Gareth Thomas, MP
House of Commons
London
SW1A 0AA

16th March 2021

Dear Mr Thomas,

Thank you for your invitation to the All-Party Group for Mutuals to discuss the proposed sale of LV= to Bain Capital. I look forward to meeting you and other members of the APPG on 23 March. The answers to the questions you have sent in your letter of 11 February are set out below.

Before I turn to the questions, I would like to set out some background information.

Having completed the sale in 2019 of the General Insurance (GI) business to Allianz – releasing the value and capital that we'd built over the previous decade in growing this franchise - it was clear to the Board that the business faced a challenge. The life and pensions market was becoming increasingly dominated by large insurers with access to capital. The scale of investment needed for LV= to remain competitive meant there was insufficient capital to both ensure the interests of With-profits members were met and support the investment needed for the future growth of LV=. Without investment the new business franchise would lose market share and eventually become unviable.

Ultimately, structured as a mutual, it is capital provided over time by our With-profits members which would be needed to fund this investment and growth. However, the time taken to deliver the returns means many With-profits members would not see the rewards before their policies came to an end – most within the next eight or nine years. We are also not able to raise further debt.

Early in 2020, with this in mind, the Board began a strategic review of the business. This was a comprehensive and rigorous process that had members' interests at its core.

Taking the investment required into account, the Board concluded that continuing 'as is' was not in our members' best interests. The Board then considered the option of closing to new business and running off the existing policies. This would have destroyed the value that LV= had built in its franchise over the years. After an extensive review against strict criteria, the Board decided that LV= needed to explore the option of seeking external investment from a third party.

In the Spring, we started a structured process to determine external interest in acquiring whole or part of the LV= business. Initially we received 12 formal bids from interested parties – a great testament to the attractiveness and potential of LV=. The Board explored each proposal thoroughly, with support from financial, legal and actuarial advisers, and compared options using a detailed assessment framework that had been shared with the Regulators. We narrowed the bids down to four by June. Following an extensive period of analysis with these parties, we further reduced this to two bids by the late summer.

Once we knew we could achieve an excellent financial outcome for members, in their statutory duty as directors, the Board also looked at other benefits the bids could bring to LV= and all our other stakeholder

groups. These included our employees, the communities we serve and the opportunity to continue to operate in the life and pensions market.
Having considered these groups carefully, the Board came to the unanimous decision that the transaction with Bain Capital presented:

1. Benefits for all our members - giving them a one-off member payment and the opportunity for enhanced customer experience through long term investment.
2. An excellent financial outcome for With-profits members, who will see:
   - Enhanced returns as a direct result of the transaction through higher payments when their policies end
   - A ring-fenced With-Profits Fund that cannot be accessed by Bain Capital and will be insulated from new business risk
   - Greater certainty around costs, with a fixed cost schedule for both administration and investment management charges – particularly important in the context of a With-Profits Fund with declining member numbers.
3. The continuation of our culture, values and ethos for our employees and the opportunity for them to be part of a growing business with a commitment to our three sites.
4. The opportunity to retain the LV= brand in the UK life and pensions market – with significant investment that will benefit competition and customer choice.

The Board recognised that moving forward with this transaction meant LV= would no longer be a mutual – a decision that was not taken lightly. However, it is our duty to put the interests of our members first, and having completed a robust and rigorous process, it is clear that the proposed transaction with Bain Capital provides the best possible outcome for members.

As a result, LV= will continue to play an important role as an employer and provider of financial resilience to our customers today and long into the future.

Yours sincerely,

Mark Hartigan

Chief Executive Officer - Liverpool Victoria Financial Services Limited

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Questions

1) Why does the Board and senior management of LV= think the sale to Bain Capital is necessary?
At all times the Board's decision making is driven by the primary objective to act in the best interests of our 1.25 million members.

At the end of 2019, we fully completed the sale of the General Insurance (GI) business to Allianz – releasing the value and capital that we have built over the previous decade in growing this franchise.

We operate in an increasingly competitive market, dominated by large insurers with access to capital. It was clear to the Board that LV= would require significant long-term investment to keep pace with these leading market players.

