Recreating Value for Policyholders

Equitable Life

Annual Report and Accounts

For the year ended
31 December 2013

The Equitable Life Assurance Society

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Keith Nicholson, Deputy Chairman
Chris Wiscarson, Chief Executive
Simon Small, Finance Director
Ian Gibson, Non-executive Director
Ian Reynolds, Non-executive Director
Cathryn Riley, Non-executive Director

With-profits Actuary
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Chairman's statement

The Society's Chairman, Ian Brimecome, on behalf of the Board

Ian Brimecome

Dear Members

In my four years as Chairman, the Board and its executive led by Chris Wiscarson, has been resolute in executing our strategy of recreating value for policyholders. What this means is a relentless search to find ways to return the Society's capital to you as fairly and as soon as possible.

Chairman's report

We are pleased to announce, therefore, that we will replace the 12.5% capital distribution introduced in April 2011 with a new level equivalent to 25% of policy values as at 31 December 2013. We have also decided to remove the 5% Financial Adjustment currently levied on policy transfers. These significant improvements come about as a result of several important breakthroughs over the last two years:

- We have eliminated all the risks associated with the Staff Pension Scheme, as a result of which a significant amount of the Society's capital has been freed up.
- We have all but withdrawn from our investment in commercial property, with no less than £126m being sold during 2013 leaving a residual portfolio of £5m. Again, this frees up capital held against the risk that property values fall.
- Our very close attention to matching income from our assets to the expected outgoings from policy maturities. This significantly reduces the negative impact of interest rate movements and consequently the capital required to be held against that risk.
- Our decision to withdraw from the annuity market in early 2012. As a result, the Society no longer has to hold capital against new annuities.
- We have replaced a number of our higher risk assets with lower risk assets, so the Society does not need to put as much capital aside for potential defaults.

Together, these steps have led to a very substantial improvement to our capital ratios, providing the foundation for a significant improvement to policy payouts. The new 25% capital distribution will be payable to with-profits policyholders who take their benefits from 1 April 2014 onwards. We cannot guarantee that distribution will always remain at this level if, for example, the economic climate changes significantly for the worse. Having said that, our strategy is to find ways to increase the capital distribution, and our thinking here is described in the Strategic report that follows my statement.

Government Compensation Scheme

We pay tribute to the Equitable Members Action Group ("EMAG") for their untiring commitment in representing policyholders who are dissatisfied with how they have been treated under the Government Compensation Scheme. EMAG also deserve enormous credit for the influence they have brought to bear in securing compensation of £5,000 to with-profits annuitants whose policies had commenced prior to September 1992. These annuitants had been previously excluded from Government compensation.

Solvency II

We are pleased at last to have greater certainty around the introduction of the new European regulations, known as Solvency II. These regulations are expected to be introduced from 1 January 2016. It is likely there will be a greater requirement for capital under Solvency II and we were very mindful of this in deciding that the 25% capital distribution is affordable.

Governance

We welcome Ian Gibson who has joined the Board as a non-executive Director. Ian is a qualified actuary, and his extensive experience of with-profits business will be of great value to the Society. Ian also joins the Audit and Risk Committee.

For many years, the Society has voluntarily adopted the relevant provisions of the UK Corporate Governance Code ("UKCGC"). As a member of the Association of Financial Mutuals, we are also subject to their Annotated Code. These codes set out standards for strong corporate governance with which companies should comply or explain why they have not done so.

In 2013, we commissioned the Board's independent advisor, Nicholas Wells, to carry out a full review of the Society's Board and its Committees. Mr Wells concluded that the Society's Board provides good governance and effective direction to the Society, that structures and processes are clear and well understood, that the Board has an appropriate mix of skills, experience and knowledge, and that a positive tone is set from the top. The principal recommendations together with our plans to respond are set out in the Corporate governance report.

We are satisfied that your Board acts with integrity, diligence and very real purpose in recreating policyholder value.

Serving policyholders

When the time comes to take the benefits under your policy, the process that you go through should be as straightforward and as clear as possible. It has to be said that the options available at retirement and the vocabulary that is often used can be unnecessarily technical. We have endeavoured to simplify the payments process, and we shall be able to make further improvements following the major transfer of our IT support services from the Lloyds Banking Group ("LBG") to Atos.

I am pleased to report that this transfer has taken place successfully. This enables us not only to run our computer systems more economically, but the transfer also gives us much more direct control over the improvements that we can now make to our computerised processes.

Every year, we conduct extensive research with policyholders to obtain their views on how we go about managing the Society. It is heartening to know that there is a clear view among policyholders that the Society is going in the right direction. Far from any complacency creeping in, your feedback acts as a strong stimulus to continue to work hard on your behalf, having obtained a better understanding of what you tell us you want.

Recreating value for policyholders

As for the future, our job is far from complete. We shall continue to reduce the risks of the Society, and we do this by looking at those areas where we continue to require significant capital to be put aside: for bond default and interest rate risk, longevity risk through our residual annuity book, the fixed costs of the Society in run-off, and the risk associated with our reassurance agreements with LBG. How we will go about this is described in the Strategic report that follows.

It remains our firm intention to continue our programme of distributing capital to you, our with-profits policyholders, as fairly and as soon as possible. We consider the new capital distribution of 25% to be the best example of recreating policyholder value at the Society for many years.

Ian Brimecome
Chairman

20 March 2014

Chris Wiscarson

Simon Small

Introduction

The Equitable Life Assurance Society is a mutual company owned by its members. The Society no longer writes any new business and is, therefore, in run-off. We manage the assets of: approximately 165,000 individual with-profits policyholders; 180,000 with-profits policyholders in company pension schemes; 150,000 unit-linked policyholders; and 30,000 annuitants. The majority of the with-profits and unit-linked business is expected to run off over the next 20 years; the annuity business will take longer.

The Society's business model is straightforward. The Society is not open to new sales, so our strategy is exclusively to serve the best interests of our existing policyholders. For those who hold with-profits policies, the Society's capital is essentially their stake in the business. At the end of 2013, that capital amounted to £691m. It is necessary to hold capital to ensure that the Society can meet its contractual obligations to policyholders far into the future in any number of challenging economic circumstances. Simply stated, the more risks the Society takes in managing its business, the more capital it needs to hold in case things go wrong.

Approximately half of individual policies and the great majority of company pension schemes have contracts entitling the with-profits policyholders to a guaranteed investment return of 3.5% per year. The risk that returns are lower than this remains the most significant financial exposure the Society faces and drives much of the strategy outlined in this report.

The Society's strategy

The Society's aim is to recreate policyholder value by distributing all of the assets among with-profits policyholders as fairly and as soon as possible. To achieve this, we carefully manage solvency to enable capital distribution and only then seek to maximise investment return, all the while providing a best value-for-money cost base.

Over the last two years, we have taken several critical steps forward in the mitigation of key risks, thereby reducing the Society's capital requirements. In particular, the settlement of our obligations to Lloyds Banking Group ("LBG") to fund the former Staff Pension Scheme has removed exposure to the volatility of the Scheme's assets and liabilities, releasing a significant amount of capital for distribution. This, combined with the continuing success of our investment and cost strategies, has allowed the Board to double the capital distribution from 12.5% to 25% commencing 1 April 2014.

We have also concluded that it is the right time to reduce to zero the Financial Adjustment when policyholders transfer their benefits on non-contractual terms.

The Board has no wish that policyholders should leave prematurely, but is firm in its belief that, when policyholders do leave, they should leave with a fair share of capital. Indeed, subject to market conditions, among other things, the Board wishes to increase capital distributions in the future.

Distributing all of the assets among with-profits policyholders as fairly and as soon as possible

The Board believes that distributing all of the assets as fairly and as soon as possible is key to recreating policyholder value. A fair distribution is one that allows a policyholder to leave with an amount of capital that does not disadvantage those that remain. As the Society is in run-off, it is also fair that capital is distributed as soon as possible. The main technique used by the Board to achieve this strategy is to reduce risks against which capital is held, thereby increasing the amount available for distribution.

Review of performance

Company solvency levels are regulated by the Prudential Regulation Authority ("PRA") and fairness to policyholders by the Financial Conduct Authority ("FCA"). We put great store in having an open and cooperative relationship so that our regulators fully understand our run-off strategy and how we are doing against our objectives.

During 2013, the Board's key action was to extricate the Society from its obligations under the former Staff Pension Scheme. In March 2001, the Society entered into contractual commitments with Clerical Medical Group (now part of LBG), whereby the Society met the major part of the funding in respect of the pension schemes covering the many staff who transferred to Clerical Medical at the time. Our obligations under the Scheme exposed the Society to significant risks such as the volatility of equity assets chosen by the Scheme's Trustees and, as important, sharp increases in the Scheme liabilities in a low interest rate environment. As a result, the Society had to hold a significant level of capital against these risks with little influence on how the Trustees and the Scheme Actuary went about their affairs.

The Board reviewed these arrangements and, subsequently, entered into transactions with the Scheme's Trustees and LBG, resulting in the removal of all the Society's obligations in respect of the Scheme, thereby releasing significant amounts of capital for distribution.

As mentioned in the Chairman's report, the Board has also taken action to further reduce the Society's exposure to the risks related to property, interest rates and potential defaults. All these actions have released significant amounts of capital for distribution. The Society also continues to benefit from not writing new annuities as these would require additional capital.

Our approach to capital distribution

A number of performance indicators are used by the Board to show the extent to which the strategies designed to recreate policyholder value are achieving the desired outcome. As regards capital distribution, the key indicator is its size and timing. These indicators are shown from 2009 when the present Board was constituted and for the years when changes occurred.

	2009 %	2011 %	2014 %
Capital distribution (% of policy value)	-	12.5	25
Financial Adjustment - reduction for early leavers	5	5	-

Capital distribution to policyholders began on 1 April 2011. At that time, a sum equivalent to 12.5% of policy values was earmarked to enhance payments for with-profits policies that mature or are transferred. Following successful completion of the strategic projects described earlier, we have conducted a further extensive review of the capital required to meet regulatory requirements, both now and under a wide range of possible future economic and regulatory conditions. In consequence, the Board has decided to double the distribution to 25%. We explain how this works in practice on page 72. Full consultation with both the PRA and the FCA took place in advance of the Board's decision.

The Board has also decided that it is now the right time to remove the 5% Financial Adjustment deducted from policy values when benefits are transferred on non-contractual terms. When policyholders leave early, we must ensure that the amounts paid to them should not reduce the payout prospects of those who remain. Given the substantial improvement in capital ratios, the Board has decided that the 5% deduction is no longer necessary.

Holders of policies where the guaranteed amount exceeds the policy value may not have seen any benefit from the capital distribution in the past. We estimate that the 25% capital distribution should lead to approximately nine out of ten individual with-profits policyholders receiving a payout greater than the policy guarantee.

Our plans for the future

Capital distribution and charges for guarantees

As is very clear from this report, the Board is determined to continue reducing the Society's risks, thereby reducing the required levels of capital. Every year, the Board will assess the impact of its risk reduction programme and decide whether a further increase in capital distribution is warranted.

We cannot be certain that capital distribution will increase, as the higher the payout, the more difficult it is to maintain that level in times of, say, market turbulence. We must also be mindful of the new, potentially more stringent, capital adequacy regime, Solvency II, coming into force in 2016.

The Society has a clear road map to meet our expected Solvency II capital requirements and our decision to increase the capital distribution to 25% has been made on the basis that it is affordable under the new solvency regime.

As capital distribution increases, the cost of meeting the 3.5% guarantees becomes less onerous which, in turn, leads to a reducing amount of capital required. The Board has assessed the potential capital available for distribution in the years ahead and considers that the maximum amount over and above the current level of Excess Realistic Assets ("ERA") is between £400m and £600m.

Unit-linked policies

In March 2001, substantially all of the Society's unit-linked business was reinsured through Halifax Life, now part of LBG. The arrangement effectively transferred the risks and rewards to LBG. The reinsurance arrangement does not, however, remove the primary liability of the Society to its policyholders, and so we need to make provisions in the Balance Sheet equal to the value of the assets to which the unit contracts are linked.

Under the terms of the reinsurance agreement, if the Society were to become insolvent, LBG can then make payments directly to policyholders. However, were Halifax Life, for any reason, not to honour its commitments under the reinsurance contract, it is the Society's capital that unit-linked policyholders would rely on to meet their contractual entitlement. Therefore, the Society has to retain capital against the risk that Halifax Life is unable to meet its contractual obligations. This is known as counterparty risk capital. This becomes even more important under Solvency II where counterparty capital requirements are especially onerous.

To mitigate this risk, the Society is in discussion with LBG to repatriate the unit-linked business. Such a transaction would also enable the Society to once again take control of all aspects of its business model for the benefit of policyholders.

Annuities

In April 2012, the Society ceased writing new annuity business, as the capital required to support this type of product was particularly large.

Under their contract conditions, policyholders are entitled to shop around at the time they retire to secure the most competitively priced pension. To help with this, the Society reached an agreement with Canada Life to offer annuity illustrations to policyholders so that they have a starting point from which to compare other company products. Therefore, from 2012 onwards, the Society has no longer had to hold capital against new annuities.

Notwithstanding this arrangement, the Society has to hold a material level of capital against the remaining £0.9bn annuity book, to address the risk that annuitants live longer than expected. This is known as longevity risk. The prime concern of the Board is that the run-off profile of the annuity book is considerably longer than the with-profits business. This would lead to a disproportionate level of capital required to support non-profit annuities relative to the with-profits fund. It is the Board's intention to establish how best to mitigate this risk, such that further capital can be released for distribution.

Carefully managing solvency to enable capital distribution and only then seeking to maximise return

The Board believes that there is great value for policyholders in managing assets in a manner that minimises risk. While this means that investment returns are expected to be lower than a strategy involving riskier equity and property assets, the significantly lower capital requirement means that the resulting surplus capital can be paid to policyholders more quickly. In a closed book, this is fair to policyholders who take their benefits in the next few years. They should not be denied a fair capital distribution for the sake of higher investment returns to those policyholders who have yet to reach their contracted payment date, so long as there remains sufficient capital to support those policyholders.

The Board has been successful in improving solvency ratios during 2013 as a direct result of actions it has taken in executing this investment strategy. In turn, this has led to an increase in capital distribution. Having carefully managed solvency, the return to with-profits policyholders has been maintained at 2%. It is the Board's intention to continue with this investment strategy.

Solvency

The first important capital measure used at the Society is ERA. ERA is the excess of assets (calculated on a realistic basis as used in the accounts) over policy liabilities (calculated on our best estimate of policyholder behaviour). The ERA has increased from £588m at the end of 2012 to £691m at the end of 2013, primarily due to investment performance, where corporate bond values have continued to improve in line with favourable economic news. The Board considers that a rising ERA, adjusted for capital distribution on policyholder exit, should be regarded as positive.

The second important capital measure used at the Society is Economic Capital ("EC"). Here we consider the impact on the Society's capital under extreme conditions, that is events that could occur once in every 200 years, resulting from, among other things, insurance risk, credit risk, market risk, operational risk and liquidity risk. Allowance for these extreme events cannot be included in the technical provisions in the accounts. The capital required on this basis has fallen, primarily due to the removal of pension risk. The Board considers that a reducing level of EC should be regarded as positive.

A simple example will show how the ERA and EC measures interact.

	2012 £m	2013 £m
ERA - the amount of capital we hold	588	691
Less: EC - the amount of capital we require	390	231
Surplus	**198**	**460**

Therefore, the surplus is the difference between the capital held and the capital required and is a key measure for deciding how much capital can be distributed to policyholders.

Individual Capital Assessment

Under PRA rules, we are also required to prepare a confidential assessment of the Society's capital needs. These capital requirements are met out of the ERA and, in extreme situations, from non-guaranteed benefits. The Board has defined a risk appetite such that the Society should hold capital at least 120% of that required under the Individual Capital Assessment ("ICA") rules. The current level is significantly in excess of this.

The Society's capital position, under all measures, has considerably strengthened during 2013 as a direct result of actions taken by the Board in executing its strategy. In particular, the principal risks and uncertainties against which we have to hold capital under the ICA regime have significantly reduced. Further improvements are planned by reducing the risks associated with credit, expenses, longevity and counterparty.

We place great store on what the policyholders think about our strategy and, in particular, our plans for capital distribution. We obtain feedback through regular questionnaires and other research. In particular, the Board seeks the views of policyholders as to whether it is steering the Society in the right direction and we are pleased to report that the great majority of policyholders have replied in the affirmative.

Investment return

The Society's strategy is to only seek to maximise return once solvency requirements have been effectively managed. Key to this strategy is carefully matching expected outgoings from policy maturities with income from its assets. This means that, as interest rates rise or fall, the Society's ability to pay actual benefits remains relatively unaffected, thereby reducing the risk and, therefore, the capital required.

This necessarily leads to a relatively conservative investment approach, with the Society's portfolio consisting primarily of British government securities (gilts) and corporate bonds. As referenced in the Chairman's report, the Society has materially reduced its holding in capital intensive equities and property. The Board is reviewing its allocation of assets and may decide over the next few years to reduce its exposure to corporate bonds in order to reduce the capital required to be held against this asset class.

The Board considers the historic and potential return net of charges in deciding upon the smoothed rate to be passed on to policyholders.

