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Liverpool Victoria Financial Services Ltd.

Primary Credit Analyst:

Simran K Parmar, London (44) 20-7176-3579; simran.parmar@spglobal.com

Secondary Contact:

Tatiana Grineva, London (44) 20-7176-7061; tatiana.grineva@spglobal.com

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Liverpool Victoria Financial Services Ltd.

Credit Highlights

Operating Company Covered
By This Report

Financial Strength Rating

Local Currency

BBB+/Stable/--

Overview

Key strengths	Key risks
Established brand offering of retirement and income-protection products, albeit in concentrated segments of the U.K. markets.	Operating performance remains challenged by competitive pressures in the U.K. markets and low investment returns.
Sound capital levels thanks to the proceeds from the sale of the general insurance business.	Strategic review of operations could lead to change in business or financial policy.
Good liquidity due to holdings in investment-grade bonds and liquid assets.	Limited sources of external financial support and high debt obligations.

The company's operating performance will remain under pressure due to market competition and low investment returns. Liverpool Victoria Financial Services (LVFS or the mutual) needs to demonstrate consistent and profitable growth to improve risk-based returns, which S&P Global Ratings believes will be difficult due to market competition and economic effects from the pandemic. Furthermore, the low interest rate environment and ongoing market volatility means limited upside from investment returns.

Strategic review could lead to significant change in business or financial policy: The outcome of the ongoing strategic review undertaken by the management and board could have a material impact on our view of LVFS' business or financial position. We await the conclusions of the review to assess the impact on the ratings.

The company's limited sources of capital and funding weigh on the ratings. As a mutual, LVFS has limited ability to raise capital from external sources. Furthermore, given the pressure on earnings, we believe that the potential to replenish capital from earnings retention or additional leverage is limited.

Outlook

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 the 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 of time. 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

- We expect the U.K. economy will contract 8.1% this year, but expand by 6.5% next year thanks to the unlocking of pent-up household spending.
- Over the forecast horizon through 2021, we expect that the Bank of England's stance will remain relatively accommodative and interest rate increases will be very gradual.
- For more macroeconomic assumptions, see "The Eurozone Will Recover Only Gradually," published July 24, 2020, on RatingsDirect.

Liverpool Victoria Financial Services Ltd.--Key Metrics

(Mil. £)	2021f	2020f	2019	2018	2017†
S&P Global Ratings' capital adequacy*	Excellent	Excellent	Excellent	Excellent	Extremely strong
Net income§	<0	<0	151	(2)	74
Return on shareholders' equity (%)§	<1	<1	12.7	(0.2)	6.8

Liverpool Victoria Financial Services Ltd.--Key Metrics (cont.)

(Mil. £)	2021f	2020f	2019	2018	2017†
New business margins on PVNBP basis (life) (%)	>1	>1	1.00	1.0	1.8

f--Forecast. PVNBP--Present value of new business premiums. *For year 2017, capital adequacy is as per old criteria nomenclature. §Net income for 2017 and 2018 includes income from discontinued operations adjusted for non-controlling interest. Forecasted net income and return on equity are for continuing operations only. †Metrics for 2017 are based on restated accounts.

