The Croft,
10 Chapel Lane,
Old Dalby,
Leics LE14 3LA.

Sir John Chadwick & Laurence Emmett,
The Office of Sir John Chadwick,
One Essex Court,
Temple, London EC4Y 9AR.

info@chadwick-office.org June 14th 2010.

Advance copy by e-mail.

Dear Sirs,

Thank you for sending me copies of Sir John's letter to the Economic Secretary to the Treasury [1] and Towers Watson's latest model [2] both dated May 25th 2010. You have thereby decided that any regulatory counterfactual model has to be somewhat more rigorous than was the contemporary regime. Following on from that, in accordance with IR3 para 2.24 [3], you have elected to take into consideration The Equitable's entire business in accordance with Policyholders' Reasonable Expectations (PRE), but reliant on the false assumption that the true nature of the Society's business was correctly disseminated and properly understood. As we shall see, the belated counterfactual imposition of PRE this involves is essentially cosmetic, in that it corrects the practical policy and stated intention of the Society in accordance with "With Profits Without Mystery" (WPWM) [4] of which policyholders were unaware to the detriment of both existing and new policyholders. And because the counterfactual model fails in much the same way as the Society did, it does not address considerations of Sound and Prudent Management (S & PM), even if it could be held to increase the extent to which it can be considered to meet the broad scope of the European Third Life Directives. Even so, because S & PM should be the overriding consideration in assessing the behaviour of prudential regulators this is incongruous. *But that in turn means that you have elected to ignore your correspondents' amply supported assertions that absent maladministration ELAS would have been radically different [5]. De facto* that invalidates any dependently ignorant counterfactual model.

The approach does, however reflect that considerations of the permissible bounds of regulation (cf. IR3 para 6.4 [3]) also require a tightening of the counterfactual model on the regulatory if not the Society's side of things. But as we have previously seen para 6.4 is dangerous ground because it does not define the permissible bounds of regulation [6] and so the question is by how much standards should be raised. In this respect you have very lately opted for the standards of contemporary actuarial custom and practice as determined by your expert panel. In view of the many and often repeated reservations abut this that have been expressed by policyholder advocates during their long dialogue with you this must be considered unsatisfactory. *Quite simply, the new standard is not high enough.* In this regard you have recently opened a route for retraction of your previous notion of early closure to new business as the basis for counterfactual reconstruction on the grounds that the duties of the regulator could be more to existing policyholders than future ones [7]. You know I contest this [6], *to which we may add that, if the aim of the prudential regulators was to keep ELAS afloat at any cost, then they were not properly observing their duties either to existing or new policyholders. It is therefore a mistake to use a counterfactual reconstruction which condones this sort of behaviour. Though it starts against the grain of a suspect mindset, in the longer term it runs with it and is thus intrinsically unsound overall.*

The third model's strictly limited assumptions have also had to ignore that the Appointed Actuary formed part of the regulatory system, and therefore do not take the Parliamentary Ombudsman's first finding of maladministration into consideration. And as we shall see, the model's justification as a technical exercise is almost entirely dependent upon the artificial limitations and remarkable peculiarities of the Parliamentary Ombudsman's Second Report (PO2) [8]. Moreover its fundamental assumptions require you to set aside the PO's later observations that, absent maladministration, nobody would have invested in the Society absent maladministration during the reference period of her investigation. *In essence her statement contradicts not only the central assumption for the model, but also the rationale for a Head B loss comparator and your latest proposals for pursuing Head B loss on that basis.*

All this aside, the most immediate problem is that, despite your personal endorsement of Towers Watson's latest counterfactual model, it gives rise to almost exactly the same fundamental objections as its predecessors, and can be demolished in the same way. In the conclusion of my urgent response follow up letter of April 7th [5] the position was summarised thus: *"It has been established that no reasonable person would have agreed with the amoral and even fraudulent position which the Treasury contends is no more than a routine business decision. Irrespective of the fact that the Treasury's contention introduces conduct of business matters, that amoral position could only have gained acceptance over a prolonged period by a process involving stealth, sustained misrepresentation and conscious deceit. The essentials of that process have been summarised for you. You had yourself previously introduced a conduct of business assertion that there was no misrepresentation in these or related matters, but have now discovered otherwise. From this it inevitably follows that there was a pivotal and catastrophic failure of regulation in the 1980s. Whether on a narrowly UK prudential or entire business EU view, we have also gone on to see why in retrospect that failure is so very hard to justify. It is even harder still to justify the fact that this essentially fraudulent transformation and pivotal regulatory failure have been so assiduously avoided by the authorities. This is a chronic disgrace, which continues to fill an already over-large graveyard of personal reputations. Such is the true measure of public outrage. And that in turn is why the matter of previously missing data for this period is so very sensitive and serious. Not only that, but it has led you to make assumptions about this period which your advisors should already have known from the existing literature were mistaken.*

