Equitable Life

Annual Report and Accounts 2002

The Equitable Life Assurance Society

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Charles Thomson, Chief Executive

Nigel Brinn, Finance and Investment Director

David Adams OBE, Non-executive Director

Ron Bullen, Non-executive Director

Sir Philip Otton, Non-executive Director

Michael Pickard, Non-executive Director

Fred Shedden, Non-executive Director

Peter Smith, Non-executive Director

Andrew Threadgold, Non-executive Director

Jean Wood, Non-executive Director

Appointed Actuary

David Murray

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Corporate Review

The Society's Chairman, Vanni Treves and Chief Executive, Charles Thomson, review 2002

Dear Members,

2002 was another challenging year for Equitable Life. However, given where we started the year, we have made real progress in the face of an exceptionally poor economic climate.

The compromise scheme relating to Guaranteed Annuity Rates (GARs), completed in February, resolved the Society's most fundamental problem and resulted in a further £250 million from HBOS, which was credited in the 2001 Accounts.

Regrettably, the following months saw your Society, along with all other with-profits funds in the life and pensions sector, facing the worst stock market conditions for a generation, with inevitable consequences for bonus rates.

We are pleased to report that, since the publication of the Interim Report in November, no material new issues have emerged. Equitable Life remained solvent in 2002 and remains solvent today. This Report and Accounts, and our returns to the Financial Services Authority (FSA), confirm that your Society maintains its ability to pay its guaranteed obligations to continuing policyholders and we more than satisfy the Required Minimum Margin (RMM) requirements of the FSA.

Strategic objectives

We set out in November clear business objectives to move the Society towards safer, more stable ground and ensure that we treat the different groups of policyholders fairly. They are:

- Stabilise the with-profits fund to ensure its continued solvency;
- Ensure we meet the guarantees provided to policyholders by pursuing an appropriate investment strategy;
- Reduce expenses and restore an efficient business model;
- Resolve outstanding claims and litigation against the fund.

Investment strategy

As we entered 2002, our investment policy was to have a balanced portfolio with a substantial proportion of the Society's with-profits assets in listed equities – in the expectation that they would outperform fixed-income securities over the longer term.

However, the steep falls in share prices in the first half of 2002 meant that the proportion of the Society's assets that could be held in listed equities, without endangering solvency, became extremely small.

In consequence, we substantially eliminated our equity holdings to protect policy values and to reduce significantly the risk posed to the fund by the volatility of our assets. The Society's relatively early withdrawal from equities in order to protect policyholders and limit any further downside was good news for policyholders. This was a very big decision but, as the year progressed, it became obvious that the result would have been much worse for the value of the Society's with-profits fund if we had not switched into fixed-interest investments. The bulk of the sales were carried out at FTSE levels above 4,800. Subsequently the market has been

The continued maintenance of solvency, together with treating different groups of policyholders fairly, have been, and continue to be, the fundamental goals for your Board.

much weaker and the FTSE index has been as low as 3,270.

We also tried to ensure that there is close matching of assets and liabilities so that if, for example, our policy liabilities increase because of a reduction in interest rates, the value of our fixed-interest investments will rise to compensate.

As a result of market value falls and the need for increased provisions, we had to take the painful, but necessary, decisions to reduce policy values in April and again in July. We must continue to set policy maturity values in order to pay out a fair share of the assets and set surrender values at fair values that reflect the need to protect the position of continuing policyholders. The Society is not alone in having to make reductions in policy values. Following the large falls in equity markets, other insurers have now made significant cuts.

The continued maintenance of solvency – the Society's ability to pay its guaranteed obligations to continuing policyholders – together with treating different groups of policyholders fairly, have been, and continue to be, the fundamental goals for your Board.

2002 Bonus declaration

On 15 April 2002, we wrote to advise policyholders that no interim bonus would be announced for 2002. The Board confirmed it would wait until the fund's performance became clearer before determining what, if any, bonus was appropriate.

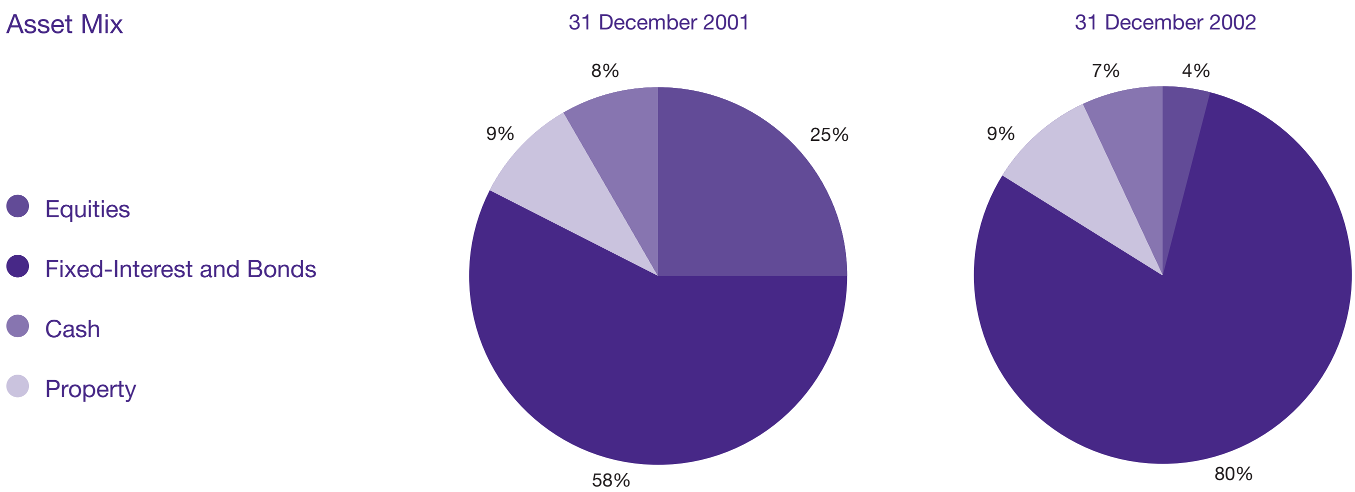
After considering the current solvency position and the financial outlook, discussed later in the Financial Review, the Board is cautiously optimistic about the Society's prospects and the improved stability of its financial affairs. The Society has announced the following bonus decisions:

- For 2002, there is no guaranteed bonus except for those policies containing the 3.5% Guaranteed Investment Return, where the annual 3.5% will be added to guaranteed policy values. The Board has set the non-guaranteed final bonus for all UK with-profits pensions policies at an accrual rate of 0% p.a. for 2002 (0% p.a. for UK life policies).
- From 1 April 2003 until further notice, interim bonus will commence at the overall rate of 3.5% p.a. (2.75% p.a. for life assurance plans). This applies to Guaranteed Interest Rate (GIR) and Non-GIR policies.
- There will be no other change in maturity or surrender payouts.

In 2002, although the fixed-income portfolio outperformed the benchmark rate used to discount liabilities by a small margin, the return on the balance of the portfolio was negative. Therefore, there is no capacity to increase policy values now in respect of 2002. However, unlike most other insurers, payouts are not being cut. This decision applies equally to GIR and non-GIR policies. Going forward, the ability to increase policy values to GIRs and non-GIRs alike depends to a considerable extent on the returns achieved on the portfolio of property, private equity and cash. If these live up to expectations there is the possibility of increasing policy values in future; conversely, if returns are poor, further reductions cannot be ruled out. Please see page 10 of the Financial Review where the Society's ability to pay bonuses in the future is discussed.

The picture today

Asset Mix



The proportion of the Society's total investment (excluding unit-linked) assets in each class is – fixed-interest securities and bonds 80%, equities 4%, property 9% and cash 7%. Contrary to our earlier hopes, changes in market conditions will not allow us to reinvest significantly in equities during the next few years even if the stock market rises again.

The with-profits fund is currently a relatively cautious investment vehicle. Our portfolio of fixed-income securities and property underpins the objective of meeting our guaranteed obligations to policyholders.

Provisions

We have previously noted the substantial level of uncertainty attaching to the various provisions in relation, for example, to non-GAR mis-selling, GAR rectification and managed pensions. Good progress has been made to reduce some of this uncertainty during 2002 and more recently. We believe that the funds we have set aside are appropriate and sufficient to deal with the various claims against the Society though, inevitably, significant uncertainties remain.

Improving longevity

As people live longer, there is a direct impact on the amounts that have to be set aside to cover annuity payments. Based on the recently published industry data on improving trends in longevity, the Board has increased reserves for future annuity payments.

Expenses

Because of all the specific issues the Society currently faces, expense levels are unacceptably high. The Society needs to get back as quickly as possible to an efficient business model. Major project resources have been allocated to addressing this issue and the finance team has been strengthened.

The Financial Review (on pages 8 to 13) provides more detailed information.

With-profits annuitants

With-profits annuitants had previously not suffered the policy value cuts applied to other policyholders. We had hoped to protect those annuitants from the reductions in policy values by spreading their reductions over their future lifetime, consistent with the expectation of future

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growth in equities. The further market falls in the first half of 2002 and the changed make-up of the with-profits fund's structure, meant that it was no longer fair to other policyholders to do this. The actions taken bring the treatment of with-profits annuitants into line with other with-profits policyholders. A process of implementing these reductions began in February 2003 and will be phased in over the next two years.

Many have asked why it is impossible for holders of with-profits annuities to leave the Society. There are a number of complex legal, regulatory and practical barriers preventing individual with-profits annuitants from transferring out of the fund. It is true, however, that the possibility remains of transferring all the annuitants to another insurance company by means of a bulk transfer if appropriate commercial terms could be agreed with another provider.

Unitisation of the fund

It has been suggested that Equitable Life's with-profits fund should be unitised to give policyholders a clear picture of the value of their savings, to provide investment options and to enable them to leave without penalty. Some have asked why this is not possible at the present time.

The Society faces significant uncertainties, fully disclosed in this Report and Accounts. Many claims have been brought against the Society by former policyholders. We are seeking damages from Ernst & Young, our former auditors, and from previous directors. The complexity of these issues, together with the large provisions established for the various reviews and other uncertainties that we inherited, neutralise any advantage in unitising the fund until there is greater certainty in Equitable Life's finances. We must advise members that, with all of the competing claims on the fund, it would be an extremely difficult and potentially costly exercise. Unitisation of the fund was fully investigated at the time the Board considered options for the compromise scheme. We are happy to explore all options for best managing the fund going forward – but in the present circumstances, unitisation is simply not a viable option.

Litigation issues – claims by the Society

In April 2002, having received very detailed advice from leading Counsel on the strength of the Society's claims and the Board's duty to pursue them, we started legal actions against Ernst & Young, our previous auditors, and 15 former directors. In February of this year, the Court accepted Ernst & Young's application to have part of our claim struck out.

Naturally, we were surprised and disappointed with the judgment but the issues are very complex and the Court confirmed that we could appeal that part of the claim found against us. That is what we are currently doing and the appeal will be heard in May. There is no malice in our actions – we have a duty to act and we must pursue these claims.

These actions are expensive – in 2002 the costs amounted to £5.1 million – but all our legal advice and the current assessment of the chances of success justify the costs that have been, and will be, incurred. Any compensation the Society receives would be injected into the fund where it would be invested for the benefit of continuing with-profits policyholders.

Outstanding claims

GAR rectification

At the time of the publication of the Interim Report last November, we announced that we were carrying out a review of the overall administration of the GAR rectification scheme. It became increasingly obvious during 2002 that the original proposals, launched by the Society's former Board, to compensate holders of GAR policies who retired before the House of Lords' ruling in 2000, needed to be changed.

This review is now well advanced and has revealed that the original scheme is very complex, time-consuming and may not be fair to continuing members.

As a result, we have decided to withdraw the current scheme and are now assessing alternative approaches that will speed up and resolve the long-standing need to provide appropriate, fair compensation for eligible policyholders in a sensible time scale.

We will send details to those affected as soon as the proposals for the alternative scheme are completed, which will be within the next several months.

We are aware that progress has been painfully slow and for that we are very sorry. We recognise that we do have a responsibility to meet the expectations of genuine claimants, but we also have a duty to all continuing policyholders in the fund.

Former non-GAR policyholders review

Any complaints relating to the GAR issue were resolved in relation to existing policyholders through the Society's GAR compromise scheme, but remain unresolved in relation to those former policyholders who had left the Society before the GAR compromise scheme came into effect on 8 February 2002.

Last September the Society announced that it would examine a new compromise scheme (under section 425 of the Companies Act) as a possible way to deal with former non-GAR policyholders' complaints. However, having carried out a detailed investigation of a s425 scheme's viability and discussed the matter with the FSA, your Board could not recommend it as the fairest way of resolving the outstanding problem.

Instead, the Society plans to implement a case-by-case assessment of non-GAR complaints by former policyholders. We expect the implementation to begin in May and be completed by late summer.

We want to protect the interests of our existing policyholders who pay for any claims, and be fair to those who have a genuine claim against the Society.

Customer service

Service to customers over the last two years has not been consistently at the level that we would wish. We are sorry that, in exceptional circumstances, when there are serious upturns in the number of policyholder enquiries, service standards have slipped. However, huge efforts have been made to improve the situation and, in recent months, in periods when the volume of transactions has been more normal, service standards have generally been good.

Remaining anomalies

We continue to identify and review various practices, such as certain product concessions beyond contractual rights, which had developed over a number of years. Given the financial position of the Society, it was appropriate to withdraw those concessions where possible. For example, the concessionary terms relating to Personal and Individual Pension Plans, FSAVC Plans, Personal Investment Plans and a number of other policy types, were withdrawn from 1 January 2003. Also with effect from that date, the charges for group pension schemes were restored to contractual rates.

