Annual Report to With Profits Policyholders 2016

11 May 2017

Wesleyan Assurance Society (Open Fund)

Wesleyan Assurance Society
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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.

Introduction

This is the Society's annual report to the Open Fund with profits policyholders covering compliance with our Principles and Practices of Financial Management (PPFM) and the exercise of discretion. This report is in respect of the financial year ended 31 December 2016, including the bonus declaration in respect of that year made in March 2017.

The Open Fund includes all policies other than those in the MSS Fund. The MSS Fund consists of the in-force with profits policies sold by Medical Sickness Society before the merger with Wesleyan in July 1997.

We publish the PPFM on our website. This document describes the way we manage the Open Fund with profits business. It also includes a Glossary of some of the most common technical words and phrases, which may be useful when reading this report.

We have also compiled a set of guides called "How our With Profits Fund works", which are also available on our website. These explain some of the phrases used in this report, such as Market Value Reductions, smoothing and bonuses.

Opinion

We believe that, throughout the year, the Society has complied with its obligations relating to the PPFM; has exercised discretion in a fair manner; and has addressed fairly any competing or conflicting rights, interests or expectations of policyholders (or groups of policyholders) including the competing interests of different classes and generations.

Our reasons for that belief are set out below.

Governance Arrangements

The Society's Board takes overall responsibility for the PPFM in the course of managing the Society for the benefit of current and future policyholders. The Board has also established a With Profits Committee (WPC). Members of the WPC are appointed by the Board and are made up of non-executive Directors and external appointees.

The WPC's main role is to give advice, and make recommendations, to the Board on:

- the way in which the Open Fund and MSS Fund are managed by the Society;
- whether the Society is complying with the PPFMs; and
- whether the Society has identified and addressed effectively the conflicting rights and interests of with-profits policyholders and other policyholders or stakeholders of the Open Fund and MSS Fund in a way that is consistent with treating customers fairly.

Day-to-day activity is more closely monitored by management. The WPC also considers changes to the PPFM as and when required, and advises the Board accordingly.

The Society's Chief Actuary, Tim Pindar, carried out the role of With Profits Actuary throughout the year. The With Profits Actuary advises the Board on the key aspects of the discretion to be exercised in respect of the with profits business.

Compliance with each section of the PPFM is also monitored and compliance confirmed formally (with evidence) by the appropriate person(s).

The Society has taken advice from the WPC and the With Profits Actuary in preparing this report.

Additional Reports

The With Profits Actuary is also required to provide a report to with profits policyholders. This is attached to this report as an Appendix.

The WPC may also make a separate statement, or report, to with profits policyholders in addition to this report, if they wish. The WPC has decided that no report is necessary this year.

Policy Benefits

All of the changes to policy benefits paid on death or maturity during or in respect of 2016 were made after taking advice from the WPC, based on detailed reports and recommendations provided by the With Profits Actuary and after discussion with him.

Asset Shares

Asset shares, which form the basis for determining payouts on with profits business, were determined for relevant classes of business as described in the PPFM. The With Profits Actuary approved the parameters used in the calculation.

The PPFM describes the miscellaneous profits or losses that are currently credited or charged to asset shares, the way in which they are charged and any limits imposed. The approach taken during 2016 was in line with the PPFM.

The Society has a large number of small "Industrial Branch" (IB) policies in force, many of which do not result in a claim and the policyholder cannot be traced. The value of these unclaimed policy values is used to increase the asset shares of other IB policies. During 2016, we changed the way this is done, to increase asset shares sooner based on expected numbers of unclaimed policies in the future. This will increase payouts to IB policyholders over the next few years.

Policies Where Premiums are Used to Buy Units

These unitised with profits policies use a shadow fund to determine the value of the policy, allowing for smoothed investment returns over the period since each investment in the fund was made. During 2016, prices were calculated monthly using the estimated year to date investment return and a formula as described in the PPFM.

