Independent Commission
on Equitable Life Payments

Equitable Life Payments Scheme: achieving a fair allocation and order of payments

Advice to the Government

21 January 2011

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ISBN 978-1-84532-828-3
PU1119

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21 January 2011

Mark Hoban M.P.
Financial Secretary to the Treasury
HM Treasury
1 Horse Guards Road
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Dear Financial Secretary,

You asked us to advise on how to allocate fairly the funding made available for the Equitable Life Payments Scheme and how to prioritise the order of payments over the next three years, excluding with-profits annuitants and their estates. This report sets out that Advice and the rationale underpinning it.

It has been very clear to us, from the correspondence we have received from individuals, and from discussions we have held, that the losses arising to policyholders from Government maladministration arouse strong feelings. While these losses have inevitably affected individuals differently, it is clear some have suffered badly. Although we have not considered cases on an individual-by-individual basis, it has been helpful to understand these personal experiences. We are extremely grateful to all those who took time to write to us and we recognise that many cases for special treatment were powerfully made.

We would also like to acknowledge the constructive and helpful approach taken by all the representative groups engaging with the Commission. In particular, we would like to thank the Equitable Members Action Group (EMAG), the Equitable Life Trapped Annuitants (ELTA), and the Equitable Life Assurance Society, all of which have been very supportive to us during

our discussions with them. We also want to acknowledge the assistance and support given by Eric Salem and Garry Siveyer, who acted as our Secretariat. For the avoidance of doubt, at no time did HM Treasury seek to influence our recommendations. However, HM Treasury did provide useful advice which we requested on the practical implications of our recommendations.

As might be expected, there are divergent views amongst interested parties and these are set out in our Advice. We have sought to reach conclusions that fairly balance these views and, where appropriate, address misunderstandings of factual issues. There will, of course, be people who disagree with our conclusions and we acknowledge that there will be those who feel that their own personal circumstances make them more deserving than others. Some disagreement is inevitable, but we believe that our recommendations achieve a fair outcome when considered across all policyholders.

Final decisions on a fair allocation of the available funding and on prioritisation of the order of payments are matters for the Government. We hope that you find our Advice helpful and shall be happy to discuss any aspects of this report with you.

Yours sincerely,

Brian Pomeroy

Brian Pomeroy CBE, Chair of the Commission

John Howard

John Tattersall

1: Executive Summary

1.1 As part of the 2010 Spending Review, the Government announced that £775 million would be made available for distribution between Equitable Life policyholders (excluding with-profits annuitants and their estates) who had suffered Relative Losses (as defined in the Government's Methodology)[1] as a result of accepted Government maladministration. The Independent Commission on Equitable Life Payments ("the Commission") has been asked to provide advice on how this amount should be allocated fairly to these policyholders (of whom there are just over one million); and how those payments should be prioritised over the next three years.

1.2 The Commission invited views from interested parties. From written responses and discussions that it has held, it has heard arguments both for and against giving special treatment to particular groups of policyholders, including holders of Guaranteed Annuity Rate (GAR) and non-GAR policies; Group Pension policies; older policyholders; and 'late-joiners'.

1.3 The Commission found that many of the cases put forward had considerable merit but, after a thorough analysis, did not feel that any were strong enough to outweigh the arguments for a simple *pro rata* allocation of the funds available. The Commission had particular sympathy for those 266,000 policyholders who found that the amounts received or receivable on their policies were below the amounts they actually invested. However, on balance it felt that paying out such losses in full or in part would have an unfair impact on payments to other policyholders or would present practical difficulties.

1.4 In arriving at its conclusions, the Commission gave weight to the significant number of respondents who felt that a *pro rata* allocation would be simplest and fairest. However, it also considered whether a straightforward *pro rata* allocation should be modified by features such as a cap on the amount payable to any policyholder or a *de minimis* sum beneath which no payment should be made. The Commission concluded that the cases for a cap and a *de minimis* were not strong except, in the case of the latter, where a payment would otherwise be disproportionate to the cost of making it. It also considered that where a

1 In the Government's Methodology ("the Methodology"), Relative Loss is the difference in the value of a notional policy which the policyholder might have held had they made an investment in a similar product in a comparator company's with-profits fund and the value of the actual Equitable Life policy.

policyholder held several policies, among which there were both gains and losses, these should be offset against each other wherever practicable.

1.5 A clear message was received that the oldest policyholders should be prioritised in the order of payments because they were least able to wait up to three years. The Commission had much sympathy with this view, particularly because younger policyholders are less likely either to have retired, or to be approaching retirement, and more likely to be in a position to mitigate the effects of a delay. The Commission concluded that the estates of deceased policyholders should be given similar priority, subject to practical considerations.

1.6 In summary, the **Commission recommends that the £775 million quantum should be allocated as follows**:

- **a *pro rata* allocation of the available quantum**, in proportion to the size of Relative Losses, principally on the grounds that no group of policyholders has been identified which in the Commission's view merits favourable treatment at the expense of other policyholders;

- **a single policyholder view**, wherever practicable, endorsing the inclusion in the Methodology of offsetting Relative Gains against Relative Losses where policyholders hold multiple policies. This will better direct funds towards those individuals that have suffered net Relative Losses across their Equitable Life portfolios; and

- **a *de minimis* amount**, in the region of £10, beneath which payments should not be made. This reflects the fact that payments below this amount would be disproportionate to the administrative costs of making them while being, in the Commission's view, of negligible significance to those who do not receive them. The Commission recognises that the costs of administering payments to members of Group schemes and to estates of deceased policyholders may justify a higher *de minimis*.

1.7 In summary, the **Commission recommends that the following groups be prioritised in the order of payment**:

- **the oldest policyholders,** as they are least able to wait for payment and are also least likely to be in a position to mitigate the effects of a delay; and

- **the estates of deceased policyholders** and, so far as possible, the estates of those who die, before receiving a payment, in the next three years. This prevents delays to beneficiaries receiving payments when they might be at their most vulnerable and reduces the difficulties that could arise in regard to the administration of estates.

1.8 This is subject to practical constraints described in Chapter 5, including the difficulties of prioritising those with Group Pension policies by age and the need to trace some policyholders.

1.9 These recommendations could, broadly, have the following effect, subject to practical constraints:

- **approximately 945,000 policyholders would receive payments equivalent to 22.4 per cent of their Relative Losses**;

- **the remaining 100,000 policyholders with Relative Losses would receive no payment** because their *pro rata* allocation amounts to less than £10;

- **almost 70 per cent of 11,250 known eligible estates could receive payment in the first year**;

- **95 per cent of all eligible policyholders over the age of 75 could receive their payment in the first year of the Payments Scheme** (the remaining 5 per cent holding policies in Group schemes, which cannot always be prioritised for practical reasons); and

- **all eligible policyholders over the age of 60 with individual (as opposed to Group scheme) policies could receive their payment in the first year of the Payments Scheme**.

1.10 While the recommendations made by the Commission are relatively simple, it has arrived at them only after thorough exploration both of the arguments put forward and of the available data. The Commission recognises that decisions on fairness in this context are essentially a matter of judgement and has taken what it considers to be a balanced approach in weighing up competing interests and views.

2: The Commission's role and approach

Introduction

2.1 The Financial Secretary to the Treasury announced on 26 May 2010 that an independent commission would be set up to advise on the Equitable Life Payments Scheme ("the Payments Scheme"). On 22 July 2010 he announced that Brian Pomeroy, John Tattersall and John Howard had been appointed to the Independent Commission on Equitable Life Payments ("the Commission"). Brian Pomeroy was nominated as Chair of the Commission.

The Commission's role as set out in July 2010

2.2 The Commission was issued with initial Terms of Reference on 22 July 2010 and asked to report by the end of January 2011. The Government asked the Commission to:

- "recommend how best to fairly allocate funds provided for the Equitable Life Payments Scheme as part of the Autumn 2010 Spending Review to those persons found to have suffered Relative Losses as a result of accepted Government maladministration; and
- advise on any groups/classes of persons that should be paid as a priority."

2.3 The Commission had no role in the subsequent decision by the Government on the total funding being made available for the Payments Scheme; the Commission's remit was solely to advise on how that funding should be fairly allocated to policyholders and whether payments to any particular groups should be prioritised. At this stage, with-profits annuitants were included within the remit of the Commission.

The Commission's revised role as set out in October 2010

2.4 On 20 October 2010, the Government confirmed in the Spending Review that it had accepted the Parliamentary and Health Service Ombudsman's findings in full. It accepted total Relative Losses from Government maladministration

to be £4.3 billion[2] and set out its accepted Methodology for calculating those losses. The calculation is based on the difference in the value of a notional policy which the policyholder might have held had they made an investment in a similar product in a comparator company's with-profits fund and the value of the Equitable Life policy they actually held. A summary of the Methodology is shown at Annex E.

2.5 The Government also announced that it expected the total amount of funding over the lifetime of the Payments Scheme, including payments to with-profits annuitants, to be in the region of £1.5 billion. It specified that:

- it would cover the full amount of the total Relative Loss suffered by with-profits annuitants and their estates; and

- £1 billion had been allocated to the Payments Scheme in the first three years of the Spending Review, which would cover both the initial costs of the first three years of regular payments to with-profits annuitants, and all payments to other policyholders.

2.6 Again, the Commission had no role in setting the Methodology, the total funding for the Payments Scheme or the decision to provide separate arrangements for with-profits annuitants. These were all decisions taken solely by the Government.

2.7 The Financial Secretary wrote to the Commission on 20 October 2010 and 27 October 2010, confirming that it was being asked to advise on the allocation of £775 million, phased over the first three years of the Spending Review period, to policyholders other than with-profits annuitants. He also instructed the Commission to base its allocation on the Government's accepted Relative Loss amount and Methodology, and asked it to have regard to the intended profiling of these payments over the three-year period. Approximately 50-55 per cent of the quantum will be available in the first year, 25-30 per cent in the second, and 15-20 per cent in the third. These letters, and the Commission's response, are shown at Annex B.

2.8 Consequently, the Commission's revised role, set out in more detail in amended Terms of Reference (available at Annex A), was to provide advice to the Government by the end of January 2011 on:

2 The Financial Secretary to the Treasury wrote to the Commission on 18 January 2011 to advise that total Relative Losses had been reduced to £4.1 billion following further work by Towers Watson. No changes had been made to the Methodology. This followed "continued improvements made to the calculations, refinements of individual policies' Relative Loss calculations, addressing data issues and on-going review of individuals' Relative Losses." The available funding for those within the Commission's remit remained unchanged. This letter is available at Annex B.

- "how best to fairly allocate funds provided for the Equitable Life Payments Scheme in the first three years of the Spending Review to those persons found to have suffered relative losses as a result of accepted Government maladministration, excepting with-profits annuitants and their estates; and

- any groups/classes of persons that should be paid as a priority with regard to the timing of payments, again excepting with-profits annuitants and their estates."

2.9 There are 460,000 holders of individual policies (excluding with-profits annuities) and 586,000 holders of Group Pension policies within the Commission's remit. These policyholders have suffered Relative Losses of almost £3.5 billion in total, according to Towers Watson's most recent analysis. A further 435,000 policyholders have not suffered any Relative Losses and so are not within the Commission's remit.

Issues outside the Commission's remit

2.10 The Financial Secretary's letter of 20 October 2010 and the amended Terms of Reference clarify the issues outside the Commission's remit. The remit does not extend to advising on the administrative and operational mechanics of delivering payments to policyholders. Nor does it include advising on the independent appeals process, which will be announced by the Government when it presents the final design of the Payments Scheme to Parliament. The Commission will also have no role in administering payments to policyholders.

The Commission's approach to engaging with interested parties

2.11 The Commission has been fully committed to transparency and has been proactive in seeking the views of interested parties throughout its work. Over the last few months it has:

- established a website detailing its work;

- issued a call for initial thoughts in September 2010, and a discussion paper in November 2010; and

- held discussions with a number of bodies, representative groups and individuals.

The Commission's website

2.12 The Commission established its own independent website in September 2010. This is available at http://equitablelifepayments.independent.gov.uk. It has

allowed the Commission to keep the public informed of its work and aided transparency of its work. The website has received 24,000 visits from more than 5,100 unique users.

Call for initial views in September 2010 and issue of a discussion paper in November 2010

2.13 Before the quantum of available funding was announced, the Commission issued an open invitation, on 3 September 2010, seeking the initial views of interested parties.[3] Following the Government's announcement at the Spending Review, the Commission issued a discussion paper on 3 November 2010,[4] summarising feedback from its initial call for views and posing a number of specific questions to which it invited responses. Almost 1,600 copies of the discussion paper were downloaded from the Commission's website.

Meeting interested parties

2.14 As well as receiving written representations, listening to the views of interested parties has been invaluable to the Commission. Since it was established, the Commission has held discussions with a number of bodies, representative groups and individuals. These included:

- the Parliamentary and Health Service Ombudsman;
- the All Party Parliamentary Justice for Equitable Life Policy Holders Group;
- Sir John Chadwick;
- the Equitable Life Assurance Society ("Equitable Life" or "the Society");
- the Equitable Members Action Group ("EMAG");
- the Equitable Life Trapped Annuitants ("ELTA)";
- the Equitable Late Contributors Action Group ("ELCAG"); and
- the National Association of Pension Funds ("NAPF").

3 Open letter from Brian Pomeroy, 3 September 2010, http://equitablelifepayments.independent.gov.uk/publications.html

4 Equitable Life Payments scheme: achieving a fair allocation and order of payments, The Independent Commission on Equitable Life Payments, 3 November 2010, http://equitablelifepayments.independent.gov.uk/publications.html

Independent actuarial and legal advice

2.15 Following an open competitive tender, the Commission appointed Towers Watson to provide it with actuarial support. Towers Watson built up considerable expertise and supporting infrastructure on issues related to Equitable Life, particularly while under instruction from the Government to provide data and modelling for its decision on Relative Loss. For the purpose of the Commission's work, however, it acted under the Commission's instructions alone; and no material was shared with other parties, including HM Treasury, without the Commission's express permission. The Commission held discussions with Towers Watson throughout the process and sought its advice on a number of questions, set out in Annex D, including technical issues and the distributional impact of recommendations being considered. The Commission's conclusions are based on the available datasets held by Equitable Life and Towers Watson as at 31 December 2010, which it understands may be subject to further refinement. Towers Watson's written advice[5] is available alongside the Commission's Advice to the Government.

2.16 The Commission also received independent legal advice from the Central Advisory Division of the Treasury Solicitor's Department.[6]

Advice received on scheme design

2.17 The Commission's Terms of Reference state that it "shall also have access to advice provided to HM Treasury on scheme design to help understand the effect that their advice will have on the deliverability of the scheme." The Commission requested such advice to ensure it understood the practical implications of recommendations that it was considering. It is available at Annex C.

5 Actuarial Advice to the Independent Commission on Equitable Life Payments, Towers Watson, 20 January 2011.

6 For the avoidance of doubt, this Department provides legal advice to central government departments and, despite its name, is not part of HM Treasury. The Central Advisory Division is separate from the Division providing advice to HM Treasury.

3: Views of interested parties

Introduction

3.1 In this chapter, the Commission sets out the views it has received from interested parties. It also includes the views of Sir John Chadwick on disproportionate impact to which, in accordance with the Terms of Reference, the Commission must have regard but by which it is not bound.

Invitations to make representations to the Commission

3.2 The initial views of interested parties were sought on:

- the principles to be applied in fairly allocating funds, whatever the level of funding provided by the Government, to those who have suffered Relative Losses as a result of accepted Government maladministration; and
- the principles that should underpin any prioritisation of payments to particular groups or classes.

3.3 The Commission's subsequent discussion paper asked for views on four main questions:

- What should be the guiding principles for determining fairness?
- Should any groups receive special treatment in a fair allocation of the available quantum of funding?
- Are there any particular features that should be incorporated in order to ensure that individual losses are fairly translated into payments from the available quantum?
- Should any groups receive special treatment in the order of payments?

Summary of representations received

3.4 The Commission received more than 50 responses to the invitation for initial thoughts and more than 60 to the discussion paper. These will be made available

on the Commission's website.[7] A list of respondents who were willing to be identified is available at Annex G. Not every view expressed by every respondent is mentioned in this document, but the Commission believes that the summary below provides a fair overview of the main arguments that have been put forward.

What should be the guiding principles for determining fairness?

3.5 The Commission asked for views on the principles that should inform its Advice, both on a fair allocation of the available quantum and on any groups or classes of policyholder that might merit prioritisation in the order in which payments are made.

3.6 Respondents did not, generally, outline guiding principles in reply to the initial invitation. Instead, they focused on their own personal experiences and the case for favouring particular groups. Responses to the discussion paper focused strongly on the need for simplicity and transparency in the allocation and prioritisation of the funding. There was a clear desire on the part of a significant number of respondents for a very straightforward design that could be easily understood. Without this simplicity, it was felt, the Payments Scheme risked being seen as unfair. This emerged as a key factor and was highlighted in a number of responses from both individuals and other bodies, including Equitable Life and ELTA.

3.7 However, although the prevailing view favoured simplicity, a number of responses did imply that simplicity was less important than the need to target limited funding on those who may be most deserving. For example, suggestions about how funding could be allocated included potentially complex points-based schemes depending on a number of different criteria, and the exclusion of particular policyholders based on factors such as whether their Relative Loss represented a significant percentage of their policy value.

3.8 Equality of treatment between policyholders was stressed by many as an important guiding principle when considering fairness, with the need to give equal treatment to all policyholders (including overseas policyholders) overriding the special interests of particular groups. However, this was not a universally held view and some respondents highlighted the case of particular policyholders over others. It was also maintained that the Government's decision to cover the Relative Losses of with-profits annuitants had established a principle of providing favourable treatment to those policyholders with the least opportunity to mitigate their losses and that adopting a different approach towards other policyholders thought to be in a similar position might therefore be inconsistent.

7 http://equitablelifepayments.independent.gov.uk/publications.html

3.9 Some respondents also made a case for the Commission's Advice to be based, so far as possible, on objective facts rather than upon judgements based on perceptions of hardship or need. In the absence of means testing, which was ruled out in the Commission's Terms of Reference, it was proposed that the Commission should avoid forming broad judgements on whether groups of policyholders may or may not be better able to cope with the losses they had suffered.

3.10 However, some respondents did argue in favour of making such judgements, although the diversity of their views served to indicate the problems in such an approach. For example, while some maintained that those with the smallest Relative Losses would be better able to absorb them, others put forward a similar argument in relation to those with the largest.

Should any groups receive special treatment in a fair allocation of the available quantum of funding?

3.11 The Commission asked for views on any groups or characteristics of policies or policyholders that might merit favourable treatment in allocating the available funding.

3.12 It received a number of responses giving personal policyholder details and estimates of the amounts that individuals believed they had lost, and describing hardships they were currently experiencing. Although the Commission has not considered cases on an individual-by-individual basis, it was helpful to have these first-hand accounts of relevant personal experiences in order to understand the severity of hardship experienced by some policyholders.

3.13 A significant number of respondents maintained that the fairest approach would be to make a *pro rata* allocation of the Relative Losses, arguing that all policyholders should be treated equally. This would mean that all policyholders would receive a payment proportionate to their Relative Loss. A *pro rata* approach was promoted as being simple, transparent, and fair to all. It was acknowledged that there may be arguments for giving special treatment in some cases, but it was felt that these did not outweigh the need to treat all policyholders with an even hand. This was an approach supported strongly by many respondents, including by Equitable Life which said that "any move from pro-rata must have a robust rationale".[8]

3.14 Others did promote the case for specific groups to receive special treatment. It was clear that many comments reflected the personal interests of individual

8 See the letter from Mr Chris Wiscarson, Chief Executive, Equitable Life, 3 December 2010, http://equitablelifepayments.independent.gov.uk/publications.html

respondents and no single group that lay within the Commission's remit received overwhelming support for special consideration.

3.15 Some proposed that so-called 'late-joiners' to Equitable Life, generally considered to be those opening policies in the late 1990s, was a group that the Commission should consider for favourable treatment. This was to reflect the fact that, in the view of those respondents, it is unlikely that Equitable Life would have been in a position to have taken on new business at that time, had it been properly regulated. Some also believed that it would be unfair to use limited funds to pay those who joined Equitable Life early since, although they may have experienced Relative Loss, they may also have benefited from significant gains arising from accepted Government maladministration. These would have arisen because in the absence of maladministration, the bonuses declared by Equitable Life would have been lower during the 1990s.

3.16 Late-joiners, it was suggested, were also more likely to have suffered what, in this Advice, the Commission terms "Money Loss", that is to have seen a reduction in the amounts received or receivable from their policy compared with the amount of money they invested in it, rather than simply a reduction in the growth of the amount invested. It was suggested, also, that Income Drawdown policyholders may well have been particularly affected in this way because they tended to transfer into Equitable Life during the 1990s with relatively mature funds and so suffered disproportionately from the policy value cuts in the early 2000s.

3.17 A small number of respondents said that any policyholders who had suffered Money Losses should be given favourable treatment, whether they joined Equitable Life 'late' or not. However, there was not strong support for this; for example, whilst EMAG acknowledged that some of its members had "lost a significant proportion of their capital",[9] it did not conclude that those with Money Losses should be favoured over others.

3.18 Age, or a proxy for age, such as being in retirement, was also proposed by a small number of respondents as a potential basis for allocation. It was generally argued that the oldest policyholders might warrant favourable treatment because they were least able to mitigate their losses.

3.19 Policyholders with Guaranteed Annuity Rates (GARs) were identified as a group that should receive less favourable treatment than others if limited funds were available. GARs were attached to certain pension policies written before July 1988 which allowed policyholders to purchase an annuity on retirement at a

9 See page 2 of EMAG's Representations to the Independent Commission on Equitable Life Payments, 3 December 2010, http://equitablelifepayments.independent.gov.uk/publications.html

contractually determined rate.[10] Some respondents argue that such policyholders should be excluded from payments altogether because, in their view, the Hyman judgment in the House of Lords in 2000 saw an unfair transfer of value in the with-profits fund from non-GAR to GAR policyholders.

