

Corporate review

Dear Members

It is heartening to be able to report that, after a very challenging 2009, the year ended with real positive momentum. The completion of the contract with HCL to provide administration services to the Society from March 2011 has added many millions of pounds of value to policyholder funds. This, together with a considerable easing in the stresses on the bond, equity and property markets, gave the Board confidence to increase policy values in 2010.

While these increases in policy values cannot be guaranteed, they are an important step towards the recreation of policyholder value that, over so many years, has been eroded.

Having set down our vision to recreate policyholder value, we believe we have three principal ways of achieving this:

- Maximising the return on policyholder assets subject to meeting solvency requirements;
- Providing the best value for money cost base;
- Achieving maximum Government compensation for policyholders.

It is our intention to distribute all of the assets amongst with-profits policyholders as fairly as possible over time.

The importance of solvency

At the heart of everything we do is the need to remain solvent. Sadly, given the events of 2000, this is a matter better understood by Equitable Life policyholders than most. It is also a matter that has profoundly affected the financial services industry, in particular, over the last two years.

At the Society, the demands of solvency are unique. The nature of the underlying guarantees on many policies requires, on the one hand, conservatism in our choice of investment which limits return much in excess of the guarantee; and, on the other hand, requires a great deal of capital above and beyond policyholder liabilities to protect policy values against unexpected events.

Given the Society's solvency imperatives, its holdings in equity-related investments and property (albeit a relatively small proportion of total assets) are simply too volatile, and the fluctuations experienced in 2008 and early 2009 put very considerable stress on the solvency margins of the Society. While, at all times, the Society remained solvent, the uncertainty around a recovery in equity, property and corporate bond prices was not assured. Prices did, of course, recover to some degree and the Board then felt it prudent to reduce its holdings in both equity-related investments and property. The virtue of this was to increase solvency cover but, in direct consequence, there is less opportunity to achieve returns much in excess of that needed to meet policy guarantees.

Tying up your funds in relatively low growth assets is not consistent with recreating policyholder value, and we will return to the implications of this at the conclusion to this report.

Government's proposed compensation scheme

At the Judicial Review in the High Court in October 2009, the Government were told that their rejection of some of the Parliamentary Ombudsman's findings was unlawful. As a result, the Government were obliged to change the Terms of Reference of Sir John Chadwick so that his advice on a compensation scheme will be more comprehensive than it might otherwise have been. We congratulate the Equitable Members Action Group ("EMAG") on their success in bringing that action. The good work carried out by EMAG is both welcome and influential and we look forward to working productively with EMAG in the interests of past and present policyholders.

The Society continues to work with Sir John to help him to reach a sensible proposal as quickly as possible, currently scheduled to be in May 2010. In Sir John's interim reports, he describes a flexible approach which has the potential to cover all those who were policyholders during the period affected by the maladministration. We support Sir John's argument in this matter.

We appeal to Sir John and the Government to bring forward a scheme that is simple and transparent. No matter how fair the theory of any scheme, if policyholders and commentators are unable to understand it, it will never seem fair.

A new third party administrator

We announced in November 2009 that, following an extensive review of the life and pensions administration providers, the Society had awarded its policy administration contract to HCL. This agreement will provide very significant cost savings and cost certainty, enabling the Society to release more value to our policyholders in the years to come. Our latest estimate is that policyholder funds can be increased by some £130m as a result of the contract, and this will be passed to policyholders in future years through reduced charges for expenses, thereby increasing policy values.

In March 2011, when HCL take over full responsibility for the administration services to the Society, policyholders can expect little change and, in particular, the contact centre will remain based in the UK. We will be communicating clearly and fully nearer the time. Until then, policyholder services will continue to be provided by HBOS, now part of the Lloyds Banking Group.

Asset management services

In a similar manner to the way we reviewed the provision of administrative services, we have embarked on an assessment of companies that provide asset management services. In recreating value, policyholders' assets should be optimally managed, and we expect to complete the selection process by the autumn of 2010.

Your Board of Directors

Over the last year, your Board has appointed a new Chairman and a new Chief Executive following the retirement of Vanni Treves and Charles Thomson. As announced in our September interim report, we also welcome Keith Nicholson, Cathryn Riley and Mark Earls to the Board.

Peter Smith retired from the Board in March 2010 and we take this opportunity to thank him for his sterling service over nine years. We will miss his thoughtful, penetrating and wise counsel through the uniquely difficult challenges that the Society's policyholders have had to face.

Recreating value for policyholders

Following our decision in 2008 to run down gradually, 2009 was, in many respects, a watershed year for the Society. Having navigated its way through the financial crisis, having put in place new third party administration arrangements and having refreshed the Board membership, the Society is now studying options for the most effective run-off strategy to recreate value for policyholders.

As a first step, the Board is establishing a set of risk objectives which guide the Executive in its decision making. One such objective is that the Society will seek to hold solvency capital in excess of the requirements laid down by the regulators so that we have time to effect remedial action before falling below the regulatory requirements. This will give reassurance to policyholders that the Society will be able to withstand market events as challenging as so recently experienced.

The solvency capital required to be held by the Society is considerable and this can be expected to increase as a result of Solvency II, the new regulations being developed by the EU Commission scheduled to come into force in October 2012.

Policyholder assets will be invested to provide a secure and stable return but, as we described earlier, growth much in excess of policy guarantees is unlikely. This dilemma is one that we can only see persisting, and one that does not easily lend itself to the recreation of policyholder value as it is difficult to significantly accelerate the distribution of solvency capital.

Accordingly, your Board is looking at what strategies would maximise the return on policyholder assets and we will report further on this well before the introduction of the new solvency regulations.

On behalf of the Society's Board of Directors

Ian Brimecome
Chairman

Chris Wiscarson
Chief Executive

29 March 2010

Financial review

Excess Realistic Assets

A very important measure of the Society's net resources is the excess of realistic assets ("ERA") over liabilities. This amount, which is reported as a policy-related liability in the technical provisions, is available to meet any unforeseen liabilities, and liabilities in excess of those provided for at the balance sheet date, and to increase policy values in the future.

At 31 December 2009, ERA were £675m, an increase of £261m over the prior year. The analysis of the with-profits assets and liabilities is as follows:

	2009 £m	2008 £m
Realistic value of with-profits assets	5,546	5,951
less:		
Policy values	4,143	4,552
Future charges	(290)	(300)
Impact of early surrenders	(28)	(34)
Cost of guarantees	574	814
Other long-term liabilities	283	287
Other liabilities	189	218
	4,871	5,537
Excess Realistic Assets	675	414

The movement in the 'Realistic value of with-profit assets' above relates primarily to claims payments made during 2009. A description of the above liabilities is set out in Note 14f on page 47.

The key movements in the ERA during 2009, as shown in the following table, are explained in more detail in later sections of this review:

	2009 £m	2008 £m
Opening Excess Realistic Assets	414	621
Investment performance net of changes in policy values	242	(311)
Mortality experience and assumption changes	(24)	3
Surrender experience and assumption changes	2	52
Changes in other valuation assumptions	(3)	26
Variances in expenses and provisions	(89)	(7)
Transfer of with-profit annuities to Prudential	-	(3)
Other movements	3	33
Expense savings from transfer to HCL	130	-
Closing Excess Realistic Assets	675	414

The Society seeks to maintain the ERA balance at a level that protects solvency while treating continuing and exiting policyholders fairly. The balance at 31 December 2009 represents 12% of with-profits realistic assets, an increase from the equivalent figure of 7% at 31 December 2008.

Financial Services Authority capital requirements

As a mutual company closed to new business, when we report to the Financial Services Authority (“FSA”) for solvency purposes, the ERA is deemed to be part of policyholder liabilities, and therefore the Society does not report a capital surplus.

In addition to the requirement to prepare financial statements on a realistic basis, the capital required for the Society’s particular risks are quantified in the preparation of a confidential assessment of its capital needs. This is required by FSA rules, introduced under the Individual Capital Assessment (“ICA”) framework. The calculations are underpinned by consideration of the underlying risks, which include credit risk, market risk, liquidity risk, operational risk and insurance risk. These capital requirements are met out of the ERA and, in extreme situations, out of policyholders’ non-guaranteed benefits.

Solvency II regime

The current regulatory framework will be replaced in 2012 by the Solvency II regime, a Europe-wide regulatory basis for establishing capital requirements for insurance companies. Current indications of the proposals being developed by the EU Commission are that the capital requirements under Solvency II will be much more onerous for the Society than the current regime. As a mutual Society, there is no recourse to further capital other than existing funds. The mitigations the Society can put in place are quite limited and generally depend upon reducing risks taken, typically by reducing the proportion of return-seeking assets we hold and hence reducing the expected level of returns, or upon holding back capital in the next few years and paying out less to policyholders. The Board does not view either of these options as meeting the strategic vision for recreating value for policyholders, and is now studying options for the most effective run-off strategy for the Society.

Investment performance and changes in policy values

The Society continues to operate a cautious investment strategy, investing largely in fixed-interest investments while retaining a relatively low proportion of the with-profits fund in equities and property. This helps the Society to match anticipated policyholder payments as they fall due, and reduces the amount of capital that is required to be held. The Society regularly reviews the appropriate composition of the with-profits fund and seeks to manage its property and equity holdings in line with the run-off of business.

As mentioned in the Corporate review, some of the assets previously invested in were too volatile to meet the Society’s solvency objectives and, in 2009, equity investments, including equity derivatives, worth £90m, and properties, worth over £70m, were sold.

The assets backing UK with-profits policies produced a gross return of 6.0% during the year. The increase in corporate bond values as a result of returning market confidence more than offset the falls in values of Government bonds, increasing the value of fixed-income securities over the course of the year. Allowing for the movements in Government bond yields over 2009 the Society’s corporate bond holdings have recovered about half of the £380m reduction in 2008. Some of the severe falls in property and, to a lesser degree, equity values over 2008 were reversed during the second half of 2009. The return adjusted for Government bond yield movements affecting both assets and liabilities was 9.2%. The return on the fund after adjustments to allow 1% for the impact of expenses, 1% for the charge for guarantees, and to allow for tax and the effect of changes in provisions and technical provisions, is 6.6%.

The charge of 1% referred to in the previous paragraph is currently held back from the investment return to meet the cost of guarantees. This charge can be reduced or increased depending on financial conditions from time to time and we expect the charge to continue at this level during 2010.

In determining changes in policy values, the Society aims to balance the objectives of:

- Retaining sufficient capital to meet regulatory requirements;
- Meeting guaranteed payments to policyholders; and
- Meeting obligations to other creditors as they fall due

against the distribution of the Society's assets over the lifetime of its policies as fairly as possible. The ability to increase policy values depends to a considerable extent on the returns achieved on, and the outlook for, the Society's corporate bond, property and equity-related portfolios, where value and liquidity are directly affected by market conditions. It is also dependent upon capital requirements and the extent to which the Board believe it is fair to distribute the ERA.

In early 2009, the Society reduced policy values by 2% for applicable pension policies and by 1.6% for life assurance contracts and set the rate of increase in policy values to nil. After consideration of all risks, reserving and capital matters, the Board reversed this reduction in early 2010 and agreed that, from the end of 2008, pension policies should increase at 3.5% p.a. and life assurance policies by 2.8% p.a. Policy values, thus increased, were used as the basis for the financial statements. Increasing policy values by less than the adjusted rate of return of 6.6%, resulted in an increase in the ERA of £126m (in 2008, the decrease in policy values was less than the adjusted return, and this resulted in a distribution from the ERA of £222m).