As a mutual we are restricted in our ability to raise capital to invest in the business, for example we cannot issue equity and the only internal source of capital we have is provided over time by our With-profits members. The scale of the investment needed for LV= to remain competitive, even with the value returned as a result of the sale of the GI business, meant there was insufficient internal capital; both to invest sufficiently and ensure the interests of With-profits members are met. The time taken to deliver the returns means many With-profits members would not see the rewards before their policies came to an end – with the vast majority of policies ending within the next eight or nine years.

There were a number of options the Board considered with members' interests the focus:

- Growing the business organically as a standalone business;
- Close to new business and enter run off; and
- Explore a transaction with a third party.

Ultimately, the Board concluded the first two options would not be in members best interests or maximise the value of the business and brand for current members without significant risk and therefore decided that they needed to explore a transaction with a third party.

Twelve bids were received and all of the proposals were explored thoroughly, supported by financial, legal and actuarial advisers and assessed using a process and criteria shared with the Regulators before the process started. There was no pre-determined outcome.

The conclusion, after advice from the With-Profits Committee (WPC), was clear and supported by every member of the Board. Bain Capital was the only option that offered an excellent financial outcome for members and also gave an unrivalled commitment to LV='s future prospects, business and people.

2) What is your estimate of the investment you claim is needed to make LV= sustainable in the long term and what other options, apart from a sale, have you considered for raising these funds?
As a mutual we do not have the same access to capital markets as listed companies – we cannot issue equity or different types of debt such as convertibles. The £350m of subordinated debt capital we raised in 2013 represents the maximum amount we could raise under Solvency II rules and we therefore cannot secure further capital from the debt markets.

The scale of the investment required, not only to remain competitive but to grow LV=, is significant. This investment would enhance the overall customer experience and new business offering through improving the current IT estate - investing in digital capabilities to allow customers greater self-service functionality. For example, modernising systems to allow integration into IFAs' back office - critical for LV= to remain relevant in the market and easy to do business with. It would also facilitate proposition development for the Savings & Retirement and Protection franchises. By way of example just to re-platform the general insurance business cost in the region of £100m.

If we remained a mutual, existing capital provided over time by our With-profits members would be needed to fund this ongoing investment and growth. Capital that would otherwise be used to fund our With-profits members distributions, would instead be used to fund that investment. Given the long payback periods in the life and pensions sector many of our members would not see the rewards, as many of today's With-profits policies will end within the next eight or nine years.

Another key consideration was the level of risk and uncertainty that comes with the scale of such significant investment and the associated change programmes. Large programmes such as LV= would require, often take longer and cost more than initial estimates suggest. Considering all of these factors together with our declining With-profits business we did not believe it was right to expose our existing capital to the risks associated with this investment.

3) How many organisations did LV= have detailed and serious discussions with about a possible sale or injection of funds from prior to selecting Bain Capital?
Once the Board decided to explore a potential transaction with a third party, we contacted a range of potential partners including in-market proprietary companies, other mutuals, new entrants, and financial investors - with all parties given access to the same information.

This comprehensive and rigorous, Board-led process resulted in 12 formal bids at the end of June - a testament to the attractiveness of the business.

Broadly speaking, we received two types of fundamentally different proposals:

- Insurance companies who would integrate LV= into their business - keeping the parts they wanted and closing the rest; and
- Organisations that weren't insurance companies but who wanted to invest in LV= to grow the business.

The Board used its strategic assessment criteria to compare the different bids, against organic options, such as the current business plan and a closure scenario. The Board concluded that the external options looked to give better outcomes for members and other stakeholders and decided to proceed with four parties, including Bain Capital. These parties participated in more detailed discussions and were also provided with access to confidential company information and management.

This phase ended in August when using the same assessment criteria, it was decided to continue discussions with two parties. Both of these parties were informed of the areas of their proposals that needed to be improved, and were provided with the same additional information to enable them to conduct further confirmatory due diligence, as they required.

From this third stage of the process, we received best and final binding offers from the two parties. Using the same assessment criteria, we decided to enter a period of exclusive talks with Bain Capital, which was announced to the market in October 2020. Following a period of exclusivity, we signed and announced the transaction in December 2020.

