Equitable Life

NEWS RELEASE

For immediate release
26 March 2012

Equitable Life's Preliminary Results Announcement for the year ended 31 December 2011

Equitable Life today published its preliminary results for the year ended 31 December 2011.

Ian Brimecome, Equitable Life's Chairman said: "We continue to make good progress. Through the challenging market environment, the Society's solvency has remained sound and we feel able to maintain the 12.5% enhancement to policy values, payable when policies mature or are transferred. In addition, we shall increase policy values by 2 per cent over 2011."

Chris Wiscarson, Equitable Life's Chief Executive said: "We remain focused on recreating policyholder value. As well as introducing the 12.5% capital distribution in 2011, we successfully transferred 400 administrative staff back into the Society from Lloyds Banking Group. In the last month, we have entered into an agreement with Canada Life where policyholders will be offered a wide range of annuities at highly competitive prices."

The Society marks its 250th anniversary in 2012 and King's College London will carry out research to establish whether financial services organisations learned the lessons from the problems at Equitable Life. King's research will be unveiled on 7 September 2012, the anniversary day itself.

- ENDS -

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Corporate review

The Society's Chairman, Ian Brimecome, and Chief Executive, Chris Wiscarson, on behalf of the Board.

Dear Members

It would not be far from the truth to say that the goings-on of 2011 read like a novel. The Japanese Tsunami, the Arab Spring, the UK riots, and the US and European economies conspired to defy all predictions and leave commentators more uncertain than ever.

Financial performance

Notwithstanding the extraordinary events of 2011, the Society's solvency remained sound. In the year since we announced our proposals to get capital back into your hands, your Board has been resolute in its desire to maintain the 12.5% enhancement to policy values, added to policies when they mature or are transferred, notwithstanding the economic traumas that we have seen day in and day out.

Maintaining the capital enhancement

We are committed to reviewing the level of enhancement each year and we confirm that we propose to hold the 12.5% level until further notice. Given the volatile market conditions that we continue to face, we consider it prudent to hold the level rather than increase it which is the Board's hope and intent for the future.

How the capital distribution works

We conducted extensive policyholder research last November and, while the great majority of policyholders were aware of our capital distribution announcement, they were less clear on the actual way it worked and how it applied to them. We have set down at the end of this review a very simple explanation which we hope is helpful.

Cautious investment strategy

The fundamental economic issue remains whether the Euro can survive in its current form and, if not, what the alternative would be? European leaders have not comprehensively addressed this question and, until they do, it is impossible to feel that there is an economic foundation from which we can truly build.

What this means for the Society is that we continue to invest your assets very conservatively with a great predisposition towards UK government stocks and cash. While this does not provide the income that one would normally require to cover the guarantees under your policies, chasing after high interest rates means saddling ourselves with risks which, quite frankly, we have no appetite for right now.

Managing your assets

BlackRock, our new investment managers, have performed ahead of expectations, delivering gross returns on the Society's assets over 2011 of 9.6%.

Some 8.1% of the 9.6% is a capital gain as asset values have increased. The 8.1% cannot be used to increase policy values, because we hold the assets until the end of their term, ready to cover the cost of maturing policies. This is known as matching.

That means, as interest rates rise or fall, the value of the underlying assets fall and rise correspondingly. And so do our liabilities to the same extent. The impact on the Society is, therefore, minimal unless, for some reason, we choose to move away from that matched position. The great advantage of matching is that our ability to pay actual benefits together with the capital enhancement remains relatively unaffected by interest rate movements. This is by far the best way of managing a closed fund.

Increasing policy values

So, after adjusting the 9.6% gross return for the 8.1% capital gain, the amount that can be passed on to policyholders over 2011 is 1.5%. This amount has to cover expenses and the cost of guarantees, and the effect of that is to show an overall reduction of 0.5%. In deciding a level of increase to your policy values to be applied for 2011, we are much influenced by the underlying return on your assets.

We estimate this to be approximately 2% per annum. Given the overall commendable investment performance in the challenging economic climate, it is this amount of 2% that the Board feels is appropriate to increase your policy values by over 2011.

The importance of solvency

Members will obviously be keen to see just how the economic climate has affected our solvency capital. We are pleased to confirm that our capital has remained at levels where we feel able to maintain the 12.5% enhancement to policy values.

Capital ratios

On page 7, you can see that the amount of capital as at 31 December 2011 amounted to £521m. This is around £170m less than at 31 December 2010. This must be seen in the context of how capital shaped up in the early months of 2009, that dreadful period after the Lehman's collapse when it was under £300m.

As we have said in previous reports to you, we hold capital to protect ourselves against rainy days and, by that analogy, we have been through a torrential storm since mid 2011. That we are able to continue our capital distribution programme is testimony to a very solid performance by the Executive Team.

Capital available for distribution

As a result of the capital enhancement programme announced in 2011, there are now many fewer cases where the underlying policy guarantee exceeds the policy value once the capital distribution is added on. Consequently, the cost of guarantees is expected to be lower and, if this is the case, we estimate that almost £300m above and beyond Excess Realistic Assets is intended to be available for distribution. This serves to emphasise the importance of finding ways to get this capital back to you. We provide further information in our Financial review on pages 10 and 11.

Solvency II

The new European regulations, Solvency II, have become somewhat clearer and they point to the Society and the industry having to hold more capital than currently. The Society is working to be ready for the introduction of the new regulations expected in January 2014. We have asserted in previous reports that holding back capital is not helpful to recreating value for policyholders who retire before they can get their hands on it. So, given the impending Solvency II world, this will not be our last word on how we deliver our fundamentally important objective of getting capital back to you.

Return of administrative staff to the Society

The Society saw another notable achievement in 2011 with the return to the fold of 400 administrative staff from the Lloyds Banking Group. For a decade, the servicing of your policies had been undertaken by staff employed by the Lloyds Banking Group.

As we reported last year, capital release requires significant administrative and systems support and we felt that the most assured way of achieving this was by transferring the administrative services back to the Society. This transition was successfully completed in June 2011, and we pay tribute to the very positive manner in which all of our staff have participated in this change.

Our people strategy

One of the important requirements to achieve a value for money cost base is to closely align the Society's total number of employees with the reduction in policies that inevitably occurs as members take their benefits. We have been very transparent about this with our staff and have explained that we would expect total numbers to reduce by around 50 in 2012 and again in 2013.

The cost of these redundancies will be shown as an exceptional item in the 2012 accounts. An exceptional item in 2012 is the cost of transferring our IT systems, currently hosted by the Lloyds Banking Group, to a new provider. It has been anticipated for some years that such expenditure would be necessary, and it is estimated that transfer costs of approximately £30m will be mitigated by a reduction in the yearly fee payable to the new provider. We are currently undertaking extensive due diligence on the two shortlisted suppliers of the hosting services, before entering into a contract with the preferred organisation later in the year.

Board changes

The day-to-day responsibilities of running the Society have changed markedly with the administration and IT staff coming back in-house. The executive skills required today are different to those required over the last several years.

Finance Director role
Your Board has concluded that the roles of Finance Director and Chief Actuary should not be held by one individual. The combined role of Finance Director and Chief Actuary carried out by Tim Bateman therefore became redundant and, at the end of last year, Tim moved on from the Society. We take this opportunity to thank him for his stewardship during the unprecedented period of economic turbulence. We shall be announcing Tim's replacement as Finance Director in the near future. The Chief Actuary role has been taken on by Martin Sinkinson who was previously Deputy Actuary to the Society.