Following the valuation at the end of 2009, the Board has determined that, for 2009, policy values should be increased by 5.5% for applicable with-profits pension policies and by 4.4% for life assurance policies respectively. It has also confirmed that, for UK with-profits policies remaining in force at 1 April 2010, the interim bonus rate applying until further notice would be 3.5% for pension policies (2.8% for UK life policies) and be backdated to 1 January 2010.

In order for the Society to meet all of its contractual liabilities over the foreseeable future, the Board has again confirmed that new distributions of surplus will be made in non-guaranteed form. Accordingly, there is no expectation of any further reversionary bonus being awarded over the next few years and, in particular, in respect of 2009. However, for those policies with Guaranteed Investment Returns ("GIR"), the value of the guaranteed benefit is not affected by a change in policy values, but is increased instead at the rate set out in the policy conditions, typically 3.5% p.a.

In consequence of the investment performance and changes in policyholder values noted above, ERA has increased by £242m (2008: decreased by £311m). Future bonus declarations will reflect the capital available for distribution in the light of the risks facing the Society as described on the previous page.

Expenses and provisions

We announced in November 2009 that the Society has entered into a contract with HCL for the provision of administration services. HCL will provide services from March 2011 and a transfer programme from HBOS, now part of the Lloyds Banking Group, to HCL is now underway. Our latest estimate is that policyholder funds have been increased by some £130m as a result of this contract, as indicated in the table on page 5. This is after providing for the total anticipated transfer costs included in exceptional expenses. The new contract with HCL enables us to reduce future running costs and to remove a large degree of uncertainty over future administration service costs, and the financial figures reflect these changes. The Society now expects to levy charges for expenses on with-profits policies at the rate of 1.0% p.a. for 2010 and 0.5% p.a. in subsequent years as a consequence of the expense savings anticipated to be achieved through the new administration contract with HCL. Any underruns in these expense charges will be held in reserve in order to take account of the uncertainty of future charges and the challenge of reducing running costs as policies mature or transfer.

While investment and claim costs have remained stable during 2009, overall expense costs have increased by £11m (costs in 2009 were £115m compared to £104m in 2008), primarily as a result of an increase in pension provisions. The Society has a continuing obligation to HBOS to fund the former Equitable Life staff pension scheme to 1 March 2016. At that time, the Society must leave the Scheme with no deficit and the provisions established make due allowance for this. As at the year end 2009, it is estimated that the Scheme has a deficit of £93.5m (2008: £63m) on the value of past service benefits, and has provided for contribution payments of £39m for benefits arising from future service to 2016.

Protection of the fund and policyholder behaviour

The Society aims for the amounts paid out to maturing and exiting policyholders to be fair but not to disadvantage those continuing policyholders such that their payout prospects are reduced. If asset values reduce, the Society may apply a maturity equaliser as in 2009 when policy values were reduced by 2%.

Where policyholders switch to a unit-linked fund or surrender their with-profits policy before maturity, the Society is not contractually required to pay out any specific amount. In consequence, the Society levies a financial adjustment of 5% of the policy value and this applied through 2009. These adjustments can be varied at any time without advance notice, any such change reflecting the then financial position of the Society.

If the Society were to be forced to sell fixed-interest securities to its disadvantage before their relevant maturity dates, or became forced sellers of property or equity holdings in order to make payments to surrendering policyholders, assets and liabilities cease to be matched. In such circumstances, those policyholders would be expected to bear the related costs incurred, by way of a higher financial adjustment.

The Society experienced a steady and decreasing level of claims during 2009, and these were broadly in line with expectations. Changes in the pattern of surrenders have been reflected in the realistic assumptions which, together with favourable actual experience in the year, result in a gain of £2m (2008: £52m) in ERA, as shown in the reconciliation table on page 5.

Allowance has been made in realistic liabilities for future discretionary non-guaranteed bonuses. As noted previously, it is the Society's intention that any future bonuses will be in a non-guaranteed form. Allowance is made for continuing contractual commitments, such as the GIR of 3.5% p.a. that is applicable to many policies. If the Society's investment return is expected to fall below a rate which covers the guarantees, and its expenses and the assumed retirement profile ceases to be appropriate as a result of significant numbers of policyholders deferring their retirement dates, higher technical provisions may be required, as described in Note 14f to the financial statements.

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 these 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 examined the issues relevant to the going concern basis which include the exposure to: investment losses; increases in corporate bond defaults in excess of current levels assumed in market prices; increases in provisions; effect of lower interest rates on the behaviour of policyholders with GIR; future expense levels (including the costs of the continuing pension obligations to former staff); persistency risks (the age or duration at which benefits are taken); and mortality risks.

The Board will take proactive action to maintain regulatory solvency at all times. With the volatility in investment and property markets, the uncertain nature of provisions and other potential strains on the Society's finances, the Board recognises the possibility that the Society may not meet regulatory solvency requirements at all times in the future. This does not, of itself, mean the Society will not be able to meet policyholder liabilities as and when they fall due.

The financial position of the Society has been projected under a range of economic scenarios. The Board has also considered the level of contingent liabilities in its analysis of the Society's financial position, as expressed in Note 22. The Board is confident of its ability to manage adverse scenarios that may arise, but extremely adverse scenarios could prejudice the continuing ability of the Society to meet policyholder liabilities as they fall due and so there cannot be absolute assurance.

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

For security and training purposes, telephone calls may be recorded. Authorised and regulated by the Financial Services Authority. The Equitable Life Assurance Society is a mutual society registered in England No. 37038. Registered Office: 20 - 22 Bedford Row, London, WC1R 4JS, United Kingdom.

Profit and loss account

For the year ended 31 December 2009

Technical account – long-term business

	Notes	Society 2009		Society 2008	
		£m	£m	£m	£m
Earned premiums, net of reinsurance					
Gross premiums written	2a	183		103	
Outward reinsurance premiums	3	(29)		(36)	
			154		67
Investment Income	4a		321		370
Unrealised gains on investments	4c		15		-
Other technical income	5a		4		4
Total technical income			494		441
Claims incurred, net of reinsurance					
Claims paid – gross amount	6	729		940	
Reinsurers' share	3	(48)		(66)	
			681		874
Change in provision for claims – gross amount	6		2		(2)
			683		872
Changes in other technical provisions, net of reinsurance					
Long-term business provision – gross amount	14a	(476)		(782)	
Reinsurers' share	3,14c	2		(28)	
			(474)		(810)
Technical provisions for linked liabilities – gross amount	14b	491		(529)	
Reinsurers' share	3,14c	(326)		526	
			165		(3)
Net operating expenses – non-exceptional	7a	37		40	
Net operating expenses – exceptional	7b	70		54	
Net operating expenses			107		94
Investment expenses including interest	4b		10		94
Other technical charges	5b		1		4
Unrealised losses on investments	4c		-		191
Taxation attributable to the long-term business	9a		2		(1)
			120		382
Total technical charges			494		441
Balance on the Technical Account			-		-

The results for 2009 and 2008 are not consolidated as explained in Note 1a. All significant recognised gains and losses are dealt with in the Profit and Loss Account. The Notes on pages 30 to 60 form an integral part of these financial statements.

Balance sheet

As at 31 December 2009

Assets

	Notes	2009 £m	Society	2008 £m
Investments				
Land and buildings	10a	375		442
Investments in Group undertakings	10b	24		30
Shares and other variable yield securities and units in unit trusts	10c	316		430
Debt and other fixed-income securities	10c	4,746		5,203
Deposits and other investments	10c	478		264
		5,939		6,369
Assets held to cover linked liabilities	11	239		74
Reinsurers' share of technical provisions				
Long-term business provision	14c	341		343
Technical provisions for linked liabilities	14c	1,971		1,770
		2,312		2,113
Debtors				
Debtors arising out of direct insurance operations	12	5		5
Debtors arising out of reinsurance operations		-		2
Other debtors		11		30
		16		37
Other assets				
Cash at bank and in hand		3		6
Prepayments and accrued income				
Accrued interest and rent		104		113
Other prepayments and accrued income	13	1		42
		105		155
Total assets		8,614		8,754

The Notes on pages 30 to 60 form an integral part of these financial statements.

Balance sheet

As at 31 December 2009

Liabilities

	Notes	2009 £m	Society 2008 £m
Technical provisions	14a & 14g		
Long-term business technical provision - gross amount		6,216	6,692
Claims outstanding		3	1
		6,219	6,693
Linked liabilities	14b	2,210	1,844
		8,429	8,537
Provision for other risks and charges	17	77	46
Creditors			
Creditors arising out of direct insurance operations		26	40
Creditors arising out of reinsurance operations		1	-
Amounts owed to credit institutions	18a	7	12
Other creditors including taxation and social security	18b	55	102
		89	154
Accruals and deferred income		19	17
Total liabilities		8,614	8,754

These financial statements were approved by the Board on 29 March 2010 and were signed on its behalf by:

Ian Brimecome
Chairman

Chris Wiscarson
Chief Executive

Equitable Life Assurance Society registered company number 37038

The Notes on pages 30 to 60 form an integral part of these financial statements.

Notes on the financial statements

1. Accounting policies

a. Basis of presentation

The financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (“SI2008/410”) relating to insurance groups, section 405 of the Companies Act 2006 and in accordance with applicable accounting standards and the Association of British Insurers’ Statement of Recommended Practice on Accounting for Insurance Business (“the ABI SORP”) issued by the Association of British Insurers dated December 2005 and revised in December 2006, which, inter alia, incorporates the requirements of ‘FRS 27 Life Assurance’. The true and fair override provisions of the Companies Act 2006 have been invoked.

The Directors have considered the appropriateness of the going concern basis used in the preparation of these financial statements, having regard to the ability of the Society to be able to meet its liabilities as and when they fall due, and the adequacy of available assets to meet liabilities. In the opinion of the Directors, the going concern basis adopted in the preparation of these financial statements continues to be appropriate. A more detailed explanation is provided in the Financial review on page 8.

Certain administrative expenses were incurred in respect of customer support services provided by HBOS, now part of the Lloyds Banking Group. References to HBOS in these accounts relate to various HBOS Group companies.

The sale in recent years of subsidiary companies has resulted in the aggregate size of the remaining subsidiary companies becoming immaterial from the point of providing a true and fair view of the affairs of the Group. Therefore, these accounts represent the results and position of the Society only.

b. Change in accounting policies

The Directors have reviewed the accounting policies and satisfied themselves as to their appropriateness. There are no changes in accounting policy from the prior year.

c. Contract classification

The Society has classified its Long Term Assurance business in accordance with ‘FRS 26 Financial Instruments: Recognition and Measurement’. Insurance contracts are contracts that transfer significant insurance risk such as non unit-linked non-profit contracts. Investment contracts are those contracts where no significant insurance risk is transferred. Investment contracts that contain a discretionary participation feature entitling the policyholder to receive additional bonuses or benefits, such as with-profit contracts, are classified as investment contracts with discretionary participation feature. Those investment contracts that do not have this feature are classified as investment contracts without discretionary participation feature.

