THE EQUITABLE LIFE ASSURANCE SOCIETY

THE WITH PROFIT FUND 1993-2000

ADDENDUM TO REPORT

Prepared for

Equitable Members' Action Group

By

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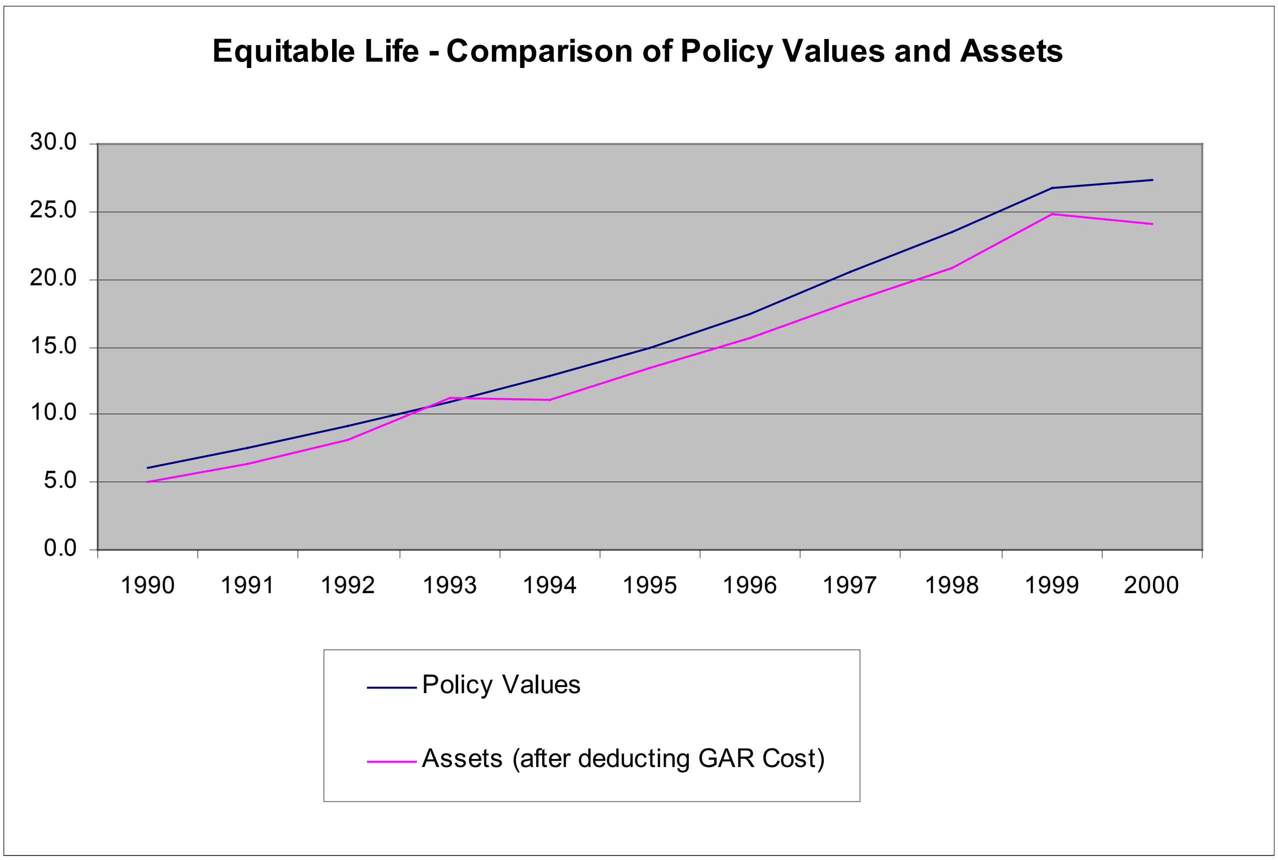
INTRODUCTION

In our original report we said 'Our researches suggest that the policy values, which Equitable indicated to members, paid on maturities and used extensively for marketing, were only fully covered by assets at one year end (31st December 1993) during the entire decade of the nineties'. Since our report was compiled solely from the published information available, we could not be entirely sure that there was indeed an asset deficit going back to 1990.

Subsequently, during the action of Equitable Life v. Ernst & Young (the previous auditors) there was produced to the Court of Appeal a report prepared for the Directors by Catherine Payne (an Equitable Life Actuary) entitled 'Comparison of Global Assets at Market Value with Full Policy Values' (Document number 1988). This covered the period 1995-1999 inclusive and is the comparison we attempted to make on behalf of EMAG members in our original report. The publication of this document has enabled us to complete the picture for 1995-1999 and to make reasonably accurate revised estimates for 1990-1994 and 2000.