The principal effect of this long line of reasoning has been to demolish the contention that absent maladministration of any sort whatsoever the Society's character would have been little different. That in turn invalidates any legitimate pretensions to a *lower quartile return ELAS lookalike, a separate Head B comparator which in so many ways resembles it, or the high and low impact counterfactual scenarios which depend on that contention. All this apart, we have seen that dependent pretensions of this sort could only have been made in the first place by ignoring the fundamental fiduciary aspects of with-profits assurance business, which inevitably raises questions about the entire UK actuarial framework rather than your advisors in particular."*

As matters stand and despite everyone's best efforts you are headed for a clash, most immediately with policyholder advocates and the later overall views of the PO. In addressing this, the following appraisal of your latest proposals divides naturally into three parts. It opens with a discussion of the third model's overall structure and scope in relation to the entire time sweep of regulatory failure and the particular nature of PO2. This is followed a more focused examination of the model itself. Next and in anticipation of future developments, your current proposals are set in the context of the full range of the Parliamentary Ombudsman's (PO's) evidential base in anticipation of the needs and requirements of international policyholders, their various jurisdictions and the EU Commission. Finally there are a summary and conclusions. As usual the more important conclusions are *italicised.*

Overall Structure and Scope of the Third Model.

1. The model occupies the ten years over which the General Complaint was upheld, i.e. from the beginning of 1990 to the end of 2000. In contrast, the succession of steadily unremitting disasters which befell the Equitable began with the 1973-6 triennium and closed with the Chief Financial Ombudsman's letter of March 22nd 2005 [9], which was duly supported by the Ms E and other lead case final decisions. That letter adopted the official stance that the only problem the Society had faced was the Guaranteed Annuity Rate (GAR), that GAR-related claims had been settled in full by the Compromise, and that Lord Penrose's findings could not be advanced in support of policyholders Financial Ombudsman Service (FOS) claims. As we have previously seen, the FOS position was the culmination of a long series of comforts and reverse arbitrage undertaken by the prudential regulators, latterly in opposition to the Conduct of Business (CoB) regulator [10, 11]. *By these criteria the detailed aspects of Towers Watson third model are seen to be confined to one relatively late decade out of a cumulatively disastrous total of three.* In essence it also explains Michael Josephs' latest observations to you, including the lack of causation [12].

2. The main PRE consideration which the model asserts is that of so called "Full and Fair" distribution, i.e. a null fund with no estate and no smoothing capability as described and discussed in the two presentations of WPWM. I have already explained why this evades the essence of policyholder expectations at Equitable, and that it ignores the historical fact that policyholders were routinely deceived as to the state of their funds and the significance of WPWM. [4]. Indeed Towers Watson themselves have concluded that the model does not survive the stresses of late 2000 and beyond. As a result the subsequent history of the Society would have been little or no different. At the outset, therefore, we have to admit that this

counterfactual exercise is a theoretical one only, because it would have been ineffective in reality. *It does, however, fit the current range of the PO's findings as extended by the Equitable Members Action Group (EMAG) judicial review process.*

3. The model does not survive the additional stress of the PO's third finding of maladministration on Guaranteed Annuity Rates if events after year 2000 are included. That it works at all depends on the fact that the PO's methods of economical ruling and causal inversion have made later GAR and *Hyman* issues subservient to later Reinsurance Treaty maladministration [5, 11]. This pushes the ultimate liability out beyond the run time of the model. Even so the model allows no credit to be taken for reinsurance of an official 1.6 billion of GAR liability by the end of year 2000, with the interesting possibility that the model may not have to change much over this period if the PO's Third Finding of maladministration is reinstated. It all depends upon the balance between estimates of cumulative reductions in bonus rate and the reduction in established or new business the model might have caused, and hence how much extra moneys can be recouped within the model in advance of need. *One way or another the result is that GAR issues are in the main postponed beyond the ten year period of the counterfactual model. It is the principal reason why the model scrapes through to the end of year 2000 in its present form.*

