HOW OUR WITH PROFITS FUND WORKS

FOR POLICIES WHERE PREMIUMS ARE NOT USED TO BUY UNITS

Products taken on or before 31 December 2002 may be what we describe as conventional with profits or unitised with profits.

If you don't have a number of units on your statement, you are invested in the conventional With Profits Fund and should read this document.

WESLEYAN

we are all about you

HOW OUR WITH PROFITS FUND WORKS

For policies where premiums are not used to buy units.
Please take the time to read this document and keep it safe with your product literature.

This document explains how our With Profits Fund works and how it affects the value of your investment. This document does not cover Medical Sickness Society policies purchased before the merger with Wesleyan Assurance Society in July 1997. Nor does it cover policies where the premiums are used to buy units. These plans are covered in either of the following documents.

- Medical Sickness Society policies purchased before our merger in July 1997
- Policies where premiums are used to buy units

You can ask us for 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 **Wesleyan Open 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 Specialist Financial Advisers. 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 our With Profits Fund work?

We invest the premiums paid by you, and our other policyholders, into the fund. We aim to increase the amount you will receive (your 'payout') based on the profits 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 **3**).

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. These usually have a smaller effect on bonuses. They can arise from other policies like yours, or from other types of policy, or different aspects of our business.

3. How do bonuses affect my payout?

Your plan 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.

You can keep track of what annual bonuses have already been added. 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 plan document to see what individual guarantees it contains.

Figure 1: Payout on a guaranteed event

- sum assured (shown in your schedule)

plus

- any annual bonuses added

plus

- any final 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 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 the annual bonus amount?

Some policies guarantee a minimum amount of investment growth. For these, annual bonuses are based on what growth is guaranteed.

For most policies, however, annual bonus rates depend on past and forecasted future investment growth, with adjustments for other profits and losses, and on 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 cannot take them away, even if our estimates turn out to be wrong. Because of this, we set our 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've held your policy.

We will also know what our other profits or losses are. We can then work out the **underlying value** of your policy (as explained below). 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 temporarily, 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' (the 'smoothing' process is explained later in this section).

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. If you have a Mortgage Endowment policy, your payout would, at the very least, cover your original mortgage.

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, so none of our With Profits return is deducted in order to provide dividends for shareholders. Our profits are re-invested for the benefit of our policyholders, although some may be used for internal finance to ensure that our fund 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:

- taking the premiums that have been paid, then
- making deductions to cover a share of the expenses and overheads of running the business (see Question **8**), including taxes, then
- we make deductions to charge for guarantees, and finally
- we add investment growth or deduct losses.

We 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 – sometimes much higher than the underlying value. We make a charge for this life cover.

We sometimes make a charge if your policy guarantees the amount of investment growth.

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' – see figure 3 below for how smoothing works.

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

Also, 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 incur in selling and administering policies overall, plus a share of the overheads of running the fund.

The costs of selling policies in any particular year are spread over the policies sold in that year.

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 are spread over all the policies that are currently on our books.

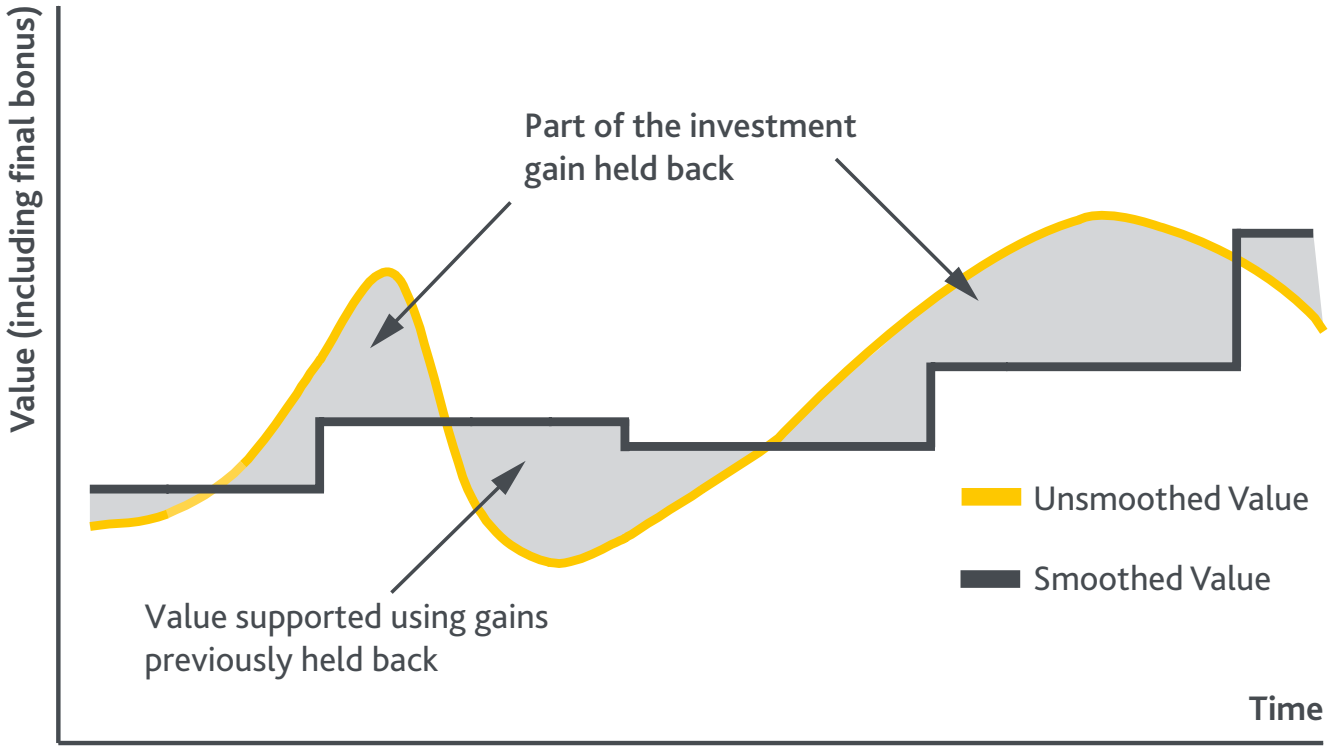
9. What if I cash in my policy?

