Principles and Practices Of Financial Management

Wesleyan Assurance Society (Open Fund)

Effective from 1 March 2021

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Wesleyan Assurance Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

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Introduction

Wesleyan Assurance Society, founded in 1841, is a mutual Society incorporated by Private Act of Parliament. Certain categories of policyholders are members and have the right to vote at general meetings. In 1997 Wesleyan merged with *Medical Sickness Society*, another mutual Society, which was itself founded in 1884. Wesleyan and its subsidiary companies undertake long term insurance business, investment advice, insurance broking, unit trust management, mortgage broking and retail banking.

Since 30 April 2004, all insurance companies issuing “With Profits” policies have been required to establish and maintain their “Principles and Practices of Financial Management” (PPFM).

This document, which is available on our website and can also be sent to you on request, is intended to provide protection for current and future With Profits policyholders by explaining how we manage our With Profits business.

We will provide a report to policyholders each year certifying that we have operated the business in line with the PPFM, and let them know if we make changes to it.

Within each section of this document, we firstly set out the “Principles” and then the “Practices”.

Principles are high level, enduring statements of the standards we adopt. They are not intended to change very often and when they do we are required to tell With Profits policyholders at least three months in advance.

Practices describe our current approach to managing the With Profits funds and these may change more often. When they do, we have to tell With Profits policyholders within a reasonable time period thereafter.

We have produced two different PPFM documents. This one relates to policies in the Wesleyan *Open Fund*. There is a separate PPFM document for policies in the closed *MSS Fund*, which covers With Profits policies sold by *Medical Sickness Society* before the merger with Wesleyan in July 1997.
We have included a glossary to explain the most common technical words and phrases. Where we use a word or phrase that is included in the glossary we have printed it in *italics*.

If you have any queries about this document, please contact our Customer Relationship Centre on 0800 092 1990 or, if you are a My Wesleyan customer, log into your account at www.mywesleyan.co.uk/login and correspond with us securely via ‘Messages’.

Note: This introduction and the glossary are provided for explanatory purposes only and do not form part of the Principles and Practices of Financial Management itself.

1. The amount payable under a With Profits policy

1.1 Principles

<u>1.1.1 Methods of determining claim values</u>

The aim of the method of determining bonus rates is that maturity values should reflect the fair share of the fund for maturing policies of different types and generations, and that changes in maturity values should be *smoothed* from year to year.

For conventional With Profits policies, the fair share of the fund is assessed using *asset shares*. *Asset shares* are used as a guide to determine the amount payable, which for an individual policy may be more or less than that policy's *asset share*.

Asset shares are not calculated for each individual policy. They are calculated for policies with terms which are multiples of five years, either for sample policies using average premium sizes, or for groups of policies of the same type. *Asset shares* are not calculated for some minor policy classes.

Bonuses which were declared under the Customer Reward Scheme were financed by the *estate*. They are paid in addition to the amount derived from the *asset share*.

For unitised With Profits policies, a *shadow fund* is used instead of *asset shares* to determine claim values. *Shadow fund* prices are based on *smoothed* investment returns, as an alternative way of calculating a *smoothed* fair share of the fund.

The current methods used to calculate *asset shares* and *shadow fund* values are described in section 1.2. Any significant changes to these methods will be approved by *the Board*, having had advice from the *Actuary*. Less significant changes will be approved by the *Actuary*.

Some approximations are made in the calculation of *asset shares*, in particular for the assumptions regarding the experience of the fund prior to 1986. When the calculations are performed some assumptions for the latest year are our best estimates of our experience for that year. These items are calculated accurately during the following year and the estimates replaced with accurate assumptions the next time that the calculations are done. Historical assumptions or parameters will only be changed when a subsequent investigation reveals an inaccuracy or when there is a change in method. Any significant changes will be approved by *the Board*, having had advice from the *Actuary*. Less significant changes will be approved by the *Actuary*.

<u>1.1.2 Annual bonus</u>

The aim in setting *annual bonuses* is to increase the guaranteed benefits gradually whilst leaving a suitable margin between our best estimate of future investment returns and the return that needs to be earned to be able to pay out the guaranteed benefits at maturity. Any changes in *annual bonus* rates will be gradual (unless this puts the solvency of the fund at risk) and will broadly reflect changes in the general level of past and expected future investment returns. It is possible that a period of poor investment returns could lead to zero *annual bonuses* for some or all With Profits policies.

A new bonus series will be introduced if, after taking into account the cost of guarantees, the experience of the fund and fairness to policyholders, the existing bonus rates are considered to be inappropriate for new business.

A new bonus series will also be introduced when changes in product design mean that existing bonus rates are inappropriate for the new product.

1.1.3 Final bonus

The aim in setting *final bonus* rates is that policyholders should receive their policies' fair share of the fund. This is assessed using either *asset shares* or a *shadow fund*. We also apply *smoothing* in line with the *smoothing* policy described below. If the benefits guaranteed to be paid by a policy already reflect at least that policy's fair share of the fund then we may not add a *final bonus*.

1.1.4 Smoothing policy

It is intended that the cost of *smoothing* will be broadly neutral over a period of 10 to 15 years, i.e. over this period there is not expected to be any significant contribution to or from the *estate* arising from differences between claim values and the underlying *asset shares*. For this purpose claim values exclude any bonuses declared under the *Customer Reward Scheme*.

Maturity and death claims are subject to the same level of *smoothing*. Less *smoothing* is applied to surrender and transfer claims.

No limit has been set on the *smoothing* cost that is considered to be acceptable in the short term. A limit would be set if the financial strength of the fund was considered to be sufficiently low that such action should be taken.

For policies that use the *shadow fund* approach the aim of our *smoothing* policy is that, over a period of 10 to 15 years, the amounts paid on claims should reflect the amounts that would have been paid if the values had been based on un*smoothed* investment returns, after allowance for miscellaneous profits and losses, and other adjustments for experience.

Surrender values

Surrender value bases for conventional With Profits policies are reviewed regularly. Resulting changes to the basis will reflect any changes in the experience of the policies under consideration
Market Value Reductions on unitised With Profits policies may only be applied when a policy's fair share of the fund is less than the *With Profits Unit Value* allocated to that policy.

1.2 Practices

1.2.1 Methods of determining claim values

Ordinary Business (OB) conventional life assurance policies

The amount payable on death or maturity is the sum assured plus *annual bonuses*, any *final bonuses* and any bonuses declared under the *Customer Reward Scheme*. The amount payable on death for low cost endowment policies is the greater of this amount and the guaranteed minimum death benefit specified in the policy literature. The amount payable on surrender is a proportion of this and is determined with reference to a formula.