Hybrid policies that include both discretionary participation features and unit-linked components have been unbundled and the two components have been accounted for separately.

Reinsurance contracts have been classified in the same manner as direct contracts, with those reinsurance contracts which do not transfer significant insurance risk classified as financial assets.

A major treaty with HBOS reinsures unit-linked and non-profit business. Some of the reinsured policies are classified as insurance and others as investment. Rather than classifying the reinsurance treaty as a whole, the underlying policies have been considered and classified.

d. Insurance contracts and investment contracts with discretionary participation feature

Earned premiums

Premiums earned are accounted for on a cash basis, in respect of single premium business and recurrent single premium pension business, and on an accruals basis in respect of all other business.

All pension policies contain an open market option under which, in lieu of the benefits that must be taken on retirement, the equivalent lump sum can be transferred to another provider. All such lump sums, arising from policies within the Society, are included in claims paid. Where such lump sums are used to purchase annuities from the Society, these are included in premium income.

Claims

Death claims are recorded on the basis of notifications received. Surrenders are recorded when notified; maturities and annuity payments are recorded when due. Claims on participating business include bonuses payable and interest. Claims payable include direct costs of settlement.

Reinsurance contracts

Outward reinsurance premiums are recognised when payable. Reinsurance recoveries are credited to match the relevant gross claims.

Liabilities

Liabilities for insurance contracts and investment contracts with discretionary participation feature are measured on an amortised cost basis as described in section m. on page 33.

e. Investment contracts without discretionary participation feature

Contracts classified as investment without discretionary participation feature are classified as financial instruments under FRS 26 and have been accounted for using the principles of deposit accounting. Deposits are no longer accounted through the Profit and Loss Account, but accounted for directly in the Balance Sheet as an adjustment to technical provisions. Fees receivable from investment contracts without discretionary participation features are reported in 'Other technical income'.

Withdrawals notified have been accounted for directly in the Balance Sheet as an adjustment to technical provisions and not through the Profit and Loss Account as claims.

Liabilities for contracts classified as investment without discretionary participation feature are measured on an amortised cost basis. The amortised cost of these financial liabilities is equivalent to the amount payable on demand without penalty.

f. Investment return

Investment return comprises all investment income, realised gains and losses, movements in unrealised gains and losses, net of investment expenses, including interest payable on financial liabilities.

All income from listed stocks and shares is included in the accounts when the security becomes ex-dividend. Other investment income, including interest income from fixed-interest investments and rent, is accrued up to the balance sheet date.

Property rental income arising under operating leases is recognised in equal instalments over the period of the lease.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and the original cost.

Unrealised gains and losses on investments represent the difference between the valuation of investments at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

g. Bonuses

The Society declares bonuses annually. Guaranteed bonuses are included in the long-term business provision. Non-guaranteed final bonuses are payable when a claim is made and an estimate of these non-guaranteed benefits, including any future discretionary increases to policy values, is included in the long-term business provision. Non-guaranteed final bonuses, payable when a claim is made, are included in claims paid.

h. Valuation of investments

All financial assets are initially recognised at cost, being the fair value at the date of acquisition. Subsequently all financial assets are valued at fair value through the Profit and Loss Account. Fair value is determined on either bid market prices for listed investments, if readily available, broker or dealer quotations, or market values of another instrument that is substantially the same. If prices are not readily available, the fair value is based on appropriate valuation techniques, supported by observable market data, where available.

A financial asset is recognised when the Society commits to purchase the asset, and is derecognised when the contractual right to receive cash flows expires or when the asset is transferred.

Financial assets at fair value through the Profit and Loss Account have two subcategories: financial assets held for trading; and those designated at fair value through the Profit and Loss Account at inception. Derivative instruments have been classified as held for trading. All other financial assets have been classified as fair value through profit and loss category. No material financial assets have been classified as held to maturity or as available for sale under FRS 26 classification.

The Society's derivatives are primarily concentrated in interest rate swaptions and Forward contracts. Hedge accounting has not been used for these Instruments. Collateral received to back derivative positions is recognised on the Balance Sheet as cash, with a corresponding liability in 'Other creditors'.

Securities lent, where substantially all the risks and rewards of ownership remain with the Society, are retained on the Balance Sheet at their current value. Collateral received in respect of securities lent is not recorded on the Balance Sheet.

i. Property

Freehold and leasehold properties are valued individually by the qualified surveyors Jones Lang LaSalle on the basis of open market value, less the estimated costs of disposal.

No depreciation is provided in respect of investment properties. The Directors consider that this accounting policy is appropriate for the financial statements to give a true and fair view as required by 'SSAP 19 Accounting for Investment Properties'. Depreciation is only one of the factors reflected in the annual valuations and the amount which might otherwise have been shown cannot be separately identified or quantified.

j. Investments in Group undertakings

Investments in Group undertakings are carried at net asset value with changes in carrying value reported in the Profit and Loss Account.

k. Impairment policy

The Society reviews the carrying value of its assets (other than those held at fair value through profit and loss) at each balance sheet date. If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the income statement. Impairment is only recognised if the loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

l. Technical provisions - long-term business provision and provision for linked liabilities

The long-term business provision is determined for the Society, following an investigation of the long-term funds, and is calculated in accordance with the rules contained in The FSA Handbook of Rules and Guidance. The investigation is carried out as at 31 December. For the with-profits business of the Society, the liabilities to policyholders are determined in accordance with the FSA realistic capital regime and in accordance with the requirements of FRS 27. These liabilities include an estimate of non-guaranteed benefits, including future discretionary increases to policy values, and provision for any guaranteed values which are in excess of policy values. Also included in the liability is an amount representing the excess of assets over other realistic liabilities. This amount is referred to as Excess Realistic Assets (“ERA”) in these financial statements and is a key measure of the Society’s resources, representing the amount 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.

The calculation of the long-term business provision for all non-profit business is calculated using the gross premium valuation method.

The technical provision in respect of index-linked annuities in payment is equal to the discounted value of the annuity benefits which allows for indexation.

The provisions in respect of with-profits investment contracts are not at fair value as there is no active market for such instruments and the basis to measure future supplementary discretionary returns is unreliable.

The Society's investment contracts without discretionary participation feature consist almost entirely of unit-linked contracts. The liability in respect of unit-linked contracts is equal to the value of assets to which the contracts are linked, and is included in ‘Technical provisions’ in the Balance Sheet.

m. Other financial liabilities

Borrowings are initially recognised at fair value and subsequently stated at amortised cost, using the effective interest method where appropriate.

n. Taxation

The charge for taxation in the Profit and Loss Account is based on the method of assessing taxation for long-term funds. Provision has been made for deferred tax assets and liabilities using the liability method on all material timing differences, including revaluation gains and losses on investments recognised in the Profit and Loss Account. Deferred tax is calculated at the rates at which it is expected that the tax will arise and has not been discounted, and is only recognised to the extent that recovery is possible at a later date.

o. Foreign currency translation

Assets and liabilities in foreign currencies are expressed in Pounds Sterling at the exchange rates ruling at the balance sheet date. Revenue transactions have been translated at rates of exchange ruling at the time of the transactions.

p. Segmental reporting

In the opinion of the Directors, the Society operates in one business segment, being that of long-term insurance business.

2. Earned premiums

	Society 2009 Premiums £m	Society 2008 Premiums £m
a. Analyses of gross premiums written are as follows:		
Individual premiums	176	99
Premiums under group contracts	7	4
	183	103
Regular premiums	49	49
Single premiums	134	54
	183	103
Premiums from non-profit contracts	51	49
Premiums from with-profits contracts	47	46
Premiums from linked contracts	85	8
	183	103
Premiums from life business	24	27
Premiums from annuity business	1	1
Premiums from pension business	158	75
	183	103
Premiums from UK business	180	100
Premiums from overseas business	3	3
	183	103
b. Gross new business premiums		
Individual premiums	134	54
Premiums under group contracts	2	1
	136	55
Regular premiums	2	1
Single premiums	134	54
	136	55
Premiums from non-profit contracts	25	23
Premiums from with-profits contracts	30	26
Premiums from linked contracts	81	6
	136	55
Premiums from life business	-	-
Premiums from annuity business	-	-
Premiums from pension business	136	55
	136	55
Premiums from UK business	136	55
Premiums from overseas business	-	-
	136	55

Annual equivalent premiums in respect of new business received during the year were £16m (2008: £6m). New premiums in respect of reinsured business during the year were £4m (2008: £6m). The increase in individual premiums result primarily from a one-off premium for the conversion from non-profit to index-linked annuities for the Staff Pension Scheme.

Following the adoption of FRS 26, deposits received in respect of investment contracts without discretionary participation feature are not included in the Technical Account or in the tables opposite. Total deposits received in 2009 were £36m (2008: £34m) and new premium deposits were £15m (2008: £6m).

Classification of new business

The Society closed to new business on 8 December 2000. However, the Society continues to recognise new business premiums and deposits in the following instances:

- Recurrent single premiums are classified as regular where they are deemed likely to renew at or above the amount of initial premium or deposit. Incremental increases on existing policies are classified as new business premiums;
- Department for Work and Pensions rebates are classified as new single premiums;
- Unless classified as investment without discretionary participation feature, funds at retirement under individual pension contracts reinvested with the Society and transfers from group to individual contracts are classified as new business single premiums and, for accounting purposes, are included in both claims incurred and as single premiums within gross premiums written. Such amounts constitute the majority of premiums from non-profit contracts. Where an amount of fund under a managed pension is applied to secure an immediate annuity, that amount is included in both claims incurred and as a single premium within gross premiums written;
- Increments under existing group pension schemes are classified as new business premiums; and
- Where regular premiums are received other than annually, the regular new business premiums are stated on an annualised basis.

3. Outward reinsurance premiums

On 1 March 2001, the Society entered into reinsurance contracts with HBOS in respect of certain of its unit-linked and non-profit business. The establishment of the reinsurance contracts effectively transferred the risks and rewards in respect of the reinsured business to HBOS.

Premiums and deposits received from policyholders in respect of reinsured business are immediately forwarded to HBOS. HBOS reimburse the Society for any claims and withdrawals the Society has paid to policyholders in respect of reinsured business. As a result of these processes, after allowing for special features of the reinsurance contracts, the impact to the Society of these contracts is minimal.

Under the terms of the reinsurance contracts with HBOS, if the Society were to become insolvent, or reasonably likely to become insolvent in the opinion of the reinsurer's board, HBOS can then make payments directly to policyholders whose policies have been reinsured.

The Society has several other outward reinsurance contracts under which relatively small volumes of business are reinsured.

The reinsurance balance, as required to be disclosed by the Companies Act 2006, and as defined by the Statement of Recommended Practice ("SORP"), which represents the aggregate total of all those items included in the Technical Account which relate to reinsurance transactions, net of related gains of £467m (2008: losses of £286m), is a net credit of £nil m (2008: £2m debit).