The Lord Penrose Inquiry

Many policyholders have suggested to us that we should take legal action against the FSA and the Government. The Penrose Inquiry, commissioned by HM Treasury, is considering the background to the Society's current position. If Lord Penrose were to be critical of the regulatory supervision of the Society, your Board would, of course, consider with its legal advisers whether it is able to seek financial redress from the government agency responsible. In the meantime, we continue to co-operate fully with Lord Penrose and his inquiry team and we await keenly his report as it may disclose information that supports action to be taken.

It is frustrating for all of us that these issues take a long time to be resolved but there is no action that we can take at this stage which would have any prospect of success. We must hold our fire until the report is published.

Memorandum and Articles

At the Annual General Meeting in May we will bring forward proposals to modernise our Articles of Association, which are intended to bring our corporate governance up to date and into line with good business practice. We have considered the existing Articles carefully and, taking account of the financial circumstances of the Society, have come to the conclusion that it is not appropriate to recommend

We aim gradually to remove the substantial uncertainties that continue to overhang the Society. As we resolve these issues and improve the Society's financial condition, we can further improve the stability of the Society and also lower the operating costs for the benefit of continuing policyholders.

wholesale revision. We have, however, consulted on less comprehensive, but more important, changes and we have received submissions that have been taken into account in the proposals that will be put before members.

Board changes

Your Board was strengthened in 2002 by the appointment of two further non-executive directors, Fred Shedden and Ron Bullen, both of whom were re-elected at last year's Annual General Meeting. In November, Charles Bellringer resigned as Chief Finance and Investment Officer after 18 months in the role, six as a Director. We were pleased to be able to replace him speedily with Nigel Brinn, who joined in January 2003.

Your Board continues to monitor the performance and composition of the Executive team to ensure that it is appropriate to deal with the issues facing the Society in the current, rapidly changing environment.

We are extremely grateful for all of the efforts of the Directors, Executive and staff in extraordinarily difficult circumstances. They continue to work tirelessly in policyholders' interests.

We would also like to record our thanks to former Equitable Life staff, now employed by HBOS, who provide our customer services and administrative support.

Looking ahead

Your Board remains focused on ensuring that Equitable Life remains solvent and is able to meet all of its obligations to policyholders. Over the coming year, we intend to ensure that the various reviews and schemes to deal with the claims against the Society are carried out efficiently and fairly. We aim gradually to remove the substantial uncertainties that continue to overhang the Society. As we resolve these issues and improve the Society's financial condition, we can further improve the stability of the Society and also lower the operating costs for the benefit of continuing policyholders. Our aim and that of your Board and the Executive is for us to be able to tell continuing policyholders that they can sleep easily again. We give policyholders this promise – your Board and Executive will continue to do everything in their power to ensure that this aim is realised as soon as possible.

Thank you for your continued support throughout what was a very difficult year. We remain resolute in dealing efficiently with all the issues that continue to face your Society and, as we look forward, your Board is cautiously optimistic for the year ahead.

Vanni Treves

Vanni Treves
Chairman

Charles Thomson
Chief Executive

Fund for Future Appropriations and regulatory solvency

The Society's net resources, after allowing for its liabilities, are represented by the Fund for Future Appropriations (FFA). This amount is available to meet its non-guaranteed bonuses and any unforeseen liabilities or liabilities in excess of those provided for at the Balance Sheet date. The FFA is the most relevant measure of the Society's ability to meet its obligations as they fall due.

A separate set of financial statements is sent to the Financial Services Authority (FSA). These form part of the Society's annual regulatory returns and detail the value of assets held in excess of its liabilities at the Balance Sheet date. This amount is compared with the Required Minimum Margin (RMM), which is calculated by the application of specified factors to the policy reserves and acts as a minimum level of required capital. The excess of net assets over RMM is widely used as a measure of the Society's strength. If the Society's excess assets fall below RMM, the FSA has powers to require that certain information and plans be prepared to demonstrate how the Society would correct the position. If the Society has a positive balance on its FFA, and can meet its liabilities as they fall due, it remains solvent, even if RMM is not met.

The following reconciliation shows the interaction of the FFA and RMM figures for the Society:

	2002 £m	2001 £m
FFA	556	1,105
Subordinated debt (note 1)	346	346
Implicit item (note 2)	200	500
Reserving adjustments and disallowed assets (note 3)	(23)	(468)
Regulatory net assets	1,079	1,483
Required Minimum Margin	723	917
Excess of net assets over RMM	356	566

(1) For the purposes of preparing the FSA returns, the subordinated debt can be treated as capital. This is achieved in practice by disregarding as a liability the inter-company loan to Equitable Life Finance plc (issuer of the subordinated debt) up to an amount not exceeding 50% of the Society's RMM. Insurance companies and other regulated financial institutions commonly adopt such practice.

(2) The implicit item is a concession, frequently adopted by insurance companies, which is granted in certain circumstances by the FSA to permit margins in the reserving basis, from business previously written, to be taken into account.

(3) Certain balances are required to be held at values that are measured on bases different from those adopted for the Accounts or otherwise are treated differently between the FSA returns and Accounts. In particular, for 2001, the FSA returns incorporated prudent adjustments to the reserving basis for mortality and future discretionary guaranteed bonuses for those policyholders with no guaranteed interest rates (non-GIRs).

There is greater optimism that the range of uncertainties in respect of provisions has reduced, due to the better understanding and further analysis of the provisions relating to rectification, compliance and other issues.

The FSA has intimated its intention to reduce reliance on implicit items in the regulatory returns of insurance companies. During 2002, the Society has reduced the value of implicit items from £500m to £200m. The principal reason for the reduction in the amount during 2002 relates to the treatment of future discretionary guaranteed bonuses for non-GIRs, which were provided in actuarial reserves in 2001 but have been excluded in 2002. As a result, the margins in reserves have been reduced and, therefore, no account of these reduced margins can be taken in the calculation of the implicit item. Even if the implicit item were not taken into account, the excess of regulatory net assets over RMM would remain positive at both year-ends.

The movement in the FFA during 2002 is shown in the following table:

	January to June £m	July to December £m
Opening balance	1,105	382
Changes in net asset values and valuation rates of interest	(178)	98
Elimination of provision for future discretionary guaranteed bonus for non-GIRs	–	241
Change in mortality assumptions	–	(179)
The effect on FFA of policy maturities and surrenders	(221)	10
Increase in provisions and expenses	(223)	(19)
Contractual cost of HBOS past service pension funding	(75)	(31)
Other movements	(26)	54
Closing balance	382	556

Each of the principal changes in the FFA is explained in more detail in the following sections of this Review.

Of the amount shown as changes in net asset values and valuation rates of interest, the losses on equity investments represent £288m in the first half of the year and £173m in the second. The Society reinvested in fixed-interest securities, which allowed it to mitigate the losses in the accounts by discounting liabilities at higher rates of interest.

The FFA of £556m at December 2002 represents 4.7% of with-profits reserves, before provisions, which compares to £382m (2.6%) at June 2002 and £1,105m (6.6%) at December 2001. Although the FFA has therefore fallen over the year as a whole, the strain has been reduced since June. The increase in the second half of the year is principally a result of the application of changes of a technical actuarial nature.

There is greater optimism that the range of uncertainties in respect of provisions has reduced, due to the better understanding and further analysis of the provisions relating to rectification, compliance and other issues. However, it should be noted that, unless the level of provisions and their related uncertainties reduce at the same rate as the number and value of policies decline as a result of maturities and surrenders, their relative importance increases in considering the adequacy of the FFA to address the risks facing the Society.

Protection of the fund and policy values

In the second quarter of 2002, the Society accelerated the implementation of a more cautious investment strategy, reducing significantly the proportion of the fund held in equities. This is explained further later in this Review.

In common with most other insurance companies, the Board took steps during the year to protect the financial position of the fund for the benefit of continuing policyholders and had to make difficult and sometimes unpopular decisions. The reasons for doing so are explained in the section below, entitled "Investment performance and capacity to pay bonuses".

On 15 April 2002, the Board introduced an adjustment to the maturity value of UK pension policies of 4%, which was increased on 1 July to 10%. At the same time, the financial adjustment on surrendered policies was increased to 14% and then to 20% on 1 July. This was followed later in the year by the start of a phasing-in, over two years, of reductions in benefits for holders of with-profits annuities.

With effect from 1 April 2003, the adjustment to maturity values, currently 10%, will be consolidated into policy values and reset to zero. The financial adjustment, for policies surrendered, becomes 11.1%. For UK policies payouts are unchanged and there is no practical financial impact on policyholders.

The Society is required to meet its contractual guaranteed liabilities as they fall due. Any reduction in asset values will not be offset by any reduction in guaranteed liabilities. Therefore, any future adverse change in the Society's financial circumstances resulting from a significant fall in net asset values or increases in provisions or non-matched liabilities would necessitate further policy value reductions. Where the Society is forced to sell fixed-interest securities to its disadvantage before their relevant maturity dates, in order to make payments to surrendering policyholders, the matched position of assets and liabilities is broken, as explained in the section below. In such circumstances, the Society may need to impose a higher financial adjustment.

Investment performance and capacity to pay bonuses

In April 2002, policyholders were informed that no interim discretionary bonus would be announced for 2002 but the Board would await the outcome of the fund's performance for the year before determining whether payment of a bonus was appropriate.

The weighting in favour of fixed-interest securities and bonds within the investment portfolio results in there being limited scope for growth in the Society's investment portfolio. In particular, any uplift in equity values from their current levels will have little direct impact on the value of the Society's assets and in its ability to boost future rates of bonus.

The Society's limited exposure to the equity market in 2002 meant that the with-profits investment assets produced a positive return of 4.8% during the year, before allowing for the impact of provisions, expenses and mortality reserves and any changes to those amounts. Compared to other with-profits offices, this is an excellent outcome, but gives a misleading impression of the Society's ability to pay bonuses because the assets comprise two major and distinct elements.

The first is the large fixed income portfolio of government and corporate bonds that is structured to match, so far as is possible, guaranteed liabilities by reference to their maturity dates. At December 2001, this portfolio accounted for 50% of the UK with-profits liabilities; by June 2002, the proportion had risen to 61% and in December 2002, to 73%. The key consideration with such a portfolio is the yield on the bonds on acquisition; any subsequent changes in market values and yields have no impact on the coupons actually received, nor on the amount obtained on redemption. Any change in market yields on the assets is matched by a corresponding change in the yield used to discount the guaranteed liabilities. A good return on the matching portfolio of fixed-interest securities, such as that seen in 2002, caused by falls in bond yields, does not provide the with-profits fund with capacity to award discretionary bonuses because the liabilities are matched and increase as a result.

The second group of assets is a more growth-oriented portfolio of property and private equity holdings (venture capital, management buyout funds, hedge funds and unquoted equities) and also includes cash. The value and liquidity of these assets, other than cash, could be affected by adverse market conditions. The non-cash part of these portfolios is managed actively, seeking to balance the beneficial higher yields arising from these investments and their potential

The Board is cautiously encouraged by the Society's prospects and the relatively improved stability of its financial affairs. As a result, the Board has decided that, for applicable with-profits policies, an interim non-guaranteed bonus at the rate of 3.5% per annum (2.75% p.a. for life assurance policies) will commence on 1 April 2003.

volatility, including credit and liquidity risk. Valuations of these portfolios are undertaken by outside investment specialists and the Board takes a cautious view in assessing their values.

It is, principally, the return on this second element of the assets that determines any change in capacity to pay discretionary bonuses in excess of those guaranteed. In 2002, although the fixed-interest portfolio outperformed the benchmark rate used to discount liabilities by a small margin, the return on the balance of the portfolio was minus 5.4%, which included the impact of falls in value of listed equity investments. Consequently, the results in 2002 do not support an increase in policy values for that year for either GIRs or non-GIRs. Accordingly, no discretionary bonuses have been declared for 2002. Policies with GIRs benefited from their contractual guaranteed bonuses of 3.5% per annum.

However, after considering the current financial solvency position and the financial outlook, detailed later in this Review, the Board is cautiously encouraged by the Society's prospects and the relatively improved stability of its financial affairs. As a result, the Board has decided that, for applicable with-profits policies, an interim non-guaranteed bonus at the rate of 3.5% per annum (2.75% p.a. for life assurance policies) will commence on 1 April 2003. In confirming the appropriate level of bonus for 2003, the Board will review the fund's performance at the end of that year. Going forward, the ability to increase policy values for both GIR and non-GIR policyholders depends to a considerable extent on the returns achieved on the portfolio of property, private equity and cash assets.

Provisions

Provisions are shown on the Balance Sheet both as part of technical provisions and as a separate category for the contractual costs of the HBOS pension funding. Provisions and expenses, taken together, before adjusting for the contractual cost of HBOS pension funding, show a small increase over the second half of the year, having increased sharply in the first half. Further details in respect of expenses are covered later in this Review.

It has been a major objective during 2002 to complete the process of identifying the most significant liabilities facing the Society, to quantify more accurately the nature and amount of the exposure and to progress their resolution. In most cases, this has been a complex task requiring advice and input from specialist professional advisers and formal legal opinions. Thereafter, substantial further work has been necessary to build systems and plan logistics to handle potential claims.

