RESPONSE TO THE MYNERS REVIEW

OF THE GOVERNANCE OF LIFE MUTUALS

BY THE EQUITABLE MEMBERS' ACTION GROUP

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1. SUMMARY AND RECOMMENDATIONS

Large mutuals have outgrown their origins as small groups of people banding together to pursue a common purpose, and they are now large organisations pursuing multiple purposes. In the process – along with importing mainstream corporate culture and changing titles from "General Manager" to "Chief Executive" - the basis of mutuality has been lost sight of. The Equitable, like many mutual life offices, is constituted as a company, and this misleads people into thinking that the governance and board behaviour of a mutual should be like that of a public limited company. Indeed the manner in which the questions for consultation have been drafted, starting with the board and only in Q7 getting to policyholders, perhaps reflects that view. In the summary we start with policyholders.

The key points we make are that:-

Regarding member[1] involvement and the ability of members to hold a board to account

There are significant barriers facing policyholders who wish to be engaged in a large mutual, namely:-

- Lack of information. Equitable has run a deliberate policy of withholding information from policyholders. Yet without better disclosure of information there is little hope of policyholders playing a meaningful role

- Obstructionism to providing contact details of members, and the absence of funding for communications

- Unrealistically high hurdles in terms of numbers of members required to vote for a resolution at an annual general meeting or to propose an extraordinary general meeting

- The board of Equitable presented a distorted view of EMAG and of a resolution proposed by members to fund EMAG making a petition to the European Parliament and legal action against the government for failing to implement the Third Life Directive properly. The board opposed the resolution, yet did not propose backing a representative case on behalf of past and present members. Whose interests was the board pursuing – is there a hidden agenda? *We do not consider the board's behaviour regarding the resolution met the standards that should be expected of mutuals*

- The threat of petitioners having to pay for costs of resolutions to annual general meetings and calling extraordinary general meetings, which is now the case with Equitable following the board recommending members vote against a subsidiary resolution

[1] We use the word "member" to denote those policyholders who are also the owners of the business, i.e. the with-profits policyholders.

Members have negligible ability to hold the board to account, which depends in part upon the provision of information, and in part on their ability to appoint and deselect directors. This requires that voting arrangements should not be designed to ensure the perpetuation of a board as a self appointed – and appointing – oligarchy and to repel "boarders", and to protect the board

We recommend that there should be legislation covering mutual life offices that:-

- **Requires the boards to inform members of significant commercial matters affecting their interests (subject to *genuine* confidential issues)**
- **States clearly that policyholders should be entitled to an *informed* say in the major strategic decisions taken by a mutual (e.g. to demutualise; to diversify; to reward or remove the directors; etc.). We believe members have a RIGHT to information about THEIR MUTUAL AND THEIR MONEY, and there should be the equivalent of an *effective* freedom of information right for members**
- **Requires the Memorandum and Articles of Association to be written to allow reasonable opportunity for members to put resolutions to Annual General Meetings (AGMs), and so that a reasonably small number of members can call Extraordinary General Meetings (EGMs). In the case of Equitable the numbers should be 500 members (which is the number required for a large building society under the Building Societies Act 1986), which would provide a serious enough hurdle to eliminate vexatious motions**
- **Amends company law to make it clear that the costs of meetings and resolutions arising from requisitions made under a company's articles are always at the cost of the company**
- **Requires that a resolution by members should be put to Annual General Meetings unless there is a blatantly obvious reason as to why it is manifestly inappropriate**
- **Gives members' resolutions prominence and restricts a board's response to whatever number of words the petitioners are allowed**
- **Requires that members putting resolutions have as much presentational time at an EGM or AGM as the board, including a right of reply**
- **Enjoins a board not to make incorrect statements about the proponents of a resolution or about a resolution, but to present information in a fair manner**
- **Requires a board, where it quotes legal opinions or publishes legal opinions, to publish the instructions and the opinions (excluding matters of genuine confidentiality. Clearly if the board is publishing advice it cannot be so confidential as to preclude publishing the instructions)**

- **Requires a company to provide members on request with a digital list of members and their addresses in a convenient machine readable form for a small service fee reflecting the cost of provision**

- **Requires that three directors should be elected on a free vote with no comment by the incumbent board**

- **Bans proxies and negative voting,** which is a consequence of the Companies' Act provision of putting a resolution requiring a for and against vote. The process can confuse members, and can lead to idiosyncratic results. **The voting should be postal voting with members provided with a list of X names and they vote for Y of them (Y < X)**

- **Requires that there should be an elected Committee of Members (none of whom should be members of the board) appointed by free vote, and resourced by the mutual. This committee would:-**

  * **appoint the auditors and fulfill the role of an audit committee**
  * **appoint an independent actuary (who should be legally responsible to the Members' Committee, not the directors, and should not be indemnified by the company at members' expense).** ***We consider it most inappropriate that the independent actuary was shortly afterwards employed by Equitable as an expert witness***
  * **have a right to be consulted on, and be charged with commenting on major policy issues such as demutualization, sale of major parts of the business, insolvency, major legal cases, new business ventures**
  * **be entitled to specify matters that must be reported in the Annual Report and Accounts**

  We regard such a committee as a check and balance against the board, which should properly be concerned with running the business but subject to scrutiny.

- **Imposes on the auditor a clearly defined legal duty to the members**

- **Requires that the board of a mutual should not discriminate against any policyholder or group of policyholders**

Regarding policyholders of a mutual compared to a proprietary office

- We do not see that there is a significant difference in the relationship between policyholders qua policyholders with a mutual life office, and that with a proprietary office. They should both be given full information about the financial aspects of their policies. But the members are also the owners of a life business, and they assume in addition ownership risks. **They should be fully informed of all the risks they are being invited to assume (which regrettably they were not, and still are not, by Equitable), and be empowered to get rid of the management.** There need be little or no difference in risk adversity of investments

Regarding a governance code for life mutuals

- We are sceptical of the value of preaching good intentions through codes. **We consider that if guidance on corporate governance is prepared for mutuals it should be a much crisper,**

less verbose document than the Combined Code, and it should be backed by statute of general (as opposed to detailed prescriptions) litigable duties that set a framework for the governance of mutuals

- **The code should recommend in the strongest terms that it is not appropriate for any member of the board (let alone the chairman) to have numerous directorships, and believe that they should be limited to three other directorships. While the current chairman's portfolio of activities may be appropriate for a character in the Mikado, we cannot see how his wide range of responsibilities can leave enough time to devote to Equitable**

Regarding non-executive directors

- We agree with the views expressed in the Cadbury report enjoining non-executive directors to bring "an independent judgement to bear on issues of strategy". **The role of a non-executive director should be to challenge the executive and (when (s)he is acting de-facto as the executive leader as is the case in Equitable), the chairman**

- It is clearly difficult for them to exercise this role when they are behoven for their appointment to the patronage of the chairman, as is the case in Equitable. Proxy voting provides the chairman de facto with the power to control board appointments. **As we recommended above proxy voting should be eliminated**

- Although we do not have much faith in non-executive directors**, we consider that the board of a life mutual should consist mainly of non-executive directors in the hope that they may act as a check to the "agency" problem[2] that clearly occurred at Equitable (and in other mutuals)**

- **They should all be provided with training on the economic and legal issues of life mutuals when they assume their posts, so that they cannot plead as an excuse when a business fails "I did not understand it"**

The role of the FSA in governance

- We do not consider that the FSA has done *anything* to improve the governance of Equitable. We have asked Mr. John Tiner, the chief executive of the FSA, for help both to obtain information from Equitable and to ensure that Equitable treated fairly the resolution that 1100 members (activated by EMAG) put to the recent Annual General Meeting. He has refused to help on *any* matter on which we sought the assistance of the FSA, and did not reply to our request regarding the resolution. He sat on his hands while Equitable inaccurately described EMAG and the resolution

- **We do not share Penrose's view that the FSA should have a further role in improving corporate governance**. In part this view is a consequence of our perception that regarding Equitable the FSA's main concerns are:-

[2] An agency problem occurs when the interests of an agent, such as the management of an organisation, differ from those of the owners or principals and the agent pursues its interests.

* to cover its back for its incompetent regulation over the period 1999-2000, and the incompetent regulation by the government over the period 1988-1999

* to ensure that Equitable does not go into corporate insolvency and thereby cause political difficulties and costs for the government. We imagine that one of the early actions of a liquidator would be to follow the example of the liquidator of BCCI and litigate against the government and the FSA for failure to regulate properly

The FSA's priorities appear to be first to itself; second to the government; third to the financial services industry; fourth to Equitable; and policyholders come a very poor fifth – the FSA cannot be relied upon to look after policyholders' interests.

The second reason for not wanting to give the FSA more duties is that it is already trying to do far too much, and much of that is poorly done.

We consider that policyholder groups can be an integral part of the accountability of a mutual. **We hope that the review will introduce measures that will make it clear to the boards of mutuals that they have to be open and accountable to policyholders. We hope that there will be no need in future for policyholders to undergo the abuse of mutuality that has occurred with Equitable under both the previous and the current board. We hope that the measures will deal with the problem of mutuals identified by Lord Penrose in his report (chapter 9, para 198):-**

> "There is no-on who can intervene effectively to influence the activities of what must remain a form of organisation managed by a self-perpetuating oligarchy, selected on an unaccountable basis by current directors as their successors in office, and vulnerable to the influence and, in an extreme case, control of professional actuaries who are answerable, if at all, only to those same directors who are fundamentally dependent on their advice."

2. INTRODUCTION

We respond to the consultation document in two parts. First, we respond to the particular questions raised in the consultation document. Second we set out in our "free form response" a description of some of the issues that we have identified in our unsatisfactory dealings with the Equitable Life Assurance Society (Equitable). We consider the possible roles of policyholder groups and describe the virulence of the attack on EMAG by the chairman of Equitable, which seemed designed to undermine the credibility, if not destroy, EMAG.

There are 5 annexes which provide chapter and verse substantiation of our criticisms of the behaviour of Equitable and the Financial Services Authority (FSA):-

1. Equitable inaccurately describes EMAG and a resolution to the AGM put by some of its members who are also members of EMAG
2. Seven examples of obfuscation and obstructionism by Equitable
3. The episode of the Review of the Memorandum and Articles of Association
4. Letters to Mr. John Tiner seeking the assistance of the FSA, and his unhelpful response
5. EMAG's recent submission to the Treasury Select Committee "The failures over the period 1999-2003 of the Financial Services Authority (FSA) in protecting the policyholders of the Equitable Life Assurance Society"

3. RESPONSE TO THE QUESTIONS IN THE CONSULTATION DOCUMENT

Q1. *To what extent does the current guidance on corporate governance, particularly the Combined Code of Corporate Governance, provide an appropriate framework for mutual life offices? Would another approach be more effective?*

The guidance in the Combined Code is largely a wish list of good practice. Apart from a few features of the governance code which are necessarily visible - such as whether there is a separate chairman or chief executive, or an audit committee – outsiders have little or no way of knowing what is in practice being implemented. There may be an audit committee (as there was in Enron headed by an accountant, and in Hollinger with all manner of prima facie worthy people on it), but it may not be effective. We note that the main thrust of the code is about the "internal" functioning of a board and business, with very little about the relationship with shareholders other than "institutional shareholders". **We consider that if**

guidance on corporate governance is prepared for mutuals it should be a much crisper and less verbose than the Combined Code[3].

Q2. *What is the best way of securing mutual life offices' compliance with corporate governance best practice?*

Legislation that defines a framework of duties which can be litigated.

Q3. *In your opinion should the ownership structure or the nature of the business conducted by a life mutual affect the composition or structure of its board? If so how?*

In view of the vigorous efforts that have been made by the boards of Equitable, Standard Life, and Nationwide to ensure that board nominees are elected and to repel "boarders", **we believe that nominations for three positions on the board should be subject to a free vote with no recommendations either pro or con from the board, no chairman proxies, and no negative votes.**

There is a sub-question "How important is it that the non-executive directors of life mutuals should possess specialist knowledge? What specific types of knowledge are most relevant to the conduct of life business in a mutual ownership framework?

> Clearly it is important that some of the non-executive members of a life company should possess specialist knowledge relevant to the business (e.g. of investment, actuarial practices, accounting for life companies, and legal and regulatory issues), but others should possess critical minds. **All should undergo a training course.** The with-profits life assurance business is technically very complex (while unit linked business is not simple), both in respect of the legal and regulatory framework within which they operate, and in their economic context. Any non-executive director should be expected to attend a course which explains the legal and regulatory framework; explains the behaviour of the stock and bond markets; and in the case of with-profits funds, the operation of such funds should be explained including basic actuarial principles based on financial economic theory. **Directors should not be able to plead as an excuse when a business fails "I did not understand it".**

Q4. *In your experience is the information and advice (including actuarial advice) used by the non-executive directors of life mutuals sufficient – in terms of quality and relevance – to*

[3] We embolden our recommendations.

enable them to exercise effective oversight of the executive? In what ways might it be improved? If more information and advice is needed, what are the resource implications? Do similar issues arise for the non-executives of other complex businesses, such as wholesale banking or science based businesses?

We cannot comment in general on the quality of information and advice given to the current board. We note, however, that it:-

- Was unable to devise an equitable basis for the policy cuts on 16 July 2001. The board unimaginatively imposed equal cuts of 16% on the values of all policyholders, which was manifestly unfair to later joiners[4]. EMAG suggested that the costs of the House of Lords decision should be born pro-rata policyholders' total bonuses (i.e. guaranteed plus non-guaranteed), which would have meant they fell more heavily on longer standing policyholders –who benefited from a decade of excessive bonuses – and less heavily on later joiners, who did not.

- Has been unable to resolve the issue of policies with guaranteed investment returns of 3½% (GIRs), which hamstring investment, and are unfair to policyholders who joined post-1996 and do not have GIRs. EMAG proposed in August 2001 that the GIRs should be included in the compromise. More recently EMAG proposed that policyholders with GIRs are offered the choice of giving them up in return for a somewhat more aggressive investment policy. The board has blown cold and hot on this proposal, but *done* nothing

- Was not able to represent accurately the recent resolution sponsored by EMAG (which we discuss below and in more detail in annex 1)

Q5 *What is the role of the non-executive director in a complex or technical business? In particular what is their capacity to understand and to challenge the executive over technical aspects of the business?*

Lord Penrose was very critical of the ability of the former non-executive directors to understand the business. In conversation with us one of them referred to the board's failure to challenge "the boys club in Aylesbury, which is very secretive". We have no reason to believe – or to not believe – that the current non-executives are significantly better informed.

[4] Penrose observed (p224 para 78) "At 31 July 2001, after giving effect to the policy value cuts, accrued terminal bonus continued to account for a substantial proportion of realistic policy values. Nowell's estimates were reflected in a table that again analysed the asset shares attributable to £1,000 of investment over time: see table 6.16 opposite and compare table 6.13 above. Again, the table qualified: it did not pretend to total accuracy. But it demonstrated that even after the cut in policy values the accrued terminal bonus was over 10% of policy value in all cases sold before 1990. In the case of contributions after January 1995, the cut eliminated all or most of the previously accrued terminal bonus, and, as a matter of arithmetic, in the last five years resulted in terminal bonus being expressed as a negative value, effectively reducing APV below guaranteed benefits".

We do, however, believe from the experience of one of the members of the Committee of EMAG who was interviewed for membership of the board, that the current non-executive members (who have de-facto been appointed by the chairman) are expected to work as a team (a phase he stressed in interview) and not publicly voice dissent.

Supposedly non-executive board members are appointed to act independently, but they are less likely to do that when they are appointed by the chairman. While we accept that a wise and mutually reinforcing board may be the ideal, the cases of Enron and Shell to name extreme examples of failure of non-executives, and of Marks & Spencer in the mid 1990s to name a less extreme example of failure, expose the potential shortcomings of consensus behaviour.

Q6 *What can the owners of a complex or technical business reasonably expect of its non-executive directors? How would you characterise the practical limitations of a non-executive director? What steps might be taken to codify what is reasonable and realistic in this context?*

The owners of a mutual (and indeed of any life office) should reasonably expect that the non-executive directors are 1) trained for their job, and 2) are prepared to act independently.

We do not consider it appropriate for board members to have numerous directorships. The chairman of Equitable, Mr. Vanni Treves, is in addition chairman of the London Business School, of Korn/Ferry International, and of Intertek Group plc; a non-executive director of 11 companies and multiple subsidiaries[5]; in addition he is a member of the Council for Industry and Higher Education, a Governor of The College of Law and of Sadler's Wells, a Trustee of the J. Paul Getty Charitable Trust, solicitor to The Royal Academy, and has just been appointed chairman of The National College for School Leadership. Although he may be a very talented individual, he simply cannot have time to understand what is going on in these various organisations. While the current chairman's portfolio of activities may be appropriate for a character in the Mikado, we cannot see how his wide range of responsibilities can leave enough time to devote to Equitable.

[5] Personal Appointments with Limited Companies, Companies House Direct, 31/12/2003.

The practical limitations of many non-executive directors is that they do now know enough about the business, are prepared to "go with the flow", and are reluctant to exercise independent judgment and challenge either the executive or their colleagues.

Q7 *What role should policyholders play in the running of mutual life companies? Are there practical barriers to policyholder participation in UK life mutuals? What action would be needed to allow more efficient engagement?*

Equitable Life has very active policyholder groups, but despite this they have had no evident influence over the board or direction of Equitable. There have been meetings and consultations, but these have been window-dressing. The most striking example was the multi-million pound exercise on the compromise scheme proposal put to members at a dozen regional meetings around the country. This generated more than 20,000 responses, but resulted in no changes whatsoever to the flawed proposal that was subsequently put to the members in December 2001, which has been demonstrated as having been grossly unfair to with-profits annuitants, non-GARs, and late-joiners.

Policyholders should be entitled to an *informed* say in the major strategic decisions taken by a mutual (e.g. to demutualise; to diversify; to reward or remove the directors; to comment upon performance). The crucial word in the foregoing answer is "informed", which requires that policyholders are provided with information. Equitable (under both the former and the current boards) has run a deliberate policy of withholding information from policyholders, see annex 2. Yet without better disclosure of information, there is little hope of policyholders playing a meaningful role. Unfortunately we can only provide examples of bad practice – good practice would be for the chairman of Equitable to live up to the promise he made to policyholders on 1 March 2001:-

> "I will communicate openly. This is our Society and members are entitled to know everything about how it is run unless open disclosure would be commercially damaging…I look forward to an atmosphere of trust and transparency between the policyholders and our Society".

The fact of the matter is that the great majority of policyholders do not wish to be engaged, as can be seen from the turnout averaging only about 12% in voting at the three last Annual

General Meetings in May 2002, May 2003 and May 2004. In practice policyholders never have had, and still have no, engagement with Equitable. Even if policyholders wish to be engaged there are significant barriers, namely:-

- Lack of information, see below and annex 2
- Voting arrangements designed to ensure the perpetuation of a board as a self appointed – and appointing – oligarchy, and to minimize the ability of members to hold the board to account, see below and annex 3
- Lack of funding to contact other policyholders, obstructionism from Equitable in providing contact details of members, see below and annex 2
- Distortion of resolutions proposed by members and opposed by the board, and now a risk of petitioners having to pay the costs, see below and annex 1

If mutuals are to have any future there needs to be a legal requirement to have an elected Members' Committee (none of whose members are members of the board) which is funded by the Society and with ready access to contact members to represent policyholders' interests in circumstances such as the appointment of auditors – the committee should fulfill the role of audit committee - appointment of an independent actuary, demutualization, insolvency proceedings, major litigation, and to instruct on information that should be included (and audited) in the annual accounts.

There is a sub-question asked about the risks of a board being hijacked by sectional interests.

> **The check and balance against a mutual being hijacked by a sectional group should be a legal obligation that the board of a mutual should not discriminate against any policyholder or group of policyholders.**

There is a sub-question about "the role for other organisations or groups to act on policyholders' behalf? If so, what organisations or groups would be best suited to such a role".

> We consider that there should by statute be an elected Members' Committee (as mentioned just above). We naturally think that there is a role for other ad-hoc organisations or groups to act on behalf of policyholders (and ex-policyholders). To date EMAG has received subscriptions and donations of the order of £500,000, thus demonstrating that a good number of Equitable's current and former members seem to consider that EMAG has been effective in achieving its objectives of informing

those members who wish to be informed as to what is going on – as can be seen from our website (www.emag.org), EMAG has funded a range of reports about Equitable - and campaigning to seek government compensation through the Parliamentary Ombudsman and through political action and the media. In a different context, we have grounds for believing that the Equitable Late Joiners' Action Group was very effective in furthering the interests of its members to receive compensation. It is not possible to generalize about "what organisations or groups would be best suited to such a role". Such ad hoc organisations or groups are only likely to be formed at time of crisis, and their effectiveness will depend upon the knowledge and style of those involved.

Q8 *Lord Penrose says that in a life mutual "…It is the policyholders who are the source of the risk capital for the enterprise" (chapter 20 paragraph 51). What does this mean for the relationship between a mutual life office and its policyholders?*

Policyholders should be given full information about the risks they are being invited to assume. Regrettably:-

- The information provided by Equitable to policyholders about its financial and legal strategies have been consistently hidden

- The risks to policyholders who joined after 1996 and whose policies do not have a GIR have been glossed over. They bear at the margin the risk of the net investment return being less than 3½%, and thus of having to fund the GIRs of earlier policyholders with the guarantee. Equitable has not explained to policyholders the consequences of the GIRs in constraining investment policy, nor provided them with the pros and cons of getting rid of the GIRs

There is an issue of principle regarding the capital of a mutual life assurance society. Although the assets admissible as reserves are subject to the discipline of market valuation, the working capital of the business is not. The assets have been paid from the policyholders' expenses deductions of retained profits. Penrose described some of Equitable Life's valuations of this sort as "aspirational". (We believe that goodwill should never appear in a valuation, and purchased goodwill should be written off over a short period). The policyholders are the owners of the assets and suffer if liabilities exceed them, yet they generally have little information about them. **We believe that policyholders need special support in gaining an understanding of the value of their Societies.**

There is a sub-question "should mutual life offices be more risk averse than their proprietary counterparts? Is there evidence that they are more risk averse?"

> **We do not think there should be a significant difference between the risk aversity of a mutual and a proprietary company that is providing pensions**, because in practice in both the risks one way or another will fall upon policyholders. Thus while Equitable was an extreme and obvious example of the risks of guarantees to one group being borne by policyholders without them – Equitable had half of all the Guaranteed Annuity Rate (GAR) liabilities written by life assurers, and it had no orphan estate – other life assurers have shifted much, if not all, of the costs of guarantees onto policyholders without guarantees. They have disguised the shift of resources by blaming the stock market, and in part paid for the guarantees by reducing returns to policyholders. In part they have drawn on their orphan estates which were built up at the expense of past policyholders, and may be rebuilt at the expense of future policyholders.
>
> Standard Life pursued a very high risk policy by over investing in equities and maintaining its misallocation for far too long.

Pension funds of any type should be relatively conservatively run.

