Equitable Life
The Way Forward

15 April 2002

Dear Policyholder,

Our vitally important Compromise Scheme is in place and the uplifts have been made. Later in the year you will receive a statement showing the impacts both of the uplifts and of the 2001 bonus announcement. We set out below important announcements on bonuses.

Of course other challenges persist.

Financial management

There has been a significant reduction since last autumn in the outflow of funds through early surrenders and policy maturities. In October 2001, that month's notifications from those seeking to claim maturity or early surrender had a total value of £776.5m, but by March 2002 the level had fallen to £237.1m. This continuing trend creates a welcome atmosphere of greater stability.

We attach an important paper setting out the Society's future strategy. As it makes clear, we must adopt a cautious bonus and investment policy. Equitable policies have unique flexibility as to how and when policyholders can take benefits, and the majority by value include a guaranteed minimum level of growth on their guaranteed value. These factors, coupled with the Society's historic low level of reserves, mean that as we stated in the Compromise Scheme we shall have a lower proportion of funds invested in property and shares (equities) compared to other UK with-profits providers, at least in the near future.

The negative stock market returns over the last two years have reduced other major pension providers' reserves and forced significant bonus reductions. While our lower stock market exposure throughout 2001 is therefore relatively good news, in the longer term we will need to explore ways to increase our equity holdings in order to boost investment returns.

'Policy values'
The apparent clarity of the term 'policy values' creates a false sense of security. It is not an absolute statement of the policy's worth like a bank or building society statement. 'Policy value' is a broad, indicative statement, of necessity subject to adjustment on a policy's early surrender or on maturity according to fund performance as is the case in other with-profits funds. This year's annual policy statements will clarify this by showing policy values in 'guaranteed' and 'indicative' form.

Bonus strategy

As with any with-profits fund, it is essential that policyholders leaving the Society do so with no more than their fair share of the assets of the fund and that the interests of continuing policyholders are protected. This principle defines the levels of financial adjustment applied to early surrenders. It also defines our policy on annual bonus and on the final bonus paid on maturity.

2001 and 2002 bonus declarations

The negative investment returns of 2001 and our requirement to hold prudent reserves mean we have set the non-guaranteed final bonus for Irish with-profits pensions policies at an accrual rate of 4% per annum for the last six months of 2001, rather than the annual rate of 6% for the whole year we had hoped to give, i.e. 2% rather than 6% will be added to indicative policy values. There is no guaranteed bonus for 2001 (except of course, for those policies containing the 3.5% Guaranteed Interest Rate, where the annual 3.5% will be added to guaranteed policy values).

The effect of this bonus announcement and the equivalent announcements for other policies will be set out in your policy statements. The implications for with-profits annuitants will be covered in a separate letter to be sent shortly.

Investment returns have remained weak this year. Consequently in the interest of prudence the Board is not announcing an interim bonus for 2002. Instead we will wait to see how the fund performs during the year before announcing an appropriate bonus.

Fair asset shares on policy surrender or maturity

From now on, in line with other with-profits funds, policyholders wishing to surrender their policies early as well as those proposing to take benefits on maturity will be quoted a 'surrender value' or 'maturity value' respectively.

These values will be set in accordance with the principle set out above of ensuring that those choosing to leave the fund take no more than their fair share, and adjusted in the light of the circumstances of the fund.

The surrender value will be subject to the financial adjustment now set at 11% for policies effected before 1 January 1998 (18% for later policies) both for individual and group schemes (although the latter will still have a group scheme calculation that could produce a higher percentage adjustment).

The maturity value includes final bonus and reflects that policy's fair share of the fund, which will not necessarily be the same as the indicative policy value. With effect from 15 April the maturity value for an Irish pension policyholder choosing to take maturity now will be the indicative policy value calculated allowing for the new bonus announcements, adjusted down by 6%. The maturity value of a policy will not be lower than the guaranteed value of that policy.

As with other with-profits funds the surrender and maturity values will be kept under constant review and the adjustments will change to reflect investment conditions and the strength of the fund.

Continuing policyholders should be reassured that these changes announced today are designed to protect them from the damaging effect of excessive value leaving the fund.

Resolving the issues of the past

Herbert Smith

As you know, on our instructions our solicitors, Herbert Smith, wrote to former Directors, auditors and advisers seeking explanations for their actions. We are now receiving responses from the former Directors to the important questions contained in the letters from Herbert Smith. One former Director, Mr Jonathan Dawson, who was appointed in January 2000, replied before the others. We are advised that we have no case against him. We are currently examining the other replies as we receive them and expect to make an announcement shortly on how we will proceed.

The Society's former auditors Ernst & Young have not provided a substantive reply. We have therefore started legal proceedings against them.