The Society, in undertaking its responsibility to be fair to all members, including former members such as non-GAR leavers, adopts a robust procedure for dealing with mis-selling claims, which has been discussed with the FSA. Work on all the main claims has been advanced and this has helped the Board in assessing the range and level of provisions to be established. There remains, however, the risk of exposure to other claims or that the provisions prove insufficient.

Amounts have been provided for GAR rectification, managed pension reviews and for non-GAR leavers, in addition to other specific mis-selling issues. The rectification scheme continued to be developed during 2002. There remain inherent uncertainties in establishing appropriate values relating to provisions, principally in respect of the applicable split of claimants into categories representing the most appropriate form of redress, and take-up rates, in addition to the possibility of changes arising from regulatory interpretations or requirements. During the year, the Society has made good progress in clarifying the substantive legal issues, around which many of the provisions have been made. The largest provision of £420m is unchanged at the year-end and relates to GAR rectification and the managed pensions review.

Contractual commitments for pension funding

A provision of £106m has been established for contractual commitments to HBOS in respect of the past service benefits under the final salary pension scheme relating to former Society employees. The liability arises under contractual arrangements entered into at the date of the sale of the administrative and sales operations to HBOS. The provision represents the contractual commitment to HBOS following the triennial valuation performed by the scheme actuary as at 31 December 2001, which is payable over the next five years, as modified to reflect changes up to the Balance Sheet date.

Maturities and surrenders

During the year the Society continued to experience a high level of maturities and surrenders. Surrenders in 2002 were £3,800m (2001: £3,723m). Maturities and other claims totalled £3,052m (2001: £3,115m). The incidence of surrenders tended to increase during periods of volatility in the equity markets, and following unfounded speculation and after corporate announcements.

The Board has had to ensure that the amounts applied in settling claims do not impair the position of continuing policyholders. The application of this principle is closely monitored and relevant courses of action to avoid undue strain on the FFA, including changes to policy values, are kept under continuous review.

Expenses

Expenses in 2002 reflect the administration costs experienced in dealing with the continuing high level of communications from policyholders and also from the ongoing effort to resolve the many legacy issues which have had to be addressed in relation to the Society's liabilities.

Exceptional expenses for the year are shown in Note 7b to the Accounts and relate principally to the contractual arrangements with HBOS for both pension provisions (as noted above) for former staff and the costs in respect of staff retention, severance and redundancy.

Further exceptional expense provisions are included as part of the technical provisions and include the project administration costs in respect of the resolution of rectification and mis-selling issues. The principal increase in expenses results from the expectation that additional policy administration costs will be necessary over the next few years and the high unit costs under the outsourced administration agreement. In addition, direct legal and project costs are expected to continue at a high level in 2003. The potential volatility in the number of policy exits, the complexity of the various rectification and mis-selling projects and the outsourcing of administration activities to a third party cause inherent uncertainties in estimating future expense levels.

Discussions with HBOS in relation to the negotiable issues under the outsourcing contract are continuing and the Board is actively pursuing efficiency savings both in relation to its direct costs and those recharged by HBOS.

Mortality and other actuarial assumptions

In addition to the matters discussed above, the Society has reflected the publication of recent research by the actuarial profession, which recognises that improvements in life expectancy will mean that providers of annuities will incur greater costs as a result of changed mortality assumptions. As a result, the technical provisions, allowing for the Society's recent mortality experience, have increased by £179m.

The valuation rates of interest, applied to calculate technical provisions, have been updated to reflect asset yields.

In addition, the Society intends to award all future discretionary bonuses in a non-guaranteed form, whilst continuing to meet contractual commitments, such as the GIR of 3.5% that is applicable to some policies. In 2002, no provision has been made for future discretionary guaranteed bonuses for non-GIR policies. The effect of this change is to reduce technical provisions by £241m.

The Board's conclusions on provisions and going concern

The Board is required to consider whether the level of provisions, allowed for in the Accounts, is adequate. As explained above, even though the Board has made provisions that it considers to be appropriate, the methodology involved relies on the adoption of assumptions and estimation techniques in the light of the available information, and a residual level of uncertainty will always remain. The degree of confidence around the levels of the individual provisions has improved since the last year-end and is at a broadly similar level

The extensive financial evaluations and modelling have provided the Board with sufficient confidence that, with careful management, the Society will remain solvent and continue to be able to meet its obligations as they fall due.

to that at the time of issuing the Interim Accounts. However, because the FFA has fallen significantly since December 2001, the potential impact of the uncertainty has increased to the extent that it was significant enough to draw it specifically to the attention of the policyholders in the Interim Accounts and is again at this time.

The Board is also responsible for making a formal assessment as to whether the going concern basis is appropriate for preparing these Accounts. The going concern basis presumes that the Society will continue to be able to meet its guaranteed obligations to policyholders and other creditors as they fall due. To do this, the Society must have sufficient assets not only to meet the payments associated with its business but also to withstand the impact of other events that might reasonably be foreseen.

Considerable time has been spent by the Board in examining the issues relevant to the going concern basis which, in summary, are the exposure to: increases in provisions, investment losses, impact of discretionary bonus payments, future expense levels (including the costs of the continuing pension obligations to former staff) and mortality.

In addition, the financial position of the Society has been projected under a very wide range of economic scenarios and asset values. The Board has also considered the level of contingent liabilities (that is liabilities not recorded in the Accounts but which could conceivably arise) in its modelling of the Society's financial position. The results of this work show that the probability, over the foreseeable future, of the Society being unable to meet its guaranteed obligations to policyholders, is not significant. The Board is confident of its ability to manage adverse scenarios that may arise, but there cannot be absolute assurance. In such circumstances, painful actions may be necessary to adjust maturity values, with-profits annuities and the financial adjustment applying to surrender proceeds.

The Board has given due consideration to all the potential risks and actions set out above and has concluded that it is appropriate to prepare these Accounts on a going concern basis.

However, as a result of volatility in investment and property markets, the uncertain nature of provisions and the other potential strains on the Society's finances set out above, and even though all these issues are subject to close management scrutiny, the Board recognises the possibility that the Society may not meet RMM at all times in the future. As noted above, any failure to satisfy RMM does not, of itself, cause the Society to become insolvent.

The Society will continue to need very diligent management of the risks referred to above and the Board will not hesitate to take appropriate action against any circumstances which jeopardise the fund's ability to meet guaranteed obligations to policyholders.

Equitable Life Finance plc (ELF)

The payment of principal and interest and all other monies payable by ELF, a wholly owned subsidiary of the Society, in respect of the £350m 8% undated subordinated Guaranteed Bonds, issued in 1997, has been irrevocably and unconditionally guaranteed by the Society.

If, when payment of interest in relation to the Bonds becomes due, the Society does not meet RMM as of the date of its latest actuarial valuation, then the payment will be deferred by ELF unless FSA consent to such payment is obtained.

Whilst the Society has assets in excess of RMM at the Balance Sheet date, there exists the possibility that the Society may not meet RMM at all times in the future, as noted above. There is, therefore, uncertainty in respect of the repayment of the interest on, and principal of, the Bonds, as Bondholders' interests are subordinated to those of the Society's policyholders and other creditors in the event of a winding up of the Society.

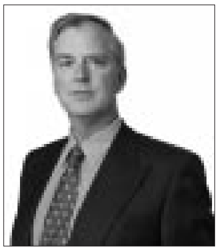
Looking forward

The extensive financial evaluations and modelling have provided the Board with sufficient confidence that, with careful management, the Society will remain solvent and continue to be able to meet its obligations as they fall due.

Board of Directors

Vanni Treves (a) (b) (c) (e)
Chairman

Vanni Treves was appointed Chairman in February 2001. He chairs the Nominations Committee. He has been a solicitor for 35 years, specialising in corporate law. He was for 30 years a Partner, for twelve of them Senior Partner. He has extensive experience on Boards, having been Chairman of four public companies and two common investment funds. Vanni is presently Chairman of Channel 4 Television and London Business School and a Governor of the College of Law. He writes and lectures extensively on corporate governance. Age 62.



Charles Thomson (b) (d)
Chief Executive

Charles Thomson joined the Board in March 2001. Since then, as Chief Executive he has restored the Society to a more stable footing through the compromise scheme. He has spent his entire career in the life assurance and pensions industry, having been Deputy Chief Executive at Scottish Widows and Chairman of the Life Board of the actuarial profession. He has served as Appointed Actuary to eight different companies. Age 54.

Nigel Brinn (d)
Finance and Investment Director

Nigel Brinn joined the Board in February 2003. He is a Chartered Accountant and joined the Society after five years as chief executive of Homeowners Friendly Society. Previously, he was Managing Director of RAC Financial Services and held a number of senior Board-level executive and finance positions with TSB Group plc, Fidelity Investments, Lazard Brothers, Fairey Group and Allied Dunbar. Age 57.

David Adams OBE (a) (d)

David Adams joined the Board in April 2001. He was Finance Director from 1974 and Chief Executive from 1979 of Harrow Council. In 1987 he became Finance Director of the Railways Pension Scheme and was appointed Chief Executive four years later. In that role he successfully led the £11bn fund through difficult times, including Railways' privatisation, maintaining members' confidence. From 1997 to 2000 he was Chief Executive of CIPFA. He has one other public and two other non-executive appointments. Age 64.

Ron Bullen (a)

Ron Bullen was co-opted to the Board with effect from 1 May 2002. He is a qualified Chartered Engineer who has spent his entire career in the manufacturing industry, primarily within the paper sector. From September 2000 until his co-option to the Board of Equitable Life, Ron was the Chairman of EPHAG, the largest of the Equitable Life policyholder groups. Age 63.

Sir Philip Otton (b) (c) (e)

Sir Philip Otton joined the Board in April 2001 and is a Deputy Chairman. He chairs the Remuneration and the Legal Audit Committees. He retired as a Lord Justice of Appeal in 2001 after 17 years in high judicial office. Sir Philip joined the Board in order to bring his experience in the Law, and particularly litigation in all its forms, to the complex legal challenges facing the Society, not least the development of the compromise scheme. Sir Philip is also a Chartered Arbitrator, Accredited Mediator and Surveillance Commissioner. Age 69.

Michael Pickard (d)

Michael Pickard joined the Board in April 2001. He was a Director of the mutual insurance company, Royal London, for 22 years and amongst the positions he occupied were Appointed Actuary, Chief Executive and Chairman. He has been Deputy Chairman of the Association of British Insurers, and a Director of the Personal Investment Authority. Since February 1999 he has been the part-time independent Chairman of Mirror Group Pension Scheme. Age 63.

Fred Shedden (b) (d)

Fred Shedden was co-opted to the Board with effect from 1 May 2002. He retired in 2000 as senior partner of McGrigor Donald, a leading Scottish law firm. Between 1992 and 1999 Fred was a non-executive Director of Standard Life Assurance Company. He is currently Chairman of Halladale Group plc and is a Director of a number of other listed and unlisted companies. He is also a member of The Scottish Further Education Funding Council. Age 58.

Peter Smith (a) (b) (c) (e)

Peter Smith joined the Board in April 2001. He chairs the Audit Committee. He is Deputy Chairman of RAC plc and a non-executive Director of N M Rothschild & Sons Limited and Safeway plc. He was Senior Partner of PricewaterhouseCoopers until June 2002. Age 56.

Andrew Threadgold (d)

Andrew Threadgold joined the Board in April 2001. He chairs the Investment Committee. He started his career as a professional economist, holding positions at a range of organisations including the Bank of England. He subsequently moved into investment management, and has been Chief Executive of PosTel (now named Hermes), the Investment Manager for the British Telecom and Post Office pension funds, and Chief Investment Officer for the large Australian life company AMP. Age 59.

Jean Wood (d)

Jean Wood joined the Board in April 2001. She has worked for 25 years in the life insurance and pensions industry, in the UK, Ireland and Canada. Jean's work ranged from staff and management development to management of sales and marketing functions, leading to a position as Managing Director of a medium-sized life company, from which she retired in 1998. Age 60.

Key to membership of principal Board Committees

(a) – Audit
(b) – Legal Audit
(c) – Remuneration
(d) – Investment
(e) – Nominations

Directors' Report

Principal activities and business review

The Equitable Life Assurance Society (the Society) is the ultimate holding company of the Equitable group of companies (the Group). The principal activity of the Group during 2002 was the transaction of life assurance, annuity and pension 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 Group are presented in the Profit and Loss Account on page 27. The operations of the Group are described in the Corporate Review and Financial Review on pages 2 to 7 and 8 to 13 respectively.

Valuation and bonus declaration

In accordance with the Society's Articles of Association and insurance company legislation, the Society's Appointed Actuary carried out a valuation of the assets and liabilities of the Society as at 31 December 2002. There is no guaranteed bonus for 2002 except for those policies containing the 3.5% Guaranteed Investment Return, where the annual 3.5% will be added to guaranteed policy values. The Board has set the non-guaranteed final bonus for all UK with-profits pensions policies at an accrual rate of 0% per annum for 2002 (0% per annum for UK life policies). The 2002 bonus decision is dealt with in greater detail in the Corporate Review on page 3.

Directors

The Directors at 31 December 2002 are shown on pages 14 and 15. The dates of appointment and resignation of Directors during the year are detailed in the Remuneration Report on pages 21 to 24. The three Directors retiring at the Annual General Meeting (AGM) by rotation are Sir Philip Otton, Charles Thomson and Andrew Threadgold, who offer themselves for re-election.

Nigel Brinn joined the Board as an executive Director on 20 February 2003. In accordance with the Articles, as a Director appointed before the AGM, he will be required to retire at that Meeting and to seek re-election.

The Directors retiring at the AGM, together with any candidates seeking election as Directors, will be shown on the proxy form to be sent to members.