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, particularly when stock market 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 5).

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.

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.

10. Where is my money invested?

Your money will be invested in the **Wesleyan Open Fund**. We invest it 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 fund and the level of guarantees made to its policyholders.

We need to avoid having so many higher risk investments that the fund becomes unable to honour its guarantees in poor investment periods.

However, because our 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.

This means that the underlying value of your investment can fluctuate more from day to day than similar investments with other companies. We therefore allow our payouts to be further away from the underlying value than other companies (see Question **7**), so that we do not need to change our bonus rates too often.

The guarantees set out in Questions **3** and **4**, reduce the risk you take.

You can find current information on how the fund is invested by visiting our website or by contacting us, as explained in Question **13**.

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

Our investments also include some holdings in subsidiary companies of the Wesleyan Group, our unit trust management company and our distribution company.

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

The main risk arises from how our investments perform, as explained in Question **7**.

Other things that might put profits at risk include:

- the risks taken by those subsidiary companies of the Wesleyan Group of companies in which the fund invests
- the risk of paying more protection claims than we'd estimated when setting our premiums, and
- the risk of paying pensions for longer than we currently estimate.

We seek to manage these risks so that, in the normal course of events, profits are made, rather than losses.

To manage the risks of investing in subsidiary companies:

- the Board has to approve the amount that will be invested in each subsidiary company, based on the risks involved compared with the expected benefits
- approval will not be given unless the expected benefits are higher than available from ordinary investments, and
- limits are placed on investments in new ventures and the total value of assets held in subsidiaries will not normally be more than 6% of the invested assets of the With Profits Fund, and the actual performance of each subsidiary company is then regularly monitored to ensure that the expected benefits are being met.

To manage the risk of protection claims being higher than we'd estimated when setting our premiums:

- the premium rates we set are regularly reviewed, and
- we may pass on some of the risk associated with very large policies, or large groups of policies, to what is called a 'reinsurer'.

To manage the risk of paying pensions for longer than we currently estimate:

- the premium rates we set are regularly reviewed, and
- we allow for expected future improvements in life expectancy.

Also, we have a separate fund containing policies sold by Medical Sickness Society before our merger. If we needed to support that fund, then our profits would reduce. We have, though, taken steps to ensure that this would only happen in very extreme circumstances.

How payouts are affected?

In the normal course of events, we aim to make sufficient profits to be able to add bonuses to your payout. However, in periods of reduced Society profits (or expected profits) or in periods in which we might make losses, we would have to consider reducing future bonuses, or even 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.

12. How do I benefit from Wesleyan Assurance Society's financial strength?

We aim to ensure that we have more money than we expect will be needed to pay out on all of our current With Profits policies. This margin represents our financial strength and is not owned by any particular policyholders, but is used to give day to day benefits to current and future policyholders.

We do this so we can:

- meet the guarantees even if our investments fall in value
- keep an above average percentage of the Fund in higher risk investments that we hope will allow us to pay higher bonuses over time
- smooth out larger rises and falls in our returns when we determine payouts, and
- select investments which we believe will grow in the long term, even if they are currently out of favour with other investors.

We see these benefits as the key components of what our With Profits Fund is about – growth prospects over the long term with the added protection of smoothed payouts.

Our financial strength enables us to meet some costs directly from time to time, rather than pass them on to policyholders. However, we would only do this if we could guarantee that our financial strength would remain strong enough afterwards.

These costs might include:

- some guarantee costs, such as a guarantee that the maturity payout from certain endowment policies will pay off a policyholder's mortgage
- large projects we undertake to develop our business strategy or modernise our infrastructure
- compensation paid to our policyholders, and
- the cost associated with the Mutual Benefits Scheme.

We are a financially strong company and our aim is to remain financially strong in the future. We monitor this strength to ensure it doesn't fall below an acceptable level. If it were to fall, we would look at how to rebuild it. For example:

- we might start to keep back some of the profits we make, so as to re-build our strength, and
- we may have to limit our pace of growth to ensure that our overall guarantees don't build up too quickly.

13. 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 Specialist Financial Adviser from Wesleyan Financial Services. To book an appointment, please call **0800 058 2965**.

Our lines are open 9am to 5pm, Monday to Friday.

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 (**Wesleyan Open 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**

We are all about you.

Since we were founded over 180 years ago, we have cherished our mutual status. It's an integral part of who we are and with no shareholders, our focus is on members and customers. We work to benefit those who invest in our business. Not only today, but also in the future.

It's why 'we are all about you'.

A guide to the many ways in which the Wesleyan Group of companies can help you to plan, prioritise and secure your financial future.

For you

- Savings & Investments
- Mortgages
- Retirement Planning
- Insurance
- Life & Income Protection

For your business

- Finance & Funding
- Personal Protection
- Equipment Insurance
- Premises Insurance

For more information about the Wesleyan Group of companies, visit **wesleyan.co.uk/ourcompanies**

If you would like this document in Braille, large print or audio format, please contact **0800 975 3710.**

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