HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number 5971, 5 November 2015

Equitable Life compensation scheme

By Timothy Edmonds

Inside:

Contents

Summary

The Coalition Government of 2010 accepted the Parliamentary Ombudsman's recommendations to pay compensation to Equitable Life policyholders who had been affected by the company's financial problems going back 25 years and the failure of government bodies to prevent such problems.

After consultation a Compensation Scheme was established. It was an enormous administrative task attempted in a short time span. The Scheme was criticised as not being nearly generous enough by Equitable Life policyholders and by the National Audit Office for operational problems.

Nevertheless the Scheme managed to

1. The compensation scheme

1.1 Introduction

Having accepted the principle of compensation, the new Coalition Government published the first details of the shape of the package as part of the 2010 Comprehensive Spending Review. The Government announced that a compensation package of £1.5 billion would be payable to Equitable Life policyholders. The full statement by the Financial Secretary outlining this policy is shown below:

> **The Financial Secretary to the Treasury (Mark Hoban)**: Our Programme for Government pledged to "implement the Parliamentary Ombudsman‟s recommendation to make fair and transparent payments to Equitable Life policyholders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure." It has been this Governments priority to provide a swift resolution to policyholders who have been waiting ten years for justice.
>
> A commitment to fair payments must be founded on a fair assessment of the losses suffered by policyholders, and that must start with the Ombudsman's approach. She sets this out in her report, *Equitable Life; a decade of regulatory failure,* where she introduces the concept of „relative loss‟: that is the difference between what Equitable Life policyholders actually received from their policies, and what they would have received if they had invested elsewhere .The representations I have received over the summer from policyholders and their representatives have overwhelmingly supported this definition, and I believe that it is the right basis for calculating loss.
>
> [...]
>
> Therefore I believe that it is a fair representation of the relative loss suffered by policyholders. Towers Watson calculate this figure as £4.3bn.
>
> As the Parliamentary Ombudsman and PASC have recognised, the Equitable Life Payments Scheme must deliver fairness to taxpayers as well as policyholders. Given the significant pressures on public finances, it would not be fair to taxpayers for the Payments Scheme to pay out the full value of relative loss. Taking into consideration other spending commitments , and the reduction in bonuses suffered by policyholders as a result of the policy value cuts in 2001 and 2003, the Government has decided that £1billion should be allocated to the Payments Scheme in the first three years of this Spending Review period.
>
> However, 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 reductions in the value of their policies because they were unable to move their funds elsewhere, or to mitigate the impact of their losses through employment. They have consistently been highlighted to me by all groups as those most in need of compensation.
>
> In light of these factors, the Government will cover the cost of the total relative loss suffered by With Profits Annuitants (WPAs) who

> took out policies after 1 September 1992, estimated at £620m. WPAs will receive regular payments, based on their full past and future relative losses.
>
> The £1 billion set aside for the first three years of this Spending Review period will cover both the cost of the first three years of WPA regular payments, and all payments to other policyholders. The Independent Commission on Equitable Life Payments will advise on the allocation of funding to policyholders other than WPAs. I have also asked the Independent Commission to advise me on the prioritisation of payments to policyholders within this group, to ensure that those whose need is greatest are paid first. WPAs will continue to receive regular payments beyond the Spending Review period, over the course of their lifetime. In this way, the payments will effectively replace the income that they would have received from their Equitable Life policies. Once these payments are taken into account, I expect that the total amount paid out through the scheme will be in the region of £1.5 billion.
>
> I have further decided that these payments will be free of tax.[1]

In January 2011 the Minister published the following written statement:

> On 22 July 2010, I announced that the Government would establish the Independent Commission on Equitable Life Payments. This was in line with the Government's pledge to “implement the Parliamentary and Health Ombudsman's recommendation to make fair and transparent payments to Equitable Life policy holders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure”.
>
> Following the spending review, the Commission was asked to carry out two tasks. The first was to advise on the fair allocation of funds totalling £775 million among all policyholders, with the exception of with-profits annuitants (WPAs) and their estates. We had already announced that there should be no means-testing and that the estates of deceased policyholders should receive payments. The second was to advise on any groups or classes of policyholders that should be paid as a priority with regard to the timing of payments, again with the exception of WPAs and their estates.
>
> The Commission has met with various interested parties, including the Equitable Members Action Group and Equitable Life, as well as receiving representations from a wide range of individual policyholders.
>
> [...]
>
> Today, I am publishing the Commission's advice and depositing a copy in the Library of the House. The Commission has recommended the following for the allocation of funds: "a pro rata allocation of the available funds, in proportion to the size of relative losses suffered. This equates to 22.4% of each policyholder's relative losses;" "a single policyholder view, wherever practicable, 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 Commission's view that administering very small payments below this sum would be

1 HC Deb 20 October 2010 c54WS

disproportionate to the administrative costs of making them while being of negligible significance to recipients."

