

# **LIVERPOOL VICTORIA FRIENDLY SOCIETY LIMITED**

## **Principles and Practices of Financial Management (PPFM)**



**Conventional With-Profits  
Unitised With-Profits  
With-Profits Pension Annuity  
Appropriate Personal Pension Plan  
Flexible Whole-Life Plan**

1 November 2011

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## 1. INTRODUCTION

### 1.1. Company Information

Liverpool Victoria Friendly Society Limited ("the Society") was founded in 1843 as a burial society. It is the UK's largest friendly society and, as a mutual organisation, has no shareholders, being owned by its members.

The Society is incorporated under the provisions of the Friendly Societies Act 1992 and is regulated by the Financial Services Authority (the "FSA").

### 1.2. Products Covered

This document covers all of the Society's with-profit products, apart from the Flexible Guarantee Bond, the Flexi-Guarantee Plan, the All-in-1 Investment Bond and the Guaranteed Capital Bond, which have a separate PPFM. It also excludes the with-profit products in the RNPFN Fund, which again are subject to their own PPFM.

### 1.3. Purpose of a PPFM

The Principles and Practices of Financial Management ("PPFM"), required by the FSA, govern how a company conducts its with-profits business. The Society's Board of Directors, after considering advice from the With-Profits Actuary, will certify each year to the FSA that its with-profits fund has been managed in accordance with the PPFM.

### 1.4. The Principles

The Principles are enduring statements of the standards the Society follows when managing its with-profits fund. These Principles cover duties to the with-profits policyholders in both current and future business and economic environments, compliance with relevant regulation and legislation and the need to be fair to all policyholders.

The Principles are not expected to change often. However, there are no restrictions on the Society's ability to change them, where appropriate, subject to satisfying the relevant regulatory requirements, including giving three months prior notice.

### 1.5. The Practices

The Practices are more detailed descriptions of how the Society responds to short-term changes to the business and economic environment.

## **1.6. Monitoring Compliance and Governance**

The Board of Directors of the Society ("the Board") produces an annual report to policyholders (available on the website or on request) on the Society's compliance with the PPFM. It is the responsibility of the Board to ensure that the Society manages its with-profits fund in accordance with the Principles and Practices set out in this document.

A With-Profits Actuary has been appointed to advise the Board on its exercise of discretion in managing its with-profits business. A report from the With-Profits Actuary to with-profits policyholders is included within the Board's annual report.

The Society also has a With-Profits Committee to provide some independent judgment on material issues in assessing compliance with the PPFM. The With-Profits Committee may also include a report to with-profits policyholders within the Board's annual report if it deems it appropriate.

## **1.7. Changes to the PPFM**

The PPFM will be reviewed at least annually to ensure that it continues correctly to reflect the Principles and Practices that are applied to the with-profits fund.

Any proposed changes will be reviewed by the With-Profits Committee and approved by the Board, after considering advice from the With-Profits Actuary, before the changes are implemented.

Holders of with-profit policies affected by this PPFM will be notified of proposed changes to any Principles in this document at least three months in advance. The FSA will also be notified of the proposed change.

Holders of with-profit policies affected by this PPFM will be notified of changes made to any Practices in this document as soon as is reasonable.

## **1.8. Consumer-Friendly PPFM**

Consumer-friendly versions of the PPFM ("CFPPFMs") are available on the website or on request. These documents contain key information from the PPFM. For the avoidance of doubt, in the event of a conflict, the PPFM will take precedence over the CFPPFMs.

## **1.9. Glossary**

The key words and phrases used within this PPFM are defined at the end of the document.

## 2. PRINCIPLES

As a minimum the Society will pay the guaranteed benefits under each contract. The Board aims to treat all groups of members fairly taking into account any conflicting interests between them. All of the other principles below are subject to these requirements. A Schedule of disclaimers is attached at the end of this document.

### **2.1 The methods used to guide the determination of the amount that it is appropriate to pay individual with-profits members**

- 2.1.1 The aim of the methods used to guide the determination of the amount payable to with-profits members on claim is to pay them a fair return on their investment.
- 2.1.2 The methods used will be applied to the extent appropriate to enable the Board to make reasonable decisions. This may mean the methods are applied by carrying out sample calculations and may not be applied rigorously for all classes of business.
- 2.1.3 The current methods are set down in various documents; any material changes to the methods used will be approved by the Board.
- 2.1.4 The Board might change the historical assumptions or parameters relevant to the methods used if it can be clearly demonstrated to the Board by the Society that incorrect assumptions and parameters have been used.