	2012 %	2013 %
Return on investments	5.6	(2.0)
Adjusted for:		
Movements affecting liabilities	(1.6)	5.5
Expenses	(1.0)	(1.0)
Guarantees	(0.5)	(0.5)
Tax and changes in provision	(0.1)	(0.4)
Return net of charges	**2.4**	**1.6**
Smoothed rate	**2.0**	**2.0**

The return on investments represents both realised and unrealised gains in the year from the invested assets. As interest rates have risen, the value of gilts has fallen but, due to our matching, the liabilities have fallen by an equivalent amount with no change to the value of policies. Therefore, we adjust the return to be passed on to policyholders by removing the effect of government bond yield movements, as they affect both assets and liabilities.

Out of this adjusted return, charges for expenses, guarantees and other liabilities are deducted. It is the return net of charges that dictates the amount payable to policyholders and is therefore the measure that best reflects investment performance.

While recognising that the return net of charges in 2013 is lower than in 2012, in part due to one-off changes in provisions, our policy is to smooth out the effects of short-term investment performance. Following the valuation at the end of 2013, and taking into account the outlook for longer-term returns on with-profits investments, the Board has confirmed that, for 2013 and until further notice, for UK with-profits policies, policy values will increase at 2% p.a. for pension policies (1.6% p.a. for life assurance policies where tax is deducted).

The Society continues to hold high levels of liquid assets in order to provide protection against the possible scenario of those policyholders who have passed their earliest contractual date deciding to take their benefits immediately. The impact of this would be approximately £1.3bn, so liquid assets significantly in excess of this amount are held in mitigation. The proportion held in liquid form has been increased in 2013 in readiness for a potentially higher level of claims following the announcement of increased capital distribution.

Providing best value-for-money cost base

We consider a value-for-money cost base to be one where the business-as-usual costs reduce in line with policy run-off, all the time providing a trusted and valued service. Not all costs are business-as-usual. In particular, any change in the former Staff Pension Scheme deficit has to be treated as a cost, thankfully for the last time in 2013. We also incur costs through the need for one-off projects. Success for such spend is to reap the benefits of the projects, which are often critical to enabling capital distribution.

During 2013, actions have been taken that have ensured that business-as-usual costs have fallen in line with policy run-off. At the same time, operational service and staff engagement scores have been maintained at very satisfactory levels. The Board intends to execute plans such that the current charge to policyholders of 1% for costs is maintained during run-off. The critically important re-hosting of the Society's IT infrastructure to Atos has completed successfully, marking another significant milestone in regaining control of the Society's destiny from LBG.

Administrative expenses

A key performance indicator is the reduction in administrative expenses in line with the run-off in numbers of policy benefits. This requires efficiency savings to be made which more than mitigate upward pressures on the cost base such as inflation. Since the current Board was constituted in 2009, policy benefit numbers have reduced by 20% and administrative expenses by 19%.

The main areas of saving continue to be from the Lean Manufacturing techniques introduced in 2011. These techniques promote continuous improvement and operational excellence within the business. In consequence, staff numbers, including contractors, fell from 416 in December 2012 to 371 by the end of 2013. This has contributed to costs falling from £34.5m in 2012 to £32.8m in 2013.

Therefore, the following is a key performance indicator.

	2012 %	2013 %
Administrative expenses cost reduction	3.7	4.8

In setting targets to deliver a value-for-money cost base, the Board is mindful of the need to, first, have in place strong controls and, second, deliver a service trusted by policyholders.

In regard to strong controls, the Society operates a robust and comprehensive risk management framework. Service is monitored across a range of objectives against which there are specific targets. In the last few years, a high level of service has been maintained in excess of the targets while reducing costs in line with run-off.

It is also essential to the success of the Society to have a motivated and engaged workforce which is flexible, responsive and understands its role in living up to the Society's four values of transparency, fairness, affordability and delivering for our policyholders. Each year, staff are asked to complete a survey covering areas important to their engagement at work. In 2013, the vast majority of staff clearly understood their role in recreating value for policyholders and that the Equitable Life is a good place to work. Very similar results were also recorded in 2012.

Other costs

Following settlement of the former Staff Pension Scheme, there will be no further scheme-related costs from 2014 onwards. At the end of 2012, the reserves held for the Scheme were £80m and, during 2013, £79m was paid to settle the contractual commitments. Therefore, there was no impact on the balance sheet for a series of transactions that has released a significant amount of economic capital.

Exceptional project expenditure in 2013 of £20m remains broadly the same as in 2012, driven by the transfer of the IT estate to Atos. This project has successfully completed within the budget of £35m.

Our future cost plans

In 2014, there will be no significant levels of redundancy, so we can ensure that experienced staff are retained to cover any rise in claims following the increase in capital distribution. Should there be a material increase in claims, the key performance indicators for business-as-usual cost reduction in line with policy numbers may not be achieved in 2014, but for very good reasons.

A reserve has been built up over the last few years which, together with the 1% charge to policyholders for expenses, is intended to provide sufficient funds to meet the Society's future expenses.

Exceptional project expenditure is planned to halve in 2014. The main areas of future expenditure include the mitigation of unit-linked counterparty and longevity risks, and funding the cost reduction programme and any regulatory change.

In conclusion, the Society has successfully achieved its key performance indicators relating to costs in 2013. Moreover, the Board has plans to reduce costs further to ensure that they run off in line with policies over the long term.

Principal risks

The Society operates a comprehensive risk management framework, through which it identifies, monitors, reports and manages its principal risks and ensures that adequate capital is held against them.

The main risk types relevant to the Society are insurance, credit, market, operational, liquidity, regulatory and strategic. The Board successfully reduced the Society's exposure to many of the risks during 2013. In particular, pension risk was eliminated in 2013 following the completion of the transactions with LBG.

Insurance risk

Insurance risk refers to fluctuations in the actual timing, frequency and severity of insured events relative to the expectations of the Society at the time of underwriting. The two most important examples are:

(i) Longevity risk, which is discussed on page 6 along with the Board's intention to reduce it within the annuity business; and

(ii) Expenses risk: the risk that the Society may not be able to reduce its costs in line with policyholder run-off. This is discussed on page 9.

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:

(i) Default risk: the risk of default on its portfolio of fixed-interest securities, especially corporate bonds; and

(ii) Counterparty risk: the risk of default by any of its reinsurers.

The Society seeks to limit exposure to credit risk by setting robust selection criteria and exposure limits covering factors such as counterparty financial strength. The Society monitors against these limits so that appropriate management actions can be taken to pre-empt loss from default events. No such defaults have occurred in 2013.

The major reinsurance treaties are with companies in LBG. Because reinsurance does not remove the Society's primary liability to its policyholders, the credit rating of LBG and certain of its group companies are monitored closely. As noted on page 6, the Board has plans to substantially reduce our exposure to this risk.

Market risk

(i) Interest rates: the risk that interest rate changes have a financial impact through mismatching of assets and liabilities.

The Society closely matches the expected income from assets to the expected outgoings from policy maturities. The more closely we are matched, the less capital is required against interest rate movements. During 2013, there were two adjustments to asset terms in line with the half year and year-end liability valuations. As a result, cash flow matching has been further strengthened and capital released.

(ii) Policy transfers: the risk that transfers are not in line with estimates.

Should interest rates fall even further from today's very low levels, there is a risk that some policyholders with a 3.5% guarantee would delay taking benefits as the guarantee becomes more attractive. This means that more capital would need to be held for longer and would therefore not be available for early distribution. To mitigate this risk, the Society holds a series of derivatives called swaptions designed to increase in value when interest rates fall below certain levels. These were changed to work more effectively in 2013, realising a small profit.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The programme to transfer our IT systems from LBG to Atos represented a significant operational risk to the Society and has now been satisfactorily eliminated. Going forward, the main sources of operational risk for the Society are those related to continued delivery of services to our policyholders, the delivery of service to the Society by significant third party suppliers, and risks in executing strategic projects.

Liquidity risk

Liquidity risk is the risk of the Society failing to meet short-term cash flow requirements, particularly those in respect of claims. For many years ahead, the Society monitors its forecast liquidity position by estimating both the guaranteed and expected cash outflows from its insurance and investment contracts and manages any potential mismatch by purchasing assets with similar durations to meet these obligations.

Regulatory risk

Regulatory risk is the risk to capital and reputation associated with a failure to identify or comply with regulatory requirements and expectations. The Society maintains an open and cooperative relationship with its regulators and has arrangements in place to identify new regulatory developments, implement changes to meet these requirements, and monitor ongoing compliance, such that the risk was fully mitigated in 2013.

Strategic risk

The Society faces a number of risks to the achievement of its strategic objectives, especially those related to capital distribution. When determining the Society's strategy, the Board assesses the risks associated with the implementation of that strategy, and sets its risk appetite. The Society manages the risks within the specified appetite, taking action when necessary to bring them back within that appetite.

The Board considers that, as a result of action it has taken, the principal risks faced by the Society are significantly less at the end of 2013 than they were at the start. Therefore, the capital required to be held against them is lower, and the amount available for distribution consequently higher. This has been critical to the decision to increase the capital distribution to 25% and to remove the Financial Adjustment. In short, policyholder value has been recreated.

Chris Wiscarson	Simon Small
Chief Executive	**Finance Director**

20 March 2014

Board of Directors




Ian Brimecome (b) (c)
Chairman

Ian Brimecome was appointed Chairman in September 2009. He joined the Board in January 2007 and is Chairman of the Nominations Committee. Ian is Chairman of Axa UK plc, Kiln Group Ltd, Delphi Financial Group and Tokio Marine North America. He is also Executive Chairman International of Tokio Marine Holdings and Deputy Chairman of Tokio Marine Asia. Ian is an outside Board Member of Philadelphia Consolidated Holdings in the United States. He has more than 30 years of experience of the financial services industry in a wide variety of roles and has advised on more than 100 merger and acquisition transactions in the insurance and asset management industries in more than 20 countries.

Keith Nicholson (a) (b) (c)
Deputy Chair and Senior Independent Director

Keith Nicholson joined the Board in August 2009. He was appointed Deputy Chairman on 1 July 2012 and chairs the Audit and Risk Committee. Keith left KPMG in 2009 after more than 30 years with the firm. He has a wealth of experience with financial services companies covering audit and advisory roles. These included FTSE 100 companies in the UK and non-UK multinationals. Keith is Chairman of Liberty Syndicate Management Limited and Deputy Chairman of Wesleyan Assurance Society. He is also a non-executive Director of Just Retirement Group plc.

Chris Wiscarson (c)
Chief Executive

Chris Wiscarson was appointed Chief Executive in September 2009. He was previously at the Lloyds Banking Group where he held very senior roles on the Group Executive Committee – most recently Group Integration Director. He started his career with Equitable Life, before moving to South Africa in 1979 as General Manager of Southern Life. In 1986, he returned to England to take up the position of Chief Executive of Save & Prosper Insurance. In 1990, he became European Director of the Lloyds Abbey Life Group and, in 1991, took up the position of Group Finance Director before becoming Chief Executive of Lloyds TSB Life. At the beginning of 2000, Chris took responsibility for the non-UK businesses in the Lloyds TSB Group, participating in 30 countries.

Simon Small
Finance Director

Simon Small joined the Society as Finance Director in July 2012. He is responsible for the Society's Finance, IT, Business Change and Investment functions, as well as taking a lead role in capital and strategic planning. Simon, a qualified accountant, has particular expertise in the financial and administrative aspects of operations and IT. He had previously worked at Lloyds Banking Group for over 20 years where, most recently, he had been the Finance Director to the team responsible for delivering the synergy benefits in the merger of Lloyds TSB and HBOS. Simon's expertise extends to negotiating deals, restructuring company finances and delivering efficiency savings.

Ian Gibson (a)

Ian Gibson joined the Board in August 2013. Ian retired from Legal & General in 2007 after more than 35 years with the organisation. He is a qualified actuary and has extensive experience of managing and advising on with-profits funds. Since retiring from Legal & General, Ian has worked as an actuarial consultant providing advice on, among other things, Solvency II and life fund transfers. He has also served on the Supervision Committee of the Life Board of the Institute and Faculty of Actuaries.

Ian Reynolds (a) (c)

Ian Reynolds, a Chartered Director and qualified actuary, joined the Board in October 2006. He is a n on-executive Director of Alternative Assets Opportunities. He served ten years on the Council of the Institute of Actuaries. Ian has more than 40 years of experience in the insurance industry. He held the roles of UK Divisional Director and then General Manager Life at Commercial Union plc and a variety of posts at Royal Insurance. He has also worked as an insurance Special Advisor at the Financial Services Authority.

Cathryn Riley (a) (b)

Cathryn Riley joined the Board in August 2009. She chairs the Society's Remuneration Committee. In a wide-ranging career covering, customer services, IT, operations, human resources and general management, Cathryn has worked for British Coal, British Airways, Coopers & Lybrand, BUPA and Aviva plc where she was Group Chief Operations Officer and a member of the Company Executive Committee. She is a non-executive Director of International Personal Finance Plc.

Key to membership of principal Board Committees

(a) – Audit and Risk
(b) – Remuneration
(c) – Nominations

Directors' report

Principal activities

The principal activity of the Society during 2013 was the transaction of life assurance, pension and annuity business in the form of guaranteed, participating and unit-linked contracts. The Society closed to new business on 8 December 2000. The results of the Society are presented in the Profit and Loss Account on page 39. The operations of the Society are described in the Chairman's statement and the Strategic report which includes reference to certain key performance indicators. The Directors' remuneration report and details of the governance arrangements of the Society are given in the Corporate governance statement on pages 16 to 34.

Directors

The Directors shown on the previous pages were Directors throughout the year with the exception of Mark Earls who resigned as a Director with effect from 14 February 2013, and Ian Gibson who was appointed as a Director on 20 August 2013.

In accordance with guidance issued by the Association of Financial Mutuals ("AFM"), all the Society's Directors will retire at the Annual General Meeting ("AGM") and offer themselves for re-election.

Directors' indemnities

The Society maintains directors' and officers' liability insurance, which gives appropriate cover for any legal action brought against its Directors. The Society has also provided an indemnity for each of its Directors, which is a qualifying third party indemnity provision for the purposes of section 234 of the Companies Act 2006.

Government Compensation Scheme

As at the end of December 2013, the Government announced that it had made lump sum payments of £511m to more than 375,000 eligible individual policyholders. In addition, more than 33,000 with-profits annuitants had received their first payments totalling £64m. Subsequent annual payments totalling £116m had also been paid. Additionally, payments of £15m had been paid to the estates of more than 2,400 deceased annuitants.

The Government has also announced that the Scheme has written to all the trustees and administrators of eligible group pension schemes that it has been able to trace, in order to obtain contact details for group scheme members. As at the end of December 2013, the Government Compensation Scheme had made more than 300,000 payments totalling £110m to those in group schemes.

In the 2013 budget, the Chancellor announced that the Government would make an ex-gratia payment of £5,000 to Equitable Life policyholders who bought a with-profits annuity before 1 September 1992 and who are aged over 60. Previously, these annuitants had been excluded from Government compensation. The Chancellor also announced that an additional £5,000 would be available to those policyholders who met these criteria and were in receipt of pension credit. The Government has announced that these payments were made in December 2013.

In October 2013, the Government announced that the date for closure of the Compensation Scheme would be extended to June 2015, so that as many eligible policyholders as possible could be traced. It launched an advertising campaign to reach out to policyholders where the Scheme does not have current address details. The Society wrote to all our current eligible with-profits policyholders in February 2014 to bring this to their attention.

If you believe you are entitled to Government compensation and have not yet heard, do call the Government helpline on 0300 0200 150.

Principal risks

The Strategic report sets down the Society's principal risks and its arrangements for managing these and holding capital against them.

Directors' responsibilities in respect of the financial statements

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Society and of the result of the Society for that period. In preparing those financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Society will continue in business.

The Directors have complied with the above requirements. The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Society, and enable them to ensure that the financial statements comply with the Companies Act 2006, as described above. They also have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Society and to prevent and detect fraud and other irregularities.

The financial statements are published on the Society's website. The maintenance and integrity of this website is the responsibility of the Directors. Legislation in the UK governing the preparation and dissemination of financial statements may differ from the legislation in other jurisdictions.

Statement of disclosure of information to auditors

The Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Society's auditors are aware of that information. As far as the Directors are aware, there is no relevant audit information about which the Society's auditors are unaware.

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 not only have sufficient assets to withstand the impact of events that might reasonably be expected to occur, but must also hold sufficient liquidity to meet the payments associated with its business.

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 continued to reduce in significance in recent years. Based on the analysis, the Board is confident of its ability to manage adverse scenarios that may arise, recognising in some scenarios that reductions to policyholder payments 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.

The Board's conclusions on information to members

The Board considers that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for the Society's members to assess the Society's performance, business model and strategy.

Employees

Employees of the Society have been regularly informed of, and consulted with, on matters of concern to them. The Society is an equal opportunities employer: all applications for employment, consideration for continued employment, training opportunities, career development and promotion are fully considered with regard to an individual's particular aptitudes and abilities. As a mutual company, the Society has no employee share scheme.

Auditors

PricewaterhouseCoopers LLP have expressed their willingness to continue in office and a resolution will be proposed at the AGM.

Signed by order of the Board

Peter Wilmot
Company Secretary

20 March 2014

Corporate governance statement

1. Statement from the Chairman

The Society aims to meet the highest standards in corporate governance and voluntarily adopts the relevant provisions of the UK Corporate Governance Code ("UKCGC"), the Annotated Code issued by the Association of Financial Mutuals ("AFM") and the UK Stewardship Code. The Society is reporting against these codes. The Board is responsible to the Society's policyholders for good corporate governance and applies high standards to ensure that this is achieved.