4. Beyond 2000 Towers Watson have concluded that the model fails, essentially for the same reasons the real Society did. *But that failure is implicit in the model with foresight and not just with hindsight, such that we must conclude that rational and competent regulators would not have accepted it.* And yet the General Complaint was not upheld beyond this point, by and large because there was deemed to be only one important determination of maladministration in this period, namely over the Reinsurance Treaty. Fundamentally this is due to the PO's Procrustean Bed system of complaint handling, whereby new findings can be ignored (see "Abbreviations and Definitions" section). But in the post closure period the PO went further than this, because in effect she allowed that the most flagrant acts of reverse regulatory arbitrage (see "Abbreviations and Definitions") were justifiable attempts to stabilise the condition of the Society. *In effect, therefore, she has commended the very things which others find the most objectionable.* The matter was raised with PO's Investigation at the both the Draft and Final Report stage [11] as shown in the Appendix. Suffice it here to remind everyone that the ignored matters qualify as serious EU Life Directive breaches by the *Francovich* criteria [5]. *Thus the third model may not survive scrutiny in the EU or other jurisdictions any more than will the idiosyncrasies of the PO's Report on which it relies.*

Detailed Considerations of Towers Watson's Third Model.

5. The third model at first passes one of the main criteria of my April 24th letter [6], which is that it goes against the immediate if not the later contemporary cultural grain. There we saw that Barry Sherlock, the Head of the Life

Assurance and Unit Trusts Regulatory Organisation (LAUTRO) was also the Society's Chief Executive until July 1991, and that one of his cherished strategies was the unbroken bonus series. One can therefore be reasonably certain that a substantial series of cuts in the Society's bonuses would have been as unwelcome to LAUTRO as it would have been to the Society's Appointed Actuary. Moreover Sherlock was Ranson's nominal superior until mid 1991. Sherlock must surely have had direct access to the Secretary of State and to other Department of Trade and Industry (DTI) ministers. From this it follows that any low level initiative to deal with Equitable's 'unique ways would almost certainly have failed, and very likely also have been expunged from the record. So a viable alternative reality must involve purposeful and coordinated action by the management of the Government Actuary's Department (GAD) and the Insurance Division of the DTI. No such action is evident in the 'Panel Scenario' on which you have chosen to give such weight. *In this connection, had the model also taken into consideration the Appointed Actuary's dual role maladministration, then the dual role and vested interests of the Head of the Conduct of Business regulator LAUTRO would necessarily now also be glaringly exposed.*

6. This besides, the detailed means by which the third model claws back previous over-distribution do not in general pass the intrinsic soundness criterion of the April 24th letter. First and foremost, the model corrects for previous inequitable over-distribution not merely from those who had benefitted from it, but those such as late GARs and newcomers who had not so benefitted. As we have seen, the proper expedient here is ring fencing with or without refinancing by demutualisation, or failing that closure [6]. But as things stand the model reinforces and perpetuates Ponzi scheme injustice, and accords neither with the principles of equity nor those governing policyholder PRE with respect to future profits. *The model also has the incidental effect of hiding the forensically important question of the amount and extent to which older policyholders augmented and crystallised their benefits before the end of 1993 when the GAR and Guaranteed Interest Rate (GIR) differential terminal bonus policies came into effect.* This is because it states the algebraic sum of new and matured policies rather than the two categories separately. *It is thus all the more important to reconcile the model with the means by which over-distribution preceding the PO's reference period and the missing data problem were previously expected to be handled.* The original over-distribution and missing data problem has not gone away. Doing nothing about it merely allows the third model to sweep the problem under the carpet and compound the injustice. *The paradox therefore is that if pre-1990 overbonusing is addressed at source there is no rationale for this particular model!* From your point of view, however, that would be to move beyond the scope of PO2 and your terms of reference. But that in turn means that after the paradox comes a *reductio ad absurdum,* which once again highlights the impossibility of a strictly Report based approach to compensation.

7. The model also fails the intrinsic soundness test for the much the same reasons as previously, because most of the methods used to weaken the valuation base are part of the series of comforts taken by the regulators which qualify as reverse regulatory arbitrage (see "Abbreviations and Definitions" section).

That notably includes Section 68 orders and the future premiums/future profits implicit items switching which I have repeatedly alluded to, and which we again discussed at our meeting on April 15th [13]. Reducing the Equity Backing Ratio (EBR) also runs counter to PRE of properly backed and smoothed with-profits assurance business because it suggests that returns will be reduced accordingly. *Hence a reduced EBR would be taken jointly with reduced bonus rates as a sign of financial weakness. It would have functioned as a further deterrent to investment or an inducement to transfer funds elsewhere.* Indeed it is one of the difficulties from which the unsold rump of ELAS continues to suffer.

