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Annual Report to With Profits Policyholders 2017

24 May 2018

Wesleyan Assurance Society (Medical Sickness Society Fund)

Wesleyan Assurance Society
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Incorporated by Private Act of Parliament (No. ZC145)
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 Medical Sickness Society (MSS) 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 2017, including the bonus declaration in respect of that year made in March 2018.

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 MSS 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” and these are also available on our website. These explain some of the phrases used in this report, such as 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 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 MSS Fund and Open Fund are managed by the Society;
- whether the Society is complying with the PPFM; 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 MSS Fund or Open 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. There is also a MSS Fund Scheme Monitoring Committee, which ensures that the MSS Fund is administered in line with the Merger Scheme.

Tim Pindar, carried out the role of With Profits Actuary throughout 2017. Jonathan Welsh became With Profits Actuary with effect from 12 April 2018 following Tim’s retirement. 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 2017 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 all major classes of business as described in the PPFM. The With Profits Actuary approved the parameters used in the calculation.

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 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.

A history of good returns on the MSS Fund, which continued in 2017, means that we have been able to maintain annual bonus rates at the same level, despite lower expected future returns.

For a small number of older pension policies, no annual bonuses are being paid because asset shares are still less than the existing guarantees. This is mainly due to a combination of the special bonuses added at the time of the merger and the significant improvement in expected mortality rates in retirement since the policies were issued.

Final Bonus on Maturity or Death

Bonuses must be declared such that the whole of the surplus of the MSS Fund is progressively and equitably distributed to the policies in the fund.

The aim in setting final bonus rates is that policyholders should receive their policies' fair share of the fund. This is assessed using asset shares as described in the PPFM. We also apply smoothing in line with our smoothing policy, as described below.

The final bonus is added to the guaranteed benefits to bring the total payout up to its fair value.

We normally review final bonus rates twice a year. Final bonuses were changed from 1 October 2017 and again following the March 2018 Declaration (in respect of 2017 experience).

When comparing payouts, we look at the expected progression of payouts on equivalent policies in future years. For example, we would compare the expected (or actual) payouts on a 30 year term policy that started in 1988 (maturing in 2018) with one that started in 1989 (maturing in 2019) and so on. Generally, particularly for longer term business, the progression is downward as our current expectation of future investment returns is not as high as returns that have been earned historically. The good investment returns that we have earned in the last two years, though, have meant that nearly all policies that mature during 2018 will receive payouts higher than we were forecasting them to be.

As mentioned previously, there are a small number of older pension policies where the asset shares are less than the existing level of guaranteed benefits. No final bonus is being paid on these policies.

Surrender and Transfer Values

In 2017, we carried out reviews of surrender values and transfer values for the major classes of with profits business. Surrender values for life, pension and income protection policies were generally increased due principally to the strong investment performance over 2017.

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 low 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).

All of the payout changes resulting from the March 2018 declaration were less than 10%.

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 fund, 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 90% of payouts are or will be within the target range.

We narrowed the target range for maturities from 1 August to bring the range in line with that for Open Fund policies. Prior to 1 August, we aimed to keep 90% of maturity payouts within a range of 65% to 135% of asset share. This was narrowed to a range of 70% to 130%.

Throughout the year, we monitor the ratio of actual claim values to their respective asset shares. Overall, 92% of maturity payouts and 85% of surrender payouts were within the target range in 2017. There are 22 maturity payouts and 5 surrenders that fell above the target range. These are all pension policies which transferred out having only paid a limited number of premiums. For these policies, as payouts were all above the target range, this protected policyholders from the full impact of initial expense charges. There was one MSS surrender below the target range. This policy has had a number of alterations due to missed premiums and the approximations made will result in the actual asset share being lower than the calculated asset share. We expect the payout to be within the target range when measured against an accurate asset share.

Investment Strategy

The Board sets our policy for strategic asset allocation for with profits business, and during 2017 the Investment Committee monitored adherence to these allocations and considered investment decisions and investment performance at a more detailed level on behalf of the Executive team.

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 2017 and no significant changes have been made to the investment policy for these assets.

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

	31 Dec 17	30 Jun 17	31 Dec 16
Equity shares	62%	60%	61%
Property	9%	8%	8%
Fixed Interest	23%	24%	23%
Other	6%	8%	8%

The ‘Other’ category mainly comprises cash deposits.

Other assets are also held, to back other MSS Fund liabilities and to reduce volatility where appropriate.

Charges and Expenses

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

During 2017, we made appropriate charges as set out in the reassurance agreement between the Open Fund and the MSS Fund which guarantees the level of expenses to be charged to policies in the MSS Fund. This agreement ensures that the MSS Fund runs off in an orderly way and that the expenses charged to asset shares do not increase unfairly as the number of policies in the fund declines.

In addition, a non-discretionary charge is made to the MSS Fund for the investment support received from the Open Fund.

Other Business Activities

During the year the PPFM Compliance Committee 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.

During 2017 there was no business activity that impacted the MSS Fund significantly.

Communication

A guide to the bonus declaration, which also sets out any changes made to the PPFM, is being included with statements sent to policyholders in 2018.

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

Changes to the PPFM

The following change was made to the PPFM from 1 August 2017

- In section 1.2.5 we now state that, when determining maturity payouts for classes of policy for which asset shares are calculated, we aim to pay between 70% and 130% of adjusted *asset share*, subject to paying a minimum of the guaranteed benefits.

Also, the following changes were made from 31 December 2017

- In section 2.2.1 we confirm that Board approval is required for any investment in derivatives. Previously, the PPFM stated that this was only required for 'material' investment in derivatives.
- In section 1.2.5 we have changed 'mediocre investment returns' to 'low investment returns' when describing the investment conditions that may lead to changes in payouts of more than 10%.

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 2017 from the With Profits Actuary to Wesleyan Assurance Society's MSS Fund With Profits Policyholders

Basis of Opinion

I have based my opinion below on the information and explanations provided to me by the Society and my operational involvement throughout the year. 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 Standards (TAS 100 and 200).

Opinion

In my opinion, the Society's annual report and the discretion exercised by the Society in respect of 2017 take, or have taken, your interests into account in a reasonable and proportionate manner.

Jonathan Welsh
With Profits Actuary

24 May 2018