The Board assesses its own performance and effectiveness as well as that of its Committees and individual Directors. More information on the processes for doing this is given below, but I would like to give my personal confirmation of the importance the Board attaches to ensuring continuing good performance throughout the Society.

This report summarises the Society's governance arrangements including reports on each of the Board Committees. Personal statements from the Chairs of the Audit and Risk Committee and the Remuneration Committee are also included below.

2. Governance by Directors

The Board

The Board meets regularly to lead, control and monitor the overall performance of the Society. The Board's principal functions are to determine the strategy and policies of the Society, to set out guidelines within which the business is managed and to review business performance. The Board considers and decides on all major matters of Society corporate strategy and ensures that the strategy is consistent with its appetite for risk. There is a formal schedule of matters reserved for the Board's decision. Members of senior management supply the Board with appropriate and timely information and are available to attend meetings and answer questions. The Directors are free to seek any further information they consider necessary as well as advice from the Company Secretary or independent professional advisers. Authority is delegated to the Chief Executive for implementing strategy and managing the Society.

The roles of Chairman and Chief Executive are separated and the Chairman has primary responsibility for the effective functioning of the Board.

Board Committees

The Board formally delegates certain specific responsibilities to the three Board Committees described elsewhere in this report. The Terms of Reference of the Committees are available on the Society's website (www.equitable.co.uk) or on request.

Board and Committee meetings

Details of the number of meetings of the Board and attendance by Directors are given in the following table. Details of the number of meetings of Committees of the Board and attendance by members of those Committees are also shown in this table.

	Board	Audit and Risk Committee	Nominations Committee	Remuneration Committee
Number of meetings during 2013	7	5	1	3
Attendance by Directors[1]				
Ian Brimecome	7	-	1	3
Chris Wiscarson	7	-	1	-
Ian Gibson[2]	3	-	-	-
Keith Nicholson	7	5	1	3
Ian Reynolds	7	5	1	-
Cathryn Riley	6	5	-	3
Simon Small	7	-	-	-

[1] See pages 12 and 13 for details of Committee membership.

[2] Appointed as a Director on 20 August 2013.

Taking advice

The Board and its Committees are able to take advice from professional advisers to assist them in assessing the business of the Society. Each Director has access to the Company Secretary.

Directors may also obtain independent professional advice, at the Society's expense, about any matter concerning the Society relevant to their duties, subject to defined procedures.

Directors

The Board had two executive Directors who served throughout 2013: the Chief Executive and the Finance Director. In addition, the Chief Operating Officer, Mark Earls, was an executive Director until he resigned on 14 February 2013. Following Ian Gibson's appointment as non-executive Director on 20 August 2013, there are five non-executive Directors on the Board. Their diverse experience, skills and independent perspective provide effective review of and challenge to the Society's activities. The Chairman and the Deputy Chairman are elected by the Board. The current Board members are described on pages 12 and 13.

The Board reviews the independence of the non-executive Directors and has concluded that all the non-executive Directors should continue to be considered to be independent.

The Directors' remuneration report on pages 23 to 34 explains the basis of remuneration of the executive and non-executive Directors.

Performance evaluation

The Board reviews its own performance and that of its Committees each year. In previous years, this has been achieved by the Board reviewing responses to a questionnaire completed by Directors and agreeing relevant actions. In 2013, we commissioned the Board's independent advisor, Nicholas Wells, to carry out a full review of the Society's Board and its Committees. This was in place of the questionnaire referred to above, and took into account the guidance in the UKCGC that an evaluation of the Board of FTSE 350 companies should be externally facilitated every three years.

The brief was to review the effectiveness of the Board as a unit, examine its structures and processes, assess the contribution made individually and collectively by Directors, and report on adherence to corporate governance best practice. The review was conducted through attendance at Board and Committee meetings, individual meetings with Directors and other senior management, and examination of relevant agendas, papers and minutes. The review found that:

- The Board's structures and processes are clear, well understood and effective. Working practices are efficient and Board papers are of appropriate quality;
- Matters reserved for the Board are clear and appropriate. Board meetings are chaired effectively. The Board sets the Society's strategy and determines its risk appetite;
- The Board's corporate governance arrangements meet the recommendations set down in the UKCGC and the Annotated Code, with the exception of terms of office for non-executive Directors;
- The Board's Committees perform their delegated roles under clear terms of reference and report back effectively to the Board;
- The Board has an appropriate mix of skills, experience and knowledge;
- The way in which the Board carries out its role, and the behaviours displayed by Board members, are helpful and appropriate, and a strong and positive tone is set from the top; and
- There is a formal and rigorous process for appointment of Directors to the Board, and Board members receive proper induction.

The four principal recommendations were as follows:

1. Use of 'deep dives' on relevant topics;
2. Addressing Board diversity, especially gender diversity, as part of succession planning;
3. Clarification of the roles of the Board and the Executive in a crisis; and
4. Further clarification of its role when Board is acting as the With-profits Committee.

Steps to implement these recommendations will take place in 2014.

With assistance from the Nominations Committee, the Board reviews the performance of individual Directors annually. The non-executive Directors meet under the leadership of the Senior Independent non-executive Director to review the performance of the Chairman. In conducting these reviews, the Board has regard to the guidance on performance evaluation accompanying the UKCGC. The Board recognised that, in accordance with the Code, any term beyond six years for a non-executive Director should be subject to particularly rigorous review and should take into account the need for progressive refreshing of the Board.

In the light of the reviews referred to above, the Board considers it has the appropriate balance of skills and experience to meet the requirements of the Society's business.

Appointments to the Board

Directors must retire and seek re-election at the first Annual General Meeting ("AGM") following appointment. The Society's Articles require one third of the Directors who are subject to retirement by rotation to retire at each AGM and also that all Directors must submit themselves for re-election by rotation at an AGM at least every three years. The Annotated Code provides that, for larger mutuals such as the Society, all Directors should submit themselves for annual re-election. The Board has decided that all the Society's Directors will retire and offer themselves for re-election at the 2014 AGM.

All appointments are subject to annual review by the Board, as advised by the Nominations Committee. The Board's policy on remuneration is set out in the Directors' remuneration report.

3. Management of the Society

The Executive team meets weekly to manage business activities. Papers are prepared and presented to the Board and its Committees by the Executive team. The Executive team comprises: the Chief Executive; the Finance Director; the Risk Director; the Chief Actuary; the Head of Customer Service; the Head of Human Resources; and the Company Secretary.

The Chief Actuary, Martin Sinkinson, advises on the Society's ability to meet obligations to policyholders, and identifies and assesses the risks that could have a material impact on this, and the capital needed to support the business. He also advises the Board on the methods and assumptions to be used for the assessment of the value of the Society's assets and liabilities, and reports on the results. The Society is also required to appoint a With-profits Actuary who advises the Board on key aspects of the discretion to be exercised in the treatment of with-profits policyholders, including advice on bonus rates. Rob Merry was the With-profits Actuary until 12 December 2013. Louise Eldred was appointed With-profits Actuary with effect from that date.

The Board has responsibility for investment strategy, investment policy and appointing investment managers. These responsibilities are discharged through the Society's Asset and Liability Committee, taking advice from the Chief Actuary, and the Committee regularly liaises with the investment advisers to oversee day-to-day investment matters.

The Head of Customer Service, Dave Pearce, is responsible for ensuring that the day-to-day needs of policyholders are met through the Customer Service and other operational teams. The Finance Director is the executive responsible for the IT services provided to the Society.

The Risk Director, Susan Puddephatt, is responsible for providing the framework of risk policies, processes and approaches to be followed by staff, and for reporting to the Audit and Risk Committee and the Board on the key risks facing the Society and how those risks are controlled and managed.

The Head of Human Resources, Carol Whitehead, is responsible for establishing appropriate standards of recruitment, performance review, union relations and staff communications.

Monthly management information in respect of financial performance, fair treatment of policyholders, complaints handling, risk management, compliance and investment performance is prepared and reviewed by senior management and the Executive team.

Each year, the Society prepares a three-year business plan and budget to assist in the monitoring of results, assets, liabilities and investment performance. Actual performance against these plans is actively monitored and, where appropriate, corrective action is agreed and implemented.

4. Internal controls and risk management

The Directors are ultimately responsible for the Society's system of internal control and for reviewing management's arrangements for ensuring its effectiveness, including the effectiveness of controls over outsourced activities. This system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable, not absolute, assurance against material loss or misstatement. The Directors actively seek to mitigate the Society's exposure to risks consistent with its strategy. They also take into consideration the materiality of the risks to be managed and the cost-effectiveness of the relevant aspects of internal control.

The Society continued to use Lloyds Banking Group ("LBG") for the provision of IT services until transfer to Atos on 3 March 2014. The Society liaised with LBG to review the appropriateness of the internal control environment and to consider specific needs or requirements of the Society, as it does with other strategic providers of outsourced services.

On behalf of the Board, the Audit and Risk Committee has reviewed the effectiveness of the internal controls for the year ended 31 December 2013, taking into account matters arising up to the date of this report. If significant failings or control deficiencies were to be identified, the Committee would confirm whether or not appropriate remedial action had been taken. The principal components of the Society's system of internal control, together with developments in 2013, are detailed below. The Society has adopted the widely recognised 'three lines of defence' approach to governance, under which primary responsibility for day-to-day risk management and compliance rests with business areas. Oversight and challenge is provided by the Risk and Compliance function as the second line of defence, and assurance is provided by Internal Audit as the third line of defence.

Control environment

The Society is committed to the highest standards of business ethics and conduct, and seeks to maintain these standards across all of its operations. The Society regularly reviews its governance arrangements, confirming the governance structure for the business and the guiding policies for the organisation.

An appropriate organisational structure for planning, executing, controlling and monitoring business operations is in place in order to achieve the Society's objectives. The structure is reviewed and updated on a regular basis, taking into account the conflicting priorities of the Society's business, to ensure that it provides clear responsibilities and control for key areas. Separate functions have been established for risk management and compliance and internal audit.

Risk management

The Audit and Risk Committee has delegated authority from the Board for reviewing the Society's internal control and risk management systems, for reviewing that the Society's risk appetite is appropriate for its needs, and that key risks are identified and managed.

A Risk Oversight Committee, consisting of members of the Executive and other members of the senior management team, meets regularly. The Committee provides oversight in regard to risk management arrangements across the Society. The Committee reviews and challenges the identification, assessment and management of material risks and the adequacy of the activities being undertaken to mitigate these risks.

The Risk and Compliance function, under the Risk Director, is responsible for ensuring that there is a clear risk management framework and methodology, which includes:

- A quarterly risk and control self-assessment process, which requires senior management to attest to the risks and associated controls in place within their area of the business;
- Developing and maintaining risk management policies for all material risk categories, including insurance, credit, market, operational, liquidity, regulatory, strategic and reputational risks. These policies are approved by the Board;
- The agreement by the Board of risk appetite statements which are closely linked to the achievement of the Society's strategic objectives, and key risk indicators for monitoring against risk appetite;
- A consistent approach across the Society for risk identification and risk assessment; and
- Detailed monitoring, review and reporting on material risks, including to the principal management and risk committees.

The framework described above is designed to meet the requirements and standards set by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"), and has been further developed to reflect practices and standards described in the EU Solvency II Directive. Although implementation of the Directive is not expected until January 2016, interim arrangements have been set out by the European Insurance and Operational Pensions Regulatory Authority ("EIOPA"). The requirements related to governance and risk management are sensible and support the good running of the business.

The Strategic report sets out the significant risks faced by the Society.

Monitoring and other assurance activities

The Risk and Compliance function reports the results of the risk assessment, regulatory and compliance monitoring and other significant changes to risks to the principal governing committees, the Audit and Risk Committee and the Board. Assurance is provided to the Audit and Risk Committee and the Board on the effectiveness of the key controls through:

- Review and recommendation to the Audit and Risk Committee of the Compliance Monitoring plan and Internal Audit Assurance plan;
- Regular reporting by Internal Audit on findings from audits, and the management actions to address these findings;
- Annual review of effectiveness of key internal controls by the Executive team, the Risk Oversight Committee and the Audit and Risk Committee;
- Reporting on the regulatory environment and associated regulatory risks by the Society's Risk Director;
- Reports received from the Society's Risk and Compliance functions on specific elements of risk and their management; and
- The work of other independent advisers commissioned to report on specific aspects of internal control.

The Audit and Risk Committee monitors the status of actions to improve the effectiveness of the system of internal control.

Internal Audit

The Society's in-house Internal Audit team provides assurance over the operation of governance, risk management and the system of internal control. This team is supported by specialist internal audit support from KPMG. Internal Audit provides the third line of defence. The programme of internal audit reviews is based on the Society's risk profile, independently assessed by Internal Audit and reviewed by the Audit and Risk Committee. The delivery of the Internal Audit plan and the activities to report and track audit findings are reviewed by the principal governing committees and are reported to, and reviewed by, the Audit and Risk Committee.

LBG is required to advise the Society of any material findings of internal audit reviews they have conducted that are relevant to the activities undertaken by LBG on behalf of the Society.

5. Policyholder communications

The Board is committed to open communications with policyholders.

In 2013, the Board commissioned extensive research among members of the Society to better understand their views on a range of issues.

In August, a series of focus groups was held to obtain a greater understanding of how policyholders think and feel about the Society's strategy. In October, quantitative research was undertaken among a large group of policyholders, whereby the majority affirmed that the Society is going in the right direction.

Annual Statements were issued to policyholders in March 2013.

The Summary Annual Report is mailed to all members each year, and further information is available on the Society's website and on request for members without Internet access.

At the AGM, members of the Board are available to answer questions. Separate resolutions are proposed on each issue so that they can be given proper consideration. Resolutions are dealt with on a show of hands unless a poll is called. The Society counts all proxy votes and indicates the level of proxies lodged on each resolution, after it has been dealt with on a show of hands. The proxy form specifically provides for members to be able to abstain on a resolution or resolutions if they wish. Written feedback was invited from those who attended the AGM.

The Society produces a document setting out its Principles and Practices of Financial Management. In 2013, there were no changes to the principles. There were some minor changes to the practices. There is also an abridged version of this document: "A guide to how we manage the with-profits fund". The latest versions of these are available on the Society's website, together with information about with-profits bonus rates. Any material changes in these documents are drawn to the attention of policyholders.

Each year, reports are produced by the Board and by the With-profits Actuary on how the with-profits fund has been managed. These documents are available on the Society's website and on request for members without Internet access.

6. Board Committees

The Audit and Risk Committee

Statement from the Audit and Risk Committee Chair

The Board's approach to governance over audit and risk is to delegate responsibility to a single committee: the Audit and Risk Committee. This means that we have an efficient and effective oversight of both the risk and control frameworks of the Society as well as taking responsibility for both internal and external audit. Naturally, this does mean that the Committee has to ensure an appropriate balance of discussion between risk and audit at its meetings throughout the year. Therefore, in planning the agendas, I seek to ensure they are structured in a manner so that risk and audit alternate as the first item of our meetings.

While the Board has delegated oversight in relation to risk matters to the Committee, there are occasions when it is more appropriate for detailed discussions on risks relating to specific events or transactions to be dealt with by the Board as a whole. Such matters in the last year included the risks around the IT transfer to Atos and the possible capital distributions. The Committee takes account of these activities in planning its work on risk for the year.

The Committee invites to its meetings members of the Executive and their direct reports as appropriate so that they provide their reports at first-hand. It enables them to hear and respond to the constructive challenges made by members of the Committee, who draw on their own experience and wider industry knowledge. This approach results in the Committee reaching agreement on appropriate outcomes for the Society. In addition, we hold meetings at least once a year with the Risk Director, the Chief Actuary and the Head of Internal Audit without any other executives present so that we can explore any issues or concerns that they may have in discharging their responsibilities.

The Committee meets with Marcus Hine, our PricewaterhouseCoopers LLP ("PwC") Audit Partner, in private session once a year at the meeting when we are considering the Annual Report and Accounts. The Committee agreed that we should hold this session at the beginning of our meeting rather than the traditional approach of being at the end of the meeting. This allows the Committee to follow through any matters with the Executive during the course of the meeting prior to making recommendations to the Board on the Annual Report and Accounts.

The report that follows gives a high level overview of the matters covered during the year together with those issues that we are required under the Annotated Code to report on.

Keith Nicholson
Chair, Audit and Risk Committee

20 March 2014

Audit and Risk Committee report

During 2013, the Committee comprised three non-executive Directors: Keith Nicholson (Chair); Ian Reynolds; and Cathryn Riley. Ian Gibson joined the Committee from 1 January 2014.

The Committee meets at least five times a year and it pays particular attention to the Society's:

- Financial reporting, and compliance with the UKCGC and the Annotated Code;
- Risk management systems, risk appetite and the identification and management of key risks;
- Control environment;
- Internal and external audit processes;
- Business continuity arrangements; and
- Procedures for handling allegations from whistle-blowers.

The Committee assists the Board in fulfilling its responsibilities in regard to the Society's Financial Statements and Annual Regulatory Returns to the PRA and previously to the Financial Services Authority ("FSA"). The Chairman reports orally to the next Board meeting, with the minutes of the Audit and Risk Committee meetings being subsequently circulated to the Board.

The Committee also considered the implications of the new solvency regime, Solvency II, due to be implemented on 1 January 2016, and the Society's preparations for this.