8. From your recent Dear Minister letter [1] one learns that not only are you backing Towers Watson, but that you remain committed to using Head B loss as the basis for a comparator. Not only that, but you propose to allocate Head A and B losses in proportion to the likelihood that policyholders would have invested elsewhere or transferred out if possible, which is the base Head A position. But if as you claim the third model would have resulted in few if any policyholders taking different investment decisions, then the proportion of loss becomes heavily weighted in favour of Head B. Now given the considerations in para 6 above, clawing back previous over-allocation during the run time of the model will have the effect of weakening the performance of ELAS relative to the financially weak offices you have chosen for the Head B comparator [3 Table 7]. The question then arises as to whether this weakening is sufficient to cause the comparator to outperform ELAS to generate relative loss, or whether ELAS still gives better returns and hence relative gains. *If so, the temptation to do a preliminary assessment and balance the matter to taste should be resisted.* Meanwhile you have elected to net the relative gains against relative losses given by your two different comparators. *I need not repeat my views on netting gains and losses across policies of different types and durations which you also propose to do, save to say that a similar netting across different comparators is open to the same fundamental class of objection.* And since you have previously proposed to run the comparators on to as late a date as possible, their time leverage will be increased. *Meanwhile there is the very real possibility that many policyholders, and in particular late joiners who have left after having incurred real historic losses, will end up with absurdly little compensation.*

9. From the practical intrinsic soundness point of view, you and your advisers have rightly introduced the question as to whether the bonus reductions necessary to claw back a previous 28% excess of total policy values over assets in 1990 would not adversely have affected the rising membership of the Society and premium inflow over this period. You have professed some uncertainty over the magnitude of this effect, and therefore have not put a figure to it. *But regardless of the fact that redressing the balance at the expense of newcomers is deplorable in itself, the intrinsic working of the model itself depends upon it.* One has therefore to put "acceptable" numbers on new premium inflow and rising membership year by year in any case in order to see by how much and by when the model might inequitably correct the previous and already inequitable over-distribution. *We should all have had these estimates.* In this connection it is worth recalling Headdon's advice to

Nash on this subject when he took over as Appointed Actuary in 1997, which also happens to be within the third model's reference period. In Headdon's opinion (which Lord Penrose related was not relayed to the Board of Directors [14]) previous over-distribution would take some fifteen years to recoup [14: chapter14.4]. Mr Headdon's own summary figures are given in Penrose Financial Table H.1, and his mode of analysis is extended to year 2000 in Table H.2. It would therefore be useful to have your advisors' opinion on whether or not it would be less burdensome to recover over-distribution earlier than Mr Headdon contemplated as they have done, granted that the overhang may well have been already fixed in maximum amount by the succession of (inherently unsound) regulatory comforts already taken by the start of the PO's reference period. *Meanwhile there is a disparity between your advisors' and Mr Headdon's opinion on the acceptable minimum time over which the moneys might have been recouped: your advisors say that demonstrating that the ratio can be brought down to 100% over a 10 year time frame is not meaningful [2] whereas in real commercial terms Mr Headdon felt it should be spread over some 15.* Evidently Mr Headdon too felt that a more rapid readjustment would adversely affect new premium inflow.

10. With this information we may review the merits and demerits of counterfactual experiments various. Bonus reductions and changes to the EBR are intrinsically sound measures in themselves, but they are signs of weakness, such that a growing proportion of investors would go elsewhere, stop contributing or transfer out if possible. Comforts such as new business and subordinated loans, improperly devised Section 68 orders, inappropriate valuation rates of interest and financial reinsurance treaties are inherently unsound. The "null impact" hypothesis requires that from the end of 1991 over-allocation is progressively recovered entirely by the cumulative effect of bonus reductions and a reciprocal cumulative rather than compound transfer to net assets, while historical increases in membership and premium inflow remain unaffected. And yet a fund in which total policy values match assets and combined reliefs still has no useful smoothing capacity, let alone other contingency reserves Put simply, this is why the model fails, and does not succeed even in postponing the inevitable.

11. Being mindful of these considerations I have set my natural diffidence aside and made a very approximate check on the effect of Towers Watson's series of bonus reductions. The steps are as follows:

- Append Towers Watson's series of bonus cuts to Penrose Table H.2.
- Back calculate the net assets.
- With 1990 as the base year, weight the bonus reductions by the ratio of increase in aggregate policy value (APV) in the years they are made.
- Cumulate the cumulative weighted bonus reductions (13.9%).
- Calculate 13.9% of 1990 APV (£ 865.6 million).
- Ditto 1990 net assets (£674.43 million).

- In bonus reduction years, multiply net assets by the percentage reduction to find the sum transferred to reserves.

