

Chairman's statement 2016



Ian Brimecome

Dear members

Every year since my first report to you in March 2010, I have made reference to the introduction of the new European regulations known as Solvency II. At long last, Solvency II became law on 1 January 2016. I am able to say that we have met all the deadlines to secure compliance with these new regulations. This has been no mean feat as the regulations govern just about every aspect of running the Society.

Our strategy

Notwithstanding this fundamental change in regulation, the one thing that remains at our core is the Society's strategy of recreating policyholder value through:

- Distributing all of the Society's assets among with-profits policyholders as fairly and as soon as possible.
- Carefully managing solvency to enable capital distribution, and only then seeking to maximise investment returns.
- Providing the best value-for-money cost base.

One key aspect of Solvency II is the requirement to assess the Society's risks, and then work out the capital that needs to be set aside to make sure that we are able to weather events that might take place once in every two hundred years. On the face of it, policyholders should take comfort from the fact that we have sufficient capital to withstand such unexpected events.

Having said that, there are some events which are much less rare where the particular nature of the Solvency II calculations require higher amounts

of capital to be held. For example, the world economic situation, with falling stock markets and commodity prices, has very important implications for the Society. In particular, continuing low interest rates with the prospect that they will stay low for a long period means that the underlying guarantees on our pensions products requires additional capital to be set aside. In practice, this capital may never be needed unless policyholders change their retirement patterns.

Also important is the widening in corporate bond spreads which points to an expectation of a higher level of default than hitherto. Again, there may be no default at all but more capital is required to be set aside, just in case. Add to this the uncertainty in the run-up to the referendum on membership of the European Union, and there is no doubt that we are navigating some very choppy seas.

This state of affairs goes to the very heart of what is important in running the Society: how to make sure that with-profits policyholders retiring over the next few years leave with their fair share of capital. Achieving this, while making sure we have enough capital left for policyholders who remain long into the future, is what your Board is here to deliver.

Managing risk

To help achieve fairness, our driving force is to reduce the risks of the business, thereby reducing the capital requirements and so increasing the amount available for distribution. In 2015, we made two very important steps forward in risk reduction.

First, we completed the recapture of our unit-linked business from Halifax Life. This led to a significant reduction in the amount of capital we are required to hold under Solvency II.

Second, the sale to Canada Life of the Society's £0.9bn annuity book announced last year completed successfully in February 2016. The sale addressed the risk that annuitants live longer than anticipated. As a result, capital is no longer required to protect against this risk.

Both of these transactions were key to our decision to increase the level of capital distribution to 35% of policy values from 1 April 2015.

We cannot guarantee that this level of capital distribution will never go down. Major economic events and evolving regulatory capital requirements must be dealt with effectively, even when that means a reduction in the distribution.

As I stated earlier, investment markets are very volatile. To quote the Chancellor of the Exchequer in his recent Budget statement: *Financial markets are turbulent... And the outlook for the global economy is weak... It makes for a dangerous cocktail of risks.* Given this climate, and the new capital regulation known as Solvency II, it is not unthinkable that the capital distribution may have to reduce. As economic stability returns, this will be the platform for the Society to, again, aim to increase capital distribution, whether or not there is any reduction in this period of turbulence.

Increases to policy values

Similar to recent years, we increased policy values in 2015 by 2% which reflects the long-term sustainable rate of return that we earn on the Society's assets. During 2015, we reviewed whether the assets held within our investment portfolio continued to be best suited to the Society in run-off.

We concluded that our emphasis on Government securities, high quality corporate bonds, and cash suited our risk minimisation strategy very well.

While returns on the assets as a result of our careful and conservative approach are necessarily low, this is entirely sensible in that it minimises the amount of capital required.

Predicting the future

I now turn to another important issue which is facing the Society in run-off. Most of the Society's with-profits policies provide an underlying 3.5% pa guarantee. With an investment return of 2% pa, the material risk faced by the Society is that policyholders defer retirement so that the guaranteed values once again become greater than the policy value even when the latter is enhanced by capital distribution.

Today, 97 out of every 100 with-profits individual policyholders have a retirement value greater than the underlying guarantee. However, the longer the low interest rate environment continues, the greater the risk that our capital distribution strategy will no longer benefit so many policyholders.

We wish to understand this risk better. In particular, we wish to establish the principal influences that cause policyholders to take their benefits.