Employees

The majority of staff transferred to HBOS group companies at 1 March 2001. Employees of the Society have been regularly informed of and consulted with on matters of concern to them.

It is the Society's policy to give equal consideration to disabled people as to others regarding applications for employment, continuation of employment, training, career development and promotion – having regard to their particular aptitudes and abilities.

In relation to employment opportunities, the Society treats applications from all sectors of the community fairly and consistently. 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.

Supplier payment policy

It is the Society's policy to agree the terms of payment on commencement of business with all suppliers and to abide by those terms. The average duration of amounts owing to suppliers at the year-end was 38 days (2001 – 29 days).

Changes to the Society's Memorandum and Articles of Association

In April 2002, the Board announced its intention to conduct a review of the Society's Memorandum and Articles of Association. A consultation document was issued in November 2002, giving initial proposals for changes and providing the opportunity for members to submit their views on possible changes. Proposals are to be put to members at the AGM regarding changes to the Articles and details of these are set out in a note accompanying the Notice of the AGM.

Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 28 February 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Society will be proposed at the AGM.

V E Treves
Chairman
31 March 2003

Corporate Governance

1. Introduction

The Society continues to aim to meet the highest standards in corporate governance and voluntarily adopts the relevant provisions of the Principles of Good Corporate Governance and Code of Best Practice (The Combined Code). The Board is responsible to the Society's policyholders for good corporate governance.

This report summarises the Society's governance arrangements and continued enhancements.

2. Governance by Directors

The Board

The Board meets regularly to lead, control and monitor the overall performance of the Society. 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 and 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 President and Chief Executive are separated and the President, as Chairman of the Board, has primary responsibility for its effective functioning.

Executive Directors

The Board has two executive Directors, the Chief Executive and the Finance and Investment Director.

Non-executive Directors

There are nine non-executive Directors on the Board, whose diverse experience, skills and independent perspective provide an effective review and challenge of the Society's activities.

The President, Vanni Treves, and two Vice Presidents, Sir Philip Otton and Peter Smith, are elected by the Board. Sir Philip Otton has been nominated as the senior independent non-executive Director. The Board members are described on page 14 and 15.

All Directors hold policies with the Society. In the opinion of the Board, in no instance do these interests interfere with the independence of the relevant Director.

The Remuneration Report on pages 21 to 24 explains the basis of remuneration of the executive and non-executive Directors.

Appointments to the Board

Directors must retire and seek re-election at the first Annual General Meeting following appointment. The Society's Articles require three Directors to retire at each Annual General Meeting, but the Directors have undertaken that all Directors will be required to submit themselves for re-election by rotation at an Annual General Meeting at least every three years. All appointments are subject to review by the Board, as advised by the Nominations Committee, at intervals not exceeding three years. The Board policy on remuneration is set out in the Remuneration Report.

Board Committees

The Board formally delegates specific responsibilities to five Board Committees, supported by senior management, which are established by the Board.

The Audit Committee
Peter Smith chairs the Audit Committee, comprising four non-executive Directors. It meets at least quarterly, frequently more often, and assists the Board in fulfilling its responsibilities in respect of the Annual Accounts, Interim Accounts and Annual Regulatory Returns to the FSA. It also reports to the Board on the accounting policies, systems of internal control and conclusions from risk management and internal control reports. The external auditors attend key meetings and have direct access to the Chairman of the Committee. The Committee keeps the relationship between the Society and its auditors under review and considers their independence, including the extent of their fees from non-audit services.

The Investment Committee
Andrew Threadgold chairs the Investment Committee, comprising five non-executive Directors, the Chief Executive and Finance and Investment Director. It normally meets monthly. It sets policy for strategic asset allocation for the with-profits, non-profit and index-linked funds, delegating implementation to the Finance and Investment Director.

The Legal Audit Committee
Sir Philip Otton chairs the Legal Audit Committee, comprising four non-executive Directors and the Chief Executive. It considers significant legal matters in particular in relation to claims by the Society against previous professional advisers, Directors and management of the Society and any other significant legal issues. The Committee meets as required by the demands of the business. The Chairman invites representatives from Herbert Smith, management and other professional advisers to attend as appropriate.

The Remuneration Committee
Sir Philip Otton chairs the Remuneration Committee, comprising three non-executive Directors. The Committee is responsible for recommending to the Board the terms of remuneration for executive Directors and non-executive Directors, including incentive arrangements for bonus payments.

The Nominations Committee
Vanni Treves chairs the Nominations Committee, comprising three non-executive Directors. The Committee

meets as necessary to consider and make recommendations to the Board regarding the appointment of Directors and the continuing suitability of the Society's Directors.

Taking advice

The Board and its Committees, subject to defined procedures and parameters, take advice from professional advisers, enabling them to manage the risks and issues arising from the Society's affairs.

Each Director has access to the Company Secretary. They may also obtain independent professional advice about any matter concerning the Society relevant to their duties, subject to defined procedures and parameters.

Subsidiary company governance

At the year-end, the Society's main subsidiaries were University Life Assurance Society (University Life) and Equitable Life Finance plc.

University Life, a life assurance and annuity business, has been closed to new business since 1976. It has a separate Court of four Directors (two of whom are Directors of the Society).

Equitable Life Finance plc issued and manages £350 million 8% Undated Subordinated Guaranteed Bonds, the proceeds of which are lent to the Society. The company has a separate Board comprising two Directors (who are Directors or executives of the Society).

The Court of University Life meets at least quarterly and the Board of Equitable Life Finance plc meets as necessary to consider all matters relevant to the effective operation of the respective companies' continuing business, including governance.

Each of the other subsidiary companies has a Board of Directors that meets as appropriate to consider the matters relevant to those companies.

3. Management of Society

The Executive Team meets regularly, usually weekly, to manage business activities. Papers are prepared and presented to the Board and its Committees, by the Executive Team. The Appointed Actuary, David Murray, who is not an employee of the Society, makes recommendations on bonus and payout levels in relation to the different classes and generations of policyholders. It is the Board's responsibility, based on these recommendations, to seek to achieve fairness between these different classes and generations. The Appointed Actuary also provides advice to the Chief Executive and Finance and Investment Director on matters relating to obligations to the policyholders. In addition, he reports to the Board on the financial position of the Society and on regulatory returns to the FSA. The Appointed Actuary acts as the Reporting Actuary for the purposes of these Accounts.

The Society retains responsibility for the investment strategy and policy, instructing independent investment managers and advisers to implement desired changes to asset allocations within the portfolio. The Chief Executive and Finance and Investment Director, taking advice from the Appointed Actuary, liaise with the investment advisers to oversee day-to-day investment matters.

4. Accountability and Audit

The Directors are ultimately responsible for the Society's system of internal control and for reviewing its effectiveness, including any 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 minimise the exposure to risks and, in doing so, take into consideration the materiality of the risks to be managed and the cost effectiveness of the relevant aspects of internal control in light of the particular environment in which the Society operates.

The Society has outsourced its administration activities to HBOS and it liaises with HBOS to review the appropriateness of the internal control environment and to consider specific needs or requirements of the Society. The Society and HBOS are actively seeking to establish a firm basis for specified, contractual service levels for the future.

The principal components of the Society's system of internal control, developments in 2002 and plans for 2003 are detailed below.

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. During 2002, the Society completed a review and revision of its governance manual, 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 pressures and conflicting priorities on the Society's business, to ensure that it provides clear responsibilities and control for key areas.

In particular, responding to these challenges, in 2002 the Society established internal functions for risk management, internal audit and programme management.

Control procedures

The Society operates a number of control procedures to safeguard the policyholders' assets and investments, including:

- Physical controls, segregation of duties and reviews by management
- Forums for the Executive Team and HBOS to consider control and other matters in relation to (i) finance, (ii) operations, and (iii) risk, audit and compliance
- The Society's Compliance Officer monitors the HBOS compliance function as it relates to the Society on a day-to-day basis in accordance with the Society's compliance strategy
- The contractual arrangement with HBOS dated 1 March 2001 that establishes operational delegations and outline service levels
- The development, communication and testing during 2002 of an appropriate Business Continuity Plan
- The implementation of detailed budgets for functional business segments
- The implementation of an enhanced expense approvals process.

The Society has also established a programme management function to structure, co-ordinate, monitor and report on the very significant projects that the Society is undertaking.

Information and communication

Monthly management information in respect of financial performance, customer service, complaints handling and investment performance is prepared and reviewed by senior management, the Executive Team and the Board. Additionally, projects have their own management information processes.

The Society prepares an annual 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.

Risk management

During 2002 the Society has established an internal risk management function. The function maintains a register of significant risks that could impact the achievement of the Society's objectives and related internal controls. This register is reviewed and updated by senior management and the Executive Team on a regular basis. Significant internal and external risks are identified and evaluated and accountability for their management is allocated to appropriate individuals.

Significant developments during 2002 include:

- The establishment of a clear risk management framework and methodology
- The implementation of risk identification and management procedures for major projects
- Regular, organisation-wide reviews of significant risks and their management including the related internal controls
- The detailed review of and reporting on certain material risks, including those that impact the solvency of the Society
- The application of detailed modelling to assess the sensitivity of the Society's position to economic and business scenarios.

In 2003 the Board expects further embedding of the risk management approach into the Society's business processes, including further analysis and assurance over the effectiveness of management controls in mitigating significant risks.

There is a discussion in the Financial Review (pages 8 to 13) of significant risks the Society faces.

Internal audit

During 2002 the Society has established an internal audit capability to provide assurance over the operation of the system of internal control. A programme of internal audit reviews, based on the Society's risk register, has been prepared and has been presented to the Audit Committee. This programme is now being implemented.

The Society also receives regular reports from HBOS in relation to the findings of internal audit reviews HBOS has conducted that are relevant to the Society.

Monitoring and corrective action

The Head of Risk Management reports to the Executive Team, Audit Committee and the Board, the results of the risk assessment and other significant changes in the risk register, including specific reports as required.

Assurance is provided to the Audit Committee and Board on the effectiveness of the key controls through:

- Reporting by the Society's internal audit function on the key controls reviewed. In performing this work reliance may be placed on the HBOS risk management and internal audit functions that review systems and controls operated by HBOS on behalf of the Society
- Reporting on the compliance environment and the management of significant regulatory risks by the Society's Compliance Officer
- Reports received from the Society's Head of Risk Management on specific elements of risk and their management
- The work of other independent advisers commissioned to report on specific aspects of internal control.

The Audit Committee monitors the status of corrective actions for the improvement of effectiveness of the system of internal control.

5. Policyholder communications

The Board is committed to a policy of openness in its communications with policyholders.

During the year, the Board has consulted with policyholders and their representatives to keep all relevant stakeholders informed on all major issues.

At its Annual General Meeting all the members of the Board are available to answer questions. Separate resolutions are proposed on each issue so that they can be given proper consideration. The Society counts all proxy votes and will indicate the level of proxies lodged on each resolution, after it has been dealt with by a show of hands, unless a poll is called.

All policyholders can gain access to the Society's Annual Report and Accounts and further information on the website equitable.co.uk.

6. Going concern

As noted in Note 1 to the Accounts on page 30, the Directors consider the adoption of the going concern basis to be appropriate in the preparation of the Accounts. A detailed assessment of the going concern basis is provided in the Financial Review on pages 12 and 13.

7. Remuneration Report

The composition and responsibilities of the Society's Remuneration Committee are set out on page 18. The Remuneration Committee's recommendations are made on the basis of rewarding individuals for the scope of their responsibilities and their performance. Where possible the Committee seeks to meet the standards set out in the Combined Code applicable to listed companies.

Proper regard is paid to the need to retain good quality, highly motivated staff and the remuneration being paid by competitors of the Society is taken into consideration. In this respect the Committee takes advice from a leading independent firm of remuneration consultants, Egon Zehnder International, and also receives benchmarking data where required.

The total emoluments of the Directors, excluding pension benefits, comprise:

Non-executive Directors	Notes	Fees £	Benefits £	Discretionary fees £	Total 2002 £	February–December 2001 £
Vanni Treves, Chairman						
Relating to period 26 February 2001 – 25 February 2002	1	–	–	264,375	264,375	–
Relating to period 1 Jan – 30 April 2002		23,500	–	–	23,500	58,750
The above fees, which include VAT, were paid to Macfarlanes.						
Fees 1 May – 31 December 2002	2	77,917	–	–	77,917	–
These fees were payable direct to V Treves.						
		101,417	–	264,375	365,792	58,750

Other non-executive Directors	Notes	Fees £	Benefits £	Discretionary fees £	Total 2002 £	April–December 2001 £
D H Adams OBE	3	18,750	–	15,000	33,750	7,183
Sir Philip Otton	3, 4	21,667	–	15,000	36,667	7,183
M J Pickard	3, 4	21,667	–	15,000	36,667	7,183
P A Smith	3, 4	21,667	–	15,000	36,667	7,183
A Threadgold	3, 4	21,667	–	15,000	36,667	7,183
J Wood	3	18,750	–	15,000	33,750	7,183
R Bullen (appointed 1 May 2002)	3	15,417	–	–	15,417	–
F Shedden (appointed 1 May 2002)	3	15,417	–	–	15,417	–
		155,002	–	90,000	245,002	43,098
Total for non-executive Directors		**256,419**	**–**	**354,375**	**610,794**	**101,848**

Notes

1. The non-executive Chairman, taking office on 26 February 2001, as previously reported, received fees at an annual rate of £60,000 and was eligible for a discretionary fee to a maximum of £250,000 for the first 12 months of service. A discretionary fee of £225,000 was reported at the Society's 2002 AGM and paid (including VAT) on 25 June 2002 direct to Macfarlanes.
2. The Chairman's fees, which increased to £125,000 per annum from 1 June 2002, as announced at the last AGM, are no longer paid to Macfarlanes and were paid direct to Mr Treves from May 2002. No discretionary fees are payable from 1 June 2002.
3. The non-executive Directors taking office on 23 April 2001 received fees at an annual rate of £10,000 and were eligible for a discretionary fee, to a maximum of £15,000, for the 12 months period to 24 April 2002. Such discretionary fees were reported to the Society's 2002 AGM and paid on 25 June 2002. From 1 June 2002, no discretionary fees are payable.
4. As announced at the last AGM, from 1 June 2002, the non-executive Directors received fees at the rate of £25,000 per annum. The following non-executive Directors also receive additional annual fees from 1 June 2002 in relation to specific services: Sir Philip Otton (Deputy Chairman), £5,000; M J Pickard (Chairman, University Life), £5,000; P A Smith (Deputy Chairman), £5,000; and A Threadgold (Chairman, Investment Committee), £5,000.