- Cumulate the cumulative sums to obtain the total transferred to reserves (£742.72 million).

- Add the total transferred to the reduction in 1990 APV (£1590.32 million).

- Ditto to the increase in reserves (£1416.15 million).

- Duly contrast and compare these two sums with the 1990 excess of APV over net assets (£1375 million).

  Rough though this check is, it indicates that the cumulative effect of Towers Watson's bonus reductions is just sufficient to correct the 1990 excess of APV over net assets in accordance with the null impact hypothesis. *Little if any allowance appears to have been made for those deciding not to invest or transfer out. To do so would require greater reductions than have thus far been applied.* ***In loss categorisation terms this implies that the current underlying Type B/Type A loss ratio is overwhelmingly Type B.***

Anticipation of future developments.

12. In the first instance, representations have been made by EMAG to the New Economic Secretary to the Treasury that all the PO's findings of maladministration should be restored. But as we have seen, this may have little effect on third model counterfactual events in the period over which the General Complaint has been upheld. The main reason for this is that the PO's causal inversion has the effect of moving the critical impact of the GAR and the subsequent collapse of the Society outside the detailed model run period. The net financial consequences are therefore much the same. *But the defining issue remains that, like its not dissimilar predecessors, the third model is so fundamentally objectionable that it will be rejected. Irrespective of whether the third model is proper, there never was any reasonable scope for an estateless non-smoothing Head B comparator given all the post 2000 accumulating liabilities and collapse.* And that in turn means that the Chadwick process will have failed should this notion be adhered to.

13. An unintended and sad consequence of all the dialogue during the Chadwick process is that the product has become progressively more defensive, and hence report-based. The flexible approach now amounts to little more than the condition of reliance on the regulatory returns being waived. Moreover no consideration has yet been taken of the PO's non-binding observations, namely that her findings be considered cumulatively if not causally, and that absent maladministration nobody would have invested in the Society during her reference period. And that in turn means that, as originally mooted by you on April 14th [ ] and examined in my April 24th letter to you [6], the Society would have closed to new business assuming that refinancing by demutualisation and ring fencing a new non-GAR sub-fund was prohibitively

expensive. ***If this line of reasoning is respected there is no place for the Towers Watson third model, or indeed a Head B comparator of any sort.*** *Of course we have been here before, and one should now reasonably expect much future pressure to take the PO's non-binding observations into consideration.* The irony is, however, that the idiosyncrasies and deliberate omissions of PO2 detract considerably from the moral force of the PO's later statements regarding the overall scope and significance of her findings. But given the strength of the overall evidential base which you have perforce accumulated this is hardly an insuperable problem. *Indeed one may confidently assert that the summary basis in evidence requires to you to adopt the PO's non-binding statement regardless of whether she personally made it in the first place, let alone whether or not it formed part of her original report.*

14. If all the PO's non-binding observations are respected then it is possible that a properly flexible approach using all her findings will be acceptable within the UK. *There is, however, a persistent problem in that the PO has said that policyholders should not be restored to the position they would have been in if the succession of cuts beginning in July 2001 had not occurred. As a result the situation remains wide open to all sorts of further manipulation and abuse. Frankly, this statement requires very careful qualification, because it depends critically upon the Procrustean Bed method of inquiry (see the Appendix plus "Abbreviations and Definitions").* Moreover the abandonment of a Head B comparator would necessitate a major reappraisal of the evolution and effects of everything that has been promoted during and beyond IR3. As a result, a material change in emphasis and direction of the Final Report would thereby be expected.

15. On the assumption that the increasingly well known limitations and idiosyncrasies of PO2 can be circumvented such that the worst of any consequent abuses can be avoided, then transparently fair compensation can be worked out in the UK. *On the further assumption that the resulting compensation is pragmatically sufficient also to satisfy international policyholders, then there may be no need to refer matters to the EU Commission. Such a practically merciful outcome would be a great relief to almost everyone.*

16. The sad fact is, however, that the present omens are not good. In persisting with a flawed concept of what might be permissible absent accepted PO2 maladministration and an accompanying Head B comparator, you are headed for a clash with all the policyholder advocates and the Equitable Members Action Group (EMAG) which remains disengaged from you. The consultation period now being over, any further changes you make will perforce have to be made unilaterally, which courts further risk. The situation is complicated even further because as matters currently stand there will be very little time for consideration of your Final Report before the proposed Bill for Equitable compensation is presented in the House of Commons. One should therefore anticipate that there will be substantive representations that your Final Report should not be accepted as a base from which an independent body should proceed to implement compensation.

