

NEWS RELEASE

**For immediate release
28 March 2011**

**A DECADE OF DISTRESS COMING TO AN END
Policyholders to benefit from 12.5% capital distribution**

- Equitable Life announced today the first major step towards the distribution of capital to its 400,000 policyholders.
- Having successfully rebuilt its capital position, Equitable Life has earmarked 12.5% of policy values as at 31 December 2010 to enhance payments for with-profits policyholders who leave the Society from 1 April 2011.
- This enhancement is above and beyond any compensation to be paid by Government.

Chris Wiscarson, Equitable Life's Chief Executive said: "We've done a lot of talking about what we'd like to do to recreate policyholder value. Today, we're actually doing what we said we were going to do. May this be the start of a better future for our policyholders."

Ian Brimecome, Equitable Life Chairman said: "What a momentous year. Getting millions of pounds of capital into policyholders' hands is what matters after a decade of distress."

- ENDS -

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Notes to editors

1. A full breakdown of figures is available in the preliminary results for the year ended 31 December 2010 published today on the Equitable website - www.equitable.co.uk/media-centre/latest-press-releases
2. The information below in respect of the year ended 31 December 2010 is extracted from the Society's Accounts for that year, which were approved by the Board of Directors on 25 March 2011 and will be filed with the Registrar of Companies.
3. Details on the Government Compensation Scheme are available on the Treasury website - www.hm-treasury.gov.uk/fin_equitable_life.htm
4. The enhancement is not guaranteed and can go up or down.

Corporate review

Dear Members

In two very important respects, the last twelve months have been momentous for the Society.

- At long last, Government has announced total compensation of £1.5bn to policyholders, past and present, for the regulatory maladministration that took place in the 1990s.
- Your Board has announced the first important step in its programme for getting capital back into policyholders' hands.

Last year, we set out our strategy to recreate policyholder value by:-

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

We are very pleased to report on our progress.

Government compensation

Last October, Government announced total compensation of £1.5bn, payable free of tax commencing in mid-2011. It is inevitable that there will be disappointment that compensation at this level only represents about one third of the total losses suffered.

However, in assessing this level of compensation, your Board is mindful that:-

- The Society has consistently supported the Parliamentary Ombudsman's recommendation to compensate for relative losses subject to public purse affordability.
- The Government has accepted the Parliamentary Ombudsman's findings in full. In regard to the reduction for public purse affordability, the Ombudsman has publicly stated that the Government's decision is not incompatible with her recommendations.
- The previous Government and, indeed, the new Coalition until relatively late in the day had placed emphasis on the work of Sir John Chadwick in evaluating compensation. Had Sir John Chadwick's advice prevailed, compensation would have been of the order of £340m.
- Our policyholder research conducted soon after Government's announcement asserted that a line be drawn under the issue, and the Government compensation scheme be accepted so that payments can proceed without delay, giving closure at last.

Taking all this into consideration, we conclude that our focus in regard to the compensation scheme should now be exclusively on getting payments made. We shall support the Treasury with the provision of policyholder data to facilitate payments and we will continue to work constructively with EMAG and other policyholder groups who have been so influential in securing compensation far in excess of the amount advised by Sir John Chadwick.

We set down at the end of this review some more information about the current status of the compensation scheme.

Getting capital back into the hands of policyholders

As we have made clear in our last two reports to you, it is a driving intention of the Board to distribute all of the Society's assets including its solvency capital to with-profits policyholders as fairly as possible over time.

We begin this distribution of capital in earnest from 1 April 2011 by earmarking a sum equivalent to 12.5% of policy values at 31 December 2010 to enhance payments for policyholders who leave the Society.

We have been managing the financial assets of the Society prudently and thoughtfully and have gone to great lengths to rebuild the capital base of the Society. In doing this, we have been mindful of the new regulations that come into force in 2013, known as Solvency II, as developed by the EU Commission.

The more capital we hold, the better the shield it provides against changing circumstances, such as significant changes in investment conditions and where a change may be required to maintain fairness for all policyholders. Indeed, the Regulators take a very close interest in the level of solvency capital and prescribe certain minimum amounts, known as regulatory solvency capital. The Society's policy is to hold amounts in excess of regulatory solvency capital.

While it is very important to have solvency capital, it is also important that with-profits policyholders leaving the Society receive their fair share of capital, provided there is enough left for those who remain. Hence, the Board's very important step to introduce capital distribution in the way we have.

We set down the amount of capital as at 31 December 2010 on page 6 of this document. As can be seen, it amounted to £694m as at 31 December 2010, a little ahead of the amount a year earlier notwithstanding that the number of policies we manage has reduced as many members cash in their funds from the Society, usually following retirement.

Administration services

In November 2009, we announced our intention to change our back office administration providers from the Lloyds Banking Group to HCL. At that time, the principal issues facing the Society were: first, the need for the new Board to establish a robust financial plan to demonstrate effective solvency management particularly in the light of the regulations known as Solvency II; and, second, the need to address the expiry in March 2011 of the administration contract terms with Lloyds Banking Group.

In the period since November 2009, as is evident from our words above, the solvency of the Society is such that we feel able to commence a programme of getting capital back into policyholders' hands. While having the right cost profile remains a key strategic objective, getting capital back to policyholders must, in our judgement, take priority. Capital release will require significant IT systems change and we do not feel able to embark on such an IT change programme at the same time as transferring the administrative services to a new provider. In consequence, we have reviewed our strategy for administration services and have decided to consider alternative operating models. In particular, we have decided not to proceed with the transition to HCL but instead take direct responsibility for our own back office while retaining Lloyds Banking Group to manage the IT platform.

For many of the administrative staff, this will represent a return to the fold and enables the Society to manage its own operational destiny to complement its capital repatriation strategy.

Fit for the future

We have covered in this report the most significant developments during 2010. In addition, we completed our transfer to new investment managers, BlackRock; we have gone to great pains to engage with our staff through the many changes they have had to manage; and, most importantly of all, we have kept in touch with policyholders through extensive research, and by communicating with you through special letters and through the media.

After a decade of disappointment, we are pleased to report on some very positive developments in recreating policyholder value.