Q9 *Lord Penrose acknowledges that the FSA's work since 1997 "…has sought to anticipate many of the lessons that might be drawn by this inquiry and it should come as no surprise that it has largely succeeded in that" (chapter 40 paragraph 3). In so far as corporate governance is concerned do you agree?*

We do not agree that the FSA has done *anything* to improve corporate governance. We have asked the FSA on several occasions for assistance with obtaining information from the Equitable and on other matters, and have been consistently fobbed off with words and technicalities, see annex 4. *We obtained nothing from the FSA*. We asked the FSA to ensure that Equitable treated the resolution which EMAG sponsored fairly (which it did not) – answer came there none. We suspect that the FSA has been effectively acting as a shadow director to Equitable and that its main objectives are to keep Equitable afloat and to avoid its own and the government's regulatory incompetence leading to demands for compensation for past and present policyholders. We attach as annex 5 a submission that we made to the Treasury Committee on the topic of "The failures over the period 1999-2003 of the Financial Services Authority (FSA) in protecting the policyholders of the Equitable Life Assurance Society".

Q10 *Is there a further role for the FSA to play in improving firms' corporate governance?*

We are aware that Penrose saw a significant role for the FSA. **Notwithstanding our antipathy to the FSA, in our opinion the FSA already has too much to do – indeed it has an impossible job. We would be concerned about giving it further duties.**

Q11 *Listed companies are subject to the influence of their shareholders particularly large shareholders and the risk of takeover. What market forces are most relevant for mutual life offices? How effective are they in promoting good performance and how might they be enhanced?*

The only "market force" we are aware of that influenced Equitable was market share. And that was not effective in promoting good performance – quite the contrary, it resulted in Equitable running a Ponzi fund.

Q12 *Do specific barriers exist to the success of mutual businesses in the UK? If so, how might they be addressed?*

We obviously joined Equitable because we believed in the advantage of mutuality - our trust was abused, and we had no understanding of the scale of downside risk that ownership vested. We are well aware of the conflicts of interest in proprietary companies offering pensions, and the too often appalling business practices they (and mutuals) employ (see for example the article by John Chapman "The incredible shrinking surrender value", Money Management, September 2004). We consider the barriers that exist to the success of mutual businesses are those resulting from the lack of the ability of members to hold a board to account, which we discussed in Q7.

Q13 *What are the forces that drive de-mutualisation? What are the implications of de-mutualisation for members and customers?*

We suspect that the main drivers to demutualise have been boards and managements hoping for larger salaries and stock options and more "fun" from new ventures, and policyholders hoping for demutualization windfalls. As the examples of the TSB and Abbey have shown,

demutualising organisations with traditionally limited experience but large free cash flows can be a recipe for waste and failure. (But then the "with it" board of GEC managed very quickly to throw away the cash mountain built up by the late Arnold Weinstock).

Q14-16 *What specific governance arrangements currently apply to other financial mutuals? In what ways do their governance arrangements differ from those that apply to life mutuals? Which if any of the options for life mutuals could be applied more widely in the financial mutual sector? What would the consequences be?*

Do small, affinity group based, mutual life firms face different governance issues from the largest firms in the sector?

Are you aware of effective governance regimes for life (or other) mutuals in other countries? Is this the result of a formal (regulatory or government) requirement or is it voluntary driven by the industry? Are there aspects of the arrangements in other countries that it would be desirable and practical to adopt in the UK?

We are not qualified to answer these questions.

4. FREE FORM RESPONSE

Large mutuals have outgrown their origins as small groups of people banding together to pursue a common purpose, and they are now large organisations pursuing multiple purposes (some of which may result in conflicting interests between members). In the process – along with importing mainstream corporate culture and changing titles from "General Manager" to "Chief Executive" - the basis of mutuality has been lost sight of. The Equitable, like many mutual life offices, is constituted as a company, and this leads people to think that the governance and board behaviour of a mutual should be like that of a public limited company. But as Penrose pointed out the governance of mutuals is subject to very weak constraints and many – including Equitable under both the previous board and the current board – have been run by strong personalities coupled with weak boards. They have been run by management for management. It is clear from Penrose's report that Equitable was run by the former General Manager and Chief Actuary, Roy Ransom, and the board had little idea as to what was going on. That situation carried on under his successor Alan Nash supported by Christopher Headdon as appointed actuary. They protect themselves from policyholder accountability by not providing information to members and through their constitutions, and the current board does the same.

By analogy, a thought of Abraham Lincoln and one of Thomas Jefferson provide the touchstone of our thinking on the basis of mutuality:-

- "There should be democracy of the people, by the people for the people"
- "When tempted to do anything in secret, ask yourself if you would do it in public; if you would not, be sure it is wrong"

These statements imply effective accountability of a mutual to its members. And this in turn requires:-

- fair voting procedures for directors
- the provision of accurate and unspun information to members
- the empowerment of members, which depends ultimately on the ability of members to hold the board to account

Equitable does not meet any of these criteria.

Voting procedures for directors

In large measure, through the provision of proxy votes to the chairman, the voting for directors can be "arranged" so that those whom the chairman and incumbent board want elected are voted in. In 2000, Mr. Edward Doogan, a member who expressed dissatisfaction with Equitable's investment performance, put himself forward for election to the board. The then chairman wrote a letter to members stating "Your Board strongly recommends that you vote to re-elect the existing directors who are retiring at the meeting…and against the resolution to elect Mr. Edward Doogan…the facts quoted in his candidate's statement are correct but are in our view selective". Mr. Doogan won 241,939[6] votes for and 246,619 against, which was an achievement given the way the voting is run, an issue to which we turn below.

Penrose suggested that mutuals suffer from the problem that boards become self perpetuating oligarchies which is clear at Equitable. He commented:-

> "There is no-on who can intervene effectively to influence the activities of what must remain a form of organisation managed by a self-perpetuating oligarchy, selected on an unaccountable basis by current directors as their successors in office, and vulnerable to the influence and, in an extreme case, control of professional actuaries who are answerable, if at all, only to those same directors who are fundamentally dependent on their advice."

The regime presided over by the succession of managing directors (Ranson/Nash/Headdon), under John Sclater as chairman, was discredited in December 2000, when the Society was forced to close its doors. No policyholder group or member succeeded in participating in any fashion whatsoever in the transition from one autocratic regime to another. The new chairman appeared from who knows where – but obviously with the blessing of the FSA. After the announcement of his appointment on 14 February 2001 he personally selected every one of the subsequently appointed directors. Although ten independent alternative member candidates have offered themselves for election over the years 2001, 2002, and 2003, all of them were roundly defeated, often reportedly with negative net votes of tens of thousands cast for candidates who receive a mandated votes from 10,000 or more qualified members. Given the secrecy of the board, it is difficult to see what contribution, if any, has been made by the non-executive directors of Equitable since their appointment in May 2001 and May 2002.

[6] Note that members are entitled to up to ten votes each depending on the value of their policies. Originally the provision roughly allocated votes pro-rata policy values, but with inflation most members now have ten.

At first sight the results of the vote at the AGM for 2001 for new directors appeared to show overwhelming support for the directors recommended by the current chairman, each of whom gained an average of 386,400 votes for and 73,698 against, and little for the "independents", each of whom gained an average of 81,616 votes for and 376,698 against. But further analysis shows that the voting results were largely dependent upon the chairman's mandated proxy votes and his "free" proxy votes, which are those where the chairman is mandated a free hand as to how to cast the votes or the voting forms are signed but the choices left blank. The majority of votes cast for those elected and against the "independents" were proxy votes cast by the chairman[7].

The voting arrangements are a direct consequence of the form of voting by resolution for each director, which requires members to vote for and against each resolution and allows proxy voting. Indeed if a voting paper is signed, but the votes are left blank, the voter is deemed to give the chairman power of proxy. The Building Societies Act 1986 allows for both voting by resolution and postal voting, which the Nationwide adopts. **Under postal voting the yes votes for each candidate are totalled and those with the most votes are appointed. There is no proxy voting and signed blank forms are void. We believe this form of voting should be prescribed.**

The two elections highlight fundamental problems with elections to large mutuals, namely:-

- few can be bothered to vote. Even in the well publicised condition of Equitable, only about 12% of the members bothered to vote at the last AGM

- the voters do not know what the candidates are like and in consequence many vote for those whom the chairman and board recommends or give the chairman a free proxy

We accept that the chairman and the incumbent board should have a say in the election of some of the board members (and indeed they have a common law obligation to recommend a suitable board for carrying on a company's business). **We do not, however, believe that the incumbent board or**

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[7] Analysis of the average votes <u>for</u> each incumbent Board member

Total	Of which: mandated to chairman		chairman's free proxy votes	
	No.	% total	No.	% total
386,400	278,415	72	101,818	26

Analysis of the average votes <u>against</u> each incumbent candidate

Total	Of which: mandated to chairman		chairman's free proxy votes	
	No.	% total	No.	% total
376,698	152,798	41	203,936	54

the chairman should have what amounts to patronage of all appointments, which may result in packing the board with trusties, all of whom are beholden to the chairman for their tenure. We believe that three directors should be elected on a free vote with no comment by the incumbent board.

Provision of information to members

As we noted earlier, on his appointment on 1 March 2001 the chairman of Equitable promised to "communicate openly". This promise was broken by mid July when the board refused to exolain the reasons for the cut in policy values by 16%. We set out in annex 2 seven examples of obfuscation and obstructionism by Equitable:-

- The refusal to provide cogent reasons for the £4.9bn cut in policy values on 16 July 2001
- The omission of key information in the Compromise Document
- The attempt to hide the solvency return for 2001 until after the voting for the AGM in May
- The failure to provide adequate information in the Annual Report and Accounts and to answer questions at the AGM to enable policyholders to judge Equitable's finances
- The failure to disclose the extent of over-bonusing during the 1990s
- The refusal unless instructed by the Financial Ombudsman's Service on a case by case basis, to provide the basis of policyholders' valuations for those considering leaving the fund
- The difficulties Equitable placed in the way of EMAG discovering the number of members

At this year's AGM, despite repeated and courteous questioning, the chief executive refused to answer how much Equitable had spent in total on legal fees on the grounds of "confidentiality" – while we can imagine that the board might be embarrassed by the amount spent, we fail to see what can be confidential in such information. Why should not the members know how much Equitable has paid Lovells to fight ELJAG and Clarke Wilmott, and paid to Mr. Gabriel Moss and other learned legal gentlemen, to prepare opinions and turn out in massed ranks for court hearings to ensure the board's view prevails, and if necessary to squash members who have the impertinence to disagree with the board's view of affairs?

<u>Empowerment of members to hold a board to account</u>

The empowerment of members depends not only upon the ability of members to vote directors onto the board, but also to put resolutions to AGMs and to EGMs. The Memorandum and Articles of Association which the current board inherited had evolved over years, and were not designed to empower members. There was nothing in them that provided for members either to put a resolution to an AGM, or to call for an EGM, and so members had to fall back on the provision in the Companies Act that calling an EGM requires holders of 10% of the shares to request one. Although obtaining support of 10% of the votes of a significant publicly listed company only requires the fund managers of a few major institutions to telephone each other, getting 10% of Equitable's voting members (say 35,000 members) to support a resolution would require a mail shot to 200,000+ members, which is an expensive undertaking at 50p a member.

EMAG organized a petition of 16,179 members who requested that 500 members should be required to put a resolution to the AGM and 1000 to call for an EGM, figures which are in line with the constitutions of Standard Life and Nationwide. At the AGM held in May 2002 the chairman said there would be a review of the Memorandum and Articles in order to "update and align the regulations with best modern practice in the light of the future needs of the business". EMAG prepared a substantive set of proposals for amending the Memorandum and Articles of Association, see annex 3. Equitable set up a working group; its proposals ignored the petition; it had no proposals for enhancing the accountability of the board to the members; its proposals consisted of 14 trivial administrative changes. Subsequently the Secretary of Equitable wrote giving specious reasons for rejecting EMAG's proposals. Eventually the board did reduce the hurdle for putting resolutions to the AGM and for calling an EGM to 1000 members[8]. Annex 3 describes the episode in more detail.

Fundamental to a mutual should be fair debate of issues on a level playing field. In 2004, at the initiative of EMAG, more than 1100 members of Equitable signed a resolution to its 2004 Annual General Meeting. The resolution proposed that Equitable put £2m into a trust fund to enable EMAG to pursue:-

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[8] We note that the Building Societies Act 1986 prescribes the maximum number of members required to put a resolution to the AGM or to call an EGM as 500.

> "Legal avenues to the EU, with a "Frankovich"[9] action and a petition to the European Commission[10]. Both would be based upon the failure of the UK government to implement the "Third Life/Non-Life" Directives of 1992 on insurance business supervision. Lord Penrose's report and Ruth Kelly's speeches contain numerous indications of this failure".

The case would argue that the British Government had not complied with its responsibilities under the European Union's Third Life Directive to require every insurance undertaking to have sound administrative and accounting procedures" (article 9) and "to prevent or remedy any irregularities prejudicial to the interest of insured persons". *Neither such a legal challenge nor a petition could be run by the Equitable; they can only be pursued by policyholders.*

The board strongly recommended members vote against the resolution, which was its prerogative. But to argue its case, the board presented a distorted view of EMAG including a false statement about EMAG, which is set out in detail in annex 1. The board also included a summary of a legal opinion by *unnamed* counsel, *but significantly the summary did not address either of the proposed measures which were the basis of the resolution.* The great majority of the policyholders will not be experienced with counsels' opinions, and will be unaware that such opinions are not necessarily objective professional advice, but may by careful instructions be designed to advocate the position of the client who commissions the work[11]. Furthermore the majority of members would not be aware that an opinion, let alone a summary of an opinion by two unnamed counsel, should be discounted unless one can see the instructions (were the barristers not invited, or even precluded from, looking at the prospects of litigating against the government qua member state and considering the prospects of a petition?).

Not surprisingly, faced with an issue which they did not understand and on which the board presented inaccurate views leading to an "unequivocal recommendation" to vote against the resolutions, four fifths of the members who could be bothered to vote, voted "no" to litigating and petitioning against the government. By its action, the board cut off an avenue for the members to seek compensation from the government. As a Guardian journalist observed "The people who will be really rubbing their hands in glee over this episode are Ruth Kelly and other ministers".

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[9] See annex 1.

[10] Subsequently, instead of making a petition to the European Commission, EMAG is making a petition to the European Parliament.

[11] Furthermore some counsel, knowing which side of their bread is buttered, willingly act as advocates rather than as purveyors of professional advice.

The episode made a mockery of the chief executive's news release of 11 March that "Ultimately it may be for the Society's members to have the final say on the matter at the AGM". Yes, they had the final say, but only after the board had vilified EMAG, alleged that legal action was infeasible, and made an "unequivocal recommendation" for members to vote against legal action.

The relationship between EMAG and Equitable

Phase 1 – the attempt to work in conjunction with the board. Initially EMAG's main objectives as set out in its constitution were to provide members and former members with information about the situation of Equitable. We attempted to work constructively with the board. As mentioned above, we proposed a more equitable way of sharing the burden of cuts which were to fall upon members, than the unimaginative and unfair across the board cut of 16% in policy values adopted by Equitable on 16 July 2001. We next proposed that the issue of GIRs, which now hobbles the investment freedom of the fund, should be resolved as part of the Compromise Settlement needed to resolve the GAO problem. Equitable also ignored this proposal. (We consider both of our recommendations have stood the test of time).

Phase 2 – growing concerns about the behaviour of the board. We were very concerned when Equitable refused to provide cogent reasons for the 16% cut – by what right was the board of a mutual withholding such information from its members, and serving up specious excuses for its secrecy? EMAG began increasingly to develop links with the media, and where we considered that Equitable was not telling the story as it should be told but spinning, we set the record straight. We built up both goodwill and credibility with many journalists, but our actions did not enamour us to Equitable. We also became increasingly concerned at the manner in which Equitable railroaded the Compromise Settlement through based on members' ignorance coupled with unjustifiably optimistic promises of better times to come. The first court hearing regarding the Compromise to define the relevant classes was announced only two or three days before the hearing date, presumably to preempt the risk that potential classes (such as international policyholders or annuitants) would make effective representations and complicate the vote.

At the expense of the members of EMAG, we commissioned Professor David Blake, Director of the Pensions Institute at Birkbeck College, London University, to prepare a report for us assessing the

adequacy and objectivity of the information provided in the Compromise Scheme Proposals. Among other things he identified omissions of:-

- Solvency level of the fund
- Fund available for appropriations
- Prospects for the fund after the Compromise

In addition:-

- Non-GAR policyholders were not told that the 2.5% uplift they were offered in the Compromise in return for giving up their claims for mis-selling had already been effectively wiped out by stock market falls in the summer and autumn of 2001. Policy values were cut by 4% six weeks after the Compromise

- Members were not told that Equitable's financial weakness was not caused solely by the decision of the House of Lords, but also by at least a decade of over-bonusing, under-reserving for liabilities and the adoption of practices of dubious actuarial merit

- With-profits annuitants were not told that without a significant rise in the stock market, their pensions would be substantially cut

We consider that due in significant measure to the narrow terms of reference drawn up for the independent actuary, his report did not identify the foregoing issues which we consider he should have reported on. We have thus made a submission on this point to the Morris Review of the Actuarial Profession, and **recommend that the independent actuary should be legally responsible to the Members' Committee, not the directors, and should not be indemnified by the company at members' expense. Furthermore we do not consider that it is appropriate (as happened in this case) that the independent actuary was employed as an expert witness by Equitable very shortly afterwards.**

The chairman was reported as saying "It is vital that policyholders are fully informed before they vote" (Daily Telegraph 8/8/01), but he made no effort to rectify the omissions. Instead the chief executive made a number of unsubstantiated and incorrect assertions about Blake's report both at a roadshow and in the Financial Times. We now know that the fund was virtually insolvent; that the fund for future appropriations was very small; and that the prospects for the fund were, and remain, very poor, which is contrary to the optimistic and incorrect claims made by the chairman and chief executive at the time of the Compromise.

We wonder whether the reason for the paucity of information in the Compromise and the limitation of the Independent Actuary's report, was designed to hide the frailty of Equitable's finances from members without GARs so that they were more likely to agree to the Compromise.

Subsequently we commissioned Blake to write an analysis of the Annual Report and Accounts for 2002. He identified the weakness of the fund, and the limiting effect the GIRs incorporated into the majority of policies have on the investment freedom of the fund.

In October 2002 we proposed to the non-executive board members that the question of having a part-time chairman should be reconsidered, both in the light of what we considered were the strategic mistakes that had been made, and also in view of the workload. We did not think that a man with (now) three other chairmanships, 11 non-executive directorships of companies (together with directorships in subsidiaries), and various other public/charitable positions had the time to fulfill such a demanding post.

In December 2002 EMAG commissioned a report by the well-known actuary Ned Cazalet to evaluate the financial position of Equitable. He explained the frailty of Equitable's finances. In March 2003 we published a report by accountants Burgess Hodgson which exposed that the problem which brought down Equitable was not the House of Lords decision, but over-bonusing. (This view was confirmed 11 months later by the publication of Penrose's report). Although we provided the report in final draft to the chief executive of Equitable, we received no comment. The Burgess Hodgson report formed a major part of a Money Programme televised in March 2003. Over this period we also became increasingly concerned about Equitable's legal strategy, which is based on bamboozling policyholders with legal opinions and frightening them with its massive legal firepower funded by policyholders. We describe the approach in annex 5.

We also voiced our concern about the generous bonuses of about £247,000 the board awarded to the chairman and chief executive (along with £15,000 each to themselves) for getting the Compromise passed. At that point in time at least two thirds of the fund was owned by policyholders who did not have GARs. They had nothing to thank the board for, both in the way in which they had been unfairly treated by the board in the cut of 16 July 2001, and then subsequently treated unfairly by the Compromise.

We also became concerned that Equitable was not acting in the interests of its members in pursuing the government for compensation. In an interview on 18 December 2002 on Channel 4, the chairman talked the talk, saying “We have made it clear that if Lord Penrose finds there is a viable claim against any arm of government, then the board will not shrink for pursuing the claim in members’ interests”. When the Parliamentary Ombudsman published her flawed report on “The regulation of Equitable Life” on 1 July 2003, the chief executive merely commented that “Policyholders will be disappointed with the conclusion of the Parliamentary Ombudsman’s report”. EMAG acted, obtaining leave to appeal for a judicial review of aspects of her report.

Then, with Penrose coming close, but before he had received any advice on the matter, in an interview with the Times on 9 January 2004, Treves was reported as “playing down the legal route, arguing that hurdles barring a successful action against a government tend to be higher than those blocking a suit against individuals or companies. Mr. Treves said that the insurer would prefer to leverage compensation out of the Treasury through “moral persuasion” by highlighting its responsibility for any regulatory failings thrown up by Penrose”. Given that he had a succession of meetings with Financial Secretary Ruth Kelly, we are surprised he did not know that there was no way in which the government intended to be swayed by any “moral persuasion”. Eventually the board commissioned the opinion summarised by Herbert Smith, and that enabled the board to take no further action other than opposing EMAG’s intention to pursue the government for compensation.

On 16 March 2004, in significant measure as a consequence of EMAG’s judicial review and lobbying (and also due to the efforts of some determined MPs) the Parliamentary Ombudsman said she would consult on whether to reopen her inquiry. On 28 April 2004 EMAG won leave to appeal for a judicial review on two points of law. The Financial Times headlined “Fresh hope for compensation for claimants in Equitable’s case”, and credited EMAG for its endeavours.

EMAG wrote asking if the board would care to make an ex gratia contribution to EMAG’s legal costs. The chairman replied on 7 May 2004:-

> “For some time now, we have been encouraging the Parliamentary Ombudsman to re-open her enquiry and working quietly with the appropriate people to secure that, if at all possible. We have not seen the need to follow a costly legal route to achieve this objective and much of our activity in this area is being undertaken without fanfare.”

In her report "A further investigation of the Prudential Regulation of Equitable Life", printed on 19 July 2004, she wrote (para 9) "The meeting with Equitable Life was particularly welcome, as their written response to my invitation was the first communication I had received directly from the Society on these matters". Equitable's written response was dated 20 May 2004; the chairman and chief executive met her *for the first time* on the morning of 25 May 2004. We wonder whether Equitable's reluctance to walk the talk and the tardiness with which it made representations to the Parliamentary Ombudsman reflects a hidden agenda. Who is the board batting for – the policyholders or the Treasury?

Phase 3 – hostility from the board. At the AGM in 2004 the chairman attacked EMAG, describing its leadership as "consistently vicious, volatile, venomous, and vindictive". The Financial Times the next day commented:-

> "There is no doubt that EMAG has sometimes been intemperate in its criticisms of the present Equitable board and its predecessor, the Financial Services Authority, the Treasury and just about everyone else in this sorry saga. Yet if it had not been for the Herculean efforts of EMAG…there would be a lot less pressure on the Parliamentary Ombudsman to reopen her inquiry – which has always been policyholders' best hope of compensation. Equitable should also drop its bluster and possibly seeking £50,000 from EMAG for legal costs incurred by the board over the action group's defeated call for campaigning funds. Shareholder and policyholder democracy costs money. Punishing EMAG for putting up a valid resolution would smack of bullying – and, yes, vindictiveness".

