Proposed Compromise: Ready for your comments

This is the proposed compromise recommended by your new Board.

It describes the Society's current situation and problems.
It explains why a compromise is needed and then sets out the principles upon which the proposed compromise has been built.
We hope you will take the time to read it and the enclosed *Background to the Proposed Compromise* (where you will find details of the alternatives considered and rejected by your Board).

We look forward to receiving your comments and views.

Equitable Life
The Way Forward

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IMPORTANT: Only with-profits policyholders are affected by the compromise. If you are not a with-profits policyholder you will not be affected by the compromise. Policyholders who are not with-profits policyholders include non-profit annuitants, and policyholders with unit linked policies.

This document, *Background to the Proposed Compromise* and the letter from the Chairman (the 'Consultation Documents') have been prepared based on information available to the Society immediately prior to the approval by the Board of this document on 12th September 2001. The publication of the Consultation Documents shall not give rise to any implication that there has been no change in such information since such approval.

Nothing in the Consultation Documents constitutes an admission of any fact or liability on the part of the Society or any other person in respect of any claim against them.

The Directors have not authorised any person to make any representation, whether oral, written, express or implied, concerning the compromise which is inconsistent with the statements made in the Consultation Documents. Consequently, if such representations are made they should not be relied upon.

Terms defined on page 38 of *Background to the Proposed Compromise* apply to this document.

Indicative timetable

12 October 2001	Consultation period closes
Early November 2001	Application to court to convene scheme meetings
Mid-November 2001	Receipt by policyholders of scheme documents
December 2001	Scheme meetings and vote counting
January – February 2002	Court approval and registration at Companies House whereupon scheme becomes effective

In Brief

The Problems

- The cost of paying for guaranteed annuity rate (GAR) benefits will be higher than the Society had expected and we cannot know what GARs will actually cost over the next 40 years.
- In addition, policyholders without GARs (non-GAR policyholders) may have claims against the Society because they were not told of the potential cost impact of GARs.
- Policyholders with GARs (GAR policyholders) may have potential claims against the Society for damage. They might suffer if policyholders without GARs successfully pursued their potential claims.
- All costs fall on all with-profits policyholders of the Society.
- This means that the value of your policy is at risk. It has already been affected and it will not grow as it would have done if these problems did not exist.

Solving the Problems

- Having examined all the options very carefully, your Board has concluded that the proposed compromise is the only realistic way to solve these problems.
- We have drawn up a proposed compromise based on firm principles of fairness, clarity, mutuality and legality.
- A compromise would mean all with-profits policyholders giving up some of their rights in exchange for an increase in their Policy Values (this includes both guaranteed and non-guaranteed elements of your policy).
- These increases would be funded from the money set aside to cover the GAR problem and from the Halifax £250 million being made available if we achieve a compromise before 1 March 2002.
- Your comments are needed before the compromise is finalised. It will then be reviewed by the Independent Actuary and the Financial Services Authority and sent to you to vote on.
- The Society will implement the compromise through a scheme of arrangement under Section 425 of the Companies Act 1985.
- If policyholders vote for the compromise by sufficient majorities it will then be placed before the High Court for approval.
- Agreeing a compromise removes many of the uncertainties facing the Society which are affecting the value of your policy. A more flexible investment policy can be adopted and the financial strength of the Society will be improved. Without a compromise the uncertainties will continue.

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Where the Society is today

Your Society is a mutual assurance society owned by you, its with-profits policyholders. The Society's with-profits fund is a single pot of money. There are no other funds from which claims or payments can be met.

As at 30 June 2001 the Society had around 485,000 individual with-profits policyholders, 70,000 of whom had policies which contained guaranteed annuity rates (GARs). These policies were sold up until 1988.

The Society's difficulties stem from the belief by previous Boards of the Society that a different final bonus policy for those GAR policyholders who chose to take GAR benefits, compared to those who did not choose to take GAR benefits, could normally meet the additional costs of GARs. In July 2000 the House of Lords ruled that this differential final bonus policy was illegal. In addition, it held that the Society was not able to limit the cost to the GAR policyholders alone.

As a result, the Society immediately had to set aside extra money to pay for these future guarantees. In addition, because the cost of paying for the guarantees could change over time as interest rates change, the Society has to adopt a much more restrictive investment policy. This meant investing in safer investments such as cash and gilts or bonds which have historically had lower growth. The uncertainty over the total cost of the guarantees as they are paid out in the years ahead has also meant the Society must adopt a cautious bonus policy. Not knowing the cost of the GARs jeopardises the Society's financial stability.

The impact of these GAR costs has been borne by all existing with-profits policyholders – GAR and non-GAR alike.

With-profits policies bought after 1988 do not have the benefit of GARs. In a very significant development the new Board has now received legal advice from Nicholas Warren QC that policyholders without guaranteed annuity rates (non-GAR policyholders) may have claims against the Society because they were not warned of the extra potential costs of GARs when they bought their policies. A reserve would have to be set aside to meet these potential claims before any non-guaranteed bonuses could be paid on or added to with-profits policies, GAR or non-GAR.

