M.N'S NOTES ON HIS MEETING WITH SIR JOHN CHADWICK, LAURENCE EMMETT, GARETH SUTCLIFFE AND SIMON BOR AT ONE, ESSEX COURT ON THE AFTERNOON OF APRIL 15TH 2010.

Background: MN was originally asked to attend Sir John in response to his urgent letter of March 12th. After that he consolidated and enlarged upon the March 12th letter as suggested in a brief reply from Laurence Emmett on March 19th. In the late phases of this exercise he received a more detailed response from Laurence Emmett, such that he was able to deal with any additional matters before submitting a more substantial response on April 7th. On arrival at Essex Court he was handed a letter from Sir John (a copy of which had been sent the day previously but not received), detailing 5 areas on which further clarification was sought. In the event, this letter provided an appropriately wide framework of reference for matters of clarification more generally, such that it was right and proper to spend most of the meeting in their discussion.

Area 1). Opening of meeting and examination of whether points 1-6 of the MN letter were more than a simple attempt to persuade Sir John to extend his terms of reference in any way.

Sir John welcomed MN and made the necessary introductions for the meeting to start. He was interested to know a little more about MN's involvement in Equitable affairs generally, and why MN had evidently devoted so much time to it. He observed that MN was unaligned, and not an official representative of any particular faction. What might have led MN to do this? MN replied that it had begun with his own interests as a policyholder and member of ELAS, and that as a result of looking after that interest he had become associated with similarly minded people who had thereafter kept each other up to the mark. As time went on, MN saw the need to maintain a more general overview in order to make sure that important matters of no immediate concern to those with more specific aims were not neglected. Beyond that, the matter was an interesting voyage of discovery in itself, during which MN had learned a lot. If that also meant that MN had to be an apologist, and address himself to a wider audience, he hoped that the meeting might take this into account and look beyond it.

MN volunteered that he had lately been an experimental physician in the pharmaceutical industry. In that he had to balance the needs and aims of his organisation with his traditional fiduciary and professional duties of care to those using his company's products and the doctors who prescribed them, his position was not dissimilar from actuaries in Life Offices. While both actuaries and doctors could attain leading roles in their Societies or firms, their original and primary duty was the welfare of policyholders and patients respectively. Doctors and lawyers had the benefit of a long and informative ethical tradition, whereas that of the actuary was not so highly or indeed so formally developed. Insofar as these insights led MN to take a firm overall line on the way the actuarial profession had served the UK generally as well as more particularly, he hoped it would be duly understood in the current circumstances.

While Sir John regarded himself as formally obliged to carry out his Terms of Reference, he wished it to be absolutely clear that he was expected to be independent

in matters of judgment as to how he did this. For example, he had not accepted representations by the Treasury to the effect that the Ombudsman had intended to restrict her earlier findings of injustice to those who had relied on regulatory returns. He was not a mediator either. MN expressed his relief and appreciation that someone as appropriately accomplished and reputable as Sir John had taken on this very difficult role.

Having thus made his position plain, Sir John asked MN to clarify whether he had properly understood it in framing his observations, and in respect of whom they were addressed. He could not agree that the matters raised were in any sense his own opinions as expressed in IR3. With this MN concurred, while reminding the meeting that the contentious matters outside Sir John's immediate remit had been introduced by the Treasury. Even so, MN felt bound to point out that the estateless lower quartile style of Head B comparator and the actuarial counterfactual scenarios proposed by Sir John's advisors were consistent with the Treasury's position, and that this was part of the ongoing problem. He also regretted not having made it clear that his observations were also made in response to Sir John's own invitation for further representation on these matters in para 2.24 of IR3. On these understandings the meeting proceeded.

Area 2). Points 7-10 of MN's letter: What would have happened had there been no maladministration?

MN's position on this was a logical extension of what had occurred prior to the PO's reference period, and hence what was carried forward into it as discussed in opening up the meeting. Beyond this, however, he expressed his overall puzzlement that the PO's report seemed to be all about the regulators, but largely regardless of the entity that was being regulated. The result was something akin to applying land battle tactical considerations to a naval engagement. It compounded the overall difficulties of linking isolated or cumulative findings of maladministration to injustice, let alone financial loss.