The Commission recommends that the following groups be prioritised for payment, subject to the practical constraints laid out in the Commission's advice: "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, as far as possible, the estates of those who die, before receiving a payment, in the next three years."

The Government accept the principles recommended by the Commission. Our task now is to work out how best those principles can be applied in practice to groups of policyholders while allowing us to begin making payments as soon as possible.

The Government will publish a detailed scheme design document that includes the practical application and delivery implications of the Commission's recommendations. I will make this available for parliamentary scrutiny in the spring.[2]

1.2 The Scheme details

The detailed payment plan was published on 16 May 2011, the Equitable Life Payment Design Scheme. Key extracts are shown below with some emphasis added by the author:

2.2 The Equitable Life Payment Scheme is a scheme set up by the Government for those persons who were adversely affected by the maladministration in the regulation of Equitable Life. In October 2010, the Government accepted that Equitable Life policyholders had suffered Relative Losses totalling £4.3 billion. Taking into account other pressures on the public purse, it announced an allocation of funding in the region of £1.5 billion for payments to these policyholders.

2.5 The Treasury has asked **National Savings and Investments (NS&I)** to deliver the Scheme on its behalf.

2.7 The Scheme is expected to begin making payments before the end of June 2011. Policyholders need take no action at this stage. **The Scheme will contact policyholders directly, so there is no need for them to contact the Scheme**.

2.8 There are three types of Equitable Life policy that are eligible for the Scheme. To be considered eligible for the Scheme, a policyholder must hold, or have held, one (or more) of these policies:

1 *Accumulating With-Profits (AWP).* There are two broad categories of AWP policy:

- *Individual* policies – purchased by, and held in the name of, an individual (or joint) policyholder; and
- *Group/Group scheme* policies – predominantly occupational pension schemes purchased by trustees on behalf of scheme members.

Conventional With-Profits (CWP).

2 HC Deb 26 January 2011 c10WS

With-Profits Annuity (WPA).

2.10 That policy must:

- in the case of CWP and WPA policies, **have been purchased between 1 September 1992 and 31 December 2000 inclusive**;[3] and
- in the case of **AWP (both individual and Group scheme) policies, either have started between 1 September 1992 and 31 December 2000 inclusive, or had a premium payment made into it between 1 January 1993 and 31 December 2000**.

2.11 For a policyholder to be considered „eligible" for the Scheme, they must have invested in an AWP, CWP or WPA policy between these dates.

2.12 To be considered for payment, the policyholder must hold (or have held) at least one eligible policy that has made a "Relative Loss".

When can I expect to hear from the Scheme?

Individual policyholders

2.15 In accordance with the advice the Government received from the Independent Commission on Equitable Life Payments, the Scheme aims to:

- commence payments to WPA policyholders8 before June 2012;
- in terms of order of payment to AWP and CWP policyholders, prioritise the oldest policyholders for earlier payment; and
- prioritise payments to estates of deceased policyholders, recognising that contact has to be made with administrators and executors once they have been traced, which could take time.

2.16 **The Scheme will aim to contact all eligible individual policyholders before June 2012**, regardless of whether they will receive a payment. To be eligible for the Scheme, policyholders must meet the criteria set out on page 8. Information provided to policyholders will include a statement explaining the value of any payment and, if applicable, details on when they can expect to receive it.

2.17 **The Scheme will make contact with eligible policyholders using contact information supplied by Equitable Life and Prudential** (for policyholders who had their policy transferred to Prudential). A data tracing service will be used to check and verify these details.

2.18 This means that:

- for those receiving a payment before June 2012, this payment will be sent soon after the letter and statement;

[3] Note the 1992 deadline no longer applies, repealed by Budget 2013

- for those receiving a payment in year two or three of the Scheme (i.e. June 2012 onwards), the Scheme will write to these policyholders before June 2012, explaining when they can expect to receive their payment and its value. The payment itself will follow;
- policyholders who are not receiving a payment, either because they did not make a Relative Loss or because they made one that falls below the minimum payment level,9 will also receive a letter and statement before June 2012 explaining the calculation; and
- **other policyholders who may have had a policy with Equitable Life but are not eligible will not receive any direct communication**.

