and most importantly transparent fashion.

I have set out previously, the written submission I made to this committee prior to the meeting of 29 January but I will restate here in a somewhat different format.

The data that Sir John will require is as follows:

(A) *For each individual annuity policy*

- consideration;
- commencement date;
- anticipated bonus rate (anything between 0% and 7.5%);
- whether the guaranteed interest rate applied (policies pre-dating July 1996);
- spousal benefits (anything from 0% to 100%);
- initial guarantee period (anything from 0 to 10 years);
- dates of birth of policyholder and spouse;
- the relevant annuity rate (unique to those circumstances); and
- the actual annual payments for each year of the policy. This includes these four elements:
  - The basic annuity.
  - Declared bonus annuity.
  - The un-guaranteed annuity.
  - The total gross annuity.

This data is available from ELAS and now the Prudential.

It has been suggested that if the most recent year's annuity statement is available then it is possible by backward iteration to determine much of the data above. In theory this is correct but because of the discontinuity of payments in the period 2002 to 2006, (following the closure of ELAS for new business) this is not in fact feasible. In any event much of the other data required to correctly undertake this work is still required.

(B) *Global*

1. The annual declaration by ELAS and now the Prudential of:
   - The Declared Bonus Rate.
   - The Overall Bonus Rate.
   - The detailed changes made each year in the period 2002 through 2006 whilst the Society was adjusting annuity policy payments to bring them into line following its closure for new business.

2. From the Prudential its estimate of future bonus rates. It must be noted that relatively minor changes to this has a profound effect on the quantum of losses for each policy so that in order to ensure transparency, this number (or numbers) should be cross referenced by an independent expert.

3. If policyholders are to be awarded a lump sum payment, then an independent assessment of future discount rates is essential, again to ensure transparency.

(C) *From each individual policyholder*

Each policyholder will need to submit what their "alternative transaction" would have been had they not purchased the with-profits annuity as a result of this mal-administration.

The Alternative Transaction is their choice of one of the other annuity types offered at the same time. Typically these were as follows:

- A guaranteed level annuity.
- A 3% escalating annuity.
- A 5% escalating annuity.
- An RPI linked annuity.

Each annuity type will produce a different, very different quantum of loss and thus any claim must be substantiated with written evidence, unless the choice was a guaranteed level annuity, which was the alternative transaction of choice by the majority claimants in the recent court case.

My experience when a cross-section of Equitable annuitants were supplied with the starting levels of the alternatives and asked to consider the alternative product they would have purchased is that:

- 57% would have chosen a level.
- 23% a 3% escalating annuity.
- 8% a 5% escalating annuity.
- 12% an RPI-linked annuity.

(D) *From the actuarial profession*

— Each policy has a unique starting annuity rate depending on the choices set out in A) above and the state of the market at the time. Somewhat surprisingly I am told that this type of data is not generally retained by ELAS (or the industry in general) but it must be calculated from other data that they hold.

— The current mortality tables.

With all of this data, it is possible to determine:

— What the with-profits annuity would have paid over the actuarial life time of the policy, taking into account all the reductions that have occurred and will occur in the future; and

— What the "alternative annuity" would pay over the same period.

The difference between the aggregate values of the two over the lifetime of the policy is the loss. This may seem like a very onerous task but in fact the calculation is fairly routine once the data has been collected.

The aggregate loss for all the policies represents the total quantum of the claim for the with-profits annuitants class of policyholder.

There will of course be a similar, though different in detail, process that has to be followed for each of all the other policyholder classes.

The aggregate of all the losses for all policyholder classes then represents the total quantum of losses and with that, the compensation made available by the Government can be easily distributed across each policy in a just, fair and transparent manner. More importantly it will not be open to challenge through the courts.

3. A With-Profits Annuitant—Case Study (Mr & Mrs F)

This husband and wife have been in contact with me by phone, letter and e-mail for some years and recently sent a copy to me of a letter they had written to The Treasury, enclosed as an Appendix, with their consent of course, save for details that would identify them. Even at this late stage in their lives and in their very difficult situation, they do not want their personal and private details to be open to one and all.