4. Total investment return

	Society 2009 £m	Society 2008 £m
a. Investment income comprises income from:		
Land and buildings	30	32
Other investments	291	338
	321	370
Net gains on realisation of investments	-	-
Investment income and net realised gains at fair value through the Profit and Loss Account	321	370
b. Investment expenses including interest comprise:		
Investment management expenses	7	9
Interest charges on loans	-	-
Net losses on realisation of investments	3	85
	10	94
c. Investment activity account		
Investment income	321	370
Realised investment gains/(losses)	(3)	(85)
Unrealised investment gains/(losses)	15	(191)
Total fair value investment income and net gains at fair value through the Profit and Loss Account	333	94
Investment management expenses and charges	(7)	(9)
Investment return for the year	326	85

Included within the tables above is £22m (2008: £10m) of net gain in respect of derivative instruments designated as held for trading, and £29m of unrealised loss (2008: £48m net gain) resulting from the retranslation of balances in connection with overseas business.

There have been no material gains or losses arising on the disposal of subsidiary companies.

d. Interest income and expense not included in the investment return

Contracts classified as investment with discretionary participation feature are measured at amortised cost. The interest income and expense in respect of such contracts is included within the Technical Account under the heading 'Change in long-term business provision'.

5. Other technical income and charges

	Society 2009 £m	Society 2008 £m
a. Other technical income comprises:		
Income from non-insurance business	-	-
Other income	4	4
	4	4
b. Other technical charges comprise:		
Transfer of assets to Prudential	-	3
Other charges	1	1
	1	4

On 15 March 2007, the Society entered into an agreement with Prudential for the transfer of its with-profits annuity policies. Following the completion of the High Court process, this business was subsequently transferred to Prudential on 31 December 2007 as a Part VII Transfer under the Financial Services and Markets Act 2000. The final value of assets to be transferred was £1.76bn. The final transfer of £3m was made in 2008 as reported in table b. above.

6. Claims incurred – gross

	Society 2009 Claims £m	Society 2008 Claims £m
Claims paid – gross amount	729	940
Change in provision for claims – gross amount	2	(2)
Gross claims	731	938

Gross claims incurred comprise gross claims paid and the change in provision for claims outstanding.

	Society 2009 Claims £m	Society 2008 Claims £m
Gross claims paid comprise:		
On death	32	40
On maturity	436	504
On surrender	184	294
By way of periodic payments	78	99
Claims handling expenses	1	1
	731	938
Life and annuity business	141	146
Pension business	589	791
Claims handling expenses	1	1
	731	938
Linked business	33	48
Non-profit business	61	64
With-profits business	636	825
Claims handling expenses	1	1
	731	938
UK business	710	914
Overseas business	20	23
Claims handling expenses	1	1
	731	938

Included in the above payments are attributable final and interim bonuses for the Society of £22m (2008: £49m).

Following the adoption of FRS 26, withdrawals made in respect of investment contracts without discretionary participation feature are not included in the Technical Account or in the tables above. Total withdrawals in 2009 were £161m (2008: £214m).

7. Net operating expenses

	Society 2009 £m	Society 2008 £m
a. Non-exceptional		
Administrative expenses	37	40

b. Exceptional

The Society incurred the following exceptional expenses during the year:

	Society 2009 £m	Society 2008 £m
Rectification and other GAR-related expenses	-	1
Pension costs for former staff	47	22
Costs of strategic initiatives	19	27
Other projects	4	4
	70	54

Exceptional expenses represent expenses associated with the Society's strategic initiatives and not associated with the administration of policies. As explained in the Financial review on page 7, exceptional expenses increased following a review of pension commitments. Costs for strategic projects reduced and included securing the new administration deal with HCL.

c. Services from auditors

PricewaterhouseCoopers LLP ("PwC") is one of a number of professional firms that undertake advisory work for the Society. Where PwC has been engaged to perform such non-audit work, in circumstances where it is to the Society's advantage that it does so, the Society's regular commitments procedures are followed and the Audit Committee reviews them to ensure that auditor independence is preserved.

During the year, the Society received the following services from the Society's auditor:

	Society 2009 £m	Society 2008 £m
Fees payable for the audit of the Society accounts	0.5	0.6
Fees payable to the Society's auditor and its associates for other services:		
Other services pursuant to legislation	0.1	0.1
All other services	1.4	0.4
	2.0	1.1

The increase in non-audit fees result from a tender exercise by the Society's management for support on due diligence work in connection with the selection process for the provision of administration services, with the aim of reducing the risk exposure of this project to the Society.

8. Directors and employees

	Society 2009 £m	Society 2008 £m
a. Staff costs		
Wages and salaries	5	4
Social security costs	1	1
	6	5

The monthly average number of employees employed by the Society during the year, including Executive Directors, required to be disclosed in accordance with the Companies Act 2006, was 21 (2008: 25). The wages and salary costs for 2009 include some redundancy costs. In addition, the Society employs a number of contractors and, under its agreement with HBOS, uses the services of HBOS staff.

b. Emoluments of Directors

Full details of Directors' emoluments, pensions and interests, as required by the Companies Act 2006, are included in the Remuneration report on pages 20 to 23.

c. Former staff pension arrangements

As a result of contractual commitments arising as part of the agreement entered into with HBOS in March 2001, when the Society sold its administrative and sales operations, the Society meets the major part of the funding in respect of the pension schemes for those staff that transferred to the employment of HBOS as a result of the sale transaction. An amount of £94m (2008: £63m) is provided in respect of the contractual commitment to HBOS in relation to the defined benefit scheme, following the triennial actuarial valuation performed as at 31 December 2007, as modified for relevant changes to the current balance sheet date. An additional provision of £39m (2008: £45m), representing an estimate of the current value of the contractual commitment to HBOS in respect of future service costs until 2016, and a provision for pension augmentations and future staff pension scheme administration costs of £2m (2008: £2m) are included within 'Technical provisions: long-term business'. The Society's commitments terminate in 2016 and the provisions above represent our best estimate of closing them out at the current balance sheet date. The basis to be used in 2016 could produce a different result.

9. Taxation

	Society 2009 £m	Society 2008 £m
a. Taxation charged to the Technical Account		
UK corporation tax		
Current tax on income for the period	3	4
Adjustments in respect of previous years	-	(2)
	3	2
Foreign tax		
Current tax on income for the period	-	-
Deferred tax		
Unrealised gains on investments	(1)	(3)
Total charge	2	(1)

The UK corporation tax charge is provided at 20% (2008: 20%), computed in accordance with the rules applicable to life assurance companies, whereby no tax is charged on pension business profits.

	Society 2009 £m	Society 2008 £m
b. Deferred taxation		
Provided in the financial statements:		
Deferred tax of the long-term fund		
Unrealised depreciation/(appreciation) in investments	2	1

Deferred taxation not provided for in the accounts relates to immaterial unrealised losses on the reinsured book.

10. Non-linked investments

	Current value		Cost	
	2009 £m	2008 £m	2009 £m	2008 £m
a. Land and buildings				
Society				
Leasehold	114	118	131	129
Freehold	261	324	325	396
	375	442	456	525

The Society invests indirectly in property through specialised unit trusts, which are classified as 'Other financial investments' (see Note 10c). Total property-related investments at 31 December 2009 are £450m (2008: £528m).

	Current value		Cost	
	2009 £m	2008 £m	2009 £m	2008 £m
b. Investments in Group undertakings				
Shares	24	30	23	23

The Society has a wholly-owned subsidiary Basinghall Street Real Estate Inc. ("BSRE"). BSRE is an American incorporated property vehicle with a value as at 31 December 2009 of £5m (2008: £6m). BSRE's principal investment is cash and its loss for 2009 was £0.1m (\$0.2m) (2008: £0.9m (\$1.4m)).

The Society holds a majority investment in Equitable Private Equity Holdings Limited ("EPEHL"), a Guernsey registered company with a value as at 31 December 2009 of £19m (2008: £24m). EPEHL's investment is Knightsbridge Integrated Holdings V.L.P., which invests in equity and venture capital projects. EPEHL made a loss in 2009 of £32k (\$52k) (2008: £34k (\$62k)) and its total capital value is £19m (\$30m) (2008: £24m (\$33m)).

	Current value		Cost	
	2009 £m	2008 £m	2009 £m	2008 £m
c. Other financial investments held at fair value through the Profit and Loss Account				
Society				
Shares and other variable yield securities and units in unit trusts				
Shares and units in unit trusts ⁽¹⁾	282	342	353	432
Other variable income securities ⁽²⁾	34	88	27	29
	316	430	380	461
Debt securities and other fixed-income securities ⁽³⁾	4,746	5,203	4,754	5,260
Deposits and other investments				
Loans secured by mortgages and policies	1	1	1	1
Deposits with credit institutions	477	263	477	263
	478	264	478	264
	5,540	5,897	5,612	5,985

Notes:

(1) Includes listed investments of £34m (2008: £138m) for the Society at fair value.

(2) Comprise derivatives including FTSE 100 Futures, US Dollar to Sterling Forward exchange contracts and interest rate swaptions. The interest rate swaption is valued on a mark-to-model basis. Both categories are classified as held for trading.

(3) Includes listed investments of £4,739m (2008: £5,199m) for the Society at fair value.

During the year, the Society has undertaken stock lending but this is not reflected on the balance sheet. Stock lending is undertaken to support market liquidity. Investments of £763m (2008: £649m) were lent in the normal course of business to authorised money brokers on a secured basis. Investments of £773m (2008: £661m) were received as collateral from brokers. Income earned on stock lending during the year, net of fees paid, was £1m (2008: £2m). Collateral is government obligations issued or guaranteed by states which are full members of the OECD (Organization for Economic Cooperation and Development) and shall not be less than 102% of the market value of borrowed securities where they are fixed-income securities or 105% where they are equity securities.

The Society closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique as described in the Accounting Policies Note 1h above.

For fixed-income securities for which there is no active market, the fair value is based on broker/dealer price quotations. Where possible, the Society seeks at least two quotations for each bond and considers whether these are representative of fair value. Where this information is not available the fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

d. Fair value hierarchies

(i) In accordance with the changes to FRS 29 in 2009, investments carried at fair value have been categorised into a fair value hierarchy:

Assets valued at quoted market prices from active markets ("Level 1")

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets.

Prices substantially based on market observable inputs ("Level 2")

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset either directly or indirectly. Level 2 inputs include the following:

- Quoted prices for similar (i.e. not identical) assets in active markets;
- Quoted prices for identical or similar assets in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly.

Prices based on unobservable inputs where observable inputs are not available ("Level 3")

Inputs to Level 3 fair values are unobservable inputs for the asset, for example, assets valued by a model or securities for which no recent market price observable price is available.

The Society holds interest rate swaptions, which are valued based on an industry recognised model, which are calibrated to market observable data where possible. Significant inputs to this model include interest rate curves and interest rate volatility. The sensitivity of the model to changes in assumptions has been assessed and indicates that changing one or more of the assumptions to reasonably possible alternative assumptions would not significantly change the fair value of financial assets.

