



House of Commons
Public Administration Select
Committee

Equitable Life

Third Report of Session 2010–11

*Report, together with formal minutes and
written evidence*

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The Public Administration Select Committee

The Public Administration Select Committee is appointed by the House of Commons to examine the reports of the Parliamentary Commissioner for Administration and the Health Service Commissioner for England, which are laid before this House, and matters in connection therewith, and to consider matters relating to the quality and standards of administration provided by civil service departments, and other matters relating to the civil service.

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The current staff of the Committee are Clive Porro (Clerk), Ben Williams (Second Clerk), Louise Glen (Senior Committee Assistant) and Su Panchanathan (Committee Assistant)

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Conclusions and recommendations

1. The search for compensation for Equitable Life members has been heavy on inquiries but light on solutions. We welcome the Government's commitment to resolving matters speedily. It is no less than those involved deserve. (Paragraph 1)
2. We welcome the fact the Financial Secretary to the Treasury has made clear that the Government accepts all findings of maladministration made by the Ombudsman. (Paragraph 7)
3. There is a fundamental incompatibility between the position of the Ombudsman and Sir John Chadwick's approach. Sir John's remit does not reflect all ten of the Ombudsman's findings. Sir John and the Ombudsman may have reached different answers because they addressed different questions. (Paragraph 9)
4. We regret that despite the Government's commitment to meet the Ombudsman's recommendations that it did not properly explore the possibility of amending Sir John's terms of reference back in May. Had this change been made then it would not have significantly altered the timescale for delivering compensation. (Paragraph 15)
5. We therefore recommend that the Government re-engages Sir John Chadwick to establish what conclusions he would reach under terms of reference which reflect all ten of the Ombudsman's findings. We believe this work can be done in parallel with the Independent Commission's work to design a compensation scheme. We think that this need not delay payment to policyholders. It would however leave open the extent of the Government's liability in the spending review, but the timetable for the CSR should not be the driving factor. Alternatively the Government must find some other way of resolving the incompatibility between the Ombudsman's findings and Sir John Chadwick's existing terms of reference. If the Government's proposals remain based on Sir John's existing terms of reference, we concur with the Ombudsman that they are, in principle, an "unsafe and unsound" basis on which to proceed. (Paragraph 16)
6. We welcome the broad consensus on the quantum of relative loss around the provisional figures produced by Towers Watson of between £4 and 4.8 billion. EMAG are of the view that this is still a considerable understatement. The only way this disagreement can be resolved is if Towers Watson are instructed to recalculate their estimate in line with the Ombudsman's findings. (Paragraph 20)
7. There is no dispute that the burden on the public purse must be taken into account in assessing the level of compensation. It follows that there must be some reduction of the compensation awarded. The reduction must strike an appropriate balance between the interests of taxpayers and the interest of policyholders. (Paragraph 25)
8. The Ombudsman's objection was to the challenge posed to her idea of injustice, not to the level of compensation that the Government finds to be affordable. The fact the Government may not be able to afford to compensate fully for relative loss is a separate issue from the how relative loss is calculated. (Paragraph 27)

9. The Government should be open with Parliament and the policyholders. It must explain the basis for the final loss figure. It must also set out how it has determined what is affordable. (Paragraph 28)
10. The Government should provide an early opportunity for Parliament to debate the announcement, and quantum, in government time. (Paragraph 29)
11. If the public is to have trust in its elected representatives, we must keep our promises. Expectations have been raised by many of those seeking election. The coalition should focus on how to meet the political commitment it has made. (Paragraph 38)
12. Given the circumstance of this case, and that legislative changes mean that the FSA no longer falls within the Ombudsman's jurisdiction, it is important to note that the decisions the Government makes cannot set a precedent for future cases. (Paragraph 39)
13. We welcome the appointment of the Independent Commission and endorse the Government's intention that it should work quickly and make the first payments in the early part of next year. We seek an assurance from the Government that the cost of administering the scheme should not come out of the total compensation sum. (Paragraph 45)
14. We endorse the principles that it should be transparent, fair, and independent as well as swift. We encourage the Commission to design a payment scheme which allocates compensation as fairly as possible and strikes a balance between speed and proper compensation to individual policyholders for their loss. (Paragraph 46)

1 Introduction

1. **The search for compensation for Equitable Life members has been heavy on inquiries but light on solutions. We welcome the Government's commitment to resolving matters speedily. It is no less than those involved deserve.**

2. We have had a long-standing interest in the prudential regulation of Equitable Life. This stems from our responsibility for reviewing special reports from the Parliamentary and Health Service Ombudsman to Parliament. The Ombudsman published her report, Equitable Life, 'A Decade of Regulatory Failure', in July 2008, which made ten findings of maladministration.¹

3. Our predecessor committee undertook two inquiries. The first, 'Justice delayed: The Ombudsman's report on Equitable Life', was published before the Government had responded to the Ombudsman.² The second, 'Justice denied?' which dealt with the Government's response to the Ombudsman's recommendations.³

4. The Government accepted only some of the Ombudsman's ten findings of maladministration. It announced that it would establish an *ex-gratia* payment scheme and commissioned Sir John Chadwick to advise independently on the extent of relative losses suffered by Equitable Life policyholders. His remit was based on this partial acceptance of the Ombudsman's findings.

5. There has since been a change of government. The Coalition's Programme for Government commits it to implementing the Ombudsman's recommendation "*to make fair and transparent payments to Equitable Life policyholders for their relative loss as a consequence of regulatory failure*".⁴ In July, the Financial Secretary published Sir John's advice which has proved controversial because it proposes that policyholders should receive around 20-25% of their relative losses.

6. This report is inevitably short and intended to inform discussion before the Government announces the total compensation figure as part of the Spending Review. Therefore it does not consider Sir John's advice or Towers Watson's supporting actuarial advice in detail. It does, however, make observations about the political commitments given by this Government and by Members of this House, and whether the process followed by government is based upon safe and sound principles. It draws on the written evidence we have received from our witnesses, as well as EMAG and Equitable Life. It also reflects the oral evidence we heard.

1 Parliamentary Ombudsman, Fourth Report of Session 2007-08, HC 815

2 Public Administration Select Committee, *Justice delayed: The Ombudsman's report on Equitable Life*, Second Report of Session 2008-09, HC 41

3 Public Administration Select Committee, *Justice denied? The Government's response to the Ombudsman's report on Equitable Life*, Sixth Report of Session 2008-09, HC 219

4 Cabinet Office, *The Coalition: our programme for government*, May 2010

2 Developments since our last Report

7. There has been uncertainty surrounding whether the current Government accepted all the Ombudsman’s ten findings of maladministration. During our evidence session we sought clarity from the Financial Secretary on this point. **We welcome the fact the Financial Secretary to the Treasury made clear that the Government accepts all findings of maladministration made by the Ombudsman.**

Ombudsman’s report v Chadwick Advice

8. The Financial Secretary, in his statement of 22 July said that the Government was committed to implementing the Parliamentary Ombudsman’s recommendation to pay compensation, made two years ago. At the same time he said that the Chadwick Report would contribute to the process of establishing a scheme that is fair both to policyholders and to taxpayers. He added that it would be one of the “*building blocks*” in resolving what is a complex matter.

9. However, **there is a fundamental incompatibility between the position of the Ombudsman and Sir John Chadwick’s approach. Sir John’s remit does not reflect all ten of the Ombudsman’s findings. Sir John and the Ombudsman may have reached different answers because they addressed different questions.** In a letter to all MPs, in July, the Ombudsman stated categorically that Sir John Chadwick’s advice was an “unsafe and unsound” basis on which to proceed. In her evidence, she elaborated on the reasons why she took this view. She explained that:

- a) Sir John’s terms of reference required him to start from a different place, i.e. the previous Government’s response to her report, rather than the report itself. His report is not based on all the findings of maladministration and injustice that she had made, only on those findings accepted by the previous Government.
- b) Sir John’s advice is predicated on a rejection of her central recommendation for redress. She recommended compensation to all policyholders who had suffered relative loss as a consequence of regulatory failure. Sir John was asked to propose limited compensation only for those people ‘*disproportionately affected*’ by the maladministration the previous Government accepted had occurred.
- c) Sir John took a different view to her about what would have happened if maladministration had not occurred. Her recommendation for redress was based on the view that, if the regulators had been doing their job properly, and information about the real state of Equitable Life had been in the public domain as it should have been, people would not have decided to invest, or add to their existing investments. Sir John thought otherwise.⁵

10. In his evidence, Sir John recognises this incompatibly. He confirms the principal reasons why he and the Ombudsman have taken different views. They are the consequence of his terms of reference. First, the terms of reference required him to disregard those

findings of maladministration and injustice which the Government did not accept. “*The effect of that requirement was that the Ombudsman reached her conclusions on the basis of findings of maladministration which were more extensive than those on which I based my advice*”.⁶ Second, unlike the Ombudsman, his remit required him to consider what steps the Equitable Life would have taken in response to the concerns that would have been raised by the Government Actuary Department (GAD) and the prudential regulators, had maladministration not occurred.⁷

11. He also takes a fundamentally different view from the Ombudsman about the behaviour of investors. In her letter to him of 20 August 2009, she explains that, “*in essence*” absent serial maladministration, no reasonable investor would have invested in or remained in Equitable Life. Sir John finds it impossible to accept this view. He points out that the Ombudsman’s report does not expressly say what she “*in essence*”.

12. At the heart of this difference is the fact that the Ombudsman’s jurisdiction and Sir John Chadwick’s terms of reference are fundamentally different. Added to this they took radically different views about how investors would have behaved had there been no maladministration. Sir John also went on to consider how Equitable Life would have reacted to regulatory actions, which the Ombudsman did not. It is these key differences in approach which then led Sir John to advise that relative losses should be reduced by around 75-80%. As the Financial Secretary recognised in his evidence, to us the controversy arises because “*these are the steps influenced by Sir John’s restricted terms of reference and are most based on subjective judgment [...]*”.⁸

13. We asked Sir John if his conclusions would have been different had his terms of reference been compatible with the Ombudsman’s findings. He said he was unable to say with certainty that this would have led him to reach a different conclusion. However, conclusions naturally followed from terms of reference. A change in one was likely to result in a change in the other.

14. We asked the Financial Secretary whether he had actually asked Sir John, back in May, whether he was prepared to amend his terms of reference and how long it would take him to do the work. He told us he had not. Sir John said it would not take long to amend the instruction to Towers Watson, but the actuarial work would probably take a few months.

15. We regret that despite the Government’s commitment to meet the Ombudsman’s recommendations that it did not properly explore the possibility of amending Sir John’s terms of reference back in May. Had this change been made then it would not have significantly altered the timescale for delivering compensation.

16. We therefore recommend that the Government re-engages Sir John Chadwick to establish what conclusions he would reach under terms of reference which reflect all ten of the Ombudsman’s findings. We believe this work can be done in parallel with the Independent Commission’s work to design a compensation scheme. We think that this need not delay payment to policyholders. It would however leave open the extent of the

6 Ev 1

7 Ev 1

8 Ev 20

Government's liability in the spending review, but the timetable for the CSR should not be the driving factor. Alternatively the Government must find some other way of resolving the incompatibility between the Ombudsman's findings and Sir John Chadwick's existing terms of reference. If the Government's proposals remain based on Sir John's existing terms of reference, we concur with the Ombudsman that they are, in principle, an "unsafe and unsound" basis on which to proceed.

Quantum of relative loss

17. There seems to be a convergence of views around the quantum figure for relative loss. The Chadwick process identified what he termed an 'external relative loss' element—the difference between the payout which would have been received had the policyholders invested in comparable product offered by an alternative provider and the payout which has actually been received (or will be received) in respect of the Equitable Life policy. A provisional figure of £4-4.8 billion has been calculated by Towers Watson, the actuaries appointed by the Treasury to assist Sir John.

18. The Ombudsman agrees that this figure is broadly consistent with the amounts claimed by those who complained to her while she was finalising her July 2008 report. "*On that basis it appears to me to be a credible estimate*".⁹ Equitable Life thinks this figure "[...] *seems to match most closely the relative loss described by the Parliamentary Ombudsman's description of relative loss*".¹⁰ Equitable Life Trapped Annuitants (ELTA) say, "*This is the only worthwhile figure provided*".¹¹

19. Only EMAG dispute it. While they concede that it is the main element worth saving from the Chadwick process, they contend that it still considerably understates the final relative loss by not factoring in three large items: the first 18 months losses; removal of exit penalties and provisions for those already invested at July 1991. This leads them to conclude the quantum of relative loss to be well in excess of £5 billion.¹²

20. We welcome the broad consensus on the quantum of relative loss around the provisional figures produced by Towers Watson of between £4 and 4.8 billion. EMAG are of the view that this is still a considerable understatement. The only way this disagreement can be resolved is if Towers Watson are instructed to recalculate their estimate in line with the Ombudsman's findings.

Burden on the taxpayer

21. One of the more difficult questions with regard to compensation is how to ensure the package is fair to both the policyholders and the taxpayer.

22. Unusually, the Ombudsman qualified her recommendation by accepting that any compensation package should take account of the potential impact it would have on the

9 Ev 5

10 Ev 9

11 Ev 24

12 Ev 15-16

taxpayer. This is echoed in the Financial Secretary's view that it is "important, particularly in these times when difficult decisions need to be made with respect to the country's finances, that we carefully balance, in the Ombudsman's words '*fairness both to those affected and to taxpayers generally.*'"¹³

23. In assessing relative loss Sir John first assessed absolute loss, that is the loss actually suffered by policyholders. Sir John has proposed that external relative loss should be capped at the absolute loss. "*The principle behind this is to ensure fairness for taxpayers.*"¹⁴ In his view it would be unfair to the taxpayer to be paid more through redress than they would actually have lost.