The Sunday Telegraph of 23 May headlined "Treves' rant left a bitter taste".

The virulent attack on EMAG at the AGM appeared to be part of an attempt to undermine the credibility of EMAG, if not to destroy it. The chairman stated that the board was considering suing EMAG for £50,000 for (unspecified) costs associated with the resolution. He must have known that there were *absolutely* no grounds for such an action against EMAG (as opposed to the members who signed the resolution) and, having achieved publicity for the threat, it was subsequently withdrawn in an unreported press release a week later. But no doubt some people, noting that the comment was made by the former head of a large City firm of solicitors, took it seriously.

It is normal practice that if a resolution is properly made in accordance with a company's articles, then the costs of that resolution will be borne by the company, but the position is not entirely clear in Equitable's constitution. EMAG had thus taken the precaution of adding a secondary resolution

to the effect that the costs would be born by Equitable. In addition to encouraging members to vote against the main resolution, the board also encouraged them to vote against this secondary resolution. *Members unfamiliar with Company Law no doubt did not realise that in voting for this resolution they would make it almost impossible for anyone to put up another resolution at an Equitable Life AGM or to requisition an EGM.* The board has turned back Equitable's corporate governance clock to where it stood in 2000, which seems an unusual step for the chairman to take since his curriculum vitae posted on Equitable's website states that he "lectures on corporate governance". *We do not consider the board's behaviour regarding the resolution met the standards that should be expected of mutuals.*

In EMAG's view the corporate governance of a mutual life assurance society will be quite impractical without an amendment to company law to make it clear that requisitions made under a company's article are always at the cost of the company.

<u>The possible roles of action groups</u>

There have been a number of policyholder groups formed by the members and ex-members of Equitable. Two have had as their prime purpose litigating against Equitable, and one has been wound up after a satisfactory outcome to its action. There is a one woman operation that provides an excellent information service for members, and there have been several other groups that were ineffective and have dissolved. EMAG is the only policyholder group that has a constitution and an elected committee. As we observed earlier, to date EMAG has received subscriptions and donations of the order of £500,000, thus demonstrating that a good number of Equitable's current and former members seem to consider that EMAG has been effective in achieving its objectives.

The voting for the resolution demonstrates that EMAG does not represent the majority of the members of Equitable. The great majority of the members cannot be bothered to vote, and of those who voted four fifths voted against the resolution. Many members – perhaps disproportionately the younger, financially more literate, and more energetic - have left Equitable (the with-profits fund has reduced from £25bn at the end of 2000 to about £11bn at the end of 2003), no doubt to get on with their lives. We suspect that the great majority of remaining members (of whom possibly a half are annuitants who cannot leave) have little understanding of the complex financial and legal situation in which they have become enmeshed. We suspect that most have as little basis for judging the actions of the current board as they had of judging the former board. EMAG represents

the "activists" who believe that members have a *right* to know about the financial circumstances of the mutual into which we put – and lost – our money, and a *right* to be told the significance of decisions taken in the name of the members. We have no doubt those rights have been abused by the previous and the current board.

Although we cannot alter the views of the majority of members, who on occasions have appeared like turkeys voting for Christmas because it comes after Thanksgiving, we do take comfort from the e-mails of support we have received such as:-

> "I want to say, on behalf of my wife and myself, how absolutely disgusted we were by the behaviour of Vanni Treves at the AGM. We have absolutely no confidence in the management of EL as at present and every confidence in EMAG to try to help us in our present plight. Keep up the good work and if you require more funds to keep going do not hesitate to ask the members. We recently wrote to Mr. Treves to ask why, if the Society is now financially stable, it is necessary to keep on cutting our annuities. He didn't even bother to reply!!. It is very obvious that the majority of annuitants are grossly ignorant of what is happening and completely apathetic. Treves is leading them, like sheep, to the slaughter".

* * *

> "I am writing to thank you and your committee for the sterling efforts you have made on behalf of members, and also record my sympathy over the disgraceful way you and the EMAG committee were treated at the Equitable AGM by the despicable Vanni Treves.
>
> I, like EMAG, am at a loss as to why he has made such a vitriolic and personal attack upon the EMAG committee members. The man is not fit to be chairman of anything let alone a Mutual! Considering the members pay his outrageous salary he has the cheek of the devil. Lets hope he gets his come-uppance and is made to grovel a little".
>
> Keep up your good work, again thanks all round."

* * *

> "I was shaking with rage when I came out of the AGM and have still not composed myself. If policyholders are so gullible and naive then they deserve all they get but the few of us who can see through it have to suffer as well…Yours in disgust and frustrated".

We consider that policyholder groups can be an integral part of the accountability of a mutual. **We hope that the review will introduce measures that will make it clear to the boards of mutuals that they have to be open and accountable to policyholders. We hope that there will be no**

need in future for policyholders to undergo the abuse of mutuality that has occurred with Equitable under both the previous and the current board.

Annex 1 Equitable inaccurately describes EMAG and a resolution to the AGM sponsored by some of its members who are also members of EMAG

On 11 March 2004 the chief executive of Equitable Life issued a news release which stated "The Society is now reviewing with its advisers the detailed content of Lord Penrose's findings and we intend to provide policyholders with our assessment of his report in due course. The board has not received any formal request to consider funding a policyholder action against the Government and, if it does, it will be considered. The board will consider the matter in the context of what is in the best interests of members. Ultimately it may be for the Society's members to have the final say on this matter at the AGM…".

At the initiative of EMAG, more than 1100 members of Equitable signed a resolution (which was limited to 1000 words to its 2004 Annual General Meeting. The resolution proposed that Equitable put £2m into a trust fund to enable EMAG to pursue:-

> "Legal avenues to the EU, with a Frankovich[12] action and a petition to the European Commission[13]. Both would be based upon the failure of the UK government to implement the "Third Life/Non-Life" Directives of 1992 on insurance business supervision. Lord Penrose's report and Ruth Kelly's speeches contain numerous indications of this failure".

The case would argue that the British Government had not complied with its responsibilities under the European Union's Third Life Directive to "Monitor and ensure the adequacy of business activity…ensure that insurance undertakings have sound administrative and accounting procedures". *Neither such a legal challenge nor a petition could be run by the Equitable; they can only be pursued by policyholders.* The resolution was delivered 23 March 2004.

On 25 March EMAG proposed in writing to Equitable's chairman a meeting to explore matters of mutual interest in seeking compensation. He responded in a letter dated 6 April 2004:-

> "I believe a meeting with EMAG, or indeed any individual or group that plans to lobby or litigate against the Society's current interests[14], could have little constructive purpose and

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[12] Francovich v. Italian Republic (Cases C-6/90 and C-9/90) [1991] E.C.R. 5357, which is a case where there has been a failure to implement a directive. The European Court said at paragraph 37 "it is a principle of Community law that the member states are obliged to make good loss and damage caused to individuals by breaches of Community law for which they can be held responsible". A Frankovich case against the government would be undertaken in a British court.

[13] Subsequently, instead of making a petition to the European Commission, EMAG is making a petition to the European Parliament.

[14] In direct contravention to this claim Equitable has met with representatives of the Equitable Life Trapped Annuitants (ELTA), which is litigating against Equitable.

> would not serve the best interests of continuing members. The Society's Board fully endorses this view".

EMAG has never had any plans "to lobby or litigate against the Society's current interests" (see below); we would have thought that trying to obtain compensation from the government was in the interests of "continuing members".

On 19 April Equitable sent out the Annual Report and Accounts and a notice of the AGM. The notice stated:-

> "Please ensure that you read the Board's statement and Equitable Members' Action Group (EMAG) statement before voting on Resolutions 5(i) and (ii).
> The Board's comments and those of EMAG on these Resolutions are shown in the additional Information booklet.
>
> Your Board has been advised (see Legal Opinion) that it would not be permissible for your Board to implement EMAG's Resolution 5(i) without the authority of Special Resolutions. Based on such advice, your Board could have decided that Resolution 5(i) should not be put to Members. However, your Board has decided that to gauge the opinion of Members as a whole, Resolution 5(i) should nevertheless be put.
>
> Members should be aware that if Resolution 5(i) is passed, it will not be possible to implement it without Special Resolutions being put to and approved by Members in due course. If Resolution 5(i) is passed, your Board will arrange for an Extraordinary General Meeting to be convened and for appropriate Special Resolutions to be put to you to enable Resolution 5(i) to be implemented.
>
> The resolutions under Resolution 5 have been requisitioned as Members' Resolutions under Regulations 11A and 11B of the Society's Articles for Association. They have been drafted by EMAG. The Board does not support these resolutions and cannot accept responsibility for their content or for any consequence arising".

The advice referred to regarding the power of the board was a mere assertion, given without any supporting reasoning. It is just too easy for a board to claim that a motion cannot be put for some reason or other. **The Companies Act should be amended to state that members' resolutions should be put to AGMs to avoid the risk of legal games.**

The board sent a 7 page booklet on the resolution – we provide an original by post. The covering letter included the statement "**The Board recommends that you vote AGAINST Resolutions 5(i) and (ii), Members' Resolutions proposed by Equitable Members' Action Group (EMAG)**, and on a sheet titled "Q. How do I vote?" the board repeated its recommendations in large emboldened

text. The pamphlet was headed in large letters "Why you should vote AGAINST Resolutions 5(i) and (ii)". It consisted of:-

1. two pages titled "A message from the Board"
2. three pages of a legal opinion by Herbert Smith
3. at the back (not clearly differentiated) two pages of EMAG's explanation of the resolution

The presentation was heavily loaded against the resolution, both in terms of numbers of pages devoted to the board's case, and the location of the resolution – which was at the end of the booklet. After reading repeatedly the board's advice to vote against the resolution and the clear insinuation that EMAG did not know what it was doing, many members may not have troubled to read as far as the resolutions and EMAG's 1,000 word explanation.

Members' resolutions should be entitled to prominence and the board's response should be restricted to whatever number of words the petitioners are allowed.

A message from your board

The board claimed that it had received "Unequivocal legal advice – no realistic claims against the regulators", which may be true. *But EMAG was not proposing to claim* against *the regulators, but against the UK government as a member state of the European Union (EU) which was responsible for implementing the Third Life Directive to ensure that an effective regulatory framework was put in place.*

Under the heading "What is EMAG's proposal" and "Why does EMAG want £2 million" the board made a number of statements which economized with accuracy, and in one case was false:-

- it claimed that EMAG's expenditure to "hire top class professional political, legal, actuarial and financial advisers" would *duplicate* that of Equitable. This is not true. First, the actions proposed could only be taken by policyholders, not by Equitable; and second, Equitable was not proposing to take action in the EU. The "leading professionals" employed by the Society are not working on the issues EMAG was intending to address

- it suggested that the purposes for which the grant/money was requested were unclear – on the contrary they were set out very clearly in the Members' Statement

- the board stated that EMAG suggested "taking legal action against the Government in Europe" and then claimed that "Our legal advice states that policyholders have a "potentially arguable

claim" on "one limited issue" in relation to the implementation of The Third Life Directive. The legal advice made no comment about taking the types of action EMAG was proposing, a petition to the European Commission (later changed to the European Parliament) and a Frankovich action

- the board states that "EMAG acknowledges that the Parliamentary Ombudsman is a viable route to be pursued [for compensation]…" without acknowledging that a major reason for this avenue still being open is the judicial review proceedings and years of lobbying by EMAG. It then states "The Society itself is currently urging a re-opening of the PO's investigation". *In fact the Parliamentary Ombudsman subsequently stated[15] that the first contact the Society ever made with her was in late May, a month after this statement was sent to members*

Under the heading "What is EMAG" the board falsely stated that "EMAG is promoting groups and lawyers proposing to sue the Society". *Our constitution expressly precludes us from litigating against Equitable.* Equitable advised us that the basis of this claim was that EMAG's website had links to such groups, namely:-

> "Under the 'Related Groups' heading, EMAG promotes 'ELTA' and 'ELCAG', action groups…which are both threatening to issue legal proceedings against the Society. Indeed, ELTA has an established Legal Action Sub Committee.
>
> Under the 'Legal Advice' heading, EMAG advertises the services of Clarke Willmott, a law firm currently advising ELTA on its proposed litigation…".

The links on EMAG's website include the Financial Services Authority, the Financial Ombudsman's Service, Equitable, EPHAG (another action group now effectively defunct), ELTA which is taking legal action against Equitable, and ELCAG which has threatened legal action. They are all there as part of EMAG's objective of providing information. (The Equitable Life Members Support Group similarly provides links to both ELTA and ELCAG). The legal link includes a reference to Clarke Willmott under the heading "A suggestion for those seeking Legal Advice in Connection with Equitable Life". We mention that they provided EMAG with helpful advice on the GAR rectification scheme, and state "This is neither advice nor a recommendation from EMAG". The Oxford dictionary defines "promote" as "support or actively encourage". EMAG has done neither. The BBC website about Burma has a link to The State Peace and Development Council. To suggest that the BBC is promoting the military junta (whose website it is) is as much a travesty of the truth as suggesting EMAG has been "promoting groups and lawyers proposing to sue the Society".

[15] A Further Investigation of the Prudential Regulation of Equitable Life?, July 2004.

The board statement observed that EMAG "does not represent only the interests of current members of Equitable Life – it also represents former members and policyholders. But the costs and risks from their proposed resolutions if passed, will fall entirely on you". This is cutting off members' noses to spite their faces – the cost would have been £6 per head. To date all effective lobbying for the benefit of all policyholders has been at the cost of EMAG subscribers, about £50 per head. Furthermore:-

- if EMAG were successful with its action then current policyholders would benefit
- there was no risks of costs from an EU petition, and naturally the Trust would be very careful regarding possible costs in a Frankovich action
- the majority of past policyholders left a significant exit charge (market value adjuster) with Equitable and surely deserve something for that
- the sum sought was small compared with £50m plus that the Society is estimated to have spent on legal fees[16] and the £5m which its legal advisers Lovells have advised ELTA, which represents 700 current annuitant with profits policyholders, that it might cost Equitable to defend its position[17]

Under the heading "How would EMAG's trust fund work?" the board tried to make out that the trust was not thought through. It was not possible to explain how it would work in the 1000 words allowed in the circulated prospectus. In fact we had a professionally prepared draft which we would have explained at the meeting which the board refused to have with us.

As part of its package against the resolution the board provided a letter by solicitors Herbert Smith titled "Possible claims by the Society and Policyholders against Regulators", 14 April 2004, which summarised an opinion by two *unnamed* counsel. Equitable subsequently refused to provide the opinions. The great majority of the policyholders will not be experienced with counsel's opinions,

[16] At the AGM in May 2004 , in response to persistent questioning by a member about the board's expenditure on legal fees, the chief executive refused to answer on the grounds that the expenditure is "commercially confidential", a view that is difficult to justify.

[17] A letter from Lovells solicitors to Clark Willmott dated 28 June 2004 stated "We note that it is proposed that ELTA members contribute a total of £500,000 to cover the costs of disbursements such as Counsel's fees and the insurance premium to cover the matter right through to trial. We do not know what levels of after the event insurance cover have been or may be obtained. However, your insurers and any potential claimants should be made aware that we have advised the Society that if these claims are not struck out on an early basis eg on the grounds of limitation or that a GLO is inappropriate, **the Society's costs of going to trial with even a modest number of test cases will almost certainly exceed £5 million including Counsels' and experts' fees."**

and will not be aware that such opinions are not necessarily objective professional advice but may be designed to advocate the position of the client who commissions the work. The majority of members would not be aware that opinions, let alone a summary of an opinion by unnamed counsel, should be discounted unless one can see the instructions. EMAG questions whether the barristers were not invited, or even precluded from, looking at the prospects of litigating against the government qua member state. **If a board quotes legal opinions it should be required to publish the instructions and the opinions (excluding matters of legal confidentiality, of which there were none in this case).**

The AGM

After the AGM on 19 May 2004 the chairman stated to a press conference that the board was considering suing EMAG for £50,000 for costs associated with the resolutions. He undoubtedly knew that there were absolutely no grounds for such an action[18]. While the threat was covered extensively in the press, the withdrawal was buried as a secondary item in a press release a week later and was not reported. No doubt some people, noting that the comment was made by the former senior partner of a large City firm of solicitors, took it seriously. Perhaps the statement was intended both to frighten members from joining EMAG, and to frighten EMAG with the power of Equitable's legal fighting machine. There might have been grounds for an action against the 1,100 petitioners, but EMAG was not in any contractual relationship with Equitable. **The Companies Act should be clarified to make it clear that the company always bears the cost of putting resolutions to the AGM and calling EGMs.**

The chairman attacked EMAG, describing its leadership as "consistently vicious, volatile, venomous, and vindictive". The serious press was not impressed. The Financial Times the next day (May 20) commented:-

> "There is no doubt that EMAG has sometimes been intemperate in its criticisms of the present Equitable board and its predecessor, the Financial Services Authority, the Treasury and just about everyone else in this sorry saga. Yet if it had not been for the Herculean efforts of EMAG…there would be a lot less pressure on the Parliamentary Ombudsman to reopen her inquiry – which has always been policyholders' best hope of compensation. Equitable should also drop its bluster and possibly seeking £50,000 from EMAG for legal costs incurred by the board over the action group's defeated call for campaigning funds.

[18] How can a valid resolution by 1100 members of Equitable lead to action against EMAG? To reassure members of EMAG, we obtained a legal opinion which unequivocally stated that there was "no viable case against EMAG".

> Shareholder and policyholder democracy costs money. Punishing EMAG for putting up a valid resolution would smack of bullying – and, yes, vindictiveness".

The Sunday Telegraph of May 23 headlined "Treves' rant left a bitter taste".

* * *

Not surprisingly, faced with an issue which they did not understand, on which the board presented inaccurate views and an unequivocal recommendation to vote against the resolutions, four fifths of the 10% of the members who could be bothered to vote, voted "no" to litigating against the government. As a Guardian journalist observed "The people who will be really rubbing their hands in glee over this episode are Ruth Kelly and other ministers".

The episode raises a number of issues:-

- The biased way in which the advice to vote against the resolution was presented. **The board should be allowed no more space to oppose a resolution than the proponents are allowed to put it**

- **A board should not have more space and more debating time to attack a resolution than the proponents have to put their case**

- **The Companies Act should clearly state that a company is responsible for bearing the costs of putting resolutions to an AGM and calling an EGM**

- Did the board avoid instructing barristers to examine the possibility of litigating on behalf of policyholders against the government for failure to implement effectively the Third Life Directive?

- Has the board been less than frank in refusing to reveal the complete advice received from Herbert Smith on this matter?

- Why did the board vehemently block the resolution? Given the money which the board has spent on legal fees and is threatening to spend defending against 700 of its own policyholders, it surely cannot be that the cost was too high to pursue possible avenues to material external compensation not available to the board?

- The board of a mutual is supposed to act in the interests of its owners, the policyholders, yet the board did not propose backing a representative case on behalf of its members, and it blocked EMAG. Whose interests was the board pursuing – is there a hidden agenda?

The episode made a mockery of the chief executive's news release of 11 March that "Ultimately it may be for the Society's members to have the final say on the matter at the AGM". Yes, they had the final say, but only after the board had vilified EMAG, alleged that legal action was infeasible, and made an "unequivocal recommendation" for members to vote against legal action.

Annex 2 Seven examples of financial obfuscation and obstructionism by Equitable

(i) The Board refused to provide any quantification and background for the reduction in policy values by 16% on 16 July 2001. The information provided to the policyholders (in an open letter to the members of Equitable on 16 July 2001) merely stated:-

- "Stock markets have fallen heavily over the last 18 months[19];
- Maturity values now significantly exceed the value of the investments underlying maturing policies;
- As a mature fund, a large number of policyholders are currently retiring and taking their benefits."

The fall of the stock market at that point only accounted for 5% reduction in the value of the fund, while the third reason is entirely specious. Subsequently Treves and chief executive Charles Thomson gave a range of spurious reasons for not providing the information that the main reason for the reduction was to rectify the over-bonusing and to shore up the fund's solvency position[20].

(ii) Omitted key information in the compromise scheme, which was a settlement under S425 of the Companies Act 1985. EMAG commissioned Professor David Blake, who is Director of the Pensions Institute at Birkbeck College, London University, to prepare a report for us entitled "An Assessment of the Adequacy And Objectivity of the Information Provided by the Board of the Equitable Life Assurance Society in Connection with the Compromise Scheme Proposals of 6 December 2001". Among other things he identified omissions of:-

- Solvency level of the fund
- Fund available for appropriations
- Prospects for the fund after the Compromise

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[19] Time and time again during 2001 and 2002 the chairman and chief executive blamed the falling stock market for Equitable's woes. In fact on 16 July 2001 the FTSE was 5537, down from its peak of 6220 at the end of December 2000, a reduction of 11%. Although the stock market did not help, given the fund's reduction in exposure to equities to about 45%, the fall in the market was a secondary factor over 2001 and the first half of 2002. Was the claim an attempt to trade on many policyholders' financial ignorance?

[20] Treves and Thomson provided the following casuistic reasons for not providing adequate information about the value reductions:-

- "it would be too expensive" - in the context of £4.9bn, too expensive? Given the £50m spent on legal fees and the £ms spent on Burson Marsteller to "manage" information, the response is untenable
- "it would involve too much work" – yet either there was a directors' summary, which could have been provided or, as has since been claimed, the directors had no summary in which case it is difficult to see how they could have taken a £4bn decision
- "the press would misinterpret it" - even if that were true, it should not prevent the publication of information to which the members are entitled
- "it would assist claims against former directors or advisers" – an incomprehensible reason

In addition:-

- Non-GAR policyholders were not told that the 2.5% uplift they were offered in the Compromise in return for giving up their claims for mis-selling had already been effectively wiped out by stock market falls in the summer and autumn of 2001. Penrose reported that on 30/8/2004 policy values were 97.8% of assets – the behaviour of the FTSE is shown at the end of this annex. Policy values were cut by 4% six weeks after the Compromise

- Members were not told that Equitable's financial weakness was not caused solely by the decision of the House of Lords, but also by at least a decade of over-bonusing, under-reserving for liabilities and the adoption of practices of dubious actuarial merit

- With-profits annuitants were not told that without a significant rise in the stock market, their pensions would be substantially cut

We consider that due in significant measure to the narrow terms of reference drawn up for the independent actuary, his report did not identify the foregoing issues which we consider he should have reported on. We have thus made a submission on this point to the Morris Review of the Actuarial Profession[21], and **recommend that the independent**

[21]The chairman of EMAG wrote "These proposals included a report by 'independent actuary' Michael Arnold of Hymans Robertson. Mr Arnold was well qualified to undertake the work, having acted in a similar capacity in respect of a series of other major reorganisations (listed in Appendix 1).