Summary and conclusions.

Your latest reliance on Towers Watson's third model ignores cogent matters previously and repeatedly put to you. Though advanced in the name of PRE, the effect of the model is, in part at least, to pass on the expense of previous inequitable over-distribution and hidden liabilities under conditions of chronic overall deficit to new policyholders. This not only perpetuates but reaffirms the effects of a prior fraudulent transition in the company's affairs and the modified Ponzi scheme it gave rise to. Like the previous high and low impact scenarios, the model is so fundamentally objectionable that it can be considered no further. And because all the model does is to follow the Society's "With Profits Without Mystery" official but internally contradictory and unworkable position [4, 7, 15] which was unknown to policyholders, it is not a viable let alone robust means of fulfilling actual PRE or the fiduciary aims of smoothed with-profits and assurance business. *To advocate a flawed model that the actuaries of the day and all the official investigations have sedulously avoided analysing is itself bizarre.* To advance the proposition at all your advisors have needed recourse to the official mythical and now discredited interpretation of PRE which that flawed model professed to espouse, when the correct if still unduly restricted framework of reference is prudential, and hence S & PM.

The third model can, however, be considered as a technically feasible exercise which exploits the restrictions and idiosyncrasies of PO2. *But as your correspondents have repeatedly demonstrated, these very restrictions and idiosyncrasies are in effect the reason why the model and its predecessors cannot be valid counterfactual exercises.* If there is any residual doubt here, then Dr Goudie has now finished providing the reference bedrock from which counterfactual reconstructions might more rationally be attempted, and indeed he has highlighted the very substantial methodological problems inherent in your particular approach in the absence of a proper analysis of why the regulator failed repeatedly [16]. *This leads one inevitably to conclude that the PO's report is too restricted and flawed to be the sole means by which fair compensation can be determined,* which takes us back to the caveats in my original covering letter to you dated Oct 20th 2009. High time it is for us all to stop treating PO2 as a sacred cow. *Though a change of mind by those who have previously adopted a perhaps unduly respectful attitude to PO2 might now lead to accusations that they have become inconsistent or even ungrateful, no useful agreement and progress can be made until the situation is more widely acknowledged.*

The third model depends for its artificially brief viability on the fact that it occupies just ten years out of a total of some thirty of progressively unremitting regulatory disaster during which the PO upheld the General Complaint. And though the PO has said that there was "a decade of regulatory failure", she has not spelt out the exact nature of this failure. Rather she has left her specific findings and her assembly of evidence to convey a rounded picture of it. But still the model ignores the origin of events pre-1990, and in bringing policy values back in line with assets during this period perpetuates the injustice to newcomers, mainly non-GARs. But like the real Society the model fails after the conclusion of the year 2000, for essentially the same reasons that the real Society did. That it survives as far as year 2000 is mainly due to the fact that causal inversion mainly pushes all GAR and DTBP-related matters out beyond 2000, whereafter because of the PO's Procrustean Bed form of inquiry, which ignores major acts of reverse arbitrage, just one important maladministration has been determined. As we have previously advised you, this mode of inquiry and reporting will not survive scrutiny outside the UK, let alone within it [5]. No more will Towers Watson's third model.

Though the combined idiosyncrasies of the PO's report and investigation rob her later statement that absent maladministration nobody would have invested in the Society during her reference period of moral force, the overwhelming weight of the wider evidential basis supports it. Indeed as first tentatively introduced by you on April 15th [13], and further explored [6], had S & PM and PRE been properly observed prior to the PO's reference period, the Society would at best have followed its traditional ethic and course, or at worst, failing being able to finance a ring fenced non-GAR sub-fund by demutualisation at the end of the RAP era, had to close to new business [6,18]. As a result there is no practical or ethical ground for continuing with an estateless minimally reformed Society Head B comparator, and it should be abandoned.

Your correspondents had hoped to avert this situation, but time for further discussion has now run out and if the Final Report follows the current line it will be widely opposed, even rejected. For overwhelmingly sound reasons and in accordance with the PO's statement the proper comparator is Type A, and based on sound and prudently managed mutual offices with the necessary free assets to support both the with-profits and assurance elements of its business. As previously explained, this permits a non-competitive approach to loss for all policyholder classes, and allows future losses to be calculated where necessary in an appropriately fair manner. The writer submits that this is what policyholders of all classes and jurisdictions should now rightly demand and expect.

Yours sincerely,

Dr Michael Nassim.

