THE EQUITABLE LIFE ASSURANCE SOCIETY

Annual Report and Accounts **2000**

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37038

Board of Directors (as at 11 April 2001)

President

V E Treves* (a,n,r)

Vice-Presidents

I P Sedgwick* (a,i,r)†

Peter Martin* (a,n,r)

P A Davis* (a)

Miss J A Page CBE*

D W J Price* (i)

J F Taylor*(n)

D G Thomas (Executive Director) (i)

C G Thomson (Executive Director) (i)

General Management

Chief Executive

C G Thomson

General Managers

† Senior independent director

* Directors considered to be independent

Members of: Audit Committee (a)
Investment Committee (i)
Nominations Committee (n)
Remuneration Committee (r)

Introduction

This report covers the main issues of 2000 and developments in the early part of 2001.

Guaranteed annuity rates and the court cases

The Guaranteed Annuity Rate (GAR) issue dominated the year and was the most important factor in many of the major decisions taken. In September 1999, the High Court found in favour of the Society in the representative action initiated and funded by the Society. The representative defendant sought leave to appeal, which was granted, and the Society again met the costs of both parties. In January 2000, the Court of Appeal found against the Society, deciding that the Society could not apply different rates of bonus depending on whether or not the policyholder took benefits based on guaranteed annuity rates. However, the judgement in the Court of Appeal did not prevent the Society from applying different rates of bonuses to the whole class of GAR policies - effectively "ring fencing" the costs of the GARs to the GAR policyholders. The Court of Appeal did not provide the certainty which the Society had sought through the representative action. Moreover, the board believed that the differential final bonus practice it had adopted was lawful and fair. In the light of these points the Society appealed to the House of Lords. On 20 July 2000, the House of Lords' judgement against the Society was announced. The House of Lords' judgement went further than the Court of Appeal and precluded "ring fencing" of GAR policies.

The result was that the Society needed to increase benefits for some policies (i.e. those with GARs) with a corresponding reduction in the benefits for other with-profits policies. The value of GAR policies had effectively increased by approximately £1.5 billion in total, based on the Society's understanding of the type of annuity to which GARs apply and assumptions regarding future interest rates, mortality experience, take-up rates and the level of future contributions to GAR policies. To allow for the cost of these increased benefits, the board decided that, for most classes of with-profits policies, no bonuses would be allotted for the first seven months of 2000. (An equivalent approach was taken for with-profits annuities.) The growth in policy values held back matched closely the estimated additional costs of the GAR liabilities.

Despite the final nature of a House of Lords' judgement, some members believe that judgement to be wrong. The Society has instructed leading Counsel, Nicholas Warren Q.C., to consider whether there is a realistic chance of successfully revisiting the judgement. The result of this work should be available before the Annual General Meeting.

An explanation of some aspects of the GAR issue that are frequently misunderstood is included on pages 6 to 9 of these Report and Accounts.

The House of Lords' judgement diminished the Society's capital strength, and in consequence reduced its investment freedom. The board concluded that it was in members' best interests for the Society to be sold, as a whole, and put the Society up for sale. A large number of organisations expressed interest and a number proceeded to detailed negotiations. However, on 7 December 2000 the last potential bidder for the whole of the Society withdrew from negotiations and the board decided that the Society should close to new business.

Negotiations for the sale of parts of the Society's business continued, with a number of parties expressing interest in various parts of the business. The sale of the Society's subsidiary, Permanent Insurance Company Limited, to Liverpool Victoria Friendly Society Limited for £150 million was agreed on 22 December 2000 and completed on 16 February 2001. On 5 February 2001, the Society announced that Halifax Group plc had agreed to acquire the Society's operating assets, sales force and the economic interest in its non-profit and unit-linked business, for payment of up to £1 billion into the with-profits fund. Under the agreement, the Society's former subsidiaries, Equitable Services and Consultancy Limited and Equitable Investment Fund Managers Limited, have been acquired by the Halifax group. The Halifax paid £500 million on 1 March 2001. An additional sum of between £250 million and £500 million is payable if a compromise agreement is reached between policyholders whose policies contain GARs and those whose policies do not. The first £250 million of this is payable immediately on the compromise agreement taking effect and the remaining £250 million depends on the achievement of agreed new business sales and profitability targets in 2003 and 2004 by the sales force, which has transferred to become the Halifax Equitable sales force.

The board decided that the offer from the Halifax was preferable to the alternatives open to the Society, including carrying on independently.

Criticism of the Society

The Society was much criticised during the year. One common complaint was that the Society misled policyholders about the extent of liabilities arising under GAR policies. Had the Society been allowed to continue its approach of applying differential bonus rates to GAR policies, the cost to the Society would have been approximately £50 million. Under the Court of Appeal judgement the cost remained around £50 million, in circumstances which included the ability of the Society to "ring fence" the GAR policies. The House of Lords' judgement, however, did not allow the Society to "ring fence". As a result, and as mentioned earlier, the cost of meeting GAR liabilities became an estimated £1.5 billion, based on assumptions including future interest rates and take-up rates.

The Society was also criticised for continuing to advertise and to sell policies in the periods following the judgements of the Court of Appeal and the House of Lords. Had the Court of Appeal judgement (as understood by the Society) been upheld by the House of Lords, the costs would not have affected the Society's future bonuses. Following the House of Lords' judgement, the withholding of seven months' bonuses reflected the estimated cost. It was expected to be in members' interests that the Society should be sold as a going concern, with its sales force and other operations intact. In this way, the greatest value could be achieved for the benefit of members. It was only after 7 December 2000, when the last potential bidder withdrew, that it became clear that the board's expectations would not be fulfilled and that, in consequence, the Society should close to new business. Some policyholders have indicated that they believe they have grounds for action against the Society as the potential liability to GAR policies was not explicitly disclosed.

On 20 July 2000, the Society introduced a financial adjustment, which applies on the non-contractual termination of with-profits policies. This was increased on 8 December 2000 to 10% of the total fund value (and to 15% on 16 March 2001 following a further significant fall in stock market values since December 2000). The financial adjustment does not apply to contractual payments such as maturity under endowment policies and retirement under pension plans. The purpose of the financial adjustment is often misunderstood - it is applied to protect the interests of policyholders who are not choosing to surrender policies early while still providing those who are surrendering policies with a fair and reasonable value. It is the essence of with-profits policies that there is "smoothing" of investment returns and sharing of other risks. For example, at times the policy value calculated using the current bonus system will give a value which is greater than the market value of the assets underlying the policy. A financial adjustment is therefore likely to be necessary when stock markets are low as they have been in recent months. While maturing policyholders are entitled to the smoothed value, the financial adjustment for surrendering policies will be set so that they receive a fair and reasonable value reflecting all the circumstances at that time. The Society is in correspondence with the Office of Fair Trading on the terms of its policies as a result of the increase in the financial adjustment in December 2000.

Investment Performance

The Equitable is one of very few life offices to publicise the return on its with-profits portfolio. This was a year of good relative investment performance. The sterling with-profits fund achieved a total return of +2.7%, compared with the return on UK pension funds as a whole of -1.8%, and is the result of solid investment performance in all areas.

While the absolute returns on equities were poor, the Society's investments produced returns in excess of their respective benchmark indices. Of particular note is the return from the portfolio of alternative investments. This portfolio (of principally venture capital and hedge funds) was set up with the aim of producing added diversification for the portfolio and rose by more than 35% last year.

Significant selling of equities took place in December 2000 and early in 2001 to reduce the risks to policyholders of a serious fall in equity markets. In total, these sales realised almost £3.4 billion, of which £2 billion occurred in 2001. This latter sum was slightly in excess of the value of the relevant securities at 31 December 2000. Some of the proceeds were re-invested in fixed-interest securities, with the balance held on deposit.

In 2000, 11 out of 15 of our actively managed unit-linked funds produced superior performance, i.e.in the first or second quartile of their peer groups.

From 1 March 2001, day-to-day asset management services are being provided to the Society at market rates by Clerical Medical Investment Group Limited (a subsidiary of the Halifax Group plc). The Society's board retains responsibility, however, for the broad investment strategy of the with-profits fund. Clerical Medical have a good record of investment performance and have recently won a number of awards. The board is confident that, in managing the Society's assets, Clerical Medical will provide good investment performance for the Society's with-profits and unit-linked policyholders.

Overall rates of return for 2000

Under the with-profits approach, the directors of the Society determine an appropriate smoothed overall rate of return for each year, taking into account the actual investment experience of current and recent years.

The directors decided to allocate an overall rate of return to pension plans for the period from 1 August 2000 to 31 December 2000 at an annual rate of 8%. For existing with-profits pension funds in force for the whole of 2000 this gives an effective return for the year of 3.3%. For pension plans, the ongoing interim rate was set at 8% p.a. so the rate of 8% p.a. applies from 1 August 2000 until further notice. Equivalent rates apply to life contracts (allowing for the effects of taxation) and to The Equitable 2000 Personal Pension Plans which have a different charging structure. The directors may change levels of final bonus at any time.

Customer Service

Historically, the Society's policyholders have been used to receiving very high quality, low cost customer service. However, during the second half of 2000 and the early part of 2001, it became impossible to maintain normal standards due to the unique circumstances. Volumes of transactions and particularly of enquiries increased massively. It is not possible to increase the number of trained staff quickly, nor is it possible to do so without increasing the cost for all members. The board much regrets this deterioration in the level of service.

Administrative services for the Society will now be provided by HECM Customer Services Limited, the newly formed operating company within Clerical Medical Insurance Group, and will be provided to the Society at cost. An objective of HECM is to return to normal standards of service as soon as possible. A formal service level agreement will set service requirements consistent with industry best practice. For the foreseeable future, the same staff, in the same locations will carry out servicing as before.

Regulation

Although the Society is closed to new business, it remains a regulated company and will need to ensure it complies with all the relevant regulations in respect of its existing business. The Halifax group will largely provide the services required by the Society to enable it to do this.

During 2000 the review of past sales of pension transfers and opt-outs continued, in line with the requirements of the regulators, and is well on course for meeting the deadline for phase II of this review of 30 June 2002. Up to the end of 2000, £130 million had been paid in compensation. It is estimated that a further £139 million will be payable before the end of phase II of the review. The estimated compensation figure has increased for a number of reasons. These are: a change in the loss assessment calculation basis for transfer cases set by the regulators, the change in bonus policy by the Society following the House of Lords' decision and additional cases that have been brought into the review. Although the compensation figures are sizeable sums, they are much smaller than would be expected on the basis of the total cost to the industry and the market share that the Society had in pension business.

In May 2000, the FSA (Financial Services Authority) published the details of a review to be carried out by the financial services industry, in connection with past sales of certain categories of Free-Standing Additional Voluntary Contribution (FSAVC) plans. Good progress is being made with this review and it is on target to complete by the deadline of 30 June 2002. The Society does not anticipate that the review will give rise to any material compensation payments.

At the beginning of 2000, the ABI (Association of British Insurers) initiated an exercise to improve the information given to holders of mortgage endowment policies on an industry-wide basis. This followed concern that such policies may not produce sufficient sums to repay policyholders' loans, owing to the general expectation of lower inflation and lower investment returns. A package of information was devised and agreed with the FSA. The Society issued the information to all mortgage endowment policyholders at the end of September 2000. Updated information will be issued to policyholders on an annual basis starting from 2002, as part of the annual bonus statement. At the time of mailing the Society had approximately 15,000 mortgage endowment policies in force, so exposure to this market is very limited. The great majority of these policies were projected to repay the loan providing the investment return achieved during the remaining policy term is 6% p.a.

