

**Note: The issue of “Transparency” dominates the following correspondence between Michael Josephs and Sir John Chadwick. It is hard to overstate its importance.**

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Michael Josephs  
29th January 2010

Sir John Chadwick

Dear Sir John,

**Second Interim Report and the Absence of Statistical Data**

**Preamble**

At the point of writing the issue of the lack of statistical data raised in my letter of 6<sup>th</sup> January has not been resolved, although in his response to that letter Simon Bor did assure me that the matter was receiving your careful attention, and this I accept without reservation.

When I spoke to him earlier this week, he confirmed that there had been no change to the stated position, and that your response was unlikely to be made public before the publication of IR3, ‘sometime in March’.

May I reiterate that in my opinion as an expert analyst of the Society’s history, such information going back to at least 1980, preferably to 1975, is essential to enable you to meet your primary remit of “establishing relative loss” on a sound and fair basis. This flows from the fact that under the WP business model as operated by Equitable, any early over-allocations of guaranteed bonus were compounded onto subsequent allocations of both guaranteed and Final bonus and could therefore only be remedied by later ‘collective punishment’.

Unless those early allocations are given due weight, there is a considerable danger that relative losses will be erroneously calculated within the EGP scheme, and that public funds will be mis-allocated to those who have not in fact made ‘relative losses’ at all.

Subsequent to my earlier letter I have been in touch with the Society, and have urged that they should take the initiative by publishing the basic tables of statistics that appear to be necessary to compare (a) various cohorts of policyholder, and (b) different types of contract, in terms of bonuses awarded and the related realistic asset positions. I attach a copy of the technical note submitted to Equitable Life at their request.<sup>1</sup>

There is no way of knowing when or whether the Society will respond to my suggestion, so the issue remains in your court until the matter is resolved in one way or another.

In the course of these discussions it emerged that they have provided no statistics whatever to your actuarial advisors, only the anonymised database of with-profit transactions for 1992

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<sup>1</sup> “The Chadwick Discussions -Statistics Required, 25<sup>th</sup> January 2010”

and later.<sup>2</sup> This seems quite extraordinary. For the reasons indicated above, your advisors cannot give comprehensive advice without such statistics.

Under the Treasury's directive we are currently denied access to the advice that your actuaries have given and their plans for future advice. Nevertheless, our past experience of the Profession's reluctance to explain the causes of policyholders' losses gives us no cause to trust whatever your advisors may be doing in secret. I feel that I must point out that these 'non-developments' cast a shadow over your whole investigation and the advice which may flow from it.

Meanwhile I find that, without such data, it is difficult to respond cogently to many of the issues raised in IR2, *and as a matter of principle I am no longer prepared to hazard further guesses based on my earlier investigations*. However, I have been able to comment on some fundamental matters where I am certain of the underlying history.

I would also comment that the present approach of resolving all matters of law and principle first, before proceeding to evaluate the quantitative impacts, amounts in practice to resolving the rules for all similar types of regulatory negligence claim, irrespective of whether the matters investigated are financially significant in this particular case. This cannot be the quickest or the most financially sound approach to the creation of a robust and fair EGP scheme.

### **Comments on Specific Issues Raised in the Second Interim Report**

(references are to those used in IR2 itself except where specifically stated)

The following responses should be read in the context of the strong reservations set out in the Preamble to this letter.

**Para 2.6 (4.83/84 of the Government Response):** There is a great deal of implausible special pleading here. These two passages both imply that incompetence should not be a bar to being a GAD Actuary. For example, the GAR problem was well known from the 1970s onwards, and every actuary knew that Schedule 5 of the Returns would contain revealing data about various exposures.

The suggestion that any regulator should have relied on Ranson, given his known arrogance and awkwardness and his failure to abide by earlier undertakings lacks all credibility. Regulators had allowed him to hold both CE and AA positions at the same time and should have been on their guard in consequence of the manifest conflicts of regulatory interest thereby created, particularly as they knew that the Society's business model was in practice unique.

**Para 3.12:** I strongly endorse your decision to adopt the flexible approach, as I believe that the alternative favoured by the Government leads to unmanageable complexities. However, this does carry with it the necessity to use a comparator which does not introduce types of loss that were unrelated to regulatory failure of any sort. If, for example, Equitable's asset management performance was 10% inferior to the market average, it could be argued that no

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<sup>2</sup> According to a very knowledgeable Equitable ex-salesman, detailed per policy premium and bonus information going back long before 1992 was available in computerised form as recently as 2001, whereas it is now said to be unavailable. This would seem to merit closer investigation.

adjustment for that should be made in the EGP, since such performance was not in itself subject to regulation.