Executive Directors	Notes	Fees £	Benefits £	Discretionary Bonus £	Total 2002 £	March–December 2001 £
C G Thomson						
Bonus relating to period 1 April 2001 – 31 March 2002	1	–	–	247,500	247,500	–
Salary and other benefits paid during 2002	2	347,188	84,600	–	431,788	347,758
		347,188	84,600	247,500	679,288	347,758
Former Executive Directors						
C A J Bellringer (appointed 1 May 2002; resigned as a Director on 25 November 2002)						
Salary		121,598	46,154	–	167,752	–
Compensation on resignation	3	105,000	57,500	32,500	195,000	–
		226,598	103,654	32,500	362,752	–
Total for Executive Directors		**573,786**	**188,254**	**280,000**	**1,042,040**	**347,758**

Notes

1. The bonus was announced at the Society's 2002 AGM and paid to C G Thomson on 25 June 2002.
2. The Chief Executive's annual rate of salary for the period 1 January to 31 March 2002 was £275,000. His annual rate of salary was increased to £371,250 with effect from 1 April 2002 and, with effect from the same date, the maximum potential annual discretionary bonus award he may receive was reduced from a maximum of 100% to a maximum of 30% of his salary. In advance of any decision by the Board to award him a discretionary bonus for 2002/03, the Chief Executive informed the Remuneration Committee that he had decided to waive half of any bonus which he may otherwise be awarded. The Remuneration Committee has recommended to the Board that the amount of C G Thomson's discretionary bonus would be £82,500 but that the Board should accept his waiver and that he should therefore be awarded and paid a bonus of £41,250 in June 2003. The Chief Executive also participates in an annual retention bonus scheme. Under this scheme, a retention bonus of £68,750 vests on 31 March in each of 2003, 2004 and 2005, but is only payable in full at 1 April 2005, provided that service has been continuous to that date. If C G Thomson's employment ceases prior to that date, subject to satisfying certain conditions, he will receive a bonus of between 25% and 100% of the vested amount at that date.
3. Severance compensation represents six months' salary and benefits by reference to the contract of employment. C A J Bellringer was Chief Finance and Investment Officer for 18 months, six as a director.

Corporate Governance
continued

Benefits

Executive Directors' benefits include a car allowance and payments in lieu of pension contributions. The executive Directors have no accrued pension entitlements (2001: 3 had such entitlements).

No benefits are paid to non-executive Directors.

Service contracts

C G Thomson has a service contract with a six-month notice period.

C A J Bellringer had a service contract with a six-month notice period. Nigel Brinn, who commenced employment on 14 January 2003, has a service contract with a six-month notice period.

No non-executive Director has a service contract.

Long-term benefits

No share options are available. The Society does not operate any other long-term benefits scheme.

Directors' remuneration

Non-executive Directors' remuneration comprises a specified fee, which includes extra amounts for specific additional responsibilities, as set out above.

Executive bonus entitlements

The Society operates an annual discretionary bonus scheme for executive Directors. The Society's policy is to ensure that executive Directors are appropriately incentivised to meet the objectives of the business. In particular, significant objectives against which targets are set and approved by the Remuneration Committee include the maintenance of solvency, the achievement of business stability, the management of significant regulatory reviews and litigation issues and the maintenance of effective service delivery.

Directors' pension entitlements

The Society does not provide an occupational pension scheme for Directors. Executive Directors are provided with a specific allowance in lieu of direct contributions.

Former Directors

The total emoluments of the former Directors of the Society in relation to the year ended December 2001 (as set out in the Society's 2001 Annual Report and Accounts) were:

- Non-executive Directors; J R Sclater – £11,097, I P Sedgwick – £11,429, P Martin – £22,274, P A Davis – £8,254, J D S Dawson – £7,143, Miss J A Page CBE – £7,143, D W J Price – £9,048, J F Taylor – £8,810.
- Executive Directors; D G Thomas – £226,065 (including contractual amounts paid on retirement and as an employee); C P Headdon – £45,377.

These payments were made up to the point of resignation as Directors from the Society, which was 24 April 2001 for all former Directors excluding J R Sclater (28 February 2001), J D S Dawson (9 April 2001) and C P Headdon (1 March 2001).

Statement of compliance with the Code of Best Practice

The Society confirms it complied with all the relevant provisions of the Combined Code throughout the year except for the matters explained in this report, summarised below:

- This report refers to the continuing substantial work on governance carried out by the Board and management in the year to date. The Board continues to seek to adopt the relevant provisions of the Combined Code including formalisation of service level arrangements with outsourced providers and completion of the process to review the Society's systems of internal control.
- Non-executive Directors are not appointed for a specific term. However, each Director's continued appointment is subject to periodic review by the Nominations Committee at intervals not exceeding three years. The Board has also agreed that all Directors should be required to seek re-election at the AGM at least every three years.

Directors' Responsibilities in respect of the Accounts

Company law requires the Directors to prepare Accounts for each financial year which give a true and fair view of the state of affairs of the Society and of the Group and of the results of the Group for that period. In preparing those Accounts, 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 Accounts;
- prepare the Accounts on the going concern basis unless it is inappropriate to presume that the Group will continue in business (see pages 12 and 13 of the Financial Review above).

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 the Group, and enable them to ensure that the Accounts comply with the Companies Act 1985 as described above. They also have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Independent Auditors' Report to the members of The Equitable Life Assurance Society

We have audited the Accounts which comprise the Profit and Loss Account, the Balance Sheets and the related notes which have been prepared in accordance with the accounting policies set out in the statement of accounting policies.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the Accounts in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Society's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the Accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the Accounts, if the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Accounts. The other information comprises only the Corporate Review, the Financial Review, the Corporate Governance report, the Directors' Report and the Statement of Directors' Responsibilities in respect of the Accounts.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Accounts. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Accounts, and of whether the accounting policies are appropriate to the Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Accounts.

Fundamental uncertainty

In forming our opinion we have considered the adequacy of the disclosures in Note 17b (iv) and Note 23, which in turn refers to the Financial Review, in respect of the uncertainties regarding the:

- Estimates of compensation payments or adjustments to future benefits which may be payable under the Rectification Scheme to policyholders who had policies with guaranteed annuity options which matured prior to the House of Lords' decision, and compensation and other costs which may be payable under the review of managed pension sales;
- Estimates of anticipated additional expenses; and
- Estimates of other miscellaneous liabilities including potential mis-selling costs, including those in respect of non-GAR policyholders who left the Society prior to the GAR compromise scheme, GAR policy endorsements and other miscellaneous costs.

In the context of the current level of the Fund for Future Appropriations, there is fundamental uncertainty as to whether the provisions will prove to be overstated or understated when compared with the actual cost of additional expenses, GAR rectification, managed pension and other mis-selling liabilities. Our opinion is not qualified in this respect.

Opinion

In our opinion the Accounts give a true and fair view of the state of affairs of the Society and the Group at 31 December 2002 and of the result of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and
Registered Auditors
London
31 March 2003

Profit and Loss Account

For the year ended 31 December 2002

Technical account – long-term business

	Notes	Group 2002 £m	Group Restated 2001 £m
Earned premiums, net of reinsurance			
Gross premiums written	2a	646.9	1,415.6
Outward reinsurance premiums	3	(418.2)	(4,608.2)
		228.7	(3,192.6)
Investment income	4a	2,135.1	4,310.3
Other technical income	5a, 5b	12.2	721.6
		2,376.0	1,839.3
Claims incurred, net of reinsurance			
Claims paid – gross amount	6	6,883.7	6,937.0
Reinsurers' share	3	(906.1)	(566.4)
		5,977.6	6,370.6
Change in provision for claims	6, 17	(19.2)	(86.9)
		5,958.4	6,283.7
Changes in other technical provisions, net of reinsurance			
Long-term business provision – gross amount	17	(4,350.2)	(5,008.2)
Reinsurers' share	3	(17.9)	(386.9)
		(4,368.1)	(5,395.1)
Technical provisions for linked liabilities – gross amount	17	(927.2)	(507.0)
Reinsurers' share	3	959.5	(3,334.7)
		(4,335.8)	(9,236.8)
Net operating expenses – non-exceptional	7a	123.8	152.9
Net operating expenses – exceptional	7b	164.2	158.3
Net operating expenses		288.0	311.2
Investment expenses and charges	4b	51.6	72.3
Unrealised losses on investments	4c	945.3	5,507.2
Other technical charges	5c	7.9	6.5
Taxation attributable to the long-term business	10	21.2	(8.0)
Minority interests		1.2	(0.3)
Transfers from the fund for future appropriations	16	(561.8)	(1,096.5)
		753.4	4,792.4
		2,376.0	1,839.3
Balance on the Technical Account		–	–

All significant recognised gains and losses are dealt with in the Profit and Loss Account. All the amounts above are in respect of continuing operations.

Balance Sheets

As at 31 December 2002

Assets

	Notes	Group 2002 £m	Group Restated 2001 £m	Society 2002 £m	Society Restated 2001 £m
Investments					
Land and buildings	11a	1,794.2	2,131.8	1,676.2	2,082.1
Investments in group undertakings	11b	–	–	132.8	65.6
Other financial investments	11c	16,130.8	20,643.0	16,089.1	20,582.3
		17,925.0	22,774.8	17,898.1	22,730.0
Assets held to cover linked liabilities	12	670.5	638.2	670.3	637.9
Reinsurers' share of technical provisions					
Long-term business provision		411.0	393.1	411.0	393.1
Technical provisions for unit-linked liabilities		2,375.2	3,334.7	2,375.2	3,334.7
		2,786.2	3,727.8	2,786.2	3,727.8
Debtors	13				
Debtors arising out of direct insurance operations		53.0	59.1	53.0	59.1
Debtors arising out of reinsurance operations		21.7	44.1	21.7	44.1
Other debtors		52.5	51.5	54.3	52.7
		127.2	154.7	129.0	155.9
Other assets					
Cash at bank and in hand		13.6	21.1	9.1	17.7
		13.6	21.1	9.1	17.7
Prepayments and accrued income					
Accrued interest and rent		226.8	197.2	226.3	196.7
Deferred acquisition costs	8	18.0	45.0	18.0	45.0
Other prepayments and accrued income	14	4.9	255.5	4.8	255.3
		249.7	497.7	249.1	497.0
		21,772.2	**27,814.3**	**21,741.8**	**27,766.3**

Liabilities

	Notes	Group 2002 £m	Group Restated 2001 £m	Society 2002 £m	Society Restated 2001 £m
Minority interests		0.1	1.5	–	–
Subordinated liabilities	15	347.9	347.5	346.2	346.2
Fund for future appropriations	16	554.3	1,113.6	556.2	1,104.9
Technical provisions	17				
Long-term business provision – gross amount		17,287.8	21,622.7	17,260.8	21,592.0
Claims outstanding		43.9	63.1	43.9	63.1
Technical provisions for linked liabilities		3,045.7	3,972.9	3,045.5	3,972.6
		20,377.4	25,658.7	20,350.2	25,627.7
Provisions for other risks and charges	18	87.3	8.0	87.3	8.4
Creditors					
Creditors arising out of direct insurance operations		94.2	154.1	93.4	152.9
Amounts owed to credit institutions	19a	167.7	353.4	167.7	353.4
Other creditors including taxation and social security	19b	81.2	101.2	90.2	108.0
		343.1	608.7	351.3	614.3
Accruals and deferred income		62.1	76.3	50.6	64.8
		21,772.2	**27,814.3**	**21,741.8**	**27,766.3**

The Accounts were approved by the Board on 31 March 2003 and were signed on its behalf by:

Vanni Treves
Chairman

Charles Thomson
Chief Executive

1. Accounting policies

Basis of presentation

The Accounts have been prepared in accordance with sections 255 and 255A of, and Schedule 9A to, the Companies Act 1985 and in accordance with applicable accounting standards and the Association of British Insurers' Statement of Recommended Practice (SORP) on Accounting for Insurance Business dated December 1998. The true and fair override provisions of the Companies Act have been invoked; see Valuation of investments below.

The Directors have considered the appropriateness of the going concern basis used in the preparation of these Accounts, 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 Accounts continues to be appropriate. A more detailed explanation is provided in the Financial Review on pages 12 and 13.

The Directors have reviewed the accounting policies and satisfied themselves as to their appropriateness. There are no material changes from the prior year, other than in relation to deferred tax, as set out below.