24. Both EMAG and Equitable Life accept the need for some reduction in compensation. In EMAG's proposals a reduction of 20% reflecting the anticipated average cuts across the public sector.¹⁵ In addition they suggest phased stage payments over the life of the Parliament.¹⁶

25. There is no dispute that the burden on the public purse must be taken into account in assessing the level of compensation. It follows that there must be some reduction of the compensation awarded. The reduction must strike an appropriate balance between the interests of taxpayers and the interest of policyholders.

Affordability

26. In his evidence the Minister notes the scheme will be a significant spending commitment for this Government. As such, he felt that it would be best to consider the amount affordable as part of the Spending Review.¹⁷ He has undertaken to set out the final loss figure when the Spending Review is announced on 20 October, alongside the funding available for the scheme.

27. We recognise that affordability will be a factor in the Government's final decision about the level of compensation. The Ombudsman was explicit that she would not object to a heavily reduced compensation sum (up to as much as 70%), so long as the Government clearly distinguished between the final loss suffered by policyholders and the amount the Government was able to pay given the current financial situation. **The Ombudsman's objection was to the challenge posed to her idea of injustice, not to the level of compensation that the Government finds to be affordable. The fact the Government may not be able to afford to compensate fully for relative loss is a separate issue from the how relative loss is calculated.**

28. The Government should be open with Parliament and the policyholders. It must explain the basis for the final loss figure. It must also set out how it has determined what is affordable.

13 Ev 22

14 Ev 19

15 Ev 12

16 Ev 16

17 Ev 22

29. The Government should provide an early opportunity for Parliament to debate the announcement, and quantum, in government time.

The Chadwick Advice

30. Sir John proposed a five stage process for calculating compensation that is due to policyholders. This began with a calculation of absolute loss, which is the loss that policyholders actually suffered. Then Sir John identified what he called external relative loss – which is the difference between the returns that policyholders actually received from their Equitable Life policies and the returns they would have received if they had invested in a comparable product in an alternative life assurance company.

31. For some policyholders, their external relative loss is greater than their absolute loss. This is because of the strong performance of comparable companies. Sir John therefore proposed that external relative loss should be capped at the absolute loss. He believed this would deliver fairness for the taxpayer. The Ombudsman does not accept this.

32. From his detailed analysis and the expert actuarial support he has received, Sir John concludes that the majority of policyholders would have made the same investment decision, even if Equitable Life had been properly regulated. The Ombudsman contests this as a legitimate premise for compensation, but on this basis, he proposes that policyholders should receive 20-25% of their capped external relative loss.

33. Finally, Sir John looked at the returns which those policyholders who would have stayed with Equitable Life would have received if it had been properly regulated. He called this internal relative loss.¹⁸ Again, the Ombudsman does not recognise the legitimacy of such an assumption.

34. Sir John Chadwick's advice has proved controversial because of the much lower level of compensation it entails. Nonetheless, we acknowledge his efforts and commitment to meet the terms of reference he was given by the previous Government.

35. However, as the Financial Secretary notes, those steps in Sir John's advice which reduce relative loss calculations by around 75-80% are those most influenced by his restricted terms of reference and involve the greatest amount of subjective judgment.

Political commitments

36. This Government came to office with the promise of early resolution to the vexed question of compensation. In its Programme for Government the new Coalition Government stated that it would:

[...] implement the Parliamentary and Health Service Ombudsman's recommendation to make fair and transparent payments to Equitable Life policyholders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure".¹⁹

18 Ev 40-42

19 Cabinet Office, *The Coalition: our programme for government*, May 2010

37. Since then ministerial pronouncements that a compensation scheme would be based on the outcome of the Chadwick process have given rise to ambiguity.²⁰ In particular Mark Hoban's reference to Chadwick in his July statement as a "*building block*" has caused great concern to policyholders.²¹

38. There is a political obligation which also extends to Parliament. At the time of the last election campaign a number of Members made the following pledge:

that if I am elected to Parliament at the next general election, I will support and vote for proper compensation for victims of the Equitable Life scandal and I will support and vote to set up a swift, simple, transparent and fair payment scheme— independent of government—as recommended by the Parliamentary Ombudsman.

If the public is to have trust in its elected representatives, we must keep our promises. Expectations have been raised by many of those seeking election. The coalition should focus on how to meet the political commitment it has made.

39. **Given the circumstance of this case, and that legislative changes mean that the FSA no longer falls within the Ombudsman's jurisdiction, it is important to note that the decisions the Government makes cannot set a precedent for future cases.**

The Independent Commission and design of the compensation scheme

40. One of the main areas of contention between Sir John and the Ombudsman is around the nature of the compensation scheme. For him "[...] *a payment scheme based on the need to establish, on an individual basis, that a policyholder relied on the Society's regulatory returns must be seen as unacceptable in practice*", because of the impossibility of knowing what individuals would have done under a different situation 15 years ago.²² He judged that only 20% of policyholders would have left Equitable Life if maladministration had not occurred. Given the impossibility of identifying this group he decided to share their compensation between all the policyholders. In this way each policyholder should receive a proportion of the compensation regardless of whether they relied on the information or not. He says the potential unfairness of this approach, as between policyholders, is the price to be paid for finality and certainty.

41. The Ombudsman strongly refutes Sir John's understanding of the approach she took. She does not agree that her approach was based on an assessment of each individual transaction and that eligibility should be restricted to those who could show they had relied on regulatory returns. She argues that in fact she left open the actual design of the scheme and recommended that an independent commission should adjudicate on the matter.

42. The Government has now established an independent commission to design a compensation scheme. Its role is to:

20 Ev 10-11

21 HC Deb 22 July 2010 cc576-7

22 Ev 1

- Recommend how best to fairly allocate funds provided for the Equitable Life Payments Scheme as part of the Autumn 2010 Spending Review to those persons found to have suffered relative losses as a result of accepted government maladministration; and
- Advise on any groups or classes of persons that should be paid as a priority.²³

43. In providing its advice, the Commission shall have regard to the practicalities of delivering the payment scheme and to the work undertaken by Sir John Chadwick on the methodology for calculating relative loss and base its allocation to policyholders on the relative loss figures provided to HM Treasury by Towers Watson.

44. In addition, in the interests of speed and of the public purse, the Commission should ensure that it does not unnecessarily replicate existing analysis determining relative loss. It will also have regard to, but need not be bound by findings on disproportionate impact carried out by Sir John Chadwick.

45. We welcome the appointment of the Independent Commission and endorse the Government's intention that it should work quickly and make the first payments in the early part of next year. We seek an assurance from the Government that the cost of administering the scheme should not come out of the total compensation sum.

46. We endorse the principles that it should be transparent, fair, and independent as well as swift. We encourage the Commission to design a payment scheme which allocates compensation as fairly as possible and strikes a balance between speed and proper compensation to individual policyholders for their loss.

3 Conclusion

47. We hope that this long and drawn out process will soon be coming to a conclusion, policyholders have waited long enough for justice. We strongly welcome the Financial Secretary's explicit acceptance of the Ombudsman's recommendation. This leads us to the conclusion that the Government cannot base its judgement on the level of compensation owed on the Chadwick approach. The Government had the opportunity to salvage this by amending the terms of reference in May, but failed to do so.

48. We have therefore recommended that the Government re-engages Sir John Chadwick to establish what conclusions he would reach under terms of reference which reflect all ten of the Ombudsman's findings. We believe this work can be done in parallel with the Independent Commission's work to design a compensation scheme. We think it is unlikely that this will delay payment to policyholders, but we acknowledge that it would leave open the question of the Government's liability in the spending review. Alternatively the Government must find some other way of resolving the incompatibility between the Ombudsman's findings and Sir John Chadwick's existing terms of reference. If the Government's proposals remain based on Sir John's existing terms of reference we concur

23 <http://equitablelifepayments.independent.gov.uk/tor.html>

with the Ombudsman that they are, in principle, an “unsafe and unsound” basis on which to proceed.

49. However, should it announce the sum available for compensation as part of Spending Review it must specify how it has adjusted the final loss figure to account of the need to balance fairness to the taxpayer and affordability. Only in this way will the Government meet its commitment to implement the Ombudsman’s findings in full.

Formal Minutes

Thursday 14 October 2010

Members present:

Mr Bernard Jenkin, in the Chair

Kevin Brennan
Nick de Bois
Charlie Elphicke
Paul Flynn

Robert Halfon
Greg Mulholland
Mr Charles Walker

Draft Report (*Equitable Life*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 49 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence reported and ordered to be published on 12 October was ordered to be reported to the House for printing with the Report.

[Adjourned till Tuesday 19 October at 10.00 am

Witnesses

Thursday 14 October 2010

Ann Abraham, Parliamentary and Health Service Ombudsman

Sir John Chadwick

Mark Hoban MP, Financial Secretary, HM Treasury

(The transcript of the above oral evidence session will be published separately at a later date as HC 485-i)

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List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010-11

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Written evidence

Written evidence from Sir John Chadwick

Thank you for your letter.

The approach which led me to give the advice contained in my Advice to Government—and the reasons which for that approach—are, I think, fully set out in the document itself. It would not be appropriate for me to add to, or detract from, that Advice. Nevertheless, within that constraint, I will come before the Select Committee (as you request) in order to give such assistance as I can.

You ask me to set out the specific matters on which I disagree with the views expressed by the Parliamentary Ombudsman in the Report on her investigation into the prudential regulation of Equitable Life. The Advice identifies three principal areas in which our respective views differ. Those are: (i) the extent to which the Society's published regulatory returns in respect of the years 1990 to 2000 would have differed if regulatory maladministration had not occurred; (ii) the effect which the different information which would have appeared in those regulatory returns (absent maladministration) would have had on decisions made by policyholders; and (iii) whether it would be practicable to operate a payment scheme which required policyholders to establish, on an individual basis, that they relied (directly or indirectly) on the Society's published regulatory returns.

The reasons why we differ can be found in the Advice. In summary:

- (i) There are, I think, two principal reasons why we have taken different views as to the extent to which the Society's published regulatory returns in respect of the years 1990 to 2000 would have differed if regulatory maladministration had not occurred. First, the Terms of Reference under which I was appointed to advise the Government required me to disregard those of the Ombudsman's findings of maladministration and injustice which the Government did not accept. The effect of that requirement was that the Ombudsman reached her conclusions on the basis of findings of maladministration which were more extensive than those on which I based my advice. Second, it was not within the Ombudsman's remit to consider—and there is nothing in the Report to suggest that she did consider—how Equitable Life and its management would have reacted to the concerns that would have been raised by GAD and the prudential regulator if the maladministration which she identified had not occurred. My Terms of Reference, by contrast, required me to consider what steps would have been taken by the Society in response to those concerns and to take those steps into account in advising as to the information that would have been likely to have appeared in the published regulatory returns.

In particular, I was asked to advise as to the extent to which the regulatory returns in respect of the years 1990 to 1996 would have been different if the maladministration accepted by the Government had not occurred (Annex A, at pages 210–211 of my Advice; and see paragraph 3.2 of my Advice). For the reasons explained in my Advice (in particular, at paragraphs 2.68 to 2.77 and 3.5) I took the view that I should extend that enquiry to the regulatory returns in respect of the years 1997 to 2000.

In addressing the question “to what extent would the regulatory returns for the years 1990 to 2000 have been different if the maladministration which is the subject of the Ombudsman's second, fourth, fifth and sixth Findings had not occurred”, I sought advice from actuaries, Towers Watson. The advice which I received is found in Section 4 of the report appended to my Advice to Government. I sought advice from a panel of independent actuaries with experience in the management of United Kingdom life companies on the question whether the assumptions which Towers Watson had made in reaching the conclusions in Section 4 of their report were reasonable in the circumstances. The report of that panel can be found at Annex C to my Advice.

- (ii) The difference of view as to what information would have appeared in the Society's regulatory returns (absent maladministration) gives rise to the difference of view as to the effect which such information would have had on decisions made by policyholders: in particular, on decisions whether to invest, or remain invested, in Equitable Life policies. The Ombudsman has taken the view—expressed in her letter dated 20 August 2009 (to which reference is made in paragraphs 7.42 to 7.47 of the Advice—that “absent the serial maladministration ... from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period—going instead to another life insurance company.” For the reasons which I have set out in Part 7 of the Advice, I have found it impossible to accept that view.
- (iii) Paragraphs 5.25 to 5.29 of the Advice set out the reasons why I have taken the view that a payment scheme based on the need to establish, on an individual basis, that a policyholder relied on the Society's regulatory returns must be seen as unacceptable in practice. It was that view which led me to consider (in Part 6 of the Advice) how losses could be assessed on some other basis (not involving the need for each individual claimant to establish reliance). That was a question which the Ombudsman did not find it necessary to address.

You have asked for my views as to the Ombudsman's concern that I have misinterpreted central parts of the conclusions in her Report. In Part 2 of the Advice I have set out—at some length—an analysis of all the Ombudsman's findings of maladministration and injustice (including those findings which the Government has not accepted). There is nothing in the Ombudsman's letter of 26 July 2010 from which I can identify those of her findings which I am said to have misinterpreted.

It may be that her concern relates to my rejection of the view which she expressed, not in her Report, but in her subsequent letter of 20 August 2009. I have explained, at paragraphs 7.42 to 7.46 of the Advice—and, at greater length, at Annex H to the Advice—why I have found it impossible to give weight to that view. Put shortly, I am satisfied that that view is not consistent with the findings of maladministration which the Ombudsman made in her Report; is not consistent with the findings of maladministration and injustice which the Government accepted; and is difficult to reconcile with the approach the Ombudsman herself took to the evidence before the Select Committee in late 2008 and early 2009.