The graph below shows the effect of the revised figures:



On the attached Schedules we have shown:

a) A comparison of our original estimates with the 'official' figures now released.
b) A note showing how we arrived at revised estimates for 1990-1994 and 2000
c) A note of the unexplained difference that arises for 2000.
d) An extract from the Court Transcript
e) A Copy of the 'Comparison of Global Assets at Market Value with Full Policy Values'

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MATTERS REVEALED BY THE COMPARISON

Our original Report made clear that we established With Profit policy values by working backwards from Independent Actuary Michael Arnold's statement that the deficit was 10% at 31st December 2000. The Society refused to provide any figures for assets, policy values or GAR Cost used in making that statement. In the circumstances we assumed 'conservative' ones in order not to exaggerate the deficiency.

It will be seen that the Society's own figures recently revealed to the Court of Appeal confirmed that Policy Values indeed exceeded assets for each of the years concerned (1995-1999 inclusive). In each case the Asset figure is close to that used in our estimates, but the policy value figure and consequently the deficit is substantially greater.

We believe that the explanation for this disparity is that Michael Arnold used a lower (by £700m) estimate of the Guaranteed Annuity Rate cost at 31st December 2000 (£1.1 billion) than that contained in the Society's Accounts and Regulatory Returns (£1.8 billion). The Society has repeatedly refused to allow him to explain his estimates. If our interpretation is correct, then the deficit at that date (using the accounts figures for GAR Costs) rises from the 10% of With Profit Assets (£2.6 billion) indicated by Mr Arnold to 12.7% or £3.3 billion.

We ask Lord Penrose to seek an explanation from Independent Actuary Michael Arnold as to why he appears to have used a figure for GAR costs at 31st December 2000 that was £700 million less than that contained in the Accounts and Returns.

CONCLUSION

From the information provided by the Society for the Court of Appeal we can safely conclude:

a) The methodology used in our Report was valid
b) Our estimates of With Profit assets were accurate
c) It is now confirmed that the Society's assets fell short of aggregate policy values at year-ends from 1995 to 1999 by amounts of between £1.6 to £2.7 billion (8% to 12%). It is extremely likely that a similar deficit arose at year-ends 1990,1991,1992 and 1994 of between £1.0 and £1.8 billion (13%-20%). 1993 only seems to have escaped the same fate by reason of a short-lived stock market spike.
d) There was indeed a 'black hole' (quite separate from GAR matters) of well over £1 billion going back to 1990

Subject to Lord Penrose's confirmation, we believe the total deficiency at 31st December 2000 was nearer 13% (£3.3 billion) than the 10% (£2.6 billion) indicated by Michael Arnold.

Burgess Hodgson June 2003

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EQUITABLE LIFE

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Revised Figures											
(Based upon internal ELAS report by Catherine Payne quoted in Court of Appeal by Counsel for Ernst & Young)											
(figures **in bold** were supplied by the Society other figures are our estimates)											
Assets applicable to With Profit fund	5,036	6,362	8,115	11,175	11,113	**13,366**	**15,699**	**19,240**	**22,367**	**26,139**	26,000
With Profit Policy Values (excluding GAR Costs £50m '98 & '99)	6,061	7,623	9,211	10,973	12,935	**14,962**	**17,424**	**20,598**	**23,517**	**26,823**	27,435
Surplus (Deficit)	(1,025)	(1,261)	(1,095)	202	(1,823)	**(1,596)**	**(1,725)**	**(1,358)**	**(1,150)**	**(684)**	(1,435)
GAR Cost per Claim against Auditors	0	0	0	0	0	0	0	(900)	(1,600)	(1,300)	(1,868)
Surplus (Deficiency) of assets as compared to policy values (including GAR Cost)	(1,025)	(1,261)	(1,095)	202	(1,823)	(1,596)	(1,725)	(2,258)	(2,750)	(1,984)	(3,303)
Surplus (Deficiency)											
As a % of Assets (excluding GAR Cost)	-20%	-20%	-13%	2%	-16%	-12%	-11%	-7%	-5%	-3%	-6%
As a % of Assets (including GAR Cost)	-20%	-20%	-13%	2%	-16%	-12%	-11%	-12%	-12%	-8%	-13%
Per Original Burgess Hodgson Report											
Assets applicable to With Profit fund	5,036	6,362	8,115	11,175	11,113	13,432	15,508	19,034	22,156	25,924	25,741
With Profit Policy Values (excluding GAR Costs)	6,336	7,668	9,031	10,753	12,459	14,421	16,817	19,950	22,701	25,866	26,447
Surplus (Deficit)	(1,300)	(1,306)	(916)	421	(1,346)	(989)	(1,308)	(917)	(546)	59	(706)
Difference in deficit £m						(607)	(417)	(441)	(604)	(743)	

