Interim Review for the half year ended 30 June 2010

Equitable Life

The Equitable Life Assurance Society

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Walton Street, Aylesbury, Buckinghamshire HP21 7QW

Board of Directors
Ian Brimecome, Chairman (b) (c)
David Adams OBE, Deputy Chairman (a) (b) (c)
Chris Wiscarson, Chief Executive (c)
Tim Bateman, Finance Director
Mark Earls, Chief Operating Officer
Keith Nicholson, Non-executive Director (a)
Ian Reynolds, Non-executive Director (a) (c)
Cathryn Riley, Non-executive Director (b)

Key to membership of the principal Board Committees
(a) Audit
(b) Remuneration
(c) Nomination

With-profits Actuary
Rob Merry

Head of Actuarial Function
Tim Bateman

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The Society's Chairman, Ian Brimecome,
and Chief Executive, Chris Wiscarson, on behalf of the Board

Dear Members

We are pleased to report that the momentum built up by the Society in the second half of 2009 following the unprecedented financial turbulence of the previous two years, has continued into 2010.

In our last Annual Report, we set down the three principal ways of recreating policyholder value:

- 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.

These clear objectives remain the overarching guide in managing the Society.

Government compensation

On 22 July, the new Financial Secretary to the Treasury, Mark Hoban MP, announced to Parliament that 'no one should be in any doubt about our commitment to policyholders, who have waited a decade for justice. We are committed to implementing the Parliamentary Ombudsman's recommendation, made two years ago…'.

We set out at the end of this report the many significant developments since the formation of the new Government.

The influence of Equitable Members Action Group in securing the new Government's commitment to compensation has been considerable. We welcome the opportunity to continue to work with them to the benefit of policyholders, past and present.

Financial position

Over the first half of 2010, the prospect of a double dip recession has received regular press coverage. Markets responded adversely to the concern that economic growth may be lower than was previously expected. Government bond yields fell between half and one per cent at most durations, with corporate bond spreads widening a little since January and equity markets falling back by 10%, and then recovering. We have continued to reduce our exposure to investment risk, with equity sales of almost £60m and property sales of some £34m.

Excess Realistic Assets totalled £736m at 30 June 2010, up from £675m at the end of 2009. The Society's regulatory solvency position remained well above the regulatory minimum.

We are particularly pleased that the financial performance of the Society has allowed the Board to maintain interim bonus at 3.5% per annum.

New investment manager

We completed our assessment of companies that provide asset management services in the spring and have appointed BlackRock Investment Management (UK) Limited to provide from October 2010 investment and investment risk management services for our 400,000 policyholders and group scheme members. BlackRock's objective will be to maximise returns on over £5.5 billion of assets while satisfying Equitable Life's regulatory capital requirements.

BlackRock is one of the world's leading investment managers with over £2 trillion of assets under management as of 30 June 2010. It is an independent firm in ownership and governance. Their depth of resource includes over 1,000 investment professionals worldwide, with 400 focusing on fixed-income. Managing insurance assets is one of the strategic focuses of the firm. Importantly, BlackRock is an industry leader in the areas of investment risk management and investment management technology.

We have asked BlackRock to follow a strategy which will match, in terms of currency, duration and nature, and within stated tolerances, the expected levels of future expenses and guaranteed payments to policyholders with expected levels of cashflows from the invested assets. The strategy must also be alive to the need for the Society to be able to react swiftly in adverse conditions.

Administration services

It is our intention to issue Annual Statements to policyholders significantly earlier than has been the case in recent years, and our plan is to have these important documents in your hands by no later than the first quarter of 2011.

We continue to work with HCL in preparing to transfer our policy administration services to them.

Looking ahead

In March, we reported on the considerable solvency capital that the Society is required to hold. This is expected to increase as a result of Solvency II, the new regulations being developed by the EU Commission.

As the new rules are finalised and the investment outlook becomes clearer, we will be assessing potential new strategies to maximise returns for policyholders. We will report further by the time of our next Annual General Meeting in 2011.

On behalf of the Society's Board of Directors on 28 September 2010

Ian Brimecome
Chairman

Chris Wiscarson
Chief Executive

Government compensation

In its first few months in government, the new Coalition achieved more in regard to policyholder compensation than had hitherto been achieved in almost a decade.

On 22 July, the new Financial Secretary to the Treasury, Mark Hoban MP, announced to Parliament that 'no one should be in any doubt about our commitment to policyholders, who have waited a decade for justice. We are committed to implementing the Parliamentary Ombudsman's recommendation, made two years ago...'.