Certain administrative expenses were incurred in respect of customer support services provided by HBOS. For the purposes of these Accounts, references to HBOS relate to various HBOS plc group companies including HECM Customer Services Ltd, Halifax Life Ltd, BOSIS Ltd and Clerical Medical Investment Group (Holdings) Ltd.

The provisions of FRS19 – Deferred Tax have been adopted in these Accounts. As a consequence, full provision has been made for deferred tax on tax assets and tax liabilities arising as a result of timing differences. In previous periods, deferred tax was provided for only where an amount was likely to become payable in the foreseeable future. The adoption of FRS19 represents a change in accounting policy, which has been accounted for as a prior year adjustment.

As a result, the comparatives in the Accounts have been restated to reflect the position on the basis of full provisioning for deferred tax (see Note 10).

Basis of consolidation

The Accounts for the Group consolidate the accounts of the Society and all its subsidiary undertakings drawn up to 31 December each year. The results of subsidiary undertakings sold during 2001 are included in the consolidated results up to the date of disposal.

The Society, as permitted under Section 230 of the Companies Act 1985, has not presented its own Profit and Loss Account.

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 Group, are included in claims paid. Where such lump sums are used to purchase annuities from the Group, these are included in premium income.

Reassurance contracts

Outward reassurance premiums are recognised when payable. Reassurance recoveries are credited to match the relevant gross claims.

Investment income

Investment income is included on an accruals basis.

Dividends are included by reference to ex-dividend dates.

Income on fixed-interest investments is adjusted for purchased accrued interest.

Property rental income arising under operating leases is recognised in equal instalments over the period of the lease.

Realised gains and losses on investments

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

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.

Claims incurred

Death claims are recorded on the basis of notifications received. Surrenders are recorded when notified, maturities and annuity payments are recorded when due. Claims on participating business include bonuses payable and interest. Claims payable include direct costs of settlement.

Bonuses

The Society declares bonuses annually and University Life declares bonuses triennially. Guaranteed bonuses are included in the long-term business provision. Non-guaranteed final bonuses payable when a claim is made are included in claims paid. No provision is made for non-guaranteed final bonus.

Deferral of acquisition costs

For contracts of the recurrent single premium type where a series of future premiums is expected to be received, only a proportion of the acquisition costs that are incurred in the year of sale are covered by the premium loadings received in that year. The remaining costs to be covered by loadings in future years are shown as deferred acquisition costs.

For single premium contracts other than managed pensions, acquisition expenses are covered by loadings in the year of sale. There is, therefore, no deferral of acquisition costs.

For managed pensions, the acquisition costs are recovered by loadings in the first four years of the contract. The balance unrecouped at any time is shown as deferred acquisition costs. For conventional level annual premium contracts, the method of calculating the long-term business provision makes implicit allowance for the full acquisition costs at the end of the year of sale. There is, therefore, no explicit deferral of acquisition costs.

The deferred acquisition costs asset takes no account of any tax relief available on expenses.

Where a deferred acquisition costs asset is created, the rate of amortisation of that asset is consistent with an appropriate assessment of the expected pattern of receipt of the relevant future loadings over the period in which the contracts concerned are expected to remain in force. To the extent that deferred acquisition costs are not recoverable from these loadings, the costs are expensed in the Profit and Loss Account.

Pension costs

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to those remaining employees of the Society for whom contributions are made under the contractual commitment with HBOS, are matched evenly, so far as possible, to the service lives of the employees concerned.

Leases

Payments under operating leases are charged to the Profit and Loss Account over the lease term in equal instalments.

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.

Valuation of investments

Investments are stated at current value at the Balance Sheet date, calculated as follows:

- Freehold and leasehold properties are valued individually by qualified surveyors on the basis of open market value, account being taken of the cost of disposal. The valuation is carried out on an annual basis.
- No depreciation is provided in respect of investment properties. The Directors consider that this accounting policy is appropriate for the Accounts 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.
- Listed securities are stated at middle market value.
- Unit trust units are stated at bid value.
- Short-term deposits are included at cost.
- Unlisted investments, including subsidiaries, are stated at Directors' valuation and are valued using appropriate generally accepted valuation bases, including the use of BVCA guidelines where appropriate.

Technical provisions – Long-term business provision and provision for linked liabilities

The long-term business provision for the Group is agreed by the Directors, on the recommendation of the Reporting Actuary of each entity following, in each case, his annual investigation of the long-term business. For the Society and University Life, the long-term business provision is calculated using the gross premium method of valuing the liabilities. Provisions for overseas branch business are calculated on a UK basis.

Technical provisions represent the amounts needed to meet the guaranteed benefits under contracts, including declared reversionary bonuses added up to and including the date of the Accounts, and make allowance, in accordance with the assumptions used, for specific levels of future contractually guaranteed bonuses and are discounted where appropriate.

The technical provision in respect of property-linked business is equal to the value of the assets to which the contracts are linked.

The technical provision in respect of index-linked annuities in payment is equal to the discounted value of the annuity benefits which allow for indexation.

Fund for Future Appropriations

The Fund for Future Appropriations represents the amount which is available for future bonuses of various kinds in excess of the levels allowed for in the technical provisions.

Foreign currency translation

Assets and liabilities in foreign currencies are expressed in sterling at the exchange rates ruling at 31 December. Revenue transactions and those relating to the acquisition and realisation of investments have been translated at rates of exchange ruling at the time of the respective transactions. Exchange gains and losses arising on retranslation of overseas operations are taken directly to the Fund for Future Appropriations.

Segmental reporting

In the opinion of the Directors, the Group operates in one business segment.

2. Earned premiums

	Group 2002 £m	Group 2001 £m
a. Analyses of gross premiums written are as follows:		
Individual premiums	520.1	1,108.9
Premiums under group contracts	126.8	306.7
	646.9	**1,415.6**
Regular premiums	318.6	640.5
Single premiums	328.3	775.1
	646.9	**1,415.6**
Premiums from non-profit contracts	240.0	675.7
Premiums from with-profits contracts	213.9	390.5
Premiums from linked contracts	193.0	349.4
	646.9	**1,415.6**
Premiums from life business	90.6	138.6
Premiums from annuity business	13.6	22.1
Premiums from pension business	541.6	1,248.7
Premiums from permanent health business	1.1	6.2
	646.9	**1,415.6**
Premiums from UK business	634.6	1,390.8
Premiums from overseas business	12.3	24.8
	646.9	**1,415.6**
b. New business		
Individual premiums	324.6	780.2
Premiums under group contracts	32.2	69.5
	356.8	**849.7**
Regular premiums	28.5	74.6
Single premiums	328.3	775.1
	356.8	**849.7**
Premiums from non-profit contracts	179.4	589.8
Premiums from with-profits contracts	112.3	143.8
Premiums from linked contracts	65.1	116.1
	356.8	**849.7**
Premiums from life business	0.5	17.5
Premiums from annuity business	1.7	2.3
Premiums from pension business	354.6	829.0
Premiums from permanent health business	–	0.9
	356.8	**849.7**
Premiums from UK business	353.5	837.3
Premiums from overseas business	3.3	12.4
	356.8	**849.7**

The Society closed to new business on 8 December 2000. However, the Society continues to receive premiums that are classified as new business where policy proceeds at retirement are reinvested in annuity or other contracts and incremental amounts are received on existing policies, as noted opposite.

Classification of new business

In classifying new business premiums, the basis of recognition adopted is as follows:

- Recurrent single premium contracts are classified as regular where they are deemed likely to renew at or above the amount of initial premium. Incremental increases on existing policies are classified as new business premiums.
- Department for Work and Pensions rebates are classified as new single premiums.
- Funds at retirement under individual pension contracts reinvested with the Society and transfers from group to individual contracts are classified as new business single premiums, and for accounting purposes are included in both claims incurred and as single premiums within gross premiums written. Such amounts constitute the majority of premiums from non-profit contracts. Where an amount of fund under a managed pension is applied to secure an immediate annuity, that amount is included in both claims incurred and as a single premium within gross premiums written.
- Increments under existing group pension schemes are classified as new business premiums.

Where regular premiums are received other than annually, the regular new business premiums are stated on an annualised basis.

3. Outward reinsurance premiums

	Group	
	2002 £m	2001 £m
Initial premium on reassurance of business	–	(4,127.0)
Ongoing outward reassurance premiums	(418.2)	(481.2)
	(418.2)	**(4,608.2)**

The initial premium on reassurance of business in 2001 represents the value of the assets transferred to match the liabilities, principally property unit-linked, reassured under the agreement with HBOS in 2001, described in Note 5b.

The reassurance balance, as required to be disclosed by the Companies Act 1985, and as defined by the SORP, which represents the aggregate total of all those items included in the technical account which relate to reassurance outward transactions, net of related unrealised losses of £433.7m (2001: £315.6m), is a net charge of £20.0m (2001: £4.6m).

Under the terms of the HBOS reassurance contracts, if the Society were to become insolvent, or reasonably likely to become insolvent in the opinion of the reassurers' Appointed Actuary, then the reassurers can make payments directly to policyholders whose policies have been reassured.

4. Investment income

	Group	
	2002 £m	2001 £m
a. Investment income comprises income from:		
Land and buildings	102.4	122.3
Other investments	1,062.0	1,074.9
	1,164.4	1,197.2
Gains on realisation of investments	970.7	3,113.1
	2,135.1	**4,310.3**
b. Investment expenses and charges comprise:		
Investment management expenses	22.7	34.6
Interest charges		
Movement in discount on provisions	–	0.1
Bank loans and overdrafts	0.9	9.2
Other loans	28.0	28.4
	51.6	**72.3**

4. Investment income (continued)

	Group 2002 £m	Group 2001 £m
c. Investment activity account		
Investment income	1,164.4	1,197.2
Realised investment gains	970.7	3,113.1
Unrealised investment losses	(945.3)	(5,507.2)
	1,189.8	(1,196.9)
Investment expenses and charges	(51.6)	(72.3)
Investment return for the year	**1,138.2**	**(1,269.2)**

5. Other technical income and charges

	Group 2002 £m	Group 2001 £m
a. Other technical income (including reassurance commission and profit on sale of operations) comprises:		
Income from non-insurance business	9.9	8.0
Profit on sale of Permanent Insurance Company Limited	–	30.2
Reassurance commission (see Note 5b)	–	300.0
Profit on sale of operations to HBOS (see Note 5b)	–	129.1
Other income arising from transactions with HBOS (see Note 5b)	–	250.0
Other income	2.3	4.3
	12.2	**721.6**

On 16 February 2001, the Society sold Permanent Insurance Company Limited (Permanent) to Liverpool Victoria Friendly Society for £150m.

b. Transactions with HBOS

On 1 March 2001, the Society sold to HBOS its administrative and sales operations, systems, and its subsidiary undertakings, Equitable Investment Fund Managers Limited and Equitable Services and Consultancy Limited, for a cash consideration of £200m.

At that time, the Society entered into reassurance contracts with HBOS in respect of certain of its unit-linked and non-profit business, the effect of which was to realise an amount broadly equivalent to the embedded value of that business of £300m.

The Society also entered into a loan facility with HBOS under which the Society could immediately draw down loans of up to £250m. Under the terms of that loan facility, if the Society achieved the compromise scheme before 1 March 2002, HBOS would unconditionally waive the repayment of £249m of loans advanced (or to be advanced) to the Society and a further £1m would be waived in 2005. At 31 December 2001, £200m had been drawn down and deposited with another HBOS company as security for the transaction.

Amendments to the facility agreement were agreed on 25 January 2002, and a further £50m was drawn down. Under the terms of the amended facility agreement, on 8 February 2002, HBOS waived the repayment of the full £250m. Income of £250m was accrued in the Profit and Loss Account to 31 December 2001 in respect of this waiver.

c. Other technical charges

Other technical charges of £7.9m (2001: £6.5m) comprise expenses, interest and taxation for non-insurance business of subsidiary companies.

6. Claims incurred – gross

	Group 2002 £m	Group 2001 £m
Claims paid – gross amount	6,883.7	6,937.0
Change in provision for claims	(19.2)	(86.9)
Gross claims	**6,864.5**	**6,850.1**
Gross claims comprise:		
On death	81.0	102.4
On maturity	2,192.3	2,212.3
On surrender	3,800.1	3,722.7
By way of periodic payments	778.4	800.1
Claims handling expenses	12.7	12.6
	6,864.5	**6,850.1**
Life and annuity business	869.0	1,486.7
Pension business	5,982.8	5,347.1
Permanent health business	–	3.7
Claims handling expenses	12.7	12.6
	6,864.5	**6,850.1**
Linked business	904.6	692.6
Non-profit business	387.1	317.8
With-profits business	5,560.1	5,827.1
Claims handling expenses	12.7	12.6
	6,864.5	**6,850.1**
UK business	6,700.5	6,497.3
Overseas business	151.3	340.2
Claims handling expenses	12.7	12.6
	6,864.5	**6,850.1**

Attributable final bonuses for the Society, and interim and final bonuses for University Life, were £484.8m (2001: £967.3m).

7. Net operating expenses

	Group 2002 £m	Group Restated 2001 £m
a. Non-exceptional		
Acquisition costs	1.1	3.1
Change in deferred acquisition costs (see Note 8)	13.4	42.8
Administrative expenses	109.3	107.0
	123.8	**152.9**

Acquisition costs reflect the expenses incurred in processing new business and drawing up insurance documents. The Society has been closed to new business since 8 December 2000 and continues to administer existing policies.

Administrative expenses include costs of £13m (2001: £25m) in respect of specific contracted customer support services provided by HBOS sales force through the former Society branch network. These contracted services terminated at 31 December 2002.