Rectification scheme

The House of Lords' judgement made it necessary to review all the payments made on the retirement of with-profits policyholders with GARs during the period 1 January 1994 to 19 July 2000. A rectification scheme was drawn up setting out the principles on which the Society proposes to make offers to affected individuals. Two eminent experts, one legal and one actuarial, subsequently endorsed the scheme and details were sent to affected policyholders in December 2000. This scheme is not affected by any compromise agreement between policyholders whose policies contain GARs and those whose policies do not.

Staff

To ensure that the Society could continue to provide service to policyholders (and to obtain the best value for members from selling the Society's operations), it was important that the Society retained its staff during what was for them a very uncertain time. Retention measures were introduced to recognise and encourage the continuing loyalty of staff during the sales process and integration with a prospective new owner. Redundancy arrangements were also put in place for the Society's staff during the year. The Society obtained independent advice from Watson Wyatt on the terms of these arrangements, based on information collected from comparable organisations in the insurance sector. The redundancy terms were modelled on this information. The sale of the Society's operating assets to the Halifax has not resulted in significant redundancies to date. However, if redundancies occur before 31 December 2002, the costs of these will be borne by the Society.

The field force represented a significant asset in which potential bidders were interested and it was important to keep the field force intact to achieve the highest value possible in the interests of members. The Society took a number of steps to achieve this including financial retention measures which when added to severance and associated costs amounted to an expenditure of £54.1 million. These actions were successful and the vast majority of the field force transferred to Halifax Equitable on 1 March 2001. Up to £250 million of the further payments which would be made to the Society by Halifax, in the event of a GAR compromise agreement being reached, depends on the achievement of agreed new business sales and profitability targets in 2003 and 2004, by the Halifax Equitable sales force.

Conclusion

The last two years have been among the most difficult and dramatic in the Society's long history. We cannot change what has occurred but we intend to act to restore stability so that we can again provide a secure and well performing Society for the benefit of existing policyholders.

Charles Thomson
Chief Executive
11 April 2001

Guaranteed Annuity Rates (GARs)

A detailed explanation of the issues surrounding GARs was given in the 1999 Annual Report. Since then the House of Lords' judgement has been received and the results of that are described in the Management Report on pages 2 to 5. There are a number of aspects relating to GARs that are frequently misunderstood. This section seeks to explain these complex issues more clearly.

A number of technical terms are used below and it may be helpful to define these at this stage. These are:

"Best estimate commercial cost" – this is used to describe the impact on policyholder benefits of the future additional cost of GARs. It is calculated on the Society's best estimate of future circumstances that are likely to be experienced, including future interest rates, mortality experience, take-up rate of GARs and future contributions to GAR policies.

"Realistically prudent technical provisions" – this is the amount shown in the Companies Act accounts for the additional cost of GARs and incorporates a degree of prudence over and above that included in the "best estimate commercial cost". The assumptions as to future circumstances are made on a more adverse basis, to give that extra degree of prudence, and for this reason the "realistically prudent technical provisions" will be higher than the "best estimate commercial cost".

"Statutory reserves" - these are the reserves which need to be shown in the statutory returns to the Financial Services Authority (FSA). They are calculated on extremely prudent assumptions as they are designed to show that guaranteed liabilities could be paid in a range of very adverse future scenarios. The assumptions are governed by regulation and by professional guidance. In such a valuation, it is necessary to assume that almost all GAR policyholders exercise their GAR options. "Statutory reserves" will therefore be considerably higher than the "realistically prudent technical provisions" contained in the Companies Act accounts.

1. Statutory reserves compared with the impact of the House of Lords' decision

It has been suggested that had policyholders been more fully aware of the statutory reserves required for GARs, this would have given them an early indication of the potential impact of the most adverse of the possible outcomes from the House of Lords. This is not the case. There is little or no connection between the statutory reserves and the impact on policyholder benefits of the House of Lords' decision. This misunderstanding may arise from the fact that the figure of £1.6 billion for the statutory reserves (appearing in the regulatory return for the period ending 31 December 1998) is similar to the amount the Society estimated needed to be set aside to deal with the consequences of the House of Lords' decision (£1.5 billion). The fact that the two figures are similar is coincidental. They deal with quite different sets of circumstances, which are described below.

Statutory reserves

There are two main elements to the benefits under with-profits policies. These are (a) the guaranteed benefits including the annual or reversionary bonus and (b) the non-guaranteed final bonus. The statutory reserves are required to ensure that all life companies are able to meet their liabilities to pay the guaranteed benefits even in very adverse economic circumstances.

GAR policyholders have the option of taking their guaranteed benefits in either cash form or as an annuity. The statutory reserves were set in line with new regulatory guidance issued in January 1999 by HM Treasury at £1.6 billion as at 31 December 1998 and at £1.7 billion as at 31 December 1999. This regulatory guidance required the Society to assume a very high rate of take up amongst GAR policyholders of the GAR annuity, in preference to the cash option. But even under these new assumptions, the statutory reserves were still concerned only with the guaranteed annuity benefits produced by applying the guaranteed annuity rate to the guaranteed cash form of benefits. The guidance did not require the Society to assume that the rate should be applied to total benefits, including a final bonus or, indeed, to anticipate a final bonus at all.

As at 31 December 2000, the statutory reserves for GARs were £2.6 billion as even more prudent assumptions were required. The large increase in these statutory reserves is due to clarification of earlier guidance and stronger assumptions in the basis on which these reserves are calculated and the decrease in long-term interest rates over the year.

For the statutory reserves to be fully called upon would require there to be not just a significantly adverse set of conditions, but for these conditions to prevail throughout the whole period during which retirement benefits would be drawn. As this is unlikely to apply, it has been possible for the Society to transfer some of the risk via a reassurance policy. This is mentioned further below. The statutory reserves are not, and were never intended to be, a means for providing for the consequences of the eventual decision of the House of Lords.

Impact of the House of Lords' decision

The litigation on which the Society embarked was designed to establish if it was lawful to pay different final bonuses to GAR policyholders depending on whether or not those holders exercised the right to take their benefits in annuity form at a rate guaranteed by the Society. It related therefore to the treatment of final bonuses, not the guaranteed benefits with which the statutory reserves are concerned.

The Court of Appeal determined by a majority of 2 : 1 that it was not lawful to differentiate in this way within the group of GAR holders. A GAR policyholder should receive the same proportionate final bonus irrespective of the form of benefits selected. The Court did not, however, rule that it was unacceptable for the Society to differentiate between GAR and non-GAR holders in this respect, so still allowing any cost of the GARs to be "ring fenced" to those policyholders with GARs.

The House of Lords' ruling took matters beyond this by saying that the Society could not apply a different bonus policy to GAR and non-GAR holders dependent on the existence or absence of GAR provisions in their policies.

The effect of this ruling was to bring about an economic transfer from non-GAR holders to GAR holders. The with-profits fund is a single pot of money. The House of Lords' judgement affects the way in which the assets in this fund are allocated between different categories of policyholder. Following the House of Lords' decision, this necessary reallocation of assets was assessed at £1.3 billion for the future best estimate commercial cost and £200 million for rectification of those policies that had matured since January 1994 (when the differential bonus system was first introduced), making £1.5 billion in total. The estimated commercial cost was based on the Society's understanding of the type of annuity to which GARs apply and assumptions regarding future interest rates, mortality experience, take-up rates and the level of future contributions to GAR policies.

The House of Lords' ruling did not, and has not since, determined the level of the Society's statutory reserves. Provision for additional statutory reserves would still have had to made as at the end of 1998, 1999 and 2000, even if the House of Lords' decision had upheld the Society's approach.

2. Estimates of the commercial cost and prudent technical provisions

Before the House of Lords' ruling, the Society estimated the commercial cost of GARs as £50 million. This was because its approach of applying different final bonus rates, depending on whether or not benefits were taken in GAR form, meant that there was no commercial cost except where it was not possible to adjust the final bonus sufficiently to reflect fully the cost of the benefits being taken in GAR form. This remained the case, even after the Court of Appeal judgement as the Society believed it remained able to "ring fence" GAR policies as described in the Management Report on pages 2 to 5. Because of this, the Society continued to explain that, if the House of Lords upheld either the High Court judgement or the Court of Appeal judgement, the estimated commercial cost of GARs would not exceed £50 million.

Although, until the House of Lords' ruling, the estimated commercial cost of GARs was £50 million, a realistically prudent technical provision of £200 million was established in the balance sheet in the Report and Accounts for 1999. This provided an allowance for more extreme future changes in financial conditions and mortality experience, in order to give a more prudent provision in the accounts.

It was only as a result of the fact that the House of Lords went further than the Court of Appeal judgement, in that it prohibited "ring fencing" the GAR policies, that the best estimate commercial cost rose to £1.3 billion.

As described above, in ascertaining provisions to be made in the accounts, a degree of prudence is applied over and above that included in the best estimate commercial cost. The future interest rates are assumed to be lower and the take-up rate of GAR options is assumed to be higher than those used for the best estimate commercial cost. For this reason the technical provision included in the accounts is higher than the best estimate commercial cost. The provision included in the 2000 accounts is £1.7 billion as disclosed in note 18 on the accounts.

The various levels of prudence in the assumptions necessary for the different purposes mentioned above are shown in the table below.

31 December 2000	Assumptions			
	Best estimate commercial cost	Realistically prudent technical provisions	Statutory reserves	Actual experience 1.8.00 – 31.12.00
Interest rates for annuities	5.6%	4.25%	4.25%	5.6%
GAR take-up rates	50%	57.5%	90%	50%
Future premium reductions	9%	10%	5%	22%
Amount (2000)	£1.3bn	£1.7bn	£2.6bn	£37m

Note
As at 31 December 1999, the "best estimate commercial cost" was £0.05 billion, the "realistically prudent technical provisions" were £0.2 billion and the "statutory reserves" were £1.7 billion. Although some of the assumptions in arriving at these figures were different in 1999, the most significant difference between 2000 and 1999 is the removal of "ring fencing".

3. Reassurance arrangements

As mentioned above, for the statutory reserves to be fully called upon would require there to be very adverse financial conditions prevailing throughout the whole period during which retirement benefits under GARs are payable. As these very adverse conditions are unlikely to apply, it has been possible for the Society to arrange a reassurance policy under which, if the GAR take-up rate exceeds 60%, the excess cost to the Society is recoverable from the reassurer. The reassurer can recover from the Society any such costs from future surpluses as they emerge. If no such surpluses emerge, the cost is borne by the reassurer. The reassurance is reflected in a reduction from the statutory reserves otherwise required but does not impact on the technical provisions in these accounts. The premium for this reassurance is small in relation to the reserves released. The reassurance arrangements had to be renegotiated after the House of Lords' decision as the reassurance was originally based on the Society maintaining its pre-House of Lords bonus system. As a consequence there was a reduction in the reserve released by the reassurance which resulted in higher statutory reserves for the Society.

