Railway Enginemen's Assurance Society Limited: Report of the Management Committee to With-Profits Policyholders for the year 2017

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A Introduction

The Society's Principles and Practices of Financial Management (PPFM) document describes how the Society manages its With-Profits business. The PPFM is available to all members from our website or by contacting the office. We also publish a summary of the PPFM entitled the Customer Friendly Principles and Practices of Financial Management (CFPPFM), which is also available from our website or by contacting the office.

The Society is required by the Financial Conduct Authority to produce an annual report to its With-Profits policyholders setting out whether it believes it has complied with its obligations in relation to its PPFM including the exercise of discretion and the way that the Society has addressed any competing or conflicting rights, interests or expectations of its policyholders. This report covers the financial year 1 January 2017 to 31 December 2017.

The Society became a directive society on 1 January 2016, so produced its first PPFM in December 2015. Some minor changes to the PPFM were made during 2017 to aid clarity, following discussions with the With-Profits Advisory Arrangement. This is the second report to With-Profits policyholders in line with the new requirements.

B Governance Arrangements

The Management Committee is responsible for the governance of the Society's With-Profits Fund, including compliance with the regulatory requirements contained in the Financial Conduct Authority's Conduct of Business sourcebook. In discharging its duties the Management Committee receives advice and guidance from the With-Profits Actuary (WPA) and the With-Profits Advisory Arrangement (WPAA).

B1 With-Profits Advisory Arrangement

During 2015, it was agreed that a WPAA would be set up. The Management Committee agreed the terms of reference of the WPAA on 23 February 2016 and the WPAA's inaugural meeting was held on 6 December 2016. The role of the WPAA is to exercise independent judgement in assessing compliance with the Society's PPFM and in addressing conflicting rights and interests of With-Profits policyholders within the Society. The WPAA reviews the exercise of discretion by the Management Committee and provides advice to it if it feels that policyholders' interests are not being fully and properly taken into account.

The WPAA further strengthened its composition during the year through the appointment of Mr. David Storrie. David, who works as a train driver for Arriva Rail North, is also a member of the Management Committee and an active Depot Introducer for the Society. As at 31 December 2017 there were 4 members of the WPAA. The Chair of the WPAA is a qualified actuary with substantial life office experience. The Terms of Reference for the WPAA are available on the Society's website or by contacting the office. The WPAA's Terms of Reference state that it should meet at least twice per year. Four meetings of the WPAA took place during 2017.

The WPAA raised no material concerns regarding the administration of the With-Profits Fund during 2017 and, therefore, the WPAA does not wish to make a separate report to policyholders for this period.

B2 With-Profits Actuary

The role of the With-Profits Actuary (WPA) includes consideration of compliance with the PPFM, and the exercise of discretion in relation to With-Profits business and the interests of With-Profits policyholders. The Society's WPA during 2017 was Mrs. Alison Carr of SDA LLP, who is a Fellow of the Institute and Faculty of Actuaries.

C Compliance with the PPFM and Exercise of Discretion

This report comments on specific areas, in particular where discretion was used and where the fair treatment of policyholders was relevant.

C1 Communications with policyholders

The Management Committee has responsibility for approving communications with policyholders by reviewing and signing off documents. The Society's PPFM and CFPPFM have been approved by the Management Committee and With-Profits Actuary, as have the bonus notices.

C2 Bonus policy and declarations

The PPFM principles state that when setting regular bonus rates, the Society aims to:

- distribute a proportion of the investment income earned by the assets backing the liabilities in a smoothed manner
- reflect the surplus generated by policies
- have regard to long-term expected rates of return on fixed interest securities
- distribute surplus in a manner that is fair to all policyholders and does not jeopardise the Society's solvency.

The PPFM principles also state that maturity and death payouts will be smoothed from one period to the next by avoiding major changes in regular bonuses.

The PPFM principles were all complied with when setting bonus rates during 2017.

All of the Society's policies are conventional With-Profit policies, with maturity payouts based on guaranteed sums assured plus bonuses. During 2017, the Management Committee approved the following regular bonuses in respect of 2016 as a percentage of sum assured:

Policies issued on or before 13 March 1984	1.0%
Policies issued after 13 March 1984	0.5%

The rates were set by reference to a sustainable level based on asset share and expected investment income according to the investment strategy. The rates were smoothed to avoid a large change in regular bonus rates.

C3 Payouts on maturity

The PPFM practices state that the aim in the long term, in determining payouts for maturing With-Profits policies, is to return as a group, on average, 100% of asset shares. On average during 2017, the maturity payouts were 99% of asset shares.

The Society has implemented final bonuses from 1 May 2018. It is anticipated that this, together with the new premium rates introduced from 1 January 2018, will lead to average maturity payouts in the long-term of 100% of asset shares.

The PPFM practices also state that subject to meeting any guaranteed benefits, the maturity payout should fall in the range of 80% to 120% of the average asset share for the group. The aim is for all maturity payouts to fall within this range, although where this is not possible for all policies, at least 90% of payouts should fall within the range. During 2017, maturing policies had payouts in the range of 85% to 114% of asset shares, other than one policy that had a payout of 171% of asset share due to an historical error relating to policies taken out in 1981. Therefore, this practice was met during 2017.