Industrial Business (IB) conventional life assurance policies

The claim amount is determined in the same way as for *OB* conventional life assurance policies except where the policyholder has opted to take the premium loan option. A premium loan was offered to all premium-paying policies in 2002 in lieu of door-to-door collections, under which all future premiums are waived in exchange for a deduction from the calculated claim amount of 82.5% of the outstanding premiums, with no interest added to the outstanding amount. The alternative option was to pay premiums by another method.

Conventional pension policies

Benefits for these policies may be expressed as a capital amount or an *annuity*. For policies with benefits expressed as an *annuity* the *annuity* payable after vesting is the basic *annuity* plus *annual bonuses*, any *final bonuses*, and any bonuses declared under the *Customer Reward Scheme*. For policies with benefits expressed as a capital amount the cash fund available at retirement is the capital amount plus *annual bonuses*, any *final bonuses*, and any bonuses declared under the *Customer Reward Scheme.* For early and late retirements the benefits are recalculated based on the premium rates at the outset of the policy, where available.

Depending on the type of policy, it may be possible to take part of the cash fund as a tax-free lump sum. The remainder may be taken either in the form of an *annuity* or as a taxable lump sum. For some policies this *annuity* will be subject to a minimum of the *annuity* calculated using the *Guaranteed Annuity Rates (GARs)* specified in the policy literature. The basis underlying the *GARs* is applied at retirement irrespective of the actual retirement age, up to a maximum retirement age of 75.

The transfer value is a proportion of the value available at retirement and is determined with reference to a formula. The amount payable on death is the premiums paid to date plus interest at a rate specified in the policy.

Unitised With Profits life assurance policies

The amount payable on death varies by policy type but is usually at least 100% of the *With Profits Unit Value*, plus any *final bonuses* and less any *Market Value Reductions* (if applicable to the product version) that apply at the date of claim. Full details of the death benefit payable can be found in the policy literature.

The amount payable on any other claim is the *With Profits Unit Value* plus any *final bonuses* and less any *Market Value Reductions* that apply at the date of claim.
Unitised With Profits pension policies

The amount payable on claim is the *With Profits Unit Value*, plus retirement bonus (if applicable) plus any *final bonuses* and less any *Market Value Reductions* that apply at the date of claim.

The aim of setting claim values is that maturing With Profits policyholders should receive the full benefit of the profits earned by their own premiums. For conventional policies, this is assessed using *asset shares*. The claims on maturity/retirement should average 100% of the *asset share* over the long term. In any one year, the amounts paid out may be more or less than asset share. For unitised With Profits policies this is assessed using a *shadow fund*.

1.2.1.1 Asset shares

Asset shares are determined on a yearly basis for conventional With Profits policies. The *asset share* is built up month by month as follows:

Asset share at start of month	
Plus	premiums received
Plus	investment return
Minus	claims paid
Minus	charges for expenses
Minus	charges for guarantees (if applicable)
Plus or minus	profits from other sources

All items are based on the actual experience for the year. Where appropriate the investment return allows for tax including an estimate of the value of any future capital gains tax. Tax relief on expenses is also allowed for.

Currently, the only minor class for which *asset shares* are not calculated is whole life policies. For these, death claim values use the same *final bonus* rates as an endowment policy of the same duration.

Investment return

The investment return allocated to *asset shares* is the investment return earned on the relevant assets as described in section 2 below (or the long term fund for investment returns earned before 1 July 1997). This return is calculated gross of tax for pensions and ISA business and net of tax for other business. Equity Policies are deemed to be invested wholly in equities and therefore use a separately calculated investment return. At present there is no other hypothecation of different investment returns to different classes of With Profits policy.

Other factors

Past mortality and persistency assumptions are based on our actual experience as determined from periodic mortality and persistency experience investigations. Similar policy types are considered together for the purpose of these investigations.

The charges for expenses are based on expense allocations as described in section 4.

Charges to cover the cost of guarantees provided are not currently made although we reserve the right to deduct such charges from *asset shares* in the future.

For *IB* policies the same *asset share* parameters are used irrespective of whether the policyholder has selected the premium loan option or is continuing to pay premiums. An average premium collection cost is charged to the *asset share*, as described in section 4.2.

Miscellaneous profits or losses

The miscellaneous profits or losses that are currently credited or charged to *Open Fund asset shares* are as follows:

	Ordinary Business (OB)	*Industrial Business (IB)*	Pensions
Profits (losses) from non-profit business	credit (charge)	-	credit (charge)
Investment charge from the *MSS Fund*	credit	credit	credit
Profits (losses) from unclaimed *IB* policies written off	-	credit (charge)	-

In addition, some profits and losses are not credited or charged to *asset shares* as they are deemed to be negligible and others (e.g. subsidiary companies) are allowed for in the calculation of the investment returns.

The profits and losses from non-profit business include profits and losses arising from protection business, unit-linked business, annuity business and *MSS non-profit business*.

An investment charge is received from the *MSS Fund*. The amount of this charge is specified in the *Merger Scheme*. These charges are re-spread to provide an even percentage adjustment to *asset shares* in each year.

These profits and losses are calculated and expressed as an adjustment to the investment return for the period in question. Currently profits and losses are included in the year in which they are incurred, subject to any limits or restrictions described in section 3.2 (business risk). Items credited or charged to *asset shares* may have been different in the past and may change in the future.

Every year a number of unclaimed *IB* policies are written off. These are typically whole life policies where contact with the policyholder has been lost and the life assured is now over the age of 100, making it extremely unlikely that a claim will be made on the policy. However, if a claim is subsequently made the policy will be honoured. An uplift was granted to asset shares in 2016 and 2017 to allow for the expected future profits that will be made on policies written off. We will continue to monitor the expected IB write offs with any profits or losses being added to asset shares as they arise.

A transfer from *Industrial Business (IB)* to *Ordinary Business (OB)* is made every year to reflect the *OB* policyholders' position as members of *the Society*. It is typically a small percentage of the total *IB* surplus distributed each year. The amount transferred each year is recommended by the *Actuary*. The transfer is reflected in *asset shares* by charging *IB asset shares* and crediting *OB asset shares*.

Asset share procedures

Asset share parameters are set for each major policy class. Initial expense parameters are set for each year of entry. Other parameters are set for each class as a whole.

The basic underlying method has been described in papers presented to *the Board*. More detailed descriptions of the methods used are maintained within the Actuarial Department. Each year a document is created specifying the parameters relating to that year. These parameters are approved by the *Actuary*. No subsequent approval is needed where these figures are used in later year's calculations.

1.2.1.2 Shadow fund

For unitised With Profits policies two separate unit accounts are maintained. Every transaction that is carried out in the With Profits Unit Fund is mirrored in the *shadow fund*, by purchasing or encashing *shadow fund* units of the same proportion as those purchased or encashed in the With Profits Unit Fund. For an individual policy the value of the *shadow fund* holding reflects the *smoothed* investment return earned by that policy (after tax, as appropriate).