Certain prior year items have been re-presented from non-exceptional to exceptional expenses to present them consistently with the current year exceptional costs (see Note 7b).

b. Exceptional

The Group incurred the following exceptional expenses during the year:

	Group 2002 £m	Group Restated 2001 £m
Costs associated with the compromise scheme	1.3	35.8
Rectification and other GAR-related expenses	15.1	4.0
Additional write down of deferred acquisition costs (see Note 8)	13.6	99.9
Costs of pursuing litigation against third parties	5.1	1.0
Former staff pension scheme costs (see Note 9c)	105.7	–
Recharge from HBOS of staff retention costs, severance costs and other redundancy costs	23.4	17.6
	164.2	**158.3**

Recharge of staff costs for the period since March 2001, and retention costs comprising retention bonuses payable to former staff now employed by HBOS, result from contractual obligations with HBOS entered into in March 2001 as part of the HBOS sales transaction.

The litigation costs of £5.1m include an amount of £1.5m for litigation shown in Note 7c below, within the table of non-audit fees payable to PricewaterhouseCoopers.

	Group 2002 £m	Group 2001 £m
c. Expenses include:		
Depreciation of tangible fixed assets	–	1.3
Operating lease rentals – land and buildings	0.7	2.0
Commission	–	0.8

The Group audit fees and expenses, inclusive of VAT, of £931,000 (2001: £898,000) comprised £872,000 in respect of statutory audit and £59,000 in respect of regulatory requirements. The element relating to the Society was £835,000 (2001: £831,000).

The fees payable to PricewaterhouseCoopers in respect of non-audit fees, inclusive of VAT and expenses, were £5.1m (2001: £7.4m) all of which related to the Society. On 1 October 2002 PwC Consulting, a division of PricewaterhouseCoopers, was sold to IBM Consulting. Advisory work previously undertaken by PwC Consulting therefore ceased to be payable to PricewaterhouseCoopers from that date.

PricewaterhouseCoopers is one of a number of professional firms that undertake advisory work for the Society. Where PricewaterhouseCoopers has been engaged to perform such non-audit work, in circumstances where it is to the Society's advantage to do so, the Society's regular commitments procedures are followed and the Audit Committee ensures that auditor independence is preserved.

The non-audit fees, including VAT and expenses, incurred in 2002 related to services in the following areas:

	Group 2002 £m	Group 2001 £m
Further assurance services:		
Review of interim accounts and other accounting advice	0.3	0.3
Tax advisory services	0.3	0.2
Other non-audit services:		
Governance and compliance work	0.3	0.9
Services to support litigation against third parties	1.5	0.5
Other services:		
Project and management support in respect of the compromise scheme	1.3	2.9
Rectification Scheme support services	0.1	1.2
Secondment of staff to administration and special projects	0.4	0.7
Former non-GAR policyholder review	0.6	–
Other services	0.3	0.7
	5.1	7.4

Other services of £0.3m include employment agency services, remuneration survey data, assistance with Annual General Meeting planning and an independent assessment of the Society's compliance with the requirements of the Financial Services and Markets Act 2000.

8. Deferred acquisition costs

	Group and Society 2002 £m	Group and Society 2001 £m
At 1 January	45.0	220.8
Change in deferred acquisition costs		
Non-exceptional (see Note 7a)	(13.4)	(42.8)
Exceptional (see Note 7b)	(13.6)	(99.9)
Disposal of Permanent	–	(33.1)
At 31 December	**18.0**	**45.0**

During the year, the Group has considered its ability to recover acquisition costs in future periods from margins arising on existing business. The exceptional element of change in deferred acquisition costs in the year arises from a further review of the likely pattern of receipt of premiums on business in force in future compared to that at previous period ends, after giving consideration to the recent pattern of renewals and surrenders.

9. Directors and employees

	Group 2002 £m	Group 2001 £m
a. Staff costs		
Wages and salaries		
Non-exceptional	1.8	15.1
Exceptional (see Note 7b)	–	15.9
Social security costs		
Non-exceptional	0.2	1.6
Exceptional (see Note 7b)	–	1.7
Other pension costs	–	2.1
	2.0	**36.4**

The monthly average number of employees of the Group during the year, including executive Directors, required to be disclosed in accordance with the Companies Act 1985, was 12 (2001: 493). Prior to the transfer of staff to HBOS in March 2001, the Group employed staff in the following areas: administration 1,478; marketing 907; and investment 67.

In addition, the Society employs a number of contractors and, under its agreement with HBOS, uses the services of HBOS staff.

b. Emoluments of Directors

Full details of Directors' emoluments, pensions and interests, as required by the Companies Act 1985, are included in the Remuneration Report on pages 21 to 24.

c. Pension arrangements

Following the sale of operations to HBOS on 1 March 2001, the Group has retained a small number of staff. Of those staff retained, two remain members of the pension schemes now operated by HBOS as the principal employer.

The Society is contractually committed to meeting the major part of the funding in respect of the pension schemes for those staff transferred to the employment of HBOS as a result of the sale transaction. An amount of £105.7m has been provided in respect of the contractual commitment to HBOS in relation to the defined benefit scheme, following the triennial actuarial valuation performed as at 31 December 2001, as modified for relevant changes up to the Balance Sheet date. An additional provision of £27.2m (2001: £39.2m), representing an estimate of the current value of the contractual commitment to HBOS in respect of future service costs over the next 14 years, is included within technical provisions for long-term business. These contractual commitments to HBOS arise as part of the sale agreement entered into with HBOS in March 2001.

10. Taxation

	Group 2002 £m	Group Restated 2001 £m
a. Taxation attributable to the technical account		
UK corporation tax		
Current tax on income for the period	36.9	57.0
Adjustments in respect of previous years	(9.1)	15.2
	27.8	72.2
Double taxation relief	(0.1)	(0.4)
	27.7	71.8
Foreign tax		
Current tax on income for the period	1.5	4.5
Adjustment in respect of prior year	4.9	–
	6.4	4.5
Deferred tax		
Unrealised losses on investments	(15.6)	(81.0)
Accelerated capital allowances	0.3	(0.8)
Deferred expenses carried forward	2.4	(2.5)
	(12.9)	(84.3)
Total charge/(credit)	**21.2**	**(8.0)**

The UK corporation tax charge is provided at rates between 20% and 22% (2001: 20% and 22%), computed in accordance with the rules applicable to life assurance companies whereby no tax is charged on pension business profits.

	Group 2002 £m	Group Restated 2001 £m	Society 2002 £m	Society Restated 2001 £m
b. Deferred taxation				
Deferred tax of the long-term fund				
Accelerated capital allowances	(0.8)	(0.5)	(0.8)	(0.5)
Unrealised appreciation in investments	–	(15.6)	–	(15.1)
Deferred expenses carried forward	5.4	7.8	5.4	7.8
	4.6	(8.3)	4.6	(7.8)
Deferred tax other than of the long-term funds	–	0.9	–	–
	4.6	(7.4)	4.6	(7.8)

The adoption of FRS19 in the Accounts for the period to 31 December 2002 has resulted in a deferred tax asset of £4.9m being recognised within other debtors (Note 13) and a deferred tax liability of £0.3m being recognised within provisions for other risks and charges (Note 18) in both the Group and the Society.

Deferred tax is included within provisions for other risks and charges, which have been revised from £0.2m (Society: £0.6m) in the prior year comparative to £7.4m (Society: £7.8m).

The change in accounting policy for deferred tax has resulted in a restatement of the credit reported in the prior year Profit and Loss Account, from £7.6m to a revised amount of £84.3m, with a resulting increase to the Fund for Future Appropriations.

11. Non-linked investments

	Current value 2002 £m	Current value 2001 £m	Cost 2002 £m	Cost 2001 £m
a. Land and buildings				
Group				
Long leasehold	503.0	532.2	475.5	516.5
Freehold	1,291.2	1,599.6	1,223.1	1,489.9
	1,794.2	**2,131.8**	**1,698.6**	**2,006.4**
Society				
Long leasehold	425.3	532.2	399.9	516.5
Freehold	1,250.9	1,549.9	1,187.8	1,425.4
	1,676.2	**2,082.1**	**1,587.7**	**1,941.9**

Independent professional valuers have valued the Group's and the Society's properties individually. The properties are included in these Accounts at those valuations. The valuations of commercial properties were carried out by Jones Lang Lasalle. Properties held under limited partnerships amounting to £638.9m (2001: £590.2m) for the Group and £520.9m (2001: £538.0m) for the Society were valued by independent valuers appointed by the respective general partner.

	Current value 2002 £m	Current value 2001 £m	Cost 2002 £m	Cost 2001 £m
b. Investments in Group undertakings				
Shares	27.4	39.2	37.1	46.3
Loans	105.4	26.4	110.0	30.1
	132.8	**65.6**	**147.1**	**76.4**

On 20 September 2002, the Society transferred one leasehold property interest to a limited partnership within the Group, increasing loans by £81.2m. The limited partnership represents a group undertaking of the Society. The Society reduced its interest from 80% to 36% in an investment venture capital vehicle during 2002. The remaining holding is included within other financial investments.

	Current value 2002 £m	Current value 2001 £m	Cost 2002 £m	Cost 2001 £m
c. Other financial investments				
Group				
Shares and other variable yield securities and units in unit trusts[1]	749.9	5,734.4	849.8	4,599.5
Debt and other fixed-income securities[2]	14,171.2	13,139.9	13,390.1	12,681.8
Loans secured by mortgages	4.3	5.6	4.3	5.6
Loans secured by policies	2.7	4.0	2.7	4.0
Deposits with credit institutions	1,202.3	1,758.7	1,214.6	1,781.2
Other investments	0.4	0.4	0.4	0.4
	16,130.8	**20,643.0**	**15,461.9**	**19,072.5**

	Current value		Cost	
	2002	2001	2002	2001
	£m	£m	£m	£m
c. Other financial investments (continued)				
Society				
Shares and other variable yield securities and units in unit trusts[1]	731.7	5,702.8	833.4	4,577.1
Debt and other fixed-income securities[2]	14,148.6	13,112.4	13,368.8	12,655.6
Loans secured by mortgages	4.3	5.5	4.3	5.5
Loans secured by policies	2.6	3.9	2.6	3.9
Deposits with credit institutions	1,201.5	1,757.3	1,213.8	1,779.8
Other investments	0.4	0.4	0.4	0.4
	16,089.1	**20,582.3**	**15,423.3**	**19,022.3**

Investments of £3,019.2m (2001: £2,633.4m), which have been lent in the normal course of business to authorised money brokers on a secured basis, are included in other financial investments.

[1] Includes listed investments of £205.7m (2001: £5,020.9m) for the Group and £192.2m (2001: £4,989.3m) for the Society at current value.

[2] Includes listed investments of £14,091.1m (2001: £13,059.2m) for the Group and £14,068.9m (2001: £13,031.7m) for the Society at current value.

12. Assets held to cover linked liabilities

	Group		Society	
	2002	2001	2002	2001
	£m	£m	£m	£m
Current value of linked assets	**670.5**	**638.2**	**670.3**	**637.9**

The cost of assets held to cover linked liabilities is £557.9m (2001: £527.7m) for the Group and £557.9m (2001: £527.4m) for the Society. These relate to index-linked business only for 2001 and 2002.

13. Debtors

	Group		Society	
	2002	2001	2002	2001
	£m	£m	£m	£m
Debtors arising out of direct insurance operations				
Amounts owed by policyholders	53.0	59.1	53.0	59.1
Debtors arising out of reinsurance operations	21.7	44.1	21.7	44.1
Other debtors				
Debtors other than Group and related companies	34.6	45.2	32.6	44.3
Outstanding sales of investments	17.9	6.3	17.9	6.3
Balances with group companies	–	–	3.8	2.1
	52.5	51.5	54.3	52.7
	127.2	**154.7**	**129.0**	**155.9**

Other debtors for the Group and the Society include deferred tax assets falling due after more than one year of £4.9m (2001: £nil).

14. Other prepayments and accrued income

	Group 2002 £m	Group 2001 £m	Society 2002 £m	Society 2001 £m
Other income arising from transactions with HBOS (see Note 5b)	–	250.0	–	250.0
Other	4.9	5.5	4.8	5.3
	4.9	**255.5**	**4.8**	**255.3**

15. Subordinated liabilities

	Group 2002 £m	Group 2001 £m	Society 2002 £m	Society 2001 £m
Amounts falling due after more than five years	**347.9**	**347.5**	**346.2**	**346.2**

On 6 August 1997, Equitable Life Finance plc (ELF), a wholly-owned subsidiary of the Society, issued £350m 8% undated subordinated guaranteed bonds (the Bonds), which are guaranteed by the Society. The proceeds, after deduction of costs associated with the issue, were loaned to the Society on similar terms as to interest, repayment and subordination as to those applicable to the Bonds. All (but not some only) of the Bonds are repayable at the option of ELF on 6 August 2007 and each fifth anniversary thereafter so long as the Bonds are outstanding.

The payment of principal and interest in respect of the Bonds has been irrevocably and unconditionally guaranteed by the Society. The obligations of the Society under the guarantee constitute direct and unsecured obligations of the Society. In the event of a winding up of the Society, the claims of the bondholders under the guarantee will be subordinated in right of payment to the claims of all creditors of the Society.