Our longest serving Director
David Adams will retire from the Board in September 2012. David has made a very considerable contribution to steering the Society through its darkest days. David's penetrating wisdom at Board, Audit and Risk Committee, and Remuneration Committee will be much missed. We thank him warmly. Keith Nicholson will succeed David as Deputy Chairman and Senior Independent Director from July 2012. It is not our intention to appoint a new director to replace David, and Cathryn Riley will join the Audit and Risk Committee to ensure appropriate governance and continuity.

Governance

The governance of the Society through the Board and its committees is key to the success of the Equitable in run-off. The expertise provided by our independent directors and their challenge to the Executive Team remain a vital component to the good running of the Society. Board members regularly meet senior individuals from investment managers BlackRock, property managers Schroders, our internal auditors KPMG, and our external auditors PwC, and the Chairman makes a point of meeting the Financial Services Authority for a private meeting at least once each year.

250th anniversary

Before closing the door entirely on the last decade, we are mindful that September 2012 sees the 250th anniversary of the Society.

Your Board has been clear in its public pronouncements that this is not an anniversary that should be celebrated but one that should be marked. Anything that has been going 250 years, however, ought not to be dismissed lightly. The fact of the matter is that for most of the Society's history, many policyholders demonstrably benefited from their association with the Equitable.

In the years following 2000, uncertainty and distress was caused to hundreds of thousands of policyholders and, worse still, the retirement savings of many individuals were a good deal less than they were anticipating. Much has been said and written about these ten years and we do not propose to add anything more here.

Learning the lessons
How then to mark the 250th anniversary? In our experience, when people are unhappy with the way they have been treated, not only do they want satisfaction in regard to their own particular circumstances, but they also wish to know what has been learnt so that it doesn't happen again.

It was evident as the new millennium progressed, regulators introduced new rules to give proper visibility to the sorts of stresses that would have shown the Equitable's weaknesses in the 1990s. So, while the life assurance industry as prompted by regulation could be deemed to have learned from the Equitable, we can ask whether other financial services organisations were cognisant of the potential causes of the Equitable failure; and, if so, what action did they take?

New research
We are pleased that King's College London has agreed to carry out proper academic research to address the question "Has anyone outside of the life assurance industry learned from the Equitable?". Dick Roberts, Professor of Contemporary History at King's College London will present the research findings on 7 September 2012, the actual day of the 250th anniversary, in the Great Hall at King's College London in the Strand.

We are sure that there will be quite a few policyholders who would wish to come along and, if you are interested, please write to our Company Secretary, Peter Wilmot, at Equitable Life, Walton Street, Aylesbury, Bucks HP21 7QW to reserve a place. Please contact us soon to reserve your seat.

Progress on the Government compensation scheme

As we write, Government compensation payments have started to flow strongly. We take the opportunity to thank the Equitable Members Action Group for their continual prompting of Government to make the payments as quickly as they can.

Time to draw a line

Our policyholder research at the end of 2011 confirmed the findings of a year earlier when policyholders asserted that a line be drawn with the Government compensation scheme being accepted so that payments can proceed, giving closure at last. It has been an unacceptably long and distressing time for policyholders to wait for Government compensation to be paid, and we are sorry that this should have been so.

Recreating value for policyholders

Now, at last, our strategy to recreate policyholder value can be focused exclusively on the future. In this respect, maximising the return on your assets subject to meeting solvency requirements and providing the best value for money cost base are the foundations to achieving our strategy.

We have recently entered into an agreement with Canada Life whereby policyholders will be offered competitive annuity rates when they come to take their pension. We shall continue to encourage policyholders to shop around at retirement so that they can compare the Canada Life annuity with that available on the open market. The most important thing is that policyholders take a decision which provides them with the best income in their retirement.

The agreement with Canada Life, together with the introduction of the 12.5% enhancement to policies as they mature or transfer, are important steps in recreating value for policyholders.

This review is rather longer than in previous years. Much was achieved in 2011 and we wanted to take this important opportunity to share with you the degree of thought going in to running the Society through a period of unprecedented turbulence. Our quest to establish options to return capital to you as fairly as possible continues. We will report further as these options become clear and actionable.

Our determination to recreate policyholder value remains undimmed.

On behalf of the Society's Board of Directors

Ian Brimecome
Chairman

Chris Wiscarson
Chief Executive

23 March 2012

12.5% Capital distribution: your questions answered

How does the capital distribution work?

It is really quite easy. At the point a policyholder decides to leave the Society, we look at the precise underlying policy value as at 31 December 2010 and, for every £1,000, we add an extra £125. We then compare the policy value, plus the 12.5% enhancement with any underlying guaranteed benefit, and pay out the larger figure. The Annual Statement that you received showed both the transfer value as enhanced by the 12.5% and the guaranteed value, so a comparison is easy.

How did you tell policyholders about the capital distribution?

We enclosed a leaflet with your Annual Statement as shown below.

Equitable Life

IMPORTANT INFORMATION ABOUT THE VALUE OF YOUR POLICY

Dear Policyholder

- The transfer value of your with-profits policy in your Annual Statement includes a 12.5% increase.
- The increase comes from capital that we hold on your behalf to provide a shield against unexpected events. Our strategy is to get some of this capital into your hands as soon as we can.
- For every £1000 of your policy value as at 31 December 2010, we have added £125 which you will receive when your policy matures or you transfer out of the Society.
- The 12.5% increase continues to apply in 2012.
- We will review this each year and it may go up or down should market conditions significantly change. Our hope is it will be maintained or increased over time.

Good news for policyholders

Why is it only being paid to policyholders when they leave?

Because that is the most appropriate time to see that policyholders get their fair share of the Society's capital. We have set the 12.5% capital distribution at a level that we consider is sustainable. We will review this each year and it may go up or down should market conditions significantly change. Our hope is it will be maintained or increased over time.

Are policyholders being paid to leave?

Certainly not. We see the position as rewarding those policyholders for their loyalty when it comes to their retirement. Our job is to be clear and transparent in explaining to policyholders what their policies will deliver, and this is what we are doing. In the year since the introduction of the 12.5% enhancement, there has been absolutely no increase to the number of policyholders moving on from the Society.

Is the 12.5% enhancement certain to be paid?

No. The amount of the enhancement may go up or down in the future. That may happen if, for example, investment conditions change significantly. Also, guaranteeing benefits always requires the Society to hold back more capital – exactly the opposite of what we want to do.

Why doesn't the guarantee under my policy increase by the 12.5%?

Any uplift to the guarantees would not represent a fair distribution of capital because it is the guarantees that require us to hold such a large amount of capital in the first place. Indeed, it is capital that is utilised to make up any gap between the underlying policy value and the guaranteeing itself. If we were to increase the guarantee for any reason, that would require the Society to hold more capital; the very opposite of what we are trying to achieve.

Is this 12.5% in addition to the amount you announced in 2011?

No. We are pleased to confirm that we are maintaining the 12.5% increase into 2012.

Will there be enough money left for policyholders who don't leave for some years?

In setting the 12.5% capital enhancement, the Board has gone to great pains to satisfy itself that the Society strikes an appropriate level of fairness between those policyholders who transfer and those who stay. It was at the front of our mind not to do something which would lead to less security for those members who stayed. We have set the 12.5% capital distribution at a level that we consider is sustainable. We shall review this from time to time with the intention that, if appropriate, it may increase.