Shadow fund prices are usually set daily. *Movement in shadow fund* prices are derived from the unsmoothed investment return of the assets in the *With Profit Pool*. Where necessary, this is estimated until an accurate return is available.

The unsmoothed investment return is adjusted for profits or losses from other sources as described in section 1.2.1.1 and also for the expense and mortality profits or losses on policies for which a *shadow fund* operates. Charges may also be made to cover the cost of guarantees provided. A *smoothing* formula is then applied to determine the movement of the *shadow fund*.

Changes to the smoothing formula are reviewed by *the Board*. The parameters used for the *smoothing* formula at each review are documented and then approved by the *Actuary*. No subsequent approval is needed where these figures are used in later reviews.

1.2.2 Annual bonus

We currently aim to set *annual bonus* rates so as to leave a suitable margin between our long term best estimate of future investment returns and the rate that needs to be earned in order to be able to pay out the guaranteed sum assured and *annual bonuses* at maturity. When the margin being left is too large or too small, the *annual bonus* rates are moved smoothly towards the target rate. To assess the margin, we compare

- The amount of final bonus we currently expect to pay at maturity based on the long term best estimate of future investment returns, and

- The amount of final bonus we expect the margin described above to provide at maturity.

This comparison is performed for a number of specimen years of entry and policy terms for each product type. We would consider results from all of these specimen comparisons before deciding to change annual bonus rates.

The Board may vary the margin after taking advice from the *Actuary*. An equivalent method and the same margin are used in setting annual growth rates for unitised With Profits policies.

Annual bonus rates for conventional With Profits policies are set once a year. Whole life policies are given the same *annual bonus* rates as equivalent endowment policies.

In stable investment conditions regular bonus rates for unitised With Profits policies are also set once a year. However in more volatile conditions we review them more frequently. We would not expect to change them more frequently than quarterly.

There is no specific limit on the amount that *annual bonus* rates may change by when being re-set. Interim bonus rates are currently equal to the rate of *annual bonus* set at the most recent declaration.

1.2.3 Final bonus

Maturity & death claims - *OB* conventional With Profits policies

We aim to target maturity values (excluding Customer Reward Bonus) at 100% of *asset share*, subject to the application of our *smoothing* policy.

Final bonus rates are initially set for policies with terms that are multiples of five years. The rates for other policy terms are derived from these rates as follows.

- The change in maturity values between policies with the same term and premium maturing one year apart is set such that it is similar to the changes for the nearest policies with terms which are multiples of five years.

- The maturity value is compared with that of a policy that entered one year later. The difference should always be positive to reflect the value of having paid premiums for an extra year.

- The change in death benefit from one year to the next is assessed. In stable investment conditions *final bonus* rates are set so that this death benefit increases steadily.

When policies maturing during the following year were written on different premium rates, different *final bonus* rates may apply to policies written before and after the change. Normally the *final bonus* rates would be set so that the maturity values are similar for policies with the same premium.

The proposed maturity values are also compared with the premiums paid and when necessary the *final bonus* rates are increased to ensure that we treat customers fairly. This is assessed by considering whether the yield earned by the policyholder on the premiums paid is reasonable.

A guarantee is in place that the maturity values for certain low cost endowment policies as agreed by *the Board* will not be less than the original death sum assured. For these policies the *final bonus* rates determined by the above methods will be increased if required to ensure that this guarantee is met.

In most cases, the *final bonus* rates for death claims are the same as those set for maturing endowment policies with the same duration. For Whole Life policies this represents an approximation as no detailed *asset share* calculations are performed.

Maturity & death claims – IB policies

The process for setting *final bonus* rates for *IB* policies is similar to that described above.

Frequency of final bonus changes

Final bonus rates for the above With Profits policies are set at least once a year. When intermediate changes are made the current procedure for calculating *final bonus* rates is less detailed. Changes in maturity payouts are determined by considering the investment return achieved in the period since the last annual investigation and the investment return expected to be achieved in the period until the next annual investigation, with the aim of producing a reasonable transition from current maturity values to those likely to be payable after the next declaration. *Final bonus* rates are then set to achieve these changes, subject to a minimum of the guaranteed benefits.

Maturity & death claims – unitised With Profits policies

Final bonus is determined individually for these policies, by reference to the difference between the value of their *shadow fund* unit holding and the *With Profits Unit Value*. If the value of shadow fund units exceeds the *With Profits Unit Value* then a *final bonus* is payable. The *shadow fund* unit prices are determined as described in section 1.2.1.2.

Under certain circumstances (as set out in the policy conditions), we may apply a *Market Value Reduction* which would reduce the value paid out on claim below the *With Profits Unit Value*. The need for, and extent of, any *Market Value Reduction* is reviewed at least quarterly

Surrender & transfer values – conventional With Profits

Surrender values for all policies except conventional With Profits pensions are calculated with reference to a formula. For most policies the benefits that the policyholder would be entitled to if they retained their policy until maturity without paying any more premiums are calculated and then discounted back to the present time. An allowance is given for a proportion of the *final bonus* rates for maturity and death claims for the elapsed duration of the policy. The basis used in the calculation is determined taking into account our experience and further adjustment factors may be applied with the aim of surrender value payments being equal to *asset shares* on average over the long term.

For conventional With Profits pensions where the policyholder is aged 55 or more, the early retirement benefit is calculated based on the premium rates at the outset of the policy, and an adjustment factor applied if on average early retirement benefits are significantly higher than the value of the underlying assets.

For other conventional With Profits pensions, the surrender value is calculated by applying a factor to the premiums paid. The factors depend on term and duration and are calculated with the aim of surrender value payments being equal to *asset shares* on average over the long term.

Surrender bases are usually reviewed at least once in each calendar year. In stable conditions it may only be necessary to undertake a high level review of the adequacy of the basis.

Surrender & transfer values – unitised With Profits

Final bonuses are determined in the same way as for maturity and death claims on these policies. We may apply a *Market Value Reduction*, except where stated otherwise in the policy conditions. The need for, and extent of, any *Market Value Reduction* is reviewed at least quarterly.

1.2.4 Smoothing policy

Maturity & death claims

The cost of *smoothing* is intended to be broadly neutral over a period of 10 to 15 years. We have maintained a record of the cost to the *estate* of *smoothing* since 1991 to monitor whether our application of *smoothing* in the past has met this intention. The excess of maturity payments over *asset share* is recorded each year and is referred to as the *smoothing* cost. This record includes unitised With Profits policies for material classes. Currently, it excludes any excess of the guaranteed benefits over the *asset shares.* The cost associated with *Guaranteed Annuity Rates* is also excluded.