E-mail copies: Peter Scawen (ELTA); Michael Josephs; Nicholas Oglethorpe; Dr Andrew Goudie; Margaret Felgate; John MacLeod; Ann Abraham; Iain Ogilvie; Dr John London; Liz Kwantes (ELM); Paul Weir (EMAG/ELCAG); Alex Henney (EMAG); Nicolas Bellord (EMAG); John Newman (EMAG); Christopher Carnaghan (EMAG); Colin Slater (Burgess Hodgson & EMAG); Paul Braithwaite (EMAG); Markus Weyer (DAGEV); Chris Wiscarson (ELAS); Diane Wallis MEP; Mairead McGuiness MEP; Andrew Tyrie MP; Vince Cable MP; Alan Duncan MP; Mark Hoban MP.

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Abbreviations and Definitions:

APV:	Aggregate Policy Value.
CoB:	Conduct of Business.
DTBP:	Differential Terminal Bonus Policy.
DAGEV:	Deutsche Arbeitgemeinschaft der Equitable Life Versicherungsnehmer.
DTI:	Department of Trade and Industry.
EBR:	Equity Backing Ratio.
ELAS:	Equitable Life Assurance Society.
ELCAG:	Equitable Life Late Contributors Action Group.
ELM:	Equitable Life Members support group.
ELTA:	Equitable Life Trapped Annuitants.
EMAG:	Equitable Members Action Group.
EQUI:	European Parliament: Committee of Inquiry into the crisis of the Equitable Life Assurance Society
EU:	European Union.
FOS:	Financial Ombudsman Service.
FSA:	Financial Services Authority.
GAR:	Guaranteed Annuity Rate.
GIR:	Guaranteed Interest Rate.
IR 3:	Chadwick First, Second and Third Interim Reports.
LAUTRO:	Life Assurance and Unit Trusts Regulatory Organisation.
MN:	The writer.
PIA:	Personal Investment Authority.
PO:	Parliamentary and Health Service Ombudsman.
PO2:	Parliamentary Ombudsman's Second Equitable Report.
PRE:	Policyholders' Reasonable Expectations.
S & PM:	Sound and Prudent Management.
WPA:	With-Profits Annuitant.
WPWM:	"With Profits Without Mystery".

Reverse regulatory arbitrage: Regulatory arbitrage is generally understood to be exploitation of the minutiae of statute, regulations, professional standards and guidelines in a manner contrary to their collective aim and spirit by regulated organisations or persons. Hence, when the regulator employs the same tactics against those it should protect it may be termed "reverse" arbitrage.

"Procrustean Bed" complaints handling: A process of aligning complaints under specified headings according to prior criteria, without due regard to significant new evidence which gainsays those criteria, or to material and relevant deviations from the headings to which the complaints have been assigned. It takes its name from the racking or hacking of the limbs of his guests by the mythical Procrustes so as to fit them in his bed.

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APPENDIX.

Formal contemporary objection to the Parliamentary Ombudsman's treatment of post-closure events [11].

<u>Nature and import of new evidence in the Report:</u>

This leads naturally into matters revealed by reading through the earlier draft chronological digests prepared for the Investigation as summarised and presented to it by MN on Sept 20th 2007 which opens Appendix 2. It has been gathered intact as Appendix 2 in order to preserve its contemporary flavour, but rendered anonymous and with date and time entries added so that the various editions of the Report Chronology may if later judged necessary be consulted or compared once due authority has been obtained. Suffice it in this narrative to say that the items group into three main categories of adverse findings resulting from reverse arbitrage by the prudential regulators as earlier defined.

These three categories are:

1. An extensive series of devices and comforts taken by the regulators over several years, which helped ELAS to maintain a public position of official solvency.
2. At the prudential/CoB interface, suppressing, discounting and dismissing evidence of *scienter*, systematic deceit and misrepresentation, and consequent liability. The consequences of this were, and continue to be, both grave and material.
3. In the course of reverse arbitrage, ending up in positions of falseness and ambiguity.

Category 1, insofar as it has been considered by the Report, appears to have been construed as worthy efforts by the regulator to save the Society for the good of each and all. But the pattern of constructive intent which emerges makes such a view very hard to accept. Despite repeated requests to the Investigation, **Category 2** reverse arbitrage has not been addressed in the Report. But given all the extensive knowledge that already exists in the area in respect of the Society's business model and methods, S & PM or PRE, this omission is incongruous. *Though substantial out of court settlements have been paid by the Society in these regards both to" late joiners" and more recently ELTA annuitants,, the effect of Category 2 reverse arbitrage has been to support the official mathematics of the Compromise and FOS stance, and to deny adequate justice or recompense to ordinary citizens.* As yet, however, there is no logical route to compensation in the draft report under this head. **Category 3** has been touched upon indirectly by the Investigation, and has surfaced in a finding of the regulatory stance being potentially misleading**. Otherwise it appears to have been regarded as a positive feature by the Report, in that the general complaint of serial regulatory failure has been upheld for the pre-closure period only (current emboldening by MN).** We fail to understand this, unless it relates to the Compromise and FOS stance being out of the Ombudsman's bounds. This may also partly explain why causal chains from maladministrations within the time period of reference to subsequent well known later injustices have not been picked up or followed through.