Excess Realistic Assets

The excess of realistic assets over liabilities ("ERA"), is the amount 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 2011, ERA were £521m, a decrease of £173m over the previous year-end position. The analysis of the with-profits assets and liabilities is as follows:

	2011 £m	2010 £m
Realistic value of with-profits assets	5,548	5,479
less:		
Policy values	3,609	3,845
Future charges	(288)	(294)
Impact of early surrenders	(15)	(19)
Cost of guarantees	1,130	755
Other long-term liabilities	360	324
Other liabilities	231	174
	5,027	4,785
Excess Realistic Assets	**521**	**694**

A description of the above liabilities is set out in Note 12f on page 48. The increase in the cost of guarantees from £755m at 31 December 2010 to £1,130m at 31 December 2011 is primarily as a result of the large decrease in interest rates during 2011.

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

	2011 £m	2010 £m
Opening Excess Realistic Assets	**694**	**675**
Investment performance net of changes in policy values	(129)	136
Variances in expenses and provisions	(18)	(90)
Effect of HCL agreement	-	(130)
Mortality experience and assumption changes	(27)	-
Surrender experience and assumption changes	(8)	(4)
Changes in other valuation assumptions	7	92
Other movements	2	15
Closing Excess Realistic Assets	**521**	**694**

The reduction of £129m shown against investment performance is primarily as a result of decreasing corporate bond values.

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 the following sections.

Investment performance

The Eurozone crisis made headline news for much of the second half of 2011. Corporate bond values, particularly those issued by banks, decreased significantly with fears that a number of European countries would be unable to service their debts. Many investors, including the Society, chose to direct funds towards UK Government stocks where interest rates fell markedly in the second half of the year.

At the end of 2011, the asset mix of the with-profits fund was 56% gilts (over a fifth of which are short term), 28% corporate bonds, 8% cash, 4% property and 4% other investments.

The Society has no bond holdings in Greece or Portugal and relatively small holdings in Spain, Italy and Ireland.

The Society continued its strategy of carefully matching the outgoings from maturities with the income from its assets. That means as interest rates rise or fall, the Society's ability to pay actual benefits remains relatively unaffected. This is by far the best way of managing a closed fund.

In line with previous years, the Society maintained its cautious approach to investment management by reducing its holdings in equities and property as these are not particularly suitable for matching the Society's liabilities. In 2011 the Society completed property sales of £193m (2010: £100m) and equity sales of £96m (2010: £100m).

UK equity markets were down by approximately 5% during 2011 and property markets were broadly flat. Although interest rates in the first half of 2011 were stable, over the second half of the year there was a large decrease.

Investment performance (continued)

The assets backing UK with–profits policies produced a gross return of 9.6% for the year. The most significant contributor to the return arose from Government bond yields which fell by approximately 1.5% 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 from the gross return of 9.6% to 1.5%. The net return on the fund for the year, after deducting charges for expenses of 1% and guarantees of 0.5%, and after adjusting for tax and the effect of changes in accounting and technical provisions, is -0.5%.

The Society is a mutual organisation in run-off and the Society's strategy of matching assets and liabilities requires a more cautious investment strategy than many other life offices. Under the Society's direction, our investment manager, BlackRock, has created a benchmark portfolio which targets the highest expected return subject to our cash flow matching and capital requirements. The Society is, as a result, able to measure the performance of the investment manager objectively.

The figures below represent only the performance of the fixed-interest element of the with-profits fund over 2011.

Performance of UK with-profits fixed-income portfolio	2011 Returns
Benchmark portfolio	8.6%
Actual portfolio	9.7%
Excess return	1.1%

BlackRock are targeted to outperform the benchmark by an average of 0.15% p.a. over a rolling three-year period.

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 on the returns achieved on the Society's assets. The returns achieved on, and the outlook for, the Society's corporate bond, property and relatively small equity portfolio, where values and liquidity are directly affected by market conditions, are more volatile than UK Government bonds. The dependence on property and equity returns has been significantly reduced over recent years following our disinvestment from those asset types.

As circumstances permit, the Society manages changes in the levels of payouts so that they are gradual and smooth, reflecting the underlying trend of investment returns. In adverse scenarios, however, and especially where investment returns are poor, there is limited scope for smoothing.

While recognising that the net return on the fund for 2011 has been -0.5%, the Board believes that it is appropriate to smooth out the effects of short-term investment performance. Following the valuation at the end of 2011, and taking into account the outlook for longer-term returns on with-profits investments, the Board has confirmed that, for UK with-profits policies, until further notice, policy values will increase at 2% p.a. for UK pensions policies (1.6% p.a. for UK life assurance policies).

The Board started the process of distributing solvency capital to policyholders on 1 April 2011. At that time, a sum equivalent to 12.5% of policy values at 31 December 2010 was earmarked to enhance payments for with-profits policies that mature or are transferred. We have conducted a further review of the capital required to meet regulatory requirements, both now and under a wide range of possible future economic conditions, and the Board are maintaining the 12.5% enhancement. The level of enhancement has been derived on a cautious basis to ensure that exiting policyholders do not disadvantage those who remain. Payout levels are kept under regular review.

Expenses and provisions

On 6 June 2011, the Society brought its administration services back in-house. The Board has been actively seeking ways to reduce the administration costs so that we have the right cost profile for a business in run-off. During 2011, a number of operational efficiencies were implemented including the launch of Lean Manufacturing, a methodology which promotes continuous improvement and operational excellence within the business.

The Society's IT hosting contract with the Lloyds Banking Group ("LBG") expires in 2013, and a project has commenced to move the IT systems to a dedicated IT organisation. It is expected that this transition will cost the Society approximately £30m. We anticipate a reduction in the ongoing costs of IT support as a result.

Administration costs of non-reinsured policies for 2011 were £33m (2010: £33m). Up to 5 June 2011, administration of reinsured policies was carried out by LBG. After that date, administration for these policies has been carried out by the Society, and administration costs have been charged to LBG. The charges made to LBG for the period from 6 June 2011 to 31 December 2011 were £2m (2010: £nil). The cost of projects reduced to £21m in 2011 (2010: £33m). Claims handling expenses in 2011 were £1m (2010: £1m).

The Society has a continuing obligation to LBG 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 2011, provision has been made for contribution payments of £16m in the period to 1 March 2016 (£28m at 31 December 2010), and for the estimated Scheme deficit of £100m (£83m at 31 December 2010). The Scheme deficit has increased principally as a result of falling equity values and falling interest rates. Payments in respect of the deficit of £7m were made during 2011.

Investment costs increased during 2011 to £8m (2010: £7m), with higher costs from BlackRock being offset, to a limited extent, by lower charges from the property portfolio.

We are required to show the increase in pension provision as a cost and, taking this into account, overall expense costs increased to £89m in 2011 (2010: £81m).

The Society currently levies charges for expenses on with-profits policies at the rate of 1% p.a. and a charge of 1% of policy values was levied for 2011.

Valuation assumptions

In the valuation at the end of 2011, a number of assumptions have been updated. We have continued to observe policyholders deferring their retirement decisions. Furthermore, the Society has adopted new mortality assumptions in respect of the remaining annuity business which reflect the continuing improvements in longevity in the population. The combined effect of these changes has reduced the ERA by £20m.

Protection of the fund and policyholder behaviour

The Society aims for the amounts paid out to maturing and exiting policyholders to be fair while not disadvantaging continuing policyholders. In particular, exiting policyholders must not leave on terms that would cause the future solvency of the Society to be impaired or payout prospects to be reduced. If adverse conditions arise, the Society will act to reduce payout levels, such as in 2009 when policy values were reduced.