4) Why does the Board of LV= believe Bain Capital are the best source of that capital rather than for example another mutual insurer?
Bain Capital was chosen because its proposal represents an excellent financial outcome for members, and in particular With-profits members, rather than because it is the best source of capital.

Bain Capital put forward a proposal that provides an excellent financial outcome for members - not only in the purchase price but also through a fixed cost schedule for administration and asset management charges that With-profits members will benefit from even as the book reduces in size. It was the only party to offer such arrangements for the full period of time taken for the With Profit Fund to run off. It was also the only offer which resulted in a much lower risk profile by removing certain risks from the With-Profits Fund, including risks associated with certain types of business.

The structure of the transaction allows the With-profits business to continue to effectively be run on mutual grounds, but in a way which reduces the risks to which With-profits members are exposed. The fund will be ring-fenced with Bain Capital unable to access the capital in the fund ie they cannot take any funds out to benefit the shareholders. These are substantial benefits to the running off of the With-profits fund, allowing more certainty around the distributions to be made to With-profits policyholders.

Bain Capital's proposal also ensures the long-term interests of With-profits members continue to be protected by an experienced With-Profits Committee which will be focussed solely on the interests of our With-profits customers.

Additionally, Bain Capital was the only party to offer the strongest commitment to the future of LV= and our people. Only Bain Capital assured an on-going presence in our three locations of Bournemouth, Exeter and Hitchin. This gives our people the opportunity to participate in an exciting future and supports the communities in which we serve.

This deal reinforces LV='s position in the Savings, Retirement and Protection market – providing continued customer and adviser choice. Core to Bain Capital's entire investment philosophy is driving sustainable, long-term growth. They see the importance and value of the LV= brand and culture – it's this potential they want to preserve and grow.

None of the twelve bids considered, offered the equivalent membership of a mutual as members have today. Compared to the Bain Capital proposal no other provided a better financial outcome, offered our With-profits members the same level of governance arrangements and a better cost structure. Nor did they provide the commitment to LV='s future prospects, business and our people.

We therefore concluded that the transaction with Bain Capital provided the best outcome for our members and for future growth.

5) Your press release on the 15th of December announcing the proposed deal with Bain Capital describes them as "one of the most experienced de-mutualisation investors in the industry globally" it would be helpful to know what you see as being the benefits of demutualisation and what other businesses Bain Capital has demutualised?
When considering potential strategic options, the LV= Board was focused first and foremost on the outcomes for members and did not have any predetermined view on how this would be achieved. The proposed transaction with Bain Capital offers an excellent financial outcome for all our members as well as

offering benefits to our other stakeholders. This transaction does also result in LV= demutualising – a decision that the Board did not taken lightly, however it was driven by what is in the best interests of members.

The Board's focus was not about the benefits of demutualising, rather on the benefits that any proposed transaction would offer. In the case of the proposal from Bain Capital these include:

- For all our members, a one-off member payment and future investment in the business ultimately providing an enhanced customer offer and experience.
- An excellent financial outcome for With-profits members with: enhanced returns; a ring-fenced With-Profits Fund that cannot be accessed by Bain Capital, insulated from significant business risk; and greater clarity around ongoing costs.
- The continuation of our culture, values and ethos for our people and the opportunity for them to be part of a growing business, with a commitment to our three sites.
- The opportunity to retain the LV= brand in the UK life and pensions market – with significant investment that will benefit competition and customer choice.

We will be creating a new ring-fenced With-Profits Fund, run for the sole benefit of the WP policyholders with Bain Capital not able to access the capital within it. This is therefore effectively a mutual fund within a shareholder owned structure.

The Bain Capital team leading this transaction has extensive experience working with insurers and mutuals. This includes the successful demutualisation of Shenandoah Life Insurance Company, a Virginia based life insurance company founded in 1916; SBLI USA – a New York based insurance company founded in 1939; and Federal Life Insurance Company – an Illinois based life insurance company founded in 1899. Similar to the LV= situation, Bain Capital got involved after these companies had decided to demutualise to help realise their full potential through future growth. Their experience and success working closely with companies that have chosen to demutualise will benefit LV= and its stakeholders.

