

LV= GROUP

Solvency and Financial Condition Report

For the year ended 31 December 2021

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Summary

LV= has prepared the Solvency and Financial Condition Report (SFCR) to provide information on our solvency (i.e. our ability to pay, primarily to policyholders, for current and future claims) and how we manage the financial strength of the Group. The purpose of the SFCR is to provide information required by the Solvency II regulatory framework, in particular the Group's capital position as at 31 December 2021. This report sets out different aspects of the Group's business and performance, system of governance, risk profile, valuation methods used for solvency purposes and its capital management practices.

The SFCR serves many types of stakeholders, with different levels of expertise and expectations. As a guide, this Summary section aims to address the requirements of policyholders and we have done our best to make this understandable for everyone. Whereas the main body of the SFCR and the appendices are aimed at analysts and investors. Some of the information in the main body of the report is quite technical, and the content is prescribed by complex regulations. A separate document containing Quantitative Reporting Templates (QRTs) is annexed to the SFCR. These are the publicly available detailed forms we submit to the PRA which contain financial information prescribed by the Solvency II regulations. The values in the public QRTs represent the rounded values of those reported in the private QRTs. As a result, small rounding differences may be present in them. The SFCR and QRTs can be found at <https://www.lv.com/about-us/company-information/returns/regulatoryreturns>.

Relevant information about the business of the Group is also provided in the LV= Annual Report for the year ended 31 December 2021, a copy of which can be found at <https://lv.com/annual-report>.

Basis of preparation of the SFCR

The SFCR has been completed in accordance with the appropriate PRA rules and Solvency II regulations.

The LV= Group SFCR has been prepared in accordance with the Solvency II regulations and the PRA rules using a Standard Formula basis. The calculation of the best estimate liabilities is based on up-to-date and credible information and realistic assumptions as at 31 December 2021.

In common with many in the industry, we present two cover ratios, an 'Investor View' for analysts and investors in our subordinated debt, that excludes the ring-fenced funds entirely, and a Solvency II regulatory basis where the ring-fenced funds are included but their surplus is excluded from the Group's surplus.

Business and Performance

The LV= Group mainly underwrites life insurance contracts in the UK. LV= is a mutual organisation, which means it is owned by its members. Its members are customers who have certain longer-term financial products underwritten by LVFS, such as life insurance, protection, investments or retirement policies.

On 15 December 2020, the LVFS Board announced that it had reached a proposed agreement whereby Bain Capital would have paid £530m to acquire LV='s Savings and Retirement and Protection businesses. The proposed acquisition was put to an LVFS member vote at a Special General Meeting on 10 December 2021. A significant majority of 69% of members who voted at the Special General Meeting supported the Special Resolution to approve the acquisition of the LV= business by Bain Capital. However, the result was below the required 75% threshold so the transaction with Bain Capital will no longer proceed. In early 2022, the LVFS Board announced its decision to continue with LV='s current status as a mutual.

The Coronavirus (Covid-19) pandemic continued to drive uncertainty over 2021 across a number of the risk categories. In 2020, as a result of Covid-19 restrictions, the business successfully transitioned working practices so that a majority of the staff could work from home during the pandemic without detriment to the service provided to customers and while ensuring the business continued to operate within risk appetite. Although a significant proportion of staff returned to the office during 2021, the business has retained the capability to transition the majority of staff to home working as was required in December 2021 following updated government guidance. The balance sheet has continued to remain resilient to increased volatility within financial markets over the year and solvency and liquidity remain comfortably in excess of the Board risk appetite. The long-term implications for mortality, morbidity and persistency experience and the UK's economic prospects continue to be assessed based on emerging Group and industry experience as the implications of the pandemic and vaccine/other mitigation activities continue to develop.

A risk assessment has been carried out on the potential impacts for the Group of the ongoing conflict in Ukraine. The direct impacts on the Group's operations and underwriting results are not expected to be material and direct exposure to Russian investments is low. We continue to monitor the ongoing situation as a component of our Political, economic and regulatory uncertainty key risk, see Section C.6 for further details.

Trading profit generation increased to £29m (2020: £9m), driven by the significantly improved new business contribution of £17m (2020: £6m loss). This result reflected an improved trading performance in both our Savings and Retirement business and our Protection business, with increased new business sales reported for both businesses. Trading profit generated from in-force business decreased slightly to £12m (2020: £15m). Operating profit generation has decreased year-on-year by £9m to £31m (2020: £40m profit), with improved trading profit generation more than offset by the reduction in positive impacts from model and basis changes at £6m (2020: £37m), with the favourable impact from cost control initiatives dampened by the adverse impact from protection persistency basis changes.

Operating profit generation of £31m was offset by £90m (2020: £96m) of non-operational items, including £30m of strategic investment spend, £24m of debt interest and £36m of restructuring, one-offs and other group items. The Group is focused on reducing the level of spend on non-operational items over the next two to five years. There was also a one-off adverse impact in the year of £20m generated by the switch from the LIBOR to SONIA yield curve. Market movements have resulted in £13m (2020: £93m) of favourable short-term investment fluctuations, with the significant year-on-year reduction mainly driven by interest rate swaps hedging the Solvency II capital position. These items have generated an IFRS loss before tax and mutual/exit bonus for the year of £66m (2020: £37m profit).

The Group allocated £28m of mutual bonus and £10m of exit bonus to eligible members during the year.

Section A of this report sets out further details about the Group's business structure, key operations, market position and financial performance over the reporting period, split by underwriting performance and investment performance.

System of Governance

The LVFS Board is committed to high standards of corporate governance and stewardship. The role of the Board is to make decisions on matters such as strategy and planning, risk management, financial matters, governance and compliance and the appointment and removal of Board members and key officers. It delegates responsibility to Board Committees to approve and form recommendations for the Board to consider or to have oversight of certain matters. As a mutual, LVFS is owned by its members and strives to provide long-term benefits and confidence through the operation of an effective governance framework, efficient controls and transparent decision making.

The Group monitors and assesses its system of governance on an ongoing basis. There have been no significant findings during the reporting period which have indicated to the Board that the system of governance is not adequate. The Board has adopted a governance structure based on the principles and provisions of the Financial Reporting Council's UK Corporate Governance Code (the 'Code'). The Board has confirmed its compliance with the Code and the Board believes that its practices are consistent with the principles of the Code and are appropriate and suitable for LVFS and its members.

There have been no significant changes in the Group's system of governance in the year. The table below summarises the changes in membership of the Board in the year:

A W Snow – resigned 16 September 2021

LV= operates a fully integrated risk management framework we call the LV=RM. This framework brings together the key processes and activities undertaken throughout the business to ensure that our customers' and members' security is at the forefront of our decision making. Structuring engagement, risk management and our values around this framework enables senior management to demonstrate that the right things are being done to manage risks within the business.

Section B of this report describes the system of governance in place throughout the Group by which its operations are overseen, directed, managed and controlled.

Risk profile

The Group's business model involves taking on risk for its policyholders in order to provide security and aid in financial planning. In order to facilitate this, LV= offers a range of Life and Health insurance products. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

The Group manages risk using a range of techniques, including reinsurance, derivatives, limits to counterparty exposure as well as by using its scale and range of products and investments to provide diversification. The Group measures its risk using a range of techniques, including European Insurance and Occupational Pensions Authority (EIOPA) prescribed Standard Formula capital calculations, internal views of risk and sensitivity testing. A number of committees, attended by senior stakeholders, meet regularly to consider the Group's risk exposure, and whether it is in line with risk appetite. This enables informed decision making on where risk mitigation is required or where further risk can be taken on. Furthermore, external opinions are sought from consultancies and regular reports are made to the PRA.

The table below shows the 31 December 2021 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2020 are provided for comparison. The amount of SCR illustrated below is £851m (2020: £832m). This differs from the total SCR reported in section E as it excludes the loss absorbing capacity of deferred tax.

SCR split by risk type, for the year ended 31 December	2021	2020	Change
Market risk	63%	52%	11%
Underwriting risk	31%	41%	(10)%
Operational risk	4%	5%	(1)%
Counterparty risk	2%	2%	0%
Total	100%	100%	

The Group SCR has increased slightly over the year. The weightings of the high level risk categories shown within the SCR have shifted towards market risk, and reduced the underwriting risk weighting. The 11% increase in market risk weighting from the previous year is driven by an increase in equity exposure. The increase in equity exposure is primarily due to investment into asset share to hedge future payments of exit bonus. The size of the equity stress has increased from the year-end 2020 level due to a gradual market recovery following the Covid-19 pandemic, further contributing to the increase in equity risk. The underwriting risk weighting has decreased due to the rise in yield curve over the year decreasing lapse risk, and the increase in market risk.

The principal risks and uncertainties facing the Group are summarised below.

- **Strategic transformation** – The execution risks associated with pursuing LV='s strategic priorities.
- **IT sustainability** – The risk that capability and capacity issues in relation to the Group's IT systems lead to significant operational or customer risk events.
- **Operational resilience** - The risk that LV= would not be able to service its members and customers during a major disruption (if this was to occur).
- **Cyber security** - The risk of customer data loss or a severe reduction in customer service as a result of a cyber-event.
- **Conduct risk** - The risk that key operational controls are ineffective, resulting in poor member or customer outcomes.
- **Political, economic and regulatory uncertainty** - The risk of a reduction in solvency, policyholder value or customer returns resulting from prolonged uncertainty within the political, economic and regulatory landscape.
- **Financial market volatility** - The risk that the financial resilience of the Group is adversely impacted by changes in the financial markets.

Section C of this report further describes the risks to which the Group is exposed and how it identifies, measures, manages and monitors these risks, including any changes in the year to the Group's risk exposures and specific risk mitigation actions taken.

Valuation for Solvency purposes

Assets, technical provisions and other liabilities are valued in the Group’s Solvency II Balance Sheet according to the Solvency II regulations. Assets and liabilities are valued at an amount for which they could be exchanged, transferred or settled by knowledgeable and willing third parties in an arms-length transaction. There have been no material changes in the valuation methods of the Group during the year.

The value of technical provisions under Solvency II is equal to the sum of a best estimate liability and a risk margin. Calculations are based on the Standard Formula approach using the Matching and Volatility Adjustment (for eligible business) and Transitional Measures on Technical Provisions.

At 31 December 2021, the Group’s excess of assets over liabilities was £1,112m (2020: £1,134m) on a Solvency II regulatory basis.

Section D of this report provides further description of the bases, methods and main assumptions used in the valuation of assets, technical provisions and other liabilities for each material asset/liability class. In addition, it also provides an explanation of the material differences between the IFRS and Solvency II bases of valuation.

Capital Management

At 31 December 2021, the Group capital surplus on a Solvency II Standard Formula basis, reported on an investor view, was £637m (2020: £690m) with a Capital Coverage Ratio (Investor view) of 187% (2020: 198%). The key performance indicators we use to monitor our capital position are the Capital Coverage Ratio and Operating capital generation, which for 2021 increased to £110m (2020: £103m), benefiting from the Group’s strong trading performance during the year. The deterioration in the Group’s capital surplus during the year was driven by non-operating expenditure and items relating to the distribution of surplus, which more than offset the £110m of operating capital generation.

The Group manages Own Funds in line with solvency capital requirements. In the calculation of the Solvency Capital Requirement (“SCR”) LVFS uses a Standard Formula approach. The results in the table below are reported on a Solvency II regulatory basis where the ring-fenced funds are included but their surplus is excluded because it is not available to the Group. The closed ring-fenced funds did not require capital support at the valuation date.

Group capital surplus (regulatory basis)

£m	2021	2020
Eligible own funds		
Tier 1	1,066	1,116
Tier 2	367	361
Tier 3	-	-
Total eligible own funds	1,433	1,477
Solvency capital requirement	796	787
Surplus	637	690
Capital Cover Ratio (CCR)*	180%	188%

*CCR is the ratio of group eligible own funds to the solvency capital requirement.

There are three tiers of capital defined by Solvency II. The quality of capital is important as the higher the quality the more likely it will be available in the event that it is needed, for example to be able to pay out claims. Tier 1 primarily represents high quality capital which is generally more secure and capable of absorbing losses. Tier 2 represents our subordinated debt and Tier 3 is the lowest quality of capital (the Group has no Tier 3 Own Funds).

Section E of this report further describes the objectives, policies and procedures employed by the Group for managing its Own Funds. The section also covers information on structure and quality of Own Funds and calculation of SCR.

Statement of directors' responsibilities

Financial year ended 31 December 2021

We certify that:

- a) The Solvency and Financial Condition Report has been properly prepared in all material respects in accordance with the PRA rules and Solvency II Regulations; and
- b) We are satisfied that:
 - i. throughout the financial year in question, the Group has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable to the Group; and
 - ii. it is reasonable to believe that, at the date of the publication of the Solvency and Financial Condition Report, the Group has continued so to comply, and will continue so to comply in future.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the UK governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.

The Solvency and Financial Condition Report was approved by the Board of Directors on 19 May 2022 and signed on its behalf by:



.....
Mark Hartigan
Chief Executive Officer

19 May 2022

Liverpool Victoria Financial Services Limited
County Gates
Bournemouth
BH1 2NF

Report of the external independent auditor to the Directors of Liverpool Victoria Financial Services Limited ('the Group') pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report Opinion

Except as stated below, we have audited the following documents prepared by Liverpool Victoria Financial Services Limited as at 31 December 2021:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of Liverpool Victoria Financial Services Limited ('the Group') as at 31 December 2021 (**the Narrative Disclosures subject to audit**); and
- Group templates S02.01.02, S22.01.22, S23.01.22, S25.01.22, S32.01.22 (**the Templates subject to audit**).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the Solvency and Financial Condition Report**'.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:

- Information contained within the relevant elements of the Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;
- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Group templates S05.01.02;
- Information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measures on technical provisions as set out in the Appendix to this report;
- the written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report (**the Responsibility Statement**).

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Group as at 31 December 2021 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)), including ISA (UK) 800 and ISA (UK) 805. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the PRA. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

Our evaluation of the Directors' assessment of the Group's ability to continue to adopt the going concern basis of accounting in the preparation of the Solvency and Financial Condition Report included:

- Undertaking an initial assessment at the planning stage of the audit to identify events or conditions that may cast significant doubt on the Group's ability to continue as a going concern;
- Obtaining an understanding of the process relating to the directors' going concern assessment;
- Making enquiries of the directors to understand the period of assessment considered by them, the assumptions they considered and the implication of those when assessing the Group's future financial performance;
- Challenging the appropriateness of the directors' key assumptions in their future performance forecast, by reviewing supporting and contradictory evidence in relation to these key assumptions and assessing the directors' consideration of plausible scenarios;
- Testing the accuracy and functionality of the model used to prepare the directors' forecasts; and
- Assessing the historical accuracy of forecasts prepared by the directors.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's ability to continue as a going concern for a period of at least twelve months from when the Solvency and Financial Condition Report is authorised for issue.

In auditing the relevant elements of the Solvency and Financial Condition Report, we have concluded that the directors of the Group's use of the going concern basis of accounting in the preparation of the relevant elements of the Solvency and Financial Condition Report is appropriate.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other Information

The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the Solvency and Financial Condition Report does not cover the Other Information and, we do not express any form of assurance conclusion thereon.

In connection with our audit of the Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the Solvency and Financial Condition Report or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

The Directors are responsible for:

- such internal control as management determines is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error;
- overseeing the Group's financial reporting process; and,
- assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report

It is our responsibility to form an independent opinion as to whether the relevant elements of the Solvency and Financial Condition Report are prepared, in all material respects, with financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level

of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Solvency and Financial Condition Report.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. Based on our understanding of the Group and the insurance sector in which it operates, we identified that the principal risks of non-compliance with laws and regulations related to breaches of the PRA's and the FCA's regulations, and we considered the extent to which non-compliance might have a material effect on the relevant elements of the Solvency and Financial Condition Report. We also considered those laws and regulations that have a direct impact on the preparation of relevant elements of the Solvency and Financial Condition Report.

We evaluated the directors' and management's incentives and opportunities for fraudulent manipulation of the relevant elements of the Solvency and Financial Condition Report (including the risk of override of controls) and determined that the principal risks were related to posting manual entries to manipulate own funds against the Solvency Capital Requirement or Minimum Capital Requirement, management bias through judgements and assumptions in significant estimates, in particular in relation to the valuation of technical provisions.

Our audit procedures were designed to respond to those identified risks, including non-compliance with laws and regulations (irregularities) and fraud that are material to the relevant elements of the Solvency Financial Condition Report. Our audit procedures included but were not limited to:

- Discussing with the directors and management their policies and procedures regarding compliance with laws and regulations;
- Communicating identified laws and regulations throughout our engagement team and remaining alert to any indications of non-compliance throughout our audit; and
- Considering the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud.

Our audit procedures in relation to fraud included but were not limited to:

- Making enquiries of the directors and management on whether they had knowledge of any actual, suspected or alleged fraud;
- Gaining an understanding of the internal controls established to mitigate risks related to fraud;
- Discussing amongst the engagement team the risks of fraud; and
- Addressing the risks of fraud through management override of controls by performing journal entry testing.

There are inherent limitations in the audit procedures described above and the primary responsibility for the prevention and detection of irregularities including fraud rests with management. As with any audit, there remained a risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal controls.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on Other Legal and Regulatory Requirements.

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Group's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Use of the audit report

This report, including the opinion, has been prepared for the Directors of the Group to enable them to comply with their obligations under External Audit Rule 2.1 of the Solvency II Firms Sector of the PRA Rulebook and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Directors for our audit work, for this report, or for the opinions we have formed.



Lionel Cazali
for and on behalf of Mazars LLP
Chartered Accountants and Statutory Auditor
Mazars LLP
30 Old Bailey
London EC4M 7AU

19 May 2022

Appendix – relevant elements of the Solvency and Financial Condition Report that are not subject to audit

The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

- The following elements of template S.22.01.21 – Column C0030 – Impact of transitional measure on technical provisions;
- Elements of the Narrative Disclosures not subject to audit which includes ‘Summary’, ‘Business and performance’, ‘System of Governance’ and ‘Risk profile’;
- Elements of the Narrative Disclosures are subject to audit but identified as ‘unaudited’ which includes “Impact of the Matching Adjustment, Volatility Adjustment and Transitional Measure on Technical Provisions (TMTP only unaudited)”, “Impact of the Matching Adjustment, Volatility Adjustment and Transitional Measure on Technical Provisions (TMTP only unaudited)” and “Capital performance and capital position (Investor View) – unaudited”; and
- The written acknowledgement by management of their responsibilities, including the preparation of the Solvency and Financial Condition Report or the ‘Responsibility Statement’.