As I have said, the Government did not accept all of the findings which the Ombudsman made in the Report which she laid before Parliament in July 2008. Nor did it accept her recommendations as to the basis of a compensation scheme. My Terms of Reference were first set out as Annex A to the Government's Response (Cm 7538) to the Ombudsman's Report. In her subsequent Report "Injustice unremedied: the Government's response on Equitable Life" (5 May 2009) the Ombudsman expressed the view (at paragraphs 64 and 72) that, whatever the outcome of my work, the proposal made by the Government in its Response would fail to provide a remedy for the injustice which she had identified. Given that view of my Terms of Reference, it is, perhaps, unsurprising that the Ombudsman has concluded that my Advice provides an "unsafe and unsound basis on which to proceed".

The Ombudsman and I have exchanged correspondence; and have met to discuss issues arising in relation to my task. That correspondence can be found in the volumes of Supplementary Material appended to my Advice: in particular at Sections IID, IVC, and XIIA. It can be seen from the letters dated respectively 25 February and 1 March 2010 (at Section XIIA of the Supplementary Material) that the Ombudsman—for reasons which I accept—was not willing to provide to me a copy of the advice which she had received from her actuarial adviser, Mr Leandro FIA, and on which, it seems, she based her conclusions as to the extent to which the Society's published regulatory returns would have differed if the maladministration which she identified had not occurred. Without sight of that advice there was, as it seemed to me, little or no prospect that our difference of view on that important issue—or on the related issue as to the effect that different information in the regulatory returns would have had on policyholders' decisions—could be resolved.

I have not met the Parliamentary Ombudsman since delivering my Advice to Government on 16 July 2010. I have taken the view that my role in relation to Equitable Life ended with the completion of the task which I was appointed to undertake.

September 2010

APPENDIX

Letter from Chair of the Committee to Sir John Chadwick, 10 September 2010

EQUITABLE LIFE

As you will know, following the Minister's statement on 22 July about how he intended to proceed with regard to Equitable Life, the Ombudsman wrote to Members of Parliament on 26 July expressing her concern that your proposals would be an "unsafe and unsound basis on which to proceed".

Our predecessor Committee took a very close interest in this matter and shared her apprehension about the way in which the previous Government had responded to her recommendations.

As you are no doubt aware there is also much concern among Members of Parliament on behalf of those of their constituents who have been adversely affected by the events surrounding Equitable Life.

It would help Members, in advance of announcement in the Spending Review next month, if you were to come before us and explain the approach you took in coming to your views and the reasons for it. We also need to you to set out in exact terms the specifics of your disagreements with the Parliamentary Ombudsman.

It would be helpful too if, in advance of that session you could briefly set this out in writing. In particular the Committee would be interested to hear your views about her concern that you have misinterpreted central parts of her conclusions in her report of July 2008 which form the basis of some of the central parts of your own report and to what extent you have sought to resolve that difference with the Ombudsman.

Can you tell us whether you have met Ann Abraham to discuss your differences?

The Clerk of the Committee will be in touch with you shortly with a formal invitation for early October. I am also writing Ann Abraham and the Minister with a similar invitation.

Written evidence from the Parliamentary and Health Service Ombudsman

EQUITABLE LIFE

Thank you for your recent letter inviting me to come before the Committee to explain why I disagree with Sir John Chadwick's proposals for the payment of compensation to Equitable Life policyholders. I would be happy to do that and I understand that we have now agreed a date of 14 October.

In your letter you ask me to address a number of questions in advance of that session. This letter and the enclosed paper are my response to those questions.

You ask why I disagree with the Chadwick proposals; why I consider they are not the correct basis on which the Government can meet my recommendations and make fair and transparent payments; and to what extent I have sought to resolve my concerns about the proposals with Sir John and the Treasury. You ask whether I have sought to meet Sir John Chadwick to that end.

First, as I hope this letter and the enclosed paper will make clear, I do not see that there is anything to be gained by a meeting between me and Sir John. In any event Sir John has made it clear to me that he does not see himself as having a continuing role in these matters. When I wrote to Members on 26 July 2010 I sent Sir John a copy of my letter for information. I enclose a copy of his reply.¹ As you will see, Sir John says that, having delivered his Advice to Government, "*his task is now complete*".

Secondly, as you know, I met the Financial Secretary to the Treasury and his officials on 13 September to explain my concerns about the Chadwick proposals. You have seen my letter of 9 September to Mark Hoban, together with the paper enclosed with that letter entitled, *Implementing the Ombudsman's recommendation for compensation for Equitable Life policy holders*, which sets out my concerns in some detail.

I also recently met and had a useful preliminary discussion with Brian Pomeroy and his colleagues on the independent commission set up to advise the Government on the design of the compensation scheme.

That brings me to your key question: the reasons for my disagreement with the Chadwick proposals and why I consider they are not the correct basis on which to implement my recommendation.

In the enclosed paper I have tried to summarise, as concisely as possible, the findings of my report and its recommendations, the previous Government's response to my report, and the new Government's approach as I understand it. I then explain the differences between Sir John's approach and my own and why they are irreconcilable. Finally, I set out what I believe now needs to happen to enable the Government to honour its commitment to pay fair compensation to Equitable Life policyholders, in accordance with the recommendation in my report of July 2008.

I know that there is a lot of material to digest here. Essentially, I think the key points are these:

- Sir John's terms of reference required him to start from a different place, ie the previous Government's response to my report rather than the report itself. The basis for his advice, therefore, was not all the findings of maladministration and injustice that I made, only those findings accepted by the previous Government. As you know, the previous Government rejected some of my findings, and qualified or reinterpreted others.
- Sir John's advice is predicated on a rejection of my central recommendation for redress. I recommended compensation to all policyholders who had suffered relative loss as a consequence of regulatory failure. Sir John was asked to propose limited compensation only for those people "*disproportionately affected*" by the maladministration the previous Government accepted had occurred.
- Sir John took a different view to me about what would have happened if the maladministration had not occurred. My recommendation for redress was based on the view that, if the regulators had been doing their job properly and information about the real state of Equitable Life had been in the public domain as it should have been, people would not have decided to invest, or add to existing investments. Sir John thought otherwise.
- The provisional figure of between £4 and £4.8 billion for total relative losses sustained, as calculated by actuaries, Towers Watson, appears credible. It is broadly consistent with the amounts claimed by those who complained to me and which informed the representations I received while finalising my July 2008 report.
- I said in my July 2008 report that, "*the public interest is a relevant consideration and that it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case*".

¹ Not printed

- My approach to compensation involves three steps:
 - Determine the total figure for relative losses sustained;
 - Consider wider questions of affordability;
 - Make payments.
- Sir John’s approach to compensation involves five steps:
 - Determine the total figure for relative losses sustained;
 - Cap the total figure for loss at a lower amount for “absolute loss”.
 - Reduce the capped figure further to either 20% or 25% of absolute loss—reflecting Sir John’s view of what would have happened if the maladministration had not occurred.
 - Consider wider questions of affordability;
 - Make payments.

Put simply, Sir John’s Advice to Government starts from a different place to my report, proceeds on a different basis, takes a different view on what would have happened in the absence of regulatory failure, takes a narrower approach to redress, and a very different approach to the calculation of compensation. It is for these reasons that I have described the Chadwick proposals as an unsafe and unsound basis on which to proceed.

As I understand it, the new Government has accepted all of my findings of maladministration and injustice. In its publication, *The Coalition: our programme for Government*, it made a commitment to implement my recommendation to make fair and transparent payments to compensate Equitable Life policyholders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure. I very much welcome that commitment. It is clear, however, that Sir John’s proposals are not compatible with delivering it.

September 2010

DELIVERING FAIR COMPENSATION TO EQUITABLE LIFE POLICYHOLDERS

A paper by the Parliamentary and Health Service Ombudsman

INTRODUCTION

1. On 20 October 2010, the Government will announce as part of the Comprehensive Spending Review the amount which will be made available to fund an independent compensation scheme for Equitable Life policyholders.

2. The Public Administration Select Committee is taking evidence on recent developments related to Equitable Life in advance of that announcement. The purpose of this paper is to assist the Committee to understand my position regarding the delivery of fair and transparent compensation.

BACKGROUND

3. Equitable Life was founded in 1762 and is generally accepted to be the oldest surviving mutual life assurance company in the world. It closed to new business on 8 December 2000 with immediate effect. Since then, the values of the policies held by people who had saved or invested with Equitable Life have been subject to significant cuts and the pensions paid out by the company have been reduced on a number of occasions. These cuts and reductions were a reflection of the factors which had led the company to close.

4. The closure of the company prompted complaints to be made alleging that there had been significant failures in regulation which had played a part in the events which led to the company closing. Following a number of inquiries and reports, in July 2004 I launched an investigation into the actions of the public bodies responsible for the prudential regulation of the company during the period prior to 1 December 2001.

MY REPORT AND RECOMMENDATIONS

5. On 16 July 2008, I laid before Parliament the report containing the results of that investigation, entitled *Equitable Life: a decade of regulatory failure*. I made ten individual findings of maladministration and upheld a general complaint that the regulators failed for considerably longer than a decade properly to exercise their functions in respect of Equitable Life.

6. I determined that this “*serial regulatory failure*” had led to injustice to those policyholders who had complained to me. That injustice took the form of financial loss, lost opportunities to make informed savings and investment decisions, and a justifiable sense of outrage.

7. In line with my general practice, I made recommendations which aimed to provide an appropriate remedy to put right that injustice. Those recommendations were, first, that the Government should apologise for the maladministration which had occurred and, secondly, that the Government should establish and fund an independent compensation scheme with a view to paying compensation to those affected by the maladministration I had found had occurred.

8. I recommended that the aim of such a compensation scheme should be to restore anyone who had suffered a greater loss, relative to that which they would have suffered had they invested in a comparable scheme with another company, to the position they would have been in had they invested in that other company.

9. In making this recommendation for compensation to be paid for the relative losses which policyholders had suffered, I recognised that it raised issues concerning the public interest and the potential impact that acceptance of the recommendation to establish a compensation scheme might have on the public purse. I said that it would be appropriate to take this into account when deciding how to respond to that recommendation.

10. Decisions as to whether such a compensation scheme 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. I therefore invited both Parliament and Government to consider further the issues that were raised by my report and by my recommendation.

THE PREVIOUS GOVERNMENT'S RESPONSE TO MY REPORT

11. In its January 2009 response to my report, the previous Government apologised to policyholders but rejected my recommendation that compensation for relative losses should be paid. Instead, it commissioned Sir John Chadwick to provide advice as to the development of a limited scheme to make *ex gratia* payments only to those most “*disproportionately*” affected by the Equitable Life affair.

12. In producing his advice, Sir John's Terms of Reference required him to follow the terms of the previous Government's response to my report. This involved the rejection, reinterpretation, or qualification of many of my findings of maladministration and injustice. In particular, he was to “*disregard*” those of my findings which the previous Government had not accepted.

13. Judicial review proceedings launched by the Equitable Members Action Group (EMAG) challenged the legality of the previous Government's response to my report. The Divisional Court held that the Government had had no cogent reasons for its rejection of some of my findings of maladministration. That response was thus unlawful.

14. As a result of this judgment, Sir John's terms of reference were amended. Those amended terms of reference were still predicated on a rejection of my recommendation for redress and Sir John was still required to proceed on the basis of that part of the Government's response which had not been ruled unlawful by the courts.

15. The previous Government's response to my report was also subject to consideration by the Committee's predecessor, which published two reports—*Justice Delayed* and *Justice Denied?*—that were critical of that response.

THE NEW GOVERNMENT'S APPROACH

16. With the election of a new Government, the position changed. In paragraph 23 of *The Coalition: our programme for Government*, the new Government said, mirroring earlier manifesto commitments, that:

We will implement the Parliamentary and Health Ombudsman's recommendation to make fair and transparent payments to Equitable Life policy holders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure.

17. Legislation has been introduced to provide authority for the payment of compensation, and an independent commission has been appointed to advise on the design of a scheme to make compensation payments within a clear timetable.

THE CHADWICK REPORT AND RECENT DEVELOPMENTS

18. The Chadwick Report commissioned by the previous Government was published in July 2010. This contained a provisional estimate of the relative losses which had occurred. These were calculated by Towers Watson, actuaries appointed by the Treasury to assist Sir John, as being in the range of £4 billion to £4.8 billion. This is broadly consistent with the amounts claimed by those who complained to me and which informed the representations I received while finalising my July 2008 report. On that basis it appears to me to be a credible estimate.

19. In line with his terms of reference, Sir John also gave advice on the proportion of those losses which he considered it would be appropriate to apportion to the regulators, the classes of policyholders which had suffered the greatest impact, and the factors which should be taken into account when determining whether “*disproportionate impact*” had been suffered.

20. In relation to the amount of compensation that should be made available to policyholders, Sir John recommended that compensation should be capped at the “absolute loss” which had been suffered. No such cap was suggested in my report.

21. He also advised that the amount of compensation should be reduced further to reflect his assessment—which differed from mine—of what policyholders would have done had no regulatory failure occurred. This approach resulted in advice that compensation of 25% of the absolute loss suffered by with-profits annuitants should be paid, with payments of 20% of their losses to be made to all other policyholders.

22. Analyses undertaken by Equitable Life and by the representatives of policyholders have estimated that the approach embodied in the Chadwick Report would lead to only 10% of relative losses being made good. They have also questioned many of the assumptions which Sir John made in coming to his advice.

23. In a statement to the House on 22 July 2010, the Financial Secretary to the Treasury explained that the Government would reflect on Sir John’s advice and would listen to representations by interested parties while further work was done to produce a final estimate of the relative losses which had been suffered. That final estimate and the amount to be made available for compensation to remedy those losses will be announced on 20 October 2010 as part of the Comprehensive Spending Review.

24. I wrote to all Members of Parliament on 26 July 2010. I welcomed many of the next steps announced by the Government and the work being done to calculate the relative losses sustained by Equitable Life policyholders. However, I also explained that basing the design or funding of the compensation scheme on the proposals set out within the Chadwick Report would not enable fair or transparent compensation to be provided and could not constitute the implementation of my recommendation.