Sir John's April 14th letter had mentioned four Area 2 items specifically. In the event they mostly got answered both directly and indirectly at different points in the meeting. They were:

i) *Reduction in bonus rates absent maladministration.* MN's position was that, after the critical period of overbonusing, the effect of all the regulatory expedients was to maintain an already maximal over allocation during the PO's reference period, such that bonus rates could not thereafter rise appreciably above the industry norm. On the one hand this explained why he felt the Equitable's historical bonus rates as the actual determinant of PRE were not unreasonable, and might be used without the need for a comparator. But on the other the effect of all the regulatory expedients was in direct contrast to the essential nature and aim of with-profits assurance business. (As to when these expedients might have been reversed and bonus levels reduced, please see the Causation section.). The only other way by which MN thought bonus levels might otherwise have risen appreciably above the norm in this period was the Ponzi element and ignorance of new business strain. He looked to Sir John's advisors for clarification of this issue if necessary and in due course.

ii) *Quasi-zillmerisation absent maladministration*. In the event this was not discussed specifically. But in that it can be regarded as another aspect of (i) and (iii), this may not matter too much.

iii) *Section 68 orders absent maladministration*. Gareth Sutcliffe asked MN to clarify his views. MN replied that he had raised the future premiums/profits switch with the PO's investigation, but in the event it had been ignored. Beyond that, however, Section 68 reliefs were antithetical to with-profits business. It was somewhat like shareholder's expectations of dividend being substantially reduced by high levels of gearing. Once again, therefore, the present position was a result of neglect of the entity being regulated.

iv) *In what sense might accepted maladministration be said to be responsible for the Society's lack of free assets?* Again for the most part this was not discussed directly. But repeated oversight of this *sine qua non* once again relates to the fact that the nature of the entity being regulated cannot be set aside from the process of regulation itself.

A change in direction: Causation.

At this point Sir John opened up the matter of causation more generally. His starting point was the *Hyman* decision. Though it was not the only source of the Society's difficulties, it had clearly been an important factor in the subsequent unravelling of its position, and in particular because there were no provisions for the Society losing it. His problem was that the PO had made no ruling of maladministration in respect of the matter. MN responded that this difficulty resulted from the PO's inverted causation, which in the end made all GAR matters subservient to later reinsurance treaty maladministration. It was all compounded by her manner of economical rather then exhaustive ruling on maladministrations and injustices generally. One might perhaps be forgiven for taking a cynical view that it was all originally intended to avoid further *Francovich* serious regulatory breach criteria in the EU. Regardless of whether that was true or not, MN felt it explained Sir John's current difficulty.

That apart, MN stated that neglect of the GAR problem was a general actuarial issue. There had been a maturity of guarantees working party in the early 80s, but nothing general had been done in response to the looming crisis, and the 1997 Bolton working party had ended in an *impasse.* In the absence of a way forward everyone was taking an expectant line, with the result that the outcome of *Hyman* was critically important for a number of businesses. Scottish Widows was a case in point. It paid out its GARs from its estate following the *Hyman* decision, but demutualised shortly thereafter. Given the Equitable's negative estate this was impossible, and that was a material underlying prudential consideration irrespective of whether maladministration had occurred it its case.

Sir John's responded by taking MN yet further back up the causal stream in consideration of the lack GAR or other provisions more generally and irrespective of emergence of the Differential Terminal Bonus Policy. On what grounds, he asked, would it be reasonable to suppose that the regulators should have taken the overall decision to close the Society to new business by the end of 1992?

MN's immediate response was that this approach was tempting because it could solve or simplify so many big problems, but Sir John added that it did not of itself solve the pre-1992 gains/losses data question. So what would have justified the regulators taking such a view? MN looked to Mr Sutcliffe to confirm that with-profits business premiums were loaded in anticipation of future surplus generally before going on to say that the matter was at its heart fiduciary. One could not continue to take in monies in respect of future profit, let alone guarantees more generally, from a then already extant position of chronic deficit.

Area 3). MN points 11-15: Relevance of the European Union.