C4 Payouts on surrender

Surrender values, where applicable, are the amounts payable on cancellation of a policy before it would otherwise be payable on death or maturity.

The PPFM practices state that the amounts payable on surrender are calculated by reference to the premiums paid and that asset share is used as a guide in determining the bonuses and surrender factors to calculate the amounts payable. This was complied with during 2017.

The PPFM practices state that the aim in the long term, in determining payouts for surrendering With-Profits policies, is to return as a group, on average 100% of asset shares, subject to smoothing and any deductions necessary to protect the interests of remaining policyholders. On average, the surrender payouts during 2017 were 98% of asset shares. This reflected the need to ensure fairness and protect the interests of remaining policyholders by limiting surrender payouts to no more than the equivalent maturity payouts. The introduction of final bonuses, as referred to in section C3, will enable maturity values to more closely match asset shares, thus allowing surrender payouts of close to 100% of asset share on average.

The PPFM also states that the surrender payout for an individual policy should fall in the range of 80% to 120% of the average asset shares for the group. The aim is for all surrender payouts to fall within this range, although where this is not possible for all policies, at least 90% of all payouts will fall within the range. During 2017, 91% of surrendering policies had payouts in the range 80% to 120% of asset share (with the other 9% paying more than 120%). Therefore, this practice was met during 2017.

C5 Investment strategy

The PPFM principles state that the investment strategy of the Society is to maximise the overall return of the investments of the Society subject to ensuring that the guarantees are met through maintaining adequate levels of solvency and liquidity. This was put into practice by holding a diversified portfolio of assets and measuring the performance for each asset class against a specified set of benchmarks. The Chief Actuary reviews the Society's investment strategy annually in light of the Society's capital requirement and solvency position, taking into account the statements in the

PPFM on investment strategy and makes proposals to the Management Committee. During 2017, the Society invested in bonds, equities, properties, deposits, mortgages and policy loans.

C6 Business risk and new business

The Society manages its risks within a defined framework which comprises the Risk Appetite Statement, the Capital Assessment of Risks and the Risk Register. Ultimate responsibility for risk management rests with the Management Committee whilst the Audit and Risk Management sub-Committee has responsibility for the detailed scrutiny of risk management issues. The Society's Own Risk and Solvency Assessment is a rolling process that provides a detailed analysis of the Society's capital adequacy, risk management and forward-looking perspective. This is achieved using a combination of internal, actuarial and regulatory documents and information to report appropriately on the Society's financial position. It is believed that the risk management system has been effective during 2017 and it has led to the identification of new risks and controls. On 1 January 2018 the Society introduced new premium rates in order to protect the interests of existing With-Profits policyholders and, in the medium term, achieve a closer alignment between asset shares and payouts. The Society intends to introduce a lump-sum investment bond product during 2018.

C7 Charges and expenses

The charges applied to policies for the purpose of determining asset shares are the charges deemed appropriate by the Management Committee taking into account the charges included within the premium rates, the level of charges disclosed in product literature and initial costs relating to the acquisition of policies. The total expenses charged to asset shares are the actual expenses incurred by the Society. This is deemed fair and appropriate given the mutual nature of the Society. The asset shares charge expenses to each policy in proportion to the premiums paid which is also deemed to be a fair allocation.

C8 Management of inherited estate

The Society maintains a level of free assets which enables it to invest in a range of investments and to fund the writing of new business. Within the Risk Appetite Statement a target range for free assets is set and if the free assets were to fall below that range then remedial action would be taken. It is confirmed that through 2017 the management of free assets was in accordance with the PPFM and Risk Appetite Statement.

D Conclusion

Considering compliance with the PPFM in 2017, the Management Committee confirms:

- In setting its payouts, including the setting of bonus rates, the Society complied with the relevant principles and practices in the PPFM except that during 2017 there were average payouts of 99% of asset shares for maturities and 98% of asset shares for surrenders. The introduction of a final bonus from May 2018 will make it more likely that payouts will be close to asset shares.
- In setting and complying with its investment strategy, the Society complied with the relevant principles and practices in the PPFM.
- In controlling its business risk and new business, the Society complied with the relevant principles and practices in the PPFM.
- In managing its inherited estate, the Society complied with the relevant principles and practices in the PPFM.

Considering the treatment of With-Profits policyholders and the exercise of discretion in 2017 the Management Committee confirms:

- With-Profits policyholders have been treated fairly in material respects in relation to the exercise of discretion.
- The discretion exercised by the Society during 2017 took the interests of each class of the Society's With-Profits policyholders into account in a reasonable and proportionate manner.

In making this declaration the Management Committee has taken into account advice provide by the With-Profits Actuary on compliance with the PPFM and exercise of discretion during 2017. The Management Committee has also received advice from the Society's With-Profits Advisory Arrangement.

J W Goolamier, Chair

19 June 2018

M A Bicknell, Chief Executive

19 June 2018