Equitable Life

Annual General Meeting presentation scripts

24 May 2007

Important note: These are the scripts of the presentations made by the Chief Executive and Chairman at Equitable Life's 245th Annual General Meeting, held at the Church House Conference Centre, London on Thursday 24 May 2007. Please note that these are not transcripts of their speeches and as such should not be read as a precise, word-for-word record.

Charles Thomson, Chief Executive

Address to Annual General Meeting 2007

Good morning ladies and gentlemen.

The year 2006 marked a real turning point in the progress of the Society.

2006: Building on the foundations

Over the previous five years, we had to do a great deal of fire-fighting to deal with the inherited problems of the Society and to put in place sound financial foundations. By the end of 2005, the Society was in a much stronger financial position. That meant that in 2006, while ensuring that we made further progress on the Society's financial development and control we were also able to take some important steps towards delivering the best possible future for our policyholders.

Our financial strength increased again and is now fully at our target level and consistent with the much more stringent capital requirements of the regulator introduced during the past few years. Our investment performance has been good, given the constraints we work under and the need to hold so much of the fund in fixed interest securities.

We announced in March 2006 that we intended to transfer most of our non-profit annuities to Canada Life. Transfers of that kind are long and complicated but we successfully completed that process in February this year.

These improvements in the Society's position have allowed us to increase bonuses. We have also been able to reduce the financial adjustment which applies on early surrender of with-profits policies to 5%, reflecting the reduction in our future uncertainties.
Let me take you through these important steps in a little more detail.

Excess Realistic Assets increased again

In recent years, the rules under which we prepare our Report & Accounts have changed to what is called 'realistic reporting'. In the new format, we report 'Excess Realistic Assets', or ERA, as our key measure of solvency.

ERA is the amount available to meet any unforeseen liabilities and liabilities in excess of those provided for and it is also available to pay for future additions to bonuses.
During 2006, ERA increased again, by £215m from £669m to £884m and our Excess Realistic Assets now represent 9.4% of the with-profits fund.

This is a very important milestone – we believe that we are now at an appropriate level of ERA for a closed fund in 'run off'.

Inevitably, the ERA will rise and fall depending on many factors, but our focus has now changed from building the necessary strength into the Society to ensuring that we pay as much as we can to those who are taking their benefits during the next few years, as well as providing properly for those who take their benefits later.

2006 Investment Outcome

Turning to investment performance in 2006. To provide security for policyholders the Society's fund is predominantly invested in fixed-income investments. However, interest rate rises such as we had in 2006 reduce the market value of fixed-income investments.

Consequently, the basic gross return on the fund was low at 2.6%.

But, the increase in interest rates not only reduces the value of our investments; it also reduces the value of our liabilities in a very similar way because we have generally chosen assets that match the liabilities. Allowing for the impact of interest rates on our liabilities as well as on our assets, the adjusted investment performance was a respectable 5.2% for 2006.

After allowing for expenses, tax and changes in our provisions, the net return available to fund increased bonuses for policies was 3.9% before smoothing and other considerations.

Canada Life transfer: a risk removed

In May last year we announced the agreement with Canada Life and by the time of last year's AGM we had written to all members to explain the reasons.

As we worked our way through resolving the fundamental problems that we had inherited, our regular strategic reviews revealed the growing relative importance of more normal life assurance risks – particularly longevity risk. The Society had a disproportionate exposure to the risk that the cost of annuity payments would increase if annuitants live longer than expected and this risk was set to grow in importance throughout the future.

A very significant part of the risk came from non-profit pension policies where the terms are all fixed. These types of policy are common across the industry and there are a number of organisations which are interested in taking on blocks of this type of policy.

Careful management of the process allowed us to create a competitive environment which helped us to secure the most attractive terms for the Society. The policies which were transferred continue to receive exactly the same benefits from Canada Life and the Society removed a large risk without having to pay anything beyond our reserves to remove that risk – so effectively at no cost to our members. A very attractive outcome.

We wrote to all policyholders in October 2006 with details of the agreement and we published additional information on our website.

As required by the legal and regulatory process both the Independent Expert and the FSA were content with the terms of the transfer.

The High Court approved the transfer on 1 February 2007 and legal completion took place on the 9th February.

The transfer of all the records happened smoothly over the weekend of the 10th and 11th of February – this was a significant logistical achievement, involving 130,000 cases with all the associated records and correspondence.

Bonus increase

We still have many policies which mature with guaranteed benefits higher than the underlying policy value. Naturally, the Society pays the guaranteed benefits in that situation and the cost of making up the difference between the underlying value and the guaranteed benefits is met from the reserves we have set up.