EQUITABLE LIFE

REVISION OF ESTIMATES

	1990 Revised	1991 Revised	1992 Revised	1993 Revised	1994 Revised	1995 Revised	2000 Revised
Bonus Rate	12.0%	12.0%	10.0%	13.0%	10.0%	10.0%	3.3%
Effective Rate	11.6%	11.6%	9.7%	12.6%	9.7%	9.7%	3.2%
With Profit Policy Values at beginning of Year	5,049	6,061	7,623	9,211	10,973	12,935	26,823
Bonus	611	753	779	1,197	1,106	1,290	855
	5,660	6,814	8,401	10,408	12,079	14,226	27,678
Premiums Received	975	1,416	1,529	1,550	1,564	1,926	2,152
Claims Paid	(574)	(608)	(719)	(984)	(707)	(1,190)	(2,394)
Policy Value at Year End	6,061	7,623	9,211	10,973	12,935	14,962	27,435

	2000 £m
With Profit Assets (Estimated based upon Accounts and Returns and ELAS report by Catherine Payne)	26,000
Deficit Reported by Independent Actuary	10%
Deficit Amount (10% of assets)	2,600
Not Related to GAR Cost (latest estimate)	1,435
Assumed Related to GAR Cost	1,165
GAR Cost per Accounts	1,868
Unexplained Difference	703

NB. All amounts have been rounded to the nearest £million.
This may give rise to small apparent arithmetical errors.

MR HAPGOOD: In core bundle 2, page 1897. This is a facsimile from Catherine Payne to Mr Headdon. It is the Society's internal document. It is headed,"Comparison of Global Assets at Market Value with Full Policy Values". Does your Lordship have that, at 1988? So full policy values, as indeed becomes very clear on the next page, includes terminal bonus. So this is a Society standing back and saying to itself, "What are our assets and how do they compare with full policy values?" Your Lordships will see that the first column covers the position as at 31st December 1995 and if we look at the third and fourth entries, that is with profit assets and with profit policy values we see that at that date the assets are worth 13.366 billion and the policies values were worth 14.962 billion. So in a sense the Society was in a notional deficit position because the ratio was 111.9 in favour of policy values. If I can just explain the background to that on the basis of information which is in the bundles. The year to 31st December 1994 had been a disastrous year because in that year the society made a negative return on its assets of minus 4.2 per cent but because of its smoothing policy it awarded overall growth in policy values of 10 per cent. So in effect it took a loss of 14.2 per cent for its own commercial reasons. Thereafter it was necessary in subsequent years to declare overall growth in policy value rates, which were less than the investment return. You can see the impact of that. I am afraid though it is not terribly clear from highlighting. But if you follow the very bottom line the figures are 111.9 per~cent; 111 per cent; 107.something per~cent, 105.4 per~cent; 102.8 per cent. So in these years: 1997, 1998, 1999 because the Society is allocating lower overall growth values than its actual investment return it is getting the position back to 100 per cent.
LORD JUSTICE RIX: That is smoothing, is it?

MR HAPGOOD: That is smoothing, yes. Smoothing had been particularly volatile in the 1990s. Mr Headdon reported that to the Board in a paper I would seek to show you. Could we then go on to the next page, noting that as at 31st December 1999 total with profits policy values were 26,873.1 million. If you go on to 1989, this is a breakdown of those headline figures on the preceding page. In paragraph 2 the first three items are the assets, market value of assets, new business loans, deferred development expenditure. Then the next four entries are liabilities. NP is non-profit plus UL, unit-linked liabilities. We are not concerned with hat. But the next three entries at 20, 815.2, 50 million GAR reserve and 6007.9. That is what makes the 26,873 with profits policy values on the preceding page. Within those figures, the 6007.9, that is accrued final bonus -- that is the non-guaranteed fund value across all with profits policies.

LORD JUSTICE RIX: That is the terminal bonus.

MR HAPGOOD: The terminal bonus. In fact within the Society they called it the final bonus. But that is the aggregate figure across all policies. Of course because that figure can be cut at any time, although it would require something drastic to lead to that decision, you have always in a sense that degree of lee-way in your overall financial position. You may care to note as at 31.12.99 accrued final bonus represented 22.3 per~cent of total with profits policy values. The next page shows the comparison for 1997 and 1996. The total with profits policy values at 31.12.97 given on page 1988 was 20,597.8 million and that is represented by the with profits liabilities at full value at 16,753 and the accrued final bonus at 3,884.8. Those come to 20,597.8.