We have reviewed replies received from the Society's former legal advisors. At this stage we are advised not to proceed against them.

As for the UK regulator, it is important that we wait for the outcome of Lord Penrose's inquiry. By doing this we avoid wasting policyholders' money on our own inquiries when Lord Penrose has access to many documents unavailable to us and will cover the ground we want to examine anyway. We had originally understood from the UK Government that Lord Penrose would publish his Report later this summer. However recently we have been concerned to learn from a Government statement that this may be delayed until next year. We have therefore contacted the Government and Lord Penrose to see whether we can assist further to make more rapid progress.

Policyholders will certainly understand that, given the complexity of the issues, it will be some considerable time before we see any tangible results from either the legal proceedings or the Penrose Inquiry.

Claims from former non-GAR policyholders

We need to ensure that valid claims are dealt with fairly and efficiently. Following discussions with the Financial Services Authority (FSA), our UK regulator since December 2001, and between the FSA and the Financial Ombudsman Service, we are working to identify potentially valid GAR-related claims from former non-GAR policyholders whose policies matured or were surrendered before the Compromise Scheme became effective.

Our first step is an independent review by the actuaries B&W Deloitte that compares, amongst other things, the performance of Equitable's products with the average performance of other comparable products, taking into account the relevant product characteristics and pricing (the terms of reference of the B&W Deloitte review are available on the Society's website at www.equitable.co.uk). The review will identify whenever particular categories of former policyholders may have suffered loss resulting from the financial effect of the GAR issue rather than investment performance.

In order for any compensation to be payable it will be necessary for former policyholders to show both that they have suffered loss as a direct result of the GAR issue and demonstrate that their policy was missold to them. We anticipate that such claims should not be extensive in scale.

The balance of the provision set aside to meet any GAR-related claims set out in the Interim Accounts will be used to meet costs of compensation identified by this review.

Our approach seeks to ensure fairness to existing policyholders who will effectively be funding any compensation, and proper compensation for former policyholders with valid claims. Any GAR-related claims made outside of this process through the Courts will be resisted vigorously.

Moving Forward

Removing anomalies and increasing fairness

The Society was criticised for removing concessions related to UK retirement annuities after the Compromise Scheme and for allegedly giving 'special deals' for certain group scheme early surrenders. In respect of retirement annuities the ending of GAR rights and allocation of compensatory uplifts under the Compromise Scheme means it would be unfair to continue concessions relating to GAR rights at other policyholders' expense.

There have never been 'special deals' for group scheme surrenders. However we have closed a loophole that enabled group scheme individual members to surrender early with a potentially lower financial adjustment than that applied to individual policyholders.

Further work is needed to make early surrender values reflect more accurately the circumstances of individual policies. Currently the administrative systems allow this for group schemes but not for individuals. We need to change this and are reviewing both the data used to calculate group scheme bulk surrenders and the systems work necessary to provide fairer individual surrender values. Both will take time.

Strengthening the Society's Corporate Governance

As we move into the next stage of the Society's activities, we add two non-executive Directors and one executive Director to the Board from 1 May 2002. Ron Bullen, an engineer and former general manager who has been Chairman of the largest policyholder group EPHAG, and Fred Shedden, a Scottish lawyer with wide business experience including several years former service on the Board of Standard Life, join as non-executive Directors. Charles Bellringer, the Society's Chief Finance and Investment Officer, an experienced chartered accountant who contributed greatly to the work on the Compromise Scheme, joins as an executive Director. The non-executive appointments follow independent assessment, interview and Board approval. New Directors require FSA approval and will be put forward for re-election at this year's Annual General Meeting (AGM).

Over the next year we will also undertake a constitutional review of the Society's Articles of Association to bring them up to date. A sub-committee of the Board has been established to carry out this review. We shall welcome contributions from policyholders. Any appropriate amendments will be put forward at the time of next year's AGM.

The Annual General Meeting

This year's AGM will take place on Monday 27 May at the Queen Elizabeth II Conference Centre, London, SW1 at 11.00am. We will circulate shortly to members the Annual Report and Accounts and other papers including voting documents for any resolutions and for elections to the Board. The Society's Articles require three members of the Board to retire by rotation at each AGM, but they can seek re-election. The three Directors retiring by rotation at this year's AGM are Michael Pickard, Peter Smith and Vanni Treves and they will all be seeking re-election.

Your Board and management team have worked very hard indeed to tackle the daunting challenges we faced when we took charge of the Society just one year ago. In that time much has been achieved but more remains to be done. We are grateful to many policyholders for their encouragement and their support for the actions we need to take to help the Society along the path to greater stability.

Yours sincerely

Vanni Treves
Chairman

Charles Thomson
Chief Executive

Equitable Life
The Way Forward