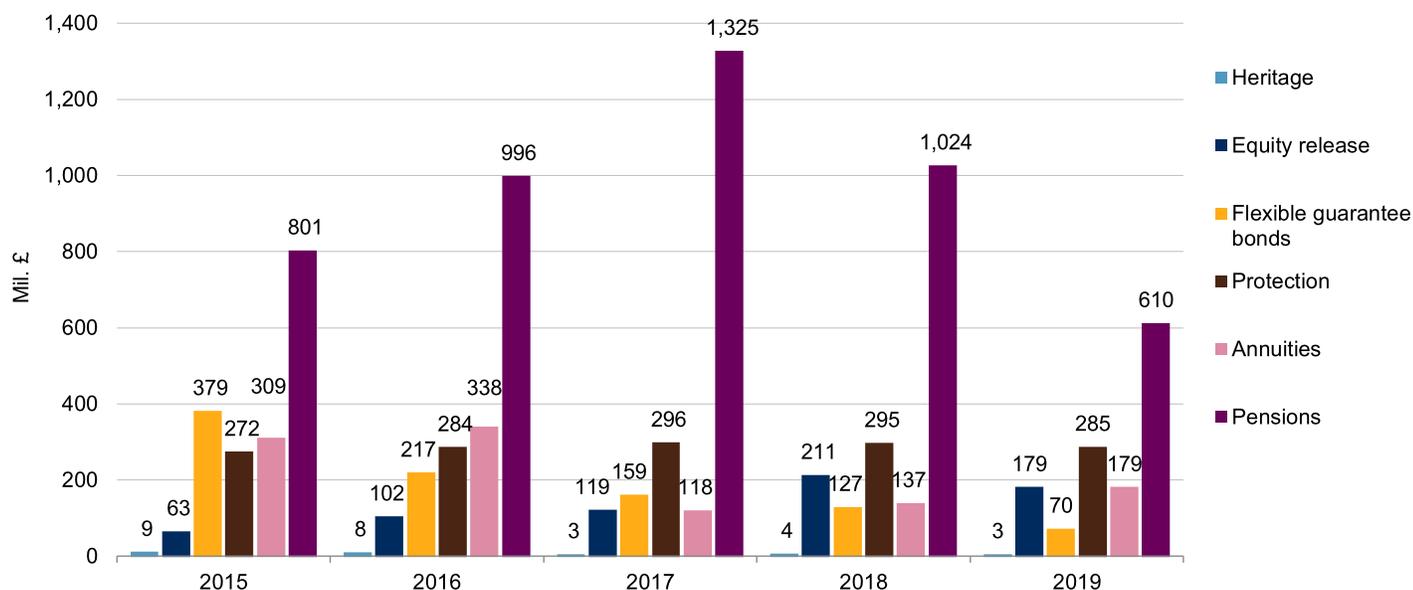
Business Risk Profile

LVFS' life strategy is based on leveraging profitable niches and targeting a mass affluent demographic at, and beyond, retirement age. The mutual insurer has a well-recognized brand and a strong market presence in the U.K. individual income-protection sector. However, the life segment's results have often been depressed by market movements, which constrains our profitability assessment. We believe post divestment of the general insurance (GI) business, LVFS' competitive position has weakened, since the business profile is now concentrated on the less profitable and more volatile life insurance business. We note that the company is exploring potential strategic options and the results from the review could lead to a reassessment of our view of the operations.

At year-end 2019, total life new business in terms of the present value of new business premiums decreased by 26% year on year to £1,323 million. New business contribution dropped by 26% year on year to £14 million at year-end 2019. The decline primarily reflects the slowdown in pensions sales.