We introduced an explicit charge in respect of the cost of guarantees some years ago and we continue to retain 0.5% from the investment returns each year in order to cover the cost of guarantees.

As I have just mentioned, the Canada Life transfer removed a significant risk from the business and now we do not need to keep so much capital to cover that particular risk.

The 2006 investment performance I spoke of earlier adjusted for the cost of guarantees and the benefit of the release of capital from the agreement with Canada Life has allowed us to allocate a final bonus of 5% per annum for 2006 and also to set the current interim bonus rate at 5% per annum for 2007.

Also, a month ago we reduced the financial adjustment on early surrender of with-profits policies from 8% to 5% of policy value, again as a result of the improved financial position, but mainly because of the reduced future uncertainty in the business.

University Life: Another important step

Some of you may be aware that Equitable Life has a subsidiary company called University Life Assurance Society. Equitable Life has owned University Life since 1919, but it closed to new business in 1975. It is now a small business with fewer than 1000 policyholders but will need to be managed for at least another thirty years. There is no material benefit to Equitable Life in having this subsidiary and indeed it could be an obstacle to other strategic opportunities for the business as a whole.

Consequently when the opportunity arose to sell University Life Assurance Society to Reliance Mutual, we took it. The agreement was announced late last year and completion will take place at the end of this month.

It is instructive that to transfer even a small business like University Life still takes six months. That helps to explain why it takes so many months to complete much larger transfers like those with Canada Life and Prudential. There is a very large amount of work to be done and a very complex formal process to be gone through – and it all needs to be done to a very high standard to protect policyholders, and to satisfy the experts, the regulators and the Courts.

Simplifying the Equitable Life business in this way helps our search for strategic options and makes it easier to evaluate options to consider whether or not they are in policyholders' interests.

Where have we got to now?

After six years of achievement overcoming the inherited problems, we have reached a stable and secure position. Given the solvency concerns that we grappled with for years, it is a real transformation that the Society is now as strong as a closed fund in 'run off' needs to be.

2006 is a year that shows that our hard earned stability has allowed us far greater control over our destiny. Of course, external factors still arise but there is now much less that can damage the smooth progress of the Society.

However, we remain heavily invested in fixed-income investments. Stringent and new financial regulation continues to prevent us changing that significantly. The disadvantage of that security is that our fund continues to have limited potential to take risks to earn higher bonuses.

Although we can be pleased with a bonus of 5% from a predominantly fixed-income fund, a broadly invested fund could – and most probably would in recent years - have done better.

While we have rescued the Society and reached a secure position we believe that we may be able to achieve a better future for our policyholders and that is why we continue to work on strategic opportunities for the business.

Now I will hand back to our Chairman, Vanni Treves

Vanni Treves, Chairman

Address to Annual General Meeting 2007

Thank you. Charles has explained the progress we have achieved in the business during 2006. Now I will take a look at developments which affect us from outside the business. I will also look forwards at the agreement we have reached with Prudential.

European Committee of Inquiry

First, the European Committee of Inquiry into the crisis at Equitable Life.

The Committee has been investigating alleged contraventions of Community law by the UK Government and allegations of maladministration in the application of that law. That is, an investigation into the operation of regulation - not an investigation into Equitable Life.

We have fully supported the Committee in its work and Charles attended the Committee on two occasions to make presentations and answer questions.

The Committee has now agreed its report to the European Parliament and having concluded that the UK failed adequately to implement the Third Life Directive, its first recommendation for remedies is that the UK Government should compensate Equitable Life policyholders.

As we have said before, we welcome any steps that will lead to Government compensation for our policyholders and we urge the European Parliament to accept the Committee's recommendations when it votes on the report next month. However, even if the European Parliament's vote is positive, I must stress that it will not be binding on the UK Government and there is a real risk that the Government will ignore it.

Parliamentary Ombudsman

Following the strong criticisms made of the regulators in Lord Penrose's report in 2004, we joined others in calling on the Parliamentary Ombudsman to investigate the actions of the regulators of Equitable Life and to include the Government Actuary's Department in that investigation. In the autumn of 2004 Parliament brought the Government Actuary's Department explicitly into the Parliamentary Ombudsman's remit for this inquiry.

The reason we called for the Parliamentary Ombudsman to undertake this inquiry is because she has the power to recommend Government compensation to Parliament.

We have done a tremendous amount of work to support and encourage the Parliamentary Ombudsman's investigation and we have had numerous lengthy, detailed and confidential meetings with her team.

