

29 November 2001

Dear Policyholder,

This week has seen important progress on both the compromise scheme and our Herbert Smith investigation into previous Boards, their auditors and advisers, and the regulators.

The compromise scheme

On Monday we received the permission of the High Court to move ahead with the compromise scheme. This means we can send the compromise scheme to policyholders for voting.

The scheme documents are now at the printers. You should receive them on 7 or 8 December. If you have not received them by Wednesday 12 December, please contact our compromise scheme helpline on 0870 906 1762, open from 8am on Thursday 6 December. We apologise in advance for their size and complexity. We understand that many policyholders would prefer short, simple documents. There is a lot of information the new Board wishes you to have and by necessity the language of the scheme documents has a strong legal flavour.

We urge you to read the documents thoroughly and then cast your vote. You will see that there are three voting classes. One covers the GAR policyholders who vote on giving up their GAR rights in return for an uplift in their policy values of an average of 17.5%. The non-GAR policyholders vote in two classes; the first on agreeing the GAR uplift, the second on waiving their legal claims relating to GARs in return for a 2.5% uplift in their policy values. Remember, achieving the compromise requires majorities in each voting class, and for those majorities to represent 75% by value. These are very high hurdles. If you support the compromise, you must vote for it.

Your new Board is unanimous in believing that the compromise scheme is in the best interests of all groups of policyholders. We believe it is the only viable way forward to end the GAR-related uncertainties that have caused so much worry for policyholders.

The Herbert Smith Inquiry

As you know, we commissioned the leading lawyers Herbert Smith to examine the conduct of previous Boards, auditors, advisers and regulators.

We have now received their advice on the steps we should take to attempt to recover the losses suffered by the Society resulting from the House of Lords ruling that the Society could not apply different terminal bonuses to GAR and non-GAR policyholders. Based on that advice Herbert Smith is writing to 20 former directors to seek their explanation for a number of issues of concern.

Also as part of the Herbert Smith Inquiry, the forensic accountancy team at PricewaterhouseCoopers (PwC) looked at the work of the Society's former auditors Ernst & Young. The PwC report raises serious concerns. Herbert Smith is writing to Ernst & Young seeking an explanation.

Herbert Smith continues to examine the legal advice provided to the previous Board. Herbert Smith is writing to the previous Board's legal advisors Denton Wilde Sapte, and also to Counsel, seeking an explanation of their advice.

In all these cases (former directors, former auditors and former legal advisers), if we do not receive satisfactory explanations, and if it is cost-effective to do so, we will commence legal proceedings.

On the regulators, we are advised by Herbert Smith to await the outcome of the Penrose Inquiry. We understand that Lord Penrose will submit his report in the second half of 2002. Meanwhile Herbert Smith will continue to examine the recently published Baird Report that investigated the conduct of the regulators from 1999 to 2000 (Lord Penrose has a much larger remit for his inquiry). Once these reports have been published and fully examined, we shall report back to policyholders on any action that we can take.

These are clearly very serious matters. Your new Board has not taken these actions lightly. However we have a duty to act in the best interests of our policyholders in seeking appropriate redress, where possible, and if it is in policyholders' interests for us to do so.

Finally, you may have seen media reports relating to our reinsurance treaty and a letter to the reinsurers signed by Christopher Headdon and dated 1 April 1999. This 'letter of understanding' was brought to the new Board's attention in September of this year. Its existence cast doubt on the amount of cover provided by the reinsurance contract.

We sought an explanation from Mr Headdon and legal advice on the status of the letter from the Society's solicitors, Lovells. While this examination was underway we brought the letter to the attention of the FSA and have kept them informed throughout. We have also successfully clarified the terms of the reinsurance treaty to the satisfaction of the FSA. This is a serious matter and is under examination by both the FSA and Herbert Smith. That said, the Society is and remains solvent.

These continue to be difficult times for everybody involved with the Society, and we do understand policyholder frustration and anxieties. We urge you to consider the compromise scheme carefully and support it as the only fair, realistic and positive way forward for your Society.

Yours sincerely,



Vanni Treves
Chairman



Charles Thomson
Chief Executive