Why is the current situation so unsatisfactory?

If you are a GAR policyholder, you can make use of your GAR when you retire. Currently, because GARs are higher than the current annuity rates available in the open market, your GAR potentially has a value. However, if interest rates increase, these open market annuity rates are likely to follow and may move above the guaranteed level. If this happens and you retire at that point, your GAR will not have any value.

Consultation for trustees of group schemes

In addition to using the methods of communication above, there will also be two additional meetings specifically for trustees. These will be in London and Manchester. If you are a trustee and wish to attend one of these meetings, please telephone 0870 166 6627. These meetings are not open to individual policyholders.

Writing to us

You can write to us with your comments at the addresses shown below.

Full details of the proposed compromise are also available at our website www.equitable.co.uk.

Group Scheme Trustees
Compromise Scheme Department
The Equitable Life Assurance Society
PO Box 173
Walton Street
Aylesbury
Bucks
HP21 7YS
United Kingdom

Individual Policyholders
Compromise Scheme Department
The Equitable Life Assurance Society
1 Olympic Way
Wembley
Middlesex
HA9 0NP
United Kingdom

Calls made to 0870 numbers in the UK are charged at national call rates.
For all other calls, the usual rates apply.

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What you need to do next – the consultation process

Please take your time to read this booklet thoroughly. You may also find it helpful to read through the companion booklet *Background to the Proposed Compromise*. Then, please let us know what you think. There are a number of different ways to do this:

You can attend one of our consultative policyholder meetings

The meetings are scheduled to take place in: Birmingham, Bournemouth, Brighton, Bristol, Cambridge, Cardiff, Edinburgh, Glasgow, London, Manchester, Newcastle, Oxford, and Sheffield.

If you would like to take part in one of the above meetings, please call our registration line on 0870 166 6626. The telephone lines will be open from 19 September until 11 October 2001 between 9.30am and 5.30pm. If you are calling from outside the UK, please telephone +44 (0)1252 771 188.

We look forward to meeting as many of you as possible at our policyholder meetings. However, tickets will be limited by the sizes of the venues available to us. Tickets will be issued on a first come, first served basis. So, we encourage you to reserve your ticket promptly. Confirmation will be given immediately over the telephone. Should the meeting you request be fully booked, then, if we can, we will offer you an alternative meeting as close as possible to your original choice. A letter of confirmation, tickets and a location map will be sent to you.

For those policyholders who cannot attend, you will still be able to see what is happening by viewing parts of the meetings via our website at www.equitable.co.uk.

Calling our compromise information line

You can also call us on the compromise proposal information line on 0870 906 1762. We will attempt to answer your questions about the compromise proposal and you will be able to leave a message giving us your views. Lines are open from 8am to midnight seven days a week.

If you are calling from outside the UK, please call +44 (0)870 906 1762.

If you are calling from Germany and would like to speak to someone in German, please call +44 (0)1296 563 008.

Calls that are not about the compromise proposal should be made to our normal helpline on 0870 901 0052. If you are calling from Ireland, please telephone 01 661 6343, or from Germany 01803 234 630. From all other countries, please telephone +44 (0)1296 386 242.

Sending your comments by e-mail

If you would like to send us your comments by e-mail, the address is comments@equitable.co.uk.

If you are a non-GAR policyholder you may have a possible claim against the Society because you were not told of the potential cost of GARs. However, not only is this subject to the normal uncertainties of claims of this nature, but if all non-GAR policyholders made claims, they would in effect be largely suing themselves because they constitute three quarters of the Society's with-profits fund.

The new Board has taken a number of steps to improve the situation but all with-profits policyholders, GAR and non-GAR alike, as owners of the Society, suffer from the fact that the Society is fundamentally unstable. We have to have a more restrictive investment policy because of the need to take account of the uncertain future cost of both GARs and the potential claims of non-GAR policyholders. This will affect the size of your fund and the benefits to which you are entitled – whether you have a GAR or non-GAR policy.

What is the current financial state of the Society?

The Society is solvent and the Board will do all in its power to ensure it remains so. Not only is the Society solvent but it satisfies the requirements of the insurance regulations, which are stricter than a simple solvency test.

From the start of the year to 30 June, surrenders from the Society's with-profits fund – where policyholders take their benefits early – have totalled £0.6 billion. In the same period £1.5 billion has been paid out in benefits as policyholders retire and take other contractual benefits. As of 30 June 2001 the with-profits fund was valued at £22.8 billion, as against £26 billion at the end of December 2000, reflecting the reduction in market values and the outflow from the with-profits fund. Since the Policy Value reductions in July 2001, which arose substantially from adverse market conditions, aggregate Policy Values and the value of the investments underlying policies are now broadly in line. Information in respect of this and other financial matters will be available in the interim financial statements for the six months to 30 June 2001. The interim financial statements will be included in the formal scheme documentation, which will be sent to you in November.

We also intend to issue a booklet containing the background to the Policy Value reductions when revised Policy Value statements are sent to you in October.