Last year's pension reforms, where policyholders can now take retirement savings in cash from age 55, are bound to have been an important factor in when and how policyholders take their retirement savings. Indeed, we have seen a marked increase in policyholder departures since last April, although only to the levels experienced in 2012. Half of the retirements since last April fall in the age range of 55 to 60. We are keen to understand whether this is a new permanent phenomenon or simply a short-term reaction to the introduction of the pension reforms. The better we can predict the future, the better we can plan fair and appropriate capital distribution.

The Society's costs

I was appointed Chairman on the same day that Chief Executive Chris Wiscarson joined the Society in September 2009. In that year, the Society's net operating expenses were £115m, of which £37m was what you might describe as business as usual. In 2015, the Society's net operating expenses were £43m, of which £26m was business as usual.

As the Society becomes smaller, there must be less and less room for complexity. Processes within the Society must be simplified, and such simplicity will inevitably cost less.

A good example of simplification is our approach to the Society's unit-linked business. We manage more than 100 unit-linked funds and, as unit-linked policyholders retire, the funds become smaller and the 0.5% pa administrative charge that we have historically levied is simply not enough to pay their way.

It is with-profits policyholders who pick up any shortfall, and so we decided that it is fair and proper to bring a greater degree of consistency in charging. Consequently, we are increasing the annual management charge to many unit-linked policyholders from 1 April 2016. Over the next year, we will also close a number of smaller funds. These steps will do a great deal to mitigate the subsidy from with-profits policyholders to unit-linked policyholders.

Government compensation

Last year, Government announced that it would be closing its compensation scheme at the end of 2015. It is appropriate that I pay tribute to the policyholder action groups for the considerable influence they have brought to bear on Government to achieve any compensation at all.

In this regard, we were pleased that Peter Scawen was awarded an MBE in the New Year's Honours List. Peter's campaigning on behalf of with-profits annuitants has been tireless.

The Equitable Members Action Group has proved equally tireless, and they continue their campaign for Government to increase the 22p in the pound compensation paid to eligible with-profits policyholders.

An uncertain world

At the same time as learning how best to manage the Society under the new Solvency II regime, we will be paying considerable attention to navigating our way through the current economic turmoil. As I wrote earlier, it is not unthinkable that we might consider it prudent to reduce the level of capital distribution.

The fact that we have been able to distribute capital at all is testimony to the success of our strategy over recent years. Our risk reduction programme has undoubtedly put the Society in a much better position.

As we find our way to a more stable world, the Board's role will once again turn to finding the most effective means to distribute capital to with-profits policyholders; the most demonstrable evidence that policyholder value is indeed being recreated.

Your questions answered

What are last year's pension reforms?

For many years, most policyholders have been required to use their retirement savings to buy a pension, often referred to as an annuity. Since 6 April 2015, you no longer have to buy an annuity. If you are over 55, you are able to take all your savings as cash. In most cases, 25% will be tax free and the remainder taxed at your marginal rate.

Do I have to take all the cash in one go?

No. You can take out lower amounts depending on the minimum withdrawal levels that apply from time to time.

What if I still want to buy an annuity?

You can certainly do that, and it is important that you shop around on the open market to find the best one for you.

Where can I go for help?

A Government-sponsored service, Pension Wise, offers free impartial guidance to policyholders about what to do with their savings at retirement. To receive free, impartial guidance, go to www.pensionwise.gov.uk. An Independent Financial Advisor can provide personal financial advice, and may charge for this service. You can find an advisor in your area at unbiased.co.uk

How does the 35% capital distribution work?

We look at the value of your with-profits policy as at 31 December 2014 and, for every £1,000, we allocate an extra capital distribution of £350 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, where applicable, and pay out the larger amount.

What do you mean by 'guaranteed value'?

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

What is capital?

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

Why is the capital distribution not added to my guaranteed value?

If we added the capital distribution to the guaranteed value of your policy, we would have to increase the amount of capital that we hold. That's the opposite of what we are trying to achieve.

The Society's Annual Report and Accounts are available at www.equitable.co.uk.
If you have requested a paper copy, this will be sent to you shortly.