### **2.2 The approach to setting annual bonus rates applicable to with-profits policies**

- 2.2.1 The rates of annual bonus will be reviewed at least annually. The general aim in setting annual bonus rates is to add bonuses at a prudent level having regard to market conditions and the rates of return expected from the underlying investments from time to time. However account will also be taken of the current and projected financial strength of the Society.
- 2.2.2 Different annual bonus rates may be used to the extent deemed appropriate by the Board for ranges or generations of policies where significant differences in the premium rates, underlying investments, expenses, costs of guarantees, policy terms and conditions or taxation are not reflected in the charges on these policies. The Board will introduce a new bonus series where it deems that these factors make it appropriate to do so.

## **2.3 The approach to setting final bonus rates applicable to with-profits policies**

- 2.3.1 The rates of final bonus will be reviewed at least annually. The rate of final bonus will be set such that total payouts (i.e. guaranteed amount plus final bonus, if any) on policies will, whenever possible, have regard to the amounts calculated under the methods referred to in section 2.1 above, subject to smoothing referred to in section 2.4 below. Account will also be taken of the current and projected financial strength of the Society.

## **2.4 The approach to smoothing the value of with-profits policies**

- 2.4.1 The Society adopts a similar approach to smoothing irrespective of the type of claim arising under a with-profits policy although different smoothing strategies may apply to different types of with-profits policy.
- 2.4.2 The aim of the smoothing policy is to protect members from temporary fluctuations and it is not intended, over the long term, to be a source of profit or loss.
- 2.4.3 The Society does not limit the total scale or cost of smoothing over the shorter-term except as is necessary to preserve the ability of the Society to meet its commitments to its members.
- 2.4.4 Market Value Reductions will only be applied to reflect movements in the value of assets held by the fund. The decision whether or not to apply Market Value Reductions will take into account the level of surrenders and the expected cost of not applying a Market Value Reduction. The surrender bases for with-profits policies will only be changed to reflect movements in the value of assets held by the fund, to reflect the level of transfers and surrenders, or in order to pay with-profits members a fair return on their investment.

## 2.5 The significant aspects of the investment strategy

- 2.5.1 The aim of the investment strategy of the fund is to optimise the return to with-profits members while preserving the ability of the Society to meet its commitments to its members. In determining the mix of assets between different asset classes, the investment strategy will take account of the current and projected financial strength of the Society, its ability to meet its regulatory capital requirements and the long-term expected returns available in the asset classes, their volatility and the benefits to be obtained from diversification.
- 2.5.2 The Society does not rely on any assets outside the fund in setting investment strategy.
- 2.5.3 The Society uses derivatives and other instruments for the purpose of efficient portfolio management or to hedge specific liabilities and not for speculation.
- 2.5.4 Some constraints on the investment strategy may be applied to match guarantees under certain policy types.
- 2.5.5 The exposure to single counterparties is limited in each asset class to manage the degree to which a counterparty default would affect the investment return on the fund.
- 2.5.6 The Society holds within its fund assets that would not normally be traded because of their importance to the Society. These may include physical assets such as the Society's office buildings, subsidiary companies and contingent support or guarantee arrangements to or from other companies within the Liverpool Victoria Group. These assets are considered to be important to the Society because they enable the Society to operate efficiently, to establish its position in the market place and to service the needs of its members and customers.
- 2.5.7 The Board reviews the assets that are not normally traded at least annually to ensure these assets still remain of use.
- 2.5.8 The Society does not impose a fixed limit on the scale of its investments in assets that are not normally traded.
- 2.5.9 The out-turn from the Society's investment in assets that are not normally traded does not directly impact the amounts payable under with-profits policies.
- 2.5.10 The Society does not impose fixed credit or liquidity requirements on assets that are not normally traded.

## **2.6 The exposure of the with-profits business to business risk**

- 2.6.1 The Society may only undertake a significant business risk after approval by the Board. The Board will only approve the taking on of such risks provided the expected benefits are no worse than the expected benefits available from alternative investment opportunities for the with-profits fund taking into account the results projected on a range of scenarios and the current and projected financial strength of the Society.
- 2.6.2 The control over existing business risk is monitored at least annually by the Board which takes account of the current and projected financial strength of the Society and the expected rate of return on the investment.
- 2.6.3 Compensation costs arising from a business risk would be borne by the with-profits fund and may, if appropriate, affect with-profits payouts.

## **2.7 The application of charges and expenses to with-profits policies**

- 2.7.1 The charges applied to unitised and accumulating with-profits policies will be the charges set out in the policy conditions.
- 2.7.2 For conventional with-profits policies, the aim of the Society's approach to applying charges and apportioning expenses is to reasonably reflect the underlying experience of the Society. In applying such charges and expenses different groups of business and generations of members will be considered together and therefore cross-subsidies between individual members will occur.
- 2.7.3 The basis on which the Society applies charges to or apportions its actual expenses may be changed in the light of new information and changes in economic conditions.