On behalf of the Society's Board of Directors

Ian Brimecome
Chairman

Chris Wiscarson
Chief Executive

25 March 2011

Government compensation

Who is eligible?

(i) Policyholders who purchased a new with-profits policy after 1 September 1992 and before 31 December 2000; and

(ii) Policyholders who paid a premium on an existing with-profits recurrent single premium policy between 31 December 1992 and 31 December 2000. Most of our pension policies are recurrent single premium policies.

How much compensation will be payable?

Government will make £1.5bn available for compensating policyholders past and present. Included in that figure is an amount to cover losses for with-profits annuitants, leaving £775m free of tax and administrative costs for distribution to everyone else.

How much will each policyholder get?

Government will base compensation on 'relative loss', which is the difference between what policyholders receive from their Equitable policies and what they would have received if they had invested in certain comparator companies.

With-profits annuitants should receive the whole of their relative losses. Other eligible policyholders should receive 22.4% of their relative loss.

Wherever practicable, Government proposes to offset relative gains against relative losses where policyholders have multiple policies. They are also considering setting a de minimus amount, in the region of £10, beneath which payments would not be made.

Government has said that about one third of policyholders have not suffered a relative loss and a further third have relative losses under £500.

Government has yet to announce how much each individual policyholder will be paid.

How will compensation be paid?

With-profits annuitants will receive regular tax-free payments. All other policyholders will receive a tax-free lump sum.

When will compensation be paid?

Government has said it will begin making payments in the middle of 2011. For policies other than with-profits annuities, it aims to complete all payments over the following three years.

Government is not in a position to say when individual policyholders will receive payments, although it has stated that the oldest policyholders and the estates of deceased policyholders will be given priority.

You have said that one of your most important objectives is to maximise Government compensation. What have you done?

We worked closely with the Equitable Members Action Group to support their key initiatives. In particular, they secured the pledges of many hundreds of MPs and prospective MPs to adopt the recommendations of the Parliamentary Ombudsman to compensate for the relative losses subject to public purse affordability.

We were ourselves very active in promoting the adoption of the Parliamentary Ombudsman's recommendation to Ministers in the new Government, and to many MPs; and last summer, wrote to all the Society's current policyholders encouraging them to give their own views in support of the Parliamentary Ombudsman's recommendation.

We were pleased that both newspapers and TV gave prominence to our pleas to Government.

What's happening next?

We expect Government to publish a detailed design document for the scheme. This is unlikely to be later than June because Government have committed to getting compensation payments flowing by the middle of the year.

Is there anything that policyholders should be doing?

We have supplied the names, addresses and all policy details to the Treasury's representatives so they now have all the information they need to begin to make contact with policyholders.

The Treasury keeps everyone up to date on their progress on the website www.hm-treasury.gov.uk/home.htm

Financial review

Excess Realistic Assets

The excess of realistic assets (“ERA”) over liabilities, reported as a policy-related liability in the technical provisions, is available to meet liabilities in excess of those provided for at the balance sheet date, as well as to increase payouts in the future.

At 31 December 2010, ERA were £694m, an increase of £19m over the previous year-end position. The analysis of the with-profits assets and liabilities is as follows:

	2010 £m	2009 £m
Realistic value of with-profits assets	5,479	5,546
less:		
Policy values	3,845	4,143
Future charges	(294)	(290)
Impact of early surrenders	(19)	(28)
Cost of guarantees	755	574
Other long-term liabilities	324	283
Other liabilities	174	189
	4,785	4,871
Excess Realistic Assets	694	675

A description of the above liabilities is set out in Note 14f on pages 48 and 49.

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

	2010 £m	2009 £m
Opening Excess Realistic Assets	675	414
Investment performance net of changes in policy values	136	242
Variances in expenses and provisions	(90)	(89)
Effect of HCL agreement	(130)	130
Mortality experience and assumption changes	-	(24)
Surrender experience and assumption changes	(4)	2
Changes in other valuation assumptions	92	(3)
Other movements	15	3
Closing Excess Realistic Assets	694	675

The Society seeks to maintain its solvency capital at a level that protects the interests of continuing policyholders while treating exiting policyholders fairly. It is the Board’s firm intention to distribute all of the assets of the Society as fairly as possible amongst the holders of with-profits policies over the lifetime of those policies and this is considered in more detail below.

Investment performance

The Society continues to operate a cautious investment strategy, investing largely in fixed-interest investments and an increased proportion in cash. The Society retains a relatively low and decreasing proportion of equities and property. This helps the Society to match anticipated policyholder payments as they fall due and reduces the amount of solvency capital required.

UK bond, equity and property markets all delivered positive returns during 2010. The environment remained volatile, driven by rising fiscal deficits and government debt levels, as we have seen in Greece and Ireland, and concerns over the sustainability of the current economic recovery. Rising interest rates in the latter part of 2010 added further uncertainty to the near-term outlook for investment markets.

The Society regularly reviews the appropriate composition of the with-profits fund. 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 2010 with equity sales of almost £100m and property sales of just over £100m.

The assets backing UK with-profits policies produced a gross return of 8.4% for the year. An important component of this return arose from Government bond yields which fell by approximately 0.5% at most durations increasing the value of the Society's fixed-interest holdings. 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 5.1%. The net return on the fund for the year, after deducting charges for expenses and guarantees of 1% per annum each, and after adjusting for tax and the effect of changes in accounting and technical provisions, is 2.7%.

The specific nature of the Society's liabilities makes comparisons with the wider market performance misleading. Working with our newly appointed investment manager, BlackRock, the Society has commissioned a theoretical benchmark which targets the highest expected return subject to our cash flow matching and capital requirements. We shall commence reporting against the benchmark in next year's report.

Payout enhancements and policy values

In determining payouts to policyholders, the Society aims to balance the objectives of distributing the Society's assets, including its solvency capital, over the lifetime of its policies as fairly as possible, having regard to:

- Meeting guaranteed payments to policyholders;
- Retaining sufficient solvency capital as a shield against changing circumstances; and
- Meeting obligations to other creditors as they fall due.

Payouts depend, to a considerable extent, on the returns achieved on, and the outlook for, the Society's corporate bond, property and equity-related portfolios, where values and liquidity are directly affected by market conditions.

