

**Interim Review
for the half year ended 30 June 2008**

The Equitable Life Assurance Society

Registered office

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Policyholder administration

Walton Street, Aylesbury, Buckinghamshire HP21 7QW

Board of Directors

Vanni Treves, Chairman (a) (b) (d)

Peter Smith, Deputy Chairman (a) (b) (d)

Charles Thomson, Chief Executive (c) (d)

Tim Bateman, Finance Director

David Adams OBE, Non-executive Director (a) (c)

Ian Brimecome, Non-executive Director (c)

Ian Reynolds, Non-executive Director (a) (c)

Fred Shedden OBE, Non-executive Director (c)

Andrew Threadgold, Non-executive Director (c)

Jean Wood, Non-executive Director (b)

Key to membership of the principal Board Committees

- (a) Audit
- (b) Remuneration
- (c) Investment
- (d) Nomination

With-profits Actuary

Kathryn Payne

Head of Actuarial Function

Tim Bateman

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2 Corporate review

The Society's Chairman, Vanni Treves,
and Chief Executive, Charles Thomson, on behalf of the Board

Dear Members

We are pleased to report that despite turbulent markets the Society remains financially sound and that we are making steady progress in our review of strategic options. The Parliamentary Ombudsman has also published her report confirming, as we suspected, major failures by regulators during the 1990s.

Key milestones since our last report are:

- Bonus rates were maintained for the first half of the year despite significant falls in the value of assets since the beginning of the year. However, we reduced bonus rates on 1 August to reflect the significantly poorer outlook for investments;
- We provided a detailed technical description of the Society's business to interested third parties and have now received several significant proposals for the future, which we are developing and evaluating; and
- The Parliamentary Ombudsman's report has been published and we are doing all we can to encourage a speedy implementation of her recommendations.

Financial position

In recent years, the Society has focused on improving and stabilising the Society's financial strength. Despite difficult market conditions, our improved financial strength has enabled the Society to maintain bonus rates for 2008 (to July) at a level above that which would be justified by investment performance alone. In August, however, we reduced bonus rates to reflect the significantly poorer outlook for investments.

Reflecting the widespread and significant reductions in asset values, the Excess Realistic Assets ("ERA") fell from £621m at 31 December 2007 to £440m at 30 June 2008, representing 7.2% of the with-profits fund (9.2% at 31 December 2007).

Strategic options

The Society remains a large business and we remain stable and secure. The business risks are now in line with those of other closed funds.

We can therefore continue to run the business as an internally managed mutual for the foreseeable future. This would mean:

- Policyholders would continue to get at least their minimum guaranteed benefits as their policies mature;
- By their nature, non-guaranteed benefits cannot be guaranteed, but in reasonable economic conditions, with interest rates around 5.0%, one might expect non-guaranteed bonus additions for UK pensions to be around 5% p.a. However, in less benign conditions, such as those we now face, this rate will be lower;
- To cover the risks of the fund, we have to hold back capital, the release of which in future may be of benefit to those who stay longer;
- On the other hand, members continue to be exposed to the profits and losses of the business, so policy values could be adversely affected, for example, by poor investment performance caused by market conditions; and
- As policies mature and the business contracts, we expect administration costs to rise in relative terms - we have allowed for this effect, but future policy values could be affected if the actual level of expenses is different from that assumed.

We continue to summarise this position as: *'Sound, but, inevitably, not without risk; some growth potential, but inevitably limited prospects'*. This is why your Board is looking for alternative options.

We have removed some important potential barriers to a transaction for the remaining policyholders of the Society by reducing annuity risks through the transfer of fixed pensions to Canada Life and removing the more specialised with-profits annuity contracts by transferring them to Prudential.

We have then produced a detailed technical description of the remaining business (known as a data book) to enable third parties to make an assessment of how they could improve prospects for our policyholders.

We have received a number of such proposals and we are working to refine and evaluate them against the continued run-off of Equitable Life as an independent fund.

It is too early to tell whether the outcome will be a proposal we can recommend, or whether it will confirm that policyholders could do as well or better with the business continuing independently. However, we can assure you that your Board, with its advisers, will conduct a detailed and rigorous analysis on your behalf.

Parliamentary Ombudsman

The Parliamentary Ombudsman published her long awaited report on 17 July 2008. In it she has laid bare the record of maladministration which she summarises in her heading '*Equitable Life: a decade of regulatory failure*'.

We pressed hard in 2004 for the Parliamentary Ombudsman to investigate the regulation of Equitable Life because she was in the right position to do so. We gave her and her team all possible support throughout. After four years and over 2,800 pages of report, she has clearly done a very thorough job.

Her language is strong and unequivocal. She found regulators acted in a '*passive, reactive and complacent manner*' and their actions were '*largely ineffective and often inappropriate*'. Most importantly, she finds '*sufficient link*' between '*serial regulatory failure*' and '*relative loss*' of policyholders. Her report backs up these statements with an enormously detailed and rigorous analysis. This leads to and justifies her central recommendation that the Government should fund a compensation scheme.