As explained above, the statutory reserves are based on the assumption of very adverse conditions prevailing. Although these are unlikely to be met in practice, the reserves have to be maintained and can affect the degree of investment freedom of the Society. The higher the reserves, the more that investment freedom is restricted. The reserve for GARs in the Society's statutory reserving requirements as at 31 December 2000 was £1.8 billion allowing for the reassurance rather than £2.6 billion which would otherwise be the case. This enables the Society to invest more freely in the interests of policyholders.

Principal activities

The Equitable Life Assurance Society (the Society) is the ultimate holding company of the Equitable Group of companies (the Group). The principal activities of the Group during 2000 were the transaction of life assurance, annuity, pension and permanent health insurance business in the form of guaranteed, participating and unit-linked contracts, and other financial services.

Following the House of Lords' decision in respect of *The Equitable Life Assurance Society v Hyman* in July 2000 the Society was put up for sale. By early December no bids had been received for the Society in its entirety and, as a result, the Society closed to new business on 8 December 2000.

On 5 February 2001, the Group announced the sale of its operating assets and the economic interest in its non-profit and unit-linked business to Halifax Group plc for a cash consideration of £500m. This transaction was completed on 1 March 2001 (see note 22 Post Balance Sheet Events for more details).

The operations of the Group, including the impact of the House of Lords' decision, are described in more detail in the Management Report and should be read in conjunction with this Directors' Report.

Financial results

There are a number of uncertainties in respect of this year's accounts. These are referred to in this Directors' Report and in Notes 18 and 25. In these circumstances the auditors have inevitably referred to the uncertainties in their audit report with a paragraph headed "Fundamental uncertainties".

The Society

Earned premiums, net of reinsurance, were £2,940.9m compared with £3,483.7m in 1999. Expenses before deferral of acquisition expenses amounted to £244.8m (*1999 £147.3m*), including exceptional expenses of £64.1m (*1999 nil*).

The amount of the technical provisions, net of reinsurance, increased to £31,235.0m from £28,060.9m of which the increase in the guaranteed annuity rate provisions, including the rectification scheme, was £1,668.0m (*1999 nil*). The market value of the net assets supporting the technical provisions was £33,546.3m (*1999 £32,902.0m*).

Equitable Investment Fund Managers Limited (EIFM), formerly Equitable Unit Trust Managers Limited

EIFM was a wholly-owned subsidiary of the Society until 1 March 2001.

Total sales of units of the trusts and OEIC shares managed by EIFM, including those bought by the Society to back unit-linked policies, amounted to £740.4m (*1999 £666.9m*) during the year and the value of funds under management at the end of the year was £3,767.6m (*1999 £3,677.6m*).

Permanent Insurance Company Limited (Permanent)

Permanent was a wholly-owned subsidiary of the Society until 16 February 2001 when it was sold to Liverpool Victoria Friendly Society Limited.

The principal activity of Permanent is the transaction of permanent health insurance.

Earned premiums, net of reinsurance, were £55.4m (*1999 £48.5m*).

University Life Assurance Society (University Life)

The Society owns all the shares of this company which ceased transacting new business some years ago. The Society is entitled to 10% of the surplus distributed at each declaration, which currently take place every three years, and of the surplus distributed as interim and terminal bonuses during each triennium. The most recent valuation for the purpose of establishing the amount of distributable surplus was made as at the end of 1999.

The Society is paid a fee for the services provided to University Life which has no staff of its own and this fee is set against the corresponding incurred expenses.

From 1 March 2001 the services provided to University Life by the Society have been provided by Clerical Medical Investment Group Ltd.

Valuation and bonus declaration

In arriving at the technical provisions the Society's Appointed Actuary has had to make an assessment of the increased liability to the GAR policyholders following the House of Lords' decision.

There has been little experience since that decision of the intentions of policyholders to take an annuity with the benefit of the GAR in preference to alternative annuity products or policy options. The majority of the Society's GAR policies express the GAR only to apply to a single life level annuity. Some policyholders have lodged complaints with the PIA Ombudsman concerning the restrictive form of GAR annuity. None of these complaints has been upheld by any PIA Ombudsman decision. There is also, against the background of all the recent uncertainty, limited experience of the extent to which GAR policyholders will maintain their recent level of contributions. Whilst the Directors believe that the provision made is realistic, because of the limited experience they recognise that there is significant uncertainty as to the quantum of the additional liability.

In the event that the compromise scheme that the Directors are seeking to promote is adopted, the impact of these uncertainties on the technical provisions and the corresponding impact on the Fund for Future Appropriations will be removed.

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 2000. Although the Society is still able to meet the exacting standards of solvency as required by the Financial Services Authority, the Directors decided that it would be unwise to add bonuses in declared guaranteed form at this time as this would further restrict future investment freedom.

Final bonus

The Society's with-profits fund earned a return of 2.7% for 2000. Although this is a modest return compared with recent years, this is satisfactory bearing in mind the performance of equity markets during 2000. Whilst notional growth was allocated to the fund at the rate of 8% for the year 2000, no growth has been allocated to with-profits funds for the period 1 January 2000 to 31 July 2000 in order to reflect the House of Lords' decision and the consequently increased costs of the guaranteed annuity rate policies. As a result, the effective rate of growth for most pension policies is 3.3% for the year. Comparable rates are set for life contracts. These overall rates of return are used to calculate levels of final bonus which is not guaranteed.

Where a policy has a guaranteed growth rate applied to a guaranteed fund that has, of course, been given.

Final bonus rates may be changed by the Directors at any time.

Directors

The Directors of the Society during the year were as set out on page 1, except for Mr V E Treves and Mr C G Thomson who were appointed as Directors on 26 February 2001 and 5 March 2001 respectively. Mr J D S Dawson, Mr C P Headdon, Mr A Nash and Mr J R Sclater CVO were also Directors until their resignations on 9 April 2001, 1 March 2001, 7 December 2000 and 28 February 2001 respectively. Mr J R Sclater CVO was President of the Society until the date of his resignation.

In December 2000, the non-executive Directors then in post announced their intention to resign once replacement non-executive Directors had been appointed. The Board expects to appoint new non-executive Directors before the date of the Annual General Meeting and on those appointments becoming effective the remaining non-executive Directors in post in December 2000 together with Mr D G Thomas will resign.

In accordance with Regulation 40 of the Society's Articles of Association any Director appointed to fill a casual vacancy or as an addition to the existing Directors must retire but is eligible to seek re-election at the next following Annual General Meeting. The Directors retiring at the Annual General Meeting, including those seeking re-election and other candidates seeking election as Directors, are shown on the proxy form accompanying the Notice of the Annual General Meeting.

Corporate governance

A statement regarding the Society's approach to corporate governance is given on pages 13 to 16.
A statement by the Directors of their responsibilities in respect of the accounts is given on page 17.

Introduction of the euro

A programme of work is currently being undertaken to make the necessary system changes to support the introduction of the euro for the German and Irish business. The costs incurred to date have not been material and are included in net operating expenses.

Staff

In relation to the employment of disabled persons the Society's policy in 2000 was to give the same consideration to disabled people as to other people, in regard to applications for employment, continuation of employment, training, career development and promotion – having regard to their particular aptitudes and abilities.

During 2000 it was the Society's continuing policy and practice to involve staff by providing and receiving information relevant to the progress, development and performance of the organisation.

Employee issues were communicated to staff through manager briefings, a system of written circulars, a staff handbook, training and development programmes. In relation to employment opportunities, the Society treated applications from all sectors of the community fairly and consistently. All applications for employment, consideration for continued employment, training opportunities, career development and promotion were fully considered with regard to an individual's particular aptitudes and abilities.

Consultation with staff on matters affecting the interests of staff and the general efficiency of the Society took place in various ways; one of these was through the elected staff representatives on a Staff Consultative Committee which met on seven occasions in the year.

All members of staff and executive Directors participated in an incentive scheme which was designed to encourage and reward corporate performance.

As a mutual company the Society has no employee share scheme in force.

Payment of suppliers of goods and services

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 proportion of trade creditors included in the Balance Sheet to total supplies invoiced in the year represents 29 days' supplies (1999 32 days' supplies).

Auditors

Ernst & Young, current auditors to the Society will not seek re-appointment at the forthcoming Annual General Meeting on 23 May 2001. A resolution is to be proposed at the Annual General Meeting for the appointment of PricewaterhouseCoopers as the Society's auditors.

I P Sedgwick
Vice-President
11 April 2001

Principles of good governance

The Society is committed to integrity and professionalism in all its activities. As an essential part of this commitment the Board pursues the highest standards in corporate governance and confirms that, except as otherwise stated, the Society has voluntarily adopted the Principles of Good Governance and Code of Best Practice (The Combined Code) appended to the UK listing rules.

Directors

The Board meets regularly, normally monthly, so that it can control key issues and monitor the overall performance of the Society and the Group. The President together with the Chief Executive and the Secretary establish an agenda for each Board meeting. Agenda items are supported by papers distributed five days before the meeting. Executives are available at Board meetings to present papers and to provide answers to questions raised by the Board. The Board decides organisational strategy and has a formal schedule of matters reserved for its decision. Authority is delegated to the Chief Executive for implementing strategy and for managing the Group.

The Society separates the roles of President and Chief Executive. The President and two Vice-Presidents, all non-executives, are elected by the Board. One Vice-President, Mr I P Sedgwick, is nominated as the senior independent non-executive Director.

The Society's practice is for the majority of Directors to be non-executive.

The Board considers that independent non-executive Directors should be free of any business or other relationship which could materially interfere with the exercise of their independent judgement. All the Directors hold policies with the Society but, in the view of the Board, in no instance do these interfere with the independence of the relevant Director. Accordingly, all non-executive Directors are considered to be independent.

All 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 a General Meeting at least every three years. All appointments are subject to review by the Board with detailed assistance by the Nominations Committee, at intervals not exceeding five years.

No non-executive Director has a service contract.

Executive Directors have service contracts for periods of up to one year.

The Board's policy on remuneration is set out in the Remuneration Report.

Board Committees (as at 11 April 2001)

There are four committees of the Board as set out below.

The Audit Committee, which comprises four non-executive Directors, is chaired by Mr I P Sedgwick. It meets at least three times a year and assists the Board in fulfilling the Board's responsibilities in respect of the accounts, which are set out on page 17. It also reports to the Board on the accounting policies of the Society, the contents of Annual Reports and Accounts, the conclusions drawn from risk management and internal control reports, and the adequacy and scope of the audit. The Auditors attend its 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 including the extent of their fees from non-audit activities.

The Investment Committee comprises two non-executive and two executive Directors. It normally meets monthly. It has been fully involved in strategic asset allocation for the with-profits and managed funds whilst delegating implementation to the Society's General Manager – Investments and his team. It monitors investment results and these are reviewed regularly by the full Board. The Committee retains more detailed control over property investments. The chairman is Mr D W J Price. Since 1 March 2001 implementation of strategic asset allocation for the with-profits and managed funds has been delegated to the Clerical Medical Investment Group.

The Nominations Committee comprises the President, as chairman, one Vice-President and one other non-executive Director. It meets as necessary and is responsible for nominating, for the approval of the Board, candidates for appointment to the Board.

The Remuneration Committee, which comprises the President and the two Vice-Presidents, is chaired by Mr I P Sedgwick. The Committee is responsible for recommending to the Board the terms and conditions of employment of Directors, including those for executive Directors. It is further responsible for considering management recommendations and advising the Board on the appropriate policy for remuneration and employment terms of the Society's staff, including incentive arrangements for bonus payments.