2.21 If the policyholder has made a Relative Loss, there are three factors that will determine the value of the payment received under the Scheme:

1 What type of policy was purchased:

- all Relative Losses on WPA policies will be covered in full; and
- the funding set aside by the Government for AWP and CWP policies will be allocated on a *pro rata* basis, in proportion to the size of policyholders" Relative Losses. This means AWP and CWP policyholders will receive 22.4 per cent of their Relative Losses.

2 Whether the loss is "small": the Government accepts the Independent Commission's recommendation that a £10 *de minimis* level should be applied beneath which payments should not be made, to avoid disproportionate administration costs. The £10 *de minimis* will not apply to WPA policyholders.

3 Whether an individual has more than one policy and whether there have been losses or gains on each of them. Where it is fair and practicable to do so, the Scheme will:

- offset Relative Losses and Relative Gains across all policies held by one policyholder. In other words reducing the Relative Loss accordingly if a policyholder has any other policies that have made a gain.
- take a collective view of all policies held by a policyholder when applying the £10 *de minimis*. This means that policyholders with small losses spread across a number of policies will not be disadvantaged compared to those with an equivalent loss on a single policy.

How will payments affect benefits, tax and tax credits entitlements?

2.23 Authorised payments made through the Scheme **will be free of UK Income Tax, Capital Gains Tax,** or (in the case of companies) Corporation Tax.

2.24 All authorised payments made through the Scheme **will not affect policyholders" eligibility for child or working tax credits. For the purposes of social security – including Pension Credit – and social care, the payments will be classed as income (for WPA payments) or as capital (for payments in relation to the other policy classes), and will affect eligibility for social security payments in the same way as any other change to their income or capital**.

[For more detail on the tax implications of compensation payments, recipients are directed to an HMRC notice available on its website

How do I find out more?

2.29 In addition to eligible policyholders receiving a letter and statement from the Scheme, a website and call centre will be available to respond to general queries.

2.30 The scheme website will contain information on eligibility and how the Scheme works. The Government recognises that for some policyholders a website will not be the easiest way to find information, therefore a dedicated call centre will also be available.

2.31 The call centre's trained staff will be able to resolve most queries, or answer general questions about the Scheme's design. However, for security reasons personal information relating to a specific policy(ies) or policyholder(s) cannot be given over the phone. **Therefore, policyholders are strongly urged to wait until they receive their letter and statement from the Scheme before contacting the call centre**.

2.32 If policyholders have queries or complaints, they can submit them to the Scheme in writing or via the call centre. **It is not possible for policyholders to challenge the rules of the Scheme through the queries and complaints procedure. Policyholders may only challenge their calculation in cases where those rules have been incorrectly applied to their policy or policies.** In these cases the policyholder will be asked to supply supporting documentation in connection with their claim.

What do I need to do next?

2.33 **Policyholders do not need to take any action at this point**. There is no requirement to register with the Scheme to be part of it. The Scheme will make contact with eligible policyholders as explained above, using information supplied by Equitable Life and Prudential (for policyholders who had their policies transferred to Prudential). A data tracing service will be used to check and verify these details. The Scheme will aim to locate and contact eligible policyholders directly, informing them of any payments due where applicable. The only exception is for Group scheme members who will not be receiving a payment. In these instances the Scheme will inform the Group trustee, who will decide how to inform its members.

2. Policyholders' next steps

As the above document makes clear, there is no need for policyholders to register claims. The Treasury and the scheme administrators are working from a full list of policyholders supplied by Equitable Life and there is no reason to suspect that this is in any way deficient.

Nor is there reason to contact the scheme if payments have not been received shortly after their start in June 2011. According to the Treasury, the scheduled payments throughout the first year of the scheme will amount to £500m. These will be prioritised so that the eldest policyholders receive their payments earliest. Payments will be ramped up gradually in the early phases, to ensure that all the payment processes are fully effective, and that policyholders' queries can be fully addressed.

First payments were made from 30th June with increasing numbers of payments being made thereafter. This will allow the scheme to address initial feedback from policyholders without affecting the gradual increase of payment volumes.

2.1 Making payments

Regular (twice yearly) reports are made by the Scheme on the progress of payments. In January 2012, 95,000 policyholders had received payments totalling £77 million. By July 2012, 288,823 policyholders had received payments totalling £277.8 million.[4] As at January 2013 370,867 policyholders had received payments totalling £535m.[5] By March 2013 the Scheme had paid out £577million to 407,000 policyholders.[6] As at 30 September 2015

2.2 Policyholders' responses

Many members may have been contacted by constituents unhappy with the compensation allotted to them. Some of the disappointment might be due to a failure to understand the basis on which it is calculated. The following notes present a highly stylised and simplified explanation of the issues around the calculations. All numbers and values used are purely illustrative only.

