

MANAGING OUR RISKS

WESLEYAN

we are all about you

MANAGING OUR RISKS

Risk Appetite

The Society's risk appetite is the amount of risk that we are prepared to accept in pursuit of our business objectives. Any new or change to risk exposure is considered in light of this risk appetite before being accepted.

Our risk appetite is set by the Board and reviewed at least annually. It is summarised below:

"We accept risk in order to deliver our strategic objectives, recognising the need to balance risk and reward and to ensure that risk is actively managed and monitored. Our reputation and relationship with our customers is vital and we will always treat our customers fairly and act with integrity. In order to meet the needs of our current and future policyholders, we will ensure that we remain financially strong and even in extreme circumstances, are able to meet our financial obligations as they fall due."

Our risk appetite is further broken down into the following four key elements: reputation, capital, liquidity and conduct. The Board regularly reviews and monitors the actual risk profile and risk limits against the approved risk appetite.

| Element | Risk Appetite Statement |
|-------------------|---|
| Reputation | We recognise that our long term sustainability depends on the strength of our reputation and relationship with our customers. Therefore, we have minimal appetite for material reputational risks and we will always treat our customers fairly and act with integrity. |
| Capital | We will ensure that we remain financially strong in line with our mission statement and consistent with our communications to policyholders. |
| Business | The Society seeks to monitor and react to external developments to ensure that it maintains/improves its low to moderate business risk profile over the longer term. This includes: <ul style="list-style-type: none"> – Regular and effective processes for business risk identification, strategic planning and business risk management; – Testing of resilience to risk events (what if scenarios). The Society seeks to maintain sufficient resilience against business risk. This includes resilience to impact on: <ul style="list-style-type: none"> – Customer outcome; – Long term financial and operational performance. |
| Conduct | We will seek to ensure at all times that our behaviour results in fair outcomes for customers. |

Principal Risks and Uncertainties

Accepting risk is fundamental to the delivery of the Society's strategic objectives, including the delivery of attractive returns for its policyholders. With Profits policyholders are also impacted by the profits or losses from a range of business activities, including from non-profit business and the Society's subsidiary companies.

The Society recognises that in a fast moving and challenging external world, our strategy may need to be changed to respond to developments in our operating environment and the Board therefore regularly reviews the Society's long term strategic plans. In developing and monitoring strategy the Board's priority is to ensure that strategic initiatives do not compromise the future financial strength or reputation of the Society or its ability to provide fair outcomes for our customers.

The Society has a Risk Management Framework in place, which includes governance structures and processes to identify, manage and monitor risks actively. Further details of the framework, and the Society's approach to risk management is set out in the Society's Report and Accounts. Robust risk management is also embedded within the culture of the Society. The effectiveness of risk management and internal control systems is reviewed at least annually, including reviews undertaken by Internal Audit, the scope of which are aligned to the key risks of the society. The principal risks and uncertainties facing the Society at the time of writing this report are as set out opposite together with the elements of the Society's risk appetite that could be impacted and actions taken to manage and mitigate them. Any recent material changes to any of the risks, and how the risks have been impacted as a result, are also detailed.