When determining maturity payouts for classes of policy for which *asset shares* are calculated, we aim to pay between currently 75% and 125% of *asset share*, subject to paying a minimum of the guaranteed benefits. Payouts may fall outside this range in some circumstances, but we will ensure that when we set payouts we have good reason to believe that at least 90% of those payouts will fall within the range. To do this, we investigate sample policies that represent groups of underlying individual policies. This use of sample policies is consistent with our *smoothing* approach for setting *final bonus* rates. It results in less disparity between the payouts for individual policies within each sample group than if we assessed payout ranges using individual policies. For example, there would be less disparity between the return on premiums paid for policies with larger or smaller premium sizes within each sample group.

In addition to applying the above payout range, our aim is that in stable investment conditions the change in maturity value or death claim value from one year to the next for equivalent policies should not exceed 10%. Subject to this, for each term of policy considered we currently aim to equate payouts to 100% of *asset share* within three or four years. To do this we project both maturity values and *asset shares* over this period, and take the current and eventual target position into account in setting bonus rates.

Larger changes in value than 10% may be required from one year to the next following volatile investment conditions, significant changes in economic conditions, or in either periods of prolonged low investment returns or periods of prolonged high investment returns. Where possible, these larger changes will be achieved by implementing more frequent changes in *final bonus* rates, although it may be necessary for a particular change in value to exceed 10% in order to achieve the required full year change. Larger changes may also be required for bonds with significant levels of annual income.

No limit has been set on the accumulated *smoothing* cost that is considered to be acceptable.

The same *smoothing* policy as described above is applied to all generations of conventional With Profits policies.

All unitised With Profits policies have benefits determined by reference to a *shadow fund* to which the above payout ranges and smoothing approach do not apply. The value of the *shadow fund* is based on *smoothed* investment returns as described in section 1.2.1.2. This means that *smoothing* is applied when premiums are received as well as when determining the claim value.

<u>Surrender & transfer values</u>

When determining surrender and transfer payouts for classes of policy for which *asset shares* are calculated, we aim to pay between currently 75% and 125% of *asset share*, subject to paying any minimum amount guaranteed. Payouts may fall outside this range in some circumstances, but we will ensure that when we set payouts we have good reason to believe that at least 90% of those payouts will fall within the range. To do this, we investigate sample policies that represent groups of underlying individual policies. This use of sample policies is consistent with our smoothing approach for setting *final bonus* rates. It results in less disparity between the payouts for individual policies within each sample group than if we assessed payout ranges using individual policies. For example, there would be less disparity between the return on premiums paid for policies with larger or smaller premium sizes within each sample group.

There is no limit on the change in surrender or transfer value for equivalent policies from one year to the next. However large changes will only be implemented following significant changes in investment conditions.

For conventional policies *final bonus* rates determined for maturity values are used directly in surrender value or transfer value calculations. These rates have already been *smoothed* in line with our current *smoothing* policy. However the full bases for these calculations are also reviewed from time to time by investigating a range of sample policies. We aim to set surrender and transfer value bases so that over the long term payments are on average equivalent to 100% of *asset share*.

The process for reviewing *Market Value Reductions* is similar except that no payout range applies. A range of sample policies are considered and a scale of *Market Value Reductions* designed to ensure that policy values on exit do not cause a significant loss to the fund.

Some unitised With Profits policy types allow policyholders to opt to receive regular income payments without these being subject to a *Market Value Reduction*. We do not currently take these payments into account when determining the cost of *smoothing*. This cost therefore falls to the *estate*. If in future this was felt to be significant then we would include these payments in the calculation of the cost of *smoothing*.

2. Investment Strategy

2.1 Principles

2.1.1 General

The assets of *the Society* identified as backing linked liabilities (e.g. unit-linked policies) are referred to as the linked assets. The remainder are the non-linked assets.

Since July 1997, the non-linked assets have been split into a *Non Profit Pool* and a *With Profit Pool*, in accordance with the *Merger Scheme*. The *Non Profit Pool* is established by matching specific fixed interest assets to the non-profit liabilities. The remainder of the non-linked assets form the *With Profit Pool*.

The majority of the non-linked assets are not formally segregated between the *MSS Fund* and the *Open Fund*. However, the *Merger Scheme* specifies that certain assets (the Own Assets) belong to the *Open Fund* only. These are predominantly investments in subsidiary companies, and fixed assets.

As required by the *Merger Scheme*, the overall investment return earned on the *With Profit Pool* is then used to determine the investment return for both the *Open Fund* and the *MSS Fund*. The investment return on the *Open Fund* is adjusted for the performance of the Own Assets. Within the *Open Fund*, asset allocation might vary between different parts of the Fund. In this event the asset allocation for the *MSS Fund* will be the same as that for the *Open Fund asset shares*, except for the Own Assets.

The underlying principle is compliance with the *Merger Scheme*.

The overall investment strategy for the *With Profit Pool* is to maximise the investment return achieved by the assets, allowing for income and capital growth and the effects of taxation. This is subject to an acceptable level of risk and any actuarial constraints.

The main factors driving the strategy are:

- Risk will be managed by following a suitable diversification policy based on asset allocation guidelines.

- Actuarial modelling will be used to assess the overall risks to the *Open Fund* and the *MSS Fund* of different asset allocations, with particular attention to guarantees within the liabilities. This will be a significant input into the asset allocation guidelines.

- This input will be used to help determine the equity content of the *With Profit Pool* which will, where appropriate, be above the industry average. Performance will therefore be dependent on the UK stockmarket and other major stockmarkets worldwide. This aim is subject to the constraints in 2.1.3 below. Publicly available information will be used to determine the unweighted average equity content of other life insurance companies from time to time.

We do not aim to buy *derivatives* or similar instruments as part of the investment strategy whilst our financial strength is sufficient to allow this approach. *Derivatives* might however be purchased to cover certain specific risks or where we determine that they provide a specific strategic advantage.

2.1.2 Non-traded assets

The *With Profit Pool* includes some assets that would not normally be traded. These include our Head Office building and investments in subsidiary companies. Investments in subsidiaries can assist us in generating sufficient new business to cover our distribution costs and overheads. The performance of these subsidiaries is monitored to confirm that we expect them to continue to help us achieve our strategic objectives, and that the expected benefits are sufficient in the context of the risks involved. We do not impose specific limits on the scale of these investments, as they have always been only a small percentage of the total assets. The profits or losses from these investments are included in the *Open Fund* investment return and hence included in *asset shares*.

We do not impose any general liquidity or credit requirements on the non-traded assets. The subsidiaries are expected to operate within the normal risk and liquidity profile of the business which they undertake.

2.1.3 Constraints on investment strategy

In addition to the considerations of risk mentioned in 2.1.1 our investment strategy may also be constrained by the need to treat With Profits policyholders fairly, which includes striking the right balance between achieving good returns for policyholders and maintaining solvency. We also set limits on our exposure to any one counterparty. For instance, *the Board* sets limits on the amounts placed with any one deposit taking institution. These limits reflect the size and status of such institutions and are reviewed from time to time.

