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Case No: CO/3455/2009

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 15th October 2009

Before :

LORD JUSTICE CARNWATH
MR JUSTICE GROSS

Between :

THE QUEEN

Claimant

On the application of

EQUITABLE MEMBERS ACTION GROUP

- and -

HER MAJESTY'S TREASURY

Defendant

-and-

**(1) THE PARLIAMENTARY COMMISSIONER
FOR ADMINISTRATION**

**(2) THE RIGHT HONOURABLE SIR JOHN
CHADWICK**

Interested Parties

- and -

THE ATTORNEY GENERAL

Intervener

Dinah Rose QC, Javan Herberg, Stephen Grosz and Jessica Boyd
(instructed by **Bindmans LLP**) for the **Claimant**

Clive Lewis QC and Paul Nicholls and Deok Joo Rhee
(instructed by **Treasury Solicitor**) for the **Defendant**

Tony Child (instructed by **Beachcroft LLP**) for the **Interested Parties**

Jason Coppel (instructed by **Treasury Solicitor**) for the **Intervener**

Hearing dates: 21st July, 22nd July and 23rd July 2009

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Approved Judgment

Lord Justice Carnwath and Mr Justice Gross:

INTRODUCTION

1. This is the judgment of the court (to which we have both contributed) in a claim for judicial review brought by the Equitable Members' Action Group ("EMAG").
2. EMAG is a company limited by guarantee, whose members comprise about 21,000 current and former policyholders with the Equitable Life Assurance Society ("Equitable"). The subject-matter of the claim concerns the Government's response, published and announced in Parliament on the 15th January, 2009 ("the Response"), to a Report by the Parliamentary Commissioner for Administration ("the Ombudsman"), entitled "Equitable Life: A Decade of Regulatory Failure", dated 16th July, 2008 ("the Report"). The Defendant ("HM Treasury") coordinated the production of the Response on behalf of the Government.
3. In summary, Equitable, founded in 1762, was the oldest mutual life assurance society in the world. It specialised in the provision of pensions, in particular "with profits" pensions. On the 8th December, 2000, Equitable closed to new business. On the 16th July, 2001 and again in April 2001 and July 2002, Equitable reduced the value of policy funds; the result was a significant reduction in annuity payments. An inquiry, led by Lord Penrose, was commissioned by Treasury Ministers on the 31st August, 2001, and its report was published on the 8th March, 2004 ("the Penrose Report").
4. Against this background, complaints were made to the Ombudsman that individuals had suffered injustice through maladministration in the period prior to December 2001, on the part of the public bodies responsible for the "prudential regulation" (as explained presently) of Equitable and the Government Actuary's Department ("GAD").
5. Over a period of some four years, the Ombudsman conducted a very extensive inquiry into the prudential regulation of Equitable. In the Report, she made 10 findings of "maladministration" and findings that, in 6 of those cases, individuals had suffered "injustice". Also and importantly, she recommended that the Government should compensate those affected.
6. In the Response, the Government accepted some findings of maladministration and injustice and explained the basis on which it did so; it also rejected a number of findings of maladministration and injustice. In particular, the Government rejected the recommendation for a compensation scheme. Instead, as expressed at para. 5.22 of the Response:

“ The Government recognises that there has been maladministration, and the representations it has received suggest that there has been a disproportionate impact on some Equitable Life policyholders. To that extent, the Government believes that some ex gratia payments will be warranted.”

To that end, the Government proceeded to appoint Sir John Chadwick to advise it in this regard, in accordance with Terms of Reference annexed to the Response ("the Chadwick Terms of Reference").

7. In these proceedings, EMAG submits that, insofar as the Government has rejected findings of maladministration and injustice made by the Ombudsman, it has failed to put forward cogent reasons for doing so. Furthermore, EMAG submits that in rejecting the Ombudsman's recommendation for a compensation scheme the Government has acted unlawfully, and that certain of the Chadwick Terms of Reference are themselves unlawful or in any event unintelligible.

EQUITABLE – FACTUAL BACKGROUND

8. So far as concerns the factual background as to Equitable's business, there is relatively little dispute; we can therefore take it shortly.
9. Policyholders in Equitable's "with profits" policies would pay premiums. Equitable would invest those premiums and utilise the proceeds to fund bonuses for the policyholders. First, basic benefits were guaranteed to increase each year by way of a guaranteed interest rate of 3.5% ("the GIR"). Secondly, usually added at yearly intervals to the GIR but at a discretionary rate, there was the "reversionary bonus". Once paid, these bonuses augmented the value of the policy and became part of the policyholder's fund. Thirdly, there was a "terminal bonus", payable at the end of the policy; the amount of the terminal bonus was not guaranteed.
10. The Equitable business model was noteworthy in a number of respects:
 - i) Equitable was owned by its members. It did not have shareholders.
 - ii) Most of its surplus assets were distributed to policyholders by way of bonus. It did not therefore build up substantial reserves. This was an important and well-known feature.
 - iii) Many of the policies it sold included guarantees; reference has already been made to the GIR. Another such guarantee was the Guaranteed Annuity Rate ("GAR"). This meant that the annuity which a given policy would provide was guaranteed regardless of prevailing annuity rates in the market – so ensuring a minimum pension amount on retirement. Equitable ceased selling new policies with a GAR in 1988, although apparently some further purchases of such policies remained possible until the early 1990s. As is common ground, Equitable's GARs were more generous and flexible than those provided by most other insurers.
 - iv) Equitable also differed from other insurers in that, from 1987, the policy value for each policyholder illustrated in its annual bonus statements included the value of the discretionary terminal bonus – albeit as an illustration only, and with the qualification that the terminal bonus was not guaranteed and could be lower than the figure in the illustration.
11. During the 1980s and 1990s, Equitable declared bonuses which were very high relative to its profits and assets. The upshot was that in the 1990s Equitable faced a substantial deficit of assets compared to its liabilities including policy values (taking account of the discretionary amounts indicated to policyholders). During that same period, Equitable received a substantial inflow of funds; its with-profits business increased six-fold in size.

Judgment Approved by the court for handing down.

12. The scale of that deficit is noteworthy. For most of the 1990s it ran at a figure in excess of £1 billion (i.e., £1,000 million), fluctuating with movements on the stock market but never coming close to elimination. The figures which follow are taken from a Table contained in the Penrose Report. The “aggregate policy values” equate to the contractual value of the policies, comprising premiums paid, the GIR and declared discretionary bonuses - collectively the Guaranteed Policy Fund (“GPF”).

Year	% Excess aggregate policy values to available assets	Aggregate policy values in excess of available assets (in million £s)
1990	28.0%	1,375
1991	24.6%	1,539
1992	16.4%	1,299
1993	1.7%	185
1994	19.8%	2,139
1995	11.9%	1,596
1996	11.0%	1,725
1997	7.1%	1,358
1998	5.4%	1,200
1999	2.8%	734
2000	11.8%	3,057

13. For the purpose of assessing its liabilities, Equitable used a discount or “valuation interest” rate and it was that discounted valuation which appeared in Equitable’s Regulatory Returns. The valuation interest rate understandably varied annually; on the available material, the highest such discount rate was that utilised in (or for) 1990 of 7.25%, giving rise to a worked example much relied on by EMAG at the hearing.

14. The example worked as follows.
- i) First, for 1990, the aggregate of policy values amounted to £2.6 billion. That was the starting figure for Equitable's contractual liabilities to policyholders. The GPF was then accumulated by applying compound interest at the GIR (i.e., 3.5%) for about the next 11 years – years to the typical retirement date. The application of this rate over the period gave a total minimum liability of £4.0 billion.
 - ii) Secondly, the sum of £4.0 billion was then discounted, by applying the valuation interest rate of 7.25%, so producing a figure of £1.9 billion.
 - iii) This calculation involves the underlying assumption that for the following 11 years, Equitable would utilise the first 7.25% return on assets invested simply to pay its liabilities and the GIR. In order to pay any discretionary bonuses, Equitable would require a rate of return on investment of in excess of 7.25%. For the 1990 year, Equitable had declared a reversionary bonus of 7.5%. As is apparent, to sustain a bonus level at that rate, Equitable would require a return on investment of something in the order of 14.75% - at least at first blush, a challenging task.

Having introduced the topic, we return, later, to questions concerning valuation interest rates and the affordability and sustainability of Equitable's bonus declarations.

15. By 1993 another feature of its business model was also beginning to present Equitable with difficulties, that is, the GARs. In very broad terms, over the period 1967 – 1993, GAR rates had been lower than market or current rates. However, for a period between autumn 1993 and spring 1994 and, thereafter continuously from about April or May 1995, GAR rates, were higher than market rates. It now became financially advantageous for those policyholders entitled to GARs to exercise this right.
16. With a view to addressing what became an increasingly onerous liability, Equitable, in 1993, introduced a “Differential Terminal Bonus Policy” (“DTBP”). The DTBP enabled Equitable to adjust the size of the terminal bonus payable to policyholders. By adjusting the size of the terminal bonus, the value of the policyholder's fund was reduced from the size it would have been if the terminal bonus had not been adjusted. In practical terms, under the DTBP, policyholders who had taken the benefit of the GAR received lower levels of terminal bonus than those who received annuities at market rates. The intention was to equalise the financial result of the different (GAR or non-GAR) forms of policy. Equitable was not alone in adopting a DTBP; other insurers had done likewise at the time Equitable did so.
17. From about October 1998, Equitable, its prudential regulators and GAD held extensive discussions about its regulatory obligation to reserve for GARs and the need to establish sufficient reserves to cover these liabilities. These discussions included debate as to whether Equitable's DTBP reduced this need to reserve. In the event, Equitable agreed to make provision in the amount of some £1.5 billion and purported to mitigate this reserving obligation by, in 1999, entering into a financial reinsurance treaty with a Dublin based reinsurer. We return to these reinsurance arrangements, below.