Why a compromise is needed

The current situation is wholly unsatisfactory and is causing great anxiety to many policyholders. The Society is financially unstable and there are competing claims on the single pot of money that is the with-profits fund. For both GAR and non-GAR with-profits policyholders, investment freedom is restricted and bonuses in the future are more uncertain. Both of these will affect growth on your policy. If you are a GAR policyholder, you cannot be sure of the value of your GAR until you retire. If you are a non-GAR policyholder you do not know if your possible claim against the Society would succeed.

We must seek to remove these uncertainties. The Board has examined the different ways of achieving this. In its view by far the best way is to reach a compromise whereby all with-profits policyholders give up some rights in exchange for increases in their Policy Values.

A compromise would remove the uncertain cost of GARs in exchange for an increase in GAR policyholders' Policy Values. The Society would therefore no longer need to put money aside in the future in case the cost of GARs increased in the years ahead. This money could instead be invested on a more flexible basis.

A compromise would also mean the threat of destabilising and expensive actions against the Society by non-GAR policyholders would be removed.

A fair compromise, whereby the cost of stabilising the Society is shared fairly by all with-profits policyholders, would mean these competing claims facing the Society are settled and the total cost of GARs is crystallised. As a result, investment flexibility would be improved and the Society could adopt a less conservative bonus policy in the future.

What if there is no compromise? What options are there?

The only realistic alternative is for the Society to continue as it is, having to take account of the uncertainties arising from the potential future cost of GARs and the threat of action by non-GAR policyholders. We would have to cope with these by continuing a more restrictive investment policy. In that bleak scenario, Policy Values would be more uncertain and growth on policies would be likely to be less than if there was a compromise.

The uncertainty would continue for everyone in the Society.

The *Background to the Proposed Compromise* (pages 30 to 37) gives details of all the alternatives that were extensively examined by the Board. None is a viable alternative to the compromise we are proposing. Any other course would mean all with-profits policyholders potentially losing significant value and suffering more uncertainty.

If these voting thresholds are met, the compromise will go the High Court for final approval. If this approval is given, the compromise will become effective. You will be included in the compromise even if you personally voted against it or did not vote.

14. I have both GAR and non-GAR benefits. Will I have two votes?

Yes. You may vote twice: once as a member of the GAR class of voters and again as a member of the non-GAR class. The voting instructions will make this clear.

15. How do I vote?

It is not yet time to vote, but when it is you will be sent a voting paper and details of the voting procedure.

16. If I have taken my benefits, can I still vote?

Not unless you still have a with-profits policy with the Society at the date of the vote (e.g. a with-profits annuity). If you are a with-profits annuitant you will be voting as a non-GAR.

17. If I am a member of an occupational pension scheme, who votes on my behalf?

The trustees of your scheme.

18. Why aren't you holding a consultation meeting in my home town?

We cannot cover all areas in the time available. That is why we are using a range of methods for gathering comments such as by letter or by using the feedback form on the website, www.equitable.co.uk, and by a number of meetings around the country.

19. What if I have more questions?

You can call our compromise helpline on 0870 906 1762 charged at national call rates. Lines are open from 8am to midnight.

8. What other options were considered?
Background to the Proposed Compromise, on pages 10 to 13 and pages 30 to 37, detail other options that were considered and why we believe the proposed compromise is the best option available. Other options we considered included setting up a ring-fenced fund and the liquidation of the Society.

9. Why is there no sliding scale by age for fixed GAR policies?
When the actuarial study was done it was clear that for these policyholders the value of the GAR benefit hardly varied at all with age.

10. Are there major legal claims against past advisers, directors or regulators that would allow us to recover enough to stabilise the Society without a compromise?
These claims are currently being investigated on behalf of the new Board by the lawyers, Herbert Smith. If there are significant claims we could pursue then we will do so. However, it would be a very long time before the Society received compensation. In the meantime the uncertainty would continue. If such claims succeed, any money received will be added to the with-profits fund for the benefit of all with-profits policyholders.

11. If there is a 'no' vote to the compromise will the Government bail out the Society?
The Government has stated that it has considered and rejected putting money in a 'lifeboat' for the Society's with-profits policyholders. The problems of the Society must be sorted out without delay. Policyholders should not rely on the possibility of Government assistance.

12. How does the independent inquiry by Lord Penrose affect the compromise?
It does not. The purpose of the independent inquiry is to provide an authoritative account of the Society's affairs and to draw lessons for the future on the conduct, administration and regulation of life assurance business. The independent inquiry will **not** offer advice to policyholders nor will it review past judicial decisions in relation to the Society or pre-judge future decisions taken by the courts. Lord Penrose is not expected to report until well after the vote by policyholders on the compromise.

13. How will the vote work?
The Society expects with-profits policyholders to fall into two voting classes:

- Non-GAR policyholders
- GAR policyholders

For the final compromise to go ahead, the vote must meet two thresholds:

- Of those voting, at least 50% of the policyholders in each class must vote in favour; and
- Of those voting, in each class those voting in favour must account for at least 75% by Policy Value.