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| Area of Risk | Risk Appetite Element(s) | Principal Risk and Uncertainty | Risk Mitigation and Management |
|---|--------------------------------|---|--|
| Financial markets and economic conditions | Liquidity, Reputation, Capital | The performance of investment markets and shifts in economic conditions affect the returns generated for policyholders and our financial strength. | <p>Funds are invested in line with each Fund's Statement of Investment Principles. The interests of With Profits policyholders are protected by the Principles and Practices of Financial Management which are designed to document how we manage the fund in line with risk appetite, including the need to balance risk and return.</p> <p>We set limits on our exposure to different asset classes, cash, bonds, property and equities and monitor exposure by geography and counterparty. Where appropriate we have put in place financial derivatives to mitigate the impact of stock volatility on our financial strength.</p> |
| | | Changes in interest rates have an effect on the calculation of the Society's assets and liabilities, potentially impacting our financial strength. For example, market value of Gilts and Corporate Bonds will increase following an interest rate decrease. However, lower interest rates also increase our liabilities and the amount of capital we are required to hold for other risks. This risk increased during 2016. | Assets and liabilities are partly 'matched' by type and duration so that they respond in a similar way to changes in investment conditions. Investment conditions and outlook are monitored closely by Executive and Board Committees and further mitigating action is taken where necessary. |
| | | A major and prolonged economic downturn and/or stock market crash could lead to a failure to meet targets and to a significant under-performance of our business plan. | We model a range of scenarios impacting different products and identify management actions to be taken to mitigate the impact if such scenarios should arise. We monitor the achievement of our business plan closely through our governance structures so that any mitigating actions required are taken in a timely way. |
| Counterparty | Reputation, Capital, Liquidity | We invest in debt securities and other assets and place money on deposit with banks in order to meet our obligations to policyholders. Derivatives and reinsurance are used to a limited extent to mitigate some financial and other types of risk. As a result of this activity exposures can arise to issuers of debt and other financial instruments as well as reinsurers. We are exposed to the risk of failure or default of one or more of these counterparties. | <p>We manage counterparty risk in line with risk appetite by setting limits on the amounts that may be invested with any single counterparty. Limits on the amount that can be placed with individual banks are approved by the Board.</p> <p>We monitor and report against these limits, keep the credit worthiness of these counterparties under regular review and have trigger levels in place to ensure prompt management action. Where appropriate, significant counterparty exposures, for example in respect of derivatives, are mitigated by the use of collateral.</p> |

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| People | Reputation, Conduct | The Society's performance and development depends on people. There is an expectation of our staff to offer our customers quality services and products in a compliant manner. There is an inherent risk that our people may not have the appropriate skills and support to deliver ongoing activities as well as maintain compliance. | <p>The culture of an organisation at all levels, from the Board down, drives good behaviours. We work continuously to ensure that the culture of the Society reinforces the importance of integrity, competence and fairness.</p> <p>Our HR policy and procedures are designed to ensure that our people have the appropriate skills and support.</p> <p>Both the Executive and the Board have regular discussions on staff performance, capability and development. Robust recruitment procedures apply to ensure new appointments are suitable for the roles. Each person has a regular one-to-one meeting with their manager, where their overall objectives and responsibilities are discussed, along with their future learning and development needs.</p> <p>We regularly review our performance management framework.</p> <p>We design our remuneration policies and procedures to reward and incentivise customer focused behaviours and compliance with regulatory requirements.</p> |
| Products | Reputation, Conduct | We operate in a market where the needs of our customers are changing rapidly, regulatory changes are giving more options for customer choice and where there is considerable innovation. | <p>We monitor closely any changes affecting our target market as part of our strategic and business planning process. We assess their potential impact with input from our Advisory Board and also through scenario testing, so that mitigating actions can be identified and taken in a timely way.</p> <p>Where appropriate and in our customers' interest, we look to broaden our product range to address competitor and market challenges.</p> <p>As part of our commitment to Treating Customers Fairly, we undertake regular reviews of financial advice given and client activity to assure ourselves that we are meeting the highest standards for quality of financial advice in our areas of expertise.</p> |