WHY THE CHADWICK PROPOSALS ARE INCOMPATIBLE WITH IMPLEMENTING MY RECOMMENDATION

25. I recommended fair compensation to all Equitable Life policyholders to remedy the relative losses they have sustained, to be delivered by an independent scheme in a transparent, simple and speedy manner. As explained above, the new Government has said that it will implement that recommendation.

26. As I have already explained in my July 2010 letter to Members of Parliament, implementation of my recommendation cannot be secured through the adoption of the approach embodied within the Chadwick Report.

27. I will now explain my reasons for taking this view. My fundamental point is that the approach embodied within the Chadwick Report has been overtaken by events, given the commitment by the new Government to implement my recommendation in full.

28. Sir John, in fulfilling his Terms of Reference, was undertaking a task that was substantively different to what is necessary to implement my recommendation. In his own words, referring in paragraph 7.66 of his Report to my approach as contrasted with the basis on which he had proceeded, “*we have reached different answers because we have addressed different questions*”.

29. The annex to this paper shows the differences which exist between the approaches embodied respectively within my report and the Chadwick Report.

30. In addition, the analysis which Sir John undertook was grounded in a view of my report which is inconsistent with what my report actually says. This can be illustrated by three key examples:

- The Chadwick Report proceeds on the basis that I intended that individuals should only be eligible for compensation to the extent that they could show that they were covered by each of the individual findings of maladministration and injustice and had relied on an individual basis on the regulatory returns.

My recommendation, however, was not qualified in any such way, and covered all those who had suffered relative loss.

- The Chadwick Report suggests that I had recommended that a compensation scheme should be established which was based on the assessment of each individual transaction made by every Equitable Life policyholder, seeking to identify specific losses related to each financial transaction made.

But I have never suggested that this would be appropriate or practical. It nevertheless became the founding basis for what Sir John described as my “*report-based approach*” to which he devoted a whole section of his advice.

- The Chadwick Report contends that I had rejected the approach embodied by submissions made by EMAG and others as to how to design a compensation scheme.

In fact, I left open the best way to design a compensation scheme—neither endorsing nor rejecting any of the various possible approaches—leaving the determination of this question as a matter for the independent commission to do openly and taking into account the views of stakeholders.

31. In summary, Sir John’s Advice to Government misunderstands and misinterprets my report in a number of important respects; starts from a different place to my report as a result of the very different basis on which it was commissioned; proceeds on a different basis; takes a different view on what would have happened in the absence of regulatory failure; takes a narrower approach to redress; and a very different approach to the calculation of compensation. It is for these reasons that I consider the Chadwick proposals to be an unsafe and unsound basis on which to proceed.

 THE STEPS REQUIRED TO IMPLEMENT MY RECOMMENDATION

32. My recommendation was that compensation should be paid to all Equitable Life policyholders for any relative loss they have sustained. I did not qualify that recommendation in any way beyond recognising that Parliament had to decide how to balance fairness to policyholders with the impact that paying compensation would have on the public purse.

33. Implementing my recommendation through the provision of fair compensation would require the following steps to be undertaken in an open and transparent manner:

- First, determining relative losses—through the identification of an appropriate comparator or comparators against which to judge the relative performance of Equitable Life and by then measuring the “gap” between the performance of this comparator or comparators and the performance of Equitable Life in relation to the different classes of policy or annuity.

A provisional estimate of £4 to £4.8 billion has been calculated by Towers Watson, the actuaries appointed by the Treasury to assist Sir John.

- Secondly, deciding what compensation should be paid—by setting out what percentage of relative loss should be made good in order to balance fairness to policyholders with the effects of the provision of compensation on the public purse.

This is under consideration as part of the Government’s Comprehensive Spending Review.

- Finally, paying each eligible policyholder—using whatever formula results from the above steps and the data which the Government now has about the affected policyholders.

An independent commission has been appointed to recommend to Government how best to fairly allocate the funds provided following the Comprehensive Spending Review.

CONCLUSION

34. I very much welcome the new Government’s acceptance of my findings of maladministration and injustice and its commitment to implement my recommendation to compensate Equitable Life policyholders for their relative loss as a consequence of serial regulatory failure. It is clear, however that the Chadwick proposals are not compatible with delivering that commitment.

35. I will be happy to assist the Committee in its consideration of these issues.

THE OMBUDSMAN’S RECOMMENDATION AND THE CHADWICK REPORT

	<i>The Ombudsman’s approach</i>	<i>The Chadwick approach</i>
Starting point	The Ombudsman’s report.	The former Government’s response to the Ombudsman’s report.
Basis	All the findings of maladministration and injustice set out in the Ombudsman’s report.	Only those findings accepted by the former Government—some rejected, others qualified or reinterpreted, some ignored.
Redress	The Ombudsman’s recommendation. Compensation to all policyholders for the relative losses they have suffered—this would be fair and reasonable in the circumstances of the case and would address all of the different forms of injustice which had resulted from all of the many types of maladministration which had occurred.	Rejection of the Ombudsman’s recommendation. Limited <i>ex gratia</i> payments to be made only to those “disproportionately affected” by the maladministration which the former Government accepted had occurred.
Approach to compensation	(1) determine relative losses sustained (2) consider wider questions of affordability (3) pay all claims	(1) determine relative losses sustained (2) cap loss figure at a lower figure for “absolute loss” (3) reduce capped figure to either 20 or 25% of loss (reflecting assumptions about what would have happened had no regulatory failure occurred) (4) consider wider questions of affordability (5) pay claims

APPENDIX

Letter from Chair of the Committee, to Ann Abraham, Parliamentary and Health Service Ombudsman, 10 September 2010

EQUITABLE LIFE

You wrote to Member's on 26 July expressing your concern that the Chadwick proposals would be an "unsafe and unsound basis on which to proceed".

As you know, our predecessor Committee took a very close interest in this matter and shared your apprehension about the way in which the previous Government had responded to your recommendations.

I understand that you are meeting with the Financial Secretary in advance of the Second Reading debate of the Equitable Life (Payments) Bill. As you are well aware there is also much concern among colleagues in the House on behalf of those of their constituents who have been adversely affected by the events surrounding Equitable Life.

It would help the Committee as well as Members, in advance of announcements in the Spending Review next month, if you were to come before us and explain in what specifics that you disagree with the Chadwick approach.

You kindly copied me your letter to Mark Hoban of 9 September but it would help our deliberations greatly if, in advance of that session, you could set out those specifics in writing: why you disagree with the Chadwick proposals; why you consider that they are not the correct basis on which the Government can meet your recommendations and make fair and transparent payments and to what extent you have sought to resolve those differences with Sir John and the Treasury. Can you tell us whether you have sought to meet Sir John Chadwick to seek to resolve these differences?

The Clerk of the Committee will be in touch with your office shortly with a formal invitation for early October.

I am also writing to Sir John Chadwick and the Minister with a similar invitation.

Written evidence from Equitable Life Assurance Society

1. INTRODUCTION

1.1 We welcome the opportunity to submit written evidence to the Public Administration Select Committee inquiry. The inquiry is an important and timely contribution to the ongoing process of getting a fair resolution for policyholders.

2. EXECUTIVE SUMMARY

2.1 Sir John Chadwick's advice has no place in Government's decision on payments to Equitable Life policyholders which resulted from maladministration and regulatory failure.

2.2 The Parliamentary Ombudsman recommended that the Government should establish and fund a compensation scheme to put those people who have suffered a relative loss back into the position that they would have been in had maladministration not occurred.

2.3 The Coalition Government committed to implement the Ombudsman's recommendations.

2.4 It is entirely proper that the Board of Equitable Life, our policyholders and their MPs rely on the clearly expressed views of the Parliamentary Ombudsman.

2.5 The Ombudsman has said that Sir John Chadwick's approach cannot provide a basis for her recommendation and that his proposals are unsafe and unsound.

2.6 Despite the Coalition Government's commitment to implement the Ombudsman's recommendation and despite the Ombudsman's condemnation of Sir John Chadwick's advice, the Coalition Government has repeatedly given Sir John's advice substantive credence.

2.7 Relative loss should be based on the Parliamentary Ombudsman's approach and only her approach.

2.8 Towers Watson estimated an "Aggregated Stage 2 Loss" of £4 billion to £4.8 billion which matches most closely the relative loss described by the Ombudsman.

2.9 In regard to policyholders who should be included in the scheme, the Ombudsman has made it clear that the right approach is to treat all investors as having left Equitable Life and invested elsewhere.

2.10 We acknowledge the Parliamentary Ombudsman's statement that it is appropriate to consider the impact of compensation on the public purse. What we do not accept is that there should be any other rationale for a haircut and, in particular, one resulting from Sir John Chadwick's advice so condemned by the Ombudsman.

3. GOVERNMENT'S COMMITMENT

3.1 In the Opposition Day Debate on 21 October 2009, Mark Hoban MP said: "*Conservative Members have been clear throughout this process. We have said that if the Ombudsman found that there was maladministration owing to regulatory failure and that compensation was required, we would accept those findings. That was our position while we campaigned for the Ombudsman to be allowed a second investigation, that was our position when the Ombudsman published her report last year, and that is our position today.*" The statement was made when Minister Hoban formed part of the Conservative opposition. He went on to say "*We have been clear in our support for the Ombudsman's recommendations. That is our position today and would be our position if elected at the next general election.*"

3.2 The Coalition Government committed to "*implement the Parliamentary and Health Ombudsman's recommendation to make fair and transparent payments to Equitable Life policy holders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure.*" (The Coalition: Our programme for Government)

3.3 On 22 July 2010, the Financial Secretary to the Treasury, Mark Hoban, stated to Parliament, "*We are committed to implementing the Parliamentary Ombudsman's recommendation.*"

3.4 We believe these commitments to have the effect that the payment scheme proposed will implement the Parliamentary Ombudsman's recommendation in full.

3.5 It is entirely proper, therefore, that the Board of Equitable Life, our policyholders and their MPs rely on the clearly expressed views of the Parliamentary Ombudsman.

4. PARLIAMENTARY OMBUDSMAN

4.1.1 In the Parliamentary Ombudsman's 2008 report, she set out that: "*My second—and central—recommendation is that the Government should establish and fund 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.*" (9.27)

4.1.2 In regard to the necessity of assessing individual cases, the Ombudsman's letter of 20 August 2009 to Sir John Chadwick said "*I do not share your view that the tribunal I recommended should be established would have needed to seek to examine each finding I made in isolation in the way envisaged in the Government's response to my report and in your Proposals document.*" She went on to say "*any limitations that you might feel constrained to impose regarding eligibility for the payments to be made to those affected by the Equitable Life affair do not derive from the nature of my findings and recommendations.*"

4.2.1 In regard to quantum of loss, the Ombudsman's report went on to say that: "*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.*" (9.28)

4.2.2 In regard to relative loss, the Ombudsman's report described it as "*a loss that they would not have suffered had they saved or invested elsewhere.*" (1/14/33).

4.2.3 Both policyholders and taxpayers alike will understand the concept of relative loss described by the Ombudsman so there needs to be a mechanism to calculate the loss that is consistent with the Ombudsman's recommendation.

4.2.4 In their letter of 21 July 2010 to the Financial Secretary to the Treasury, Towers Watson provided an estimate of "*Aggregated Stage 2 Loss*" of £4 billion to £4.8 billion, defined as "*the difference between the payout which would have been received ... in respect of a comparable product offered by an alternative provider and the payout which has actually been received ... in respect of the Equitable Life policy.*" This seems to match most closely the relative loss described by the Parliamentary Ombudsman. While, we would expect the Towers Watson figure to need adjustment to reflect fully the Ombudsman's description of relative loss, we do not believe that this would involve major additional work.

4.2.5 Relative loss should be based on the Parliamentary Ombudsman's approach and only her approach.

4.3.1 In regard to policyholders who should be included, the Ombudsman said in her letter to Sir John of 20 August 2009 "*In essence, the view expressed in my report is that, absent the serial maladministration I had determined occurred from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period—going instead to another life insurance company.*"

4.3.2 Therefore, we think the right approach is to treat all investors as having left Equitable Life and invested elsewhere.

4.4 The Ombudsman has been clear a) in her recommendation, b) in her definition of relative loss, and c) in her identification of policyholders who would have left, or not joined Equitable Life. These stand in their own right for implementation by Government.

5. SIR JOHN CHADWICK'S REPORT

5.1.1 In January 2009, Sir John Chadwick was commissioned to advise the previous Government. The terms of reference on which Sir John Chadwick's work is based were limited by the previous Government's rejections of some of the Ombudsman's findings.

5.1.2 Sir John says in section 4.24 of his 2010 report "*Advice to Government in relation to the proposed Equitable Life payment scheme*" that the then Labour Government "*decided not to accept that it would be appropriate to establish a compensation scheme in the way the Ombudsman had recommended. I have not been asked to advise how compensation under such a scheme would be awarded; and I have not been asked to advise as to whether it would be appropriate to make payments in respect of lost opportunities*".

5.1.3 Sir John goes on to say, in section 4.25 of his advice, that "*I have reached the conclusion that the approach was not what the Ombudsman had in mind*".

5.2 In her letter to Members of Parliament of 26 July 2010, the Ombudsman explains that "*In the light of the new Government's commitment to implement that recommendation in full, the approach embodied in the Chadwick report ... cannot provide a basis for the implementation of my recommendation.*"

5.3 The Ombudsman went on to say that Sir John's proposals "*if acted upon, would not in any sense enable fair and transparent compensation to be delivered.*" Then, most importantly, she asserted that the Chadwick report "*misinterprets central parts of the conclusions outlined in my July 2008 report and has ignored others*". She goes on to state that "*the Chadwick proposals seem to me to be an unsafe and unsound basis on which to proceed.*"

5.4 Given the Parliamentary Ombudsman's condemnation, we do not consider it necessary to address the report by Sir John Chadwick. As we said in 3.5 above, it is entirely proper that the Board of Equitable Life rely on the clearly expressed views of the Parliamentary Ombudsman, precisely because the Coalition Government itself is committed to implementing the Parliamentary Ombudsman's recommendation.