Accountability and Audit

The Board reviews the Annual Report and Accounts following detailed review by the Audit Committee and satisfies itself that the reports present a balanced and understandable assessment of the Society's and the Group's position and prospects.

The Directors are ultimately responsible for the system of internal control for the Society and the Group and for reviewing its effectiveness. A sound system of internal control provides reasonable, but not absolute, assurance that a company will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of business, by circumstances which may be reasonably foreseen. In assessing what constitutes reasonable assurance, the Directors have regard to the materiality of any risks incurred, the likelihood of such risks crystallising and the costs and benefits of particular aspects of the internal control system. A system of internal control cannot, however, provide protection with certainty against a company failing to meet its business objectives or against all material errors, losses, fraud, or breaches of laws or regulations. The events leading to the judgement given by the House of Lords and the Society's closure to new business are described in the Management Report. The Directors consider that those outcomes were not the result of a deficiency in the system of internal control in operation during the year.

In accordance with the requirements of the Combined Code, the Directors review annually the effectiveness of the system of internal control, including financial, operational and compliance controls and risk management. The review is undertaken at a special meeting of the Audit Committee using reports provided by the Society's assurance functions. The results of the review are then reported to, and considered by, the Board.

Following a decision by the Board to strengthen, during 2000, the assurance functions and the process for identifying and evaluating business risks, the Board considers that by 31 December 2000 the system did fully accord with the guidance for Directors, 'Internal Control: Guidance for Directors on The Combined Code', the so called 'Turnbull guidance'.

The main elements of the Society's system of internal control as at 31 December 2000 were as follows:

- An organisational structure including clearly defined levels of authority and division of responsibilities.
- An annual presentation to the Board from management responsible for each principal business area.
- A comprehensive system of financial reporting, forecasting and planning.
- A report on the results of the annual valuation by the Appointed Actuary.
- A process for identifying, evaluating and managing the significant risks faced by the business including a risk management group which assisted the Board in ensuring the proper taking of risk.
- Dedicated internal audit, business risk management and compliance functions having reporting lines independent of line management.
- Regular review of significant control issues by the Audit Committee, including consideration of reports from management, the Society's assurance functions and from the Society's external auditors.

The Society's system of internal control remained substantially unchanged from the year end until 1 March 2001, when the operations were sold to Halifax Group plc. From that date a high level framework of control was established with work progressing on detailed service level agreements.

Going Concern

The Society closed to new business on 8 December 2000. The Directors consider that the Society, operating as a closed fund, has adequate resources to continue in business for the foreseeable future. Further, the Society has complied and continues to comply with the appropriate statutory and regulatory requirements. For these reasons, the Board continues to adopt the going concern basis in preparing the accounts.

Statement of Compliance with the Code Provisions

The Society confirms that it complied with the provisions of The Combined Code throughout the year with the exception that non-executive Directors are not appointed for specified terms (code provision A.6.1). However, a Director's continued appointment is subject to periodic review by the Nominations Committee at intervals not exceeding five years. Directors are also required to seek re-election at General Meetings at least every three years.

Remuneration Report

The composition and responsibilities of the Society's Remuneration Committee are set out on page 14. The Remuneration Committee's recommendations are made on the basis of rewarding individuals for the size of their responsibilities and their performance therein. Proper regard is paid to the need to retain good quality, highly motivated staff at all levels and the remuneration being paid by competitors of the Society is taken into consideration.

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

	Notes	Fees and salaries £	Benefits £	Annual bonus £	Payment in lieu of notice £	Total 2000 £	Total 1999 £
Non-executive Directors							
J R Sclater CVO		65,000	70			65,070	56,816
I P Sedgwick		36,000	-			36,000	33,917
Peter Martin	1	75,200	406			75,606	62,811
P A Davis		26,000	-			26,000	25,167
J D S Dawson (appointed 1.1.00)		24,250	-			24,250	-
Miss J A Page CBE		22,500	-			22,500	21,458
D W J Price		28,500	-			28,500	27,667
J F Taylor	2	31,458	-			31,458	28,696
A G Tritton		-	-			-	35,162
D W Wilson		-	-			-	11,819
		308,908	476			309,384	303,513
Executive Directors							
C P Headdon	3	161,364	7,980	58,091		227,435	96,297
D G Thomas		200,308	1,066	68,931		270,305	244,043
A Nash (resigned 7.12.00)	4	232,095	9,334	–	256,800	498,229	279,958
		593,767	18,380	127,022	256,800	995,969	620,298

Notes
1. Includes fees received of £15,099 from a directorship of University Life and £24,851 from a directorship of Permanent.
2. Includes fees received of £8,958 from a directorship of Equitable Services and Consultancy Limited.
3. C P Headdon was appointed Chief Executive on 7 December 2000 succeeding A Nash. The 1999 comparative represents his remuneration from 1 July 1999, being the date he was appointed a Director of the Society. The total of his salary, benefits and Business Performance Bonus for 1999 was £178,458.
4. A Nash resigned on 7 December 2000 and was entitled to one year's notice under his contract. Further details of his pension entitlement are disclosed on page 16.

Benefits

Benefits comprise miscellaneous reimbursed expenses and other benefits regarded as taxable. For executive Directors these benefits mainly arise from the provision of a company car. Tax legislation requires that the annual benefit is assessed according to the cost of the car provided.

Annual Bonus

On 3 August 2000 the Society introduced a new contractual bonus scheme. The scheme applies to all staff of the Society, including its executive Directors. The scheme was set up to recognise the importance of the Society continuing to provide high standards of service to its clients by retaining a stable and highly competent workforce capable of running and further developing the Society's business on an ongoing basis. The maintenance of a viable business operation was fundamental to the Society realising a sale of its operations to a third party. Payments under the scheme are non-pensionable.

Service Contracts

Executive Directors have service contracts for periods of up to one year.

No non-executive Director has a service contract.

Long-term benefits

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

Directors' pension entitlements

During the year the executive Directors, one non-executive Director and some staff participated in the Society's defined benefits pension scheme. The scheme is non-contributory, fully insured under policies held with the Society and governed by an independent trust.

Further details on the defined benefits scheme are shown in Note 9.c.i. in the Notes on the Accounts on page 30 of this document.

The pension entitlements of the Directors are as follows:

	Age at 31.12.00	Years of pension entitlement at 31.12.00 (see note 6)	Increase/ (Decrease) excluding inflation, in accrued pension during the year £000	Accumulated annual benefit at 31.12.00 (see note 6) £000
J R Sclater CVO	60	15	2.8	14.2
A Nash	52	30	(5.7)	90.4
C P Headdon	44	22	47.3	94.2
D G Thomas	56	35	13.4	115.5

Notes

1. The pension entitlement shown is that which would be paid annually on retirement based on service to 31 December 2000 or, if earlier, to retirement date

2. The Normal Retirement Age for the purposes of the scheme for J R Sclater CVO is 65. Pension entitlement is earned according to the pension formula for each year of service up to retirement.

3. Members of the scheme have the option to pay Additional Voluntary Contributions to secure additional benefit.

4. The pension cost for the Society's schemes in 2000 was 21.3% of pensionable pay which takes sufficient account of the increase in accrued entitlement shown in the table above.

5. With the exception of C P Headdon each of the above Directors is married.

6. The accumulated annual benefit is payable on normal retirement date, except in the case of A Nash who chose to receive an actuarially discounted pension payable from 7 December 2000. The transfer value of the pension was enhanced by £59,324 reflecting his contractual period of notice.

For executive Directors the normal retirement age under the scheme is 60 and, on retirement at or after this age, a pension is payable equal to 1/60th of final pensionable salary for each year of pensionable service, subject to Inland Revenue limits.

For death before retirement, a capital sum equal to three times pensionable salary is payable, together with a spouse's pension of one-third of the member's pensionable salary.

For death in retirement, a spouse's pension of 50% of the member's pre-commutation pension is payable. Additionally, in the case of death within five years after retirement, a lump sum is payable equal to the balance of five years' instalments of pension.

In the event of death after leaving service but prior to commencement of pension, a lump sum equal to the transfer value of the member's benefit just prior to death, less any amount required to provide a spouse's Guaranteed Minimum Pension (GMP), is payable to beneficiaries decided by the trustees.

In all circumstances, children's allowances are also payable, usually up to the age of 18 or, if still in full-time education, 23.

The scheme is contracted-out. Increases in pensions in payment are given only on the excess over GMP. Post-retirement pension increases are guaranteed at the lesser of 5% p.a. and the increase in the Retail Price Index (RPI). The practice has been generally to award annual increases in line with inflation.

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 result of the Society and 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.

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 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.

We have audited the accounts on pages 19 to 40, which have been prepared on the basis of the accounting policies set out on pages 22 and 23.

Respective responsibilities of Directors and Auditors

As described on page 17, the Society's Directors are responsible for the preparation of the accounts in accordance with applicable United Kingdom law and accounting standards. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

Basis of 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 judgements made by the Directors in the preparation of the accounts and of whether the accounting policies are appropriate to the Group'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 mis-statement, 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 uncertainties

In forming our opinion, we have considered the adequacy of the disclosure and the provision made in respect of the increased liability to policyholders arising out of the decision in the House of Lords regarding the rights of policyholders with guaranteed annuity rate options. As explained in Note 18 there is limited experience of the extent to which policyholders will exercise the guaranteed annuity rate option and the level of contributions they make in the future. Therefore while the provision has been set on the basis of information currently available a fundamental uncertainty exists as to whether future experience will lead to a higher or lower liability. In the event of a significant change to the experience, there would be material impact on the Fund for Future Appropriations.

In addition, in forming our opinion we have considered the adequacy of the disclosures made in the accounts concerning the possible outcome of any actions that may be initiated against the Society as a consequence of matters emerging from the various regulatory and other enquiries in progress. Details of the circumstances relating to these fundamental uncertainties are disclosed in Note 18a (v) and (ix) and Note 25.