Protection of the fund and policyholder behaviour (continued)

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 2011. 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 a forced seller of property or private equity holdings in order to make payments to surrendering policyholders, assets and liabilities would 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 lower levels of claims in 2011. With-profits claims decreased to £383m from £441m in 2010. Changes in the pattern of surrenders have been reflected in the realistic assumptions, which have resulted in a reduction in the ERA of £8m (2010: a reduction of £4m).

Allowance has been made in realistic liabilities for future discretionary non-guaranteed bonuses. It continues to be 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. We are seeing a general deferral of retirement decisions and that deferral is taken into account within the valuation assumptions. If 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 12f 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 Financial Services Authority ("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, from 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%.

As we explained last year, the current regulatory framework will be replaced by the Solvency II regime, a Europe-wide regulatory basis for establishing capital requirements for insurance companies. The Society continues to prepare for the Solvency II implementation date which is now expected to be 1 January 2014. The change to the Solvency II capital requirements is likely to require the Society to hold more capital than under the current regime.

In assessing the level of enhancement to payouts as set out above, the Board has taken into account a number of the planned changes under Solvency II. Further changes in Solvency II capital requirements could have an impact on the speed of the Society's capital distribution plans.

Capital distribution and charges for guarantees

As a result of the payout enhancement introduced on 1 April 2011, the cost of meeting policy guarantees as policies exit the fund has reduced.

Within the annual valuation we do not make an allowance for future capital distribution. It is instructive, however, to assess the working capital of the fund under the alternative assumptions shown below: one which assumes no future capital distributions; one which shows the future capital distributions.

	Assuming No Future Capital Distributions £m	Assuming Future Capital Distributions £m
Realistic value of with-profits assets	**5,548**	**5,548**
less:		
Policy values	3,609	3,609
Future capital distributions	-	801
Future charges	(288)	(152)
Impact of early surrenders	(15)	(15)
Cost of guarantees	1,130	722
Other long-term liabilities	360	352
Other liabilities	231	231
Total realistic liabilities	5,027	5,548
Working Capital for Fund (ERA)	**521**	**-**

The key point to note is that in order to assess the potential capital available for distribution in the years ahead, one should make reference to the future capital distributions of £801m in the alternative presentation. The difference between that figure and the ERA of £521m, some £280m, is intended to be available under the Society's distribution plans.

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 financial position of the Society has been projected under a range of economic scenarios, which take into account consequential policyholder behaviour, in order to assess how robust the Society remains in adverse conditions. The projections make allowance for capital distributions. The Board has also considered both contingent liabilities and uncertainties 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 reductions to 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 2011

Technical account - long-term business

	Notes	2011		2010	
		£m	£m	£m	£m
Earned premiums, net of reinsurance					
Gross premiums written	2a	76		90	
Outward reinsurance premiums	3	(16)		(19)	
			60		71
Investment income	4a		263		292
Unrealised gains on investments	4c		333		178
Other technical income			4		3
Total technical income			**660**		**544**
Claims incurred, net of reinsurance					
Claims paid - gross amount	5	473		545	
Reinsurers' share	3	(37)		(53)	
			436		492
Change in provision for claims - gross amount	5		(1)		(2)
			435		490
Changes in other technical provisions, net of reinsurance					
Long-term business provision - gross amount	12a	100		(9)	
Reinsurers' share	3,12c	(15)		(22)	
			85		(31)
Technical provisions for linked liabilities - gross amount	12b	(57)		228	
Reinsurers' share	3,12c	105		(227)	
			48		1
Net operating expenses					
Administration expenses non-reinsured policies	6a	33		33	
Administration expenses reinsured policies	6a	2		-	
Exceptional expenses - former pension scheme	6b	24		7	
Exceptional expenses - projects	6b	21		33	
			80		73
Investment expenses including interest	4b		8		7
Other technical charges			1		1
Taxation attributable to the long-term business	8a		3		3
			92		84
Total technical charges			**660**		**544**
Balance on the Technical Account			-		-

The results for 2011 and 2010 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 2011

Assets

	Notes	2011 £m	2010 £m
Investments			
Land and buildings	9a	174	320
Investments in Group undertakings	9b	27	25
Shares and other variable yield securities and units in unit trusts	9c	158	228
Debt and other fixed-income securities	9c	5,235	4,220
Deposits and other investments	9c	454	1,109
		6,048	**5,902**
Assets held to cover linked liabilities	10	**288**	**240**
Reinsurers' share of technical provisions			
Long-term business provision	12c	379	364
Technical provisions for linked liabilities	12c	1,845	2,064
		2,224	**2,428**
Debtors	11		
Debtors arising out of direct insurance operations		4	5
Debtors arising out of reinsurance operations		1	
Other debtors		13	12
		18	**17**
Other assets			
Cash at bank and in hand		**9**	**11**
Prepayments and accrued income			
Accrued interest and rent		82	85
Other prepayments and accrued income		1	1
		83	**86**
Total assets		**8,670**	**8,684**

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

Liabilities

	Notes	2011 £m	2010 £m
Technical provisions	12a & 12g		
Long-term business technical provision – gross amount		6,306	6,206
Claims outstanding		–	1
		6,306	**6,207**
Technical provisions for linked liabilities	12b	**2,133**	**2,304**
		8,439	**8,511**
Provision for other risks and charges	15	100	77
Creditors			
Creditors arising out of direct insurance operations		21	25
Creditors arising out of reinsurance operations		–	1
Amounts owed to credit institutions	16a	5	5
Other creditors including taxation and social security	16b	89	44
		115	**75**
Accruals and deferred income		**16**	**21**
Total liabilities		**8,670**	**8,684**

These financial statements were approved by the Board on 23 March 2012 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 in respect of the non-depreciation of investment properties as explained in Note1i. The financial statements do not include a cash flow statement under the exemption for mutual life assurance companies within 'FRS 1 Cash flow statements'.

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 11.

Up to 6 June 2011, certain administrative expenses were incurred in respect of customer support services provided by companies that are part of the Lloyds Banking Group ("LBG"). Since 6 June 2011, the Society has IT services provided by LBG and has funding commitments in connection with former staff pension arrangements. References to LBG in these accounts relate to various LBG companies.

The aggregate size of the Society's remaining subsidiary companies is 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 LBG 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 as described in section l. on page 34.

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.

The Board started the process of distributing solvency capital to policyholders on 1 April 2011 by enhancing with-profits policy values when a claim is made.

No allowance is made within the long-term business provision for the capital distribution plans. Capital distribution amounts paid in respect of policies which mature or transfer are included in claims paid.

1. Accounting policies (continued)

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. Where possible fair value is based on market observable data, which is used to determine a bid market valuation. Where market observable data is not available or is inadequate it will be supplemented by broker or dealer quotations, the market values of another instrument that is substantially the same or other appropriate valuation techniques.

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 as defined in the Royal Institute of Chartered Surveyors ("RICS") Valuation Standards, 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

	2011 Premiums £m	2010 Premiums £m
a. Analyses of gross premiums written are as follows:		
Individual premiums	74	87
Premiums under group contracts	2	3
	76	**90**
Regular premiums	34	39
Single premiums	42	51
	76	**90**
Premiums from non-profit contracts	42	47
Premiums from with-profits contracts	28	37
Premiums from linked contracts	6	6
	76	**90**
Premiums from life business	17	19
Premiums from annuity business	1	1
Premiums from pension business	58	70
	76	**90**
Premiums from UK business	74	88
Premiums from overseas business	2	2
	76	**90**

	2011 Premiums £m	2010 Premiums £m
b. Gross new business premiums		
Individual premiums	42	51
Premiums under group contracts	1	1
	43	**52**
Regular premiums	1	1
Single premiums	42	51
	43	**52**
Premiums from non-profit contracts	23	24
Premiums from with-profits contracts	16	22
Premiums from linked contracts	4	6
	43	**52**
Premiums from life business	-	-
Premiums from annuity business	-	-
Premiums from pension business	43	52
	43	**52**
Premiums from UK business	43	52
Premiums from overseas business	-	-
	43	**52**

2. Earned premiums (continued)

b. Gross new business premiums (continued)

Annual equivalent premiums in respect of new business received during the year were £5m (2010: £6m). New premiums in respect of reinsured business during the year were £4m (2010: £6m).