5.5 Sir John Chadwick's advice has no place in Government's decision on payments to Equitable Life policyholders which resulted from maladministration and regulatory failure.

6. AMBIGUITY OF INTENT

6.1 Despite the Coalition Government's commitment to implement the Ombudsman's recommendation and despite the Ombudsman's condemnation of Sir John Chadwick's advice, the Coalition Government has repeatedly given Sir John Chadwick's advice substantive credence.

6.2 Steve Webb MP, Minister of State for Pensions, said in Parliament on 14 June 2010: "*The hon. Gentleman will know that Sir John Chadwick will produce his report in July. I understand from discussions with the Treasury that a compensation package will be produced on the basis of that*".

6.3 On 26 June, Mark Hoban gave a written answer to Phil Woolas MP saying "*Sir John Chadwick is advising the Treasury on the relative losses suffered by Equitable Life policyholders in relation to those accepted cases of maladministration resulting in injustice.*" The expression "*accepted cases of maladministration*" is and only is relevant under Sir John's advice. It is specifically not relevant to the Parliamentary Ombudsman's recommendation, the recommendation that the Government signed up to.

6.4 On 22 July, Mark Hoban said "... *Sir John's review is just one of the building blocks in resolving what is a complex matter...*" We have not been made aware of any other building blocks, and the only one the Government refers to is the one which the Ombudsman described as "*unsafe and unsound*", the same Ombudsman whose recommendation that Coalition Government signed up to.

6.5 On 8 September, the Deputy Prime minister said "... *we are absolutely committed to bringing justice to the Equitable Life policyholders. These people were shamelessly, shamefully betrayed year after year by the previous Government. We have published a Bill on this, we have taken the recommendations from Sir John Chadwick, which we will consider, and we will create an independent mechanism by which justice is finally provided to the policyholders, who were so shamefully overlooked by the previous Government.*"

6.6.1 The terms of reference of the Independent Commission refer to "*accepted Government maladministration*" in clauses 1 and 6. This effectively extends the limitations of Sir John's work to the Independent Commission.

6.6.2 As an important aside, we would suggest Clauses 1 and 6 of the terms of reference of the Independent Commission, ought most properly to refer to "*relative losses as a result of the maladministration found by the Ombudsman*". Minister Hoban has expressed the view to us that this change would require "*a new and lengthy period of analysis*". We challenge this assertion. Such a change to their terms of reference would still allow the Commission to use Towers Watson's "*Aggregated Stage 2 Loss*" and their analysis of that, and apply it to implement the Ombudsman's recommendation free from the constraints set by the former Government.

6.6.3 We also do not accept that the Commission would need to duplicate Sir John's work. Minister Hoban wrote to the Chief Executive of Equitable Life on 5 August 2010 stating that "*it is vital that the commission does not unnecessarily duplicate work that has already been carried out*" and that "*for the commission not to have regard to Sir John's work ... would be an error*". However, in that letter, he

acknowledged that *“the calculation of relative loss is the starting point”*. Towers Watson’s work on *“Aggregated Stage 2 Loss”* is well matched to the Ombudsman’s description of relative loss quoted above (see 4.2.2 above) and it does not seem to need the duplication of work which he fears.

6.7.1 These repeated references to a) Sir John Chadwick’s work and b) to the term *“accepted Government maladministration”* stipulated by the previous Government, imply that the Coalition Government’s actions may not be consistent with the commitment to implement the Parliamentary Ombudsman’s recommendation.

6.7.2 Sir John Chadwick’s report was developed for the previous Government in a manner inconsistent with the Parliamentary Ombudsman’s recommendation. We look to Parliament to support its Ombudsman and hold the new Government to account in delivering the Coalition commitment to implement the Parliamentary Ombudsman’s recommendation.

7. PUBLIC PURSE

7.1 Minister Hoban has suggested that the Equitable Life has agreed with the principle of adopting a discount to reflect that not all policyholders would have left Equitable Life. This is not correct. We have never agreed this approach. We have consistently argued that such a discount is fundamentally unfair, indeed, wrong. As the PO said *“absent the serial maladministration I had determined occurred from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period—going instead to another life insurance company.”* (see 4.3.1 above)

7.2 What we do acknowledge is the Parliamentary Ombudsman’s statement in her 2008 report. *“that it is appropriate to consider the potential impact on the public purse of any payment of compensation in this case.”* What we do not accept is that there is any other rationale for a haircut and, in particular, one resulting from Sir John Chadwick’s advice so condemned by the Ombudsman.

7.3 In respect of the potential impact on the public purse of any payment of compensation, the Ombudsman invited Parliament to consider the issues raised in her report and for Parliament to reflect on what its response to her report should be. The Equitable Life (Payments) Bill does not refer to the amount of compensation, so that amount will not be subject to Parliamentary scrutiny as the Ombudsman intended. Consequently, Parliament needs to find a way to express its view on the amount of compensation.

8. CONCLUSION

8.1 Sir John Chadwick’s advice has no place in Government’s decision on payments to Equitable Life policyholders which resulted from maladministration and regulatory failure.

8.2 Relative loss should be based on the Parliamentary Ombudsman’s approach and only her approach.

8.3 We acknowledge the Parliamentary Ombudsman’s statement that it is appropriate to consider the impact of compensation on the public purse. What we do not accept is that there should be any other rationale for a haircut and, in particular, one resulting from Sir John Chadwick’s advice so condemned by the Ombudsman.

October 2010

APPENDIX

Letter from Chair of the Committee to Chris Wiscarson, Chief Executive, Equitable Life Assurance Society, 20 September 2010

EQUITABLE LIFE: PASC INQUIRY

As you may know, during the Second Reading debate on the Equitable Life (Payments) Bill the Chair of the Public Administration Select Committee, Bernard Jenkin, announced that the Committee intends to hold a further, very short inquiry into the Government’s response to the Ombudsman’s recommendation on Equitable Life as soon as the House returns in October in order to elucidate the exact differences between the Ombudsman’s recommendations, Sir John Chadwick’s report and the Government’s view.

The Committee would welcome a short written submission from Equitable Life to this inquiry which should be with me by Friday 1 October.

Written evidence from Equitable Members Action Group

SUMMARY AND INTRODUCTION

1. The expectations of 40,000 EMAG members and thousands more who are victims of the Equitable Life scandal were high when in May the new Parliament included 380 MPs who had signed an election pledge to *“...support and vote for proper compensation for victims of the Equitable Life scandal..... as recommended by the Parliamentary Ombudsman.”* They also welcomed the formation of the new Coalition Government whose agreement states *“that it will implement the Parliamentary Ombudsman’s recommendation to make fair and transparent payments to the Equitable Life policyholders for relative loss*

as a consequence of regulatory failure". EMAG thought a positive relationship with the Treasury could be cultivated but, despite our best endeavours and good intentions, EMAG has continued to be treated as the enemy.

2. We met the Financial Secretary, Mark Hoban, on 24 May. He had already agreed to a seven week extension to Sir John Chadwick's timetable, despite no changes to the remit. Mr. Hoban refused EMAG's request to set aside the "Chadwick Process" and asked instead for EMAG to re-engage, which EMAG refused point blank. He glossed over the glaringly obvious mismatch between Chadwick's unchanged terms of reference and the Coalition Government's new promise to implement the Parliamentary Ombudsman's recommendations. Subsequently, and at great length Mr Hoban introduced the Chadwick report to the House on 22 July 2010, stating that it was a "building block" for assessing compensation. No other "building blocks" were described. Unsurprisingly, the Parliamentary Ombudsman wrote to all MPs on 26 July to denounce the Chadwick report as an "unsafe and unsound" basis for compensating policyholders.

3. EMAG was appalled by the Chadwick report, which by breathtaking sophistry reduced the sum of £4.8 billion for relative loss to between £400 million and £500 million—giving a new meaning to decimation. We analysed the report in detail and published a Critique (on our website at: www.emag.org.uk).

4. As the Parliamentary Ombudsman, Ann Abraham, wrote in her letter to Sir John 27 November 2009, *"In essence, the view expressed in my report is that, absent the serial maladministration I had determined from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period—going instead to another life insurance company."* We believe that the "Chadwick Process" was kept in situ by the Treasury as a device to justify minimising compensation, to retain the £1 billion already allocated in the forward plan (as confirmed by ex-Chief Secretary to the Treasury, Liam Byrne) for payments only to those "disproportionately impacted".

So, the Treasury has, by sleight of hand, proposed simply taking the same sum already pencilled in, temporarily and expediently cut it by 50%, and sought to repackage it as somehow meeting the Parliamentary Ombudsman's recommendation for fair compensation. Sir John explains the divergence between his views and those of the Parliamentary Ombudsman in his report thus: *"We have reached different answers because we have addressed different questions."* (Para 7.1.1). But in our opinion he was seeking excuses for cuts while she was seeking justice.

5. At the meeting we had with Mr. Hoban 24 May, and subsequently in a series of letters sent to him from 28 May to 27 August, we have asked without success for a detailed breakdown of Towers Watson's estimate of "aggregate stage two loss" in the range of £4.0 billion–£4.8 billion, which is similar to the "relative loss" recommended by the Parliamentary Ombudsman. When we eventually met Towers Watson in September we discovered that they have made material assumptions based on Sir John's specified template with which we do not agree. Regrettably, the Treasury have been very reluctant to provide the necessary information to EMAG which might allow us to verify or otherwise comment upon the figures provided by Towers Watson. It is clear to us that, 20 months after the commencement of the "Chadwick Process" Towers Watson have still not been instructed by the Treasury to prepare a comprehensive figure for "relative loss" arising from all the cumulative findings of maladministration by the Parliamentary Ombudsman. This figure should form the basis from which government and MPs view the quantum of compensation for Equitable policyholders. The true "relative loss" figure, if the material omissions/corrections EMAG has identified are incorporated, will certainly exceed £5 billion.

6. The Equitable scandal has dragged on for a decade. Over this period some 50,000 policyholders have died and many more have not enjoyed the comfort in retirement for which they saved. We must perforce accept the financial position of the country, but EMAG does not accept that after all these years Equitable policyholders should be expected to bear a disproportionate share of the burden. If the public sector as a whole is bearing an average cut of 20%, we see no reason why Equitable policyholders should bear any higher proportion.

We also see no reason why the quantum should be announced as part of the Comprehensive Spending Review (CSR) cuts on 20 October. This just looks like more Treasury chicanery to deliberately plan very bad news for Equitable's victims to be announced on the year's optimum "Jo Moore" day. We believe that, having waited so many years, there should be a proper informed debate on the quantum to build upon the excellent Equitable Life debate that took place in the Commons on 14 September, when so many backbenchers expressed disquiet at the prospect of their integrity being impugned by the Treasury seeking to make a derisory settlement based on the irrelevant and discredited "building block" of the Chadwick report.

7. The main part of our report comprises four sections:

1. The Coalition's promise and the Chadwick Report.
2. Transparency and our quest for a sound figure for "relative loss".
3. The independent Payment Commission.
4. Conclusion.

Annexes: A. *Sir John Chadwick's revised terms of reference*

B. *The revised TOR for Chadwick in the light of the Labour Government's acceptance/non-acceptance of findings and the significance of the omissions*

C. *Decimating "relative loss"*

8. We suggest the Committee might enquire of Mr. Hoban :

(These questions are also interspersed into the body of this submission)

- (i) *Precisely which of the Parliamentary Ombudsman's findings does the Coalition Government not accept? (Given that Towers Watson only quantified those ones accepted by the previous Labour Government.)*
- (ii) *If the answer is "none", why does he see value in Chadwick's report, given that it was prepared to terms of reference which were rendered incompatible by the Coalition Government's promise in May?*
- (iii) *What is the purpose of elevating the Chadwick report if not to justify minimising compensation?*
- (iv) *What are the other "building blocks" and, if there are any, why are they not in the public domain?*
- (v) *What is meant by "transparency" (because EMAG's experience is just more Treasury obfuscation)?*
- (vi) *Why, 20 months after initiation of the "Chadwick Process" and the expenditure of £3 million, is there is no comprehensive figure for "relative loss" as recommended by the Parliamentary Ombudsman upon which MPs and government can base a decision?*
- (vii) *Given the way EMAG have been fobbed off and not provided with information about Towers Watson's calculation of "relative loss", what is HMT trying to hide?*
- (viii) *Exactly what is meant by the Independent Payment Commission's terms of reference instruction to "findings accepted by the Government"?*
- (ix) *Why has the Commission been instructed to even consider the Chadwick report and address "disproportionate impact", which should now be irrelevant?*

THE COALITION'S PROMISE AND THE CHADWICK REPORT

9. Following EMAG's judicial review, the Treasury was instructed to reinstate some (but not all) of the key findings of injustice, and it set Sir John Chadwick revised terms of reference. They stated, crucially, that he was to disregard findings by the Parliamentary Ombudsman which the Government did not accept and instructed that he should reconstruct how Equitable might have performed absent maladministration (see Annex A).

In March 2010 EMAG very publicly disengaged from the "Chadwick Process" (and informed MPs why) for three reasons:

- Following the revised terms of reference it became clear that he was working on contrived and counterfactual methodologies based on the Reconstruction of Equitable Life (REL), without an enquiry into any evidence, to arrive at an actuarial formula to slash payments.
- Although the Government had claimed that Chadwick's inquiry was "independent", the secretary Simon Bor was seconded from the Treasury; in his career as a QC Chadwick has frequently acted for the Government.
- It became obvious, on the publication of the Third Interim Report, that Chadwick was taking no notice of representations that we and others were making—the alleged process of consultation was a charade. He was demonstrably in thrall to the Treasury and was anything but "independent".