The engagement letter between Mr Arnold and Equitable Life instructed him:

1) To report upon 'the reasonableness and appropriateness of the actuarial assumptions, valuations and methodologies used by the Society' for the purpose of:
   a) Assessing the aggregate cost of the GAR rights
   b) Allocating benefits under the Scheme among GAR and non-GAR policyholders
   c) Calculating policy values to determine Scheme voting power.

2) To report on 'the overall reasonableness and fairness from an actuarial point of view' of the proposed compromise between the Society and its GAR and non-GAR policyholders

It appears to us that either these instructions were unduly narrow or Mr Arnold took narrow view of them. Various matters were known at the time (and others have emerged subsequently) upon which expert comment by the independent actuary, would have greatly enhanced the Court's and policyholders' understanding of the compromise proposals. These include:

1) Whether allowance should be made in the compromise to mitigate the obvious unfairness to late-joining policyholders of the 16% policy value cut.
2) Whether the compromise should tackle the problem of the guarantee of 3.5% annual interest, included in about three-quarters of all policies. It subsequently emerged that the existence of these guarantees virtually precluded Equitable from investing in equity shares.
3) The fact that for non-GAR policyholders the 2.5% uplift they were offered in the compromise had already been effectively wiped out by stock market falls in the summer and autumn of 2001.
4) The fact that Equitable Life's financial weakness was not caused solely by the decision of the House of Lords, but also by at least a decade of over-bonusing, under reserving for liabilities and the adoption of practices of dubious actuarial merit.
5) The fact that without a significant rise in the stock market, the pensions of with-profit annuitants would need to be substantially cut.

These matters are set out in further detail in Appendix 2.

actuary should be legally responsible to the Members' Committee, not the directors, and should not be indemnified by the company at members' expense.

The chairman was reported as saying "It is vital that policyholders are fully informed before they vote" (Daily Telegraph 8/8/01), but he made no effort to rectify the omissions of which these three were crucial. We now know that the fund was virtually insolvent; that the fund for future appropriations was very small; and that the prospects for the fund were then – and remain – very poor.

(iii) In May 2002 the Board carefully avoided publishing the solvency return until after the AGM, or at least until after postal votes for directors were sent in. It could have provided details after depositing the return with the FSA on 30 April 2002, but it contrived specious excuses in an attempt to keep it away from the press[22].

In addition to the question of the scope of Mr Arnold's report, his engagement letter (Appendix 3) discloses a very unsatisfactory balance between the responsibilities he owed

a) To the policy holders whose interests he was looking after and
b) To the management of the Society.

Clause 3 says 'my report on the scheme ('the report') will be for the exclusive benefit of the Society and the Court. I will be solely responsible to the Society'. Policyholders had to make do with a statement of intent in clause 2. "I will owe a duty to act independently which will over-ride any duty to the Society". However the document goes on to make it clear that this duty was not intended to be legally enforceable. Clause 4 says "I do not and will not accept any responsibility, duty of care or liability to any person other than the Society, and the Society must make this clear to policyholders".

Furthermore, clause 12 says 'the Society shall also indemnify me and Hymans Robertson on demand against any claims, losses, damages and liabilities arising from claims against me and/or Hymans Robertson brought directly by the Society's policyholders relating to the performance of my obligations under this letter'.

So not only did Mr Arnold and his firm not owe a duty of care to the policyholders, the Society also indemnified him against any claims that such policyholders might make.

In addition, there were practical considerations under which weighed in favour of the Society's directors who:

1) appointed Mr Arnold in the first place
2) authorised his fee
3) were able to offer him further work in the future. In fact Equitable used Mr Arnold as a witness in its case against Ernst and Young.

It will be seen that the balance of influence over Mr Arnold enjoyed by the directors of Equitable Life greatly outweighed that of the policyholders to whom he reported.

In the light of these comments, we ask you to consider

a) whether the role of 'independent actuary' actually works in practice to protect the interests of policyholders
b) whether steps should be taken to ensure that his instructions are sufficiently wide to properly inform policyholders of all relevant matters
c) whether the balance of influence should be re-weighted in favour of policyholders
d) whether it is right that the insurance company (at policyholders' cost) should indemnify the 'independent actuary' against claims by policyholders"

[22] During May 2002 EMAG, the Financial Times, the Daily Mail and some consulting actuaries tried to obtain a copy of the return. All were fobbed off by the Equitable. Finally, after all postal votes would have been despatched, on 24 May "The Financial Times was last night supplied with a full copy of the statutory solvency return after making repeated requests to Equitable. The mutual said that it had wanted to wait before distributing copies until they were available to

(iv) Provided inadequate information in the Annual Report & Accounts and at the AGM in 2002 to enable policyholders to judge the Society's finances. There was no analysis of:-

- the with-profits fund's available assets together with a comparison between, on the one hand, the available assets and, on the other hand, aggregate policy values, where the latter are differentiated between guaranteed and non-guaranteed elements and the annuitants

- the fund's performance i.e. return by asset class

- the nature and implications of the guaranteed interest rate problem, which now hobbles the fund

The Interim Report for the first half of 2003 was also short on information.

(v) Failed to disclose the extent of over-bonusing during the 1990s. Even after figures for 1995-99 were made available in court by Ernst & Young as part of its defence against Equitable, the chief executive refused to provide figures for the year 2000 on the grounds that to do so "would not be helpful to the continuing policyholders". Related to this he refused to clarify the observations by the Independent Actuary in the Compromise that at 31/12/00 "policy values exceeded assets by about 10%" – 10% of what number?

(vi) Refusing to provide the basis of policy valuation for members who are considering leaving the fund, viz a statement relating the annual statement of policy values provided every May to the offer which Equitable makes to policyholders who may subsequently consider taking either a contracted or a non-contracted exit. Two of EMAG's Committee Members were told that "it is not our policy to provide such information", which we regard as outrageous. It is analogous to a bank providing an opening and closing statement of account, and not much else in between.

(vii) Obstructionism regarding obtaining the number of members. In 2001 EMAG asked for, and was given, a CD Rom of the names and addresses of the members of Equitable. In 2002 on one occasion we asked for a revised list of members, and were told that we could have a paper copy which would cost about £7,000 (derived by applying the Companies Act obligation on companies to provider details of shareholders and allowing them to charge a prescribed fee. We also asked several times for the number of members, which was notably not reported in the Annual Report and Accounts, and on each occasion we were refused the information. We thus devised a statistical approach to estimating the number. On 1 August 2002 we asked for access to the register of members in London at the head office of Equitable. On 2 August we were told that we could have access in Basingstoke (which is the registered office) from 10.00-12.00 and "Information made available for inspection may be copied by the person inspecting the

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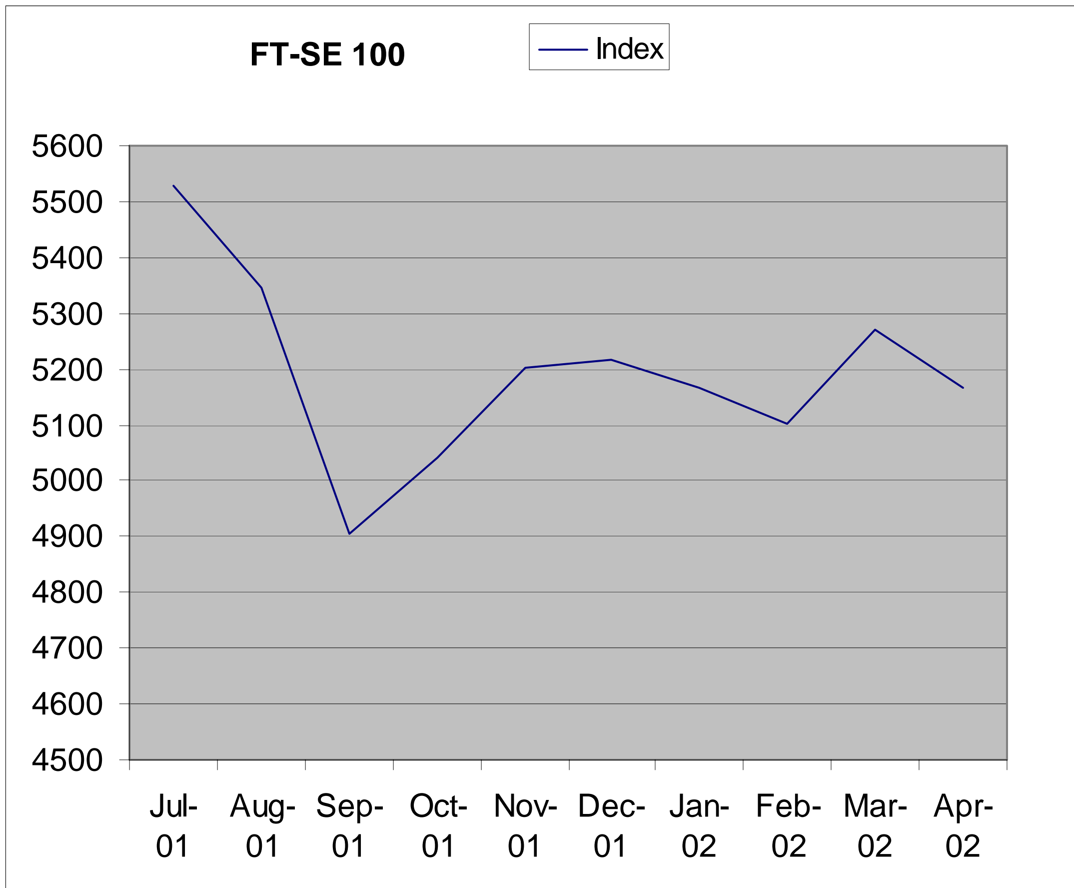
everyone from Companies House". Then at the AGM the Society's chief investment officer and finance director claimed that the reason for the delay in providing the solvency return was due to a delay by the FSA in providing it to Companies House, from where members and journalists could request it. The claim about Companies House was misleading – there is no bar on Equitable providing the return once it has been filed with the FSA.

Register by means of taking notes. No further facilities, such as printing or copying facilities are provided. The Society provides access to the Register by means of one computer terminal. It will not therefore be possible for more than one person to inspect the register at any one time". Equitable used the letter of the Companies acts to exercise petty minded obstructionism. **Members should be entitled to a digital list of members on a CD Rom for a small service fee**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Annex 3 The episode of the Review of the Memorandum and Articles of Association

In May EMAG mailed its members inviting them to sign the following petition asking that:

> We, the undersigned, being Members of the company representing not less than one-twentieth of the total voting rights of all the members having at the date hereof a right to vote at the next annual general meeting of the company, hereby require you to give to members entitled to receive notice of the next annual general meeting notice of the following resolutions, which it is intended to move thereat as Special Resolutions:
>
> **SPECIAL RESOLUTIONS**
>
> 1. THAT the Articles of Association be amended by the alteration of the first sentence of clause 8 to read as follows: -
>
>   The Directors shall, on the requisition of any five Directors or any one thousand members, forthwith proceed duly to convene an Extraordinary General Meeting of the Society.
>
> 2. THAT the Articles of Association be amended by the insertion of the following clause, to be numbered clause 12, and the subsequent re-numbered of the existing clauses 12 to 70 inclusive as clauses 13 to 71 inclusive: -
>
>   12. The directors shall, upon receipt of a requisition signed by at least 500 members of the company, give to members of the company entitled to receive notice of the next annual general meeting notice of any resolution which may properly be moved and is intended to be moved at that meeting as if the requirements of Section 376(2) of the Companies Act 1985 (as amended) had been fully met.
>
> 3. THAT the Articles of Association be amended by the alteration of the existing clause 41 so that “fifty members” shall be inserted in the place of “two members”.

16,179 qualified members signed the petition, and EMAG drafted proposed changes to the Articles (see the appendix to this annex) which called for:-

- the provision of information to members about the affairs of the Society
- the calling of an extraordinary general meeting (EGM) and resolutions at annual general meetings
- the conduct of annual and extraordinary general meetings (AGMs)
- voting on resolutions and for the directors of the Society
- the composition of the board
- the provision of information to members on the value of their policies

By way of response, at the AGM held in May 2002 the chairman, said there would be a review of the Memorandum and Articles in order to:

> "…update and align the regulations with best modern practice in the light of the future needs of the business. In other circumstances it might be appropriate to undertake a radical review and total revision of the Articles. However the Board feels that the expense and effort involved in such a major exercise would not be justifiable in the Society's current position".

In a letter to the chairman dated 18 October 2002, which contained EMAG's extensive proposed governance revisions, EMAG wrote "In view of the level of support of members we would be obliged if you would convene an EGM and put EMAG's proposals to a resolution". We did not receive the courtesy of a reply.

The board set up a working group which published its deliberations on 15 November 2002 as a consultation document on which it invited comment. The working group proposed 14 changes, all of which were trivial[23] (with the modest exception that the number of members required for nominating a director would increase from 2 to 50), and largely concerned convenience of administration. The Working Group entirely ignored EMAG's governance submission and petition, and notwithstanding Mr. Bullen's pledge, none related to improving the democratic accountability of Equitable to its members.

On 27 January 2003 the Company Secretary of Equitable wrote to EMAG[24]. The board dismissed virtually all of EMAG's proposals on the grounds that the proposals would involve too much "….diversion of management time and the significant expense of such a major exercise are not justifiable in the Society's current position. This approach seems to have been borne out by the low-key response of the membership generally to consultation on the review. We received your submission and a number of other members' submissions that appear to have been inspired by your e-mail headed "EMAG asks you to act now on Equitable Life's Governance proposal. Otherwise, although attention was drawn to the consultation in the interim accounts sent to all members, only five other members responded". Since Equitable could have simply copied Standard Life's April 2002 revised constitution with a few amendments, we do not believe that altering the Memorandum and Articles along the lines we had proposed would have involved either much time or expense.

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[23] E.g. the first two were that the language used in the articles should be updated, and the requirement that the AGM should be held in April or May should be changed to April, May, or June.

[24] We can provide a copy of this response on request.

Regarding the requisitioning of EGMs, where EMAG had proposed reducing the number of members to call one, the Secretary wrote that:-

> “At an early stage in its deliberations, the Working Group expressed a preference for a requirement for a minimum of, say, 1,000 members to requisition an EGM, and investigated this possibility carefully. However, the Working Group was concerned at the possibility that the right to request an EGM would be used for inappropriate purposes. It would therefore have wanted to incorporate a proviso along the lines of that adopted by Standard Life. In the absence of such a proviso, a relatively small group of members might requisition EGMs for vexatious purposes at frequent intervals, and at enormous cost to the Society. Accordingly the Working Group has recommended to the Board that the Companies Act requirements be retained in respect of the number of members required to requisition a general meeting, (and also in respect of the number of members required to requisition a resolution). The Board has accepted this recommendation”[25].

The voting membership of Equitable at this time was circa 350,000 members. Standard Life, with 2,500,000 voting members, had adopted the figure of 1,000 qualified members to call an EGM at their April 2002 AGM.

Regarding the election of directors: EMAG had proposed election "first past the post" positive votes with no negative votes and no Chairman's proxies. The Secretary wrote:-

> As regards "first past the post" we have investigated the procedures adopted by other companies and have taken legal advice. We have been advised that a public company would not be able to elect directors in this manner; the Companies Act effectively requires that in those companies the election of each director be dealt with by a separate resolution, with members voting for or against. While the Society is not a public company, we think that we should follow that example of good business practice. Moreover we have to take into account the likely reaction of the Society's membership as a whole and we feel that a significant body of members may object to losing the right to vote against the election of a particular candidate for director.

The Secretary provided unconvincing reasons for:-

- Eliminating proxy voting
- Limiting directorships
- Proposing to change voting weight proportional to each individual members’ guaranteed fund. This should not be difficult to propose (it was the basis of the voting for the Compromise)

[25] The technicalities of the proviso are irrelevant as the board reversed its position.

Provision of information was side-stepped by stating that it was not appropriate to incorporate provisions permanently in the Articles but "The Society aims to follow best practice in this area". In fact the Society provides no more information than required under accounting and FSA regulations.

Eventually the board agreed to propose modifying the constitution to allow 1000 members to put a resolution to the AGM and 1000 members to call for an EGM. We note that the Building Societies Act 1986 prescribes the maximum number of members required to put a resolution to the AGM or to call an EGM.

Although the change to the voting requirement is a practical proposition for an action group, it still has a number of difficult features:-

- only the very simplest of concepts can be addressed by a resolution, which has to be quite unequivocal and clear to members who are not familiar with the intricacies of corporate governance

- there is a long time lag. Resolutions have to be presented at least eight weeks before the AGM to allow the directors time to respond and to include the resolution in the printed bundle that has to be sent to policy holders some weeks before the AGM. This in turn means that the resolution itself must be drafted about four months before the AGM in order to allow the proposing organisation time to canvass 1,000 supporters. The effect of the long time lag between the drafting of the resolution makes a resolution subject to changes in circumstances that may occur over the intervening several months, which imposes another constraint upon the character of resolution that can be put forward

- even with a very simple requisition the drafting of the resolution and the voting is problematic. An antagonistic board will almost certainly find fault with the wording of a resolution regardless of the skill of the person drafting it, if not funding technical faults with the resolution so that they could ignore it

- the proposing group has no right of reply

Although the new constitution is a great deal better than the previous one, it is still very restricted and cumbersome to operate, and we consider that the proposals we made represent good practice.

Annex 4 Letters to Mr. John Tiner seeking the assistance of the FSA, and his unhelpful response

We have on a number of occasions written to Mr. John Tiner asking for help from the FSA to handle various proposals, or actions, or inactions by Equitable, including:-

- Paul Braithwaite wrote on 14 November 200, David Strachan replied on 4 December 2000
- Paul Braithwaite wrote on 5 November 2001, Tiner replied on 27 November 2001
- Alex Henney wrote on 5, 12, 18 November and 10 December 2003 and Tiner replied on 10 January 2003
- Alex Henney wrote on 6 April 2004 and 17 May 2004, and received no reply

We attach our letter of 12 November 2002 and Tiner's letter of 10 January 2004, and also our letters of 6 April 2004 and 7 May 2004.

None of the responses assisted EMAG in any way. While a few of the responses had good reasons why the FSA was not able to assist, most were sets of empty words or evasive, resorting to technicalities and avoiding the spirit of the request as to why the FSA could not assist. To illustrate we draw one request from our letter of 12 November to Tiner and Allen, and Tiner's response.

Our request:-

(ix) Basis of valuation of members leaving the fund. We have repeatedly been alerted by departing members to the refusal by the Society to provide substantiation for the payment figure received. **The FSA has refused to intervene**. Several such cases, when brought to the attention of quality newspapers have resulted in an immediate hike in payment and admission of mistake. Any respectable financial institution must surely provide chapter and verse on the calculation of a final fund payout?

Tiner replied:-

(ix) Equitable Life has explained publicly that where a policyholder takes a contractual surrender, the payout will be calculated as the policy value, subject to the "maturity adjuster", or the guaranteed value if that is higher. We understand that the basis of calculation for pensions and life policies was most recently explained in a letter from Equitable Life on 1 July 2002. As the letter explains, the value of a non-contractual surrender is calculated by applying the market value adjuster ("MVA") to the policy value at the time of surrender. The underlying "guaranteed" and "policy" values have built up by the addition of the declared guaranteed bonuses and the non-guaranteed interim bonus rate. The effect of the additions can been seen from the annual statements that all policyholders receive.

A statement of principle was of no use – Henney wanted the steps in the calculation. Subsequently he raised a complaint to the Financial Ombudsman's Service, who instructed Equitable to provide the calculations, which they did. Another member of the EMAG Committee had the same problem, and went through the same routine. We are in no doubt that given the many words that the FSA has written in its documents about the need for life assurers to inform policyholders on an ongoing basis about their policies, it could have at least persuaded – if not instructed – Equitable to provide this basic service to policyholders.

THE EQUITABLE MEMBERS ACTION GROUP

38 Swains Lane
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12th November, 2002.

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And Mr. Roger Allen
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Dear Messrs. Tiner and Allen,

A complaint regarding the lack of information provided by the Equitable to its members

1. I was holding this letter until we received the interim accounts to make any appropriate comment on them. The accounts (up to 20 June) were promised in October, but October is coming late this year. I imagine you are well aware that companies normally get their interims out 6-8 weeks after the end of the period.

2. I imagine that you would agree that one of the root causes of the difficulties of the Equitable Life was the inadequate provision of information about the situation of the with-profits fund both to prospective members and to existing members. You are well aware that one of the key strands of your With-Profits Review has been to stress the importance of providing customers of insurance products in general, and with-profits policies in particular, with adequate information both before and after point of sale.

3. The original objective of the Equitable Members Action Group was: "to support with-profits members in making informed decisions on the best long-term future of members". You will see from our re-designed website www.emag.**org.uk** that EMAG still strives to obtain and publish information of help to all policyholders (past and present). We were thus pleased when Mr. Treves wrote in an open letter published in various newspapers on 1 March 2001 that:-

> "I will communicate openly. This is our Society and members are entitled to know everything about how it is run unless open disclosure would be commercially

damaging…I look forward to an atmosphere of trust and transparency between the policyholders and our Society".

4. In similar vein the Annual Report and Accounts for 2001 claimed that "The Board is committed to a policy of openness in communication with policyholders". Notwithstanding those claims, he and the chief executive, Mr. Charles Thomson, have consistently obstructed us achieving our objective. The members have been subject to obfuscation, some misinformation, and much spin for the whole period since Mr. Treves became chairman. I provide you with nine examples:

(i) Inadequate information on the Halifax Equitable deal. Your colleague Michael Foot once told me he could see no reason why members should not be provided with information about the deal. We were provided with some information by way of the draft heads of terms, but no figures which would allow us to judge whether it was in our interests, nor the level of costs we could expect for the services that HBOS would render us. (It seems that these costs are high). I wrote to you about this issue, and attach the relevant extract from the letter, see attachment 1.

(ii) No quantification nor background for the reduction in policy values by 16% on 16 July 2001. The information provided to the policyholders (open letter to the members of Equitable, 16 July 2001) merely stated:-

- "Stockmarkets have fallen heavily over the last 18 months;
- Maturity values now significantly exceed the value of the investments underlying maturing policies;
- As a mature fund, a large number of policyholders are currently retiring and taking their benefits."

The fall of the stock market at that point accounted for only about 5% of the reduction in value of the fund – could we not have been advised of this? Why did we have to wait until December 2001 for the Independent Actuary's report in the Compromise to tell us that the fund had been 10% over-valued at 31/12/2000? And what is the relevance of the third point? Was it a euphemism for the fact that it took Mr. Thomson so long to appreciate that members who took contracted exits in the first half of 2001 received (we estimate) about £200m more than their asset share?