Directors' remuneration report

Directors' remuneration report

The total emoluments of the Directors were as follows:

Executive Directors' emoluments

	Salary		Performance related bonus		Benefits		Long-term incentive plan		Total	
	2014 £	2015 £	2014 £	2015 £	2014 £	2015 £	2014 £	2015 £	2014 £	2015 £
C M Wiscarson	450,000	450,000	-	-	100,669	105,020	-	-	550,669	555,020
S A Small	229,500	229,500	86,063	114,750	65,919	68,229	135,000	135,000	516,482	547,479
Total	679,500	679,500	86,063	114,750	166,588	173,249	135,000	135,000	1,067,151	1,102,499

Executive Directors' emoluments have been audited by PricewaterhouseCoopers LLP.

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. Non-executive Directors' remuneration, other than that for the Chairman, is set by the Board. The Chairman's remuneration is set by the Remuneration Committee.

Fees are set by reference to market data, and the Board has discretion to increase fees periodically. Fees were increased from 1 January 2016, the first such increase for non-executive Directors since 2012, and for the Chairman since 2013.

Fees for the non-executive Directors are as follows:

	Annual fee	Effective from
Chairman	£150,000 pa	1 January 2016
Senior Independent Director and Chair of Audit and Risk Committee	£60,000 pa	1 January 2016
Other non-executive Directors including Chair of Remuneration Committee	£50,000 pa	1 January 2016

Executive Directors' remuneration policy

Executive Director remuneration comprises salary, an annual performance bonus, and payments in lieu of pension contributions, together with benefits comprising travel, private medical insurance, income protection and life insurance. Details are set out in the following table.

Base salary

Value

Chief Executive: £450,000 pa; Finance Director: £229,500 pa.

Reviewed annually with changes, if applicable, usually effective from 1 January. Promotion or an increase in responsibility could lead to a higher increase than that made to other staff at the Society.

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

Benefits

The Society does not provide an occupational pension scheme for Directors. A cash allowance is provided in lieu.

The Society also pays the premiums on behalf of Directors relating to private medical insurance, income protection and life assurance.

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 pa; 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.

Discretionary annual bonus

Rewards achievement of key deliverables in the relevant financial year.

Maximum potential value

80% of base salary.

For the remainder of his employment with the Society the current Chief Executive is eligible for consideration for a bonus of up to 25% of his basic salary for exceptional performance.

Operation

Performance is monitored throughout the year, and a formal assessment is presented to the Remuneration Committee at the half year and year end.

Where performance is on target, 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.

50% of the sum awarded is deferred, with effect from the 2016 financial year, and subject to malus, with the deferred amount being paid in equal instalments on the three anniversaries following initial payment.

Up to 100% of the gross sum is subject to clawback.

Performance metrics

A 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.

In addition to the discretionary annual bonus, in the event of a corporate transaction, the Society may introduce a retention bonus arrangement, linked to value created, to ensure executive Directors remain with the Society during a period of uncertainty. It is not possible to set out the terms of such an arrangement in advance as they would arise from the specific circumstances at the time. Disclosure would follow in the Remuneration report in the year following the establishment of such an arrangement.

Proposed changes to the Directors' remuneration policy

Extract from the Remuneration Committee Chair Statement in the Annual Report and Accounts 2015

Last year, the Remuneration Committee decided that there was no need to introduce a new Long-Term Incentive Plan ("LTIP") upon its expiry in 2015. The Committee proposed a new annual bonus scheme with a higher bonus opportunity and a substantial deferred portion subject to clawback and malus provisions, as defined on page 28 of the Annual Report and Accounts 2015. I said that we would seek views before bringing forward our finalised proposals for members' approval at the AGM in May 2016.

Our principal way of obtaining members' feedback was through four focus groups held in London and Cardiff. I am very grateful to attendees for so clearly articulating their views. In summary, attendees asserted that: arrangements must be simple; there must be a strong link between pay and performance; and there should be no increase in the overall level of executive Director remuneration.

The Committee wholeheartedly concurs with these views. We are now seeking formal endorsement of the proposals we put forward last year.

The new remuneration policy:

- One bonus scheme with a higher bonus opportunity
- No LTIP
- 50% of sum awarded deferred for up to three years
- Clawback and malus

In putting this policy forward, we have certainly simplified things by not replacing the LTIP and by having just one bonus scheme. The objectives for payment under the scheme are clearly set down in the policy. Since 2014, 30% of the bonus awarded has been deferred for one year. Under the new policy, from January 2016, 50% of the bonus awarded will be deferred for up to three years.

In addition, the entire discretionary bonus will be subject to clawback and the deferred portion of the bonus will also be subject to malus.