**Para 4.3:** I reaffirm my earlier argument that policyholders' losses derived from over-distribution and overpayment to earlier cohorts of policyholders going back over many years prior to 1992, which can be summarised as the failure to maintain an adequate estate. I cannot quantify this over-distribution further in the absence of agreed statistical data. However, it does imply that it is essential to set off notional gains and notional losses by the same policyholder where such are found to have occurred.

**Para4.4 footnote 7:** You say "*Although there is material to suggest that excessive bonuses were declared during the 1980s, I find it difficult to see how this could be determined as a fact on the basis of the information available to me.*" I would suggest that you do not need to determine this "as fact", merely as the most likely explanation of losses from the perspective of the EGP. How could this be disproved? Also, I am certain that I could demonstrate to you that the 1975-88 distributions were unsound from a business perspective and that they were the primary source of the losses experienced by later policyholders. The GAR-related losses were small in comparison.

**Para 4.5:** Please see my earlier comments (letter of 6/1/2010).

**Para 4.15,4.16:** For the first time, the concept of a comparator with a mix of sources changing over time is explicitly introduced here. In principle this introduces an array of say 20 parameters varying over 30 years, i.e. 600 separate parameter values. As such an array could be tweaked to produce any desired result whatever, with no assurances of fairness or relevance, an approach along such lines is almost guaranteed to destroy any vestige of transparency in the eventual scheme.

I urge that you reconsider my earlier suggestion of the "Ideal Comparator", a self comparator approach which excludes all losses that do not derive from over-bonusing and related errors.

**Para 4.17 et seq "End Date":** It must be assumed that all final calculations of loss and payment will involve an EGP Scheme Date, which would be the date up to which interest would be added; i.e. the notional payment date. Additional interest should only be paid for substantial delays (say 12 months or more) after the Scheme Date.

The question which then arises is "*Why should the End Date be different from the Scheme Date?*" There appears to be no good reason for any such distinction: the arguments about whether people should or should not have exited after closure to new business are without merit and irresolvable almost by definition. Everyone should be treated on the same basis and have their losses revalued at the same year to year rates. Why introduce complexities which are not required?

## **"Questions to be Addressed"**

**Section 6, General:** The Parliamentary Ombudsman has made clear that her recommendations for redress derive from the collective failures of the regulators exemplified by her individual findings. Her choice of title was crucial, not accidental: - "*A Decade of*

*Regulatory Failure*". She could and should, from the evidence set out in her Report, have told Ministers and Parliament that for ten years Equitable Life was allowed, with no serious queries and no serious challenges, to do whatever it wanted to do, however unusual and however dubious.

At every point where principled resistance on the part of the highly skilled professionals employed to regulate life assurance might have reduced the harm being done to policyholders, there was no substantive action whatever. Quite why this is so has never been seriously explored in any public context, but it is the basic reason why there must be no apportionment of liabilities away from the Government. The Treasury, in seeking to defend failing regulatory departments, merely confirms its overriding responsibility for the consequences of their negligent behavior.

**6.8,6.9 Start Date:** For safety, the earliest start date should be taken as 1975; i.e. excessive bonuses prior to that date should be disregarded. In the absence of agreed statistics I can provide no arguments in support of this statement. Policy data prior to 1992 should be recovered manually where such policies look like giving rise to large claims, the definition of 'large' being set so that it is cost effective to recover the additional data. Otherwise approximate methods should be employed.

**6.10-6.12 Comparator:** (see also Para 4.15, 4.16 above) The "Ideal Comparator" proposed in my letter of 12 October 2009 is what you describe as a "real comparator". It avoids nearly all the complications that arise with notional comparators, and the same comparator can be used for every type of business, because the bonuses awarded by the Society were numerically consistent over all classes of business (even though they should not have been). The basic issue to be decided is the relative size of estate needed to counteract the effects of the Society's highly aggressive valuation policy and the consistent failure to advise the Directors of the state of the realistic liabilities.

You have received many suggestions to the effect that different classes of business deserve to be treated differently, or that certain types of contract were more valuable per unit of premium than other types of contract, but I argue that these suggestions also produce unnecessary and unintelligible complications. Once one type of business is subject to 'contract revision', then all types of business demand similar treatment.

Essentially, I argue that even if the technical basis of such proposals is sound, (which I doubt), the effects would largely disappear by the time the calculations of EGP were worked through, because nearly all losses derive essentially from unsupportable bonus allocations that took place much earlier in time. There is no merit in having a complicated scheme when a simple one will deliver a very similar result which is as fair or fairer.