18. Meanwhile, in 1997 and 1998, after further falls in interest rates, Equitable began to receive complaints from policyholders about the DTBP. In the event, on the 15th January, 1999, Equitable funded and commenced legal proceedings against a representative GAR policyholder, Mr. Hyman, to determine whether the DTBP was permissible (“the *Hyman* litigation” or “*Hyman*”). The *Hyman* litigation culminated in the decision of the House of Lords in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408. The litigation followed a somewhat chequered course. At first instance, Sir Richard Scott V-C (as he then was) granted declarations affirming the validity of the decisions of Equitable’s directors to apply the DTBP. By a majority, the Court of Appeal allowed Mr. Hyman’s appeal, Morritt LJ (as he then was) dissenting. The House of Lords unanimously dismissed Equitable’s appeal, holding that Equitable was not entitled to adopt the DTBP. The essence of the decision of the House of Lords is summarised in the headnote (at pp. 408-9) as follows:

“.....the self-evident commercial objective of the inclusion of guaranteed rates was to protect the policyholder against a fall in market annuity rates by ensuring that if such a fall occurred he would be better off than he would have been with market rates; that, in such a context, the reasonable expectation of the parties must have been that the directors would not exercise their discretion in conflict with those rights; that, consequently, a restriction precluding the directors from resolving upon a differential policy designed to deprive the guarantees of any substantial value had to be implied into article 65 as such an implication was essential to give effect to the reasonable expectations of the parties; that, alternatively, since a discretion could not be exercised for purposes contrary to those of the instrument by which it was conferred, it was a breach of contract for the directors to exercise their discretion in such a way as to subvert the terms of the policy documents; and that, accordingly, the directors were not entitled to adopt a principle of making the final bonuses payable to guaranteed annuity rate policyholders dependent upon how they exercised their rights under the policy or award any other differential bonuses which eliminated the benefit of the guaranteed annuity rate.”

19. On one view, contractual analysis triumphed over considerations pertaining to Equitable’s mutual nature. Be that as it may, the consequences of the decision of the House of Lords for Equitable were devastating. The additional liability was in the region of £1 billion, a shortfall that Equitable was unable to fund. As already described, Equitable closed to new business and a new board of directors cut policy values on a number of occasions. Attempts continued to run down the remaining business of Equitable and to break it up; the details are not relevant to the present proceedings. It is, however, convenient to note here that one of the ramifications of the outcome of the *Hyman* litigation was that Equitable could no longer rely on its reinsurance treaty (see above), as the treaty was contingent on Equitable maintaining the DTBP.

THE REGULATORY SYSTEM

20. At all material times, the supervision of insurance companies was the subject of separate regulatory regimes: (1) “prudential regulation” and (2) “conduct of business regulation”. In simple terms, prudential regulation was concerned essentially with the solvency of insurance companies and (since 1994) the soundness and prudence of their management. Conduct of business regulation related primarily to the marketing and sale of a company’s products and the provision of related advice to current and potential policyholders. The Ombudsman’s investigation covered only prudential regulation, not conduct of business regulation; and her report covered prudential regulation only for the period prior to the 1st December, 2001. On 1st December, 2001, the Financial Services and Markets Act 2000 came into force, and the FSA became the single regulator for financial services, taking on responsibility for both prudential and conduct of business regulation. However, that change is not material for present purposes.
21. The prudential regulators of Equitable changed during the relevant period. The Department of Trade and Industry (“the DTI”) was the regulator in the period prior to the 4th January, 1998. From that date until the 1st December, 2001, HM Treasury was the prudential regulator. From January 1999, prudential supervision of Equitable was carried out by the Financial Services Authority (“the FSA”) on behalf of HM Treasury, save that HM Treasury retained some regulatory powers under the Insurance Companies Act 1982. The GAD was not itself a prudential regulator, but it played an important role in the supervision of Equitable. It was responsible for the review of Equitable’s regulatory returns and provided advice to the prudential regulator over the period in question. For obvious reasons, specialist actuarial advice, such as was provided by GAD to the prudential regulator, was central to the regulation of life insurance companies.
22. The philosophy which guided the prudential regulation of insurance companies in the United Kingdom for more than a century was the doctrine of “freedom with publicity”. It is well described by Ms Lewis of HM Treasury in her (most helpful) witness statement. The aim was to strike a balance between safeguarding policyholders’ interests and avoiding undue restrictions on commercial freedom. The corollary of that freedom was the requirement that insurance companies should provide, in the event, increasing amounts of information which would be made public. As Ms Lewis expressed it:

“ ...UK Government policy always sought to strike the right balance between protecting the consumer and ensuring that the regulatory burden imposed on life insurance companies was not so great as to stifle innovation and competition to the detriment of the consumer.”
23. Turning to some particular features of the regulatory landscape, the Insurance Companies (Amendment) Act 1973 (“the 1973 Act”) placed increasing reliance on the actuaries of the insurance companies, through the introduction of the Appointed Actuary system. In addition, there was an expansion of the role of the prudential regulator in scrutinising returns submitted by insurance companies. Perhaps most importantly for present purposes, the 1973 Act introduced the concept of “policyholders’ reasonable expectations” (“PRE”), apparently as a “safety-net”

power. This concept empowered the prudential regulator (nominally, the Secretary of State) to intervene in the affairs of a company if there were grounds to believe that PRE were not being met. Over time, the prudential regulator's role was expanded yet further, but it is unnecessary to set out the details here.

24. It is, however, necessary to make some reference to the provisions of the Insurance Companies Act 1982, as amended ("the 1982 Act"). Sections 37 and 45 incorporated in statutory form the earlier residual or "safety-net" power of the Secretary of State. Section 37 set the framework for the subsequent provisions. Sections 38 to 44 of the 1982 Act covered specific instances of failure to comply with particular regulations. Section 45 provided an additional power, enabling the Secretary of State to intervene in situations other than those specifically provided for.
25. The nature of these broad based regulatory powers can be seen from the relevant provisions of sections 37 and 45 of the 1982 Act which read as follows:

“ **37.** (1) The powers conferred on the Secretary of State by sections 38 to 45 below shall be exercisable in relation to any insurance company to which this Part of this Act applies and shall be exercisable in accordance with the following provisions of this section.

(2)The powers conferred by sections 38 and 41 to 45 below shall be exercisable on any of the following grounds:

(a) that the Secretary of State considers the exercise of the power to be desirable for protecting policy holders or potential policy holders of the company against the risk that the company may be unable to meet its liabilities or, in the case of long term business, to fulfil the reasonable expectations of policy holders or potential policy holders.

(b) that it appears to him –

(i) that the company has failed to satisfy an obligation to which it is or was subject by virtue of this Act or any enactment repealed by this Act or by the Insurance Companies Act 1974...

(6) The power conferred on the Secretary of State by section 45 below shall not be exercisable except in a case in which he considers that the purpose mentioned in that section cannot be appropriately achieved by the exercise of the powers conferred by sections 38 – 44 below or by the exercise of those powers alone...

(8) The grounds specified in subsections (2)(b) to (g) and (4) above are without prejudice to the ground specified in subsection (2)(a) above.

...

45. (1) The Secretary of State may require a company to take such action as appears to him to be appropriate –

(a) for the purpose of protecting policy holders or potential policy holders of the company against the risk that the company may be unable to meet its liabilities or, in the case of long term business, to fulfil the reasonable expectations of policy holders or potential policy holders; or

(b)for the purpose of ensuring that the criteria of sound and prudent management are fulfilled with respect to the company.”

THE OMBUDSMAN

26. The office of Ombudsman was established by the Parliamentary Commissioner Act 1967 (“the Act”). As expressed in its long title, this is an Act:

“ to make provision for the appointment and functions of a Parliamentary Commissioner for the investigation of administrative action taken on behalf of the Crown, and for purposes connected therewith.”

At the outset, it may be noted that the Ombudsman is a “Parliamentary Commissioner” appointed to investigate action taken by the Executive.

27. By section 4 (1) of the Act, the Ombudsman’s jurisdiction extends to the “government departments, corporations and unincorporated bodies” listed in Schedule 2 to the Act. Section 4 (2) provides that Schedule 2 may be amended by Order in Council. Schedule 2 in turn sets out a lengthy list of departments and others subject to such investigation. At the request of the Ombudsman, the GAD was specifically added to Schedule 2 and so brought within the jurisdiction of the investigation (by the Parliamentary Commissioner Order SI 2004 No. 2670, which came into force on the 15th November, 2004).

28. S.5 of the Act deals with the matters subject to investigation:

“(1) Subject to the provisions of this section, the Commissioner may investigate any action taken by or on behalf of a government department or other authority to which this Act applies, being action taken in the exercise of administrative functions of that department or authority, in any case where –

(a) a written complaint is duly made to a member of the House of Commons by a member of the public who claims to have sustained in injustice in consequence of maladministration in connection with the action so taken; and

(b) the complaint is referred to the Commissioner, with the consent of the person who made it, by a member of that House with a request to conduct an investigation thereon.

(2) Except as hereinafter provided, the Commissioner shall not conduct an investigation under this Act in respect of any of the following matters, that is to say –

(a) any action in respect of which the person aggrieved has or had a right of appeal, reference or review to or before a tribunal constituted by or under any enactment or by virtue of Her Majesty's prerogative;

(b) any action in respect of which the person aggrieved has or had a remedy by way of proceedings in any court of law:

Provided that the Commissioner may conduct an investigation notwithstanding that the person aggrieved has or had such a right or remedy if satisfied that in the particular circumstances it is not reasonable to expect him to resort or have resorted to it."

29. It is convenient here to interpose section 12(3) in these terms:

"It is hereby declared that nothing in this Act authorises or requires the Commissioner to question the merits of a decision taken without maladministration by a government department or other authority in the exercise of a discretion vested in that department or authority."

30. These provisions contain a number of important features:

- i) A member of the public who has a relevant complaint cannot approach the Ombudsman directly; the sole route by which a complaint can reach the Ombudsman is by a referral from a Member of the House of Commons ("a MP").
- ii) The subject-matter of an Ombudsman's investigation is "action taken in the exercise of administrative functions", of what may broadly be termed the Executive.
- iii) The threshold conditions for an investigation by the Ombudsman are that (1) a member of the public claims to have sustained "injustice" in consequence of (2) "maladministration" in connection with the administrative action in question. Logically of course, it is the "maladministration" in connection with the administrative action which occurs first and gives, or may give, rise to the "injustice". We return, presently, to the meaning of "maladministration" and "injustice".
- iv) The Ombudsman may not inquire into the "merits" of a decision taken by the Executive without maladministration.

