

Towers Watson’s “relative loss” figures are flawed because they are based strictly on Sir John Chadwick’s template, NOT the PO’s.

Introduction

The letter from Towers Watson (TW) to Mark Hoban of 21st July purports to establish from data supplied by Equitable Life, bottom up, what is the true “relative loss”. It reports the figure to be between £4 and £4.8 billion, before it goes on to quantify the various slicing devices that Chadwick has invented beyond the intentions of the Parliamentary Ombudsman (PO).

EMAG believes that the PO’s damning letter to all MPs (www.emag.org.uk/documents/AA2MPs26July10.pdf) of 26th July, describing Chadwick’s report as “unsafe and unsound”, renders it a dead duck which should be discarded. It is inappropriate even as a building block for determining compensation to Equitable policyholders.

But, over and above Chadwick’s shabby, obfuscatory and irrelevant inventions it is vital to understand that Towers Watson’s calculation of “relative loss” is built on the quicksand of Chadwick’s model. His hybrid definition of “relative loss” is very far from complete. This is because it simply does not include or quantify all the PO’s findings, and the start date is 18 months later than the PO and the Divisional Court instructed – thus the figure of £4.8 billion is only a partial quantification.

Ten reasons why the TW figures are flawed:

1. The fundamental point is that “The Chadwick Process” was designed for a different purpose. It was the Labour Government’s device to advise the Treasury on a hardship scheme for Equitable savers who were “disproportionately impacted” and, crucially, only to address those findings that Labour had accepted.

Sir John himself explains at his para 7.6.6 why there is such a substantial divergence between his views and that of the PO: *“We have reached different answers because we have addressed different questions.”*

But the Coalition’s agreement of 11th May 2010 was: *“We agree to implement the Parliamentary and Health Ombudsman’s recommendation to make fair and transparent payments to Equitable Life policyholders...”*. This rendered Chadwick’s remit obsolete and irrelevant, though the Treasury chose to allow it to run its course and granted Chadwick a delay of seven weeks for no reason with absolutely no changes to the terms of reference, for reasons one can only speculate upon.

2. The PO proposed “relative loss” as the measure of compensation - defined simply as being what a policyholder has lost from investing in Equitable compared with what he/she would have received from investing in another average company (with the same investments and timing). Chadwick has claimed that “relative loss” should be severely limited in a way which he dubiously claims is implicit in the PO’s report but he gives no other reason for this suggestion. The PO has since roundly condemned Chadwick’s interpretation.

3. Chadwick's advice is based upon only a subset of the findings of the PO. He himself admits that he has, in consequence, come up with completely different answers from what the PO recommended. 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.*" (7.6.6).

4. Chadwick's terms of reference from the last Labour government required him to reject key findings of the PO. For example, one of the most important elements of regulation was that each company was to employ an Appointed Actuary – a role "central to the financial soundness of life companies in the UK". It was his job to ensure that the company was run with all due regard to prudential regulation and in particular to have regard to policyholders' reasonable expectations (PRE). It is obviously necessary that the Appointed Actuary should have a measure of independence from the management of the company. Combining this role with Chief Executive, as happened with Equitable for six years from 1991, was wholly wrong and should have been rejected by the regulators. This was the PO's first finding of maladministration but it was inexplicably rejected by the Labour government. This rejection inevitably leads to Chadwick not even considering the finding, partly explaining Chadwick's different conclusions from the PO - in particular her view that the failure of regulation started in 1991.

5. Other findings by the PO have been rejected, the most astonishing being the one regarding the (arguably

fraudulent) reinsurance treaty, which was accepted by the Labour government. But Chadwick has taken it upon himself to reject this, claiming that he was authorised by the judgement in the recent Judicial Review so to do. In making the finding the PO wrote that it was so serious that anyone investing or remaining with Equitable after 1st May 1999 should be compensated in full. Chadwick's unilateral and unfounded rejection of that finding means that group of investors would, under Chadwick's proposal, receive only a very small proportion of what the PO ruled they should get.