After reviewing the capital required to meet regulatory requirements, both now and under a wide range of possible future economic conditions, the Board has decided that it is appropriate to start the process of distributing solvency capital to policyholders. The Society has, therefore, earmarked a sum equivalent to 12.5% of policy values at 31 December 2010 to enhance payments for with-profits policyholders who leave the Society. This level has been derived on a cautious basis to ensure that exiting policyholders do not disadvantage those who remain. Payout levels will be kept under regular review and, while the Board reserves the right to reduce or remove the distribution of capital at any time, it is hoped that the 12.5% enhancement can be maintained.

Following the valuation at the end of 2010, and as part of the cautious approach taken, the Board has determined that policy values at the end of 2010 should be unchanged from the levels established at the end of 2009. It has also confirmed that, for UK with-profits policies remaining in force at 1 April 2011, until further notice, policy values will increase at 2.0% p.a. for UK pensions policies (1.6% p.a. for UK Life assurance policies) backdated to 1 January 2011.

The policy values as at the end of 2010, as described in the previous paragraph, were used as the basis for the financial statements. Leaving policy values unchanged over 2010 resulted in an increase in the ERA of £102m. In 2009, policy values increased by less than the returns, and this resulted in an increase in the ERA of £126m, which effectively reduced by £80m at the end of March 2010 following the further increase in policy values announced at that time.

Expenses and provisions

We announced in 2009 that the Society had entered into a contract with HCL for the provision of administration services. As explained in the Corporate review, it has been decided not to proceed with the transition to HCL. Accordingly, the Society will take the administration services back in-house and approximately 350 staff will transfer across from Lloyds Banking Group. The expected benefits of £130m from the HCL transfer will now not arise as anticipated. Higher administrative costs have been capitalised in the valuation at the year end. Expenses and provisions have been increased by some £90m, as indicated in the table on page 6. This increase is based on a comparison of amounts for ongoing costs over the future lifetime of the business, which provides for the total anticipated expense of undertaking the transfer of staff and systems. The Board will be actively seeking ways to reduce these costs so that we have the right cost profile for a business in run-off. The Society expects to levy charges for expenses on with-profits policies at the rate of 1.0% p.a. for 2011 and until further notice, as was the case immediately before the HCL contract was signed.

Investment costs remained stable during 2010, with higher costs from BlackRock being offset by lower charges from the property portfolio. Overall expense costs have decreased by £34m (costs in 2010 were £81m compared to £115m in 2009), primarily as a result of a decrease 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 31 December 2010, provision has been made for contribution payments of £28m to be made in the period to 1 March 2016, and the estimated Scheme deficit of £83m.

Valuation assumptions

In the valuation at the end of 2010, a number of important assumptions have been updated in the light of the changing circumstances of the Society. The future asset mix of the Society now reflects the lower proportion of the assets expected to be invested in equity and property. This reduces the volatility of future returns and hence the expected cost of guarantees has fallen. We observed some changes in policyholders' retirement behaviour during 2010, with policyholders tending to defer their retirement decisions. Reflecting this in our assumptions has a small positive effect on the ERA. The higher charge for expenses gives rise to an additional amount of income to meet future expenses. This is largely offset by an increase in the cost of guarantees. Overall, the changes in assumptions increased the ERA by £92m for 2010 (in 2009 valuation assumption changes reduced the ERA by £3m).

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 the prospects for the continuing solvency of the Society is impaired or payout prospects are reduced. If adverse conditions arise, the Society will act to reduce payout levels, such as in 2009 when policy values were reduced.

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 was the charge throughout 2010. 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 decreasing level of claims in 2010. Changes in the pattern of surrenders have been reflected in the realistic assumptions which, after allowing for favourable actual experience in the year, result in a small reduction in the ERA, in respect of these, of £4m (2009: a gain of £2m).

Allowance has been made in realistic liabilities for future discretionary non-guaranteed bonuses. As we have noted before, 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 Guaranteed Investment Return ("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 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. This is described further in Note 14f to the financial statements.

Capital requirements now and in the future

As a mutual company closed to new business, the Society must meet regulatory capital requirements out of its existing resources. The capital required for the Society's particular risks is 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. The Board has agreed that its risk appetite is for policy values to be kept at such a level that the ratio of solvency capital to the ICA requirements is in excess of 130%.

The current regulatory framework will be replaced in 2013 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, according to the latest EU Commission survey (Quantitative Impact Study 5), will be more onerous for the Society than the current regime. An EU report on the results of the survey was published in March 2011.

In assessing the enhancements for payouts set out above, the Board has taken into account the anticipated changes to solvency capital requirements under Solvency II.

Future capital distribution

Following our decision to distribute capital, we have revised the Principles and Practices of Financial Management, which set out the way we manage the with-profits fund. As a result of the enhancements to payouts described in the Corporate review, the cost of meeting policy guarantees as policies exit the fund will reduce. The Board has therefore concluded that it would be appropriate to reduce the charge for guarantees levied against policy values from 1% per annum to 0.5% per annum for 2011, until further notice.

At the next valuation on 30 June 2011, we will report on the position of the Society, taking the capital distribution into account and reflecting the reduced cost of guarantees.

The Board's conclusions on 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: higher interest rates; the costs of the continuing pension obligations to former staff; investment losses; increases in corporate bond defaults in excess of current levels assumed in market prices; future expense levels; increases in provisions; effect of lower interest rates on the behaviour of policyholders with Guaranteed Investment Returns; 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 in order to assess how robust it remains in adverse conditions. The projections make allowance for capital distributions. The Board has also considered the level of contingent liabilities in its analysis of the Society's financial position and considers that these have reduced in significance in recent years. Based on these analyses, the Board is confident of its ability to manage adverse scenarios that may arise, recognising in some scenarios, that very strong action to reduce policyholder payouts would be required.

The Board has assessed these uncertainties using the latest available information and has concluded that it is appropriate to prepare these financial statements on a going concern basis.