The Integrated Assurance plan, covering the proposed assurance activities to be conducted by the Internal Audit and Regulatory Risk and Compliance teams, is submitted to the Committee for review and challenge prior to approval.

In relation to the financial statements, the following significant issues were considered by the Committee during 2013:

- The valuation of the Society's liabilities and the methodologies and assumptions used in assessing these. Papers were presented to the Committee by the Chief Actuary and his team. Also, PwC commented on the reasonableness of the assumptions and how they compared to those used by the industry. The Committee reviewed the methodology and the data underlying the assumptions drawing on their own knowledge and experience;
- The valuation of the Society's invested assets. Reports from the Finance Director were submitted to the Committee providing information on the valuation processes followed for invested assets, including how these provided a fair value. The Committee sought to understand the basis of the determination of assets classified as Level 3 investments (as described in Note 9d to the financial statements) and the approach to their valuation; and
- Review of contingent liabilities and uncertainties. Consideration included reports from the Chief Actuary on liabilities under the pension schemes for which LBG was the principal employer, and reports from the Society's Head of Legal Services on any other legal uncertainties. The Committee concluded that the contingent liabilities and uncertainties set out in the 2012 Annual Report and Accounts had been substantially discharged within the provisions established and therefore no further disclosure was required.

The Committee keeps the relationship between the Society and its external auditors under review and considers their independence, including the extent, if any, of their fees from non-audit services. As part of the review, the Committee obtains confirmation that, in PwC's opinion, their independence as auditors has not been compromised. The Committee approves the terms of engagement and the remuneration to be paid to the external auditors in respect of audit services.

The Society's general principle is that our external auditors should not provide non-audit services to the Society. If it was proposed to use them for non-audit services, prior approval from the Committee would be required.

The Audit and Risk Committee has primary responsibility for recommending to the Board the appointment, reappointment and removal of the external auditors. In considering this, the Committee takes into account the firm's independence and whether it would be appropriate to invite tenders for the role of external auditors.

PwC have acted as the Society's external auditors since 2001 and the Society has not made the role of external auditor subject to formal tender process during that time. In recommending the reappointment of PwC as the Society's external auditors and not making the role subject to tender, the Committee has considered the need for continuity of experience in the external auditor; in particular, in periods of significant challenge, and now in a period of major change following the transfer of its IT systems to Atos. There was a rotation of the Audit Partner at PwC during 2013. The Society intends to submit the role of external auditor to formal tender process at the time the next rotation of Audit Partner is due (expected to be in 2018), subject to continued satisfactory performance by PwC until that time.

The Committee reviews the effectiveness of the external audit process, and the latest review was conducted at the Committee's meeting on 19 March 2014 utilising input from the Chair and the Finance Director. The Committee concluded that PwC's performance had been effective and therefore there was no reason for a tender at this stage.

The UKCGC states that the Board should satisfy itself that at least one member of an Audit Committee has recent and relevant financial experience. The Board has hitherto taken the view that, rather than an individual or individuals, the Audit and Risk Committee as a whole should be considered in this respect. With effect from December 2013, the Board has agreed that Keith Nicholson should be regarded as the member having recent and relevant financial experience.

The UKCGC states that no one other than the Committee Chair and members should be entitled to be present at a meeting of an Audit Committee, but others may attend at the invitation of the Committee. The Audit and Risk Committee has indicated that any Director may attend its meetings if he or she wishes.

The Nominations Committee

The Nominations Committee comprises three non-executive Directors: Ian Brimecome (Chair), Keith Nicholson and Ian Reynolds; and the Chief Executive, Chris Wiscarson.

The Committee assists the Board in ensuring that the composition of the Board is appropriate to govern the Society effectively, that suitable candidates are identified to fill vacancies or to add to the strength of the Board, and that the Society meets the relevant principles and provisions of the UKCGC and the Annotated Code. The Committee also reviews, on an ongoing basis, the appropriateness and suitability of each Director for continuing membership of the Board. The Committee makes recommendations to the Board regarding the appointment of Directors.

The Board is committed to appropriate diversity, including gender diversity.

We wish to have a leadership team who bring different skills and perspectives as well as different experiences and backgrounds. To this end, we aim to have an equal number of women and men in senior management positions by the latter part of 2016. At the end of 2013, the Society's workforce comprised 66% women and 34% men, whereas in senior management positions there were 34% women and 66% men. Currently, two of the seven members of the Executive Committee are women, as is the With-profits Actuary, appointed in December 2013, and the Head of IT, appointed in February 2014.

The Society's Board comprises five non-executive Directors, one of whom is a woman, and two male executive Directors. It is the Board's intention to have at least two women Directors by the end of 2015.

During 2013, the Society undertook a search for a new non-executive Director. The external search consultancy, Per Ardua Associates Limited, assisted in this process. The search consultancy has no other connection with the Society. As a result of the search, Ian Gibson was appointed as non-executive Director on 20 August 2013.

On joining the Board, any new Director receives an extensive induction programme, including meetings with other Directors and senior management and information on important aspects of the Society's business.

Directors' remuneration report

Statement from the Remuneration Committee Chair

My philosophy since taking over as Chair, supported wholeheartedly by the Remuneration Committee, has been to significantly strengthen governance over executive compensation. It is vitally important to have stretching but achievable targets, regular performance reviews, clear distinction between short-term and long-term incentives and, most importantly of all, to have remuneration aligned to the Society's strategy and the interests of policyholders. In all these areas, we can point to considerable improvement over the last few years.

In determining executive compensation, the Committee under my leadership strives to provide a clear link between pay and the Society's strategic priorities.

We are determined to get the balance right between recognition of the Society's good performance and policyholder views on excessive pay. We also seek to strike an appropriate balance between fixed and variable compensation. In making its assessment of executive performance in 2013, the Committee was mindful of the very significant progress the Society has made against its strategic objective of recreating value for policyholders. In particular, the increase in capital distribution to 25% and the transfer of the Society's IT systems to Atos represent very considerable achievements.

To assist the Committee in exercising judgement, we are scrupulous in examining relevant data such as the pay of other financial services organisations. Such data is used with caution, as there are few direct comparators with the Society, and we wish to avoid remuneration being ratcheted up on the basis of such information. When applying judgement, we seek to ensure that the Society pays the right amount to attract and retain talented individuals while not overpaying.

All executive incentive and bonus schemes are established and monitored by the Committee. We seek to reward Directors on the scope of their responsibilities and, most importantly, their performance.

I wish to talk more about how the Committee approaches the issue of balance.

On the one hand, remuneration policy must support the Society's need to recruit and motivate appropriately qualified individuals, recognising the significance of their responsibilities, competencies, experience and performance. The policy should, in our view, encourage enhanced performance aligned with prudent risk taking.

On the other hand, we put great store on the concept of reasonableness. For example, we reference pay to the median of the sector, not the upper quartile, recognising that we are a business in run-off. Having said that, where we have fewer people carrying out larger roles and delivering significantly better outcomes for policyholders, an increase in their reward can be justified as reasonable.

During the year, the major items considered by the Committee were: the first vesting under the Long-term Incentive Plan ("LTIP"); and, for executive Directors, the maximum bonus opportunity and the introduction of bonus deferral. The details of each of these items are set out later in the Directors' remuneration report.

I have put great emphasis in this report on the all-important balance that must be achieved in regard to executive remuneration. Members of the Committee have satisfied themselves that the decisions and policies reflected in this report achieve this balance.

Cathryn Riley
Chair, Remuneration Committee

20 March 2014

About the Remuneration Committee and the Directors' remuneration report

The Remuneration Committee, the Board Committee with responsibility for recommending remuneration policy to the Board, comprises three non-executive Directors, Cathryn Riley, Ian Brimecome and Keith Nicholson. The Committee reviews remuneration policy annually and sets the terms of employment and remuneration of executive Directors.

The Committee operates to the standards set out in the UKCGC and by the Association of British Insurers ("ABI") and takes into account the Regulators' Remuneration Code, which is not binding on the Society.

The Committee's formal annual review of its approach and processes found them to be appropriate and effective. Under the UKCGC, the Remuneration Committee should set the remuneration of the Chairman. Until the end of 2013, the Board took this responsibility; it has now been delegated by the Board to the Committee.

During 2013, the Society received remuneration survey information from Towers Watson. This survey is an important reference source in understanding the levels of remuneration within the UK insurance sector. For Directors, reference is also made to FTSE 350 remuneration, and to remuneration within the mutual sector sourced from the AFM.

The Society received advice and services which materially assisted the Committee in considering matters relating to Directors' remuneration from the following:

Firm	Services	Fees, excl. VAT £000
Tidden Services Ltd	Expert remuneration analysis	27
Mercer Limited	Pension scheme advice	15
Towers Watson Ltd	Remuneration survey	3
Hogan Lovells LLP	Legal advice	1

Towers Watson Ltd, Mercer Limited and Hogan Lovells LLP are independent of the Society. Nicholas Wells, Director, Tidden Services Ltd, also carried out the review of the Board and its Committees in 2013.

The Directors' remuneration report is provided in three sections in line with the requirements set out in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, as follows:

1. A statement from the Chair of the Remuneration Committee;
2. The Society's Directors' remuneration policy; and
3. Remuneration outcomes for 2013.

At the AGM in May 2014:

- The Directors' remuneration policy will be put to a binding vote; and
- The annual Directors' remuneration report will be put to an advisory vote.

Directors' remuneration policy

This section of the report sets out the remuneration policy for which the Society will seek approval at the AGM. Our intention is that the policy, subject to such approval, will be effective from the day after the AGM.

We would make particular reference to the following:

- The maximum opportunity under the discretionary annual bonus scheme for executive Directors to be 50% of base salary. This is consistent with the Finance Director's maximum opportunity of 50%. As an exception, the current Chief Executive's bonus opportunity will remain at 25% for the remainder of his employment at the Society, this having been agreed when he joined in 2009.

- Part deferral of discretionary annual bonus commencing with effect from the 2014 financial year. An amount of 70% of the sum determined by the Remuneration Committee under the bonus scheme will be paid in January 2015 with the remaining 30% payable in January 2016. Payment of the deferred amount can be cancelled or reduced in specific circumstances, which are detailed in the policy table that follows.

- The Society currently has two executive Directors. While there are no current plans, the Society may, in the future, decide to increase the number of executive Directors.

The policy is intended to give the Society sufficient flexibility to manage Directors' remuneration and to handle changing circumstances without having to seek approval other than at future AGMs.

Executive Director remuneration comprises salary, an annual performance bonus, participation in an LTIP, payments in lieu of pension contributions, together with benefits comprising travel, private medical insurance, life insurance and permanent health insurance. Details are set out in the table that follows.

Directors' remuneration policy (continued)

Base salary

Purpose and link to strategy
Guaranteed cash earnings to attract and retain executives of suitably high calibre to manage the Board's strategic plans and lead the Society.

Maximum potential value
Chief Executive: £450,000 p.a.; Finance Director: £229,500 p.a.

Reflects the individual's skills and experience.

Reviewed annually with changes usually effective from 1 January, if applicable. The annual pay increase for the Society's staff is taken into account. Promotion or an increase in responsibility could lead to a higher increase.

Total remuneration is referenced to the median for the sector. We may pay higher salaries and total remuneration for strongly performing individuals or to attract and retain executives of the right calibre.

Operation
Paid monthly in twelve equal instalments.

Performance metrics
None, although overall performance of the individual is considered by the Committee when setting and reviewing salary annually.

Benefits

Purpose and link to strategy
The Society does not provide an occupational pension scheme for Directors. Directors are provided with a cash allowance in lieu.

The Society also pays the premiums on behalf of Directors relating to medical insurance, permanent health insurance and life assurance, particulars of which may be obtained from the Company Secretary. The Committee may alter benefits from time to time and, where this occurs, an explanation will be provided in the subsequent annual Directors' remuneration report.

London is the principal place of work for executive Directors. When Directors are required to travel to the Society's Aylesbury office, the associated costs are covered by the Society.

Maximum potential value
Cash allowance in lieu of pension: Chief Executive: £70,000 p.a.; other executive Directors: 10% of base annual salary.

Insurance premiums vary year by year. The current annual cost is shown in the executive Directors' emoluments table.

The costs of travel to Aylesbury vary year by year in line with business needs.

Operation
The cash allowance in lieu of pension is paid monthly in twelve equal instalments.

No changes were made to the insurance benefits during the year.

The costs of travel to Aylesbury are taxable benefits, and are paid by the Society on a 'grossed up' basis.

Performance metrics
None.

Annual discretionary bonus

Purpose and link to strategy
Rewards achievement of key deliverables in the relevant financial year.

Maximum potential value
50% of base salary.

The current Chief Executive's maximum bonus opportunity will remain at 25% for the remainder of his employment with the Society.

Operation
Performance is monitored throughout the year, and a formal assessment in respect of senior management is presented to the Remuneration Committee at the half year and year end.

Where performance is at the threshold level, typically 75% of the maximum bonus is paid but, in some circumstances, it may be lower. Where performance is assessed as exceeded, bonus of up to the maximum is payable. Where performance does not reach the threshold level, no bonus is payable.

An amount of 30% of the sum awarded is to be deferred with effect from the 2014 financial year. Payment of the deferred amount can be cancelled or reduced in specific circumstances such as re-statement of the financial accounts of the Society, failure by the individual to comply with regulation, significant adverse post-implementation review findings relating to a project or task for which the individual is accountable or dismissal for cause.

Performance metrics
A 'balanced scorecard' is agreed each year setting out specific performance objectives. Objectives are determined so that the interests of bonus scheme participants and of policyholders are aligned. In particular, there is a strong focus on ensuring that executives act in ways that achieve business stability through, for example, treating customers fairly and prudently managing risk. The target objectives of executive Directors clearly state the tolerated level of risk, and support the prompt and effective mitigation of risks arising beyond this tolerated level. Details of the 2013 and 2014 scorecards are set out later in the Directors' remuneration report.

Long-term incentive plan

Purpose and link to strategy
Rewards achievement of key deliverables relevant to the longer-term strategy of the Society, and is designed to retain key staff.

Maximum potential value
The total maximum value of the plan for the Finance Director is £337,500. The Chief Executive does not participate in the plan.

Operation
Two vesting dates to which business and individual performance conditions apply. The first vesting payment is deferred by 12 months. Performance conditions must be met for payment to be made.

The current LTIP comes to an end in 2015 and the Remuneration Committee is considering what to do for the future. As is the case today, performance conditions under any new plan will relate to the longer-term delivery of the Society's strategy and will be distinct from the criteria used to determine payment of the discretionary annual bonus. Should a new incentive plan be introduced, the value will remain broadly similar to that currently.

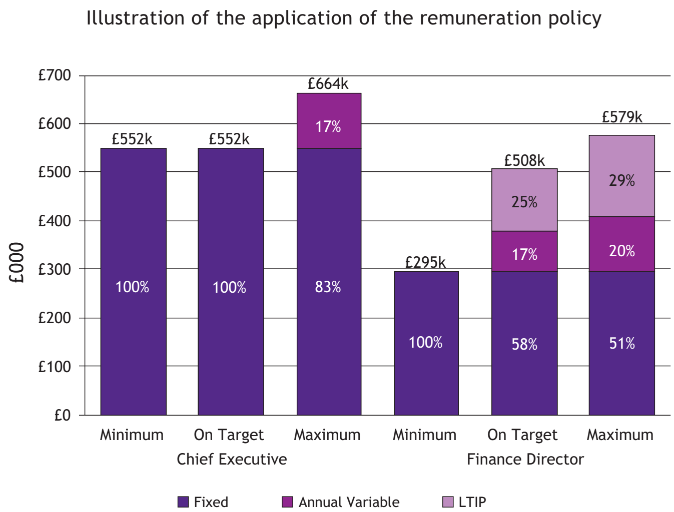
Performance metrics
Continued effective capital distribution to policyholders; expense reduction in line with long-term targets; prompt identification and mitigation of risks.

Illustration of the application of the remuneration policy

We estimate that the level of remuneration received by each of the two executive Directors for the first full year in which the policy applies will be, indicatively, at three different levels of performance:

1. Minimum: where only fixed pay (salary, benefits and cash in lieu of pension) is payable and no bonus or long-term performance-related pay accrues;
2. On target: fixed pay plus annual discretionary bonus and long-term performance-related pay vesting both at on target level; and
3. Maximum: fixed pay plus full vesting of all performance-related pay.

The chart below shows the value and composition in terms of fixed, annual variable and LTIP of the remuneration package of the Chief Executive and Finance Director under the three levels of performance described above.



The basis of calculation and key assumptions used to compile the chart are as follows:

- Salary, benefits in kind and cash in lieu of pension, as described in the remuneration policy table, are shown at the estimated cash cost to the Company. No relocation assistance is currently in payment.
- Bonus at on target reflects the position where the corporate and personal metrics in the balanced scorecard are achieved. Bonus at maximum reflects the position where overall performance is exceeded and represents the amount at which the bonus payment is capped.
- The LTIP figures relate only to the Finance Director. The Chief Executive does not participate in the plan. LTIP on target represents the value of each vesting at 75% of the maximum. LTIP at maximum represents the capped maximum payment.

Approach to recruitment of Directors

Our approach is that total remuneration should be referenced to the market median for on target performance. This is consistent with the treatment of existing Directors. Exceptional performance would lead to total reward in or close to the upper quartile market position but not in the top decile.