Chart 1

Evolution Of LVFS Product Mix On PVNBP



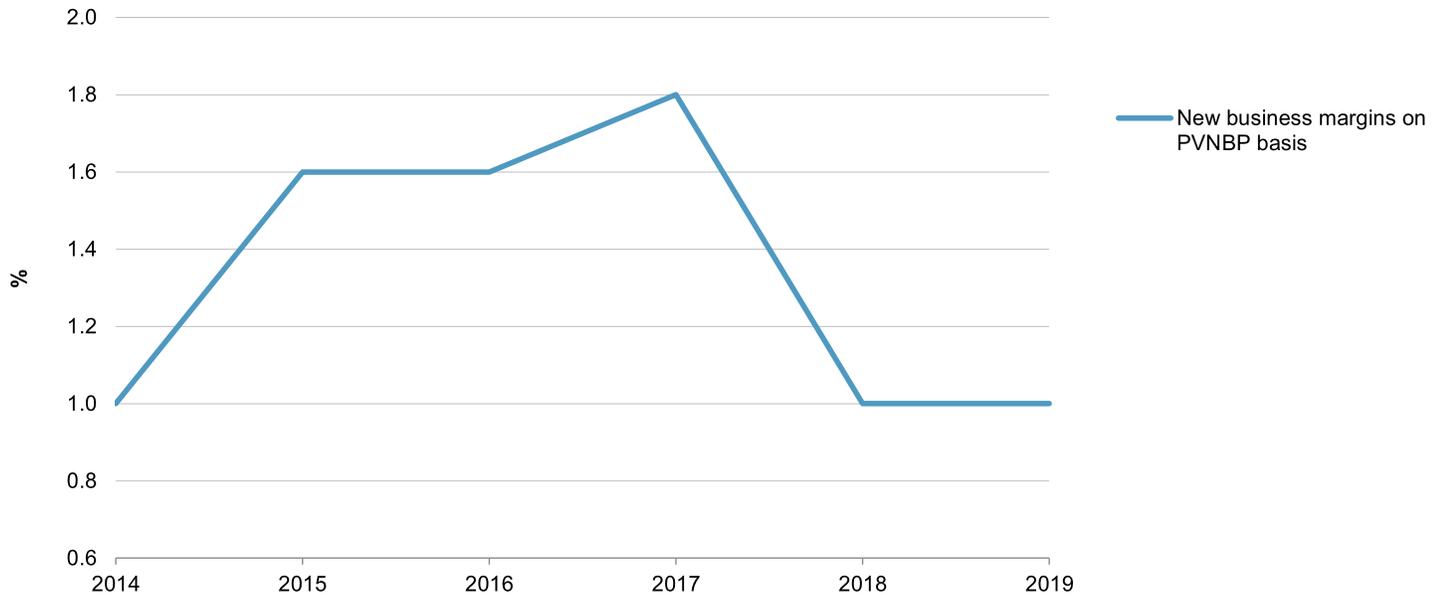
LVFS--Liverpool Victoria Friendly Society. PVNBP--Present value of new business premiums. PVNBP includes discontinued products, mainly lifetime annuities and 50+. Source: S&P Global Ratings.

In our view, LVFS will find it difficult to improve profitability and build a sustainable market position in the life business, given the tough competition it faces and economic impact from COVID-19. Successful implementation of strategic objectives such as on-going cost efficiency program and the ability to competitively develop and stabilize the life operations will be vital over the next one-to-two years.

Prospectively, we expect that LVFS' operating performance will remain challenged, and new business margins are likely to remain at below 1.0%. Further deterioration in scale would increase pressure on the creditworthiness of the operations.

Chart 2

LVFS' New Business Margins



LVFS--Liverpool Victoria Friendly Society. PVNBP--Present value of new business premiums. Source: S&P Global Ratings. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

Financial Risk Profile

We anticipate that LVFS will maintain its capital and financial profile, which will help alleviate some of the earnings pressure. Depending on the outcome from the ongoing strategic review, we could revise our assessment of the company's financial profile.