Profit and loss account

For the year ended 31 December 2010

Technical account – long-term business

	Notes	2010		2009	
		£m	£m	£m	£m
Earned premiums, net of reinsurance					
Gross premiums written	2a	90		183	
Outward reinsurance premiums	3	(19)		(29)	
			71		154
Investment Income	4a		292		321
Unrealised gains on investments	4c		178		15
Other technical income	5a		3		4
Total technical income			544		494
Claims incurred, net of reinsurance					
Claims paid – gross amount	6	545		729	
Reinsurers' share	3	(53)		(48)	
			492		681
Change in provision for claims – gross amount	6		(2)		2
			490		683
Changes in other technical provisions, net of reinsurance					
Long-term business provision – gross amount	14a	(9)		(476)	
Reinsurers' share	3,14c	(22)		2	
			(31)		(474)
Technical provisions for linked liabilities – gross amount	14b	228		491	
Reinsurers' share	3,14c	(227)		(326)	
			1		165
Net operating expenses – non-exceptional	7a	33		37	
Net operating expenses – exceptional	7b	40		70	
Net operating expenses			73		107
Investment expenses including interest	4b		7		10
Other technical charges	5b		1		1
Taxation attributable to the long-term business	9a		3		2
			84		120
Total technical charges			544		494
Balance on the Technical Account			-		-

The results for 2010 and 2009 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 32 to 61 form an integral part of these financial statements.

Balance sheet

As at 31 December 2010

Assets

	Notes	2010 £m	2009 £m
Investments			
Land and buildings	10a	320	375
Investments in Group undertakings	10b	25	24
Shares and other variable yield securities and units in unit trusts	10c	228	316
Debt and other fixed-income securities	10c	4,220	4,746
Deposits and other investments	10c	1,109	478
		5,902	5,939
Assets held to cover linked liabilities	11	240	239
Reinsurers' share of technical provisions			
Long-term business provision	14c	364	341
Technical provisions for linked liabilities	14c	2,064	1,971
		2,428	2,312
Debtors			
Debtors arising out of direct insurance operations	12	5	5
Other debtors		12	11
		17	16
Other assets			
Cash at bank and in hand		11	3
Prepayments and accrued income			
Accrued interest and rent		85	104
Other prepayments and accrued income	13	1	1
		86	105
Total assets		8,684	8,614

The Notes on pages 32 to 61 form an integral part of these financial statements.

Balance sheet

As at 31 December 2010

Liabilities

	Notes	2010 £m	2009 £m
Technical provisions	14a & 14g		
Long-term business technical provision - gross amount		6,206	6,216
Claims outstanding		1	3
		6,207	6,219
Linked liabilities	14b	2,304	2,210
		8,511	8,429
Provision for other risks and charges	17	77	77
Creditors			
Creditors arising out of direct insurance operations		25	26
Creditors arising out of reinsurance operations		1	1
Amounts owed to credit institutions	18a	5	7
Other creditors including taxation and social security	18b	44	55
		75	89
Accruals and deferred income		21	19
Total liabilities		8,684	8,614

These financial statements were approved by the Board on 25 March 2011 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 32 to 61 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 9.

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 35.

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 for 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 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

Monetary 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

	2010 Premiums £m	2009 Premiums £m
a. Analyses of gross premiums written are as follows:		
Individual premiums	87	176
Premiums under group contracts	3	7
	90	183
Regular premiums	39	49
Single premiums	51	134
	90	183
Premiums from non-profit contracts	47	51
Premiums from with-profits contracts	37	47
Premiums from linked contracts	6	85
	90	183
Premiums from life business	19	24
Premiums from annuity business	1	1
Premiums from pension business	70	158
	90	183
Premiums from UK business	88	180
Premiums from overseas business	2	3
	90	183
b. Gross new business premiums		
Individual premiums	51	134
Premiums under group contracts	1	2
	52	136
Regular premiums	1	2
Single premiums	51	134
	52	136
Premiums from non-profit contracts	24	25
Premiums from with-profits contracts	22	30
Premiums from linked contracts	6	81
	52	136
Premiums from life business	-	-
Premiums from annuity business	-	-
Premiums from pension business	52	136
	52	136
Premiums from UK business	52	136
Premiums from overseas business	-	-
	52	136

Annual equivalent premiums in respect of new business received during the year were £6m (2009: £16m). New premiums in respect of reinsured business during the year were £6m (2009: £4m). The decrease in individual premiums year-on-year relates primarily to a one-off premium in 2009 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 2010 were £49m (2009: £36m) and new premium deposits were £22m (2009: £15m).

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 £416m (2009: gains of £467m), is a net credit of £nil m (2009: £nil m credit).

4. Total investment return

	2010 £m	2009 £m
a. Investment income comprises income from:		
Land and buildings	19	30
Other investments	260	291
	<u>279</u>	<u>321</u>
Net gains on realisation of investments	13	-
Investment income and net realised gains at fair value through the Profit and Loss Account	<u>292</u>	<u>321</u>
b. Investment expenses including interest comprise:		
Investment management expenses	7	7
Net losses on realisation of investments	-	3
	<u>7</u>	<u>10</u>
c. Investment activity account		
Investment income	279	321
Realised investment gains/(losses)	13	(3)
Unrealised investment gains/(losses)	178	15
Total fair value investment income and net gains at fair value through the Profit and Loss Account	<u>470</u>	<u>333</u>
Investment management expenses and charges	(7)	(7)
Investment return for the year	<u>463</u>	<u>326</u>

Included within the tables above is £2m net gain (2009: £22m net loss) in respect of derivative instruments designated as held for trading, and £11m unrealised loss (2009: £29m unrealised loss) resulting from the retranslation of balances in connection with overseas business.

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

	2010 £m	2009 £m
a. Other technical income comprises:		
Other income	3	4
	<u>3</u>	<u>4</u>
b. Other technical charges comprise:		
Other charges	1	1
	<u>1</u>	<u>1</u>

6. Claims incurred – gross

	2010 Claims £m	2009 Claims £m
Claims paid – gross amount	545	729
Change in provision for claims – gross amount	(2)	2
Gross claims	543	731

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

	2010 Claims £m	2009 Claims £m
Gross claims paid comprise:		
On death	32	32
On maturity	327	436
On surrender	108	184
By way of periodic payments	75	78
Claims handling expenses	1	1
	543	731
Life and annuity business	97	141
Pension business	445	589
Claims handling expenses	1	1
	543	731
Linked business	39	33
Non-profit business	62	61
With-profits business	441	636
Claims handling expenses	1	1
	543	731
UK business	522	710
Overseas business	20	20
Claims handling expenses	1	1
	543	731

Included in the above payments are attributable final and interim bonuses for the Society of £19m (2009: £22m).