6. Despite the judgement in the Judicial Review (October 2009), which stated that compensation should commence with money invested from July 1991, Chadwick has decided that the start date should now be 31st December 1992 - claiming that loss of data dictates this. EMAG has recently been assured that the majority of the data is retrievable. Furthermore, Chadwick could have extrapolated backwards for 18 months in exactly the same way as he has done forwards for the decade following.

7. The final absurd conclusion by Chadwick is that there was really nothing wrong with Equitable that would have justified firm action by the regulators and that it would have collapsed anyway in the year 2000. This raises the question as to what purpose the regulators serve in his peculiar vision of the "Reconstructed Equitable Life" (REL) in the 1990s, on which he bases that conclusion. It is quite clear that Equitable finally collapsed because the regulators had allowed it for many years to over-

bonus and not to make proper reserves for its guaranteed annuities. It was a Ponzi scheme, where the regulators could and should have interceded forcefully - and should (arguably) have stopped Equitable selling new policies by mid-1993. If one reads Chadwick's "Supplementary Material (sections VIII to XII) ", it is patently clear that the society and all of the half dozen individuals who did engage with his process were universally opposed to his Reconstructed Equitable Life.

Notwithstanding, Chadwick believes his invented REL justifies a deduction of an astounding 75% to 80% of any compensation! This, despite the fact that the vast majority of the incremental £20 billion invested in the 1990s came in from new investors who would certainly not been tempted to invest in Equitable had they known of the capital weakness of the society.

8. Nowhere in the 2,147 pages of Chadwick's advice are there any figures showing what amount the policyholders have actually lost. Once Equitable had given the Treasury details of premiums paid over the years it should have been a simple exercise for Towers Watson, the actuaries advising Chadwick and the Treasury, to calculate the true overall loss by policyholders, per the PO. EMAG has repeatedly asked in writing for these figures and how they are composed but they have been withheld. So much for the promised transparency.

9. What has been provided is the ten-page letter from Towers Watson to Mark Hoban of 21st July. It gives totals specifically based on Chadwick's limited and incomplete findings but with absolutely no indication as

to how these totals have been calculated. A figure for “relative loss” of between £4 and £4.8 billion has been given, based on Chadwick’s hybrid concept. This happens to be close to the estimate made by EMAG three years ago, which was incorporated into the PO’s report. But there is no explanation as to how it is calculated. For example, have TW included penalties for early leaving - which would be inappropriate. Contrary to the requirement of the Divisional Court, it appears that the first 18 months of investments have been totally ignored and “relative loss” has been calculated with a starting date of 31st December 1992. EMAG has repeatedly asked for details but this has been treated with contempt by Mark Hoban in his letter to EMAG of 5th August: *“The Government has been completely transparent about how the figures have been calculated”*. That is simply not true. There is neither calculation nor explanation in either the Chadwick advice or the letter from Towers Watson.

10. The remainder of the letter from Towers Watson to Mark Hoban of 21st July is largely incomprehensible. But as Towers Watson themselves say ***“If it [the assumptions] is not accepted, the bonus rates, policy value cuts and consequential losses have no basis, given their derivation from the returns reconstructed on these assumptions”***.

EMAG believes the TW figures to be highly questionable because they are based on a single carefully selected set of assumptions. To cite one example: TW has assumed a 2% deduction for expenses in respect of the average of companies against which

Equitable is being compared. In fact 1% would be more appropriate. That seemingly insignificant extra 1% reduces relative loss by some £1 billion!

Surely TW should have quantified a range of assumptions and different outcomes? But TW has been asked to quantify ONLY the one single loaded set of Chadwick's specific assumptions – with no prerogative for them to go beyond.

This is disgraceful and dishonourable when taken in the context of the Coalition's promise to: “agree to implement the Parliamentary and Health Ombudsman's recommendation to make fair and transparent payments...”

A calculation of "relative loss" based on ALL the PO's findings, from the correct start date with proper deduction for expenses should be commissioned from Towers Watson, unfettered by Chadwick's dodgy assumptions. The figure would be considerably higher than £5 billion.

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