The Parliamentary Ombudsman had hoped to publish her report before Parliament's summer recess. However, having had a detailed response from the Treasury, the Government Actuary's Department and the Financial Services Authority which runs to more than 500 pages, she has now said that she will not be able to publish her final report before Parliament's summer recess. At this stage she has not given a new timetable for publication.

We quite understand the need for her to carry out her responsibilities fully and thoroughly, but we are disappointed and frustrated by this further delay as, I am sure, you are. We remain of the view that the Parliamentary Ombudsman's report is the best hope for Government compensation for our policyholders. If she finds maladministration leading to injustice and recommends that the Government should pay compensation to policyholders, we will, of course, do all we can to put pressure on the Government to do the right thing for policyholders.

Prudential transfer: Rationale

Now I turn to the Prudential agreement.

The agreement we have signed with Prudential represents another hugely important step forward for Equitable Life. So, we think it is important for us to take some time to explain it to you today.

Charles has described the dilemma we face. We now have stability but our investment constraints limits the potential for future bonuses.

It is a problem for the whole business, but it is most immediate for with-profits annuitants because they are receiving their benefits now. The impact of limited bonus earning potential is visible in their bank accounts each month.

Most with-profits annuitants have policies which need high investment returns to maintain their pensions and they cannot choose to go elsewhere – annuity policies cannot be transferred on an individual basis.

With-profits annuities are also unusual policies – not many life companies write this sort of pension – so, when considering strategic options for the business, it was clear that the options for the business as a whole were limited by the presence of the with-profits annuities.

For these reasons, having dealt with the disproportionate mortality risk through the Canada Life deal, we turned our focus next to find a strategic option for with-profits annuitants. The agreement with Prudential offers policyholders that option.

Prudential transfer: The benefits for with-profits annuitants

So what does this agreement mean for with-profits annuities?

Essentially this:

If the transfer goes ahead, the with-profits annuity policies will transfer to Prudential.

The policy conditions will not change; so the policies will look the same – for example, if a with-profits annuity provides for a spouse's pension it will continue to do so after the transfer to Prudential; if it includes a guaranteed investment return it will continue to do so.

The only important thing that will change – and it is a very important thing - is that the investment will be Prudential's with-profits fund instead of Equitable Life's.

The future bonuses for with-profits annuitants will depend on the investment performance of Prudential's with-profits fund. Prudential's with-profits fund has much greater investment freedom and consequently, much greater bonus earning potential than Equitable Life can provide.

Of course, investment freedom can also have its downside and no-one can promise that Prudential will be able to pay greater bonuses in future than Equitable Life. But we believe that this sort of opportunity - to have benefits relating to an actively managed, mixed investment fund – is attractive to annuitants. After all, that is the sort of fund they originally chose for their pension.

Why is this a good deal for the whole Society?

We have had some policyholders say "Isn't this just a deal for with-profits annuitants; I am not a with-profits annuitant, so it isn't for me."

Although the with-profits annuitants will see the most immediate and obvious benefits, it is a deal which will benefit all with-profits policyholders.

Because, as I have said, with-profits annuity policies are relatively unusual, they are a likely barrier to potential purchasers of the rest of our business. Having found an opportunity for with-profits annuities, the remaining policies in the Society are likely to fit in with many other companies' existing businesses or aspirations. When the with-profits annuities have been transferred to Prudential, we believe that we will have greater opportunities for finding the right future for the remaining policyholders – whether that is a sale or run-off.

It is important that non-annuitants understand the need to address the situation of with-profits annuitants for the benefit of all policyholders.

I will now hand back to Charles to provide some further details about this most important transfer.

Charles Thomson, Chief Executive

Address to Annual General Meeting 2007

Prudential transfer explained

Thank you Vanni. Equitable Life is a mutual and the Board's duty is to do what is in policyholders' interests. The Society is strong enough to run off on its own and we will consider transactions if, and only if, we expect the outcome for policyholders to be improved beyond what we can do ourselves using the Society's existing resources.

Even on a superficial view, the proposition from Prudential looks appealing. However, we were very concerned to look into the detail and to consider what concerns there could be about the future. We asked ourselves what protections could be provided for the future for the policyholders who will transfer. Let me show you some of the answers.

First, these policies will go into a sub fund of the Prudential's With-profits fund known as the DCPSF. DC stands for "defined charges" - that is, for our policyholders, substantially fixed charges. In that sub fund 100% of the investment return achieved will go to with-profits annuity policies. In other parts of the Prudential's with-profits fund, as is common in a proprietary company, 10% of the investment return goes to the shareholders. Our annuitants are used to getting 100% and this deal will preserve that.