(ii) Analysis of investments according to fair value hierarchy:

31 December 2009	Level 1	Level 2	Level 3	Total Fair Value	Other Assets	Balance Sheet Total
Asset category	£m	£m	£m	£m	£m	£m
Land and buildings	-	-	-	-	375	375
Investments in Group undertakings	-	-	24	24	-	24
Shares and units in unit trusts	-	120	162	282	-	282
Other variable income securities	-	-	34	34	-	34
Debt securities and other fixed-income securities	2,062	2,536	148	4,746	-	4,746
Loans secured by mortgages and policies	-	-	1	1	-	1
Deposits with credit institutions	14	463	-	477	-	477
Total non-linked invested assets	2,076	3,119	369	5,564	375	5,939
Assets held to cover linked liabilities	141	98	-	239	-	239
Total invested assets	2,217	3,217	369	5,803	375	6,178

(iii) There have been no significant transfers between Level 1 and Level 2 during the year.

(iv) Level 3 reconciliation:

	Total £m
Balance at 1 January 2009	486
Total net gains or (losses) recognised in the Profit and Loss Account	(82)
Purchases	4
Sales	(30)
Transfers into Level 3	17
Transfers out of Level 3	(26)
Balance at 31 December 2009	369

The total net losses shown above are included within 'Unrealised gains on investments' within the Profit and Loss Account, of which £82m loss relates to assets which were still held at the end of the period.

Seven stocks, of total value £17m, were transferred to Level 3 during the period as their valuation was based on inputs that are no longer observable for those assets.

Three stocks, of total value £26m, were transferred from Level 3 to Level 2 during the period as market observable inputs for these assets became available.

11. Assets held to cover linked liabilities

	2009 £m	Society	2008 £m
Current value of linked assets held at fair value through the Profit and Loss Account	239		74

The cost of assets held to cover linked liabilities is £222m (2008: £63m) for the Society.

12. Debtors

	2009 £m	Society	2008 £m
Debtors arising out of direct insurance			
Amounts owed by policyholders	5		5
Debtors arising out of reinsurance insurance			
Other debtors	-		2
Debtors other than Group and related companies	11		30
	16		37

The carrying values of these items equate closely to fair values and are expected to be realised within a year of the balance sheet date.

Amounts in 'Debtors other than Group and related companies' include an entitlement for the return of the variation margin associated with the FTSE Futures investment from Goldman Sachs (2009: nil, 2008: £17.5m), and an assigned account owned by HSBC (2009: £7m, 2008: £7m).

13. Other prepayments and accrued income

	2009 £m	Society	2008 £m
Prepayments	1		42

The prepayments for 2008 include an interest-bearing advance payment made to a service provider.

14. Technical provisions

a. Gross long-term business technical provisions

	Society	
	2009	2008
	£m	£m
With-profits technical provisions		
With-profits insurance technical provisions		
Policy values	313	405
Future charges	(32)	(35)
Impact of early surrenders	(1)	(1)
Cost of guarantees	52	77
Other long-term liabilities	65	74
	397	520
With-profits investment technical provisions		
Policy values	3,831	4,147
Future charges	(258)	(265)
Impact of early surrenders	(28)	(33)
Cost of guarantees	522	737
Other long-term liabilities	219	213
	4,286	4,799
Excess Realistic Assets	675	414
	5,358	5,733
Non-profit technical provisions		
Non-profit insurance technical provisions	848	954
Non-profit investment technical provisions	10	5
	858	959
Total long-term business technical provisions	6,216	6,692

b. Gross linked liabilities

	Society	
	2009	2008
	£m	£m
Index-linked annuities	247	78
Other linked insurance liabilities	153	140
Other linked investment liabilities	1,810	1,626
Total linked liabilities	2,210	1,844

**c. Reinsurers' share of technical provisions:
insurance and investment contracts**

	Society	
	2009	2008
	£m	£m
Non-profit insurance technical provisions	331	338
Non-profit investment technical provisions	10	5
	341	343
With-profits insurance technical provisions	-	-
With-profits investment technical provisions	-	-
Index-linked annuities	8	4
Other linked insurance liabilities	153	140
Other linked investment liabilities	1,810	1,626
	1,971	1,770
Total reinsurers' share	2,312	2,113

d. Movement of gross technical provisions investment contracts without discretionary participation feature

	Society	
	2009	2008
	£m	£m
At 1 January	1,631	2,253
Change arising from new deposits	36	34
Change arising from withdrawals	(161)	(214)
Other changes	314	(442)
At 31 December	1,820	1,631

e. The long-term business provision – non-profit and index-linked annuities

The long-term business provisions for the Society's non-profit and index-linked annuities have been calculated using the gross premium method. The principal assumptions and their comparatives are shown in the table below. Actuarial bases have been modified in respect of valuation interest rates, mortality assumptions and future expense allowances. Explanations of the effect of those changes are set out in notes (1), (2) and (3) below.

The principal assumptions used in valuing the non-profit and index-linked annuities in payment were as follows:

Class of business	Interest rate %		Future expense allowance	
	2009	2008	2009	2008
Non-profit annuities in payment				
Basic Life and General Annuity business – pre 1992	5.00	4.63	£4.46 p.a.	£20.00 p.a.
Basic Life and General Annuity business – post 1991	4.50	4.17	£4.46 p.a.	£20.00 p.a.
Pension business	5.00	4.63	£4.46 p.a.	£20.00 p.a.
Index-linked annuities in payment				
Basic Life and General Annuity business – pre 1992	0.54	1.79	£4.46 p.a.	£20.00 p.a.
Basic Life and General Annuity business – post 1991	0.49	1.61	£4.46 p.a.	£20.00 p.a.
Pension business	0.54	1.79	£4.46 p.a.	£20.00 p.a.

Notes:

(1) Valuation interest rates are based on the yields on the assets held, reduced for risk. Reductions from the yield for risk for corporate fixed-interest securities are based on credit ratings. Fixed-interest yields have risen and index-linked yields have fallen compared to those at the end of 2008. The changes to the valuation interest rates in aggregate have increased the index-linked annuity provision by £27m and decreased the non-profit technical provisions by £19m. Similarly, the market value of the backing assets has changed as yields have changed and this in part offsets the change in technical provisions. The change in asset values and technical provisions are not equal at this valuation due to the decreased allowance for the risk of bond defaults allowed for in the valuation interest rates.

(2) Future expenses in respect of non-profit and index-linked annuities in payment are allowed for in two ways: an explicit per policy allowance and an expense allowance for fund management, expressed as a percentage of the value of the fund, of 0.06% p.a. (2008: 0.06% p.a.). The per policy expense allowance in the basis reflects the charges agreed with HCL for future administration. The expense allowance has been assumed to increase at 5.1% p.a. (2008: 3.15% p.a. plus 5.75% p.a. arising from diseconomies of scale). The expense allowances for 2009 shown above apply to UK policies which account for 95% of annuity contracts. The expense allowance for non-UK policies is higher at £52.47 p.a. in 2009 (2008: £20.00 p.a.). The changes to the expense basis in the aggregate have reduced the provision for expenses by £19m.

(3) The Society continues to make allowance for future improvements in longevity of annuitants. The Society's valuation has been carried out using recently published mortality tables and an investigation into the Society's actual mortality experience. The overall effect of this review has been to increase index-linked annuity and non-profit annuity technical provisions by £26m (2008: decreased by £4m).

A sensitivity analysis, carried out in connection with the effect of a change in mortality basis on the technical provisions, has demonstrated that an assumed 10% improvement in the mortality rates would result in a £26m (2008: £24m) increase in the non-profit and index-linked annuity technical provisions. This change is equivalent to the life expectancy of a 65-year-old male increasing by an additional 12 months (2008: 12 months).

Mortality assumptions by class of business	2009	2008
Non-profit and index-linked annuities in payment		
Basic Life and General Annuity business	72.5% IML00 ult (U=2009)* for males 77.5% IFL00 ult (U=2009) * for females	82.5% IML00 ult (U=2008)* for males 82.5% IFL00 ult (U=2008) * for females
Pension business (both reinsured and retained business)	87.5% PNMA00MC (U=2012) ** for males 80.0% PNFA00MC (U=2012) ** for females	90.0% PNMA00MC (U=2011) ** for males 97.5% PNFA00MC (U=2011) ** for females

Notes:

* The allowance for future mortality improvements is based on implied mortality improvements as per IML92/IFL92 (subject to a minimum improvement of 1.5% p.a.).

** The allowance for future mortality improvements is based on the implied future improvements as per PMA/PFA92 MC tables (subject to a minimum improvement of 1.5% p.a.).

f. The long-term business provision – with-profits business

The long-term business provisions for the Society's with-profits business have been calculated in accordance with the FSA realistic capital regime. The principal assumptions used to calculate these provisions and the comparatives are described below.

The calculation of realistic liabilities for the Society is based upon the projection of 5,000 different scenarios and includes an estimate of any future non-guaranteed bonuses that may be payable. The value of the liabilities is made up of the following components:

- Policy values – the total of policy values for all with-profits policies (or their equivalents for with-profits annuities and conventional with-profits contracts);
- Future charges – the margin assumed to be retained each year before making future increases to policy values;
- Impact of early surrenders – the value of the financial adjustment assumed to be deducted on non-contractual surrenders;
- Cost of guarantees – the cost of meeting contractual guarantees in excess of the policy values; and
- Other long-term liabilities include miscellaneous provisions (as described in Note 14g), with-profits reinsured business, less a deduction for the present value of future profits from non-profit business as described below.

The present value of future profits from non-profit business represents the future profits expected from cash flows of the in-force non-profit and index-linked annuity business, less an amount to meet the cost of holding capital in respect of this business. These profits have been deducted as a capitalised amount from the technical provisions in accordance with the requirements of FRS 27. The resulting anticipated present value of future profits is a loss of £23m (2008: £26m).

(i) Options and guarantees

Options and guarantees are features of life assurance contracts that confer potentially valuable benefits to policyholders. They expose the Society to two types of risk: insurance (such as mortality and morbidity) and financial (such as market prices and interest rates). The value of an option or guarantee comprises two elements: the intrinsic value and the time value. The intrinsic value is the amount that would be payable if the option or guarantee was exercised immediately. The time value is the additional value that reflects the possibility of the intrinsic value increasing in future, before the expiry of the option or guarantee. In adopting FRS 27, the intrinsic and time values of all options and guarantees are included in policyholder liabilities.

The Society now has in issue two principal types of with-profits policy: Recurrent Single Premium (“RSP”) policies and Conventional With-Profits (“CWP”) policies. These policies represented 97% and 3%, respectively, of the total policy values at 31 December 2009 (97% and 3% of the total policy values at 31 December 2008). For the majority of RSP policies issued before 1 July 1996, each premium (after charges) secures a Guaranteed Investment Return (“GIR”), typically at the rate of 3.5% p.a. For the majority of RSP policies issued after 1 July 1996, the GIR is nil%. For CWP policies, guarantees are payable at specified dates or on the occurrence of specified events.

The options and guarantees in respect of the Society’s with-profits business relate to a guarantee on contractual termination (for example, on retirement, maturity, death or on payment of an annuity). The terms of the guarantee vary by contract. For the Society’s RSP contracts where there is a GIR, the value of that guaranteed return is assessed based on assumed retirement ages of policyholders. Certain policies also contain a guaranteed minimum level of pension as part of the condition of the original transfer of state benefits to the policy.

For CWP business, there is a guarantee that the amount payable on death or at maturity (where appropriate) will not be less than the sum assured and any declared reversionary bonuses.

All the Society’s material options and guarantees are valued on a market-consistent stochastic basis. The valuation involves constructing 5,000 scenarios, aggregating the results under each scenario and then calculating the average liability.