The Minister went on to say that the amount available for compensation will be announced as part of the Government Spending Review on 20 October 2010. He has established an Independent Commission to determine how the scheme should allocate the funds which Government decides can be afforded. The Ombudsman herself accepted the constraint of the public purse and, in the current economic climate, a reduction appears inevitable.

We welcome the Government's publication of a timetable pointing to the first payments to policyholders in mid 2011. While these first payments are still some months away, we recognise the complexity of what needs to be accomplished and this is the first time a commitment to payment dates has been made.

We hope our faith in Government to do what they say they are going to do will not be undermined by inappropriate reliance on Sir John Chadwick's advice which is based on objectives that appear to us quite different from what was anticipated by the Parliamentary Ombudsman.

We have never supported an approach which places store on the methodology used in calculating the lower ranges of numbers that arise from Sir John Chadwick's advice. He himself says in section 4.24 of his report published in July that the then Labour Government 'decided not to accept that it would be appropriate to establish a compensation scheme in the way the Ombudsman had recommended. I have not been asked to advise how compensation under such a scheme would be awarded; and I have not been asked to advise as to whether it would be appropriate to make payments in respect of lost opportunities'.

Sir John goes on to say, in section 4.25 of his advice, that 'I have reached the conclusion that the approach was not what the Ombudsman had in mind'.

Indeed, on 26 July 2010, the Parliamentary Ombudsman herself wrote to Members of Parliament to say that:

'The Chadwick proposals seem to me to be an unsafe and unsound basis on which to proceed… I welcome the appointment of an independent commission… I also welcome the clear timetable… The work done by Towers Watson to calculate the relative losses sustained by policyholders and annuitants is also to be welcomed. I note that the provisional figures of £4 to 4.8 billion… This all provides a firm foundation on which to build. Unfortunately, I cannot say the same for the proposals within the Chadwick report. …Sir John's terms of reference included the rejection… of my recommendation… I have noted that it misinterprets central parts of the conclusions outlined in my July 2008 report. …I am very disappointed to discover that Sir John has explicitly rejected those explanations and… has substituted his own interpretation of these matters without seeking my further comments…'.

Since publication in 2008, your Board's position has been that it accepts the Parliamentary Ombudsman's report and calls on the Government to implement her recommendation as they committed to do in the Coalition agreement. It is, in our judgement, more than sufficient that her report and subsequent submissions, clear as they are, be the basis for the new Government's payment scheme.

We welcome the transparency demonstrated by Government in publishing a range of potential loss figures, and we accept that the Government still has work to do before it can decide on the final affordable sum. Having said that, we have made representations to Government on what, on behalf of policyholders, we consider fair. We also wrote directly to policyholders in August to make them aware of Government's thinking and the short timetable for representation.

On 14 September, there was a debate in Parliament on the second reading of the Bill to enable Treasury to make payments to policyholders. It was heartening to see the strength of feeling by Members of Parliament in terms of Government acting properly in accordance with its Coalition commitment. The weight of argument was strongly in favour of supporting the Parliamentary Ombudsman's recommendation, and the lower ranges of numbers emerging from Sir John Chadwick's advice were repeatedly criticised. However, the decision on compensation falls to Government, and the Minister responsible repeatedly made reference to the constraints of the public purse as Government is entitled to do given the Ombudsman's assertions in this respect.

The role of the Equitable Members Action Group in securing so many Members of Parliament to sign a pledge to support the recommendations of the Parliamentary Ombudsman in the run-up to the election cannot be praised too highly. The existence and importance of these pledges was much mentioned in the Parliamentary debate. The strength of feeling amongst MPs on behalf of policyholders in their constituencies was very evident, and it is hoped that Government will be influenced to pay compensation which does honour their Coalition commitment.

We are in contact with the Treasury to assist with the practical implications of a payment scheme. Equitable Life will be an important source of data and we stand ready to support Treasury in making sure the implementation of the payment scheme does begin no later than the summer.

The Society reports regularly on developments in regard to Government compensation on our website www.equitable.co.uk.