That explained, we introduce some additional items from the Report. These extend the list of comforts taken, so further describing the pattern of reverse arbitrage that took place. The result is to reinforce the earlier appraisal of what its overall constructive intent must therefore have been, and hence what injustices must have followed from it. Thus, to the Appendix 2 list of comforts designated from 2(a) to (s) now we add:

t) Allowing the Society to take credit for the reinsurance treaty in the year before it was signed. This is analogous to comfort 2(q).

u) Turning a blind eye to the all the consequences of the July 2001 cuts, and postponing making a formal request to the Society to take steps to restore itself to a sound financial condition until they had been effected. The net effect of this inaction and reversed procedure was to create the main slack for first bribing and buying out the GARs in the Compromise Scheme that followed. Once that had been ratified and implemented, further cuts for provisions that the prudential regulators knew had not been made or described under the Scheme could thereafter be imposed with impunity. *We submit that this preparatory position, and all that we now know the prudential regulators did to facilitate it, falls within PO's rights of observation and jurisdiction.*

v) As opened up in Appendix 2 but not then fully appreciated, in effect delaying answering Noel's Nov 16th 2001 letter as to how much credit could be taken for the reinsurance treaty until *after* *** (actuarial review paragraph 19.47). In the author's view, that is both a significant comfort and a further example of reverse arbitrage. It is also a fine example of the Janus (two faced) style of memorandum so frequently encountered in the Chronology.

w) The Compromise Scheme was agreed by the court. Hence ELAS's 2001 returns were prepared on the basis that *** (Actuarial Review paragraph 19.47 as above-period outside the Report's jurisdiction.)

u) From EMAG's draft comments to the Investigation we add their observation that at the time the Compromise Offer went out to policyholders the Society's assets were insufficient to cover the proposed 2.5% uplift to non-GARs-hence the later 4% cut. As a result EMAG concludes that the FSA should have insisted that the Compromise Document should contain a 'Statement of Affairs' showing all assets and liabilities made up to a recent date, as is routinely included in commercial compromise proposals. This would have shown the deficiency. This point was made by the FSA's own insolvency expert: "This calls for another pro-forma balance sheet which necessarily will not be in a Companies Act format, and it should show the position before and after the proposed deal." -31/07/2001 [14:08].

In reviewing this long succession of comforts, one wonders why all the losses were not pulled together fully into one really big hit in July 2001. Everything yet to come was pretty much all up in lights after incoming ELAS AA Peter Nowell's valuation. Perhaps ongoing uncertainties about how to deal with mis-selling liabilities and details of the lead into the Compromise clouded some of the issues. But more significantly, announcement of the full scale loss could have provoked uproar, and more pressing questions into insolvency. If so, this would have been a potent deterrent from so doing. However there is another interesting aspect of the July 2001 cuts in that they seem to have had little effect on monthly Required Minimum Margin for solvency (RMM) presentations in the draft report. Cutting total policy values maintains the ratio of what is guaranteed to what is not, but might ordinarily have been expected to also improve the mathematical reserves and hence the RMM. However, the incoming AA may well have felt the need to rebalance the liabilities and re-state the resilience reserve consistently with a new and future convention in conformance with statutes and guidelines.

No immediately useful purpose would be served by rehearsing and discussing the minutiae of all the various comforts, suppressions of the public *scienter*/liability trail and false positions which comprise the entire process of reverse arbitrage listed in Appendix 2 and as supplemented above. That would require an inappropriately long narrative account over and above the listing already provided, and so it is fortunate that ex-EMAG Chairman Alex Henney (AH) has prepared one which covers a lot of this material (see references). Quite simply, we had not expected to emerge so troubled and oppressed by its magnitude and extent, let alone its clear relevance to matters already raised. Whether individually or in combination, these actions or inactions have resulted in gross and obvious injustice. ***The Investigation has itself unearthed them, and it is a matter of the utmost concern that the Report has been obliged to leave the whole matter aside despite due notice and representations that it be considered. (emboldened by MN).***