Second, the future charges for administration will be fixed at the level that Equitable Life currently needs to levy.

What about other costs? As I mentioned earlier, we currently withhold 0.5% of our investment return to cover the cost of paying for policies where the guarantees are greater than the underlying policy values. Prudential will have the same issue (some guaranteed benefits will still exceed the underlying policy values) and so they will make the same adjustment. However, Prudential have undertaken to make this 0.5% a maximum. So, if the cost of the guarantees reduces the charge will be reduced as would have happened at Equitable Life. However, if the cost of guarantees increases the charge will not be increased by Prudential (whereas it would have increased with Equitable Life).

We will apportion the Equitable Life with-profits fund and hand over the with-profits annuitants' fair share to the Prudential. From this Prudential will charge the cost of providing all these benefits and the guarantees and protections for with-profits annuitants. We expect the with-profits annuitants' fair share of Equitable Life's with-profits fund to be slightly more than enough to meet Prudential's charge and the money left over will be added to with-profits annuitants policy values as a small increase to final bonus.

These points illustrate that this deal does stand up to the closest scrutiny and is carefully designed to be fair to all policyholders and significantly improves the prospects for with-profits annuitants.

Why it works for Prudential

So, you may be wondering how this deal can work for Prudential.

After all Prudential is a plc and it would not enter a £1.8 billion agreement just for our benefit. The discussions we have had with policyholders told us it was important for a solution to be transparent and that is one reason why we wanted the agreement to be simple and clear – so that policyholders will be able to understand it.

It works for Prudential because it is a much larger organisation and also open to new business. It continues to develop. Their costs are less than ours.

Further, when we look at costs we have to bear in mind that as a closed fund, there is a risk that our costs per policy will rise as the fund runs down. That is not a consideration for Prudential.

Effectively, we currently make a charge of 1% pa of the fund to administer the policies. For the reasons I have just mentioned, Prudential's costs are significantly less than 1% and so it will make a profit for its shareholders from the administration of the business. That is the commercial justification of the transfer from their point of view and explains how we have managed to produce another attractive transaction.
The transfer will also give them a significant increase in scale in a part of their business which is an area of strategic focus for them. So, the business they will acquire fits into the strategic direction of their business as well as making money for their shareholders.

Five policyholder safeguards

I will finish this look at the Prudential transaction by describing the many protections for policyholders:

First, as a mutual, your board's primary responsibility is the interests of all policyholders. If, having taken advice from lawyers, actuaries and financial experts, we did not think this was in policyholders' interests we would not recommend that you vote for it as we expect to do in September.

Second, an Independent Expert will be appointed to look at the impact of the transfer on all groups of policyholders: with-profits annuitants, the Society's other policyholders (whether with-profits or not) and also Prudential's policyholders. If the expert were to conclude that any group of policyholders would be materially worse off, the transfer will not proceed.

Third, the Financial Services Authority is the regulator for both Equitable Life and Prudential. Part of its remit is to protect policyholders' interests. If they felt the transfer was not in policyholders' interests they would object and it would not proceed.

The fourth safeguard is the need for members' approval. We will hold an Extraordinary General Meeting of the Society, an EGM, probably in late September or October, at which members will be invited to vote on the transfer. Members of the Society will be able to attend and vote or send in votes by post. We will send a pack of information with details and voting forms nearer the time. If members do not approve the transfer it will not proceed.

Finally, the transfer proposal will go to the High Court. The Court will consider the voting results from the EGM, and evidence from the Independent Expert and the FSA. Also, any policyholder who feels they may be adversely affected will be able to address the Court. If the Court does not feel the transfer is in the interests of policyholders it will not proceed.

These five safeguards make absolutely certain that anyone who may feel the transfer is not the right way forward has the opportunity to be heard.

Conclusion

In conclusion:

We have looked hard at the alternatives and we have listened to policyholders, both informally and through systematic research. We believe that the agreement with Prudential is a major step forward which very closely matches what policyholders have told us that they want.

There is still a long way to go, but the transfer could give with profits annuitants a significantly better outlook and it will also open the door for options for other policyholders. Don't forget, it is an agreement which we believe will benefit all with-profits policyholders in due course. It goes beyond the immediate obvious benefits for the with-profits annuitants.

As policyholders you have all been through a very difficult period since the start of the new millennium. For much of that time, we were working hard on the fundamentals of the business, and having to react to numerous external issues. At last, it is obvious that the hard work on the fundamentals has delivered results and we are now in a position to consider the future of the business from a position of strength.

Ladies and Gentlemen, thank you.