Glossary

For convenience a number of defined terms are used throughout this document. These are set out below:

The Liverpool Victoria Group

Group / LV=	LVFS together with its subsidiaries
LVFS	Liverpool Victoria Financial Services Limited
LVLC	Liverpool Victoria Life Company Limited
LVPL	LV Protection Limited

TAC	Teachers Assurance Company Limited
ExCo	The executive management committee of the Group established by the CEO

Other terminology

ALCO	Asset and Liability Committee
BEL	Best Estimate Liabilities
CCR	Capital Coverage Ratio
CEO	Chief Executive Officer of LVFS and the Group
Delegated Acts	Refers to Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 unless another Delegated Regulation is specified
EIOPA	The European Insurance and Occupational Pensions Authority
ENID	Events not in data
ESG	Environmental, Social and Governance
IAS	International Accounting Standard
IB	Industrial Branch
IFRS	International Financial Reporting Standards
MA	Matching Adjustment
MAP	Matching Adjustment Portfolio
MCR	Minimum Capital Requirement. For Group this is the minimum consolidated Group SCR
OB	Ordinary Branch

ORSA	Own Risk and Solvency Assessment
PRA	Prudential Regulation Authority
QRTs	Quantitative Reporting Templates
RNPFN	Royal National Pension Fund for Nurses
SCR	Solvency Capital Requirement
SF	Standard Formula
SFCR	Solvency and Financial Condition Report
SII	Solvency II
SII Directive	Refers to Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) unless another Directive is specified
SMF	Smoothed Managed Fund – We are now marketing our Flexible Guarantee products (FGB/F) under the Smoothed Managed Fund proposition
TA Fund	Teachers Assurance Fund
TMTP	Transitional Measures on Technical Provisions
UK	United Kingdom
UWP	Unitised With-profits
VA	Volatility Adjustment

A. Business and Performance

The 'Business and performance' section of the report sets out the Group's business structure, key operations and financial performance over the reporting period.

Business Performance

The LV= business is managed on a Solvency II basis and the key metrics we use to monitor the capital performance of our business are reported in Section E. The Group's IFRS performance is monitored using the metrics below. Trading profit generation and operating profit generation are non-GAAP alternative performance measures that the Group considers to be a meaningful measure for stakeholders as they enhance the understanding of the Group's underlying performance over time by separately identifying non-trading and non-operational items. The various items excluded from trading and operating profit generation, but included in the IFRS result for the year, are outlined below and in the Alternative Performance Measures section of the LV= Annual Report.

LV= Group P&L (£m)	2021	2020
New business contribution/(loss)	17	(6)
Existing business	12	15
Trading profit generation	29	9
Estate investment income	8	15
Experience variances	(12)	(21)
Model and basis changes	6	37
Operating profit generation	31	40
Strategic investment, debt interest and other items	(90)	(96)
LIBOR to SONIA yield curve	(20)	-
Short-term investment fluctuations and related items*	13	93
(Loss)/ profit before tax and mutual/exit bonus	(66)	37
Mutual bonus	(28)	(28)
Exit bonus	(10)	(45)
Income tax expense	(11)	(41)
Pension scheme actuarial gain/(loss), net of tax	23	(54)
Impact of discontinued business	-	(2)
Non-controlling interest	-	(6)
Transfer from the Unallocated divisible surplus	(92)	(139)

* Short-term investment fluctuations represent the difference between the long-term average return expected from assets and the actual investment return achieved on these assets in the current period. These are presented outside of operating profit for the life business in order to exclude the impact of temporary volatility. This includes the impact of tax charges deducted from policy asset shares and the RNPFN fund.

Trading profit generation

Trading profit generation increased to £29m (2020: £9m), driven by the significantly improved new business contribution of £17m (2020: £6m loss). This result reflected an improved trading performance in both our Savings and Retirement business and our Protection business, with increased new business sales reported for both businesses. Trading profit generated from in-force business decreased slightly to £12m (2020: £15m).

Operating profit generation

Operating profit generation has decreased year-on-year by £9m to £31m (2020: £40m profit), with improved trading profit generation more than offset by the reduction in positive impacts from model and basis changes at £6m (2020: £37m), with the favourable impact from cost control initiatives dampened by the adverse impact from protection persistency basis changes.

Loss before tax and mutual/exit bonus

Operating profit generation of £31m was offset by £90m (2020: £96m) of non-operational items, including £30m of strategic investment spend, £24m of debt interest and £36m of restructuring, one-offs and other group items. The Group is focused on reducing the level of spend on non-operational items over the next two to five years. There was also a one-off adverse impact in the year of £20m generated by the switch from the LIBOR to SONIA yield curve. Market movements have resulted in £13m (2020: £93m) of favourable short-term investment fluctuations, with the significant year-on-year reduction mainly driven by interest rate swaps hedging the Solvency II capital position. These items have generated a loss before tax and mutual/exit bonus for the year of £66m (2020: £37m profit).

IFRS Surplus (UDS) generation

The IFRS Unallocated Divisible Surplus (UDS) has decreased by £92m to £1,023m during 2021 (2020: £139m decrease). In addition to the 2021 loss before tax and mutual/exit bonus of £66m, were mutual bonus and exit bonuses allocated and distributed to our eligible with-profit members of £38m, the tax charge of £11m and positive pension revaluations of £23m.

For further information on the results, please refer to the LV= Annual Report.

A.1 Business

a) Name and legal form of undertaking

On 2 January 2020, Liverpool Victoria Friendly Society Limited was converted to a company limited by guarantee registered under the Companies Act 2006, under the name Liverpool Victoria Financial Services Limited (LVFS). LVFS is the ultimate parent of the LV= Group of companies.

Registered office:
County Gates
Bournemouth
BH1 2NF
Telephone: 01202 292333

b) Name and contact details of the supervisory authorities responsible for financial supervision.

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) are responsible for the financial supervision of the Company, and the Group.

PRA

Address: 20 Moorgate
London
EC2R 6DA
Phone: 020 7601 4444

FCA

Address: 12 Endeavour Square
London
E20 1JN
Phone: 020 7066 1000

c) Name and contact details of the external auditor

The independent auditor is Mazars LLP

Address: 30 Old Bailey
London
EC4M 7AU

d) Description of the holders of qualifying holdings in the undertaking

As LV= is a mutual organisation, there are no external qualifying holdings within the meaning of the Solvency II regulations. The ultimate parent company for all of the subsidiary companies within the Group is LVFS.

e) Details of the undertakings within the group

The material subsidiary undertakings of the Group as at 31 December 2021 are as follows:

Name of Subsidiary	Principal activity	Percentage held
Frizzell Financial Services Limited	Property management	100%
Liverpool Victoria Financial Advice Services Limited	Financial advice services	100%
Liverpool Victoria Life Company Limited #	Life insurance	100%
LV Protection Limited #	Insurance	100%
LV Capital Limited	Holding company	100%
LV Equity Release Limited	Origination of equity release lifetime mortgages	100%
LV Life Services Limited	Management services	100%
LV Commercial Mortgages Limited	Commercial mortgages	100%
NM Pensions Trustees Limited	Self-invested personal pension (SIPP) administrator	100%
Teachers Financial Services Limited	Insurance and financial intermediary	100%
Teachers Assurance Company Limited #	General insurance	100%
Teachers Management Services Limited	Management services	100%

Denotes Solvency II regulated undertakings

The proportion of the voting rights in the subsidiary undertakings held directly by the parent company do not differ from the proportion of ordinary shares held. The Group and all principal undertakings are incorporated and domiciled in the UK.

All holdings are in relation to ordinary shares. Dormant companies have been excluded from the above list but are included in the QRT S.32.01, which is annexed to this SFCR.

The Group prepares its financial statements on an IFRS basis and presents the parent company and all subsidiaries on a consolidated basis.

Under Solvency II, the non-insurance regulated entities are not consolidated but are accounted for as investments in participations.

f) Material lines of business and material geographic areas.

The Group mainly underwrites life insurance contracts within the UK.

The Group conducts life assurance business through its Savings and Retirement, Protection and Heritage segments. The principal activity is the provision of life, pensions and investments products and managing the Heritage legacy book.

The products and services from which each reportable segment derives its income are as follows:

- Savings and retirement: pensions, savings, investments and equity release products and provision of financial advice.
- Protection: life insurance and income protection products.
- Heritage: savings and investment products that are no longer actively marketed, the majority of these are with-profits products.

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

On 15 December 2020, the LVFS Board announced that it had reached a proposed agreement whereby Bain Capital would have paid £530m to acquire LV's Savings and Retirement and Protection businesses. The proposed acquisition was put to an LVFS member vote at a Special General Meeting on 10 December 2021. A significant majority of 69% of members who voted at the Special General Meeting supported the Special Resolution to approve the acquisition of the LV= business by Bain Capital. However, the result was below the required 75% threshold so the transaction with Bain Capital will no longer proceed. In early 2022, the LVFS Board announced its decision to continue with LV's current status as a mutual.

The Coronavirus (Covid-19) pandemic continued to drive uncertainty over 2021 across a number of the risk categories. In 2020, as a result of Covid-19 restrictions, the business successfully transitioned working practices so that a majority of the staff could work from home during the pandemic without detriment to the service provided to customers and while ensuring the business continued to operate within risk appetite. Although a significant proportion of staff returned to the office during 2021, the business has retained the capability to transition the majority of staff to home working as was required in December 2021 following updated government guidance. The balance sheet has continued to remain resilient to increased volatility within financial markets over the year and solvency and liquidity remain comfortably in excess of the Board risk appetite. The long-term implications for mortality, morbidity and persistency experience and the UK's economic prospects continue to be assessed based on emerging Group and industry experience as the implications of the pandemic and vaccine/other mitigation activities continue to develop.

A risk assessment has been carried out on the potential impacts for the Group of the ongoing conflict in Ukraine. The direct impacts on the Group's operations and underwriting results are not expected to be material and direct exposure to Russian investments is low. We continue to monitor the ongoing situation as a component of our Political, economic and regulatory uncertainty key risk, see Section C.6 for further details.

A.2 Underwriting performance

Underwriting performance by line of business compared to previous reporting period

The following tables provide further information on IFRS underwriting income and expenses of the Group's continuing operations, analysed by material lines of business:

All business is underwritten in the UK.

Net earned premiums

Group	2021 £m	2020 £m
Gross earned premiums		
Long-term insurance and participating investment contracts		
Single premium		
Investments and savings	437	192
Pensions and annuities	138	157
Regular premium		
Investments and savings	17	20
Pensions and annuities	6	6
Life and health protection	248	238
Gross earned premiums	846	613
Premiums ceded to reinsurers		
Long-term insurance premiums	(284)	(273)
Net earned premiums	562	340

2021 gross earned premiums of £846m increased by 38% compared to 2020. The increase in new business premiums is driven by increased new business sales in our Savings and Retirement business, mainly due to the strong performance of the Smoothed Managed Funds range during the year, and in our Protection business, particularly in Term Life.

Net benefits and claims

Group	2021			2020		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	965	(263)	702	1,047	(256)	791
Change in the provision for claims	5	-	5	34	-	34
Fair value adjustment to reinsurance receivables	-	(9)	(9)	-	(10)	(10)
Exit bonus	(10)	-	(10)	(33)	-	(33)
	960	(272)	688	1,048	(266)	782

2021 net benefits and claims of £688m have decreased by 12% compared to 2020. This is mainly caused by the decrease in maturities relating to Flexible Guarantee Bonds, where maturities and surrenders were exceptionally high during 2020 as people accessed their funds when faced with the uncertainty generated by the Covid-19 pandemic.

Net change in contract liabilities

Group	2021	2020
	£m	£m
Gross (increase)/decrease in long-term contract liabilities		
Decrease/(increase) in long-term insurance contract liabilities - participating	44	(158)
Increase in investment contract liabilities - participating	(5)	(25)
Decrease/(increase) in long-term insurance contract liabilities - non-participating	351	(154)
Increase in investment contract liabilities - non-participating	(351)	(217)
Increase in long-term linked insurance contract liabilities	(193)	(43)
	(154)	(597)
Mutual bonus	28	28
Exit bonus	-	12
	(126)	(557)
Increase/(decrease) in long-term contract liabilities ceded to reinsurers		
Increase in long-term insurance contract liabilities relating to non-participating contracts	72	71
(Decrease)/increase in long-term insurance contract liabilities relating to participating contracts	(99)	96
Increase in long-term linked insurance contract liabilities	38	23
	11	190
(Decrease)/increase in non-participating value of in-force business	(7)	48
Net change in contract liabilities	(122)	(319)

The gross increase in long-term contract liabilities for 2021 was £126m (2020: £557m). This gross increase is mainly due to policyholders' investment gains, following favourable movements in UK and overseas equity markets. These gains are partially offset by the excess of benefits and claims over premiums.

Other operating and administrative expenses

Group	2021	2020
	£m	£m
Commission paid on acquisition of business	76	59
Amortisation and impairment of intangible assets	1	10
Depreciation on property and equipment	3	3
Loss on disposal of property and equipment	2	-
Investment management expenses and charges	21	15
Auditor's remuneration	1	2
Employee benefits expense	86	90
Facilities expense	7	5
Marketing and advertising	3	5
Other staff costs	9	12
IT costs	26	26
Legal, consultancy and other fees	34	24
Customer redress	20	-
Other expenses	5	6
Claims handling cost recognised in Gross benefits and claims	(11)	(11)
Net operating and administrative expenses	283	246

Net operating and administrative expenses for 2021 of £283m have increased by 15% compared to 2020, driven by the one-off cost of raising a £20m provision to cover the expected customer redress costs in respect of mis-selling claims on pension products sold by the Teachers Assurance Group prior to it being transferred into the LV= Group in 2016. There was also a £17m increase in commission costs, mainly driven by the increased new business sales in the Protection business and a £10m increase in fees mainly related to the strategic review.

Solvency II lines of business

In addition to the above, the material Solvency II lines of business by reference to IFRS gross written premiums, a component of underwriting performance, are outlined below based on gross written premium analysed within the Quantitative Reporting Template (QRT) S.05.01, which is annexed to this SFCR.

Life insurance

LVFS's long-term business, which represents 100% of total gross premiums written, includes participating insurance and investment business and non-participating insurance and investment business. The material life insurance Solvency II lines of business for the year ended 31 December are as follows, based on contribution to life insurance business gross written premiums:

Life insurance	2021	2020
Insurance with-profit participation	22%	19%
Index-linked and unit-linked insurance	48%	43%
Other life insurance	25%	32%
Health	5%	6%

Gross written premiums collected under non-participating investment contracts are deposit accounted rather than accounted for through the income statement under IFRS.

A.3 Investment performance

a) Income and expenses with respect to investment activities

Components of investment activities

Investment income is reported consistently with IFRS. Investment income includes dividends, interest from investments at fair value, interest on loans and receivables and interest on loans secured on residential and commercial property. Dividends are recorded on the date on which the shares are declared ex-dividend.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses on investments represent the difference between the valuation of fair value assets at the Statement of Financial Position date and their valuation at the last Statement of Financial Position date or, where purchased during the year, the purchase price. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

Investment management expenses and charges of £21m (2020: £15m) are reported in Other operating and administrative expenses. These expenses are directly attributable to investment activities.

Investment performance

The following tables summarise the investment performance of the Group's continuing operations, on an IFRS basis:

Investment income

Group	2021	2020
	£m	£m
Income from investments at fair value through income:		
- Dividend income	73	70
- Interest income from debt and fixed interest securities	112	123
- Interest on loans secured on residential property	28	32
- Interest on loans secured on commercial property	9	8
Interest on loans and receivables	-	4
	222	237

Investment income has reduced slightly to £222m (2020: £237m).

Net gains on investments

Group	2021	2020
	£m	£m
Investments at fair value through income:		
- Debt securities	(249)	250
- Equity securities	605	442
- Loans and mortgages	(45)	11
Derivatives at fair value through income	(94)	83
	217	786

The gain on investments of £217m (2020: £786m) contains a £605m gain on equity securities driven by the strong performance of equities both in the UK and overseas. This was offset by falling values in debt securities, loans and mortgages and derivatives driven by interest rate movements. Included within net gains on investments are realised gains of £303m (2020: £288m).

b) Information about any investments in securitisation

There are no material investments in securitisation (2020: £nil).

A.4 Performance of other activities

The results of other activities of the Group's continuing operations are as follows:

Finance costs

Group	2021	2020
	£m	£m
Interest expense on subordinated liabilities	23	23
Interest expense on lease liabilities	1	1
	24	24

In 2013 LVFS issued £350m of Fixed Rate Reset Subordinated Notes at par. The directly related costs of £4m incurred to issue the Notes have been capitalised as part of the carrying value and are being amortised using the effective interest rate basis over the period to the first call date in 2023. The effective interest rate on the £350m liability is 6.654% resulting in a £23m finance charge for the year.

The Notes have a maturity date of 22 May 2043 but the issuer has the option to redeem the Notes at the first call date of 22 May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% (£23m) per annum for the period until the first call date on 22 May 2023, payable annually in arrears on 22 May each year. If the Notes are not redeemed on 22 May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points.

Other income

Group	2021	2020
	£m	£m
Asset management charges	23	20
Commission	18	14
Other fee income	9	11
	50	45

Other income is mainly made up of asset management charges relating to policyholder pension business, and commission income from the origination of Equity Release mortgages. Other income has increased year-on-year to £50m (2020: £45m), reflecting increasing volumes of new business.

Leasing arrangements

The Group occupies leased premises for its head office and a small number of regional offices. At 31 December 2021 right of use assets held by the Group were £19m (2020: £21m) and lease liabilities were £23m (2020: £25m). Right of use assets and lease liabilities are unwound over the lease terms. The remaining lease terms averaged 3 years for regional offices and 19 years for the head office. Lease rentals are typically renegotiated every 5 years to market rentals and include break clauses for additional flexibility.

A.5 Any other information

There is no additional information to disclose for section A

B. System of Governance

The Directors of LVFS during the year were as follows:

A. Cook	A. Hutchinson
S. Creedon	L. Savage
D. Barral	M. Hartigan
S. McInnes	A.W. Snow – resigned 16 September 2021
C. Ledlie	

Alan Cook resigned on 28 February 2022 and Seamus Creedon was appointed interim chair with effect from 1 March 2022. David Barral resigned on 7 March 2022. Alison Hutchinson and Luke Savage resigned on 31 March 2022. Suzy Neubert and Natalie Ceeney, were appointed to the Board on 1 March 2022 subject to regulatory approval.

This section outlines how the Group is directed and controlled, and provides an overview of the Group system of governance. It also describes the remuneration policy and practices, and adherence with the 'Fit and Proper Requirements', which is the regulatory standard required when appointing those who effectively run the organisation or have other key roles.

The Board is committed to high standards of corporate governance, which it believes are critical to business integrity and performance. The Board believes that implementing an effective Risk Management System is fundamental to achieving these high standards, and this section also describes how this works in detail.

Unless otherwise stated, the risk management and internal control systems described in this section are implemented consistently across LVFS and its subsidiaries.

Adequacy of the governance structure

The Group monitors and assesses its system of governance on an ongoing basis. There have been no significant findings during the reporting period which have indicated to the Board that the system of governance is not adequate. The Board has adopted a governance structure based on the principles and provisions of the Financial Reporting Council's UK Corporate Governance Code (the 'Code'). The Board has confirmed its compliance with the Code and the Board believes that its practices are consistent with the principles of the Code and are appropriate and suitable for LVFS and its members.

The LV= Report on Directors' Remuneration can be found in the LV=Annual Report. It is prepared in line with best practice and the reporting requirements which apply to listed companies where possible.