Annual Bonus

Annual bonuses accumulate and, once added, are guaranteed to be paid on claim at maturity or death. 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.

The investment return applied to asset shares in 2016 was well above our expected return, following two years of returns below expectation. We have lowered our expectation of future returns, largely due to continuing low gilt yields, but given the good 2016 return we have been able to maintain our annual bonus rates for 2016.

Final Bonus on Maturity or Death

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 our smoothing policy, as described below.

For unitised with profits business, the final bonus depends on the difference between the value of the shadow fund and the value of the units purchased. This will change on a daily basis.

For all other with profits business, we normally change final bonus rates twice a year. Most payouts were decreased with effect from 1 January 2017.

Following the bonus declaration in March 2017, payouts were generally lower than those on policies maturing in the previous year with the same policy term. However, as the investment return earned on our asset shares during the second half of 2016 was above our expected return, payouts were generally higher than we had been forecasting.

Since 2005, we have guaranteed that the original mortgage amount will be repaid under all Open Fund mortgage endowment policies. Any resulting additional payments above asset share will be financed from the Society's estate and will not be met by paying lower benefits to other policyholders. The cost of this guarantee in 2016 was not significant.

Surrender and Transfer Values

In 2016, we carried out reviews of surrender values and transfer values for policies where premiums are not used to buy units (conventional with profits business). Surrender values for life policies generally increased as a result of the review. Transfer values for pension policies were mostly reduced from April 2016, in order to better match asset shares.

Market Value Reductions

For unitised with profits contracts, the surrender value is the value of units, to which a Market Value Reduction (MVR) may apply if the policy's fair share of the fund is lower. The need for MVRs is reviewed regularly and no MVRs were required in 2016.

Smoothing Policy

When determining payouts for maturity and death claims, we currently aim to equate average payouts to 100% of asset share within three or four years. In stable investment conditions we aim to change maturity values by no more than 10% from one year to the next, though the PPFM states that larger changes may be required following volatile investment conditions, significant changes in economic conditions, or in either periods of prolonged mediocre investment returns or periods of prolonged high investment returns. For further details, please refer to the relevant 'How our With Profits Fund Works' document on our website (www.wesleyan.co.uk).

Almost all full year changes were less than 10%. However, full year reductions of more than 10% have been applied to some longer term policies to track the significant downward trend in asset shares.

Target Ranges

The PPFM contains target ranges for maturity and surrender payouts relative to their asset shares. Target ranges should be large enough that they do not unnecessarily restrict the management of the business, but not so wide that it will undermine policyholder confidence. Our high equity backing ratio means that a relatively wide target range needs to be set, as we wish to smooth out the ups and downs of the equity markets. This smoothing is considered to be of benefit to policyholders.

We set our bonuses with the aim of keeping our payouts within the target range and ensure that we have good reason to believe that at least 90% of payouts are or will be within the target range.

Throughout the year, we monitor the ratio of actual claim values to their respective asset shares. Overall, 99% of maturity payouts and 100% of surrender payouts were within the target range in 2016. Only two very small policies fell outside the target range. These received payouts above the target range, which helped to protect the policyholders from the full impact of expense charges. A further six policies, for which an accurate comparison against their target range could not be made, are included in the percentages above but are not expected to be outside the target range in practice.

Since target ranges were introduced at the start of 2006, 92% of maturity payouts and 96% of surrenders have been within the target range.

Investment Strategy

The Board sets our policy for strategic asset allocation for with profits business, and during 2016 the Executive team monitored adherence to these allocations and considered investment decisions at a more detailed level.

Our investment strategy for assets backing with profits policies, as described to policyholders, has consistently referred to maximising returns based on significant equity investment where possible. We have been able to maintain this high equity backing ratio again during 2016. No significant changes have been made to the investment policy for these assets. A separate investment strategy is maintained for the rest of the assets, including the Society's estate.