The proposed compromise

The proposed compromise includes contributions from policyholders and policyholder action groups. The proposed compromise is now ready for your comments and suggestions.

Principles of the proposed compromise

Any compromise has to be based on firm and fair principles. These principles are the foundations of the compromise. Every key point in the proposal should be assessed against these principles.

Basic principles

The basic principles to bring an end to the GAR problem and potential claims by non-GAR policyholders are:

- **Fairness** The compromise must be fair to all with-profits policyholder groups
- **Clarity** The compromise must be easy to understand
- **Mutuality** The compromise must mean all with-profits policyholders share the pain and the benefit of the compromise fairly
- **Legality** The compromise must be able to be implemented

GAR compromise principles

The basic principles outlined above are reflected in the following GAR compromise principles:

- fair value compensation given to the GAR policyholders as a group should reflect a realistic estimate of the additional cost to the Society of providing GAR benefits in the future; the realistic estimate should be neither cautious nor optimistic;
- the realistic estimate of the additional cost to the Society of providing GAR benefits in the future should form the financial basis of the compromise between GAR policyholders and the Society; it should be affected only by the need to compensate non-GAR policyholders for giving up their possible claims (see below);
- the compensation should be distributed among GAR policyholders in proportion to the value of the legal rights which they are being asked to give up;
- the compensation should take the form of a proportionate increase in GAR policyholders' relevant Policy Values in both guaranteed and non-guaranteed form.

Non-GAR compromise principles

The basic principles outlined above are reflected in the following non-GAR compromise principles:

- the non-GAR compromise should recognise the financial interests (arising from the cost of GARs) of all non-GAR policyholders in a limited with-profits fund;
- the starting point for fair value compensation for non-GAR policyholders as a group is a comparison with industry pay-outs. There are practical difficulties with this approach, as discussed in section 5 of *Background to the Proposed Compromise*;
- fair value compensation for non-GAR policyholders should require that account is taken of:
  - the uncertain prospects of success of their claims;

3. Would I be worse off giving up my GAR rights?

You could be. However, if you were planning on taking part of your fund as a tax-free lump sum, which most people do, the difference may not be very great. In addition, the proposals will give you an increased fund with which to buy an open market option such as an income drawdown or a with-profits annuity or indeed an equivalent annuity on the open market. Any benefit on death before retirement is also increased.

4. What is my tax position?

If you take all your benefits in GAR form, all the income from your pension is taxable. For higher-rate taxpayers taking part of your fund as a lump-sum may have advantages. You can use it to buy a 'purchased life annuity', from which part of the income counts as a return of your capital and is tax-free. So the after-tax income from the purchased life annuity may be greater than the GAR pension sacrificed. You should obtain advice on your individual tax position from your accountant or tax adviser; you should also bear in mind that the level and basis of tax may change.

5. If you are a GAR policyholder very close to retiring.

If you are very close to retiring, you may be able to weigh up precisely whether you will be better off taking your GAR today or accepting the increase in policy value. **Policyholders who have already reached an age at which they can take their contractual retirement benefits under their policy can retire immediately, taking the GAR rights if desired (provided they do so before the Scheme becomes effective). This important issue is also discussed in *Background to the Proposed Compromise* (see section 2.3 A GAR Buy-Out Scheme).**

6. The GAR increase was said to be 20%. Why is it only 17.5% on average?

The original estimate was made before the potential claims of the non-GAR policyholders had been investigated. Without the potential claims of non-GAR policyholders the average would have been 20.5%. The reduction reflects the need to provide an increase to non-GAR Policy Values in exchange for non GAR policyholders giving up their potential claims against the Society. If these claims were not given up most would represent 'prior' claims on the Society which would have to set aside a sum before any bonuses could be allocated to policies.

7. Why is the increase in Policy Value lower for people with pre-October 1975 GAR policies?

The increase in Policy Value directly reflects the value of the rights given up. Retirement annuity policies issued before October 1975 offer a much lower level of GAR. These GARs are, therefore, much less valuable than the other GARs.

Age Table

Age on 31.12.2001	Retirement Annuity policies issued before October 1975 ('Flexible' form of GARs)	Retirement Annuity policies issued after September 1976 ('Fixed' form of GARs)	All other policies (with the 'Flexible' form of GARs)
30 or less		16.3%	16.5%
31		16.3%	16.5%
32		16.3%	16.5%
33		16.3%	16.5%
34		16.3%	16.5%
35		16.3%	16.6%
36		16.3%	16.8%
37		16.3%	17.0%
38		16.3%	17.2%
39		16.3%	17.4%
40		16.3%	17.7%
41		16.3%	18.0%
42		16.3%	18.3%
43		16.3%	18.5%
44		16.3%	18.8%
45	3.5%	16.3%	19.1%
46	3.5%	16.3%	19.3%
47	3.5%	16.3%	19.6%
48	3.6%	16.3%	19.8%
49	3.6%	16.3%	19.9%
50	3.6%	16.3%	20.1%
51	3.7%	16.3%	20.2%
52	3.8%	16.3%	20.3%
53	3.8%	16.3%	20.4%
54	3.9%	16.3%	20.4%
55	4.0%	16.3%	20.3%
56	4.1%	16.3%	20.3%
57	4.1%	16.3%	20.2%
58	4.2%	16.3%	20.1%
59	4.3%	16.3%	19.9%
60	4.5%	16.3%	19.7%
61	4.8%	16.3%	19.5%
62	5.0%	16.3%	19.3%
63	5.1%	16.3%	19.1%
64	5.3%	16.3%	18.9%
65	5.5%	16.3%	18.7%
66	5.9%	16.3%	18.5%
67	6.0%	16.3%	18.3%
68	6.2%	16.3%	18.1%
69	6.4%	16.3%	17.8%
70	6.6%	16.3%	17.6%
71	6.8%	16.3%	17.4%
72	6.9%	16.3%	17.3%
73	7.0%	16.3%	17.1%
74	7.1%	16.3%	17.0%
75	7.2%	16.3%	16.9%