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 30 June 2010, ERA were £736m, an increase of £61m over the year-end position. The analysis of the with-profits assets and liabilities is as follows:

	30 June 2010 £m	31 Dec 2009 £m
Realistic value of with-profits assets	5,574	5,546
less:		
Policy values	4,061	4,143
Future charges	(303)	(290)
Impact of early surrenders	(26)	(28)
Cost of guarantees	634	574
Other long-term liabilities	284	283
Other liabilities	188	189
	4,838	4,871
Excess Realistic Assets	**736**	**675**

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

	Jan to June 2010 £m	Jan to Dec 2009 £m
Opening Excess Realistic Assets	**675**	**414**
Investment performance net of changes in policy values	101	242
Policy value increase at 31 December 2009	(31)	
Mortality experience and assumption changes	-	(24)
Surrender experience and assumption changes	5	2
Changes in other valuation assumptions	(7)	(3)
Variances in expenses and provisions	(16)	(89)
Other movements	9	3
Expense savings from transfer to HCL	-	130
Closing Excess Realistic Assets	**736**	**675**

The Society seeks to maintain the ERA balance at a level that protects its regulatory capital while treating continuing and exiting policyholders fairly.

Financial Services Authority capital requirements

As a mutual company closed to new business, when we report to the Financial Services Authority ("FSA") for regulatory capital 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. The Society continues to prepare for the significant regulatory changes which will be more onerous for the Society than the current regime. In preparedness for Solvency II, the Society is in the process of assessing its capital needs based on the latest EU Commission survey, the results of which will be used by the Commission to finalise the regulations. The report on the results of the survey is scheduled to be presented in April 2011.

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.

Investment conditions have continued to be volatile for all types of investments in the first half of the year and the outlook for the near future indicates conditions will remain volatile with the possibility of a deterioration if a 'double dip recession' occurred. Some of the assets previously invested in were considered too volatile to meet the Society's regulatory capital objectives and, as mentioned in the Corporate review, over the first half of 2010, equity investments worth £59m, and properties, worth £34m, were realised in addition to the disposals made during 2009.

The assets backing UK with-profits policies produced a gross return of 6.3% in the first half of the year. An important component of this return derived from the increase in the value of the Society's fixed-interest holdings as a result of Government bond yields, which fell by around 0.5 to 1% at most durations. We adjust the return to be passed on to policyholders to remove the effect of Government bond yield movements as they affect both assets and liabilities. This reduces the return available to be passed on to policyholders to 2.9%. The net return on the fund, after deducting charges for expenses (1% per annum), the charge for guarantees (1% per annum), for tax and the effect of changes in provisions and technical provisions, is 1.7%. In consequence, the Board has decided to retain the interim bonus of 3.5% per annum for pension policies.

The charge for guarantees of 1% per annum 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 1% per annum during 2010.

Expenses and 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 30 June 2010, provision has been made for contribution payments in respect of future service of £33m to be made in the period to 1 March 2016, and the estimated scheme deficit of £87.5m.

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 reduce policy values, as in 2009, when they 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 has been maintained in 2010. These adjustments can be varied at any time without advance notice, any such change reflecting the then financial position of the Society.

The Society has experienced a fairly steady and decreasing level of claims so far in 2010, 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 £5m (2009: £2m) in ERA.

Business risks

Full details of material contingent liabilities and uncertainties are set out in the 2009 Annual Report and Accounts. An update on Government compensation has been provided in the Corporate review.

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

As noted in the 2009 Annual Report and Accounts, the Society has made appropriate provisions for future expenses, alleged mis-selling and other risks based on currently available information. As more information becomes available, the range of possible outcomes in relation to these issues has narrowed and the degree of confidence around the levels of the individual provisions has increased. The Society now considers that the potential impact of these uncertainties has diminished significantly over the past few years, but the potential impact of the range of uncertainties relating to provisions could still be significant.

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; the effect of lower interest rates on the behaviour of policyholders with Guaranteed Investment Returns ("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 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.

The Board is also responsible for taking action to maintain regulatory capital 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 capital 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 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.

Summary balance sheet

as at 30 June 2010

Assets	30 June 2010 £m	31 Dec 2009 £m
Investments		
Land and buildings	362	375
Shares and other variable yield securities and units in unit trusts	298	340
Debt and other fixed-income securities	4,790	4,746
Deposits and other investments	571	478
	6,021	5,939
Assets held to cover linked liabilities	240	239
Reinsurers' share of technical provisions	2,232	2,312
Other assets	103	124
Total assets	**8,596**	**8,614**

Liabilities		
Technical provisions		
Excess realistic assets	736	675
Other with-profits technical provisions	4,649	4,683
Non-profit technical provisions	928	858
Linked liabilities and claims	2,097	2,213
	8,410	8,429
Other liabilities	186	185
Total liabilities	**8,596**	**8,614**

Note:

The Equitable Life Assurance Society's Summary balance sheet is not consolidated and represents the position of the Society only, is unaudited and does not constitute statutory financial statements as defined in section 435 of the Companies Act 2006.