- v) The Ombudsman “shall not” conduct an investigation when the person aggrieved has or had a remedy in any court of law or before a tribunal. The Ombudsman scheme therefore normally has no application when the law is capable of providing redress. As Lord Denning MR put it, in *R v Local Commissioner, ex parte Bradford Council* [1979] 1 QB 287, at p. 310, Parliament was “at pains” to ensure that the Ombudsman should not conduct an investigation “which might trespass in any way on the jurisdiction of the courts of law or of any tribunals.” The only proviso is (as set out in s.5(2)) that the Ombudsman may conduct an investigation, notwithstanding the availability of a legal right or remedy, “if satisfied that in the particular circumstances it is not reasonable to expect” the person aggrieved to resort or have resorted to it.
31. Section 7 of the 1967 Act makes provision for the procedure to be followed in respect of an investigation by the Ombudsman. This includes affording to those alleged to have taken or authorised the action complained of, an opportunity to comment on allegations contained in the complaint. The Ombudsman has a very wide discretion indeed as to the procedure for conducting an investigation, save that section 7(2) provides for it to be conducted in private.
32. Section 8 deals with evidence, the production of documents and disclosure. It provides as follows:
- “ (1) For the purposes of an investigation under s.5(1) of this Act the Commissioner may require any Minister, officer or member of the department or authority concerned or any other person who in his opinion is able to furnish information or produce documents relevant to the investigation to furnish any such information or produce any such document.
- (2) For the purposes of any investigation under this Act the Commissioner shall have the same powers as the Court in respect of the attendance and examination of witnessesand in respect of the production of documents.
- (3) No obligation to maintain secrecy or other restriction upon the disclosure of information obtained by or furnished to persons in Her Majesty’s service, whether imposed by any enactment or by any rule of law, shall apply to the disclosure of information for the purposes of an investigation under this Act; and the Crown shall not be entitled in relation to any such investigation to any such privilege in respect of the production of documents or the giving of evidence as is allowed by law in legal proceedings. ”

Plainly this section confers considerable powers upon the Ombudsman. In some respects, notably in the disapplication of Public Interest Immunity (“PII”), they go beyond those of the courts. That said, there are important limits on the Ombudsman’s powers and jurisdictional scope, as provided by section 8(4) (dealing with cabinet proceedings), section 8(5) (privilege other than PII) and Schedule 3 (a wide range of matters not subject to investigation).

33. Section 10 of the Act deals with Reports by the Ombudsman. It is helpful to take this section in stages. First, section 10(1) provides (insofar as here relevant) that where the Ombudsman conducts an investigation under the Act, he shall send to the relevant MP a report of the results of the investigation. The Report (in the present case) was presented to Parliament on the 16th July, 2008, pursuant to sub-section (4) of the same section. Where the investigation has been conducted under section 5(1) of the Act, section 10(2) requires the Ombudsman, in addition, to send a report of the results of the investigation to the principal officer of the department or authority concerned and to any other person alleged in the relevant complaint to have taken or authorised the action complained of.

34. Secondly, section 10 (3) provides:

“ If, after conducting an investigation under section 5(1) of this Act, it appears to the Commissioner that injustice has been caused to the person aggrieved in consequence of maladministration and that the injustice has not been, or will not be remedied, he may, if he thinks fit, lay before each House of Parliament a special report upon the case. ”

S. 10(3) therefore only applies where it appears to the Ombudsman that there has been both maladministration and injustice, and that the injustice has not been or will not be remedied. In this case and in the light of the Response, the Ombudsman, pursuant to section 10(3), did indeed lay a special report, dated 5th May, 2009, before both Houses of Parliament (“the Special Report”). It appears (Special Report, para. 71) that this was only the fifth occasion on which this procedure had been followed since the establishment of the office of Ombudsman in 1967.

35. Reference has already been made to the two threshold conditions for an Ombudsman’s investigation under section 5(1) of the Act: “maladministration”, and “injustice”. Neither term is defined in the Act, but each has been the subject of judicial interpretation.

36. As to “maladministration”, it was accepted by Lord Denning MR in *Bradford (supra)*, at pp. 311-312 that it will cover “... ‘bias, neglect, inattention, delay, incompetence, ineptitude, perversity, turpitude, arbitrariness and so on’...” It was an open-ended list, going to the *manner* rather than the *merits* of the decision or discretion in question. (See too, s.12(3) of the Act, already noted.) As Eveleigh LJ observed (at p.314), the Act made provision for investigation where a person claimed to have sustained injustice as a result of “inefficient or improper” administration.

37. As to “injustice”, in *R v Parliamentary Commissioner for Administration, ex parte Balchin* [1998] 1 PLR 1, at p.11, Sedley J (as he then was) accepted that injustice had been widely interpreted:

“so as to cover not merely injury redressible in a court of law, but also ‘the sense of outrage aroused by unfair or incompetent administration, even where the complainant has suffered no actual loss’...”

It followed, Sedley J observed (*loc cit*):

“...that the defence familiar in legal proceedings, that because the outcome would have been the same in any event there has been no redressible wrong, does not run in an investigation by the commissioner.”

38. The observations of Collins J in *R v The Commissioner for Local Administration, ex parte S*, transcript, CO/2088/97, judgment 11th November, 1998, while underlining the need for “some prejudice”, were to much the same effect. He said this (at p.6):

“So far as injustice is concerned, it is clearly not enough that the Applicant feels that she has been unfairly treated and so has suffered an injustice. The law permits the Commissioner to find maladministration without injustice. Therefore, it is a trite observation to say that it must follow that the mere finding of maladministration cannot mean that there must be injustice as well. Itmust be established that there is some prejudice to the Applicant before a finding of injustice can properly be made. That prejudice may be no more than the loss of an opportunity.....and certainly it is not required that any particular damage be established. Indeed it is quite plain that the word ‘injustice’ was used with a view to indicating something wider than is covered by the concept of damage and also perhaps to avoid the need to delve into questions of causation which might otherwise arise in certain cases.”

39. In the Report, the Ombudsman adopted this analysis of “injustice”. Before us, neither the meaning of “maladministration” nor “injustice” was in dispute.

THE REPORT, THE RESPONSE AND THE SPECIAL REPORT

40. *The Report*: Following various previous investigations which need not be described here, the Ombudsman took the decision to commence the investigation which culminated in the Report in July 2008. The nature and scale of the investigation merit brief comment. The Ombudsman had available all the evidence she required, including materials previously available to Lord Penrose. Throughout the investigation, she was advised by legal, actuarial and academic advisers. On a number of occasions, she invited and received submissions or comments from the public bodies whose actions were under consideration. She circulated three drafts of the Report to those public bodies before publication of the (final) Report and, on each occasion, invited and considered their responses and revised the draft in the light of those responses. The Report itself runs to five volumes. The investigation took some 4 years, from commencement to publication of the Report.

41. The terms of reference for the Ombudsman’s investigation were as follows:

“To determine whether individuals were caused an injustice through maladministration in the period prior to December 2001 on the part of the public bodies responsible for the prudential regulation of the Equitable Life Assurance Society and/or the Government Actuary’s Department; and to recommend appropriate redress for any injustice so caused.”

42. In the event, the Ombudsman made 10 findings of maladministration and findings that in 6 of those cases (findings 2, 3, 4, 5, 6 and 10), individuals had suffered injustice. As will be seen, in the Response, the Government accepted in whole or in part nine of the ten findings of maladministration and three of the six findings of injustice. These proceedings are essentially concerned with those findings of the Ombudsman which the Government did not accept. The Ombudsman made two recommendations as to remedies for the injustice found by her, arising from maladministration on the part of the prudential regulators and GAD. The Government accepted the first recommendation (the giving of an apology) but, as already noted, rejected the Ombudsman's second and "central" recommendation, namely, a compensation scheme.
43. *Findings rejected:* It is fair to all concerned first to list those complaints, made against the prudential regulators and GAD, which the Ombudsman rejected:
- i) That the regulator and GAD had not acted in good faith.
 - ii) That the regulator had not operated the regulatory regime as it was intended by Parliament to be operated and in conformity with EU Directives.
 - iii) That the regulator and GAD had failed to keep pace with developments in the pensions and life assurance industry and to adapt accordingly.
 - iv) That the regulatory framework was out of date and unwieldy.
 - v) That the regulator and GAD had failed to give sufficient consideration to the suggestion that some measures used to bolster Equitable's solvency assumed a future surplus.
 - vi) That the regulator failed to ensure any satisfactory correlation between declared policy values and Equitable's assets; the Ombudsman noted that Equitable was "not in this regard at the extreme end of the spectrum".
 - vii) That the regulator and GAD had permitted Equitable to operate an unsound business model; the Ombudsman remarked that it was not for the regulator to approve or monitor an insurance company's business model or to act as a "shadow director".
44. *Findings of maladministration* We turn to the findings of maladministration made by the Ombudsman, so far as here relevant. They are findings 2, 3, 4, 5, 6 and 10, all of which led to findings of injustice. The findings of maladministration are:
- i) That the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1990 to 1993, related to (i) the valuation rate of interest used to discount the Society's liabilities and (ii) the affordability and sustainability of the Society's bonus declarations, constituted maladministration by GAD (*finding 2*);
 - ii) That the failures, when the introduction of the Society's differential terminal bonus policy was identified as part of the scrutiny of the 1993 returns, (i) to inform the prudential regulators about the policy, (ii) to raise the matter with

the Society, or (iii) to seek to identify what the rationale was for the introduction of the policy and how it was being communicated to policyholders, constituted maladministration by GAD (*finding 3*);

- iii) That the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1994 to 1996, related to (i) the valuation rate of interest, (ii) the affordability and sustainability of bonus declarations, (iii) apparently arbitrary changes to the assumed retirement ages, and (iv) the holding of no explicit reserves for the liabilities associated with prospective liabilities for capital gains tax, for pensions mis-selling costs, and for guaranteed annuity rates, constituted maladministration by GAD (*finding 4*);
- iv) That the failures (i) to ask for the information GAD needed in respect of the Society's 1995 returns to enable them, as part of the scrutiny process, to be sure that the Society had produced a valuation that was at least as strong as the minimum required by the applicable Regulations, and (ii) to pursue the information before them that the omitted information had led to the users of the returns misconstruing the financial strength of the Society constituted maladministration by GAD (*finding 5*);
- v) That the failures (i) to ensure that the financial reinsurance arrangement was not taken into account within the Society's 1998 returns without an appropriate concession being given, and (ii) to ensure that the credit taken by the Society within its returns for 1998, 1999, and 2000 properly reflected the economic substance of that arrangement constituted maladministration by the FSA (*finding 6*);
- vi) That the misleading information about the Society's solvency position and its record of compliance with other regulatory requirements, produced by the FSA during the period after the Society closed to new business, constituted maladministration by the FSA (*finding 10*).