The increase for GAR policyholders with fixed GAR policies does not vary with age because the actuarial study showed that the value of their GAR benefits hardly changed with age.

- the argument that non-GAR policyholders as owners of approximately three quarters of the with-profits funds would be responsible for three quarters of their own compensation, whilst acknowledging that there are differing legal opinions on this point;
- the compensation to non-GAR policyholders should be allocated as a proportionate increase in Policy Values and an increase in guaranteed benefits so as to broadly replace the guaranteed bonuses that would reasonably have been expected in the absence of the House of Lords' judgment;
- the compensation to non-GAR policyholders should be reflected in a proportionate reduction in the increases to GAR policyholders.

Principles for distribution of the Halifax £250 million

Details of the arrangements with Halifax plc are set out in *Background to the Proposed Compromise*.

The basic principles outlined above are reflected in the following principles for the distribution of the Halifax £250 million:

The Halifax £250 million should:

- accrue to the with-profits fund generally;
- be allocated pro rata across the uplifted Policy Values of all with-profits policyholders;
- all be added in non-guaranteed form.

Ensuring the principles are carried through to the compromise

The Society is concerned to reassure all with-profits policyholders that it has taken all reasonable steps to ensure that these principles are an appropriate basis for the proposed compromise. In addition to close scrutiny by the Society's new Board, the principles are being assessed by:

- Michael Arnold (the Independent Actuary engaged by the Society to report on the principles underlying the compromise and the Society's actuarial work); and
- the Financial Services Authority.

In addition, the Board has commissioned an independent review of the relevant systems of the Society to ensure the correct data is used for voting purposes.

With-profits policyholders will be asked to vote on the compromise. A majority in number representing three quarters in value of each class (i.e. GAR policyholders and non-GAR policyholders) voting will be needed to approve the compromise.

YOUR COMMENTS

We would like to hear your views on these principles which are the bedrock of the compromise:

- **If you agree with the principles or have spotted ways to improve them, please let us know**
- **Please point out which principles you disagree with and why and let us know how you think they can be improved**

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How the proposed compromise would work

If the compromise is voted through, these principles will be closely considered by the High Court which must approve the compromise before it becomes effective.

Assuming the compromise is in place before 1 March 2002, with-profits policyholders would be offered an immediate increase in their Policy Values in exchange for giving up some of their rights.

For **GAR policyholders** Policy Values would be increased on average by 17.5% in return for with-profits policyholders giving up their GARs. GAR policyholders will also be asked to give up any claims which they may have arising out of the potential claims by non-GAR policyholders. The exact increase will depend principally on the type of GAR policy held and when it was taken out.

- GAR policyholders will then at contractual retirement dates be able to use their increased fund to buy a range of open market options from other pension providers as well as income drawdown or with-profits annuity or benefits from the Society. Currently GARs can only take their GAR annuity from the Society and there are only a limited number of ways in which the GAR benefits can be taken.

For **non-GAR policyholders** Policy Values would be increased by approximately 2.5% in return for giving up any claims they may have because they were not told when they bought their policies of the potential cost of GARs to the Society.

- With-profits annuitants are non-GAR policyholders. Their current level of pension income would be increased by 2.5% when the compromise is completed. Future increases or decreases in their pension, related to the growth on their policy, will operate from the increased level (the 1.5% adjustment to the annuity calculation announced on 16 July 2001 will continue to apply).

Increases will be calculated as at the date of the vote excluding any transfers or switches into the with-profits fund after midnight on 18 September 2001, and applied immediately the compromise becomes effective.

Why an average increase of 17.5% for GAR policyholders and 2.5% for non-GAR Policyholders?

GAR policyholders are being offered a larger increase because the current value of the GARs they would be giving up is significant. The increase for non-GAR policyholders is less because:

- the estimated value of their potential claims is lower; because the possible claims which they would be giving up, like all claims of this nature, are uncertain; and
- because non-GAR policyholders represent about three quarters (by value) of the Society they would meet a large part of the cost of any successful action themselves.