Just how partisan Chadwick has been, can be seen from the correspondence exchanges between Sir John and the Society, Dr Andrew Goudie, Michael Josephs and others, all made in good faith after the publication of Interim 3. These are to be found in "Supplementary Material (sections VIII to XII)". There are 343 damning pages which demonstrate unequivocally that Sir John Chadwick took not a blind bit of notice of anyone's reasonable points and he ALWAYS favoured those arguments advanced by the Treasury.

10. On 24 May 2010 EMAG had a meeting with Financial Secretary Mark Hoban. In Parliament on 21 October 2009 Hoban had stated that "*if the Ombudsman found that there was maladministration owing to regulatory failure and that compensation was required, we would accept those findings*". In consequence, we were thus hopeful that we would find a responsive ear for our views, but this was not to be. Mr. Hoban astonished those EMAG Directors present by asking us to re-engage with Chadwick, which we refused point blank.

We asked for Chadwick's work to be sidelined, apart from the work by Treasury-appointed actuaries (Towers Watson) on "relative loss". We gave as our reason that Chadwick's terms of reference were not compatible with the Coalition's commitment to honour the Parliamentary Ombudsman's findings. In Annex B we set out what findings the previous Government did not accept, and the significance of the latter for Chadwick's study. At that time we were not aware that Chadwick had further taken it upon himself (no

doubt at the request of the Treasury) to “retry” and effectively to dismiss the one finding of injustice which the Government had originally accepted in January 2009—namely the one relating to the valueless reinsurance treaty which the FSA had accepted to cover up Equitable’s parlous financial condition in 1998.

11. On 2 September, EMAG board Directors Colin Slater and Chris Carnaghan met with Ms. Anne Macadam who is the Treasury’s Head of Policy, Equitable Life Payment Scheme. They were surprised that she still talked in terms of “those aspects of the Parliamentary Ombudsman’s report which the Government had accepted”. When Mr. Slater pointed out that the present Government had accepted ALL of the Parliamentary Ombudsman’s findings, she seemed to think this was not so.

12. We suggest the Committee might care to enquire of Mr. Hoban:

- (i) *Precisely which of the Parliamentary Ombudsman’s findings does the Coalition Government NOT accept (given that Towers Watson only quantified those ones accepted by the previous Labour Government).*
- (ii) *If the answer is “none”, why does he see value in Chadwick’s report, given that it was prepared to terms of reference which were rendered incompatible by the Coalition Government’s promise in May?*
- (iii) *Why one of his senior Treasury officers dealing with Equitable was failing to act on the Coalition’s stated intention?*

13. On 22 July Mr. Hoban published Chadwick’s report together with the associated work by Towers Watson—a total of more than 2,000 pages.² EMAG was appalled by the report, which contrived through actuarial alchemy to reduce the sum of £4.8 billion “relative loss”, to £400 million–£500 million. We analysed the report in detail and published a Critique which is on our website (www.emag.org.uk). Chadwick indulged in a slicing and dicing exercise which began by disregarding the earliest and latest periods of maladministration with injustice.

Instead of taking the Parliamentary Ombudsman’s accepted start date for maladministration of 1 July 1991, Chadwick used data shortcomings to shift the start date 18 months to 31 December 1992, which cut the estimated “relative loss” by of the order of a very material £700m. Chris Wiscarson, Chief Executive of Equitable Life, has expressed the view that it would be reasonable for an actuary to extrapolate the total data back for the valuable but missing 18 months with reasonable accuracy. Sir John Chadwick took it upon himself to re-try and reject the Parliamentary Ombudsman’s major finding of maladministration relating to the valueless reinsurance treaty.

14. Next, with extraordinarily tortuous logic, chopping and obfuscatory narrative³ he reinterpreted the Parliamentary Ombudsman’s crystal clear concept of “relative loss” by capping it with a contrived concept of “absolute loss” and calling it “external relative loss”. He then made the specious claim that this was what the Parliamentary Ombudsman really meant by “relative loss”! This process reduced the sum apparently lost to £2.3 billion–£3.0 billion, a reduction of about 45%. The steps that followed were even more extraordinary: Chadwick took the request by the Treasury to reconstruct how Equitable might have performed “*as if the maladministration accepted by the Government had not occurred*” and asked Towers Watson to create a hypothetical simulation. Chadwick/Towers Watson made carefully selected assumptions of minimal changes in the Reconstruction Equitable Life (REL) so that the bonus declarations and overbonusing would have been little different from what they were in reality. And thus, as in real life, Equitable would have had to close to new business when it actually did.

Presumably Roy Ranson, Equitable’s Chief Executive for the early part of the 1990s, would similarly have been expelled from the Institute of Actuaries (as he in fact was) for not maintaining a smoothing fund, which was non-existent in the REL as in reality. Chadwick’s interpretation of regulation without maladministration would still have wrecked Equitable—not in any way a credible scenario or one which the Treasury has in the past talked up as a strength of British regulation.⁴ This exercise reiterates the attempt to look only at the form of each event in the best light to the regulators and to ignore the substance of them and the effect of their accumulation.

Chadwick used the marginal difference between reality and REL to pretend that not many policyholders would have left Equitable if it had been properly regulated without maladministration. Hence the loss due to maladministration was apparently not that significant. He then devised a meretricious concept which he called “internal relative loss” which, because of Chadwick’s assumptions, are deemed trivial. *Indeed according to Towers Watson the aggregate of “internal relative losses” is actually a profit!* What Chadwick is asking readers to believe is that proper regulation would have produced a worse result for policyholders than the failed regulation described by the Parliamentary Ombudsman. Without any foundation, he insinuated that the Parliamentary Ombudsman did not think of this concept because her terms of reference precluded her from considering the actions of other than the public bodies. Chadwick used the concept in an economically meaningless equation to cut his assessment of losses by a further 80%!

² According to a letter to us from the Treasury dated 20 September 2010 the “Chadwick Process” cost £3.1 million, of which Chadwick received £309,075 and Towers Watson £2.5 million.

³ EMAG sets out an example of his style in Annex 5 of the Critique titled The Semantic travails and travels of “Absolute Loss” and “Relative Loss”.

⁴ Treasury evidence to Treasury Select Committee, Supplementary Memorandum from HM Treasury, 16 October 1998.

15. To report that 75%–80% of the money injected in the 1990s would still have been deposited even had investors had known the true state of the Society is unsubstantiated poppycock. Of the £20 billion of new funds injected in the period, the vast majority was from new investors who would not have touched Equitable with a bargepole if the regulator had exposed its financial frailty. We show in Annex C the steps by which Chadwick decimated apparent loss.

We believe that the reason for persevering with the “Chadwick Process”, which Mr. Hoban claims is only a “building block” and that “is not necessarily accepted”, has been to use it as a cruel blunt instrument for depressing expectations based on a supposedly “independent” and reputable legal figure. It does no credit to the Coalition Government that the Treasury persists in peddling it, resulting in grossly misleading “cookie cutter” letters that go to enormous length to explain the Chadwick Report’s seemingly plausible but highly questionable sophistry. EMAG has copies of dozens of such letters and even four which Coalition MPs sent after the debate on 14 September—the latest being dated 23 September. After extensive explanation of Chadwick’s report, these letters continue:

“[Chadwick] therefore proposes that policyholders should receive 20–25% of their capped external relative loss. This results in a figure of £600 million. I understand this is a concept which EMAG supports, but EMAG believes a smaller proportion of investors would have made the same investment decision.”

16. We suggest the Committee might care to enquire of Mr. Hoban:

- (iv) *What is the purpose of elevating the Chadwick report?*
- (v) *What are the other “building blocks” and, if there are any, why are they not in the public domain?*

TRANSPARENCY AND EMAG’S QUEST FOR “RELATIVE LOSS”

17. At the meeting five EMAG Directors held with Mr. Hoban on 24 May, and subsequently in a series of letters sent to Mr. Hoban between 28 May and 27 August (which can be supplied on request), we asked without success for detailed explanation of Towers Watson’s estimate of “aggregate stage two loss” in the range of £4–4.8 billion included in their letter of 21 July to Mr. Hoban. This estimate is similar in concept to evaluating loss relative to investment elsewhere in the manner recommended by the Parliamentary Ombudsman. It is the main item worth salvaging from the “Chadwick Process” but it is still understated in respect of omissions described earlier.

On 5 August Mr. Hoban invited EMAG to “*come forward with ideas that are robust, evidence-based and workable*” by the end of August. Given the Treasury’s refusal to part with any of the detail repeatedly asked for in writing, this was, to say the least, disingenuous of him. We were prevented from meeting Towers Watson until 2 September.

At the meeting we discovered that Towers Watson had made an incorrect assumption in their calculation of “relative loss”. They took the actual net financial return policyholders achieved from investing in Equitable, which for many included incurring a penalty “market value adjuster” or exit fee on taking a non-contractual exit to leave a stricken fund. To calculate the return they would have achieved from investing in a portfolio of other reputable funds (which EMAG calls “Elsewhere Life”), Towers Watson were instructed to assume that policyholders would have incurred an exit fee there too. But this is not reasonable: Policyholders would have had no reason to leave “Elsewhere Life” to mitigate losses on a non-contractual date and would not have incurred those penalties. *The consequence of this assumption is to understate the estimate of “relative loss” by several hundred million pounds.* The Towers Watson estimate is deficient in three further respects:

- (i) It does not include the first year and a half of the maladministration period (July 1991–December 1992) since Chadwick chose to exclude this (para 13). Towers Watson has refused to provide an estimate of the sum involved. EMAG’s estimate is in the order of £750 million.
- (ii) The calculation purports to include the losses of those that had already invested in the fund at the start date. However, since these are included on the basis of Chadwick’s supposedly “properly regulated” Equitable Life (REL), the amount so included is trivial or negative. The effect is to exclude those already invested from the “relative loss” calculation, so reducing the estimated “relative loss”.
- (iii) Losses attributable to with-profits annuities are reported by Towers Watson as being only in direct proportion to those of other policyholders. However, EMAG estimates them to be significantly larger, prima facie. But, as we have not been provided with the data, we cannot do more than speculate that this is incorrect, to the disadvantage of all with-profits annuitants.

18. The Treasury and Towers Watson have been very reluctant to provide any of the information to EMAG which might allow us to verify or otherwise comment upon the aggregate range provided by Towers Watson. For example, they have refused to provide the information for individual sample policies. In response to questions raised, EMAG’s Colin Slater received an inadequate reply on 9 September, to which he responded on 15 September asking for more information, which has not been provided.

We would not be surprised if the Treasury or Towers Watson produces a limited response right at the 11th hour. It is clear to us that Towers Watson has not, despite EMAG's explicit written demand of 3 September in our formal response to HMT, been instructed to prepare a revised and inclusive recalculation of "relative loss" to accommodate the three large items not yet factored in (first 18 months losses, removal of exit fee penalties from "Elsewhere Life" comparison and provision for those already invested at July 1991), which would then without doubt revise "relative loss" to a sum well in excess of £5 billion.

19. The Committee might wish to enquire of Mr. Hoban:

- (vi) *What is meant by "transparency" (because EMAG's experience has been just more Treasury obfuscation)?*
- (vii) *Why, 20 months after initiation of the "Chadwick Process" and an expenditure of £3 million, is there is no reliable figure for "relative loss" as recommended by the Parliamentary Ombudsman upon which MPs and government can base a decision?*
- (viii) *In view of the way EMAG have been fobbed off and not provided with information about Towers Watson's calculation of "relative loss", what is HMT trying to hide?*

THE INDEPENDENT COMMISSION

20. We have concerns about the Independent Commission set up to allocate compensation. Its terms of reference explicitly refer to the discredited Chadwick report.

For example at Point 3: *"The Commission will have regard to the work undertaken by Sir John Chadwick on the methodology for calculating relative loss and base its allocation to policyholders on the relative loss figures provided to HM Treasury by Towers Watson."*

And also, there's a reference at Point 1 to: *"as a result of accepted government maladministration"*. It is apparent that the Treasury continues to believe that "accepted" embraces ONLY those Parliamentary Ombudsman findings that were accepted by the Labour Government (ie only within the "Chadwick Process" terms of reference) and they do not embrace ALL the Parliamentary Ombudsman's findings, as implied in the Coalition's promise.

21. If the Government accepts the Parliamentary Ombudsman's findings, the Committee might ask Mr. Hoban:

- (ix) *Why the Independent Commission's terms of reference refer to: "findings accepted by the Government"?*
- (x) *Why it has been instructed to consider the Chadwick report for its work?*

CONCLUSION

22. The Equitable scandal has been going on for a decade. Over this period some 40,000 policyholders have died and many more have not enjoyed the comfort in retirement for which they saved. They wrongly imagined that "regulated by Her Majesty's Government" was a gold seal of approval that they could rely upon. In the bigger picture, the integrity of the Government and trust in politicians has diminished, and the cause of encouraging people to save for their old age has been badly damaged. It is time to draw the matter to a close, but to an honourable close without the need for further litigation.

23. We had hoped that we would be entering a new and constructive phase in our relations with the Treasury. Regrettably, this has not been the case and we are left with no alternative other than to express our profound distrust of the Treasury. Its dirty tricks have continued unabated. There is a grave danger of damaging the reputation of the Coalition Government. Many backbenchers, having been encouraged to sign a personal pledge, are now concerned that their personal integrity may be impugned by a derisory proposed settlement.

24. EMAG believes that the Chadwick report, written to a deliberately restricted and now obsolete brief, executed with actuarial alchemy and legalese, should be summarily binned as "not fit for purpose". The Coalition's commitment is to honour the Parliamentary Ombudsman recommendation. That is unequivocal—compensate for "relative loss". The Parliamentary Ombudsman considered and dismissed the idea of a percentage reduction for the behaviour of others and she rejected that argument. The way forward is to agree a comprehensive figure for "relative loss" (which would exceed £5 billion) and to apply a transparent percentage "haircut" in line with average cuts elsewhere. We believe a possible way to maximise the fair payment due, but mitigate the impact on the nation's finances, is to phase payments over the life of this Parliament.

