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Ratings

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Liverpool Victoria Financial Services Ltd.

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Liverpool Victoria Financial Services Ltd.

Anchor	bbb+
Business Risk	**Satisfactory**
Competitive position	Satisfactory
IICRA	Low
Financial Risk	**Strong**
Capital and earnings	Excellent
Risk exposure	Moderately high
Funding structure	Moderately negative

+

Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

=

SACP	bbb+

+

Support	0
Group support	0
Government support	0

=

BBB+/Stable/--

Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Strengths	Risks
Sound capital levels thanks to the proceeds from the sale of the general insurance business.	Operating performance remains challenged by high cost base.
Good liquidity due to significant holdings in investment-grade bonds and liquid assets.	Potential acquisition by Bain Capital creates uncertainty over future strategy and capital position.
Established brand offering operating in the retirement and income-protection markets.	Although improving, fixed charge coverage metrics remain low by industry standards.

Liverpool Victoria Financial Services Ltd.'s (LVFS' or the group's) operating performance will remain under pressure due to market competition and low investment returns. LVFS will likely seek to build its market share through profitable growth over the next two years. S&P Global Ratings believes LVFS will find this growth challenging due to tough market conditions in the competitive U.K. life market and current low interest rates.

The potential acquisition by Bain Capital could affect the future strategy and financial position. LVFS announced an agreement with Bain Capital in December 2020 to sell the group for £530 million and effectively demutualize. If the sale is approved by members, then we believe Bain would in the short term likely continue to follow the strategy laid down by the current management team. However, there will be more uncertainty around LVFS' capital position and long-term strategy.

We expect that capital will remain a key strength for the rating over the next two years, depending on the new acquirer's capital strategy. The sale of LVFS' non-life operations to Allianz has left the group with an excess of capital above our 'AAA' benchmark, per our risk-based model. We expect that modest growth over the next 24 months will mean LVFS is able to maintain a surplus over our 'AAA' benchmark.

Outlook: Stable

The stable outlook on LVFS reflects our view that its capital adequacy will remain stable and a strength for the group. We believe that it will be challenging for LVFS to improve the business profile of its life operations due to competitive market conditions. However, in our view, it will maintain and profitably build on its competitive position through investments in its brand and network.

Downside scenario

We could lower the ratings over the next two years if:

- LVFS' business profile and the market share of its life operations deteriorate compared with peers', or if its operations are unable to sustainably generate competitive returns;
- We see a substantial deterioration in capital or a material shift in risk exposure that weakens LVFS' capital and earnings; or
- LVFS' financial position weakens, for example, because of insufficient capital or liquidity available relative to current and future needs.

Upside scenario

We consider an upgrade unlikely over the next two years. We might consider a positive rating action only after a material strengthening of LVFS' business profile, showing sustainable resilience in capital and earnings, and a material improvement in financial strength for a prolonged period. The combination of a constrained business profile and reduced earnings capacity gives LVFS less of a buffer in our assessment of its credit profile than we previously assumed.

Key Assumptions

- U.K. GDP to bounce back in 2021 with growth of 4.3% as the economy re-opens following the end of lockdown restrictions.
- Although interest rates will remain at historic lows, there will be incremental increases in interest rates over 2021-2022 with 10-year yields in excess of 0.5%.
- For economic assumptions see "Economic Outlook Europe Q2 2021: The Path To A Strong Restart," published March 25, 2021, on RatingsDirect.
- LVFS' strategy will be broadly unchanged if the acquisition by Bain Capital is completed.

Key metrics

	2022F	2021F	2020	2019	2018	2017
Gross written premium (mil. £)	~620	~615	613	656	788	2,431
S&P Global Ratings capital adequacy	AAA	AAA	AAA	AAA	AAA	AAA
Net income (mil. £)	~5	~5	(12)	151	(2)	74

Key metrics (cont.)						
	2022F	**2021F**	**2020**	**2019**	**2018**	**2017**
Return on equity (%)	~1	~1	(1.0)	12.7	(0.2)	6.8

F--Forecast.