How the 17.5% increase is calculated

The increase for GAR policyholders is calculated by

2. What would I get for giving up my GAR rights?

We have identified three types of GAR policies. What you would get in exchange for your GAR rights at retirement depends principally on the group into which your policy falls. The reason these vary is that different types of GAR rights have different values. **Flexible GAR policies** allow spouse's pensions, increasing pensions and guarantee that pension payments will be made for at least five years on GAR terms if you die. **Fixed GAR policies** do not allow any of these features on GAR terms:

Type of GAR policy	Features	Increases in GAR policy value in exchange for GAR rights
Retirement annuity policies issued before October 1975 (these GAR policies have much lower guaranteed annuity rates, hence the lower increase)	Flexible	Exact increases depend on age (please see Age Table below). For example: Current age 45: 3.5% Current age 55: 4.0% Current age 65: 5.5%
Retirement annuity policies issued after September 1976	Fixed	Increase in Policy Value is 16.3% at all ages
All other GAR policies including individual pension plans, retirement annuities sold from October 1975 to September 1976, transfer plans and group pensions including group additional voluntary contribution (AVC) agreements	Flexible	Exact increases depend on age (see Age Table below) For example: Current age 45: 19.1% Current age 55: 20.3% Current age 65: 18.7%

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1. How do I know what I am giving up as a GAR policyholder? What is the value of my GAR rights?

The value of the GAR rights you will give up depends on the prevailing annuity rates available in the market at the time you retire, and on the value of future growth up to the date of retirement. It will also depend on what you choose to do and the terms of your policy, such as:

- Whether your policy allows for a spouse's pension on GAR terms payable if you die first.
- Whether your policy and circumstances allow you to carry on paying premiums in future and so increase the value of your GAR rights.
- Whether you intend to take part of your pension fund on retirement as a tax-free lump sum (which most policyholders do).
- Whether you intend to take a different sort of pension such as income drawdown or an investment backed annuity to which GARs do not apply.

It is important for you to note that increases apply to existing funds only. They would not apply to any contributions made after a cut off date to be determined so as to ensure fairness to all policyholders.

taking a realistic estimate of the total additional cost of GAR policies in the future and allocating that among GAR policies today. We cannot be sure exactly what GARs will cost in the future, but we have experience running from mid-2000 which shows how much GARs are currently costing and therefore what value retiring GAR policyholders are placing on the guarantees. The realistic estimate cost is £1.06 billion which would represent an increase of on average 20.5% of Policy Values. This increase is then reduced to 16.2% in order to pay for their share of the Policy Value increases of non-GAR policyholders to compensate them for giving up potential claims they may have against the Society. Finally, allowing for the Halifax £250 million increases the average uplift to 17.5%. As you can see on page 22, the exact increase for different GAR policyholders varies with the different types of GAR policy and in some cases with the age of the policyholder.

How the 2.5% increase is calculated

The increase of 2.5% for non-GAR policyholders has been calculated as follows:

The theoretical aggregate sum of all the potential claims of non-GAR policyholders has been estimated to be £850 million. However, not all these claims are likely to be successful. The range of probability of success of these potential claims, when taken as a whole, was estimated by the Society's legal advisers to vary widely from perhaps 20% to 70%.

Around 75% by value of the Society's with-profits fund is made up of non-GAR policies. Any successful claims would have to be met out of the with-profits fund largely owned by non-GAR policyholders. Therefore, around 75% of non-GAR policyholders' claims could end up being paid for by non-GAR policyholders themselves. As a result compensation would have to be reduced by 75%. There are differing legal views on whether, if a claim was framed in a certain way, this would still be the case. The range of discount on account of this would therefore be up to 75% depending on which legal opinions were followed. The lawyers, however, all agree that there is doubt and that the contrary view is arguable. There is insufficient time to bring a test case, and probable appeals from it, to resolve the issue if the compromise is to be in place before 1 March 2002 which is the deadline for receipt of the Halifax £250 million.

In summary, the total estimated value of potential claims of £850 million needs to be discounted with regard to the probability of success (between 20% and 70%) and with regard to non-GAR policyholders paying for non-GAR claims themselves (between 0% and 75% but estimated to be between 25% and 65%). Having carefully examined the range of legal advice the new Board has taken the view that the likely value for potential claims lies in the range of £100 million to £300 million and has decided to propose a scheme using a value of £220 million.

This sum of £220 million equates to an uplift of 1.4% across all non-GAR Policy Values. This, together with the non-GAR proportion of the Halifax £250 million, brings the uplift to 2.5% in total for non-GAR policies.

How are the policy value increases being paid for?

The increases are paid in two ways:

1. By using the balance of the amount set aside following the House of Lords ruling in July 2000. This amounts to £1.06 billion.
2. By using the £250 million coming to the Society from Halifax if a compromise becomes effective before 1 March 2002.

What happens if a compromise is agreed?

The outlook for all policies – GAR and non-GAR alike – will be much better. The main legal uncertainties will have been removed, enabling the Society to operate a more flexible investment policy. This, over time, should generate better returns for your policy than if there is no compromise.

