Britain: Ombudsman demands government fund for Equitable Life insurance and pension victims

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A report by the parliamentary ombudsman, Ann Abraham, into the failed insurance and pension society, Equitable Life, took four years to compile.

Published recently, it states that more than a million policyholders left with lower-than-expected retirement income were the victims of "a decade of regulatory failure" by government departments and regulatory authorities. It identified 10 instances of maladministration by public authorities.

The ombudsman called on the government to apologise and to set up a fund to compensate policyholders for losses. While the report does not give a figure for compensation, the Equitable Members Action Group (EMAG) says that assuming about 70 percent of policyholders can show that they have suffered a loss, this would amount to about £4.5 billion.

Paul Braithwaite from EMAG welcomed the report, saying it was a "devastating indictment" of the performance of regulators over many years. "The UK regulators were fully aware for a decade that Equitable Life was effectively insolvent, yet they allowed the society to suck in another £20 billion in pension contributions from more than one million new investors."

The report is another political and financial crisis for Prime Minister Gordon Brown and the Labour government, which, with the Financial Services Authority, had sought to delay and rebut the original draft report with a 500-page rejoinder. Yet another of Brown's measures—the financial services regulatory regime of which he was the architect during his 10-year stint at the Treasury—has come unstuck.

Not one of the institutions involved in the regulation of the insurance industry over an 11-year period—the Treasury, the Government Actuary Department (GAD), the Department of Trade and Industry, the Financial Services Authority (FSA) and its predecessors, the auditors, Ernst & Young, and accountancy body, the Institute of Accountants in England and Wales (ICAEW)—comes out unscathed.

The report reveals and confirms that the government's real relationship with the City is one of complete subservience to the dictates of finance capital.

The 246-year-old Equitable Life, the world's oldest mutual life insurer and a venerable City institution, was a major pension provider, responsible for more than £26 billion of investors' cash. It announced in December 2000 that it would not be selling any new policies and was on the verge of collapse. This was the biggest crisis in the pensions industry.

Its failure was not the result of a stock market collapse, but of its own practices. It followed a House of Lords ruling one year earlier that the society's payment of a differential bonus to policyholders, and thus its refusal to honour promises to make minimum payments to 90,000 people who had invested in the "guaranteed annuity rate" (GAR) pension policies, was illegal. Without the cash reserves of £1.5 billion needed to honour the agreement made when selling the policies between 1958 and1988, it was unable to find a buyer for the business.

Since then, it has wound down its activities and sold off most of its operations, transferring its sales force and non-profits policies to the Halifax Building society for £1 billion in February 2001, its subsidiary University Life to Reliance Mutual in December 2006, its £1.7 billion worth of with-profits annuities to Prudential in December 2007 and £4.6 billion of its fixed pensions to Canada Life in February 2007.

Its new management decided in 2001 to impose an across-the-board cut in policy values to the tune of £4 billion. The 1.5 million savers still with the society by 2001 faced low returns on their investment or a fall in the value of their policies if they moved them elsewhere. Those who continued to invest in Equitable Life's with-profits policies saw the value of their savings slashed anyway, by more than 30 percent in three years, because there was not enough money to go around. This was also the case for some who were already receiving pension payments.

About 500,000 people are still saving for their pensions in the society's £7 billion with-profits fund, either as individuals or via group pension schemes. But some 30,000 of them have died over the last eight years. Many of them were forced to live their last years in very reduced circumstances. Fifteen more die every day.

The parliamentary ombudsman's report follows 12 other reports into different aspects of the Equitable Life fiasco commissioned by the government. One of these earlier reports commissioned by the Treasury, an interested party in the affair, by Lord Penrose, attributed most of the blame to the society. "Principally, the society was the author of its own misfortunes. Regulatory failures were secondary factors," Penrose wrote.

His report said that serious failings among senior management went back to the 1980s, when the company had failed to set aside sufficient reserves for the guaranteed annual annuities. These were no longer sold after 1988 when the investment climate changed, making them too expensive to operate.

There was "a culture of manipulation and concealment," and the society did not communicate details of its finances to either its policyholders or regulators. During the 1980s and 1990s, Equitable, as a mutual society without shareholders, had been paying out bonuses to its members—the policyholders—and concealing the fact that it had not built up sufficient reserves and was in effect running the guaranteed annuities on the back of new policyholders enticed by the bonuses and loans.

Penrose particularly criticised the chief executive between 1991 and 1997, Roy Ranson, for failing to provide pertinent financial information. He wrote that non-executive directors were "ill-equipped," "ill-prepared" and "incompetent," as regards the particular difficulties of supervising a complex life assurance firm. Ranson, in addition to being CEO, was appointed actuary at the firm from 1982 to 1997. This overlap of regulatory and executive functions led to confusion and conflicts of interest.

Penrose could not avoid the glaringly obvious and, going beyond his remit, criticised the supervision of Equitable Life. His report found that the system of regulation, which handled Equitable with a light touch, was "inappropriate." The Department for Trade and Industry, in particular, had insufficient understanding of how to measure the solvency of a firm like Equitable, thereby allowing the society to get away with not putting aside sufficient reserves. The Government Actuary's Department (GAD) was insufficiently tough on the society, failing to respond to changes in bonus policy and failing to demand disclosure from management.

However, he argued that there was no evidence of "maladministration or negligence" among regulators and said—letting the government off the hook—that as a general principle, "building false expectations of regulators can lead to a destruction of public confidence," and he stressed that regulators themselves must inform consumers about the realities of the financial system. "Effective consumer education is essential."

EMAG, Equitable's policyholders, were not satisfied with this and asked the parliamentary ombudsman to review its supervision. But her first report in 2003 cleared the Financial Services Authority (FSA), one of the society's regulators, of any failure of supervision in the run-up to its collapse. EMAG pressed for another and fuller investigation.

