

# Report to With-Profits Policyholders on the management of the fund during 2018

## 1. Executive Summary

The Board of The Equitable Life Assurance Society (“The Society”) has reviewed the management of its with-profits business for the 2018 calendar year.

The Board is satisfied that it has exercised its discretion in managing the with-profits fund fairly, and met its obligations as set out in the Principles and Practices of Financial Management.

In reaching these conclusions, due regard has been paid to the advice received from the Society’s With-Profits Actuary.

## 2. Introduction

The way in which the Society manages the with-profits fund is described in its Principles and Practices of Financial Management (PPFM). Readers of this report may find it helpful to refer to the Society’s PPFM which can be found on the Society’s website [www.equitable.co.uk](http://www.equitable.co.uk). We also publish a simpler guide on the website called “*A guide to how we manage the with-profits fund*”.

This report summarises the key decisions taken by the Board in 2018 that affected with-profits policyholders.

This report covers:

- governance of the with-profits business;
- exercise of discretion in the management of with-profits business, including how competing or conflicting rights, interests or expectations of policyholders have been addressed; and
- compliance with the PPFM.

### **3. Governance**

The Society's Board makes decisions about the management of the Society, including those related to its with-profits business.

The Society is a mutual company that is closed to new business. This limits the potential for conflicts of interest and has led Board to conclude that the duties required of a With-Profits Committee are best carried out by the whole Board. The With-Profits Committee convened when required as part of Board meetings in 2018 to specifically consider items relating to with-profits business, with the primary aim of ensuring that with-profits policyholders are treated fairly. The Terms of Reference for the With-Profits Committee are published on the Society's website.

A With-Profits Sub-Committee assisted the With-Profits Committee throughout 2018 to give appropriate scrutiny to the Strategic plans being progressed by the Society. In addition to selected Directors, an external member sits on the With-Profits Sub-Committee.

The With-Profits Actuary advises Board on all matters affecting the with-profits business of the Society. Louise Eldred served as With-Profits Actuary throughout 2018. Her report to with-profits policyholders is attached as an appendix to this report.

Board is satisfied that the arrangements in place for the governance of its with-profits business are appropriate, and meet current regulatory requirements.

### **4. Exercise of Discretion**

A review has been carried out to assess whether discretion was fairly exercised by Board during 2018. Details of the assessment are set out in sections 4.1 to 4.7 below.

In making its assessment, Board considered the following questions:

- Was the exercise of discretion even-handed or did it (implicitly or explicitly) favour one group of policyholders over the rest?
- Was the exercise of discretion transparent?
- Was the exercise of discretion consistent with communications to policyholders? Have communications been clear, fair and not misleading, and have they been consistent with the PPFM?

Board aims to treat all of its policyholders fairly, and has concluded that its exercise of discretion was fair throughout 2018.

## **4.1. Strategy**

### **4.1.1. Future of the Society**

At the end of 2017, Board changed the strategy of the Society away from run-off, subject to finding a partner. The change in strategy is to be put into effect by a Scheme of Arrangement and by a Part VII transfer under the Financial Services and Markets Act 2000. It will require endorsement by creditor and member votes and the sanction of the Courts. The new strategy will distribute all available assets to with-profits policyholders, by removal of investment guarantees and conversion of with-profits policies to unit-linked and transfer all the Society's business to another provider. This strategy is consistent with the long-standing Principles applied in managing the with-profits business and is reflected in the Practices set out in the PPFM following its June 2018 update.

In pursuit of this strategy, in the first half of 2018 Board selected Utmost Life and Pensions (formerly known as Reliance Life) as its partner following a robust selection process. Achieving fair treatment of with-profits policyholders was a fundamental part of Board's deliberations when taking this decision.

The new strategy was then announced to policyholders in July 2018, setting the expectation of a vote by with-profits policyholders in mid-2019, with the change happening towards the end of 2019.

Board has made a number of decisions during 2018 regarding the details of the strategy. Key considerations when making these decisions have been the impact on policyholders and the fairness between different groups of policyholders, as well as the need to protect the viability of the Society should the plans fail resulting in a return to run-off.