The remuneration components for new Directors would be the same as those for existing Directors; that is: base salary; discretionary annual bonus with a maximum opportunity of 50% of base salary; LTIP with a maximum payment of 150% of base salary at the time of participating in the plan; 10% of base salary cash payment in lieu of a pension contribution; and payment of medical insurance, permanent health insurance and life insurance premiums. Exceptionally, the Remuneration Committee may make a payment towards the cost of relocation. The specific individual circumstances of the joining Director will be the basis for determining whether any such costs will be met. No such payments were made in 2013.

As a consequence of joining the Society, new Directors may lose the right to payments from their previous employer. While we would not compensate a Director for this upon arrival, we may choose to recognise such loss through the discretionary annual bonus, should performance justify this. We may also similarly recognise preparation by the Director in readiness for joining the Society.

Payment for loss of office

The notice period for the Chief Executive is twelve months, and for other executive Directors, six months. These time periods have been put in place to safeguard the Society, in recognition that it typically takes several months to appoint successors to these positions.

The Society has the right to terminate any Director's employment by making a payment in lieu of the whole or unexpired part of the notice period. Such payment in lieu would be a sum equivalent to the Director's then annual salary for the relevant period.

Executive Directors are not eligible for a redundancy payment. Termination payments will be calculated on the following basis:

- Base salary due in respect of the notice period remaining;
- Benefits in respect of the same period;
- Discretionary annual bonus relating to the period worked, for example, a 'good leaver' with a leaving date halfway through the financial year could receive a bonus relating to half a year's work; and
- A payment under the LTIP subject to being a good leaver.

The LTIP includes the following provisions:

- A good leaver is defined as an individual ceasing to hold office or employment with the Society by reason of death, injury, ill health, redundancy or retirement; and
- If a good leaver ceases to be employed by the Society before the final vesting date, the participant may be paid an amount as determined by the Remuneration Committee. If the participant is not a good leaver, the participant shall not be so entitled.

Service contracts

There are no obligations on the Society in the Directors' service contracts which could give rise to, or impact on, remuneration payments or payments for loss of office which are not disclosed elsewhere in this report. No legacy matters arise from previous contracts. The contracts are available for inspection at the Society's registered office.

Use of discretion

The Committee has discretion to increase base salary. This would typically take place at the time of the annual pay rise, on promotion or following an increase in responsibility.

The Remuneration Committee exercises discretion regarding payments under the discretionary annual bonus and LTIP up to the maxima disclosed in this report and in determining whether a Director ceasing employment is defined as a good leaver.

Such discretion is necessary not only to evaluate the annual bonus and LTIP but also to reduce payments where circumstances are appropriate. Such flexibility is considered to be in the best interests of the Society and, other than in respect of base salary and the discretionary annual bonus scheme, is only exercised exceptionally.

Directors' remuneration in the context of pay and employment in the Society

The Society applies the same remuneration principles to all staff, ensuring there is alignment with business strategy throughout the Society. As well as salary, pension and other benefits, all staff have the opportunity to receive a discretionary annual bonus. Some senior managers have the opportunity to participate in the LTIP.

The Remuneration Committee takes into account any annual pay increase for Society staff when determining the levels of pay for Directors.

The Society shared the Directors' remuneration policy with ACCORD, our employees' trades union, prior to the policy being finalised.

Succession planning

The Society acts to ensure that successors are identified and prepared for filling senior management positions in case of planned or unplanned departure. In some cases, this can be achieved by passing on responsibilities to other senior managers, rather than making a replacement appointment. This approach has proven effective when addressing recent changes at executive level.

Succession planning is reviewed twice each year by the Remuneration Committee, and actions are undertaken to ensure effective continuity of management within the Society. The relatively small size of the Society means that it is not always possible to fill senior positions internally, and the Society maintains appropriate links with firms experienced at identifying external candidates.

Consideration of member views

The proxy votes received, excluding abstentions, in respect of the Remuneration report at the Society's AGM held on 20 May 2013, were as follows:

	2012	2013
For	50,738 (88%)	58,674 (89%)
Against	7,013 (12%)	7,264 (11%)

In drawing up the remuneration policy, the Society has been informed by this level of approval, by comments made at the AGM, and by the small number of letters received about remuneration during the past year.

Non-executive Directors' fees

Non-executive Directors receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives. Fees are set by reference to market data, and the Board has discretion to increase fees periodically. The rationale for any increase will be provided. The fees for non-executive Directors, other than the Chairman, were last increased in 2012.

The Chairman's fees were last increased in 2013. In both cases, these increases were the first since 2009.

Non-executive Directors' remuneration, other than that for the Chairman, is set by the Board. As previously stated, the remuneration of the Chairman is set by the Remuneration Committee.

Fees for the non-executive Directors are as follows:

	Annual fee	Effective from
Chairman	£140,000 p.a.	1 July 2013
Senior Independent Director and Chair of Audit and Risk Committee	£55,000 p.a.	1 July 2012
Other non-executive Directors including Chair of Remuneration Committee	£45,000 p.a.	1 July 2012

There is a one month notice period under non-executive Directors' service agreements.

Annual report on remuneration

The total emoluments of the Directors were as follows:

Executive Directors' emoluments

	Salary		Performance related bonus		Benefits[1]		Long-term incentive plan		Total	
	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013
	£	£	£	£	£	£	£	£	£	£
C M Wiscarson	450,000	450,000	-	-	90,896	101,712	-	-	540,896	551,712
S A Small[2]	99,808	225,000	98,438	112,500	15,740	65,192	-	-	213,986	402,692
Other[3]	230,000	95,795	86,250	-	29,158	11,215	-	-	345,408	107,010
Total	**779,808**	**770,795**	**184,688**	**112,500**	**135,794**	**178,119**	**-**	**-**	**1,100,290**	**1,061,414**

Notes:

[1] London is the principal place of work for executive Directors. When they are required to travel to the Society's Aylesbury office, the associated costs are covered by the Society. These are taxable benefits. The amount in 2013 in respect of C M Wiscarson was £21,375 (2012: £9,760) and S A Small £37,715 (2012: £3,928), and these sums are included under Benefits above. The increased travel in 2013 was necessary following M Earls' resignation. The 2013 figures are best estimates, with the precise amount to be finalised following tax year end.

[2] S A Small was appointed as a Director with effect from 23 July 2012.

[3] M Earls was paid to 6 May 2013, the end of his contractual notice period.

Audited by PricewaterhouseCoopers LLP

Payments to past Directors

No discretion was applied by the Remuneration Committee to payments made to M Earls. Mr Earls received payment in accordance with his contract, being his base salary and associated benefits. His eligibility for a payment under the LTIP ceased upon his resignation.

Relative importance of spend on pay

In 2013, spend on pay totalled £16m (2012: £18m). The table below compares this to capital distributions and attributable final and interim bonuses paid to policyholders of £31m (2012: £37m). In the future, in line with our strategy of increasing capital distribution and providing best value-for-money cost base, we expect the level of capital distributions to increase and for total spend on pay to reduce.

	2012 £m	2013 £m
Remuneration of executives	1	1
Remuneration of employees other than executives	14	12
Other including social security and pension costs	3	3
Total spend on pay	18	16
Capital distribution amounts and attributable final and interim bonuses	37	31
Total spend on pay as a percentage of capital distribution amounts plus attributable final and interim bonuses	48%	50%
Remuneration of executives as a percentage of remuneration of all employees	7.5%	8.4%

Executive pay represented 8.4% of the total spend on pay in 2013 (2012: 7.5%).

Benefits

As the Society does not provide an occupational pension scheme for Directors, C M Wiscarson and S A Small have no accrued pension entitlements (2012: no accrued pension entitlements). Other benefits relate to travel and premiums for medical insurance, permanent health insurance and life assurance.

Performance related bonus

The performance of C M Wiscarson against the objectives in his balanced scorecard was as follows:

Objective	Measure	Performance
Policyholders	Payments to policyholders within agreed timescales	Achieved
	Policyholder views regarding direction of Society: percentage of positive views less percentage of negative views to be greater than 50%	Exceeded
Financial	Solvency ratios within appetite	Exceeded
	Not to exceed cost budget	Achieved
Risk	Manage risk within agreed limits	Achieved
	Effective governance	Achieved
Projects	Reduced capital requirement following settlement of the Staff Pension Scheme arrangements	Exceeded
	Transfer of IT data centre to Atos	Achieved
People	Staff survey positive scores exceed 70% on all questions	Achieved

The Remuneration Committee considered that C M Wiscarson's performance was at the top of expectations and merited a bonus at 25% of base salary. It was C M Wiscarson's wish not to accept a bonus and the Committee accepted this. No bonus payments have been made to C M Wiscarson since joining in 2009.

The remuneration of the Society's Chief Executive since 2009 has been as follows:

Year	Chief Executive	Chief Executive's total remuneration	Annual bonus as % of maximum opportunity	Long-term vesting as % of maximum opportunity
2013	C M Wiscarson	£551,712	0%	0%
2012	C M Wiscarson	£540,896	0%	0%
2011	C M Wiscarson	£533,788	0%	0%
2010	C M Wiscarson	£537,623	0%	0%
2009*	C M Wiscarson	£177,472	0%	0%
2009*	C G Thomson	£1,388,153	85%	100%

* C G Thomson resigned on 26 August 2009 and C M Wiscarson became Chief Executive from 2 September 2009.

C M Wiscarson does not participate in any LTIP.

There has been no change in the remuneration of the Chief Executive compared with 2012. By comparison, employees of the Society received a 2% increase in base salary effective from 1 January 2013, and most staff received an annual discretionary bonus.

The performance of S A Small against his objectives was as follows:

Objective	Measure	Performance
Policyholders	Capital distribution	Exceeded
	Policyholder views regarding direction of Society: percentage of positive views less percentage of negative views to be greater than 50%	Exceeded
Financial	Solvency ratios within appetite	Exceeded
	Not to exceed cost budget	Achieved
	Operational excellence targets	Achieved
Risk	Embedding finance policies	Achieved
	Effective oversight of third party relationships	Achieved
Projects	Transfer of IT data centre to Atos	Exceeded
People	Staff survey positive scores in Finance exceed 70% on all questions	Achieved

S A Small's performance was considered by the Committee to merit a maximum bonus of 50% of base salary, particularly in view of the increase in capital distribution and his leadership of the IT data centre transfer programme.

Performance targets for 2014

The 2014 balanced scorecard set for C M Wiscarson is as follows:

Objective	Measure	Performance Required
Policyholders	Payments to policyholders within agreed timescales Policyholder views regarding direction of Society	Issue payments within agreed timescales Percentage of positive views less percentage of negative views to be greater than 50%
Financial	Solvency ratios Expenses budget	Ratios to be within agreed limits Not to exceed budget
Risk	Manage risk within agreed limits Solvency II preparation	Key risk indicators in place and monitored Not to exceed risk limits Deliver to agreed milestones
Projects	Strategic projects	Complete projects to time, cost and quality
People	Staff survey	Positive scores to exceed 70% on all questions

The 2014 balanced scorecard set for S A Small is as follows:

Objective	Measure	Performance Required
Policyholders	Investment management Policyholder views regarding direction of Society	Manage investments within agreed limits in best interests of policyholders Percentage of positive views less percentage of negative views to be greater than 50%
Financial	Solvency ratios Expenses budget New reporting requirements Cost targets in Business Plan	Ratios to be within agreed limits Not to exceed budget Successful implementation Agree and implement tighter cost targets
Risk	Third party management Finance's Solvency II preparations IT key performance indicators	Effective oversight Deliver to agreed milestones Performance to be in line with indicators
Projects	Strategic projects	Complete sponsored projects to time, cost and quality
People	Finance staff survey	Positive scores to exceed 70% on all questions

2014 pay award

It is the Society's practice to review basic salaries towards the end of each financial year, taking into account affordability, changes in pay within the insurance sector and the external economic environment. In 2013, following such review, it was decided to award a 2% increase in basic annual salary, from January 2014 (January 2013: 2%). No change was made to the salary of the Chief Executive.

Payments made to non-executive Directors[#]

Total payments to non-executive Directors are set out below. No other payments were made.

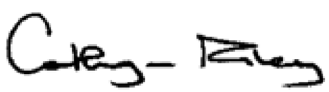
Non-executive Directors	2012 £	2013 £
I Brimecome, Chairman	125,000	132,500
Other non-executive Directors		
I A Gibson*	n/a	16,558
K Nicholson	50,000	55,000
D I W Reynolds	42,500	45,000
C Riley	42,500	45,000
Other**	30,000	n/a
Total for non-executive Directors	**290,000**	**294,058**

* I A Gibson was appointed on 20 August 2013.
** D H Adams retired on 30 September 2012.

[#] Audited by PricewaterhouseCoopers LLP

Approval

This report was approved by the Board of Directors on 20 March 2014 and signed on its behalf by:



Cathryn Riley
Chair, Remuneration Committee

7. Statement of compliance with the UK Corporate Governance and Annotated Codes

The Board considers that the Society has applied the relevant principles and has complied with all the relevant provisions of the UKCGC and the Annotated Code (and associated guidance) throughout the year except for the matters summarised below. The Board does not regard the exceptions as a material departure from the principles and provisions of the UKCGC and the Annotated Code.

Non-executive Directors are not appointed for a specific term. With effect from 1 January 2015, the terms of office for non-executive Directors will be set to be not more than three years. The Board will be able to renew the terms of office if it considers this appropriate.

The performance evaluation of the Board and its Committees was facilitated by the Board's independent advisor.

Until December 2013, decisions regarding the remuneration of the Chairman were taken by the Board, following recommendations from the Chair of the Remuneration Committee and the Chief Executive.

Until December 2013, the Board considered that, rather than an individual or individuals needing to have recent and relevant financial experience, the Audit and Risk Committee as a whole should be considered as having the requisite skills and experience.

Signed on behalf of the Society's Board of Directors

Ian Brimecome
Chairman

20 March 2014

Report on the Society's financial statements

Our opinion

In our opinion the Society's financial statements:

- give a true and fair view of the state of the Society's affairs as at 31 December 2013 and of the Society's result for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say below.

What we have audited

The Society's financial statements, which are prepared by The Equitable Life Assurance Society, comprise:

- the Society's balance sheet as at 31 December 2013;
- the Society's profit and loss account for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). Certain disclosures required by the financial reporting framework have been presented elsewhere in the Annual Report and Accounts ("the Annual Report"), rather than in the notes to the Society's financial statements. These are cross-referenced from the financial statements and are identified as audited.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Society's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the Society's audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Society's financial statements as a whole to be £34million. In arriving at this judgement, we have had regard to the Society's Excess of Realistic Assets over liabilities, which is the amount available to meet liabilities in excess of those provided for at the balance sheet date, as well as to increase payouts to policyholders in the future.

We agreed with the Audit and Risk Committee that we would report to them misstatements identified during our audit above £1.5million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

In establishing the overall approach to our audit, we assessed the risks of material misstatement and applied professional judgement to determine the extent of testing required over each balance in the Society's financial statements. We tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, testing transactions and balances to supporting evidence or a combination of both. In respect of outsourced service providers (third party organisations providing investment management, custody and information technology support services to the Society) we were able to gain appropriate audit evidence through a combination of evaluating the providers' published assurance report on internal control and testing controls operated by the Society that monitor the procedures carried out by the service providers.

Areas of particular audit focus

In preparing the Society's financial statements, the Directors made a number of subjective judgements, for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified during our audit. We discussed these areas of focus with the Audit and Risk Committee. Their report on those matters that they considered to be significant issues in relation to the Society's financial statements is set out on page 22.

Area of focus	How the scope of our audit addressed the area of focus
Valuation of long-term business provision We focused on the Directors' assessment of the valuation of the long-term business provision for settlement of future benefits because it involves complex and subjective judgements about future events, both internal and external to the business, for which small changes can result in significant impacts to the valuation of the long-term business provision. Those assumptions to which the long-term business provision is most sensitive include future improvements in mortality, future administrative expenses and persistency including how the Guaranteed Investment Return affects policyholder behaviour.	We assessed the Directors' valuation of the long-term business provision by testing the underlying Society data, the approach and the assumptions used against recognised actuarial practices and by applying our industry knowledge. Our work involved testing the data used by the Directors in the determination of the assumptions to policyholder records and industry statistics.
Valuation of 'Level 3' financial investments We focused on this area, given the materiality of the related balances and the subjective nature of the valuation of assets classified as 'Level 3' in the fair value hierarchy in note 9d to the Society's financial statements.	We understood the basis on which the Directors and the Society's investment manager determined the fair valuation of these financial investments. We tested the methodology and assumptions used in the valuation applied by the Directors, which included consideration by us of independent data sources.
Risk of management override of internal controls ISAs (UK & Ireland) require that we consider this.	We assessed the overall control environment of the Society including the arrangements for staff to 'whistle-blow' inappropriate actions and interviewed senior management and the Society's Internal Audit function. We examined the significant accounting estimates and judgments relevant to the Society's financial statements for evidence of bias by the Directors that may represent a risk of material misstatement due to fraud. We also tested a sample of manual journal entries.

Going concern
The Directors have voluntarily complied with Listing Rule 9.8.6 (R) (3) of the Financial Conduct Authority and provided a statement in relation to going concern, set out on page 15, required for companies with a premium listing on the London Stock Exchange.

The Directors have requested that we review the statement on going concern as if the Society were a premium listed company. We have nothing to report having performed our review.