## **2.8 The management of the inherited estate**

2.8.1 The inherited estate means the excess of the value of the assets of the fund over a realistic assessment of the liabilities and provides the working capital for the Society. The Board manages the Society's inherited estate through regular monitoring of its size and its ability to undertake the uses as referred to below whilst preserving the ability of the Society to meet its commitments to its members.

2.8.2 The inherited estate is primarily used for:

2.8.2.1 Providing statutory capital to meet reserving requirements, including:

- supporting the smoothing of benefits paid to with-profits members,
- meeting reserving requirements in excess of a realistic assessment of the liabilities,
- providing capital support to cover the costs of meeting guarantees.

Charges applied to policies to cover the cost of guarantees remain within the with-profits fund as part of the inherited estate.

2.8.2.2 Allowing investment freedom,

2.8.2.3 Providing working capital to cover any mismatch in timing between the receipt of charges applied to policies in the fund and the actual expenses incurred in the acquisition and maintenance of those policies,

2.8.2.4 Meeting any exceptional costs in managing the with-profits business arising as a result of legislation, taxation or other circumstances which in the reasonable opinion of the Board should not be charged to policyholder benefits because it would be unfair to do so, and

2.8.2.5 Financing new business, financing acquisitions, taking business risk and providing working capital for operational projects.

2.8.3 The Society does not set a target range for the inherited estate.

- 2.8.4 The relative size of the inherited estate will influence the investment policy and volume of new business that can be sold. At a low level of the estate, the Board may restrict the investment policy of the fund, the smoothing of benefits to existing policyholders and the level of new business being written in the fund. At a high level of the estate, the Board may pursue a less restrictive investment policy and (if possible) greater volumes of new business with the overall aim of improving policy values for a greater number of policyholders. The Board may also consider other actions to improve policy values if there is a high level of the estate.
- 2.8.5 There is no division of the inherited estate between any classes of business within the fund.
- 2.8.6 There are currently no constraints on the Board's freedom to deal with the inherited estate or currently any obligation on the Board to distribute the estate to the current generation of members.

## **2.9 Volumes of new business and arrangements on stopping taking new business**

- 2.9.1 The volume of new business accepted into the with-profits fund will be such that, in the opinion of the Board, it does not materially worsen the reasonable benefit expectations of the existing with-profits members or threaten the ability of the Society to meet its commitments to its members. The volume of new business deemed acceptable will allow for the characteristics of the business written, including whether it is with-profits and/or non-profits business.
- 2.9.2 In the event of the Society permanently ceasing to take on new business of any significant amount and not carrying out any other business activity, the Board would seek to distribute the inherited estate in an equitable manner over the remaining lifetime of the with-profits policies. If such an event occurred, all of the practices and some of the principles, including the approach taken to investment strategy and smoothing, may be changed.

## **2.10 Equity between the with-profits fund and any shareholders**

- 2.10.1 The Society is a mutual with no shareholders and therefore all distributed profit is available for our members in accordance with the rules of the Society.
- 2.10.2 No changes to the profit sharing arrangements are envisaged.

### **3. PRACTICES**

The Practices may be changed from time to time and the information below only reflects current practice. There are no restrictions on the Society's ability to change the Practices.

#### **3.1 The methods used to guide the determination of the amount that it is appropriate to pay individual with-profits members**

3.1.1 For most major classes of business the Society considers Asset Shares to guide the determination of the amount payable to with-profits members. "Asset Share" means broadly, in relation to with-profits policies, the accumulation, at investment rates of return, of premiums paid less an allowance for expenses incurred, taxation, the cost of benefits provided and any charges for the cost of guarantees or the use of capital. For conventional with-profits policies, the Society does not pay the precise Asset Share to each member on claim, instead it calculates, as often as required according to paragraph 3.1.6 below, specimen current and projected Asset Shares for sample policies and uses these as a guide to payouts across the range of policies, taking into account past and likely future trends. In general, each sample policy represents only those policies which have the same material characteristics as the with-profits policies they represent e.g. policies of a particular type issued in a particular year with the same maturity year.

In addition the Society may increase the Asset Share if the Board decides to allocate miscellaneous surpluses (such as profits arising from business risks and distributed from 2011 by way of mutual bonus, as described in section 3.6 below). Miscellaneous surpluses added to Asset Shares for a given calendar year are not permanent additions. They may be reduced or removed in the future if the Board considers it appropriate, having taken account of the current and projected financial strength of the Society at the time and the aim to treat all groups of members fairly.

For some major classes of policy, where Asset Shares are not appropriate because of historic practice or due to lack of data, we use other methods to assist the Board to assess a fair return on the with-profits members' investment. These other methods include, for example, bonus rates for non-premium paying policies determined from premium-paying policies and bonus rates for tax-exempt policies determined from taxable policies.