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| Legislation and regulation | Reputation, Capital, Conduct | The pace and scale of regulatory changes impact the Society's strategy, profitability and capital position. We need to respond to a wide range of national and international regulatory reforms, some of which, (such as the new more flexible retirement income options) have a very short time scale for implementation. | We monitor and evaluate the impact of legislative and regulatory changes, with material matters being considered at the Group Risk Committee and the Board. We seek to engage actively with our regulators – the Prudential Regulation Authority and the Financial Conduct Authority – through regular contact, through their planned visits and through active participation in industry representation. All major regulatory and legislative change activities are organised via projects, utilising a strong project management approach. |
| | | New rules harmonising minimum capital levels and risk management across Europe ('Solvency II') took effect on 1 January 2016. | We manage our capital to withstand a much higher level of risk than the regulatory requirements demand, in line with our risk appetite. |
| Information security | Reputation, Conduct | Over the last few years the Society has been evolving its own online capability. We are committed to increasing our online presence further to allow greater access to customers. As we develop our digital channel, cyber security is set to become a more prominent business risk. | We have invested in a variety of tools to help protect our IT infrastructure and continue to enhance our approach to cyber security and protect customer's personal data, including how we are positioned to prepare for, detect and respond to the increased sophistication of cyber attacks. |
| Insurance risk | Capital | The Society's business involves the underwriting of risks where the ultimate liability is dependent on long-term factors such as the rates of mortality, morbidity (i.e. sickness), persistency (the proportion of policies that remain in force) and our expenses. | We have extensive experience and expertise to assess and set our price for known risks and to make sure that our reserves are appropriate. |
| | | Despite our prudent approach when determining our capital requirements, unexpected events could take place which lead to losses. For instance, this could arise from a step change increase in life expectancy meaning that our annuitants and pensioners live much longer. If our actual experience deviates from our assumptions, this could impact our financial position. However, lower interest rates increase our liabilities and the amount of capital we are required to hold for other risks. | We regularly review the experience against our assumptions. We also hold a prudent amount of capital to ensure that we are able to meet our liabilities and obligations under stressed conditions. Additionally, we use reinsurance where we deem it to be appropriate, to mitigate the effect of adverse experience. |

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| Internal Change programme | Reputation, Conduct | <p>Internal change programmes are under way to improve our capabilities and the experience of our customers.</p> <p>We have developed a challenging medium term plan to update and improve our IT systems as well as implement regulatory and other business changes.</p> | <p>We have an agreed project lifecycle which sets out the project delivery framework covering all aspects of project management. Each major project has a business case agreed by the Board setting out the long term financial benefit to customers.</p> <p>We also have a medium-term business plan at divisional level which shows our capacity for undertaking change programmes alongside regulatory and mandatory projects.</p> <p>Strategic and operational plans are reviewed regularly by the Board to ensure all planned changes are in line with our ability to manage them.</p> |
| Distribution model | Reputation, Conduct | <p>A professional and personalised advice service is at the heart of how the Society meets the needs of its customers. This is delivered through a nationwide network of Financial Consultants. Where appropriate they recommend products provided by the Wesleyan Group as well as selected third parties. Customers pay for this advice only if they decide to proceed with a product purchase. The charge is collected through the plan taken out.</p> <p>There is risk that the regulator's view on how firms charge for advice may change, and they may challenge the charging model we have adopted.</p> | <p>We closely monitor regulatory developments and other changes within the market. We review our distribution model if necessary to ensure that it remains in line with what our customers and the regulator expect.</p> |
| | | <p>As the Wesleyan Group concentrates distribution of its financial products through our own Financial Consultants, it is exposed to the risk that unsuitable financial advice might be given.</p> | <p>All of our Financial Consultants are qualified to the required standard and are regularly assessed and monitored within our training and competency framework.</p> |

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| Acquisitions | Reputation, Capital, Conduct | <p>In developing and implementing our future strategy the Society considers the acquisition of external businesses to complement our current range of products and businesses for the benefit of our customers and members.</p> <p>Any company making acquisitions runs the risk of not identifying negative issues within the business to be acquired; paying too much for the acquisition; not realising the planned benefits; or not integrating the acquired entity into its culture.</p> | We have an established governance structure at project and Board level for reviewing acquisitions, with particular focus on these risks, drawing on external assistance for due diligence as appropriate. Planning for integration is a key part of each acquisition project. |

Within the Society's latest annual report and accounts, further detail is given regarding the specific risk types to which the Society and its policyholders are exposed, and our approach to managing those risks, to ensure that the residual risk exposures are within acceptable tolerances agreed by the Board. The report and accounts also includes a sensitivity analysis, setting out how changes in a range of risk factors may impact our capital.

Wesleyan Assurance Society

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