25. Equitable's victims must perforce accept the financial position of the country, but they do not accept that they should be expected to bear a disproportionate share of the burden. They argue that they have, effectively, lent the Government £5 billion for the last decade and forgone the opportunity to spend or invest it elsewhere. Payback is long overdue. If the public sector as a whole is bearing a cut of 20%, EMAG doesn't

accept why Equitable policyholders should bear any higher proportion. We also see no reason why the quantum should be announced, and doubtless be buried, as part of the CSR cuts to be announced on 20 October. There should surely be a further debate in the Commons on the quantum?

September 2010

Annex A

SIR JOHN CHADWICK'S REVISED TERMS OF REFERENCE

He was instructed to “disregard [the Parliamentary Ombudsman’s] Findings which are not accepted by the Government”. In relation to the Findings accepted, Chadwick was asked to advise the 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 Parliamentary Ombudsman, as opposed to the actions of Equitable Life and other parties.
- The classes of policyholders which have suffered the greatest impact as a result of maladministration.
- 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.
- The nature and extent of the finding of maladministration and injustice in relation to Finding 5 and the nature and extent of the finding of injustice in relation to Findings 2 & 4 so far as those Findings are now accepted”

The Treasury also asked Chadwick to consider “the extent to which the regulatory returns in each of the years for 1990 to 1996 would have been different if the maladministration accepted by the government had not occurred”.⁵ He was not asked “how would Equitable have performed if it had been effectively regulated”.

Annex B

THE REVISED TERMS OF REFERENCE FOR CHADWICK IN THE LIGHT OF THE LABOUR GOVERNMENT'S ACCEPTANCE/NON-ACCEPTANCE OF FINDINGS AND THE SIGNIFICANCE OF THE OMISSIONS

<i>Ombudsman's findings of maladministration</i>	<i>Government's response</i>	<i>Revised terms of reference for Chadwick setting out the Government's acceptance of injustice⁶</i>	<i>Comment</i>
1. The DTI failed to insist in 1991 when approving Ransom as chief executive that he should relinquish his role as Appointed Actuary.	Not accepted the maladministration.		This allowed Chadwick to claim no change in management or business strategy.
2. GAD failed to scrutinize regulatory returns for each year from 1990 to 1993 re: (i) the valuation rate of interest for discounting liabilities (ii) the affordability and sustainability of bonus declarations.	Accepted maladministration but not injustice. Forced by Court to accept injustice.	Accepts maladministration re (i) and (ii). In relation to injustice accepts that returns for 1990 to 1993 might have looked different if no maladministration. Seeks Chadwick's advice on how different the returns might have looked “if the maladministration accepted by the Government had not occurred”.	
3. GAD failed when ELAS introduced its differential bonus policy in 1993 (i) to inform DTI (ii) to raise the issue with ELAS (iii) to understand the rationale for the policy and how it was communicated to policyholders.	Accepted part of maladministration but none of injustice. The Court did not require acceptance.		This allowed Chadwick to delay reserving for GARs.

⁵ Conflated request under findings 2, 4 and 5 taken from Annex A of Chadwick's Advice.

⁶ Annex A of Chadwick's advice.

<i>Ombudsman's findings of maladministration</i>	<i>Government's response</i>	<i>Revised terms of reference for Chadwick setting out the Government's acceptance of injustice</i>	<i>Comment</i>
4. GAD failed to scrutinize regulatory returns for each year from 1994 to 1996 re: (i) the strength of the valuation rate of interest for discounting liabilities (ii) the affordability and sustainability of bonus declarations (iii) changes to assumed retirement ages (iv) holding of no explicit reserves for capital gains tax, pension mis-selling costs, and GARs.	Accepted maladministration but not injustice re (i) and (ii). Accepted maladministration but not injustice re (iii). Accepted maladministration and injustice re (iv) relating to the GAR reserve but not the other parts of (iv). Qualified acceptance of injustice by claiming that the GAR reserve should be "of a modest amount". Blamed inadequate returns by ELAS which did not disclose GAR situation fully in years following 1990. Did not accept maladministration re reserves for CGT and mis-selling.	Accepts maladministration that led to injustice, in respect of (i) and (ii). Regarding (i) (ii) and (iv) the Government seeks Chadwick's advice on how different the returns might have looked "if the maladministration accepted by the government had not occurred".	
5. GAD failed in relation to regulatory returns for 1995: (i) to check that ELAS's valuation was greater than the minimum required by Regulations (ii) to do anything when aware that Standard & Poor's was misconstruing the returns and overstating the financial strength of ELAS.	Government initially accepted part of maladministration but none of injustice. Forced by Court to accept injustice in respect of both parts. Asked Chadwick to advise re its "nature and extent".	Accepts maladministration and injustice in respect of (i) and (ii). Seeks Chadwick's advice on how different the returns might have looked "if the maladministration accepted by the Government had not occurred".	
6. The FSA failed to ensure that a reinsurance treaty credited as nearly £1 billion in the returns for 1998 (i) was <i>not</i> taken into account in the 1998 returns without a concession. (ii) did not reflect the "economic substance of the treaty"—it was valueless.	Accepted finding of maladministration and injustices, but claimed ELAS could have explored other options. (In fact they were unrealistic).	Accepts "In relation to injustice... because the regulator permitted credit to be taken for the reinsurance treaty, Equitable Life's returns gave a materially misleading picture as to its insolvency".	Although the Government accepted the finding Chadwick "retried" it and rejected it.
7. The FSA failed to ensure proper disclosure in the returns for 1998 and 1999 of the potential consequences of losing the Hyman litigation.	Accepted maladministration but on a more limited basis in any event no finding of Parliamentary Ombudsman of injustice.		Parliamentary Ombudsman considered this was covered by #6, so no additional finding of injustice.
8. The FSA failed to record its decision to permit ELAS to remain open.	Accepted maladministration.		Not relevant.
9. That decision was unsound following the loss of the Hyman case.	Accepted maladministration with caveats. Did not accept that any injustice could have resulted from the maladministration. in any event no finding of Parliamentary Ombudsman of injustice.		Parliamentary Ombudsman considered covered by #6, so no additional finding of injustice.
10. The FSA provided optimistically misleading information about ELAS's solvency position after it closed for new business.	Accepted maladministration and injustice with caveats. The Government indulged in word play to provide slimy slither room.	Accepts the finding of injustice but believes the numbers affected are small.	

DECIMATING “RELATIVE LOSS”

The table below shows an example of a typical policyholder who invested £10,000 in an Equitable pension policy at the beginning of 1995. By December 2000 the total policy value had grown to £16,531. On 16 July 2001 it was cut by 16% (£2,645) leaving £13,886, which was taken on a contractual exit without suffering any penalty. If the person had invested in Elsewhere Life, the fund would have been worth £18,668. The rows 1 to 6 show how Chadwick got from relative loss to his advice figure for the policyholder. The two right hand columns show Towers Watson’s aggregate amounts provided in their letter to Mark Hoban of 21 July 2010 and how they got from their under-estimate of relative loss of £4.0–4.8 billion to Chadwick’s advice figure of £4–500 million.

	<i>Typical Example</i>	<i>Towers Watson Aggregate Range</i>	
		<i>From</i>	<i>To</i>
	<i>£</i>	<i>£m</i>	<i>£m</i>
The Ombudsman’s concept of “Relative Loss”			
What (s)he would have got from Elsewhere Life	18,668		
What s(he) did get	13,886		
1. Relative Loss	4,782	4,000	4,800
Chadwick’s concept of “Absolute Loss”			
What (s)he would have got if the 16% cut had not occurred	16,531		
What s(he) did get	13,886		
2. Absolute Loss	2,645	2,900	3,700
Chadwick’s concept of “External Relative Loss”*			
3. The lesser of stage 1 and 2	2,645	2,300	3,000
4. Application of Chadwick’s discount (approx 79%) derived from the Reconstruction.			
	529	475	650
5. Chadwick’s concept of “Internal Relative Loss”, which was actually a profit.			
	(134)	(124)	(162)
6. Include an “allowance” for “Internal Relative Loss” to give Chadwick’s advice.			
	421	400	500

A full explanation of the meretricious concepts of Absolute Loss, External Relative Loss, Chadwick’s discount, and Internal Relative Loss are provided in our Critique.

APPENDIX

**Letter from Chair of the Committee to Paul Braithwaite, General Secretary,
Equitable Members Action Group, 20 September 2010**

EQUITABLE LIFE: PASC INQUIRY

As you may know, during the Second Reading debate on the Equitable Life (Payments) Bill the Chair of the Public Administration Select Committee, Bernard Jenkin, announced that the Committee intends to hold a further, very short inquiry into the Government’s response to the Ombudsman’s recommendation on Equitable Life as soon as the House returns in October in order to elucidate the exact differences between the Ombudsman’s recommendations, Sir John Chadwick’s report and the Government’s view.

The Committee would welcome a short written submission from EMAG to this inquiry. I note that you have already made a submission to HM Treasury on 6 September. Would you be content for the Committee to draw on this for their inquiry?

If instead you wish to provide a specific memorandum to the Committee I would be grateful for a short submission to be with me by Friday 1 October.
20 September 2010

Written evidence from Mark Hoban MP, Financial Secretary to the Treasury

Before my appearance in front of the Public Administration Select Committee, and following your letter of September 2010, I thought it would be helpful if I set out for the Committee the differences as I understand them between the approach of the Parliamentary Ombudsman and that of Sir John Chadwick. I will also set out my strategy for achieving a fair resolution on Equitable Life and the framework that is guiding the decisions that the Government will take on Equitable Life at the Spending Review.

In our programme for Government, we stated that we would “*implement the Parliamentary and Health Ombudsman’s recommendation to make fair and transparent payments to Equitable Life policy holders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure.*”

THE DECISION TO ALLOW SIR JOHN CHADWICK TO COMPLETE HIS REPORT

When I took on my role as Financial Secretary to the Treasury, this was one of the most complex and pressing issues that I was responsible for. My approach to this issue is guided by the principles that the Parliamentary Ombudsman set out in her report—namely that the scheme should be independent, transparent and simple. I have been faced with a series of decisions about how to take forward this issue given that over two years has passed since the Ombudsman published her report.

The Ombudsman herself recognised that her report could not be directly translated into the design of a payments scheme, so she proposed that a tribunal be set up for “*assessing the individual cases of those who have been affected by the events covered in this report and providing appropriate compensation.*”⁷ The previous Government decided not to take this route and instead commissioned Sir John Chadwick to undertake work on determining the extent of relative losses suffered by policyholders.

From the beginning, there were calls from various parties asking me to either dismiss the Chadwick process entirely, or amend Sir John’s Terms of Reference from those set by the previous administration. I considered these options carefully and decided to allow Sir John to continue his work as planned. If I had followed this advice to either scrap Sir John’s work and establish the tribunal or revise Sir John’s terms of reference I believe this would have created an unacceptable delay in resolving this issue.

Although the Ombudsman set out a way forward, her report did not provide a detailed basis for calculation of loss. She envisaged that the tribunal would do this, but in its absence, Sir John’s work has helped to address some of the issues which needed to be resolved so that there was a sound basis for the calculation of individual losses. Elements of Sir John’s work enabled our actuaries to produce the first bottom-up calculation of losses. To disregard Sir John’s work in its entirety, therefore, would mean that it would have had to have been undertaken once more from scratch.

Sir John also devised an alternative approach to calculating loss. Using an extensive database provided by Equitable Life, this approach looks at policyholder classes to determine how to calculate loss rather than trying to ascertain at an individual level whether policyholders relied on regulatory returns, as the Ombudsman envisaged (in the absence of the Equitable Life database available to Sir John). Regardless of whether Sir John’s work is used, there was always the need to gather the detailed information needed for the scheme and interpret it into a functional scheme.

On 22 July 2010, I published Sir John Chadwick’s advice on calculating losses, the extensive actuarial advice underpinning it, and all the representations he has received from interested parties.

SIR JOHN CHADWICK’S METHODOLOGY

I think it would be helpful for me to give a brief overview of Sir John’s methodology.

Sir John sought to establish the payment required to “*put those people who have suffered a relative loss back into the position they would have been in, had maladministration not occurred*”, as the Ombudsman recommended.⁸ He understood the Ombudsman to have meant, by “relative loss”, whether “*complainants suffer[ed] a loss that they would not have suffered had they saved or invested elsewhere*”.⁹

1. In order to assess relative loss, Sir John first assesses the loss which policyholders actually suffered (“absolute loss”). Having regard to the Parliamentary Ombudsman’s report, where she states:

“*...the fact that those who are, or were at the relevant time, members of the Society underwent the series of policy value and bonus cuts during the period after it closed to new business...is sufficient evidence in my mind to persuade me to conclude that...financial loss has been sustained...*”¹⁰

⁷ Ombudsman’s report, Chapter 14, paragraph 138

⁸ Ombudsman’s report, Chapter 14, paragraph 395

⁹ Ombudsman’s report, Chapter 14, paragraph 33

¹⁰ Ombudsman’s report, Chapter 14, paragraphs 31, 32

Sir John assesses absolute loss as the reduction in the amount which Equitable Life had promised to policyholders, which was imposed as a consequence of the reduction in policy values in July 2001.

The actuaries, Towers Watson, have estimated this as £2.9–3.7 billion.

2. Sir John then goes on to identify what he calls external relative loss—that is the difference between the returns that policyholders actually received from their Equitable Life policies and the returns they would have received if they had invested in a comparable product in an alternative life assurance company. This step produces a figure of £4–4.8 billion.

There is considerable consensus around the main tenets that produce this loss figure. That is not to say that all interested parties are signed up to every detail and assumption underlying it, but they have generally recognised the comparators chosen to reach it as being appropriate. The figure produced represents the actual financial loss suffered by policyholders as well as loss of opportunity to realise gains elsewhere.