As noted in the Directors' report, the Directors have concluded that it is appropriate to prepare the Society's financial statements using the going concern basis of accounting. The going concern basis presumes that the Society has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the Society's financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Society's ability to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Strategic report and the Directors' report for the financial year for which the Society's financial statements are prepared is consistent with the Society's financial statements.

Other matters on which we are required to report by exception
Adequacy of accounting records and information and explanations received
Under the Companies Act 2006, we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Society, or returns adequate for our audit have not been received from branches not visited by us.

We have no exceptions to report arising from this responsibility.

Directors' remuneration
Under the Companies Act 2006, we are required to report if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from these responsibilities.

Corporate governance statement
On page 15 of the Annual Report, as required by Provision C.1.1 of the Annotated UK Corporate Governance Code issued by the Association of Financial Mutuals, the Directors state that they consider the Annual Report and Accounts taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. On page 22, as required by C.3.8 of the Code, the Audit and Risk Committee has set out the significant issues that it considered in relation to the Society's financial statements, and how they were addressed. Under ISAs (UK & Ireland), we are required to report to you if, in our opinion:

- the statement given by the Directors is materially inconsistent with our knowledge of the Society acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the Audit and Risk Committee does not appropriately address matters communicated by us to the Audit and Risk Committee.

We have no exceptions to report arising from this responsibility.

Other information in the Annual Report
Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the Society's audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Society acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Matter on which we have agreed to report by exception

Corporate governance statement

The Directors have requested that we review the parts of the Corporate governance statement relating to the Society's compliance with the nine provisions of the UK Corporate Governance Code as specified for our review by the Listing Rules of the Financial Conduct Authority (because the Society applies listing rules 9.8.6R 5 and 6 as if it were a listed company) and with the eight provisions of the code specified by the Association of Financial Mutuals. We have nothing to report having performed our review.

Responsibilities for the financial statements

Our responsibilities and those of the Directors

As explained more fully in the Directors' report on pages 14 and 15, the Directors are responsible for the preparation of the Society's financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Society's financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Marcus Hine

Marcus Hine (Senior Statutory Auditor) for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
20 March 2014

Technical account – long-term business

	Notes	2012 £m	2012 £m	2013 £m	2013 £m
Earned premiums, net of reinsurance					
Gross premiums written	3	46		25	
Outward reinsurance premiums		(14)		(15)	
			32		10
Investment income	4		349		296
Other technical income			4		4
Total technical income			**385**		**310**
Claims incurred, net of reinsurance					
Claims paid – gross amount	5	464		402	
Reinsurers' share		(34)		(34)	
			430		368
Changes in other technical provisions, net of reinsurance					
Long-term business provision – gross amount	12d	(39)		(595)	
Reinsurers' share	12d	(49)		54	
			(88)		(541)
Technical provisions for linked liabilities – gross amount	12d	153		291	
Reinsurers' share	12d	(179)		(290)	
			(26)		1
Net operating expenses					
Administration expenses	6a	35		33	
Exceptional expenses projects	6a	24		21	
Exceptional expenses former pension scheme	6b	(10)		16	
			49		70
Investment expenses including interest	4		7		7
Other technical charges			1		-
Unrealised loss on investments	4		9		403
Taxation attributable to the long-term business	8		3		2
			69		482
Total technical charges			**385**		**310**
Balance on the Technical Account			-		-

The results for 2013 and 2012 are not consolidated as explained in Note 1a. All significant recognised gains and losses are dealt with in the Profit and Loss Account. All amounts relate to continuing operations. The Notes on pages 42 to 70 form an integral part of these financial statements.

Balance sheet

as at 31 December 2013

Assets

	Notes	2012 £m	2013 £m
Investments			
Land and buildings	9a	114	3
Investments in Group undertakings	9b	21	22
Shares and other variable yield securities and units in unit trusts	9c	129	61
Debt and other fixed-income securities	9c	5,384	4,934
Deposits and other investments	9c	311	307
		5,959	**5,327**
Assets held to cover linked liabilities	10	**262**	**263**
Reinsurers' share of technical provisions			
Long-term business provision	12c	428	374
Technical provisions for linked liabilities	12c	1,936	1,961
		2,364	**2,335**
Debtors			
Debtors arising out of direct insurance operations	11	4	4
Debtors arising out of reinsurance operations	11	5	-
Other debtors	11	15	4
		24	**8**
Other assets			
Cash at bank and in hand		**9**	**7**
Prepayments and accrued income			
Accrued interest and rent		73	65
Other prepayments and accrued income		2	4
		75	**69**
Total assets		**8,693**	**8,009**

The Notes on pages 42 to 70 form an integral part of these financial statements.

Liabilities

	Notes	2012 £m	2013 £m
Technical provisions	12a		
Long-term business technical provision – gross amount		6,267	5,671
Technical provisions for linked liabilities	12b	2,198	2,224
		8,465	**7,895**
Provision for other risks and charges	15	53	-
Creditors			
Creditors arising out of direct insurance operations		21	21
Creditors arising out of reinsurance		-	2
Amounts owed to credit institutions	16a	6	4
Other creditors including taxation and social security	16b	130	71
		157	**98**
Accruals and deferred income		**18**	**16**
Total liabilities		**8,693**	**8,009**

These financial statements were approved by the Board on 20 March 2014 and were signed on its behalf by:

Simon Small
Finance Director

Equitable Life Assurance Society registered company number 37038

The Notes on pages 42 to 70 form an integral part of these financial statements.

1. Accounting policies

a. Basis of presentation

The financial statements have been prepared under the provisions of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance companies, 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 section h. 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 Directors' report on page 15.

The Society had IT services provided by the Lloyds Banking Group ("LBG") and had funding commitments in connection with former staff pension arrangements. References to LBG in these accounts relate to various LBG companies.

The size of the Society's remaining subsidiary company is immaterial from the point of providing a true and fair view of the affairs of the Group. Therefore, these accounts are not consolidated and 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-profits 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, and are almost entirely unit-linked contracts.

Hybrid policies that include both discretionary participation feature 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 underlying policies reinsured by the treaty are classified as insurance and others as investment. Rather than classifying the reinsurance treaty as a whole, the underlying policies have been considered and the reinsurance classified accordingly.

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'.

Claims

Death claims are recorded on the basis of notifications received. Retirements at the option of policyholders and surrenders are recorded when notified; contractual retirements, maturities and annuity payments are recorded when due. Claims on with-profits business include bonuses payable, which in turn include capital distribution amounts. Claims payable include interest and 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 k.

e. Investment contracts without discretionary participation feature

Unit-linked and non-profit investment contracts classified as investment without discretionary participation feature are classified as financial instruments under FRS 26 and so have been accounted for using the principles of deposit accounting. Policyholders' deposits and withdrawals are not included in premiums and claims in the Profit and Loss Account, but are accounted for directly in the Balance Sheet as adjustments to technical provisions. Fees receivable from investment contracts without discretionary participation feature are reported in 'Other technical income'.

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, and movements in unrealised gains and losses, net of investment expenses, including interest payable on financial liabilities.

Investment income, including interest income from fixed-interest investments and rent, is accrued up to the balance sheet date. Other income is recognised when it becomes payable.

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. 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 that were designated at inception as fair value through the Profit and Loss Account. As required by FRS 26, derivative instruments have been classified as held for trading. All other financial assets have been classified as fair value through the Profit and Loss Account. No material financial assets have been classified as held to maturity, loans and receivables or as available for sale under FRS 26 classification.

The Society's derivatives are 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'.

1. Accounting policies (continued)

g. Valuation of investments (continued)

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.

h. 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 Institution 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.

i. 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.

j. Impairment policy

The Society reviews the carrying value of its assets (other than those held at fair value through the Profit and Loss Account) 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 Profit and Loss Account. 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.

k. 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 combined Financial Conduct Authority ("FCA")/Prudential Regulation Authority ("PRA") 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 PRA realistic capital regime and in accordance with the requirements of FRS 27. These liabilities include guaranteed bonuses and 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. With-profits policy liabilities do not include an allowance for capital distribution.

With-profits technical provisions include 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 capital, as described in the Strategic report.

The calculation of the long-term business provision for all non-profit and index-linked annuity business is calculated using the gross premium valuation method, where the provision equals the discounted value of benefits and expenses.

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.

l. 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.

m. 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. Income and expense transactions have been translated at rates of exchange ruling at the time of the transactions.

n. Segmental reporting

In the opinion of the Directors, the Society operates in one business segment, being that of long-term insurance business.

2. Reinsurance

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. However, the primary obligation under the policies remains with the Society and so the technical provisions on the balance sheet include reinsured policies.

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. 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 reinsurance contracts create an asset on the Balance Sheet of £2,335m, being the entitlement for the Society to recover from LBG the claims paid under reinsured business (see Note 12c). 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 has several other outward reinsurance contracts under which relatively small volumes of business are reinsured.

The reinsurance balance amounted to a credit to the long-term business Technical Account at 31 December 2013 of £255m (2012: £248m credit). This credit is largely driven by an increase in the reinsurer's share of liabilities for unit-linked policies and is offset by a corresponding increase in the technical provisions for linked liabilities.

3. Earned premiums

Premiums received in respect of investment contracts without discretionary participation feature are not included in the Technical Account or in the table below, as stated in Note 1e. The total of these deposits received in 2013 was £34m and represents linked pension business (2012: £54m).

New premium deposits were £3m (2012: £23m). Premium income included in the Technical Account is analysed in the table below.

	2012 £m	2013 £m
Analyses of gross premiums:		
Individual premiums	43	24
Premiums under group contracts	3	1
	46	**25**
Regular premiums	29	20
Single premiums	17	5
	46	**25**
Premiums from non-profit contracts	21	14
Premiums from with-profits contracts	22	9
Premiums from linked contracts	3	2
	46	**25**
Premiums from life business	15	13
Premiums from annuity business	1	-
Premiums from pension business	30	12
	46	**25**
Premiums from UK business	44	23
Premiums from overseas business	2	2
	46	**25**

3. Earned premiums (continued)

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 a number of instances, including:

- Unless classified as investment contracts without discretionary participation feature, 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.

Of the £25m gross premiums reported in the Technical Account and analysed in the preceding table, £5m was new premium income in the year (2012: £18m). The new premium income related to single premium pension business and was split £2m non-profit, £2m with-profits and £1m linked (2012: £7m non-profit, £10m with-profits, £1m linked). Annual equivalent premiums in respect of new business received during the year were £0.5m (2012: £2m). New premiums in respect of reinsured business during the year were £1m (2012: £1m).

4. Total investment return

	2012 £m	2013 £m
a. Total investment return		
Investment income comprises income from:		
Land and buildings	7	1
Other investments[1]	226	204
Net gains on realisation of investments	116	91
Investment income and net realised gains at fair value through the Profit and Loss Account	**349**	**296**
Investment expenses including interest comprise:		
Investment management expenses	**(7)**	**(7)**
Unrealised losses on investments	**(9)**	**(403)**
Investment return for the year	**333**	**(114)**

Note:

[1] Included within the table above is £33m net loss (2012: £11m net gain) in respect of derivative investments (US dollar to sterling forward exchange contracts and interest rate swaptions), held to mitigate currency and interest rate risks. All derivatives are designated as held for trading.

The unrealised loss in 2013 is largely driven by rising yields reducing the value of gilts. The investment return of (£114m) corresponds to a return on invested assets of -2.0% (2012: 5.6%). The relationship between the return on invested assets and the return allocated to policies is explained in the Strategic report.

b. 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

	2012 £m	2013 £m
Claims paid - gross claims	464	402
Investment contract claims which are deposit accounted for and so not included in the Technical Account	142	299

Claims paid include claims handling expenses of £1m (2012: £1m).

Included in the above payments are capital distribution amounts and attributable final and interim bonuses for the Society of £31m (2012: £37m).

6. Net operating expenses

	2012 £m	2013 £m
a. Non-exceptional		
Administration expenses	35	33
b. Exceptional		
Costs of strategic initiatives and other projects	23	20
Redundancies	1	1
Cost of operating the business	**59**	**54**
Exceptional costs of former pension scheme	(10)	16
Total net operating expenses	**49**	**70**

Exceptional expenses represent expenses associated with the Society's strategic initiatives and are not associated with the administration of policies. Costs of strategic initiatives and other projects include the costs associated with the transfer of IT services to our new IT provider Atos, and activity relating to future strategic initiatives.

The change in the 'Costs of former pension scheme' is explained in the Strategic report and in Note 7c.

c. Services from auditors

PricewaterhouseCoopers LLP ("PwC") has not undertaken any advisory work for the Society in the year. Should PwC be engaged to perform such 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.

6. Net operating expenses (continued)

c. Services from auditors (continued)

During the year, the Society received the following services from the Society's auditor:

	2012 £m	2013 £m
Fees payable for the audit of the Society's accounts	0.4	0.3
Fees payable to the Society's auditor for other services:		
Audit of regulatory return	0.2	0.2
All other services		
Agreed upon procedures associated with half-year position	0.1	0.1
	0.7	**0.6**

7. Directors and employees

	2012 £m	2013 £m
a. Staff costs		
Wages and salaries	15	13
Social security costs	2	2
Pension costs	1	1
	18	**16**

The monthly average number of employees employed by the Society during the year, including executive Directors, required to be disclosed in accordance with the Companies Act 2006, was 360 (2012: 396). Staff numbers reduced during 2013 due to efficiencies made in the year.

In addition to employees, the Society engages the services of a number of contractors. Total staff numbers at the end of 2013 were 371 (2012: 416).

Throughout the year, a group personal pension plan with Legal & General 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 Directors' remuneration report.

c. Former staff pension arrangements

The Society entered into an agreement with Clerical Medical Group (now part of LBG) in March 2001, when it sold its administrative and sales operations. As a result of contractual commitments arising from that agreement, the Society met 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.

During 2013, the Society ceased to be a participating employer of the schemes and paid amounts to settle all liabilities in connection with the schemes. The payments made by the Society were £79m; the total provisions held at 31 December 2012 were as detailed in the following table. The payments made reflect the settlement of future as well as past obligations and the transfer of risks and uncertainty associated with the schemes.

The Society's obligations arising from the 2001 contracts in respect of the pension schemes and as an employer associated with the schemes are now fully extinguished.

The table below details the Balance Sheet positions in relation to pension schemes with LBG.

Balance Sheet positions associated with staff pension schemes

	Notes	2012 £m	2013 £m
Provision for other risks and charges			
Pension commitments for former staff	15	53	-
Other creditors including taxation and social security			
Defined benefit pension scheme	16	10	-
		63	**-**
Technical provisions - other long-term liabilities: exceptional expense provision			
Provision for future service cost	12f(iii)	10	-
Provision for future administration cost	12f(iii)	7	-
Total of Balance Sheet positions		**80**	**-**

The 2012 provision for the pension commitments to former staff represented the Society's current best estimate of the amount required to settle its commitment in respect of past service. The best estimate was based on the triennial actuarial valuation performed as at 31 December 2010, as modified for changes in scheme membership, invested assets and other economic factors.

The following table shows an analysis of the movement in the provision in the year.

Change in provision for staff pension schemes in the year

	2012 £m	2013 £m
Opening provision	100	53
Contributions paid in respect of past service	(27)	(9)
Contributions in respect of 2013 agreement	-	(70)
Amount recognised in creditors	(10)	10
Changes recognised in the Technical Account (see Note 6b)	(10)	16
Closing provision	53	-

8. Taxation

	2012 £m	2013 £m
Taxation charged to the Technical Account		
UK corporation tax		
Current tax on income for the period	3	1
Adjustments in respect of previous years	-	1
Total charge	**3**	**2**

The UK corporation tax charge is provided at 20% (2012: 20%), computed in accordance with the rules applicable to life assurance companies, whereby no tax is charged on pension business profits.

9. Non-linked investments

	Cost 2012 £m	Cost 2013 £m	Current Value 2012 £m	Current Value 2013 £m
a. Land and buildings				
Leasehold	67	9	77	2
Freehold	59	3	37	1
	126	**12**	**114**	**3**

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 2013 are £5m (2012: £131m).

	Cost 2012 £m	Cost 2013 £m	Current Value 2012 £m	Current Value 2013 £m
b. Investments in Group undertakings				
Shares	**21**	**21**	**21**	**22**

The Society's group undertaking is a majority investment in Equitable Private Equity Holdings Limited ("EPEHL"), a Guernsey registered company. EPEHL's investment is Knightsbridge Integrated Holdings V L.P., which invests in equity and venture capital projects. EPEHL made a loss in 2013 of £25,000 ($42,000) (2012: £26,000 ($43,000)) and its total net asset value is £22m ($36m) (2012: £21m ($35m)).

	Cost 2012 £m	Cost 2013 £m	Current Value 2012 £m	Current Value 2013 £m
c. Other financial investments held at fair value through the Profit and Loss Account				
Shares and other variable yield securities and units in unit trusts				
Shares and units in unit trusts	109	91	40	18
Other variable yield securities[1]	24	80	89	43
	133	**171**	**129**	**61**
Debt and other fixed-income securities[2]	**5,058**	**4,883**	**5,384**	**4,934**
Deposits and other investments	**311**	**307**	**311**	**307**
	5,502	**5,361**	**5,824**	**5,302**

Notes:

[1] Comprise derivatives including US dollar to sterling forward exchange contracts and interest rate swaptions. The interest rate swaptions are valued on a mark-to-model basis. Both categories are classified as held for trading. If the forward foreign exchange contract is held to maturity in March 2014 the Society will be obliged to pay $46.1m and will receive £28.2m.