Our opinion is not qualified in this respect of the above matters.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Society and of the Group as at 31 December 2000 and of the result of the Society and of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young
Registered Auditor

London
11 April 2001

Technical Account – Long-term Business

		GROUP		SOCIETY	
		2000	1999	2000	1999
	Notes	£m	£m	£m	£m
Earned premiums, net of reinsurance					
Gross premiums written	1	3,009.7	3,545.4	2,945.8	3,488.0
Outward reinsurance premiums		(13.2)	(13.0)	(4.9)	(4.3)
		2,996.5	3,532.4	2,940.9	3,483.7
Investment income	2	2,673.6	1,981.4	2,653.0	1,957.1
Unrealised gains on investments		–	2,298.1	–	2,314.2
Other technical income	3a	67.3	69.1	16.4	14.5
		5,737.4	7,881.0	5,610.3	7,769.5
Claims incurred, net of reinsurance					
Claims paid – gross amount	4	2,949.0	2,730.8	2,914.8	2,694.9
Reinsurers' share		(3.2)	(5.5)	(1.6)	(3.3)
		2,945.8	2,725.3	2,913.2	2,691.6
Change in provision for claims	4	150.0	–	150.0	–
		3,095.8	2,725.3	3,063.2	2,691.6
Changes in other technical provisions, net of reinsurance	18				
Long-term business provision excluding new declared bonus and GAR		1,038.6	1,570.4	1,024.2	1,565.0
Guaranteed annuity rate (GAR) provision		1,468.0	–	1,468.0	–
Provision for GAR rectification scheme		200.0	–	200.0	–
New declared bonus		–	422.7	–	422.7
Long-term business provision – gross amount		2,706.6	1,993.1	2,692.2	1,987.7
Reinsurers' share		(2.7)	(8.0)	(0.4)	(1.0)
		2,703.9	1,985.1	2,691.8	1,986.7
Other technical provisions					
Technical provisions for linked liabilities		317.2	1,069.3	317.4	1,069.1
		3,021.1	3,054.4	3,009.2	3,055.8
Net operating expenses – non-exceptional	5	217.8	147.5	208.4	142.8
Net operating expenses – exceptional	8	64.1	–	64.1	–
Net operating expenses		281.9	147.5	272.5	142.8
Commission	10	9.0	7.7	nil	nil
Investment expenses and charges	2b	43.4	36.7	43.4	36.7
Unrealised losses on investments		1,795.6	–	1,709.5	–
Other technical charges	3b	46.4	31.6	–	–
Taxation attributable to the long-term business	11a	42.5	24.1	42.5	19.7
Minority interests		(0.2)	7.6	–	–
Transfers (from)/to the fund for future appropriations	17	(2,598.1)	1,846.1	(2,530.0)	1,822.9
		(379.5)	2,101.3	(462.1)	2,022.1
		5,737.4	7,881.0	5,610.3	7,769.5
Balance on the Technical Account		–	–	–	–

All significant recognised gains and losses are dealt with in the Profit and Loss Accounts. Exchange gains and losses arising on retranslation of overseas operations are taken directly to reserves. All the amounts above are in respect of continuing operations.

Assets

		GROUP		SOCIETY	
		2000	1999	**2000**	1999
	Notes	**£m**	£m	**£m**	£m
Investments					
Land and buildings	12a	2,218.9	2,096.8	2,170.7	2,051.6
Investments in group undertakings	12b			229.5	164.7
Other financial investments	12c	27,188.3	26,768.5	26,862.5	26,455.0
		29,407.2	28,865.3	29,262.7	28,671.3
Assets held to cover linked liabilities	13	4,560.1	4,228.4	4,516.4	4,184.5
Reinsurers' share of technical provisions					
Long-term business provision		31.8	29.1	6.2	5.8
Debtors	14				
Debtors arising out of direct insurance operations		66.3	69.6	49.2	55.4
Debtors arising out of reinsurance operations		0.5	1.0	–	–
Other debtors		223.5	95.4	220.8	97.7
		290.3	166.0	270.0	153.1
Other assets					
Tangible assets	15	20.9	19.0	20.0	18.1
Cash at bank and in hand		6.0	13.3	–	–
		26.9	32.3	20.0	18.1
Prepayments and accrued income					
Accrued interest and rent		190.4	186.3	187.2	183.1
Deferred acquisition costs	6	220.8	268.1	187.9	235.2
Other prepayments and accrued income		26.4	44.7	24.3	43.3
		437.6	499.1	399.4	461.6
		34,753.9	33,820.2	34,474.7	33,494.4

Liabilities

	Notes	GROUP 2000 £m	GROUP 1999 £m	SOCIETY 2000 £m	SOCIETY 1999 £m
Minority interests		2.8	16.2		
Subordinated liabilities	16	347.2	346.9	346.2	346.2
Fund for future appropriations	17	2,273.3	4,868.3	2,311.3	4,841.1
Technical provisions	18				
Long-term business provision – gross amount		26,857.9	24,137.4	26,611.3	23,905.2
Claims outstanding		150.0	–	150.0	–
Linked liabilities	18	4,523.6	4,205.4	4,479.9	4,161.5
		31,531.5	28,342.8	31,241.2	28,066.7
Provisions for other risks and charges	19	78.6	37.6	78.6	32.1
Creditors					
Creditors arising out of direct insurance operations		52.1	45.4	48.0	41.0
Creditors arising out of reinsurance operations		0.3	0.9	0.1	0.1
Amounts owed to credit institutions	20a	49.4	23.4	36.4	21.4
Other creditors including taxation and social security	20b	354.6	84.3	362.1	104.5
		456.4	154.0	446.6	167.0
Accruals and deferred income		64.1	54.4	50.8	41.3
		34,753.9	33,820.2	34,474.7	33,494.4

I P Sedgwick
Vice-President

Peter Martin
Vice-President

11 April 2001

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 with 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 note 12.a. Non-linked investments – Land and buildings.

A new line, Other technical charges, has been added to the face of the Profit and Loss Account as a result of the continuing review of developing best practice in the insurance industry. Other technical charges comprises the expenses, interest and taxation of the non-insurance business of subsidiary companies. The revised disclosure is consistent with the SORP. Comparative figures for the Group on the face of the Profit and Loss Account and in the notes on the accounts have been restated to reflect this change.

Basis of consolidation
The Group accounts consolidate the accounts of the Society and all its subsidiary undertakings drawn up to 31 December each year.

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 now 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 in respect of individual and personal pension policies insured with the Society are included in payments under policies and where either annuities or managed pensions are bought the lump sums are included in premium income.

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.

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

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
Movements in unrealised gains and losses on investments arising in the year are shown in the Profit and Loss Account. Unrealised gains and losses on investments are calculated as the difference between the valuation of investments at the Balance Sheet date and the original cost.

Claims incurred
Death claims are recorded on the basis of notifications received. Surrenders, maturities and annuity payments are recorded when due. Claims on participating business include bonuses payable and interest. Reinsurance recoveries are credited to match the relevant gross amounts. Claims payable include direct costs of settlement.

New declared bonuses
The new declared bonuses charged to the Profit and Loss Accounts for a given year are the value of the new reversionary bonuses declared at the end of that year calculated by reference to the policies in force at that time. The Society declares bonuses annually and University Life declares bonuses triennially. No provision is made for 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 incurred in the year of sale is covered by the premium loadings received in that year. The balance remains to be covered by loadings in future years and is shown as deferred acquisition costs in these accounts.

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 in these accounts.

For conventional level annual premium contracts sold by the Society, 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.

For contracts sold by Permanent, the method of calculating the long-term business provision assumes that acquisition costs will be recovered regularly from the series of premiums payable. The balance of acquisition costs to be recovered from loadings in future premiums is included in deferred acquisition costs in these accounts.

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 a prudent 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.

Pension costs

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees 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 Accounts equally over the lease term.

Deferred taxation

Deferred taxation is calculated using the liability method but is provided only where the amount is likely to become payable in the foreseeable future.

Valuation of investments

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

- Freehold and leasehold properties are individually valued 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.
- Listed securities are stated at the 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.

Fixed assets and depreciation

Expenditure on motor vehicles, fixtures, fittings, computer equipment and other equipment is capitalised and depreciated over the expected useful lives of the relevant assets, having regard to expected residual values.

The periods generally applicable are:

- motor vehicles 2½ years
- plant, fixtures and fittings 5 to 10 years
- computer equipment 3 to 5 years

Long-term business provision

The long-term business provisions for the Group are determined by the Directors on the advice of the respective Appointed 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. In the case of Permanent the calculation uses the net premium valuation method. Provisions for overseas branch business are calculated on a UK basis.

Since the Society is a mutual office all assets belong to the policyholders. For the purpose of these accounts, however, the liability to policyholders in respect of these assets has to be divided into two parts. The first part, called technical provisions, is represented by assets needed to meet the guaranteed benefits under contracts, including declared bonuses added up to and including the date of the accounts and making allowance, in accordance with the assumptions used, for specific levels of future declared bonuses.

The balance of the assets, which is mainly represented by the fund for future appropriations, comprises assets which are held on account for future bonus additions of various kinds in excess of the levels allowed for in the technical provisions.

In the case of University Life a similar treatment applies except that, since this society is a proprietary office, the Proprietor will ultimately be entitled to an appropriate proportion of the surplus to be distributed in the future.

For Permanent, an office writing non-profit business, all unappropriated surpluses arising in the year are available to the shareholder.

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.

Segmental reporting

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

1. Earned premiums

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
a. Analyses of gross premiums written are as follows:				
Individual premiums	2,305.2	2,748.1	2,255.4	2,704.1
Premiums under group contracts	704.5	797.3	690.4	783.9
	3,009.7	3,545.4	2,945.8	3,488.0
Regular premiums	1,494.6	1,567.9	1,430.8	1,510.5
Single premiums	1,515.1	1,977.5	1,515.0	1,977.5
	3,009.7	3,545.4	2,945.8	3,488.0
Premiums from non-profit contracts	278.1	211.5	231.1	170.0
Premiums from with-profits contracts	2,156.7	2,721.6	2,156.4	2,721.4
Premiums from linked contracts	574.9	612.3	558.3	596.6
	3,009.7	3,545.4	2,945.8	3,488.0
Premiums from life business	588.3	777.3	569.6	761.5
Premiums from annuity business	38.3	53.6	38.3	53.6
Premiums from pension business	2,346.3	2,679.2	2,336.8	2,672.0
Premiums from permanent health business	36.8	35.3	1.1	0.9
	3,009.7	3,545.4	2,945.8	3,488.0
Premiums from UK business	2,819.7	3,283.7	2,755.8	3,226.3
Premiums from overseas business	190.0	261.7	190.0	261.7
	3,009.7	3,545.4	2,945.8	3,488.0
b. New business				
Individual premiums	1,607.4	2,044.4	1,596.4	2,033.5
Premiums under group contracts	202.2	289.8	198.8	286.1
	1,809.6	2,334.2	1,795.2	2,319.6
Regular premiums	294.5	356.6	280.2	342.1
Single premiums	1,515.1	1,977.6	1,515.0	1,977.5
	1,809.6	2,334.2	1,795.2	2,319.6
Premiums from non-profit contracts	181.8	128.3	170.1	115.8
Premiums from with-profits contracts	1,309.6	1,819.0	1,309.6	1,819.0
Premiums from linked contracts	318.2	386.9	315.5	384.8
	1,809.6	2,334.2	1,795.2	2,319.6
Premiums from life business	416.4	623.3	409.6	617.2
Premiums from annuity business	18.5	33.3	18.5	33.3
Premiums from pension business	1,369.0	1,671.5	1,367.0	1,669.0
Premiums from permanent health business	5.7	6.1	0.1	0.1
	1,809.6	2,334.2	1,795.2	2,319.6
Premiums from UK business	1,648.9	2,088.9	1,634.5	2,074.3
Premiums from overseas business	160.7	245.3	160.7	245.3
	1,809.6	2,334.2	1,795.2	2,319.6

1. Earned premiums continued

Classification of new business

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

- New 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.
- DSS rebates are classified as new single premiums.
- Funds at retirement under individual pension contracts left 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. Where an amount of fund under a managed pension is applied to secure an annuity in payment, 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 on an annualised basis.

