HANDOUT ACCOMPANYING MINISTER FOR MANPOWER'S SPEECH ON FINANCIAL SECURITY IN RETIREMENT AT COS DEBATES 2008

THE LESSON OF EQUITABLE LIFE

Between the 1950s and the 1980s, Equitable Life sold policies that took in contributions and invested them to produce a retirement lump sum. At retirement, the proceeds comprised accumulated bonuses, as well as a final (discretionary) bonus. The policyholder was allowed to invest the retirement proceeds with Equitable Life at a guaranteed rate. Alternatively, the policyholder could invest the retirement proceeds at current annuity rates.

The guaranteed rates were based on mortality and interest rate assumptions thought reasonable at the time the policyholder purchased the policy. For most of the period, current annuity rates remained more attractive than the guaranteed rate. So it did not make sense for policyholders to take up the guaranteed rate. However, towards the end of 1993, interest rates fell, and the guaranteed annuities became more attractive compared to current rates offered by other annuity providers. After briefly rising, interest rates fell again. Hence, from 1995 onwards the annuity guarantees provided a higher rate of return.

Equitable Life sought to recover the cost of meeting the annuity guarantees, by reducing the retirement proceeds. This was achieved through cutting what would have been the policyholder's final bonus, if the policyholder elected to take up the guaranteed annuity. This practice prompted a lawsuit, culminating in a UK House of Lords decision in 2000, in favour of the policyholders. As a result, Equitable Life had to set aside £1.5 billion to meet these liabilities. Within a year, due to this and other factors, the insurer, with assets of over £30 billion was reduced to a position where "it had to close to new business, put itself up for sale, apply significant market value adjustments, and reduce the apparent value of its in-force policies by just under £5 billion."

Source: Report of the Equitable Life Inquiry (the Penrose Report)