3.20 Others took a contrary view and said that policyholders with GARs should not be excluded or receive unfavourable treatment. They argued that those with GARs had still experienced Relative Losses and that the uplift to the policy values which they received as part of the Compromise Scheme[11] would appropriately reduce their payment under the Methodology. Since the Methodology already accounts for the differences between policyholders with and without GARs, the Commission, they maintained, need do nothing more in this respect when deciding how funding should be allocated. EMAG, for example, argued that those with GARs "should simply be treated even-handedly *pro rata* to their losses, which are substantially less than non-GARs".[12]

3.21 EMAG also argued that policyholders with individual policies should be preferred over those with Group Pension policies. It said that "few holders of Group Pension policies have been seriously affected (or indeed noticed) their loss" and that this contrasted with "a hard core of about 200-300,000 policyholders whose funds represent their primary provision for retirement, many at an advanced stage of their working lives. They have been badly hit".[13] This was not, however, a view advanced by many others and the Commission received representations and general correspondence from those with Group Pension policies that offered the opposite perspective.

3.22 For example, the NAPF urged the Commission to "be very cautious about assuming... that one category of policyholders (e.g. those saving in AVCs[14] through group policies) might have more to fall back on by way of property, savings and other pensions than other categories (e.g. individual policyholders)". It asserted that such assumptions "are likely to be wrong". The NAPF argued that many people experience a mixture of employment and self-employment during their careers and may only have an opportunity to save into a company pension scheme in the later years of their working life following a long period of self-employment. As those in self-employment "may lie anywhere on a spectrum

10 Contributions into those policies after that year continued to attract GARs.

11 The Compromise Scheme, effective on 8 February 2002, removed GAR benefits from policies in return for an average increase in policy values of 17.5 per cent for holders of GAR policies. Non-GAR policyholders received on average a 2.5 per cent uplift to their policy values in exchange for giving up the right to make GAR-related claims against Equitable Life.

12 See page 4 of EMAG, 3 December 2010.

13 Ibid., p.4.

14 Additional Voluntary Contributions (AVCs) refer to voluntary contributions made by a member of an occupational pension scheme over and above his or her normal contributions.

that could have a Queen's Counsel at one end and a window cleaner at the other", it would be wrong to assume automatically that all those making AVCs have means to fall back on. In other cases, it was said, those who are employed throughout their career may rely on AVCs to top up their pension because they have always been on low earnings and have no other savings.[15] Some suggested that individuals with Group Pension policies might actually merit favourable treatment because they had a limited choice in where their money was invested.

3.23 A small number of representations proposed that those policyholders who had already received compensation should not receive further payments under the Payments Scheme. It was felt that they had already been compensated for their losses, although no distinction was made by respondents between compensation for accepted Government maladministration and for other causes, such as mis-selling.

3.24 A small number of representations mentioned overseas policyholders. One overseas correspondent commented, for example, that overseas policyholders should receive their full Relative Losses because they should not be subject to public purse considerations in the UK.

Are there any particular features that should be incorporated in order to ensure that individual losses are fairly translated into payments from the available quantum?

3.25 The Commission asked for views on applying features, such as a cap on payments or a *de minimis* amount of allocated loss below which payments should not be made.

3.26 As described above, *pro rata* allocation received much support on grounds of both simplicity and fairness. Many who proposed this argued for a straightforward *pro rata* allocation with no additional features. However, some believed that *pro rata* should be combined with other features, such as a cap and a sliding scale.

3.27 Those who supported a cap, under which no policyholder would receive more than a set maximum amount, did so on the basis that those with the largest Relative Losses were likely to have the means to cope with them because, it was felt, they were likely to have large policy values even after taking account of their losses. It was argued that this would allow those with more modest losses, for whom a payment was thought likely to be more significant, to receive a greater proportion of their Relative Loss. Some proposals were offered as

15 See the letter from Mr James Walsh, Senior Policy Adviser, the NAPF, 4 January 2011, http://equitablelifepayments.independent.gov.uk/publications.html

to an appropriate level at which to set a cap; these ranged from £10,000 per policyholder upwards. Some preferred to see a sliding scale under which, for example, policyholders would receive 100 per cent of the first £x of Relative Loss, 50 per cent of the next £y, and so forth. Proposals were made for several combinations of percentages and amounts of loss, for example 100 per cent of the first £5,000 and 50 per cent of the next £10,000.

3.28 Others rejected a cap and a sliding scale on the grounds that they would be unfair and could further disadvantage some of those who had been worst affected. EMAG, for example, indicated it might be prepared to accept a cap as a "political prerequisite"[16] but that "it does not agree generally with the idea of favouring those with small losses at the expense of those who have been badly hurt".[17] Views were also expressed that those with largest losses had earned more and saved more and that it would be unfair to penalise them for having done so.

3.29 It was also contended that applying a cap or a sliding scale would necessarily entail making arbitrary judgements about policyholders' resources. For example, those with the largest losses may only have one policy, while those with more modest losses, not affected by a cap or sliding scale, may have several policies with other providers and so, in reality, be able to bear their loss more easily. Others felt that a cap or sliding scale could add unnecessary complexity, which would be unwelcome because it would make the Payments Scheme more difficult to understand.

3.30 There were also mixed views about applying a *de minimis* level of loss below which payments would not be made. Some were strongly in favour, with EMAG describing it "as essential to ensure that very limited resources are not spent upon those who have barely noticed their loss at the expense of those who have seen their retirement provision slashed". [18] Where a *de minimis* was supported, suggestions as to its appropriate level ranged from £500 to £2,000. There were, however, no proposals for how to deal with the potential unfairness that such an approach could create for those just under the *de minimis* amount, for example £499 or £1,999 in the examples above. Others wanted to see just a very low *de minimis*, with the objective of excluding extremely small payments where the administrative cost of making them would be disproportionate.

3.31 However, some felt strongly that on grounds of fairness there should be no *de minimis* at all. They thought that there would be some policyholders who might value even a relatively small payment and that it would be wrong for the Commission to reach an arbitrary judgement on the amount that an individual policyholder may think worth receiving; this would depend on individual

16 See page 4 of EMAG, 3 December 2010.

17 Ibid., p.5.

18 Ibid., p.5.

circumstances, which the Commission is unable to investigate through means testing. Nevertheless, it was also generally acknowledged by respondents arguing against a *de minimis* level that there may be a case for introducing one where the administrative cost of making a payment would otherwise be disproportionate.

3.32 The Commission also asked for comments on whether it should take a combined view of multiple policies held by a single policyholder (referred to in this Advice as a "single policyholder view"). This would mean that Relative Gains on one policy would be offset against Relative Losses on another held by the same policyholder. The small number of respondents commenting on this mostly supported it, with EMAG indicating that they had no objections to such an approach. A very small number of others thought differently, believing that a policyholder should receive the benefits of having chosen multiple policies for the purposes of diversification.

Should any groups receive special treatment in the order of payments?

3.33 The Commission asked for views on any groups, excluding with-profits annuitants, that should be prioritised in the order of payments. This reflects the Government's decision that payments will be made over the course of three years and that it is not therefore possible to pay everyone at the same time; approximately 50-55 per cent of the quantum will be available in the first year, 25-30 per cent in the second, and 15-20 per cent in the third.

3.34 There was a high degree of consensus on this issue. The age of the policyholder was consistently seen as an appropriate basis for prioritising the speed of payments, the oldest policyholders being seen as the highest priority. The principle behind this was also reflected in the views of those who proposed that retired people should be among the first to receive payments.

3.35 A small number of respondents raised the prospect of also bringing forward payments to those in special circumstances, notably those suffering from a terminal illness. It was, however, also recognised that any decision to favour a group in this way could lead to claims for prioritisation from others, such as those who considered that they were in hardship. Complex bureaucracy and administrative cost were also adduced as militating against such an approach, since people would have to demonstrate that they had a terminal illness or hardship and the Government would have to verify their claim.

3.36 An alternative proposal was that the Government should phase payments in such a way as to ensure that the largest number of policyholders would be paid each year (regardless of age). It was suggested that the Government should establish which policyholders were the easiest to pay and pay them first.

3.37 There were very few comments on how to prioritise the estates of deceased policyholders. One response proposed that estates should only be paid after the oldest living policyholders had received payment, and that estates where there was a surviving spouse should receive the next priority. Another maintained that all the estates of deceased policyholders should be given similar priority to the oldest policyholders.

With-profits annuitants

3.38 As already mentioned, the Government announced that it would cover the cost of the total Relative Loss suffered by with-profits annuitants and their estates and, consequently, instructed the Commission to exclude them from its considerations. However, for completeness, the Commission sets out below a summary of the representations it received about with-profits annuitants prior to the Spending Review.

3.39 A very significant proportion of responses to the invitation for initial views made a case for with-profits annuitants to receive favourable treatment in the allocation of funding. It was argued that with-profits annuities differed from other policies in that the decision to purchase them was irrevocable and the annuity could not subsequently be surrendered. Consequently, with-profits annuitants have been referred to as “trapped” because, unlike those with other types of policy, they were unable to withdraw their capital from the annuity to invest it elsewhere. It was noted that they were also likely to be among the most elderly and least able to mitigate their losses by increasing their incomes through other sources. With-profits annuitants were also identified as a group most in need of early payment, particularly because they would be among the oldest and therefore be least able to wait for payments.

3.40 These were widely held views in the representations received by the Commission, although this may reflect the fact that a very large proportion of the responses at that time were from with-profits annuitants themselves. The Commission has no remit to comment on the Government’s decision to cover the cost of the full Relative Losses of with-profits annuitants.

Sir John Chadwick’s Advice on disproportionate impact

3.41 The Commission’s revised Terms of Reference state it should “have regard to, but need not be bound by, findings on the disproportionate impact set out by Sir John Chadwick” in his Advice to the Government in July 2010.[19] His views on

19 Advice to the Government in relation to the proposed Equitable Life payment scheme, The Office of Sir John Chadwick, July 2010, Part 9.

disproportionate impact are set out in Part 9 of his Advice and the Commission met him to discuss his findings. He identifies three broad classes of policyholder that he believes may have suffered "to an extent greater or less than other policyholders"[20] as a result of maladministration. These are summarised below.

Relationship between premiums, payouts and loss

3.42 Sir John argued that a distinction could be drawn between those policyholders exiting contractually whose amounts received or receivable on their policies were below the amounts invested (which he refers to below as "real loss") and those who had experienced lower than anticipated gains:

"Members of the public are likely to have considerable sympathy for policyholders who have suffered real loss and might well take the view it is fair to redress "real loss" from public funds in a manner analogous to those who have received compensation in respect of "lost" bank or building society deposits, at least, up to limits of the kind employed in those situations. Those who are not policyholders are likely to have considerably less sympathy for those who have only suffered losses in the sense adopted by the Ombudsman - that is, of failing to make gains which they expected to make."[21]

Policyholders' capacity to mitigate effects of accepted maladministration

3.43 The second consideration raised by Sir John was the extent to which policyholders might have been able to mitigate the effects of Government maladministration and the policy value cuts. He suggested that this involved "both the extent to which the policyholder depended on the payouts to be received under the policy (having regard to his other sources of income); and the extent to which – once the difficulties at Equitable Life became known – the policyholder was able to take action to mitigate the effect of those difficulties."[22] Sir John identified with-profits annuitants as being the main group of policyholders to which these considerations applied.

Those who have benefited from Equitable Life

3.44 Thirdly, Sir John received advice that "absent accepted maladministration, the overall bonuses declared and paid by the Society during the 1990s would have been lower than they in fact were."[23] He suggested, therefore, that it would be

20 Ibid., p.200.
21 Ibid., p.196.
22 Ibid., p.197.
23 Ibid., p.199.

appropriate to take account of any benefits that policyholders had *gained* as a result of accepted Government maladministration.

3.45 Sir John also identified the view that policyholders with GARs had benefited unduly from the Society. He explained:

"The view is widely held among lawyers experienced in this field that the House of Lords' decision in *Hyman* was unexpected and did not accord with the principles that should have been applicable in relation to a mutual Society. And, while GAR liabilities were not the only problem confronting the Society in the late 1990s and early 2000s, it is clear the inability to apply the DTBP[24] even to premiums paid into GAR policies after the decision- contributed significantly to the severe difficulties which arose in 2000 and 2001."[25]

3.46 He concluded:

"Policyholders of other classes might well, therefore, consider that – in circumstances where the poor return from their policies was due, in part, to what they see as the determination of some GAR policyholders to obtain a disproportionate share of the Society's funds – it would be inappropriate if payments were now made to GAR policyholders at the expense of non-GAR policyholders. If there were no constraints on the expenditure of public funds it might be possible to pay non-GAR policyholders the full amount of their loss (however calculated) and still to pay GAR policyholders a proportion of their loss. But realism suggests that this is unlikely to be an option."[26]

The conclusions of the Parliamentary and Health Service Ombudsman

3.47 The Government accepted in full the Parliamentary and Health Service Ombudsman's ("the Ombudsman") findings in her 2008 report on Equitable Life.[27] The Commission met with her and has been mindful of her findings in reaching its conclusions. The Commission noted, in particular, the principles

24 The Differential Terminal Bonus Policy was implemented by Equitable Life whereby it reduced the terminal bonus paid to a policyholder who took benefits to which a guaranteed annuity rate was applied. The benefits were reduced by such an amount as to make the resulting policy value equal to that paid to a policyholder who opted to take benefits at the current annuity rate (subject always to the minimum guaranteed benefits).

25 See page 200 of The Office of Sir John Chadwick, July 2010.

26 Ibid., p. 200.

27 Equitable Life: a decade of regulatory failure, Parliamentary and Health Service Ombudsman, July 2008.

that the Ombudsman believed should underpin the Payments Scheme, including that it should be both transparent and simple:

"[It] should operate in a transparent manner, with the basis being made public of the decisions as to how compensation is to be calculated, as to what procedure will govern the consideration of individual cases, and as to the criteria which will be taken into account when considering those cases. Those decisions should only be made after appropriate consultation is undertaken, including with those directly affected."[28]

"[It] should be simple, not imposing undue burdens, whether evidential or procedural, on those making claims to the scheme."[29]

Conclusions

3.48 The Commission has heard a wide range of views on how to allocate the available funding fairly and how to prioritise the order of payments. A strong case has been made for a simple scheme, with a *pro rata* allocation being seen by many as the most sensible way forward. This, broadly speaking, can be said to have been the prevailing view among respondents. However, arguments were also made both for and against giving favourable treatment to particular groups. The merits of these points of view are explored in the following chapters.

28 See page 396 of Equitable Life: a decade of regulatory failure, Part One: main report, the Parliamentary and Health Service Ombudsman, 16 July 2008.
29 Ibid., p 39.

4: Fair allocation of the available quantum

The Commission's approach

4.1 Before considering the merits of the various representations made to the Commission, both on the case for giving special treatment to particular groups of policyholders and on the inclusion of particular features in the Payments Scheme (such as caps), it is relevant to set out the four considerations that the Commission has applied in forming its judgements on a fair allocation.

4.2 The first is that all cases for favourable treatment, or the inclusion of particular features, should be measured against a 'base case' of a *pro rata* allocation, which would be 22.4 per cent of Relative Loss.[30] This is because *pro rata* is widely considered to be the most naturally fair allocation; it should therefore be used as the benchmark against which to measure the effects of giving one or more groups differential treatment in allocation.

4.3 The second consideration is that, where – as in this case – the amount available for distribution is a fixed sum, giving favourable treatment to one group of policyholders, by paying them more, automatically puts others at a disadvantage compared with the position in which they would have been under a simple *pro rata* allocation. Therefore, in deciding whether to give favourable treatment to one group, the Commission must determine whether there are any factors *apart from the size of individual policyholders' Relative Loss itself* that are sufficiently strong to justify others receiving less than a *pro rata* share.

4.4 The third consideration concerns the rationale that is required to justify any differential treatment. In the Commission's view, proposals should be considered in the context of there needing to be clear evidence that at least one of the following two conditions is met: that a particular group of policyholders has been hit demonstrably harder than others by accepted Government maladministration; or that it is demonstrably in greater need of additional payment. On the matter of those hit harder by accepted Government maladministration, there would have to be sound evidence that the circumstances faced by a particular group of policyholders were such that, through no fault or deliberate action on their own part, they were exposed to more 'unfair' outcomes than other investors (again, beyond the size of Relative

30 *Pro Rata* in this context means that the 775 million quantum is distributed to policyholders in direct proportion to their Relative Losses.

Losses suffered, which is automatically taken into account by the Methodology). On the question of greater need, the Commission has considered views expressed or implied by respondents that some policyholders may be able to cope with their losses better than others.

4.5 The fourth consideration concerns the impact that the Commission's recommendations on allocation will have on the complexity and practicality of the Payments Scheme. The Commission has sought advice from HM Treasury[31] on the practical constraints to which it should have regard. It has sought to avoid recommending a method of allocation that involves excessively complex calculations or other features and believes that, in considering any departure from a *pro rata* allocation, the impact on the Payment Scheme's complexity and transparency to policyholders is an important factor to be taken into account. The Commission has heard a clear message from many respondents that the allocation it recommends should be both simple and clear to all those affected and that complexity in itself can be an enemy of fairness.

4.6 These considerations represent tests that the Commission has applied, where they are relevant, to different options in deciding whether to recommend them.

A single policyholder view

4.7 Respondents to the discussion paper who addressed the matter were broadly supportive of taking a single policyholder view, meaning offsetting Relative Gains against Relative Losses where a policyholder holds multiple policies.

4.8 The Commission notes the argument that taking this approach could be unfair, insofar as investors may have spread their investments across a number of different policies in order to hedge risks. However, the Commission takes the view that, since Equitable Life has a single with-profits fund, it does not make sense to consider the purchase of several policies within the fund as diversified investments.

4.9 Under the Methodology, offsetting losses and gains, both within and between policy classes, is included in the final Relative Loss calculation. The Commission endorses this, and recommends that offsetting at policyholder level be applied wherever practicable. This includes offsetting any Relative Gains made on with-profits annuity policies against Relative Losses on other policies held by the same policyholder. To do otherwise would be unfair to policyholders who have suffered Relative Losses only.

31 See the letter from Mr Mike Williams, Director of Business and Indirect Tax at HM Treasury, 13 January 2011. This is shown at Annex C.

4.10 The Commission recognises, however, that such offsetting may not be possible or practicable in all cases, and has had regard to the HM Treasury's comments on the matter, namely that:

- due to data limitations, it is not possible to offset losses or gains on Group Pension policies against losses or gains from policies in other classes, or against losses or gains from policies held by the same policyholder across different Group schemes; and

- there are situations where the policyholder is not the ultimate beneficiary of the policy and therefore potentially not the rightful recipient of Payments Scheme funds. A beneficiary may find that some or all of their losses have been offset by gains that in fact accrued to a different beneficiary. However, to apply offsetting rigorously at a beneficiary level (as opposed to a policyholder level) would significantly delay the commencement of payments.[32]

4.11 There is therefore, in the light of practicalities, a choice to be made between avoiding offsetting completely and offsetting at the policyholder level despite an unfairness that may occur in some cases. Assuming that the number of such cases is relatively small, the Commission would recommend that offsetting be applied where it is practicable to do so, because it considers that this would lead to a fairer outcome overall than not offsetting at all.

Groups that the Commission has considered for special treatment

4.12 Based largely on the responses received to its discussion paper, and the contributions made by Sir John Chadwick and EMAG among others, the Commission has considered the case for giving differential treatment to the following groups in allocating payments:

- Holders of non-GAR policies vis à vis holders of GAR policies;

- Those in different age groups;

- Those in different policy classes;

- Those who have the greatest need, or vulnerability to losses;

- Overseas policyholders;

- Those who have already received compensation;

32 See letter from Mr Mike Williams, 13 January 2011.

- Holders of Income Drawdown policies;
- Late-joiners; and
- Sufferers of Money Loss.

Holders of non-GAR policies vis à vis holders of GAR policies

4.13 The guarantees offered by Equitable Life in respect of GAR policies were more generous than standard market practice. As a result of Equitable Life's policy terms, policyholders had significant flexibility on when they could retire and benefit from the guarantee. In addition, Equitable Life's recurring single premium policies were unusual in that policyholders could continue to contribute to pensions policies which had a GAR option with no constraints on the level of contributions that could be made, or on when they could be made. During the 1990s, interest rates fell and expectations of future mortality rates reduced. Together, these factors meant that annuity rates available in the market fell, and the GAR policy guarantees became increasingly valuable to those policyholders who had them. However, the guarantees began to have a detrimental effect on the Society's balance sheet. Following the House of Lords ruling on the Hyman case in 2000, which prevented the proposed internal solution to the problems Equitable Life faced,[33] the Society effected the Compromise Scheme between holders of GAR and non-GAR policies.

4.14 The Commission has considered the view that it would be unfair to give equivalent treatment to policyholders with GARs as to policyholders without them, in the context of limited funds being available to cover Relative Losses. Some respondents went further and suggested that policyholders with GARs be excluded from receiving payments altogether. They came to this view, in part, because of the large uplift that holders of GAR policies received to their policy values at the time of the Compromise Scheme.

4.15 More specifically, some respondents have asserted that, following the House of Lords ruling referred to above, an 'unfair' transfer of funds[34] from non-GAR to GAR policyholders occurred. This transfer took place because Equitable Life sought to reduce the increasing liabilities it faced in relation to GAR policies through the Compromise Scheme, in which policyholders voted for a settlement.

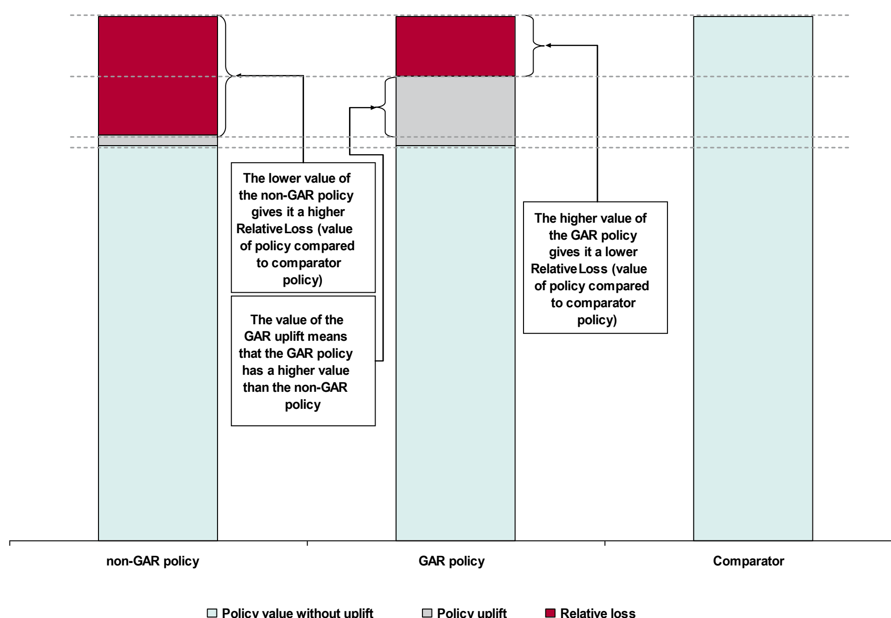
33 See footnote 24 on the Differential Terminal Bonus Policy for further information.
34 As Equitable Life is a mutual, the cost of the GAR Compromise Scheme had to be borne largely by its members. Equitable Life did raise £500 million from the sale of its non-profit, unit linked business and its sales force to the Halifax, which became effective in March 2001. An additional £250 million was made available, conditional on the Compromise Scheme being agreed. These funds contributed towards the cost of the Compromise Scheme, and would not have been available in a comparator company.