B.1 General information on the system of governance

Governance structure

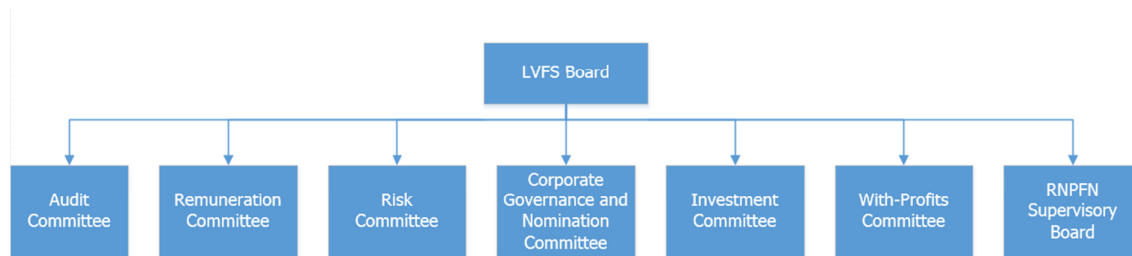
Liverpool Victoria Financial Services Limited (LVFS) is the ultimate parent undertaking of the LV= group. LV='s governance framework defines the decision-making authorities and responsibilities of the Board, committees and management. The governance framework assists with the oversight and delivery of LVFS's performance, strategy, values and culture.

The role of the Board is to make decisions on matters such as strategy and planning, risk management, financial matters, governance and compliance and the appointment and removal of Board members and key officers. It delegates responsibility to Board Committees to approve and form recommendations for the Board to consider or to have oversight of certain matters. The Board sets the tone from the top on the group's governance, culture and values and to be collectively responsible for the long-term success of the group. The LV= Board is comprised of an independent non-executive chair, independent non-executive directors and executive directors. The directors collectively have the appropriate balance of skills, knowledge and experience in the financial services industry, in particular life insurance, with-profits, investments, risk and governance.

The Board exercises stewardship over the Group's subsidiaries through its right to appoint Board members and reservation to the Board of certain matters outlined in the constitutions of the subsidiaries (the Articles of Association).

In setting its governance arrangements, the Board reserves decision making powers to itself, or delegates these powers to a Board approved committee. The CEO has responsibility for any matter not reserved to the Board. A full description of the Board's role and responsibilities is set out in the Governance section of the 2021 LV= Annual Report.

The following chart illustrates the governance structure:



The Board has overall responsibility for the Group's risk management, internal control and reporting systems. Accordingly, they ensure that Group-wide requirements across all these areas are set on a consistent basis throughout the business. This is straightforward to achieve due to the Board's influence over the Group's wholly owned subsidiaries and the fact that all of these subsidiaries, utilise the group's risk and finance functions.

Within its Systems of Governance, the LVFS Board has adopted a Three Lines of Defence model with key oversight functions being Risk, Compliance, Actuarial and Internal Audit. In setting up these functions, the Board has ensured that:

- They are free from influences that may compromise their ability to undertake duties in an objective, fair and independent manner.
- Each function operates under the ultimate responsibility of, and reporting to, the Board.
- They have the necessary authority, resources and expertise, as well as unrestricted access to all relevant information necessary to carry out their responsibilities.

The scope, authority and responsibility for each of the Three Lines of Defence is set out in a Board-approved Risk Mandate, which is included as part of the Risk Strategy. The Mandate, in conjunction with the Risk Operating Model, confirms how each function achieves independence and how potential conflicts of interest are managed.

The following table summarises the key roles and responsibilities for each function:

<p>Risk Management function</p>	<p>The Risk Management function sets the strategic direction on risk matters and provides oversight of the operation of the Risk Management Framework (LV=RM) across the Group.</p> <p>Risk Management activity is an enabler for the business achieving its goals. To ensure that there is a cohesive and co-ordinated approach to managing risk, the various resources across the Group must be deployed efficiently and effectively in order that risks and exposures are identified, managed and mitigated. The Group’s approach to risk management and risk governance is based upon the ‘Three Lines of Defence Model’. The LV= Risk Strategy sets out the mandate of the Risk Management function and the ‘Three Lines of Defence Model’. A detailed account of all Risk Management activity is provided in section B.3.</p>
<p>Compliance function</p>	<p>The Compliance Function reports to the Chief Risk Officer. The Compliance function is a fundamental element of the Second Line of Defence, with key compliance responsibilities included in the following roles:</p> <ul style="list-style-type: none"> • The Chief Compliance Officer reports to the Chief Risk Officer. Primary responsibilities of the role relate to advising on conduct risk compliance and oversight of non-prudential regulatory change. In addition, they hold the regulatory responsibilities for Money Laundering Reporting Officer and Data Protection Officer. The Chief Risk Officer retains accountability for advising the business on compliance with prudential risk matters, including the impact of prudential regulatory change on the Group’s risk profile. • The Risk Management Compliance team reports to the Director of Regulatory Risk and is responsible for designing and facilitating the implementation of the Regulatory Risk Management Framework. <p>Further details of Compliance Function responsibilities and activities are included within section B.4.</p>
<p>Actuarial function</p>	<p>The Actuarial Function forms part of the Second Line of Defence led by the Chief Risk Officer.</p> <p>The Actuarial Function:</p> <ul style="list-style-type: none"> • Provides oversight and challenge to the calculation of the technical provisions of the Group and reports to the relevant governance committees on the appropriateness of the methodologies, models, assumptions and data used. • It also reports on the appropriateness of the underwriting and reinsurance policies and arrangements applied. <p>Further details are provided in section B.6.</p>
<p>Internal Audit function</p>	<p>Internal Audit act as the third line of defence. The internal audit team provides independent and objective assurance to the Audit Committee and to the executive team on the effectiveness of the systems of risk management and internal controls across the business.</p> <p>A detailed account of the function’s operations and responsibilities is provided in section B.5.</p>

Remuneration

The Group has a Remuneration Committee consisting of non-executive directors of the Board. Its main responsibilities are to recommend to the Board the policy on the structure of remuneration across the Group; determine and oversee the design and implementation of the Remuneration Policy and associated remuneration practices for executive directors and senior management; to determine specific remuneration packages for executive directors and senior management; and to oversee the policy, design and governance of variable remuneration schemes across the Group, including the Distribution Performance Reward scheme.

The Remuneration Policy is designed to support LV's strategy, promote long-term sustainable success and seeks to align remuneration with performance. Variable remuneration, with the amount paid linked to performance, forms an important part of the remuneration package for all employees. All employees are eligible to participate in the annual bonus, with the total pool to be shared among all employees calculated based upon Group performance. Group performance for the purposes of determining the annual bonus pool is assessed based upon the Balanced Scorecard with a mix of financial and non-financial performance conditions.

Each person's bonus amount is determined based on their individual performance. For employees covered by Solvency II regulations, a proportion of their variable remuneration bonus award may be deferred and paid out over future years, in order to comply with regulations.

Senior employees may also be invited to participate in the Long-Term Incentive Plan (LTIP). The final value of an LTIP award is determined based upon long-term performance conditions measured over a three year period. The LTIP therefore incentivises senior employees and rewards them for delivering the strategic priorities and strong business performance over the long term.

The full Report on Directors' Remuneration can be found in the 2021 LV= Annual Report.

B.2 Fit and proper

Everyone employed by the LV= Group needs to meet defined criteria for being Fit and Proper as defined in the Fit and Proper Policy, which is owned by Group Human Resources. This policy requires that everyone meets the following principles:

- Honesty, integrity and reputation
- Competency and capability
- Financial soundness

Key management personnel of the Group are aligned to the FCA/PRA Senior Managers and Certification Regime and include Board members as well as Senior Management Function holders within Risk Management, Internal Audit, Compliance, Actuarial, the Money Laundering Reporting Officer and other roles seen as being a Significant Management Function. Collectively, these personnel possess professional qualifications, experience and knowledge in multiple areas.

These include, but are not limited to:

- Business strategy, including financial and actuarial analysis
- Regulatory framework and requirements
- System of governance and risk management
- Insurance and financial markets
- Information technology and project management

A standard recruitment process exists, which is based on multiple factors including consideration of experience, skills, qualifications, behaviours and attitude. The Referencing Minimum Standard establishes the key checks to be performed to ensure that candidates meet the Fit and Proper standards.

The following key checks are completed:

- 2 year employment history
- Right to work in the UK
- 5 year address history
- Fraud checks
- Credit checks
- Sanctions checks
- Qualification checks (depending on role)

An application to the FCA/PRA is required when recruiting Senior Management Function Holders and the organisation conducts additional checks for these roles including:

- 6 year regulatory employment history
- Completion of fitness, propriety and conflicts of interest questions
- FCA/PRA prohibitions
- Directorships
- Criminal Records Bureau (For Senior Manager Function only)

All referencing for any Senior Manager Functions, Key Function Holders and Certified Staff need to be completed prior to commencement of employment.

On an annual basis, a Fitness, Propriety and Conflicts of Interests attestation is conducted for all Senior Manager Functions, Key Function Holders and Certified Staff. This check includes directorships, financial soundness and conflicts of interest.

B.3 Risk management system

LV= operates a fully integrated risk management framework (LV=RM) which brings together the key processes and activities undertaken throughout the business to ensure that our members’ and customers’ security is at the forefront of our decision making. Structuring engagement and risk management practices in line with this framework and our values enables senior management to demonstrate that risk is actively and appropriately managed across LV=.

Like all financial service firms, LV= continued to face a number of challenges throughout 2021 including:

- The unprecedented ongoing uncertainties and implications of Coronavirus (Covid-19);
- Continuing developments over the UK’s future relationship with the EU and the rest of the world following Brexit;
- Increasing stakeholder and regulatory expectations over firms’ environmental, social and governance activities in response to global issues such as climate change;
- Operating in competitive markets where LV=, working with third parties such as advisors, asset managers and reinsurers, seeks to continue to deliver favourable customer outcomes; and
- A growing digital economy, increasing focus on data protection and the heightened threat posed by cyber criminals.

In addition, LV= continues to undergo significant change and transformation including the delivery of a number of trading initiatives and the ongoing drive to reduce the complexity of the business in order to improve efficiency and lower our cost base. Over 2021, the transformation agenda also included the preparations for the proposed transaction with Bain Capital.

Despite the challenging context, LV=has continued to prioritise delivering positive outcomes for our members and customers, with activity underpinned by the LV=RM. A key emphasis throughout 2021 was the continued embedding of LV=RM across the business.

Overall Board responsibilities

The Board is responsible for determining the appropriate level of risk to which the group may be exposed and ensuring that these risks are appropriately controlled. These include the risks to the business model and future performance, those which threaten policyholder security and/or liquidity and those which could have a detrimental impact upon member outcomes.

The Board seeks to achieve this by ensuring that the LV=RM continues to include the setting of a proportionate risk strategy, risk appetite and clear risk mandate and organisational design. The Risk Committee, on behalf of the Board, regularly monitors the operational effectiveness of the LV=RM to ensure that it continues to drive a suitably robust risk culture within LV=.

LV=RM Overview

The LV=RM framework is owned by LV=’s chief risk officer on behalf of the Board. It provides a systematic set of processes, tools and behaviours which allow senior management to respond effectively to any potentially significant internal or external event that may impact on delivering the business strategy. The LV=RM also enables LV= to enhance its business and risk based decisions, while ensuring that it remains compliant with all regulatory and legislative requirements, as well as internal policies.

The key elements of the LV=RM are summarised below:

Risk Universe	The risk universe is a standard set of key risk categories where LV= has, or is likely to have, material risk exposures. These are used for identifying, reporting and modelling LV=’s risk exposures.
Risk Strategy	This sets out LV=’s approach to risk management including providing a clear direction and preference for taking on or avoiding risk.
Risk Governance	This covers the framework and processes which demonstrate to the Board that appropriate and effective risk management, oversight and assurance is being undertaken for all material risks faced by the business.
Risk Appetite	These are a set of statements and supporting measures which clearly state the level of risk that the Board is willing to accept in order to achieve its business objectives.
Risk Policies and Standards	These set out the expectations and evidence requirements for how the Board expect the key risks within the risk universe to be identified, categorised, assessed, controlled, monitored and reported.
Risk & Control	This is an integrated and co-ordinated set of processes which facilitate the timely and effective

Assessment	identification, assessment and management of risks that could or will impact LV=.
Own Risk & Solvency Assessment	The Own Risk & Solvency Assessment (ORSA) processes facilitate the timely and effective identification, assessment, monitoring and control of LV= risk, capital and liquidity positions.
Culture and Performance	This includes performance measures that drive appropriate behaviours and promote an effective risk culture.
Training and Communications	This is a programme of regular and timely risk-based training and communication across all areas of the business. It ensures that there is a clear understanding of risk management processes and controls.
MI & Reporting	The provision of complete, accurate and timely management information to senior management and the Board to allow them to discharge their risk management responsibilities and to facilitate risk-based decision making.

Further information on these elements is provided below.

Risk universe

LV= is exposed to both financial and non-financial risks, with profitability and growth, together with customer outcomes dependent upon the proactive management of these risk exposures. The Risk Universe sets out the key risk categories where LV= has, or is likely to have, material risk exposures. At a high level the risk categories which LV= is exposed to are:

- Life insurance risk
- Financial markets risk
- Credit counterparty risk
- Liquidity risk
- Strategic risk
- Conduct risk
- Operational risk

Clear executive accountabilities for managing each of these risks have been agreed at the Risk Committee.

Risk strategy

The risk strategy is aligned with the business strategy and ensures that an effective approach to risk management is in place, in line with its business and financial goals. This risk strategy aims:

- To inform the Board in setting a robust risk appetite which ensures that the business model and strategy are designed and executed in a controlled manner to safeguard member value.
- To drive a strong risk culture that ensures the business is managed in line with the Board's risk appetite.

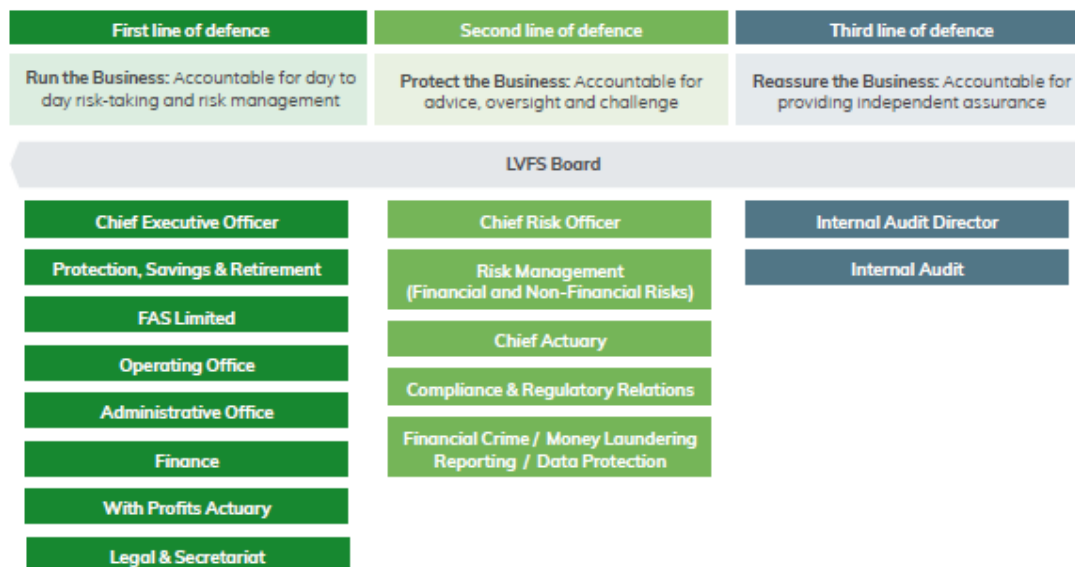
Risk governance

LV= operates a three lines of defence model as part of its day-to-day risk management operations, as set out within a board-approved risk mandate. The Board delegates much of its oversight of risk matters to the Risk Committee, which together with the (executive) Management Risk Committee, the chief risk officer and the risk management teams, ensures that the business is operating in line with the requirements of the LV=RM.

The roles and responsibilities across the three lines of defence model are included within the risk strategy. Ownership of risk is summarised as follows:

- **First line of defence:** led by the chief executive who is supported by the executive and senior leadership team. The executive team are accountable for the management of risk and are required to identify, assess, manage and report on the risk profile on a current and forward looking basis. Sound risk management tools, practices and knowledge facilitate informed business decision making in accordance with the LV=RM, and in particular LV='s risk appetite.
- **Second line of defence:** led by the chief risk officer who is supported by the risk management team, compliance and actuarial functions and other risk management professionals across the organisation. Risk management develops and directs the implementation of the LV=RM, monitors, reviews and challenges first line compliance with this framework and escalates material breaches to the Board.
- **Third line of defence:** led by the internal audit director who is supported by the internal audit team and the Audit Committee. Internal audit provides independent and objective assurance to the Audit Committee and to

executive management on the effectiveness of the systems of risk management and internal controls across the business.



Risk appetite

The LV= risk appetite comprises a suite of quantitative and qualitative statements that are used to measure current and future business performance. These cover five broad dimensions:

- Overall attitude to risk;
- Financial;
- Conduct;
- Operational and transformation;
- Regulatory and stakeholder engagement.

Each of the appetite statements provide direction to senior management regarding their priorities in the execution of the risk strategy and where appropriate, are underpinned by a suite of more granular supporting measures, limits and triggers.

Risk and control assessment

Management undertake regular assessments to help determine whether the risk and control environment continues to operate in line with expectations. This helps ensure that the risks that LV= faces are identified, understood and managed effectively. The conclusions of these assessments are used to inform our senior management and the Board as to whether there is an increasing likelihood that a single risk or group of risks could impact LV= or its members and customers.

Own risk and solvency assessment (ORSA)

The ORSA is an integral part of LV='s capital management processes and the overall LV=RM. The ORSA comprises iterative internal risk and capital assessment processes operated throughout the year to monitor ongoing risk exposures relative to appetite, and to ensure solvency and liquidity needs are met on both a current and forward-looking basis. These processes support the implementation and embedding of the LV=RM and include risk strategy and risk appetite, risk identification, assessment and measurement, risk monitoring and reporting, linkages to business strategy and stress and scenario testing.

The ORSA is an effective tool used to inform strategic decision-making. The annual ORSA Report is developed and agreed with the Board and consolidates the findings from the ORSA processes performed throughout the year. The ORSA report also includes key outcomes, for example from the risk review of the business financial plan; stress and scenario testing (including reverse stress testing); the assessment of the appropriateness of the Standard Formula; and regular solvency and risk exposure monitoring. The solvency position of the business is determined in accordance with the Solvency II Standard Formula requirements.

Risk management effectiveness

LV= conducts an annual risk maturity and culture assessment to assess the ongoing effectiveness of the embedding of the LV=RM and to test how the risk culture of the business is evolving over time. The outputs from this assessment are used to determine areas for further development under LV='s programme of continuous improvement.

