



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

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Brian Pomeroy

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 t. 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 decide not to invest in 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 policies 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,

A handwritten signature in black ink, appearing to read 'Mh'.

MARK HOBAN MP
FINANCIAL SECRETARY TO THE TREASURY