This gave holders of GAR policies an average uplift of 17.5 per cent to their policy values in exchange for giving up their rights to GAR benefits, while holders of non-GAR policies received an average uplift of 2.5 per cent for the waiver of any GAR-related claims against Equitable Life. To the extent that this view reflects dissatisfaction with a House of Lords decision, the Commission does not believe that it is appropriate to take account of it in its considerations.

4.16 In agreeing to the Compromise Scheme, GAR policyholders were giving up something more valuable than they would have had, were they to have instead invested in a comparator company. The Methodology does not therefore include the impact of uplifts received as part of the GAR Compromise Scheme in the calculation of the comparator payment. Similarly, non-GAR policyholders would not have received the uplifts that they did receive, had they invested in a comparator company, and these are also excluded from the calculation of the comparator payout. Since the comparator takes no account of uplifts, the effect is that Relative Loss is reduced by the value of any uplift received, whether on GAR or non-GAR policies. This is illustrated in Figure 4.1 below.

4.17 The Commission has concluded that the Methodology already accounts properly for these differential uplifts.

Figure 4.1: Impact of the Compromise Scheme on Relative Losses under the Methodology



Source: Towers Watson.

Age

4.18 Some respondents have suggested that the Commission should take age into consideration in its recommendations on allocation. This section sets out the Commission's reasons as to why it does not feel there is a strong case for recommending differential treatment for those in different age bands.

4.19 Table 4.1 below (which shows Relative Loss by age band) does not show evidence of any age band having experienced disproportionately larger Relative Losses. It shows that younger policyholders are more likely to have suffered Relative Losses, although these are, on average, smaller than those suffered by policyholders in the higher age bands. Towers Watson has informed the Commission that the larger average losses suffered by older policyholders reflect the fact that they generally have larger policy values, which may be attributable to a longer period of making premium payments as compared with younger policyholders. In any event, the size of Relative Losses is reflected in the Methodology, so that, all else being equal, those with larger Relative Losses will receive larger payments.

Table 4.1: Relative Loss by Age Band

Age	Number	% of all policy-holders with a loss	Loss (£m)	Average loss (£)
<40	102,582	82%	76.4	745
40 - 44	127,100	83%	148.4	1,168
45 - 49	149,446	80%	261.7	1,751
50 - 54	142,011	80%	340.2	2,395
55 - 59	142,947	77%	425.3	2,975
60 - 64	155,354	71%	584.8	3,764
65 - 69	103,585	61%	515.7	4,978
70 - 74	55,015	47%	431.8	7,849
75 - 79	23,336	39%	306.7	13,142
80 - 84	9,822	50%	121.4	12,355
85 - 90	2,910	45%	32.0	10,984
>=90	1,322	58%	19.1	14,417
Deceased	12,610	49%	55.3	4,385
Unknown Age	18,252	60%	140.1	7,677
Total	1,046,292	71%	3,458.7	3,306

Source: Towers Watson.

4.20 The case for favourable treatment of any age bands would, therefore, have to be made on the basis of a related need or of exposure to particularly unfair outcomes. The Commission has not been presented with a strong argument to support either conclusion. Arguments put forward by respondents have, directly or indirectly, supported special treatment for a number of different age groups.

It has been argued that those in the highest age bands may be in greater need since they would have had least opportunity to mitigate their losses and may also be more vulnerable. EMAG has maintained that many of its members will have invested in pension schemes in the years before maturity and will therefore have been subjected to heavy losses when the policy value cuts occurred.[35] They, it is argued, would now be mostly in their 60s and 70s. Towers Watson's analysis also suggests that late-joiners, who some respondents contended were hit harder by the policy value cuts, would tend to fall into younger age bands (see paragraph 4.44 to 4.47 below on late-joiners).

4.21 The Commission therefore believes that there is no strong case for any particular age group to receive favourable treatment over another in the allocation of limited funds.

Policy class

4.22 The Commission received a small number of representations recommending differential treatment on the basis of policy class.[36] It has not received sound evidence that could support favouring any one policy class at the expense of others. It appears that, in the absence of supporting data, such treatment would require the Commission to make a generalised judgement about individual circumstances, hardships faced, or unfair outcomes experienced by a large number of policyholders in one or more policy class.

4.23 As Table 4.2 below illustrates, average losses are significantly higher for individual policies than for Group Pension policies. However, this reflects the fact that individual (i.e. AWP and CWP) policy values are, on average, significantly higher.

Table 4.2: Relative Loss by Policy Class

	Number of policyholders with a Relative Loss	Total Relative Loss (£m)	Average Relative Loss (£)	Average Policy Value (£)
Individual (AWP & CWP)	**460,193**	**2,622.8**	**5,699**	**54,227**
Group Pension	**586,099**	**835.9**	**1,426**	**12,149**
Total	1,046,292	3,458.7	3,306	30,657

Source: Towers Watson.

35 See EMAG, 3 December 2010.

36 The three classes that fall within the Commission's remit are AWP, CWP and Group Pension policies. See the Glossary in Annex H for further information.

4.24 A case has been put forward that members of Group schemes should be considered less deserving than holders of individual policies on the basis that payments would be less significant to them, either in absolute terms or as a proportion of their total pension arrangements, and that those who have suffered Relative Losses have probably not noticed them. However, the Commission does not believe that it has sufficient evidence to conclude that the 586,000 policies with Relative Losses in Group schemes fit this assumed profile. As a counter-example, some people who have not been members of occupational pension schemes during their working lives, but have joined one later in their careers, may have sought to build up their pensions through AVCs and may therefore find their losses of similar or greater significance than many individual policyholders. The NAPF has argued that many people who experience a mixture of employment and self-employment, or those on low earnings and hence with a need to top up their policies, may fall into this category.

4.25 Another respondent suggested that Group scheme policyholders were in effect 'trapped' in the same way as with-profits annuitants. The Commission notes that there may in some cases be material obstacles to transferring AVCs out of a trustee scheme (for example if this would require the individual to terminate their pension arrangement within the Group scheme, hence possibly losing a significant benefit), with the result that losses on these AVCs could, potentially, have been difficult to avoid.

4.26 On balance, however, the Commission has not seen any sound evidence to lead it to the conclusion that valid generalisations can be made about the circumstances faced, or unduly unfair outcomes suffered, by members of Group schemes or in any other policy class.

Proxies for need and vulnerability to losses

4.27 A number of representations have included arguments for special treatment that are, in part at least, underpinned by a view that payments should be directed towards those policyholders who need them most (or conversely, away from those who need them least). The issue of need is a difficult one for the Commission to address, since its Terms of Reference rule out means testing. Thus any assessment of whether one group is more or less needy than another (for example where losses or circumstances have caused greater hardship) would have to be made on broad assumptions about the individual circumstances of the policyholders within the group. The Commission does not believe that such a case can be made for any of the groups mentioned in responses. Even where there is very good reason to feel sympathy towards policyholders because of their particular circumstances, for example those who are likely to have limited capacity to mitigate their losses, it would not be possible to target them with any accuracy on the basis of the data available to the Commission.

4.28 The Commission has investigated whether there are any other characteristics, for which data exists, of individuals' losses that could serve as an accurate proxy for need. However, data on policyholders is limited to information on policy premiums and proceeds, and basic personal detail such as age. The Commission has considered whether one such proxy might be *Relative Losses as a proportion of policy value*, on the basis that policyholders whose loss represents only a small proportion of their policy value may derive less utility from payments than those for whom it is a large proportion.

4.29 The Commission therefore explored the option of tilting payments away from those whose loss is small in relation to their policy value (see Table 4 in Annex F). By way of example, the Commission considered the impact of giving no payment to those policyholders with a ratio of Relative Loss to policy value of 10 per cent or less. This would mean almost 182,000 policyholders receiving nothing, while around £72 million would be freed up for redistribution to other policyholders who would then receive, on average, 24.5 per cent per cent of Relative Losses (as compared with 22.4 per cent under a *pro rata* allocation).

4.30 The Commission feels that such redistribution could create a significant unfairness for a large number of policyholders, including some with large Relative Losses, without significantly benefiting others. Redistributing in this way would also lead to greater complexity. Finally, the Commission has not seen evidence to conclude that the losers under this approach would be less deserving than the gainers.

4.31 In conclusion, the Commission does not feel that the data available to it provides any reliable basis upon which it could make an assessment of policyholders' need or of their ability to bear their losses.

Overseas policyholders

4.32 The Commission has received a small number of responses about the treatment of overseas policyholders. There are approximately 24,000 policyholders with Relative Loss who purchased their policies abroad, while others are now based overseas.[37]

4.33 The Commission does not see any substantive differences, in terms of greater need or exposure to unfair outcomes as a result of accepted Government maladministration, between policyholders who live in the UK and those who live abroad (apart potentially from taxation implications, which fall outside the Commission's remit), or between those who purchased their policies in the UK and those who purchased them abroad. One respondent argued that those who purchased policies abroad were misled, in that they were given to believe their

37 See Towers Watson, 20 January 2011.

premiums would be ring-fenced from the rest of the mutual fund. If this were the case, it would be the result of misleading sales information rather than of accepted Government maladministration, and would not therefore fall within the Commission's remit. The individuals affected would need to have followed the redress procedure for mis-selling if they had wished to pursue such claims.

4.34 Another argument put forward is that, in contrast to UK-based policyholders, overseas policyholders should receive payment of their full Relative Losses because UK public purse considerations should not apply to them. The Commission's role is to recommend a fair allocation of the £775 million quantum announced by the Government between policyholders who have suffered Relative Losses. The decision to apply public purse considerations in setting the quantum was made by the Government and is not a matter for the Commission.

Policyholders who have already received compensation

4.35 The Commission is aware that there have been a number of compensation schemes relating to Equitable Life policies. It has discussed them with Towers Watson and Equitable Life, and has sought clarification on how payments made under such schemes are treated in the Methodology. From a perspective of fairness, the Commission is concerned to ensure that:

- any policyholders who received compensation for reasons of accepted Government maladministration (as opposed to, for example, mis-selling) should have the amounts in question offset against their Relative Loss; and

- policyholders who have been previously compensated for reasons other than accepted Government maladministration should not see their entitlement to payments diminished as a result. Indeed some compensation payments, insofar as they took the form of an *uplift to the recipient's policy value* (as opposed to being made as cash payments), can themselves be considered as having been subject to loss as a result of accepted Government maladministration in the same way as premium payments, thus serving to *increase* the policyholder's Relative Losses. In other cases the compensation payments may reduce Relative Losses.[38]

4.36 From its discussions with Equitable Life and Towers Watson, the Commission has been informed that Equitable Life did not make any compensation payments in relation to Government maladministration. The Commission does not therefore need to consider the first point further.

38 In cases where compensation is categorised as deferred proceeds from the policy itself, or where it has been paid to compensate for shortfalls in administration or errors in the calculation of the benefit, the Methodology includes it in amounts receivable from Equitable Life. This means that it will commensurately reduce Relative Losses.

4.37 The Commission is satisfied that the second point has been addressed in the Methodology in respect of all compensation scheme payments on which Towers Watson has been able to obtain the relevant data.[39] It should be noted, however, that other compensation schemes are known to have existed, some of which, respondents have told the Commission, are subject to confidentiality agreements. Details of these are therefore not available to the Commission or the Government, so it is not possible to include them in the Relative Loss calculations. For this reason, the Commission accepts that the Government will be limited in its ability to account for all previous compensation schemes according to these principles in the allocation of payments.

4.38 However, should more information about such payments become available after this Advice is published, the Commission recommends that the Government applies the principles set out here in reflecting them in Relative Loss calculations, as far as is practically possible and if excessive additional complexity can be avoided.

Income Drawdown policies

4.39 As indicated in Chapter 3, some respondents have argued that holders of Income Drawdown policies[40] were hit particularly hard by the policy value cuts, as they may have been more vulnerable to financial losses and hardship.

4.40 When exploring the scale of financial losses suffered, the Commission noted that Income Drawdown policies tended, when compared with other policies, to be larger in size; purchased later (sales peaked between 1995 and 1998);[41] and sold without the same guarantees as were present in other policies, particularly when compared with policies purchased earlier in the 1990s and before. As a result, they may have been more likely than others to suffer high Relative Losses. However, these higher Relative Losses will have been reflected in the Methodology.

4.41 Having analysed a number of representations submitted by individuals, the Commission believes that the true source of the grievance felt by many with Income Drawdown policies may not have been that they were more exposed than others to *Relative* Losses (i.e. where their returns were particularly poor compared with what would have been received in a comparator firm), but rather that they were more likely to have made a *Money* Loss. The Commission would argue that it is the fact they made a Money Loss, rather than that they held an Income Drawdown policy, that would merit consideration for special treatment. Money Loss is explored in more detail later in the chapter.

39 The Commission has received this data in confidence from Towers Watson.

40 Equitable Life referred to its Income Drawdown policies as ‘Managed Annuity policies’.

41 For further information see Towers Watson, 20 January 2011.

4.42 On the question of circumstances – including hardship – that holders of Income Drawdown policies may have faced, the Commission notes the view expressed that parallels can be drawn with with-profits annuitants. EMAG has argued that both sets of policyholders are of about the same age, so their capacity to mitigate losses may be limited. As Income Drawdown policies are clear alternatives to annuities, it seems reasonable to assume that the impact of the cuts on policyholders' pension savings may be equally damaging for both groups, all else being equal. However, as acknowledged by EMAG and others, holders of Income Drawdown policies were not trapped in the same way as with-profits annuitants, in that they had the option of transferring their policy to another insurance company, or of using the policy to purchase a conventional annuity.[42]

4.43 The Commission believes that it would therefore be difficult, in the context of a limited quantum, to argue that holders of Income Drawdown policies should receive a larger share to the detriment of others. If, for example, the greater age of these policyholders were held up as a critical factor, then older holders of all policies should arguably be given special treatment. Similarly, if it is the size of their Relative Losses or the fact that they have made Money Losses that is considered instrumental, then special treatment should be given to all other policyholders who have suffered for these particular reasons, rather than just those with Income Drawdown policies.

Late-joiners

4.44 As set out in Chapter 3, a number of respondents have argued that those who joined Equitable Life in the late 1990s and thereafter should be considered for favourable treatment. The Commission believes that this argument is informed by two perceptions. The first is that Equitable Life would have been unlikely to take on new business if it had been appropriately regulated. The second is that late-joiners may have been subject to particularly unfair outcomes, since they were investing close to the point when the policy value cuts occurred and would therefore have been harder hit than others because they would not have benefited from bonuses accumulated in earlier years.

4.45 On the first question, the Commission does have sympathy with the argument that, had Equitable Life been subject to appropriate regulation, the precarious situation in which it found itself by the end of the 1990s may well have been clearer to a number of these investors. On the question of whether particularly unfair outcomes were suffered by late joiners, the Commission has analysed data provided by Towers Watson. Table 4.3 below shows that, while, for example, those who joined after 1997 were more likely to suffer Relative Losses, these were not necessarily larger than for those who joined in earlier years. However as with Income Drawdown, it was suggested (both implicitly and explicitly) that late-

42 See EMAG, 3 December 2010.

joiners were more prone to suffering Money Losses. Data from Towers Watson supports this.[43]

Table 4.3: Individual policy (AWP and CWP) and Group Pension Relative Losses by entry year

	Individual policies (AWP and CWP)			Group Pension				
Entry Year	Loss (£m)	Number of policy-holders	Average Relative Loss (£)	Loss (£m)	Number of policy-holders	Average Relative Loss (£)	Proportion of policy-holders	Average policy size (£)
before 1987	685.2	56,914	12,040	18.2	12,488	1,456	44.2%	79,454
1987	79.7	10,558	7,551	10.0	6,570	1,519	43.7%	38,144
1988	153.0	25,545	5,989	30.5	23,229	1,314	46.9%	23,473
1989	228.6	46,484	4,918	38.0	23,056	1,648	60.0%	22,738
1990	133.7	21,221	6,298	39.8	23,218	1,712	54.4%	21,537
1991	149.0	21,725	6,857	42.4	26,878	1,577	57.6%	19,805
1992	190.1	24,473	7,768	147.5	32,599	4,524	70.3%	21,070
1993	172.1	22,421	7,675	147.4	40,110	3,674	80.4%	17,329
1994	140.6	21,417	6,567	69.9	41,348	1,691	79.8%	13,812
1995	155.6	24,302	6,402	71.3	49,075	1,452	83.4%	12,896
1996	178.9	31,601	5,660	76.2	61,613	1,237	85.1%	12,331
1997	159.4	38,251	4,168	64.3	70,755	909	85.4%	8,993
1998	105.8	35,408	2,988	43.9	65,968	666	84.9%	7,477
1999	66.1	50,118	1,318	27.1	61,369	442	86.9%	4,875
2000	25.1	29,755	845	9.5	47,823	198	86.9%	3,551
Total	2,622.8	460,193	5,699	835.9	586,099	1,426	70.6%	21,648

Source: Towers Watson.

4.46 On balance, the Commission does not feel there is a justifiable case for benefiting late-joiners as a group, for similar reasons to those for which it does not recommend special treatment for people in particular age groups or Income Drawdown policyholders. First, if they had suffered greater Relative Losses than others, this would in any event be reflected in the Methodology. Second, it would create an arbitrary distinction between late *joiners* (i.e. those who took out new policies) and late *contributors* (those who took out policies earlier, but continued to pay premiums in the late 1990s and beyond). Third, an arbitrary decision would be required on a precise date after which anyone who joined would be entitled to a greater proportion of their Relative Losses than someone who joined before it. The Commission has not seen a persuasive argument in favour of a particular date. Even if one were found, the Commission does not believe that those who joined the Society, say, one day or one week before this date should be

43 See Table 7 in Annex F.

disadvantaged, without a compelling reason, compared with those who joined on or after it.

4.47 The Commission does not, therefore, recommend giving favourable treatment to late joiners. As with Income Drawdown, many of the arguments made in support of such treatment implied that Money Loss was the real cause of grievance.

Money Losses

4.48 Of all the groups that respondents have proposed as deserving of special treatment, the Commission has the greatest sympathy for those who suffered Money Losses, that is to say those who found that the *amount received or receivable on their Equitable Life policy was below the amount invested*.

4.49 The Commission believes that there are a number of strong arguments both for and against giving favourable treatment to that part of Relative Loss that is represented by Money Loss. The Commission notes that Sir John Chadwick also identified Money Loss as a cause of *disproportionate impact*.

4.50 Towers Watson has advised the Commission that approximately 266,000 of those policyholders with Relative Losses also incurred Money Losses, almost all of whom, it is believed, exited Equitable Life non-contractually.[44] As already described, this is likely to have been at the heart of the grievance felt by many of those who argued that late-joiners and holders of Income Drawdown policies should receive favourable treatment. The Commission has identified two causes of Money Loss.

4.51 The first is that policyholders who left non-contractually may have been subjected to a Market Value Adjuster (MVA), which modifies the level of payment to a "fair value" based on the assets supporting the policy. Importantly, in the early 2000s, equity markets fell significantly and many with-profits funds (which are partially invested in equities) experienced negative returns. Consequently, it is likely that such policies would have suffered reductions in value over this period, which led many companies (including Equitable Life) to apply significant MVAs. Policyholders who exited contractually were not subjected to MVAs.[45]

44 Non-contractual exit refers to the situation where a policyholder chooses to 'cancel' their policy before its maturity date. It is not believed that any policyholders who left contractually (i.e. when their policy matured) made a Money Loss, apart from in very exceptional circumstances.
45 However, it should be noted that those who remained with the Society may have seen their annual policy values reduce to fall into line with the value of underlying assets in the medium- to long-term.

4.52 The second cause of Money Loss is that those who exited non-contractually were more exposed to the impact of the policy value cuts in the early 2000s, since policy guarantees did not apply to those who exited in this way.

4.53 Where the amount of a cut was larger than the value of the accrued final bonus on a policy, the guaranteed fund was not affected, but rather, any excess in the amount of the cut over the accrued final bonus was recorded as a 'negative final bonus'. If a policyholder subsequently exited in accordance with their contractual terms, they would receive their full guaranteed policy value. Any negative final bonus that had accrued would not affect their payment, and would therefore not cause a Money Loss other than in very exceptional circumstances.

4.54 However, in the case of investors who accrued a negative final bonus and then decided to exit non-contractually, the payment received would have borne the full impact of the policy value cuts since a policyholder leaving non-contractually would suffer the full negative final bonus (as well as the effect of any applicable MVA). The effect was potentially to reduce the value of their policies to below the total amount invested, thereby giving rise to a Money Loss.

4.55 Of these cause of Money Losses, the Commission has treated the second (policy value cuts), as well as any part of the MVA over and above what would be applied by comparator companies, as relevant to its remit.

4.56 The Commission believes that there are two arguments that may work in support of giving favourable treatment for Money Loss. The first is whether it is reasonable for investors in with-profits products to expect that they would, at the very least, receive back the amount they invested, when they leave contractually. Based on its understanding of the assurance market, the Commission believes that this is, in the vast majority of cases, a reasonable assumption. Especially for AWP policies, the guaranteed value of the fund will initially be at least as great as the initial investment (although some reduction may be made to allow for initial expenses). If a policyholder takes out a policy and exits contractually, they would receive at least the amount of the guaranteed fund.[46]

4.57 The second argument is that it may be reasonable to assume that all policyholders who left Equitable Life non-contractually were, *de facto*, forced out. The Commission cannot make a definitive judgement on this, as it does not have access to information underpinning the decisions made by each policyholder at the time, and it accepts that differing perceptions and personal circumstances may have led to different individual decisions on whether to stay or leave. It could be, for example, that it was those with greater financial

46 For CWP policies, whether a policyholder expects to receive at least the value of the initial investment will depend on the policy structure. CWP policies are intended to provide mortality cover (rather than just acting as a savings vehicle, which is the purpose of AWP policies).

awareness, or access to more sophisticated advice, who felt more inclined to leave. However, the Commission recognises that, by the time of the policy value cuts, the extent of the regulatory failure would have been widely known, which could have led to uncertainty in the minds of policyholders about how to act. Furthermore, Towers Watson has informed the Commission that financial advisors were reluctant to provide advice to Equitable Life policyholders from the late 1990s onwards due to the complexity of the issues involved.