45. *Findings of injustice:* Having made these findings of maladministration, all contained in Part One, Chapter 11 of the Report, she next considered whether that maladministration resulted in injustice to the complainants. She addressed this topic in Chapter 12 of the Report. The discussion in Chapter 12 was carefully constructed, and the sequence is important:

- i) First, she set out the "specific consequences" of each finding of maladministration.
- ii) Secondly, she listed three "general consequences" which flowed from the maladministration she had found.
- iii) Thirdly, she considered whether the consequences which she had determined flowed from the maladministration constituted "injustice" to those who had complained to her. For this purpose, she effectively dealt with findings 2, 4 and 5 together, and then findings 3, 6 and 10 separately.

46. It will be more convenient to look in detail at the specific findings of injustice, and the Government's responses to them when considering the specific heads of challenge
47. *Remedies:* In Ch. 14 of Part One of the Report, the Ombudsman dealt with "Remedy and Recommendations". As already foreshadowed, her first recommendation was for an apology from the public bodies involved in the regulatory failures identified in the Report. The Government has accepted that recommendation and no more need be said about it.
48. Her second recommendation, also as already foreshadowed, was for the establishment of a compensation scheme -
- "... with a view to assessing the individual cases of those who have been affected by the events covered in this report and providing appropriate compensation." (para 138)

She added:

"139. The aim of such a scheme should be to put those people who have suffered a relative loss back into the position that they would have been in had maladministration not occurred.

140. Addressing relative loss in this way would remedy any financial loss that has occurred and also the loss of opportunities to invest elsewhere than the Society. It is thus the most appropriate remedy for the injustice that I have found resulted from maladministration. "

49. *The Government's Response:* We will look in more detail at the Response in the context of the individual heads of challenge. At this stage we summarise the position in respect of each finding:
- i) *Findings 2 and 4:* So far as material to this dispute, the Government accepted these findings of maladministration in full but did not accept the Ombudsman's findings of injustice in respect of both (1) valuation interest rates and (2) affordability and sustainability of bonuses. In this regard, the Government relied in part on actuarial advice from Oliver Wyman ("the OW report").
 - ii) *Finding 3:* As to maladministration, the Government accepted that part of the Ombudsman's finding which related to the failure by GAD to alert the regulator to Equitable's introduction of the DTBP; but not the remainder of the finding, relating to the failure by GAD to raise the matter with Equitable, and its failure to seek to identify the rationale for the introduction of the policy and how it was communicated to policyholders. It did not accept the finding of injustice.
 - iii) *Finding 5:* The Government accepted the Ombudsman's finding of maladministration only in part, in relation to the failure to request the resilience reserve figure for 1995. The Government did not accept that GAD was under any obligation to interpret or act on ratings produced by

independent third parties. Nor did the Government accept that its failure to request for itself the amount of the resilience reserve for 1995 was the cause of any misunderstanding by independent third parties. The Government did not accept the Ombudsman's determination of injustice, linked as it was to findings 2 and 4.

- iv) *Finding 6:* The Government accepted both the Ombudsman's findings of maladministration and injustice in relation to Equitable's reinsurance. It accepted that Equitable's returns would have given a materially different picture of Equitable's solvency, had no credit for the reinsurance treaty been permitted by the regulator. The Response, however, added certain "observations" as to the Ombudsman's findings of injustice, which it will be necessary to look at in more detail.
- v) *Finding 10:* The Government accepted the Ombudsman's finding of maladministration, on the basis that the FSA's statement in October 2001 had the potential to mislead policyholders and others reading it. The Government also accepted the Ombudsman's finding of injustice, but again subject to certain observations.
- vi) *Remedies:* The Response rejected the recommendation of a compensation scheme but accepted that some *ex gratia* payments would be warranted, for which purpose it had asked Sir John Chadwick to conduct an investigation. We shall return below to his detailed terms of reference, in the context of the challenge to this aspect of the Response.

50. *The Special Report:* Mention has already been made of the Ombudsman laying the Special Report before Parliament. In this Report, the Ombudsman suggested that this had perhaps been the "most complex" investigation ever undertaken by her office. While acknowledging that (at para. 8):

"Decisions as to whether...a compensation scheme... [as recommended]... would be in the public interest and as to how public resources should be spent are matters for Parliament and Government and not for me..."

the Ombudsman expressed herself as "deeply disappointed" at the rejection of many of her findings in the Response (para. 24). She went on to say (para. 25) that she was "entirely unpersuaded" by the basis for the rejections set out in the Response.

51. The Ombudsman expressed three concerns about what she termed the "Chadwick process" (paras. 31 and following):

- i) First, it broke the link between injustice resulting from maladministration and the provision of any remedy. In this regard, she complained in particular as to limiting eligibility for any future payment to those who had suffered "disproportionate impact" and the limits on the "liability" of the regulators – both as to apportionment (see below) and the asserted reluctance to compensate for regulatory failure.

- ii) Secondly, as to lack of clarity and the risk of delay (as she saw it) attendant upon the Chadwick process.
 - iii) Thirdly, as to the selective use made in the Response of the Penrose Report.
52. The Ombudsman went on to say that, whatever the outcome of Sir John Chadwick's work, it was "clear" that the injustice she had found to have resulted from maladministration would not be remedied (para. 64). She was unable to conclude that the Government's proposals complied with her recommendation for a compensation scheme (para. 69). In all the circumstances, she had thought it appropriate to lay the Special Report before Parliament. We mention the Special Report as part of the background, but not as material to our own consideration of the legality of the Response. It will ultimately be for Parliament, not the courts, to decide how to respond to the Special Report

THE LEGAL FRAMEWORK

53. At the hearing before us, there was some debate as to the legal framework within which the Government's response to the Ombudsman's recommendations should be considered. Much of the argument turned on the interpretation of the principles set out by the Court of Appeal in *R (Bradley) v Work and Pensions Secretary* [2008] EWCA Civ 36; [2009] QB 114, by which we are of course bound. We note that, for EMAG, Ms Rose QC reserved the right to argue at a higher level that the basis of review established by that case was too restrictive. Although we were referred to a number of other authorities and leading textbooks, we do not think they add or detract usefully for present purposes from the guidance in *Bradley*.
54. *Bradley* itself concerned a report of the Ombudsman addressing the role of Government in the events leading up to the winding-up of certain final salary schemes with inadequate funds. Various findings of maladministration and injustice had been made by the Ombudsman, together with a number of recommendations. The Secretary of State had declined to accept the Ombudsman's findings of maladministration and a number of her recommendations. Proceedings for judicial review followed. It was common ground that *recommendations* of the Ombudsman, as opposed to her findings, were not binding on the Secretary of State. The principal issue was whether, or to what extent, the findings of the Ombudsman were binding on the Secretary of State. It was argued by the claimants that the Ombudsman's findings of maladministration were binding on the Secretary of State, unless themselves flawed or irrational; the Secretary of State submitted that his discretion was not so limited, and that he was entitled, acting rationally, to prefer his own view, without needing to show that the Ombudsman's view was itself flawed in some way.
55. In resolving that dispute, the court found assistance in the scheme of the legislation, the purpose being to give Members of Parliament -
- "... access to the services of an independent and authoritative investigator as 'a better instrument which they can use to protect the citizen'".

56. The legislation, especially s.10(1), emphasised the role of the Ombudsman as a “servant of Parliament” (para 46). It did not, however, follow that the legislation precluded a minister, called to account before Parliament,

“... from explaining, as part of his justification for the decision to provide no remedy in respect of the complaint, his reasons for rejecting the commissioner’s finding of maladministration” (para 41)

57. Such a bar would be “wholly foreign” to the purpose for which the legislation had been introduced (para 41). Parliament could have enacted a provision requiring a public body whose conduct had been the subject of an investigation to accept the Ombudsman’s findings of maladministration; but it had not done so.

58. In the light of these considerations, Sir John Chadwick concluded:

“It follows that unless compelled by authority to hold otherwise, I would conclude that...the Secretary of State, acting rationally, is entitled to reject a finding of maladministration and prefer his own view. But, as I shall explain, it is not enough that the Secretary of State has reached his own view on rational grounds: it is necessary that his decision to reject the ombudsman’s findings in favour of his own view is, itself, not irrational having regard to the legislative intention which underlies the 1967 Act. To put the point another way, it is not enough for a minister who decides to reject the ombudsman’s finding of maladministration simply to assert that he had a choice: he must have a reason for rejecting a finding which the ombudsman has made after an investigation under the powers conferred by the Act.” (para 51)

59. Amplifying this conclusion, Sir John Chadwick said this:

“...It is not...a general rule that facts found in the course of a statutory investigation can only be impugned on *Wednesbury* grounds: although, plainly, if the investigator can be shown to have acted irrationally, that will be a powerful reason for rejecting his findings. The true rule...is that the party seeking to reject the findings must himself avoid irrationality: the focus of the court must be on his decision to reject, rather than on the decision of the fact-finder.” (para 71)

In this regard, Sir John agreed with the formulation of the test by counsel for the claimants in *Bradley* (there also Ms Rose), as follows:

“... the relevant test is not whether a reasonable Secretary of State could himself conclude that failure to disclose risks in official leaflets was [not] maladministrative. Such a test would fail to take into account the fact that Parliament has conferred on the Ombudsman the function of making findings of maladministration and that the decision under review is a

decision to reject that conclusion. The question is not whether the defendant himself considers that there was maladministration, but whether in the circumstances his rejection of the Ombudsman's finding to this effect is based on *cogent reasons*." (para 72, emphasis added)

60. The application of this approach is best illustrated by reference to the facts of *Bradley*, and to the challenge which was upheld by the court. One complaint related to the contents of a leaflet PEC 3 issued by the relevant Department in January 1996, the purpose of which was to provide a brief summary of the changes introduced by the Pensions Act 1995, and why they had been made. One answer to that question was the following:

"The Government wanted to *remove any worries* people had about the safety of their occupational (company) pension following the Maxwell affair." (emphasis added)

61. The Ombudsman found that the leaflet was inaccurate in that it failed to convey the limitations of the protection in fact offered to non-pensioners, which would not remove "any worries" but at most offered "a reasonable expectation – but not a guarantee" of achieving benefits equivalent to those lost. The Department rejected that criticism, on the ground that it was reasonable to expect people to obtain more detailed information about a specific pension scheme, rather than relying on "brief, general and introductory material" such as was issued by the Department (paras 81-5).
62. Sir John Chadwick summarised the Secretary of State's argument before him and his reasons for rejecting it:

"90. On the basis of those reasons it is submitted that the Secretary of State "was rationally entitled to conclude" that the reader of leaflet PEC 3 would not be so misled into thinking that the MFR provided a guarantee that all occupational pensions were safe and secure in all circumstances. If he was entitled so to conclude, then (it is said) he was entitled to reject the Ombudsman's finding on that point.