In accordance with the Trust Deed, where the payment of any amount in relation to the Bonds is due and the Society cannot meet the Required Minimum Margin (RMM) of assets over liabilities required under the Trust Deed, by reference to the Insurance Companies Act 1982, on the due date (or would not be able to meet RMM immediately after such payment), then the payment (or an appropriate part thereof) will be deferred unless the FSA's consent is obtained.

16. Fund for future appropriations

	Group 2002 £m	Group Restated 2001 £m	Society 2002 £m	Society Restated 2001 £m
At 1 January (see Note 10)	1,113.6	2,189.4	1,104.9	2,226.8
Transfer to the Profit and Loss Account	(561.8)	(1,096.5)	(551.4)	(1,120.1)
Goodwill previously written off on acquisition of Permanent	–	23.1	–	–
Exchange gain/(loss) on retranslation of overseas operations	2.5	(2.4)	2.7	(1.8)
At 31 December	**554.3**	**1,113.6**	**556.2**	**1,104.9**

17. Technical provisions

a. Gross technical provisions movement

	Group 2002 £m	Group 2001 £m	Society 2002 £m	Society 2001 £m
At 1 January				
Long-term business provision	21,622.7	26,857.9	21,592.0	26,611.3
Claims outstanding	63.1	150.0	63.1	150.0
Provisions for linked liabilities	3,972.9	4,523.6	3,972.6	4,479.9
	25,658.7	31,531.5	25,627.7	31,241.2
Retranslation of opening foreign branch technical provisions	15.3	(8.9)	15.3	(8.9)
Change in long-term business provision	(4,350.2)	(5,008.2)	(4,346.5)	(5,010.7)
Change in provision for claims	(19.2)	(86.9)	(19.2)	(86.9)
Change in technical provisions for linked liabilities	(927.2)	(507.0)	(927.1)	(507.0)
Sale of Permanent (see Note 5)	–	(261.8)	–	–
At 31 December	**20,377.4**	**25,658.7**	**20,350.2**	**25,627.7**
At 31 December:				
Long-term business provision	17,287.8	21,622.7	17,260.8	21,592.0
Claims outstanding	43.9	63.1	43.9	63.1
Provisions for linked liabilities	3,045.7	3,972.9	3,045.5	3,972.6
	20,377.4	**25,658.7**	**20,350.2**	**25,627.7**

b The long-term business provision

The long-term business provisions for the Society and University Life have been calculated using the gross premium method of valuing the long-term, non-linked liabilities. The provisions are based on guaranteed benefits only and do not include non-guaranteed final bonuses. The technical provisions have been calculated on the actuarial bases considered most appropriate by the Reporting Actuary. The principal assumptions and the comparatives at 31 December 2001 are shown in the table below.

Actuarial bases have been modified in respect of mortality, valuation interest rates and related assumed future bonus rates. Explanations of the effect of those changes are set out in Notes i and iii below.

In 2001, as a result of changes in the actuarial valuation bases, technical provisions were £1,000m lower, and the balance on the fund for future appropriations correspondingly higher, than they would have been on the previous actuarial basis.

17. Technical provisions (continued)

b The long-term business provision (continued)

The principal assumptions used in valuing the main classes of business of the Society were as follows:

Class of business	Interest rate % 2002 £m	Interest rate % 2001 £m	Future expense allowance 2002 £m	Future expense allowance 2001 £m
Endowment assurances (with-profits)				
Basic Life and General Annuity business	2.000	2.250	3.00% of premium	3.00% of premium
Pension business	2.500	2.500	4.00% of premium	4.00% of premium
Recurrent single premium (with-profits)				
Life business	3.625	2.750	See Note ii	See Note ii
Pension annuities in payment – old series	4.625	4.750	£40 p.a.	£40 p.a.
Pension annuities in payment – new series	4.625	2.750	£40 p.a.	£40 p.a.
Pension business – old series	4.625	4.750	See Note ii	See Note ii
Pension business – new series	4.625	2.750	See Note ii	See Note ii
Non-profit annuities in payment				
Basic Life and General Annuity business – pre 1992	4.750	4.750	£40 p.a.	£40 p.a.
Basic Life and General Annuity business – post 1991	4.250	4.750	£40 p.a.	£40 p.a.
Pension business	4.750	5.250	£40 p.a.	£40 p.a.

i. For with-profits business, the interest rates shown are the valuation rates of interest reduced by the assumed rates of future discretionary guaranteed bonus. In general, valuation interest rates have been reduced to reflect changes in fixed-interest rates at the Balance Sheet date. Accordingly, at 31 December 2002, the valuation rates have been marginally strengthened, compared with the prior year but because of the close matching of assets and liabilities, there is minimal net effect on assets. For policies which do not have contractual increases to guaranteed benefits, being with-profits new series pension business and pension annuities, valuation interest rates have been increased; of the increase, 2% is to give effect to the Society's intention not to apply future discretionary increases to guaranteed benefits. The effect of this change of basis is to reduce technical provisions by £241m.

ii. The aggregate amount for ongoing expenses, grossed up for taxation where appropriate, allowed for in the provisions for the next twelve months, is £68m (2001: £71m). The amount allowed for each successive year allows for the effect of policy exits and inflation.

Future expenses are allowed for in different ways depending on the nature of the product:

- For with-profits recurrent single premium business, expenses are allowed for by an explicit per policy expense differing by policy type, increasing by 3.5% p.a. and an expense allowance for fund management, expressed as a percentage of the value of the fund. The resultant calculation is a refinement of the treatment adopted at 31 December 2001, where expenses were allowed for by an annual loading of 0.4%, increasing by 3.75% p.a. of the basic benefit at maturity.
- For annuities in payment, an expense amount per policy per annum is applied, varying with any changes in the annuity.
- For other business, expense allowances are a percentage of future premiums. For certain assurance contracts, the discounted value of a policy fee of £3.00 p.a. is included in the provision.

iii. The mortality assumptions, detailed in the following table, used to value annuities in payment, have been updated to reflect current mortality tables, incorporating industry experience of improvements in mortality, together with the Society's recent mortality experience. These changes, after adjusting for the effect of mortality on endowment assurances, increased technical provisions by £179m (2001: £150m).

Mortality assumptions by class of business	2002	2001
Endowment assurances (with-profits)		
Basic Life and General Annuity business	AM80 ultimate for males AF80 ultimate for females	AM80 ultimate for males AF80 ultimate for females
Pension business	AM80 ultimate for males AF80 ultimate for females	AM80 ultimate for males AF80 ultimate for females
Recurrent single premium (with-profits)		
Pension annuities in payment – old series	PMA92MC (U=2011) for males PFA92MC (U=2009) for females	PMA92-2 (U=2005) for males PFA92-1 (U=2005) for females
Pension annuities in payment – new series	PMA92MC (U=2011) for males PFA92MC (U=2009) for females	PMA92-2 (U=2005) for males PFA92-1 (U=2005) for females
Non-profit annuities in payment		
Basic Life and General Annuity business	85% IMA92 (U=2002) for males IFA92 (U=2002) for females	IMA92 (U=2001) for males IFA92 (U=2001) for females
Pension business	PMA92MC (U=2011) for males PFA92MC (U=2009) for females	PMA92-2 (U=2005) for males PFA92-1 (U=2005) for females

iv. Technical provisions include amounts in respect of specific provisions:

- An amount of £420m (2001: £420m), which is the current estimate of the compensation or adjustments to future benefits which may be payable under the Rectification Scheme to policyholders who had policies with guaranteed annuity options which matured prior to the House of Lords' decision and compensation and other costs which may be payable under the review of managed pensions sales. This provision is based on an assessment of the likely level of claims, the level of current interest rates and the possible form of compensation which may be payable on individual cases, if a claim is found to be appropriate.
- Anticipated additional expenses of £130m (2001: £116m) over future years, including Rectification Scheme and managed pensions review administration costs, contractual commitments to HBOS in respect of pension scheme future service costs, litigation being pursued against third parties and anticipated additional costs associated with servicing policies in 2003 and 2004.
- An amount of £15m (2001: £87m) in respect of the Society's potential liability for compensation relating to the pensions transfers and opt outs review and the review of free-standing AVCs.
- An amount of £147m (2001: £120m) for other miscellaneous liabilities, including potential mis-selling liabilities. The principal components are provisions for mis-selling claims from non-GAR policyholders who left the Society prior to the GAR compromise scheme, liabilities in respect of GAR policy endorsements and miscellaneous costs.

c. Technical provision for linked liabilities

The technical provision in respect of property-linked business is equal to the value of the assets to which the contracts are linked. This business is wholly reassured to HBOS (see Note 3).

For index-linked annuities in payment, the technical provision is equal to the discounted value of the annuity benefits which allow for indexation, calculated using the same mortality assumptions as shown above for non-profit annuities in payment and using an interest rate of 2.00% p.a. (2001: 2.25% p.a.) for pension business, 2.00% p.a. (2001: 2.25% p.a.) for pre-1992 general annuity business and 1.75% p.a. (2001: 2.00% p.a.) for post-1991 general annuity business.

A provision in respect of future expenses on all linked business and mortality risks on property-linked business is included in the long-term business provision – gross amount. The future expenses on property-linked business are wholly reassured.

18. Provisions for other risks and charges

	Group 2002 £m	Group Restated 2001 £m	Society 2002 £m	Society Restated 2001 £m
Provisions for deferred taxation	0.3	7.4	0.3	7.8
Branch properties provisions	–	0.6	–	0.6
Former staff pension commitments to HBOS	87.0	–	87.0	–
	87.3	**8.0**	**87.3**	**8.4**

The movement in the provisions for deferred taxation is included in Note 10.

Branch property provisions have now been released as the leases have been sold or transferred.

Of the amount of £105.7m charged in the Profit and Loss Account for the Society's contractual commitment to HBOS in respect of the former staff pension scheme, £87m is included as a provision for other risks and charges and is expected to be payable in instalments over the four years from the Balance Sheet date. A further £18.7m is included within accruals and deferred income (see Note 9c).

19. Creditors

	Group 2002 £m	Group 2001 £m	Society 2002 £m	Society 2001 £m
a. Amounts owed to credit institutions				
Bank overdrafts	167.7	153.4	167.7	153.4
Bank loan – secured	–	200.0	–	200.0
	167.7	**353.4**	**167.7**	**353.4**

The bank loan from HBOS was secured by a charge over a deposit placed in an assigned account with a subsidiary of the lender.

	Group 2002 £m	Group 2001 £m	Society 2002 £m	Society 2001 £m
b. Other creditors including taxation and social security				
Outstanding purchases of investments	13.6	8.3	13.6	8.3
Balances with group companies	–	–	18.6	14.9
Corporation tax	40.1	57.2	40.1	57.2
Other creditors	27.5	35.7	17.9	27.6
	81.2	**101.2**	**90.2**	**108.0**

20. Subsidiary and associated undertakings

a. Principal subsidiary undertakings

The principal subsidiary undertakings, all of which are wholly and directly owned, are as follows:

	Nature of business
Equitable Life Finance plc	Arranging and managing loan finance
University Life Assurance Society	Life assurance and annuity business. Closed to new business.

All the above holdings are of ordinary shares. In addition, the Society has an interest in the loan capital of Covent Garden Retail LP, a property investment vehicle. Other holdings in subsidiary undertakings do not materially affect the results or assets of the Group.

b. Significant holdings

At 31 December 2002, the Group and the Society held more than 20% of the nominal value of a class of equity shares in 23 (2001: 24) companies. None of these companies is regarded by the Directors as an associated undertaking and none of the holdings materially affect the results or assets of the Group or of the Society. These investments are included in the Balance Sheet at current value.

Full information on subsidiary undertakings and companies in which the Group and the Society hold more than 20% of the nominal value of a class of equity share will be annexed to the Society's next statutory annual return submitted to the Registrar of Companies.

21. Related party transactions

The aggregate of premiums paid and amounts transferred into policies with the Society and of amounts paid into individual savings accounts managed by Equitable Investment Fund Managers Limited, which was sold to HBOS in 2001, by Directors was £Nil (2001: £78,460).

Payments to Directors in 2001 and 2002 under policies with the Society were immaterial.

22. Commitments

Operating lease commitments, all of which relate to land and buildings, are detailed below.

	Group		Society	
	2002 £m	2001 £m	2002 £m	2001 £m
Between two and five years	–	0.1	–	0.1
After five years	–	0.1	–	0.1
	–	**0.2**	**–**	**0.2**

Property investment commitments not provided for in the Accounts amounted to £131.5m (2001: £269.1m) for the Group and for the Society.

Commitments in respect of uncalled capital on certain investments amounted to £142.1m (2001: £208.9m) for the Group and for the Society.

23. Contingencies and uncertainties

The Society has made appropriate provisions for mis-selling and other risks based on currently available information. During the year, as more information has become available, the range of possible outcomes in relation to these issues has continued to narrow. The degree of confidence around the levels of the individual provisions has improved since 31 December 2001. However, as discussed in the Financial Review, because of the reduction in the size of the Fund for Future Appropriations since 31 December 2001, the potential impact of the range of uncertainties relating to the provisions has increased to the extent that it has become more significant. Even though there exists a significant uncertainty in relation to the amounts of provisions, the Directors do not consider that this extends to the going concern basis of preparation of the Accounts.

The uncertain nature of the provisions, the potential volatility of asset values and potential strains on the FFA arising from surrenders and maturities could result in the possibility that RMM (which is a measure of the capital that the FSA requires life assurance companies to hold in excess of that required to meet guaranteed obligations to policyholders) may not be satisfied at all times in the future.

Attention is also drawn to the implications of these uncertainties on the ability of the Society to make payments of interest and principal in relation to the subordinated debt in Note 15.