2.2 Practices

2.2.1 General

The Board is responsible for setting our policy regarding the acceptable level of risk within the investment portfolios. This includes responsibility for the approval of any new or novel investment instruments.

The Executive Committee has responsibility for detailed monitoring of the investment parameters agreed by *the Board*. A Statement of Investment Principles is also maintained for each fund and the Executive Committee formally review this annually.

Specific assets are held for the Non Profit Pool and for the linked assets. Derivatives are held to match the liability arising from guaranteed annuity options on particular types of policy in the MSS Fund. These derivatives are held within the surplus assets of the MSS Fund so have no impact on asset share investment returns.

The investments currently permitted for the *With Profit Pool* are all listed and unlisted UK and international securities (e.g. equities, government and other fixed interest or index-linked stocks, convertibles, warrants and subsidiary companies), unit trusts, OEICs, property, cash and other money market instruments, including *derivatives*. Any use of *derivatives* requires Board agreement.

The *With Profit Pool* will operate within asset allocation guidelines, which consist of maximum and minimum percentages for each asset type. These ranges and the position within the range are discussed in detail regularly at Executive Committee meetings and the actual asset allocations are published half-yearly on our website. Detailed strategies are adopted for investment in each of equity, property, cash and corporate bonds as set out below.

Our current policy regarding exercise of rights is to vote where appropriate, particularly in relation to contentious issues or where *the Society* has a significant stake in the company concerned.

2.2.2 Equity strategy

The main points of the equity strategy for the *With Profit Pool* are:

- The majority of investments are held over the long term rather than actively traded.
- The percentage of equities invested outside the UK is subject to an agreed range.
- Capital Gains Tax planning may influence decisions on sales of individual stocks.
- There is a short term equity sales plan in place which would operate at very low stock market levels, to safeguard solvency.

2.2.3 Property strategy

The main points of the property strategy for the *With Profit Pool* are:

- The majority of property investments are held over the long term rather than actively traded.
- When buying new properties we normally look to purchase high quality freehold or long leasehold assets let to strong covenants.
- Sales are considered where the unexpired term on a lease is relatively short or where it is felt that there are limited prospects for future growth or where an exceptional sale figure can be achieved, e.g. to a special purchaser.
- We seek to maintain diversity in our property holdings both by location and by type of property.

2.2.4 Cash strategy

The main points of the cash strategy for the *With Profit Pool* are:

- We normally invest in time deposits with a range of authorised borrowers.
- Most of our deposits are kept relatively short (up to 6 months) for cash management purposes.
- As well as Sterling, we may also hold balances in other major currencies, often with a view to investing in equity and bond markets overseas when we feel the timing is appropriate.

2.2.5 Fixed interest strategy

The main points of the fixed interest strategy for the *With Profit Pool* are:

- The majority of fixed interest investments are held over the long term rather than actively traded.

- We focus almost entirely on corporate bonds with a credit rating of BBB- or better and Government backed securities.

- We invest selectively from new issues of bonds and trade in the secondary market in line with our long-term buy and hold strategy.

2.2.6 Non-traded assets

The main assets that would not normally be traded are:

- Our Head Office building in Birmingham;
- Subsidiary companies; and
- Fixed assets.
- *Seed capital* to subsidiaries and related parties.

These assets are in total only a small percentage of the *With Profit Pool*. They do not result in any constraints on our investment freedom, although the Head Office building is included in the property portfolio, to which a suggested range is applied.

Whilst we do not apply a limit on the size of individual subsidiary investments, we monitor the total level of assets held as subsidiary companies; this total will not normally be more than 6% of the Open Fund invested assets. The *Actuary* will consider this limit when any proposal is made to invest in an additional subsidiary company. The With Profits Committee regularly monitor the level of *seed capital* and any potential impact on policyholder returns.

The investment return earned on the Head Office building and on subsidiary companies is included in the investment return of the *Open Fund*, with the exception of any subsidiary company profits and losses that the Board decides should be allocated to specific parts of the Fund, such as the *estate* or particular groups of policyholders. The fixed assets are not ascribed any investment return.

2.2.7 Other asset classes

The main points of the other asset classes strategy for the *With Profit Pool* are:

- The Society may invest in asset classes other than those listed in sections 2.2.2 to 2.2.6.

- Investment in such assets will generally be in line with our overall strategic approach.

- The Society currently has relatively modest exposure to other asset classes – mainly infrastructure and private equity.

- Our investment in other asset classes will normally be achieved through investing in some form of investment trust or other pooled fund.

3. Business risk

3.1 Principles

The *Open Fund* is exposed to the business risks of subsidiary companies as well as the business risks arising from the operation of long-term insurance itself.

The Society itself can only carry out long-term insurance business. However, we may invest in subsidiary companies if over the long term we expect that the resulting investment return, and value of other benefits we expect to accrue to *the Society*, is better than the return that would be expected on ordinary investments. Such investments are reflected in the investment return earned on the *Open Fund*.

The Board will decide whether to undertake a particular business risk, and has the responsibility for reviewing and setting a limit on the scale of such risks. Where appropriate, limits will be set for individual risks.

In the event that the *MSS Fund* was unable to pay its guaranteed liabilities, support would be provided by the *Open Fund*.

If the size of the *estate* were to fall below the level required to provide adequate capital for the *Open Fund* then it might become necessary for policyholders to bear directly risks which are currently borne by the *estate*. In that event some charges may be deducted from policyholders' *asset shares* instead of being met by the *estate*.

Any compensation costs will be met from the *Open Fund*, other than those arising from policies issued by *Medical Sickness Society* before the merger with Wesleyan, which are met from the *MSS Fund* in accordance with the *Merger Scheme*.

3.2 Practices

When approving an individual business development project or a major strategic project, the Board will establish controls around the project to ensure a suitable balance between risk and reward, including reviews as appropriate of:

- Profitability in comparison with other uses of capital (i.e. the reward)
- The sensitivity of profits to changed assumptions (i.e. the risk)
- The capital allocated to the project; for major strategic projects, capital modelling will be undertaken

Subsequently, in addition to the normal financial monitoring process, more detailed reviews will be undertaken as the Board deems appropriate.

Our long-term insurance business is exposed to morbidity and mortality risks. We are also exposed to the risks arising from persistency (i.e. the rate at which policies lapse or are surrendered), from guarantees we provide in policies and from our *smoothing* policy.

The Society’s liabilities include annuity business arising from *bulk annuity buyouts*. *Open Fund Ordinary Business (OB)* and *Open Fund* pensions With Profits policyholders are exposed to any associated longevity risk.

We have guaranteed the liabilities of subsidiary companies in order to protect the value of these investments by the *Open Fund*.

From 2018 onwards, the level of expenses to be charged to IB business for the administration of each policy will increase by a defined formula. Any profit or loss from these expenses being different to the actual costs will be attributable to the estate.