For policies where the guaranteed value at contractual termination exceeds the policy value at that date, the excess would be paid and estimates of such excess form part of the realistic liabilities. In calculating the amount payable to policyholders, account is taken of any management actions such as making changes to policy values in response to changes in market conditions. The cost of these guarantees has decreased from £814m in 2008 to £574m at 31 December 2009 principally as a result of an assumed reduction in the charge for expenses from 2011, increases in policy values for 2009 and rising Government bond yields. This amount is included within ‘Technical provisions’ (see Note 14a).

There is inherent uncertainty in calculating the cost of these guarantees and options, as the value depends on future economic conditions, policyholder actions (such as early or late retirement and surrenders) and mortality. In calculating the value of the guarantees, account has been taken of actual experience to date, in addition to industry benchmarks and trends. For economic assumptions, prices for relevant quoted and non-quoted derivatives are used to confirm market consistency.

(ii) Assumptions – with-profits business

Mortality

Using the results of an investigation into the Society's actual mortality experience, mortality assumptions have been derived for the with-profits business as detailed in the table below:

Mortality assumptions by class of business	2009	2008
Endowment assurances (with-profits)		
Basic Life and General Annuity business	90.0% AMC00 ultimate for males	90.0% AMC00 ultimate for males
	97.5% AFC00 ultimate for females	97.5% AFC00 ultimate for females
Pension business	90.0% AMC00 ultimate for males	90.0% AMC00 ultimate for males
	97.5% AFC00 ultimate for females	97.5% AFC00 ultimate for females

Mortality assumptions for other classes of business are not material and, for this reason, are not shown above.

Future charges

A charge of 1.0% p.a. (2008: 1.0% p.a.) is assumed to be retained before making future increases to policy values. This charge provides capital to meet the expected cost of guarantees (the additional cost where a policy's guaranteed benefits exceed its policy value, now or expected in the future).

Expenses

A further charge of 1.0% p.a. for 2010, reducing to 0.5% p.a. (2008: 1.0% p.a.) from 2011 reflecting the new HCL administration contract, is assumed to be deducted each year before making future increases to policy values. In addition, an expense provision of £107m for expenses (2008: £147m) has been incorporated with the aim of maintaining a stable expense charge as the business declines. Taken together, these allowances are intended to provide for future expenses in respect of with-profits business. A 10% increase in future expenses would decrease the ERA by £27m (2008: £43m).

Retirement and surrender assumptions

For the majority of RSP contracts, benefits can be taken on contractual terms at a range of ages. For example, benefits from Retirement Annuity policies can be taken at any age between 60 and 75, whereas benefits from Group Pension policies are expected to be taken at the scheme's normal retirement age. This date is referred to as the Earliest Contractual Date ("ECD"). A proportion of policyholders take their benefits before the earliest expected retirement date.

An investigation of the actual retirement ages for the Society's with-profits policyholders, analysed by type of contract, has been carried out based on actual experience during 2008 and 2009. The results of that investigation have been used to set the assumed retirement ages for the valuation.

The retirement assumptions vary between different product types. The range of retirement dates assumed varies between policyholders being assumed to retire 2 years (2008: 2 years) earlier than ECD and up to 14 years (2008: 13 years) later than ECD.

A sensitivity analysis has been carried out to illustrate the potential impact on ERA, at 31 December 2009, of GIR on RSP business under certain scenarios modelled on a stochastic basis, where the results are aggregated and the average liability is calculated. If interest rates fall below a given level, it is possible that policyholders with policies that have a guaranteed return (usually 3.5% p.a.) and variable retirement dates may choose to defer retirement. If policyholders wait until interest rates fall below 2.5% and defer their retirement by up to five years (from that previously assumed), while the interest rate in the scenario is below 2.5%, ERA would reduce by £25m (2008: £95m). If the level of interest rates at which behaviour changes is 3.5% and the same period of deferment is assumed, the reduction is £45m (2008: £135m). If the deferral were for a period of up to 10 years, the reduction is £35m (2008: £135m) at 2.5% and £65m (2008: £205m) at 3.5% respectively.

The Society holds a series of receiver swaptions with a range of terms. The purpose of these swaptions is to provide additional capital when interest rates on similar fixed-interest securities fall. These swaptions are designed to partially mitigate any increase in liabilities for RSP policies with a non-zero GIR, if policyholders defer their retirement plans. A fall in interest rates of 1.0% at all terms would increase the value of the swaptions by £34m (2008: £67m) and a similar increase would decrease the value by £17m (2008: £37m).

An investigation of the actual surrender rates for the Society's with-profits business, analysed by type of contract, has been carried out based on actual experience during 2008 and 2009. The results of that investigation have been used to set the assumed surrender rates for the valuation.

Non-contractual surrender rates are assumed to fall steadily over the next few years to a long-term rate of 1.5% p.a. (2008: 1.5% p.a.). The effect of the change in the surrender rates has been to decrease the ERA by £16m (2008: increase by £23m).

A financial adjustment of 5.0% (2008: 5.0%) of policy values is assumed as a deduction on surrender prior to contractual termination.

Economic assumptions

In order to produce many projections of different scenarios of the business, an economic model is required. The economic model used by the Society in the valuation was supplied by Barrie & Hibbert. The model has been calibrated to the gilt yield curve at the valuation date and this determines the risk-free rates used in the projections. The effect of the change in yield curve from 2008 to 2009 was to decrease the ERA by £36m (2008: increase of £48m). Assumptions are also required for the volatility of the asset values for different asset categories. Bond volatilities vary by term and duration and are calibrated to those implied by swap option volatilities obtained from market sources. For equity values, the model produces a ten year volatility of 27% (2008: 34%). For property values, the model uses an assumed volatility of 15% (2008: 15%).

g. The long-term business provision – miscellaneous provisions

Technical provisions include amounts in respect of specific provisions:

- Anticipated additional exceptional expenses of £133m (2008: £70m) over future years, including costs of implementing the HCL administration contract, contractual commitments to HBOS in respect of pension scheme future service costs and anticipated additional costs associated with servicing policies in the medium term; and
- An amount of £10m (2008: £34m) for other miscellaneous liabilities including, inter alia, a provision for other legal claims against the Society.

h. Technical provision for other linked liabilities (excluding index-linked annuities)

The technical provision in respect of other linked business (excluding index-linked annuities) is equal to the value of the assets to which the contracts are linked. This business is wholly reinsured to HBOS (see Note 3).

A provision in respect of future expenses and mortality risks on other linked insurance business is included in the long-term business provision. The future expenses on other linked business are wholly reinsured.

15. Capital statement

a. Analysis of capital

The capital statement in respect of the Society's life assurance business at 31 December 2009 is set out below. These figures are calculated in accordance with the regulations set out in The FSA Handbook of Rules and Guidance.

	2009 £m	2008 £m
Available capital resources		
Adjustments onto a regulatory basis – valuation differences ⁽¹⁾	615	451
Adjustments onto a regulatory basis – inadmissible assets	(2)	(2)
Total available capital resources	613	449
Long-term Insurance Capital Requirement (LTICR)	(230)	(251)
With-profits Insurance Capital Component (WPICC)	(383)	(198)
Total regulatory Capital Resource Requirements (CRR)	(613)	(449)
Excess of available capital resources over CRR	-	-

Note:

(1) Valuation differences represent any difference placed on the valuation of liabilities in the financial statements compared with those reported in the regulatory return to the FSA.

b. Available capital resources

The total available capital resources show the capital, calculated in accordance with regulations set out in The FSA Handbook of Rules and Guidance, that is available to meet the capital requirements of the business. The available capital resources for the Society amount to £613m (31 December 2008: £449m).

The table below shows the effect of movements in the total amount of available capital of the Society during the year:

Available capital resources	2009 £m	2008 £m
At 1 January	449	740
Investment return and interest rate movements	114	(321)
Other valuation assumptions	22	58
Other movements	28	(28)
At 31 December	613	449

c. Restrictions on available capital resources

It is the Society's aim to manage its business in a sound and prudent manner for the benefit of all policyholders. The Society closed to new business in 2000 and new policies are only issued where there is a regulatory or contractual obligation to do so. The Society has no shareholders and all surpluses and deficits belong to the with-profits policyholders. The Society seeks to ensure that it can meet its contractual obligations to both policyholders and creditors as they fall due. Any new distributions of surplus will be made in non-guaranteed form.

d. Capital requirements

Each life assurance company must retain sufficient capital to meet the capital requirements specified by the FSA. The minimum level of capital required is represented by the Capital Resource Requirement ("CRR").

For the Society, the CRR comprises the Long Term Insurance Capital Requirement ("LTICR") and any additional capital requirement over LTICR, which results from consideration of realistic liabilities. This additional amount of capital required is referred to as the With-Profits Insurance Capital Component ("WPICC").

Actuarial guidance together with FSA rules for closed with-profits funds requires that all capital is anticipated to be distributed to policyholders, leaving a nil balance for the realistic capital of the Society. The WPICC for the Society is therefore the difference between the available capital resources (representing the balance of realistic capital) and the LTICR, leaving a nil balance of excess capital resources.

e. Sensitivity to market conditions of liabilities and components of capital

The with-profits realistic liabilities are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are most sensitive to the level of fixed-interest yields and the values of equities and property, with the reduction in capital resources being more pronounced at lower levels of yields, as a result of the guarantees to policyholders increasing in value. Reductions in the value of property and equities directly reduce the available capital resources. The Board may take actions, such as changes to policy values, to mitigate reductions in capital resulting from an adverse change in market conditions.

The principal non-economic assumptions are the level of future mortality rates, level of future expenses, changes in future retirement ages and future surrender rates.

16. Management of financial risk

a. Risk management framework

As described in the Corporate governance section, the Society has established a comprehensive risk management framework. Through this framework, the Society seeks to manage and monitor the various risks to which the Society is exposed. These include other risks such as operational risk and insurance risk.

Also included within this process are the various financial risks, namely:

- Market risk: covering interest rate risk, equity and property price risk, derivative risk and currency risk;
- Credit risk; and
- Liquidity risk.

These risks are discussed in more detail below, and form part of the FRS 29 disclosures.

The Society uses a number of tools to manage the above risks. In addition to the regulatory testing described in Notes 14 and 15, the Society prepares an Individual Capital Assessment (“ICA”) report in accordance with FSA requirements on an annual basis where a number of scenarios are tested to assess the potential effect on capital. The current regulatory framework will be replaced in 2012 by the Solvency II regime, a Europe-wide regulatory basis for establishing capital requirements for insurance companies. Other tools more specific to managing an individual risk are included below.

b. Market risk

The Society holds a portfolio of investments which are subject to movements in market price. Market risk is the risk of adverse financial changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity and property prices, and foreign currency exchange rates. The main responsibility for monitoring this risk lies with the Investment Committee of the Society. The majority of these assets are held to support contractual liabilities arising from both with-profits and non-profit classes of business.

For these long-term business classes, the Society's asset liability management framework aims to hold assets whose values will, as far as possible, move in line with the corresponding guaranteed liabilities to limit the overall impact of market risk on capital.

In line with the Society's with-profits investment policy, investments are mainly in fixed-interest securities, gilts (2009: 35%, 2008: 39%) and corporate bonds (2009: 42%, 2008:39%).