Mr. Treves and Mr. Thomson provided the following reasons for not providing adequate information about the value reductions:-

- "it would be too expensive" - in the context of £4,000 million, too expensive? Given the large legal fees incurred by the Society and how much is spent on Burson Marseller to "manage" information, the response cannot be regarded as serious

- "it would involve too much work" – yet either there was a directors' summary, which could have been provided or, as has since been claimed, the directors had no summary in which case it is difficult to see how they could have taken on a £4bn decision

- "the press would misinterpret it" - even if that were true, it should not prevent the publication of information to which the members are entitled

- "it would assist claims against former directors or advisers" – an incomprehensible reason
- "the auditors would not allow it" – why not? who pays their fees? complete nonsense

- "no other with profit office does it" - no other with profits office is in the mess in which the Equitable is

I hope you will agree with us that providing such a set of ill founded reasons to members is not compatible with the spirit, if not the ruling, of the message you are conveying in your Review.

(iii) Omissions in the Compromise Document. We commissioned Professor David Blake to prepare a report for us entitled "An Assessment of the Adequacy And Objectivity of the Information Provided by the Board of the Equitable Life Assurance Society in Connection with the Compromise Scheme Proposals of 6 December 2001". Professor Blake asked:-

> "Is the information provided the most up-to-date available? Most of the information in the above documents is now nearly six months old. In the interests of transparency and full disclosure, the following additional information is needed: a statement of affairs at November 30 providing information on:-
>
> - Number of policyholders (both GAR and non-GAR) still in the fund
> - Value of the fund
> - Solvency level of the fund
> - Fund available for appropriations."

Mr. Thomson rubbished Professor Blake's report, alleging in a letter to the FT that Professor Blake had not seen certain information. Professor Blake had seen the information. He also alleged that "Blake had made mistakes in all of his first five paragraphs". Despite two courteous and precise requests from Professor Blake, Mr. Thomson did not substantiate his allegation. Subsequently the Society has relied on Mr. Justice Lloyd's views on the matter – despite his lack of academic expertise in Professor Blake's field and his seeming lack of awareness of the possibility of using the press or the internet to update members inexpensively.

(iv) The Equitable's attempt to hide its solvency return in May 2002 until after the AGM. As you know the Equitable was obliged to provide its solvency return in digitised form to the FSA by 30 April 2002. During May EMAG, the Financial Times, the Daily Mail and some consulting actuaries tried to obtain a copy of the return before the AGM on 27/5/02. All were fobbed off by the Equitable. Finally, after all postal votes would have been despatched, on 24 May we read:-

"The Financial Times was last night supplied with a full copy of the statutory solvency return after making repeated requests to Equitable. The mutual said that it had wanted to wait before distributing copies until they were available to everyone from Companies House".

At the AGM the Society's chief investment officer and finance director, Mr. Charles Bellringer incorrectly claimed that the reason for the delay in providing the solvency return was due to a delay by the FSA in providing it to Companies House, from where members and journalists could request it. Yet by virtue of Rule 9.7 of the interim "Prudential Source Book: Insurers", policyholders have a right to receive "deposited documents" once they are deposited. There was nothing stopping the Society from providing the information to those who asked for it - and we had.

One is bound to ask whether the responsible officers of the Society were trying to hide the Society's weak solvency position and its reliance on financial engineering to scrape by.

(v) A consistent refusal to publish the number of members. We have on a number of occasions asked for - and on each occasion been refused – the number of members. We then thought that we would count the register. The Equitable made it as difficult as possible, saying we could only see it in Aylesbury for two hours a day and have access to one terminal – compare this with Mr. Treves' fine words quoted in paragraph **2** above. Attachment 2 is a letter I wrote to the relevant official in the Company Law Bill Team, see attachment 2. As of November 2002, the most recent count we have is for 16 months ago and the Society refused to provide the qualified member voting base at the time of the AGM.

(vi) Information not provided in the Annual Report & Accounts and at the AGM. At the AGM I asked for information which was not provided in the Annual Report & Accounts. The information was not provided, and so I wrote to Mr. Treves on 13 June setting out a request for the following information (see attachment 3):-

- in laymen's terms an analysis of the with-profits fund's available assets together with a comparison between, on the one hand, the available assets and, on the other hand, aggregate policy values, where the latter are differentiated between guaranteed and non-guaranteed elements and the annuitants
- a proper analysis of the fund's performance i.e. return by asset class the membership issue
- the nature and implications of the GIR issue

You are no doubt well aware that in your reports on the With-Profits Review you clearly indicated that the first two pieces of information should be available. And I imagine you would not disagree that information about GIRs should be available as it is a material risk to the Society. I attach the most unsatisfactory reply I received, see

attachment 4. When I received it I was very angry and told Mr. Treves that I regarded it as "contemptible drivel".

(vii) Failure to provide information under article 65 of the Society's Memorandum and Articles of Association. You are aware that we suffered two further policy value reductions this year. Knowing that we would be provided with little or no information, we checked the Society's Memorandum and found that article 65 reads as follows:-

> "The Directors shall at such intervals as they deem expedient but at least once every three years…cause an investigation to be made into the financial condition of the Society…by the Actuary…the Directors report to the Members upon the results of the valuation".

I wrote to Mr. Thomson on 5 September and drew his attention to the article and to the OED's definition of the relevant meaning of the word "report"[26] and commented "While the Directors have made statements, they have not *reported in the proper meaning of the word* on the investigations made into the financial condition of the Society that led to cuts in policy value of July 2001, April 2002, July 2002. I would be obliged if you would provide the members of the Society with the reports as required by the Articles of Association by publishing them on the website."

I received the following reply from the Society's new head of press relations and corporate communications, Mr. Tony McGarahan on 16 September:

> "The investigation under Article 65 is the annual valuation of the Society; published in the returns to the FSA, formerly to the Insurance Directorate. This document is on the Society's website."

On 7 October, after talking to Mr. Roger Allen, I wrote to Mr. Treves (see attachment 5), reciting the two letters and then pointing out (among other things) that:-

- the Directors' Report dated 15th April 2002 refers to "Valuation and bonus declaration", which was obviously not the solvency return

- Article 65 refers to a "Directors' report to members", not one to a regulatory authority and quite distinct from the Accounts prepared under Article 64. It also states "Provided that in the valuation of the assets the values thereof be not estimated beyond the market prices [if any] of the same ..." which clearly implies

[26] The definitions are:

- "An account brought by one person to another of some matter specially investigated".
- "A formal statement of the results of an investigation, or of any matter on which definite information is required, made by same person or body instructed or required to do so".

that future income should not be included. The solvency return includes future income

- Mr. Allen advised me that solvency returns "are not used for valuing the assets and declaring bonuses. Valuation and bonuses are worked out from first principles. They [i.e. solvency returns] are not a tool in that process"

- recently, another day and another (and slightly more elaborate) story from McGarahan, which is attachment 4. We are now taking legal advice on the issue

This pathetic little episode shows the depths to which the Board will go to hide information from the members.

(viii) Recently, our general secretary sought policy clarification of whether the GIR accrues daily both for on-going contracts and for non-contractual departures. The written reply was typical: "The Society is not prepared to discuss circumstances surrounding other clients policies….I feel that no useful purpose will be served by any further correspondence on this matter." So, the Society's policy basis of accrual of GIRs remains unexplained to its members (we would have put the answer on our website).

(ix) Basis of valuation of members leaving the fund. We have repeatedly been alerted by departing members to the refusal by the Society to provide substantiation for the payment figure received. **The FSA has refused to intervene**. Several such cases, when brought to the attention of quality newspapers have resulted in an immediate hike in payment and admission of mistake. Any respectable financial institution must surely provide chapter and verse on the calculation of a final fund payout?

5. I could provide more evidence, but trust you will consider that I have provided enough – if not more than enough – to make the point about how the Society keeps members in the dark. The result of that policy is that policyholders are not provided with the information that they need to make informed judgments about their financial futures, while those who are annuitants have received no explanation of their prospects.

6. If Mr. Treves, Mr. Thomson, et al were running a tight ship, they might get away with secrecy. But they give the appearance of not knowing what they are doing - other than cutting members' policy values:-

- Last year they ignored EMAG's suggestion for resolving the GIR issue along with the GAR issue, and so are now reduced to writing bonus statements and concurrently reducing policy values

- They ignored our suggestion last year for treating non-GAR members more equitably by spreading the 16% reduction pro-rata the non-contractual bonuses, and returning the

investments of the late joiners. Now we have the Bacon & Woodrow actuarial report; ELJAG; and the prospect of yet another expensive Section 425 scheme of arrangement

- Mr. Thomson dismissed as impractical our suggestion that those who wished could give up their GIR and switch into what would be effectively a unit linked managed fund. Instead, with actuarial blinkers, Mr. Treves and Mr. Thomson wrote on 15/4/02 "The Society aims to return to running a conventional with-profits fund". That was an unrealistic objective, the absurdity of which was rapidly revealed in a cut in policy values two months later and a switch out of equities to a position of just a 5% holding and no prospect of any material reversal. As Mr. Thomson does not appear to have a grasp of the obvious we have commissioned Mr. Ned Cazalet to report on the issue, and will be publishing once we receive the Interim Accounts

- We were told regarding the Compromise:-

  "This represents to me the end of the crisis. It may not be nirvana, but we would have stability and the prospect of growth". Treves reported on 21/9/01.

  "We will have a more strong bonus policy. We will have a stronger investment flexibility", Treves on Money Box on 12/1/02.

  "Equitable Life has vowed to splash out £4bn buying shares". (Mr. Thomson as reported in the Times, 7/01/02).

And pigs can fly.

I believe that sooner or later there is bound to be a full and proper independent investigation of the way in which the Equitable has been managed and supervised not only before the departure of the old Board but also since then. One purpose of this letter is to ensure that there will then be no doubt about the extent to which EMAG has raised with the FSA our concerns about the inadequacy of the provision by the Society of relevant information to policyholders over the past two years and the continuing inadequacy of such provision of information. More immediately the letter is intended to express EMAG's hope that, in line with the fine words in the FSA's documents, the FSA will now **act to** help ensure that the members of Equitable receive the information to which they are entitled.

This letter is written with the agreement of the Committee of EMAG. For your information it is the only properly constituted Action Group representing policyholders with a constitution, an elected Committee, a register of paid-up members, and a non-trivial bank balance.

Yours sincerely.

ALEX HENNEY

c.c. EMAG Committee, EMAG website, Equitable Board, various journalists, various MPs, Mr. Allan Asher, Director of Campaigns, Consumers' Association, and Mr. Hugh Burns, Penrose Inquiry.

From John Tiner
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Alex Henney Esq
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10 January 2003

Thank you for your letters to me of 5, 12 and 18 November, and 10 December about Equitable Life. Howard Davies has also passed to me your letters of 29 November and 13 December in order that we can give you a consolidated response.

I am sure that you will appreciate that many of the points that you raise are really for the management of the Society to answer rather than the FSA. However, with that caveat, I shall endeavour to respond to the points in the order you have raised them in your various letters to us.
I will start by working through the points in your letter of 12 November and the numbering below refers to the paragraph numbering in that letter.

1. It is clear from your letter of 18 November that you are aware that the interim accounts were published on 15 November, and covered the period up to 30 June. Naturally, I agree entirely with your view that the sooner financial information can be made available to its intended audience, the better. However, so far as we are aware, Equitable Life is not under any obligation to produce interim accounts at all, so their production is a positive voluntary move on the part of the Society's management. It follows that it is difficult to be too critical of the production timetable, particularly if the process of compiling the information has been unusually complex.

2. Your comments here conflate a number of separate points. From our experience, in general terms, the information provided by Equitable Life to its policyholders has been on a par with other with-profits offices. Of course, there is always room for improvement. We have published legal advice from Ian Glick QC and Richard Snowden about the lack of information given to some policyholders about the risks of the potential costs of the GARs, and the consequences of failing to provide that information. We therefore need to be careful to distinguish between the generality and the specifics. Our statements in the context of the With-Profits review have been about the general provision of information to policyholders to enable them to have an informed view of their investments.

3. Your letter then goes on to demonstrate a number of ways which you say is evidence that the Society's management have failed to provide information to policyholders. Of course the FSA

would have no objection to a company disclosing any of the information you have mentioned, but that is not to say we consider we should necessarily require it. I offer some comments on the examples that you have given.

(i) The FSA has no objection to the parties to the agreement disclosing the information. However, the agreements include commercial information that is subject to confidentiality restrictions. It would probably not, therefore, be open to one of the parties to disclose the information if the other objected to its disclosure. You say that EMAG would like to take a view on the terms of the agreements between HBOS and Equitable Life to ensure that they are in the interests of policyholders. The terms of the deal were considered by the FSA before it was completed. We did not need to approve the deal, but we were satisfied that we had no reason to object to the arrangements proposed.

(ii) The information that was used to assess Equitable's decision to cut policy values was management information that would not ordinarily be published by a firm. It seems to us also that this specific decision was particularly complex and was based on a number of underlying actuarial and other assumptions and accordingly involved a significant degree of judgement. I am sure you will appreciate that financial information put into the public domain raises questions about the level of audit scrutiny necessary to validate the information, with consequences for costs and speed of action.

(iii) We considered the points raised in Professor Blake's report. We accept the argument, which Equitable Life's Counsel advanced in court, that there had to be a cut-off for the information to be used for the purposes of the scheme. If the cut-off had been later, it would simply have delayed progress on the scheme while the later figures were audited. The information would still have been out of date by the time of the vote. In any case, we do not consider that the later information, had it been available to policyholders, would have changed the basic assessment of the benefits for policyholders of the compromise scheme.

(iv) The FSA processes the regulatory returns when they are received from insurance firms. Companies are required to make the returns publicly available. We note that the requirement that you refer to (IPRU (INS) 9.7R) gives a firm 30 days to comply with a request (from the date of the request or the date that the returns were deposited, whichever is later). If you have evidence that Equitable Life failed to comply with this requirement, we should be pleased to receive it.

(v) Section 356 of the Companies Act 1985 provides for access to be given to the register of members of a company in certain circumstances, or on the payment of the prescribed fee, for a person to receive a copy of the register. It is not clear from what you have said that Equitable Life has failed to provide the necessary access. A company that fails to comply with the requirements under that section may be guilty of an offence. The Department of Trade and Industry is responsible for enforcing those provisions.

(vi) We have proposed various changes to the way that with-profits offices operate for the future, and are now in the process of developing our proposals, which we will consult on further. We certainly have proposed that consumers should have access to more information about their investments and many firms are already responding to our

proposals by trying to improve the information they provide to consumers. However, we need also to recognise that firms are not yet subject to this proposed obligation to disclose further information.

(vii) The articles of association are a matter for the company concerned rather than the FSA. It is fairly typical for a with-profits office to have a requirement in its constitution to conduct a valuation every three years. However, we require life offices to undertake such a valuation annually.

(viii) As a general matter, we cannot discuss the details of Equitable Life's approach to paying bonuses on particular types of policy. Relevant information should be available in relevant policy documents and the other material produced by the company, such as the with profits guide and the annual returns. We would expect a firm to explain to individual policyholders how the specific terms of their policies work, but it is not clear to me that you are suggesting that Equitable Life has failed to do that. However, I will return to the points raised in your letter of 18 November at the end of this letter.

(ix) Equitable Life has explained publicly that where a policyholder takes a contractual surrender, the payout will be calculated as the policy value, subject to the "maturity adjuster", or the guaranteed value if that is higher. We understand that the basis of calculation for pensions and life policies was most recently explained in a letter from Equitable Life on 1 July 2002. As the letter explains, the value of a non-contractual surrender is calculated by applying the market value adjuster ("MVA") to the policy value at the time of surrender. The underlying "guaranteed" and "policy" values have built up by the addition of the declared guaranteed bonuses and the non-guaranteed interim bonus rate. The effect of the additions can been seen from the annual statements that all policyholders receive.

I do not think there is anything specifically I can respond to in paragraphs 5 and 6 of your letter. However, I can confirm that the FSA is clear about the extent of the information that EMAG has asked for and the extent to which Equitable Life has felt able to comply with those requests. I have highlighted above areas where we believe that the information should have been available and the basis on which that should have been done.

In your letter of 18 November, you set out details of the policies that you and your wife have with Equitable Life. You will understand that it is not for me to provide an explanation of the figures. However, there may be some general points I can make. First, I am not sure what the relevance might be of the ratios you have highlighted. For example, the guaranteed value is not a proportion of the indicative policy value. The values are derived independently, one by the addition of guarantees and the other by the addition of non-guaranteed bonus. I have already commented above (see paragraph (ix)) on the relationship between those values and the surrender and maturity values.

At a general level, I should also say that is difficult to draw direct comparisons between different policies. The values you refer to will be affected by a number of things, including the type of policy, the amount of premiums paid and the precise date of every payment, the impact of any guarantees that might be provided for under the terms of the contract and any charges that may be deducted.

I need also to reply to your comments in your letter of 5 November about the MVA. The precise circumstances in which a firm may impose an MVA may vary. However, I enclose a copy of an

FSA factsheet about with-profits policies which includes a general explanation of MVAs and how companies set surrender values. We have been following the way Equitable Life is using MVAs for some time and we have found no evidence that there is anything in Equitable Life's approach that is inconsistent with the general statements in the enclosed factsheet. You will appreciate that the points made in paragraph (ii) above are equally relevant in this context.

You enclosed with your further letter of 10 December some papers relating to a review of the Equitable Life's interim accounts. We have noted the observations made in those documents, but do not think it would be appropriate for us to comment on them.
Your letter also enclosed a note that you have submitted to members of Equitable Life's board. Clearly, as members of the Society you are entitled to express views of this kind, but again it raises issues on which the FSA cannot comment. I should, however, remind you that Mr Treves' appointment was subject to regulatory approval by the FSA when he took up his position at Equitable Life and the requirement about fitness and properness is, of course, ongoing. The FSA has not received information which would cause us to review whether Mr Treves continues to be fit and proper to perform the functions for which he has been retained.

The other matter covered in your letter is the report by Cazalet Consulting that suggests that Equitable Life policyholders might be better off if their policies were converted from with-profits to unit-linked policies. That is clearly a matter of judgement. It does, however, seem to us that policies could only be converted in that way, with the agreement of policyholders. Even if that were likely to be achievable in practice, which it may not, it may well be that the exercise would involve very considerable costs that might well exceed any benefits that might be achieved. We note from the information that you have provided that Equitable Life appears to have considered this as an option but has concluded it would not be viable. Of course, it is open to policyholders individually to switch from with-profits to unit-linked products at any time, if they think that is likely to be in their interests, although we understand a financial adjuster would normally apply to such transfers.

I will now turn to the points you have raised in the two letters you addressed to Howard Davies, to which he has asked me to reply.

You raised five specific points in your letter of 29 November 2002 and I shall respond to them in the order they appear in your letter.

The first two issues refer to specific events in the past. As you know, the FSA commissioned an independent review led by Ronnie Baird, Director, Internal Audit and Quality Control at the FSA, to see what lessons could be learnt from the events at Equitable Life. The report of that review was published last year and, in the light of its findings, I was commissioned to lead a project to consider how the FSA would regulate insurance firms in future. My initial report to the Economic Secretary to the Treasury outlining our proposals for change was submitted in November 2001. The report included our response to the recommendations in the Baird Report. In October 2002, we published *The Future Regulation of Insurance – A Progress Report*, which sets out the further steps we have taken to strengthen insurance regulation, and our plans for completing the project's programme of work. All those publications are available on the FSA's website. I do not think there is anything I can usefully add to the information that is already available on those matters. Of course the issues you refer to may also be considered by the reviews being carried out by Lord Penrose and the Parliamentary Commissioner and I cannot prejudge any comments that they might make when their reports are published.

In the context of the second point, you have however raised a number of issues that I can respond to on the compromise scheme. Last December, we published a detailed statement in which we explained why we thought Equitable Life's compromise scheme offered a fair exchange for the rights and potential claims policyholders were being asked to give up. That scheme offered policyholders certain uplifts to their policy values in exchange for giving up either the right to take a GAR or the right to pursue a mis-selling claim in relation to the GARs. A clear majority of policyholders supported the proposals which were subsequently approved by the court. Policyholders who left the with-profits fund before the scheme became effective were not bound by it. Their legal rights are therefore unaffected by the scheme and so if they were missold, they still have the right to take their claims to the Ombudsman or to the Courts, and Equitable Life remains liable to pay any compensation that might be awarded. Equitable Life is now proposing to try to reach a settlement with former policyholders with respect to any claims that they may have.

Your third point criticises the FSA for not requiring Equitable Life to "resolve" the GIR issue. Many policies issued by Equitable Life contain GIRs. They are a contractual right under the relevant policies and the FSA does not have the powers to remove those rights, nor to require anyone else to remove them. Clearly it would be open to Equitable Life to offer to buy out the GIR rights, if it thought that was an appropriate course of action.

Your fourth point is about the adequacy of information given to policyholders by Equitable Life, which is a point I have already dealt with above.

The last point you raised in that letter was on the powers of the members to influence and control the affairs of the Society. We have made it plain in previous discussions that the FSA does not have the powers to achieve what you are seeking. While there may be some circumstances in which our powers under the Financial Services and Markets Act might be relevant to the governance of the Society, the purposes for which we may exercise the powers are clearly limited. At the end of the day, subject to any statutory limitations and requirements, it is for the members of a company to decide upon the form of its constitution. We have seen no evidence that Equitable Life is any different from any other company in that respect.

Finally, I turn to your letter of 13 December 2002. That does not appear to raise any issues that I have not already addressed above.

EQUITABLE MEMBERS' ACTION GROUP

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6th April, 2004.

Mr. John Tiner,
Chief Executive Elect,
The Financial Services Authority,
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London E14 5HS

Dear Mr. Tiner,

You may recall that on 28 February 2002 I wrote to you a letter titled "The governance of Equitable in particular and of big mutuals in general" and a further letter on 20 March 2002 titled "Improving the governance of mutuals". You do not appear to have responded to these letters. In a letter to Howard Davies dated 13 December I quoted fine words from the FSA's "Progress Report: The Future of Regulation" regarding "The need for effective corporate governance" and said "we ask the FSA to instruct the Society to modernize its governance to radically improve the democratic accountability of the Board of the members. Consistent with your response to **all** our requests for assistance on behalf of policyholders versus Equitable[27] you turned down our request for help in a letter dated 10 January 2003. You stated "We have made it plain in previous discussions that the FSA does not have the powers to achieve what you are seeking". Although you may not have the formal powers, I have little doubt that you have sufficient informal powers of persuasion and I equally have little doubt that you understood full well the significance of the issues we were raising.

I imagine that you have read Penrose's report. You may have noted his observations in paras 51 and 54 of chapter 20:-

> "Under the Society's articles policyholders were effectively powerless, and the board was a self-perpetuating oligarchy amenable to policyholder pressure only at its discretion. It is impossible in practice for policyholders to initiate by requisition an EGM or otherwise to raise special business. Board appointments are effectively in the hands of the current board".

> "The constitutional position of Equitable may be unusual. Participation in governance by members was impracticable. The articles relied on the current Companies Act provisions, with their requirement to obtain the support of 10% of the voting power to initiate special business, which may be well-enough adapted to organisations with a relatively low membership, but are poorly adapted to any large financial mutual with hundreds of thousands of members and no adequate public register to enable a group of concerned members to requisition business. Other offices, such as Standard Life, now allow a minority by number to requisition business. I see no ready means by which regulators could force the

[27] Paul Braithwaite's letter to you of 5/11/2001 and my various letters to you of late 2001 and early 2002.