We also increase the level of expenses to be charged to the *MSS Fund* for administration of each policy in line with a defined formula, so the *Open Fund* carries the risk that the expenses will be larger or smaller than expected.

Risks

We are also exposed to risks arising from:

- falls in stock markets or the value of individual investments;
- the failure of reassurers or other suppliers;
- the inability to easily sell investments for cash;
- weaknesses in internal controls over our operations;
- costs in excess of those allowed for in premium rates and policy charges; and
- mortality and investment experience in the Society's staff pension scheme, which may result in a surplus or deficit affecting the required contribution rate.

The Board aim to achieve a balance between the interests of different classes of with-profit policyholders, having regard to the advice of the *Actuary*. *The Board* may take external advice when making these decisions.

Each year *the Board* sets our "risk appetite". This is an overall assessment of the degree of risk to which we are willing to be exposed. Any new exposure is considered beforehand based on reports, which relate back to the risk appetite.

We monitor risks through regular reports on those risks and their mitigation. Actions to mitigate these risks are agreed and their implementation is monitored. Whenever appropriate, limits are set on the amount and type of new business, based on the advice of the *Actuary*. Action may also be taken to limit risks from existing business.

For new business, in our calculation of premiums and assessments of profitability we make an allowance for the additional risks being taken compared with investing in ordinary types of investment. We also use sensitivity tests or investment models to examine the risks and achieve a balance between risks and rewards.

For existing business, we examine the possible actions (such as reassurance) we could take to mitigate risks. These are benchmarked against not taking any action to determine what action, if any, should be taken.

Treatment of business risks in policy benefits

We consider each business risk separately to decide how to reflect the profits and losses from that risk in the *asset shares* and *shadow fund* values of with-profits policies. *The Board* determines the treatment of each business risk, based on the advice of the *Actuary*.

Some risks (e.g. the purchase of an IFA subsidiary) are regarded as investments by the *Open Fund*, and allowed for in the calculation of the investment returns.
Some risks (e.g. profits or losses from life and pension non-profit business, and the investment charge received from the *MSS Fund*) produce miscellaneous profits and losses, which are added to or subtracted from the investment returns earned in each year in determining *Open Fund asset shares*.

These adjustments are not generally *smoothed* before being applied to *asset shares*. However, on the advice of the *Actuary*, the impact of particular profits or losses may be spread over a period in order to reduce their impact on policy values in the year in which they occur. The only adjustment currently being spread in this way is the profit from investment charges being received from the *MSS Fund.*

The *Actuary* may decide that the impact of some business risks is sufficiently small that they can be ignored in calculating *asset shares* or *shadow fund* values.

The *Actuary* will also recommend which classes of policyholder in the *Open Fund* bear each business risk. Policyholders' *asset shares* are credited with the profits or charged with the losses arising from the appropriate business risks as described in section 1.2.1.1. For this purpose the classes of policyholder considered are *Industrial Business (IB)*, *Ordinary Business (OB)* and Pensions Business. The following table shows which classes of policyholder currently bear various risks. These and other risks may have been borne differently in the past.

Type of risk	Class of business			
	IB	OB	Pensions	*Estate*
OB With-Profit Business (except some guarantees)		X	X	
Pensions With-Profit Business (except some guarantees)		X	X	
Industrial Business (except some guarantees)	X			
OB and Pensions non-profit business including *bulk annuity buyout* business		X	X	
Income protection business		X	X	X
MSS Fund underlying guarantee				X
MSS Fund policy expenses guarantee				X
Guarantees under Select Investment Bonds and Wesleyan Growth Bonds				X
Guaranteed Annuity Rate options				X
Guaranteed maturity values that apply to certain low cost endowment policies				X
Subsidiary companies*	X	X	X	X
Staff Pension Scheme				X
IB policy expense guarantee				X

*apart from any subsidiary company profits and losses that *the Board* decides should be allocated to specific parts of the Fund, such as the *estate* or particular groups of policyholders.

Any assets purchased specifically for the *MSS Fund* significantly reduce the risk arising from the underlying guarantee provided by the Open Fund. In recognition of this, the *estate* meets one-third of the cost of buying these assets. The other two-thirds are met directly by the *MSS Fund* itself.

In order to treat our customers fairly, in adverse circumstances a maximum overall charge equivalent to 1% of With Profits policy *asset shares* would be made in any one year in respect of non-profit business.

In extreme adverse circumstances, however, we will relax this limit. This would be a temporary relaxation until capital has returned to an acceptable level. Further action might also be taken as described in section 5.2.

4. Charges and expenses

4.1 Principles

Our overall aim in applying charges and allocating expenses to With Profits policies is to charge policyholders the costs incurred in selling and administering policies, plus an appropriate share of overheads.

For conventional With Profits policies expense allocations determined as above are deducted from the *asset shares*.

For unitised With Profits policies the difference between the explicit charges and the actual expenses incurred may be reflected in the calculation of the amounts payable under these policies.

Investment costs are charged in proportion to the size of the investment. Sales costs and commission payments are charged in proportion to premium size. Other costs are charged as an amount per policy.

The basis for applying charges and allocating expenses may change if our practices for operating the business change or if an expense investigation indicates that an alternative method of charging is more appropriate.

4.2 Practices

We currently charge With Profits policies their fair share of expenses incurred in distributing and administering policies. These include selling costs, underwriting costs, servicing costs, the cost of paying claims, investment costs, and a share of overheads.

The costs are first allocated to the appropriate part of the business, *Industrial Business (IB)*, *Ordinary Business* or Pensions. Where direct allocation is not possible we use time analyses and other methods to apportion the costs. Costs are also divided into acquisition and maintenance costs. The amount of new business written each year is analysed and used to estimate the proportion of acquisition costs that relate to With Profits business. A similar estimate is made for maintenance costs. This is based on the volumes of in-force business.

The direct costs of buying and selling investments are allowed for in calculating the investment return earned on the assets. Other investment costs are analysed separately. They are charged for by slightly reducing the investment return that is credited to *asset shares*. The amount charged is therefore proportional to the size of the investment.

On the advice of the *Actuary*, the impact of exceptional expenses may be spread over a period in order to reduce their impact on policy values in the year in which they occur.

<u>Conventional policies (except IB business)</u>

The costs described above are charged to the *asset share*.

IB business

The expenses allocated to IB policies will increase in line with a defined formula. Any profits or losses from these expenses being different to the actual costs will be attributable to the estate.

Unitised With Profits policies

The charges that are currently applied are set out in the policy literature. No other charges are currently made. However expense profits and losses may be allowed for when calculating the *shadow fund* return in future by comparing the charges made with the actual expenses incurred.

Costs determined by *the Board* as being met by the *estate* will not be passed on to current policyholders. These costs may then be recouped by the *estate* from future profits.