The Society will not face the uncertainties arising from the future cost of honouring GARs and the threat of action from non-GAR policyholders. These uncertainties will be removed once a compromise is in place. Of course, after the compromise has become effective, the Society will still require careful and prudent management.

What you need to do now

At this stage we are asking for your views on the proposed compromise. The section on page 26 shows the ways in which you can give us your views. It also details the policyholder meetings that are taking place around the country where the directors of the Society will be available to discuss the proposed compromise with you.

After the consultative process has been completed, appropriate modifications will be considered. A final compromise will be drafted and then forwarded to the Independent Actuary and the Financial Services Authority for their review. The Inland Revenue will be asked to confirm that the compromise carries with it no adverse tax consequences for with-profits policyholders.

The compromise document will then be sent to you in November with exact details about how it will affect your individual policy and how you can vote. We will be asking you to vote on the compromise at around the end of the year. If policyholders approve it (there needs to be a majority in number also representing three quarters in value of those voting in each class), it will then go to the High Court for approval. If the High Court approves the compromise it will be presented to the Registrar of Companies. At that point, the compromise will come into effect and the increases to the Policy Values will be applied. An indicative timetable for the implementation of the Scheme is set out on page 28.

YOUR COMMENTS

We welcome your views on the structure and benefits of the proposed compromise which flow from the underlying principles

So what are the advantages of the compromise to me as a non-GAR policyholder?

- You receive an increase of 2.5% on your Policy Value.
- The guaranteed element of your policy will be increased by up to 4% for UK pension policies that are entitled to declared bonuses depending on the type of policy (if your policy does not have a guaranteed 3.5% annual growth the guaranteed value increases by 4%; if your policy has 3.5% guaranteed growth, it will be increased by the difference, i.e. 0.5%). The UK life assurance and international business equivalent rates apply.
- The Society will have greater investment flexibility and a less conservative bonus policy.
- Bonuses will not need to be cut in future to meet any increases in the cost of GAR benefits if interest rates fall.
- Your policy will not have the risk of bearing the cost of the Society fighting an expensive and lengthy battle arising from potential claims by other non-GAR policyholders. If these claims were to be successful most would represent ‘prior’ claims on the fund, and a sum would have to be set aside from the with-profits fund to meet them before any further bonuses could be allocated.
- You will belong to a Society with a stronger financial footing.

So what are the disadvantages to me?

- You give up a potential claim against the Society on the grounds that you were not told about the potential cost of GARs when you bought your policy.
- You give up the possibility of the GARs falling in value if interest rates rise, thus benefiting your fund.

Example 5
With-profits annuity taken out before July 1996 (i.e. with 3.5% annual growth guaranteed)

	Guaranteed annuity (see note 2)	Total annuity
Basic % increase	0.5%	1.4%
Additional % increase from the Halifax £250 million (see note 1)	-	1.1%
Total % increase	0.5%	2.5%
Current annuity per year	£16,000	£19,000
Increase in annuity if the compromise is agreed	£80 (0.5%)	£475 (2.5%)
New annuity per year	£16,080	£19,475

The increased annuity after the compromise is in place will be used as a base for future annuity payments. Payments will increase or reduce depending on growth on the fund in future years and the growth rate which was anticipated when the annuity was taken out subject to the additional 1.5% reduction announced on 16 July 2001.

Notes:

1. *All increases in Policy Values assume that the compromise is agreed and in place before 1 March 2002 and, as a result, £250m is made available to the Society by the Halifax.*
2. *For non-GAR pension and with-profits annuity policies bought before July 1996, the 0.5% increase in the guaranteed value together with the 3.5% guaranteed annual growth provides the 4% increase in guaranteed values for 2000 under the terms of the compromise. For with-profits bonds the 3.0% increase in guaranteed values is the net of tax equivalent of the 4% increase for non-GAR pension policies.*
3. *The greater of the total Policy Value and the guaranteed value is payable on contractual events (e.g. retirement).*

The following examples illustrate the typical effect of the proposed compromise on different GAR policies using the Age Table on page 22.

Example 1
Retirement Annuity policy taken out after September 1976

	Guaranteed value	Total Policy Value
Basic % increase	15.0%	15.0%
Additional % increase from the Halifax £250 million (see note 1)	-	1.3%
Total % increase (see page 22)	15.0%	16.3%
Value now	£86,000	£97,000
Increase in value if the compromise is agreed	£12,900 (15.0%)	£15,811 (16.3%)
New value	£98,900	£112,811

Example 2
Retirement Annuity policy taken out after September 1976

	Guaranteed value	Total Policy Value
Basic % increase	15.0%	15.0%
Additional % increase from the Halifax £250 million (see note 1)	-	1.3%
Total % increase (see page 22)	15.0%	16.3%
Value before increase	£75,000	£72,000
Increase in value if the compromise is agreed	£11,250 (15.0%)	£11,736 (16.3%)
New value (see note 2)	£86,250	£83,736

Example 3
Individual Pension Plan taken out prior to 1988 (policyholder aged 56 on 31 December 2001)