- 3.1.2 The main assumptions or parameters in the Asset Share calculations for conventional with-profits policies (other than With Profits Pension Annuity policies) are determined using actual experience or a reasonable assessment of actual experience. For unitised and accumulating with-profits policies and With Profits Pension Annuity policies, the expense deductions are the charges set out in the policy conditions and Key Features document where appropriate; otherwise a reasonable estimate of actual experience is used.
- 3.1.3 The Society applies different assumptions or parameters across generations of with-profits policies as indicated in paragraph 3.1.2 above and paragraph 3.1.6 below. The assumptions or parameters are adjusted to reflect the taxation position of the class of business and whether the business is Pensions, Industrial Branch or Ordinary Branch business (and for the latter two, whether whole of life or endowment) where different expense assumptions or average premiums are used. These differences are intended to reflect a reasonable estimate of actual experience for each group of policies.
- 3.1.4 The Society's actuarial department documents the methods, parameters and assumptions that it uses to determine the amount payable to with-profits members in a report to the Board.
- 3.1.5 Any proposed material changes to the current methods or to the current parameters or assumptions relevant to a particular method will be identified in the report, referred to above, and submitted to the Board for approval.
- 3.1.6 The Society aims to make payouts on maturing policies that are between 75% and 135% of Asset Share, except for policies where a higher guaranteed payment is due. The Society manages the with-profits fund with the longer term aim of making total aggregate maturity payouts of 100% of Asset Share. For conventional with-profits policies, Asset Share for this purpose means an estimate of the Asset Share derived from the Asset Share of one or more of the sample policies described in paragraph 3.1.1 above. However, the Society may make a maturity payment that falls outside the target range if it believes it might be fair, or fairer, to a particular policyholder and the other with-profits policyholders to do so.

Where relevant, the Society aims to make payouts on maturing policies that are between 95% and 105% of Asset Share after allowing for smoothing referred to in section 3.4 below.

The Society aims to make payouts on surrendering and transferring policies that are between 75% and 135% of Asset Share. For conventional with-profits policies, Asset Share for this purpose means an estimate of the Asset Share derived from the Asset Share of one or more of the sample policies described in paragraph 3.1.1 above. However, the Society may make a surrender/transfer payment that falls outside the target range if it believes it might be fair, or fairer, to a particular policyholder and the other with-profits policyholders to do so.

The investment return allocated to particular asset shares is the investment return on the assets (the "asset pool") underlying the asset shares. The Society seeks to include all with-profits policies in a common asset pool wherever it is appropriate for them to share a common investment policy. Certain products (e.g. the With-Profits Income Bond) require a separate pool of assets to generate a different asset mix to support a specific product feature. Details of the current investment mix of the separate asset pools are available on the Liverpool Victoria web-site ([www.lv.com](http://www.lv.com)) or can be obtained directly from the Society. Investment returns are calculated as often as required in order to calculate Asset Shares.

- 3.1.7 The Society apportions maintenance expenses equal to the charges to its unitised and accumulating with-profits policies. Any difference between the expenses apportioned to unitised and accumulating with-profits policies and the actual expenses deemed incurred in respect of such policies is charged to the inherited estate. The balance of the Society's total maintenance expenses is apportioned between all the conventional non-profit and with-profits policies as a reasonable measure of the maintenance expenses applicable to that business. Any excess of the actual acquisition expenses of the Society over the charges on unitised and accumulating with-profits policies deducted from Asset Shares and the reasonable acquisition expenses of conventional with-profits policies is met by the inherited estate.
- 3.1.8 The Society determines the tax payable under a with-profits policy as if it were written in isolation. Any difference between the total actual liability to tax of the Society and the sum of the amounts within the individual Asset Share calculations is met by or credited to the inherited estate.

- 3.1.9 The Society is a mutual with no shareholders, so there is no additional liability to tax on with-profits policies arising because of transfers to shareholders.
- 3.1.10 The Society does not currently make a charge for the cost of guarantees or for the use of capital in its Asset Share calculations other than for
- 3.1.10.1 the costs implicit in the charges on unitised and accumulating with-profits policies, and
  - 3.1.10.2 the explicit charge for the cost of guarantees and smoothing for the With Profits Pension Annuity (Series 3 onwards).

Charges for mortality risks are made by deduction of appropriate amounts from Asset Shares.

## **3.2 The approach to setting annual bonus rates applicable to with-profits policies**

- 3.2.1 In setting annual bonus rates on conventional Ordinary Branch with-profits policies, the Society has regard to current and prospective gilt yields for the average outstanding term of the liabilities. The annual bonus rates for Industrial Branch and Pensions business will normally be lower to reflect the higher expense levels and the levels of guarantees inherent in these products. For most unitised with-profits policies, the annual bonus rate is set at broadly 50% of expected future investment returns from time to time reduced to allow for taxation and charges. Regard is also had to the current and prospective level of Asset Shares relative to guaranteed benefits, which may result in a lower rate being set. This approach also applies to Appropriate Personal Pension Plans ("APPs") from the bonus declaration for 2010. Prior to that, bonus rates for APPs were set allowing for the current level of aggregate APPs funds compared to their aggregate Asset Shares.