For *IB* policies the premium collection costs charged to the *asset share* are the average of the actual collection costs associated with the different collection methods, including an allowance of 22% of premium for policies with the premium loan option.

Material outsourcing agreements, which cover the supply of some of our computer services requirements, are in operation. In addition, our unit trust subsidiary company has outsourced its administration. These agreements require us to give twelve months' notice to terminate the contract.

The criteria for the allocation of expenses between the *MSS Fund* and the *Open Fund* are set out in the *Merger Scheme*.

There is an internal reassurance arrangement in place between the *MSS Fund* and the *Open Fund* which guarantees the level of expenses charged to the MSS Fund, as described in section 3.2. This has no impact on the expenses charged to *Open Fund asset shares*

The costs directly incurred by the subsidiary companies are charged to those companies, with the exception of any subsidiary company profits and losses that the Board decides should be allocated to specific parts of the Fund, such as the *estate* or particular groups of policyholders. Similarly, the Board may decide, on the advice of the *Actuary,* that some income received by a subsidiary company from *the Society* should not be included in the subsidiary company's profits or losses for the purposes of *asset shares*, in which case it will also not form part of the expenses charged to policyholders. Other costs are apportioned equitably between companies based on the results of the internal expense investigation.

5. Management of the estate

5.1 Principles

We view the *estate* as being for the benefit of current and future policyholders; current policyholders are not entitled to expect the *estate* to be distributed to them in normal circumstances. The management of the *estate* is not constrained by any previous corporate arrangements. The *estate* is not divided between any classes of policy or between *Industrial Business (IB)* and *Ordinary Business*. The *estate* does not include any excess of assets over *asset shares* in the *MSS Fund*. The assets of that fund are used solely for the benefit of the policyholders in that fund. In the event that the *MSS Fund* was unable to pay its guaranteed benefits to its policyholders, the *estate* would provide the required support for that Fund.

We monitor the size of the *estate* over time having regard to the volume, range and nature of the business, and ensure that the uses to which the *estate* is put, and all payments to or from it, are reasonable and appropriate.

We aim to provide the security of a strong *estate*, both relative to other companies and as far as possible in absolute terms, to reduce the constraints on our investment freedom. However, there are no specific targets for the size of the *estate*. *The Board* receives actuarial advice regarding the risks to and impact on the *estate* arising from all aspects of the running of the business, to ensure that the *estate* is managed appropriately.

The *estate* is primarily used for the following purposes:

- to meet regulatory capital requirements;
- to finance the cash flow strains which arise from new policies we write or from policies already written;
- to enable us to invest a higher proportion of the *With Profit Pool* in equities and property;
- to *smooth* the payouts to With Profits policyholders;
- to meet some guarantee costs, where *the Board* have established that the *estate* has taken the guarantee risk or have determined that the guarantee cost is exceptionally high and should not be charged in full to policyholders;
- to provide finance for business developments with an expectation that the *estate* will recoup its investment from future profits; and
- to meet *exceptional costs.*

Some of these uses might be given precedence over others, particularly if the *estate* were to become too small.

5.2 Practices

The following costs have currently been identified as being met by the *estate*.

- The cost of no-*Market Value Reduction* guarantees for certain products where no MVR guarantees apply under the policy terms. This does not include the cost of no-*Market Value Reduction* guarantees on death; this cost is deducted from asset shares.

- The cost of *Guaranteed Annuity Rates (GARs)* included in some *Open Fund* pension policies.

- The cost of the guarantee that the maturity values under certain low cost endowment policies as agreed by *the Board* will not be less than the death sum assured.

- Profits or losses that are not considered material enough to justify measuring them accurately in order to make the appropriate charges to *asset shares*.

- The cost of collecting IB premiums if it exceeds 22% of the in-force premiums.

- Profits or losses arising from the expense arrangement given to IB policyholders.

- The cost of compensation arising from the pension, FSAVC and endowment mortgage mis-selling reviews in respect of *Open Fund* policies, the cost of administering those reviews, plus all current compensation costs other than those met by the *MSS Fund*.

- The cost of running the business in excess of the costs charged to policyholders.

- Profits or losses arising from the expense guarantee given to the *MSS Fund*.

- The cost of entering new markets for the Society.

- The cost associated with the Mutual Reward Scheme.

- The costs arising from staff pension scheme risks, other than the cost of each year's accrual of pension.

The costs of most new strategic developments are not currently regarded as *exceptional costs* and hence are charged to policyholders. Costs previously charged to the *estate* may be recouped by the *estate* from future profits.

The *estate* forms part of the *Open Fund*. The assets backing the *estate* are as described in section 2 above.

There are guidelines in place which are used to help assess whether the *estate* is too large and the options to be considered if it is, but there is no fixed limit on the maximum size or scale of the *estate*. When considering whether it is too large we take into account various matters including:

- the desire to maintain an unrestricted investment strategy;
- the possibility of a major failure of a reassurer or other counterparty of the Society;
- the extent to which we wished, or might wish, to offer contracts with guarantees needing the backing of a strong *estate*; and
- the fact that, as a mutual Society, sources of external capital are limited.

If *The Board* judge that the *estate* is too large then we may distribute part of the *estate* to With Profits policyholders or a sub group of With Profits policyholders as deemed appropriate.

If the *estate* became so small that the minimum regulatory capital requirement was threatened, we would take whatever action was necessary to maintain that capital. In the short term this would mean invoking a plan for gradual sales of equities, or the use of suitable equity *derivatives*, to reduce both asset volatility and the regulatory capital requirement. In the medium term, further measures would be considered, such as paying less than full *asset share* and/or charging other losses to *asset shares*, reducing *annual bonus* rates, changing further the investment mix of the *With Profit Pool*, or closure to new business.

In the past, practices may have varied from those given above.

6. New business volumes and arrangements on stopping selling new business

6.1 Principles

To consider the volume of new With Profits business and non-profit business that can be written in the *Open Fund* we carry out projections of the future financial strength of the fund assuming differing levels of new business, and a range of different future economic scenarios.

The sustainability of the financial strength of the fund in different circumstances is investigated and reported to *the Board* along with the risks and the associated capital requirements. Based on these results *the Board*, having taken advice from the *Actuary*, considers whether any limits need to be imposed on the volume of new business to be written.

If the *Open Fund* ceased to write material amounts of new With Profits business, for example if the only new business was increases in premiums under existing business, we would carry out a full strategic review of the options available.

The options to be considered could include, but would not necessarily be limited to:-

- ceasing to write any new business;
- continuing to write new non-profit business;
- seeking a merger with another insurance company;
- continuing to distribute other providers' products to customers, via a subsidiary company; or
- demutualisation.

