

Tarred with the same brush

- Story by: Carl Lamb
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Not all Equitable Life policies are bad, in fact those holding retirement annuity policies and executive pension plans are onto a good thing

The name Equitable Life is one very deeply mired in the psyche of the UK investor. The life fund closed on 8 December 2000 and since then - despite a number of other life fund closures happening around the same time, some of which also had dire consequences for their policyholders - it has been the most high profile of failures and not without reason.

Equitable Life, the world's oldest mutual life company, founded in 1762, at the time accounted for around 10 per cent of the British pensions market. It closed its doors to new business in December 2000, having tried to find a buyer for the business. The Prudential was in the spotlight as a potential purchaser but ultimately declined to make a firm proposal saying it could not make the numbers stack up.

The underlying problem for the company was its guaranteed annuity rate policies, which allowed policyholders to opt for minimum pension payouts and receive a bonus when their policy matured. This guarantee was typically in double figures, around £12,500 a year for £100,000 in pension savings, and affected about 90,000 policyholders out of a total of some 500,000.

Sold between 1957 and 1988, by 1999, longer life expectancy among policyholders and lower interest rates meant they were considerably more expensive to honour than the company had originally expected.

The company tried to get the policyholders to foot the bill either by accepting a cut in their bonuses or by giving up their right to guaranteed annuity rates, which led to a legal battle between the two.

Equitable Life won the first round of the legal battle in September 1999 but the Court of Appeal and House of Lords overturned the judgment, ruling that the society was obliged to meet its commitments and pay the guaranteed rates and bonuses.

This equated to around £1.5bn, which the Equitable was unable to afford on its own.

At the time of the closure, the company's life fund was roughly 60 per cent invested in shares and 40 per cent in bonds. The closure forced the reversal of the investment strategy, which led to lower investment returns and seriously cut its ability to meet its commitments going forward.

Equitable managed more than £34bn on behalf of 650,000 savers and policyholders of the life fund fell into two camps: there were around 200,000 people with unit-linked pensions but the majority were in its with profits fund.

For IFAs dealing with clients holding unit-linked contracts, the situation was relatively straightforward, the price of the units were known and clear and the policyholder was able to exit the fund without penalty, subject to the underlying asset value. For unit-linked policies our advice has invariably been to take their money out as better returns are available elsewhere.

The real problem was, and is, in the with profit funds. There are three types of with profit funds: The with profit life fund (similar in design to endowment policies), the with profit pension fund, and a sub-section of the with profit pension fund, the with profit annuity contracts.

If we start with the with profit annuity holders, the Equitable's with profit annuity book of business was sold to the Prudential last year. Each year the with profit returns have been reducing and most people have seen their income drop to 50 to 60 per cent of the original starting point. For policyholders, the sale is designed to bring stability to the fund and their income, with the potential, and that word must be stressed, that in the longer term they may start to see an increase. But the reality is that all these policyholders can really hope for is a drawing of a line in the sand and stability.

For policyholders whose savings are held in the with profit pension fund, it really depends on the individual's current situation and the contract they have in place. Currently, the Equitable is levying a 5 per cent market value adjuster to the fund, unless the policyholder is taking benefits. This means, if the policyholder is currently over 50, or from 6 April 2010 over 55, and contractually they are going to buy an annuity, or go into drawdown, they are allowed to exit the fund without the MVA penalty being applied.

As far as the with profit life fund is concerned, if clients have an endowment policy or with profits savings plan with Equitable then the annual return they are getting is so low that it can be virtually worthless.

For these clients, a review of their individual circumstances is essential, including the current value of the fund, what the surrender value may be and the options. So, if it is possible to get the money out without paying tax on it, that is, it is a qualifying policy, the question has to be asked whether the client will be better off taking the money out and paying off debts, or reinvesting elsewhere? What needs to be born in mind of course, is that at the moment the client will get back the value of the fund minus the 5 per cent MVA.

The assumption often made in the media is that Equitable Life policies are all bad, but that is not the case.

For certain people, particularly those with the retirement annuity policies and executive pension plans that include a guaranteed roll-up, they are quite valuable (see: case study).

Nobody should be making a sweeping statement that all policyholders should exit Equitable funds because it is very much to be reviewed on a case-by-case basis.

But on other hand, policyholders should not keep money in the fund believing that the government is going to bail them out. Look at the fact that we are already several years down the road, the Parliamentary Ombudsman has come down in favour of the Equitable policyholders, and yet the government still has done nothing.

What is important is that clients do not bury their heads in the sand. Advisers need to ensure the client fully understands the contract they have and to undertake reviews of the client's individual circumstances on an ongoing basis.

Finally, those individuals who believe they have a genuine case with regard to misrepresentation or mis-selling in respect of their policies should consider joining one of the Equitable Life action groups.

Case study

The client is 57 years old with £600,000 in an Equitable Life retirement annuity policy. This is a with profits contract with a contractual retirement age of 60 years. The policy is delivering a 3.5 per cent guaranteed roll-up every year. The client is risk averse.

Potentially, we could take the money out and put it into the market, but there is investment risk involved and you can argue that 3.5 per cent is not a bad rate of return given current interest rate levels. Indeed, who is to say, given the client would want to be invested in low-risk products, that he is going to get a greater annual return than 3.5 per cent?

In this case, our advice is to stay with the policy until the contractual retirement age of 60 years.

At that point, we have two options, either to exit the Equitable penalty free (which he will be able to do as he will be taking benefits) or, as the guaranteed roll-up continues to be applied to the policy until it is vested, to maintain it until his actual date of retirement.

The worst case scenario for this client in staying with the Equitable is that the company goes into administration, but then we can fall back on the Policyholder Protection Act.

Carl Lamb is managing director of Almary Green