Their letter sets out clearly typical issues facing probably the majority of annuitants.

They had their own business, saved prudently for their retirement, which they effected in 1989 and as can be seen had a decent pension of just over £31,000 per annum but made up of 7 separate pensions consisting of five with-profits annuities from Equitable Life, plus a further two conventional annuities one from Equitable and the other from GE, plus of course their state pension which I assume started on their respective 60th and 65th birthdays.

Mr F had suffered a number of illnesses with the most recent scare, the possibility of cancer of the liver, yet to be confirmed. Obviously we all hope and pray that this prognosis is not correct and this burden at least can be lifted from Mr F's shoulders.

But Mr & Mrs F present some typical issues regarding compensation that we must recognise:

(1) They have multiple policies with Equitable Life.

(2) With an income of £15,000 per annum plus say another £10,000 from their state pension, they actually have a "reasonable" income, but since they have a mortgage their discretionary income is probably extremely limited. (I regard discretionary income as that amount of your income that is not pre-committed to paying standing costs, mortgage, utilities, etc, small amounts of savings to cover exceptional costs that arise from time to time, boiler breakdown, major car repairs).

Through no fault of their own, annuitants have set aside money prudently for their retirement and now find that yes they can manage, and they will cut back, rely on family and social services, but the period of their lives when they tried to ensure they would not have financial worries is now one of stress and anxiety.

With a 50% reduction in their annuity income from ELAS, Mr & Mrs F have been catastrophically affected by the demise of ELAS. That, of course is self-evident but even a small reduction in a family's overall income, even as low as 10% might create financial problems that would not be automatically evident from a cursory glance of the loss tables. For example a couple with no or limited assets might have an income capable of meeting their needs, if they had a mortgage and some debts arising from purchases so that their discretionary income is in effect zero and any reduction will create problems for them.

3. Mr F is not healthy and he is concerned that his wife will be left without adequate financial resource in the event of his early death. I have no doubt that this alone is adding substantially to his level of stress, which as is generally accepted is a primary driver at least in heart disease and some cancers.

In my many conversations with annuitants over the last 6 years, the one constant theme is illness and concern for the future arising from this catastrophe that has befallen them through no fault of their own.

4. Their financial situation will get worse, even assuming a long and healthy life, as their annuity is guaranteed to decline each year for the foreseeable future. Of course if Mrs F is widowed then her situation will be close to disastrous.

> This again is not atypical. The problem that it creates for Sir John Chadwick is that any annuitant might fail the "disproportionate loss" test today but pass it in a few years time when this is all forgotten. That is quite unacceptable and unjust. The only way to ensure that Mr & Mrs F at least feel decently treated is to ensure that they get their share of the money that Government feels it is able to put on the table.

So to summarise, when you look at the detail of each individual's life and circumstances the concept of "disproportionate loss" simply does not and cannot work in any way that is fair and just. As stated, if Sir John Chadwick's brief cannot be changed, then Parliament must demand that he allows ELTA, and others of course such as EMAG, full access so that we can assist him.

4. Caveat Emptor

People objecting to any compensation being paid to policyholders frequently quote this phrase as if it represents the legal position. There are several problems with:

1. It is not a law. If I may quote from the Concise OED: "Caveat Emptor: the principle that the buyer is responsible for checking the quality and suitability of goods before purchase." So it is not some binding term in a contract just some pithy advice. Not to be ignored of course but not mandatory.
2. Even if it is, it is the wrong law. The entire point is that these circumstances relate to a regulated industry. Indeed, there is a substantial argument that these are contracts to which the principle of "utmost good faith" applies as insurance contracts. It is nonsense to raise an irrelevant "legal" phrase entirely out of context. The entire point is that the with-profits annuities were compulsorily purchased contracts to provide a "safe and secure" income in retirement and were specifically approved by the Government for this purpose from a body, which was subject to regulation by the Government and provided them in a way that was regulated.
3. Ignoring the fact that it is not a law and is not applicable, what exactly might this mean in the context of ELAS?