B.4 Internal control system

The internal control system includes a range of functions, roles and activities that collectively ensure an appropriate control environment for the business. It enables us to operate efficiently and respond to any significant or evolving risks that could prevent or limit the achievement of our business objectives, through implementing the following requirements:

- **Control Environment:** The setting of a robust control environment and business culture.
- **Risk Identification:** Maintaining the LV= RM and associated procedures which enable the identification of all material risks to the achievement of our business objectives.
- **Risk Assessment:** Operating a Risk Management System and procedures which enable the assessment, control and reporting of all material risks and the assessment of controls to manage these risks within risk appetite.
- **Control Activities:** Having in place business processes/procedures that provide assurance that all necessary control activities are in place and are working effectively.
- **Control Standards:** Having a policy framework and policy suite that are fit for purpose and provide the Board's minimum requirements for the management of Operational, Financial and Conduct controls.
- **Information and Communication:** Ensuring clear information and communication in respect of our internal control systems, including responsibilities and core risk management objectives.
- **Monitoring Activities:** Performing periodic and regular attestation reviews of the effectiveness of Operational, Financial and Conduct controls across the business, and reporting on the status of control design and performance through regular risk assessment processes.

Compliance with these requirements will support an integrated and standardised approach to establishing and maintaining an effective and efficient internal control system.

Group compliance

The Compliance function is a fundamental element of the Second Line of Defence, with key compliance responsibilities included in the following roles:

- The Chief Compliance Officer reports to the Chief Risk Officer. Primary responsibilities of the role relate to advising on conduct risk compliance and oversight of non-prudential regulatory change. In addition, they hold the regulatory responsibilities for Money Laundering Reporting Officer and Data Protection Officer. The Chief Risk Officer retains accountability for advising the business on compliance with prudential risk matters, including the impact of prudential regulatory change on the Group's risk profile.
- The Risk Management Compliance team reports to the Director of Regulatory Risk and is responsible for designing and facilitating the implementation of the Regulatory Risk Management Framework.

The Risk Management Compliance Statement of Practice sets out mandatory requirements to reasonably assure that the Group remains compliant with the legal environment within which it operates, and remains within Risk Appetite. It includes the principles by which the compliance system is designed and operated, and sets out the key components of the system that support understanding and effective operation across the Group.

The policy is owned by the Chief Compliance Officer, who is responsible for ensuring that it is produced and kept current and is reviewed by all business areas prior to formal approval submission. It is approved by the Chief Risk Officer who is accountable for ensuring maintenance of the policy content as well as supporting policies, processes and procedures.

The policy requires that Risk Management Compliance implement and maintain a Regulation and Legislation Matrix which sets out individual departmental responsibilities for compliance. Each such department is required to:

- Establish a robust compliance system to identify and assess the impact of new requirements or changes to requirements in the legal environment.
- Advise the Board, senior management and other personnel regarding changes to the legal environment, as appropriate.

In addition, Risk Management Compliance is responsible for developing and implementing:

- **Compliance Plan:** An annual compliance plan which oversees the implementation of changes to the legal environment and strategic priorities of the Compliance function, to feed the Group Risk annual plan for review and approval by the Management Risk Committee and the Board Risk Committee.
- **Compliance Monitoring Plan:** An annual risk-based compliance monitoring plan which sets out the key independent assurance activities to be undertaken, for review and approval by the Board Risk Committee.

B.5 Internal audit

Internal Audit

The purpose of Internal Audit (IA) is to provide independent and objective assurance to the Audit Committee and Executive Management on the effectiveness of systems of risk management and internal controls across LVFS and its subsidiaries, in order to mitigate key business risks and to assess the sustainability of the organisation. The purpose, authority and responsibility of IA is set out in the Internal Audit Charter. This document is subject to annual review and approval by the Audit Committee.

IA undertake an annual planning exercise to determine which activities and controls should be subject to audit review over the following year. The audit plan is set by reference to the audit universe, the principal risks facing the business, strategic priorities, and any emerging risks or regulatory changes. The plan is benchmarked against previous audit coverage, alignment to the risk assurance plan, and industry hot topics for audit coverage. The Audit Committee reviews, challenges and approves the scope and content of the plan.

At each Audit Committee meeting, the Internal Audit Director provides a report on:

- Progress with delivery of the Audit Plan for the year and any proposed changes to the plan;
- Key findings from audit reports and any emerging themes across the business; and
- Status of completion of management’s audit actions.

On an annual basis, the Internal Audit Director provides an opinion on the Control Environment to the Audit Committee, which includes an assessment of the culture of the organisation.

Independence and Objectivity

IA reports independently to the Audit Committee on its work. The Internal Audit Director has a dual reporting line to the Chairman of the Audit Committee and to the LVFS CEO, and also has unrestricted access to the Chairman of LVFS. The Internal Audit Director regularly meets with the Chairman and Audit Committee members. The Audit Committee approves IA resources and budgets.

IA attend and observe Executive Committee meetings and any other key management decision making forums and have regular individual meetings with the CEO and Executive Committee members. IA have sufficient and timely access to key management information, including Board level papers.

IA have no direct operational responsibility or authority over any activities of the organisation, other than the assurance work undertaken. IA have a robust process to identify and manage any potential conflicts of interest which may influence objectivity or independence. IA staff are required at all times to be objective, constructive and not be influenced by personal, business or other issues, which might impair impartiality.

On an annual basis, the effectiveness and independence of IA is evaluated by the Audit Committee. To enable this, the Internal Audit Director performs a review of the function and reports to the Audit Committee with the conclusions. The approach to this review for 2021 included:

- An assessment of compliance of the function against Internal Audit’s mandate and professional standards:
 - The relevant sections of the Audit Committee ToR;
 - The Internal Audit Charter;
 - The CIIA Code “Effective Internal Audit in the Financial Services Sector” (including the revisions issued in September 2017); and
 - SMF5 (Internal Audit) responsibilities.
- A review of business feedback on individual audit reviews;
- A review of the results of quality assurance activity on audit files performed during 2021; and
- A review of the resourcing position, skills and training plans for the function.

The Internal Audit Director asserted that Internal Audit operated as an effective function during 2021 which was noted by Audit committee in April 2022.

B.6 Actuarial function

The Actuarial Function forms part of the Second Line of Defence led by the Chief Risk Officer, who reports directly to the Chief Executive Officer.

The Actuarial Function provides oversight and challenge to the calculation of the technical provisions of the Group and reports to the relevant governance committees on the appropriateness of the methodologies, models, assumptions and data used. It also reports on the appropriateness of the underwriting and reinsurance policies and arrangements applied.

The methodology and assumptions used in the calculation of the Life Insurance technical provisions are proposed by the Actuarial Analysis and Reporting teams who also perform the calculation. These teams sit within the Group Finance Function, reporting to the Chief Financial Officer, independently of the Chief Risk Officer. The proposed methodology and assumptions are reviewed by the Life Chief Actuary, as are the technical provisions themselves. The methodology, assumptions and results, along with the independent Actuarial Function reviews, are considered subsequently by the Audit Committee, before being recommended to the LV= Board for approval.

The Actuarial Function also provides advice and guidance to the Chief Risk Officer on the operation of the Risk Management Framework, especially the Capital Management Framework. This includes assistance with the oversight of risk exposures and advice on various capital management initiatives.

B.7 Outsourcing policy

To ensure a consistent approach across the Business, LV maintains a Critical & Important Outsourcing Policy, which forms part of LV's Supplier Engagement Policy. This policy is reviewed on an annual basis and sets out detailed requirements on areas including:

- overall sourcing strategy
- supplier assessment criteria
- principles for identifying critical and important relationships
- contractual and operational requirements and ongoing supplier relationship management.

Critical or important operational functions or activities which have been outsourced

In line with other large financial services organisations, the business has a number of critical and important external suppliers and service providers. These provide support for asset management, IT infrastructure, maintenance and system hosting and print and distribution.

These partners provide several benefits to LV=, including cost efficiency and access to improved technology within the business's administrative capability. Wherever processing or specialist work is undertaken by these partners, LV= remains fully responsible for the oversight, management and performance of the outsourced activity.

The nature of the services provided, and the jurisdictions they operate in, are listed below:

Description of Function or Activities	Jurisdiction of Service Providers
Investment of Assets, Investments in commercial mortgages	England and Wales
Infrastructure Management, Application Management & systems development, Desktop services and Telephony	England, Wales and India
Outbound Printing and Distribution services	England and Wales
Software as a Service and Hosting arrangement	England, Wales and Scotland
Software and customer facing applications development	England, Wales and Scotland

B.8 Additional information

In response to the Coronavirus outbreak the Group has developed and put in place contingency plans to minimise business disruption, with our primary focus being the continued safety of our staff and ensuring that we continue to provide a high quality service for our customers.

A formal business continuity plan process was invoked on 17 March 2020 and as a result, a Crisis Management Team has been created, with Georgina Farrell (Chief Administration Officer) chairing. This has continued to meet throughout 2021.

C. Risk Profile

C.1 Overview

C.1.1 Overview of risk exposures

The Group's business model involves taking on risk for its policyholders in order to provide security and aid in financial planning. In order to facilitate this, LV= offers a range of Life and Health insurance products. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

The Group manages risk using a range of techniques, including reinsurance, derivatives, limits to counterparty exposure, as well as by using its scale and range of products and investments to provide diversification. The Group measures its risk using a range of techniques, including European Insurance and Occupational Pensions Authority (EIOPA) prescribed Standard Formula capital calculations, internal views of risk and sensitivity testing. A number of committees, attended by senior stakeholders, meet regularly to consider the Group's risk exposure, and whether it is in line with risk appetite. This enables informed decision making on where risk mitigation is required or where further risk can be taken on. Furthermore, external opinions are sought from consultancies and regular reports are made to the PRA.

The table below shows the 31 December 2021 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2020 are provided for comparison. Reference to the SCR in this and later sections is to the final post-diversified SCR including ring-fenced funds unless stated otherwise. The amount of SCR illustrated below is £851m (2020: £832m). This differs from the total SCR reported in section E.2 as it excludes the loss absorbing capacity of deferred tax.

SCR split by risk type, for the year ended 31 December	2021	2020	Change
Market risk	63%	52%	11%
Underwriting risk	31%	41%	(10)%
Operational risk	4%	5%	(1)%
Counterparty risk	2%	2%	0%
Total	100%	100%	

The Group SCR has increased slightly over the year. The weightings of the high level risk categories shown within the SCR have shifted towards market risk, and reduced the underwriting risk weighting. The 11% increase in market risk weighting from the previous year is driven by an increase in equity exposure. The increase in equity exposure is primarily due to investment into asset share to hedge future payments of exit bonus. The size of the equity stress has increased from the year-end 2020 level due to a gradual market recovery following the Covid-19 pandemic, further contributing to the increase in equity risk. The underwriting risk weighting has decreased due to the rise in yield curve over the year decreasing lapse risk, and the increase in market risk. See sections C.2.2 and C.3.2 for further details.

C.1.2 Measurement of risk exposures

The Group's measurement of risk exposures has not changed materially over the reporting period.

The Group measures its risk exposures using a variety of metrics. These metrics are reported to senior management, the Audit Committee, the Risk Committee and the Board. This allows management to identify the key areas of risk exposure and make informed decisions as to whether the current levels of exposure are consistent with the Group's risk appetite.

The Group uses the following metrics:

- Regulatory capital is measured using the Standard Formula approach, and reported to the PRA on a quarterly basis.
- The Group maintains its own internal view of capital measurement, which informs risk appetite surrounding regulatory surplus capital. This uses internal and external knowledge to assess risk in a more bespoke way than can be done using the Standard Formula approach.
- An analysis of change is performed on Own Funds on a quarterly basis for the Group and Life entities, including evaluating how actual experience compares to the expected position. An analysis of change is also performed on the capital requirements on a quarterly basis, looking at individual risks as well as the whole SCR.
- Capital and Own Funds are monitored using sensitivities and approximations on a regular basis and the results reported to Senior Management. These results are then compared to actuals on a quarterly basis.

- Regular experience analysis is performed on key assumptions to evaluate their continued suitability. This includes both demographic experience and expenses.
- Stress and scenario testing is performed annually for the Own Risk and Solvency Assessment (ORSA) and business planning exercises.

C.1.3 Prudent person principle

The Group operates within an investment framework which ensures that all assets are invested in accordance with the prudent person principle. The investment framework is suitably flexible to manage the different investment needs of the diverse business areas within the Group. All investment and strategic management decisions are set within Board approved risk appetite limits. Working within this risk framework, considerations of commerciality, treating the customer fairly and policyholders' reasonable expectations are embedded into the investment strategies for each business unit as appropriate.

All invested assets, other than Equity Release Mortgages, are managed by external investment managers under an investment management agreement. Within the agreement, there are a number of investment guidelines which reflect the risk appetite limits and investment management parameters. The Equity Release Mortgages held by LVFS are originated and administered by its subsidiary LVER, and this arrangement is governed by the terms set out in the Mortgage Purchase Agreement. All investment guidelines are approved by the Board or a delegated authority of the Board.

These limits are embedded within each internal fund at asset class level and include; admissibility, duration, rating, sector, concentration, optionality and liquidity. These limits are monitored continuously by the investment manager and reported to LV= on a weekly basis. The investment manager is required, under the IMA, to deliver full investment guideline and investment underperformance reports including any active or passive breaches as part of the breach reporting process. Limits are also monitored independently by LV= and reported to the appropriate governance committee monthly.

C.1.4 Risk concentration

The Group offers a wide range of product options catering to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location. As such, the Group has a diverse and balanced mix of business and risk exposures.

In addition, the Group uses a variety of measures to limit any excess concentrations:

- investing in a range of assets governed by investment mandates and asset counterparty limits set by the Group;
- using various hedging and asset liability matching strategies to reduce market risk;
- managing counterparty risk through risk limits on exposure and concentration; and
- limiting excess concentrations of underwriting risk through a range of reinsurance strategies.

As the Group has substantially written all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

Where material, further information on risk concentrations relating to particular risks are given in sections C.2 to C.6.

C.2 Underwriting risk

In determining the price of its insurance products, and when reporting the financial results relating to these products, the Group makes a number of assumptions related to the future amounts and timing of payments. Underwriting risk arises from the actual outcome being different to these assumptions.

C.2.1 Underwriting risk exposure

The Group writes the majority of its Life and Health business within LVFS and is exposed to underwriting risk in these areas. The Group wrote a small amount of non-life business within its subsidiary LVPL. The table below shows the 31 December 2021 split of underwriting risks within the Standard Formula SCR. The results for 31 December 2020 are provided for comparison. The amount of SCR illustrated below is £265m (2020: £335m). This differs from the underwriting risk capital shown in section E.2 as it fully allows for diversification within the SCR calculation.

SCR split of underwriting risk, for the year ended 31 December	2021	2020	Change
Life lapse	52%	60%	(8)%
Life expenses	23%	19%	4%
Health	18%	13%	5%
Life longevity	6%	7%	(1)%
Non-life premium and reserving and catastrophe	0%	0%	0%
Other	1%	1%	0%
Total	100%	100%	

Lapse risk is generally a significant risk across the life insurance industry, due to the long-term nature of life business. As a result, lapse rates on material product lines are closely monitored. Lapse risk also captures the risk associated with the take-up of policyholder options, notably the option to take a cash lump sum at retirement instead of the annuity on OB Pensions deferred annuity with-profits business. The cost of fewer policyholders taking cash at retirement has a material contribution to the lapse risk of the Group.

Expense risk affects all business lines and covers the possibility of higher than expected expenses, for example due to higher than expected inflation.

All health exposure, including expense risk, comes from protection products which behave similarly to life insurance policies, but pay out on the diagnosis of a serious illness or on the loss of earnings due to illness. This category also includes the risk of pandemics.

The remaining risks include the risk of higher than expected mortality, life catastrophe risk such as a pandemic, and disability claims. These risks are relatively minor for the Group, being either small in nature, heavily reinsured, or heavily diversified against other sources of risk.

Pandemic remains a minor risk to the Group despite the on-going Covid-19 situation. This is due to the fact that the Group has reinsurance and benefits from diversification between its varying exposures to mortality and longevity. A small manual reserve is held at year-end 2021 against the potential for adverse Covid-19 related mortality experience over 2022. Claims rates over the year on several lines of business were elevated due to Covid-19, predominantly on the non-profit book, however these were largely offset by the short-term Covid-19 provisions established at year-end 2020. As economies have reopened inflation and interest rates have increased from year-end 2020, however month on month variability in economic conditions continues and is likely to remain over the short to medium term. The Group has a strong capital position and actively monitors and manages its market risk exposures to deal with any economic shocks. See section C3 for further details on exposure to market movements.

C.2.2 Material changes over the reporting period

The most material change in underwriting risk components over the year is a reduction in the lapse risk weighting, though lapse risk remains the largest component. The £70m (8%) decrease in lapse risk capital is due to the increase in interest rates over the year with some additional benefit from changes in the expense basis and persistency basis.

Expense risk capital and health risk capital on Protection products have increased proportionally from the reduction in lapse risk exposure.

C.2.3 Risk mitigation techniques

Reinsurance is used as a risk mitigation technique across a range of products to transfer mortality, morbidity, longevity, and catastrophe risk outside of the Group. Reinsurance is used for various reasons including managing risks within appetite, capital financing, protection against large individual losses and access to expertise. The effectiveness of reinsurance is monitored through the review and approval of new reinsurance arrangements by the relevant governance committees, the ongoing monitoring of counterparty credit risk at the relevant governance committees, and the internal and external audit review of governance and processes.

C.2.4 Risk concentrations

The Group has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and, within each of these categories, to achieve a sufficiently large population of risks to reduce the variability of the expected outcome. The Group minimises the level of insurance concentration through the use of portfolio analysis and reinsurance. The Group is exposed to material changes in policyholder behaviour, for example through lapses, cash commutation and guaranteed annuity option take-up rates. These risks are captured within the underwriting risk modules.

C.3 Market risk

Market risk arises as part of the Group's general investment performance and product pricing. The risk to the Group arises from the performance of the investments being different from that assumed in the planning and pricing processes.

C.3.1 Market risk exposure

As an institutional investor, the Group invests in a range of assets, governed by mandates and limits set by the Board. The table below shows the 31 December 2020 split of market risks within the Standard Formula SCR. The results for 31 December 2020 are provided for comparison. The amount of SCR illustrated below is £537m (2020: £433m). This differs from the market risk capital shown in section E.2 as it fully allows for diversification within the SCR calculation.

SCR split of market risk, for the year ended 31 December	2021	2020	Change
Spread	51%	64%	(13)%
Equity	41%	27%	14%
Interest rates	4%	6%	(2)%
Currency	4%	3%	1%
Property	0%	0%	0%
Concentration	0%	0%	0%
Total	100%	100%	

Spread risk is a significant risk for the Group as it has a high exposure to corporate bonds. This arises primarily from the enhanced and fixed term annuity business, where corporate bonds are used to back a large proportion of the liabilities. There is also a material contribution to spread risk from the defined benefit pension schemes, which also invest a significant proportion of their assets in corporate bonds. Spread risk also arises from the Group's equity release mortgage loans, due to the treatment under Standard Formula calculation of the SCR. As a major risk, spread risk is considered in more detail within the Group's internal view of risk, where alternative calibrations and approaches (such as looking at the yield of gilts above swaps) are considered.