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 above. Total deposits received in 2011 were £41m (2010: £49m) and new premium deposits were £9m (2010: £22m).

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 (now part of LBG), 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 LBG.

Premiums and deposits received from policyholders in respect of reinsured business are immediately forwarded to LBG. LBG 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 LBG, if the Society were to become insolvent, or reasonably likely to become insolvent in the opinion of the reinsurer's board, LBG 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 £46m (2010: gains of £416m), is a net debit of £159k (2010: £470k credit).

4. Total investment return

	2011 £m	2010 £m
a. Investment income comprises income from:		
Land and buildings	13	19
Other investments	228	260
	241	279
Net gains on realisation of investments	22	13
Investment income and net realised gains at fair value through the Profit and Loss Account	**236**	**292**
b. Investment expenses including interest comprise:		
Investment management expenses	**8**	**7**
c. Investment activity account		
Investment income	241	279
Realised investment gains/(losses)	22	13
Unrealised investment gains/(losses)	333	178
Total fair value investment income and net gains at fair value through the Profit and Loss Account	596	470
Investment management expenses and charges	(8)	(7)
Investment return for the year	**588**	**463**

Included within the tables above is £48m net gain (2010: £2m net gain) in respect of derivative instruments designated as held for trading, and £10m unrealised loss (2010: £11m 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. Claims incurred - gross

	2011 Claims £m	2010 Claims £m
Claims paid - gross amount	473	545
Change in provision for claims - gross amount	(1)	(2)
Gross claims	**472**	**543**

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

	2011 Claims £m	2010 Claims £m
Gross claims paid comprise:		
On death	32	32
On maturity	264	327
On surrender	104	108
By way of periodic payments	71	75
Claims handling expenses	1	1
	472	**543**
Life and annuity business	58	97
Pension business	413	445
Claims handling expenses	1	1
	472	**543**
Linked business	27	39
Non-profit business	61	62
With-profits business	383	441
Claims handling expenses	1	1
	472	**543**
UK business	452	522
Overseas business	19	20
Claims handling expenses	1	1
	472	**543**

Included in the above payments are capital distribution amounts, attributable final and interim bonuses for the Society of £33m (2010: £19m).

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 2011 were £155m (2010: £183m).

6. Net operating expenses

	2011 £m	2010 £m
a. Non-exceptional		
Administration expenses non-reinsured policies	33	33
Administration expenses reinsured policies	2	-
Administrative expenses	**35**	**33**

From 6 June 2011, the administration expenses include the costs of administering reinsured policies. Administration costs in relation to reinsured policies are recovered and recognised in 'Other technical income'.

b. Exceptional

The Society incurred the following exceptional expenses during the year:

	2011 £m	2010 £m
Costs of former pension scheme	24	7
Costs of strategic initiatives	19	30
Other projects	2	3
	45	**40**

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 9, exceptional expenses increased following a review of pension commitments. Costs for strategic projects included the costs associated with the transfer of administration back to the Society, continuing development of the Society's capital distribution strategy and initial activity to identify a new IT service provider.

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 and 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:

	2011 £m	2010 £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	0.2	0.1
All other services	0.1	0.6
	0.8	**1.2**

Non-audit fees in 2011 primarily relate to work performed by PwC on the interim review.

7. Directors and employees

	2011 £m	2010 £m
a. Staff costs		
Wages and salaries	9	4
Social security costs	1	-
Pension costs	1	-
	11	**4**

The monthly average number of employees employed by the Society up to 6 June 2011, including executive Directors, required to be disclosed in accordance with the Companies Act 2006, was 20 (2010: 21). During this time, under its agreement with LBG, the Society used the services of LBG staff. From 6 June 2011 the monthly average number of employees employed by the Society, including executive Directors, increased to 367 following the transfer of administration services back to the Society.

Following the transfer of administration services on 6 June 2011, a group personal pension plan has been made available to all employees. Pension costs represent the employer contribution to this plan and are based on a percentage of salary.

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 21 to 26.

c. Former staff pension arrangements

As a result of contractual commitments arising as part of the agreement entered into with HBOS (now part of LBG) 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 LBG as a result of the sale transaction. An amount of £100m (2010: £83m) is provided in respect of the contractual commitment to LBG in relation to the defined benefit scheme, following the triennial actuarial valuation performed as at 31 December 2010, as modified for relevant changes to the current balance sheet date. An additional provision of £16m (2010: £28m), representing an estimate of the current value of the contractual commitment to LBG in respect of future service costs until 2016, and a provision for future staff pension scheme administration costs of £3m (2010: £3m) 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 finally settle the position in 2016 could produce a different result.

8. Taxation

	2011 £m	2010 £m
a. Taxation charged to the Technical Account		
UK corporation tax		
Current tax on income for the period	3	2
Adjustments in respect of previous years	-	1
Total charge	**3**	**3**

The UK corporation tax charge is provided at 20% (2010: 20%), computed in accordance with the rules applicable to life assurance companies, whereby no tax is charged on pension business profits.

	2011 £m	2010 £m
b. Deferred taxation asset		
Provided in the financial statements:		
Deferred tax of the long-term fund		
Unrealised depreciation/(appreciation) in investments	1	1

Deferred taxation not provided for in the accounts relates to unrealised losses on the reinsured book and is estimated at £1m. A deferred taxation asset has not been recognised in this regard due to uncertainty of recovery.

9. Non-linked investments

	Current Value		Cost	
	2011 £m	2010 £m	2011 £m	2010 £m
a. Land and buildings				
Society				
Leasehold	115	112	110	110
Freehold	59	208	64	271
	174	**320**	**174**	**381**

The Society invests indirectly in property through specialised unit trusts, which are classified as 'Other financial investments' (see Note 9c). Total property-related investments at 31 December 2011 are £198m (2010: £379m).

9. Non-linked investments (continued)

	Current Value 2011 £m	Current Value 2010 £m	Cost 2011 £m	Cost 2010 £m
b. Investments in Group undertakings				
Shares	**27**	**25**	**24**	**24**

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 2011 of £6m (2010: £6m). BSRE's principal investment is cash and its loss for 2011 was £25k ($39k) (2010: profit £71k ($111k)).

The Society holds a majority investment in Equitable Private Equity Holdings Limited ("EPEHL"), a Guernsey registered company with a value as at 31 December 2011 of £21m (2010: £19m). EPEHL's investment is Knightsbridge Integrated Holdings V L.P., which invests in equity and venture capital projects. EPEHL made a loss in 2011 of £29k ($45k) (2010: £31k ($48k)) and its total capital value is £21m ($34m) (2010: £19m ($31m)).

	Current Value 2011 £m	Current Value 2010 £m	Cost 2011 £m	Cost 2010 £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)	78	193	158	258
Other variable income and securities(2)	80	35	24	26
	158	**228**	**182**	**284**
Debt securities and other fixed-income securities(3)	**5,235**	**4,220**	**4,911**	**4,095**
Deposits and other investments	**454**	**1,109**	**454**	**1,109**
	5,847	**5,557**	**5,547**	**5,488**

Notes:

(1) Includes listed investments of £nilm (2010: £63m) 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 £5,120m (2010: £4,216m) for the Society at fair value.

