

**Report to with-profits policyholders on
the management of the fund during 2010**

Report to with-profits policyholders on the management of the fund during 2010

Introduction

This statement is a report by the Board of Equitable Life Assurance Society (the Society) to with-profits policyholders covering their management of the with-profits fund during the calendar year 2010.

Governance

During 2010, the Board has maintained appropriate governance arrangements for the Society's with-profits business to ensure that it complies with, maintains and records its Principles and Practices of Financial Management (PPFM).

In determining the governance arrangements for the management of the with-profits business of the Society, the Board decided that it would act as the governing body for with-profits business as it has the necessary range of skills and appropriate experience in non-executive and executive roles. The With-profits Actuary provides guidance and advice to the Board on all matters affecting the with-profits business of the Society. For a mutual company without the potential conflicts caused by shareholder requirements, the Board believes that this is an appropriate and proportionate response to the requirements of the regulations.

The reports to policyholders over the last two years noted that work was ongoing to better understand the management of the Society's with-profits business as its financial situation evolves; in particular, to understand the interaction of the need to hold capital for solvency requirements and to manage the level of Policy Value increases and the level of the Financial Adjustment. Additionally, the 2009 Report also proposed that a consistent approach should be adopted for the calculation of all measurements used in the determination of payouts.

During the course of 2010, the Board received reports which considered these matters in more detail. This work has culminated in the announcement made at the end of March 2011, explaining that the Board had implemented a process for the prudent distribution of capital. The Board has agreed a set of risk appetites which allow for the distribution of the capital, on a cautious basis. Details of the distribution can be found in the 2010 Annual Report and Accounts.

As part of the governance processes, the PPFM is reviewed at least once each year. The PPFM was last reviewed and revised in June 2010 and, in view of the work on the distribution of capital being undertaken during 2010, no material changes were made following this review. The PPFM has been further amended in 2011 to set out the capital distribution programme and the PPFM ratio has been replaced with a ratio based on the coverage of solvency capital. This solvency capital ratio will be used to assess payouts and the Financial Adjustment going forward. The revised PPFM is now available on the Society's website. The most significant changes made are summarised in Appendix B.

The FSA has recently issued consultation on new rules for the management of the with-profits business, including governance arrangements. The Society will review its own arrangements in the light of the consultation and any emerging new regulations.

The Board decided that an external review of compliance with the PPFM in 2010 should be performed. The key points of this external review are covered in this report.

Use of discretion

The Board aims to treat all of its policyholders fairly. As part of the preparation of this report, a detailed review of the following items was undertaken to check that the outcome of the discretion applied was fair and even-handed towards policyholders.

- Reversionary and Final Bonus rates to be applied to policies;
- Investment policy in the light of product descriptions disclosed to policyholders;
- Surrender value methodology (including the Financial Adjustment);
- Allocation of expenses to with-profits business;
- Operational discretions; and
- Changes to the PPFM.

The review also considered whether the nature and content of policyholder communications concerning the above matters were clear, fair and not misleading.

In order to assess whether discretion has been applied fairly, the Board considered the following questions:

- Whether the use of discretion was even-handed or whether it (implicitly or explicitly) favoured one group of policyholders over the rest?
- Whether the exercise of discretion was transparent?
- Whether the exercise was consistent with the communications policyholders have had in the past?

The Board concluded that the actions taken were fair to policyholders and in accordance with the principles and practices described in the PPFM. Policyholder communications concerning the matters above were felt to be clear, fair and not misleading.

The detailed observations setting out the areas for further consideration are given below.

Detailed considerations in 2010

Bonus rates

The Society has stated that it does not expect to declare any reversionary or guaranteed bonuses in the foreseeable future. This expectation appears in the PPFM, the booklet called 'A guide to how we manage the with-profits fund' and general statements in the Annual Report and Accounts. The Board considers this to be even-handed as all policyholders are treated in the same way.

Policy Values as at the 31 December 2009 were increased in January 2010 and March 2010 and further increases were awarded at the rate of 3.5% per annum for UK pension policies until March 2011.

As investment conditions improved over the course of the year, Policy Values were below the lower end of the PPFM ratio range. The Board considered this position regularly throughout 2010 and decided that it would not act to increase Policy Values further. The main reasons for this were continuing volatility and spikes of uncertainty in the investment markets affecting the solvency position, and the continuing consideration of ways to fairly distribute capital.

Following detailed work in 2010 and early 2011, the Board has now approved a methodology under which capital may be distributed to policyholders. It has also agreed a set of risk appetites which will assist in the determination of future distributions. In particular, the Board accepted a risk appetite based on its desired level of capital. In the revised PPFM, the PPFM ratio has now been replaced by a requirement to monitor the solvency capital ratio and to maintain that within certain bounds. This will also affect the method used to determine the level of the Financial Adjustment applied to non-contractual exits.

Investment policy

The Board notes that investment policy is clearly reported in the Annual Report and Accounts and in the PPFM. The Board acknowledges that the current investment policy is not what policyholders would have expected when they took out their policies. Taking into account the events of 2000-2003, and the more recent volatility in the financial markets, combined with the Society's own well-publicised difficulties and the tighter regulatory regime, the rationale for the current policy is clear and has been communicated to policyholders on several occasions.

During 2010, we transitioned to a new Investment Manager, BlackRock, and have established a new mandate for the management of the assets.

