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PPFM Compliance Report to With Profits Policyholders 2022

30 June 2023

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 Board'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 2022, including the bonus declaration in respect of that year made in April 2023.

The MSS Fund consists of the in-force with-profits policies sold by Medical Sickness Society before the transfer of its business to Wesleyan Assurance Society (Wesleyan) in July 1997. We have a separate with-profits fund called the "Open Fund", which comprises all in-force with-profits policies except for those in the MSS Fund. A separate report is available for the Open Fund.

We publish the MSS Fund 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 guide called "How our With Profits Fund works" and this is also available on our website. The guide explains 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 in the remainder of this report.

Compliance in this context means performing the obligations set out in the PPFM. Occasionally in performing these obligations errors or operational issues arise which may impact on policyholder payments. However, providing such issues are managed appropriately including redressing any policyholder detriment, they do not result in non-compliance with the PPFM.

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.

The WPC also considers changes to the PPFM when required and advises the Board accordingly.

There is also a Monitoring Committee for the MSS Fund, which ensures that the fund is administered in accordance with the terms agreed as part of the transfer of Medical Sickness Society business to Wesleyan Assurance Society in 1997 (as set out in a Scheme of Transfer).

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) within the Society.

The Board 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 the changes to policy benefits paid on death or maturity during or in respect of 2022 were made after taking advice from the WPC and the With Profits Actuary.

<u>Asset Shares</u>

Whilst bonuses are calculated by reference to asset shares for sample policies, the aggregate asset shares used to calculate the overall liabilities are based on actual policy data for all policies. Most policies have a history of flexible payments for which there is insufficient data available to calculate precise asset shares. Therefore, an approximate method is used to estimate the aggregate asset shares.

Following a review of the methodology used, as the number of remaining policies continues to reduce, we amended the approach to estimating the aggregate asset shares during 2022. The result of this was to reduce the aggregate asset shares and consequently increase the surplus in the fund. In order to distribute the surplus “progressively and equitably” to the MSS Fund with-profits policyholders (as required by the Scheme of Transfer) the increase in surplus was used to enhance the asset shares for the sample policies used for determining the bonus rates, resulting in higher final bonus rates than would have been the case using the previous methodology.

We will continue to review this methodology to ensure that the remaining surplus in the fund is distributed as fairly as possible.

The With Profits Actuary approved the parameters and the surplus distribution adjustment used in the calculation.

Annual Bonus

Recent increases in expected future returns have meant that, with effect from April 2023, we were able to increase annual bonus rates by 0.25% for Life products and 0.5% for pension policies where the benefits are expressed as a cash fund on retirement.

For a small number of older pension policies where the benefit is in the form of an annuity, no annual bonuses are being paid because asset shares are mostly still less than the existing guarantees. This is mainly due to a combination of lower interest rates and the significant improvement in life expectancy that has occurred since these 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 policy's fair share of the fund, subject to smoothing.

We normally review final bonus rates twice a year. Final bonuses were reviewed in September 2022 and no changes were required. Final bonus rates were changed as a result of the April 2023 declaration (in respect of 2022 experience). Despite falling markets in 2022, many policies have had an increase in value over the preceding 12 months. This is as a result of the additional distribution of surplus described in the asset shares section.

There are a small number of older pension policies where the asset shares are less than the existing level of guaranteed benefits. These policyholders receive the guaranteed level of benefits and no further final bonus is being paid on these policies.

It should be noted that final bonus rates are not guaranteed and can be changed any time without prior notice, to ensure that outcomes remain fair to policyholders.

Surrender and Transfer Values

The PPFM states that surrender bases are usually reviewed at least once in each calendar year. Surrender values have been updated to reflect the revised bonus rates implemented at each bonus declaration and we have monitored surrender payouts against fair value as part of our target range monitoring. The parameters in the surrender value basis have not been reviewed during 2022, but these would not be expected to change materially from one year to the next. The surrender value basis will be reviewed during 2023.

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 on equivalent policies 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.

All payout changes at the April 2023 declaration were within 10% of the maturity values on equivalent policies paid the previous year with the exception of some deferred annuity policies which saw increases in the annuity amount of larger than 10%. This was due to the exceptional increases in the level of interest rates over 2022 which resulted in a significant increase in the annuity that could be supported by the underlying policy value. Subject to some smoothing, the benefit of the higher annuity was passed onto policyholders in full.

Target Ranges

The PPFM specifies 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 and allow us to smooth out the ups and downs of 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 aim to have at least 90% of payouts within the target range.

The target range for maturities and surrenders narrowed from 75%-125% to 80%-125% from 2022 onwards. This change was recently formalised in a revised PPFM. This change is of benefit to policyholders in the event of significant increases in asset values.