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 2010 were £183m (2009: £161m).

7. Net operating expenses

	2010 £m	2009 £m
a. Non-exceptional		
Administrative expenses	33	37

b. Exceptional

The Society incurred the following exceptional expenses during the year:

	2010 £m	2009 £m
Pension costs for former staff	7	47
Costs of strategic initiatives	30	19
Other projects	3	4
	40	70

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 8, exceptional expenses decreased following a review of pension commitments. Costs for strategic projects included the costs of developing the Society's capital distribution strategy and its future administration strategy.

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 & Risk Committee reviews them to ensure that auditor independence is preserved.

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

	2010 £m	2009 £m
Fees payable for the audit of the Society accounts	0.5	0.5
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	0.6	1.4
	1.2	2.0

In addition to work performed by PwC on the interim review, non-audit fees relate to technical and project support on investment accounting for the change of asset manager during 2010. Objectivity and audit independence were maintained by the use of non-audit PwC staff and guidelines established to maintain separate audit integrity. Fees were pre-approved on a fixed fee basis.

8. Directors and employees

	2010 £m	2009 £m
a. Staff costs		
Wages and salaries	4	5
Social security costs	-	1
	4	6

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 (2009: 21). 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 22 to 24.

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 £83m (2009: £94m) 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 £28m (2009: £39m), 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 £3m (2009: £2m) are included within 'Technical provisions: long-term business'. The Society's commitments terminate in 2016 and the provisions above represent the 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

	2010 £m	2009 £m
a. Taxation charged to the Technical Account		
UK corporation tax		
Current tax on income for the period	2	3
Adjustments in respect of previous years	1	-
	3	3
Deferred tax		
Unrealised gains on investments	-	(1)
Total charge	3	2

The UK corporation tax charge is provided at 20% (2009: 20%), computed in accordance with the rules applicable to life assurance companies, whereby no tax is charged on pension business profits.

	2010 £m	2009 £m
b. Deferred taxation asset		
Provided in the financial statements:		
Deferred tax of the long-term fund		
Unrealised depreciation/(appreciation) in investments	1	2

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

10. Non-linked investments

	Current Value		Cost	
	2010 £m	2009 £m	2010 £m	2009 £m
a. Land and buildings				
Society				
Leasehold	112	114	110	131
Freehold	208	261	271	325
	320	375	381	456

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 2010 are £379m (2009: £450m).

	Current Value		Cost	
	2010 £m	2009 £m	2010 £m	2009 £m
b. Investments in Group undertakings				
Shares	25	24	24	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 2010 of £6m (2009: £5m). BSRE's principal investment is cash and its profit for 2010 was £0.1m (\$0.1m) (2009: £0.1m (\$0.2m)).

The Society holds a majority investment in Equitable Private Equity Holdings Limited ("EPEHL"), a Guernsey registered company with a value as at 31 December 2010 of £19m (2009: £19m). EPEHL's investment is Knightsbridge Integrated Holdings V L.P., which invests in equity and venture capital projects. EPEHL made a loss in 2010 of £31K (\$48K) (2009: £32K (\$52K)) and its total capital value is £19m (\$31m) (2009: £19m (\$30m)).

	Current Value		Cost	
	2010 £m	2009 £m	2010 £m	2009 £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⁾	193	282	258	353
Other variable income securities ⁽²⁾	35	34	26	27
	228	316	284	380
Debt securities and other fixed-income securities ⁽³⁾	4,220	4,746	4,095	4,754
Deposits and other investments	1,109	478	1,109	478
	5,557	5,540	5,488	5,612

Notes:

(1) Includes listed investments of £63m (2009: £34m) 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 £4,216m (2009: £4,739m) 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 £623m (2009: £763m) were lent in the normal course of business to authorised money brokers on a secured basis. Investments of £641m (2009: £773m) were received as collateral from brokers. Income earned on stock lending during the year, net of fees paid, was £1m (2009: £1m).

Collateral is government obligations issued or guaranteed by states which are full members of the Organization for Economic Cooperation and Development ("OECD") 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, such as mark-to-model or net asset value.

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 FRS 29, 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 2010	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	-	-	-	-	320	320
Investments in Group undertakings	-	-	25	25	-	25
Shares and units in unit trusts	-	63	130	193	-	193
Other variable income securities	-	-	35	35	-	35
Debt securities and other fixed-income securities	2,153	1,903	164	4,220	-	4,220
Deposits and other investments	55	1,053	1	1,109	-	1,109
Total non-linked invested assets	2,208	3,019	355	5,582	320	5,902
Assets held to cover linked liabilities	166	74	-	240	-	240
Total invested assets	2,374	3,093	355	5,822	320	6,142

(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 2010	369
Total net gains or (losses) recognised in the Profit and Loss Account	(4)
Purchases	-
Sales	(43)
Transfers into Level 3	51
Transfers out of Level 3	(18)
Balance at 31 December 2010	355

The total net losses shown above are included within 'Unrealised gains on investments' within the Profit and Loss Account, of which £4m loss relates to assets which were still held at the end of the period.

Ten stocks, of total value £51m, were transferred into Level 3 during the period as their valuation was based on inputs that are no longer observable for those assets.

Seven stocks, of total value £18m, 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

	2010 £m	2009 £m
Current value of linked assets held at fair value through the Profit and Loss Account	240	239

The cost of assets held to cover linked liabilities is £208m (2009: £222m) for the Society.

12. Debtors

	2010 £m	2009 £m
Debtors arising out of direct insurance		
Amounts owed by policyholders	5	5
Other debtors		
Corporation tax debtor	1	-
Deferred tax asset	1	1
Debtors other than Group and related companies	10	10
	17	16

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 assigned account owned by HSBC (2010: £7m, 2009: £7m).