The allocations of assets backing with profits policies at recent dates are shown below:

	31 Dec 16	30 Jun 16	31 Dec 15
Equity shares	59%	60%	60%
Property	8%	7%	8%
Fixed Interest	23%	23%	20%
Other	10%	10%	12%

The "Other" category mainly comprises cash deposits.

Charges and Expenses

Our aim in allocating expenses to with profits policies is to charge the costs incurred in selling and administering the policies, plus an appropriate share of overheads.

During 2016, we made appropriate charges in order to meet this aim.

Management of the Estate

We aim to provide the security of a strong estate. This allows us the freedom to invest asset shares in assets that we expect to give higher returns over the long term. We monitor the size of the estate over time, and ensure that the uses to which the estate is put are reasonable and appropriate.

In 2016 the estate was used for various activities, including meeting the costs associated with the Society's Solvency II project to adopt new European solvency capital rules. Under the 2016 Mutual Benefits scheme, the cost of which was borne by the estate, a 15% discount on general insurance and surgery insurance was offered to eligible customers. Eligible customers were:

- all in-force with profits policyholders (other than pension and IB policyholders)
- members of the Society (other than those who are members solely because they hold a qualifying pension policy)
- policyholders who are within the two-year period before they qualify as members (other than pension policyholders).

New Business Volumes

Writing new business uses up capital initially. Therefore, we carry out projections of the future financial strength of the fund assuming different levels and types of new business, including policies with guarantees and both with profits and non profit business.

The Group's overall new business levels (excluding brokered business) in 2016 were 3.8% lower than in 2015. This was largely due to a fall in the sale of investment products, including ISAs.

Other Business Activities

During the year, the Society's management and the WPC have monitored our business activity and the risks we run as a result, to ensure it is managed in line with the PPFM and to treat our customers fairly.

In 2016 the Society made further progress towards the delivery of its growth objectives. Some changes were made to its organisational model to make it more scalable and more supportive of the Society's business structure. This has allowed the Society to further increase its focus on its customers and to be more efficient.

Communication

A guide to the bonus declaration, which also sets out changes made to the PPFM, is being included with statements sent to policyholders in 2017.

Further information is available on our website, www.wesleyan.co.uk (select 'Investments and Savings' and then 'With Profits - how it works'). This includes our guides called 'How our With Profits Fund works'.

Changes to the PPFM

There were minor changes to the PPFM from 31 December 2016 to:

- amend the description of the way that IB write off profits are allocated to asset shares to reflect the work undertaken in 2016 to capitalise the value of future IB policies that are not expected to claim and add this to all IB with profits asset shares going forward
- clarify that transactions in the shadow fund occur in the same proportion to those in the With Profits Fund
- reflect the extension to the maximum length of time that cash deposits will be kept. This has increased from three to six months
- clarify the section that explains the cap that currently applies to the level of non-profit losses that can be charged to asset shares, and how this cap may be relaxed if the level of available capital falls beyond a certain level.

Changes are approved by the Board after taking advice from the WPC and details are provided on the Society's website.

Appendix

Annual Report for 2016 from the With Profits Actuary to Wesleyan Assurance Society's Open Fund With Profits Policyholders

Basis Of Opinion

During the year, I have advised the Society on all key aspects of the discretion to be exercised in respect of with profits business. As a result I have been involved in the Society's consideration of all relevant matters addressed in the Society's report to you, including the preparation of that report.

I have based my opinion below on the outcome of those considerations. I have also taken into account, where relevant, the Financial Conduct Authority's rules and guidance in the FCA Handbook (section COBS 20).

This report complies with relevant actuarial guidance and standards, including the Technical Actuarial Standard on Reporting (TAS R).

Opinion

In my opinion, the Society's annual report and the discretion exercised by the Society in respect of 2016 take, or have taken, your interests into account in a reasonable and proportionate manner.

Tim Pindar
Chief Actuary

11 May 2017