2. Investment income

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
a. Investment income comprises:				
Group companies			3.2	1.6
Other investments				
land and buildings	126.0	109.7	126.0	109.7
other investments	1,127.0	1,101.2	1,110.3	1,086.8
	1,253.0	1,210.9	1,236.3	1,196.5
Gains on realisation of investments	1,420.6	770.5	1,413.5	759.0
	2,673.6	1,981.4	2,653.0	1,957.1
b. Investment expenses and charges comprise:				
Investment management expenses	11.3	8.3	11.3	8.3
Interest charges				
movement in discount on provisions (see note 19)	3.7	–	3.7	–
payable on loans	28.4	28.4	28.4	28.4
	43.4	36.7	43.4	36.7
c. Investment activity account				
Investment income	1,253.0	1,210.9	1,239.5	1,198.1
Realised investment gains	1,420.6	770.5	1,413.5	759.0
Movement in unrealised investment (losses)/gains	(1,795.6)	2,298.1	(1,709.5)	2,314.2
	878.0	4,279.5	943.5	4,271.3
Investment management expenses including interest	(43.4)	(36.7)	(43.4)	(36.7)
Investment return for the year	834.6	4,242.8	900.1	4,234.6

3. Other technical income and charges

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
a. Other technical income comprises:				
Subsidiary income from non-insurance business	62.8	65.3		
Income from Group companies			13.0	12.2
Stock lending and underwriting commission	3.2	2.1	3.2	2.1
Other income	1.3	1.7	0.2	0.2
	67.3	69.1	16.4	14.5

b. Other technical charges:

Other technical charges comprise expenses, interest and taxation for non-insurance business of subsidiary companies.

4. Claims incurred

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Gross claims incurred comprise:				
On death	104.7	95.0	97.5	88.0
On maturity and surrender	2,232.2	1,942.7	2,227.2	1,935.6
By way of periodic payments	753.0	685.6	731.8	664.8
Claims handling expenses	9.1	7.5	8.3	6.5
	3,099.0	2,730.8	3,064.8	2,694.9
Life and annuity business	583.2	373.1	574.3	362.1
Pension business	2,485.0	2,329.3	2,481.2	2,325.6
Permanent health business	21.7	20.9	1.0	0.7
Claims handling expenses	9.1	7.5	8.3	6.5
	3,099.0	2,730.8	3,064.8	2,694.9
Linked business	275.2	232.2	267.6	225.3
Non-profit business	277.3	270.5	251.6	242.6
With-profits business	2,537.4	2,220.6	2,537.3	2,220.5
Claims handling expenses	9.1	7.5	8.3	6.5
	3,099.0	2,730.8	3,064.8	2,694.9
UK business	2,807.4	2,658.8	2,774.0	2,623.9
Overseas business	282.5	64.5	282.5	64.5
Claims handling expenses	9.1	7.5	8.3	6.5
	3,099.0	2,730.8	3,064.8	2,694.9

Gross claims incurred comprise gross claims paid and the change in provision for claims outstanding. Included within claims paid are interim, terminal and final bonuses for the Group of £545.7m (*1999 £511.2m*) and for the Society of £543.5m (*1999 £508.6m*).

5. Net operating expenses – non-exceptional

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Net operating expenses – non-exceptional comprise:				
Acquisition costs	124.4	105.9	119.0	100.1
Change in deferred acquisition costs	47.3	6.9	47.3	10.3
Administrative expenses	46.1	34.7	42.1	32.4
	217.8	147.5	208.4	142.8

6. Deferred acquisition costs

	GROUP			SOCIETY		
	Deferred		Charge	Deferred		Charge
	£m	£m	£m	£m	£m	£m
Deferred costs at 1 January 1999		275.0			245.5	
Acquisition costs incurred in the year	105.9			100.1		
Dealt with in the technical provisions	(51.6)		51.6	(51.6)		51.6
	54.3			48.5		
Apportionment for the year		48.0	6.3		42.8	5.7
Amortisation of prior year acquisition costs		(54.9)	54.9		(53.1)	53.1
Deferred costs at 31 December 1999		268.1			235.2	
Acquisition costs incurred in the year	124.4			119.0		
Dealt with in the technical provisions	(82.0)		82.0	(82.0)		82.0
	42.4			37.0		
Apportionment for the year		31.4	11.0		26.8	10.2
Amortisation of prior year acquisition costs		(78.7)	78.7		(74.1)	74.1
Deferred costs at 31 December 2000		220.8			187.9	
Acquisition costs charged for 2000		171.7			166.3	
Acquisition costs charged for 1999		112.8			110.4	

7. Expenses before deferral of acquisition costs

	GROUP 2000 £m	GROUP 1999 £m	SOCIETY 2000 £m	SOCIETY 1999 £m
a. Expenses before deferral				
Net operating expenses as reported in the				
Profit and loss accounts – non-exceptional	217.8	147.5	208.4	142.8
– exceptional (see note 8)	64.1	–	64.1	–
Commission	9.0	7.7	nil	nil
Acquisition costs deferred in the year	31.4	48.0	26.8	42.8
Amortisation of prior year acquisition costs	(78.7)	(54.9)	(74.1)	(53.1)
	243.6	148.3	225.2	132.5
Claims handling expenses	9.1	7.5	8.3	6.5
Investment expenses and charges including interest charges	43.4	36.7	43.4	36.7
Interest charges	(32.1)	(28.4)	(32.1)	(28.4)
Expenses before deferral	264.0	164.1	244.8	147.3
b. Expense ratio				
Earned premiums	3,009.7	3,545.4	2,945.8	3,488.0
Expense ratio (expenses before deferral as a % of earned premiums)	8.8%	4.6%	8.3%	4.2%
Expense ratio excluding exceptional expenses	6.6%	4.6%	6.1%	4.2%

	GROUP 2000 £m	GROUP 1999 £m	SOCIETY 2000 £m	SOCIETY 1999 £m
c. Expenses include:				
Depreciation of tangible fixed assets	7.7	8.5	7.3	8.3
Operating lease rentals – land and buildings	8.1	8.5	8.0	7.8

Auditors' remuneration, inclusive of VAT, for the Group was £457,660 (*1999 £478,411*) for audit services and £6,357,595 (*1999 £1,140,055*) for non-audit services. Auditors' remuneration, inclusive of VAT, for the Society amounted to £323,017 (*1999 £347,800*) for audit services and £6,356,161 (*1999 £807,363*) for non-audit services. £44,650 in respect of 1999 audit services for the Group and for the Society relates to 1998.

8. Net operating expenses – exceptional

As a result of the House of Lords' decision, the subsequent offer for sale of the Society and closure of the fund to new business, the Society incurred a number of exceptional expenses reported separately in the Profit and Loss Account.

	GROUP 2000 £m	GROUP 1999 £m	SOCIETY 2000 £m	SOCIETY 1999 £m
Net operating expenses – exceptional comprise:				
Costs associated with offering the Society for sale	6.5	–	6.5	–
Provision for field force retention, severance costs and employer's NI contributions	54.1	–	54.1	–
Accrual for non-field force staff retention costs	3.5	–	3.5	–
	64.1	–	64.1	–

9. Directors and employees

	GROUP		SOCIETY	
	2000	1999	2000	1999
	£m	£m	£m	£m
a. Staff costs comprise:				
Administration				
Salary	38.0	32.4	33.9	29.1
Bonus	4.3	3.9	4.3	3.4
Marketing				
Field staff remuneration	39.4	32.1	38.4	31.1
Non-field staff salary	10.8	9.8	10.2	9.3
Non-field staff bonus	1.3	1.2	1.3	1.2
Investment				
Salary	3.3	2.9	3.3	2.9
Bonus	0.8	0.7	0.8	0.7
	97.9	83.0	92.2	77.7
Retention bonus and severence costs – exceptional	51.3	–	51.3	–
	149.2	83.0	143.5	77.7
Social security costs – non-exceptional	10.4	7.9	9.8	7.4
Social security costs – exceptional	6.3	–	6.3	–
Other pension costs	15.1	10.6	14.3	9.7
	181.0	101.5	173.9	94.8
The monthly average number of employees during the year was as follows:				
Administration	1,460	1,328	1,289	1,159
Marketing	1,035	1,012	977	962
Investment	64	62	64	62
	2,559	2,402	2,330	2,183

	2000	1999
	£	£
b. Emoluments of Directors		
The total emoluments of the Directors comprise:		
Fees of non-executive Directors	309,384	303,513
Remuneration of executive Directors		
Basic remuneration	612,147	465,677
Annual bonus	127,022	154,621
Payment in lieu of notice	256,800	–
Transfer value of one year's enhanced pension benefit	59,324	–
	1,364,677	923,811
Number of Directors accruing retirement benefits under		
Defined benefit scheme	4	5
Defined contribution scheme	nil	nil
Highest paid Director		
Emoluments	270,305	279,958
Accrued pension, accumulated annual benefit	115,471	93,300

Further details of Directors' emoluments are given in the Remuneration Report on pages 15 and 16.

9. Directors and employees continued

c. Pension arrangements

The Society operates two non-contributory pension schemes for the benefit of the staff of the Society and of Permanent. The schemes' actuary is of the opinion that the pension cost included within management expenses of the Group of £15.1m (*1999 £10.6m*) and the Society of £14.3m (*1999 £9.7m*) is consistent with the cost of providing the promised pension benefits in accordance with Statement of Standard Accounting Practice No.24. The schemes are fully insured under policies held with the Society.

i. Defined Benefits Scheme

Certain permanent members of staff together with a number of Directors (see note 9.b.) are members of this scheme. The scheme actuary was an employee of the Society throughout the year. The scheme actuary values the scheme triennially using the projected unit method with a 50 year control period and an allowance for new entrants. The most recent actuarial valuation was performed as at 1 January 2000 and the key assumptions used were as follows:

Salary increases	6% per annum
Investment return	7% per annum
Rate of increase to current and future pensions in payment in excess of the Guaranteed Minimum Pensions	3% per annum

On this basis the actuarial value of the policies of £167.5m represented 96% of the liabilities determined.

Pension costs are accounted for on the basis of charging the expected cost of providing pensions over the period during which the Group benefits from the employees' services. The effect of variations from regular cost are spread over the expected average remaining service lives of members of the scheme. A provision of £4.6m (*1999 £0.4m*) is included in Provisions for other risks and charges, representing the excess of accumulated pension cost over the amount funded.

ii. Defined Contributions Scheme

This scheme was set up during 1995. All employees will normally become eligible to join this scheme upon becoming permanent members of staff.

10. Commission

All commission payments are made by Permanent. The Society does not pay commission to third parties.