What's a loss?

The Equitable Life Compensation Scheme (ELCS) was set up to compensate people for their losses. It is hard to do this because no one lost any money in an *absolute* sense.[8] By way of comparison, investors with Farepak lost money as their vouchers were no longer redeemable.

4 HC Deb 2 July 2012 c31WS
5 HC Deb 5 February 2013
6 PAC, *Administering the Equitable Life Payment Scheme*, HC 111 2013/14, p5
7 Written Statement 3 November 2015 HLWS280
8 If there are any exceptions to this rules their numbers are tiny and can be ignored for the purposes of this example.

They bought vouchers worth £100 and their value was £0. Their loss was £100. It was an absolute loss.

Equitable investors invested in policies. A £100,000 investment, they were told would give them an annuity of £25,000. None of the investors lost their £100,000. What they ended up with was an annuity of £15,000. There is no *absolute loss* of money here. People invested in products which they expected to have a value of £x but that did not happen, but one can think of any number of other investment decisions people make that do not turn out exactly as they expect and the result is not regarded as a loss, or indeed profit.

Given that ELCS had to fix on a sum to compensate loss for, it had to calculate what that loss was in its absence.

How to determine the size of losses?

One approach could have been to compare what Equitable promised with what it delivered. The problem with this approach of course is that the reason why Equitable got into difficulties was because it made unsustainable promises in order to attract business. The larger the promise the larger the loss on this basis – regardless of any connection with the real world or likely market returns. The table below shows what ELCS did to solve the puzzle.

Annuity results based on £20 a month over 25 years

	Company	Annuity value £'s
Stage 1	Standard Life	14,000
	Prudential	15,800
	Norwich Union	14,700
	Scottish Widows	16,100
	Average comparator outcome	15,150
	Equitable Life projection	25,000
	Equitable Life outcome	11,500
Stage 2	Relative loss compared to:	
	Comparator companies	3,650
	Equitable Life promises	9,850

The approach adopted by ELCS was to take a number of similar life assurance companies offering broadly similar products and see what those companies actually produced by way of returns. They added the results up and averaged them. It was argued that if Equitable investors had not invested in Equitable Life this is what they would have got. They then compared this average figure with what Equitable actually paid out. The difference was called the *relative loss*; i.e. the loss relative to alternative comparable investments.

In the case above our policy holder would get £3,650 compensation. This is substantially less than the perception of most policy holders because they are comparing what they got with what they were promised, in this case their loss is seen to be £9,850. Of course, the more exaggerated were the EL promises and projections the greater is the perceived loss.

Non-annuitant investors in EL, would have had the same calculation applied to them and then only received 22.4% of that relative loss.

3. Is the scheme fair?

3.1 Introduction

There is a continuing campaign for full compensation of all 'losses' by some policyholders which has been firmly rejected by government since 2010. This section looks at whether the Scheme itself (and on its own terms) has been fair.

It would be of little surprise that if one could rewind time and examine every detail of every policy taken out over the period and assign values to all the variables over the past 20 years for millions of policies and take in all the circumstances, to find that the amount paid in compensation was not 'right' or 'fair' for a single policyholder.

The compensation scheme was an immensely complex exercise in terms of calculating such basic things as 'loss' and in terms of data retrieval undertaken during the worst fiscal crisis the country has experienced at least since the War, and against the background of a ticking clock – many of the likely beneficiaries being elderly. Neither government nor those involved with the scheme would deny that it was something of an imperfect compromise with some 'rough edges'. The Coalition Government in particular, would argue that imperfect as it was it represented a serious improvement on what the previous government had offered, namely nothing and that whatever approximations of reality were made they were justified by the overriding need to provide something for an ageing population of claimants.

3.2 The Scheme in retrospect

As was mentioned above, the practicalities of implementing a compensation scheme including such a large number of people and over such an extended period of time, were never going to be easy or straightforward. That the scheme was running against the background of an ageing cohort of claimants added a pressing time factor to the mix. The fact that the scheme has broadly done what it set out to do, i.e. compensate people broadly in line with their entitlements within a reasonable period, and had made so many payments (£577 million to 407,000 pensioners within two years) is an achievement which some members of EMAG might, at times, have wondered whether they would ever see in their lifetime. This achievement is set against the report of the Public Accounts Committee which is fairly critical of the management of the scheme.