4.58 The Commission therefore believes that there are good reasons for giving favourable treatment to sufferers of Money Loss, including that it would go to the root of cases put forward by many about late-joiners and holders of Income Drawdown policies.

4.59 However, the Commission has identified three arguments against giving such treatment. First, in the responses that the Commission received, explicit support for favouring those who have suffered Money Losses came only from a very small minority, although it could be said that all those who referred to having received less than they put in were implicitly expressing support for it.

4.60 Second, as illustrated in Table 6 in Annex F, the total Money Loss of policyholders who suffered Relative Loss amounts to £190 million, or 24 per cent of the available £775 million quantum for allocation. Thus, a decision to pay out Money Losses in full would see the *pro rata* allocation available to the 780,000[47] policyholders without Money Losses reduced by 20 per cent, leaving them to receive only 17.9 per cent of their Relative Losses, compared with 22.4 percent on a *pro rata* basis. It would also materially redistribute funds away from those who remained with Equitable Life (or who left contractually after the policy value cuts) towards those who exited non-contractually. The evidence supporting the case that those who left non-contractually were forced out is not sufficiently strong, in the Commission's view, to justify imposing such a large monetary reduction on the other policyholders.

4.61 Third, having explored the matter thoroughly, the Commission concluded that giving favourable treatment for Money Losses would introduce considerable additional complexity to the Payments Scheme. The additional calculations that would be required could raise a number of anomalies that would need to be resolved; based on the advice received from Towers Watson, the Commission also feels that it would become significantly more difficult to communicate loss calculations to individual policyholders.

4.62 Because of the unacceptably large impact that giving favourable treatment for Money Loss would have on other policyholders, the Commission explored an option of applying it to less than a full 100 per cent of Money Loss. It asked

47 This would be subject to change if a *de minimis* were applied.

Towers Watson to advise on the effect that this would have on individual calculations.[48] The Commission concluded that the level of complexity involved, and the challenge of communicating how payments had been arrived at, would increase substantially under such an option. Moreover, selecting a level lower than 100 per cent would lead to the further difficulty of having to make an arbitrary judgement as to where to pitch it.

4.63 In summary, the Commission's view is that there are a number of arguments in support of giving favourable treatment to sufferers of Money Losses. However the extent of unfairness that this could impose on the 75 per cent of policyholders who have Relative Losses but no Money Losses, in addition to the extra complexity that would be introduced, are strong arguments against it. The Commission therefore does not, on balance, recommend giving favourable treatment to those who have suffered Money Losses.

Features the Commission has considered to ensure that individual losses are fairly translated into payments

4.64 The Commission received a number of responses to the question of whether there is a case for particular features to translate individual losses into a fair allocation system. It has considered the merits of including the following:

- a cap on any individual's payment;
- a *de minimis* level below which payments should not be made to a policyholder; and
- a percentage step (see paragraph 4.77) in payments, which could also include sliding scales.

A cap on any individual's payment

4.65 As the effect of a cap would be to redistribute funding from those with larger losses to those with smaller losses, it would need to be justified on the basis that the former were in a sense less deserving of their full *pro rata* share of Relative Losses (for example on the basis that they needed it less, or had been hit less hard by accepted Government maladministration). As explained earlier, the Commission does not believe that it has sufficient knowledge of individual policyholders' circumstances to determine that those with larger losses will find their payment under the Payments Scheme less significant to their financial wellbeing, or that they have in some sense experienced a less unfair outcome as a result of maladministration than those with smaller losses. Some respondents

48 See Towers Watson, 20 January 2011.

have also pointed out that a cap would penalise people with a single large policy with Equitable Life, as compared with those who may have several smaller policies with a range of providers and therefore be in a better position to bear their losses.

4.66 The other major consideration for the Commission is the materiality of the difference that this redistribution would make to gainers and losers respectively. The Commission has investigated whether it is possible to tilt funding in such a way that it has only a minimal impact on the losers at the top while giving a meaningful boost to those in the middle or at the bottom of the loss range. The options that the Commission has explored are summarised in Table 4.4 below.

Table 4.4: Different caps on payments made to any individual policyholder (on *pro rata* allocation)[49]

Cap (£)[1]	No. of policyholders who lose	Average % cut to losers' *pro rata* payment	No. of policyholders who gain	*Pro rata* factor before cap is applied	*Pro rata* factor after cap is applied	Resultant increase in payments to these policyholders (%)
75,000	200	70	1,046,092	22.4	23.4	4.5
50,000	425	67	1,045,867	22.4	23.6	5.5
21,431	2,654	58	1,043,638	22.4	24.6	10.0
10,585	10,908	57	1,035,384	22.4	26.9	20.0
7,268	21,644	60	1,024,648	22.4	29.1	30.0

1 Note that this is cap per policyholder (as opposed to policy) where known. The caps set out in the last three rows of this table have been selected to illustrate the level needed to give those beneath it a 10, 20, and 30 per cent 'uplift' on their *pro rata* allocation.

Source: Towers Watson.

4.67 The table shows that, in order to make what the Commission would consider to be a material difference to those in the middle or at the bottom of the losses scale, the cap would have to be brought down to around £20,000 or lower. A higher cap would be largely symbolic since it would bring little benefit to those below it, while still potentially causing hardship to some above it (for example if it were the sole policy in which they had saved for retirement). On the other hand, in order to make a material difference to those beneath it, a cap would need to be set at a level that is, in the Commission's eyes, unacceptable because it

49 The impact of the cap has been modelled using *pro rata* allocation. This is potentially more meaningful than applying the cap to full Relative Loss, as there is a close relationship between a *pro rata* allocation and actual average payments that will be made to individuals in the context of the limited quantum.

would result in a significant redistribution away from a number of policyholders with larger losses.

4.68 Taking these considerations into account, the Commission does not recommend a cap on payments. It notes the view put to it that there may be wider public policy reasons for viewing a cap as desirable, for example, on the grounds that paying what might be seen as excessively large sums of public money to a small number of individuals would simply be wrong in principle. However, the Commission believes that this is a consideration outside its remit. The Commission also notes that there will be no cap on payments to with-profits annuitants.

A *de minimis* level of loss below which payments should not be made

4.69 A number of respondents have said that a *de minimis* is desirable, broadly on the grounds that smaller losses are likely to be less significant to individual policyholders than larger losses. Other respondents opposed a *de minimis* because of the arbitrariness of the decision that the Commission would have to make about the minimum level of payment. A *de minimis* would have the opposite effect of a cap, in that it would redistribute funds away from those with smaller losses and towards those with larger ones. The Commission does not believe there is sufficient justification for redistributing funds away from those with smaller losses simply on the grounds that they would see them as insignificant.

4.70 The Commission explored a number of different *de minimis* levels, in order to assess whether it would be possible to make a material difference to those with greater losses while avoiding excessive impact on those with smaller losses. These are summarised in Table 4.5 below.

Table 4.5: Different *de minimis* levels on payments (on *pro rata* allocation)

De minimis (£)	No. of policyholders with Relative Losses who receive no payment	% of total policyholders with Relative Loss who would receive no payment	No. of policyholders who continue to receive payment	*Pro rata* factor before *de minimis* is applied	*Pro rata* factor after *de minimis* is applied	Resultant increase in payments to these policyholders (%)
None	0	0	1,046,292	22.4	22.4	0
1	16,414	2	1,029,878	22.4	22.4	Negligible
10	101,268	10	945,024	22.4	22.4	Negligible
50	307,251	29	739,041	22.4	22.6	<1
100	438,831	42	607,461	22.4	25.9	2.0
500	751,134	72	295,158	22.4	25.2	12.6
2000	931,227	89	115,065	22.4	31.9	42.2

Source: Towers Watson.

4.71 The table shows that a *de minimis* would have to be very high to have a significant positive effect on those who losses lay above it. For example, a *de minimis* of £500 on *pro rata* would result in as many as 72 per cent of policyholders with Relative Loss receiving no payment; while the remaining 28 per cent of policyholders would see their payment increase only modestly from 22.4 per cent to 25.2 per cent of their total Relative Losses.

4.72 Additionally, from a perspective of fairness, the Commission recognises that even a relatively small amount could be seen as significant by many individuals (some of whom are evidently in hardship). It would require an arbitrary assumption about individuals' circumstances to pick a *de minimis* level beneath which the loss of payments could be said to be of no consequence. Any such level would probably be well below that required to permit a redistribution of payments that would make a material difference to those with greater losses.

4.73 While the Commission notes that questions of administration costs and of fairness to taxpayers do not fall expressly within its remit, it has been asked to have regard to practicalities. It also believes that it should have regard to the proportionality of its recommendations. Therefore, notwithstanding the points made above, it has considered the case for avoiding very small payments where the administrative costs of disbursing them would be disproportionately large. In its letter on practicalities, HM Treasury has informed the Commission that the average cost of making a payment to a person with an individual policy will be in the region of £10, and is likely to be greater than this for those in Group schemes and for estates of deceased policyholders that have already closed.[50]

50 See Annex C.

4.74 The Commission has therefore considered the case for setting a *de minimis* of £10. Table 4.5 shows that this would cause more than 100,000 policyholders, who would be due payments of £10 or less under a *pro rata* allocation, to receive no payment.

4.75 The Commission recommends that a *de minimis* in the region of £10 be included in the Payments Scheme on account of the disproportionate administrative costs that would be incurred in making smaller payments. The Commission believes that, while some may feel affronted by payments of between £10 and, for example, £50, others may feel that they would be worthwhile receiving. It believes this level would be sufficiently low that it would not impose hardship on those who would receive nothing.

4.76 In the light of the advice received from HM Treasury, the Commission recognises that costs of administering payments to members of Group schemes and to estates of deceased policyholders may justify a higher *de minimis* in those cases.

A percentage step in payments, which could also include sliding scales

4.77 A percentage step in payments,[51] either with or without a sliding scale, would in principle produce a similar effect to applying a cap. It would redistribute funding away from those with higher losses to those with lower ones. The same fairness considerations that led the Commission to conclude that a cap should not be included in the Payments Scheme would also apply here, namely that there is no sufficiently strong justification for assuming that those with larger losses are less deserving of their full *pro rata* share; and that the adverse effect on those with larger losses would be unacceptably high if such an arrangement were calibrated to a level that would make a material difference to those with smaller losses.

4.78 Steps and sliding scales would entail a similar requirement for arbitrary judgement as with a cap, and would also add an additional layer of complexity to the calculations.

Conclusions and impact

4.79 The Commission recommends that the available £775 million should be allocated to policyholders, excluding with-profits annuitants and their estates, as follows:

51 A step here means a method of allocation whereby policyholders will receive, as a minimum, a given percentage of the first part of their Relative Losses (e.g. 100 per cent of the first £2,000), and could also include a sliding scale (e.g. 50 per cent of the next £5,000, and so on).

- a *pro rata* allocation of the available quantum, in proportion to the size of Relative Losses, principally on the grounds that no group of policyholders has been identified which in the Commission's view merits favourable treatment at the expense of other policyholders;

- a single policyholder view, wherever practicable, endorsing the inclusion in the Methodology of offsetting Relative Gains against Relative Losses where policyholders hold multiple policies. This will better direct funds towards those individuals that have suffered net Relative Losses across their Equitable Life portfolios; and

- a *de minimis* amount, in the region of £10, beneath which payments should not be made. This reflects the fact that payments below this amount would be disproportionate to the administrative costs of making them while being, in the Commission's view, of negligible significance to those who do not receive them. The Commission recognises that the costs of administering payments to members of Group schemes and to estates of deceased policyholders may justify a higher *de minimis*.

4.80 Implementing these recommendations would have the following effects:

- approximately 945,000 policyholders with Relative Losses[52] would receive payments equivalent to their *pro rata* allocation (22.4 per cent of Relative Losses); and

- the remaining 100,000 policyholders with a Relative Loss, but whose *pro rata* allocation amounted to less than £10, would receive no payment.

4.81 The distributional impact of the recommendations is set out in Tables 1, 2A and 2B in Annex F.

Impact of the recommendations on the basis of gender, age, ethnicity and disability

4.82 The Commission's Terms of Reference require it to "consider the impact of their recommendations on the basis of gender, age, ethnicity and disability."

4.83 The distributional impact of the Commission's allocation recommendations on gender and age is set out in Tables 10 and 11 in Annex F.

4.84 The Commission is satisfied that its recommendations do not discriminate on grounds of gender or age. It has been advised that any disparities are likely to be

52 This is equivalent to 90 per cent of all policyholders with Relative Losses.

due to different patterns of participation in the pensions market – which to some extent result in differences in the average size of policy values – as between the genders and as between policyholders in different age bands:

- Gender: the £10 *de minimis* on payments results in 12 per cent fewer females and 8 per cent fewer males receiving payment as compared with a *pro rata* allocation. However, this simply reflects the gender balance among those who have *pro rata* losses below £10.

- Age: applying a *de minimis* of £10 means that approximately 13 per cent of policyholders under the age of 50 who suffered a loss will not receive a payment. It also means that 8 per cent of policyholders over 65 who suffered a loss will not receive a payment. However, this reflects the fact that older policyholders are more likely to have larger Relative Losses.

4.85 Data relating to the ethnicity and disability of policyholders is not available. It has therefore not been possible to make an assessment. However, the Commission has no reason to believe that its recommendations will have a disproportionate impact based on either ethnicity or disability.

Examples of how this Advice might be applied to individual policyholders

The three examples below illustrate how this Advice might be translated into the calculation of individual payments:

Example 1

Policyholder has a single policy, which was terminated on 31 December 2004, with a fairly large Relative Loss.

Payout Received from Equitable Life on 31 December 2004	**£630,000**	**[A]**
Notional Payout from Comparator Company on 31 December 2004	**£690,000**	**[B]**
Relative Loss at Date of Exit (31 December 2004) ([B] – [A])	**£60,000**	**[C]**
Relative Loss including interest to 31 December 2009 ([C] x(1+4%)[1])	**£72,999**	**[D]**
Apply pro-rata factor ([D] x 22.4%)	**£16,359**	**[E]**
Apply *de minimis* if less than £10	**No**	
Relative Loss Payment	**£16,359**	

1 The Government's accepted Methodology allows for interest to accrue on Relative Losses from the date that the loss is incurred up to 31 December 2009. This is explained more fully in Annex E.

Example 2

Policyholder has a single policy, which was terminated on 31 December 2008, with a small Relative Loss.

Payout Received from Equitable Life on 31 December 2008	**£120**	**[A]**
Notional Payout from Comparator Company on 31 December 2008	**£150**	**[B]**
Relative Loss at Date of Exit (31 December 2008) ([B] – [A])	**£30**	**[C]**
Relative Loss including interest to 31 December 2009 ([C] x(1+4%)1)	**£36**	**[D]**
Apply pro-rata factor ([D] x 22.4%)	**£8**	**[E]**
Apply *de minimis* if less than £10	**Yes**	
Relative Loss Payment	**£0**	

Example 3

Policyholder holds two policies, one of which makes a Relative gain, and one of which makes a Relative Loss. The policies both terminated on 31 December 2008.

	Policy 1	Policy 2	Total	
Payout Received from Equitable Life on 31 December 2008	£146,000	£356,000		[A]
Notional Payout from Comparator Company on 31 December 2008	£145,000	£385,000		[B]
Relative Loss at Date of Exit (31 December 2008) ([B] – [A])	(£1,000)	£29,000	£28,000	[C]
Relative Loss including interest to 31 December 2009 ([C] x(1+4%)1)			£29,120	[D]
Apply pro-rata factor ([D] x 22.4%)			£6,525	[E]
Apply *de minimis* if less than £10			No	
Relative Loss Payment			£6,525	

Source: Towers Watson.

5: Prioritisation in the order of payment

The Commission's approach

5.1 The £775 million available to policyholders other than with-profits annuitants is to be paid over the course of three years, beginning in 2011/12. Approximately 50-55 per cent will be paid in the first year, 25-30 per cent in the second year and 15-20 per cent in the third year. This amounts to approximately £388 million to £426 million in the first year, £194 million to £233 million in the second year, and £116 million to £155 million in the third year. The Government has indicated that payments will take the form of a single lump sum to each recipient.

5.2 In this context, the Commission's Terms of Reference ask it to "advise on any groups/classes of persons that should be paid as a priority with regard to the timing of payments, again excepting with-profits annuitants and their estates". It has also been asked to have regard to the practicalities of delivering the Payments Scheme.

5.3 It is not possible to provide equal treatment to all policyholders because payments are to be made over three years. It is therefore necessary to consider which policyholders are in greatest need of a payment in the near future. As with allocation, the Commission cannot consider a means-tested approach based on individual circumstances.

5.4 Consequently, the Commission has assessed which groups of policyholders should take priority in the order of payments based on those:

- most likely to be in the greatest need of payment in the near future, without looking at individual circumstances; and
- for whom practical considerations make an earlier payment possible and desirable.

5.5 However, the Commission does not believe its Advice should be interpreted as rigidly constraining the order in which payments made. The Government should seek to make payments as quickly as possible but take a pragmatic approach where problems arise in making payments to individual policyholders within a particular category. There may be occasions, for example, where it is not possible to trace an individual in a priority category quickly and that should not delay payments to others.

Groups that the Commission has considered for special treatment

5.6 Based on its discussions with interested parties and the representations it has received, the Commission has considered four potential bases for prioritisation. These are:

- age;
- the estates of deceased policyholders;
- people with special circumstances; and
- making payments such that the maximum number of policyholders is paid each year.

Prioritising by age

5.7 There are more than 113,000 individual policyholders over the age of 65, including 34,000 over the age of 75, who have suffered full Relative Losses of almost £1.3 billion. There are a further 83,000 individuals in Group Pension policies over the age of 65, including almost 3,100 over the age of 75, who have suffered full Relative Losses of almost £146 million. This is shown in Tables 3A, 3B, 3C in Annex F.[53]

5.8 The responses to both the Commission's invitation for initial thoughts and its discussion paper showed very strong support for prioritising by age, with the oldest policyholders being paid first since they are likely to be the most vulnerable and least able to wait up to three years for payment. Prioritising by age also helps to address, broadly, the proposal that those who have retired should be considered as a priority, without the need to establish whether a policyholder has actually retired.

5.9 The Commission has been advised that prioritising policyholders by age does not lead to any significant practical difficulties for those holding, or who held, accumulating with-profits policies or conventional with-profits policies. However, prioritising by age those with Group Pension policies may be more difficult, so it is unlikely to be possible to prioritise by age in all cases. Advice to the Commission is that:

"Identifying and prioritising payments to elderly individuals should in general not be problematic for AWP or CWP policyholders. However, it will not be straightforward for Group schemes. We are likely to be making the majority of

53 Ages of policyholders at 31 December 2009.

payments to individuals within Group schemes via a Paying Agent, usually the Scheme Administrator, for whom, the most cost effective approach will be to make as many individual payments as possible in one pass. Therefore, we expect all traceable policyholders within a scheme to receive their payment around the same time. It would be extremely difficult and disproportionately costly to prioritise policyholders within Group schemes based on age or any other specific criteria, and to do so would delay the start of the scheme more generally." [54]

5.10 The Commission agrees strongly that prioritisation by age, where this can be identified, is the most sensible approach and is fairest to policyholders. As well as being the least able to wait for payment, the oldest policyholders are also those least likely to have had an opportunity to mitigate the effects of accepted Government maladministration. Younger policyholders are less likely to be approaching retirement and more likely to be in a position to mitigate the effects of a delay.

5.11 Where the age of a policyholder cannot be used to prioritise payments, such as within some Group schemes, a pragmatic approach should be taken, with priority being given to the oldest policyholders wherever it is possible and practicable to do so.

Prioritising the estates of deceased policyholders

5.12 The Commission's Terms of Reference state that "the estates of deceased policyholders must be considered as part of the scheme in the same manner as living policyholders". It is not possible to know the precise number of deceased policyholders because of data limitations.[55] However, it is known that there are at least 12,500 of them, with full Relative Losses of £55 million. This is shown in Table 3C in Annex F.

5.13 Only a few specific representations were received in relation to paying the estates of deceased policyholders and no strong pattern emerged. One proposal was that their estates should only be paid after the oldest policyholders had received payment, with estates where there is a surviving spouse receiving next priority. However, others believed that the estates of deceased policyholders should take a similar priority to the oldest policyholders.

5.14 The Commission has been advised that it is possible to start the process of paying the estates of deceased policyholders early and that there are practical reasons

54 See letter from Mr Mike Williams, 13 January 2011.

55 The data available to Towers Watson does not allow it to identify those policyholders who have died subsequent to leaving Equitable Life.

for beginning the process as soon as possible because it may take some time to identify the estates and their executors or administrators.[56]

5.15 The Commission believes that eligible estates should be paid as a priority. A deceased person's executor or administrator will be expected to deal with their estate in a timely manner and it could create practical and financial difficulties if the estate had to be held open longer than necessary. It would also delay beneficiaries receiving payment at a time when they might be at their most vulnerable, whether they are a surviving spouse or not. Priority should, therefore, be given to estates that are open, or are opened over the course of the three years. This would mean, where possible and practicable, bringing forward payments to the estates of any policyholders who die before receiving their payment during that period.

5.16 Estates that have already been closed would be treated in the same manner. If an estate needs to be reopened then it is desirable that this should happen as soon as possible. Delays could also make it more difficult to trace the executor or administrator.

Prioritising people with special individual circumstances

5.17 The Commission received a small number of representations that a mechanism should be introduced to allow those with special individual circumstances to have a payment brought forward. Terminal illness in particular was highlighted as such a circumstance.