The Group has material exposure to equity risk from investment into asset shares to hedge future exit and mutual bonus payments. This approach is capital intensive however it is deemed the most suitable to protect policyholder exit bonus and is permitted by the Group's strong capital position. Equity risk otherwise arises from the defined benefit pension schemes and the Group's with-profits business. For the pension schemes, investment returns have no direct impact on scheme members' benefits, so any reduction in equity values reduces surplus. For with-profits business, falls in equity markets increase the costs associated with guarantees.

Interest rate risk is present under all lines of business, as the level of best estimate liabilities are calculated by discounting future cashflows.

The Group has only a limited exposure to currency (foreign exchange) risk through its investment in overseas assets.

A small amount of commercial property risk arises mainly from the with-profits business and from the Group's pension schemes. Note that residential property risk also arises from the Group's equity release mortgage portfolio but this is not directly stressed within the Standard Formula calculation of the SCR and is instead monitored using the Group's internal view of capital.

Sensitivities to key market risks are provided in section C.8.1.

C.3.2 Material changes over the reporting period

Equity risk capital has increased by £103m over the year, primarily due to investment into asset share to hedge future payments of exit bonus. The increase in equity risk capital is also due in part to stronger equity performance and an increase in the size of the equity stress over 2021.

Spread risk remains relatively unchanged, though the weighting has decreased by 13% due to the increase in equity exposure.

Currency risk capital has increased by £10m over the year. Investment into US Dollar corporate bonds, introduced in 2020, has increased over the year to back the annuity business however a cross currency swap is in place to mitigate the risk and ensure compliance with the requirements of the Matching Adjustment. Overall exposure to currency risk remains low.

C.3.3 Risk mitigation techniques

The Group uses derivatives as part of its management of market risk. Derivatives are currently used to manage interest rate risk, equity risk, inflation risk and currency risk.

Risk type	Description
Equity	Equity exposures across LVFS are managed using portfolios of derivatives. This has included implementing internal hedges to manage the costs we are exposed to on our with-profits business, including smoothing, guarantees and expenses, with derivatives used to manage the remaining exposure. The exposure associated with the annual management charges on unit-linked business are managed using futures contracts.
Interest rates	A number of strategies are employed by LVFS to manage interest rate risk, beyond its selection of physical assets to match the exposure arising from the liabilities. Interest rate swaps are used to improve asset and liability matching across LVFS. A cash flow swap is used by the matching adjustment portfolio to facilitate strong cash flow matching on annuity business. Transitional measures on technical provisions (“TMTP”) is utilised by LVFS and used to manage interest rate risk to the Solvency II balance sheet.
Inflation	Inflation exposure across LVFS and within the defined benefit pension schemes is managed using inflation linked assets and inflation swaps.
Currency	LVFS invests in a variety of foreign denominated assets, primarily in asset share, UWP backing funds and the Matching Adjustment Portfolio. LVFS employs currency hedges to remove the currency exposure where it is believed that policyholders’ interests are best served by doing so, and to comply with the Matching Adjustment Portfolio rules.

Spread risk is not mitigated but managed in-line with Group policies.

C.3.4 Risk concentrations

Equity risk is managed by investing in a diverse portfolio of high quality securities. This ensures that holdings are diversified across industries. Concentrations in any one company or industry are limited by parameters established by the Investment Committee. The exposure to property risk, from equity release mortgages, is managed through limits on the maximum loan to value ratio and seeking to limit concentrations in particular geographic areas.

C.4 Credit counterparty risk

Credit counterparty risk arises from the holding of certain investment assets, hedging, reinsuring certain product related risks to third parties, and from normal trade credit such as premium finance. The risk to the Group is that a counterparty defaults on its obligations or fails to meet them in a timely manner.

C.4.1 Credit counterparty risk exposure

The principal risk that the Group is exposed to is the default of an external counterparty. This risk arises in a number of areas:

- The default of assets the Group has invested in, including derivatives. This is both for monies invested by the Group and monies invested on behalf of policyholders.
- The default of reinsurers, to the extent that the reinsurer owes money to the Group. Given reinsurance is a key risk mitigant then any reinsurance default could significantly impact the Group's capital position above and beyond any base balance sheet losses.
- The default of insurance intermediaries on money owed to the Group.

C.4.2 Risk Mitigation techniques

Group policy and risk limits are applied to credit counterparty risk covering aspects such as the total exposure, concentration and ability to cover SCR in the event of failure of a reinsurance counterparty and by taking action where necessary to avoid the limits being breached. Group counterparty exposures are monitored by the Asset and Liability Committee. Reinsurance concentration risk is managed through contracting with a diverse range of reinsurers with credit ratings within an agreed risk appetite.

C.4.3 Material changes over the reporting period

Credit counterparty risk capital decreased by £4m over the year primarily due to a reduction in reinsurance exposure, in part due to improved credit outlook.

C.4.4 Risk concentrations

In order to limit its exposure to a single default, the Group monitors its ability to cover SCR in the event of failure of an individual reinsurance counterparty over the Plan period on an annual basis, and the reinsurer credit ratings for any changes on a quarterly basis. This enables management decisions such as investment strategy and reinsurance arrangements to be evaluated against the total exposure of the Group and the Group's Risk Appetite.

C.5 Liquidity risk

Liquidity Risk is the risk that LVFS and/or its subsidiaries, though solvent, either do not have sufficient financial resources available to meet their obligations when they fall due, or can secure them only at excessive cost. This excessive cost may arise either because of the nature of the investments held or adverse market conditions.

Liquidity within the Group is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies. The Group does not hold capital specifically for liquidity risk but has a liquidity risk appetite statement which requires that, across the Group, the business must have sufficient liquidity to be able to achieve the Business Plan without taking actions that would be materially detrimental to its solvency, earnings or reputation. Adherence to the risk policy and monitoring of the liquidity stock relative to both short and long term liquidity adequacy requirements is performed by the Asset and Liability Committee on a monthly basis.

Liquidity Risk is managed using several methods; these include:

- maintaining forecasts of cash requirements and adjusting investment management strategies as appropriate to meet these requirements, both in the short and long term.
- holding sufficient assets in investments which are readily marketable in a sufficiently short timeframe to be able to settle liabilities as they fall due.
- forecasting additional cash demands under stressed conditions, including demands for collateral, and identifying management actions to be taken to liquidate sufficient assets and reduce other cash outflows, so as to meet the increased demands.
- the appropriate matching of the maturities of assets and liabilities, whereby the Group undertakes asset and liability management to ensure that the duration and term structure of liabilities is matched by the assets held to support them.
- maintenance of a catalogue of management actions that can be utilised under stressed conditions to enhance available liquidity.

The Group is not exposed to concentrations of liquidity risk.

The expected profit included in future premiums (EPIFP) is the change in technical provisions, excluding risk margin, under the assumption that the premiums relating to existing insurance and reinsurance contracts that are expected to be received in the future are not received for any reason other than the insured event having occurred, regardless of the legal or contractual rights of the policyholder to discontinue the policy.

The expected profit in future premiums (EPIFP) for the Group at the end of 2021 was £368m (2020: £338m). The expected profit in future premiums primarily results from our LVFS Protection business, where we expect to receive future premiums for the benefits promised within the contracts.

C.6 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events. Operational risk arises as a natural consequence of business activity and is managed actively within the business.

The principal operational risks and uncertainties facing LV= are summarised within the table below.

Key Risk	Impact and Mitigation
<p>Strategic transformation</p> <p>The execution risks associated with pursuing the strategic priorities</p>	<p>Throughout 2021, the business was exposed to elevated strategic execution risk relating to the major change initiatives, in particular, due to the proposed transaction with Bain Capital. As might be expected with a transformation project of that size and complexity, the business was exposed to additional pressures arising through managing many interdependencies, diverse stakeholder groups and external unexpected factors. Given the level of ongoing organisational change, we are mindful of the associated heightened culture and people risk across the business, and the risks to executing the business as usual plan during 2022. These risks continue to be a key management focus and are monitored relative to appetite.</p>
<p>IT sustainability</p> <p>The risk that capability and capacity issues in relation to our IT systems lead to significant operational or customer risk events.</p>	<p>LV= currently operates with a number of legacy IT systems and infrastructure which can be exposed to capability or capacity issues including, for example, the system being unavailable for a period of time. These risks could result in adverse operational and customer impacts should they crystallise. During the year, significant investment and progress has been made in addressing IT sustainability risk, although the risk remains significant. Addressing these risks remains a top strategic priority and the mitigation work continues as part of a multi-year project.</p>
<p>Operational resilience</p> <p>The risk that LV= would not be able to service our members and customers during a major disruption (if this was to occur).</p>	<p>During 2021, LV=, along with the wider industry, faced a number of operational challenges, most notably through the continuing uncertainties of Covid-19 and the associated implications on the way of operating, which are expected to continue during 2022. Through extensive crisis management and business area engagement, management was able to identify and implement appropriate responses, with a focus on ensuring continued delivery of expected customer outcomes. LV= continues to make progress with compliance with upcoming Operational Resilience regulations.</p>
<p>Cyber security</p> <p>The risk of customer data loss or a severe reduction in customer service as a result of a cyber-event.</p>	<p>The threat of external cyber-attacks has increased in 2021, and is expected to remain heightened during 2022, with cyber criminals looking to exploit both customers and the business. LV= operates a comprehensive cyber risk strategy which is designed to ensure that the business continues to identify, assess and respond to the ever changing threat of a cyber-attack. In addition, a range of messaging has been delivered to improve customer awareness of the threat of fraudulent activity. The business is investing in cyber-security enhancements and it remains a top strategic priority to ensure the controls to mitigate internal and external cyber security risk are robust.</p>
<p>Conduct Risk</p> <p>The risk that key operational controls are ineffective, resulting in poor member or customer outcomes.</p>	<p>The complex and long-term nature of life and pensions products means that, as customer needs change over time, there is a risk that products do not perform as customers would expect and that they no longer deliver appropriate customer outcomes. LV= operates a product governance framework which ensures that each new product or product change is subject to review. In addition, regular product reviews ensure our existing products perform as customers would expect and continue to deliver appropriate customer outcomes.</p> <p>Our continuing response to the Covid-19 crisis included product changes and servicing initiatives aimed at helping vulnerable customers.</p>
<p>Political, Economic and Regulatory uncertainty</p> <p>The risk of a reduction in solvency, policyholder value or customer returns resulting from prolonged uncertainty within the political economic and regulatory landscape.</p>	<p>While significantly reduced from 2020, the UK economy continued to be exposed to heightened uncertainty during 2021 as a result of Covid-19 developments. There continues to be increased uncertainty as a result of the current conflict in Ukraine and the implications this has on the UK economy. The rate of inflation increased significantly over 2021 and this elevated level is expected to continue into 2022. Our existing operational hedging programmes and ongoing reviews are in place to manage and mitigate such risks.</p> <p>We also recognise the upcoming changes in relation to Solvency II which will likely have implications for capital management.</p>

C.7 Emerging and other material risks

As well as monitoring near-term risks, senior management and the Board also consider emerging risks and opportunities which may impact LV= in the future. The top themes from our review included:

Emerging risks	Example events/drivers
Business interruption	These consider future business interruption events (including a further pandemic) which could impact the UK infrastructure, communications and ways of working.
More sophisticated financial crime	This could include an organised crime attack on customer pension or savings data, which could impact a significant number of customers, create severe brand damage and require significant resource to remediate the situation.
Corporate governance and legislation	This includes both adverse regulation together with regulators raising the standards required to demonstrate compliance. The impact would potentially include increased regulatory attention on both an individual company and industry-wide basis.
Market/Competitor disruption	New players enter the market, most likely in the protection sector, together with market changes, particularly in relation to digital platform innovation.

Each emerging risk is assigned to an executive team owner whose regular reporting to the Risk Committee includes an updated assessment of the emerging risks assigned to them, including, where appropriate, how LV= tracks the risk, the actions that LV= can take to respond to the risk and the triggers for the action to be considered.

Climate Change risk

Since 2019 there has been increased focus across a range of stakeholders on the financial risks associated with climate change. LV= recognises the importance of understanding and managing the potential short and long-term implications of climate-related risk and has incorporated this risk within its existing risk management framework, to ensure appropriate oversight is maintained and enhanced over time.

A plan to identify and integrate risks associated with climate change into the existing risk management framework was developed in 2019 and is now materially complete. However, LV= continues to enhance the management and governance oversight of climate-related risks, particularly in relation to asset transition risk (discussed further below) as part of its approach to ESG (environmental, social and governance) investment management. The Risk Committee and Investment Committee have continued to be engaged on this issue.

Climate change was prominently featured within the 2021 ORSA Report including qualitative and quantitative assessments of the risks to which LV= is exposed. This included an assessment of the LV= Scope 1 and 2 emissions, as well as indicative analysis of the Scope 3 emissions from LV='s investment holdings.

The financial performance of LV= and the wider insurance sector may be adversely affected by harmful environmental events and developments including those related to physical risks and asset transition risks, as described below:

Physical risks

Physical risks due to climate change arise from a number of factors and relate to specific weather events (such as heat waves, floods, wildfires and storms) and longer-term shifts in the climate (such as changes in precipitation, extreme weather variability, sea level rise and rising mean temperatures).

Longer-term changes to the climate are likely to affect the longevity, morbidity and mortality risks to which the LV= business is currently exposed, although the scale and direction attributed to climate change is not yet known. Currently LV= mitigates these risks through the significant use of reinsurance and other risk reduction instruments. LV= will continue to monitor evolving industry best practice and regulatory guidance for assessing and adjusting for mortality and longevity changes as the experience emerges over time.

LV= is also exposed to physical risk through potential adverse impacts to property values arising from the investments in commercial property and residential property from equity release loans.

Following the sale of the general insurance business at the end of 2019, LV= no longer has any direct significant short-term exposure to the immediate physical risks of climate change (e.g. claims from flood or storm damage to insured properties).

Asset transition risks

Asset transition risks can arise from the process of adjustment towards a low-carbon economy. A range of factors influence this adjustment, including: climate-related developments in policy and regulation, the emergence of disruptive technology or business models, shifting sentiment and societal preferences, or evolving evidence, frameworks and legal interpretations.

LV= is exposed to a reduction in the value of assets held which are either considered environmentally unfriendly or whose prospects may be adversely affected by climate change. In addition, LV= is also exposed to a potential fall in the value of equity or corporate bond investments, and/or counterparty default as a result of a business failure particularly related to climate risks.

LV= is addressing asset transition risk as part of its approach to ESG investment management. LV= continues to increase the range of ESG funds available for customers, monitors the emissions from different funds and has developed a Responsible Investment Framework, which covers climate change alongside other ESG issues. ESG metrics are monitored and ESG funds form part of the strategic asset allocation for most of our with-profits funds and Smoothed Managed Fund products. ESG funds are available for customers to invest in directly. In addition, LV= is working with our asset managers, Columbia Threadneedle Investments, to understand how the ESG ratings of potential investments influence fund managers' decision making.

We recognise that these risks may also impact our members, customers and suppliers. Consumers and companies will increasingly consider the environmental impact of their investments and select investments which take into account ESG factors, rather than those with a greater carbon footprint.

LV= actions in relation to climate change risk

LV= holds capital against unexpected and extreme changes to its business model from both insurance and asset related risks, in line with prudential regulations. This is considered sufficient at the current time and will be adjusted over time in line with emerging climate related risk experience.

Other actions taken in 2021 to increase focus on climate change risk include:

- The creation of a Sustainability Working Group, with executive ownership and representation from across LV=.
- Ongoing risk reporting throughout the year.
- Increasing the engagement and focus on sustainability with our external asset managers, including development of appropriate management information to support reporting.
- Continuing updates on potential risk exposures and external requirements at the Risk and Investment Committees.

C.8 Sensitivities

This section sets out the Group’s sensitivity to various economic and demographic assumptions. The sensitivities in this section show the impact of changes in key assumptions in isolation. In reality, there may be an interaction between the assumption and other factors. The sensitivities do not always behave in a linear way so using these sensitivities to assess a larger or smaller movement may not give an accurate result. They should only be treated as estimates which give a broad indication of the direction and magnitude of the change in surplus capital. The estimates have been calculated using a combination of analysis and expert judgement and include some approximations where these are not material to the final results. The economic and demographic sensitivities shown below are in respect of the Solvency II Surplus (excluding the RNPFN and Teachers ring-fenced funds). The impact on RNPFN surplus under stress is not included in the sensitivities as burn-through is not expected under stress due to the strong surplus position at year-end 2021. The Teachers fund is very low materiality.

C.8.1 Economic sensitivities

Market risk arises as part of the general investment performance and product pricing. The risk to the Group arises from the performance of the investments being different from that assumed in the planning and pricing processes. The estimated impact on Group surplus capital to a range of economic changes is shown below. These have been aligned with the sensitivities disclosed within the LV= Annual Report.

The following sensitivities are performed:

- An immediate 25% decrease in the market values of equities.
- An immediate 100 bps decrease in all risk-free interest rates.
- An immediate 100 bps increase in all risk-free interest rates.
- An immediate 50 bps increase in gilt interest rates but with swap rates remaining fixed. Note that the risk of gilt-swap spreads widening is not captured as part of SCR.
- An immediate 100 bps increase in corporate bond interest rates but with gilt and swap rates remaining fixed. Unlike the SCR calculation, the impact on the volatility adjustment has been taken into account in calculating this sensitivity.

The sensitivities assume that the TMTP is not recalculated. If there was an extreme stress that caused a material change in the Group’s risk profile, then the TMTP might be recalculated (subject to the approval of the PRA), which could impact some of the sensitivities shown.

The regulations require that TMTP is recalculated every two years. Given its strong capital position the Group utilises the recalculation of TMTP as part of its hedging strategy, since TMTP recalculation removes a large amount of the interest rate, credit spread and gilt swap sensitivity shown below. The Group monitors the impact of changes in market conditions regularly between recalculations. Equity exposure within the insurance business is largely managed using a portfolio of derivatives with additional exposure arising from the defined benefit pension schemes.

Furthermore, the sensitivities assume no management actions are taken, above those already modelled as part of the valuation of technical provisions and SCR, in order to mitigate any adverse impacts.

Surplus capital at 31 Dec 2021:		£637m	
Sensitivities	Change in Surplus (including from change in SCR) (£m)	Change in SCR (£m)	Change in CCR (%)
25% market fall in equities	(45)	(82)	3%
100 bps fall in interest rates	(58)	72	(13)%
100 bps rise in interest rates	34	(47)	10%
50 bps rise in gilt swap spreads	(139)	(4)	(17)%
100 bps rise in credit spreads	123	(9)	17%

The equity sensitivity reduces the value of the Group’s assets, including those in the defined benefit pension schemes. It also increases the guarantee costs associated with the with-profits business.