Comparison of Global Assets at Market Value with Full Policy Values

£m	31/12/95	31/12/96	31/12/97	31/12/98	31/12/99
Total assets	16,804.4	19,520.2	23,918.0	28,343.4	33,188.0
Aggregate policy values	18,400.3	21,245.4	25,276.0	29,543.1	33,922.1
	109.5%	108.8%	105.7%	104.2%	102.2%
With profits assets	13,366.1	15,698.6	19,239.8	22,367.2	26,138.0
With profits policy values	14,962.0	17,423.8	20,597.8	23,566.9	26,873.1
	111.9%	111.0%	107.1%	105.4%	102.8%

Notes:
1. The 31/12/98 and 31/12/99 liabilities include a GAR reserve of £50m.
2. At 31/12/99 the pensions review reserve increased from £70m to £132m.

COMPARISON OF ASSET VALUES AND TOTAL POLICY VALUES AT 31/12/99

1. The usual annual comparison of assets at market value with current full policy values has been carried out. The overall global position is summarised below. The positions for the various international funds will follow shortly.

2. The global position at 31/12/99 compared with that at last year end is as follows:

	31/12/99 £m	31/12/98 £m
Market Value of Assets	32,666.8	27,823.0
New Business Loans	504.9	497.5
Deferred Development Expenditure	16.4	22.9
	33,188.0	28,343.4
NP + UL liabilities	7049.1	5,976.2
With-Profits liabilities at full value	20,815.2	18,897.4
Guaranteed Annuities Reserve	50.0	50.0
Accrued Final Bonus	6007.9	4,619.5
	33,922.1	29,543.1
Aggregate policy values as a % of assets:	102.2%	104.2%
Aggregate with-profits policy values as a % of with-profits assets:	102.8%	105.4%

3. Of note is the increase in reserves from £70 million to £132 million for the pensions review.

4. The GAR reserve, for the purpose of comparing to last year's results, has been kept at £50m.

5. If you have any queries or wish to see the underlying figures in more detail, please let me know.

VAL/JGE
30/06/00

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<u>COMPARISON OF ASSET VALUES AND TOTAL POLICY VALUES AT 31/12/97</u>

1. The usual annual comparison of assets at market value with current full policy values has been carried out. The UK figures, as for previous years, are precise ones. Following the conversion of the majority of the international business onto CPAS during 1997, those figures are also precise. The only group of business for which an assumption has been made is the German-style with-profits business which is administered on a stand-alone system.

2. The position at 31/12/97 compared with that at 31/12/96 was as follows:

	31/12/97 £m	31/12/96 £m
Market Value of Assets	23434.4	19073.7
~~New Business Loans~~	~~456.4~~	~~413.3~~
Deferred Development Expenditure	27.2	33.2
	23918.0	19520.2
NP + UL liabilities	4678.2	3821.6
With-Profits liabilities at full value	16753.0	14527.0
Accrued Final Bonus	3844.8	2896.8
	25276.0	21245.4
Aggregate policy values as a % of assets:	105.7%	108.8%
Aggregate with-profits policy values as a % of with-profits assets:	107.1%	111.0%

3. The reductions in ratios are in-line with estimates made earlier in the year and have moved broadly as expected in a year during which the with-profits fund rose by approximately 4% more than the rise in with-profits policy values.

4. As it is now early July, I thought it might be worthwhile to include in this short note an updated estimate of the with-profits policy values as a percentage of with-profits assets: that updated percentage at the end of May is 98.8% (the with-profits return to the end of May was 12.4% compared with an increase in liabilities of approximately $3\frac{3}{4}$%).

5. If you have any queries or wish to see the underlying figures in more detail, please let me know.

ACTV/MWS
07/98

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1990

AGGREGATE POLICY VALUES AS AT 31/12/95

	£m
Assets at Market Value	16387.5
100% of unrecouped strains	370.1
Deferred Development Expenditure	46.8
	16804.4
NP & UL liabilities	3438.3
WP liabilities (full value)	12363.4
Accrued final bonus	2598.6
	18400.3
Aggregate policy values as % of assets	109.5%
With-Profits Policy Values as % of assets excluding non-profit and unit-linked assets	111.9%
Excess of with-profits policy values over assets as % of with-profits policy values	10.7%