Dr Michael Nassim
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29 March 2010

Dear Dr Nassim

Equitable Life

I refer to your letter of 12 March 2010 addressed to Sir John and myself, to which Sir John has asked me to respond.

You start by summarising "the position", in five numbered paragraphs at page 1. I understand these paragraphs to be intended to be a summary of the Treasury's representations to Sir John, which were published at the same time as the Third Interim Report. They cannot, I think, be taken as a summary of the provisional views expressed in the Report itself. That said, I am not sure that your paragraphs do, in fact, accurately summarise the Treasury's position: in particular, it is not clear that your point 2 accurately summarises the contents of paragraph 36 of the Treasury's letter at page 36 of the Correspondence file.

At the top of page 2, you write that to use the categorisation of loss into Head A and Head B as the basis for two comparators "is a *non sequitur* in that it is based on fundamentally flawed assumptions". Are you, in this sentence, referring to the matters which you raise in the following paragraph? If not, it would assist Sir John if you could explain your point more fully. The analysis which underlies the distinction between Head A and Head B comparators is set out in the Second and Third Interim Reports. It is not clear to what "assumptions" you refer; nor why you suggest they are "fundamentally flawed".

Turning to the following paragraph, you write that AFP (to follow your abbreviation for "a former policyholder") has submitted that, absent maladministration, "the ELAS with-profits fund would have been . . . different in character"; and that this observation precludes the approach to Head B loss which has been provisionally put forward in the Third Interim Report. It is unclear why AFP's observation (to which you have added the word "radically") should lead to

the use of a "Head A" model for calculating "Head B" loss. Nor is it clear to me why the Ombudsman's statement that her findings should be considered cumulatively should be treated as pointing to this result.

In the following paragraph, you assert that every reasonable person should object to proposition 2 (from your summary of the Treasury's position). Leaving aside the question whether your summary accurately reflects the Treasury's position, you have not accurately reflected the approach provisionally put forward at paragraph 6.4 of the Third Interim Report:

> "*The goal of regulation is to set limits to the extent to which financial institutions may be mismanaged or improvidently run. Where regulation fails, it is proper to attribute to the regulator any losses resulting from the failure to keep mismanagement and improvidence within those limits. But, equally, it would be inappropriate to attribute to the regulator any losses that would have occurred even if there had been no regulatory failure; in particular, any losses which result from mismanagement or improvidence committed within the limits imposed by the regulatory system.*"

Do you disagree with this approach? If so, it would be of assistance if you were to explain the basis for that disagreement.

As for the following paragraphs all aspects of the regulation of the Society prior to 1990 – and the "conduct of business" regulation of the Society during the 1990s – fall outside both Sir John's and the Ombudsman's remit.

On page 3, you suggest, incorrectly, that Sir John has not addressed the cumulative effect of the Ombudsman's findings. A similar comment has been made, as you may be aware, in a letter sent to Sir John by EMAG. I set out Sir John's response (in a letter to EMAG dated 23 March 2010):

> "*I do not accept that it would be possible to assess the overall effect of maladministration, without first considering the findings individually. It seems to me that this view is implicit in the reasoning of the Ombudsman, in so far as she made some findings of maladministration without a matching finding of injustice: see, for example, Report paragraphs 1/12/86-88 (page 345) and 1/12/151-153 (pages 351-352). But even if this view is not implicit in the Ombudsman's reasoning in this way, it is explicit in the reasoning of the Divisional Court, in so far as it upheld the legality of the Government's decision to accept aspects of the Ombudsman's third finding of maladministration, but to reject the matching finding of injustice: see paragraphs 98-102 of the judgment.*

> *The premise underlying the provisional views expressed in my Third Interim Report (and which I currently intend – unless persuaded otherwise – should form the basis of my final advice) is that, while it is necessary to consider the overall effect of the maladministration taken together, it is not appropriate to do so without regard to the actual findings of maladministration which were made by the Ombudsman and accepted by the Government.*"

Following on from this, you have made reference to the Ombudsman's observation in correspondence subsequent to her Report that:

> "*absent ... serial maladministration ... from July 1991 onwards, no reasonable investor would have joined or remained with Equitable Life throughout that period*."