Throughout the year, we monitor the ratio of representative sample claim values to their respective asset shares. As in previous years, due to the flexible nature of this business, some policies become paid up early in their contract term. Typically, the payouts on these policies fall above the target range. In 2022 the impact of these payments in excess of target range was assessed and other classes of policies were enhanced to ensure that there was no effect on the remaining customers in the fund. We are comfortable that this is a reasonable outcome for all policyholders. We will continue to review this approach for appropriateness as the fund matures.

Investment Strategy

The Board sets our policy for strategic asset allocation for with-profits business, and during 2022 the Investment Committee monitored adherence to these allocations and considered investment decisions and investment performance at a more detailed level.

Our investment strategy for assets backing with-profits policies, as described to policyholders, has consistently referred to maximising returns subject to an acceptable level of risk based on significant equity investment where possible.

In 2021 we implemented a sustainable investment approach across all funds which aims to ensure the assets we invest in deliver better outcomes for our customers the environment, the climate and the communities we all live in. More information on our approach to sustainability is available here: https://www.wesleyan.co.uk/savings-and-investments/sustainable-investing

Our investment strategy is reviewed each year and in 2022 this resulted in the decision to transition into a more globally diverse equity portfolio. This aims to reduce the impact of any single country or region's performance. This transition began in 2022 and will continue into 2023.

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

	31 Dec 22	**30 Jun 22**	**31 Dec 21**
UK Equities	41%	42%	42%
Overseas Equities	25%	23%	23%
Property	9%	10%	9%
Fixed Interest	20%	20%	21%
Other	5%	6%	5%

The ‘Other’ category mainly comprises cash deposits and derivative assets used to protect the fund against changes in interest rates.

Charges and Expenses

During 2022, the expenses deducted from asset shares were 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, as specified by the Transfer Scheme.

Other Business Activities

During the year the With Profits Committee 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.

The number of policies in the MSS Fund has fallen below 5000, which is the threshold upon which the With Profits Actuary can consider whether to merge the MSS Fund into the Open Fund. We are currently comfortable that MSS policyholders are not disadvantaged by continuing to manage the MSS Fund separately to the Open Fund. However, we are actively considering whether it is in the best interests of with-profits policyholders in both the MSS Fund and Open Fund to merge the funds in the future. We will keep policyholders informed of relevant developments.

A run-off plan for the fund is maintained and reviewed periodically to ensure it remains up to date. This allows us to ensure that - as the number of policies remaining in the fund falls - the surplus in the fund is being distributed progressively and equitably to the remaining policyholders in the fund.

In 2022 new Consumer Duty regulations were released by the FCA. We will review products within the MSS Fund in line with this new guidance by the regulatory deadline of 31 July 2024.

There was no other business activity that materially impacted the MSS Fund

Communication

A guide to the bonus declaration is being included with statements sent to policyholders in 2023.

Further information is available on our website, https://www.wesleyan.co.uk/savings-and-investments/with-profits-fund. This includes our guides called 'How our With Profits Fund works'. There are three different guides covering different types of policy.

Changes to the Medical Sickness Society Fund PPFM from 1 June 2023

The following changes were made to the Practices set out in the Medical Sickness Society Fund PPFM from 1 June 2023.

- A change has been made to the way aggregate asset shares for some pension policies are calculated to more accurately reflect the amounts that will be paid in practice. Section 1.2.1.1 has been updated to reflect the change in practice.
- The target ranges have been narrowed from 75%-125% to 80%-125% for maturity and surrender claims. This has been reflected in section 1.2.5.
- Throughout the document the word ‘merger’ has been replaced with ‘transfer’ where it is referring to the 1997 transfer of business from Medical Sickness Society to Wesleyan. This is to make a clear distinction between the 1997 transfer and a possible merger between the MSS Fund and the Open Fund to avoid any confusion in future.

Appendix

Annual Report for 2022 from the With Profits Actuary to Wesleyan Assurance Society's MSS Fund With Profits Policyholders

Basis of Opinion

As With Profits Actuary for Wesleyan Assurance Society (Wesleyan), I advise Wesleyan on the key aspects of discretion that it exercises in respect of with-profits business and I am required by the Financial Conduct Authority's rules to report to with-profits policyholders as to whether Wesleyan's annual report to with-profits policyholders and the discretion exercised by Wesleyan in respect of the period covered by the report has taken the interests of the with-profits policyholders into account in a reasonable and proportionate manner.

I have based my opinion below on the information and explanations provided to me by Wesleyan, and on my own knowledge and investigations. In doing so I have taken into account the relevant rules and guidance issued by the Financial Conduct Authority, the actuarial profession and the Financial Reporting Council.

Opinion

In my opinion, Wesleyan's annual report and the discretion exercised by Wesleyan in respect of 2022 take, or have taken, your interests into account in a reasonable and proportionate manner, and was consistent with disclosures to customers and the PPFM (Principles and Practices of Financial Management).

I note that the surrender value basis will be subject to a review during 2023 which I fully support and I will consider the outcome of this review when complete.

Stewart Gracie
With Profits Actuary

30 June 2023