The interest rate sensitivities impact all fixed interest assets held by the Group such as government and corporate bonds and interest rate derivatives. They also impact liabilities which are discounted using swap rates. Where the assets and liabilities are closely matched, these impacts broadly offset each other. However in other areas, such as the Risk Margin, there is no corresponding offset which leads to a material sensitivity. The rise in interest rate sensitivity improves capital coverage despite the rise in interest rates being the biting stress in the Standard Formula SCR calculation. This is because the interest rate sensitivities include a stress to the Risk Margin and SCR which both fall under a rise in interest rates scenario and are not in scope of the Standard Formula SCR stress. The benefit from the fall in Risk Margin and SCR more than offsets the cost on assets less liabilities. A more granular split of the interest rate sensitivities is used to manage the Group's interest rate exposure.

The gilt-swap spread sensitivity is an increase in gilt interest rates but with swap rates remaining fixed. Many of the assets held by the Group are government bonds, and are therefore linked to gilt yields. In contrast, swap rates are used to calculate liabilities, SCR and Risk Margin so the impact on this side of the balance sheet is only through an assumed increase in the volatility adjustment and matching adjustment. A widening of gilt spreads, relative to swaps, therefore reduces the value of the Group's assets by more than that of its liabilities which leads to a material sensitivity.

The credit spread sensitivity improves capital coverage because of the difference in approach between the sensitivity and the SCR calculation. Credit spreads widening causes the value of corporate bond assets held by the Group to fall, which causes a reduction in surplus within the SCR calculation. However, in reality, the volatility adjustment and discount rate used to value defined benefit schemes' liabilities increase in the event of credit spreads widening. In the sensitivity calculation this has been taken into account and has a beneficial impact because it reduces the value of liabilities which more than offsets the reduction in value of assets. However, the Standard Formula calculation of the SCR does not permit the recalculation of the volatility adjustment or defined benefit schemes' liability discount rate and so this benefit is ignored.

C.8.2 Demographic sensitivities

Demographic stresses relate to the behaviour and circumstances of policyholders. In pricing its products, the Group makes certain assumptions about how policyholders will behave, and how many policies will result in a claim under different policy conditions (such as accident, death and ill health). By their nature different products are affected differently by different demographic trends. For example protection products pay out on death, but annuity products generally pay an income until death.

The sensitivities shown below allow for the benefit of reinsurance, and only relate to those policies exposed to the relevant risk. So for example, the mortality sensitivity assumes a 15% increase in the mortality of protection policyholders (and hence more claims). However, it does not allow for a 15% increase in the mortality rate of the annuitants which would increase surplus. They are therefore provided merely to illustrate the magnitude of any downside in extremely severe scenarios.

The following sensitivities are performed:

- 15% increase to mortality rates.
- 20% decrease to mortality rates.
- 50% increase to lapse rates for all products.
- 50% decrease to lapse rates for all products.
- 50% decrease in OB Pension cash-take up rates at retirement.

The mortality stresses refer to the assumed rate of future mortality, and represent a percentage change in the volume of death claims.

The lapse stresses are calculated in a similar way and represent a percentage change in the volume of lapses or surrenders.

The sensitivities make an approximate allowance for TMTP recalculation by not including a change in Risk Margin which is generally hedged by changes in TMTP when recalculated. They also assume that no management actions are taken, above those already modelled as part of the valuation of technical provisions and SCR, in order to mitigate any adverse impacts. The sensitivities should only be treated as estimates which give a broad indication of the direction and magnitude of the impact of the sensitivity.

The Group has entered into a number of reinsurance arrangements, the benefits of which are included within the results below.

Surplus capital at 31 Dec 2021:		£637m	
Sensitivities	Change in Surplus (including from change in SCR) (£m)	Change in SCR (£m)	Change in CCR (%)
15% increase in mortality rates (affected business only)*	4	0	1%
20% decrease in mortality rates (affected business only)*	(47)	0	(6)%
50% increase in lapses	(10)	24	(4)%
50% decrease in lapses	48	(18)	8%
50% decrease in OB Pensions cash - take-up rates at retirement	(61)	(16)	(6)%

* Affected business is defined in line with Solvency II Standard Formula.

For the increase in mortality rates, the exposure comes from products where claims are paid out on death. For these products, higher mortality rates increase the amount of claims paid out. However, the Group's surplus exposure also depends on its reinsurance arrangements which may act to offset this increase in claims and can improve the capital position on an increase in mortality rates, depending on the structure and level of reinsurance. The Group has large amounts of reinsurance in place to manage and remove its exposure to mortality risk, meaning that the surplus shows only a very small and slightly beneficial exposure to increases in mortality rates.

For the decrease in mortality rates, the majority of the exposure comes from the deferred and in-payment annuities, where an income is paid for as long as the policyholder survives. The impact of this sensitivity is adverse on surplus.

For the 50% increase in lapses, the majority of the exposure comes from changes to the SCR. Under Solvency II, the SCR lapse stress is applied as a proportion of the existing lapse assumption. Therefore, an increase to lapse rates increases the size of this stress. The impact of this sensitivity on surplus is lower than the SCR capital held in respect of lapse risk primarily because, within the SCR, only those policies which would cause a strain to the Group are used in the calculation.

For the 50% decrease in lapses, the benefit to surplus comes primarily from the unitised with-profits bonds and Protection business. The impact of this sensitivity on surplus is lower than the SCR capital held in respect of lapse risk primarily because, within the SCR, only those policies which would cause a strain to LVFS are used in the calculation.

The 50% decrease in OB Pension cash take-up rates at retirement results in a higher proportion of policyholders taking the guaranteed annuity option. The increase in Best Estimate Liability (BEL) is partially offset by a reduction in SCR, where as more of the risk has been crystallised in the base position, there is less residual exposure under stress.

C.9 Additional information on risk profile

Further information can be found on an IFRS basis within the LV= Annual Report.

D. Valuation for Solvency Purposes

D.1 Assets

Assets on a Solvency II basis	2021	2020
Assets	£m	£m
Pension benefit surplus	197	148
Property, plant and equipment held for own use	27	31
Investments (other than assets held for index-linked and unit-linked contracts):		
Holdings in related undertakings, including participations	66	70
Equities	433	480
Bonds	4,579	4,929
Collective Investments Undertakings	3,637	3,721
Derivatives	83	131
Deposits other than cash equivalents	141	179
Assets held for index-linked and unit-linked contracts	4,362	3,813
Loans and mortgages	929	860
Reinsurance recoverables	1,179	1,208
Insurance and intermediaries receivables	11	11
Reinsurance receivables	81	64
Loans and Receivables (not insurance)	25	16
Cash and cash equivalents	105	115
Any other assets, not elsewhere shown	19	9
Total assets	15,874	15,785

For Solvency II valuation purposes, assets and other liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and other liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

Reconciliation between IFRS and Solvency II valuation		2021			
		IFRS	Presentational adjustments	Solvency II Valuation adjustment	Solvency II
Assets	Note	£m	£m	£m	£m
Goodwill	1	46	-	(46)	-
Intangible assets	1	7	-	(7)	-
Pension benefit surplus	2	197	-	-	197
Property, plant and equipment held for own use	#	25	-	2	27
Investments (other than assets held for index-linked and unit-linked contracts):					
Holdings in related undertakings, including participations	3,4	-	55	11	66
Equities	4	8,431	(7,998)	-	433
Bonds	4	4,439	140	-	4,579
Collective Investments Undertakings	4	-	3,651	(14)	3,637
Derivatives	4,5	84	(1)	-	83
Deposits other than cash equivalents	4	-	141	-	141
Assets held for index-linked and unit-linked contracts	6	-	4,362	-	4,362
Loans and mortgages	7	927	2	-	929
Reinsurance recoverables	8	1,909	-	(730)	1,179
Insurance and intermediaries receivables	9	101	(89)	(1)	11
Reinsurance receivables	#	-	81	-	81
Loans and Receivables (not insurance)	10	46	(20)	(1)	25
Cash and cash equivalents	11	385	(278)	(2)	105
Any other assets, not elsewhere shown	12	70	(46)	(5)	19
Total assets		16,667	-	(793)	15,874

= Disclosure note not provided as Solvency II value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Goodwill and other intangible assets

For Solvency II valuation purposes, goodwill and other intangible assets are valued at £nil.

Under Solvency II intangibles can only be ascribed a value when they can be sold separately and it can be demonstrated that there are quoted prices in active markets for the same or similar assets. All intangible assets do not meet those conditions and therefore are ascribed a value of £nil.

2. Pensions Benefit Surplus

For Solvency II purposes, any pensions benefit surplus is valued consistently with IFRS.

Under IFRS, any Pensions Benefit Surplus is valued under IAS19, whereby the net surplus or deficit is calculated annually with the assets valued at fair value and the liabilities discounted at the rate of return available on high quality corporate bonds. The net surplus, to the extent recoverable or deficit is recognised as a pension benefit asset or liability in the Statement of Financial Position. No separate liability for funding requirements is recognised as LVFS has an unconditional right to any of the assets of the pension schemes which would remain following the schemes' termination.

3. Participations

Under IFRS participations are consolidated within the financial statements. For Solvency II valuation purposes certain investments are not consolidated and are valued as participations.

Participations	£m
Investments in group undertakings - IFRS	-
Joint venture properties reclassified as participations	55
Adjusted equity method valuation differences	11
Participations - Solvency II valuation	66

4. Investments

All financial investments, primarily consisting of debt securities, equity securities and unit trusts are measured at fair value for both Solvency II and IFRS purposes. Fair value is obtained from quoted market prices or, if they are not available, by using relevant valuation techniques. Further information on financial investments valued using an alternative method to either a quoted market price in active markets for the same or similar assets is included in section D.4. An active market follows the IFRS definition, where an active market is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

5. Derivatives

For Solvency II valuation purposes, derivatives are valued consistently with IFRS.

Under IFRS, derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Derivatives are not traded on an active market and are therefore valued using an alternative valuation method (see section D.4).

	Asset £m	Liability £m	Total £m
Derivative fair value asset - Solvency II valuation	83	(197)	(114)

6. Assets held for index-linked and unit linked funds

Under IFRS, assets held for index-linked and unit linked funds are included in financial assets at fair value through income (and valued consistently as described in note 4 Investments above).

For Solvency II valuation purposes, these assets are valued consistently with IFRS but are reported separately.

7. Loans and Mortgages

For Solvency II valuation purposes, loans and mortgages are valued consistently with IFRS, with a reclassification adjustment for accrued interest which is included in investments rather than accrued interest. Loans and mortgages are not traded on an active market and are therefore valued using an alternative valuation method (see section D.4).

	£m
Equity release mortgages	532
Commercial mortgages	395
Total included in Financial assets at fair value through income – IFRS	927
Reclassify accrued interest on commercial mortgages from accrued interest	2
Total Loans and Mortgages - Solvency II valuation	929

8. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of business. Reinsurance assets represent balances recoverable from reinsurance companies.

For Solvency II valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities (see Section D.2 Technical Provisions).

9. Insurance and intermediaries receivables

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policy holders, agents, brokers and intermediaries. Insurance and intermediaries receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

	£m
Total Insurance receivables – IFRS	101
Presentational adjustment to reinsurance receivables	(81)
Presentational adjustment for linked assets	(8)
Solvency II valuation adjustments	(1)
Total Insurance and intermediaries - Solvency II valuation	11

For Solvency II valuation purposes, any future premiums which fall due after the valuation date (included in insurance receivables) and any premium debts (included within intermediaries receivables), are subject to best estimate liability calculation of technical provisions (see D.2 Technical Provisions)

10. Loans and Receivables (not insurance)

For Solvency II valuation purposes, loans and receivables are valued consistently with IFRS. On the Solvency II balance sheet, the secured notes and cash collateral pledged are classified under investments and any receivables for linked assets are classified under Assets held for index-linked and unit-linked contracts.

	£m
Investment receivables	26
Other receivables	13
Cash Collateral pledged	7
Loans and Receivables (not insurance) – IFRS	46
Presentational adjustment to deposits other than cash equivalents	(7)
Presentational adjustment for linked assets	(11)
Presentational adjustment – reclassify accrued interest to Investments	(2)
Solvency II Regulated subsidiaries valuation adjustment	(1)
Total Loans and Receivables (not insurance) - Solvency II valuation	25

11. Cash and cash equivalents

For Solvency II valuation purposes, cash is valued consistently with IFRS with the following reclassification adjustments:

	£m
Cash and cash equivalents - IFRS	385
Reclassify short-term bank deposits to investments as deposits other than cash equivalents	(258)
Reclassify certificates of deposits to bonds	(26)
Presentational adjustment for linked assets	6
Solvency II Regulated subsidiaries valuation adjustment	(2)
Total Cash and cash equivalents - Solvency II valuation	105

12. Any other assets, not shown elsewhere

For Solvency II valuation purposes, prepayments and accrued interest are valued consistently with IFRS. On the Solvency II balance sheet, the accrued interest on bonds is included in the market value of investments.

Under IFRS, prepayments and accrued interest balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Prepayments and accrued interest – IFRS	62
Corporation tax asset - IFRS	8
Any other assets, not elsewhere shown – IFRS	70
Presentational adjustment – reclassify accrued interest to Investments	(46)
Solvency II Regulated subsidiaries valuation adjustment	(5)
Any other assets, not elsewhere shown - Solvency II valuation	19

D.2 Technical provisions

D.2.1 Technical provisions by line of business

Total Technical Provisions by line of business:

Line of Business	2021 £m	2020 £m
Insurance with-profits participation	6,104	6,176
Index-linked and unit-linked insurance	4,262	3,742
Other life insurance (including Health)	3,323	3,720
Total Group Technical Provisions	13,689	13,638

The following table sets out the Group Technical Provisions split by Solvency II lines of business as at 31 December 2021.

Line of Business	31 December 2021 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) Unaudited	Total Technical Provisions
Insurance with-profits participation	6,112	129	(137)	6,104
Index-linked and unit-linked insurance	4,256	21	(15)	4,262
Other life insurance (including Health)	3,410	109	(196)	3,323
Total Group	13,778	259	(348)	13,689

The impact on the MCR and Eligible Own Funds to meet the MCR are found in the section E.2.1.

D.2.2 Technical provisions methodology and assumptions

A description of the bases, methods and assumptions used for the valuation of the technical provisions is set out below. Assumptions relating to business within the Teachers Assurance (TA) Fund have largely been omitted on grounds of materiality.

Best Estimate Liability

The BEL is calculated in accordance with the Solvency II Directive, Delegated Regulations and regulatory guidance. The following sections describe how the rules and guidance have been applied. Unless otherwise stated the methodology and assumptions apply to all types of business.

The BEL is the probability weighted average of future cashflows required to fulfil obligations to policyholders under existing contracts taking account of the time value of money using the relevant risk-free interest rate term structure. Allowance is made for contract boundaries, although the adjustment is not material. The cashflows are projected gross, without deduction of the amounts recoverable from reinsurance contracts. Recoverables from reinsurance contracts are calculated separately and are included as an asset on the balance sheet.

Risk Margin

The Risk Margin represents the estimated cost of the capital a third-party insurer would be required to hold to support the insurance business over its period of run-off. It is derived by projecting the SCR forward (under the Standard Formula, and removing MA and VA) using a cost of capital of 6%. The third-party insurer is assumed to hedge any market risks, where possible. All market risk exposures are assumed to be hedged, so the calculation allows only for non-market risks. The SCR is projected for most risks using a proxy (an item, such as the BEL, which is expected to move broadly in line with the size of the stress). However for material product and risk combinations, the SCR projection approach is used. The individual risk SCRs are then summed over all the products to produce the SCR for each risk. The aggregate SCR is determined by applying a correlation matrix. The correlation matrix assumed is the same as that used for the Life and Health Standard Formula SCR. These SCRs are then discounted and the prescribed cost of capital rate is applied.

Risk-Free Rates

The basic risk-free interest rate term structure of spot rates as published by the PRA was used. No transitional adjustment was made to the discount rate.

Matching Adjustment

The Matching Adjustment (MA) has been applied (having been approved for use by the PRA) for all annuity business in the Matching Adjustment Portfolio. The MA is an addition that can be made to the risk-free yield curve to allow for the higher expected returns on the assets supporting the liabilities. This is available for annuity business where the cashflows are reasonably predictable, and therefore a portfolio of government and corporate bonds can be purchased with cashflows that match those of the liabilities sufficiently closely. The addition to the risk-free curve is calculated as the addition to the discount rate needed to set the value of liabilities equal to the value of assets. Within this calculation a deduction is made for potential defaults and the cost of downgrade on the bond portfolio (the 'fundamental spread'):

The assets used to back the annuities within the Matching Adjustment Portfolio are:

- Government bonds (including inflation-linked government bonds)
- Corporate bonds
- Commercial Mortgage Loans
- Cash flow swaps
- Cash.

The MA used at the valuation date was 111bps (2020: 92bps).

Volatility Adjustment

The Volatility Adjustment (VA) has been applied (having been approved for use by the PRA) for all Life policies outside the Matching Adjustment Portfolio, except for Protection, OB Pensions, Heritage non-profit pension annuities, Unit Linked Pensions, ex-RNPFN and ex-Teachers business.

The VA prescribed by the PRA was 15bps (2020: 11bps) at the valuation date.

Transitional Measure on Technical Provisions (TMTP) - unaudited

The TMTP provides firms with relief from day 1 from the financial impact on technical provisions of moving to the Solvency II regime. The relief then reduces step-wise annually over 16 years. The TMTP was used for Life and Health business (except within the TA Fund). The TMTP is recalculated every 24 months or sooner if there is a change in risk profile that materially impacts the TMTP. The TMTP was recalculated as at 31 December 2021, in line with the biennial recalculation requirement. The TMTP is restricted where necessary so that the Financial Resources Requirement (the sum of the technical provisions, other liabilities and the SCR) is no lower under Solvency II than would have been the case under the previous solvency regime, although this restriction did not apply at the last recalculation point.

TMTP has reduced by £33m, following the annual amortisation, and biennial recalculation (2020: £32m).

Impact of the Matching Adjustment, Volatility Adjustment and Transitional Measure on Technical Provisions (TMTP only unaudited)

The impact of not applying the MA, VA or TMTP is set out in the S.22.01.22 QRT annexed to this report, an extract of which is below:

£m	Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions (unaudited)	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
Technical provisions	13,689	348	18	199
Basic own funds	1,433	(325)	(18)	(199)
Eligible own funds to meet Solvency Capital Requirement	1,433	(325)	(18)	(199)
Solvency Capital Requirement	796	1	2	75

Tax

All products are classified as either Basic Life Assurance and General Annuity Business (BLAGAB) or non-BLAGAB business. As a mutual, LVFS is exempt from tax on non-BLAGAB business, and therefore no allowance for taxation is made in the calculation of the BEL. For products classified as BLAGAB, allowance is made for “I-E” taxation, where “I-E” refers to the liability to tax on any excess of investment income over expenses.

With-Profits and Smoothed Managed Funds specific

The BEL is calculated as the sum of the asset shares and future policy-related liabilities. It excludes any surplus funds, as set out in section E. The costs of guarantees, options and smoothing form part of the BEL. These are calculated using stochastic methods. A market-consistent set of economic scenarios is generated and the costs valued in each scenario using a discount curve equal to the projected future risk-free curve for that scenario. These scenarios are produced by an Economic Scenario Generator.

