Report to With-Profits Policyholders on the management of the fund during 2013

1. Executive Summary

Board of The Equitable Life Assurance Society ("The Society") has reviewed the management of the Society's with-profits business for the 2013 calendar year. It is satisfied that it has both exercised its discretion in the management of the fund fairly in a reasonable and proportionate manner, and met its obligations as set out in the Principles and Practices of Financial Management (PPFM).

In reaching these conclusions, due regard has been paid to the advice received from the Society's With-Profits Actuary.

2. Introduction

The way in which the Society manages the with-profits fund is described in its PPFM. This report from the Society's Board for the 2013 calendar year summarises the key decisions that affected with-profits policyholders, and sets out how the PPFM has been complied with.

This report covers:

- governance of the with-profits business;
- exercise of discretion in the management of with-profits business, including how competing or conflicting rights, interests or expectations of policyholders have been addressed; and
- compliance with the PPFM.

Readers of this report may find it helpful to refer to the Society's PPFM, which can be found on the Society's website www.equitable.co.uk. Also available on the website is a simpler guide to how the with-profits business works called "*A guide to how we manage the with-profits fund*".

3. Governance

The Society's Board makes decisions about the management of the Society, including those related to its with-profits business.

The nature of the Society, a mutual company not writing new business, has led Board to conclude that the duties required of a With-Profits Committee are best carried out by the whole Board. Board therefore forms a With-Profits Committee at each Board meeting to specifically consider items relating to with-profits business, with the primary aim of ensuring that with-profits policyholders are treated fairly. The Terms of Reference for Board acting as With-Profits Committee are published on the Society's website.

The With-Profits Actuary advises Board on all matters affecting the with-profits business of the Society. Rob Merry was With-Profits Actuary in 2013 until 12 December. Louise Eldred was appointed With-Profits Actuary on 12 December 2013; her report to with-profits policyholders is attached as an appendix to this report.

Board is satisfied that the arrangements in place for the governance of its with-profits business are appropriate and proportionate, and meet current regulatory requirements.

4. Exercise of Discretion

Board aims to treat all of its policyholders fairly. A review has been carried out to assess whether such discretion was fairly exercised by Board during 2013.

In making its assessment, Board considered the following questions:

- Was the exercise of discretion even-handed or did it (implicitly or explicitly) favour one group of policyholders over the rest?
- Was the exercise of discretion transparent?
- Was the exercise of discretion consistent with communications to policyholders? Have communications been clear, fair and not misleading, and have they been consistent with the PPFM?

Details of the assessment are set out in the sections below.

Board concluded that its exercise of discretion was fair in 2013.

4.1. Bonus rates

No reversionary bonus was declared for 2012, in line with the stated intentions of the Society not to declare any reversionary or guaranteed bonuses in the foreseeable future. This is as set out in the PPFM and general statements in the annual Report and Accounts, and is even-handed as all policyholders are treated in the same way.

Policy Values for UK pension policies were increased by 2% pa for 2012, while the return available for distribution was 2.4%. This level of smoothing, taken together with previous levels of distribution and smoothing, was consistent with the requirements of the PPFM. The interim rate for 2013 was also set at 2% pa. Adjusted rates applied to contracts in taxed funds, including contracts subject to the Irish levy. Maintaining the rate at this level was fair and even-handed in light of the market conditions, risk appetite, solvency implications and the PPFM.

Capital distribution has continued during 2013, with payouts being determined by adding to Policy Values a capital distribution amount equivalent to 12.5% of Policy Values at 31 December 2010. During 2013, Board has kept the level of capital distribution under review, and has taken actions necessary to enable an increase in the level of capital distribution as soon as possible. The capital distribution amount will be increased from 1 April 2014 to 25% of Policy Values at 31 December 2013. The level of capital distribution during 2013 was fair and even-handed, and in accordance with the PPFM.

Bonus decisions and payout levels were communicated to policyholders in the annual Report and Accounts and in annual statements. Information was shared with with-profits policyholders in September when a letter advised them that the Society was looking at how to return more capital to them, subject to regulatory agreement. The information provided to policyholders over the year on bonuses and levels of payouts were fair, not misleading and as transparent as was reasonable.

4.2. Investment Policy

During 2013, the majority of the assets of the with-profits fund were invested in fixed-interest securities matching guaranteed liabilities, with the matching of guarantees being improved during the year.

The Society continued to de-risk its investment portfolio by selling equity and property holdings in the year. This leaves the equity backing ratio of the fund close to zero and much lower than policyholders would have expected when they took out their policy. This strategy has been extensively communicated to policyholders in a clear, fair and not misleading way through the PPFM, the annual Report and Accounts and in the leaflet that accompanies annual benefit statements.