5.18 While sympathetic to those in such difficult circumstances, the Commission does not, on balance, believe it would be appropriate to prioritise one group over another on these grounds. There are likely to be individual cases that are deserving, whether because of illness or extreme hardship, and where a powerful argument for priority could be made. However, as those raising this issue themselves acknowledged, prioritising on the basis of special individual circumstances may be seen as unfair by others who will feel they also merit earlier payment. Information relating to illness and hardship is not available and the Commission has been advised that additional costly procedures would need to be introduced to assess and validate claims. Difficult judgements would have to be made in setting criteria for assessing such cases. It could also introduce an element of means-testing in the case of claimed hardship.[57] Consequently, this is not an option that the Commission recommends.

56 See the letter from Mr Mike Williams, HM Treasury, 13 January 2011.
57 Ibid.

Prioritising payments so that the maximum number of policyholders is paid each year

5.19 One response to the Commission's discussion paper suggested an approach to prioritisation focused on the objective of making the maximum number of payments as quickly as possible. This would mean maximising the number of policyholders paid in each of the three years by establishing which were the easiest to pay.

5.20 The Commission agrees that it is desirable to make as many payments as possible each year. However, if this were the central objective then, given the limited level of funding in each of the three years, it would logically be necessary to pay all those with the lowest Relative Losses first. This would mean those with the largest losses not receiving a payment until 2013/14, which would include many of the most elderly policyholders as they tend to have the largest losses. Consequently, this is not an option that the Commission recommends.

Conclusions and impact

5.21 Based on the evidence and analysis above, the Commission recommends giving priority, wherever it is possible and practicable to do so, to:

- the oldest policyholders; and
- the estates of deceased policyholders.

5.22 This meets the Commission's criteria for prioritising payments based on those most likely to be in the greatest need of payment in the near future, without looking at individual circumstances, and the need to consider practical constraints.

5.23 It is not possible to provide a precise estimate of the way in which payments to different policyholders would be phased because of the likely practical constraints upon making payments to policyholders (or their estates) in Group schemes and tracing the estates of deceased policyholders. However, for illustrative purposes, assuming that none of those in Group schemes can be prioritised (and would therefore be paid later than those with individual policies), and that a *de minimis* of £10 is applied to a *pro rata* allocation, a *possible* effect on the eligible 945,000 policyholders is as follows:

- almost 70 per cent of 11,250 known eligible estates could receive payment in the first year, subject to practical constraints;
- 19 per cent of all eligible policyholders could receive their payment in the first year (accounting for more than 50 per cent of the 775 million);

- around 95 per cent of all eligible policyholders over the age of 75 could receive their payment in the first year of the Payments Scheme (the remaining 5 per cent hold policies in Group schemes, which cannot always be prioritised for practical reasons); and
- all eligible policyholders over the age of 60 with individual (as opposed to Group scheme) policies could receive their payment in the first year of the Payments Scheme.

5.24 The distributional impact of the Commission's recommendations on prioritisation is shown in Tables 8 and 9 in Annex F. These tables compare the effects, alternatively, of being able to prioritise by age in Group schemes and, as seems likely, of not being able to do so for practical reasons.

Impact of the recommendations on the basis of gender, age, ethnicity and disability

5.25 The Commission's Terms of Reference require it to consider the impact of its recommendations on the basis of gender, age, ethnicity and disability.

5.26 The Commission is content that its recommendations on prioritisation are not discriminatory on the basis of gender. Table 5.1 below shows very similar proportions of men and women with Relative Losses receiving payments in each of the three years, whether those in Group schemes can be prioritised by age or not. For example, making the same assumptions as in paragraph 5.23, 51 per cent of eligible men and 50 per cent of eligible women could receive a payment in 2011/12.

TABLE 5.1 Gender impact on prioritisation of payments using *pro rata* Losses and £10 *de minimis*

	Male	Female
Total Relative Losses (£m)	2,632.8	822.7
Total *pro rata* Losses (£m)	590.3	184.4
Proportion of *pro rata* Losses	76%	24%
All policyholders prioritised by Age		
Proportion of *pro rata* losses paid in year one	56%	53%
Proportion of *pro rata* losses paid in year two	18%	16%
Proportion of *pro rata* losses paid in year three	27%	32%
Individual (AWP and CWP) policyholders prioritised by and age with Group policyholders paid subsequently		
Proportion of *pro rata* losses paid in year one	51%	50%
Proportion of *pro rata* losses paid in years two and three	49%	50%

Note: Due to data issues, this table excludes five policyholders of unknown gender with £1.3 million of relative losses

Source Towers Watson.

5.27 The Commission believes that prioritisation in the order of payments by age and to the estates of deceased policyholders is consistent with the Human Rights Act 1998 and other applicable law. The Government has sought advice on the prioritisation of payments from the Commission because it has indicated it will be making payments over the course of three years. Prioritisation is therefore a necessity in the Payments Scheme. In this context, the Commission believes it is proportionate and justified to give priority to the oldest policyholders and the estates of deceased policyholders.

5.28 Data relating to the ethnicity and disability of policyholders is not available. It has therefore not been possible to make an assessment. However, the Commission has no reason to believe that its recommendations will have a disproportionate impact based on either ethnicity or disability.

6: Summary of recommendations

Fair allocation of the available quantum

6.1 **The Commission recommends that the available £775 million should be allocated to policyholders, excluding with-profits annuitants and their estates, as follows**:

- **a *pro rata* allocation of the available quantum** in proportion to the size of Relative Losses suffered. This equates to 22.4 per cent of each policyholder's Relative Losses;
- **a single policyholder view**, wherever practicable, endorsing the inclusion in the Methodology of offsetting Relative Gains against Relative Losses where policyholders have multiple policies; and
- **a *de minimis* amount, in the region of £10**, beneath which payments should not be made. This reflects the fact that, based on the advice received, payments below this amount would be disproportionate to the administrative costs of making them. The Commission recognises that the costs of administering payments to members of Group schemes and to estates of deceased policyholders may justify a higher *de minimis*.

Prioritisation in the order of payment

6.2 **The Commission recommends that the following policyholders be prioritised in the order of payment**, **excluding with-profits annuitants and their estates, wherever it is possible and practicable to do so**:

- **the oldest policyholders**, as they are least able to wait for payment and are also least likely to be in a position to mitigate the effects of a delay; and
- **the estates of deceased policyholders** and, so far as possible, the estates of those who die, before receiving a payment, in the next three years. This prevents delays to beneficiaries receiving payments when they might be at their most vulnerable and reduces the difficulties that could arise in regard to the administration of estates.

A: Terms of Reference (as amended on 27 October 2010)

Role

1. The role of the Independent Commission is to:

   - Recommend how best to fairly allocate funds provided for the Equitable Life Payments Scheme in the first three years of the Spending Review to those persons found to have suffered relative losses as a result of accepted Government maladministration, excepting With Profits Annuitants (WPAs) and their estates.

   - Advise on any groups/classes of persons that should be paid as a priority with regard to the timing of payments, again excepting WPAs and their estates.

2. In providing its advice, the Commission shall have regard to the practicalities of delivering the payment scheme.

3. The Commission may review additional evidence should this be necessary to fulfil the terms of reference, but having regard to the need to keep to the time constraints set out in paragraph 7.

4. Subject to the following Ministerial requirements, the Commission is free to operate as it sees fit. These requirements are:

   - £775 million funding is available for payments to non-WPAs as part of the Spending Review. The proposed allocation made by the Commission must be within this amount.

   - Payments must fit within the spending envelope supplied by the Government to aid the affordability and operational delivery of this scheme.

   - The Commission will base the allocation on methodology endorsed by the Government at the Spending Review.

   - Means-testing will not be used as a method to decide how payments are divided.

   - The estates of deceased policyholders must be considered as part of the scheme in the same manner as living policyholders.

- The Commission will not consider tax implications for the purposes of its work.

- The Commission will not consider the application of interest to losses or payments for the purposes of its work.

Objectives

5. The primary aim of the Commission is to recommend how best to fairly allocate funds provided for the Equitable Life Payments Scheme to those persons found to have suffered relative losses as a result of accepted Government maladministration, excepting WPAs and their estates.

6. The Commission should provide regular updates as it carries out its work in order to aid transparency and ensure that the public is kept informed of its proceedings, and to enable work on the establishment of the payment scheme to progress in parallel as far as possible.

7. The Commission should provide its final advice to the Government by the end of January 2011.

Assumptions and Evidence

8. The Government has accepted £4.3bn as the relative loss figure. This figure encompasses the Parliamentary Ombudsman's findings of maladministration, all of which the Government accepts.

9. The Commission will accept the methodology used to arrive at this figure, as endorsed by HM Treasury at the Spending Review, as the basis for their calculations.

10. In the interests of speed and of the public purse, the Commission should ensure that it does not unnecessarily replicate existing analysis determining relative loss.

11. It will have regard to, but need not be bound by, findings on disproportionate impact set out by Sir John Chadwick.

12. The Commission will meet with representatives of interested parties as appropriate.

13. The Commission will consider the impact of their recommendations on the basis of gender, age, ethnicity and disability.

Spending Envelope and Timing of Payments

14. The Government will provide the Commission with a spending envelope of £775million. The Commission should have regard to the profiling of these payments over the three year period (approximately 50-55% in the first year, 25-30% in the second and 15-20% in the third.)

15. The Commission can make a recommendation on prioritising the timing of payments to particular groups of policyholders.

Structure/ Composition

16. The Commission will comprise of three people, one of whom will act as Chair.

Interaction with Scheme Design Consultants and Actuarial Support

17. The Commission shall have at its disposal actuarial support to calculate the permutations of various scenarios for allocating payments to individual policyholders and members or trustees of group schemes. This actuarial support will consist solely of responding to the Commission's directions.

18. The Commission shall also have access to advice provided to HM Treasury on scheme design to help understand the effect that their advice will have on the deliverability of the scheme. However, the Commission will not advise on the administrative and operational mechanics of delivering payments to policyholders, or the appeals process.

B: Correspondence between the Financial Secretary to the Treasury and the Commission about the Terms of Reference, October 2010 and January 2011

B.1 Annex B contains the following letters:

1. The Financial Secretary to the Treasury wrote to the Commission on 20 October 2010. This letter sets out the Government's decision at the 2010 Spending Review and further clarifies the role of the Commission.

2. The Financial Secretary to the Treasury wrote to the Commission on 27 October 2010 with the revised Terms of Reference. These were amended following the Government's announcement at the 2010 Spending Review and are reproduced at Annex A.

3. The Chair of the Commission, Brian Pomeroy, wrote to the Financial Secretary on 29 October 2010 to set out the Commission's approach following the publication of the revised Terms of Reference and confirm the appointment of Towers Watson as actuarial support.

4. The Financial Secretary to the Treasury wrote to the Commission on 18 January 2011 to set out a change in the total Relative Loss figure following refinements by Towers Watson. The letter from Towers Watson to the Financial Secretary is also included.

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Brian Pomeroy, Esq
Chair
Independent Commission on Equitable Life
Payments
Eastcheap Court
11 Philpot Lane
London EC3M 8UD

20 October 2010

Dear Brian

SPENDING REVIEW ANNOUNCEMENT ON EQUITABLE LIFE PAYMENTS

Thank you for the work you and your fellow Commissioners have done since your appointment. I note that you have already had one round of engagement with stakeholders and plan to continue this process as your work continues. That is very helpful in ensuring a process that is as transparent as possible to stakeholders.

In light of the Spending Review and my related announcement on Equitable Life, I am writing to you to set out:

- The figure that the Government accepts as the relative loss suffered as a result of maladministration in the regulation of Equitable Life in the period prior to December 2001;
- The decision by the Government to cover the cost of the total relative loss suffered by With-Profits Annuitants (WPAs), estimated at £620m;
- The £1bn funding that has been allocated to the Equitable Life Payments Scheme in the first three years of the Spending Review; and
- Your role in advising on the allocation of the remaining funding, in the first three years of the Spending Review Period, amongst those holders of non With-

Profits Annuities policies who have suffered relative loss as a result of the maladministration.

Relative loss

On 22 July, I published Sir John Chadwick's report on losses sustained as a result of the maladministration in the regulation of Equitable Life, alongside estimates from Towers Watson of the intermediate figures produced by each calculation in his methodology. After considering Sir John's advice, the views of the Parliamentary Ombudsman, and representations from interested parties, I have concluded that relative loss is the difference between what Equitable Life policyholders actually received or will receive from their policies, and what they would have received if they had invested in a comparable product elsewhere. The references to relative loss in your terms of reference are to be read in that sense.

In their letter published alongside my Spending Review announcement, Towers Watson have, based on the assumptions I instructed them to work from, calculated this relative loss to be £4.3bn. I endorse this figure along with the methodology used to determine it. It encompasses the Parliamentary Ombudsman's findings, all of which the Government accepts.

As part of endorsing this figure and the methodology underlying it, I have accepted a start date of the end of 1992 for calculations of relative loss. There are two reasons for this decision:

1. There is no reliable personal policyholder data prior to this period; and
2. Due to the process by which regulatory returns were reported, no policyholder would have had the information that would lead them to leave Equitable Life prior to this date, even if maladministration had not occurred.

In addition, in the underlying methodology I have accepted an approach to non-contractual exits and Market Value Adjustments that ensures like is compared with like as between Equitable Life and the comparators.

Guarantees that bite when polices are withdrawn contractually are based on the guaranteed value of the policy. These guarantees build up over the lifetime of the policy based on smoothed investment returns. On contractual exit the policyholder will receive the greater of the guaranteed value and the smoothed value of the underlying assets.

An (MVA) or 'exit cost' adjusts the policy value on earlier exit to calculate the actual value of the underlying assets at the point of withdrawal, where asset values have reduced due to market movements.

Applying an MVA means that no single policy holder can withdraw more than their assets are actually worth. This is the appropriate comparator to ensure that like is being compared with like between Equitable Life and the basket of comparators. Adjusting the value in this way avoids paying for investment performance whilst allowing for the effect of maladministration.

The Commission should base its allocation to policyholders on this finalised relative loss figure and methodology.

Funding available for payments and full coverage of WPAs total losses

As the Parliamentary Ombudsman has said: "it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case", and the Government has carefully considered the amount of funding that should be made available to the Payments Scheme in this Spending Review. When affordability is taken into consideration, it is important that the position of those who have been hardest hit by their losses is recognised. Policyholders with With-Profits Annuities were particularly vulnerable to their losses because they were unable to move their funds elsewhere, or to mitigate the impact of their losses through employment. They are also generally the oldest policyholders.

In light of these factors, the Government has decided to cover the cost of the total relative loss suffered by WPAs, estimated at £620m. WPAs will receive this in the form of regular payments, based on their full relative loss, and covering both past and future losses. The estates of WPAs will receive their full past losses, as a lump sum payment.

£1bn will be allocated to the Payments Scheme in the first three years of this Spending Review period, which will cover both the initial costs of the first three years of WPA regular payments, and all lump sum payments to other policyholders. The Government expects the total amount of funding over the lifetime of the scheme, including to WPAs, to be in the region of £1.5bn.

Role of the Independent Commission on Equitable Life Payments

In light of this, your role will be to advise on:

- The allocation of the remainder of funding which has been provided for the Equitable Life Payments Scheme in the first three years of the Spending

Review amongst those persons who have suffered relative loss as a result of the maladministration, excepting WPAs and their estates; and

- Any groups/classes of persons that should be paid as a priority with regard to the timing of their payments, again, excepting WPAs and their estates.

Your Terms of Reference ask that you have regard to practicalities of delivering the payment scheme. Notwithstanding that, I would like to clarify that you are not required to advise on the administrative and operational mechanics of delivering payments to policyholders. The independent appeals process for individuals within the scheme will be announced by the Government when it presents the final scheme design to Parliament.

The Government has now clearly stated that we accept all of the Ombudsman's findings, the amount that we recognise as the relative loss figure and the methodology used to calculate this figure. In light of the fact that these final decisions have now been made, I feel it is appropriate to amend your terms of reference to reflect these. The amendments in your terms of reference will state the exact figure you will be asked to advise on allocating and the profile for these payments over three years. I will write to you shortly with these new terms of reference.

I am grateful to you for undertaking this important task, and I look forward to receiving your final advice by the end of January 2011.

Yours sincerely,

MARK HOBAN MP
FINANCIAL SECRETARY TO THE TREASURY

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Brian Pomeroy, Esq
Chair
Independent Commission on Equitable
Life Payments
Eastcheap Court
11 Philpot Lane
London
EC3M 8UD

27 October 2010

Dear Brian

In my letter dated 20 October, I informed you that I would be updating the terms of reference for the Independent Commission of Equitable Life Payments in light of the decisions that had been made at the Spending Review.

Please find attached the Commission's updated terms of reference which should help guide your task in the coming months. These specifically take into account the Government's Spending Review decision to cover the relative losses for With Profit Annuitants (WPAs) in full, and the knock-on implications for the Commission's work. I look forward to receiving your advice by the end of January 2011.

Yours sincerely,

MARK HOBAN MP
FINANCIAL SECRETARY TO THE TREASURY

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http://equitablelifepayments.independent.gov.uk/

29 October 2010

Mr Mark Hoban MP
Financial Secretary to HM Treasury
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Financial Secretary,

Thank you for your letter, dated 20 October 2010, concerning the announcement about the Equitable Life Payments Scheme in the 2010 Spending Review. You have also now published the Commission's revised Terms of Reference.

The Commission will continue its work in accordance with your letter and the Terms of Reference, which we note includes using the Government's accepted relative loss figure and methodology as the basis of allocating funding to policyholders. By end of January 2011, we will provide advice to the Government on:

- how to fairly allocate the £775m provided for the Equitable Life Payments Scheme in the first three years of the Spending Review to those persons found to have suffered relative losses as a result of accepted Government maladministration, excepting with-profits annuitants and their estates; and
- any groups or classes of persons that should have priority as regards the timing of payments, again excepting with-profits annuitants and their estates.

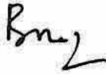
I agree with you about the need for transparency, and confirm that we are fully committed to working as transparently as possible. We met a number of interested parties in the period before the Spending Review. Following an open call for initial thoughts, we have also received a number of e-mails and letters from individuals, setting out their ideas on fair allocation and prioritisation. The Commission intends to embark on a second round of

engagement shortly, when we will be publishing a list of questions for further discussion and a summary of the representations already received from interested parties.

To complete the next phase of the Commission's work and to meet our deadline, it will be essential that we have effective actuarial support. Following an open competitive tendering process, the Commission has this week appointed Towers Watson to provide it with such support. Towers Watson has built up considerable expertise and supporting infrastructure on issues related to Equitable Life, particularly while under instruction from Government to provide data and modelling for its decision on relative loss. For the purpose of our work, however, they will act under the Commission's instructions alone; and no material will be shared with other parties, including HM Treasury, without the Commission's express permission. We believe they will be well placed, under our direction, to play an effective role in calculating the permutations of various scenarios for allocating payments which we shall need in order to complete our work.

We look forward to providing you with our advice by the end of January 2011.

Yours sincerely



Brian Pomeroy CBE
Chairman

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Brian Pomeroy, Esq.
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Independent Commission on Equitable Life Payments
Eastcheap Court
11 Philpot Lane
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18 January 2011

Dear Brian

I am writing to inform you that Towers Watson has advised me that, since the publication of the Commission's revised Terms of Reference in October, there has been some movement in the Relative Loss figures which inform your advice. These changes have been driven by continued improvements made to the calculations, refinements of individual policies' Relative Loss calculations, addressing data issues and on-going review of individuals' Relative Losses.

The updated figures are as follows:

Estimate of Relative Loss by policy class (£m)[1]

Policyholder losses type	**December 2010**
Individual (Accumulating With-Profit)	2,575
Individual (Conventional With-Profit)	50
Group pensions	835
With Profit Annuities	615
Relative Loss (including offsetting within a policy class but before cross-class offsetting)	4,075
Cross-class offesting[2]	(5)
Relative Loss (Aggregated Stage 2 Loss)	4,070

The funding envelope for policyholders within your remit – those who are not With-Profits Annuitants – remains the same at £775 million.

I attach Towers Watson's letter on this matter for your reference.

I look forward to receiving your advice on the payments scheme later this month.

Yours sincerely,

MARK HOBAN MP
FINANCIAL SECRETARY TO THE TREASURY

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18 January 2011

Mark Hoban MP
Financial Secretary to the Treasury
Her Majesty's Treasury
1 Horse Guards Road
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SW1A 2HQ

Dear Mr Hoban

Equitable Life Payment Scheme – Update of aggregated loss figures

Following the submission of Sir John Chadwick's report "Advice to government in relation to the proposed Equitable Life payment scheme" dated 16 July 2010 ("Sir John's Advice"), we provided you with an initial estimate of the aggregate loss under Sir John's Advice, as well as the results of certain intermediate calculations that represent stages in reaching that aggregate loss estimate.

We produced an updated estimate to the loss figures to inform the Spending Review process, set out in our letter dated 19 October 2010. This letter updates the estimates we previously provided, incorporating modifications to the initial estimates as we have continued to enhance our calculations and further analyse the policyholder database in order to more accurately reflect the Relative Loss suffered by individual policyholders.

Basis of calculations and results

The loss calculation is based on the following definition of Relative Loss:-

"Relative Loss is the difference in the value of a notional policy which the policyholder might have held had they made an investment in a similar product in a comparator company's with-profits fund and the value of the actual Equitable Life policy."

This Relative Loss corresponds to, and is calculated in the same way, as the loss previously defined as Aggregate Stage 2 loss, in our letter dated 19 October, and as such no other bases are considered in this letter.

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Table 1 below summarises the Relative Loss, split by policy type, calculated as at 31 December 2010.

TABLE 1

Estimate of Relative Loss by policy class (£m)[1]

Policyholder losses type	December 2010
Individual (Accumulating With-Profit)	2,575
Individual (Conventional With-Profit)	50
Group pensions	835
With Profit Annuities	615
Relative Loss (including offsetting within a policy class but before cross-class offsetting)	4,075
Cross-class offestting[2]	(5)
Relative Loss (Aggregated Stage 2 Loss)	4,070

1 Losses are rounded to the nearest £5m
2 This includes offsetting between groups AWP/CWP and WPA/non-WPA where WPA gains can only offset non-WPA losses.

The Relative Loss (Aggregated Stage 2 Loss) calculated at the time of the Spending Review was £4.3bn. This allowed for full offsetting with no restrictions. The equivalent Relative Loss at December 2010 is £4,052m but Table 1 shows the results reflecting the current offsetting allowance. This follows your decision of 20 October 2010 to cover WPA losses in full.