	Guaranteed value	Total Policy Value
Basic % increase	19.0%	19.0%
Additional % increase from the Halifax £250 million (see note 1)	-	1.3%
Total % increase (see page 22)	19.0%	20.3%
Value now	£90,000	£108,000
Increase in value if the compromise is agreed	£17,100 (19.0%)	£21,924 (20.3%)
New value	£107,100	£129,924

Example 4
Retirement Annuity policy taken out before October 1975 (policyholder aged 59 on 31 December 2001)

	Guaranteed value	Total Policy Value
Basic % increase	3.1%	3.1%
Additional % increase from the Halifax £250 million (see note 1)	-	1.2%
Total % increase (see page 22)	3.1%	4.3%
Value now	£13,000	£27,000
Increase in value if the compromise is agreed	£403 (3.1%)	£1,161 (4.3%)
New value	£13,403	£28,161

Notes:

1. *All increases in the total Policy Values assume that the compromise is agreed and in place before 1 March 2002 and the Halifax £250 million is made available to the Society.*
2. *The greater of the total Policy Value and the guaranteed value is payable on contractual events (e.g. retirement).*

Example 4
With-profits annuity taken out after June 1996 (i.e. without 3.5% annual growth guaranteed implicitly)

	Guaranteed annuity (see note 2)	Total annuity
Basic % increase	4.0%	1.4%
Additional % increase from the Halifax £250 million (see note 1)	-	1.1%
Total % increase	4.0%	2.5%
Current annuity per year	£10,000	£11,000
Increase in annuity if the compromise is agreed	£400 (4.0%)	£275 (2.5%)
New annuity per year	£10,400	£11,275

The increased annuity after the compromise is in place will be used as a base for future annuity payments. Payments will increase or reduce depending on growth on the fund in future years and the growth rate which was anticipated when the annuity was taken out subject to the additional 1.5% reduction announced on 16 July 2001.

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Example 3
With-Profits Bond policies

	Guaranteed value (see note 2)	Total Policy Value
Basic % increase	3.0%	1.4%
Additional % increase from the Halifax £250 million (see note 1)	-	1.1%
Total % increase	3.0%	2.5%
Example A		
Value now	£18,000	£20,000
Increase in value if the compromise is agreed	£540 (3.0%)	£500 (2.5%)
New value	£18,540	£20,500
Example B		
Value now	£10,800	£9,000
Increase in value if the compromise is agreed	£324 (3.0%)	£225 (2.5%)
New value (see note 3)	£11,124	£9,225

So what are the advantages of the compromise to me as a GAR policyholder?

- You receive an increase of on average 17.5% on your Policy Value. The exact amount principally depends on your type of policy.
- After the increase you will have a larger fund with which to take tax free cash, buy a spouse's pension or take any of a range of flexible ways of taking your pension on the open market from other pension providers such as income drawdown or with-profits annuity, on retirement.
- You are no longer exposed to the risk that your GAR option could fall in value or have no value at all if market annuity rates rise.
- Your future policy will not have the risk of bearing the cost of the Society fighting an expensive and lengthy battle arising from claims by non-GAR policyholders. If these claims were to be successful most would represent 'prior' claims on the fund, payable before any bonuses are allocated to policies.
- Your policy is likely to grow faster because the Society will have greater investment flexibility.
- A larger fund will be available for your beneficiaries if you should die before retirement.
- Bonuses will not need to be cut to meet increases in the cost of GAR policies.
- You will belong to a Society with a stronger financial footing.

So what are the disadvantages to you?

- You give up the right to a GAR when you retire. If current annuity rates have fallen further by the time you retire, the guarantee would be more valuable.

How will this affect you?

How the compromise will affect non-GAR policyholders

The following examples illustrate the typical effect of the proposed compromise on different non-GAR policyholders:

Example 1
Non-GAR pension policies bought after June 1996 (i.e. without 3.5% guaranteed annual growth)

	Guaranteed value	Total Policy Value
Basic % increase	4.0%	1.4%
Additional % increase from the Halifax £250 million (see note 1)	-	1.1%
Total % increase	4.0%	2.5%
Example A		
Value now	£94,000	£100,000
Increase in value if the compromise is agreed	£3,760 (4.0%)	£2,500 (2.5%)
New value	£97,760	£102,500
Example B		
Value now	£120,000	£105,000
Increase in value if the compromise is agreed	£4,800 (4.0%)	£2,625 (2.5%)
New value (see note 3)	£124,800	£107,625

Example 2
Non-GAR pension policies bought before July 1996 (i.e. with 3.5% guaranteed annual growth)

	Guaranteed value (see note 2)	Total Policy Value
Basic % increase	0.5%	1.4%
Additional % increase from the Halifax £250 million (see note 1)	-	1.1%
Total % increase	0.5%	2.5%
Example A		
Value now	£88,000	£100,000
Increase in value if the compromise is agreed	£425 (0.5%)	£2,500 (2.5%)
New value	£88,440	£102,500
Example B		
Value now	£80,000	£72,000
Increase in value if the compromise is agreed	£400 (0.5%)	£1,800 (2.5%)
New value (see note 3)	£80,400	£73,800

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