In 2005, the European parliament's commission of inquiry—set up because the society had sold policies not just to UK citizens but to citizens in the EU—blamed the UK government for failing to ensure that EU legislation had been implemented properly. It also argued that the system of regulation was "excessively lenient" in failing to ensure that Equitable was solvent. It pointed out that there was no real prospect of policyholders gaining any redress under the UK's legal and regulatory system. Consequently, the government had an obligation to assume responsibility and establish a compensation scheme.

The FSA tried to prevent the ombudsman from carrying out a second and more thorough investigation—and with good reason. Ms Abraham, whose remit by virtue of her statutory position was the effectiveness of the society's regulation, reversed her original findings. Her report excoriated the government and regulatory authorities and accused it of maladministration for its role in the society's collapse in 2000.

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

Her report revealed a catalogue of failings and maladministration.

The Department for Trade and Industry and the Government Actuary's Department (GAD) had regulated in a "passive, reactive and complacent manner." GAD had let one person hold the role of both CEO and appointed actuary for more than six years, which meant that there was no potential whistleblower to protect investors. GAD had failed to question or resolve any of the issues that were apparent in the insurer's annual regulatory returns, GAD had allowed the introduction of a different terminal bonus to policy holders that was the subject of the legal case brought against the society and ultimately led to its collapse, but failed to tell the regulators and raise the matter with the society.

While GAD and the FSA, which took over prudential regulatory responsibility in the last two-and-half years of the society's life, "often initiated discussions appropriately with equitable," they still allowed Equitable to get away with non-compliance. For example, they let it take credit on their books for reinsurance contracts that had not been concluded and did not cover the issue at the heart of the House of Lords ruling.

They failed to question the lack of crucial information on the society's returns that gave an inaccurate picture of its financial situation, even though they knew that the ratings agencies were "misconstruing the company's financial strength," thereby enabling it to declare a bonus in 1999. The net result was that investors were making decisions based on false information. In the words of the ombudsman, investors "were thus actively misled."

Furthermore, the FSA failed to ensure that Equitable Life warned new policyholders of the serious implications of losing the legal case that was then under way. Even after losing the case, the regulators still allowed the society to stay open for new business despite the fact that it was then unsound. Finally, after the society closed for new business, the FSA provided information that was "misleading and unbalanced, with assurances being provided that the society was solvent, when that was in considerable doubt and was not the view always held within the FSA."

Despite the ombudsman's trenchant and very valid criticisms of the regulatory authorities, she never deals with the more fundamental question. Regulation was and can never be more than a cosmetic device to licence the essentially fraudulent nature of the pensions and insurance-selling industry. It doubles when the need arises as the industry's public relations arm.

In practice, "regulation" consisted of asking questions but being satisfied with bland assurances; allowing the society to continue selling new policies when it was essentially insolvent and give out misleading information; giving "advice" and not instructions; backing down when Equitable Life threatened a Judicial Review or ministerial intervention for going beyond its powers; and being fobbed off with reassurances about future profits, re-insurance arrangements and selling costs.

While the society's policyholders have welcomed the thoroughness of the report, it is far from clear that the government will establish and fund a compensation scheme for the policyholders, as the report recommends. Chancellor of the Exchequer Alistair Darling is likely to argue that the government cannot be held liable for all the losses suffered by investors.

An earlier ombudsman's report in 2006 that also found the government guilty of maladministration over advice given on occupational pension schemes that led to 125,000 people losing all or some of their occupational pension savings had recommended full compensation. The government immediately rejected her findings and the case went to the High Court, which ruled earlier this year against the government. One of its accusations was that the government had rejected the findings too quickly, which suggests that at the very least the government will drag its feet for as long as possible before making any announcement.

Though the government stepped in to rescue Northern Rock and shore up the banks via a "liquidity scheme" with hundreds of billions of taxpayers' money, it is reluctant to compensate policyholders when its own official bodies are found guilty of maladministration.

EMAG has said it is "digging in for a long fight" and getting its members to write to MPs and candidates in marginal constituencies. Some lawyers have argued that policyholders could have a claim for "misfeasance in public office," similar to the failed case brought by Railtrack's shareholders.

The *Financial Times*, the City's mouthpiece, provides an insight into the thinking of the financial elite. It called in a self-serving editorial for the government to fund limited redress, arguing that it is not the job of the taxpayer to bail out completely investors who put their money into an institution that gets into financial trouble. This would remove responsibility from the institutions, their advisors and investors. But more importantly, it would also lead the financial regulators to behave too cautiously or to regulate strictly. That of course would never do.

But there are, it argues, two strong reasons for partial compensation. Firstly, the moral case, since the authorities allowed Equitable to present misleading information to the public. "Secondly, there is a public interest in encouraging people to make long term financial provision for themselves so that an aging population looks less to the state for its pensions."

As well as encouraging private pensions to slash welfare spending, the *Financial Times* is also concerned that nothing will disrupt the implementation of the government's new national pension savings scheme, which would invest the public's and employers' compulsory contributions in the Stock Market.

Equitable Life is by no means the worst case in terms of the outcomes on guaranteed annuities. Patrick Collison of the *Guardian* newspaper noted that millions of pensions companies' customers have received payouts that are worse than those of Equitable Life. He went on to use this, plus the fact that most of Equitable's victims were doctors, dentists and lawyers, as arguments to support the government's expected refusal to provide compensation at the taxpayers' expense. He also pointed out that "by mid-2003 virtually every insurance company in the UK was technically bankrupt and receiving 'waivers' from the FSA."

What he, like all the rest of the financial commentators will not say was that the case of Equitable Life and the failure of regulation to rein in the financial services industry demonstrate the absolute necessity for pensions to be publicly funded and provided.