You are correct to note that this view does not appear to have been expressly stated in the Report. But further, the sentence quoted was (on my understanding) written in relation to *all* of the Ombudsman's findings of maladministration: including, that is, those which were not accepted as well as those which were accepted. To this extent, it is a view which covers matters that fall outside Sir John's Terms of Reference. Further, even if the Ombudsman's post-report observation were to be accepted, there would remain the need for a Head B comparator in respect of those who invested prior to July 1991.

In your conclusion to the relevant paragraph, you write that it is a "fundamental absurdity" to attempt to define loss purely with reference to the failings of the prudential regulators. But that is precisely what a Tribunal established in accordance with the Ombudsman's recommendations would have been required to do: and it is what the Terms of Reference require. Sir John has not been asked to advise as to the extent of losses suffered, generally, as a result of the manner in which the Society chose to carry on its business: his remit is to advise as to the extent of losses suffered as a result of regulatory maladministration found by the Ombudsman and accepted by the Government. It is important not to lose sight of this.

I do not understand the paragraph at the bottom of page 3 and the top of page 4. Sir John has explained why he takes the provisional view that WPAs, non-GAR policyholders and those who joined late have suffered a greater impact (proportionately to their investments) than other policyholders. It appears clear that you disagree with these views: it would be of assistance if you were to set out your reasons for this disagreement.

The final paragraph at the bottom of page 4, concerning the role of Watson Wyatt, has been addressed in my earlier letter of 19 March.

At page 5, you present a "Summary" of your views, which includes a demand for "assurances" from Sir John. It is no part of Sir John's role to give "assurances": his role is to give advice to the Government. But, to address your questions:

1. Sir John currently intends to advise that relative losses should be measured by reference to a Head B and a Head A comparator, for the reasons set out in the Second and Third Interim Reports.
2. If there are cogent arguments why the use of a Head B comparator to measure relative losses is inappropriate, then Sir John will consider those arguments. But, for the reasons set out in the Third Interim Report and elsewhere in this letter, Sir John is not been persuaded by such arguments on this point as have been put to him to date.
3. I am not sure I fully understand this point. The position of international policyholders was not raised elsewhere in your letter; the only respect in which in which they may have to be treated differently in the context of an *ex gratia* payment scheme is that, for the reasons set out at paragraph 3.2 of the Third Interim Report, their data in readily available electronic form does not go back quite as far as that for some (but not all) classes of UK policyholders. This is a practical limitation: not a matter of principle.
4. It is unclear to which "new matters introduced by the Treasury" you are referring; but, if the reference is to the fifth bullet point of Sir John's revised Terms of Reference (introduced following the judgment of the Divisional Court handed down in October 2009), he must take the view that it is for the Government to specify the matters on which it seeks advice. That is not, of course, to suggest for a moment that it is for the Government to dictate the advice that it wants on those matters: if that were the Government's intention it would not have appointed an independent adviser.
5. Sir John would not have put forward, in his Third Interim Report, provisional views which he did not believe to be both flexible and fair; but he is ready to consider reasoned argument why those provisional views should be reviewed, modified or abandoned.
6. Your professed "concerns" regarding Towers Watson are without substance. Moreover, it is incorrect that the panel which has been appointed to review Towers Watson's work was selected by Towers Watson. It was not. It was selected by Sir John, from a list of those senior members of the profession with relevant experience whose other interests do not give rise to a conflict.

I understand that Sir John's Private Secretary, Simon Bor, will be in contact with you to arrange a meeting, with the intention of further discussing the matters raised in your letter.

Yours sincerely

Laurence Emmett
Counsel to the Office of Sir John Chadwick