The change in the Relative Loss figure has been driven by continued improvements made to the calculations, refinements of individual policies' Relative Loss calculations, addressing data issues and on-going review of individual's Relative Losses. The changes should be seen in the context of total policy values which, for AWP business alone, is in excess of £30bn. These changes are described in more detail in the section below.

Continued work on the loss calculations

We have continued to develop, enhance and review the models used to calculate the individual losses since the Spending Review and this work is still ongoing. This works includes, but is not limited to, the following activities:

- Continuing to investigate reconciliation issues or unusual data for groups of coverages and for individual coverages. This has often involved corresponding with Equitable Life in order to obtain more data and/or in some cases developing modified approaches to dealing with group of coverages to improve their reconciliation and so calculated loss.
- Applying updated or revised data from Equitable life, for example:
  - The use of a new, more reliable data field ("WP effective date") to indicate the start date of a policy which may have influenced the eligibility of some coverages and also affected the loss calculation for polices where complete data is not available. This represented a relatively material change to Relative Loss.
  - Details of accumulating class business which was previously excluded by Equitable from the data

- WPA "failed" policies are grossed up in the aggregate loss figure by increasing the total WPA loss by a pro-rata factor which is based on the number of "fails" and the average loss for relevant policies. As more "fails" are resolved the grossing up figure is adjusted and we have also enhanced the approach used to gross-up.
- Corrections to allow for a small number of coverages which failed to run through the model at the time of the Spending Review.
- Continued review/amendment of minor assumptions to ensure they remain appropriate, e.g. equity-backing assumptions for CWP future loss calculations.
- Enhancements to the offsetting process to ensure coverage matching is appropriate and allow for previous compensation schemes and the use of WPA gains to offset non-WPA losses.
- Ongoing technical/peer review of the models including sample policy testing to test for robustness of calculations.

The most material changes in the results arises from:

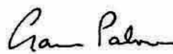
- a change in the approach for the modelling of Equitable contractual payments where guarantees apply for eligible policies. This change is a methodology change and a model correction.
- Further information from Equitable Life regarding the interpretation of the data for "WP effective date".

There are still model approach changes we expect to implement following decisions on the treatment of fail flags.

Conclusion

We will continue to refine our approach and calculations over the coming months, during which time we expect there to be some further changes to the loss calculation. In particular, we are waiting for some decisions to be made by HM Treasury, for example on suggested treatment of fail flags, which will impact the calculation of Relative Loss. We expect the final relative loss figure to fall in the range of £4.1bn to £4.3bn

Yours sincerely



Gavin Palmer

C: Correspondence between HM Treasury and the Commission about the practical constraints on the Equitable Life Payments Scheme, January 2011

C.1 Annex C contains the following letters:

1. The Chair of the Commission, Brian Pomeroy, wrote to HM Treasury on 12 January 2011 to request advice on the practical constraints on delivery of the Payments Scheme.

2. The Director of Business and Indirect Tax at HM Treasury, Mr Mike Williams, wrote to the Commission on 13 January 2011 with the advice requested.

Independent Commission on Equitable Life Payments

Eastcheap Court
11 Philpot Lane
London
EC3M 8UD

http://equitablelifepayments.independent.gov.uk/

12 January 2011

Mr Mike Williams
Director of Business and Indirect Tax
Budget, Tax and Welfare Directorate
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Mike,

As you know, our Terms of Reference state that the Commission shall "have access to advice provided to HM Treasury on scheme design to help understand the effect that their advice will have on the deliverability of the scheme". This is to enable us to take account, in our conclusions, of any practical constraints on the delivery of the Payments Scheme.

Further to the informal discussions we have already had about factors affecting practicality generally, I would be grateful if you could provide us with answers from the Payments Scheme Delivery Team to the following questions:

- What are the delivery constraints, if any, on a pro rata allocation of the quantum according to the size of full Relative Losses?
- What are the delivery constraints, if any, on giving favourable treatment to those who have suffered 'Money Losses' (i.e. where the amounts received or receivable on their policies are below the amounts invested by the policyholder)?
- Where is it practicable to take a combined view of multiple policies held by a single policyholder and in what circumstances is offsetting practicable?
- What are the delivery constraints, if any, of applying a *de minimis* amount beneath which payments would not be made?
- What is the administrative cost of making a payment to a policyholder?

- Can you identify and prioritise payments to the oldest policyholders, including those in Group Pension schemes?
- Can you identify and prioritise payments to the estates of deceased policyholders, including to those estates where the policyholder dies after the Payments Scheme is established?
- Can you identify and prioritise payments to policyholders with special circumstances, such as those with a terminal illness or in extreme hardship?

These are issues being considered by the Commission and this letter should not be considered as an indication of our early conclusions.

Yours sincerely,

Brian

Brian Pomeroy CBE
Chairman

HM TREASURY

1 Horse Guards Road
London
SW1A 2HQ

13 January 2011

Brian Pomeroy,
Chairman,
Independent Commission on Equitable Life Payments,
Eastcheap Court,
11 Philpot Lane,
London,
EC3M 8UD

Dear Brian,

In line with the Independent Commission on Equitable Life Payments' terms of reference, which ask the Commission to "have regard to the practicalities of delivering the payment scheme", you have asked me to write to you answering some questions you have on the practical implications of some of the options that the Commission is considering. The questions you have asked me to answer are:

1. What are the delivery constraints, if any, on a pro rata allocation of the quantum according to the size of full Relative Losses?

2. What are the delivery constraints, if any, on giving favourable treatment to those who have suffered 'Money Losses' (i.e. where the amounts received or receivable on their policies are below the amounts invested by the policyholder)?

3. Where is it practicable to take a combined view of multiple policies held by a single policyholder, and in what circumstances is offsetting practicable?

4. What are the delivery constraints, if any, of applying a *de minimis* amount beneath which payments would not be made?

5. What is the administrative cost of making a payment to a policyholder?

6. Can you identify and prioritise payments to the oldest policyholders, including those in Group Pension schemes?

7. Can you identify and prioritise payments to the estates of deceased policyholders, including to those estates where the policyholder dies after the Payments Scheme is established?

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8. Can you identify and prioritise payments to policyholders with special circumstances, such as those with a terminal illness or in extreme hardship?

Following consultation with our preferred delivery partner, National Savings and Investments (NS&I), and Towers Watson, our actuarial advisors, I have set out below our answers to these questions. As you will appreciate, HMT's work on the establishment of the scheme is still very much a work in progress, so the views below represent our best current assessment of these issues, but cannot be read as a definitive view.

1. What are the delivery constraints, if any, on a pro rata allocation of the quantum according to the size of full Relative Losses?

There no delivery constraints on this approach.

2. What are the delivery constraints, if any, on giving favourable treatment to those who have suffered 'Money Losses' (i.e. where the amounts received or receivable on their policies are below the amounts invested by the policyholder)?

The following does not constitute advice on the principle of giving favourable treatment to 'money losses', but it sets out what we believe the impact of doing so would be on the delivery of the scheme. Including 'money losses' would inevitably increase the complexity of payment calculations. Our understanding from Towers Watson is that this would require a number of assumptions to be made to enable them to include the capability to calculate money losses within their current model, but that the Commission could and would need to provide advice to that effect. It would raise further 'flagged' cases, where a payment amount is not readily derivable for an individual policyholder from the model due to data issues. Towers Watson believe that the introduction of these assumptions and new flagged cases would not materially impact the timeframe for the delivery of their payment file to HMT. However, introducing complex new calculations at this stage will inevitably represent a delivery risk, as it introduces the potential for new, unforeseen difficulties in the calculation to arise.

Finally, we believe this would inevitably complicate further what is already a very complex issue, accentuating the communications challenge the scheme will face. This would be likely to increase the number of queries from individuals about how their payments have been calculated, thereby increasing costs. This would particularly be the case if policyholders received a set percentage, rather than the whole of their money loss.

3. Where is it practicable to take a combined view of multiple policies held by a single policyholder and in what circumstances is offsetting practicable?

Making payments to policyholders within Group Schemes will be more complex than making payments to individual policyholders. The poor quality of individual policyholder data, including contact details of members, means that we are unable to make these payments to many Group Scheme members directly, and will pay them through the Scheme Administrators. It also means that we are unable to match Group Scheme members to other non- group policies they hold to a high degree of accuracy to give a single

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policyholder view. It is, however, possible to give a single policyholder view across other policies.

In the existing Towers Watson calculation of relative loss, offsetting of gains against losses is applied at policyholder level within and across the AWP (excluding Group schemes) and CWP policy classes. Gains from WPA policies are also offset against losses that a policyholder has sustained in an AWP (excluding Group Schemes) or CWP policy. Gains and losses are offset where a member holds more than one policy within a single Group Scheme.

Because of the constraints set out above on matching Group Scheme members to other policies they hold, offsetting cannot be consistently applied where a Group Scheme member also holds an individual policy, or a policy within a different Group Scheme.

In addition, we only have data available to us to offset at a policyholder level, but there are various situations where the policyholder is not the ultimate beneficiary of the policy, and therefore potentially not the payee under the scheme. Key examples of this would be where policies are taken out in trust, or on behalf of another family member. To offset at beneficiary level would require Towers Watson to run a whole new series of calculations, which they could only do once all the payees had been identified, which could potentially add a delay of years to the start of the scheme, and is therefore not practicable given the Government's ambition to start making payments in the middle of this year. We are currently investigating the volume of cases in which this situation occurs. It would be helpful for your advice to include views on how far offsetting should be pursued in the face of practical difficulties of this sort.

4. <u>What are the delivery constraints, if any, of applying a *de minimis* amount beneath which payments would not be made?</u>
   There are no delivery constraints on the application of a *de minimis*.

5. <u>What is the administrative cost of making a payment to a policyholder?</u>
   Current estimates suggest that the average cost of making a payment to an individual policyholder will be in the region of £10. This is currently an indicative cost only, as we are still in negotiations with NS &I on the pricing model.

   In addition, the average cost of making a payment to an individual in a Group Scheme is likely to be higher. This is because individuals' contact data within the majority of Group Schemes is poor, and we may need to ask the Scheme Administrators to make the payments for us. If we do this we will need to enter into a contract with each relevant Scheme Administrator – we will need to set aside resources to cover the making of these contracts, and Scheme Administrators' expenses in tracking and paying their members. We do not yet have a firm estimate of the cost, because making payments to Group Scheme members will be a complex procedure, and we have not yet finalised how this fits with NS&I's pricing model.

   In addition, opening estates of deceased policyholders which have already closed is likely to increase the administrative cost of making payments to these estates. Again, we do not yet have final figures on these costs.

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6. Can you identify and prioritise payments to the oldest policyholders, including those in Group Pension schemes?
   Identifying and prioritising payments to elderly individuals should in general not be problematic for AWP or CWP policyholders. However, it will not be straightforward for Group Schemes. We are likely to be making the majority of payments to individuals within Group Schemes via a Paying Agent,- usually the Scheme Administrator, for whom, the most cost effective approach will be to make as many individual payments as possible in one pass. Therefore, we expect all traceable policyholders within a scheme to receive their payment around the same time. It would be extremely difficult and disproportionately costly to prioritise policyholders within Group Schemes based on age or any other specific criteria ,and to do so would delay the start of the scheme more generally.

7. Can you identify and prioritise payments to the estates of deceased policyholders, including to those estates where the policyholder dies after the Payments Scheme is established?
   We do not have comprehensive, up to date information on which policyholders are deceased, or the contact details for all estates (and in any event this is a moving target). To update this information would require a tracing and data cleansing exercise at the start of the scheme. It is likely that tracing estates may take some time, which adds to the justification for starting this work as soon as possible, but means that we could not guarantee to be in a position to make payments to all estates in the early months of the scheme. In addition, we anticipate that a number of payee's estates will now be closed, which will be considerably more complex to deal with, and there will be an inevitable time lag in re-opening such estates.

   The same difficulties outlined above with regards to prioritising payments to the most elderly policyholders within Group Schemes also hold true for prioritising payments to the estates of deceased members of these Schemes.

   There is no specific administrative challenge to bringing forward the payments of those who die during the lifetime of the scheme provided this is limited to cases where the delivery body are advised of these circumstances by, for example, the estate or by the deceased relative. Such a process could be built into the business procedures at the delivery body.

8. Can you identify and prioritise payments to policyholders with special circumstances, such as those with a terminal illness or in extreme hardship?
   There is an existing Government commitment that there will be no means testing within the scheme. Notwithstanding that, given no data is available to us regarding the personal circumstances of policyholders, the administration required to process such cases is likely to be extremely burdensome on both the taxpayer and the claimant, especially if it were to be rigorous enough to effectively counter fraud. The process would also inevitably need to be time-consuming, and erode a great deal (if not all) of the benefit of including a process designed to prioritise these payments. Criteria for hardship cases would need to be agreed,

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involving very difficult judgments about where to draw the line; a claims process established for policyholders to be able to apply; these claims then independently verified; and an appeals process established.

It may be possible to give the Scheme Administrator some limited administrative discretion over the order of timing of individual payments, which may provide the means of dealing with truly exceptional cases.

I hope you find this response helpful in the development of your advice.

Yours sincerely,

Mike Williams

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D: Questions asked of Towers Watson

D.1 The Commission held discussions with Towers Watson throughout the process and sought their advice on a number of specific questions, which are set out below. Towers Watson's written advice[58] is published alongside the Commission's advice to the Government.

"Allocation

1. Please set out the Government's methodology for calculating Relative Loss arising from accepted Government maladministration.

2. Please explain, with examples and a distribution of Relative Losses, how the differential treatment given to GAR policies and non-GAR policies at the time of the Compromise Scheme is factored into the methodology.

3. Please provide a distribution of Relative Losses, both on a full Relative Loss and where useful a *pro rata* allocation basis, and analysis of trends by:

   (i) age;

   (ii) policyholder class;

   (iii) those with income drawdown;

   (iv) year of entry; and

   (v) country of purchase.

4. Please explain how Relative Losses could be calculated as a percentage of policy value. Please provide a distribution of those Relative Losses and an analysis of trends.

5. Please provide the following information in relation to compensation schemes:

   (i) What previous compensation schemes has Equitable Life undertaken? If possible, please include amounts and numbers of policyholders compensated.

58 Actuarial Advice to the Independent Commission on Equitable Life Payments, Towers Watson, 20 January 2011.

(ii) Please identify which, if any, are related to Government maladministration.

(iii) Please set out how compensation is accounted for in the methodology and any implications the Commission should be aware of when forming its judgements.

6. Please provide the following information in relation to Money Loss:

(i) Please explain how the Money Loss element of Relative Loss can be calculated (both for full and partial preferential treatment scenarios), consistent with the Government's methodology, and provide a distribution of those losses.

(ii) Please provide an explanation of the factors that have caused Money Loss.

(iii) Please describe the wider circumstances that policyholders would have needed to consider when deciding whether to leave Equitable Life non-contractually.

(iv) Please confirm whether any policyholders exited contractually and suffered a Money loss.

Features

7. Please explain the impact of setting a cap at (i) £50,000 and (ii) £75,000 on the basis of a *pro rata* allocation. Please include the impact on policyholders due to receive a payment and the amount of funding that would be made available for redistribution.

8. At what level would a cap need to be set in order for the *pro rata* allocation to those policyholders with the biggest losses to be reduced, to the extent that those beneath the cap receive a (i) 10% (ii) 20% and (iii) 30% 'boost' on their *pro rata* share? How many policyholders would be affected both above and below the cap, and what would be the reduction in payment compared to a *pro rata* loss incurred by those above the cap?

9. At what level would a step (i.e. 100% of first x%) need to be set so that the bottom (i) 10%, (ii) 20%, (iii) 30% in terms of size of loss would receive their Relative Losses in full?

10. Please explain the impact of setting a *de minimis* amount on payments at i) £1 (ii) £10 (iii) £50 (iv) £100 and (v) 500 and (vi) £2000 on the basis of a *pro rata* allocation. Please include the impact on the number of policyholders due to receive a payment and the amount of funding that would be made available for redistribution.

Others

11. Please provide the distributional impact of the Commission's final recommendations, including on age, gender, ethnicity and disability. Please compare this to a *pro rata* distribution of the available quantum. This should also include the distributional impact on age and gender of the Commission's final recommendations on prioritisation of the order of payment, including an analysis of which policyholders could be paid in Years 1, 2 and 3 of the spending profile set out by HM Treasury in the Commission's Terms of Reference (27 October 2010)."

E: Methodology for calculating Relative Loss

Below is a summary, prepared by Towers Watson, of the Relative Loss Methodology.[59]

E1: Introduction

1. This Annex describes the Government's methodology for calculating Relative Loss on AWP (Accumulating With-Profit) and CWP (Conventional With-Profit) policies arising from the accepted Government maladministration in the regulation of Equitable Life. The Equitable Life Payment Scheme ("ELPS") will make payments to individuals who are deemed to have suffered a Relative Loss, subject to the funds, of £1.5bn, which have been granted to the ELPS.

2. More detail on the methodology can be found in Towers Watson's Actuarial Advice to Sir John Chadwick, in its report dated 14 July 2010 ("Advice to Sir John Chadwick"). The methodology accepted by the Government corresponds to Aggregate Stage 2 Loss, as defined in Towers Watson's letter to the Financial Secretary dated 19 October 2010.

E2: Definition

3. Relative Loss is the difference in the value of a notional policy which the policyholder might have held had they made an investment in a similar product in a comparator company's with-profits fund and the value of the actual Equitable Life policy. Where this difference is positive a Relative Loss will be calculated and where this difference is negative a Relative Gain has been made.

4. This Annex describes how Relative Loss is calculated for Equitable Life policies (excluding With-Profit Annuity ("WPA") policies). Section E3 describes the key elements of the calculation for non-WPA policies. Section E4 describes the process of offsetting losses and gains to determine an individual's Relative Loss.

59 For further information see Towers Watson, 20 January 2010.

E3: Relative Loss Calculation For Non-WPA Policies

Eligibility

5. In order to be eligible for Relative Loss, an individual must have one or more policies:

   - that were invested in Equitable Life's with-profits fund and
   - into which premiums were paid within the Loss Calculation Period.

6. We first describe the approach to calculating Relative Loss for AWP business and later consider CWP business.

AWP Relative Loss Calculation

Loss Calculation Period

7. The Loss Calculation Period is defined as the period between 1 September 1992 and 31 December 2000, inclusive, as part of the Government's methodology. A Relative Loss is only calculated in respect of premiums which were paid into Equitable Life's with-profits fund within this period.

8. Premium data is unavailable prior to 31 December 1992[60] and so, for policies which commence before 1 September 1992 premiums paid before 31 December 1992 are not included in the Loss calculation. For policies that commenced between 1 September 1992 and 31 December 1992 inclusive, the policy value at 31 December 1992 is assumed to be a premium upon which Relative Loss is calculated. This is deemed acceptable within the Methodology as it can be reasonably concluded that all premiums that contributed to the policy value were paid after 1 September 1992 for these policies.

Comparator payouts

9. The definition of Relative Loss can also be expressed as:

   Relative Loss = Comparator payout – Equitable Life (actual) payout

10. The payouts in the expression above are in respect of those premiums which were paid within the Loss Calculation period. The comparator in the expression above consists of a basket of with-profits companies which were intended to represent alternative companies offering the appropriate mix of with-profits

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60 For some individual and group policies the premium data is only available at a later date. For these policies approximations have been made in order to calculate the Relative Loss.

business over the period in question, in which investors may have invested, had they not invested in Equitable Life. The comparators, including how they differ between life and pensions business, are described in detail in Section 5 of Towers Watson's Actuarial Advice to Sir John Chadwick (pages 85 to 109).

11. The individual comparator company payouts, which make up the comparator, are not available at an individual policy level. An approximation to the comparator payout is derived from the unsmoothed investment returns of the comparator company's with-profits fund, with various adjustments applied. The adjustments include those to allow for expenses, demutualisation enhancements, shareholder transfers and smoothing. Following these adjustments the comparator payouts are then calibrated to the average of the Money Management payouts of the comparator companies. This ensures that the smoothed comparator payout reflects the published payouts of the comparator companies.

Smoothing

12. The comparator companies' returns require an adjustment to reflect the smoothing which the comparator companies would have applied to their investment returns before declaring bonuses.

The calibration to Money Management payouts

13. Calibration factors are applied, which differ for pensions and life policies and by year of premium payment and termination, to the comparator payouts (or the average of the comparator companies' payouts). The calibration ensures that the comparator payout is consistent with the published payout data for pensions and life policies.

14. More detail on the methodology used to determine the comparator payouts including the adjustments required, smoothing and calibration to payout data was provided in Section 7 of Towers Watson's Actuarial Advice to Sir John Chadwick (pages 124 to 150).

Relative Loss for maturities, deaths, surrenders and in-force policies

15. The payouts received from the comparator and Equitable Life will have differed depending on the way that policies were terminated. The approach to the calculation of the Relative Loss is therefore considered separately for:

- Policies which have matured (or policyholders who have died);
- Policies which have surrendered contractually;
- Policies which have surrendered non-contractually; and

- Policies which were still in-force at 31 December 2009.

16. Section 8.4 of Towers Watson's Actuarial Advice to Sir John Chadwick provides context around the Relative Loss methodology for each of the above.

17. Equitable Life policies which matured will have received the maximum of their overall policy value and their underlying guarantee. The comparator companies would have paid out the bonuses which had been declared plus any final or maturity bonus, the sum of which is approximated by the comparator payout as described earlier. The Relative Loss will therefore be calculated as the difference between the comparator payout and the Equitable Life payout.

    Relative Loss = Comparator payout - Equitable Life (actual) payout

18. Some policy contracts allow the policy to be surrendered contractually, on specific dates, with no penalties applied. For these polices the Relative Loss will be calculated in the same way as for policies which have matured.

19. Equitable Life policies which surrendered non-contractually may have been subject to a Market Value Adjuster ("MVA"). This was intended to bring the payout into line with the policyholder's fair share of Equitable Life's assets (i.e. his unsmoothed asset share). In order to compare like with like, in these cases Relative Loss is calculated by reference to the policyholder's notional unsmoothed asset share in the comparator, by using the comparator's with-profits investment returns prior to any adjustment for smoothing or calibration. The Relative Loss is then calculated as:

    Relative Loss = Comparator payout less any approximate deduction - Equitable Life (actual) payout

20. Relative Loss for policies which were still in-force at 31 December 2009 is calculated in the same way as for policies which have surrendered non-contractually. This assumes that the value of the underlying assets is paid out on this date. This approach also removes any distortions which may arise due to discrepancies between Equitable Life and the comparator smoothing techniques.