### **4.1.2. Policies written in the European Union (EU)**

Uncertainty continued throughout 2018 about the outcome of the UK's negotiations with the EU on the arrangements that would apply after the UK's planned exit from the EU on 29 March 2019, Brexit. A potential scenario existed that would leave the Society unable to administer its Irish and German business. To plan for such an eventuality, in 2018 Board established a wholly-owned subsidiary in Ireland with the intention of transferring the Society's EU business to this under a Part VII transfer should that be necessary.

In making these plans Board was focused on the need to treat Irish and German policyholders fairly, particularly that they should still be able to participate in the uplift arising from the planned strategic changes discussed above.

## **4.2. Bonus rates**

In line with the stated intentions of the Society not to declare any reversionary or guaranteed bonuses in the foreseeable future, no reversionary bonus was declared for 2017. This is as set out in the PPFM and general statements in the annual Report and Accounts, and is even-handed as all policyholders are treated in the same way.

Policy Values for UK pension policies were increased by 2% for 2017. This was in line with the expected sustainable long-term return, net of charges for guarantees and expenses, and was consistent with the requirements of the PPFM. The interim rate for 2018 was also set at 2% pa. Adjusted rates applied to contracts in taxed funds. The 2% pa rate takes into account the 0.5% pa charge made for the cost of guarantees in with-profits contracts. This charge spreads the cost of the guaranteed interest rates within all with-profits contracts between all with-profits policyholders in proportion to policy size. This is consistent with the Society operating one fund, sharing in the smoothed profits and losses throughout run-off.

Maintaining the rate at this level was fair and even-handed in light of risk appetite, solvency levels, the PPFM, and current economic conditions.

Policy Values are the smoothed asset shares of each with-profits policy. Since matching guaranteed liabilities with fixed-interest assets in 2010, smoothing is carried out over the expected future run-off of the with-profits fund. When paying benefits in 2018, the Society paid out 100% of smoothed asset shares, plus capital distribution, or the guaranteed benefits if greater. Board considers this method of determining payouts to be fair to policyholders and is as described in the PPFM.

A review of final bonus rates for whole of life contracts took place in 2018 to ensure that payouts for these contracts remain aligned with the asset shares for these policies.

## **4.3. Capital distribution**

Distribution of capital to policyholders has continued during 2018, with payouts determined by adding a Capital Distribution Amount to Policy Values. This method distributes capital among all policyholders as they leave the Society in proportion to the size of their policy. Board regards this methodology as treating different groups of policyholders fairly.

At the regular annual review in March 2018, Board maintained the Capital Distribution Amount at 35% of Policy Values at 31 December 2014. In setting the level of CEF Board seeks to strike a balance between avoiding the excessive accumulation of capital and maintaining stability in payouts. Continuation of the existing level of capital distribution was felt to be reasonable and fair to policyholders.

Board kept the level of capital distribution under review throughout 2018, and considered that it remained fair and in accordance with the PPFM.

The maintenance of the Capital Distribution Amount, as well as the bonus decisions and payout levels was confirmed in both the 2017 Report and Accounts and in annual statements. In addition, a letter to policyholders in January and the 2017 Report and Accounts advised that the Society was exploring how to make the 35% uplift more certain, and how it might be increased. Board regards communication about capital distribution to have been fair, transparent and not misleading.

#### **4.4. Investment Policy**

During 2018, the majority of the assets of the with-profits fund remained invested in fixed-interest securities. These were selected so that investment income and maturity proceeds from the portfolio will be received when funds are expected to be needed to pay the guaranteed policy liabilities.

The majority of the corporate bonds in the portfolio were sold in 2018 to reduce risk, with the proceeds being reinvested in Government bonds of equivalent terms so the assets still match the guaranteed policy liabilities. Removal of credit risk in this way aims to protect the uplift that would be added to policies under the strategic proposal.

The Society's investment portfolio has a very small exposure to equity holdings. This leaves the equity backing ratio of the fund close to zero and much lower than policyholders would have expected when they took out their policy. This strategy has been extensively communicated to policyholders in a clear, fair and not misleading way through the PPFM and the annual Report and Accounts.

Board considers that the security this investment strategy offers is fair to all with-profits policyholders. Investment in low risk assets that match liabilities allows more capital to be distributed to policyholders sooner. This is in line with the Society's strategy, and in accordance with the PPFM.