For With Profits Pension Annuity policies (Series 3 onwards), the annual bonus rate also has regard to the relationship between the Asset Share referred to in paragraph 3.1 above and the Asset Share subject to smoothing referred to in section 3.4 below. The annual bonus rate may also vary by calendar year of entry.

For the With-Profits Income Bond, the annual bonus rate is set at broadly 90% of expected future investment returns from time to time before allowance for taxation and explicit charges.

For Flexible Whole Life Plans, the annual bonus rate is set at broadly 80% of expected future investment returns from time to time before allowance for taxation and charges.

In setting annual bonus rates on all with-profits policies, account will also be taken of the current and projected financial strength of the Society, and of the longer term aim of making total aggregate maturity payouts of 100% of Asset Share. Bonus rates may be reduced if Asset Shares are likely to be insufficient to meet the cost of existing or potential guaranteed benefits.

- 3.2.2 The Society re-sets or expects to re-set annual bonus rates once a year. The Society may change annual bonus rates more frequently than annually if the results of calculations performed in accordance with paragraph 3.2.1 above indicate a change by a factor of 10% or more in the bonus rate from the previous level is appropriate.
- 3.2.3 The Society's current practice is not to alter annual bonus rates by more than a factor of 50% from their previous level at the time of any change or by an amount not exceeding 0.5%, if greater.
- 3.2.4 The Society sets its interim bonus rate for conventional with-profits policies at the same time it sets its annual bonus rates for these policies using the same practices. The Society reserves the right to change its interim bonus rate before the next declaration of annual bonus rates if the results of calculations performed in accordance with paragraph 3.2.1 above indicate that a change by a factor of 10% or more from the previous level is appropriate.

### **3.3 The approach to setting final bonus rates applicable to with-profits policies**

3.3.1 The Society's current approach to setting final bonus rates on maturities, deaths, transfers and surrenders is such that total payouts (i.e. guaranteed benefits plus final bonus, if any) on policies will broadly reflect the amounts calculated under the methods referred to in section 3.1 above, subject to smoothing referred to in section 3.4 below. Final bonuses are not added to Flexible Whole of Life Plans. The degree to which total payouts on transfers and surrenders reflect the amounts calculated under the methods referred to in section 3.1 above will depend on the volume of transfers and surrenders, the impact of the surrender and transfer value amounts on remaining policies and on practical considerations regarding the frequency with which it is appropriate to amend the formulaic basis. The total payouts may be reduced if there is evidence that significant smoothing losses are being incurred due to a high level of transfers and surrenders.

For the With Profits Pension Annuity, a top-up bonus may be payable. Any top-up bonus will be applied as an increase to the Annuity payable during the policy year. Top-up bonus rates may vary by calendar year of entry. The top-up bonus will broadly reflect the amounts calculated under the methods referred to in section 3.1 above, subject to smoothing referred to in section 3.4 below. For the With Profits Pension Annuity (Series 3 onwards) the top-up bonus will not take smoothing into account if the impact of smoothing on the total annual annuity amount is greater than 10%.

3.3.2 For individual policies, the Society does not apply a Market Value Reduction at the same time a final bonus applies and vice-versa.

3.3.3 For with-profits policies that have formulaic surrender or transfer bases (for example, conventional policies rather than unitised policies), a proportion of the level of final bonus applicable to a maturity or death claim for the same policy type is included in the policy value on claim. The amount included is determined using the methods referred to in section 3.1 above, subject to smoothing referred to in section 3.4 below.

- 3.3.4 The Society expects to set its final bonus rates for conventional with-profits policies on an annual basis. The Society may change final bonus rates more frequently than annually (the current practice permits up to four changes a year) if the results of calculations performed in accordance with section 3.1 above, subject to smoothing referred to in section 3.4 below, indicate a change by a factor of more than 5% in the amount that it is appropriate to pay compared to the previous level.

### **3.4 The approach to smoothing the value of with-profits policies**

- 3.4.1 The Society does not set a period over which it expects smoothing to be neutral.
- 3.4.2 The Society does not set an overall limit to the accumulated cost of, or excess from, smoothing. Any costs or excesses from smoothing are charged to the inherited estate.
- 3.4.3 The Society applies different smoothing strategies to different types of policy. In determining the amount that it is appropriate to pay for conventional with-profits policies, except for whole-of-life policies and the With Profits Pension Annuity, the Society smoothes the investment returns used over the previous five years, taking the geometric average of the actual investment returns.

For the With Profits Pension Annuity (Series 1), the Society smoothes the investment returns used over the previous five years and two years, taking the geometric average of the actual investment returns, using the smoothing period that provides the higher annuity amount. For the With Profits Pension Annuity (Series 2 onwards), the Society smoothes the investment return used over the previous two years, taking the geometric average of the actual investment returns. Other aspects of experience are not smoothed.

