Trustee toolkit downloadable

An introduction to investment

Case example 2 of 5: Equitable Life

Matt Logan, financial reporter, talks about what happens when a company selling with-profits policies fails to properly manage the highs and lows of its returns.

This case example is linked to the tutorial **Types of asset: alternative assets**.

The Pensions Regulator

What was the problem?

'For many years Equitable Life sold with-profits policies which offered policy holders certain guarantees at retirement.

These guarantees related to the rate at which they would be able to exchange their fund for pension income at retirement. In the 1990s, the value of these guarantees increased dramatically.'

What did Equitable Life do about it?

'They paid reduced terminal bonuses to those people with the guarantees when compared with the terminal bonus they paid to everyone else. In doing this, they were attempting to share their available resources 'equitably' between the two groups of policy holders.'

Wasn't that the fair way to do it?

'Well the investors with guarantees didn't think so! A test case went before the courts, who decided that the holders of the guarantees had been unfairly treated when they had been granted artificially low terminal bonuses which in effect reduced the pension available to them.

To meet the requirements of the Court, Equitable Life had to reduce terminal bonuses for all policies and increase terminal bonuses for those investors with the guarantees. Equitable Life put itself up for sale and it continued to trade and sell new policies for a while.

When the last potential buyer withdrew from the sale process Equitable Life closed to new business and now continues to run its existing policies.'

But what could Equitable Life have done?

'Equitable Life's problem partly stemmed from the fact that its policy was to distribute a high proportion of its investment returns in the bonuses it declared, significantly more than its competitors. It took pride in this approach.

The result was that it had too little in reserve to manage to meet these guarantees. Had they retained more and distributed less in annual bonuses, they might have been able to weather the guarantee problem.'

Why should trustees with other with-profits policies be bothered about all this?

'Well all trustees need to monitor the returns on their policies very carefully. And they should be prepared to ask searching questions if they're worried.

The Equitable Life story illustrates what happens when smoothing goes wrong. It should protect you from serious loss in the bad years, but it can only do so by withholding some of the gains in the good years.'

You have now reached the end of this case example.