91. For my part, I am not persuaded that that is the correct approach: I am not persuaded that the Secretary of State was entitled to reject the Ombudsman's finding merely because he preferred another view which could not be characterised as irrational. As I have said, earlier in this judgment, it is not enough that the Secretary of State has reached his own view on rational grounds: it is necessary that his decision to reject the Ombudsman's findings in favour of his own view is, itself, not irrational having regard to the legislative intention which underlies 1967 Act: he must have a reason (other than simply a preference for his own view) for rejecting a finding which the Ombudsman has made after an investigation under the powers conferred by the Act.....

95. ... the judge observed... that no reasonable Secretary of State could rationally disagree with the Ombudsman's view that the information in the leaflet PEC 3 was incomplete and potentially misleading. I am satisfied that the judge was correct in that observation; but, for my part, I prefer to say that, in the circumstances of this case, it was irrational for the Secretary of State to reject the Ombudsman's finding to that effect....”

63. Thus it was not enough that the Secretary of State had formed the view that people would not be misled. It was the Ombudsman who had the primary task of assessing the nature of the maladministration and its consequences. The Secretary of State was entitled to disagree with her assessment for cogent reasons, but not to disregard it. It is fair to observe that the distinction may be a narrow one, but that is the result of the special statutory context. In agreeing Wall LJ described Sir John Chadwick’s judgment in that case as having -

“... skilfully and correctly steered the argument between the difficult political and jurisdictional shoals and eddies” (para 143).

64. We must attempt the same task in the more complex factual context of the present case.

65. *Discussion:* In considering the application of *Bradley* to the facts of the present case, we agree with Mr. Lewis that the subject-matter of the challenges falls into three distinct categories:

- i) First, the Government’s rejection of the Ombudsman’s *findings* (of maladministration or injustice, as the case may be).
- ii) Secondly, the challenge to the Government’s rejection of the Ombudsman’s *recommendation* of a compensation scheme.
- iii) Thirdly, the challenge to the Chadwick Terms of Reference, concerning the Government’s proposal for *ex gratia* payments.

66. As we see it, it is only in respect of (i), the actual *findings* of the Ombudsman, that the *Bradley* approach is directly applicable. Although not bound by them, the public body can only reject the findings of the Ombudsman for “cogent” reasons, that is for reasons other than merely a preference for its own view. That is not a precise test, but it would be wrong in our view for us at this level to attempt a further definition of the “cogent” reasons test or to suppose that there is some exhaustive list of such reasons. What is required instead is a careful examination of the facts of the individual case – with the focus resting upon the decision to reject the findings of the Ombudsman, rather than the Ombudsman’s findings themselves.

67. Particular factors weighing against rejection in the present case are the complex nature of the Ombudsman’s investigation, together with the fact that her findings were made after taking detailed expert advice, including actuarial advice; and the fact that the public bodies involved in the Ombudsman’s investigation had extensive opportunities to make representations. On the other hand, where it can be

demonstrated that the Ombudsman has gone wrong in fact or in law, or where the Government has carried out further work not done by the Ombudsman, the case for rejection may be easier to justify.

68. As for (ii), the Government's rejection of the Ombudsman's *recommendation* for a compensation scheme, it was not and could not have been submitted that the recommendation was binding on the Government. There was no serious dispute that in this context the legal test is the conventional one of irrationality or *Wednesbury* unreasonableness. Further, as the context necessarily entails a consideration of the allocation of resources from the public purse, the Court would be likely to proceed with caution before intervening: see, *De Smith's Judicial Review* (6th ed.), at para. 11-014.
69. The same test applies to (iii) the *Chadwick Terms of Reference*. Again, the EMAG challenge cannot succeed unless irrationality or *Wednesbury* unreasonableness is established, although we accept that one such ground might be (if established) that some aspect of the Terms is (for example, as argued by EMAG, the expression, "disproportionate impact") unintelligible. Here too the issue concerns competing demands on the public purse and hence there is a need for the Court to proceed with caution before intervening.

PARLIAMENTARY PRIVILEGE – A FOOTNOTE

70. We record that counsel instructed by the Attorney General on behalf of the Speaker of the House of Commons ("the Speaker") made a brief appearance before us. By the time of that appearance, the issue concerning the Speaker had been reduced to a single passage in the EMAG Statement of Facts and Grounds. In that passage, EMAG had quoted and relied upon evidence given to the Public Administration Select Committee ("the PASC") by the Economic Secretary to the Treasury. The Speaker submitted that such reliance on evidence given to the PASC should not be permitted; it infringed the principles as to Parliamentary Privilege and was, in any event, irrelevant. We indicated that although by the time of the Speaker's intervention we had already read the offending passage, we would put it out of our minds and no further reference would be made to it. None was.

THE ISSUES

Findings 2 and 4

Summary

71. In summary, the Ombudsman held that GAD was responsible for maladministration because it failed to ask and resolve questions which arose from Equitable's regulatory returns for 1990-1993 (finding 2) and for 1994-6 (finding 4), relating to (i) the valuation interest rate it had used and (ii) the affordability and sustainability of its bonuses. One of the consequences of the maladministration was that the regulatory returns in respect of these two matters were unreliable. Her finding of injustice was of injustice sustained by any policyholders who relied on the returns in these respects, and who suffered either a financial loss or a loss of opportunity to take an informed decision as a result of such reliance.

72. The Government rejected the finding of injustice, because it found that the returns were not in breach of the regulations applicable at the time, and they would not have been any different had the acts of maladministration not occurred. Accordingly those who relied upon the returns had not suffered any injustice.
73. The claimants challenge this view as being based, first, on an unduly narrow view that if Equitable's practices were "technically within the regulations, that is the end of the matter"; and, secondly, on the flawed conclusion in the OW report that the bonuses were sustainable and in accordance with PRE.

Detailed findings

74. Before considering those arguments, we must set out in more detail the Ombudsman's conclusions as to the consequences of the maladministration she had found, since it is these consequences which form the basis of her finding of injustice.
75. It is important to note her view as to the significance of the regulatory returns. When reaching her conclusion in respect of maladministration she said:

"Seeking to ensure that the regulatory returns of an insurance company were accurate and complete was at the heart of the role of the prudential regulators, acting with the advice and assistance of GAD." (cap 11 para 34)

76. It seems equally clear that in this respect she was not limiting herself to the question of technical compliance with regulatory requirements. Thus, in an earlier passage dealing with bonuses (on which both parties rely for different reasons), she had explained that she was –

".. not suggesting that it can be established that the Society was in breach of the regulatory requirements to which it was subject..." (cap 10 para 197)

There had been a similar comment in relation to valuation interest rates (cap 10 para 186)

77. As to specific consequences flowing from *finding 2*, the Ombudsman said this:

"17. One consequence...was that the prudential regulators and GAD could not be satisfied that the Society was acting prudently and with proper regard to the interests and reasonable expectations of its policyholders. Another consequence ...is that the Society was never asked to justify whether it could afford its bonus declarations or how it proposed to sustain the level of bonus that it declared.

18. A further consequence was that the impression was given to existing and potential policyholders that the Society was financially sound and able to pay generous bonuses, when the prudential regulators and GAD could not have been satisfied on either point.

19. That maladministration led to lost opportunities to seek further understanding as to whether the Society's business model was inherently prudent or whether that model exposed the Society's members to unnecessary risk."

The specific consequences found to flow from *finding 4* were these:

"36. One consequence of this failure was that an early opportunity was lost to address the issue of the Society's practice as to reserving for guaranteed annuity rates. Another consequence was that the Society's liabilities were considerably understated.

37. That maladministration reinforced that which I have found in relation to the introduction of the differential terminal bonus policy, in that the problems which caused the Society eventually to close to new business were further obscured and opportunities were lost to address those issues earlier than eventually happened."

78. The Report went on to set out the "general consequences" flowing from the maladministration as found:

"59.

- the first was that the Society's published returns were unreliable;
- the second was that there were lost opportunities to address critical issues earlier; and
- the third was that regulatory decisions were taken on a basis which had insufficient regard to the range of powers that the prudential regulator possessed."

79. As to the first, she considered that the published returns "materially understated the Society's liabilities in several respects" and that this would have misled those seeking to assess the financial strength of the Society:

"Anyone investing in the Society - whether as a new investor or as someone making a further investment in it - from the second half of 1991 onwards was at risk of being misled, if he had regard to the regulatory returns, about the financial condition of the Society. The prudential regulators permitted returns to be published which those regulators could not have been satisfied revealed the Society's true liabilities or an accurate financial picture" (para 62-3)

80. As to the second, if the prudential regulators had raised concerns at an earlier date -

“... the resulting problems might have crystallised earlier and before they became so acute... some of those factors might have been ameliorated by earlier action... instead they developed over time to become intractable...” (paras 69-70).

81. This led to her determination of injustice, arising from the maladministration found in *findings 2, 4 and 5*:

“100. I find that injustice was sustained by any policyholder who relied on the information contained in the Society’s returns for 1990 to 1996 and who suffered either a financial loss or a lost opportunity to take an informed decision as a result of such reliance. Where a policyholder neither relied on this information nor suffered a loss of either type, I find that no injustice resulted from this maladministration.”

Discussion

82. The issue between the parties, in relation to these findings, seems to us to come down to a relatively short point, turning on the correct interpretation of the Ombudsman’s reasoning.

83. In their Skeleton, the claimants explain her conclusion thus:

“On a proper understanding of the Report, injustice was found to have been suffered by those who had suffered financial loss, or loss of the opportunity to make an informed decision, as a result of the unreliability of (Equitable’s) returns or as a result, more broadly, of GAD’s failure to engage with questions which might have exposed underlying concerns and mitigated the resulting problem.”

84. For the Government, Mr Lewis fairly criticised the second part of that submission (after “or”) as reading words into the Ombudsman’s actual finding. She did not in terms find injustice arising from the failure to engage with questions “more broadly”, save in so far as any such failure might be reflected in the inadequacy of the returns. Similarly Miss Lewis, in her statement on behalf of the Government, lays stress on the nature of the finding of maladministration:

“The Ombudsman’s finding is that GAD failed to question and to seek to resolve questions within Equitable’s regulatory returns arising in the respects identified. The Ombudsman does not say that the GAD failed to detect any breach of the regulatory requirements by Equitable, or that the Prudential Regulator should have exercised any powers of intervention. These features underline the Government’s decision to reject her findings of injustice

It is notable in relation to her finding as to the affordability and sustainability of the Society’s bonuses that the Ombudsman relies heavily on policyholders’ reasonable expectations

(‘PRE’) and not on any finding that Equitable’s regulatory returns were in breach of relevant regulatory requirements, coupled with a particular approach to the question of injustice...” (paras 96-97).