The point, which was implicit in my earlier paper on "Calculation of Losses", is that if one uses a comparator which corrects the earlier bonus allocations (specifically the total bonus), then other effects drop out. Total GAR size becomes smaller and hence less significant, and the allowable Compromise adjustments would have been smaller. In saying this I am assuming that all historical contractual changes are retained in the comparator, apart from the quantitative issues flowing from bonus revisions.

**I have previously commented on most of the remaining issues which you have listed and as my position on them has not changed, I would ask you to refer to my earlier correspondence on these matters.**

**Yours sincerely**

**Michael Josephs**

**Attachment to Letter of 29/1/2010 to Sir John Chadwick**  
**Technical Note [presented to Equitable Life]**

Date: 25<sup>th</sup> January 2010

The Chadwick Discussions  
Statistics Required

Action Groups and policyholder advocates have always attached great importance to TRANSPARENCY in the development of the Chadwick proposals. This necessarily includes the provision of a common base of policy statistics, which would provide an adequate framework for debate between various interest groups, and for evaluating and comparing proposals quantitatively as well as qualitatively.

It has been suggested to the Society that they could take the initiative in publishing such a basic set of data, which has not hitherto been publicly available. Alternatively, Sir John Chadwick's actuarial advisors could do the same with the permission of the Society.

I have been asked to suggest what compilation of statistics would serve.

The appended table indicates what, in my opinion, would be needed: There are only 8 statistical items, to be provided for each separate class of business over a period of 35 years. Of course, many classes of business were in existence for a considerably shorter period, for example Personal Pensions did not exist before 1988.

The great value of such a compilation would be in providing reliable and consistent data, which does not at present exist.

There would be no need to expend undue effort to achieve a high degree of precision. All that is required is that the figures be broadly consistent within each notional year, and provide reasonable continuity from year to year.

I hope that these suggestions will enable constructive progress to be made in the near future.

MJ

**Table 1: Statistics Required for Chadwick Evaluation**

<b>Class of Business</b>	<b>Basic Statistic for year</b>	<b>year</b>	<b>1975</b>	<b>1976</b>	<b>1977</b>	<b>.....</b>	<b>2008</b>	<b>2009</b>
Endowments	Contracts c/fwd number					.....		
	New Contracts number					.....		
	Terminated Contracts number					.....		
	Premium Fund c/fwd [raw <sup>3</sup> ]					.....		
	Guaranteed bonuses c/fwd [raw]					.....		
	Total Policy Value c/fwd [raw]					.....		
	Claims - monetary value					.....		
	Premiums -monetary value					.....		
Bonds	Contracts c/fwd number					.....		
	New Contracts number					.....		
	Terminated Contracts number					.....		
	Premium Fund c/fwd [raw]					.....		
	Guaranteed bonuses c/fwd [raw]					.....		
	Total Policy Value c/fwd [raw]					.....		
	Claims - monetary value					.....		
	Premiums -monetary value					.....		
etc. etc	Contracts c/fwd number					.....		
	New Contracts number					.....		
	Terminated Contracts number					.....		
	Premium Fund c/fwd [raw]					.....		
	Guaranteed bonuses c/fwd [raw]					.....		
	Total Policy Value c/fwd [raw]					.....		
	Claims - monetary value					.....		
	Premiums -monetary value					.....		

<sup>3</sup> In this context 'raw' means simple totals of the data advised to clients, prior to any actuarial discounting or reversionary valuation.

7 January 2010

Dear Mr Josephs

Sir John Chadwick has asked me to acknowledge your letter to him of 6 January 2009. He is considering carefully the points that you make and he is grateful for your explanation of the further information you would find useful in helping to contribute to Sir John's work.

He notes your comments regarding his letter to you of 26 October 2009. It may be helpful to be clarify that Sir John has been appointed to advise the Government and it is therefore a matter for the Government whether or not to publish any advice he provides, including his interim reports. This includes any quantitative data that he sees it as relevant to include in that advice.

Yours sincerely,

Simon Bor  
Simon Bor | **The Office of Sir John Chadwick**  
Private Secretary to Sir John Chadwick

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Michael Josephs  
6th January 2010

Sir John Chadwick

Dear Sir John,

**Quantitative Data and Methods**

In a telephone discussion with Simon Bor on Monday 4<sup>th</sup> January, I raised the issue of the lack of quantitative information in either of the Interim Reports so far released for general consumption.

Whereas there has been extensive and detailed disclosure of your thinking on the formal basis of a payment scheme, there has been almost no disclosure on the quantitative front or on the actuarial assumptions behind the quantification of loss, which are, for policyholder advocates, equally important.