For conventional whole-of-life policies, smoothing is applied by limiting the change in the payout at a single review of final bonus rates, rather than by smoothing the investment returns used to calculate Asset Shares.

In determining the amount that it is appropriate to pay for unitised and accumulating with-profits policies the Society smooths the investment returns used over the previous two years taking the geometric average of the actual monthly investment returns. Other aspects of experience are not smoothed. The Society may introduce a new pricing series for unitised with-profits policies at times of a sustained significant up-turn or down-turn in investment returns. The Society will also introduce new pricing series for new products as appropriate.

For unitised with-profits bonds, if the Asset Share calculated using actual investment returns falls sufficiently far below the Asset Share calculated using smoothed investment returns, then the amount payable may be reduced towards the actual Asset Share by taking an appropriate percentage of the smoothed Asset Share.

- 3.4.4 The Society's current approach for conventional with-profits policies is that for similar policies of the same original term maturing in successive years, payouts do not change by more than 20% from one year to the next.
- 3.4.5 Subject to the distinction in section 3.4.3, the Society applies the same approach to smoothing, irrespective of the size of the claim or the entry-date of the policy.
- 3.4.6 For unitised with-profits bonds, if the amount determined in accordance with section 3.4.3 is below the value of the units allocated to the policy, then a Market Value Reduction may be applied, if permitted by the terms of the policy document, so as to bring the value of the units down to the amount payable.
- 3.4.7 The Society applies surrender and transfer bases, where appropriate, on a reasonably broad basis so as to avoid continual adjustments being necessary.
- 3.4.8 Partial payments under unitised with-profits policies are met by cancellation of a proportion of the policy value such that the value of the proportion cancelled is equal to the amount of the partial payment. For this purpose, the value of the proportion cancelled will take into account any Market Value Reduction that is applicable to the partial payment. At the time of any partial payment, the value of that partial payment plus the residual policy value will be equal to the total surrender value immediately prior to the partial payment.

### 3.5 The significant aspects of the investment strategy

- 3.5.1 The Society does not rely on any assets outside the fund in setting investment strategy.
- 3.5.2 The Society currently formally reviews its long-term investment strategy annually. The investment outlook and performance are monitored periodically between formal reviews when tactical decisions may be made. Board approval is required before tactical investment decisions outside the previously agreed long-term investment strategy can be implemented.
- 3.5.3 The Society seeks to optimise the return to its with-profits members while preserving its ability to meet its commitments to its members and its ability to meet its regulatory capital requirements. It also aims to match closely the guaranteed liabilities under some specific contracts, such as With Profits Pension policies, where these exceed Asset Share. The Society seeks to maintain a reasonable degree of matching of creditors through short term liquid assets where the creditors are short term and of largely known amounts. A different mix of assets is held in the inherited estate than the mix supporting policy Asset Shares.
- 3.5.4 In determining the mix of assets between different asset classes, the investment strategy will take account of the current and projected financial strength of the Society, its ability to meet its commitments to its members, its ability to meet its regulatory capital requirements, the requirements of specific product features and the long-term expected returns available in the asset classes, their volatility and the benefits to be obtained from diversification. Details of the current investment mix of the separate asset pools are available on the Liverpool Victoria website ([www.lv.com](http://www.lv.com)) or can be obtained directly from the Society.
- Cashflow projections are carried out to ensure sufficient liquidity is maintained to cover expected cash outflow.
- 3.5.5 Before investing in new or novel investment instruments, the Society seeks the formal approval of the Board as to their suitability. The Board will consider any proposals, and the associated risks, in the context of the overall investment strategy that has been adopted.

- 3.5.6 The Society holds within its fund assets that would not normally be traded. These may include physical assets such as the Society's office buildings, subsidiary companies and contingent support or guarantee arrangements to or from other companies within the Liverpool Victoria Group. The out-turn from the Society's investment in assets that are not normally traded does not directly impact the amounts payable under with-profits policies. The Society's investment strategy is determined allowing for continuing investment in these assets.

### **3.6 The exposure of the with-profits business to business risk**

- 3.6.1 The current limits that the Society applies in relation to business risk from acquiring and maintaining non-profit and with-profit policies are set out in section 3.9 below. The Society does not currently set fixed limits on the amount of its with-profits fund that may be invested in any subsidiary companies or related group companies. Instead it applies the principles set out in section 2.6 of the Principles part of this document.

The Society is exposed to business risk in the normal course of events that arise from a range of factors, including product design (for example the provision of guarantees to policyholders), selling and marketing practices, interest rate and market fluctuations, operational risks and demographic changes. It also provides a capital support facility to the RNPFN Fund (a ring-fenced sub-fund within the Society), which would be called on if the RNPFN Fund were unable to meet its regulatory capital requirements. Further information on some of the business risks undertaken by the Society can be obtained from the Annual Report & Accounts, which are available on the Liverpool Victoria web-site ([www.lv.com](http://www.lv.com)) or directly from the Society.