The next step is for Parliament to consider her report and we wrote to policyholders over the summer to urge you to contact your MP and make him or her aware of policyholders' interests. We continue to meet politicians across the

political spectrum to make strong representations on behalf of members, but if you have not contacted your MP, let us take this opportunity again to emphatically encourage you to do so.

Looking ahead

The Society has made significant progress in recent years and it is pleasing to be able to cope with turbulent market conditions from a position of comparative strength.

The Society's financial soundness, even in difficult conditions, allows us to consider proposals for improvements from third parties without undue pressure - if these proposals do not improve prospects for policyholders, we will reject them.

The Parliamentary Ombudsman's report has given an authoritative account of maladministration in the regulation of Equitable Life and has enabled Parliament to consider, and we hope require, compensation for policyholders.

As always, you may rest assured that your Board will continue to do everything it possibly can to maintain the stability and the security of your Society and to improve further the prospects for all policyholders.

On behalf of the Society's Board of Directors on 9 September 2008



Vanni Treves
Chairman



Charles Thomson
Chief Executive

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Review of the Society's financial position

The key performance measure of the Society's net resources, Excess Realistic Assets ("ERA"), is represented by the excess of realistic assets over liabilities before deduction of the estimate of the value of future discretionary increases to policy values. This amount, which is reported as a policy-related liability in the technical provisions in the Balance Sheet, is available to meet any unforeseen liabilities and liabilities in excess of those provided for at the balance sheet date and to enhance bonuses in the future.

At 30 June 2008, the ERA was £440m, a decrease of £181m over the previous year end. The analysis of the with-profits assets and liabilities is as follows:

	30 June 2008 £m	31 December 2007 £m
Realistic value of with-profits assets	6,110	6,775
less:		
Policy values	5,132	5,383
Future charges	(199)	(206)
Impact of early surrenders	(35)	(31)
Cost of guarantees	294	442
Other long-term liabilities	317	384
Other liabilities	161	182
	5,670	6,154
Excess Realistic Assets	440	621

The Society seeks to maintain the ERA balance at a level that protects solvency while treating continuing and exiting customers fairly. Reflecting the widespread and significant reductions in asset values, the ERA fell to £440m at 30 June 2008 (£621m at 31 December 2007) representing 7.2% of the with-profits realistic assets (9.2% at 31 December 2007).

The key movements in the ERA during the period are shown in the following table:

	January to June 2008 £m	January to December 2007 £m
Opening Excess Realistic Assets	621	884
Investment performance and effect of bonuses	(223)	(112)
Mortality experience and assumption changes	-	(22)
Surrender experience and assumption changes	7	19
Changes in other valuation assumptions	4	28
Variances in provisions and expenses	15	(13)
Transfer of with-profits annuities to Prudential	(3)	(188)
Other movements	19	25
Closing Excess Realistic Assets	440	621

Over the period, assets have fallen significantly but policy values have continued to increase and this cost has been met from the ERA. Increases in interest rates have resulted in lower values for fixed interest securities with the impact on the ERA being offset by a corresponding reduction in the cost of guarantees. The increase in interest rates has been exacerbated by the continuation of the financial market's evaluation of risk associated with corporate bonds (commonly known as the 'credit crunch'). Property and equity values have also fallen significantly during the period. However, there have been small positive contributions to the ERA from surrender experience and reductions in certain provisions.

The policy value attributable to with-profits policies may include an element of non-guaranteed final bonus. Estimated final bonus, sometimes referred to as terminal bonus, included in the policy value, is not guaranteed. However, for realistic reporting, a prudent allowance for future bonuses, based on assumed future net investment returns that take account of deductions for potential risks, is included in the valuation of the long-term business technical provisions in the financial statements.

Developments during the year

The Society has successfully concluded the transfer of the with-profits annuities to Prudential. The 2007 year-end accounts contained an estimate of the remaining amounts associated with the transfer. The item in the table above (detailing the movements in ERA) represents the difference between the estimate in the 2007 year-end accounts and the actual amount required.

The Society has now completed negotiations with HBO5 on the initial premium dispute in relation to the 2001 reinsurance agreement and the outcome has been reflected in these accounts. Additionally, the 401 with-profits annuitants' claims previously reported in the 2007 annual financial statements have been settled during the year. We are in the process of finalising a fair settlement of expenses with the claimants' solicitors.

The Society continues to make significant progress in considering proposals to improve prospects for our policyholders as outlined in the Corporate Review. In order to assess these proposals it has been necessary to perform additional detailed work on the way the business may be run-off if we remain an independent mutual. If the Society receives an acceptable proposal from a third party, significant costs will be incurred in securing the associated benefits.