During the year, the Society has undertaken stock lending but this is not reflected on the Balance Sheet as the beneficial ownership of assets lent remains with the Society. Stock lending is undertaken to support market liquidity. Investments of £780m (2010: £623m) were lent in the normal course of business to authorised money brokers on a secured basis. Investments of £817m (2010: £641m) were received as collateral from brokers. Income earned on stock lending during the year, net of fees paid, was £0.3m (2010: £1m).

Collateral is government obligations issued or guaranteed by states which are full members of the Organisation 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 valuation techniques use market observable data wherever possible, including prices obtained via pricing services, dealer quoted prices, or models such as net asset value.

For fixed-income securities for which there is no active market, the fair value is based on prices obtained from pricing services or 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; and
- 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 2011 Asset category	Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m	Other Assets £m	Balance Sheet Total £m
Land and buildings	-	-	-	**-**	174	**174**
Investments in Group undertakings	-	-	27	**27**	**-**	**27**
Shares and units in unit trusts	-	-	78	**78**	**-**	**78**
Other variable income securities	-	-	80	**80**	**-**	**80**
Debt securities and other fixed-income securities	3,297	1,570	368	**5,235**	-	**5,235**
Deposits and other investments	30	423	1	**454**	-	**454**
Total non-linked invested assets	**3,327**	**1,993**	**554**	**5,874**	**174**	**6,048**
Assets held to cover linked liabilities	206	11	71	**288**	-	**288**
Total invested assets	**3,533**	**2,004**	**625**	**6,162**	**174**	**6,336**

9. Non-linked investments (continued)
d. Fair value hierarchies (continued)

(iii) The change in the distribution of assets between Level 1 and Level 2 during the year reflects purchases and disposals of assets. 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 2011	355
Total net gains or (losses) recognised in the Profit and Loss Account	34
Purchases	5
Sales	(41)
Transfers into Level 3	275
Transfers out of Level 3	(3)
Balance at 31 December 2011	**625**

The total net gains shown above are included within 'Unrealised gains on investments' within the Profit and Loss Account, of which £57m gain relates to assets which were still held at the end of the period.

Twenty-seven stocks, of total value £275m, were transferred into Level 3 during the period as their valuation was based on inputs that are no longer observable for those assets.

Three stocks, of total value £3m, were transferred from Level 3 to Level 2 during the period as market observable inputs for these assets became available.

10. Assets held to cover linked liabilities

	2011 £m	2010 £m
Current value of linked assets held at fair value through the Profit and Loss Account	**288**	**240**

The cost of assets held to cover linked liabilities is £215m (2010: £208m) for the Society.

11. Debtors

	2011 £m	2010 £m
Debtors arising out of direct insurance		
Amounts owed by policyholders	4	5
Debtors arising out of reinsurance	1	-
Other debtors		
Corporation tax debtor	-	1
Deferred tax asset	1	1
Debtors other than Group and related companies	12	10
	18	**17**

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.

12. Technical provisions

a. Gross long-term business technical provisions

With-profits technical provisions	2011 £m	2010 £m
With-profits insurance technical provisions		
Policy values	235	258
Future charges	(30)	(29)
Impact of early surrenders	(1)	(1)
Cost of guarantees	79	55
Other long-term liabilities	64	60
	347	**343**
With-profits investment technical provisions		
Policy values	3,374	3,587
Future charges	(258)	(265)
Impact of early surrenders	(14)	(18)
Cost of guarantees	1,051	700
Other long-term liabilities	296	264
	4,449	**4,268**
Excess Realistic Assets	**521**	**694**
	5,317	**5,305**

Non-profit technical provisions		
Non-profit insurance technical provisions	978	890
Non-profit investment technical provisions	11	11
	989	**901**
Total long-term business technical provisions	**6,306**	**6,206**

b. Gross linked liabilities

	2011 £m	2010 £m
Index-linked annuities	299	249
Other linked insurance liabilities	130	149
Other linked investment liabilities	1,704	1,906
Total linked liabilities	**2,133**	**2,304**

12. Technical provisions (continued)

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

	2011 £m	2010 £m
Non-profit insurance technical provisions	368	353
Non-profit investment technical provisions	11	11
	379	**364**
With-profits insurance technical provisions	-	-
With-profits investment technical provisions	-	-
Index-linked annuities	11	9
Other linked insurance liabilities	130	149
Other linked investment liabilities	1,704	1,906
	1,845	**2,064**
Total reinsurers' share	**2,224**	**2,428**

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

	2011 £m	2010 £m
At 1 January	1,917	1,820
Change arising from new deposits	41	49
Change arising from withdrawals	(155)	(183)
Other changes	(88)	231
At 31 December	**1,715**	**1,917**

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) on the following page.

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	
	2011	2010	2011	2010
Non-profit annuities in payment				
Basic Life and General Annuity business - pre 1992	3.90	4.66	£10.00 p.a.	£3.13 p.a.
Basic Life and General Annuity business - post 1991	3.51	4.19	£10.00 p.a.	£3.13 p.a.
Pension business	3.90	4.66	£10.00 p.a.	£3.13 p.a.
Index-linked annuities in payment				
Basic Life and General Annuity business - pre 1992	-0.51	0.52	£10.00 p.a.	£3.13 p.a.
Basic Life and General Annuity business - post 1991	-0.46	0.47	£10.00 p.a.	£3.13 p.a.
Pension business	-0.51	0.52	£10.00 p.a.	£3.13 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 updated to reflect latest experience data. Fixed-interest yields and index-linked yields have fallen compared to those at the end of 2010. The changes to the valuation interest rates in aggregate have increased the index-linked annuity provision by £39m and increased the non-profit technical provisions by £44m. 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. (2010: 0.11% p.a.). The per policy expense allowance in the basis reflects an assessment of future variable administration costs; the increased allowance reflects improved analysis and attribution of the variable elements of costs following the insourcing of administration as previously advised. This reallocation of expenses results in a higher expense provision for annuities and a corresponding reduction in the expense provision for with-profits business. The expense allowance has been assumed to increase at 3.2% p.a. (2010: 3.4% p.a.). The expense allowances for 2011 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 £5m.

(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 volume of recent annuitant mortality experience data is decreasing as a result of past disposals of blocks of annuity business. This leads to a greater degree of uncertainty in the experience analysis and will require greater weight to be given to wider industry data in the future. The overall effect of this year's review of mortality has been to increase index-linked annuity and non-profit annuity technical provisions by £27m (2010: increased by £3m).

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 £37m (2010: £30m) 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 (2010: 12 months).

Mortality assumptions by class of business	2011	2010
Non-profit and index-linked annuities in payment		
Basic Life and General Annuity business	75% IML00 cmi2010 (U=2011)* for males	72.5% IML00 ult (U=2010) ** for males
	77.5% IFL00 cmi2010 (U=2011) * for females	77.5% IFL00 ult (U=2010) ** for females
Pension business	75% PNML00 cmi2010 (U=2011) * for males	87.5% PNMA00MC (U=2013) *** for males
(both reinsured and retained business)	65% PNFLA00 cmi2010 (U=2011) * for females	80.0% PNFA00MC (U=2013) *** for females

Notes:

* The allowance for future mortality improvements is based on the mortality improvements as per cmi2010 tables (with a long-term improvement rate of 1.5% p.a. for males, 1.25% p.a. for females).