Business Risk Profile: Satisfactory

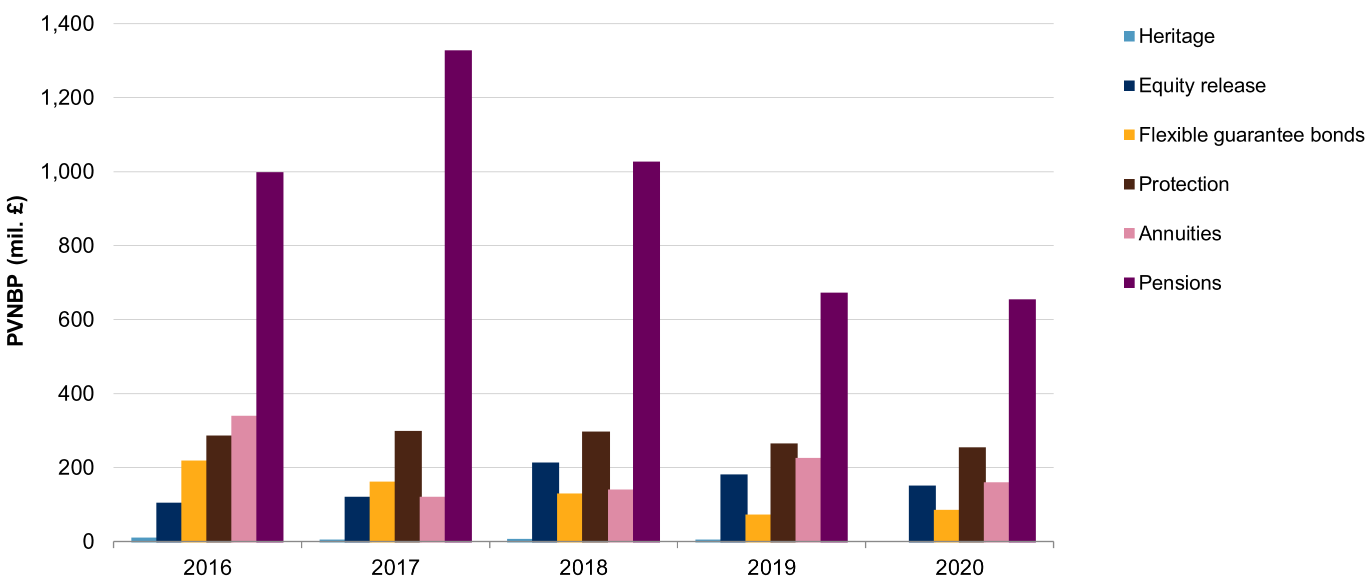
We expect that LVFS will retain its current focus on the U.K. life and savings markets over the next two to three years. The group sold the remainder of its non-life motor and home business to Allianz at year-end 2019. We do not expect LVFS to diversify outside of the U.K. or into any products outside its core of retirement, savings, and protection over the next two years.

LVFS benefits from a strong brand name in the U.K., well regarded by both its customers and financial advisors. The group has a clearly defined strategy that focuses on targeting what it calls the "mass affluent demographic" (those with pension pots of £100,000-£500,000 at retirement) who require a retirement income and investment services, and often financial advice. The acquisition by Bain Capital would effectively de-mutualize the group, meaning the with-profits fund LVFS operated would be closed to new members. A U.K. parliamentary group investigated the proposed acquisition and released a report in April 2021 that was critical of LVFS' decision to demutualize. However, we believe the decision will not have a material negative effect on the group's brand and reputation in its core markets. LVFS is one of the last major mutuals left in the U.K., with many much larger life insurers demutualizing over the past two decades.

The group's operating results have been weaker than many of its peers' such as Royal London, Aviva, and Legal and General in recent years. The sale of LVFS' motor and home business to Allianz left the group with a significant cost base for its now reduced size. This has put LVFS at a competitive disadvantage compared to peers. We expect that management will continue to focus on right sizing the group's cost base over the next two years, reducing controllable operating costs to about £95 million in 2023 from £108 million in 2020. In 2020, LVFS recorded negative trading results for its new business in both the retirement and savings and protection segments. This was due to material impacts from COVID-19, which reduced volumes and margins. That said, we note that in 2020 LVFS was able to increase its market share, which should help expand its book in the next two years. We expect that, in 2021-2022, LVFS' new business will return to positive margins of over 1%.

Chart 1

COVID-19 Hit Margins And Volumes Of Many LVFS Products
Measured on present value of new business premiums basis



PVNBP--Present value of new business premiums. Source: S&P Global Ratings.