The Bain Capital team has been involved in over 20 insurance company transactions over their careers, many of which have been in the retirement and savings sector and been mutuals.

6) What will the Members gain from the sale of LV='s non-profit business to Bain Capital and what additional payment will they receive for giving up their mutual membership?

LV= is owned by our members, and it is their interests that we place first and foremost. We believe that this transaction provides an excellent financial outcome for all our members.

As a result of this transaction all eligible members are expected to benefit from a one-off cash payment upon full completion of the transaction.

In addition, for With-profits members, the transaction delivers an excellent financial outcome giving them greater security and increased pay-outs as policies end. The capital available for distribution is expected to increase by up to 40% and will be used to increase payments to With-profits members as their policies end. These members will also have the benefit of being in a separate ring-fenced fund with the capital held solely for the benefit of the With-profits policyholders and separated from the ongoing risks relating to new non-profit business.

Details on the value of these payments will be shared with members in a detailed pack when we invite them to vote on our proposals later this year – we cannot currently disclose what these are likely to be as we are validating our proposals with an Independent Expert to ensure what the Board is proposing is fair to all members.

Bain Capital put forward a proposal that provides an excellent financial outcome for members - not only in the purchase price but also through fixed cost administration and asset management agreements that our With-profits members will benefit from even as the With-profits book reduces in size. Bain Capital was the only party to offer a long-term arrangement which would last for the whole period of the run off of the With-Profits Fund. The offer from Bain Capital results in a much lower risk profile by removing certain risks from the With-profits fund including risks associated with certain blocks of business. These are substantial benefits to the running off of the With-profits fund, allowing fair distributions to be made to our WP policyholders.

Finally, Bain Capital has indicated it will be investing in the business to enhance our customer service and digital capability which LV= could not have done without its investment and which will improve the customer experience for all policyholders in the future.

7) What discussions have the Board or management had with Regulators about the proposed demutualisation and sale to Bain Capital so far?

We have maintained a close and open relationship with both the FCA and PRA throughout this process. We have held regular meetings and provided information to both Regulators at all the key stages of the transaction including: assessing the proposals using the Strategic Assessment Framework (SAF); moving into exclusivity with Bain Capital; and on-going interaction during the implementation stage of the transaction.

Below are examples of the key discussions:

- Prior discussion regarding the development of the SAF used to assess the options available to: remain open to new business under the existing structure; close to new business and run the business off; or seek external investment from a third party.
- The development of the SAF was discussed frequently to ensure the framework was balanced, and the final version was shared with both Regulators.
- All Board material and Board decisions have been provided to the Regulators following each meeting and follow up meetings held with the Regulators to discuss content.
- Members of the Board and the Executive team have and will continue to meet frequently with the Regulators to discuss all aspects of the transaction.
- The Regulators were informed when through the SAF it was concluded that there was a need to explore the potential third-party outcomes involving a partner or a buyer. The Regulators were subsequently engaged and informed of all activity during the due diligence stages of the bid process.

The decision at the Board meeting in September 2020 to progress with Bain Capital was immediately shared with both Regulators and discussions were held on next steps. We have developed, and shared with the Regulators a critical path timetable and detailed the interactions and approvals required from them. We will ensure sufficient time for the Regulators to consider the reports of the Independent Expert and consider the member communications. We are also in the process of setting up regular project meetings with the PRA/FCA to manage the project through the various stages of the Regulatory and court approval process.

8) Could you explain for us why the corporate structure of LV= was altered in 2020 from a Friendly Society and what difference does this change make to the process of demutualisation?
LV= was a Friendly Society governed by the Friendly Societies Act 1992. Many of that Act's provisions have not been updated and it restricted our ability to manage the business effectively and in the best interest of our members.

Converting to a Company Limited by Guarantee would have enabled us to split the capital in our business between two funds: separating the With-Profits Fund to protect the interests of With-profits members; and allowing more flexibility by creating a mutual capital fund to house our existing and new non-profit policies, with sufficient capital to invest and grow LV='s business. Our original intent at that time.