- 3.6.2 The Society does not currently charge losses from business risks against Asset Shares, though losses from one source may be offset against profits from another. In addition the Society may pay more than would be indicated by Asset Shares if the Board decides to allocate profits from business risks.
- 3.6.3 With effect from 2011, profits from business risks are being allocated through the declaration of mutual bonus. The decision on whether to declare a mutual bonus in respect of a given year and, if so, the level and form of the bonus and which policies should receive it, will be determined by the Board and will take into account the performance of the Society's trading businesses, along with the Society's capital position.

### **3.7 The application of charges and expenses to with-profits policies**

- 3.7.1 The charges applied to unitised and accumulating with-profits policies are the charges set out in the policy conditions.

Where the level of a charge is not guaranteed, it may be varied by the Society, subject to the requirement to treat customers fairly.

The expenses applied to conventional with-profits policies include the costs incurred in acquiring such policies, along with the costs incurred in administering and paying claims on them (including investment costs).

- 3.7.2 Any difference between the charges applied to unitised and accumulating with-profits policies in determining the amount payable under such policies and the actual expenses deemed incurred in respect of such policies is charged to the inherited estate. The Society's actual expenses charged to Asset Shares in respect of its conventional with-profits policies are equal to the expenses borne by its with-profits fund in respect of such policies.
- 3.7.3 The Society does not charge expenses to the with-profits fund at an amount other than the costs it bears in carrying out its business.
- 3.7.4 The Society obtains a range of out-sourced services from independent suppliers. These contracts are either for fixed terms and contain provisions enabling the Society to terminate the contract and implement an agreed exit plan where there has been a breach of specified conditions in the contracts or are for no fixed term where the services can be ceased with immediate effect. These arrangements are monitored for performance against agreed Service Levels. The fixed term contracts also contain clauses enabling the Society to terminate the contracts at certain fixed points during the term of the contract with the payment of compensation.
- 3.7.5 The Society currently out-sources the investment management of its assets to Threadneedle Asset Management under an arrangement scheduled to run until 2018. The performance of the asset manager is reviewed on a regular basis against agreed performance targets. The Society is able to terminate all or parts of the arrangement without compensation with immediate effect if the manager fails to meet agreed criteria.

- 3.7.6 As a mutual, the Society has no shareholders. No judgement is therefore required in applying charges and apportioning expenses between the with-profits fund and shareholder owned funds, firms or service companies.

### **3.8 The management of the inherited estate**

- 3.8.1 The inherited estate is primarily used for:

- 3.8.1.1 Providing statutory capital to meet reserving requirements, including:

- supporting the smoothing of benefits paid to with-profits members,
- meeting reserving requirements in excess of a realistic assessment of the liabilities,
- providing capital support to cover the costs of meeting guarantees.

Charges applied to policies to cover the cost of guarantees remain within the with-profits fund as part of the inherited estate.

- 3.8.1.2 Allowing investment freedom,

- 3.8.1.3 Providing working capital to cover any mismatch in timing between the receipt of charges applied to policies in the fund and the actual expenses incurred in the acquisition and maintenance of those policies,

- 3.8.1.4 Meeting any exceptional costs in managing the with-profits business arising as a result of legislation, taxation or other circumstances which in the reasonable opinion of the Board should not be charged to policyholder benefits because it would be unfair to do so, and

- 3.8.1.5 Financing new business, financing acquisitions, taking business risk and providing working capital for operational projects.

- 3.8.2 The Society's investment strategy for the inherited estate takes account of the uses in 3.8.1.1 to 3.8.1.5 above, including the investment in subsidiaries.

3.8.3 The Society does not have any current guidelines in place as to the size or scale of the inherited estate or as to how the firm would manage the inherited estate and over what time period if it became too large or too small.

3.8.4 At least once a year the Board determines (after receiving advice from the With-Profits Actuary) whether there is a surplus within the fund which exceeds the capital which the Society is required to hold and whether it is to retain that excess surplus as part of the inherited estate or to implement any other permitted arrangements to deal with excess surplus consistent with the Society's regulatory obligations to with-profits members as a whole.

### **3.9 Volumes of new business and arrangements on stopping taking new business**

3.9.1 The Board monitors at least annually the current and projected financial strength of the Society and uses this to determine the maximum volume of new business and any particular limits on classes of business, including non-profit business, within the with-profits fund.

3.9.2 The Society does not currently set a minimum proportion or scale of new business of a with-profits type to justify the with-profits fund staying open to new business.