** The allowance for future mortality improvements is based on the implied future improvements as per IML92/IFL92MC tables (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 PMA92/PFA92MC tables (subject to a minimum improvement of 1.5% p.a.).

12. Technical provisions (continued)

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 12g), 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 (2010: £32m 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 2011 (98% and 2% of the total policy values at 31 December 2010). 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 £755m in 2010 to £1,130m at 31 December 2011 principally as a result of falling Government bond yields. This amount is included within 'Technical provisions' (see Note 12a).

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	2011	2010
Endowment assurances (with-profits)		
Conventional With-Profits business	90.0% AMC00 ultimate for males	90.0% AMC00 ultimate for males
	97.5% AFC00 ultimate for females	97.5% AFC00 ultimate for females
Recurrent Single Premium business	82.5% AMC00 ultimate for males	90.0% AMC00 ultimate for males
	87.5% AFC00 ultimate for females	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. (2010: 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. (2010: 1.0% p.a) is assumed to be deducted each year before making future increases to policy values. In addition, an expense provision of £239m for expenses (2010: £180m) 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 £51m (2010: £46m).

12. Technical provisions (continued)

f. The long-term business provision - with-profits business (continued)

(ii) Assumptions - with-profits business (continued)

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 2010 and 2011. 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 1 year (2010: 2 years) earlier than ECD and up to 12 years (2010: 12 years) later than ECD.

A sensitivity analysis has been carried out to illustrate the potential impact on ERA, at 31 December 2011, 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 £160m (2010: £40m). If the level of interest rates at which behaviour changes is 3.5% and the same period of deferment is assumed, the reduction is £190m (2010: £70m). If the deferral were for a period of up to 10 years, the reduction is £245m (2010: £55m) at 2.5% and £310m (2010: £105m) 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 £54m (2010: £36m) and a similar increase would decrease the value by £34m (2010: £18m).

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 2010 and 2011. 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. (2010: 1.5% p.a.). The effect of the change in the surrender rates has been to decrease the ERA by £13m (2010: decrease by £16m).

A financial adjustment of 5.0% (2010: 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 2010 to 2011 was to decrease the ERA by £63m (2010: increase of £47m). 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 27% (2010: 26%). For property values, the model uses an assumed volatility of 15% (2010: 15%).

g. The long-term business provision - miscellaneous provisions

Technical provisions include amounts in respect of specific provisions:

- Anticipated additional exceptional expenses of £78m (2010: £104m) over future years, including costs of implementing changes in the IT systems provider, contractual commitments to LBG 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 (2010: £2m).

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 LBG (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.

13. Capital statement

a. Analysis of capital

The capital statement in respect of the Society's life assurance business at 31 December 2011 is set out below. These figures are calculated in accordance with the regulations set out in The FSA Handbook of Rules and Guidance.

Available capital resources	2011 £m	2010 £m
Adjustments onto a regulatory basis - valuation differences [1]	439	361
Adjustments onto a regulatory basis - inadmissible assets	(1)	(1)
Total available capital resources	**438**	**360**
Long-term Insurance Capital Requirement (LTICR)	(239)	(238)
With-profits Insurance Capital Component (WPICC)	(199)	(122)
Total regulatory Capital Resource Requirements (CRR)	**(438)**	**(360)**
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. Movement in 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 £438m (31 December 2010: £360m).

13. Capital statement (continued)

b. Movement in available capital resources (continued)

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 LBG to the Society:

Movement in available capital resources	2011 £m	2010 £m
At 1 January	360	613
Investment return and interest rate movements	178	13
Other valuation assumptions	(50)	32
Other movements	(50)	(298)
At 31 December	**438**	**360**

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.

14. Management of financial risk

a. Risk management framework

As described in the Corporate governance section, the Society has 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, regulatory 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 12 and 13, 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 is expected to be replaced in 2014 by the Solvency II regime, a Europe-wide regulatory basis for establishing risk-based 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 investment policy, with-profits investments are mainly in fixed-interest securities, gilts (2011: 56%; 2010: 39%) and corporate bonds (2011: 28%; 2010: 30%).

With regard to unit-linked business, liabilities are reinsured with LBG 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 following table 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.

14. Management of financial risk (continued)

b. Market risk (continued)

Adverse Changes	2011	2010
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	0.8%	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	2011 £m	2010 £m
Above adverse changes – including where long-term gilt yields rise	161	153
Above adverse changes – including where long-term gilt yields fall	187	192

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 were 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:

	2011				2010			
	Assets		Liabilities		Assets		Liabilities	
	£m	%	£m	%	£m	%	£m	%
Currency								
Sterling	8,371	97	7,967	98	8,365	96	7,806	98
Euro	209	2	176	2	214	3	177	2
US Dollar	90	1	6	-	105	1	6	-
Other	-	-	-	-	-	-	-	-
Total	**8,670**	**100**	**8,149**	**100**	**8,684**	**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 (2010: £5m) 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; and

- The risk of default by any of its reinsurers.

14. Management of financial risk (continued)

c. Credit risk (continued)

These risks are monitored by the Society's Executive Investment Committee and its Risk Oversight 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. However, the major reinsurance treaties are with companies in the Lloyd's Banking Group. Because reinsurance does not remove the primary liability of the Society to its policyholders, the credit rating of Lloyds Banking Group and certain of its group companies are monitored closely in order to manage the risk.

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:

2011	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Credit ratings						
Debt and other fixed-income securities	2,984	417	818	518	25	4,763
Other variable yield securities	734	3	14	9	-	760
Total of fixed and variable yield securities	**3,718**	**420**	**832**	**528**	**25**	**5,523**
Deposits with credit institutions	423	-	30	-	-	453
Cash at bank and in hand	-	-	9	-	-	9
Other financial assets	42	5	19	13	22	101
Reinsurers' share of technical provisions and liabilities (Note 12c)	-	-	2,224	-	-	2,224
	4,183	**425**	**3,114**	**541**	**47**	**8,310**

2010	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Credit ratings						
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 12c)	-	-	2,428	-	-	2,428
	3,868	**350**	**3,342**	**490**	**60**	**8,110**

The total of fixed and variable yield securities includes £288m 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 £74.8m (2010: £25.7m) 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 £74.9m and is included in 'Deposits and other investments' in Note 9c.

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 £2,224m for business reinsured with a number of LBG companies (2010: £2,428m). Of the £2,224m total, £1,805m is linked business reinsured with Halifax Life Limited principally invested in regulated Open Ended Investment Companies ("OEIC"), £379m is non-profit business also reinsured with Halifax Life Limited, and £40m is linked business reinsured with companies in the Clerical Medical Group. 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 £7m (2010: £10m) of investments (credit ratings of A: £3m and AAA: £4m) with Lloyds Banking Group.

At the reporting date, no material financial assets were past due nor impaired (2010: £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 Executive 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 60% 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 £251m at year end 2011 (2010: £451m). In adverse market conditions, it may not be possible to realise these investments without delay.

As noted in Note 12f (ii), the majority of RSP benefits can be taken on contractual terms at a range of ages. The following table 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 1 year (2010: 2 years) earlier than ECD and up to 12 years (2010: 12 years) later than ECD.