Actual historical investment data was used to derive retrospective asset shares. The assumed future investment returns for each asset class for with-profits business were derived using the market-consistent Economic Scenario Generator.

A simplifying assumption of combining similar asset classes was used, such as modelling all equities (whether UK or Overseas) as UK Equities and treating all fixed interest bonds as zero coupon UK government bonds.

When projecting future investment returns, the various benchmark asset mixes are used throughout the projection. Regular Bonus rates are generally assumed to continue at the same level as at the valuation date.

Final Bonus rates are set equal to the current declared Final Bonus rates for the first time step. Mutual bonus accrued to the valuation date is included in Technical Provisions. Exit bonus is included in Technical Provisions as it's declared, i.e. up to the following 31 December. Thereafter, an algorithm is used to calculate future Final Bonus rates given the modelled economic scenario and the bonus philosophy set out in the Group's Principles and Practices of Financial Management.

Mortality and Morbidity

Life Protection and Annuity business is exposed to changes in life expectancy (mortality – reduced life expectancy, longevity – increased life expectancy) and health expectancy (morbidity) experience.

Most Protection business is exposed to mortality and morbidity risks as higher mortality rates and adverse morbidity will lead to increased claims, which in turn, lead to an increase in contract liabilities. Protection whole of life assurance business is exposed to longevity due to the structure of the reinsurance, as is annuity business.

The assumed rates of mortality and morbidity are set in line with recent experience, where it is available in sufficient volume to provide reliable results. Where the experience is not considered sufficient, the assumptions are set by reference to either industry experience or the terms on which the business is reinsured.

The mortality assumed for the most significant modelled products for year-end 2021 is shown in the tables below.

LVFS

Product	Base Percentage	Mortality/Morbidity Tables
Enhanced Annuities	100%	PMA08/PFA08 with enhancements CMI_2019 Adjusted
Standard Annuities	100%	PMA08/PFA08 CMI_2019 Adjusted
Deferred Annuities (Pre-vesting)	106%	AMC00/AFC00 CMI_2019 Adjusted
Deferred Annuities (Post-vesting)	Various	PML08/PFL08 CMI_2019 Adjusted
Ex-RNPFN Annuities	Various	PMA08/PFA08 CMI_2019 Adjusted
WPPA/PIPA	86%	PMA08/PFA08 CMI_2019 Adjusted
Term Assurances (FPP)	Various	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2019 Adjusted
Term Assurances (LVLI)	85.5%	TMN00/TMS00 TFN00/TFS00 adjusted CMI_2019 Adjusted
Term Assurances (LVFS)	Various	TMN00/TMS00 TFN00/TFS00 adjusted CMI_2019 Adjusted
IB Endowment/Whole of Life Assurance	112%	ELT17
Whole of Life Assurances (50+)	100%	AMC00/AFC00 adjusted CMI_2019 Adjusted
Whole of Life Assurances (Lifetime+)	100.8%	TMN00/TFN00/TMS00/TFS00 adjusted CMI_2019 Adjusted
Critical Illness	67.1%	Reinsurer rates
Income Protection Inceptions	Various	CMIR12
Income Protection Terminations	Various	CMIR12

RNPFN Fund

Product	Base Percentage	Mortality Tables
Deferred Annuities (Pre-vesting)	50%-60%	AM00/AF00
Deferred Annuities (Post-Vesting)	Various	PMA08/PFA08 CMI_2019 Adjusted

The mortality rates used for the enhanced annuities were adjusted for the additional mortality expected to apply to the lives concerned, with an allowance for the mortality to converge to standard mortality at advanced ages. For this purpose, the business was divided into groups by broad types of medical condition or lifestyle.

Mortality Improvements

Future mortality improvements are allowed for using the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2019 projection model, with the following advanced parameterisation:

- Period smoothing parameter (S_k) of 7.0
- Long term improvement rates of 1.5% for males and 1.25% for females
- Initial additions to improvement rates ("A" parameter) of 0.1% for males and 0.2% for females.

For simplicity, this is referred to as "CMI_2019 Adjusted".

Persistency

Persistency relates to how long a policyholder retains the product and influences the Group's ability to recover initial costs of sale from premiums and charges that relate to the product. Persistency assumptions include allowances for lapse, becoming paid-up, surrenders, withdrawals and transfers. Additionally, cash commutation and guaranteed annuity rate take up rates are covered, as is an allowance for "gone-aways" under IB whole-of-life with-profits business. These

assumptions, which typically vary by product line, duration in-force, fund size and sales channel are largely based on internal experience investigations and expert judgement.

For unit-linked pensions, separate persistency rates apply for surrender (including external transfers, early retirements, full encashments and partial encashments) and drawdown.

Cash commutation rates are segmented by relevant homogeneous groups. These are set using expert judgement and recent experience.

“Gone-aways” arise where policyholders are no longer aware of the existence of their policy and it is either not practical to trace them, or tracing activity has been unsuccessful. Additionally, a proportion of policyholders will have deceased without the proceeds being claimed. These policies are unlikely to give rise to a future claim and therefore a proportion of policies are treated as “gone-away” and reserves are reduced by applying reduction factors dependent on age, policy type and premium paying status.

Policyholder behaviour

The BEL allows for the impact on cash flows of any policyholder actions, i.e. lapse, surrender, or the exercise of options. The value of future options and guarantees allows for the following policyholder actions.

The following policyholder behaviour is modelled deterministically:

- Surrender rate at guarantee points for FGB/F, SMF and All-in-1 bonds – at the guarantee date the surrender rate was increased to reflect the increased likelihood of policyholders lapsing (and therefore being entitled to the guaranteed return of premiums)
- Guaranteed annuity option take up rates on RNPFN Savings and Pensions
- Cash commutation option take up rates on LVFS OB Pensions.

The following policyholder behaviour is modelled dynamically:

- For FGB/F and SMF adjustments are applied for the following: lapse rates where guarantees are in the money (ITM); cancellations of out of the money (OTM) guarantees; and, for non-guaranteed policies, a mass lapse when the policyholder benefits from smoothing.

Expenses

All expense cashflows incurred in servicing the liabilities relating to existing contracts over their future lifetime were taken into account in determining the best estimate liabilities. The modelled expense cashflows assume maintenance unit costs that are derived from an internal expense analysis.

The following expenses were included in the internal expense analysis:

- Administrative expenses
- Claims management expenses
- Acquisition expenses.

This expense analysis allocates costs at cost centre level to acquisition and maintenance, and across product groups. The maintenance unit cost is then derived at a product level from the amount of allocated cost and the policy count.

An allowance for diseconomies of scale is made where per policy unit costs are expected to increase due to a reduction in numbers of policies relative to fixed costs and overheads.

In addition to maintenance services costs, investment expenses associated with products are allowed for in the Best Estimate Liabilities.

Inflation

The assumed inflation measure was the Retail Price Index (RPI). For with-profits business, inflation is linked to the Economic Scenario Generator. RPI-linked liabilities were projected to increase in line with RPI, consistent with contractual terms. Expense inflation was based on RPI plus a margin.

Events not in data (ENIDs)

ENIDs refer to any events that are not captured within the data used to derive the assumptions underlying the Best Estimate Liabilities. For life business, material ENIDs are allowed for by adjusting the best estimate assumptions using expert judgement and any relevant available data.

Simplifications

The use of simplifications within the Group is not considered material.

Uncertainty within the Technical Provisions

The calculation of the Technical Provisions uses established actuarial and statistical techniques to produce a best estimate of expected realistic future cash flows and liabilities. These calculations are nevertheless based on data, assumptions and models, which may not reflect actual future experience. As such a level of uncertainty is associated with these results.

Notable areas of uncertainty include:

- The quality of the data, especially around older policies on legacy administration systems.
- The assumptions used by the models; in particular in terms of investment experience or policyholder behaviour. These assumptions are discussed above. The sensitivity of the results to these assumptions can best be seen by considering the makeup of the SCR, and the underlying sensitivities. Details of this can be found in sections C and E.
- The modelling methodology, including the Economic Scenario Generator. The Group uses stochastic techniques to value both the with-profits benefits and the value of guaranteed annuity options.
- The future impact of the Covid-19 pandemic both on insurance claims and on the wider economy is highly uncertain. High levels of reinsurance provide significant protection against adverse experience. There is no explicit adjustment to long-term assumptions for the impact of Covid-19. An allowance has been made in reserves of £4m for potential short-term adverse mortality, persistency and unemployment experience on non-profit business.

D.2.3 Comparison of Solvency II and IFRS technical provisions

The table below shows the difference between the gross technical provisions under Solvency II and IFRS.

Technical Provisions (gross)	Solvency II value £m	IFRS value £m	Difference £m
Insurance with-profits participation	6,104	6,231	(127)
Index-linked and unit-linked insurance	4,262	4,257	5
Other life insurance (including health)	3,323	4,075	(752)
Total Group	13,689	14,563	(874)

Notes:

(i) The IFRS value in the table above does not include outstanding claims of £116m, which are disclosed as part of technical provisions for IFRS but reported as insurance and intermediaries payable for Solvency II.

(ii) The TMTP component of technical provisions is not audited.

The Risk Margin and TMTP are significant sources of difference between Solvency II and IFRS; there is no equivalent in the latter.

The other main differences between Solvency II and IFRS are as follows:

Discount rates: While the risk-free reference curve under IFRS has been aligned to the rates prescribed by the PRA for use under Solvency II (derived from swap rates), there are differences due to additions to the risk-free rates. Under Solvency II, LVFS makes use of the VA and MA, which allow the liabilities for some products to be discounted at rates higher than risk-free. There is no equivalent to the VA under IFRS. The equivalent to the MA under IFRS is the illiquidity premium, which represents compensation for risks not borne by a portfolio of 'hold to maturity' assets. The illiquidity premium is applied to all non-profit annuity business but under Solvency II, the MA is only applied to annuity business within the Matching Adjustment Portfolio and the VA applied to all other annuity business (including some with-profits annuities). For the with-profits and SMF business, where the VA is applied, the movement in the PRA-curve with the VA is the primary difference between Solvency II and IFRS (other than the Risk Margin and TMTP).

Prudent margins: Under IFRS, the technical provisions for non-profits business (excluding SMF) are calculated with margins for adverse deviation, and separately, the value of the release of these margins is calculated (PVFP). This prudence is not present in the direct BEL calculation under Solvency II, which contains a best estimate projection of future cash flows.

Surplus in closed funds: There is a presentational difference for the surplus in closed funds; under IFRS this is a liability whereas under Solvency II it is an adjustment to Own Funds.

Contract boundaries: These exist under Solvency II but not IFRS.

D.2.3.1 Description of Reinsurance Recoverables

The BEL is calculated gross without deduction of amounts recoverable from reinsurance contracts. The calculation of recoverable amounts is carried out separately for reinsurance contracts as the probability-weighted average of the discounted future cash flows allowing for contract boundaries.

The amounts recoverable are then adjusted to allow for the default risk associated with the reinsurance counterparties. The assumptions and models used were the same as those used for the BEL, described earlier in this section.

Reinsurance recoverables are reported as a reinsurance asset on the balance sheet and include a deduction for the risk of reinsurer default.

Generally, there is no allowance for any future reinsurance purchases that may be used to cover existing obligations or for future business in the BEL that was expected to be written under the treaties.

The Matching Adjustment was calculated using liability cash-flows gross of reinsurance, with the methodology allowing for longevity swap recoverables in the asset cashflows.

There are no Special Purpose Vehicles (SPVs).

D.2.3.2 Material changes in assumptions

The Lifetime+ long term lapse rate and OB Pension cash commutation rates have been updated to reflect emerging experience. The Unit-Linked Pensions persistency basis has been simplified and updated to reflect recent experience.

The unit cost allocations have been revised to reflect further work to improve efficiency and reduce the operating expense base. In addition, the method of allocation was further refined, leading to greater allocation of overhead expenses towards the growing open business lines and away from closed legacy with-profits products.

D.3 Other liabilities

Other liabilities on a Solvency II basis	2021	2020
	£m	£m
Provisions other than technical provisions	22	3
Deferred tax liabilities	122	91
Derivatives	197	196
Debts owed to credit institutions	66	113
Insurance and intermediaries payables	153	139
Reinsurance payables	12	7
Payables (trade, not insurance)	134	100
Subordinated liabilities	367	361
Any other liabilities, not elsewhere shown	-	3
Total Other Liabilities	1,073	1,013

Reconciliation between IFRS and Solvency II valuation		2021			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Provisions other than technical provisions	#	22	-	-	22
Deferred tax liabilities	1	122	-	-	122
Derivatives	#	197	-	-	197
Debts owed to credit institutions	2	66	-	-	66
Insurance and intermediaries payables	3	54	(12)	111	153
Reinsurance payables	4	-	12	-	12
Payables (trade, not insurance)	5	155	(14)	(7)	134
Subordinated liabilities	6	349	14	4	367
Any other liabilities, not elsewhere shown	#	-	-	-	-
Total Other Liabilities		965	-	108	1,073

#= Disclosure note not provided as Solvency II value equal to IFRS or the amounts are immaterial.

Note: The Solvency II value includes outstanding claims of £116m, reported as part of technical provisions for IFRS.

Supporting Notes

1. Deferred tax liability

IFRS Deferred Tax Liabilities at 31 December 2021 are £122m and relate to timing differences recognised on unrealised gains and the pension scheme.

2. Debts owed to credit institutions

For Solvency II valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

LVFS uses financial instruments to transfer elements of financial market risk exposures. Significant counterparty exposures are mitigated by the use of collateral. For over-the-counter transactions undertaken by LVFS, collateral is received from the counterparty. The collateral can be sold or re-pledged by LVFS and is repayable if the contract terminates or the contract's fair value decreases. Negative amounts in the table below represent cash collateral pledged, where this can be offset against cash collateral received from the same counterparty.

The financial liability is presented below based on the undiscounted contractual obligations and as such will not agree with the balances disclosed within the Statement of Financial Position in the statutory financial statements.

	£m					
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Debts owed to credit institutions	10	-	-	66	-	76

3. Insurance and intermediaries payables

For Solvency II valuation purposes, insurance and intermediaries payables are valued consistently with IFRS. However there are Solvency II presentational differences to disclose Reinsurance payables separately and to reflect that under IFRS the Life Claims outstanding are disclosed as part of the technical provisions and for Solvency II purposes are disclosed as insurance and intermediaries payables.

Under IFRS, insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£m
Insurance and intermediaries payables – IFRS	54
Presentational adjustment to transfer Reinsurance payables	(12)
Solvency II Regulated subsidiaries valuation adjustment	(5)
Presentational adjustment to transfer claims outstanding from technical provisions to insurance and intermediaries payables	116
Insurance and intermediaries – Solvency II valuation	153

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

	£m					
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Insurance and intermediaries payables	54	-	-	-	-	54

4. Reinsurance payables

For Solvency II valuation purposes, reinsurance payables are valued consistently with IFRS but are reported separately for Solvency II, rather than within insurance payables.

Under IFRS, reinsurance payables are recognised when due. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Reinsurance payables	£m
Total reinsurance payables – IFRS	-
Due to reinsurers (presentational adjustment from Insurance payables)	12
Total reinsurance payables - Solvency II valuation	12

5. Payables (trade, not insurance)

For Solvency II valuation purposes, payables (trade, not insurance) are valued consistently with IFRS and adjusted to remove (a) the amounts reported by the Regulated subsidiaries as these are treated as Participations under Solvency II – see Section D.1 note 3 and (b) accrued interest on the subordinated debt, as this is classified within the Solvency II fair value of subordinated debts – see note 6.

Under IFRS, trade payables are recognised when due. Payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Bank overdrafts	2
Trade payables	7
Other taxes and social security costs	6
Other creditors	35
Lease liabilities	23
Accruals	82
Payables (trade, not insurance) – IFRS	155
Solvency II valuation adjustment - Regulated subsidiaries	(7)
Presentational adjustment – accrued interest on the subordinated debt	(14)
Payables (trade, not insurance) - Solvency II valuation	134

6. Subordinated liabilities

In 2013 LVFS issued £350m of Fixed Rate Reset Subordinated Notes at par. The effective interest rate on the Notes is 6.654%. The Notes have a maturity date of 22 May 2043 but LVFS has the option to redeem the Notes at the first call date of 22 May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% per annum for the period until the first call date on 22 May 2023, payable annually in arrears on 22 May each year. If the Notes are not redeemed on 22 May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points. There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, LVFS would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements.

LVFS has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

These Subordinated Notes meet in full the requirements in Article 73 of the Delegated Acts and as such is classed as Tier 2 Capital.

For Solvency II valuation purposes, the Notes are measured using the risk-free rate at the valuation date, while keeping the spread versus risk-free rate at point of issue constant, thus eliminating the effect of changes in credit rating. The model uses the discounted cashflow approach with the spread measured against the risk-free rate to equate back to the amount of debt issued. It also allows for accrued interest at point of valuation.

Note that due to a late correction to the value placed on the subordinated debt, the figure disclosed in the LVFS Solo SFCR was understated by £19m at £348m. This had no impact on Own Funds.

Under IFRS, the Notes are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the earliest possible redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

Subordinated liabilities	£m
Subordinated notes (GBP 350m)	349
Subordinated liabilities – IFRS	349
Solvency II valuation fair value adjustments	4
Presentational adjustment – accrued interest on the subordinated debt	14
Subordinated liabilities - Solvency II valuation	367

The subordinated liability is expected to be settled more than 12 months after the balance sheet date.

7. Contingent liabilities

There are no material contingent liabilities to be recognised for Solvency II valuation purposes.

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Group aims to use quoted market prices or observable inputs to value all assets and liabilities. However, where there is no external market or readily observable inputs, the Group will use an alternative method such as discounted cash-flow or mark-to-model.

Assumptions used in valuation approach and areas of uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but are based on a combination of internally developed models, calibrated to market observable data where possible as well as independent third-party evidence. Valuation uncertainty arises where there is reliance on third-party adherence to expected valuation standards or potential variation in the expected range of the key inputs into models. Where possible, the adequacy of valuations made using alternative valuation techniques are compared against experience.

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Equity release mortgages (£532m) are not traded on an active market and hence a mark-to-model valuation approach is used which is classified as an Alternative Valuation Method (AVM). The fair value of the Equity Release mortgage assets is determined using a discounted cash flow model which takes into account the contractual rate of interest charged on the loans, projected house prices, the expected mortality and morbidity of the mortgagor and mortgagor actions.

The discount rate is the zero-coupon swap curve with adjustments for profit and liquidity premiums.