Board considers that the protection this strategy offers is fair to all with-profits policyholders. Investment in low risk assets, whose cashflows match the liabilities, increases solvency ratios, allowing more capital to be distributed as fairly and as soon as possible. This is in line with the Society's strategy, and in accordance with the PPFM.

4.3. Surrender Values

The Financial Adjustment (FA) is a key aspect of the Society's surrender value basis and is reviewed regularly. It did not change during 2013, remaining at 5% for most policies. Details of the FA have been clearly communicated to policyholders in the annual Report and Accounts.

Board gave careful consideration to the appropriate level of the FA during the year. The decision to retain the FA balanced the need to be fair to those policyholders leaving the Society with fairness to those who remained.

4.4. Allocation of expenses

The Society is a mutual organisation so all expenses are met by the with-profits fund. It is a key business objective that the costs of the organisation are managed down appropriately, without adversely affecting service levels, as the business runs-off, as clearly communicated to policyholders in the annual Report and Accounts. The expenses incurred in 2013 were below budget, and lower budgets have been set for 2014. The discretions exercised in cost control and setting budgets have been fairly exercised.

In 2013, expenses continued to be charged to with-profits policies by means of a 1% reduction in the growth rate added to Policy Values. Expenses are charged in proportion to policy size, as they have been for several years, and fairness between generations of policyholders is assisted by maintenance of the level of the charge at 1% pa. This method of expense charges is described in the PPFM, and has also been clearly communicated to policyholders in the annual Report and Accounts.

4.5. Operational discretions

Operational discretions for individual contracts largely take the form of variations to policy terms and conditions such as reinstatements of policies, ex-gratia payments for administrative errors, and complaints. In all these areas, there are well-tested processes and procedures. No material systemic issues or unfairness issues have come to light over the year.

In 2013, the Society progressed with the transfer of its IT service provider from Lloyds Banking Group (LBG) to Atos, a major project with accompanying risks that has been successfully completed. The anticipated savings of the new arrangement fully offset the costs of the project. The decisions taken under this project are in the interests of all with-profits policyholders and therefore fair. The intention to transfer IT services was covered in the annual Report and Accounts, and has been communicated in a clear, fair and not misleading way.

In 2013, the Society signed agreements with LBG and with the Trustees of the Staff Pension Scheme, which removed the risks of the Scheme from the Society, such that it no longer needs to hold capital against them. The cost of these agreements was close to the provisions held for the pension scheme at the previous year-end valuation, the result overall being fair to the with-profits policyholders. Policyholders were advised of the completion of the first, and largest, phase of the project with information being published on the Society’s website, and in our letter to policyholders in September.

5. Compliance with the PPFM

Board aims to manage the with-profits business in accordance with its PPFM. A review has been carried out into how the Society has complied with the requirements of the PPFM in 2013.

In June 2013 a number of clarifying amendments and updates were made to the practices described in the PPFM, although the principles remained unaltered. Consideration of compliance with the PPFM was, in practice, not affected by these changes.

Board concluded that the discretions it had exercised in 2013, as described in section 4 above, complied with its PPFM.

6. Conclusion

Board concludes that the discretions it exercised in 2013 were both fair to policyholders, and in accordance with its PPFM.

Signed on behalf of the Society's Board of Directors

Ian Brimecome
Chairman
20 March 2014

Appendix

Report from the With-Profits Actuary

To the with-profits policyholders of The Equitable Life Assurance Society ("the Society")

As With-Profits Actuary to the Society, it is my responsibility to advise Board on the management of the Society's with-profits business. I am also required to report annually to with-profits policyholders on the exercise of discretion in relation to that business. This is my report for the year ended 31 December 2013.

I have carried out a review of the Society's exercise of discretion and its compliance with the PPFM in 2013.

In my opinion:

- the discretion exercised by the Society in 2013 took the interests of the Society's with-profits policyholders into account in a reasonable and proportionate manner;
- the Society complied with its PPFM during 2013; and
- the attached annual report from Board accurately summarises the key decisions that have impacted with-profits policyholders during the year.

In reaching these opinions, I have taken into account the information and explanations provided to me by the Society. In addition, prior to my appointment on 12 December 2013, I had extensive discussions with the previous With-Profits Actuary regarding the Society's management of its with-profits fund during 2013.

In preparing this report, I have taken into account the relevant rules and guidance issued by the Prudential Regulatory Authority and the Financial Conduct Authority, and the requirements of the Technical Actuarial Standards issued by the Financial Reporting Council that apply to this work[1]. In my opinion, there have been no departures from these Technical Actuarial Standards in performing this work.

Louise Eldred
With-Profits Actuary
20 March 2014

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[1] *TAS R (Reporting), TAS D (Data) and the Insurance TAS*