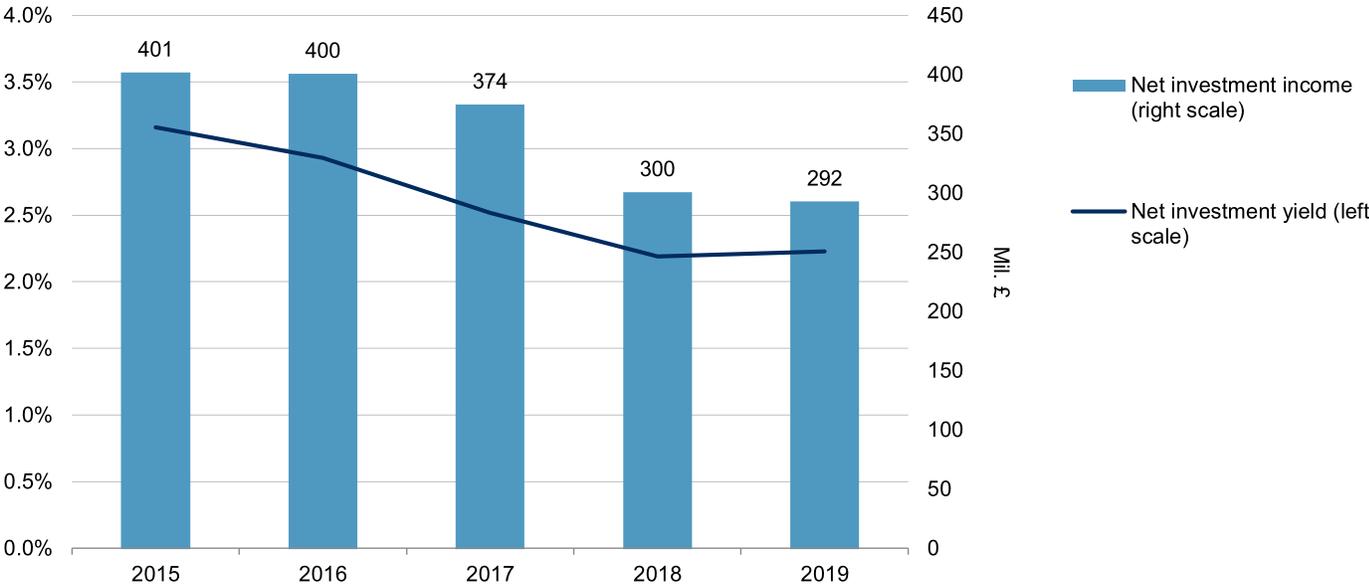
That said, weak profitability from the life operations constrains LVFS' ability to organically build up capital for future growth while servicing its financial obligations. Earnings have fallen after the sale of GI transaction because the nonlife operations were generating a significant proportion of the group's earnings. Furthermore, the scale of the balance sheet and reliance on soft capital such as hybrids and value-in-force (the present value of profits that will emerge from policies over time) limit our assessment.

In recent years, LVFS has witnessed significant variations in both capital and earnings. The past levels of retained earnings have proven insufficient to adequately reinforce the balance sheet to withstand market effects. We consider earnings to be 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. We note that in the first half of 2020, LVFS entered into a buy-in transaction on £800 million pensions liabilities, which alleviates some

of the risk from the defined benefits pension scheme. Investment yields are also facing pressure from the low-interest-rate environment and the ongoing market volatility. High potential sources of capital and earnings volatility therefore constrain our overall assessment of the financial risk profile.