13. Other prepayments and accrued income

	2010 £m	2009 £m
Prepayments	1	1

14. Technical provisions

a. Gross long-term business technical provisions

	2010	2009
	£m	£m
With-profits technical provisions		
With-profits insurance technical provisions		
Policy values	258	313
Future charges	(29)	(32)
Impact of early surrenders	(1)	(1)
Cost of guarantees	55	52
Other long-term liabilities	60	65
	343	397
With-profits investment technical provisions		
Policy values	3,587	3,831
Future charges	(265)	(258)
Impact of early surrenders	(18)	(28)
Cost of guarantees	700	522
Other long-term liabilities	264	219
	4,268	4,286
Excess Realistic Assets	694	675
	5,305	5,358
Non-profit technical provisions		
Non-profit insurance technical provisions	890	848
Non-profit investment technical provisions	11	10
	901	858
Total long-term business technical provisions	6,206	6,216

b. Gross linked liabilities

	2010	2009
	£m	£m
Index-linked annuities	249	247
Other linked insurance liabilities	149	153
Other linked investment liabilities	1,906	1,810
Total linked liabilities	2,304	2,210

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

	2010	2009
	£m	£m
Non-profit insurance technical provisions	353	331
Non-profit investment technical provisions	11	10
	364	341
With-profits insurance technical provisions	-	-
With-profits investment technical provisions	-	-
Index-linked annuities	9	8
Other linked insurance liabilities	149	153
Other linked investment liabilities	1,906	1,810
	2,064	1,971
Total reinsurers' share	2,428	2,312

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

	2010	2009
	£m	£m
At 1 January	1,820	1,631
Change arising from new deposits	49	36
Change arising from withdrawals	(183)	(161)
Other changes	231	314
At 31 December	1,917	1,820

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	
	2010	2009	2010	2009
Non-profit annuities in payment				
Basic Life and General Annuity business – pre 1992	4.66	5.00	£3.13 p.a.	£4.46 p.a.
Basic Life and General Annuity business – post 1991	4.19	4.50	£3.13 p.a.	£4.46 p.a.
Pension business	4.66	5.00	£3.13 p.a.	£4.46 p.a.
Index-linked annuities in payment				
Basic Life and General Annuity business – pre 1992	0.52	0.54	£3.13 p.a.	£4.46 p.a.
Basic Life and General Annuity business – post 1991	0.47	0.49	£3.13 p.a.	£4.46 p.a.
Pension business	0.52	0.54	£3.13 p.a.	£4.46 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 and these reductions have been lowered this year. Fixed-interest yields and index-linked yields have fallen compared to those at the end of 2009. The changes to the valuation interest rates in aggregate have increased the index-linked annuity provision by £1m and increased the non-profit technical provisions by £18m. Similarly, the market value of the backing assets has changed as yields have changed and this in part offsets the change in technical provisions.

(2) Future expenses arising directly from 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 0.11% p.a. (2009: 0.06% p.a.). The per policy expense allowance in the basis reflects an assessment of variable administration costs after the transfer of administration from Lloyds Banking Group to the Society. The 2009 per policy expense allowance was based on HCL's charging structure under which a higher proportion of the Society's cost base varied in line with policy volumes. These were loaded into these allowances. The expense allowance has been assumed to increase at 3.4% p.a. (2009: 5.1% p.a.). The expense allowances for 2010 shown above apply to both UK and non-UK policies. The changes to the expense basis in aggregate have increased the provision for expenses by £1m.

(3) The Society continues to make allowance for future improvements in longevity of annuitants. The Society's valuation has been carried out using published mortality tables and an investigation into the Society's actual mortality experience. The overall effect of this review of mortality has been to increase index-linked annuity and non-profit annuity technical provisions by £3m (2009: increased by £26m).

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 £30m (2009: £26m) 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 (2009: 12 months).

Mortality assumptions by class of business	2010	2009
Non-profit and index-linked annuities in payment		
Basic Life and General Annuity business	72.5% IML00 ult (U=2010)* for males 77.5% IFL00 ult (U=2010) * for females	72.5% IML00 ult (U=2009)* for males 77.5% IFL00 ult (U=2009) * for females
Pension business (both reinsured and retained business)	87.5% PNMA00MC (U=2013) ** for males 80.0% PNFA00MC (U=2013) ** for females	87.5% PNMA00MC (U=2012) ** for males 80.0% PNFA00MC (U=2012) ** 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 £32m (2009: £23m loss).

(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 98% and 2%, respectively, of the total policy values at 31 December 2010 (97% and 3% of the total policy values at 31 December 2009). 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 increased from £574m in 2009 to £755m at 31 December 2010 principally as a result of an assumed increase in the charge for expenses from 2011 and falling 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	2010	2009
Endowment assurances (with-profits)		
Basic Life and General Annuity business	90.0% AMC00 ultimate for males 97.5% AFC00 ultimate for females	90.0% AMC00 ultimate for males 97.5% AFC00 ultimate for females
Pension business	90.0% AMC00 ultimate for males 97.5% AFC00 ultimate for females	90.0% AMC00 ultimate for males 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. (2009: 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. (2009: 1.0% p.a. for 2010, reducing to 0.5% p.a. from 2011) reflecting the decision not to proceed with the transfer of administration to HCL, is assumed to be deducted each year before making future increases to policy values. In addition, an expense provision of £180m for expenses (2009: £107m) 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 £46m (2009: £27m).

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 2009 and 2010. 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 (2009: 2 years) earlier than ECD and up to 12 years (2009: 14 years) later than ECD.

A sensitivity analysis has been carried out to illustrate the potential impact on ERA, at 31 December 2010, 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 £40m (2009: £25m). If the level of interest rates at which behaviour changes is 3.5% and the same period of deferment is assumed, the reduction is £70m (2009: £45m). If the deferral were for a period of up to 10 years, the reduction is £55m (2009: £35m) at 2.5% and £105m (2009: £65m) 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 £36m (2009: £34m) and a similar increase would decrease the value by £18m (2009: £17m).

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 2009 and 2010. 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. (2009: 1.5% p.a.). The effect of the change in the surrender rates has been to decrease the ERA by £16m (2009: decrease by £16m).