While these changes affect executives, I wish to make it clear that we propose no change to the current Chief Executive's bonus arrangement. His maximum opportunity will remain at 25% of base salary, although he has never taken a bonus or pay increase. The Chief Executive has no LTIP arrangements.

In making recommendations to adopt a new remuneration policy, the Remuneration Committee considered the merit of doing away with any sort of bonus. We concluded that such a practice would not be in the best interests of the Society. It would lead to fixed salaries above our appetite, and be a disincentive to staff to 'go the extra mile'. Such a unique stance would not only be potentially demotivating to our staff but would also provide a substantial barrier to good people joining the Society as and when the need arises.

I want to reassure members that removal of the LTIP does not mean that the Society is no longer focused on the long term. I hope it is clear from the business strategy that we place proper emphasis on what is needed to provide policyholder value both now and in the future.

In writing this report, I am mindful that the Society remains a substantial business managing £7bn savings for more than 450,000 policyholders. It is essential to have the right people running the organisation and they must be paid properly. In setting the level of reward, we have made our approach simpler, with a stronger link between pay and performance, and have put in place safeguards, including a higher proportion of deferred pay and the introduction of malus and clawback.

In closing, I repeat my words from last year: it is a very firm principle that this new policy does not lead to greater levels of overall remuneration through the back door. You have my commitment on this. I commend the Society's new remuneration policy to members.

Cathryn Riley
Chair, Remuneration Committee

Board of Directors

The Board reviews the performance of Directors on a regular basis. Following this formal evaluation, the Board recommends that those retiring at the AGM should be re-elected and confirms that it considers that they continue to make a valuable contribution to the effective functioning of the Board and to the appropriate mix of skills and experience needed by your Society.

Ian Brimecome - 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, Tokio Millennium Re AG, Tokio Marine Kiln Group Ltd, Tokio Marine North America, Delphi Financial Group and HCC Holdings. He is also Executive Chairman International of Tokio Marine Holdings, Deputy Chairman of Tokio Marine Asia and a non-executive Director of Edelweiss Tokio Life. Ian 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 - 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 Special Markets. He is also a non-executive Director of Just Retirement Group plc.

Chris Wiscarson - Chief Executive

Chris Wiscarson was appointed Chief Executive in September 2009. Before that, he was a member of the Group Executive Committee at Lloyds Banking Group. 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 joined the Lloyds Banking Group, where he held a number of senior roles including European Director and Finance Director of the Lloyds Abbey Life Group, then Chief Executive of Lloyds TSB Life. At the beginning of 2000, he was appointed the Director responsible for the non-UK businesses in the Lloyds TSB Group before taking up the position of Group Integration Director.

Simon Small - Finance Director

Simon Small joined the Society as Finance Director in July 2012. He is responsible for the Society's Finance, IT Change, Company Secretariat and Investment functions, and takes 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, latterly as 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.

Penny Avis

Penny Avis joined the Board in January 2015. A Chartered Accountant, Penny is a former Deloitte corporate finance partner with wide-ranging merger and acquisition and accounting experience. Penny was an elected non-executive Board member at Deloitte UK LLP responsible for oversight of executive management and acted as a mentor to partner-track directors. Prior to Deloitte, Penny worked for PwC and Arthur Andersen. She is a non-executive Director, and chair of the Audit Committee at Envestors Ltd, a private corporate finance business.

Ian Gibson

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. After retiring from Legal & General, Ian 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.

Cathryn Riley

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 latterly 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, ACE Underwriting Agencies Ltd, ACE European Group Ltd and AA Insurance Services Ltd.

AGM venue

Holiday Inn - Regent's Park

Carburton Street, London W1W 5EE

Tel: 0871 942 9111



Holiday Inn - Regent's Park has excellent transport links by tube from Euston, King's Cross, St Pancras and Paddington to Great Portland Street and from Waterloo to Warren Street.

Nearest underground

Great Portland Street (Hammersmith and City, Metropolitan and Circle lines), Warren Street (Victoria and Northern lines), Regent's Park (Bakerloo line).

Parking

There is an NCP car park that is below the hotel entrance located on Carburton Street (this is chargeable). In addition, there is metered parking in the nearby streets.

Venue access and facilities for the hard of hearing

Holiday Inn - Regent's Park has wheelchair access via the main entrance (on Carburton Street) and also from the NCP car park below. Facilities are available for the hard of hearing; those requiring assistance should ask at the registration desk.