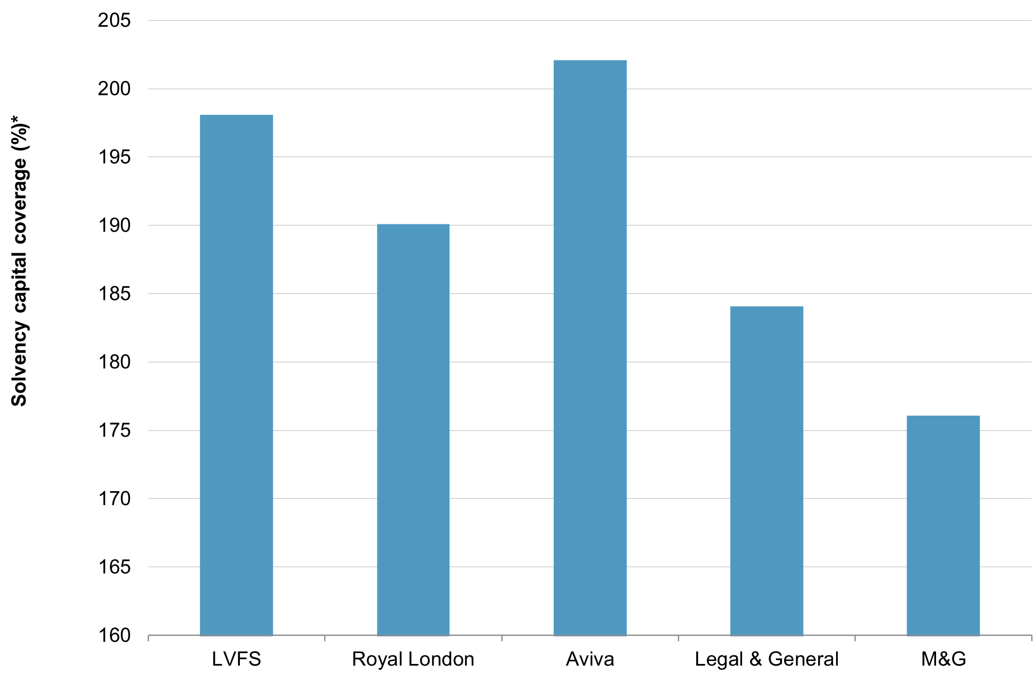
Financial Risk Profile: Strong

We expect that LVFS' robust capital position will remain a key rating strength over the next two years, depending on the new acquirer's capital strategy. LVFS currently has a large capital surplus over our 'AAA' benchmark, under our model, and one of the highest regulatory capital surpluses in the U.K. life market. We expect that LVFS will maintain 'AAA' levels of capital over the next two years since forecast limited growth will not add significant risk to its balance sheet.

We do note, however, that in the long-term the group's capital position is likely to deteriorate unless management address operating performance. The group's solvency "investor" coverage ratio fell by 46% to 198% in 2020 from 244% in 2019 as capital generated was consumed by nontrading expenditure, debt interest, de-risking the pension scheme, and distributions to members. The group's limited earnings constrain its ability to organically build up capital for future growth, especially considering its not-insignificant financial obligations. The disposal of LVFS' non-life business had a significant effect on earnings, since non-life operations generated a substantial proportion of profits in the years leading up to the sale. We also note that LVFS has lower quality of capital than that of some peers, with significant amounts of its capital resources comprising hybrids and value-in-force (the present value of profits that will emerge from policies over time).

Chart 2

LVFS' Capital Cover Is One Of The Strongest Of Its Main U.K. Peers



*All ratios are based on the group's solvency II coverage on an investor or shareholder basis (some may be published estimates). Source: S&P Global Ratings.

We believe that LVFS' earnings,like many of its peers' in the sector, are likely to be somewhat susceptible to external regulatory or legislative pressures. Additionally, LVFS has a relatively high defined-benefits pension liability, and the investment portfolio is concentrated in the financial sector. Slightly offsetting this is the buy-in transaction LVFS completed in 2020 on £800 million of its pensions liabilities, which alleviates some risk from its defined benefits pension scheme. Investment yields are also facing pressure from the low-interest-rate environment and ongoing market volatility. High potential sources of capital and earnings volatility therefore constrain our overall assessment of the financial risk profile.

Other Key Credit Considerations

Governance

LVFS has a sound governance structure and recently reviewed its risk framework to update policies after the divestment of its non-life operations. If the acquisition by Bain is completed, we would expect changes to the board but for it to still maintain independence from the owners.

Liquidity

We have a favorable view of the mutual's liquidity position, based on its highly liquid asset portfolio.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Appendix

Liverpool Victoria Financial Services Ltd. Credit Metric History

	--Fiscal year ended Dec. 31--	
(Mil. £)	**2020**	**2019**
S&P Global Ratings capital adequacy	N/A	N/A
Total invested assets	14,135	13,783
Total shareholder equity	1,115	1,254
Gross premium written	613	656
Net premium written	340	390
Net premium earned	340	390
Reinsurance utilization (%)	44.54	40.55
EBIT	59	273
Net income (attributable to all shareholders)	-6	189
EBIT fixed-charge coverage (x)	2.46	11.38
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	2.46	11.38
Financial obligations/adjusted EBITDA (x)	6.34	1.37
Financial leverage including pension deficit as debt (%)	25.12	22.93
Net investment yield (%)	1.70	2.23
Net investment yield including investment gains/(losses) (%)	7.33	10.41

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	**Strong**	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	**a-/bbb+**	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of April 15, 2021)*

Operating Company Covered By This Report	
Liverpool Victoria Financial Services Ltd.	
Financial Strength Rating	
Local Currency	BBB+/Stable/--
Issuer Credit Rating	
Local Currency	BBB+/Stable/--
Subordinated	BBB-
Domicile	United Kingdom

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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