85. Thus the key to the Government’s approach is that, notwithstanding the Ombudsman’s wider concerns in relation to affordability and sustainability, the finding of injustice turned solely on the narrow issue of compliance with regulatory requirements.
86. If that is the correct interpretation of the Ombudsman’s report, then it is hard to criticise the response. However, it seems to us important to read this part of the Ombudsman’s report as whole. The actual finding of injustice must be seen in the context of the preceding discussion. Viewed in that light, it seems to us that the thrust of the claimants’ submission is correct. The finding of injustice was directed to the impact of the returns on those relying on them, because that was the mechanism by which the Ombudsman moved from the general adverse effects of the maladministration, to the “injustice” suffered by particular individuals. However, she clearly saw that issue as directly connected with the general failures to which she had referred earlier in the same chapter. Otherwise, there would have been no purpose in mentioning those “consequences” as part of the immediate background to her finding of injustice.
87. Implicit in that approach seems to be the view that, if the problems had been identified and addressed at an earlier date, the inherent weaknesses of the Society’s position would not only have been brought to light, but would have been reflected in some way in its published returns, so that those relying on the returns would have had a more accurate picture on which to base their decisions. It is also apparent from her earlier comments that she accepted that this might have involved more than the bare minimum necessary to meet the regulatory requirements. It is true that she did not spell out the mechanism by which this would have been achieved, nor the precise form which the better information would have taken in the returns. But she clearly saw the regulator’s duty as going beyond that of securing minimum compliance, and as including a duty not to permit returns to be published which they –

“...could not have been satisfied revealed the Society’s true liabilities or an accurate financial picture.”

88. This point is linked in our view to the claimants’ second point relating to the OW report. The importance of that actuarial advice was acknowledged in Ms Lewis’ statement where, having referred to the Government’s conclusion that Equitable was acting “in a manner consistent with the relevant regulatory requirements”, she added:

“The Government... was satisfied *in the light of actuarial advice that it had received* that the information contained in Equitable’s regulatory returns would not have been different even if GAD had questioned Equitable’s approach at the time...” (para 106, emphasis added)

89. In the Response itself, the Government, having concluded that there had been no basis for regulatory action in relation to valuation interest rates, went on to consider issues of “affordability and sustainability”, asking itself whether:

“...there is any other basis for criticising the affordability or sustainability of Equitable Life’s bonus declarations in the context of the regulatory regime in place at the time.” (para 4.51)

90. It commented:

“Equitable...would set its allowance for future bonuses each year having regard to the ...difference between the valuation interest rate and its risk adjusted yield, plus the business’ additional profits. From the 1996 regulatory returns onwards, data is available to show that the difference between the valuation interest rate and its risk adjusted yield, after allowance for the guaranteed investment return was around 0.5% to 0.75% p.a. This amount – an allowance for future bonuses – was therefore set aside by Equitable...each year in its reserves. The Government *is further advised* that these bonus allowances paid sufficient regard to *the reasonable expectations of the policyholders* in the context of the regulatory regime in place at the time....” (para 4.53 emphasis added)

91. On this basis it concluded that, if GAD had raised the issues of affordability and sustainability of future bonuses –

“... the Society would have been able to establish that its approach to future bonuses was sustainable and affordable (in the sense that it was complying with the applicable valuation regulations) between 1990 and 1993 (finding 2) and 1994 and 1996 (finding 4)...” (para 4.55)

92. These paragraphs we take as implicit recognition that, in considering regulatory compliance, the sustainability of its approach to future bonuses in the light of the reasonable expectations of policyholders (PRE) was a material factor; and also as an indication that for its conclusions on that issue the Government was dependent on its actuarial advice.

93. The claimants make a number of criticisms of the weight put by the Response on the OW report, including the following:

- i) OW’s terms of reference were directed to the narrow question of compliance with the applicable regulatory requirements, rather than the broader issue of PRE.
- ii) The Ombudsman had herself received detailed actuarial advice in the form of a report from Tony Leandro FIA, which had been subject to peer review, and comment by interested parties. Although this was listed as one of the

documents made available to OW, they make no reference to the report and no attempt to refute its findings.

- iii) To support their conclusion that the bonuses were “affordable and sustainable” OW relied on evidence that a margin of 0.5% was available to fund future discretionary bonuses, whereas the bonus in fact declared in 1996 was 4%.
 - iv) The table relied on by OW for that purpose was taken from the Penrose Report (Table D4 – reproduced at para. 12 above), the earlier part of which (not quoted by OW) showed that the bonuses declared during all the years relevant to findings 2 and 4 resulted in a deficit for every year.
 - v) OW’s observation that Equitable’s practice was “consistent with PRE” was unsupported and unreasoned, and contrary to the actual conclusions of a panel of the Institute of Actuaries, on which OW purported to rely.
 - vi) In relation to valuation interest rates, in focussing on the question whether the assets were sufficient to cover liabilities, OW showed no more than that Equitable may have been able to show that it had sufficient assets to meet its *contractual* liabilities, but not to satisfy policyholders’ reasonable expectations for discretionary bonuses; nor did they address the Ombudsman’s view that, to satisfy the valuation regulations, the margin should have been not merely greater than zero but “significantly so, if an allowance is made for future bonuses on with-profits business” (cap 10 para 139-40).
94. We have already referred to the table taken from the Penrose report which, at least on its face, indicates that, from the early 1990s, Equitable would have had serious difficulties in demonstrating its ability to meet policyholders’ reasonable expectations, in accordance with its existing practices. Even more striking, because it provides an objective expert view, is the conclusion of the disciplinary panel of the Institute of Actuaries. This related to charges brought against Mr Ranson, Equitable’s appointed actuary at the relevant time. The panel found breaches of PRE, because of the failure to have regard to the practical implications if, in order to meet the cost of guaranteed benefits, the Society had to reduce future bonuses. They held that annual policy values reported to policyholders overstated their share of the assets in that –
- “... aggregate policy values exceeded the value of the fund and consequently policyholder expectations were aroused that could not in practice be fulfilled.” (para 122)
95. These points seem to us at the very least to throw serious doubt on the extent to which the OW report provided an adequate basis for rejecting the Ombudsman’s view on the ability of the Society to satisfy PRE. Indeed, in his oral submissions, Mr Lewis was not notably energetic in its defence. We do not, however, think it necessary or possible for us to resolve the differences between the experts within the limitations of the present judicial review proceedings. Putting it at its highest, and even discounting the criticisms, the OW report was no more than an indication of a possible alternative expert view to that on which the Ombudsman’s based her conclusion. It falls far short of providing support for the Government’s apparently definitive assertion that the Equitable bonus allowances “paid sufficient regard to the reasonable expectations of the policyholders”. Nor in our view could it justify a positive conclusion that action

by GAD at an earlier stage could have made no difference, at least to the extent of providing an opportunity for a closer review of these issues. As the cases show, the Ombudsman was entitled to regard the mere loss of such an opportunity as sufficient to found her finding of injustice.

96. We observe that Mr Lewis' helpful summary of the Government's case on this issue contains no reference to the OW report. He says simply:

“The Ombudsman did not make a finding of injustice based on PRE or any failure by the regulator to exercise statutory powers of intervention (including requiring the provision of additional information to policy holders or other interventions).”

97. We agree that, if that were the correct interpretation of the Ombudsman's findings, the disputes over PRE and the other broader issues would be irrelevant. However, for the reasons we have given, and in agreement with the claimants, we think that it ignores the context in which the finding of injustice was made. In this respect we conclude that the Government's response lacked cogency, and fell short of the statutory requirement.

Finding 3

Summary

98. The Ombudsman found that GAD was responsible for maladministration because when, in 1993, Equitable introduced the DTBP, GAD did not (i) inform the prudential regulator, (ii) raise the matter with Equitable or (iii) seek to identify the rationale for the policy or how it was being communicated to policyholders. She made no finding of financial loss; instead, the determination of injustice was in these terms:

“121....I consider that the loss of opportunities to take informed decisions about their financial affairs during the period from July 1994 to April 1999 in full knowledge of the exposure of the Society to guaranteed annuity rates and of the risks that such exposure generated constitutes injustice to policyholders and I consequently make a finding that policyholders suffered such injustice as a result of maladministration.”

99. The Government accepted that failure to inform the regulator of the adoption of the DTBP was maladministration. It did not accept that failure to raise the matter with Equitable or to seek to identify the rationale for the policy or how it was being communicated to policyholders was maladministration. The Government also did not accept the finding of injustice.
100. It is to be noted that the difference between the parties in respect of this finding is relatively narrow, because of the limited periods in which GARs became valuable. From 1967 to 1993, market interest rates had exceeded the GARs, which accordingly were of no value. As interest rates fell, GARs became more valuable, first for a short period between about October 1993 and April 1994, and then at all material times from 1995 onwards. In the context of finding 4, the Government did accept injustice

due to maladministration “concerning the failure to hold explicit reserves for guaranteed annuity rates” (para. 4.77). The duty only arose, on the Government’s view in 1995, when GARs became valuable following the fall in interest rates. On this footing, though the Government did not accept injustice arising from maladministration in connection with the scrutiny of the 1993 returns (thus, in practical terms, in or from mid-1994 when the 1993 accounts would have been under review), it did accept injustice arising from maladministration in connection with the scrutiny of the 1995 and subsequent year returns (thus, in or from mid-1996). The difference between the parties is thus narrowed to what might be termed a “2 year gap”: depending on whether this point bites from mid-1994 or mid-1996.

The issues

101. The Government’s response relies principally on the view that at the relevant time DTBPs were accepted practice, and that accordingly, even if GAD or the regulator raised the issue at an earlier stage, there was no reason to think that it would have made any difference in practice. In particular, there is no reason to think that it would have led to earlier court action to test the legality of the practice, since this only arose as a result of the complaints in 1997 to 1998. The claimants say that this pays insufficient attention to the special features of Equitable, which made their sudden reliance on DTBPs a particular concern. They make a number of other detailed criticisms of the Government’s reasoning, in particular its failure to address “the real basis”, which was that –

“... an opportunity was lost to engage the Society in discussion about the rationale for the introduction of this new policy, [and] about whether that policy met the reasonable expectations of the Society’s policy-holders...