If the Society remains an independent mutual however it is likely that significant expenditure will be necessary to improve existing systems and processes in order to administer the business as cost-effectively as possible in the long-term. So far the Board has approved only those costs necessary to take the evaluation of any sale proposals received to the stage where a recommendation about the future of the Society can be made to policyholders. Your Board will only approve additional expenditure if it firmly believes this to be in the interests of policyholders, either in pursuing proposals made by third parties or to provide a cost-effective run-off of the Society's business.

Investment performance and capacity to pay bonuses

During the period, the Society continued to operate a cautious investment strategy of retaining a low proportion of the with-profits fund in equities and property, in order that its assets match closely its liabilities. The weighting in

favour of fixed-income securities within the investment portfolio results in there being limited scope for growth of the fund, as any changes to asset values resulting from movements in yields are substantially mirrored in equivalent and offsetting changes in the value of liabilities.

The Society achieved a gross return on the with-profits fund of -3.1% in the first half of 2008. After adjusting for changes in gilt interest rates in the period, the effective gross return was 0.5%. The Society currently deducts 1.0% p.a. (0.5% for the period) for the cost of administration (this figure allows for future diseconomies of scale) and 0.5% p.a. (0.25% for the period) for the future cost of guarantees from policies maturing where the minimum guaranteed benefit exceeds the policy value. After taking account of those deductions and the negligible impact of changes in provisions, the effective net return on the with-profits fund in the first half of 2008 was -0.3%.

Despite significant falls experienced in the investment markets during the period, bonus rates for 2008 were maintained at a gross rate of 5.0% p.a. for the first half of the year. From 1 August 2008, bonus rates were reduced to 3.5% p.a. to reflect the significantly poorer outlook for investments. We will keep investment performance under review and will take further action to amend bonuses where necessary.

Protection of the fund and policy surrenders

Where a policyholder surrenders his or her with-profits policy (or switches to a unit-linked fund) before maturity, contractual obligations in respect of payouts under the policy generally do not apply. The Society takes account of the interests of all policyholders in these circumstances by paying the policy value (or equivalent), less a financial adjustment. In setting the financial adjustment, the aim is for the amounts paid to surrendering policies to be fair, but not to disadvantage continuing policyholders. In particular, the amounts paid to surrendering policyholders should not reduce the payout prospects of the continuing policyholders.

This adjustment can be varied at any time without advance notice to policyholders and any such change would reflect the financial position of the Society at that time.

Policyholders' withdrawals from the fund have continued in an orderly manner during the period and the financial adjustment for individual policies has been maintained at 5.0%. The financial adjustment for group schemes is assessed scheme by scheme.

Business risks

Full details of material contingent liabilities and uncertainties are set out in the 2007 annual financial statements. Updates on the positions with the Parliamentary Ombudsman's report and the strategic approaches being undertaken for the Society have been provided in the Corporate Review.

Provisions continue to be made for the Society's contractual commitments in respect of the two pension schemes for which HBoS is the principal employer. However, there remains a possibility that a more conservative basis may need to be adopted in future in calculating the Society's obligations.

As noted in the 2007 annual financial statements, there remains the possibility that further complaints and claims can be made against the Society, alleging fraud or mis-selling or otherwise seeking compensation. The Society has made significant progress in managing these risks and provisions have been adjusted accordingly.

The Board's conclusions on provisions and going concern

The Board is responsible for making a formal assessment as to whether the 'going concern' basis is appropriate for preparing any financial statements. The going concern basis presumes that the Society will continue to be able to meet its guaranteed obligations to policyholders and other creditors as they fall due. To do this, the Society must have sufficient assets not only to meet the payments associated with its business, but also to withstand the impact of other events that might reasonably be expected to happen.

The Board has given due consideration to potential risks and possible actions and has concluded that it remains appropriate to prepare the Society's financial statements on a going concern basis.

Summary group balance sheet

as at 30 June 2008

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	30 June 2008 £m	31 December 2007 £m
Assets		
Investments		
Land and buildings	556	625
Investments in group undertakings	18	16
Shares and units in unit trusts	415	466
Fixed-income securities	5,153	5,661
Deposits and other investments	297	337
	6,439	7,105
Assets held to cover linked liabilities	80	76
Reinsurers' share of technical provisions	2,418	2,792
Other assets	215	236
Total assets	9,152	10,209
Liabilities		
Technical provisions		
Excess realistic assets	440	621
Other with-profits technical provisions	5,509	5,975
Non-profit technical provisions	822	881
Linked liabilities and claims	2,226	2,553
	8,997	10,030
Other liabilities	155	179
Total liabilities	9,152	10,209

Note:

The Equitable Life Assurance Society's Summary Balance Sheet is not consolidated and represents the position of the Society only and is unaudited and does not constitute statutory financial statements as defined in section 240 of the Companies Act 1985.