> remaining mutuals to adopt articles that facilitated policyholder action, unless it could be brought within the test of "treating policyholders fairly". But one way or another, means must be found to give policyholders an effective voice in mutual management. Without that, policyholders' committees and other such devices will not be of substance".

Some 1100 members have tabled a resolution for the AGM asking that the Board allocate £2m to a trust fund to enable EMAG to pursue the government for compensation. Given the past three years of spinning and obfuscation, we do not trust the Board to behave in a straightforward manner. We noted a reference in the Telegraph (31/03) to the board "checking the legality of the document and list of names" and are concerned that it may indulge in the type of sleight of hand which Standard Life descended to. We also noted that it is inviting one of the expensive firms of solicitors and some even more expensive barristers it employs at policyholder's expense to come up with an opinion on whether there is sufficient evidence of regulatory failure in Penrose to sue the government. We are concerned that it may have effectively briefed the barristers to come up with a neutralising opinion, as it did to discount the second opinion by Nicholas Warren QC on misselling[28]. **I hope this time I can ask you with a prospect of success that you will help ensure that the Society neither tries to cheat nor to spin.**

I am copying this letter to Paul Myner for his review of mutuals so that he can watch "governance" in real time. We will in due course be making a full submission about the unsatisfactory state of governance of the Society; the inadequate effort the Society made to "modernize" (to use a vogue word) its articles of association; and the lack of help we had from you in our attempts to discover what the Board of Equitable was doing for – and as often as not – to its members.

Yours sincerely,

ALEX HENNEY

c.c. Vanni Treves
Charles Thomson
Board members
EMAG Committee
Various journalists

[28] I noted that on p279 para 40 Penrose starts "Notwithstanding the contrary Moss opinion…" which prima facie may indicate his view is in line with ours. I set out the story of legal obfuscation in my recent submission to Treascom "The failures over the period 1999-2003 of the Financial Services Authority (FSA) in protecting the policyholders of the Equitable Life Assurance Society (Equitable)", which is on our website www.emag.org.uk.

EQUITABLE MEMBERS' ACTION GROUP

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17th May, 2004.

Mr. John Tiner,
Chief Executive Elect,
The Financial Services Authority,
25 The North Colonnade,
Canary Wharf,
London E14 5HS.
John.tiner@fsa.gov.uk

Dear Mr. Tiner,

I write further to my letter dated 6 April. As I predicted the Board is not behaving in a straightforward manner. It published a statement opposing EMAG's resolution, which is of course its prerogative. But in doing to is grossly misrepresented both EMAG and its position. I attach the statement which it sent out to members. It is notable that the Society's website publishes many pages of propaganda about the board rejecting EMAG's resolution and the legal opinion of Herbert Smith whilst neither reproducing the actual resolution nor the 1,000 words of explanation supplied by EMAG.

First, EMAG is not promoting "groups and lawyers proposing to sue the Society". The basis of this assertion was that we have links on our website to such groups and lawyers. The links on our website include the FSA, the FOS, Equitable, EPHAG and others (including ELTA and ELCAG). They are all there as part of our objective of providing information. (The Equitable Life Members Support Group similarly provides links to both ELTA and ELCAG). The legal link includes a reference to Clarke Wilmott under the heading "A suggestion for those seeking Legal Advice in Connection with Equitable Life". We mention that they provided EMAG with helpful advice on the GAR rectification scheme, and state "This is neither advice nor a recommendation from EMAG". The Oxford dictionary defines "promote" as "support or actively encourage". EMAG has done neither. The claim is as specious as claiming that because the BBC website about Malaya has a link to The State Peace and Development Council, the BBC is promoting the military junta whose website it is.

Second, the Board is in error in suggesting that the purposes for which the grant is requested by EMAG are unclear and that EMAG's expenditure would duplicate expenditure by the Society. EMAG's objectives in this regard are:-

- To persuade the Parliamentary Ombudsman that there has been maladministration such as should lead to the payment by the Government of compensation (an area in which to date only EMAG, rather that the Society, has made any progress). Part of the money would go to pursuing the application for judicial review. *As the Society has no locus in this matter, there is no duplication*

- To get the European Commission to take up with the British Government the issue of breaches by the United Kingdom of the 3rd Directive (a point which the Society's lawyers have recognised can usefully be taken, if at all, only by *policyholders* and not by the Society) via:-

  * possibly a Francovich case

  * a petition to the European Commission

  The Society has no locus in either of these approaches, and thus there is no duplication. Furthermore we do not think that Herbert Smith's letter accurately reflected the euro situation.

We asked the Board for a meeting at which we would have explained all our thinking Treves, however, refused, because (he alleged) EMAG has "attempted to destabilize the Society; and they have resulted in significant, unnecessary costs being incurred by the Society's continuing members, costs they can ill afford to bear". When I asked him to specify, his reply indicated that the claims were mere bombast. We deplore the board's behavior in failing to accept EMAG's repeated written requests to meet, the claiming we are not being clear in our objectives and procedures.

Turning to the procedural aspects, EMAG supplied the required 1,000 member requisition, resolution and 1,000 word explanation on March 24th. The Society refused to answer whether the resolution was to be put and we only learned that it was going forward by reading it in the Sunday Telegraph on April 18th. Unless the Board is aware from the postal votes that it has defeated the resolution, I expect that Treves will attack the resolution at the AGM, our representative is not allowed to make a statement, but has been allotted 10 minutes at the end of the meeting (by which time some members will have left) to answer any questions.

The Board's statements lack integrity – they are shoddy manipulative trickery and should be below standards acceptable to the FSA. Clearly, if a plc were to publish such equivalently misleading material about an issue of concern to its shareholders, I imagine that you would take an interest. I hope you will do so in this case.

I copy this letter to Paul Myners. He can observe the continuation of the abuse of mutuality which Penrose pointed to and which Michael Foot agreed was a significant issue.

Yours sincerely,

ALEX HENNEY

c.c. Board Members
EMAG Committee

Annex 5

THE FAILURES OVER THE PERIOD 1999-2003 OF THE FINANCIAL SERVICES AUTHORITY (FSA) IN PROTECTING THE POLICYHOLDERS OF THE EQUITABLE LIFE ASSURANCE SOCIETY

"O, what a tangled web we weave,
When first we practise to deceive"
Walter Scott

A submission to the Treasury Select Committee's Inquiry
Restoring Confidence into long term savings
by Alex Henney, Chairman, Equitable Members' Action Group

SUMMARY AND RECOMMENDATIONS

1. Although we appreciate that there are many factors affecting people's willingness to save for the long term, this paper focuses on the ways in which the Financial Services Authority (FSA), since its inception and latterly in concert with the board of the Equitable Life Assurance Society (Equitable), has failed the policyholders of Equitable and has consistently short-changed policyholders without guaranteed annuity options (GAO) (especially the late joiners[29]). The debacle, and the way it has been handled, may well have contributed to reducing the level of the long term savings because many people have lost faith in the competence of regulation.

2. There are three reasons why Equitable collapsed:-

- it failed to reserve for GAOs on *reversionary* bonuses from the mid-1980s
- throughout the 1990s, in order to improve its marketing appeal, Equitable declared bonuses well in excess of the value of assets. In consequence it was paying departing policyholders in excess of their asset value with money from new investors, which left a hole of some £3bn. Furthermore, contrary to its claims, it was not operating a with-profits fund that smoothed returns by building up a smoothing fund when financial times were good to support payouts when times were poor; there was no smoothing fund and this left another hole of about £1½-2bn at the end of 2000. All policyholders who did not leave before 16 July 2001 have paid for these black holes and the failure to reserve by reductions in policy values of 25-30%

[29] For the avoidance of doubt I took out my policy in 1988, so am not a later joiner, who are defined as joining after September 1998 when the board of Equitable was advised on the risks of losing a representative case, subsequently known as the Hyman case

- the coup de grâce came from the House of Lords on 20 July 2000, when it ruled that Equitable could not apply differential bonuses (as between policyholders who did not have GAOs[30] and those who had them) in order to offset the cost of guaranteed annuity option on *terminal* bonuses. Correcting this was estimated originally to cost £1½bn, and in the Compromise involved a reallocation of some £900m from non-GAO policyholders to those with GAOs

3. While the decisions not to reserve, to over-bonus, and the poor presentation of the case to the House of Lords[31], were clearly the responsibility of the board of Equitable, the first two reasons also reflected a long term failure of prudential regulation. First, the regulator should have required reserving from the late 1980s, but it failed to act until the winter of 1998/99. And when the FSA finally acted in 1999 it allowed Equitable to reserve by window dressing its solvency returns with valueless financial engineering devices instead of requiring real assets. Subsequently three of the four devices it was allowed to use have either been disallowed by the FSA or are being phased out.

4. Second, in 1997 at latest the Government Actuary's Department (GAD) became aware of the over-bonusing, but stated "it did not necessarily cause them any concern". It should have caused concern because all through the 1990s and until after it closed, Equitable was paying departing policyholders some 10% more than their asset share. Even when Equitable lost in the Court of Appeal on 21 January 2000, the FSA did not call Equitable in and require it to behave prudently. **This allowed the chief executive of Equitable to send out a letter on 1 February 2000 to policyholders which claimed that the financial consequence of losing at the House of Lords would be minimal. The FSA then failed to ask him the basis of his assertion, which we now know was wrong.** *As a result of the FSA's lack of action thousands more joined Equitable and existing investors put more money in, all to the tune of nearly £2bn.* When the fund closed and the stock market faltered in 2000 the "money-go-round" stopped, leaving the policyholders who remained with Equitable after 16 July 2001 to cover a hole of £4-5bn with reductions in policyholder values of 25-30% and in the pensions of with-profits (more accurately, with-losses) annuitants. *These cuts have not been primarily due to falls in the stock market, but are largely the consequence of past mismanagement and misregulation.*

[30] Equitable had attempted to neutralize the financial effect of the GAOs on the *terminal* bonuses of policyholders who exercised their option, by reducing their terminal bonus.

[31] Equitable put the case for the non-GAO policyholders poorly. It did not make a case for their policyholders' reasonable expectations, and as has subsequently become clear it had many matters that it would not have wished **to have** in the public domain; it did not indicate the magnitude of the possible financial consequences of the decision which the House of Lords took. One of the five law lords party to the decision commented extra-judicially that "if the case has been put differently and we had known the true facts, the outcome might have been different".

5. While the government and then the FSA as prudential regulator failed to protect "policyholders' reasonable expectations" (PRE), which was their role under the Insurance Companies Act 1982, they also failed to ensure that (prospective) policyholders had the information which allowed them to judge Equitable's financial situation for themselves. The prudential regulator neither acted *in loco parentis*, nor ensured that policyholders and informed observers had access to the information necessary to enable them to look after themselves.

6. After the House of Lords decision, without undertaking any analysis of Equitable's financial situation and indeed not understanding its financial situation, firm in a baseless belief that a sale was "99.9% certain", the FSA allowed Equitable to remain open in at attempt to sell itself. This decision treated new policyholders irresponsibly. It was implicitly signalling to them that if a purchaser could be found who would fund the liability for GAOs and who would handle the over-bonusing, then **their** PRE would be met – if not they would be in a mess. And in a mess they were. The FSA then did nothing to require Equitable to compensate fully those who joined after the House of Lords' decision in the compromise of February 2002 (which was an agreement under S425 of the Companies Act 1985). Rather it left them the choice to retain their rights to claim for mis-selling by leaving Equitable, and then to either appeal to the Financial Ombudsman's Service (FOS) or the courts, or to rely on fairness from FSA/Equitable (which has not been on offer). *This episode showed clearly the conflict between the FSA's objectives of preserving market confidence (however undeserved), which was its overriding priority and will generally prevail, versus that of protecting consumers.*

7. Although the chairman of the FSA observed to the Treasury Select Committee[32] that the **House of Lords'** decision "overturned the fundamental principle of the way in which returns were allocated in the life industry", he failed to ask the government to attempt to legislate to mitigate the consequences of the flawed decision[33]. In autumn 2001 the FSA/Treasury probably realised that Equitable was in much more of a mess than they had thought and could not be sold, and we have been told that a meeting was convened with several investment banks to discuss what could be done. FSA/Treasury should also have realised the significance of the complete failure of conduct of business regulation, and that claims for mis-selling by policyholders without GAOs could be a major

[32] 5 February 2001.
[33] The decision was flawed in part because of the poor presentation of the non-GAO case, and because Steyn LJ contradicted a previous decision he had made regarding the strength of companies' articles of association.

problem, while claims for possible fraudulent misrepresentation and the disclosure in court of certain board minutes would rapidly expose the failures of regulation. **(I have already alluded to the FSA's failure to either prevent the chief executive of Equitable from writing a misleading letter about the possible financial implications of the House of Lords case and then failing to question it when it was published).**

8. The FSA not only failed to help the majority of the members who suffered from the House of Lords decision, it acted in concert with Equitable to short-change them and other non-GAO policyholders. First, it endorsed the Proposed Compromise, which offered them a mere 2½% that was promptly taken away by a cut in policy values of 4%. The FSA should have known enough to be aware that the benefit offered to non-GAO policyholders was not only inadequate, but that Equitable could only deliver it if the stock market rose significantly (it fell); that the information provided was inadequate; and that some of the public statements made by the chairman and the chief executive to promote the benefits of the Proposed Compromise to the policyholders would not be allowed by Stock Exchange rules **in the case of a quoted company – statements that** events have shown were **incorrect.** The FSA was complicit in endorsing by silence the **dissemination of defective information.**

9. **In 2002 the FSA** required Equitable to commission a report by an actuarial consultant to assess the cost of the GAO liability to non-GAO policyholders, together with a legal opinion supporting the consultant's methodology. The consultant's conclusion was that non-GAO policyholders' loss was up to 5% of policy value, a figure that was less than the market value adjuster[34] (MVA) policyholders suffered leaving the fund, let alone the reduction in policy values of 16% in July 2001. The FSA has accepted the Equitable using the 5% as the basis of compensation, and made no public objection to Equitable's intention to use the figure in a proposal for a second compromise scheme for 70,000 former policyholders who left Equitable to retain their rights to claim for mis-selling[35]. This proposal was stopped by the Equitable Late Joiners Action Group (ELJAG), who sought compensation for fraudulent misrepresentation and threatened to oppose the

[34] Life assurance companies frequently charge policyholders a market value adjuster when they make a non-contracted exit (i.e. they do transfer to another pension provider but do not take a pension). Since the House of Lords decision Equitable's MVA has varied between 7.5% and 20%.

[35] Mis-selling is not a legal term, but is used as a generic description for breaches in the rules of the conduct of business regulation under section 62 of the Financial Services Act and the rules of LAUTRO, later the PIA; negligent misrepresentation; fraudulent misrepresentation; deceit; failure to fulfill a common law duty to advise; and a breach of implied warranties.

settlement in court and to undertake a discovery process that would have brought Equitable board minutes into the public domain. This could potentially have overturned the compromise, and seriously embarrassed the FSA and Equitable, if not worse.

10. In conjunction with the FSA, in order to persuade policyholders into accepting the compromise settlement and subsequently other proposed settlements for mis-selling, Equitable has pursued three main policies:-

- to provide policyholders with minimum information and to “news manage” and “spin-up” its financial situation

- to eliminate policyholder’s rights to take legal action against it for mis-selling, which has generally been formulated as claims for negligent misrepresentation under S2(1) of the Misrepresentation Act 1967

- to minimise liability for mis-selling to former policyholders who left before the compromise

11. Equitable has run a deliberate policy of obfuscation so that policyholders could not properly judge its financial situation. The most important examples of lack of information have been:-

- refusing to provide information regarding the financial background to the cut in policy values of 16% for pension funds on 16 July 2001. Contrary to claims made by Equitable that the main reason for the cut was the fall in the stock market, the main reason was to offset the cumulative effect of a decade of over-bonusing and the absence of a smoothing fund; to allow for mis-selling; and possibly to prepare a war chest to “give” back a bonus to policyholders to induce them to sign the compromise

- omitting key financial information from the Proposed Compromise published in December 2001

- attempting to hide the extent of over-bonusing. I suspect the purpose may be to reduce compensation for mis-selling by avoiding raising an additional way in which non-GAO policyholders could claim for mis-selling

- failing to explain in a structured manner the significance of the guaranteed investment return (GIR) of 3½% provided to the majority of policyholders, which now hobbles investment strategy and imposes the risk that the cost of failure to achieve a net return of at least 3½% (say a gross return of about 4½%) upon the policyholders without GIRs. **This is something which, as EMAG pointed out to the board in August 2001 when it was considering the S425 compromise, ought to have been, but was not, dealt with in the compromise**

We have numerous letters from Equitable refusing to provide us with information to which the members of Equitable either as policyholders or as owners of it should have been entitled.

12. *Some of the shortcomings in the provision of information have undoubtedly impacted adversely on decisions that policyholders made in delaying leaving Equitable and reinvesting elsewhere in an attempt to repair the ravages caused by Equitable.* Although the FSA has a statutory obligation under the Financial Services and Markets Act 2000 to "have regard to the needs that consumers may have for advice and account information" and has published many statements endorsing the need for companies to provide information, Mr. John Tiner of the FSA has refused our requests to ensure Equitable provide the foregoing and other information that would have been of value to policyholders.

13. The second strand of the FSA/Equitable strategy has been to induce policyholders to sign settlements that involve them giving up their rights to claim for mis-selling. The compromise settlement eliminated mis-selling claims by the majority of non-GAO policyholders, while the proposed second settlement would have done the same for the 70,000 non-GAO policyholders who had left to retain their right to claim for mis-selling. Furthermore, all of the cases where Equitable has settled with pension policyholders under threat of court action (nearly always well in excess of its standing offer of 5% compensation), have been subject to confidentiality agreements (gagging orders).

14. The third strand of Equitable's strategy has been to publish carefully briefed opinions that appear to deliberately discount the liability due for negligent misrepresentation **by (i) limiting the grounds for misrepresentation, and (ii) not considering the possibility of** fraudulent misrepresentation. **Lawyers appeared to be** briefed on the basis that compensation for misrepresentation should be limited to the "GAO risk", i.e. that non-GAO policyholders had not been informed of their possible liability to fund GAOs. But of greater financial significance, prospective policyholders were sled to believe that they were investing in a with-profits fund which would return them their smoothed asset share based roughly on the returns accruing from their investment less expenses. As pointed out in paragraph 2, since Equitable did not have a smoothing fund, there was no scope for smoothing. And because it over-bonused, a part of all new policyholders' investments was paying off outgoing policyholders. The sales claim amounted did

not accurately represent the character of the fund, and these considerations were perhaps three times the cost of the GAO risk. *If my assumption regarding the restricted nature of the briefs is correct, then Equitable's use of legal opinions based on them to support its inadequate offer of 5% to late joiners might be interpreted as misrepresentation or even suggestion falsi, suppression veri.*

15. Then, starting from the inappropriate briefs, the opinions published by Equitable assumed that the law as it stands was not the law; claimed that Equitable's representatives were not providing "advice" but only "information", which results in a cap on compensation; and from their superficial and unquantified analysis of the rationale for the MVA, claimed that those who left to preserve their legal rights should not be compensated for the cost of the MVA they suffered. The only opinion which we can be confident is genuinely independent argues that compensation for negligent misrepresentation should be based on the "alternative investment measure". This is the difference in value between a claimant's actual investment in Equitable and the alternative investment**s** he would have made if properly advised. The opinion could see no justification for discounting the MVA. The barrister acting for the Financial Ombudsman Service (FOS) concurred with these views.

- 16. The FSA must have been kept closely informed about Equitable's negotiations with ELJAG and of other private settlements. The FSA (and FOS) must be well aware **it is quite possible that** some policyholders have a case for fraudulent misrepresentation. They are also well aware that there is one compensation rule for the informed and more prosperous former policyholders who are prepared to fight Equitable and have often gained *much more* than Equitable's 5%. The remainder of the former policyholders, many of whom perhaps are of modest means; some are elderly and are reluctant to get in a fight; and most do not understand the tactics Equitable is deploying, get 5%. Policyholders have been enmeshed in a legal hall of mirrors created by very expensive lawyers, payed for by the policyholders themselves. *The FSA neither considered the issue of possible fraudulent misrepresentation –* ***perhaps it deliberately ignored it to avoid upsetting the apple cart - nor has it attempted to level the playing field between the compensation paid to former policyholders who take legal action and those who accept the Equitable's inadequate offer of 5%, by its silence implicitly condoning the offer.*** *The FSA's implicit treatment of the "little" policyholders brings out again the inherent conflict of interest between its responsibility to maintain orderly markets and its responsibility to protect individual consumers.*

17. The FOS is effectively a subsidiary of the FSA, which appoints its board and controls its budget. The July 2002 Memorandum of Understanding between the FSA and FOS enjoins that "there should be consultation at an early stage on any issues which might have implications for either organization". Although we do not have concrete evidence, we suspect that the FOS is acting in a coordinated way with the FSA and may be mitigating the endeavours it is making to seek redress for policyholders. The relationship between the FOS and FSA is markedly different from that for representing the interests of gas and electricity customers, where (as the current chairman of the FSA is well aware) "Energywatch" is funded separately and its members are appointed separately from the Gas and Electricity Markets Authority. EMAG is concerned that the FOS's delay in announcing quantum for damages may dis-enfranchise possible claims due to the three year rule on making a claim to the FOS.

18. The Financial Services and Markets Act 2000 precludes both the National Audit Office from investigating the FSA under the National Audit Act 1983, and the Parliamentary Ombudsman from investigating it for maladministration[36]. The Act also protects the FSA and its staff from being held liable to policyholders for losses resulting from its negligence. But in France, Germany and Italy the respective supreme courts have held that the banking regulators can be held liable for loss caused to depositors as a result of their negligence. What applies to banking depositors in these countries, should under the Insurance Directives presumably also apply to policyholders both in those countries and in the United Kingdom.

19. **Surely investors in an organisation regulated by Her Majesty's Government have a right to expect something better than the failures that both caused and have followed the Equitable collapse, and the obfuscation and legal trickery that has followed it. The FSA has done nothing for the majority of policyholders (those without GAOs) of Equitable, and has through its silence tacitly colluded in manifestly unfair treatment of late joiners. In particular the FSA:-**

- **failed to rein in Equitable in 1999 and the first half of 2000 to stop it over-bonusing and raising unrealistic expectations of performance in order to support its marketing effort**

[36] The investigation the Ombudsman published last year of the FSA covered a period before the 2000 Act came into force, when the FSA was acting on behalf of the Treasury and the relevant legislation was the Insurance Companies Act 1982.