[2] Includes listed investments of £4,934m (2012: £5,380m) 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. At the balance sheet date, investments of £329m (2012: £521m) were lent in the normal course of business to authorised money brokers on a secured basis, and investments of £347m (2012: £537m) were received as collateral from brokers. Income earned on stock lending during the year, net of fees paid, was £0.2m (2012: £0.3m).

Collateral received from brokers is government obligations issued or guaranteed by states which are full members of the Organisation for Economic Cooperation and Development ("OECD") and is not less than 102% of the market value of borrowed fixed-income 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 observable price is available.

The Society holds interest rate swaptions, which are valued based on an industry recognised model, which is 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.

9. Non-linked investments (continued)

d. Fair value hierarchies (continued)

(ii) Analysis of investments according to fair value hierarchy:

31 December 2013 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	-	-	-	-	3	3
Investments in Group undertakings	-	-	22	22	-	22
Shares and units in unit trusts	-	-	18	18	-	18
Other variable income securities	-	-	43	43	-	43
Debt securities and other fixed-income securities	3,171	1,497	266	4,934	-	4,934
Deposits and other investments	17	289	1	307	-	307
Total non-linked invested assets	**3,188**	**1,786**	**350**	**5,324**	**3**	**5,327**
Assets held to cover linked liabilities	199	-	64	263	-	263
Total invested assets	**3,387**	**1,786**	**414**	**5,587**	**3**	**5,590**
Total invested assets	**61%**	**32%**	**7%**	**100%**	**-**	**100%**

31 December 2012 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	-	-	-	-	114	114
Investments in Group undertakings	-	-	21	21	-	21
Shares and units in unit trusts	-	-	40	40	-	40
Other variable income securities	-	1	88	89	-	89
Debt securities and other fixed-income securities	3,512	1,639	233	5,384	-	5,384
Deposits and other investments	20	290	1	311	-	311
Total non-linked invested assets	**3,532**	**1,930**	**383**	**5,845**	**114**	**5,959**
Assets held to cover linked liabilities	180	-	82	262	-	262
Total invested assets	**3,712**	**1,930**	**465**	**6,107**	**114**	**6,221**
Total invested assets	**60%**	**31%**	**7%**	**98%**	**2%**	**100%**

(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 2013	465
Total net gains or (losses) recognised in the Profit and Loss Account	(57)
Purchases	124
Sales	(125)
Transfers into Level 3	25
Transfers out of Level 3	(18)
Balance at 31 December 2013	**414**

The total net losses shown above are included within 'Unrealised losses on investments' within the Profit and Loss Account, of which £66m loss relates to assets which were still held at the end of the period.

Five stocks, of total value £25m, were transferred into Level 3 during the period as their valuation was based on inputs that are no longer market observable for those assets.

Four stocks, of total value £18m, 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

	2012 £m	2013 £m
Current value of linked assets held at fair value through the Profit and Loss Account	**262**	**263**

The cost of assets held to cover linked liabilities is £235m (2012: £207m) for the Society.

11. Debtors

	2012 £m	2013 £m
Debtors arising out of direct insurance		
Amounts owed by policyholders	4	4
Debtors arising out of reinsurance	5	-
Other debtors		
Corporation tax asset	-	1
Debtors other than Group and related companies	15	3
	24	**8**

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

	2012 £m	2013 £m
Non-profit technical provisions		
Non-profit insurance technical provisions	1,071	961
Non-profit investment technical provisions	7	7
	1,078	**968**
With-profits technical provisions		
With-profits insurance technical provision		
Policy values	209	184
Cost of guarantees	77	60
Future charges	(30)	(27)
Impact of early surrenders	-	-
Other long-term liabilities	74	35
	330	**252**
With-profits investment technical provision		
Policy values	3,161	2,984
Cost of guarantees	1,103	817
Future charges	(258)	(238)
Impact of early surrenders	(13)	(11)
Other long-term liabilities	278	208
	4,271	**3,760**
Excess Realistic Assets	**588**	**691**
	5,189	**4,703**
Total long-term business technical provisions	**6,267**	**5,671**

b. Gross linked liabilities

	2012 £m	2013 £m
Index-linked annuities	273	274
Other linked insurance liabilities	137	152
Other linked investment liabilities	1,788	1,798
Total linked liabilities	**2,198**	**2,224**

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

	2012 £m	2013 £m
Non-profit insurance technical provisions	421	367
Non-profit investment technical provisions	7	7
	428	**374**
Index-linked annuities	11	11
Other linked insurance liabilities	137	152
Other linked investment liabilities	1,788	1,798
	1,936	**1,961**
Total reinsurers’ share	**2,364**	**2,335**

d. Movement in technical provisions

	Gross technical provisions				Reinsurers’ share of technical provisions	
	Non-linked £m	ERA £m	Sub Total £m	Linked £m	Non-linked	Linked £m
Opening positions	5,679	588	6,267	2,198	428	1,936
Change arising from new deposits[1]	-	-	-	34	-	34
Change arising from withdrawals[1]	-	-	-	(299)	-	(299)
Other changes reported in Technical Account	(699)	103	(596)	291	(54)	290
Closing positions	**4,980**	**691**	**5,671**	**2,224**	**374**	**1,961**

Note:

[1] Premiums (Note 3) and claims (Note 5) in respect of investment contracts without discretionary participation feature are not included in the Technical Account, but are reported as deposits to and withdrawals from technical provisions.

e. Movement in Excess Realistic Assets

The principal movements in the ERA during the period are shown in the following table.

	2012 £m	2013 £m
Opening Excess Realistic Assets	521	588
Investment performance net of changes in policy values	81	75
Variances in expenses and provisions	34	8
Mortality experience and assumption changes	(6)	-
Surrender experience and assumption changes	(5)	(5)
Changes in other valuation assumptions	(29)	24
Other movements	(8)	1
Closing Excess Realistic Assets	**588**	**691**

The primary reason for the increase in the ERA, shown within ‘Investment performance net of changes in policy values’, is the strong performance by corporate bonds as described in the Strategic report.

12. Technical provisions (continued)

f. With-profits technical provisions

The long-term business provisions for the Society's with-profits business have been calculated in accordance with the PRA 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 includes an estimate of any future non-guaranteed bonuses that may be payable. The realistic liabilities do not include an allowance for capital distribution. The value of the liabilities is made up of the following components:

- Policy values: for recurrent single premium ("RSP") policies, the policy value represents a smoothed investment return (net of charges for expense, taxation, the cost of guarantees and other factors) applied to premiums paid. Other types of with-profits policies are valued to achieve an equivalent result;
- Cost of guarantees: the cost of meeting contractual guarantees in excess of the policy values, now and in the future. Further information is provided in section (ii) below;
- Future charges: the margin assumed to be retained each year from the return earned on with-profits assets, before making future increases to policy values. A charge of 1% p.a. (2012: 1% p.a.) is assumed to be retained to provide capital to meet the expected cost of guarantees;
- Impact of early surrender: the value of the Financial Adjustment assumed to be deducted from future non-contractual surrenders. The deduction is assumed to be 5% of policy values (2012: 5%) and depends on the assumed level of surrenders prior to contractual termination. Had the Financial Adjustment been assumed to be 0% the ERA would decrease by £11m (2012: £13m); and
- Other long-term liabilities, including miscellaneous provisions, less a deduction for the present value of future profits from non-profit business. Further information is provided in section (iii) below.

Factors such as economic assumptions, policyholder retirement dates, surrenders and mortality experience affect a number of the above components, and further information is provided in section (i) below.

(i) Factors affecting a number of components of with-profits technical provisions

Economic assumptions

In order to produce valuations of the cost of guarantees, future charges and the impact of early surrenders, an economic model is required to generate projections of policy values in many different economic scenarios. The valuation involves constructing 5,000 scenarios, aggregating the results under each scenario and then calculating the average liability. In each scenario, policy values are assumed to change in line with the projected return on with-profits assets net of charges.

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 2012 to 2013 was to increase the ERA by £22m (2012: decrease £29m). 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 swaption volatilities obtained from market sources. For equity values, the model produces a 10 year volatility of 22% (2012: 26%). For property values, the model uses an assumed volatility of 15% (2012: 15%).

Retirements

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 from age 60, whereas benefits from Group Pension policies are expected to be taken at each scheme's normal retirement age. This date is referred to as the Earliest Contractual Date ("ECD"). A proportion of policyholders take their benefits before and a proportion after 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 experience during 2012 and 2013. 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 ranges of retirement dates assumed vary between policyholders being assumed to retire at ECD (2012: at ECD) and up to 13 years (2012: 13 years) later than ECD.

If the assumed retirement dates were all one year earlier, the ERA would decrease by £5m (2012: increase £17m). If the assumed retirement dates were all one year later, the ERA would increase by £6m (2012: decrease £13m).

Surrenders

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 experience during 2012 and 2013. 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. (2012: 1.5% p.a.). The effect of the change in the surrender rates has been to decrease the ERA by £3m (2012: decrease by £5m).

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	2012	2013
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	82.5% AMC00 ultimate for males
	87.5% AFC00 ultimate for females	87.5% AFC00 ultimate for females

Mortality assumptions for other classes of business are not material and, for this reason, are not shown above.

(ii) Cost of guarantees

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 a guarantee comprises two elements: the intrinsic value and the time value. The intrinsic value is the amount that would be payable if the 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 guarantee. In adopting FRS 27, the intrinsic and time values of all guarantees are included in policyholder liabilities.

All the Society's material guarantees are valued on a market consistent basis using the economic model and assumptions, as described in section (i) above.

The Society has in issue two principal types of with-profits policy: RSP policies and Conventional With-Profits ("CWP") policies. These policies represented 98% and 2%, respectively, of the total policy values at 31 December 2013 (98% and 2% of the total policy values at 31 December 2012). 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.

12. Technical provisions (continued)

f. With-profits technical provisions (continued)

(ii) Cost of guarantees (continued)

The 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.

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 decreased from £1,180m in 2012 to £877m at 31 December 2013, principally as a result of rising government bond yields. This amount is included within 'Technical provisions' (see Note 12a).

There is inherent uncertainty in calculating the cost of these guarantees, 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. Information on retirement, surrender and mortality assumptions is included in section (i) above. For economic assumptions, prices for relevant quoted and non-quoted derivatives are used to confirm market consistency.

(iii) Other long-term liabilities

Technical provisions include amounts in respect of specific provisions so that the total of the Society's technical provisions properly reflect our best estimate of the liabilities held.

Other long-term liabilities	2012 £m	2013 £m
Regular expense provision	241	200
Miscellaneous provisions		
Exceptional expense provision	56	21
German legal claims	2	1
Financial options	9	5
Present value of non-profit business	44	16
Other long-term liabilities	**352**	**243**

In addition to the 1% p.a. (2012: 1% p.a.) future charge to provide capital to meet the cost of guarantees previously described, a further charge of 1% p.a. (2012: 1% p.a.) is deducted from the return earned on assets each year and is available to meet the cost of running the with-profits business. This amount is not sufficient to meet business running costs and so a regular expense provision of £200m (2012: £241m) is held in 'Other long-term liabilities', with the aim of maintaining a stable expense charge as the business declines. Assumptions for retirements, surrenders and mortality affect the estimation of future costs of running the business and are described in section (i) above. A 10% increase in future expenses would decrease the ERA by £45m (2012: £51m).

The exceptional expense provision represents the anticipated additional exceptional expenses of £21m (2012: £56m) over future years, including costs of implementing changes in the IT systems provider and anticipated additional costs until the Society's cost base reaches the stable long-term state assumed in calculating the regular expense provision. In 2012, the provision included contractual commitments to LBG in respect of pension scheme future service costs (see Note 7c).

Financial options represent the value of the option within a small number of CWP policies to take their benefits in annuity form.

The present value of non-profit business represents the future profits and losses 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 amounts 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 non-profit business is a loss of £16m (2012: £44m loss).

g. Non-profit technical provisions

Annuities in payment and deferred annuities comprise most of the Society's non-profit technical provisions. The majority of this provision is for annuities in payment for which the technical provisions have been calculated using the gross premium method, where the provision equals the present value of the future benefits and expenses. The principal inputs to the valuation for both types of annuity are:

- Interest rates based on yields on the assets held, with reductions for credit risk;
- Future expenses arising directly from non-profit and index-linked annuities; and
- Annuitant longevity.

The assumptions and their comparatives are shown in the following tables, along with explanations of the effect of changes in the year on the technical provisions net of reinsurance.

(i) Interest rates

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 reviewed in light of latest experience data. Fixed-interest and index-linked yields have risen compared to those at the end of 2012. The changes to the valuation interest rates in aggregate have decreased the net non-profit technical provisions by £27m and have decreased the net index-linked annuity provision by £1m. Similarly, the market value of the backing assets has altered as yields have varied, and this in part offsets the change in technical provisions.

Class of business	Interest Rate %	
	2012	2013
Non-profit annuities in payment		
Basic Life and General Annuity business - pre 1992	3.10	3.50
Basic Life and General Annuity business - post 1991	2.79	3.15
Pension business	3.10	3.50
Index-linked annuities in payment		
Basic Life and General Annuity business - pre 1992	0.20	0.22
Basic Life and General Annuity business - post 1991	0.18	0.20
Pension business	0.20	0.22
Non-profit deferred annuities	2.10	2.80

12. Technical provisions (continued)

g. Non-profit technical provisions (continued)

(ii) Future expenses

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. The per policy expense allowance in the valuation basis reflects an assessment of future variable administration costs and has been assumed to increase at 3.5% p.a. (2012: 3.1% p.a.).

Class of business	Future per policy expense allowance 2012	2013
Non-profit and index-linked annuities in payment		
Basic Life and General Annuity business - pre 1992	£10.00 p.a.	£10.00 p.a.
Basic Life and General Annuity business - post 1991	£10.00 p.a.	£10.00 p.a.
Pension business	£10.00 p.a.	£10.00 p.a.

The expense allowance for fund management, expressed as a percentage of the value of the fund, is 0.11% p.a. (2012: 0.11% p.a.). The expense allowances for 2013 shown above apply to both UK and non-UK policies. The impact of the changes in the year on the expense provision has been an increase of £2m (2012: £nil).

(iii) Annuitant longevity

The Society continues to make allowance for future improvements in the 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. This year's review of mortality resulted in no change in index-linked annuity and non-profit annuity technical provisions net of reinsurance (2012: increased by £2m).

A sensitivity analysis, carried out in connection with the effect of a change in mortality basis on the net technical provisions, has demonstrated that an assumed 10% improvement in the mortality rates would result in a £36m (2012: £39m) 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 (2012: 12 months).

Mortality assumptions by class of business	2012	2013
Non-profit and index-linked annuities during payment		
Basic Life and General Annuity business	75% IML00 cmi2011 (U=2012)* for males	75% IML00 cmi2011 (U=2013)* for males
	77.5% IFL00 cmi2011 (U=2012)* for females	77.5% IFL00 cmi2011 (U=2013)* for females
Pension business	75% PNML00 cmi2011 (U=2012)* for males	75% PNML00 cmi2011 (U=2013)* for males
	65% PNFLA00 cmi2011 (U=2012)* for females	65% PNFLA00 cmi2011 (U=2013)* for females

Note:

* The allowance for future mortality improvements is based on the mortality improvements as per cmi2011 tables (with a long-term improvement rate of 1.5% p.a. for males, 1.25% p.a. for females).

h. Gross linked liabilities

Index-linked annuities are valued in the same way as non-profit annuities, as described in Note 12g. The technical provision in respect of other linked business is equal to the value of the assets to which the contracts are linked. This business is wholly reinsured to LBG (see Note 2).

A provision in respect of future expenses and mortality risks on other linked insurance business and future expenses on index-linked annuities is included in the non-profit insurance technical provisions.

13. Regulatory valuation capital statement

a. Analysis of capital

This note presents the capital position of the Society, as reported in the Society's annual PRA insurance returns, also known as Peak 1. This is a different view of capital than either the ERA (known as Peak 2), as calculated under the realistic valuation regime and reported in the Balance Sheet; or the Economic Capital ("EC") view, that underpins strategic decisions and is referred to in the Strategic report.

As part of regulatory valuation reporting, each life assurance company must retain sufficient capital to meet the capital requirements as specified in the FCA/PRA Handbook of Rules and Guidance.

Each life assurance company calculates the available capital resources as the value of the assets less the value of the liabilities on a regulatory valuation basis as specified in the FCA/PRA Handbook of Rules and Guidance. Each company is required to hold a minimum level of capital known as the Capital Resource Requirement ("CRR").

The CRR comprises the Long-Term Insurance Capital Requirement ("LTICR") and if required, an additional element of capital required so as to reduce the surplus capital to be no more that the surplus on a realistic valuation basis. This additional amount of capital is added to the CRR, and is referred to as the With-profits Insurance Capital Component ("WPICC").

However, for the Society as a closed mutual with-profits fund, the PRA require that all capital is anticipated to be distributed to policyholders, leaving a nil balance of surplus capital on a realistic valuation basis. To achieve this, the WPICC for the Society is therefore the difference between the available capital resources and the LTICR, leaving a nil balance of excess capital resources.

The capital statement in respect of the Society's life assurance business at 31 December 2013 is set out below.