We therefore decided to convert to a Company Limited by Guarantee in order to have more flexibility and freedom as well as the ability to structure ourselves to compete in today's market place.

The Companies Act 2006 has been regularly updated and contains much clearer and more up to date requirements and provisions regarding governance, corporate structure and operations, as well as acknowledging technological advances since 1992.

The change to a Company Limited by Guarantee also means that LV= can use a scheme of arrangement to restructure our business as would have been the case had we split our business into two separate funds. It also gives us the ability to change an article in our constitution to implement a transaction with a company other than a mutual, giving more flexibility to potential transactions with third parties to the benefit of our members.

The change to a Company Limited by Guarantee was all about LV='s long-term future and providing greater flexibility to the Board and the right foundations from which to build on our heritage and strong brand to create an even stronger business.

9) What do LV='s current management believe are Bain Capital's plans for the future of the insurance business they are hoping to buy? a) For example what are their plans for jobs, offices and customer advice services? b) Do they expect Bain Capital to fund their takeover and ownership of LV='s insurance business through debt, which would be added to the new company's debt stock?
It is important to explain that Bain Capital would, in the event of the proposals going ahead, be the owner and not the day-to-day manager of the company. The leadership team is expected to continue leading the business on a day-to-day basis. They will be supported by a new Board which, although still to be determined, is expected to have representatives of Bain Capital and will also include a majority of independent directors.

In terms of plans for the future, Bain Capital is investing in LV= for the potential growth opportunities it offers to develop distribution channels and build out the savings and retirement and protection businesses. This includes developing LV='s digital offering, as well as developing face-to-face advice and relationships with advisers who recommend LV='s products. We will continue to build on the existing focus on operational efficiencies to enable the business to grow sustainably and deliver a better experience for customers.

Of all the bidders, Bain Capital offered the strongest commitment to the future of LV= and our people. Only Bain Capital assured an on-going presence in our three locations in Bournemouth, Exeter and Hitchin. As a result, the transaction does not change the plans for our employees or the way we serve customers.

As part of the legal process (Part VII transfer) to complete the transaction, LV='s existing subordinated debt - then in issue - will transfer with the business. There is no additional debt being issued by LVLC as part of the transaction and the debt levels of LV= will not increase as a result of the transaction.

10) How are members of LV= being given access to independent advice so they can judge themselves whether the sale to Bain Capital is in its and the business' best interests?

An Independent Expert (IE) has been appointed to evaluate the implications of the plans from a member and customer perspective and will consider the impact on both With-profits and non-profit customers. The IE will produce two reports (a) the vote on approval of the transaction and (b) on the proposed change to our rules to allow the transaction to be fully implemented.

A separate report will also be produced by the With-profits Actuary focused on the impact on With-profits members.

The full reports produced by the IE and the With-profits Actuary will be available to members on our website or on request, and a summary included in the member voting communications sent out ahead of the member vote.

If the transaction proceeds there will be a separate IE appointed for the Part VII process to also produce a report on the impact on members of the transfer of the business to Bain Capital. The process to appoint an IE for this role is underway.

11) We would welcome your comment on reports in the media that the With-profits Committee did not agree that the Bain Capital offer was in the best interests of members and preferred a £540m Royal London bid?

The With-Profits Committee's (WPC) role is to provide advice and recommendations to the Board to ensure the rights, interests and reasonable expectations of With-profits policyholders are fully considered and receive fair treatment. Their role is defined by terms of reference set by the Board but reflecting the requirements of COBS20* from the FCA Handbook.

The WPC was involved at every stage of the strategic review with the Committee meeting in advance of each Board meeting to discuss the relevant papers that were also being presented to the Board on all the potential outcomes or transactions. At each stage the WPC gave advice to the Board as the transaction developed. No decision was taken by the Board that was in conflict with any advice or recommendations given by the WPC.

At the decision point to enter into exclusive negotiations with Bain Capital, the WPC unanimously agreed with the Board that the Bain Capital transaction represented an excellent outcome for With-profits members.

* COBS20 – *refers to the FCA Handbook on the Conduct of Business rules. Section 20 applies to a firm carrying on with-profits business*.