With regard to unit-linked business, liabilities are reinsured with HBOS and no market risk is considered to arise on this class of business.

As an overall indication of the sensitivity of the Society to changes in market price, consideration is given to the impact on the ERA as a consequence of a number of adverse changes simultaneously occurring. These changes are detailed in the table below and include: reductions in the market price of key asset categories; adverse changes on the yields of corporate bond relative to government-backed fixed-interest securities; and adverse changes in the assumed level of future policy surrenders. These adverse changes are consistent with the requirements for the Society's regulatory risk capital margin tests.

Adverse Changes	2009	2008
Reduction in market price of equities	20.0%	20.0%
Reduction in market price of properties	12.5%	12.5%
Percentage change in long-term gilt yields	17.5%	17.5%
Widening of spread of corporate bonds relative to gilts	0.7%	0.8%
Reduction in surrender rates	32.5%	32.5%

In such adverse investment conditions, the Society could make appropriate reductions to with-profits policy values. These reductions would mitigate market risk, but do not remove the risk entirely for with-profits policies because of the guarantees provided. After adjusting for the reductions, the adverse impact on the ERA of the Society would be as follows:

Adverse Changes	2009	2008
	£m	£m
Above adverse changes – including where long-term gilt yields rise	197	306
Above adverse changes – including where long-term gilt yields fall	122	232

In the scenario where long-term gilt yields are assumed to fall, the figures above exclude the gain in the value of the Society's swaptions. However, where long-term gilt yields are assumed to rise, the corresponding loss has been included. In both scenarios, any potential impact in policy liabilities as a result of changes to flexible retirement dates assumptions has been excluded.

(i) Interest rate risk

Interest rate risk is the risk that the value or future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The Society's exposure to changes in interest rates is concentrated in the investment portfolio. However, changes in investment values attributable to interest rate changes are mitigated by corresponding and partially offsetting changes in the economic value of the insurance provisions, and investment contracts liabilities. A potential market risk for the Society is in respect of GIR on with-profits policies, which are typically 3.5% p.a. When the market returns are below this rate, the cost of providing these guarantees is correspondingly higher. To mitigate this risk the Society holds a series of interest rate swaptions.

The Society monitors this exposure to changes in interest rates through regular periodic reviews of the asset and liability position. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance provisions, are modelled and reviewed periodically.

The Society is also exposed to the risk of changes in future cash flows from variable income securities arising from the changes in interest rates.

The Society's sensitivity to interest rate risk is included in the overall market risk sensitivity included in the stress scenario table above, excluding the impact of the Society's swaptions.

(ii) Equity and property price risk

The Society invests in equity and property assets, whose market values are typically more volatile than other classes of asset held by the Society, but which we believe provide long-term benefits for the Society's members. To mitigate the risk of changes in the market price of these asset classes, the Society limits the proportion of the total assets invested in these categories. In addition, as indicated in section (i) above, further mitigation takes place by partially offsetting changes in the liabilities of the Society.

The Society's sensitivity to equity and property price risk is included in the overall sensitivity to market risk described previously.

(iii) Derivative risk

The Society invests in derivatives within strict guidelines agreed by the Board of Directors and overseen by the Investment Committee. Derivatives are used for efficient investment management and risk management. Interest rate swaption derivatives are used to mitigate interest rate risk. Forward exchange contracts are used to mitigate currency risk. Derivative transactions are fully covered by cash or corresponding assets and liabilities. Derivative contracts are entered into only with approved counterparties, thereby reducing the risk of credit loss.

(iv) Currency risk

The Society's principal transactions are carried out in Pounds Sterling and its exposure to the risk of movements in foreign exchange rates is limited. The risk arises primarily with respect to the US Dollar.

The Society's financial assets are primarily denominated in the same currencies as its insurance and investment liabilities, which mitigate the foreign currency exchange rate risk for any overseas operations. Therefore the main foreign exchange risk arises from recognised assets and liabilities denominated in currencies other than those in which insurance and investment liabilities are expected to be settled. In 2009, the Society invested in a US Dollar Forward exchange contract to partially mitigate this risk.

The relative exposure of the Society to currency risk is shown in the following table:

	2009				2008			
	Assets		Liabilities		Assets		Liabilities	
	£m	%	£m	%	£m	%	£m	%
Currency								
Sterling	8,271	96	7,749	98	8,331	95	8,134	98
Euro	225	3	184	2	258	3	200	2
US Dollar	118	1	6		163	2	6	
Other	-				2			
Total	8,614	100	7,939	100	8,754	100	8,340	100

The excess of the total value of assets over the total value of liabilities represents the Society's ERA. A change of 10% in Pounds Sterling to Euro/US Dollar exchange rates at the reporting date would have changed the ERA by £7m (2008: £22m) after allowing for the mitigating impact of the US Dollar Forward exchange contract.

c. Credit risk

Credit risk is the risk that a counterparty will fail to pay amounts in full when due. The main credit risks faced by the Society are:

- The risk of default on its portfolio of fixed-interest securities, especially corporate bonds;
- The risk of default by any of its reinsurers.

These risks are monitored by the Society's Investment Committee. A key aspect of this is the Society's policy of investing predominantly in high-quality corporate bonds and government issued debts.

The Society's objective is to earn competitive relative returns by investing in a diversified portfolio of securities. The Society manages this risk by up-front stringent underwriting analysis, reviews by the Investment Committee and regular meetings to review credit developments. Watch lists are maintained for exposures requiring additional review and all credit exposures are reviewed at least annually.

With regard to reinsurance, wherever possible, steps are taken to limit counterparty risk. The major reinsurance treaties are with companies in the HBOS Group. Because reinsurance does not remove the primary liability of the Society to its policyholders, the credit rating of these companies is monitored closely.

The Society's exposure to credit risk is summarised below according to the lowest of the external credit ratings supplied by Moody, Standard & Poor, and Fitch:

2009

Credit ratings	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Debt and other fixed-income securities	2,411	483	1,093	463	78	4,528
Other variable yield securities	428	-	20	-	-	448
Total of fixed and variable yield securities	2,839	483	1,113	463	78	4,976
Deposits with credit institutions	473	-	14	-	-	487
Cash at bank and in hand	-	3	-	-	-	3
Other financial assets	45	16	28	12	20	121
Reinsurers' share of technical provisions and liabilities (Note 14c)	-	-	2,312	-	-	2,312
	3,357	502	3,467	475	98	7,899

2008

Credit ratings	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Debt and other fixed-income securities	3,228	442	1,123	354	27	5,174
Other variable yield securities	84	1	18	-	-	103
Total of fixed and variable yield securities	3,312	443	1,141	354	27	5,277
Deposits with credit institutions	-	-	192	-	72	264
Cash at bank and in hand	-	-	6	-	-	6
Other financial assets	55	10	74	9	44	192
Reinsurers' share of technical provisions and liabilities (Note 14c)	-	2,113	-	-	-	2,113
	3,367	2,566	1,413	363	143	7,852

The total of fixed and variable yield securities and deposits with credit institutions includes £230m of assets held to back linked liabilities. Deposits with credit institutions includes £9m of assets to back linked liabilities. Other financial assets comprise debtors and prepayments and accrued income.

When calculating technical provisions in respect of non-profit business, when deriving the discount rate to be used, reductions based on credit risk are made to the published yields of invested assets exposed to credit risk. This reduction to the discount rate results in an increase to the assessed technical provision, thereby providing an implicit margin against the risk of default by the counterparties.

The potential credit risk exposure from default by swaption counterparties is mitigated by the receiving of collateral. Collateral of £26.6m (2008: £70.2m) has been received in cash and has been invested in assets similar in nature to cash. The value of these assets at the year end was £33.6m and is included in 'Deposits with credit institutions' in Note 10c.

The largest single credit risk exposure amounts to £2,312m for HBOS reinsurance (2008: £2,115m). The Society holds a further £36m (2008: £60m) of investments (credit ratings of BBB: £31m and AA: £5m) with the Lloyds Banking Group, parent company of HBOS.

At the reporting date, no material financial assets were past due nor impaired (2008: £nil) and management expects no significant losses from non-performance by these counterparties.

d. Liquidity risk

Over the longer term, the Society monitors its forecast liquidity position by estimating both the guaranteed and expected cash outflows from its insurance and investment contracts and purchasing assets with similar durations to meet these obligations. The sensitivity of these outflows to changes in policyholder behaviour is also monitored. Large volumes of surrenders or policyholders taking their benefits earlier than expected can cause the forced sale of illiquid assets at impaired values. If this is to the disadvantage of continuing customers the market value adjustment to policy values will be varied to maintain fairness.

An important aspect of the Society's management of assets and liabilities is ensuring that cash is available to settle liabilities as they fall due. Monitoring of this risk is undertaken by the Investment Committee. The Society maintains cash and liquid deposits to meet these demands on a daily basis, thereby mitigating liquidity risk. The ratio of illiquid assets to total invested assets is monitored monthly.

The Society's liquidity exposure is relatively limited even in a scenario such as corporate bonds becoming illiquid, over 45% of investment assets held backing insurance and investment liabilities are held in liquid assets such as gilts and cash, which can normally be quickly realised. Also, in times of market uncertainty and potentially poorer liquidity, market value adjustments may be borne by those with-profits insurance and investment contract customers who decide to transfer or withdraw their benefits.

Part of the Society's assets is invested in property (including property unit trusts) and unlisted equity, amounting to £657m at year end 2009 (2008: £735m). In adverse market conditions, it may not be possible to realise these investments without delay.

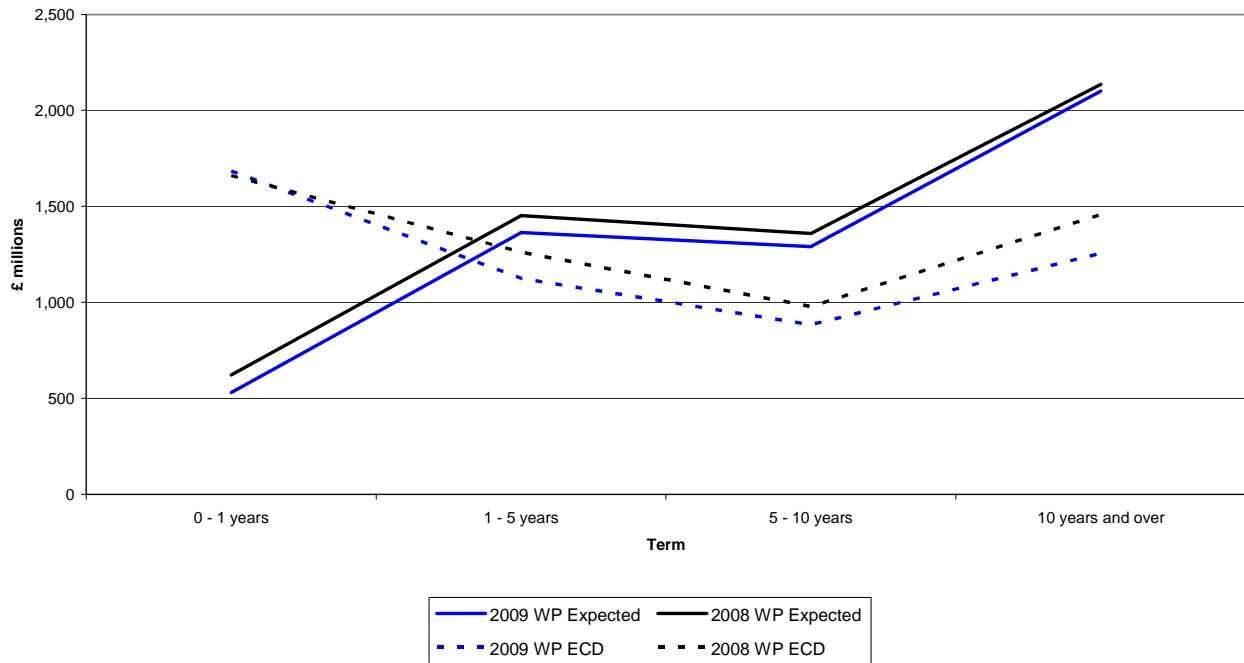
As noted in Note 14f (ii), the majority of RSP benefits can be taken on contractual terms at a range of ages. The table below details the cash flows using retirement assumptions based on recent experience, that vary between different product types. The range of retirement dates assumed varies between policyholders being assumed to retire 2 years (2008: 2 years) earlier than ECD and up to 14 years (2008: 13 years) later than ECD.