The Society holds a range of derivatives to protect against interest rate movements. Interest rate falls could damage the solvency position of the Society, particularly if combined with policyholders deferring taking their benefits. Interest rate rises could reduce the amount available to uplift policies under the strategic proposal. In addition to protection against interest rate changes, in 2018 the Society entered into a spread-lock contract to protect the uplift against the risk that changes in interest rates on Government bonds diverge from changes to swaps rates.

#### **4.5. Surrender Values**

If a claim is made on a policy at a time when contractual benefits are not guaranteed, a surrender value is paid. This is set to be the Policy Value reduced by any Financial Adjustment (FA) in force. The FA is therefore a key aspect of the Society's surrender value basis and is reviewed regularly. No FA was applied during 2018.

In setting the FA, and in accordance with the PPFM, Board balances the need to be fair to those policyholders leaving the Society with fairness to those who remain.

#### **4.6. Allocation of expenses**

As the Society is a mutual organisation, the liability for all expenses falls to the with-profits fund, with contributions towards these costs being made by other contracts. It is a key business objective that the costs of the organisation are reduced as the business runs-off, without adversely affecting service levels. This objective is clearly communicated to policyholders in the annual Report and Accounts. Expenses incurred for administration in 2018 were below the levels budgeted in the Society's business plan, and the budget for administration costs has been further reduced for 2019.

Exploring options for the future of the Society and implementation of those plans has incurred additional expenditure. The Board has considered such costs against the potential to release a significant amount of capital, and achieve a fairer distribution of that capital, to with-profits policyholders.

Additional expenditure was incurred in 2018 in preparation for the UK leaving the EU. These costs have been higher than originally anticipated, although Board considered them necessary to secure the continued operation of the business.

Board considers that the discretions exercised in cost control and setting budgets have been fair.

In 2018, expenses of 1% have continued to be charged to with-profits policies. This is taken into account in the 2% pa increases to Policy Values described in section 4.2. Expenses are charged in proportion to policy size, as has been the case for several years. Fairness between different generations of policyholders is assisted by maintenance of the level of the charge at 1% pa. This method of expense charges is described in the PPFM, and has also been clearly communicated to policyholders in the annual Report and Accounts.

Initial charges on contributions to recurrent single premium contracts were removed in 2018. Board applied this change to all of the Society's contracts other than those where contractual premiums were specified at outset. Board considered this to be fair to all classes of policy.

#### **4.7. Operational discretions**

For individual contracts, operational discretions largely take the form of variations to policy terms and conditions such as reinstatements of policies, and ex-gratia payments for administrative errors. In these areas, there are well-tested procedures. No systemic or unfairness issues have been identified in 2018.

#### **5. Compliance with the PPFM**

The Board managed the with-profits business in accordance with its PPFM in 2018. This was confirmed by a review carried out by the With-Profits Actuary.

In June 2018 updates were made to the practices described in the PPFM to take account of the change in the Society's strategy and removal of initial contribution charges. The principles remained unaltered.

#### **6. Conclusion**

Board concludes that the discretions it exercised in 2018 were both fair to policyholders and in accordance with its PPFM.

Signed on behalf of the Society's Board of Directors

A handwritten signature in black ink, appearing to read 'I Brimecome', with a small mark above the 'i'.

Ian Brimecome  
Chairman  
1 April 2019

## Appendix

### Report from the With-Profits Actuary

To the with-profits policyholders of The Equitable Life Assurance Society

As With-Profits Actuary to the Society, it is my responsibility to advise Board on the management of the Society's with-profits business. I am also required to report annually to with-profits policyholders on the exercise of discretion in relation to that business. This is my report for the year ended 31 December 2018.

I have carried out a review of the Society's exercise of discretion and its compliance with its PPFM in 2018 and in my opinion:

- the discretion exercised by the Society in 2018 took the interests of the Society's with-profits policyholders into account in a reasonable and proportionate manner;
- the Society complied with its PPFM during 2018; and
- the annual report from Board accurately summarises the key decisions that have impacted with-profits policyholders during the year.

In reaching these opinions, I have taken into account the information and explanations provided to me by the Society.

In preparing this report, I have complied with the relevant rules and guidance issued by the Prudential Regulation Authority and the Financial Conduct Authority, and the requirements of the Technical Actuarial Standards issued by the Financial Reporting Council that apply to this work<sup>1</sup>.



Louise Eldred  
With-Profits Actuary  
1 April 2019

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<sup>1</sup> TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance