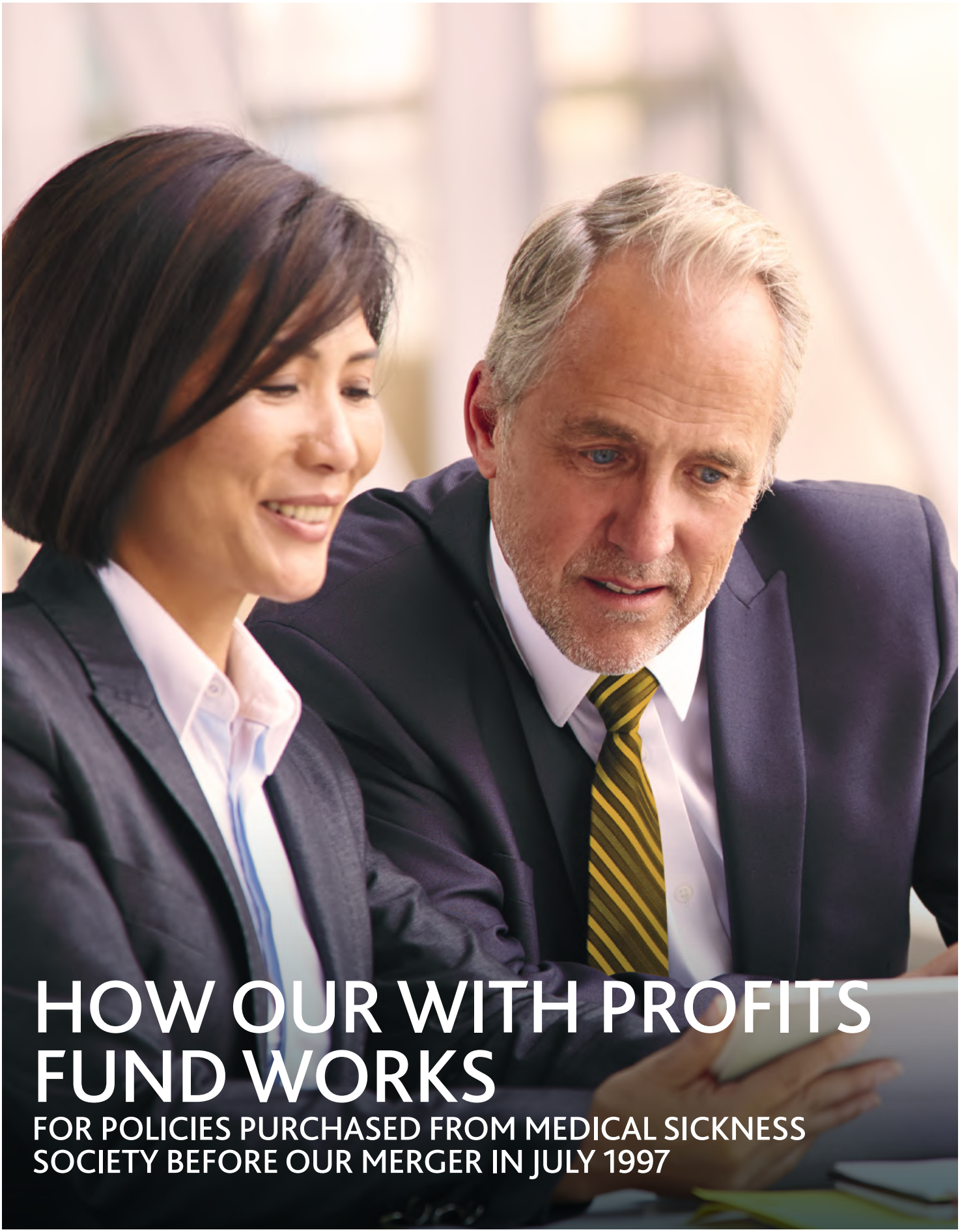


HOW OUR WITH PROFITS FUND WORKS

FOR POLICIES PURCHASED FROM MEDICAL SICKNESS SOCIETY BEFORE OUR MERGER IN JULY 1997

WESLEYAN

we are all about you

HOW OUR WITH PROFITS FUND WORKS

For policies purchased from Medical Sickness Society (MSS) before our merger in July 1997.

Please take the time to read this document and keep it safe with your product literature. It explains how our With Profits Fund works and how it affects the value of your investment.

This document covers Medical Sickness Society (MSS) policies purchased before the merger.

These are administered in a separate fund to the rest of our business, called the **MSS Fund**. This fund was closed to new business at the time of the merger. Policies purchased after the merger are administered in our **Open Fund**.

As part of the merger, the High Court approved a set of rules for how the **MSS Fund** should operate. This is called the **merger agreement**.

If you would like a copy of the merger agreement, you can contact us and ask for a copy.

If you purchased a policy after the merger, you may want to read one of our other documents that are available. These are:

- for policies where premiums are not used to buy units, and
- policies where premiums are used to buy units in the With Profits Fund.

You can ask us for a copy of either of these documents at any time, or you can find them on our website at: www.wesleyan.co.uk

In this document, whenever we refer to 'the fund' we mean the **MSS Fund**.

Whenever we refer to 'we', 'us' and 'our' we mean Wesleyan Assurance Society.

When we refer to 'policy document' or 'policyholder' throughout this document, this can also mean 'plan document' and 'plan holder' as your particular product may refer to 'plan' rather than 'policy'.

Financial advice can be provided by Wesleyan Financial Services through its team of Financial Consultants. Wesleyan Financial Services is the advice and distribution company of the Wesleyan Group of companies and is wholly owned by Wesleyan Assurance Society.

Your questions answered

1. What is a With Profits Fund?

A With Profits Fund is a type of investment fund offered by insurance companies, such as Wesleyan Assurance Society. The fund aims to provide growth over the long term whilst giving some protection against short-term market fluctuations, through mechanisms such as 'smoothing' and 'bonuses' (these are explained in more detail later in this document). Having these mechanisms in place means that policy values are not expected to be as volatile as other managed funds that invest in similar assets.

Some With Profits policies offer guarantees that can be valuable if you have to cash in your policy when markets have fallen. These are known as '**guaranteed events**' and are covered in more detail in Question **4**.

2. How does the With Profits Fund work?

We invest the premiums paid by you, and our other pre-merger policyholders, into the fund. We aim to increase the amount you will receive (your 'payout') based on the returns we make from our investments.

However, to provide you with some protection from the risk of our investments falling in value rather than rising, we also guarantee part of your payout. If our investment growth is enough for us to afford to pay you more than this guaranteed part, we add **bonuses** (see Question **6**).

Your payout (including bonuses) is only guaranteed in the circumstances set out in your policy document. In this document, we refer to these as '**guaranteed events**'. Less may be payable at other times (see Question **9**).

As an investor in this fund, any bonuses you receive are also influenced by other profits or losses we make on policies in the fund.

The merger agreement requires us to gradually distribute the entire fund to the remaining policies in the fund. This will also affect your bonuses (see Question **7**).

3. How do bonuses affect my payout?

Bonuses operate in different ways depending on what type of With Profits policy you have.

- If you are already receiving a With Profits regular pension, please see Question **13**.
- If you have a With Profits income protection policy, please see Question **14**.

Your policy document states what the guaranteed part of your payout is in more detail. This is called the 'sum assured' and will be paid (on a **guaranteed event**) provided no premiums have been missed. The payout might be made in one lump sum payment, or a series of payments such as a pension income.

We aim to add **annual bonuses** to the sum assured throughout the life of your policy. Once we add an annual bonus, it increases what you are certain to receive on a **guaranteed event** such as your death, maturity of your policy, or reaching your selected benefit date.

We might also add a **final bonus** on payout, along with an additional annual bonus, called an 'interim bonus'. An interim bonus covers the period since annual bonuses were last added.

Some pension policies might also receive a bonus when benefits are taken. This is paid alongside the final bonus, and ensures that you get an appropriate payout whatever retirement age you choose.

You can keep track of what annual bonuses have already been added to your policy. These are shown on your annual statement.

4. What is a guaranteed event?

For some policies, a guarantee may apply on death. Some policies may also have an agreed end date when a guarantee applies. These are known as '**guaranteed events**' on your policy.

A small number of our policies do not add any bonuses when the payout is made on death. You should check your policy document to see what individual guarantees it contains.

Figure 1: Payout on a guaranteed event

- sum assured (shown in your policy schedule)

plus

- any annual bonuses added

plus

- any interim bonus, to be worked out on payout

plus

- any final and vesting bonus, to be worked out on payout.

Please see Question **9** for what happens if you cash in your policy.

5. What is a Guaranteed Annuity Rate (GAR)?

Some pension polices contain valuable Guaranteed Annuity Rates (GARs). You should check your policy to see if it contains a GAR. The rate on the GAR would have been set many years ago when annuity rates were much higher.

If your plan contains a GAR, it means that you will likely be entitled to a higher annuity rate than you would normally get on the open market. If you hold such a policy, we will write to you with details of your pension options when you reach your selected benefit date.

6. What affects annual bonus rates?

Annual bonus rates depend on past and forecasted future investment growth, with adjustments for other profits and losses. We will assess whether we expect to be able to get enough overall growth to increase your guaranteed payout.

We cannot be sure how much overall growth we might get because the value of our investments will continue to rise and fall until you receive your payout. We forecast our future growth and combine it with our past growth. This gives us an estimate of the overall growth we expect to get by the time you receive your payout. We use this overall growth estimate in order to set annual bonus rates.

Once we add annual bonuses, we can't take them away, even if our estimates turn out to be wrong. Because of this, we set annual bonus rates prudently, using only part of our estimate.

We aim to keep adding annual bonuses gradually.

If our estimate increases, we might start adding higher annual bonuses. Our estimate might increase even if the value of our investments have fallen recently, because we forecast better future returns.

Similarly, if our estimate reduces, we might start adding lower annual bonuses. Our estimates could reduce even if the value of our investments have been rising recently, because we forecast lower future returns.

We might have to stop adding annual bonuses altogether if the estimated future returns are poor. In particular, this may be necessary if what we've already guaranteed to pay you includes all the past and expected future growth combined.

7. What affects the final bonus amount?

The amount of any final bonus depends mainly on the value of the assets in the fund at the time of payout. It is only at this stage that we will know what investment growth, or loss, we've made on the fund while you have held your policy.

We will also know what our other profits or losses are, and how much remaining fund there is to distribute. We can then work out the **underlying value** of your policy (as explained on the next page). Normally, this value will be high enough to allow us to add a final bonus.

If we based final bonus directly on the underlying value, your payout would be directly affected by short-term stockmarket fluctuations around the time of your payout. For example, your payout could occur when the value of our investments have fallen, only to rise again later.

One of the most important aims of our With Profits Fund is to help to shelter you from such short-term fluctuations in returns by a process called 'smoothing'. We adjust the underlying value of your fund by applying **smoothing** (see page **6**).

You are also protected if stockmarket levels are low at the time of your payout on a **guaranteed event**. The minimum amount you will receive is the payout we've already guaranteed you including any annual bonuses that have already been added.

Figure 2: The amount of your final bonus is set by:

- looking at what we can pay in total, based on the underlying value of your policy, adjusted for smoothing

compared with

- the payout we've already guaranteed you, including annual bonuses already added. If this is greater, we would not pay a final bonus.

Please see Question **9** for what happens if you cash in your policy.

Unlike many other insurers, we don't have any shareholders. Our profits are re-invested for the benefit of our policyholders, although some may be used for internal finance to ensure that our business remains sustainable, safe and secure.

How we work out the underlying value

We do not calculate the underlying value individually for every policy. We look at either a range of typical policies, or groups of similar policies in the same product line.

For these policies, we do a calculation bringing together the premiums that have been paid and their share of how much profit or loss has been made. We then make an adjustment to help us ensure that the entire fund is gradually distributed to policies such as yours. We do this by:

- taking the premiums that have been paid, then
- making deductions to cover a share of the expenses and overheads of running the policies in the fund (see Question **8**), including taxes, then
- we make deductions to charge for guarantees, then
- we add investment growth or deduct losses, and finally
- we make an adjustment based on gradually distributing the entire fund.

We may allow for other profits and losses made by the fund when doing these calculations.

We charge for any guarantees which could pay out significantly more than the underlying value. Many policies guarantee high payouts on death or illness – sometimes much higher than the underlying value. We make a charge for this cover.

We adjust underlying values based on our best estimates of what the fund will be able to afford in the future. We set adjustments so as to distribute the entire fund gradually and fairly as policies are paid out. Adjustments are applied fairly across all policies, allowing for their size and the period they've run for.

How smoothing works

In periods of good investment returns we may keep back some of the return. What we keep back would then be gradually applied to your policy and can be used to cushion the fall in your share of the fund if there is a subsequent period of poorer investment returns. This helps to shelter you from short-term investment fluctuations and is known as 'smoothing'.

Over time, payout values on maturity or retirement at the specified selected benefit date will average 100% of the underlying value.

We will normally ensure that your payout isn't more than 10% different from what we have paid a similar policy in the year before. We may need to go beyond these normal smoothing rules in extreme circumstances.

We set our payouts with the aim that the difference between the smoothed payout and underlying value of a policy will be less than 25%. This difference may be more than 25% for a small number of policies.

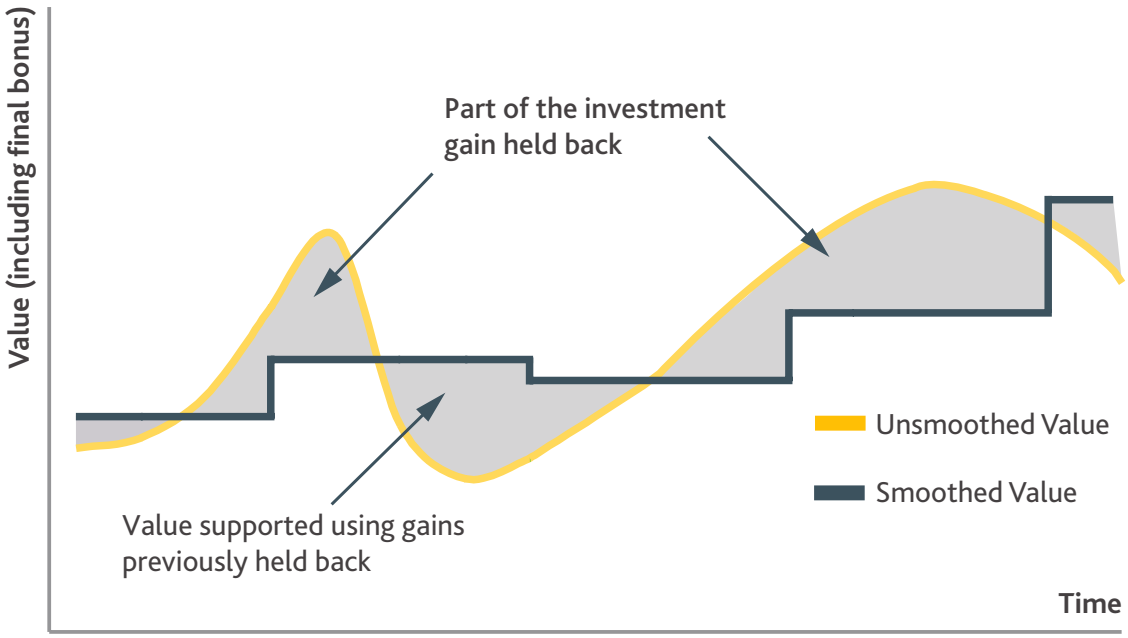
Smoothing can only adjust for short-term fluctuations because we need to be able to balance out the good and bad years. In the long term, on average, we aim to pay out 100% of underlying values. So, if investment values remain low, then payouts are likely to be lower. Similarly, if investment values remain high, then payouts are likely to be higher.

8. What expenses do I pay for?

The expenses we deduct from your policy are the costs we have incurred in selling and administering policies overall, plus a share of the overheads of running the fund.

The costs of selling policies in each past year have been spread over the policies sold in that year.

Figure 3. Smoothing illustration - the diagram below shows how smoothing is applied to your investment



The smoothed value reflects your total payout including any final bonus.

If the other costs can be identified as only being incurred in administering one group of policies, then they are spread over that group of policies. All other costs of administering policies and running the fund are spread over all the policies that are currently in the fund.

To ensure a fair allocation of the expenses across the policies in the **MSS Fund**, an arrangement is in place between this fund and the Open Fund. By re-spreading the expenses projected to arise in the future, the agreement ensures that the expenses charged to each policy will not rise unfairly.
It also sets the increase in the level of the expenses to be charged to the **MSS Fund** for administration of each policy in line with a defined formula, so the Open Fund now carries the risk that these expenses will be larger than expected.

The **MSS Fund** purchases specific assets to reduce the risks arising from guarantees or options contained on policies within the fund. Two-thirds of any costs associated with purchasing these assets are met by the **MSS Fund**, with the other one-third being met by the Open Fund's estate.

The merger agreement explains which expenses can be charged to the fund and also how to calculate a fair share of the overheads.

In addition, we make a deduction for the charge paid by the fund to the Open Fund for the investment support it receives. The amount of this charge is set out in the merger agreement.

9. What if I cash in my policy?

With Profits policies are designed for long-term investment. You may get back less than you paid in if you decide to cash in your policy when stockmarket values are low.

If you cash in your policy during these times, guarantees do not normally apply. Instead, we will pay you what the fund can afford based on the underlying value of your policy. Paying more than the fund can afford could mean lower payouts to policyholders who continue to invest in the fund for the long term. Also, we will normally apply less smoothing if you take your money early (see 'How smoothing works' on page **6**).

We recommend that you seek financial advice before deciding to cash in your policy early so you understand about any valuable benefits you may be giving up.

10. Where is my money invested?

As part of the merger agreement, we pool the investments of this fund with the Open Fund. The resulting investment profits or losses are shared fairly between the two funds.

We invest your money in a range of investments with the emphasis very much on assets which we expect, over time, to provide a return above the rate of inflation, such as quoted company shares and commercial property. They are the sort of investments which normally have the best long-term growth prospects.

However, these investments also carry a risk. We cannot be sure they will grow enough to meet our guarantees to policyholders. Therefore, we also choose some lower growth investments, like interest-paying bonds and cash deposits. These have lower risk and provide more reliable growth, helping us to meet the guarantees.

We keep the mix between the higher and lower risk investments under review.

The mix mainly depends on the overall strength of the Open Fund and the level of guarantees made to its policyholders. We need to avoid having so many higher risk investments that the Open Fund becomes unable to honour its guarantees in poor investment periods.

However, because the Open Fund is financially strong, it is able to aim mostly for higher risk investments. We therefore expect to keep an above average percentage of your money in higher risk investments, compared with other insurance companies.

The way we set our annual bonuses reduces the risk you take. For further information, see Question **6**.

You can find current information on how the fund is invested by visiting our website or by contacting us, as explained in Question **15**.

We invest in a wide range of companies and properties. This ensures that losses from any particular company or property could only have a limited impact on the fund overall.

11. Could losses be made in the long term, and what would happen to payouts?

Quite apart from how our investments perform, we might make losses, or reduced profits, in some years. This is because we provide valuable protection benefits and guarantees to our policyholders.

For example, some of our policies provide life and sickness cover. We then face the possibility of incurring losses if more policyholders die, or become sick, than we'd estimated when setting our premiums. We seek to manage this by considering what it might cost us to purchase protection against high levels of deaths or sickness.

One typical arrangement is where we share the risk with other insurance companies, known as reassurers. We have set up such an arrangement to reduce the potential losses from high levels of claims on our income protection policies.

Examples of other areas where we could make losses are:

- paying out guaranteed pensions, including guaranteed annuity rates. The cost for some policies is now higher than previously expected, and
- paying out compensation to policyholders.

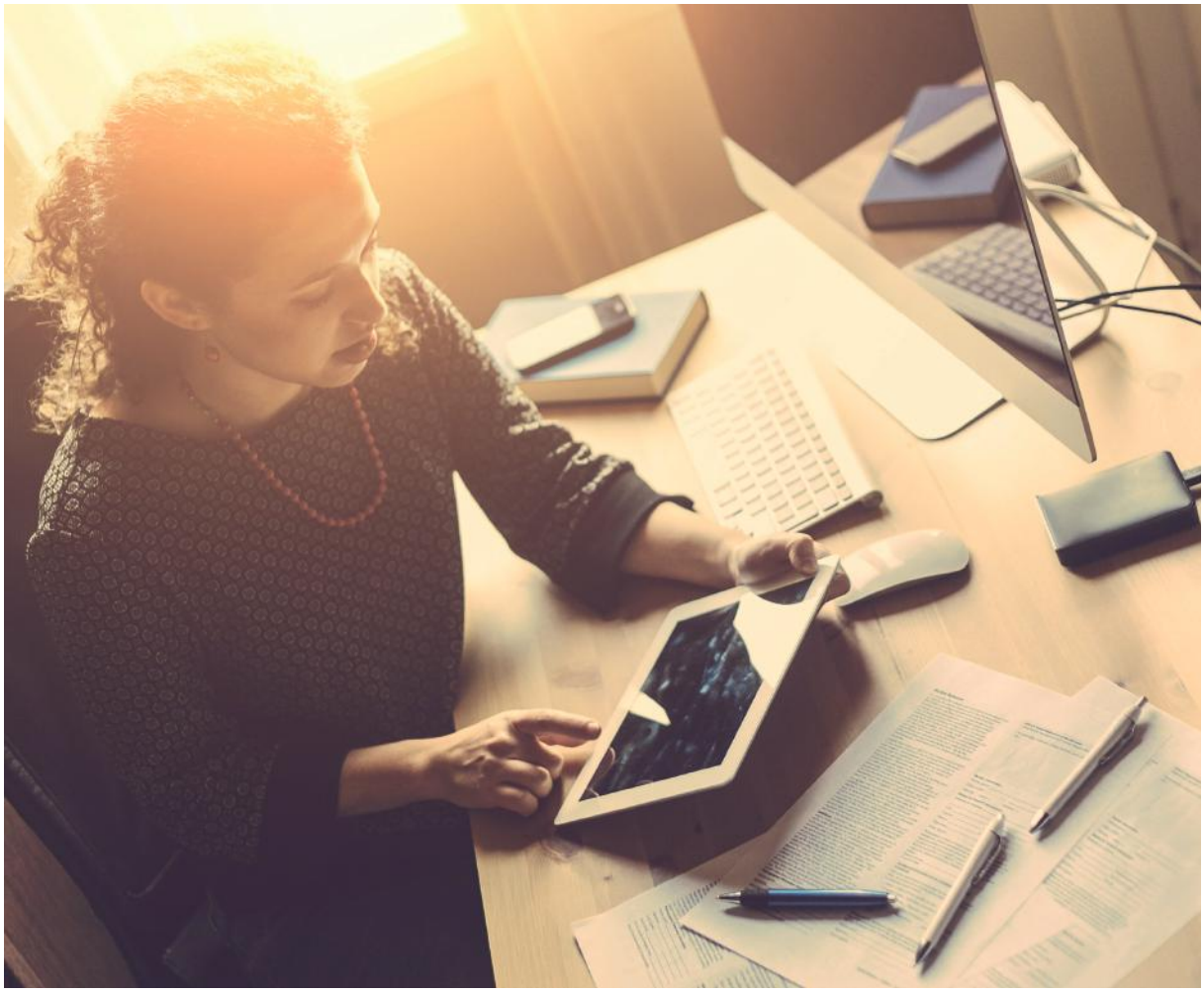
However, the merger agreement restricts the losses that may be charged to this fund.

In the event of a sustained period of losses, we would have to consider reducing future bonuses, possibly stopping them altogether. This is because we would give priority to using the fund to honour guaranteed payouts under the terms of each policy (including any annual bonuses already added).

We promise to meet any guaranteed payouts, under the terms of each policy, whatever the future profits or losses of the fund. The financial strength of the Open Fund would be used to ensure guaranteed payouts could still be made in extreme circumstances.

12. What happens when the fund gets too small?

Because the fund is closed, it will eventually get quite small. There may come a point when we believe it is not in the best interests of policyholders to keep it running as a separate fund. At that point, we would seek approval to transfer the remaining policies into the Open Fund.



We do not know when this might be and any decision would have to meet any relevant legal and regulatory requirements at the time. The merger agreement states that for a transfer to be made, the total number of policies in the fund would have to have fallen below 5,000.

13. What if I'm already receiving a With Profits regular pension?

The amount of pension you receive each year is guaranteed and we may increase it by adding annual bonuses. These bonuses will depend on the bonuses declared for similar policies that are not yet being paid, the financial health of the fund, and the assumptions about bonuses made when determining the price of this type of pension. Once added, annual bonuses increase the amount of pension you will receive each year.

We do not add any other types of bonus to these policies.

14. What if I have a With Profits income protection policy?

Your policy pays a guaranteed benefit during illness. We do not add any bonuses to this benefit. Instead, we aim to build up a lump sum that will be paid at the agreed end date of your policy, or earlier death. The lump sum will be the total of any annual bonuses added, and any final bonus we add at the time you are paid the lump sum.

We will let you know about any bonuses that are applied to your plan. It will depend on the arrangement we've made to share the risk with our reassurers. A final bonus may be added if the average annual investment growth, achieved since the July 1997 merger date, is significantly higher than 7.65%.

15. Where can I find out more?

If you have any questions on the information we have covered in this document, or you would like further information, please contact your Wesleyan Financial Services Consultant. To book an appointment, please call **0800 058 2965**.
Our lines are open Monday to Friday, 8.30am to 6.30pm and from 9am to 2pm on Saturdays.

Each year, we publish an annual report which explains how we have acted to manage the fund during the year. We also produce a more detailed guide about how we run the fund (which includes further information about some of the terms used in this document). This is called 'Principles and Practices of Financial Management (Medical Sickness Society Fund)'. You can get a copy of either of these by calling **0800 058 2965**, or you can visit our website **www.wesleyan.co.uk**

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