



“Unsafe and unsound”

a critique of the Chadwick Report

A paper by Alex Henney, Director of EMAG, September 2010

EXECUTIVE SUMMARY AND INTRODUCTION

In her massive report “Equitable Life: a decade of regulatory failure” (July 2008) the Parliamentary Ombudsman (Parliamentary Ombudsman) Anne Abraham, found ten cases of maladministration by government regulators and the Treasury’s agent the Financial Services Authority (FSA), and she found extensive injustice which resulted either in direct financial loss or “loss of opportunity”. She recommended that the government should establish a scheme “to put those people who had suffered a *relative loss* back into the position that they would have been in had maladministration not occurred” (italics added). **She implicitly endorsed EMAG’s estimate of £4.8bn of relative loss**, which the Treasury’s own actuaries¹ Towers Watson have broadly confirmed.

The discredited Labour government responded in January 2009², rejecting most of the cases of injustice which cut out about 90% of the relative loss, and appointed a retired judge, John Chadwick, to advise it on an *ex-gratia* payment scheme. EMAG took the government to a judicial review, which in October 2009 resulted in the government having to reinstate some - but not all – of the key findings of injustice. The government enjoined Chadwick to “disregard findings which are not accepted”, an instruction that had very significant implications for Chadwick in his report of 310-page report backed with four hundred more of actuarial material published on 22 July 2010³. Chadwick – acting as an advocate for the government, not as an independent judge - knew what the piper wanted and decimated (in the Roman sense) the assessment of loss. He started by slicing the beginning and the end:-

- The Parliamentary Ombudsman determined that losses started from the second half of 1991. Chadwick contrived specious reasons for moving the date to 31 December 1992, **which cut the estimated relative loss by about £750m.**
- Although the government accepted the finding of maladministration with injustice regarding the phony reinsurance treaty, in an extraordinary and virtually incomprehensible piece of “reasoning”, Chadwick “retried” the issue effectively eliminating the consequences of a disgraceful regulatory failure.

He devised a spurious redefinition of the Parliamentary Ombudsman’s “relative loss” which he called “External Relative Loss”, and pretended this equalled her concept. **This manipulation reduced the loss to £2.3–£3.0bn.** He asked Towers Watson to reconstruct to his formula how Equitable might have performed had it been regulated without maladministration. This subjective and biased exercise assumed that the regulators would have been almost (but not quite) as pusillanimous as the maladministrative ones had been. The aim was to show that absent maladministration Reconstructed Equitable would have performed little differently because from what actually happened, because from the twisted logic he applied to assessing the supposed loss of policyholders, the smaller the difference the less would be his assessment of losses. And so the less the compensation from government.

¹ Towers Watson in a letter to Mark Hoban, 21 July 2010.

² The Government’s response to the Report of the Parliamentary Ombudsman’s Investigation, Cm7538, January 2009.

³ Advice to government in relation to the proposed Equitable Life payment scheme, J. Chadwick, July 2010. Advice to government in relation to the proposed Equitable Life payment scheme, J. Chadwick, July 2010.

From the Reconstruction he also devised another meaningless metric “Internal Relative Loss” which he pretended the Parliamentary Ombudsman would have developed but for “the fact that she was not able to make findings regarding the actions of persons other than the public bodies which she had investigated. This absurd surmise was typical of his too often outlandish “logic”.

Chadwick’s coup de grâce was then to guesstimate (i.e. to minimise) the proportion of policyholders who might have left the hypothetical Reconstructed Equitable, which was easy since it produced not dissimilar performance. So he was able to conclude “that there would have been some, but not a large, reduction in the extent of the new investment income”, which he estimated as 25% to 20% depending on the type of policy. He applied these factors *illogically* to External Relative Loss and 75% and 80% to Internal Relative Loss and added them together to arrive at **£4–£500m**

With two fabricated cumulative deductions of 45% and a further 80%, he gets from an estimate of relative loss of about £4.8bn, per the Parliamentary Ombudsman, down to his proposed compensation figure of £400–£500m. Chadwick explains the substantial divergence between his views and those of the Ombudsman thus: “*We have reached different answers because we have addressed different questions.*” But the question she was answering was what and how maladministration led to injustice, while he was answering how to come up with seemingly plausible reasons for cutting the government’s liabilities for its incompetence and misbehaviour.

The Parliamentary Ombudsman immediately wrote a letter to MPs on 26 July, 2010 in which she stated unequivocally that Chadwick’s report “would not in any sense enable fair and transparent compensation to be delivered”, and was “unsafe and unsound”. She also commented that “It misrepresents central parts of the conclusions outlined in my July 2008 report and has ignored others”.

This report aims to expose the dissembling and dishonesty of the Treasury. Mark Hoban has described the Chadwick report in Parliament as “challenging and complex”. It is so because its aim is not to develop the Parliamentary Ombudsman’s relatively straightforward concept of relative loss, but to devise a seemingly complex methodology to cut the assessment of loss. Furthermore, whether by intent to obscure or due to Chadwick’s limited expressive skills, it is badly written, with convoluted hair splitting mumbo jumbo, dense legal language and actuarial alchemy. Just as “a picture is worth a thousand words”, so in this type of analysis, expressing concepts algebraically and numerically, not only makes it easier for the reader, but also acts as a discipline on the writer. Perhaps the lack of clear numerical explanation is because Chadwick is not particularly numerate, nor familiar with money issues – or is it a clever intent to confuse? The main text of Chadwick’s document could have been written more clearly in at most half – if not a third – the length - *but then that would have clearly exposed its logical flaws.*

These are serious criticisms, which are not credible as mere generalisations. They must be substantiated in detail, which is the objective of this report. To that end, the critique is developed in moderate length in the main text and then supported in further detail by Annexes including one presenting the gibble-gabble of

Chadwick's ratiocination, which has to be read to be believed (Annex 5). Although they are not a light read, the reader can be assured they are much less tedious than Chadwick's turgid tome – any doubting Thomas can go to http://chadwick-office.org/downloads/Sir_John_Chadwick_Advice.pdf to remind themselves!

The publication of Chadwick's document together with its backing material does no credit to the Treasury, some of whose officials cannot be but aware of its shortcomings. They know full well that most MPs and journalists will not read it but will instead be impressed by its weight and the number of pages (2,200), and of those who do try to read it very few will be able to understand it. We imagine it has been published as a smokescreen, in order to claim that a detailed, complex and, by insinuation objective, study has been undertaken which shows that claims by EMAG that Equitable policyholders lost in the order of £5bn are bunkum, and the real figure is a fraction of this sum. But it is Chadwick and those officials on cost indexed pensions who are peddling bunkum.

The main report comprises five sections:-

1. The Parliamentary Ombudsman's recommendation of Relative Loss as a basis for compensation
2. The Government's Response – the first slice
3. Chadwick begins slicing
4. The "Reconstructed" Equitable
5. Decimating "Relative Loss" in easy stages

There are seven annexes:-

1. The Parliamentary Ombudsman's Findings of Maladministration; their consequences and her findings of injustice
2. The Government's Response to the Findings
3. Chadwick's Disposal of Finding 6
4. The Fabrication of a "Reconstructed" Equitable
5. The semantic travails and travels of "Absolute Loss" and "Relative Loss"
6. Redefining "Relative Loss" and contriving "Internal Relative Loss"
7. The Coup de Grâce