Had no maladministration occurred, I consider that it is on the balance of probabilities likely that the Society’s growing exposure to guaranteed annuity rates would have been understood much earlier, as would the Society’s related reserving practices.” (cap 12 paras 103, 105)

102. It seems to us that the Government had cogent reasons for departing from the Ombudsman’s finding of maladministration (to the extent it did) and the finding of injustice. At the outset and notwithstanding the special features of Equitable, hindsight must be eliminated. Save for the short period between October 1993 and April 1994, market interest rates had exceeded the GARs for some 26 years, from 1967 to 1993. Against this background, the Government was eminently entitled to form its own view of the likely course of events had the GAD informed the regulator of Equitable’s changed practice in respect of DTBP. It was common ground that if advice had been taken at that time as to the legality of DTBPs, it was likely to have been positive. Once hindsight is eliminated, the detailed criticisms made by the claimants lack force and fall far short of establishing a case of irrationality. As has already been seen (when dealing with finding 4), the position changed later, once GARs consistently exceeded market interest rates.

Finding 5

Summary

103. Equitable produced two valuations of its assets and liabilities – the main valuation (in the form which Equitable chose to present) and the appendix valuation (to show that the valuation it presented produced a valuation at least as strong as that required by regulations). In order to be able to assess whether the valuation Equitable produced was as strong as that required by the regulations, GAD needed to know the value of Equitable’s “resilience reserve”. This was the extra reserve required to cover contingencies such as a sharp fall in the stock market. GAD had requested this information in previous years, but failed to do so in 1995.
104. The Ombudsman also found that a rating agency, Standard & Poor’s, had produced a rating which, she concluded, indicated that it had been misled by the regulatory returns. The Ombudsman concluded that GAD should have informed the regulator that Standard and Poor’s had been misled.
105. The finding of maladministration against GAD was as follows:
- “... the failure by GAD (i) to ask for the information GAD needed in respect of the Society’s 1995 returns to enable them, as part of the scrutiny process, to be sure that the Society had produced a valuation that was at least as strong as the minimum required by the applicable Regulations, and (ii) to pursue the information before them that the omitted information had led to the users of the returns misconstruing the financial strength of the Society, constitutes maladministration ..” (cap 11 para 84)
106. The finding of injustice was the same as for findings 2 and 4, that those who relied on the regulatory returns and suffered a financial loss or a loss of opportunity had suffered injustice (cap 12, paras 89 - 100).
107. The Government accepted that there was maladministration by reason of the failure of GAD to request the resilience reserve, but not by failing to follow up what use third parties (such as Standard and Poor’s) were making of the regulatory returns. The Government did not accept that GAD was responsible for the way in which rating agencies such as Standard and Poor’s produced their ratings:
- “... the Government does not accept that it was under any obligation to interpret or act on ratings produced by independent third parties. Nor does the Government accept that its failure to request for itself the amount of the resilience reserve for 1995 was the cause of any misunderstanding by independent third parties...” (para 4.115)
- It did not accept that GAD or the prudential regulator were under “any duty” to act in response to the credit rating produced by Standard and Poor’s (para 4.119).

Discussion

108. Underlying the Government’s response was the fact that there was no statutory obligation on Equitable to include its resilience reserve in the regulatory returns. If

GAD had asked about the resilience reserve, it would have discovered that, as was required, Equitable had in fact made proper provision for that reserve. This would not have led to the regulatory return being any different. Accordingly no one could claim to have suffered injustice as a result of the information in the returns. The Government had no obligation in respect of the rating agencies, and could not be held responsible for their misinterpretation of the returns.

109. The claimants argue that the Response adopts too narrow a view of the Ombudsman's findings. Her finding of maladministration needs to be read in the context of earlier evaluation of the public bodies' submissions (cap 10 para 393-5). There she had emphasised the widespread use made of the Standard and Poor's ratings, well known to GAD, to the extent that they were used by GAD and the regulators in scrutiny reports and in Ministerial briefings. The flaws in the ratings were, in her view, "a direct result of the way in which the Society presented its returns without objection from GAD". Although she accepted that the presentation was not contrary to the regulations, and did not suggest that GAD should have intervened under the 1982 Act, GAD should have alerted the prudential regulators to the issue, and recommended that those ratings should not be used as briefing material.
110. In the reasoning leading to her finding of maladministration (cap 11), she said that the ratings –

“...confirmed not only that the users of the regulatory returns might be misled by the Society's presentation but also that they had been misled.” (cap 11 para 76)

In these circumstances, particularly in a regime which was “predicated on the doctrine of ‘freedom with publicity’”-

“... the failure of GAD to seek to persuade the Society to provide the information within its returns (or to recommend that the prudential regulators considered taking action to secure that it was so provided) is inexplicable....

... There were clearly alternative courses of action open to GAD which it would have been proportionate for them to have taken in respect of information that could mislead the reader of the returns as to the actual financial position of the Society, as compared to the statutory minimum requirements.

Such potentially misleading information should have been of fundamental concern to any prudential regulator acting reasonably. The failure by GAD to ensure that misleading information was not disseminated through the Society's returns *thus also falls far short of acceptable standards of good administration*” (paras 79, 82-83, emphasis added)

111. In simple terms, as the claimants submit, the Government's response misses the point. The basis of the Ombudsman's finding was, not that GAD or the prudential regulator were under any formal “obligation” to interpret or act on the statements of the rating agencies; but that, in circumstances where they knew that the returns were giving a

misleading impression to authoritative independent observers, their failure to do so fell short of “acceptable standards of administration”. Her view of the requirements of good administration was thus broader than that of strict compliance with the regulations, or with any specific legal duties of the regulator.

112. We agree with that submission. For the reasons we have given when discussing the concept of maladministration, we think that it was open to the Ombudsman to adopt a broader approach than the strict legal requirements. By concentrating on the narrow issue of legal obligation, the Government’s response fails in this respect also to provide a cogent reason for rejecting the Ombudsman’s finding.

Finding 6

Summary

113. Equitable took steps, at the behest of GAD, to hold reserves for its GARs liability from 1998. It did so by entering into a reinsurance treaty. Equitable claimed credit for the value of that treaty in its regulatory returns. The Ombudsman concluded that, although Equitable was not entitled to claim credit for it in its returns for 1998-2000, GAD had permitted it to do so (p. 324, para 87). By claiming credit for the reinsurance treaty, Equitable was able to present a stronger picture of its financial state than would otherwise have been possible.

114. The Ombudsman found that those who joined Equitable after 1st May 1999 or paid a premium which they were not obliged to after that date suffered injustice. Her finding of maladministration against GAD was in these terms:

“... the failure by the FSA, acting on behalf of the prudential regulators, (i) to ensure that the financial arrangement was not taken into account within the Society’s 1998 returns without an appropriate concession being given, and (ii) to ensure that the credit taken by the Society within its returns for 1998, 1999 and 2000 properly reflected the economic substance of that arrangement, constitutes maladministration ...” (cap 11, para 101)

115. She found consequent injustice:

“... in respect of all those who joined the Society or paid a further premium that was not contractually required in the period after a May 1999, any financial loss that they have sustained constitutes injustice in consequence of maladministration. Those affected by that maladministration have also suffered injustice in the form of lost opportunities to take informed decisions about their financial affairs” (cap 12, para 146)

116. The Government accepted the findings both of maladministration and of injustice. However, it added certain observations arising out of the finding of injustice, in particular as the possible alternative courses of action steps which might have been taken by Equitable to protect its position and that of its policyholders. These

observations led to some considerable debate at the hearing before us, with EMAG submitting that they amounted to backdoor attempts at qualifying the finding of injustice. These concerns were given force by Sir John Chadwick's comments on this issues in his document, "Equitable Life ex-gratia payment scheme: My proposals as to the approach to be adopted and the issues to be addressed" ("Sir John Chadwick's proposals"), he said:

" The effect of my Terms of Reference.... is that those paragraphs of the Response *qualify the extent to which I am obliged and permitted* to take the Ombudsman's Findings of injustice into account in determining the extent of relative losses suffered by classes of policyholders in respect of the Sixth Finding." (para 2.13)

117. It seems therefore that he himself regarded the observations as formal "qualifications" by the Government of its acceptance of the finding of injustice, which were binding on him and precluded him from reviewing the merits of the Ombudsman's own position on these points. This issue was not satisfactorily resolved in the pre-hearing correspondence, but in our view the position was put beyond doubt by Mr Lewis in his Summary statement which contained the following:

"The Government recognises that both the Ombudsman's analysis and its own are matters of speculation. However, the availability of other possible options should be taken into account when assessing the impact and nature of the injustice. *Those are matters that Sir John Chadwick can consider.* He will, in accordance with paragraph 3 of his terms of reference, be able to make findings of fact as he may think necessary: that can include findings in relation to the availability of alternatives, the effect of that on the published solvency position and the effect on third parties." (emphasis added)

118. We take this as sufficient indication to Sir John that his remit is not as limited as he at first considered, and that he can look behind the Government's "observations" and form his own view of their merits. On that basis we need say no more about this ground of challenge.