The previous discussion had served to introduce the significance of the PO's method of investigation and ruling in relation to the EU Life Directives and *Francovich.* Sir John asked what impact the European Union might have on his work. Would UK policyholders sue the UK Government in the EU Courts? MN thought that would require a suitably deep pocket, and Sir John pointed out that EMAG had already expended not inconsiderable resource on subjecting the Government to judicial review. In any event, Sir John was not sure how this could affect his work at the present. MN thought the question was not just about UK citizens, but also those of other nationalities and jurisdictions. Sir John replied that he was cognisant of such groups as exemplified by the work of Margaret Felgate.

MN thought that on this wider issue the EQUI Report should also be consulted. In point of fact EQUI had concluded that the EU Directives had been correctly transposed but not correctly implemented. Sir John commented that he had read that report, and that his impression was that it consisted primarily of reports as to what EQUI had been told, rather than an inquiry as such. MN agreed, adding that it was not wholly digested. However its evidential base, like that of the PO, was a material consideration. Moreover it had made specific recommendations as to compensation, and asked that Member States should actively assist their citizens in obtaining it. In that case, Sir John observed, it was a matter that might be addressed at the level of the EU Commission. MN said he thought so too.

As to where one went from here, MN was hesitant to suggest anything more specific than that Sir John might consult the PO with regard to the route forward from these and other difficulties. Sir John reminded MN that he had already had an exchange with the PO, which notably included her August 20th 2009 letter.

MN asked what Sir John had made of the DAGEV submission. Simon Bor volunteered that he had translators on hand for it, but that in the event it had not materialised.

Area 4). MN point 17.2: Apportionment.

Since the meeting MN has re-visited 17.2, and it does not state that Sir John suggested that the notion that the Society was "principally the author of its own misfortunes" constitutes a basis for reducing payments to policyholders. That suggestion is the Treasury's, and was dealt with in Appendix I of MN's March 12th letter. Sir John had, however, in his April 14th letter suggested that it is important to distinguish, so far as possible, between losses resulting from accepted maladministration and losses

which would have occurred, absent maladministration, from the commercial objectives of the Society.

It is therefore proper to bear this later analysis as well as the preceding matters of the meeting in mind in evaluating what MN proceeded to say on that subject. MN stated that, because Conduct of Business regulation had been entirely omitted there was in effect a large unknown term in the apportionment equation. Hence regardless of how or why that had come about it never had been possible to make any rational or satisfactory approach to apportionment vis-à-vis the Society in any case.

Area 5). MN point 20.1: Actuarial advice.

Sir John expressed himself well satisfied with the acuity and quality of the advice he had so far received from his external appointees. In clarification of MN 20.1, his April 14th letter states that he selected the members of the Panel from a list of senior actuaries with relevant experience and expertise. It was at his request that Towers Watson appointed those whom he had selected. Laurence Emmett clarified the matter further after the meeting in response to another query from MN. That clarification was that the original list had been drawn up by Towers Watson, and it was from this list that Sir John had made his selection. MN did not pursue the wider issue any further at the meeting.

Conclusion of the meeting.

Sir John thanked MN for attending and said he was welcome to come back again. MN thanked Sir John for this offer, and was content to leave it that if the need arose he was at Sir John's disposal, and that he would attend on that basis. In conclusion, he handed a bundle of papers concerning a recent Financial Ombudsman award in respect of his own annuity to Gareth Sutcliffe. He hoped they might illuminate the difficulties everyone faced in dealing not just the rescissionary bases for past and future loss, but also the situation in which ELAS annuitants transferred to the Prudential now found themselves.

Michal Nassim. April 18th 2010.

Primary copy to the Office of Sir John Chadwick under covering letter.
This version revised in reconciliation with notes made by Laurence Emmett at the meeting as relayed to MN from SB by e-mail on April 23rd at 18.18 hrs.

E-mail copies of amended version to Peter Scawen (ELTA), Stephen Pearl, Michael Josephs, Dr Andrew Goudie, Margaret Felgate and Nicholas Oglethorpe.

E-mail recipients are strongly advised to delete the original version of these minutes in respect for confidentiality and propriety..