In 2010, the equity and property portfolio was considered too volatile to meet the Society's regulatory capital objectives, and so we continued to reduce our exposure to investment risk during the year with equity sales of almost £100m and property sales of just over £100m.

As a result of the sales noted above and activity by BlackRock to achieve our cash flow matching objectives, the level of cash holdings built up during 2010 exceeded the investment guidelines set out in the PPFM. The PPFM has now been amended to reflect our revised guidelines, which include a much higher proportion in cash.

The Society regularly reviews the appropriate composition of the with-profits fund, and the investment strategy will be amended as necessary to link to the Society's risk objectives and its need to satisfy capital requirements. It is expected that the Society's investment mix will be increasingly weighted towards fixed-interest securities and cash.

Surrender value methodology

The Financial Adjustment ("FA") is a key aspect of the Society's surrender value basis and is regularly reviewed.

The Board considers surrender experience and the financial position of the Society as part of the regular review and will act to change the FA as circumstances develop in order to treat all its policyholders, both remaining and exiting, fairly. The FA was left unchanged at 5% throughout 2010, despite the improving financial position of the Society, as the Board was mindful of the very difficult conditions in 2009 as well as the work going on to formulate a more detailed capital distribution programme.

During the year, policyholder communications concerning surrender and transfer values, and their interaction with guarantees, were revised to highlight the value of the guarantees that with-profits policies contain.

Allocation of expenses

For a mutual society such as Equitable Life with its single fund structure, all costs (expenses of management, tax, etc.) are met from the with-profits fund.

In 2010, expenses were charged at 1% of Policy Value. This is set out in the PPFM and has been widely communicated in the past via With-Profits Guides and sales literature. During 2010, the Society reviewed its strategy for administration services and decided to consider alternative operating models. In particular, the Board decided not to proceed with the transition to HCL. The capital distribution programme described earlier will require significant IT systems change. The Board has concluded that the Society should take direct responsibility for its policy administration, in particular, to provide greater control over the changes for capital distribution, given their scale and pace.

The Board has therefore reviewed the allocation of expenses and the way in which charges are levied, looking at both current levels and likely future levels. The Board concluded that the charge should remain at 1% per annum. The Board continues to believe that the current approach to expense charging will treat all generations of policyholders in a fair way. The methodology is described in the PPFM and is also discussed in the Annual Report and Accounts.

Operational discretions

The Board notes that operational discretions normally take the form of variations to terms and conditions such as meeting the costs of new taxes for a period, changes in the retirement legislation for people aged 75 or over, reinstatements of policies, ex-gratia payments for administrative errors and complaints. In all these areas, there are now well-tested processes and procedures, which are followed in the majority of cases. Where it is found that administrative processes are not operating in line with policy terms and conditions, the Board has established review procedures to implement the changes necessary to ensure fair treatment for policyholders.

A statement from the With-profits Actuary that he is satisfied that the Society has acted in accordance with policyholders' interests is attached at Appendix A.

Signed on behalf of the Board

Ian Brimecome
Chairman
March 2011

Appendix A

The regulator, the FSA, requires that the content of this report is validated by the Society's With-profits Actuary in accordance with the supervisory provisions laid out in the FSA Handbook.

Having reviewed the report prepared by the Board the With-profits Actuary makes the following statement:

“It is my opinion, based on the information and explanations provided to me by the Society, and taking into account the relevant rules and guidance, that the report to with-profits policyholders on the management of the fund during 2010 and the discretions exercised by the Society in respect of the calendar year 2010 have taken the interests of the relevant classes of the Society's with-profits policyholders into account in a reasonable and proportionate manner.”

R Merry
With-profits Actuary
March 2011

Appendix B

Overview of changes made during review of PPFM in March 2011

Summary

The Principles and Practices of Financial Management (PPFM) were reviewed and an updated version published March 2011. The PPFM is available on the Society's website www.equitable.co.uk.

Changes to Principles

The statement that, on surrender, the Society pays the policy value less a financial adjustment was removed from the Principles to allow the Society greater freedom in how it manages surrender values to the benefit of all policyholders.

Changes to Practices

The table below summarises the changes made by section within the PPFM.

Section reference	Change made/comments
General	The major change at this revision is the introduction of Capital Distribution.
2.3	Wording amended to help draw the distinction between Policy Value increases and Capital Distribution
2.4	A new section to introduce the concept of Capital Distribution
2.5	A new section to make it clear that Capital Distribution will apply for all with-profits policies
3	General amendment of wording to clarify operation of Capital Distribution Amount and for consistency with statements in Report & Accounts
4.2.1	Wording amended to help draw the distinction between Policy Value increases and Capital Distribution
4.2.2	Change to reflect higher expense charges expected
4.2.3	Change to reflect lower charge for guarantees following introduction of Capital Distribution
4.2.4	Clarification of capital requirements
4.2.5	Change to reflect operation of Capital Distribution Amount
5.2	Change to reflect smoothing approach for Capital Distribution Amount. Removal of description of Maturity Equaliser.
6.1, 6.2	Change to reflect operation of Capital Distribution Amount
7.2	Changes to investment policy reflected
8.2	Annual update of wording to reflect changes in Report & Accounts and operation of Capital Distribution Amount
8.2.4 c)	Change to reflect in-sourcing of administration
8.2.4 d)	Clarification of risk to with-profits policyholders
General	Revision of dates as applicable throughout the document and minor amendments to clarify wording and remove historical references.