### **3.10 Equity between the with-profits fund and any shareholders**

3.10.1 The Society is a mutual with no shareholders. All distributed profits are available for its members in accordance with its rules.

## 4. SCHEDULE

### General

None of the contents of this document forms part of, or varies, the terms or conditions of any policy under which Liverpool Victoria Friendly Society Limited is the insurer. In the event of any inconsistency between the contents of this document and any policy, the terms and conditions of the policy prevail.

This document is intended to assist knowledgeable observers to understand the way in which the with-profits business of the Society is conducted and the material risks and rewards involved in effecting or maintaining a with-profits policy with the Society. It is not a comprehensive explanation either of the management of the with-profits business of the Society or of every matter which may affect that business. In addition, no part of the document should be read as a recommendation to policyholders or potential policyholders or their advisers in relation to the effecting or maintaining of a with-profits policy.

Statements in this document in relation to the risks and rewards involved in effecting and maintaining a with-profits policy with the Society are by their nature forward-looking statements that are subject to a variety of uncertainties. Readers of this document should read such forward-looking statements in that context.

The contents of this document may change as the circumstances of the Society and the business environment changes. The document may also change to reflect changes made by the Society to the management of the with-profits business. The Society intends to give 3 months notice of any change to the Principles in this document. Changes to the Practices may be made without notice, in which case the Society will inform you within a reasonable timescale after the change is made.

Readers of this document should read the whole document. Reading only selected sections or paragraphs in isolation may result in a misleading impression of the way in which the with-profits business of the Society is conducted and the material risks and rewards involved in effecting and maintaining a with-profits policy with the Society. The Principles and their associated Practices set out in this document should in particular be read together.

### Business Risks

UK life insurance businesses are subject to a number of inherent risks that arise from a range of factors, including product design (for example the provision of guarantees to policyholders), selling and marketing practices, interest rate and market fluctuations, operational risks and demographic changes. The Society makes provisions that it considers to be appropriate for the risks that it identifies in relation to its with-profits businesses. There can be no assurance that all risks that might emerge have been identified nor that the provisions for identified risks will prove to be adequate. In addition, the risks to which the with-profits businesses are exposed will inevitably change over time.

### Asset Shares

Although asset shares are used as a broad guide for payouts on policies, policyholders have no entitlement to receive the asset shares on their policies. Asset shares can also decrease as well as increase and, at any time, an asset share may be greater or less than the contractual guaranteed benefits due under the policy. Asset shares are defined in detail in section 1.1 of the Practices.

### Governance Arrangements

Changes to the PPFM are subject to the approval of the Board. Independent judgement in assessing compliance with the PPFM and addressing conflicting rights and interests of policyholders is provided by the With-Profits Committee. The With-Profits Committee is a sub-committee of the Board, the membership of the With-Profits Committee consists of a Chairman who is independent of the LV Group, a non-executive director and the Managing Director, Life.

## 5. GLOSSARY

### **The “Board”**

The Board of Directors of Liverpool Victoria Friendly Society Limited.

### **The “Society”**

Liverpool Victoria Friendly Society Limited.

### **Annual Bonus**

An annual distribution of surplus which is guaranteed at the maturity date of the policy (or at a specified encashment date) provided certain conditions are met. It is also known as **regular bonus**, **reversionary bonus** or **declared bonus**.

### **Asset Share**

The accumulation, at investment rates of return, of premiums paid less an allowance for expenses incurred, taxation, the cost of benefits provided and any charges for the cost of guarantees or the use of capital.

### **Asset Pool**

The assets underlying asset shares or any other notional sub-division of the with-profits fund.

### **Conventional With-Profits Policy**

An older-style with-profits policy that is not a unitised with-profits policy.

### **Final Bonus**

An addition made to investments in the with-profits fund when a claim arises. It is not guaranteed and may change at any time. It is also known as **Terminal Bonus**.

### **Market Value Reduction (MVR)**

A reduction to the unit value of a policy that may be made if the policyholder takes money out of the fund. It applies to unitised with-profits policies only and is used to achieve a fair level of payouts and to be fair to the remaining with-profits policyholders in the fund. There may be MVR-free events for the policy such as specific points during its term, when an MVR is guaranteed not to be applied. The policy conditions will specify when these arise.

### **Miscellaneous Surplus**

Profits of a non-investment nature.

### **Mutual Bonus**

A discretionary addition made by the Society to allocate profits from business risks to eligible policies. It is not guaranteed.

### **Unitised With-Profits Policy**

A policy where the value of the benefits is measured by reference to a number of units allocated to the policy at the date of calculation.

### **With-Profits Actuary**

The With-Profits Actuary is a regulatory role with responsibility for advising the Board in relation to its exercise of discretion as it affects with-profits policyholders.

### **With-Profits Committee**

A committee that provides some independent judgment in assessing compliance with the PPFM and addressing conflicting rights and interests of policyholders.