	2012 £m	2013 £m
Available capital resources	367	450
Long-Term Insurance Capital Requirement (LTICR)	(236)	(211)
With-Profits Insurance Capital Component (WPICC)	(131)	(239)
Total regulatory Capital Resource Requirement (CRR)	**(367)**	**(450)**
Excess of available capital resources over CRR	**-**	**-**

13. Regulatory valuation capital statement (continued)

b. Movement in available capital resources

The available capital resources for the Society amount to £450m (31 December 2012: £367m). The table below shows the effect of movements in the total amount of available capital of the Society during the year.

Movement in available capital resources	2012 £m	2013 £m
At 1 January	438	367
Investment return and interest rate movements	(8)	82
Other valuation assumptions	(102)	(1)
Expense reductions	56	36
Other movements	(17)	(34)
At 31 December	**367**	**450**

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. Sensitivity to market conditions of liabilities and components of capital

The available capital resources 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 mix of assets held to back the liabilities, as the yield on these determines the interest rate at which the liabilities are valued. Reductions in the value of property and equities and defaults on fixed-interest assets directly reduce the available capital resources, as does any increase in non policy-related provisions.

The principal non-economic assumptions are the level of future mortality rates, the level of future expenses, future retirement ages and future surrender rates.

14. Management of financial risk

a. Risk management framework

As described in the Strategic report, the Society operates a comprehensive risk management framework. The Society uses a number of tools to assess the impact of its risks on the capital position of the Society. The Society carries out a number of tests to assess the combined impact of certain stresses on the ERA, as specified in the FCA/PRA Handbook (Peak 2). The financial risks considered in these various tests are described in more detail below.

In addition, the Society prepares an Individual Capital Assessment ("ICA") report, which considers the potential impact on capital of one in two hundred year events. The conclusions of the ICA report do not form part of the disclosures that follow.

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 Society's Asset and Liability Committee.

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, as follows:

UK with-profits assets mix	2012 %	2013 %
Gilts	56	47
Corporate bonds	29	30
Short-term gilts and cash	10	21
Property	2	-
Other	3	2
	100	**100**

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 bonds 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 risk capital margin tests undertaken on a realistic valuation basis for PRA reporting.

Adverse changes	2012	2013
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	0.7%	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	2012 £m	2013 £m
Above adverse changes - including where long-term gilt yields rise	155	88
Above adverse changes - including where long-term gilt yields fall	135	73

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 on policy liabilities as a result of changes to flexible retirement dates assumptions has been excluded.

14. Management of financial risk (continued)

b. Market risk (continued)

(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 contract liabilities.

A further risk for the Society is in respect of GIR on with-profits RSP policies, which are typically 3.5% p.a. When the market returns are below this rate, the cost of providing these guarantees would increase if policyholders defer their retirement beyond the dates assumed. The sensitivity of the ERA to policyholders deferring their retirement by one year is described in Note 12f (i). To mitigate this risk, the Society holds a series of interest rate 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 beyond the dates assumed in the valuation. A fall in interest rates of 1% at all terms would increase the value of the swaptions by £49m (2012: £57m) and a similar increase would decrease the value by £22m (2012: £37m).

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 described previously.

(ii) Equity and property price risk

The Society has largely divested its equity and property assets so these are no longer significant sources of risk. 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 Asset and Liability 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. 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.

	2012				2013			
	Assets		Liabilities		Assets		Liabilities	
	£m	%	£m	%	£m	%	£m	%
Currency								
Pounds sterling	8,426	97	7,923	98	7,773	97	7,148	98
Euro	209	2	176	2	202	3	164	2
US dollar	58	1	6	-	34	-	6	-
Total	**8,693**	**100**	**8,105**	**100**	**8,009**	**100**	**7,318**	**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 and US dollar exchange rates at the reporting date would have changed the ERA by £4m (2012: £4m) 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.

These risks are monitored by the Society's Asset and Liability 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 first satisfies its solvency objectives and then aims 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 Asset and Liability 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 LBG. Because reinsurance does not remove the primary liability of the Society to its policyholders, the credit rating of LBG and certain of its group companies are monitored closely in order to manage the risk.

14. Management of financial risk (continued)

c. Credit risk (continued)

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. The shift from AAA to AA in the year reflects the downgrade of UK gilts.

2013	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Credit ratings						
Debt and other fixed-income securities	544	2,710	737	468	17	4,476
Other variable yield securities	17	695	9	-	-	721
Total of fixed and variable yield securities	**561**	**3,405**	**746**	**468**	**17**	**5,197**
Deposits and other investments	289	-	17	-	1	307
Cash at bank and in hand	-	-	7	-	-	7
Other financial assets	12	28	14	10	13	77
Reinsurers' share of technical provisions and liabilities (Note 12c)	-	-	2,335	-	-	2,335
	862	**3,433**	**3,119**	**478**	**31**	**7,923**

2012	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Credit ratings						
Debt and other fixed-income securities	2,977	366	754	505	22	4,624
Other variable yield securities	995	3	15	9	-	1,022
Total of fixed and variable yield securities	**3,972**	**369**	**769**	**514**	**22**	**5,646**
Deposits and other investments	290	-	20	-	1	311
Cash at bank and in hand	-	-	9	-	-	9
Other financial assets	39	6	15	11	28	99
Reinsurers' share of technical provisions and liabilities (Note 12c)	-	-	2,364	-	-	2,364
	4,301	**375**	**3,177**	**525**	**51**	**8,429**

The total of fixed and variable yield securities includes £263m (2012: £262m) 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, in deriving the discount rate to be used, reductions based on credit risk are made to the market 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 £46.5m (2012: £89.4m) 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 £46.6m 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 changes in value of derivatives has been driven by changes in the credit rating of counterparties.

The largest single credit risk exposure amounts to £2,335m for business reinsured with a number of LBG companies (2012: £2,364m). Of the £2,335m total, £1,921m is linked business reinsured with Halifax Life Limited, principally invested in regulated Open Ended Investment Companies ("OEIC"), £374m 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 £24m (2012: £22m) of investments (£23m credit rating AAA, £1m credit rating A) with LBG.

At the reporting date, no material financial assets were past due nor impaired (2012: £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 Asset and Liability 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, 68% 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, financial adjustments may be borne by those with-profits insurance and investment contract customers who decide to transfer or withdraw their benefits on non-contractual terms.

Part of the Society's assets is invested in property (including property unit trusts), unlisted equity and illiquid fixed income securities, amounting to £207m at the year end (2012: £332m). In adverse market conditions, it may not be possible to realise these investments without delay.

As noted in Note 12f (i), 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 at ECD (2012: at ECD) and up to 13 years (2012: 13 years) later than ECD.

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

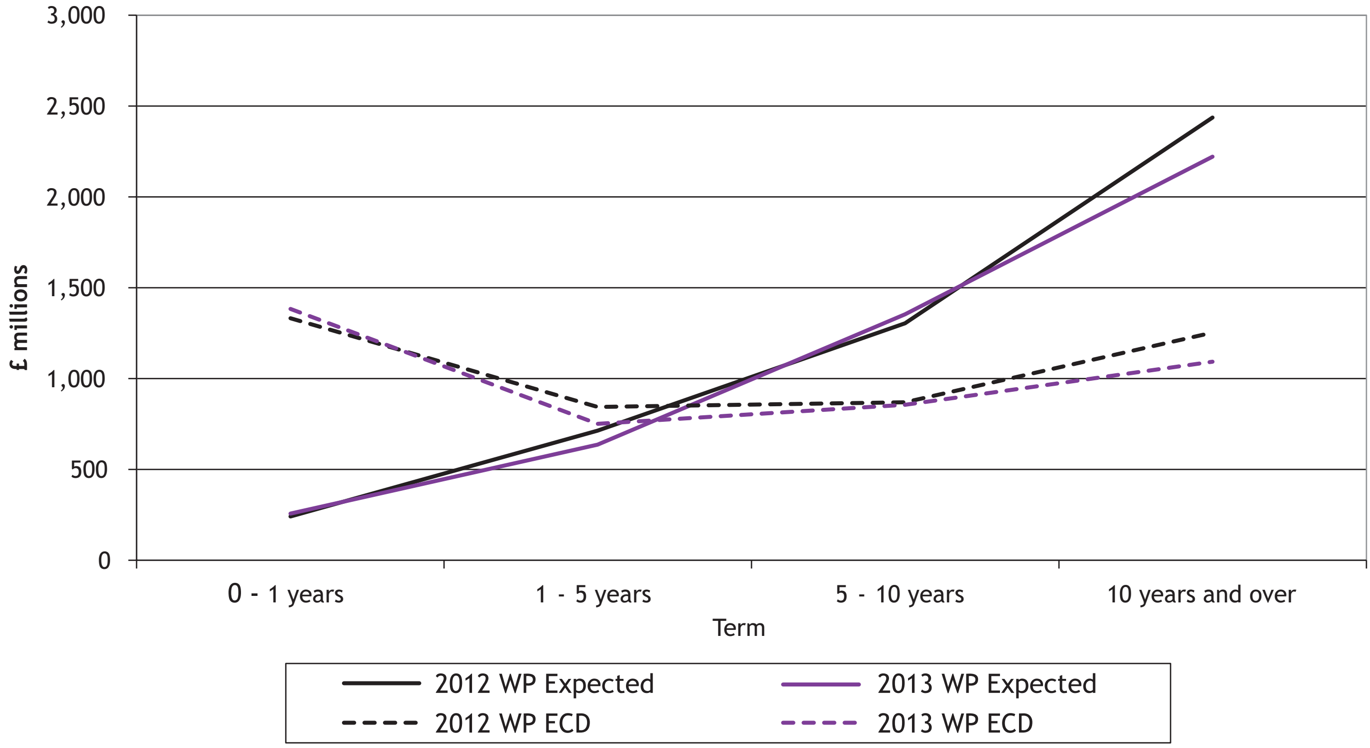
2013 Estimated cash flows (undiscounted)	0-1 year £m	1-5 years £m	5-10 years £m	10 years and over £m	No term £m	Total £m	Carrying value £m
Unit-linked investment contracts	128	476	548	1,129	-	2,281	1,798
Other non-profit investment contracts	7	-	-	-	-	7	7
With-profits investment contracts	257	636	1,353	2,222	-	4,468	3,760
Other financial liabilities	98	-	-	-	-	98	98
Total financial liabilities	**490**	**1,112**	**1,901**	**3,351**	**-**	**6,854**	**5,663**
Of which reinsured	135	476	548	1,129	-	2,288	1,805
Total net financial liabilities	**355**	**636**	**1,353**	**2,222**	**-**	**4,566**	**3,858**
Net insurance liabilities	144	380	423	1,097	-	2,044	1,109
Excess Realistic Assets	-	-	-	-	691	691	691
Total net liabilities	**499**	**1,016**	**1,776**	**3,319**	**691**	**7,301**	**5,658**

2012 Estimated cash flows (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	111	554	485	948	-	2,098	1,788
Other non-profit investment contracts	7	-	-	-	-	7	7
With-profits investment contracts	240	713	1,304	2,436	-	4,693	4,272
Other financial liabilities	157	-	-	-	-	157	157
Total financial liabilities	**515**	**1,267**	**1,789**	**3,384**	**-**	**6,955**	**6,224**
Of which reinsured	118	554	485	948	-	2,105	1,795
Total net financial liabilities	**397**	**713**	**1,304**	**2,436**	**-**	**4,850**	**4,429**
Net insurance liabilities	130	270	319	1,052	-	1,771	1,241
Excess Realistic Assets	-	-	-	-	588	588	588
Total net liabilities	**527**	**983**	**1,623**	**3,488**	**588**	**7,209**	**6,258**

If it is assumed that policies terminate at ECD, the cash flows 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 (solid graph lines) would vary from those at ECD (broken graph lines).

Estimated cash flows from with-profits investment contracts
Expected termination dates versus ECD



With-profits policies with an ECD prior to 31 December 2013 have a contractual value no lower than total guaranteed benefits, and equalled £1.3bn at 31 December 2013 (2012: £1.3bn). The liquid assets previously referred to include £3.2bn to back with-profits policies (2012: £3.4bn). This is more than sufficient to meet the value of these guaranteed with-profits benefits.

15. Provision for other risks and charges

	2012 £m	2013 £m
Pension commitments for former staff	53	-
	53	**-**

In 2012, there was, in addition to the £53m above, a further £10m of pension commitments classified as creditors. Information regarding the settlement of pension commitments for former staff can be found in Note 7c.

16. Creditors

a. Amounts owed to credit institutions

Amounts owed to credit institutions of £4m represent uncleared payments to policyholders (2012: £6m).

16. Creditors (continued)

	2012 £m	2013 £m
b. Other creditors including taxation and social security		
Balances with Group undertakings	13	14
Derivatives positions		
Obligation to return swaptions variation margin to Morgan Stanley and Goldman Sachs	89	46
Defined benefit pension scheme (creditor with LBG, Note 7c)	10	-
Other creditors	18	11
	130	**71**

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 2013, the Society held more than 20% of the nominal value of a class of equity shares in 5 companies with a value of £2m (2012: 5 companies, value £4m).

At 31 December 2013, the Society held more than 20% of the partnership interests in 1 limited partnership investing in properties with a value of £2m (2012: 1 partnership, value £10m).

At 31 December 2013, the Society held more than 20% of the partnership interests in 3 portfolios investing in private equity investment companies included in 'Shares and other variable yield securities', with a value of £2m (2012: 3 portfolios, value £2m).

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 2013 (2012: £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 £13m (2012: £15m) for the Society.

Commitments of £nil (2012: £5m) in respect of refurbishment associated with property lettings are reflected in property valuations.

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

Capital distribution and the cost of guarantees

As described in the Strategic report, the distribution of capital as policies exit from the fund decreases the cost of meeting policy guarantees. 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: the first assuming no capital distribution, as per the accounts; the second assuming capital distribution remains at 25% for the remainder of the lifetime of the business; and the third assuming capital increases each year from 25% in 2014 at a constant rate, which aims to pay out all the capital over the lifetime of the business.

	Capital Distribution		
	Nil%	25% unchanged	25% increasing
	£m	£m	£m
Total with-profits assets	4,817	4,817	4,817
less:			
Technical provisions			
Policy values	3,168	3,168	3,168
Cost of guarantees	877	364	144
Future charges	(265)	(140)	(140)
Impact of early surrenders	(11)	(11)	(11)
Future capital distributions	-	1,079	1,299
Other long-term liabilities	243	243	243
Other liabilities	114	114	114
Working capital for fund (ERA)	**691**	**-**	**-**

Under the heading 'Future capital distributions', it can be seen that £1,299m is available for distribution. The Strategic report describes this as "between £400m and £600m" over ERA.

Economic capital analysis

The Strategic report refers to a second measure of capital, being the amount the Society is required to hold, Economic Capital, which reduced from £390m to £231m during the year. In 2013, the Society settled all obligations associated with the former Staff Pension Scheme and this reduced the amount of Economic Capital the Society is required to hold by approximately £160m. Including 2012, the total reduction in Economic Capital relating to the former Staff Pension Scheme was £200m. Other factors affecting Economic Capital in 2013 were the disinvestment from riskier property and equity assets and the decision to hold more capital in preparation for Solvency II.

Capital distribution: your questions answered

How does the capital distribution work?

For each with-profits policy, we look at its value as at 31 December 2013 and, for every £1,000, we allocate an extra capital distribution of £250 to that value. At the point a policyholder leaves the Society, we take the policy value plus the capital distribution, compare it with the policy's guaranteed value and pay out the larger amount.

What do you mean by the policy's "guaranteed value"?

Most policies have a guaranteed value and this is clearly shown on your Annual Statement.

Why is the capital distribution only being paid to policyholders when they leave?

Because that's when we know for sure that the Society no longer needs to hold capital for that particular policyholder.

What is capital?

It's the money a company needs to hold to protect itself against things going badly wrong that would otherwise lead to insolvency.

How do you calculate the amount of capital the Society needs?

We take the value of all the assets we hold and then deduct a conservative estimate of what we are contractually required to pay out to policyholders in the future. Our regulators specify a certain minimum excess. Anything in addition to that is known as surplus capital. That is what we are determined to return to with-profits policyholders as fairly and as soon as possible.

How can you afford to pay capital out?

Over the last few years, the Society has been successful in reducing the risks it faces. As risks are reduced, this frees up capital which can be returned to policyholders.

Is the 25% capital distribution guaranteed?

No. It can go up or down in the future depending on, among other things, regulatory requirements and the Society's capital needs from time to time. We intend to continue to reduce the Society's risks and, if these plans are successful, our hope is that the capital distribution will increase.

Does this 25% replace the 12.5% distribution announced in 2011?

Yes.

Are you paying policyholders to leave?

No. Definitely not.

How do I know that you will have enough money for policyholders who aren't planning to take their benefits for some years?

We have gone to great lengths to establish an appropriate level of fairness between policyholders who leave and those who stay. We know that we can afford the 25% now. That doesn't mean to say it will never go down, because it might. We believe that the 25% currently best meets the balance between policyholders who want to take their benefits now, compared with those who want to take theirs in the years to come.

Why aren't you increasing the guaranteed value by 25%?

If we increased the guaranteed value of your policy beyond that we are already committed to, we would have to increase the amount of capital that we hold. That's the very opposite of what we are trying to achieve.

Do I need to do anything now?

No, you do not need to take any action now.

Where can I find further details on the Society's performance?

On our website www.equitable.co.uk

Where can I get financial advice?

We recommend you speak to an Independent Financial Advisor or visit the website www.moneyadviceservice.org.uk

Recreating Value for Policyholders

Equitable Life

Recreating Value for Policyholders Recreating Value for Policyholders Recreating Value for Policyholders