- **allowed Equitable to remain open after the House of Lords decision, then did nothing to ensure that those who suffered from its decision were compensated**

- **failed to take any measures to redress the consequences for policyholders without GAOs of the House of Lords' decision**

- **endorsed a flawed compromise settlement which was unfair to policyholders without GAOs, especially late joiners**

- **has allowed Equitable to obfuscate its financial situation, which has adversely affected the interests of people who would have left earlier if the appropriate information had been available**

- **has, by its silence, allowed the inadequate offer of 5% which Equitable offers former policyholders for mis-selling**

- **avoided addressing allegations of possible fraudulent misrepresentation to policyholders**

- **has implicitly by its silence been party to Equitable's policy of enmeshing people in legal finesse which very few people understand, in particular in the presentation of legal opinions**

This unsatisfactory performance provides no comfort that people's long term savings would be protected by the FSA.

20. **It is profoundly unsatisfactory that the FSA is not adequately accountable to either Parliament or to policyholders, and so can behave inappropriately with limited risk of being taken to task.**

Recommendations

21. EMAG recommends that:-

1. **The FOS is reconstituted as an entirely separate statutory entity from the FSA.**

2. **The FSA and the independent FOS are made legally liable to pay compensation when, due to their negligence, consumers of financial services lose some or all of the value of their deposits, investments, or policies.**

3. **The National Audit Office should be empowered to undertake efficiency studies of the FSA and FOS, and the Parliamentary Ombudsman should be empowered to investigate them for maladministration.**

4. **The Treasury Select Committee should undertake a study of the behaviour of the Treasury, the FSA, and board of Equitable from the period 1 September 2001, which is after the closing date for Penrose's Inquiry.**

We would hope that having appreciated the failures and the behaviour of the government and FSA, the Committee will endorse full compensation of the current and former policyholders of Equitable who remained with it after 16 July 2001. These policyholders have suffered significant losses in paying for the costs of the GAOs, of the over-bonusing, and of the lack of smoothing fund. The payment has been both by cuts and by MVAs for those who left the fund. *Since the Equitable is a mutual, there is only one pot of money and that pot is inadequate to provide adequate compensation for all – adequate compensation can only come from the government.* Of course we would say that for the benefit of policyholders including ourselves. But we also say it to restore confidence that regulation by the FSA means something of value.

* * *

The main part of the report is structured in three main sections as follows:-

- The collapse of Equitable and the performance of the FSA in 1999 and 2000. This section briefly describes the long-standing failures that underlay the collapse, and then the inaction by the FSA and the flawed decision to leave Equitable open after the House of Lords' decision

- The policies pursued by Equitable under the new board and either endorsed by the FSA or presumably condoned by its silence. This section describes FSA/Equitable's policies of 1) not providing information to policyholders about its financial situation; 2) attempting to get non-GAO policyholders and former policyholders to relinquish their rights to claim for mis-selling; and 3) attempting to minimize compensation for mis-selling

- Following Equitable's closure the FSA has acted in concert with Equitable. This section outlines the ways in which the FSA has supported the Equitable's policies

There are four annexes:-

- Extracts from the Memorandum of Understanding between the FSA and FOS
- Seven examples of financial obfuscation by Equitable
- The possible fraudulent misrepresentation issue
- Further detail on some of the opinions regarding compensation for mis-selling

THE COLLAPSE OF EQUITABLE AND THE PERFORMANCE OF THE FSA IN 1999 AND 2000

22. There are three reasons why Equitable collapsed:-

- it failed to reserve for guaranteed annuity options (GAOs)[37] on *reversionary* bonuses from the mid-1980s

- throughout the 1990s, in order to improve its marketing appeal, Equitable declared bonuses well in excess of the value of assets. In consequence it was paying departing policyholders in excess of their asset value with money from new investors, which left a hole of some £3bn. Furthermore, contrary to the claims by its sales representatives, it was not operating a with-profits fund that smoothed returns by building up a smoothing fund when financial times were good to support payouts when times were poor – there was no smoothing fund, and this left another hole of about £1½-2bn at the end of 2000. All policyholders who did not leave before 16 July 2001 have paid for these holes and the failure to reserve by reductions in policy values of 25-30%

- the coup de grâce came from the House of Lords on 20 July 2000, when it ruled that Equitable could not apply differential *terminal* bonuses (as between policyholders who did not have GAOs and those who had them) in order to offset the cost of guaranteed annuity option on *terminal* bonuses. Correcting this was estimated originally to cost £1½bn, and in the Compromise involved a reallocation of some £900m from non-GAO policyholders to those with GAOs

Although the decisions not to reserve, to over-bonus, and the poor presentation of the case to the House of Lords, were clearly the responsibility of the Board of the Society, the first two reasons also reflected regulatory failure. First, the regulator should have required reserving from the late 1980s, but it failed to act until 1998. Second, although the Government Actuary's Department (GAD) was aware of over-bonusing from 1997 “it did not necessarily cause any concern”, and GAD did nothing to stop the practice. Under the Insurance Companies Act 1982 the prudential regulator – initially the Insurance Directorate of the Department of Trade and Industry, then during 1998 the Insurance Directorate of the Treasury, and after 1 January 1999 the FSA - had roles of ensuring the regulatory solvency of life assurers and of protecting “policyholders’ reasonable expectations” (PRE). In the case of Equitable the prudential regulator failed to achieve the latter objective.

23. Although the actuarial methodology for reserving for guaranteed options incorporated in unit linked policies was developed in the early 1980s, and the current Government Actuary, Mr. C. Daykin, was involved in a working group which used the methodology, GAD did not recommend to

[37] GAOs are also called Guaranteed Annuity Rates (GARs). For consistency I always refer to GAOs and have changed accordingly.

the Insurance Directorate that life assurers should use an equivalent methodology to reserve for GAOs *until 1998*. Because reserving for guarantees would have reduced bonuses, which would have depressed sales of new policies, few companies reserved until they were told to. Then having determined in 1998 that Equitable should reserve to meet its solvency margin[38], and engaged in an acrimonious dispute with Equitable over the winter of 1998/99 about the level of reserving, the FSA allowed it to meet the reserving requirement with a valueless reinsurance agreement in which GAD was intimately involved. Yet GAD subsequently referred to the agreement (which it had effectively endorsed) as "regulatory arbitrage", and criticised Equitable's Appointed Actuary for valuing it at nearly £1bn for solvency purposes. Subsequently the FSA has disallowed this type of agreement in the solvency calculation. This agreement was allowed in addition to other valueless devices with which Equitable was allowed to window dress its solvency returns, namely:-

- a future profits implicit item of £925m, a device which the FSA then allowed but is now phasing out[39]
- a subordinated loan of £346m, which counted as a regulatory asset but not as a liability
- a Zillmerising[40] adjustment which reduced regulatory liabilities by nearly £1bn, but which GAD did not appreciate existed until November 2001. It then ruled that it should not be allowed

24. In November 2000, having allowed or been ignorant of the devices Equitable was using to window dress its solvency return, GAD observed "at first sight the solvency position looked reasonable, but the available assets of £3,861m to cover the required minimum margin of £1,114m included a future profits implicit item of £925m, disregarded the liability to repay a subordinated loan of £346m and benefited from a reduction of almost £1.1bn in the GAO reserve from the reinsurance agreement. Without these items, the available assets would be just £1511m, a less satisfactory picture for this large fund". If these devices were not allowed and GAD had allowed for an increase in liabilities resulting from disallowing the Zillmerising, then *the regulatory solvency margin would have been £600m below the required minimum.*

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[38] Under the Insurance Companies Regulations 1994 life assurance companies had to demonstrate that their assets (as defined for regulatory solvency purposes) exceeded their liabilities by more than a "required minimum margin". Life assurers have to make an annual return of their solvency position to the prudential regulator, currently the FSA previously the Insurance Directorate of the government.

[39] So that Equitable can appear to be solvent, the FSA is currently allowing it to claim a future profits item of £150m – where those profits are coming from in a bond fund when interest rates are increasing and bond values are decreasing is something of a puzzle.

[40] A Zillmerising adjustment spreads the cost of acquisition of policies over a number of years. Having failed to pick it up, GAD was told that Equitable had made such an adjustment (which reduced its liabilities for solvency purposes by about £1bn) by one of the potential bidders, who asked whether it would continue to be allowed. GAD answered "no".

25. If the FSA had required Equitable in 1999 to reserve with real assets, it would have stopped Equitable from declaring a bonus, which would have exposed its finances. The resulting publicity would have saved tens of thousands of new policyholders and existing policyholders the loss they incurred by investing in Equitable in 1999 and 2000. (New investment in the with-profits fund was £2,721m in 1999 and £2,156m in 2000).

26. In 1997, at latest, GAD became aware of the over-bonusing, but stated "it did not necessarily cause them any concern". It should have caused concern because all through the 1990s and until after it closed, Equitable was paying departing policyholders some 10% more than their asset share[41]. It was to a degree operating a "Ponzi fund" or "pyramid selling scheme" whereby part of the money from new investors was funding departing policyholders. This disposal of funds was not in accordance with PRE; Equitable clearly told policyholders in bonus statements and Annual Reports that they would receive their smoothed asset share, neither more nor less, an approach which requires building up a smoothing fund when financial returns are good to compensate for when returns are poor. Contrary to the frequent claims which it made during the 1990s in its Annual Report and Accounts and in its policy documents explaining "With-Profits", Equitable was not running a smoothed with-profits fund; it had no reserves with which to smooth. Indeed during most – if not all – of the 1990s including 2000[42], at the end of the longest post-war bull market, it had a *negative* smoothing fund. It pursued this policy either with the complicity of, or the ignorance of, the prudential regulator. When the stock market faltered in 2000 and the fund closed the "money-go-round" stopped, leaving the policyholders who remained with Equitable after 16 July 2001 to cover a hole of £4-5bn reductions in policyholder values of 25-30%, *which have not been due to falls in the stock market*. The reductions have been particularly hard on with-profit annuitants, who are locked into the fund, and few of whom have options for working to restore their losses.

27. Although over the winter of 1998/99 the Insurance Directorate of the Treasury and then the FSA had an acrimonious argument with Equitable requiring it to meet technical reserves for its solvency margin and required it to reduce its reversionary bonus from 6% to 5%, the FSA did little,

[41] The Equitable Life Assurance Society: The with-profit fund 1993-2000, Burgess Hodgson, March 2003; Addendum to the report ELAS and the with-profit fund 1993-2000, Burgess Hodgson, 25 June 2003; The Alternative Penrose Report, Burgess Hodgson, 27 December 2003.

[42] At the end of 2000 total policy values exceeded assets by 10%.

or nothing, to reduce the *total* bonus (i.e. reversionary plus terminal bonuses). In March 1999 Equitable declared a total bonus of 10% for 1998, and this was the headline figure that Equitable used for marketing. In May 1999:-

> "GAD said that losing the court case would result in Equitable having to reduce the terminal bonus additions for a wider group of policyholders, possibly all of them…The total current asset shares which has been indicated to members as their policy values exceeded total current admissible assets".

28. Even when Equitable lost in the Court of Appeal on 21 January 2000, the FSA made no attempt to call it in and tell it to stop unjustifiably inflating PREs. As a result of the FSA's inertia, at the beginning of February the chief executive of Equitable was free to write a letter that reassured existing and prospective policyholders that the **financial** consequence of an adverse ruling in the House of Lords **would be minimal and** was covered by provisions. **The FSA then failed to ask him the basis of his assertion, which we now know was wrong.** Then in March 2000, notwithstanding GAD's views, Equitable declared a total bonus of 12% for 1999, an *increase* from the previous year. *As a result of the FSA's inertia thousands more joined Equitable and existing investors put more money in, all to the tune of nearly £2bn.*

29. The FSA's next failure came after the House of Lords decision. Without undertaking any thorough analysis of Equitable's financial situation, indeed not understanding its financial situation but firm in a baseless belief that a sale was "99.9% certain", the FSA allowed Equitable to remain open in at attempt to sell itself. An official from the Treasury observed to the Parliamentary Ombudsman's investigation "The FSA had not appreciated the extent of Equitable's problems until it had become apparent during the bidding process". It took the several life assurers who had expressed an interest in buying Equitable less than three months to work out what the prudential regulator, with years of knowledge of Equitable, failed to understand – as one told the FSA, it would not be worth taking Equitable "*at any price*".

30. This decision treated new policyholders irresponsibly. It was implicitly signalling to them that if a purchaser could be found who would fund the liability for GAOs and who would handle the over-bonusing, then your PRE would be met – if not you will be in a mess. And in a mess they were. Although the then head of prudential regulation commented to the Parliamentary Ombudsman's investigator that such "policyholders could be compensated if they sustained loss as a

result of joining on the basis of misleading information", *the FSA then did nothing to ensure that those who had suffered from its unwise decision were compensated by Equitable in the compromise settlement. Then it did nothing to stop Equitable's manifestly unfair proposal to compensate them with 5% of policy value,* ***see below***. Doubtless the former head of prudential regulation is now enjoying his index linked civil service pension.

31. *The FSA's decision to allow Equitable to remain open showed clearly the conflict between the FSA's objectives of preserving market confidence (however undeserved), which was its overriding priority and will generally prevail, versus that of protecting individual consumers.*

32. Although the chairman of the FSA observed in questioning to the Treasury Select Committee[43] that the House of Lords' decision "was unexpected and it overturned the fundamental principle of the way in which returns were allocated…it is having redistributional consequences in other parts of the market and we have to live with them", he failed to ask the government to attempt to seek legislation that would mitigate the consequences of the flawed decision[44]. Likewise, when Equitable cut its policy values by 16% in July 2001 he failed to press Equitable to cut them in such a way that longer standing policyholders (notably those with GAOs) bore proportionately larger cuts (as EMAG had proposed to Equitable four months earlier on 9 March 2000), but went along with Equitable's across the board cut that was manifestly unfair to the late joiners.

33. Some time in the autumn of 2000 it became apparent that Equitable was in a very big mess and could not be sold, and the mess was due in part to the failure of prudential regulation. The Treasury and the FSA convened a meeting with a number of investment banks to discuss what could be done. Also about this time they should have realised that although the failures of prudential regulation were the basic cause of the financial mess, the failure of conduct of business regulation posed extensive threats of claims for mis-selling, and that if claims for fraudulent misrepresentation were to get to court they would more than embarrass the government and the FSA. **(I have already alluded to the FSA's failure to either prevent the chief executive of Equitable from writing a misleading letter about the possible financial implications of the House of Lords case and then**

[43] 15 February, 2001.
[44] The decision was flawed in part because of the poor presentation of the non-GAO case, and because Steyn LJ contradicted a previous decision he had made regarding the strength of companies' articles of association.

failing to question it when it was published). The report prepared by Mr. Ronnie Baird[45], the former Director of Internal Audit of the FSA, makes it very clear that conduct of business regulation under the FSA was a complete failure. It includes many comments made by, or about, FSA conduct of business regulation such as:-

> what if anything to do to "at least justify a stance of non-involvement"
>
> "is there at least enough for a meeting"?
>
> "My general feel is that Enforcement do not have an appetite for this one"
>
> "Is there anything we should now be doing on this? I know we were going to about a year ago (my delay) - has the time passed?"
>
> "The tradition is at the more passive end of the supervisory process. The nature of their supervision is much more reactive than proactive"

O, Sir Humphrey.

34. The FSA has been attempting to excuse itself from blame. One excuse has been to misquote from Baird's report that *"the die was cast"* before January 1999. In fact the report said "it is fair to say that by 1 January 1999 the die was cast and we have seen nothing which the FSA could have done thereafter which would have mitigated, in any material way, the impact of the court case as far as existing policyholders were concerned, or made any material beneficial difference to the final outcome so far as Equitable Life was concerned". *Baird did not in this quotation comment on what the FSA might have done for new policyholders, or indeed for existing policyholders who put in more money, after 1 January 1999.*

35. While the government and then the FSA as prudential regulator failed to protect "policyholders' reasonable expectations" (PRE), which was their role under the Insurance Companies Act 1982, they also failed to ensure that (prospective) policyholders had the information which allowed them to judge Equitable's financial situation for themselves. The prudential regulator

[45] Report of the Financial Services Authority on the Review of the regulation of The Equitable Life Assurance Society from 1 January 1999 to 8 December 2000, FSA, 16 October 2001.

neither acted *in loco parentis*, nor provided policyholders and informed observes with the information to look after themselves[46].

36. In summary, the FSA failed to protect PRE by not requiring Equitable to reserve in money, but allowing it to window-dress its solvency return; by doing nothing to stop Equitable over-bonusing in 1999 (for the year 1998) and again in 2000; and by allowing it to remain open after the House of Lords decision. The FSA then did nothing to require Equitable to fully compensate those who joined after the House of Lords decision, and failed to ask the government to attempt to legislate to mitigate the consequences of the House of Lords' flawed decision. Subsequently, as I will explain, it has been acting in concert with Equitable to push the cost of its mistakes onto the current and former policyholders of Equitable.

[46] The information policyholders did not receive is elaborated in chapter 8 "A case study in serial regulatory failure by the government and its agent, the Financial Services Authority", a second submission to the Inquiry conducted by Lord Penrose into the lessons that can be learnt from the Equitable debacle, Alex Henney for EMAG, 27 March 2003.

THE POLICIES PURSUED BY EQUITABLE UNDER THE NEW BOARD AND EITHER ENDORSED BY THE FSA OR TACITLY CONDONED BY THE FSA'S SILENCE

37. Over the last three years, Equitable has been pursuing three main policies:-

- to provide policyholders with minimum information and to "news manage" and "spin-up" its financial situation
- to eliminate policyholders' rights to take legal action against Equitable for mis-selling[47] (which have generally been formulated as claims for negligent misrepresentation under S2(1) of the Misrepresentation Act 1967)
- to minimise liability for mis-selling to former policyholders who left before the compromise

The aims have been first to confuse policyholders into accepting the compromise settlement, and then subsequently other proposed settlements for mis-selling. Equitable has spent a great deal of money (perhaps in total of the order of £50m over the last three years) on the legal trade, and has developed a slick legal fighting machine. Part of the money has been spent on the case against the former directors and auditors. But most of the money has been spent on stitching up the members. Lovells advice on settlements with policyholders, and numerous barristers have acted for Equitable in various ways by appearing in court and providing opinions to briefs prepared by Equitable which suit the purposes of FSA/Equitable. They also confuse most policyholders who are not familiar with the linguistic acrobatics the legal trade can rise to.

Providing policyholders with minimal information, managing news, and spinning

38. In an open letter published in various newspapers on 1 March 2001, Mr. Vanni Treves, the chairman of Equitable stated "I will communicate openly. This is our Society and members are entitled to know everything about how it is run unless open disclosure would be commercially damaging…I look forward to an atmosphere of trust and transparency between the policyholders and our Society". The Annual Report and Accounts for 2001 stated that "The Board is committed to a policy of openness in its communications with policyholders". Nothing could be further from the truth – Equitable has run a deliberate policy of obfuscation so that policyholders (who are also its

[47] "Mis-selling" is not a legal term, but is used as a generic description for breaches in the rules of the conduct of business regulation under section 62 of the Financial Services Act and the rules of LAUTRO, later the PIA; negligent misrepresentation; fraudulent misrepresentation; deceit; failure to fulfill a common law duty to advise; and breach of implied warranties.

owners) could not properly judge its finances. Some of the examples of lack of information are detailed in Annex 2 and are summarised as follows:-

- refusing to provide information regarding the financial background to the cut in policy values of 16% for pension funds on 16 July 2001. Contrary to claims made by Equitable that the main reason for the cut was the fall in the stock market, the main reason was to offset the cumulative effect of a decade of over-bonusing and the absence of a smoothing fund; to allow for mis-selling; and possibly to prepare a war chest to "give" back a bonus to policyholders to sign the compromise

- omitting key financial information from the Proposed Compromise published in December 2001

- delaying publication of the solvency return for April 2002 until after the AGM postal vote was completed

- providing inadequate information in the Annual Reports and Accounts and at the AGM in 2002

- failing to explain in a structured manner the significance of the guaranteed investment return (GIR) of 3½% provided to the majority of policyholders[48], which now hobbles investment strategy and imposes the risk that the cost of failure to achieve a net return of at least 3½% will be borne by the policyholders without GIRs. **This is something which, as EMAG pointed out to the board in August 2001 when it was considering the S425 compromise, ought to have been, but was not, dealt with in the compromise**

- attempting to hide the extent of over-bonusing. I imagine the purpose was to reduce compensation for mis-selling by avoiding raising an additional way in which non-GAO policyholders could claim for mis-selling

- refusing to provide policyholders with the basis of policy valuations and revised with-profits annuities

We have numerous letters from Equitable refusing to provide us with information to which the members of Equitable either as policyholders or as owners of it should have been entitled.

39. Some of the shortcomings in the provision of information have undoubtedly impacted adversely on decisions which policyholders made about their policies. Thus for example if Equitable had responded to our request for information about the cut in policy values on 16 July 2001 and explained that Equitable had for years been over-bonusing and was in a *very* weak financial position, then I am sure that I along with many other policyholders would have taken our

[48] Some 75% of the fund by value comprises policies which incorporate a guaranteed return of 3½%. The guarantees not only constrain the investment freedom of Equitable to more or less exclude equities, but in this period of low interest rates, achieving a net return of 3½% after the Society's now high costs, is not a sure prospect. Any deficit below a net return of 3½% is borne by policyholders who joined after 1996 and who do not have the guarantee.

policies elsewhere much sooner. In consequence we would have achieved returns on them to begin to repair the ravages caused by Equitable. Likewise if the Proposed Compromise published in December 2001 had included the solvency position, a structured analysis of the implications of the GIRs, and a realistic view of the fund's future miserable prospects, then I have little doubt more policyholders would have left then.

40. Instead of a realistic assessment of prospects stating that the fund was crippled, policyholders were spun the following lines about the proposed compromise:-

> "We believe there is no reason why policyholders cannot look forward to satisfactory fund performance in the future, particularly if a compromise is achieved between Guaranteed Annuity Rate and non-Guaranteed Annuity Rate policyholders. The board has said they will keep policy values under review and adjust them in the light of prevailing investment conditions".
>
> "This represents to me the end of the crisis. It may not be nirvana, but we would have stability and the prospect of satisfactory growth". Treves as reported in the Independent on 21/9/01.
>
> "Equitable Life has vowed to splash out £4 billion on buying shares, if the troubled insurer wins a crucial vote this week aimed at shoring up its ailing finances. Charles Thomson, chief executive of Equitable, told The Times that the insurer would halt a divestment programme triggered after a controversial ruling in the House of Lords effectively forced Equitable to close its doors to new business. Since then Equitable has steadily reduced its exposure to the equity markets from a peak of 60 per cent to today's level of 34 per cent…Mr. Thomson said: "If we get backing from our members over the compromise deal, we will bring the equity ratio back up to a fully competitive level. The current 34 per cent level is a low figure based on historical comparisons"." The Times 7/1/02[49].
>
> "We will have a more strong bonus policy. We will have a stronger investment flexibility". Treves on Money Box on 12/1/02.