11. Taxation

	GROUP		SOCIETY	
	2000 £m	1999 £m	**2000 £m**	1999 £m
a. Taxation charged to the Technical Account				
UK corporation tax				
Current tax on income for the period	67.6	25.6	58.7	21.4
Adjustments in respect of previous years	(9.9)	(3.0)	(6.7)	(2.7)
	57.7	22.6	52.0	18.7
Double taxation relief	(0.7)	(0.5)	(0.7)	(0.5)
	57.0	22.1	51.3	18.2
Foreign tax				
Current tax on income for the period	5.5	7.6	5.5	7.6
	5.5	7.6	5.5	7.6

Continued

11. Taxation continued

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Deferred tax				
UK	(20.1)	(4.8)	(14.4)	(5.3)
Overseas	0.1	(0.8)	0.1	(0.8)
	(20.0)	(5.6)	(14.3)	(6.1)
Total charge	42.5	24.1	42.5	19.7

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
b. Deferred taxation				
Provided in the accounts:				
Deferred tax of the long-term fund				
Accelerated capital allowances	0.1	–	0.1	–
Short-term timing differences	–	16.5	–	16.3
Unrealised appreciation in investments	8.5	12.1	7.7	5.8
	8.6	28.6	7.8	22.1
Deferred tax other than of the long-term funds	(0.8)	(1.0)	–	–
	7.8	27.6	7.8	22.1
Not provided in the accounts:				
Accelerated capital allowances	1.2	1.2	1.2	1.2
Unrealised appreciation in investments	93.2	146.5	93.2	143.4
	94.4	147.7	94.4	144.6

12. Non-linked investments

	Current Value		Cost	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
a. Land and buildings				
Group				
Long leasehold	596.8	490.4	565.9	470.3
Freehold	1,622.1	1,606.4	1,499.0	1,508.9
At 31 December	2,218.9	2,096.8	2,064.9	1,979.2
Society				
Long leasehold	596.8	490.4	565.9	470.3
Freehold	1,573.9	1,561.2	1,437.2	1,458.6
At 31 December	2,170.7	2,051.6	2,003.1	1,928.9

Included in the figures shown for current value is £24.9m (*1999 £23.9m*) in respect of buildings which are owned and occupied by the Society. It is considered that the useful economic lives and residual values of these properties are such that their depreciation is immaterial and is thus not provided. Notional rent of £2.1m (*1999 £2.0m*), based on market rentals, is charged to expenses and is included in investment income.

12. Non-linked investments continued

97% of the Group's and of the Society's properties were valued individually as at 31 December 2000 by independent professional valuers and are included in the accounts at those valuations. Unit-linked properties were valued by independent professional valuers on a four-month rolling basis over the year. The valuations were carried out by Jones Lang Lasalle in respect of commercial properties, CB Hillier Parker in respect of unit-linked properties and by Savills plc in respect of agricultural properties. Properties held under limited partnerships amounting to £467.2m (*1999 £465.5m*) for the Group and £415.2m (*1999 £420.3m*) for the Society were valued by valuers appointed by the respective general partner.

No depreciation is provided in respect of investment properties. The Directors consider that this accounting policy is necessary for the accounts to give a true and fair view. Depreciation is only one of the factors reflected in the annual valuation, and the amount which might otherwise have been shown cannot be separately identified or quantified.

	Current Value		Cost	
	2000	*1999*	**2000**	*1999*
	£m	*£m*	£m	*£m*
b. Investments in Group undertakings				
Shares	204.5	143.4	151.7	144.0
Loans	25.0	21.3	28.9	26.6
At 31 December	229.5	164.7	180.6	170.6

	Current Value		Cost	
	2000	*1999*	**2000**	*1999*
	£m	*£m*	£m	*£m*
c. Other financial investments				
Group				
Shares and other variable yield securities and units in unit trusts	15,214.1	16,643.6	9,921.0	9,688.5
Debt and other fixed-income securities	10,241.3	9,369.0	9,266.6	8,480.9
Loans secured by mortgages	7.2	8.5	7.2	8.5
Loans secured by policies	5.2	5.8	5.2	5.8
Other loans	–	1.0	–	1.0
Deposits with credit institutions	1,720.2	740.2	1,761.7	733.3
Other investments	0.3	0.4	0.3	0.4
	27,188.3	26,768.5	20,962.0	18,918.4

	Current Value		Cost	
	2000	*1999*	**2000**	*1999*
	£m	*£m*	£m	*£m*
Society				
Shares and other variable yield securities and units in unit trusts	15,125.9	16,545.3	9,859.9	9,629.4
Debt and other fixed-income securities	10,022.2	9,165.2	9,065.2	8,294.6
Loans secured by mortgages	6.7	8.3	6.7	8.3
Loans secured by policies	5.0	5.7	5.1	5.7
Deposits with credit institutions	1,702.4	730.1	1,743.8	723.1
Other investments	0.3	0.4	0.3	0.4
	26,862.5	26,455.0	20,681.0	18,661.5

Investments of £2,917.8m (*1999 £1,077.5m*), which have been lent in the normal course of business to authorised money brokers on a secured basis, are included in other financial investments.

The value of listed investments included above at current value under Shares and other variable yield securities and units in unit trusts is £14,268.1m (*1999 £16,100.3m*) for the Group and £14,180.0m (*1999 £16,002.0m*) for the Society.

The value of listed investments included above at current value under Debt and other fixed-income securities is £10,093.4m (*1999 £9,131.0m*) for the Group and £9,874.3m (*1999 £8,728.9m*) for the Society.

13. Assets held to cover linked liabilities

	GROUP		SOCIETY	
	2000	1999	2000	1999
	£m	£m	£m	£m
Cost of linked assets	3,563.5	3,038.9	3,530.6	3,005.9

14. Debtors

	GROUP		SOCIETY	
	2000	1999	2000	1999
	£m	£m	£m	£m
Debtors arising out of direct insurance operations				
Annuities due in early January, paid in December	39.2	42.6	39.0	42.5
Tax relief due on premiums	4.7	5.7	4.7	5.7
Other policyholder debtors	5.5	7.3	5.5	7.2
Amounts owed by policyholders	49.4	55.6	49.2	55.4
Amounts owed by intermediaries	16.9	14.0		
	66.3	69.6	49.2	55.4
Debtors arising out of reinsurance operations	0.5	1.0	–	–
Other debtors				
Debtors other than Group and related companies	95.3	52.4	82.3	47.6
Outstanding sales of investments	128.2	43.0	128.2	41.3
Group companies			10.3	8.8
	223.5	95.4	220.8	97.7
	290.3	166.0	270.0	153.1

15. Tangible assets

	Motor vehicles	Plant fixtures & fittings	Computer equipment	Total
	£m	£m	£m	£m
Group				
Cost				
At 1 January 2000	9.8	17.0	13.4	40.2
Additions	3.2	4.0	3.6	10.8
Disposals	(2.9)	(3.6)	(3.8)	(10.3)
At 31 December 2000	10.1	17.4	13.2	40.7
Depreciation				
At 1 January 2000	3.8	9.4	8.0	21.2
Provided in year	2.1	2.4	3.2	7.7
Disposals	(1.8)	(3.6)	(3.7)	(9.1)
At 31 December 2000	4.1	8.2	7.5	19.8
Net book value at 31 December 2000	6.0	9.2	5.7	20.9
Net book value at 31 December 1999	6.0	7.6	5.4	19.0

15. Tangible assets continued

	Motor vehicles	Plant fixtures & fittings	Computer equipment	Total
	£m	£m	£m	£m
Society				
Cost				
At 1 January 2000	9.4	16.6	12.6	38.6
Additions	3.1	3.9	3.4	10.4
Disposals	(2.8)	(3.6)	(3.8)	(10.2)
At 31 December 2000	9.7	16.9	12.2	38.8
Depreciation				
At 1 January 2000	3.7	9.3	7.5	20.5
Provided in year	2.0	2.3	3.0	7.3
Disposals	(1.7)	(3.6)	(3.7)	(9.0)
At 31 December 2000	4.0	8.0	6.8	18.8
Net book value at 31 December 2000	5.7	8.9	5.4	20.0
Net book value at 31 December 1999	5.7	7.3	5.1	18.1

16. Subordinated liabilities

On 6 August 1997 Equitable Life Finance plc, a wholly-owned subsidiary of the Society, issued £350m 8.0% Undated Subordinated Guaranteed Bonds which are guaranteed by the Society. The proceeds, after the deduction of costs associated with the issue, were lent to the Society on terms similar to those applicable to the Bonds. The Bonds are repayable by Equitable Life Finance plc on a non-instalment basis on 6 August 2007 and each fifth anniversary thereafter, so long as the Bonds are outstanding.

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	£m	£m
Amounts falling due in five years or more	347.2	346.9	346.2	346.2

17. Fund for future appropriations

The fund for future appropriations comprises all funds the allocation of which to policyholders has not been determined by the end of the financial year.

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	£m	£m
Movement in the year				
Balance at 1 January	4,868.3	3,028.3	4,841.1	3,025.3
Transfer (to)/from the Profit and Loss Accounts	(2,598.1)	1,846.1	(2,530.0)	1,822.9
Exchange gain/(loss) on retranslation of overseas operations	3.1	(6.1)	0.2	(7.1)
Balance at 31 December	2,273.3	4,868.3	2,311.3	4,841.1

The exchange gain/(loss) on retranslation of overseas operations has not been included in a separate statement of total recognised gains and losses owing to its insignificance.

18. Technical provisions

a. The long-term business provision

The long-term business provisions for the Society and University Life were calculated using the gross premium method of valuing the long-term, non-linked liabilities. In the case of Permanent, the net premium method of valuing that company's long-term, non-linked liabilities was used.

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

Class of business	Mortality	Interest rate %	Future expense allowance	Rates of future bonus: On sum assured %	Rates of future bonus: On existing bonus additions %
Endowment assurances					
Basic Life and General Annuity business	AM80	3.25	3.00%	1.50	1.50
Pension business	AM80	3.75	4.00%	2.00	2.00
Non-profit temporary assurances					
Basic Life and General Annuity business	TM80 Adj	3.50	3.00%	–	–
Pension business	TM80 Adj	4.50	4.00%	–	–
Recurrent single premium (with profits)					
Life business	–	0.00	0.25% p.a.	i.	i.
Pension annuity in payment – old series	PMA80-4 (C=2010) for males PFA80-3 (C=2010) for females	3.50	£40 p.a.	i.	i.
Pension annuity in payment – new series	PMA80-4 (C=2010) for males PFA80-3 (C=2010) for females	0.00	£40 p.a.	i.	i.
Pension business – old series	–	3.50	0.25% p.a.	i.	i.
Pension business – new series	–	0.00	0.25% p.a.	i.	i.
Non-profit annuity in payment					
Basic Life and General Annuity business	IM80 (C=2010) for males IF80 (C=2010) for females	4.75	£40 p.a.	–	–
Pension business	PMA80-4 (C=2010) for males PFA80-3 (C=2010) for females	5.25	£40 p.a.	–	–

i. For recurrent single premium business the interest rate shown is the effective discount rate applied i.e. the valuation interest rate reduced by the future expense allowance and the assumed rate of future bonus.

ii. Except for annuities in payment and recurrent single premium business, expense allowances are a percentage of future premiums. Additionally, for certain assurance contracts, the value of a policy fee of £3.00 p.a. is included in the provision.

iii. The adjustment to the mortality table for temporary assurances is a five year age deduction plus a flat addition of 0.0005 to the resultant mortality rates. For female lives the equivalent rates are based on the AF80 table with a four year age deduction and a flat addition of 0.0002.

iv. The basis used for calculating the provision at 31 December 1999 had the following key differences from the basis detailed above:

- the interest rates for non-profit annuities were 5.75% p.a. for pension business and 5.25% p.a. for general annuity business.
- the mortality assumption for pension business annuities in payment was PMA80-3 (C=2010) for males.

18. Technical provisions continued

v. The technical provisions include an amount of £1,668m (1999 £200m) in respect of the estimated additional future liability for guaranteed annuity options over the provision included for benefits taken in cash form. The significant increase in the provision reflects the impact of the House of Lords' decision. The provision included at 31 December 1999 was set assuming that either the Court of Appeal or the High Court decision would be upheld. The House of Lords' decision went further than the Court of Appeal decision and prohibited "ring fencing" of GAR policies.