For each option considered, *the Board* would review the impact on *the Society*, in particular with regard to investment policy, *smoothing* policy and the management of the *estate*. Some options could lead to the eventual distribution of some of the *estate* to policyholders, subject to retaining sufficient capital to meet regulatory requirements and ensuring that suitable investment and *smoothing* policies could be followed. However, other options under which *the Society* was continuing to operate independently would not lead to such a distribution.

The circumstances of any closure to new business could have a significant bearing on the action taken regarding the management of the *estate*. For example, different action would be likely to be taken if the assets and liabilities were to be transferred to another insurance company, compared with *the Society* remaining independent.

6.2 Practices

In considering the size of any limits that need to be imposed on the volume of new business written within the *Open Fund*, *the Board* will take into account the volume of new business that is likely to be written. This is determined by *the Society's* budgeting process.

If it were planned to write specific products that carry particular risks for the fund such as significant guarantees, a limit would be placed on the maximum volume for each such product. The *Board* would set this limit after taking advice from the *Actuary* on the risks to our financial strength of such products, taking into account ways of mitigating these risks, such as reassurance or hedging strategies.

Any limits set would have regard to the time period during which such new business is expected to be written and the spread of the dates over which guarantees apply.
The overall aim in setting such limits is to ensure that the fund is not exposed to risks that could jeopardise its financial strength. These risks however would be balanced against the advantage of writing sufficient new business to cover our overheads.

A significant proportion of the total business within the *Open Fund* may be non-profit business (including linked business). The aim of writing such business is to offer a wider range of products or fund choices to customers. We also aim to make reasonable profits from this business as currently these enhance the returns to with-profit policyholders without causing undue additional risks. A limit may be set on the volume of particular non-profit products if the additional risks are judged to be disproportionate to the expected benefits.

We also consider the minimum amount of new business that should be written to justify the *Open Fund* remaining open to new business by considering the contribution that new business makes to meeting our fixed costs.

If a sufficient volume of new business could not be written to cover our costs, then *the Board* would consider whether it was justifiable that the fund remained open to new business and would take advice from the *Actuary*. This may arise following a rapid reduction in new business or a gradual reduction over a long period.

If *the Board* concluded that the fund should not remain open to new business then a plan would be developed and communicated to members. This plan would depend upon the financial strength of *the Society* at that time, the projected future strength under different economic scenarios, and the extent, if any, to which financial support from outside the *Open Fund* may be available in future. We would also reassess the risks to the fund, for example any risks arising from guarantees within the business, and consider action to mitigate such risks.

If the amount of new With Profits business became too small in relation to the volume of existing With Profits business then, unless this was expected to be temporary, we would carry out a full strategic review and investigate a range of options for the future of the Fund.

7. Shareholders

7.1 Principles

Wesleyan Assurance Society is a mutual organisation with no shareholders.

Glossary

Actuary	The Society's Actuary as defined in our rules. Under PRA and FCA rules, *the Society* is required to appoint a With Profits actuary and a Chief Actuary. The With Profits actuary provides advice to *the Society* on the operation and management of its With Profits business and the exercise of discretion. The Chief Actuary advises *the Society* on the risks that it faces and on the amount of capital required to support the business. These two roles may be undertaken by the same person advising *the Society* in different capacities. Any reference to Actuary in the text means the more appropriate of these two roles.
Annual bonus(es)	Bonuses which are added each year to With Profits policies to increase the guaranteed benefits payable.
Annuity	A series of regular payments made to a policyholder for a specified period of time: for example, until death.
Asset share(s)	A measure used as a guide to a policy's fair share of the fund, calculated as described in section 1.2.1.1.
The Board	The Board of Directors of Wesleyan Assurance Society.
Bulk annuity buyout	A collection of annuity policies for a group of people purchased from a single source such as an occupational pension scheme or another life assurance company.
Customer Reward Scheme	A scheme under which Wesleyan added extra annual bonuses to policies, funded from the *estate*. The scheme was discontinued in 2003.
Derivatives	Financial instruments, the prices of which are directly dependent upon the value of one or more underlying securities. They are often used to hedge risk or to exchange a floating rate of return for a fixed rate of return.
Estate	The amount by which the assets of the Society exceed the *asset shares* and other anticipated liabilities of the current in-force policies, and represents our financial strength.
Exceptional costs	Costs which, in the view of *the Board,* it would not be reasonable to charge to *asset shares.*

Final bonus(es)	A bonus which is added to a policy when it becomes a claim. Final bonus rates are not guaranteed.
Guaranteed Annuity Rates (GARs)	A guaranteed minimum rate at which a retirement fund built up under a pension policy is converted to an annuity.
Industrial Business (IB)	Life assurance business sold under the Industrial Assurance Acts 1923 to 1958 under which the premiums were originally contracted to be collected door to door.
Market Value Reduction	A reduction in the value of the units in the With Profit Fund on payment of a surrender value, death value, transfer value or early retirement fund value in circumstances where the policy's fair share of the fund is below the value of the units.
Medical Sickness Society	Medical Sickness Annuity and Life Assurance Society Limited. This company merged with Wesleyan in 1997.
Merger Scheme	A Scheme approved by the Court which sets out how the merger of Wesleyan with *Medical Sickness Society* on 1 July 1997 should take place, and how the *Open Fund* and the *MSS Fund* should be managed thereafter. The current interpretation of the Merger Scheme is described in the PPFM. If there are any changes to this interpretation then compliance with the *Merger Scheme* takes precedence.
MSS Fund	A closed fund set up under the terms of the *Merger Scheme*. It contains all the with profit policies of *Medical Sickness Society* in-force on that date and is maintained as a separate account within the Wesleyan's Long Term Business Fund.
MSS non-profit business	Non-profit policies sold by *Medical Sickness Society* prior to the merger with Wesleyan. As a result of the merger these policies became part of the *Open Fund*.
Non Profit Pool	A subset of the assets of the *Open Fund*, chosen to match the nature and term of the non-profit liabilities as closely as reasonably practicable.
Open Fund	The Wesleyan Long Term Business Fund excluding the *MSS Fund*.
Ordinary Business (OB)	Life assurance business excluding *Industrial Business* and pensions business.

Persistency	The rate at which policies lapse or are surrendered.
Seed Capital	Start-up capital for related party or subsidiary.
Shadow fund	A unit account used in the calculation of a policy's fair share of the fund as described in section 1.2.1.2.
Smoothing	Smoothing is an important and fundamental aspect of With Profits policies, allowing policyholders to benefit from investment in the stock market, but with the short-term highs and lows evened out.
The Society	Wesleyan Assurance Society.
With Profit Pool	The group of assets that back the Society’s With Profits business, as described in section 2.1.1.
With Profits Unit Value	For unitised with profits policies, this is equal to the amount paid into the policy, less charges plus *Annual bonuses*, but excluding *Final bonus*. The With Profits Unit Value is the minimum amount which would be paid out on maturity or surrender of a policy unless a *Market Value Reduction* is applied.