3. For some policyholders, their external relative loss is greater than their absolute loss. This is because of the strong performance of comparable companies. Sir John has proposed that external relative loss should be capped at the absolute loss. The principle behind this is to deliver fairness for the taxpayer. Sir John argues that it would be unfair to the taxpayer for policyholders to be paid more through redress than they have actually lost. As he states in his report, this approach:

*“...would restore to the policyholder (in whole or in part) the loss which he has suffered as a result of the post-closure policy value cuts; but it would not give him the full benefit of gains that he would (or might) have made, had he made his investment elsewhere”.*¹¹

This step produces a figure of £2.3–3 billion.

I am aware that there are some disagreements over the start date used to reach these figures due to the availability of data. However other than that issue, the steps outlined above and the figures that stem from those steps are not reliant on the acceptance or rejection of the Ombudsman’s individual findings, as they stem from factual calculations, not judgements based on her findings.

At this point, we move onto the more subjective and controversial elements of Sir John’s advice. These areas are based on the partial acceptance of the Ombudsman’s findings by the previous Government and they form the basis of Sir John’s Terms of Reference.

4. Sir John believes that had Equitable Life been properly regulated, some policyholders would have invested elsewhere, but some would have not. The Equitable Members Action Group has agreed with this general concept. However, it is not possible to know at an individual level exactly which policyholders would have invested elsewhere and who would have stayed.

Quantifying how much investment would have fallen by is therefore a matter of judgement. From his detailed analysis and the expert actuarial support he has received, Sir John concludes that the majority of policyholders would have made the same investment decision, even if Equitable Life had been properly regulated. He therefore proposes that policyholders should receive 20–25% of their capped external relative loss. This results in a figure of £475–650 million.

This has proven to be very controversial. Representations I have received have shown that many people feel that the majority of policyholders would not have made the same decision in staying with Equitable Life and/or investing new money in the Society.

5. Finally, Sir John looked at the returns which those policyholders who would have stayed with Equitable Life would have received if it had been properly regulated. He called this internal relative loss. Including this in the calculation brings the aggregate relative loss figure according to Sir John’s methodology to £400–500 million.

This reduction in losses reflects the fact that during the relevant period, some policyholders suffered both losses and gains as a result of the maladministration, in particular through the payment of high bonuses in the early 1990s. Sir John has argued that these should be offset against each other where possible.

STEPS TAKEN FOLLOWING PUBLICATION OF SIR JOHN CHADWICK’S ADVICE

Following publication of Sir John’s advice, I announced that I would carefully consider the report and listen to representations from interested parties on the next stage of the process.

While parts of Sir John’s advice are contentious, it is clear to me that there are parts of his work and that of Towers Watson that are essential to establishing this scheme. Sir John’s alternative approach provides a mechanism to establish a scheme that is administratively simple, and the bottom up loss figures are important for us to have regardless of the shape of any scheme.

¹¹ Sir John Chadwick’s report, Part 1, paragraph 1.24

I can understand why there has been disagreement by some parties with regard to steps 4 and 5. These are the steps that are influenced by Sir John's restricted terms of reference, are most based on subjective judgement and where there is room for the greatest disagreement. Sir John carried out his analysis and evidence-gathering and came to the view he did while others have undoubtedly come to a different conclusion. Step 4 in particular has been one which representations I have received have been most forthright in criticising.

As the Ombudsman noted in her report, it is appropriate to consider the impact of the payment scheme on the public purse. The scheme will be a significant spending commitment for this Government and as such, I felt that it would be best to consider the amount affordable for the scheme as part of the Spending Review. It is important, particularly in these times when difficult decisions need to be made with respect to the country's finances, that we carefully balance, in the Ombudsman's words "*fairness both to those affected and to taxpayers generally*".¹²

I have always made it clear that I would not just blindly follow Sir John's advice. I have stated that it is a building block in our approach and I stand by this. We have taken other steps towards finding a resolution to this issue. A good example of this is the establishment of the Independent Commission on Equitable Life Payments Scheme to provide advice on the best way to allocate payments and this reflects the Ombudsman's call for any scheme to be independent of Government. The Commission—comprised of Brian Pomeroy, John Tattersall and John Howard—has begun work and is meeting with interested parties to listen to their views on the principles to be applied in fairly allocating funds and any prioritisation of payments. To enable payments to begin as soon as possible, I have asked the Commission to report in early 2011.

Since this Government was formed, we have also introduced and had the Second Reading of the Equitable Life (Payments) Bill. This Bill authorises the Treasury to incur expenditure, and make payments to those adversely affected by the Government's maladministration of Equitable Life Assurance Society. This is an important and necessary step in resolving this matter. The fact that we have taken it so swiftly shows just how important this issue is to us.

Further, we have made good progress on understanding the losses suffered at a policyholder-by-policyholder level, to understand the distribution of losses and where they have had greater impact on individuals. Over the summer, Towers Watson have been carrying out work to further refine the figures provided on 20 July to include data from 2009. This will allow updated figures to be provided at the Spending Review.

The Equitable Life issue is a complex one and there are no simple answers on how best to resolve this matter. The Parliamentary Ombudsman has provided the overall guiding principles of independence, transparency, and simplicity which I have put at the heart of my approach to finding a resolution. In recognition of the long wait policyholders have had I have also added swiftness to those principles. I did not believe when I took on my current role that starting from scratch was an option, so I think it is important to use elements from Sir John's work which develop the thinking underpinning the Ombudsman's recommendations. There has been some disagreement over aspects of his work, in particular areas that have required a subjective judgment. This is to be expected in a matter as emotive as this. However, my job is to be objective with the views and information that I been provided and find a way forward that is fair to both taxpayers and policyholders alike.

October 2010

APPENDIX

Letter from Chair of the Committee to Mark Hoban MP, Financial Secretary, HM Treasury, 10 September 2010

EQUITABLE LIFE

I wrote to you on 30 July following your statement to the House on 22 July and the Ombudsman's letter to colleagues of 26 July in which she concluded that Sir John Chadwick's proposals seemed to her to be an "unsafe and unsound basis on which to proceed".

As I said in my letter, our predecessor Committee took a very close interest in this matter and shared her apprehension about the way in which the previous Government had responded to her recommendations.

I understand that you have been meeting with the main interested parties in advance of the Second Reading debate of the Equitable Life (Payments) Bill. As you are well aware there is also much concern among colleagues in the House on behalf of those of their constituents who have been adversely affected by the events surrounding Equitable Life.

¹² Ombudsman's report, Chapter 14, paragraph 143

It would help Members, in advance of the announcements in the Spending Review next month, and no doubt having heard views from colleagues at Second Reading, if you could come before the Committee and explain the approach you have been considering with regard to fulfilling your commitment to implement the Ombudsman's recommendations and to make fair and transparent payments to Equitable Life policyholders.

It would be helpful too if, in advance of that session you could set out that approach to us in writing, in particular the differences between the Ombudsman's recommendations and Sir John Chadwick's recommendations, and how you intend to reconcile these differences.

The Clerk of the Committee will be in touch with your office shortly with a formal invitation for early October.

I am also writing to Ann Abraham and to Sir John Chadwick with a similar invitation.

Written evidence from Equitable Life Trapped Annuitants (ELTA)

At the request of Mr Bernard Jenkin, Chairman of PASC, and in light of the timescale involved, this submission is confined solely to the most unsatisfactory headline issues in respect of the current position and a brief outline of the unique aspects of the With-Profits Annuitants (WPAs).

1. CHADWICK REPORT

1.1 It is a widely held view that the Chadwick Report is a product of his restricted Terms of Reference rather than a basis to implement the Parliamentary Ombudsman's recommendations. This is recorded clearly in his Report and within the Actuarial Advice provided to him by Towers Watson. It is also recorded that Sir John Chadwick set further parameters on Towers Watson to govern the actuarial advice that they supplied to him.

The Ombudsman's letter to Sir John dated 20 August 2009 stated "As I see it, any limitations that you might feel constrained to impose regarding eligibility for the payments to be made to those affected by the Equitable Life affair do not derive from the nature of my findings and recommendations. Any such limitations instead derive directly from the limited approach adopted by the Government in its response to my report."

1.2 It is clear as a result that generally (and in particular due to those restricted Terms of Reference) the outcome of Sir John's Report does not reflect the intention of the Parliamentary Ombudsman who has commented most damningly:

"In light of the new Government's commitment to implement that recommendation in full, the approach embodied in the Chadwick report . . . cannot provide a basis for the implementation of my recommendation." (Parliamentary Ombudsman in letter to Members of Parliament 26 July 2010)

1.3 Further, she has stated that Sir John's proposals "if acted upon, would not in any sense enable fair and transparent compensation to be delivered." (*ibid*)

1.4 Additionally, she has recorded that the Chadwick report "misinterprets central parts of the conclusions outlined in my July 2008 report and has ignored others" and "the Chadwick proposals seem to me to be an unsafe and unsound basis on which to proceed". (*ibid*)

1.5 It is also clear that the Coalition Government has repeatedly stated that it is committed to the implementation of the Parliamentary Ombudsman's recommendations:

"We have been clear in our support for the Ombudsman's recommendations. That is our position today and would be our position if elected at the next general election." (Mark Hoban MP in the Opposition Day Debate 21 October 2009)

"We are committed to implementing the Parliamentary Ombudsman's recommendation." (Mark Hoban MP 22 July 2010)

1.6 In contrast, an implementation of the Chadwick Report and the resulting discounted compensation levels set out in Towers Watson's letter to the Treasury dated 21 July 2010 will not bring matters to any form of satisfactory conclusion and will be challenged as a clear failure to implement both the Parliamentary Ombudsman's recommendations and the Government's pledge to do so.

It must surely be in the interest of the Coalition Government to bring this matter to a close. The advice set out in the Chadwick Report will not meet that fundamental criterion.

2. POSITION OF THE WITH-PROFITS ANNUITANTS (WPAs)

2.1 As at 31 December 2000, it is recorded that there were 68,000 With-Profits Annuity policies out of a total of over 1.3 million. This appears a small number but the position of the WPAs is important firstly because of the unique nature of their purchase and secondly the size of their losses (which is referred to below under Headline figures).

2.2 There are specific issues related to With-Profits Annuity policies. The purchase of such a policy was an irreversible transaction with retirement monies intended to produce a level of income for the balance of the WPA's life in circumstances where ordinarily there would be no opportunity to supplement any shortfalls in income from future employment. The WPAs are all elderly—with the significant majority in their mid to late 70's and older.

2.3 Sir John Chadwick accepts that the WPAs have been disproportionately affected and that their position is particularly compelling—see the references in his report for instance at point 4.80 (page 130), point 7.71 (page 186), point 9.8 (page 196), point 9.13 (page 197), point 9.15 (page 198), point 10.26 (page 207) and footnote 936 (page 207).

2.4 The disproportionate impact and their unique position surely must be beyond serious contention. The idea of “shaving” their true relative loss as has been done in the Chadwick Report by the adjustment of the parameters of the Parliamentary Ombudsman's recommendation cannot be acceptable to any fair minded person—particularly in light of their irreversible position and the importance of Equitable's financial status to them.

The WPA's occupy a special and unique position amongst the policyholders of Equitable Life and merit special and unique treatment to address their losses.

3. HEADLINE LOSS FIGURES

3.1 Towers Watson provide a headline loss figure of £4 to £4.8 billion. This is the only worthwhile figure provided. All other figures are a consequence of the adjustments in the Chadwick Report. It is understood that the WPAs component of that figure is around £650 to £750 million.

3.2 Indeed, the insanity of the restrictions to which Chadwick has been working result in around 30% of With-Profits Annuity policies (19,490 pre-dating the 1992 cut off) not being included in that figure and not getting any compensation at all. It must be remembered that the Parliamentary Ombudsman advised Sir John Chadwick that:

“In essence, the view expressed in my report is that, absent the serial maladministration I had determined occurred from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period—going instead to another life insurance company.”
(Parliamentary Ombudsman in letter to Sir John Chadwick 20 August 2009)

3.3 Further the WPAs who purchased With-profits Annuity policies pre-dating 1991 have also suffered significant losses as a result of the maladministration (as illustrated by relative performance against the Prudential with-profits annuity in the relevant later years) because they were trapped within the product and could not escape the effect of that maladministration.

Therefore adjusting for those policies omitted as a result of the Chadwick process produces a headline figure (assuming that the Towers Watson calculations are correct) of approx. £1 billion.

3.4 According to these figures, the WPA's represent approx 6% of the policyholder community but approx 25% of the relative losses. This clearly illustrates the significance of With-Profits Annuity and why it can be stated that they are disproportionately impacted by the maladministration. It must be recalled that the Parliamentary Ombudsman has made it entirely clear that the interpretations that she intended to omit some policyholders from her recommended compensation are entirely misplaced.

3.5 Towers Watson have provided some sample calculations to ELTA's representatives following our recent meeting. However, there are queries outstanding on various assumptions that TW have to make which would allow those sample calculations to be considered more fully. These include:

- (i) Mortality assumptions;
- (ii) the critical assumptions that have to be made about the Future Bonus rate declarations by the Prudential, both for the ELAS sub-fund (within which the ex ELAS annuities are held.) and the Prudential With Profits fund and similarly for the Scottish Widows; and
- (iii) What discount rates that should be applied to future losses.

3.5 Even apparently small changes in the assumptions of these values have a profound impact on the loss calculations.

3.6 The methodology adopted to headline loss appears reasonable subject to further consideration but the final position cannot be judged until that further information is supplied. Clearly, this cannot be a fair and transparent process unless and until sufficient detail is supplied to truly judge the calculations made.

It cannot be considered fair or reasonable that some WPA's who purchased their annuities before the so-called cut off date and who have suffered equally with all other WPA's should be denied any share of the compensation payment.

October 2010