41. To assist in the task of "selling" the compromise to policyholders, Equitable spent several £m on the "issue management" firm Burson-Marsteller, which has acted for dictators Ceauscescu and Pinochet and for Union Carbide over Bhopal. The FSA took no action to stop the chairman and chief executive making statements to promote the benefits of the Proposed Compromise to the policyholders that appear to be of a type that would not be allowed by Stock Exchange rules **in the**

[49] Note that this claim was directly at odds with the statement by The Appointed Actuary in the Compromise Document published on 12/12/01 that "I expect that the Society's investment strategy would remain broadly the same in the short term as it is now…the high level of guarantees within the with-profits fund may severely restrict [investment in equities] for some time".

case of a quoted company – **statements that events have shown were incorrect.** *The FSA was complicit by its silence in not requiring these comments to be qualified.*

42. On 15 April 2002 Equitable cut policy values by 4%, thus more than negating the 2½% uplift to policy values which they had received for supporting the compromise and signing away their rights to pursue Equitable for mis-selling. It also published a pamphlet titled "Equitable Life 2002 and beyond" which claimed that "Our strategy is to keep moving the with-profits fund closer towards being a conventional with-profits fund". This unrealistic objective was rapidly overtaken by events. On 1 July 2002 Equitable cut policy values by a further 6%, and by the autumn it had 5% in equities – it was a bond fund. Subsequently, after the AGM in 2003, the chairman admitted that if the fund had not switched out of equities it would have been at risk of insolvency. Another example of misinformation was a letter from a director, Ron Bullen, to The Times on 7 June 2002 stating "You are wrong to suggest that there will be massive cuts in pensions". Cuts of 20-30% were announced for some 50,000 with-profits annuitants in November 2002 taking effect in 2003 with further cuts of up to 17% taking effect in 2004[50].

Depriving policyholders of their right to claim for mis-selling

43. The second strand of the strategy has been to get members to sign settlements that involve them giving up *all* their rights to claim against it for mis-selling. The compromise settlement legally silenced the majority of non-GAO policyholders.

44. On 30 September 2002 Equitable proposed another S425 settlement with an offer of compensation of up to 5% of policy value (i.e. compensation was not related to actual losses) to 70,000 former policyholders who had left to retain their right to claim for mis-selling. This offer was less than the policyholders had lost through paying a market value adjuster[51] (MVA) to leave the fund, let alone the 16% cut in pension policy values in July 2001. Equitable indicated the settlement would cost in the range £40-75m, which represented an average of approximately £570-1070 per policyholder. If the settlement had been endorsed by the necessary majority it would have prevented *all* late joiners from pursuing further claims. A determined group set up the Equitable

[50] The cuts are the sum of Equitable's basic cut plus a cut based on the "average basic return" which policyholders chose when they took the annuity. The major part of the cuts are the basic cut by Equitable.

[51] Life assurance companies frequently charge policyholders a market value adjuster when they make a non-contracted exit (i.e. they do NOT transfer to another pension provider and take a pension). Since the House of Lords decision the MVA has varied between 7.5% and 20%.

Late Joiners Action Group (ELJAG), and raised a substantial legal fighting fund to obtain restitution of the losses they had incurred; ELJAG was claiming for fraudulent misrepresentation, see Annex 3. (Equitable is denying that it has found a case for fraudulent misrepresentation). The proposal for another S425 settlement was withdrawn after ELJAG put its case to Equitable (copied to the FSA) that the scheme had flaws, and threatened that if Equitable persisted with the settlement ELJAG would oppose it in court, and undertake a discovery process of specified board minutes and other documents, which would doubtless have caused Equitable and the FSA at least great embarrassment, if not worse.

45. As explained below, there have been a number of legal settlements of claims by policyholders (including ELJAG) at levels well above the 5% that Equitable has been offering to former policyholders. All those who have received proper redress have signed gagging orders.

The battle of opinions[52]

46. The board of Equitable commissioned Mr. Nicholas Warren QC and Mr. Tom Lowe to prepare an independent opinion on the mis-selling issue. The thrust of their advice was that there was a substantial case that the sale of non-GAO policies was in breach of the rules of LAUTRO from 1988 and then after 1994 of the PIA, and hence Equitable was in breach of section 62 of the Financial Services Act 1986 because the risk of liability to pay for policies with GAOs had not been disclosed. They described the prospects of successful claims as "significantly better" than 50/50. They also opined that there were sound claims at common law for negligent misstatement, and for misrepresentation under section 2(1) of the Misrepresentation Act 1967 for non-disclosure of the "GAO risk". (Further details of their opinion are included in Annex 4).

47. With regard to negligent misrepresentation Warren and Lowe concluded that the Royscot case (see Annex 4), which determined that compensation for negligent misrepresentation under section 2(1) of the Misrepresentation Act 1967 was the same as that for fraudulent misrepresentation, applied and they did not consider that the so called SAAMCO cap (see Annex 4) can work in respect of claims made under section 2(1). They observed "In such a case, it is possible

[52] I am grateful for help with this section and annex 3 to solicitors Clarke Willmott, who have considerable experience in acting for former Equitable policyholders and obtaining compensation of significantly more than 5% of policy value.

to obtain damages based on an alternative transaction"[53]. Regarding non-GAO policyholders who have transferred out, they concluded that the MVA can be claimed as part of the compensation:-

> "We are unable to accept that those who left in order to obtain certainty and stem any further loss were acting other than reasonably. … It has been suggested to us that once the compromise scheme is published policyholders would not be seen as acting reasonably in departing and that their ability to recover the "market value adjuster" would be open to question. We would take a great deal of persuasion before accepting this view."

It is clear from their opinion that Equitable, or an adviser acting for it, had suggested that they reach contrary conclusions not only on this issue, but also on Royscot and on the SAAMCO cap, that would have significantly reduced their assessment of the principles underlying liability for misrepresentation.

48. Along with the publication of the initial Compromise Proposals in September, Equitable published Warren and Lowe's opinion together with a hasty and short (11 pages) opinion from Mr. Gabriel Moss QC et al[54] that it had commissioned. The opinion's purpose was clearly to attempt to limit the damage (as Equitable saw it) of the implications of Warren and Lowe's opinion that non-GAO policyholders had a good chance of gaining significant compensation for mis-selling, and that in quantum of damages it might significantly offset the claim of the GAO policyholders.

49. Concurrently the FSA published an opinion by Mr. Ian Glick QC and Mr. Richard Snowden[55]. While agreeing on the likelihood of claims, contrary to Warren and Lowe they concluded that "the result reached by the Court of Appeal in Royscot cannot be supported" and endorsed the application of a SAAMCO cap. They also argued:-

> "[a]s such, on the basis of our understanding of the Society's MVA, we do not think that it would be recoverable as damages by a non-GAO policyholder who had left the Society."

They concluded that Equitable should only be liable for the GAO risk. They were, however, tentative in their conclusions, recognizing that different views were arguable. Although the FSA claimed in its assessment of the compromise[56] that their "advice reached broadly similar

[53] The "alternative investment measure" is the difference in value between the outturn of a claimant's actual investment and the alternative investment he would have made if properly advised.
[54] 19 September 2001.
[55] The Equitable Life Assurance Society, 19 September 2001.
[56] The FSA's Assessment of Equitable Life's Compromise Scheme, 7 December 2001.

conclusions" to Warren and Lowe, their advice contradicts it in essential respects. Could the FSA's claim have been intended to confuse policyholders that the barristers agreed?

50. The Proposed Compromise[57] states that "it is the Board's view, having taken further legal advice from other Counsel (i.e. Moss et al) that despite the substantial arguments that there are potentially significant GAO-Related Claims against the Society, it is not possible to be sure that any particular Non-GAO Policyholder has a definite GAO-Related Claim against the Society for any particular sum". As it stands, this generality is of course correct given that neither the FOS or the courts had at that point in time ruled on any cases, nor had Equitable settled any cases (which it now has). The definite, but skimpy and hasty, opinion by Moss et al and the tentative opinion by Glick and Snowden were used to offset Warren and Lowe's views to arrive at the offer of an uplift of 2½% for non-GAO policyholders who remained with Equitable for supporting the Proposed Compromise and signing away their right to such redress for mis-selling. *The FSA endorsed this offer, which does not seem fair* ***to non-GAO policyholders****, especially to late joiners.*

51. As part of its attempt to settle the claims of late joiners, at the instigation of the FSA, Equitable employed actuarial consultants B&W Deloitte to assess "By how much may Non-GAO policyholder benefits have been reduced to meet the cost associated with paying Guaranteed Annuity Rates on GAO policies"[58], which was published in September 2000. By making a comparison with how other with-profits policies had fared, the consultant arrived at a loss of up to 5% of policy value. But this was a dubious figure because the comparison assumed that the alternative to investing in Equitable and suffering its MVA on leaving was to invest in another life assurer and *also suffer its MVA*. There is, however, no reason to believe that if an investor had invested elsewhere (s)he would have withdrawn the policy and suffered an MVA. The opinion also put a speculative value of "up to 6.5%" on the greater flexibility of Equitable's policies, and opined that flexibility was an important selling point that "may" have been an important attraction. This proposition reduced the quantum of cost the consultant assessed.

[57] Proposal to be affected by Scheme of Arrangement pursuant to Section 425 of the Companies Act 1985 between The Equitable Life Assurance Society and its Scheme Policyholders, 1 December 2001.
[58] Non-GAR Mis-Selling Claims: Independent Actuarial Review, September 2002.

52. In order to support B&W Deloitte's approach Equitable employed Mr. Christopher Carr QC and Mr. Gabriel Moss QC to give an opinion[59]. They supported a SAAMCO cap, and stated that "In our opinion Royscot was wrongly decided…Whilst it may be necessary for the question to be reviewed by the House of Lords itself, when that occurs we believe that Royscot will be overruled". They argued that there should be no compensation for the MVA, and that compensation should be limited to the GAO risk. The opinions by B&W Deloitte and Carr/Moss were the basis of the FSA/Equitable's offer of 5% compensation in the withdrawn proposed compromise to cover non-GAO policyholders who had left the fund and were claiming mis-selling. And it is the basis of Equitable's standing offer to such former policyholders.

53. Next, in April 2003, ELJAG commissioned Mr. George Bompas QC to advise on whether there was a case for fraudulent misrepresentation, which apparently he did[60], and on compensation. He supported Royscot, disagreed with the SAAMCO cap, and argued that compensation should equal "the difference between the amount of their premiums and the amount returned by the Society. Additionally, of course, ELJAG's members can expect to receive interest" (i.e. he argued for total rescission, viz return of funds plus interest).

54. Following the FOS's determination of five lead cases in which it found misrepresentation in four and the fifth found that Equitable had failed to discharge its duty to provide the full and proper advice, the FOS commissioned an opinion by Jonathan Hirst QC[61], which essentially agreed with Warren and Lowe's views on compensation. Finally, in a lengthy opinion for Equitable[62], which is intended to rebut Hirst's views and which is long on jesuitical sophistry, Carr and Moss elaborated on what they conceive as Hirst's errors.

55. Regardless of the arguments about Royscot and the SAAMCO cap, it seems to me that there is a fundamental flaw in the opinions which attempt to argue that the basis of compensation for misrepresentation should be limited to the "GAO risk", because the lack of information about the GAO risk was not the only misrepresentation. Prospective policyholders were being led to believe that they were investing in a with-profits fund which would return them their smoothed asset share

[59] Penalties for Mis-selling, 19 September, 2002.
[60] This part of his opinion was gagged as part of the settlement between Equitable and ELJAG.
[61] In the Matter of the Financial Services and Markets Act 2000 and in the Matter of Complaints by Former Members of The Equitable Life Assurance Society, 10 July 2003.
[62] Equitable Life: Remedies for Misrepresentation and Negligent Advice: The Opinion of Mr. Hirst, 30 September 2003.

based roughly on the returns accruing from their investment less expenses. As observed earlier, it is generally understood that operating a smoothing process requires a *(positive)* smoothing fund. They were not told that part of their investment was funding outgoing policyholders, nor that there was no smoothing fund. A significant part of the loss which late joiners (and other non-GAO policyholders) suffered from in the various cuts in policy values from 16 July 2001 and later was due to rectifying the consequences of over-bonusing (about £3bn) and the lack of a smoothing fund (which should have been of the order of £1.5bn at the end of 2000). *Indeed since prior to the compromise the cost of the GAO liability was estimated of the order of £1.5bn, the cost of rectifying the "black holes" was significantly larger than the liability for GAOs.* The omission from consideration of the matters was understandable in the case of Warren and Lowe's opinion. However, it may be inexcusable that the FSA did not **appear to** brief Glick and Snowden and the FOS did not **appear to** brief Hirst on the issue, while if **(as seems likely)** Equitable did not brief Carr and Moss on the issue in their 2002 and 2003 opinions[63]. ***Equitable should not have used these legal opinions to support its inadequate offer of 5% to late joiners might be interpreted as misrepresentation or even suggestion falsi, suppression veri.*** *The FSA appears to have tacitly connived with this intent by its silence, and with the use of opinions without briefs. Although those in the legal trade are aware that opinions cannot be properly evaluated without seeing the briefs, laymen are not generally aware of this. If my assumption regarding restricted nature of the briefs is correct, then Equitable's use of them to support its inadequate offer of 5% to late joiners might be interpreted as misrepresentation.*

56. Furthermore, the opinions by Glick and Snowden and by Carr and Moss arguing against allowing compensation for the MVA Equitable charged policyholders who left were very superficial. None of them chose to investigate the rationale for the MVA, let alone checked how the MVA was quantified, see Annex 4.

The proof of the pudding is in the eating

57. ELJAG obtained evidence of a number of settlements already paid by Equitable to their members who had bought Personal Investment Plans (PIP) on the reassurance of sales

[63]Equitable refused to provide me with the briefs for these opinions on the specious grounds of legal privilege. Ms. Jane Whittles of the FOS informed EMAG that she could not provide the brief for Hirst on the same grounds, as did the General Counsel of the FSA. In fact briefs have legal privilege, but a client can waive it provided there is nothing in the brief that is confidential to another party. It is difficult to imagine that this was the case in any of the briefs.

representatives that they could be withdrawn without an MVA. In consequence a number of people treated them like a short term higher rate interest account and "deposited" substantial sums of money. When they came to withdraw their money to avoid being bound by the S425 compromise, they were subject to the policy value reduction of 16 July 2001 (14% in their case) and to an MVA of typically 10%. They complained, and Equitable offered them 5% of policy value.

58. In an unpublicised move, the FSA instructed Equitable to repay the 20,000 or so PIP policyholders in full (i.e. capital plus interest earned on it). The consequence of this can be seen from figures provided by two of the people settled in this way:-

	Case 1	Case 2
Invested	£25,000	£129,377
Amount due under representations at time of sale	£27,908	£150,541
Initial payout by Equitable	£20,650	£112,366
Redress paid on FSA's instructions	£6,867	£35,117
Equitable's 5% offer would have been	£1,395	£7,527

59. Solicitors Clarke Wilmott have advised me that they have considered over a hundred policyholders' cases. Some of these cases have settled and a number are subject to confidentiality agreements, but it is not confidential that in some cases the settlement was significantly in excess of the 5%. In addition there have been a number of cases referred to in the small claims court which have been settled with gagging orders. ELJAG's settlement for about 175 policyholders was reported at £5m[64] and covered payment of their legal costs, which are thought to be of the order of £¾m: if Equitable's costs were similar in magnitude (they may well have been more), then the total legal bill was probably at least £1½m. ELJAG's stated objective was to recover their capital plus loss of interest together with their legal costs. From comments in the press and by policyholders, it is reasonable to infer that the settlement they received was along these lines.

* * *

- 60. Equitable has operated a policy of providing minimal compensation to policyholders who do not have either the resources or the know-how to argue for proper compensation. It has entrapped them in a legal hall of mirrors created by very expensive lawyers, payed for by the policyholders themselves. Equitable's objective seems to be never to get to the stage of being forced to reveal material in court let alone receive a judgment against it, regardless of cost.

[64] Article by Pauline Skypola in the Financial Times, 3 January 2004.

Complainants with deep pockets, strong nerves and good lawyers are being secretly successful in achieving payoffs far in excess of the compensation offers that are in the public domain. ***The FSA neither considered the issue of possible fraudulent misrepresentation – perhaps it deliberately ignored it to avoid upsetting the apple cart - nor has it attempted to level the playing field between the compensation paid to former policyholders who take legal action, and those who accept the Equitable's inadequate offer of 5%, by*** **its silence implicitly condoning the offer.** *Its treatment of policyholders brings out again the inherent conflict of interest between its responsibility to maintain orderly markets and its responsibility to protect individual consumers.*

FOLLOWING THE CLOSURE THE FSA HAS ACTED IN CONCERT WITH EQUITABLE

61. The FSA is well aware of Equitable's strategies, and has been pulling Equitable's strings to help it in its damage limitation efforts of obfuscating its financial circumstances and fending off aggrieved former policyholders.

62. In contravention of its statutory duties and many statements advocating openness for policyholders, the FSA is apparently conniving with Equitable in not providing policyholders with adequate information about its finances. Sections 2 and 5 of the Financial Services and Markets Act 2000 state:-

> 2 (1) In discharging its generation functions the Authority must, so far as is reasonably possible, act in a way -
>
> a) which is compatible with the regulatory objectives…
>
> (2) The regulatory objectives are –
> …
> (c) The protection of consumers
> …
>
> 5 (2) In considering what degree of protection may be appropriate, the Authority must have regard to –
> …
> c) the needs that consumers may have for advice and account information"

63. The FSA has published its commitment to provision of information. Its Principle 7 "Communication with clients" states "A firm must pay due regard to the information needs of its clients, and communicate information to them in a way in which is clear, fair and not misleading". One of its papers observes[65]:-.

> "This means we need to consider issues such as what information is needed for…achieving better information about firms for consumers…".
>
> "Public disclosure of information about financial institutions helps actual and potential consumers of financial services products and other market participants to understand the financial position and strength of the institutions they are dealing with. For consumers, the availability of this information allows them to make better informed decisions and choices. However, consumers may not make this assessment alone, since in many cases they will rely upon information/sophisticated users, such as the media, agents and brokers, independent

[65] The new regulatory reporting environment, Discussion Paper 12, The Financial Services Authority, May 2002.

> financial advisers and the like, to give them relevant information to address their needs. To this end, information that is publicly disclosed needs to be relevant, reliable and easily accessible. So, the data being collected should be targeted to achieving information that gives a clearer picture of a firm's financial well-being, and is in line with the principles of good information."

Another of its documents[66] identifies strategic aims including:-

- "consumers should be better able to make informed choices and achieve fair deals in their financial dealings"
- consumers should be able to secure a fair deal through:-
  - "requiring firms to treat customers fairly, during and after the point of sale, for example by giving clearer and fairer information
  - equipping consumers to make informed decisions, for example through improved product disclosure and consumer education initiatives"

64. According to Financial Secretary Ruth Kelly "The FSA…has been working with the Society to ensure that clear and appropriate information is available to policyholders as developments occur and that they continue to receive appropriate support"[67].

65. The FSA's deeds do not match its words. On 12 November 2002 I wrote to Mr. John Tiner of the FSA a letter titled "A complaint regarding the lack of information provided by the Equitable to its members". The letter listed a number of matters where we regarded Equitable's performance as inadequate including those listed in Annex 2. On 10 January 2003 I received from Mr. Tiner a letter in which he refused to help on any of the issues, including provision of information about my policy valuations[68]. We recently drew Mr. Tiner's attention to the inadequacy of Equitable's interim accounts for 2003[69], and the response was as unhelpful as previously.

66. The FSA should have known enough to be aware that the 2½% benefit offered to non-GAO policyholders in the Proposed Compromise was dependent upon the stock market rising

[66] "The future regulation of insurance: A Progress Report" by the Financial Services Authority, October 2002.
[67] Hansard 4 November 2003.
[68] When I complained to the FOS about Equitable's refusal to provide me with information about my policies, they required Equitable to give me the information. But their help did not create a precedent and subsequently other policyholders have suffered from the same obstructionism including Mr. C. Carnaghan, who is a Committee member of EMAG.
[69] E.g. There was no figure for the value of the with-profits fund; no explanation of the dependence of technical solvency of £150m on future profits – where were they coming from? No explanation that £320m of the subordinated debt did not count as a liability.

significantly (which it did not), and that the information provided was inadequate. In March 2002 it told Equitable to commission the report by B&W Deloitte that is the basis of Equitable's inadequate 5% offer to former policyholders for mis-selling. The FSA has kept quiet about the opinion, and the offer.

67. The FSA must have been closely informed about Equitable's negotiations with ELJAG and of other cases settled by negotiation, and be well aware that there is one compensation rule for the informed and prosperous former policyholders who are not intimidated by the law, and another compensation rule for the "little" former policyholders.

68. A retired solicitor member of EMAG, Mr. Nicolas Bellord, recently wrote to the FSA criticising the way in which Equitable is handling a review of managed or draw down pensions:-

> "The definition of 'GAO related claims' in the Schedule of Terms is far too wide as it effectively rules out ALL claims against the Society involving breach of s.62 of the Financial Services Act 1986, misrepresentation and fraud. By signing up for this offer policyholders effectively lose any rights they may need to enforce if they are not satisfied with the Managed Pension Review. To widen the definition of 'GAO related claims' in this way to all claims is just lawyers' trickery and as a retired lawyer I have become increasingly ashamed of this kind of knavery which has permeated the whole affair. In inviting policyholders to sign up for this offer they are getting no advice as to how this would affect any compensation they might get under say the Managed Pension Review. This is an immensely complex issue upon which lay people are getting no help or advice. How are you going to distinguish between damages for mis-selling, misrepresentation, fraud or anything that may be provable from GAO related losses? It is quite clear that it would be most unwise for anyone who has a further claim against the Society to settle upon this basis.
>
> …The current offers in respect of the 'GAO Related Mis-selling Claims' are quite outrageous: No details are given as to how the offers are actually calculated so the policyholder has no idea how the sum is arrived at so he has no means of knowing whether it is fair. Yes there are references to Counsel's opinion and the B&W Deloitte Report but how can you expect anyone other than an expert to interpret these?
>
> Generally I believe that you should not have allowed the Society to proceed in this way. You may say that you have not endorsed these offers by the Society but you cannot evade your

> responsibility in respect of conduct of business in this way. You have a duty in the dire circumstance of Equitable Life to supervise their every move and to give consumers help and advice on this. I believe in an ideal: that in this country problems such as this should be dealt with on a fair and decent basis and above all on an open basis - invoking commercial or any other kind of confidentiality is just dishonest. Further that all citizens (which we now are) and thus all members of this Society should be treated on an equal footing. This is just not happening with the Equitable Life Society. The reputation of our legal system has been dragged through the mud".

69. The FSA has consistently treated non-GAO policyholders unfairly, first supporting the inadequate offer of 2½% in the compromise settlement; then by its silence endorsing the inadequate offer of 5% to those who left to protect their right to claim for mis-selling; and putting its head in the sand regarding the possibility of fraudulent misrepresentation. *The FSA's treatment of "little" policyholders brings out again the inherent conflict of interest between its responsibility to maintain orderly markets and its responsibility to protect consumers.*