A financial adjustment of 5.0% (2009: 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 used is market consistent and 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 2009 to 2010 was to increase the ERA by £47m (2009: decrease of £36m). 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 26% (2009: 27%). For property values, the model uses an assumed volatility of 15% (2009: 15%).

g. The long-term business provision – miscellaneous provisions

Technical provisions include amounts in respect of specific provisions:

- Anticipated additional exceptional expenses of £104m (2009: £133m) over future years, including costs of implementing changes in administration provider, 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 £2m for legal claims made in Germany against the Society (2009: £10m total legal claims).

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. An allowance is made in the valuation for the extent to which these are payable by the reinsurer.

15. Capital statement

a. Analysis of capital

The capital statement in respect of the Society's life assurance business at 31 December 2010 is set out below. These figures are calculated in accordance with the regulations set out in The FSA Handbook of Rules and Guidance.

	2010 £m	2009 £m
Available capital resources		
Adjustments onto a regulatory basis – valuation differences ⁽¹⁾	361	615
Adjustments onto a regulatory basis – inadmissible assets	(1)	(2)
Total available capital resources	360	613
Long-term Insurance Capital Requirement (LTICR)	(238)	(230)
With-profits Insurance Capital Component (WPICC)	(122)	(383)
Total regulatory Capital Resource Requirements (CRR)	(360)	(613)
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 £360m (31 December 2009: £613m).

The table below shows the effect of movements in the total amount of available capital of the Society during the year. Other movements in 2010 include £(287)m for the impact on expenses of insourcing administration from Lloyds Banking Group to the Society:

	2010 £m	2009 £m
Available capital resources		
At 1 January	613	449
Investment return and interest rate movements	13	114
Other valuation assumptions	32	22
Other movements	(298)	28
At 31 December	360	613

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 2013 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 Executive 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 (2010: 39%, 2009: 35%) and corporate bonds (2010: 30%, 2009: 42%).

With regard to unit-linked business, liabilities are reinsured with HBOS and no market risk is considered to fall on the Society in respect of 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	2010	2009
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%	0.7%
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	2010	2009
	£m	£m
Above adverse changes – including where long-term gilt yields rise	153	197
Above adverse changes – including where long-term gilt yields fall	192	122

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 Executive 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. Long-term gilt futures are used to manage market risk during periods of asset transition. Derivative transactions are fully covered by cash or corresponding assets and liabilities. Derivative contracts are entered into only with approved counterparties and, where possible, on regulated exchanges, 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. The Society invests 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:

	2010				2009			
	Assets		Liabilities		Assets		Liabilities	
	£m	%	£m	%	£m	%	£m	%
Currency								
Sterling	8,365	96	7,806	98	8,271	96	7,749	98
Euro	214	3	177	2	225	3	184	2
US Dollar	105	1	6	-	118	1	6	
Other	-	-	-	-	-			
Total	8,684	100	7,989	100	8,614	100	7,939	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 £5m (2009: £7m) 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 Executive 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 Executive 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, steps are taken, wherever possible, 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:

2010

Credit ratings	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Debt and other fixed-income securities	2,313	344	808	470	45	3,980
Other variable yield securities	459	-	12	9	-	480
Total of fixed and variable yield securities	2,772	344	820	479	45	4,460
Deposits with credit institutions	1,053	-	55	-	-	1,108
Cash at bank and in hand	-	-	11	-	-	11
Other financial assets	43	6	28	11	15	103
Reinsurers' share of technical provisions and liabilities (Note 14c)	-	-	2,428	-	-	2,428
	3,868	350	3,342	490	60	8,110

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

The total of fixed and variable yield securities and deposits with credit institutions includes £240m of assets held 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 £25.7m (2009: £26.6m) 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 £25.7m and is included in 'Deposits and other investments' in Note 10c.

The potential credit risk exposure from default by futures counterparties is mitigated by daily settlement of variation payments and through trading on a regulated futures exchange. None of the change in value of derivatives has been driven by changes in the credit rating of counterparties.

The largest single credit risk exposure amounts to £2,428m for HBOS reinsurance (2009: £2,312m). In the event of the insolvency of the reinsurer, the Society would be liable for any shortfall between the obligations under the policies and the amounts recovered. The Society holds a further £10m (2009: £36m) of investments (credit ratings of BBB: £7m and AA: £3m) with the Lloyds Banking Group, parent company of HBOS.

At the reporting date, no material financial assets were past due nor impaired (2009: £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 55% 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 £451m at year end 2010 (2009: £657m). In adverse market conditions, it may not be possible to realise these investments without delay.

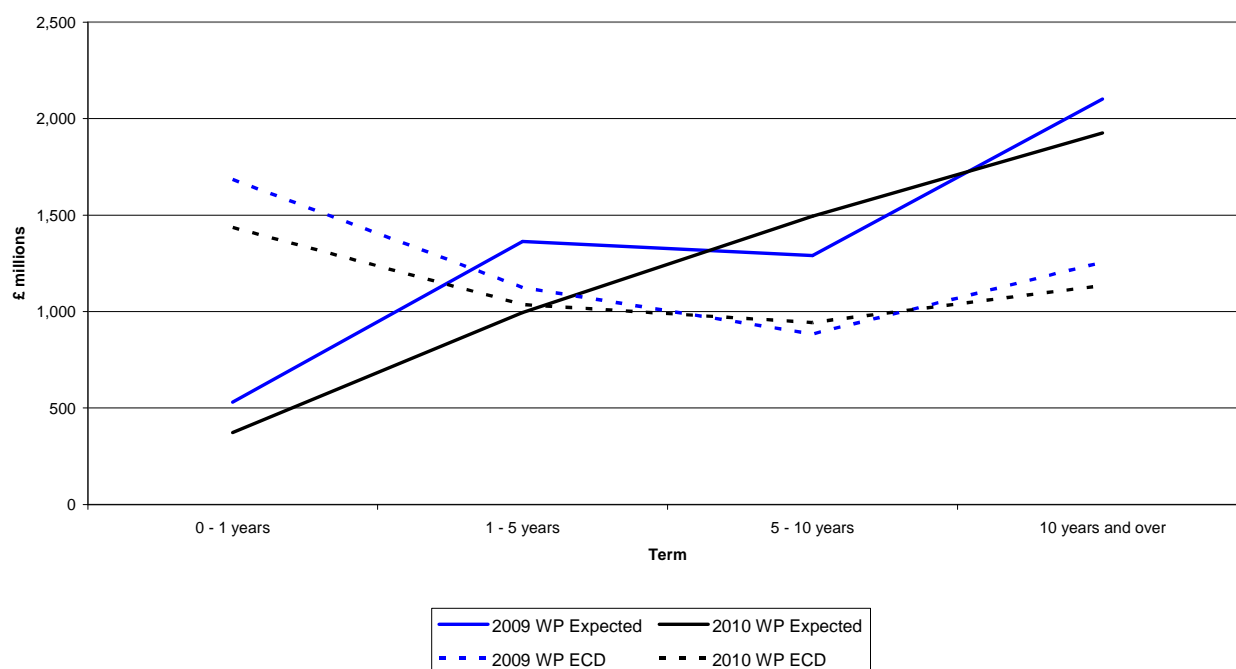
As noted in Note 14f (ii), the majority of RSP benefits can be taken on contractual terms at a range of ages. The table below details the cash flows using retirement assumptions based on recent experience, that vary between different product types. The range of retirement dates assumed varies between policyholders being assumed to retire 2 years (2009: 2 years) earlier than ECD and up to 12 years (2009: 14 years) later than ECD.