We have earlier pressed for disclosure of the actuarial advice that you were receiving to which you replied in your letter of 26th October 2009<sup>4</sup> that it was a matter for the Treasury, which we found extremely surprising and troubling.

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<sup>4</sup> *"I have received advice on actuarial matters – which, naturally, include quantitative data – from Towers Perrin; but it is not the case that "detailed statistics ... underlie [my] proposals". To the extent that my Advice (or any interim advice) provides HM Treasury with figures on which to base any decision to make payments, it will be for the Treasury to decide whether those figures and the basis on which they have been determined are made public. "*



Several of us have considerable experience of analysing both the financial history of Equitable, and of exploring the quantitative implications of various approaches to redress payments, and we are aware that there are many pitfalls for the unwary. It is also obvious from the history of the affair that actuaries in general have been insensitive to the rights and the legitimate concerns of Equitable's policyholders. Indeed, such approaches involving massive bias towards the desires of insurance company management are still current.<sup>5</sup> It would not be in any way reasonable or realistic for you to assume that the advice you receive from your actuarial advisors was free of defects or unconscious bias. This can scarcely come as a surprise as in your judicial capacity, you will have encountered many instances of "expert advice" that was partisan in one way or another.

It may be that you are planning on disclosure of these matters "after the event", when it will be easier to see exactly what is relevant, but we would strongly advise to the contrary. Releasing the information now may well provoke immediate controversy, but it will be constructive debate, not total opposition.

To be somewhat more specific we would have expected by now to have been told:

- a) What sort of general information is available in the ELAS archives in relation to its "underwriting book" and how far back in time each set of information is available. Specifically we need to know whether premium and claim data are available in non-discounted form for each class of policy, and how the various submissions in the Annual Returns reconcile back to the raw data.
- b) In what form the individual policy data on the Society's electronic records is held, and how far back that goes, together with further explicit information on data which are only held in less easily processed form.
- c) Some overall year by year statistics of the totals by policy type of *premiums paid, guaranteed bonuses awarded, total bonus awarded, and the equivalent figures for claims*, all expressed in raw (non-discounted) form.

To take a concrete example, you state in IR2, paragraph 4.5 as follows:

*"In light of the above, if were to make a deduction in respect of funds already invested by July 1991 (as to which I have not yet made a decision), I am minded to do so by a general deduction applied to all funds held at that date in recognition of the extent to which policy values at that date exceeded the value of the Society's assets."*

As stated, this would be manifestly unjust, treating someone who had just opened a policy for £100,000, in the same way as someone who had been a member since 1975 and had accumulated the same amount by way of a small initial premium of £7,500 and very substantial (and excessive) bonuses totalling £92,500 (which is equivalent to 16.5% average annual growth).

There is a very strong argument that any initial adjustment should apply to the 'bonus element' of the policy value and not to the 'premium element' which represents the capital

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<sup>5</sup> See, for example, the December 2009 issue of "The Actuary" at <http://www.the-actuary.org.uk/871312>

contributed in the first instance. According to my approximate reconstructions the total asset shortage in 1992 was between 40% and 50% of total policy values, whereas bonuses in total were around 60% of total policy values. If those figures are correct (which I doubt)<sup>6</sup>, then the appropriate notional reduction should be 45/60ths of each policy's *total bonus* as at the end of 1992. This would imply no adjustment to a 1992 policy, but the 1975 policy instanced would be reduced in notional value by 67%.

I would point out that in money terms, the scale of the asset shortages, i.e. the overbonusing, at the end of 1992 is very large, and unless appropriate offsets are made would increase apparent losses by £10 Billions at the end of year 2000. So both equity between policyholders and the avoidance of a quite unjustified call on the public purse demand that such adjustments are made.

Equally, it seems to me that the scale of the corrections needed would justify a substantial data recovery exercise to obtain more accurate data from the Equitable records, at least in respect of those pre-92 policies which might give rise to large ex-gratia payments. We do not find the bland statement from your advisors that "... *to process that data would require disproportionate time and expense*"<sup>7</sup> to be credible as it stands.

We are seeking to be as constructive as possible in our submissions to your review of possible payment schemes, but without the sort of quantitative data and explanations that I have indicated, there are likely to be further numerous and avoidable delays.

Yours sincerely

Michael Josephs

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<sup>6</sup> As I emphasised in earlier correspondence, the proper data from the underwriting book as outlined above is needed to achieve any degree of accuracy. In its place I have made numerous plausible assumptions, some of which may be wide of the mark.

<sup>7</sup> Footnote 7, page 14 of IR2