Interest and inflation

21. Losses on policies which were terminated prior to 31 December 2009 are calculated at the date of termination and are then accumulated to 31 December 2009 at a fixed rate of interest of 4%p.a compound, to derive the Relative Loss. This accumulation allows for inflation and interest on the amount of loss to 31 December 2009.

Overseas policies

22. Relative Losses for non-UK policies are calculated in the same way as for UK policies and the Relative Loss is then converted into a GBP loss amount using the exchange rates applicable at 31 December 2009.

Previous Compensation Schemes

23. Some Equitable Life policyholders were eligible for other compensation payments as a result of compensation schemes that were unrelated to Government maladministration. These form part of the actual Equitable Life policy value.

24. Where these payments are in respect of mis-selling compensation schemes and form an uplift to fund value, paid within the Loss Calculation Period, these are treated as a premium payment into the Equitable Life policy. Therefore, they will contribute towards any Relative Loss calculated. However, any payments with respect to mis-selling which were paid in cash are excluded from the loss calculation as they are not subject to maladministration.

25. For compensation paid due to the GAR Compromise Scheme, payments are categorised as deferred proceeds from the policy itself. These payments were made to policyholders who were disadvantaged relative to other policyholders who were either not subject to a differential terminal policy or benefitted from the GAR compromise scheme. These payments were made separately to the GAR Compromise Scheme and were not due to Government maladministration.

26. For most other compensation schemes, where Equitable Life has made a payment to a policyholder to compensate for shortfalls in administration or errors in the calculation of the benefit, the compensation is included in the Equitable Life proceeds and will generally reduce the loss incurred on that policy.

The GAR Compromise Scheme

27. As part of the GAR Compromise Scheme, which policyholders voted in favour of, Equitable Life made uplifts to GAR and non-GAR policy values on 8 February 2002, of 17.5% and 2.5% respectively. The Equitable Life policy values incorporate the effect of the GAR and non-GAR uplifts whereas the comparator payouts do not have any such uplifts applied. The GAR Compromise Scheme is described in more detail in Section 8.6.1 of Towers Watson's Actuarial Advice to Sir John Chadwick and its treatment within the GAR Compromise Scheme is described further in the main text of Towers Watson's report.

Tax

28. There is no allowance for policyholder tax within the Relative Loss methodology.

Future Losses

29. There is no allowance for future losses for AWP policies within the Relative Loss methodology.

Conventional With-Profit (CWP) policies

30. Relative Loss for CWP policies is calculated using similar principles to AWP policies, but differences in product structure require modifications to the approach described above.

Eligibility

31. In order to be eligible for Relative Loss, a CWP policy must have both commenced and paid premiums within Loss Calculation Period.

32. Relative Loss on a CWP policy is calculated in respect of all premiums paid into Equitable Life's with-profits fund, including those paid after 31 December 2000 up to 31 December 2009. Due to data issues on policies which commenced prior to 5 April 1993, approximations are required to estimate losses on these policies.

CWP Relative Loss Calculation

33. The definition of CWP Relative Loss can similarly be expressed as:

    Relative Loss = Comparator payout – Equitable Life (actual) payout

34. For CWP policies which terminate prior to 31 December 2009, the Equitable Life (actual) payout is available from the Equitable Life database. For CWP policies which were still in-force at 31 December 2009 a surrender payout is estimated in order to calculate loss in respect of past premiums paid.

35. For CWP policies a different approach to that used for AWP policies is required to estimate the comparator payout. The payout is estimated by considering the difference in the Internal Rate of Return (IRR[61]) earned by the comparator and the actual Equitable Life policy by assuming the same premiums were invested into an AWP policy rather than a CWP policy. This difference represents the additional return that is assumed to be earned on the comparator's CWP policy.

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61 The IRR of a series of cashflows is the discount rate that makes the net present value of a series of cashflows equal to zero. It represents the rate of return on the series of cashflows.

The reasoning behind the IRR approach and use of an equivalent AWP policy has previously been outlined in Section 8.3.5 of Towers Watson's Actuarial Advice to Sir John Chadwick.

Future Losses

36. As CWP policyholders are contractually obliged to continue paying premiums, a future loss is calculated for any CWP policy in-force at 31 December 2009.

37. The Equitable Life policy value at 31 December 2009, and any expected future premiums, are projected forward to the earlier of the expected maturity date and 31 December 2019 under assumed future investment returns for both Equitable Life and comparator. The assumed future investment returns are based on assumptions for equity backing ratios and asset returns. The future loss is calculated as:

    Future Relative Loss = Projected comparator payout – Projected Equitable Life payout

38. The Equitable Life and comparator payouts are simply the projected Equitable Life and comparator fund values at the assumed future exit date. These are then discounted back to 31 December 2009 at the risk-free rate of return.

E4: Offsetting

39. Once losses have been calculated for all policies, they are aggregated to determine the individual policyholder's Relative Loss.

40. Where possible each individual policyholder is assigned all Relative Losses (and gains) in respect of policies to which they hold. The sum of these losses and gains provides the net Relative Loss for an individual policyholder, or in other words their losses and gains are offset against one another.

41. Relative Losses on policies held by an individual will be offset by any relative gains on other policies held by the same individual with the exception of WPA and Group policy losses.

42. Losses on WPA policies are ring-fenced meaning that losses on WPA policies cannot be offset by gains on non-WPA policies. However, gains on WPA policies are used to offset losses on non-WPA policies.

43. It is not possible to identify members of Group schemes who also hold individual policies, or policies in different Group schemes. Therefore offsetting is only applied within Group schemes (gains and losses are offset where a member holds more than one Group policy within the same Group scheme).

F: Distributional analysis

F.1 The following tables have been produced by Towers Watson, acting under the Commission's direction. The figures and calculations in these tables either represent, or are derived from, the Relative Loss figure and Methodology on which the Government instructed the Commission to base its recommendations. Data on with-profits annuity policies (including estates) have been excluded, since these do not fall within the Commission's remit.

F.2 More information on these tables is available in Towers Watson's report to the Commission.

F.3 The tables are subject to the reliances and limitations set out in Towers Watson's report. The figures used are correct as of 31 December 2010 (and are rounded as appropriate), and reflect the changes outlined in the Financial Secretary's letter dated 18 January 2011 (see Annex B).

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Table 1: Distribution of total Relative Losses by policy group and size

Size of Relative Loss (£)			Individual policies (AWP & CWP)		Group Pension		Total		Proportion of all policyholders with a Relative Loss	
			Number	Loss (£m)	Number	Loss (£m)	Number	Loss (£m)	by Number	by Loss
No losses			144,853	n/a	290,520	n/a	435,373	n/a	n/a	n/a
0	to	10	3,363	<0.1	28,101	0.1	31,464	0.1	3%	<1%
10	to	20	4,107	0.1	18,877	0.3	22,984	0.3	2%	<1%
20	to	50	15,149	0.5	41,073	1.4	56,222	1.9	5%	<1%
50	to	100	27,675	2.0	49,818	3.7	77,493	5.7	7%	<1%
100	to	250	39,738	6.7	101,171	17.1	140,909	23.7	13%	1%
250	to	500	40,110	14.6	97,200	35.2	137,310	49.8	13%	1%
500	to	1,000	51,347	37.6	94,639	67.7	145,986	105.3	14%	3%
1,000	to	1,500	36,628	45.3	45,946	56.4	82,574	101.7	8%	3%
1,500	to	2,000	28,642	49.9	29,219	50.4	57,861	100.3	6%	3%
2,000	to	2,500	23,137	51.9	17,546	39.2	40,683	91.1	4%	3%
2,500	to	5,000	71,564	257.1	38,008	131.8	109,572	388.9	10%	11%
5,000	to	7,500	35,236	215.9	12,020	72.8	47,256	288.7	5%	8%
7,500	to	10,000	20,700	179.2	5,097	43.8	25,797	223.0	2%	6%
10,000	to	15,000	23,002	280.9	4,014	48.2	27,016	329.1	3%	10%
15,000	to	20,000	12,259	211.9	1,447	24.8	13,706	236.7	1%	7%
20,000	to	25,000	7,196	160.5	688	15.3	7,884	175.8	1%	5%
25,000	to	50,000	13,324	456.9	810	26.8	14,134	483.7	1%	14%
50,000	to	75,000	3,709	223.8	155	9.2	3,864	233.1	<1%	7%
75,000	to	100,000	1,516	130.0	52	4.4	1,568	134.5	<1%	4%
100,000	to	125,000	712	79.1	33	3.6	745	82.7	<1%	2%
125,000	to	150,000	366	49.7	27	3.7	393	53.4	<1%	2%
150,000	to	175,000	204	32.9	21	3.4	225	36.3	<1%	1%
175,000	to	200,000	159	29.7	11	2.1	170	31.8	<1%	1%
200,000	to	225,000	96	20.3	10	2.1	106	22.5	<1%	1%
225,000	to	250,000	63	14.9	5	1.2	68	16.1	<1%	<1%
Greater than		250,000	191	71.5	111	171.0	302	242.5	<1%	7%
Total policyholders with loss			460,193	2,622.8	586,099	835.9	1,046,292	3,458.7	100%	100%

Table 2A: Distribution of *pro rata* Relative Losses by policy group and size

Size of Relative Loss (£)			Individual policies (AWP & CWP) Number	Loss (£m)	Group Pension Number	Loss (£m)	Total Number	Loss (£m)	Proportion of all policyholders with a *pro rata* Loss by Number	by Loss
No losses			144,853	n/a	290,520	n/a	435,373	n/a	n/a	n/a
0	to	10	19,704	0.1	81,615	0.3	101,319	0.4	10%	<1%
10	to	20	25,134	0.4	46,676	0.7	71,810	1.1	7%	<1%
20	to	50	39,407	1.3	96,094	3.2	135,501	4.6	13%	1%
50	to	100	38,773	2.8	95,534	6.9	134,307	9.8	13%	1%
100	to	250	67,990	11.4	124,077	20.0	192,067	31.4	18%	4%
250	to	500	66,835	24.3	70,939	25.0	137,774	49.4	13%	6%
500	to	1,000	72,367	52.1	42,113	29.3	114,480	81.4	11%	10%
1,000	to	1,500	37,264	45.6	13,845	16.8	51,109	62.4	5%	8%
1,500	to	2,000	22,192	38.4	6,105	10.5	28,297	48.9	3%	6%
2,000	to	2,500	14,598	32.6	3,111	6.9	17,709	39.6	2%	5%
2,500	to	5,000	32,199	112.2	4,447	14.9	36,646	127.0	4%	16%
5,000	to	7,500	10,421	63.4	796	4.8	11,217	68.1	1%	9%
7,500	to	10,000	4,863	41.8	252	2.1	5,115	44.0	<1%	6%
10,000	to	15,000	4,328	52.4	196	2.3	4,524	54.8	<1%	7%
15,000	to	20,000	1,835	31.6	65	1.1	1,900	32.7	<1%	4%
20,000	to	25,000	887	19.7	36	0.8	923	20.5	<1%	3%
25,000	to	50,000	1,139	38.0	81	2.8	1,220	40.8	<1%	5%
50,000	to	75,000	166	9.9	26	1.6	192	11.5	<1%	1%
75,000	to	100,000	57	4.8	11	1.0	68	5.8	<1%	1%
100,000	to	125,000	18	2.0	13	1.5	31	3.4	<1%	<1%
125,000	to	150,000	4	0.6	10	1.4	14	1.9	<1%	<1%
150,000	to	175,000	5	0.8	3	0.5	8	1.3	<1%	<1%
175,000	to	200,000	2	0.4	4	0.8	6	1.1	<1%	<1%
200,000	to	225,000	4	0.9	6	1.2	10	2.1	<1%	<1%
225,000	to	250,000	0	0.0	2	0.5	2	0.5	<1%	<1%
Greater than		250,000	1	0.3	42	30.2	43	30.5	<1%	4%
Total policyholders with loss			460,193	587.7	586,099	187.3	1,046,292	775.0	100%	100%

Table 2B: Distribution of *pro rata* payments by policy group and size, including a £10 *de minimis* on payments to any single policyholder

Size of payment (£)			Individual policies (AWP & CWP)		Group Pension		Total		Proportion of all policyholders receiving a payment	
			Number	Loss (£m)	Number	Loss (£m)	Number	Loss (£m)	by Number	by Loss
0	to	10	0	0.0	0	0.0	0	0.0	0%	0%
10	to	20	25,102	0.4	46,658	0.7	71,760	1.1	8%	<1%
20	to	50	39,428	1.3	96,060	3.2	135,488	4.6	14%	1%
50	to	100	38,752	2.8	95,539	6.9	134,291	9.8	14%	1%
100	to	250	67,980	11.4	124,058	20.0	192,038	31.4	20%	4%
250	to	500	66,831	24.3	70,983	25.0	137,814	49.4	15%	6%
500	to	1,000	72,361	52.1	42,145	29.3	114,506	81.4	12%	11%
1,000	to	1,500	37,273	45.6	13,844	16.8	51,117	62.4	5%	8%
1,500	to	2,000	22,207	38.4	6,120	10.5	28,327	49.0	3%	6%
2,000	to	2,500	14,602	32.6	3,112	6.9	17,714	39.6	2%	5%
2,500	to	5,000	32,219	112.2	4,455	14.9	36,674	127.1	4%	16%
5,000	to	7,500	10,426	63.4	794	4.7	11,220	68.1	1%	9%
7,500	to	10,000	4,870	41.9	254	2.2	5,124	44.0	1%	6%
10,000	to	15,000	4,331	52.5	196	2.3	4,527	54.8	<1%	7%
15,000	to	20,000	1,840	31.7	65	1.1	1,905	32.8	<1%	4%
20,000	to	25,000	888	19.8	36	0.8	924	20.6	<1%	3%
25,000	to	50,000	1,140	38.0	81	2.8	1,221	40.8	<1%	5%
50,000	to	75,000	166	9.9	26	1.6	192	11.5	<1%	1%
75,000	to	100,000	57	4.8	11	1.0	68	5.8	<1%	1%
100,000	to	125,000	18	2.0	13	1.5	31	3.4	<1%	<1%
125,000	to	150,000	4	0.6	10	1.4	14	1.9	<1%	<1%
150,000	to	175,000	5	0.8	3	0.5	8	1.3	<1%	<1%
175,000	to	200,000	2	0.4	4	0.8	6	1.1	<1%	<1%
200,000	to	225,000	4	0.9	6	1.2	10	2.1	<1%	<1%
225,000	to	250,000	0	0.0	2	0.5	2	0.5	<1%	<1%
Greater than		250,000	1	0.3	42	30.3	43	30.5	<1%	4%
P'holders receiving a payment			440,507	587.9	504,517	187.1	945,024	775.0	100%	100%

Table 3A: Impact of Commission's proposals on Individual policyholders – Relative Loss and Proposed Payment by Age Band

	Individual policy (AWP and CWP) policyholders with Relative Loss			Individual policy (AWP and CWP) policyholders with *pro rata* Loss with £10 *de minimis*		
Age	**Number**	**Loss (£m)**	**Average loss (£)**	**Number**	**Loss (£m)**	**Average loss (£)**
<40	50,118	56.0	1,118	45,392	12.5	276
40 - 44	51,936	96.0	1,849	48,737	21.5	441
45 - 49	60,013	179.0	2,983	57,101	40.1	703
50 - 54	57,384	244.4	4,258	55,394	54.8	989
55 - 59	56,491	296.9	5,256	55,016	66.6	1,210
60 - 64	62,705	418.4	6,673	61,253	93.8	1,531
65 - 69	45,968	403.0	8,767	44,998	90.3	2,008
70 - 74	32,942	400.0	12,144	31,960	89.7	2,806
75 - 79	20,566	305.4	14,850	19,730	68.5	3,470
80 - 84	9,502	121.3	12,762	9,055	27.2	3,002
85 - 90	2,901	32.0	11,017	2,776	7.2	2,581
>=90	1,322	19.1	14,417	1,300	4.3	3,287
Deceased	8,343	51.3	6,146	7,793	11.5	1,475
Unknown Age	2	<0.1	1,339	2	<0.1	300
Total	460,193	2,622.8	5,699	440,507	587.9	1,335

Table 3B: Impact of Commission's proposals on Group policies – Relative Loss and Proposed Payment by Age Band

	Group Pension policies with Relative Loss			Group Pension policyholders with *pro rata* Loss with £10 *de minimis*		
Age	**Number**	**Loss (£m)**	**Average loss (£)**	**Number**	**Loss (£m)**	**Average loss (£)**
<40	52,464	20.3	388	38,414	4.5	117
40 - 44	75,164	52.4	697	62,127	11.7	188
45 - 49	89,433	82.6	924	76,531	18.5	241
50 - 54	84,627	95.8	1,132	75,047	21.4	286
55 - 59	86,456	128.4	1,485	78,239	28.7	367
60 - 64	92,649	166.3	1,795	83,631	37.3	445
65 - 69	57,617	112.7	1,956	51,338	25.2	492
70 - 74	22,073	31.8	1,439	18,251	7.1	389
75 - 79	2,770	1.3	460	1,463	0.3	192
80 - 84	320	0.1	286	116	<0.1	171
85 - 90	9	<0.1	376	4	<0.1	183
>=90	0	<0.1	0	0	<0.1	0
Deceased	4,267	4.0	943	3,460	0.9	260
Unknown Age	18,250	140.1	7,678	15,896	31.4	1,976
Total	586,099	835.9	1,426	504,517	187.1	371

Table 3C: Impact of Commission's proposals on all policies – Relative Loss and Proposed Payment by Age Band

	Relative Loss				*Pro rata* Loss with £10 *de minimis*				
Age	**Number**	**%age of all policy-holders**	**Loss (£m)**	**Average loss (£)**	**Number**	**%age of all policy-holders**	**Loss (£m)**	**Average loss (£)**	**Average policy size (£)**
<40	102,582	82%	76.4	745	83,806	67%	17.0	203	3,340
40 - 44	127,100	83%	148.4	1,168	110,864	72%	33.2	300	5,349
45 - 49	149,446	80%	261.7	1,751	133,632	72%	58.6	439	8,270
50 - 54	142,011	80%	340.2	2,395	130,441	73%	76.2	584	12,365
55 - 59	142,947	77%	425.3	2,975	133,255	72%	95.3	715	17,726
60 - 64	155,354	71%	584.8	3,764	144,884	66%	131.1	905	24,991
65 - 69	103,585	61%	515.7	4,978	96,336	57%	115.6	1,200	33,333
70 - 74	55,015	47%	431.8	7,849	50,211	43%	96.8	1,928	46,355
75 - 79	23,336	39%	306.7	13,142	21,193	35%	68.7	3,244	61,626
80 - 84	9,822	50%	121.4	12,355	9,171	47%	27.2	2,966	77,683
85 - 90	2,910	45%	32.0	10,984	2,780	43%	7.2	2,578	65,972
>=90	1,322	58%	19.1	14,417	1,300	57%	4.3	3,287	54,032
Deceased	12,610	49%	55.3	4,385	11,253	44%	12.4	1,101	35,626
Unknown Age	18,252	60%	140.1	7,677	15,898	52%	31.4	1,976	16,279
Total	1,046,292	71%	3,458.7	3,306	945,024	64%	775.0	820	21,648

Table 4: Relative Loss as a proportion of 2000 Year End Policy Value

			Number of policyholders with Relative Loss analysed by loss as a proportion of policy value at 2000 year end											
Size of loss (£)			**0 - 10%**	**10 - 20%**	**20 - 30%**	**30 - 40%**	**40 - 50%**	**50 – 60%**	**60 - 70%**	**70 - 80%**	**80 - 90%**	**90 - 100%**	**100% +**	**Total**
0	to	10	8,349	6,812	7,592	2,824	154	30	21	5	6	1	56	25,850
10	to	20	5,867	4,520	5,100	1,590	95	11	4	2	1	2	2	17,194
20	to	50	13,274	12,751	12,493	3,272	320	21	8	3	4	2	9	42,157
50	to	100	15,429	15,910	25,248	6,746	935	35	8	4	4	3	22	64,344
100	to	250	29,427	31,947	44,716	11,376	3,513	133	21	7	5	2	34	121,181
250	to	500	26,442	31,451	44,347	14,334	3,289	221	47	25	14	7	53	120,230
500	to	1,000	24,538	36,651	45,543	18,727	4,074	391	73	40	32	30	110	130,209
1,000	to	1,500	13,769	21,172	24,487	11,628	2,786	297	38	13	17	9	68	74,284
1,500	to	2,000	9,823	15,297	16,583	8,187	2,077	263	36	8	13	9	51	52,347
2,000	to	2,500	5,511	11,261	11,754	6,523	1,660	190	20	11	6	8	36	36,980
2,500	to	5,000	13,340	31,737	31,350	17,456	4,824	712	60	24	23	18	87	99,631
5,000	to	7,500	5,300	12,595	14,044	8,216	2,270	357	37	6	13	6	54	42,898
7,500	to	10,000	2,646	6,594	7,622	4,647	1,461	251	18	8	7	2	30	23,286
10,000	to	15,000	2,549	6,664	8,171	5,192	1,510	240	17	5	6	5	25	24,384
15,000	to	20,000	1,139	3,238	4,277	2,590	812	143	13	3	3	2	18	12,238
20,000	to	25,000	596	1,830	2,492	1,604	437	76	4	2	0	2	8	7,051
25,000	to	50,000	832	3,183	4,666	2,960	768	157	9	6	5	4	18	12,608
50,000	to	75,000	167	799	1,458	871	169	44	5	1	0	0	9	3,523
75,000	to	100,000	39	263	625	361	86	15	4	2	0	0	2	1,397
100,000	to	125,000	15	134	296	196	56	6	0	0	1	1	1	706
125,000	to	150,000	6	72	174	89	28	9	0	0	0	0	0	378
150,000	to	175,000	3	44	86	67	14	2	0	0	0	0	1	217
175,000	to	200,000	4	27	65	56	10	2	0	0	1	0	0	165
200,000	to	225,000	1	18	46	25	6	2	2	0	0	0	0	100
225,000	to	250,000	1	9	33	8	2	2	0	0	0	0	0	55
Greater than		250,000	4	55	100	72	19	11	13	0	1	1	4	280
Deceased			2,499	2,395	1,638	1,097	614	115	17	1	3	2	16	
Total			181,570	257,429	315,006	130,714	31,989	3,736	475	176	165	116	714	922,090

Note: Not all policyholders with Relative Losses are included here, because not all have a policy statement (and hence a policy value) on 31/12/2000.