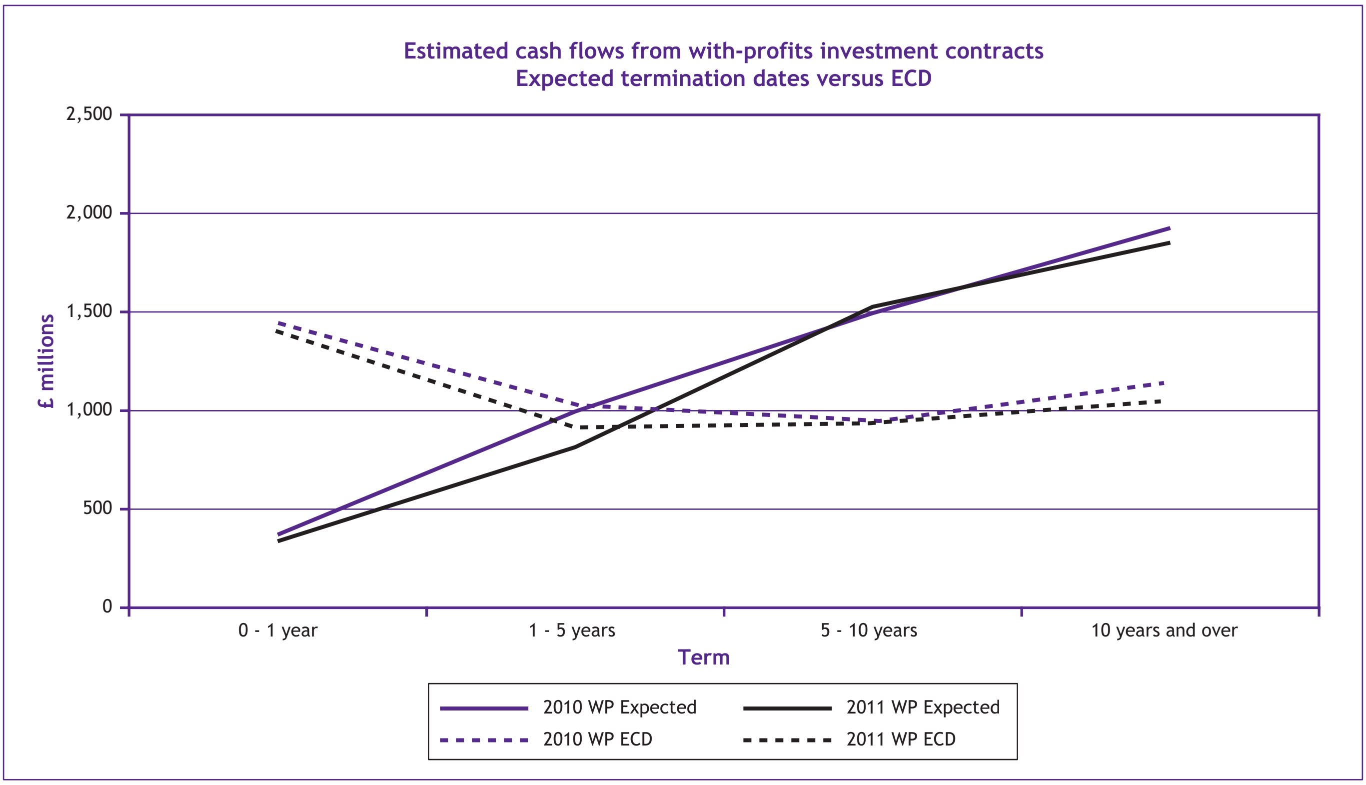
14. Management of financial risk (continued)
d. Liquidity risk (continued)

2011 Estimated cashflows (undiscounted)	0-1 year £m	1-5 years £m	5-10 years £m	10 years and over £m	No Term £m	Total £m	Carrying Value £m
Unit-linked investment contracts	108	524	458	950	-	2,040	1,704
Other non-profit investment contracts	11	-	-	-	-	11	11
With-profits investment contracts	337	814	1,526	1,851	-	4,528	4,449
Other financial liabilities	116	-	-	-	-	116	116
Total financial liabilities	**572**	**1,338**	**1,984**	**2,801**	**-**	**6,695**	**6,280**
Of which reinsured	119	524	458	950	-	2,051	1,715
Total net financial liabilities	**453**	**814**	**1,526**	**1,851**	**-**	**4,644**	**4,565**
Net insurance liabilities	140	274	325	992	-	1,731	1,245
Excess Realistic Assets	-	-	-	-	521	521	521
Total net liabilities	**593**	**1,088**	**1,851**	**2,843**	**521**	**6,896**	**6,331**

2010 Estimated cashflows (undiscounted)	0-1 year £m	1-5 years £m	5-10 years £m	10 years and over £m	No Term £m	Total £m	Carrying Value £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**

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).



With-profits policies with an ECD prior to 31 December 2011 have a contractual value no lower than total guaranteed benefits, and equalled £1.3bn at 31 December 2011 (2010: £1.1bn). The liquid assets referred to above include £3.4bn (2010: £3.1bn) 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.

15. Provision for other risks and charges

	2011 £m	2010 £m
Pension commitments for former staff	100	77
	100	**77**

The provision for pension commitments for former staff is £100m. There was no creditor position with LBG in 2011 (2010: £5.6m). Pension payments for former staff relate to the contractual agreement with LBG (described in Note 7c). The balance of the movements is due to changes in economic assumptions.

16. Creditors

a. Amounts owed to credit institutions

Amounts owed to credit institutions of £5m represent uncleared payments to policyholders (2010: £5m).

	2011 £m	2010 £m
b. Other creditors including taxation and social security		
Balances with Group companies	11	9
Corporation tax	1	-
Derivatives positions		
Obligation to return swaption variation margin to Morgan Stanley	75	25
Forward US$/GBP exchange contract (1)	-	1
Defined benefit pension scheme creditor with LBG (Note 15)	-	6
Other creditors	2	3
	89	**44**

Note:

(1) The fair value of a forward US Dollar and Sterling currency exchange contract (2011: £0.4m liability; 2010: £1.2m liability). If the balance sheet position is held to maturity in March 2012 the Society will be obliged to pay $107.2m and will receive £68.7m.

17. Subsidiary and associated undertakings

a. Principal subsidiary undertakings

The Society has no material subsidiary undertakings, as outlined in Notes 1 and 9.

b. Significant holdings

At 31 December 2011, the Society held more than 20% of the nominal value of a class of equity shares in 5 companies with a value of £8m (2010: 8 companies, value £12m).

At 31 December 2011, the Society held more than 20% of the partnership interests in 1 limited partnership investing in properties with a value of £8m (2010: 1 partnership, value £14m).

At 31 December 2011, the Society held more than 20% of the partnership interests in 4 portfolios investing in private equity investment companies included in 'Shares and other variable yield securities', with a value of £2m (2010: 4 portfolios, value £3m).

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.

18. Related party transactions

There were no material related party transactions during 2011 (2010: £nil).

19. 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 £18.0m (2010: £18.9m) for the Society.

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

20. Contingent liabilities and uncertainties

There exist some uncertainties that, if they were to materialise, could adversely impact on the financial position of the Society.

Claims against the Society in district courts across Germany continue to be defended successfully, with some appeals outstanding, for which legal expenses have been provided. Also outstanding are investigations initiated by the Accountancy and Actuarial Disciplinary Board ("AADB") in respect of the provision of information, advice and audit activity relating to financial statements of Equitable Life in the 1990s.

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

The Board continues to closely monitor the contractual commitments the Society has in respect of the two pension schemes for which LBG is principal employer, as set down in Note 7c 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.

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. Note 14 provides greater detail on the impacts of this on the Society.

The financial position of the Society has been projected under a range of economic scenarios, which take into account consequential policyholder behaviour, in order to assess how robust the Society remains in adverse conditions. The projections make allowance for capital distributions. The Board has also considered both contingent liabilities and uncertainties 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 reductions to 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.