2009	0-1 year	1-5 years	5-10 years	10 years and over	No term	Total	Carrying value
Estimated cash flows (undiscounted)	£m	£m	£m	£m		£m	£m
Unit-linked investment contracts	153	696	599	1,141	-	2,589	1,810
Other non-profit investment contracts	10	-	-	-	-	10	10
With-profits investment contracts	530	1,363	1,291	2,102	-	5,286	4,286
Other financial liabilities	92	-	-	-	-	92	92
Total financial liabilities	785	2,059	1,890	3,243	-	7,977	6,198
Of which reinsured	163	696	599	1,141	-	2,599	1,820
Total net financial liabilities	622	1,363	1,291	2,102	-	5,378	4,378
Net insurance liabilities	208	295	317	1,080	-	1,900	1,153
Excess Realistic Assets					675	675	675
Total net liabilities	830	1,658	1,608	3,182	675	7,953	6,206

2008	0-1 year	1-5 years	5-10 years	10 years and over	No term	Total	Carrying value
Estimated cash flows (undiscounted)	£m	£m	£m	£m		£m	£m
Unit-linked investment contracts	145	613	541	1,028	-	2,327	1,626
Other non-profit investment contracts	5	-	-	-	-	5	5
With-profits investment contracts	622	1,452	1,359	2,135	-	5,568	4,799
Other financial liabilities	154	-	-	-	-	154	154
Total financial liabilities	926	2,065	1,900	3,163	-	8,054	6,584
Of which reinsured	150	613	541	1,028	-	2,332	1,631
Total net financial liabilities	776	1,452	1,359	2,135	-	5,722	4,953
Net insurance liabilities	267	322	302	966	-	1,857	1,210
Excess Realistic Assets					414	414	414
Total net liabilities	1,043	1,774	1,661	3,101	414	7,993	6,577

The cash flows assuming policies are terminated on ECD, would vary from those detailed above as policies past the ECD would result in a cash flow in the category '0-1 year' and policies yet to reach ECD would be earlier than shown. Unit-linked contracts, with the exception of unit-linked annuities, can be terminated at any time resulting in a cash flow in the category '0-1 year'. All liabilities relating to unit-linked and other non-profit investment contracts are reinsured so that, in practice, the Society is not exposed to any liquidity risk in respect of such contracts. The following graph indicates how the estimated cash flows for with-profits investment contracts above (solid graph lines) would vary from those at ECD (broken graph lines).

**Estimated cashflows from with-profits investment contracts
Expected termination dates versus ECD**



With-profits policies with an ECD prior to 31 December 2009 have a contractual value no lower than total guaranteed benefits, and equalled £1.3bn at 31 December 2009 (2008: £1.3bn). The liquid assets referred to above includes £2.5bn (2008: £2.4bn) to back with-profits policies which is more than sufficient to meet the value of these guaranteed with-profits benefits.

All liabilities relating to unit-linked and other non-profit investment contracts are reinsured so that the Society is not exposed to a material liquidity risk in respect of such contracts. In extreme scenarios the reinsurer might be unable to liquidate underlying assets.

17. Provision for other risks and charges

	Society	
	2009 £m	2008 £m
Provisions for deferred taxation	-	-
Pension commitments for former staff	77	46
	77	46

The provision for pension commitments for former staff of £76.7m is in addition to a creditor to HBOS for payments during 2010 totalling £16.8m (2008: £16.8m). Pension payments for former staff relate to the contractual agreement with HBOS (described in Note 8c). The balance of the movements is due to changes in economic assumptions.

18. Creditors

	Society 2009 £m	2008 £m
a. Amounts owed to credit institutions	7	12

Amounts owed to credit institutions represent uncleared payments to policyholders. An amount of £7m (2008: £7m) placed in an assigned account owned by HSBC is included in 'Debtors' in Note 12.

	Society 2009 £m	2008 £m
b. Other creditors including taxation and social security		
Balances with Group companies	8	9
Corporation tax	1	3
Other creditors	46	90
	55	102

Amounts in 'Other creditors' include an obligation to return the variation margin associated with the swaption investment to Morgan Stanley (2009: £26.6m, 2008: £70.2m) and the contractual commitment to HBOS in relation to the defined benefit pension scheme referred to in Note 17.

19. Subsidiary and associated undertakings

a. Principal subsidiary undertakings

The Society has no material subsidiary undertakings as outlined in Notes 1 and 10.

b. Significant holdings

At 31 December 2009, the Society held more than 20% of the nominal value of a class of equity shares in 9 companies with a value of £13m (2008: 11 companies, value £18m).

At 31 December 2009, the Society held more than 20% of the partnership interests in 1 limited partnership investing in properties with a value of £18m (2008: 1 partnership, value £18m).

At 31 December 2009, the Society held more than 20% of the partnership interest in 4 portfolios investing in private equity investment companies included in shares and other variable yield securities, with a value of £4m (2008: 6 portfolios, value £7m).

None of the above holdings are regarded by the Directors as associated undertakings as the Society does not exert significant influence. None of the holdings materially affects the results or net assets of the Society. These investments are included in the Balance Sheet at current value, which is based upon the Society's share of relevant net assets.

Full information on subsidiary undertakings and companies and limited partnerships, in which the Society holds more than 20% of the nominal value of a class of equity share or ownership interests, will be annexed to the Society's next statutory annual return submitted to the Registrar of Companies.

20. Related party transactions

There were no material related party transactions during 2009 (2008: £nil).

21. Commitments

The Society has no material operating lease commitments.

There are no property investment commitments provided for in the financial statements (2008: £nil) for the Society.

Commitments in respect of uncalled capital on private equity fund interests, not provided for in the financial statements, amounted to £21.4m (2008: £23.9m) for the Society.

In line with usual business practice, warranties have been provided for the strategic transactions completed in the year.

22. Contingent liabilities and uncertainties

There exist some uncertainties that, if they were to materialise, could adversely impact on the propriety of preparing these financial statements on an ongoing concern basis. Over the last few years, these uncertainties have been addressed to a very significant extent, and those that remain are referred to below. The Board has assessed the possibility of these uncertainties and has concluded that it is right to prepare these financial statements on a going concern basis having taken legal and actuarial advice on the latest available information.

- The Society has contractual commitments in respect of two pension schemes for which HBOS is the principal employer, as set down in Note 8c to the financial statements. Although full provision is made for estimated contractual liabilities calculated on a basis consistent with that adopted by the Scheme Actuary in his triennial valuations, there remains the possibility that it may be necessary for a more conservative basis to be adopted in future in calculating the Society's obligations.
- As noted in the Financial review on page 7, it is the Society's intention that any future bonuses will be in a non-guaranteed form. Allowance is made for continuing contractual commitments, such as the GIR of 3.5% p.a. that is applicable to many policies. In valuing policy liabilities, guarantees are valued under a range of economic scenarios. The calculation of the technical provisions is based on a projection of current market conditions, allowing for current retirement experience. There remains a risk to the Society that investment conditions change or that policyholders defer their retirement. To mitigate this risk, the Society continues to invest in interest rate swaptions.
- The Parliamentary Ombudsman laid her final report into the regulation of Equitable Life before Parliament on 16 July 2008. It made no findings about the actions of the Society.

Sir John Chadwick has been appointed by the Government to advise them on the establishment of an ex-gratia scheme in respect of certain findings of regulatory maladministration identified by the Parliamentary Ombudsman. The Society continues to liaise with Sir John and the Government regarding the proposed scheme. Sir John has published three interim reports and his final report to the Government is expected in May 2010.

In view of the findings in the Ombudsman's report and the content of Sir John's interim reports, the Society has concluded that the likelihood of successful claims being brought against the Society as a result of those reports or Sir John Chadwick's final advice is extremely limited.

- The Institute of Chartered Accountants in England and Wales has initiated disciplinary proceedings against Ernst & Young in respect of its conduct in certain of its audits of the Society. The Accountancy and Actuarial Discipline Board ("AADB") are investigating an accountant and an actuary in respect of the provision of information for use by the Financial Reporting Review Panel relating to the financial statements of Equitable Life in 1999. The actuary is also being investigated by the AADB in relation to audits of the 1997, 1998 and 1999 financial statements.

The AADB is also investigating the conduct of certain actuaries in relation to the provision of advice by, or on behalf of, the Government Actuary's department to prudential regulators.

Although these proceedings cannot result in a requirement for the Society to take any particular action, and it is unlikely that they will give grounds for any new claims, their findings could influence the way in which new claims, if any, are presented against the Society.

- Ninety-one claims have been issued against the Society in district courts across Germany. The Society is continuing to challenge these claims and a significant number of them have been determined in its favour. The courts have found in favour of the Society in all cases held so far, and in light of this, the Society now believes the costs associated with this group of claims are unlikely to be significant.

The Society has made appropriate provisions for future expenses, alleged mis-selling and other risks based on currently available information. Over time, as more information becomes available, the range of possible outcomes in relation to these issues can be expected to continue to narrow, and the degree of confidence around the levels of the individual provisions can be expected to increase. The Society now considers that the potential impact of the uncertainties referred to on page 8 of the Financial review and in this Note have diminished significantly over the past few years. However, the potential impact of the range of uncertainties relating to provisions could be significant.

As discussed in the Financial review, the Board will take proactive action to maintain regulatory solvency at all times. With the volatility in investment and property markets, the uncertain nature of provisions and the other potential strains on the Society's finances, the Board recognises the possibility that the Society may not meet regulatory solvency requirements at all times in the future. This does not, of itself, mean the Society will not be able to meet policyholder liabilities as and when they fall due.

The financial position of the Society has been projected under a range of economic scenarios. The Board has also considered the level of contingent liabilities in its analysis of the Society's financial position. The Board is confident of its ability to manage adverse scenarios that may arise, but extremely adverse scenarios could prejudice the continuing ability of the Society to meet policyholder liabilities as they fall due, and so there cannot be absolute assurance.