The House of Lords' decision has no direct impact on some assumptions used in calculating the additional provision for guaranteed annuity options and, as such, the interest rate and mortality assumptions are consistent with the assumptions for other similar business and with previous valuations. However, the House of Lords' decision will have an impact on the decisions of policyholders in the future as to the extent to which they take-up the guaranteed annuity option and continue to pay future contributions. The technical provisions have been calculated based on the limited experience to date. There is fundamental uncertainty as to whether the future decisions of policyholders will conform to the assumptions made. As a result, the technical provision could be either overstated or understated with a corresponding effect on the fund for future appropriations. The technical provisions are calculated on the basis of the Society's understanding of the type of annuity to which GARs apply.

vi. The technical provisions include an amount of £200m which is the current estimate of the compensation or adjustments to future benefits which will be payable under the Rectification Scheme to policyholders who had policies with guaranteed annuity options which matured prior to the House of Lords' decision. This estimate is subject to significant uncertainty as to the choices such policyholders will make when deciding on future benefits.

vii. An additional reserve of £123m (1999 £132m) is held in respect of the Society's potential liability for compensation relating to the pension transfers and opt-outs review. This includes £7m for the costs of administering the review to its conclusion. The House of Lords' decision had an impact on levels of bonus which resulted in an increase in the estimated cost of compensation. The total increase in estimated compensation during 2000 was £73m. Total compensation of £153m had been calculated on the cases already reviewed by 31 December 2000 (*1999 £71m*).

viii. A provision of £7m has been calculated for the review of Free Standing Additional Voluntary Contribution policies.

ix. The Society is to undertake a review of sales of Managed Pension policies. The review will be specific in nature to determine whether any sales have been made to policyholders with a risk profile which would make such a contract inappropriate. The review will consider the suitability of the nature of the contract. There is a contingent liability in respect of this review, which will only crystallise to the extent that the suitability of the contract and/or the investment medium are found to be inappropriate. If both the suitability of the contract and of the investment medium were found to be inappropriate in all cases, the liability would be up to £200m. Pending the outcome of the review, the Society has not included a provision for this contingency.

b. Technical provisions 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. For index-linked annuities in payment the technical provision is equal to the investment liability, calculated using the same mortality assumptions as shown above for the non-profit annuities in payment and using an interest rate of 2.00% p.a. for general annuity business and 2.25% p.a. for pension business (*2.00% p.a.* and *2.25% p.a.* respectively at *31 December 1999*).

18. Technical provisions continued

An additional 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.

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
c. Gross technical provisions movements				
Balance at 1 January				
Long-term business provision	24,137.4	22,181.3	23,905.2	21,954.3
Claims outstanding	–	–	–	–
Provisions for linked liabilities	4,205.4	3,137.2	4,161.5	3,093.7
	28,342.8	25,318.5	28,066.7	25,048.0
Retranslation of opening foreign branch technical provisions	14.9	(38.1)	14.9	(38.1)
Changes in long-term business provision excluding new declared bonus and GAR	1,038.6	1,570.4	1,024.2	1,565.0
Changes in guaranteed annuity reserves (GAR)	1,468.0	–	1,468.0	–
Changes in provision for GAR rectification scheme	200.0	–	200.0	–
New declared bonus	–	422.7	–	422.7
Change in provision for claims	150.0	–	150.0	–
Change in technical provisions for linked liabilities	317.2	1,069.3	317.4	1,069.1
Balance at 31 December	31,531.5	28,342.8	31,241.2	28,066.7
Balance at 31 December				
Long-term business provision	26,857.9	24,137.4	26,611.3	23,905.2
Claims outstanding	150.0	–	150.0	–
Provisions for linked liabilities	4,523.6	4,205.4	4,479.9	4,161.5
	31,531.5	28,342.8	31,241.2	28,066.7

19. Provisions for other risks and charges

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Provisions for deferred taxation	7.8	27.6	7.8	22.1
Provisions for field force retention, severance costs and employer's NI contributions	54.1	–	54.1	–
Branch properties provisions	12.1	9.6	12.1	9.6
Pension provisions	4.6	0.4	4.6	0.4
	78.6	37.6	78.6	32.1

The movement in the provisions for deferred taxation is included in note 11.

The movement in the provisions for the field force represents the expense for the year and is disclosed in note 8.

Branch property provisions are calculated on a discounted cash flow basis. The increase in the provision arising from the unwinding of the discount and change in discount rate in the year amounted to £3.7m (*1999 nil*) and the remainder of the movement is charged to net operating expenses.

The movement in the pension provisions is included in note 9.

20. Creditors

a. Amounts owed to credit institutions

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Bank overdrafts	49.4	23.4	36.4	21.4

b. Other creditors including taxation and social security

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Outstanding purchases of investments	294.5	42.2	294.5	42.2
Group companies			45.3	49.0
Other creditors	60.1	42.1	22.3	13.3
	354.6	84.3	362.1	104.5

21. 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
Equitable Life – Finanzberatung und Versicherungsvermittlung GmbH	Sales and marketing of life assurance and pensions
Equitable Services and Consultancy Limited *(sold 1 March 2001)*	Consultancy, insurance services and sale/hire of computer systems
Equitable Investment Fund Managers Limited *(sold 1 March 2001)*	Open ended investment company management
Permanent Insurance Company Limited *(sold 16 February 2001)*	Permanent health insurance, life assurance and annuity business
University Life Assurance Society	Life assurance and annuity business. Closed to new business

All the above holdings are of ordinary or like shares. Other holdings in subsidiary undertakings do not materially affect the result or assets of the Group. Equitable Life – Finanzberatung und Versicherungsvermittlung GmbH is registered in Germany.

b. Significant holdings

At 31 December 2000 the Group and the Society held more than 20% of the nominal value of a class of equity shares in 30 companies. None of these companies is regarded by the Directors as an associated undertaking and none of the holdings materially affects the result or assets of the Group or of the Society. These investments are included in the Balance Sheets 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.

22. Post Balance Sheet Events

a. Sale to Halifax Group plc

On 5 February 2001, the Group announced the sale of its administration and sales operations, systems, Equitable Investment Fund Managers Limited, Equitable Services and Consultancy Limited and the economic interest in its non-profit and unit-linked business to Halifax Group plc for a cash consideration of £500m. This transaction was completed on 1 March 2001, and is not recognised in the financial statements for 2000.

The £500m cash consideration was paid to acquire the following assets:

- economic interest in the Group's non-profit and unit-linked business,
- operating assets, including the Group's IT and administration platform which will be managed by Clerical Medical Investment Group (Holdings) Limited, a wholly-owned subsidiary of Halifax Group plc,
- the Society's salesforce, which will be rebranded Halifax Equitable,
- the operating subsidiaries as listed above.

The Halifax Group plc also agreed to pay the following:

- an amount of £250m in cash, contingent on the Society achieving a settlement between its guaranteed and non-guaranteed annuity rate policyholders.
- a further cash consideration of £250m, contingent on the settlement as described above and on the achievement of agreed new business sales and profitability targets in 2003 and 2004 by the Halifax Equitable salesforce.

The transfer of economic interest in the non-profit and unit-linked business was made by way of a reassurance agreement.

The Halifax Group plc will have no economic interest in the Society's with-profits fund, which is closed to new business and will remain owned by the Society.

b. Rebalancing of the investment portfolio

Following the Society's closure to new business on 8 December 2000 the with-profits fund was rebalanced, as outlined in the letter to policyholders dated 8 December 2000. The rebalancing exercise involved increasing the proportion of bonds and gilts and reducing holdings in equities, a process which was completed in early 2001. Equities with a value of £2 billion at 31 December 2000 were sold in the first two months of 2001 to realise a sum slightly in excess of that value.

c. Sale of Permanent Insurance Company Limited

On 16 February 2001 Permanent Insurance Company Limited (Permanent) was sold to Liverpool Victoria Friendly Society for £150m payable in cash. The Society purchased a majority shareholding in Permanent in 1995 and acquired full control in 1997. The Society's total investment in Permanent was approximately £82m.

During 2000, Permanent contributed gross premiums of £64.2m, investment income of £18.9m and claims of £29.4m towards the Group.

23. Related Party Transactions

The aggregate of premiums paid and amounts transferred into policies with the Society, University Life and Permanent and of amounts paid into personal equity plans and individual savings accounts managed by EIFM in 2000 by Directors was £301,750 (*1999 £804,066*).

The aggregate of payments under policies with the Society in 2000 to Directors was £102,351 (1999 £91,712).

24. Commitments

Property investment commitments not provided for in the accounts amounted to £394.2m (*1999 £306.0m*) for the *Group and for the Society.*

Commitments in respect of uncalled capital on certain investments amounted to £256.7m (*1999 £188.0m*) for the Group and for the Society.

Operating lease commitments, all of which relate to land and buildings, payable within one year of the Balance Sheet date were in respect of leases expiring:

	GROUP		SOCIETY	
	2000	1999	**2000**	1999
	£m	£m	£m	£m
Between one and five years	0.4	0.1	0.4	–
After five years	8.7	7.4	8.7	7.4
	9.1	7.5	9.1	7.4

25. Contingent Liabilities

Subsequent to the House of Lords' decision, a number of enquiries by various regulatory and professional bodies have been instigated including the Treasury Committee of the House of Commons. In those proceedings and elsewhere certain policyholders have indicated they believe that they have grounds for an action against the Society for mis-selling of business due to the non-disclosure of the guarantees to GAR policyholders. There is the further possibility that other causes of action may arise. It is not possible to assess the impact of the outcome of these matters, if any, on the financial position of the Society and no provisions have been made.

Society

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m	1992 £m	1991 £m
New business										
New annual premiums	**280.2**	342.1	418.6	494.4	414.9	326.4	308.5	323.0	294.2	281.2
Single premiums	**1,515.0**	1,977.5	2,176.9	1,949.9	1,590.2	1,289.5	1,035.2	1,087.4	931.7	834.7
Income										
Premium income	**2,940.9**	3,483.7	3,729.5	3,452.1	2,830.3	2,361.8	2,052.0	2,100.8	1,876.6	1,715.4
Investment income (excluding realised gains)	**1,255.9**	1,212.6	1,130.6	1,071.1	997.3	841.7	740.7	668.4	571.6	459.0
Expenditure										
Payments under policies	**3,054.9**	2,685.1	2,540.4	2,221.5	1,734.9	1,428.4	1,108.0	1,121.7	946.3	838.7
Expenses of management	**244.8**	147.3	150.8	141.6	122.9	114.4	113.0	121.0	124.3	124.3
Commission	**nil**	nil	nil	nil	nil	nil	nil	nil	nil	nil
Taxation	**42.5**	19.7	42.9	66.0	46.2	28.0	11.7	19.5	6.9	1.2
Expense ratio	**8.3%**	4.2%	4.0%	4.1%	4.3%	4.8%	5.5%	5.8%	6.6%	7.2%
Assets										
Value of total net assets	**33,546**	32,902	28,068	23,676	19,305	16,612	13,545	13,407	9,497	7,368

Guide for clients on the accounts

A guide to the basis of presentation of the accounts – 'A guide for clients on the accounts' is available on request from the Company Secretary.

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The Equitable group comprises: The Equitable Life Assurance Society, University Life Assurance Society