2010	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	134	646	580	1,279	-	2,639	1,906
Other non-profit investment contracts	11	-	-	-	-	11	11
With-profits investment contracts	370	996	1,494	1,926	-	4,786	4,268
Other financial liabilities	76	-	-	-	-	76	76
Total financial liabilities	591	1,642	2,074	3,205	-	7,512	6,261
Of which reinsured	145	646	580	1,279	-	2,650	1,917
Total net financial liabilities	446	996	1,494	1,926	-	4,862	4,344
Net insurance liabilities	143	281	323	978	-	1,725	1,120
Excess Realistic Assets	-	-	-	-	694	694	694
Total net liabilities	589	1,277	1,817	2,904	694	7,281	6,158

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

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 2010 have a contractual value no lower than total guaranteed benefits, and equalled £1.1bn at 31 December 2010 (2009: £1.3bn). The liquid assets referred to above include £3.1bn (2009: £2.5bn) 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

	2010 £m	2009 £m
Pension commitments for former staff	77	77
	77	77

The provision for pension commitments for former staff of £77.3m is in addition to a creditor to HBOS for payments during 2011 totalling £5.6m (2009: £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

	2010 £m	2009 £m
a. Amounts owed to credit institutions	5	7

Amounts owed to credit institutions represent uncleared payments to policyholders. An amount of £7m (2009: £7m) placed in an assigned account owned by HSBC is included in 'Debtors' in Note 12.

	2010 £m	2009 £m
b. Other creditors including taxation and social security		
Balances with Group companies	9	8
Corporation tax	-	1
Derivatives positions	26	27
Other creditors	9	19
	44	55

Amounts in 'Derivative positions' include:

- The obligation to return the variation margin associated with the swaption investment to Morgan Stanley (2010: £25.7m, 2009: £26.6m).
- The fair value of a forward US Dollar and Sterling currency exchange contract (2010: £1.2m liability, 2009: £0.1m asset). If the balance sheet position is held to maturity in March 2011 the Society will be obliged to pay \$135.9m and receive £85.6m.

Amounts in 'Other creditors' include 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 2010, the Society held more than 20% of the nominal value of a class of equity shares in 8 companies with a value of £12m (2009: 9 companies, value £13m).

At 31 December 2010, the Society held more than 20% of the partnership interests in 1 limited partnership investing in properties with a value of £14m (2009: 1 partnership, value £18m).

At 31 December 2010, 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 £3m (2009: 4 portfolios, value £4m).

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 2010 (2009: £nil).

21. Commitments

The Society has no material operating lease commitments.

Commitments in respect of uncalled capital on private equity fund interests, not provided for in the financial statements, amounted to £18.9m (2009: £21.4m) for the Society.

No new warranties have been provided for the strategic transactions completed in the year, although the Society remains subject to warranties provided in previous years.

22. Contingent liabilities and uncertainties

There exist some uncertainties that, if they were to materialise, could adversely impact on the financial position of the Society. Over the last few years, these uncertainties have been addressed to a very significant extent, and the range of possible outcomes has continued to narrow.

The major development during 2010 was Government's announcement of a payment scheme in response to the Parliamentary Ombudsman's report into the regulatory handling of the Society. In contrast, there was little change in respect of the 91 claims against the Society in district courts across Germany where the cases have all been defended successfully so far. Also outstanding are investigations initiated by the Accountancy and Actuarial Disciplinary Board ("AADB"). The 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.

It is not considered that the uncertainties described above represent a significant financial threat, and it is considered that the risk of any material new issues arising for the Society appears limited.

The Board continues to closely monitor the contractual commitments the Society has in respect of the two pension schemes for which HBOS is principal employer, as set down in Note 8c to the financial statements. There remains a possibility that it may be necessary for a more conservative basis to be adopted in future in calculating the Society's obligations.

Additionally, there remains a risk to the Society that investment conditions change or policyholders defer their retirement, which may materially alter the calculations of technical provisions for policy liabilities.

The process of transferring administration services back to the Society brings with it a range of operational risks, which makes the estimation of future costs more uncertain, and will require careful management. The Society has arrangements in place for identifying, monitoring and managing these risks.

The financial position of the Society has been projected under a range of economic scenarios, in order to assess how robust it remains in adverse conditions. The projections make allowance for capital distribution. The Board has also considered the level of contingent liabilities in its analysis of the Society's financial position and considers that these have reduced in significance in recent years. Based on these analyses, the Board is confident of its ability to manage adverse scenarios that may arise, recognising that in some scenarios very strong action to reduce policyholder payouts would be required.

The Board has assessed these uncertainties using the latest available information and has concluded that it is appropriate to prepare these financial statements on a going concern basis.