Table 5: Individual policy (AWP and CWP) and Group Pension Relative Losses by entry year

	Individual policies (AWP and CWP)			Group Pension				
Entry Year	Loss (£m)	Number of policy-holders	Average Relative Loss (£)	Loss (£m)	Number of policy-holders	Average Relative Loss (£)	Proportion of policy-holders	Average policy size (£)
before 1987	685.2	56,914	12,040	18.2	12,488	1,456	44.2%	79,454
1987	79.7	10,558	7,551	10.0	6,570	1,519	43.7%	38,144
1988	153.0	25,545	5,989	30.5	23,229	1,314	46.9%	23,473
1989	228.6	46,484	4,918	38.0	23,056	1,648	60.0%	22,738
1990	133.7	21,221	6,298	39.8	23,218	1,712	54.4%	21,537
1991	149.0	21,725	6,857	42.4	26,878	1,577	57.6%	19,805
1992	190.1	24,473	7,768	147.5	32,599	4,524	70.3%	21,070
1993	172.1	22,421	7,675	147.4	40,110	3,674	80.4%	17,329
1994	140.6	21,417	6,567	69.9	41,348	1,691	79.8%	13,812
1995	155.6	24,302	6,402	71.3	49,075	1,452	83.4%	12,896
1996	178.9	31,601	5,660	76.2	61,613	1,237	85.1%	12,331
1997	159.4	38,251	4,168	64.3	70,755	909	85.4%	8,993
1998	105.8	35,408	2,988	43.9	65,968	666	84.9%	7,477
1999	66.1	50,118	1,318	27.1	61,369	442	86.9%	4,875
2000	25.1	29,755	845	9.5	47,823	198	86.9%	3,551
Total	2,622.8	460,193	5,699	835.9	586,099	1,426	70.6%	21,648

Table 6: Distribution of Money Losses by policy group and size of Money Loss

Size of Money Loss bands (£)			Individual policies (AWP & CWP) Number	Individual policies (AWP & CWP) Money Loss (£m)	Group Pension Number	Group Pension Money Loss (£m)	Total Number	Total Loss (£m)
0	to	10	6,720	<0.1	14,386	0.1	21,106	0.1
10	to	20	4,419	0.1	9,454	0.1	13,873	0.2
20	to	50	12,754	0.5	20,784	0.7	33,538	1.2
50	to	100	13,130	0.9	25,474	1.9	38,604	2.8
100	to	250	14,429	2.4	45,087	7.4	59,516	9.8
250	to	500	11,290	4.1	28,170	9.9	39,460	14.0
500	to	1,000	11,644	8.4	15,787	11.0	27,431	19.3
1,000	to	1,500	5,972	7.3	5,025	6.1	10,997	13.4
1,500	to	2,000	3,587	6.2	2,242	3.9	5,829	10.1
2,000	to	2,500	2,430	5.4	1,214	2.7	3,644	8.1
2,500	to	5,000	5,264	18.3	1,737	5.8	7,001	24.1
5,000	to	7,500	1,818	11.1	309	1.9	2,127	12.9
7,500	to	10,000	881	7.5	87	0.7	968	8.3
10,000	to	15,000	844	10.3	69	0.8	913	11.1
15,000	to	20,000	418	7.2	34	0.6	452	7.8
20,000	to	25,000	168	3.7	23	0.5	191	4.3
25,000	to	50,000	301	10.2	28	1.0	329	11.2
50,000	to	75,000	56	3.4	16	1.0	72	4.4
75,000	to	100,000	31	2.7	8	0.7	39	3.4
100,000	to	125,000	9	1.0	6	0.7	15	1.7
125,000	to	150,000	1	0.1	8	1.1	9	1.2
150,000	to	175,000	2	0.3	5	0.8	7	1.2
175,000	to	200,000	2	0.4	2	0.4	4	0.8
200,000	to	225,000	2	0.4	0	<0.1	2	0.4
225,000	to	250,000	1	0.2	2	0.5	3	0.7
Greater than		250,000	6	3.0	22	14.2	28	17.2
Total Money Loss			96,179	115.2	169,979	74.4	266,158	189.5
Total Relative Loss			460,193	2,622.8	586,099	835.9	1,046,292	3,458.7
Proportion			20.9%	4.4%	29.0%	8.9%	25.4%	5.5%

Table 7: Individual policy (AWP and CWP) and Group Pension Money Losses by entry year

	Individual policies (AWP and CWP)			Group Pension			
Entry Year	Money Loss (£m)	Number of policy- holders	Average Money Loss	Money Loss (£m)	Number of policy- holders	Average Money Loss	P'holders with Money Loss as a Proportion of p'holders with Relative Loss
before 1987	12.7	2,764	£4,612	0.3	453	£591	5%
1987	1.7	631	£2,719	0.1	186	£714	5%
1988	3.4	1,878	£1,784	0.5	1,887	£281	8%
1989	6.1	4,570	£1,328	0.6	1,618	£372	9%
1990	3.8	2,017	£1,904	0.8	1,498	£537	8%
1991	3.9	2,088	£1,867	0.8	1,939	£396	8%
1992	3.9	2,498	£1,568	10.0	2,539	£3,936	9%
1993	2.3	1,596	£1,411	10.0	3,206	£3,107	8%
1994	3.1	2,204	£1,405	2.4	6,672	£354	14%
1995	5.7	3,646	£1,570	4.3	11,180	£382	20%
1996	9.6	6,657	£1,437	8.2	19,518	£422	28%
1997	13.2	10,531	£1,256	11.0	27,035	£408	34%
1998	16.1	12,189	£1,324	13.0	30,782	£423	42%
1999	19.6	30,539	£642	8.9	32,744	£271	57%
2000	10.0	12,371	£807	3.5	28,722	£123	53%
Total	115.2	96,179	£1,197	74.4	169,979	£438	25%

Note: The Money Loss suffer by Group policies which commence in 1992 and 1993 is, on average, significantly higher than the Money Loss suffered by individual policyholders and Group policyholders who entered in other years. This is due in part to some large Group policies commencing in 1992 and in 1993.

Table 8: Prioritisation by age in the order of payments of the available quantum (with £10 *de minimis*) – policyholders from all classes treated equally

		Loss (£m)	Number of policyholders	Percentage of losses paid	Percentage of policyholders paid	Year of payment
Deceased	AWP & CWP	11.5	7,793	1.5%	0.8%	First
	Group	0.9	3,460	1.6%	1.2%	First
>= 90	AWP & CWP	4.3	1,300	2.2%	1.3%	First
	Group	0.0	0	2.2%	1.3%	First
85 - 89	AWP & CWP	7.2	2,776	3.1%	1.6%	First
	Group	<0.1	4	3.1%	1.6%	First
80 - 84	AWP & CWP	27.2	9,055	6.6%	2.6%	First
	Group	<0.1	116	6.6%	2.6%	First
75 - 79	AWP & CWP	68.5	19,730	15.4%	4.7%	First
	Group	0.3	1,463	15.5%	4.8%	First
70 - 74	AWP & CWP	89.7	31,960	27.0%	8.2%	First
	Group	7.1	18,251	27.9%	10.1%	First
65 - 69	AWP & CWP	90.3	44,998	39.6%	14.9%	First
	Group	25.2	51,338	42.9%	20.3%	First
60 - 64	AWP & CWP	93.8	61,253	55.0%	26.8%	First / Second
	Group	37.3	83,631	59.8%	35.7%	First / Second
55 - 59	AWP & CWP	66.6	55,016	68.4%	41.5%	Second
	Group	28.7	78,239	72.1%	49.8%	Second
50 - 54	AWP & CWP	54.8	55,394	79.1%	55.6%	Third
	Group	21.4	75,047	81.9%	63.6%	Third
45 - 49	AWP & CWP	40.1	57,101	87.1%	69.6%	Third
	Group	18.5	76,531	89.5%	77.7%	Third
40 - 44	AWP & CWP	21.5	48,737	92.2%	82.9%	Third
	Group	11.7	62,127	93.7%	89.4%	Third
< 40	AWP & CWP	12.5	45,392	95.4%	94.3%	Third
	Group	4.5	38,414	95.9%	98.3%	Third
Unknown Age	AWP & CWP	<0.1	2	95.9%	98.3%	Third
	Group	31.4	15,896	100.0%	100.0%	Third
Total		775.0	945,024			

Table 9: Prioritisation by age in the order of payments of the available quantum (with £10 *de minimis*) – Group Pension policyholders all assumed to receive payment in years 2 and 3 of the Payments Scheme

		Loss (£m)	Number of policyholders	Percentage of losses paid	Percentage of policyholders paid	Year of payment
Individual (AWP & CWP)	Deceased	11.5	7,793	1.5%	0.8%	First
	>= 90	4.3	1,300	2.0%	1.0%	First
	85 - 89	7.2	2,776	3.0%	1.3%	First
	80 - 84	27.2	9,055	6.5%	2.2%	First
	75 - 79	68.5	19,730	15.3%	4.3%	First
	70 - 74	89.7	31,960	26.9%	7.7%	First
	65 - 69	90.3	44,998	38.5%	12.4%	First
	60 - 64	93.8	61,253	50.6%	18.9%	First
	55 - 59	66.6	55,016	59.2%	24.7%	Second
	50 - 54	54.8	55,394	66.3%	30.6%	Second
	45 - 49	40.1	57,101	71.5%	36.7%	Second
	40 - 44	21.5	48,737	74.2%	41.8%	Second
	< 40	12.5	45,392	75.9%	46.6%	Second
Group	Unknown Age	<0.1	2	75.9%	46.6%	Second
	Deceased	0.9	3,460	76.0%	47.0%	Second
	Living	186.2	501,057	100.0%	100.0%	Second/Third
Total		775.0	945,024			

Table 10: *Pro rata* distribution of Relative Losses by age and gender

	Male[1]		Female		Total	
Age	**Number**	**Loss (£m)**	**Number**	**Loss (£m)**	**Number**	**Loss (£m)**
<40	52,178	9.6	50,404	7.5	102,582	17.1
40 - 44	67,604	20.6	59,496	12.6	127,100	33.3
45 - 49	86,226	40.4	63,220	18.2	149,446	58.6
50 - 54	87,377	56.1	54,634	20.2	142,011	76.2
55 - 59	89,750	73.0	53,197	22.3	142,947	95.3
60 - 64	99,029	101.7	56,325	29.3	155,354	131.0
65 - 69	67,348	89.5	36,237	26.1	103,585	115.6
70 - 74	38,709	76.5	16,306	20.3	55,015	96.8
75 - 79	16,680	55.1	6,656	13.6	23,336	68.7
80 - 84	7,132	21.0	2,690	6.2	9,822	27.2
85 - 90	1,861	4.5	1,049	2.7	2,910	7.2
>=90	711	2.3	611	1.9	1,322	4.3
Deceased	8,870	8.8	3,740	3.6	12,610	12.4
Unknown Age[1]	17,878	31.1	369	<0.1	18,252	31.4
Total[2]	641,353	590.2	404,934	184.5	1,046,292	775.0

1 Group schemes in the name of trustees are assigned Male gender status and no date of birth

2 Due to data issues, there are five policyholders where the gender is unknown with £0.3 million of *pro rata* losses

Table 11: *Pro rata* distribution of Relative Losses, incorporating a £10 *de minimis*, by age and gender

	Male[1]		Female		Total	
Age	**Number**	**Loss (£m)**	**Number**	**Loss (£m)**	**Number**	**Loss (£m)**
<40	43,277	9.6	40,529	7.5	83,806	17.0
40 - 44	60,411	20.6	50,453	12.6	110,864	33.2
45 - 49	79,079	40.4	54,553	18.2	133,632	58.6
50 - 54	81,682	56.1	48,759	20.1	130,441	76.2
55 - 59	84,701	73.0	48,554	22.3	133,255	95.3
60 - 64	93,338	101.7	51,546	29.3	144,884	131.1
65 - 69	63,320	89.5	33,016	26.1	96,336	115.6
70 - 74	35,660	76.5	14,551	20.3	50,211	96.8
75 - 79	15,104	55.1	6,089	13.6	21,193	68.7
80 - 84	6,599	21.0	2,572	6.2	9,171	27.2
85 - 90	1,768	4.5	1,012	2.7	2,780	7.2
>=90	698	2.4	602	1.9	1,300	4.3
Deceased	7,972	8.8	3,281	3.6	11,253	12.4
Unknown Age[1]	15,637	31.1	256	<0.1	15,898	31.4
Total[2]	589,246	590.3	355,773	184.4	945,024	775.0

1 Group schemes in the name of trustees are assigned Male gender status and no date of birth

2 Due to data issues, there are five policyholders where the gender is unknown with £0.3 million of *pro rata* losses

Table 12: Gender impact on prioritisation scenarios

	Male	Female
Total Relative Losses (£m)	2,632.8	822.7
Total *pro rata* Losses (£m)	590.3	184.4
Proportion of *pro rata* Losses	76%	24%
All policyholders prioritised by Age		
Proportion of *pro rata* losses paid in year one	56%	53%
Proportion of *pro rata* losses paid in year two	18%	16%
Proportion of *pro rata* losses paid in year three	27%	32%
Individual (AWP and CWP) policyholders prioritised by and age with Group policyholders paid subsequently		
Proportion of *pro rata* losses paid in year one	51%	50%
Proportion of *pro rata* losses paid in years two and three	49%	50%

Note: Due to data issues, Table 12 excludes five policyholders where the gender is unknown with £1.3 million of Relative Losses and £0.3 million of *pro rata* losses.

G: List of respondents to the invitation for initial thoughts and discussion paper

List of respondents to the invitation for initial thoughts and discussion paper

G.1 The Commission has sought to publish all representations, either in full or in part, where they are relevant to its remit, in order to aid transparency.

G.2 The published correspondence and representations have been redacted where, in the view of the Commission, it may be inappropriate to publish the views expressed. For example, confidential information or information that might identify individuals has been redacted. Names have been included where the Commission has individual correspondents' permission; others have been published anonymously. These will be published on the Commission's website at http://equitablelifepayments.independent.gov.uk/publications.html.

Respondents to the invitation for initial thoughts published in September 2010

G.3 On 3 November 2010 the Commission published a representative sample of the submissions and correspondence received in response to the invitation issued in September 2010 for initial views from interested parties. The Commission received more than 50 responses in total.

G.4 The Commission sought to publish all representations, where appropriate. During this initial phase, the Commission received much correspondence from with-profits annuitants. The Commission's Terms of Reference, revised on 27 October 2010, excluded with-profits annuitants from its remit, but a representative sample of these views was included for the purposes of transparency. The Commission has not otherwise published representations from individuals that focus on issues outside its remit, such as the total funding being made available for the Payments Scheme or payment mechanisms.

Responses from representative groups and other bodies:

Equitable Late Contributors Action Group ("ELCAG")

Equitable Life Trapped Annuitants ("ELTA")

Guernsey Financial Services Commission

Responses from individuals willing to be identified:

Mr Roy Bartram and Mrs Kathleen Bartram

Mr Robert Dyer

Ms Margaret Felgate

Mr Martin Gilmore

Mr Geoffrey Glover

Mr David Gordon

Mr Michael Josephs

Dr John London

Dr Michael Nassim

Mr John Snow

Mr Brian Thompson

Mr Alan Wakeford

Respondents to the discussion paper published in November 2010

The Commission received more than 60 written representations in total.

Responses from representative groups and other bodies:

Equitable Life Assurance Society

Equitable Life Member Support Group

Equitable Life Trapped Annuitants (“ELTA”)

Equitable Members Action Group (“EMAG”)

Guernsey Financial Services Commission

Merseyside Pension Fund

National Association of Pension Funds (“NAPF”)

Tyne and Wear Pension Fund

West Yorkshire Pension Fund

Responses from individuals willing to be identified

Ms Penelope Blackmore

Ms Margaret Felgate

Mr Bryan Firth

Mr C. A. Griffiths

Mr James Lingard

Mr Peter Murton

Mr Stephen Phillips

Mr Simon Randall

Mr Keith Sheppard

Mr F. Stoddart

Mr John Watson

Mr Philip Wilmot

H: Glossary

Accumulating with-profits policy (AWP) A class of policy in which the policy value grows as premiums are contributed and reversionary bonuses are credited.

Additional Voluntary Contributions (AVCs) Voluntary contributions made by a member of an occupational pension scheme over and above his or her normal contributions.

Annuitant An annuity policyholder.

Annuity (conventional or non-profit) A policy into which a policyholder pays a single premium, (often the proceeds of a pensions policy) in return for guaranteed benefits until the death of the policyholder, usually for the purpose of providing an income during retirement.

Asset share The value of a life insurance policy, calculated as the accumulation of premiums paid with actual investment returns, net of expenses, charges for the cost of guarantees, tax and other deductions. The unsmoothed Asset Share reflects the actual value of the underlying assets; the smoothed asset share reflects the smoothing of volatile returns that an insurance company applies to its with-profits policies.

Cap A maximum amount that will be paid to any eligible policyholder (the cap would apply to policies in the case of Group policies).

Compensation schemes (previous) Schemes that provided redress to policyholders (in the form of cash payments or uplifts to policy values) who had seen their benefits compromised due to errors or misinformation (including mis-selling by company representatives). No previous scheme has been identified that compensated policyholders for accepted Government maladministration.

Compromise Scheme The scheme, effective on 8 February 2002, which removed GAR benefits from policies in return for an average increase in policy values of 17.5 per cent for holders of GAR policies. Non-GAR policyholders received on average a 2.5 per cent uplift to their policy values in exchange for giving up the right to make GAR-related claims against Equitable Life.

Contractual exit Policy termination in accordance with the contractual terms of the insurance contract, usually on occurrence of a specified event (for example maturity), after which the policy is no longer 'in-force'. On contractual exit, the policyholder is entitled to receive a minimum of the guaranteed value of the policy. See also 'Non-contractual exit'.

Conventional with-profits policy (CWP) A class of policy which has a clearly defined initial guaranteed amount usually payable at maturity or on death of the policyholder. This guaranteed amount is usually much higher than the initial investment in the policy, and is increased from the premium paid through the duration of the policy by the addition of regular or reversionary bonuses which, once added, cannot be taken away. A terminal or final bonus is often paid in addition on termination.

De minimis A specified amount beneath which payments would not be made. This could either be in regard to any one policy, or any one policyholder.

Differential Terminal Bonus Policy (DTBP) A policy implemented by Equitable Life whereby Equitable Life reduced the terminal bonus paid to a policyholder who took benefits to which a guaranteed annuity rate was applied. The benefits were reduced by such an amount as to make the resulting policy value equal to that paid to a policyholder who opted to take benefits at the current annuity rate (subject always to the minimum guaranteed benefits).

End Date The date at which the amount of Relative Loss is calculated (31 December 2009). For policies which have terminated prior to this date, interest is paid from the date of termination to this date.

Equitable Life Payments Scheme ("the Payments Scheme") The Payments Scheme announced by the Government to "make fair and transparent payments to Equitable Life policyholders... for their Relative Loss as a consequence of regulatory failure." The Commission has been asked to recommend how best to allocate fairly available funds within this Payments Scheme, and to advise on whether any groups should receive priority in the order of payments (excepting WPAs and their estates in both cases).

Guaranteed Annuity Rate (GAR) The rate governing the minimum amount that an insurance company would pay on an immediate retirement, expressed as a percentage of the fund converted to pension. Unlike the current annuity rate, this was based on an interest rate and a mortality basis specified within the policy and expressed as a guarantee.

Group Pension policy A policy class whereby each policy represents the interests of several individuals. It is usually administered by a trustee.

Income Drawdown policy (Equitable Life's Managed Annuity policy) Income drawdown (also known as "Unsecured Pension" or "Managed Annuity policies") is the name given to a product which allows policyholders to keep retirement savings invested and take an income each year rather than buy an annuity. The amount that can be withdrawn each year must fall between Government-set limits.

Market Value Adjuster (MVA) An adjustment applied to non-contractual terminations to ensure the payout targets approximately 100 per cent of the unsmoothed asset share.

Money Loss The loss resulting where the amounts received or receivable on policies were below the amounts the policyholder actually invested, which would be capped at Relative Loss.

Non-contractual exit Where the policyholder terminates a policy before it has matured or reached its end date, which usually incurs a financial penalty.

Offsetting A method of summing the losses and gains made on policies held by a single policyholder. Losses on one policy would be reduced by gains on other policies, and vice versa, in order to calculate net loss.

Policy class A particular category of with-profits Equitable Life policies. See sections on AWP, CWP, Group Pension policy and WPA for further information.

Policy value The full value of the policy accumulated at the overall rate of return declared to date. The policy value is comprised of both guaranteed and non-guaranteed components.

Policy value cuts Equitable Life made a series of cuts to AWP policy values in the early 2000s. The first cuts were made in 2001 and reduced policy values by 16 per cent for Pensions policies, and by 14 per cent for Life policies. In 2002, further cuts of 10 per cent were made to the policy values of Pensions policies (9 per cent for Life policies). The value of CWP policies was also cut, but for these policies the cuts were made by reducing the rate of final bonus. International policies also suffered policy value cuts, but these were generally applied later, depending on where the policy was domiciled. Other policy value cuts have also been made since.

***Pro rata* allocation** Where the £775 million quantum is distributed to policyholders in direct proportion to their Relative Losses.

Relative Loss Relative Loss is the difference in the value of a notional policy which the policyholder might have held had they made an investment in a similar product in a comparator company's with- profits fund and the value of the actual Equitable Life policy.

Relative Loss Methodology ("The Methodology") The Methodology that underpins the Government's accepted definition of Relative Loss (see Annex E), which the Commission has been asked to use as the basis for its calculations.

Relative Gain Where the amount actually received or receivable on a policy is greater than the amount that the policyholder would have received if they invested in comparator products elsewhere.

Step An allocation whereby policyholders will receive, as a minimum, a given percentage of the first part of their Relative Losses.

With-profits annuitant (WPA) The holder of a class of policy where a single premium is paid by the policyholder in return for a series of annuity payments paid until death. The level of annuity payment received each year will depend on bonuses credited to the policy as well as choices made by the policyholder at commencement. WPAs are excluded from the Commission's remit.

ISBN 978-1-84532-828-3
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