Finding 10

119. The Ombudsman found that the FSA was responsible for maladministration by reason of comments it made about Equitable's solvency following its closure to new business:

"... the misleading information, about the Society's solvency position and its record of compliance with other regulatory requirements, that was produced by the FSA, acting on behalf of the prudential regulator, during the period after the Society closed to new business, constitutes maladministration ..." (cap 11 para 160)

120. She held that those who relied on the FSA's statements had suffered injustice:

“I find that injustice resulted from maladministration to all those who can show that they relied on misleading information provided by the FSA, that such reliance was reasonable in the circumstances, and that it led to a financial or other loss. Where all this cannot be shown, I find that no injustice resulted from this maladministration.” (cap 12 para 168)

121. The Government accepted the findings of maladministration “on the basis” that one statement made by the FSA – on 12th October 2001 – was inaccurate because, when it said that Equitable was “solvent”, it failed to explain with sufficient clarity that its assessment of Equitable’s financial strength had altered from earlier assessments. To that extent it accepted the finding of injustice, but again added certain observations, particularly as to the information which would have been available by that time from other sources. In the “Summary” of its Response, which also formed the appendix to Sir John’s terms of reference, it stated:

“The Government accepts the finding of injustice, although it believes that the number of policyholders who could show reasonable reliance solely on statements made by the FSA is likely to be relatively few.” (response p 48)

122. We think that this issue can be dealt with relatively shortly. The claimants’ concern is similar to that in respect of finding 6, that is, that the apparently limited “basis” on which the Government has accepted the finding of maladministration, and its observations on the finding of injustice, may unduly restrict the scope of Sir John Chadwick’s inquiry. However, we do not understand that to be the intention or effect of the Response. As Ms Lewis explains, since the Ombudsman did not specify particular statements in her finding of maladministration, the response focused on the particular statement of 12th October because it accepted that it was unclear and capable of being misunderstood.
123. However, the Ombudsman’s finding of injustice is in more general terms, referring to claims by those “who can show that they relied on misleading information provided by the FSA, that such reliance was reasonable in the circumstances...” That was accepted by the Government, and forms the starting-point for Sir John’s inquiry. The Government is entitled to argue (as it does in the paragraph of the Summary quoted above) that the number who could show reasonable reliance on “statements made by the FSA” would be relatively few. The strength of such arguments will be a matter for Sir John’s inquiry; but in our view the reference to “statements” in the plural itself implies acceptance that the inquiry is not necessarily limited to the single statement on 12th October.
124. There is a sub-issue in respect of this finding. The claimants refer to the Ombudsman’s observation that the FSA’s internal communications indicated concern about Equitable’s solvency which was at variance with public statements. The Government in response pointed to the obvious dangers of a regulator publicly airing such private doubts or concerns until it had sufficient information to satisfy itself that the concerns were well-founded. However, the Ombudsman thought that this missed the point:

“If a public body is giving clear assurances about something, the onus is on them to have established that those assurances have a sound basis in fact before giving such assurances.” (cap 10 para 692)

125. As it seems to us, there were cogent reasons for the Government’s response on this sub-issue. In a highly charged situation such as this, the judgment for the authorities as to when and how to go public on unproven concerns is one of obvious sensitivity and difficulty. But it is unnecessary and perhaps unhelpful to go further. We do not understand the Government to contest the view that it would be have been maladministration for the FSA to provide to the public specific information or assurances, which it knew, or had reason to believe might be, misleading. It follows that the Government’s (well-founded) response as to a regulator’s private doubts or concerns does not narrow the scope of the Government’s acceptance of injustice under this head.

Remedies

126. We turn to the Ombudsman’s recommendations in respect of remedies, and the Government’s response. As already indicated, the Government rejected the recommendation of a compensation scheme but stated that some *ex gratia* payments would be warranted. Three main considerations were relied on for this conclusion (paras. 5.15 ff):

- i) *Apportionment*: The remit of the Ombudsman extended only to the role of the regulator; the Ombudsman did not and could not consider the role and responsibility of Equitable and other parties.
- ii) *Competing demands on the public purse*: The Government had a responsibility “to taxpayers generally to balance competing demands on the public purse”; it would not be right to sign a blank cheque on taxpayers’ behalf (para. 5.17-18).
- iii) *Presumption against compensation for regulatory failure*: The Response stated:

“...Parliament has accepted that it is not generally appropriate to pay compensation even where there is regulatory failure. The responsibility to minimise risks and to prevent problems occurring in a particular financial institution lies, first and foremost, with the people who own and run that institution. It would have serious repercussions for the nature and practice of regulation and the relationship between governments and financial markets, were the taxpayer to provide a remedy for all losses whenever financial institutions fail and maladministration by the regulator was found.” (para. 5.20)

127. In respect of the Government’s “alternative proposal”, the Response stated:

“The Government recognises that there has been maladministration, and the representations it has received

suggest that there has been a disproportionate impact on some Equitable Life policyholders. To that extent the Government believes that some *ex gratia* payments will be warranted” (para. 5.22)

128. However, the Government considered that any such payments also needed to take into account -

“...the extent to which losses suffered by policyholders were the result of the maladministration which has been accepted, or can be attributed to other factors such as the conduct of Equitable itself.” (para 5.23)

129. All these matters required detailed analysis. Apart therefore from seeking full policyholder data from Equitable, the Government asked Sir John Chadwick to advise it on a number of matters, in accordance with the Terms of Reference, which were annexed to the Response. They were as follows:

“The Government accepts five findings of maladministration in full, four findings in part, and rejects one finding. Within those findings four cases of maladministration resulting in injustice are accepted, as set out at Appendix 1.

In relation to those accepted cases of maladministration resulting in injustice, Sir John will advise HM Treasury on:

- The extent of relative losses suffered by different classes of policyholder in respect of each case of maladministration, taking account of, among other things, wider market conditions during the period under consideration, and comparable insurance products available over the same period;
- The proportion of those losses which it would be appropriate to apportion to the public bodies investigated by the Ombudsman, as opposed to the actions of Equitable...and other parties;
- The classes of policyholders which have suffered the greatest impact as a result of maladministration; and
- Factors, arising from this work, which the Government might wish to take into account when reaching a final view on determining whether disproportionate impact has been suffered.

Assumptions and evidence

Sir John will:

1. Accept as correct and be able to consider all of the Ombudsman's findings of both maladministration and injustice in so far as those findings are accepted by the Government, but disregard findings which are not accepted;
2. Accept as definitive the Ombudsman's account of the events at Equitable.....
3. Make such other findings of fact (if any) as he may think necessary in the light of the evidence contained in the publicly available reports produced to date....
4. Review additional evidence should this be necessary to fulfil the terms of reference, but having regard to the need, so far as possible, for an expeditious process;
5. If he deems it necessary, seek written representations as appropriate from interested parties.

.....”

130. As already noted, Appendix 1 to the Chadwick Terms of Reference contained a Summary of those instances where the Government accepted that maladministration had led to injustice.
131. A number of points are made by the claimants:
- i) In so far as the court accepts their grounds of challenge to aspects of the Government's response to the findings of injustice, the Chadwick terms of reference will need to be modified accordingly. (This is not controversial, and requires no further comment from us.)
 - ii) The basis of the proposed *ex gratia* scheme is flawed because:
 - a) Discrimination between policyholders on the basis of the relative level of impact experienced by them, rather than that of restoring policyholders to the position that they would have enjoyed had the maladministration not occurred (or “*restitutio ad integrum*”), is contrary to principle;
 - b) The concept of “disproportionate impact” is unexplained and unintelligible;
 - c) The instruction to Sir John to advise on the proportion of losses attributable to maladministration, as opposed to the actions of Equitable or other parties, is inconsistent with the Ombudsman's definition of the injustice as found by her and accepted by the Government;
 - d) The claim that Parliament does not in general support the concept of compensation for regulatory failure is unsupported and inconsistent

with both the intention of the 1967 Act and the Ombudsman's terms of reference.

132. In relation to the last point, we say at once that we found no evidentiary support, at least in the material before us, for the claim (at Response para 5.20) that Parliament "has accepted" that compensation for regulatory failure is "not generally appropriate". The statement was in effect repeated by Ms Lewis (para 190), when referring to the view of "Parliament (and indeed successive Governments)", but without any supporting references, for example to Hansard or other public statements. Nor were we given any explanation as to the reasons for departing from this supposed principle in previous well-publicised cases (such as, for example, Barlow Clowes). However, the question of Parliamentary policy in general is a matter for Parliament not us. It is not in dispute, as we understand it, that the question whether to establish a compensation scheme in any particular context, and the limits of such a scheme, is a matter for the Government, reporting to Parliament, and not reviewable in the courts save on conventional irrationality grounds.

133. As to the particular criticisms (points (a) to (c) above), they fall significantly short of making out a case of irrationality.

- i) The concept of *restitutio ad integrum* is of course a familiar part of the law of compensation. However, once it is accepted (at least in the absence of proven irrationality) that there is no legal requirement for the Government to establish a compensation scheme at all, we do not understand the argument that it is irrational or contrary to principle for it to establish a more limited scheme, based on relative level of impact.
- ii) The term "disproportionate" is admittedly imprecise, but it is not in our view unintelligible. Nor is there any indication that Sir John so regards it. Ms Lewis said that, having accepted that injustice had been caused by maladministration, the Government took account of representations received by it:

"The Government was aware from constituency cases and through Parliamentary debate that for some policyholders the consequences of that injustice may have been particularly hard. There has been significant and voluminous correspondence received by the Treasury during the course of the Ombudsman's investigation highlighting the plight of individual policyholders..." (para 196)

In our view, the Government was clearly entitled to take account of such considerations. It will be for Sir John to consider how to give them practical effect.

- iii) The question of apportionment is not straightforward but there is nothing irrational about leaving it for Sir John Chadwick to consider. On the one hand, the terms in which the Ombudsman defined injustice were clearly designed to isolate those elements which had a direct link with the administrative failure of the regulatory authorities, as opposed to losses generally attributable to the mismanagement of the Society. In her report she had rejected a similar argument, made to her by the public bodies as a reason to persuade her not to recommend a financial remedy; she said:

“... such a recommendation (would not) be designed to remedy losses caused by the Society, as has been suggested by the public bodies. In relation to the findings of maladministration leading to injustice, such as I have made in this report, the ‘primary wrongdoer’ is the body or bodies which have acted with such maladministration, not any third party.” (cap 14 para 122)

On the other hand, regulatory failure can indeed only cause loss if it is linked to some failure by the body subject to regulation. It cannot be categorised as irrational to question the extent to which the public purse should be drawn upon in such circumstances.

- iv) The claimants also point to common law principles of civil liability, under which a joint tortfeasor is fully liable to a claimant for his losses, notwithstanding the possibility of a right to contribution from other tortfeasors. But in that regard, the common law principles have themselves proved problematical, leading to the sometimes inappropriate search for a “deep pocket” to bear the entirety of the loss. Again, it is not irrational to decline to follow those principles slavishly, so leaving room to take into account the many demands on the public purse - all the more so, when it is borne in mind that the Ombudsman’s role is not to replicate that of a court or to provide what might be termed legal alternative dispute resolution.
- v) We are fortified in these individual conclusions by this further consideration as to the scope of the action taken so far – namely, that it does not go beyond asking Sir John Chadwick to advise as to the limits of the ex gratia scheme. In giving his advice, Sir John is free to take into account the points made by the claimants and, if he sees merit in them, to advise appropriately.

CONCLUSION

134. For the reasons given we uphold the grounds of challenge in respect of findings 2, 4 and 5 to the extent that we have indicated above. We reject the other grounds of challenge. We will invite submissions on the consequences in terms of orders and ancillary matters.