Chart 3

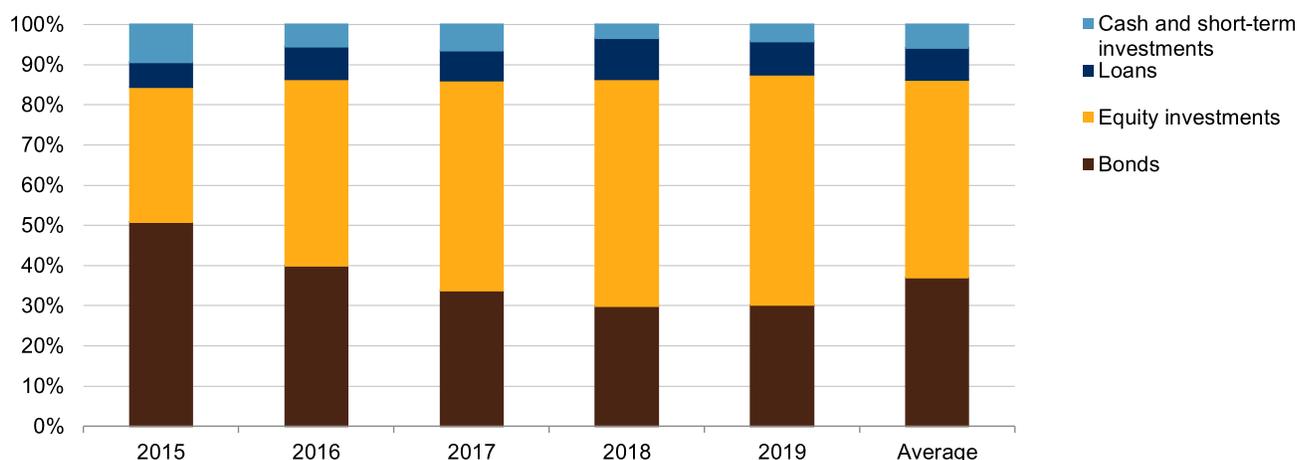
LVFS' Investment Income



LVFS--Liverpool Victoria Friendly Society. Source: S&P Global Ratings.
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Chart 4

LVFS' Investment Portfolio



LVFS--Liverpool Victoria Friendly Society. Source: S&P Global Ratings.
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We expect that debt coverage metrics will remain under pressure because LVFS' earnings capacity remains low compared to its financial obligations.

In our opinion, LVFS has limited sources of external capital and liquidity. The £350 million hybrid issue in May 2013 already exceeds our 25% ceiling for inclusion in total adjusted capital. Consequently, we would not give capital credit for any further hybrid issues. Furthermore, as a mutual insurer, LVFS does not have the option of raising funds through equity issuance.

Other Key Credit Considerations

Governance

LVFS has a sound governance structure and has recently reviewed its risk framework to update policies after the divestment of the GI operations. We view the risk structure and governance as neutral to our assessment.

Liquidity

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

Ratings Score Snapshot

Liverpool Victoria Financial Services Ltd.--Ratings Score Snapshot	
Business Risk Profile	Satisfactory
Competitive position	Satisfactory
IICRA	Low

Liverpool Victoria Financial Services Ltd.--Ratings Score Snapshot (cont.)

Financial Risk Profile	Strong
Capital and earnings	Excellent
Risk exposure	Moderately high
Funding structure	Moderately negative
Anchor*	bbb+
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	BBB+

IICRA--Insurance industry and country risk assessment. *This is influenced by our view of LVFS' weaker operating performance than most of its higher-rated peers and uncertainty over its future financial profile.

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

Related Research

- A Strategic Options Assessment By U.K. Life Insurer LVFS Could Lead To Future Rating Actions, June 15, 2020

Appendix**Liverpool Victoria Financial Services Ltd.--Credit Metrics History**

(Mil. £)	2019	2018	2017†
S&P Global Ratings' capital adequacy*	Excellent	Excellent	Extremely strong
Total invested assets	13,783.0	12,357.0	15,088.0
Total shareholder equity	1,254.0	1,127.0	1,189.0
Gross premiums written	656.0	788.0	835.0
Net premiums written	390.0	542.0	(257.0)
Net premiums earned	390.0	542.0	(257.0)
Reinsurance utilization (%)	40.6	31.2	130.8

Liverpool Victoria Financial Services Ltd.--Credit Metrics History (cont.)

(Mil. £)	2019	2018	2017†
EBIT	235.0	(9)	118.0
Net income (attributable to all shareholders)	151.0	(2)	74.0
Return on shareholders' equity (%)	12.7	(0.2)	6.8
EBIT fixed-charge coverage (x)§	9.8	(0.4)	4.9
EBITDA fixed-charge coverage (x)§	10.2	--	5.3
Financial obligations/EBITDA adjusted	1.4	N.M.	2.8
Financial leverage including pension deficit as debt (%)	21.7	23.7	23.1
Net investment yield (%)	2.2	2.2	2.2
Net investment yield including investment gains/(losses) (%)	10.4	(2.2)	4.8

N.M.--Not meaningful. *For year 2017, capital adequacy is as per old criteria nomenclature. §Fixed charge coverage is calculated based on EBIT.
†Metrics for year 2017 are based on restated accounts.

Ratings Detail (As Of September 9, 2020)*

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.

Additional Contact:

Insurance Ratings Europe; insurance_interactive_europe@spglobal.com

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