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From light touch to heavy-handed regulation

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After years of investigations and reports, including a damning ruling from the parliamentary ombudsman, the government's response to the plight of Equitable Life's policyholders was eagerly awaited. The result was a (much belated and clearly begrudging) apology but still no compensation, merely the appointment of a judge to assess the extent to which regulatory failure was to blame.

It should be noted that the guaranteed annuities at the heart of the Equitable Life fiasco were introduced as a result of regulation in the first place. Four decades ago, insurance companies, for reasons that appear bizarre in a modern context, were prohibited from selling investment products unless they contained an insurance element. Guaranteeing the interest rates on annuities was that insurance element.

Equitable Life was not the only company to sell guaranteed annuity products; but it was particularly successful. It is Britain's oldest mutual insurer and was one of the most respected. It was clearly the fault of its management that, unlike some other insurers, they did not adequately reserve for those guaranteed annuities, and being a mutual it had no shareholder funds to fall back on. But it was a failure on the part of its regulators - the Department of Trade, the Government Actuary's Department and, more recently, the Financial Services Authority (FSA) not to spot it or take any action over several decades.

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In the late 1980s I was a member of the practitioner working party that assisted in writing the first IMRO rulebook; IMRO being the regulator for investment managers, now subsumed into the FSA. Regulatory penalties include formal criticism, fines, temporary suspension, or permanent withdrawal of licence. As a trustee, if my investment manager was suspended from acting for pension schemes for a month, I would immediately move elsewhere; we pointed out that suspending a major market participant for a period would put them completely out of business. To reinforce the point we persuaded IMRO to omit 'suspension' as a sanction from its rule book.

We were convinced, as were the regulators, that the rules were aimed at 'cowboys'; reputational and business risk would ensure that the large financial houses complied with best practice.

How wrong we were. Along came the scandalous mis-selling of personal pensions followed by endowment mortgages, Equitable Life and the current bank meltdowns; the real miscreants throughout have been the large financial institutions.

The FSA's regime of 'light touch' regulation on large reputable institutions is clearly a thing of the past; we are about to enter a prolonged period of more rigorous, onerous and prescriptive regulation. Let's hope it doesn't extend to the government dictating who can sell what product - that's how the Equitable Life scandal started in the first place.