   In today's highly complex world it is impossible for anyone to be an expert in the products and services available today. How do you determine if the car you are driving, the plane you are flying in, has been designed carefully and prudently, and does not have inherent faults known to the manufacturer, the regulatory authorities etc. Nobody outside a select few of technicians and engineers have that capability. We are entirely reliant on the expertise and integrity of the manufacturer and the endeavours of the regulating authorities to ensure that products comply with the agreed industry standards. That is an analogy but it is obvious how it applies to financial services and it is exactly why as a result that financial services is a regulated industry.

There is no possibility that policyholders could have understood the very technical details of the with-profits annuity and were entirely reliant on the effectiveness of the regulatory system. The policyholders were let down.

With all due respect the principle of caveat emptor does NOT apply in this situation.

February 2009

APPENDIX

CASE STUDY—Mr & Mrs F

Dear Peter,

I write to you in the knowledge of your valuable assistance in a fair solution to the Equitable problem. Because of the recent statements in Parliament last week and my personal problems I can not afford to wait another eight years nor possibly another eight months. I believe there was a suggestion of an early "Interim Payment" to benefit "Proportionally Disadvantaged" parties. Along with my fellow With Profit Annuitants and their dependants who have suffered the most severe penalties exacted by the society since year 2000 in particular years 2003–04 when the final bonuses were almost one hundred percent withdrawn, we believe resulting in With Profit Annuitants paying the major price in keeping the society solvent. Many of us have seen our lives badly affected and it could be suggested that the whole sorry affair has contributed to many other unexpected problems other than loss of money such as health and family.

I am trapped in more ways than one, Equity release is not an option as my wife is 14 years my junior and at her current age I am unable to obtain an adequate sum and anyhow capital now produces little return. My home is big, old and very costly to maintain and now impossible to sell at a realistic price and offers no short term solution.

As time could be pressing and the subject urgent I would be very appreciative if you could present my case before any Body or persons who could quickly process and consider my claims. Hopefully you may be in a position to assist and I assure you of my thanks for any assistance you can offer.

Yours Sincerely,

Mr *

PS

I am attaching what I hope are adequate details to support my claim and would be happy to provide any confirmation or further detail required.

Mr * born 19-04-1930 [78 years and 9 months]
Mrs * born 02-06-1944 [64 years and 7 months]

Health record Mr *: 2003 stroke. 2006 Bells Palsy. Skin cancer removed. 2008 heart disease diagnosed. Liver tumour, scans and biopsy in progress.
Mortgage: £35,000 short term, interest only.
Personal assets of approximately £9,000.
Outgoings estimated exceeding income by a minimum of 20% excluding any travel/holiday costs and unexpected maintenance repair and replacement expenses.

Pension savings invested of approximately £300,000 from Equitable pension policies plus transferred from Abbey Life and other provider all invested in Equitable Life With Profit Annuities.

Income Year 2000 Equitable Life		*Year 2008 Transferred to Prudential*
Commenced 01.10.1989 Ref P2005470		Ref 190122/0570365610
£18,815.60p	−£10,190.48p = -54.16%	£8,625.12p
Commenced 01.04.1990 Ref R0276441		Ref.190118/0570491740
£3,572,78p	−£1,970.54p = −55.15%	£1,602.24p
Commenced 01.06.1990 Ref R0103131		Ref 190206/057037990
£937.58p	−£519.74p = −55.04%	£417.84p
Commenced 01.05.1988 Ref ANN0024902		Ref 190125/0570091190
£3,643.27p	−£1,584.07p = −43.05%	£2,059.20p
Commenced 01.05.1988 Ref ANN0051242		Ref 190125/0570215760
£4,305.01p	−£1,326.97p = −30.82%	£2,978.04p
£31,274.24p Total	−£15,591.80p = −50% Total	£15,682.44p Total Continuing to decrease year on year
Plus other private annuity pension.		£33.40p
Commencing 2003 Equitable Life.		
Commencing 2004 G.E Life.		£785.00p
Total of all pensions annual gross 2008		£16,500.88p
Plus DHSS State Pension		

Estimated loss of Equitable with profit annuities in years 2000–08 approx £86,000 taking no account of any improvements and benefits as enjoyed before 2000.

Printed in the United Kingdom by The Stationery Office Limited
3/2009 422395 19585