The Report – *Administering the Equitable Life Payment Scheme* – made the following criticisms:

When setting up the Equitable Life Payment Scheme (the Scheme), HM Treasury (the Treasury) failed to learn the lessons from previous government compensation schemes. It focused on an arbitrary deadline for making the first payments to policyholders rather than on detailed operational planning and clearly defined responsibilities. This weak set-up led to a series of administrative failures including delays in making payments to policyholders and poor customer service. There is yet another arbitrary deadline of March 2014 for closure of the Scheme, increasing the risk that some policyholders, who remain untraced, will miss out on receiving the money they are owed.[9]

An earlier external review of the Scheme, by the National Audit Office had been published in April 2013.[10] It acknowledged the inherent difficulties of the undertaking and that some of these were outside of the control of the Scheme itself.

Its main criticism was that the Government had an unrealistic view of how quickly payments could be made and had set targets that reflected this. The haste to start payments quickly actually contributed to some of the longer term problems the Scheme encountered.

3.3 Complaints

Constituents unhappy with a decision in their case can use the complaints procedure. The ELCS website has the following information:

If you have a complaint about the way the Scheme's rules have been applied or how the Scheme has handled your case, you should write to the Scheme's Complaints Department with details of your complaint at this address:

Complaints Department; Equitable Life Payment Scheme

PO Box 4110

Glasgow; G58 1EL

The Scheme will acknowledge the complaint within 5 working days and aim to resolve the complaint within 8 weeks. A full investigation of the problem you have raised will be carried out and the Scheme will write to you to let you know the outcome.

If you are unhappy with the outcome and the Scheme can assist you no further in resolving the complaint, you may request the Independent Review Panel to consider your case. The Independent Review Panel provides a final review process to people who have not been able to resolve their complaint through the Scheme's complaints process.

You will receive an Independent Review Panel Referral Number and a form to complete to send to the Review Panel. The Review Panel will then correspond with you directly. The Independent Review Panel cannot consider your case until you have completed the Equitable Life Payment Scheme complaints process and all contact with the Panel must be in writing.

Click here to visit the Independent Review Panel Website.

9 Public Accounts Committee; *Administering the Equitable Life Payment Scheme*; HC 111 2013/14

10 National Audit Office; Administering the Equitable Life Payment Scheme; HC 1043 2012/13, July 2013

4. What's been achieved?

As the Scheme draws to a close, it will end in December 2015, a Ministerial Statement in November 2015, outlined what had been achieved and recent improvements for ex policyholders:

> As at 30 September 2015, the Equitable Life Payment Scheme has now issued payments of nearly £1.08 billion to 915,453 policyholders. This means the Scheme has now paid 88% of eligible policyholders, and 92.9% of the money due. The Scheme will today be publishing a further progress report, which can be found at .
>
> The Scheme has made major efforts to trace policyholders, including extensive electronic tracing methods, writing to policyholders' last known addresses, a national advertising campaign, working with other government departments and liaising with group scheme trustees. As announced at the Summer Budget, a final attempt to trace policyholders has been made through the Department for Work and Pensions (DWP) by the DWP sending letters to all untraced policyholders due £50 or more for whom the Scheme holds a National Insurance number and other data such as their name. These letters have now been sent. Despite this there remain approximately 125,000 policyholders whom the Scheme has been unable to pay.
>
> As the Chancellor announced in the Summer Budget on 8 July, the Scheme will be closing to new claims on 31 December 2015. Any policyholders who still believe themselves to be eligible are encouraged to call the Scheme on 0300 0200 150 before 31st December 2015. The Scheme can verify the identity of most policyholders on the telephone, which means any payment due can usually be received within 2 weeks. This will not affect the yearly payments made by the Scheme to With-Profits Annuitants, which will continue for the duration of those annuities. The Scheme has written to all With-Profits Annuitants to make them aware of this.
>
> In the Summer Budget, the Chancellor also announced that payments to non-With Profit Annuitant policyholders who receive Pension Credit will be doubled. Any policyholders who have made a claim from the Scheme by the time it closes on 31 December and are receiving Pension Credit on that date will receive this second payment without having to take any action. Policyholders can check their eligibility for Pension Credit using the Government's Pension Credit calculator at https://www.gov.uk/pension-credit-calculator.[11]

[11] Written Statement 3 November 2015 HLWS280

About the Library

The House of Commons Library research service provides MPs and their staff with the impartial briefing and evidence base they need to do their work in scrutinising Government, proposing legislation, and supporting constituents.

As well as providing MPs with a confidential service we publish open briefing papers, which are available on the Parliament website.

Every effort is made to ensure that the information contained in these publically available research briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

If you have any comments on our briefings please email papers@parliament.uk. Authors are available to discuss the content of this briefing only with Members and their staff.

If you have any general questions about the work of the House of Commons you can email hcinfo@parliament.uk.

Disclaimer