- 2) Commercial mortgages (£397m) are not traded on an active market. The fair value of the loans secured on commercial property is determined using discounted cash flows to reflect changes in underlying gilt yields, discount spreads and debt margins. There are two factors used to create the discount rate that is used to value the loans secured on commercial property. Firstly, the prevailing gilt rate at point of valuation which is fully market observable. Secondly, the credit spread which is based on the managers' expectation of the level that they would price the loan at if it were funding in the market at that point in time. The managers base their assessment of the spread on comparable loans they fund in the market and considerations specific to the funded asset or the sponsor. Where the value is not expected to be recovered through ongoing loan payments, the fair value represents the recoverable value of the property in the market post transaction costs. As at 31 December 2021, £nil of commercial mortgages were valued in this way.
- 3) Derivatives (asset £83m, liability £197m) are not traded on an active market and hence are valued by discounted cash flow techniques, using observable yield curves and models such as Black Scholes using implied market forward rates and volatilities.
- 4) Holdings in related undertakings (£55m) being joint venture properties reclassified as participations. LVFS measures its interest in the joint venture at fair value in accordance with IAS 28, using the adjusted net asset method using unobservable external prices factoring in distributions or calls since the latest valuations.
- 5) Unlisted equity (£20m) being private equity holdings are valued at net asset value using unobservable external prices factoring in distributions or calls since the latest valuations. The private equity valuations are reviewed on a monthly basis by LVFS Group Treasury to ensure ongoing validity and accuracy.
- 6) Property, plant and equipment (£27m) is generally valued at the IFRS carrying value, based on cost less accumulated depreciation with assets written down to their recoverable amount where this is less than the carrying value. The IFRS carrying value is deemed to be materially the same as fair value, except in the case of own use properties which have been revalued upwards by £2m as part of the Solvency II valuation.

D.5 Any other information

The Group does not consider that there is any further information which is required to be reported in respect of the solvency II valuation approach.

E. Capital Management

The Capital Management section of the report describes the objectives and approach that the Group takes in managing its capital position. The section provides information about the structure and quality of own funds and the calculation of the SCR under the Standard Formula.

Capital performance and capital position (Investor View) – unaudited

The LV= business is managed on a Solvency II basis and the key metrics we use to monitor the capital performance and capital position of our business position are Operating capital generation and the Capital Coverage Ratio. Operating capital generation is used for decision making, to monitor the Group's performance, growth and financial strength as well as for internal performance management. Further information on this Solvency II metric, including a definition, is included in the LV= Annual Report.

Operating capital generation

Operating capital generation during 2021 was £110m (2020: £103m).

£m	2021	2020
Trading business	87	58
Estate investment income	8	15
Experience variances	(6)	(18)
Model & basis changes and capital initiatives	21	48
Operating capital generation	110	103

Over the course of 2021 our trading businesses have added £87m (2020: £58m) to the Solvency II capital surplus. This result reflected an improved trading performance in both our Savings and Retirement business and our Protection business, with increased new business sales reported for both businesses. Estate investment income added an additional £8m (2020: £15m) of operating capital.

Adverse experience variances of £6m (2020: £18m) mainly relate to equity release adverse impacts potentially driven by the Covid-19 pandemic, while favourable model and basis changes and capital initiatives have added £21m (2020: £48m) to our operating capital. Model and basis changes of £10m (2020: £31m) comprise a large number of changes with the most significant impact being favourable future impacts arising from our initiatives to reduce targeted operating expenses below £100m in the next few years. In addition, operating capital benefited from £11m (2020: £17m) of capital initiatives implemented during the year including the introduction of a unit-linked pension policy minimum charge.

Capital position

At 31 December 2021 the Group capital surplus on a standard formula basis was £637m (2020: £690m) with capital cover of 187% (2020: 198%).

£m	2021	2020
Opening surplus	690	944
Operating capital generation	110	103
Strategic investment, debt interest and group items	(86)	(81)
Items relating to the distribution of surplus	(65)	(92)
LIBOR to SONIA yield curve	(37)	-
TMTP amortisation	(32)	(32)
Pension scheme impacts	12	(49)
Economic variances	44	(103)
TMTP recalculation	1	-
Closing capital surplus	637	690

Solvency II capital surplus has decreased by £53m to £637m (2020: £690m). Operating capital generation of £110m (2020: £103m) has been offset by non-trading expenditure, items relating to distributions to members, the impact of the switch from the LIBOR to SONIA yield curve and the annual reduction in the Transitional Measures on Technical Provisions (TMTP) we are permitted to take credit for.

Non-trading expenditure of £86m (2020: £81m) is made up of £30m of strategic investment spend, £24m of debt interest and £32m of restructuring, one-offs and other group items. The Group is focused on reducing the level of spend on non-operational items over the next two to five years. Items relating to distribution of surplus of £65m (2020: £92m) include £28m of allocated mutual bonus, £10m of exit bonus and a further £27m of capital impact relating to distribution related activities. The surplus is further reduced by the impact of the switch from the LIBOR to SONIA yield curve of £37m and the annual step-down in TMTP of £32m (2020: £32m).

Market movements have resulted in positive economic variances of £44m (2020: £103m adverse) primarily arising from increasing swap rates. The business designs its hedging strategy to restrict impacts of market movements on its post-TMTP recalculation capital position. Therefore, there is a broad offset to these positive variances within the £72m reduction in the favourable impact of the TMTP recalculation, which fell from £73m reported at the end of 2020 to its final 2021 impact of £1m. Favourable pension scheme impacts of £12m (2020: £49m adverse) have also impacted the capital surplus, mainly driven by the increase in the discount rate.

Capital position and changes in risk profile on a Solvency II regulatory basis

At 31 December 2021 the Group capital surplus on a standard formula basis was £637m (2020: £690m) with capital cover of 180% (or 187% excluding the impact of the ring-fenced funds) (2020: 188% or 198% excluding the impact of the ring-fenced funds), see table below for further details. The results shown below include the closed ring-fenced funds. The closed ring-fenced funds did not require capital support at the valuation date.

£m	2021	2020	Change
Own funds	1,433	1,477	(44)
SCR	796	787	9
Surplus capital	637	690	(53)
CCR	180%	188%	(8%)

The Group's capital position was affected in the year by the following:

- **Trading Profit (increase in surplus capital of £87m)**
 - The total surplus after capital from trading was £87m over 2021, including a reduction in capital of £48m, as the run-off of capital-intensive and closed lines of business was only partially replaced by capital on new business, particularly on credit and lapse risks.
- **One-off impact from Model and Basis Changes (increase in surplus capital of £10m before TMTP recalculation).**
 - Expenses have reduced over the year reflecting cost saving activities undertaken by the Group which drives an increase in surplus of £17m. These lower expense reserves have also reduced the Group's exposure to lapse risk.
 - Following recent experience, there has been a strengthening of the lapse basis on the UL Pensions business for policies in drawdown, as well as Lifetime+ Whole of Life policies, reducing surplus by £9m and £6m respectively.
 - Following a review of the methodology, there has been an overall reduction in the charges applied to asset shares on the with-profit pensions annuities for mortality experience, increasing reserves and thereby reducing surplus by £10m.
 - The claims inceptions rates have decreased on the Income Protection and Waiver-of-Premium business following a review of recent experience, increasing surplus by £9m.
 - An update was made to the calculation of reserves, primarily allowing for the inflation rate specified in the reinsurance treaty for the enhanced annuity business, increasing surplus by £7m.

- **Management Actions (increase in surplus of £11m)**
 - The non-profit RNPFN annuity business was brought into the matching adjustment portfolio, and part of the unit linked business was transferred into LVFS to help facilitate the orderly run-off of the closed RNPFN fund. This decreased the Group's surplus by £20m, primarily from an increased exposure to credit and currency risk capital.
 - A minimum charge was introduced on UL Pensions business written prior to mid-2020, as well as a management action to increase the charge should costs increase. Together these increased surplus by £32m, through a reduction in reserves and fall in lapse and expense risk capital.
- **Non-Operational expenses and TMTP run off (reduction in surplus of £118m)**
 - Non-operational expenses during the year included strategic costs (-£30m), debt interest (-£24m), restructuring costs (-£15m) and costs associated with the Bain Capital transaction (-£21m).
 - In addition the annual step down of TMTP reduced surplus by £32m as it reduces by 1/16th every year from its inception in 2016 to a position of zero TMTP at the end of 2031.
- **Economic impacts over 2021 (increase in surplus capital of £58m before TMTP recalculation).**
 - Interest rates have increased significantly over the year increasing the surplus position by £72m. However, a significant amount of the increase in surplus (£55m) is reversed via the TMTP recalculation.
- **With Profit Surplus Distribution (reduction in surplus of £65m)**
 - Over two transactions during 2017 and 2019 LV= sold its general insurance business to Allianz. The sale proceeds not needed for meeting costs are to be distributed to with-profits policyholders through terminal bonus enhancements (TBE) and the continuation of annual mutual bonus declarations.
 - The payment of TBE as well as the annual mutual bonus declaration have reduced the Group's surplus position over the year by £31m.
 - In addition, a further investment has been made into asset share funds to hedge future terminal bonus declarations. In the long term this reduces LVFS's exposure to market movements assuming that terminal bonus is declared as expected in future years.
- **LIBOR to SONIA discount rate (decrease in surplus capital of £37m before TMTP recalculation)**
 - There was a change to the prescribed regulatory interest rate used to calculate the value of liabilities and derivatives, moving from LIBOR to SONIA, with the new SONIA rate lower than the previous LIBOR rate, causing an increase in the value of liabilities and capital.

The Group has used various capital management strategies during the year including internal and external hedging arrangements, see section C.3.3 for further details.

E.1 Own funds

The Group seeks to create value for its members by investing in the development of the business while maintaining an appropriate level of capital available. The risk appetite for each type of principal risk is set based on the amount necessary to meet the Solvency II capital requirements.

a) Policies and objectives

The Group's key capital management objectives are that:

- (i) Regulatory capital will be managed to remain within upper and lower limits agreed by the Board;
- (ii) Risk exposures will be managed to ensure our risk profile does not deviate materially from that projected in our agreed business plans;
- (iii) Policyholder protection is not materially or inadvertently reduced as a result of where capital is held across the Group; and
- (iv) Expected surplus generation is not less than that required to restore LV= to target solvency following a breach in the Board agreed limit over a period of 5 years.

These objectives are reviewed at least annually, and benchmarks are set by which to judge the adequacy of the Group's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Group. The Group is required to hold sufficient capital to meet the Solvency II capital requirements based on the higher of the Solvency Capital Requirement or Minimum Capital Requirement.

The assessment depends on various actuarial and other assumptions about potential changes in market prices, future operating experience and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the SCR and MCR to meet the PRA's total requirements and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements. This is the responsibility of the Chief Financial Officer and is monitored through the Asset and Liability Committee (ALCO), one of the day-to-day monitoring committees which reports into the Board.

b) Measurement and monitoring of capital

Method 1 as referred to in Article 230 of the Solvency II Directive is applied by the organisation to calculate the Group solvency position.

The capital position of the Group is monitored on a regular basis and reviewed formally on a quarterly basis by ALCO. The Group's key capital management objectives are reviewed and benchmarks are set by which to judge the adequacy of the Group's capital and ensure that sufficient capital is available.

The Group's capital requirements are forecast on a regular basis and compared with the available capital and the Group's minimum internal rate of return. The internal rate of return forecast to be achieved on potential investments is also measured against minimum required benchmarks taking into account the risks associated with the investment.

In the event that sufficient capital is not available, actions would be taken either to raise additional capital or to reduce the amount of risk accepted thereby reducing the capital requirement through, for example, reinsurance, reducing business volumes or a change in investment strategy.

The items reported under Own Funds are classified by the regulations and split into three categories depending on different factors such as quality, liquidity and timeline to availability when liabilities arise. Tier 1 includes ordinary share capital, non-cumulative preference shares and relevant subordinated liabilities. Tier 2 includes cumulative preference shares, and subordinated liabilities with a shorter duration. Tier 3 own funds are those which do not satisfy the Tier 1 or Tier 2 requirements.

Different limit amounts held under the three tiers apply to the MCR and SCR. As Tier 1 comprises the highest quality with the longest redemption period, the majority of the eligible amount of own funds to cover the MCR and SCR is composed of Tier 1 own funds.

c) Own fund items

The following table details the structure, amount and quality of basic own funds and ancillary own funds (excluding the surplus from ring-fenced funds which are not available to the Group).

	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Surplus funds	1,112	-	-	1,112
Reconciliation reserve	(46)	-	-	(46)
Subordinated liabilities	-	367	-	367
Total Basic Own Funds	1,066	367	-	1,433
Total Basic Own Funds after deductions	1,066	367	-	1,433

Surplus Funds

Surplus funds are similar to the unallocated divisible surplus of the Group as reported under IFRS. This represents the excess of assets over technical provisions and other liabilities. It includes amounts that have yet to be formally declared as bonuses for the participating policyholders together with the free assets of the Group. Any profit or loss for the year is transferred to the surplus funds account.

UK regulations, the Group's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contracts benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders. For further details please refer to Section D.2.2 under the heading 'With-profits and Smoothed Managed Funds specific'.

Reconciliation reserve

This reduces the Tier 1 capital and represents surplus funds within ring-fenced funds which are not available to the Group. The matching adjustment portfolio does not have any surplus in excess of its notional SCR, and as a result no restriction to own funds has been applied.

Subordinated liabilities

Details of the Group's subordinated liabilities, which are included as Tier 2 capital within own funds, together with the valuation methodology are given in section D.3, note 6.

Minority interest

There are no material minority interests to report.

Eligibility

For the SCR, the sum of the eligible amounts of Tier 2 and Tier 3 items shall not exceed 50 % of the SCR. For the MCR, Tier 3 capital items are not eligible and Tier 2 items shall not exceed 20 % of the MCR. The items which are classified as Tier 3 include other own funds not falling into Tier 1 or 2. Article 76 of the Delegated Acts specifies deferred tax assets as Tier 3 capital.

Changes in own funds during the reporting period

	LVFS Group		
	1 January 2021 £m	Movement £m	31 December 2021 £m
Eligible own funds			
Tier 1 capital	1,116	(50)	1,066
Tier 2 capital	361	6	367
Tier 3 capital	-	-	-
Total capital	1,477	(44)	1,433
Made up of:			
Surplus funds	1,134	(22)	1,112
Deferred tax	-	-	-
Reconciliation reserve	(18)	(28)	(46)
Subordinated liabilities	361	6	367
Minority interests	-	-	-
Total capital	1,477	(44)	1,433
Total eligible own funds to meet SCR	1,477	(44)	1,433

- Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax and reconciliation reserve.
- Tier 2 capital represents subordinated debt.
- Tier 3 capital represents deferred tax asset.

Surplus funds have decreased due to the Solvency II loss generated during the year. The reconciliation reserve comprises of adjustments (e.g. Ring-fenced funds, Deferred tax etc.) to the capital elements used in the calculation of the SCR.

d) Eligible own funds

The following tables detail the eligibility of Own Funds to meet the SCR and MCR.

	Tier 1	Tier 2	Tier 3	Total
Total available Own Funds to meet the Group SCR	1,066	367	-	1,433
Total eligible Own Funds to meet the Group SCR	1,066	367	-	1,433

Total available Own Funds to meet minimum Group SCR	1,066	367	-	1,433
Capital restrictions	-	(321)	-	(321)
Total eligible Own Funds to meet the minimum Group SCR	1,066	46	-	1,112

No Own Funds have been reported for the prior year as allowed by article 303 of the Delegated Regulations.

e) Material differences between equity as shown in the financial statements and excess of assets over liabilities as calculated for solvency purposes.

As a mutual insurer, LVFS is owned by its members and not by any shareholders. Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets

of LVFS. Any profit or loss for the year arising through the Statement of Comprehensive Income is transferred to or from the Unallocated divisible surplus.

The following table provides a reconciliation of equity (Unallocated divisible surplus) under IFRS to Solvency II excess of assets over liabilities.

	At 31 December 2021	
	£m	£m
Analysis of Equity per the statutory financial statements		
Unallocated divisible surplus		1,023
Solvency II Adjustments (excluding reclassifications)		
<u>Assets</u>		
- Decrease in valuation of goodwill (Section D.1 note 1)	(46)	
- Decrease in valuation of intangibles (Section D.1 note 1)	(7)	
- Increase in valuation of property, plant and equipment (Section D.1)	2	
- Increase in valuation of participations (Section D.1 note 3,4)	11	
- Decrease in valuation of collective investments undertakings (Section D.1 note 4)	(14)	
- Decrease in valuation of reinsurance recoverable (Section D.1 note 8)	(730)	
- Decrease in valuation of insurance and intermediaries receivables (Section D.1 note 9)	(1)	
- Decrease in valuation of loans and receivables (not insurance) (Section D.1 note 10)	(1)	
- Decrease in valuation of cash and cash equivalents (Section D.1 note 11)	(2)	
- Decrease in valuation of other assets (Section D.1 note 12)	(5)	
		(793)
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2)	874	
- Outstanding claims (included in insurance and intermediaries payable for Solvency II)	116	
		990
<u>Other liabilities</u>		
- Increase in insurance and intermediaries payable (Section D.3 note 3)	(111)	
- Decrease in trade payables (Section D.3 note 5)	7	
- Increase in subordinated debt (Section D.3 note 6)	(4)	
		(108)
Total Equity - Solvency II valuation		1,112
Restricted own fund items due to ring-fenced fund		(46)
Subordinated liabilities allowable as own funds items		367
Total own funds - Solvency II valuation		1,433
Excess of Assets over Liabilities - Solvency II valuation		
Total Assets		15,874
Total Technical Provisions		(13,689)
Total Other Liabilities		(1,073)
Excess of Assets over Liabilities - Solvency II valuation		1,112

Differences in the asset and liability valuation methodology used for Solvency II purposes and that used under IFRS are set out in Section D.

Any surplus own funds over the notional SCR of RNPFN and Teachers, which are both ring-fenced funds, are restricted so the Group does not benefit from these surplus funds.

f) Own-fund item subject to transitional arrangements

There are no own fund items subject to transitional arrangements.

g) Consolidation of Group's own funds

The Group's Own Funds have been calculated using the accounting consolidation-based method which is considered the default method. Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated on

consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In assessing whether certain own funds cannot be made available to cover Group SCR, the supervisory authorities shall consider the following elements:

- a) Are there legal or regulatory requirements restricting the transfer of assets to another insurance or reinsurance undertaking within the group.
- b) Can the own funds be made available within a maximum of 9 months of requirement.
- c) Are there costs associated with making such own funds available for the Group.
- d) The following cannot be used to cover Group SCR
 - Ancillary own funds
 - Preference shares, subordinated mutual members account and subordinated liabilities;
 - Net deferred tax assets
 - Any minority interest in a subsidiary ancillary services undertaking
 - Any minority interest in an insurance or reinsurance subsidiary which exceeds the contribution of that subsidiary to the Group SCR
 - Any restricted own funds in ring-fenced funds.

Not all assets within an undertaking are unrestricted. Certain products or activities result in ring-fenced fund structures which give one class of policyholder greater rights to assets within their own fund. Although these assets are included in computing the excess of assets over liabilities for own fund purposes, they cannot in fact be made available to meet the risks outside the ring-fenced fund. The Group has identified the Royal National Pension Fund for Nurses (RNPFN) and the Teachers With-Profit fund as ring-fenced funds which restrict the transferability of own fund items.

The Group has subordinated liabilities and has previously reported net deferred tax assets and minority interests. For further information refer to the Valuation for Assets and Liabilities sections of this report.

Accordingly restrictions in the transferability and fungibility of own funds in related undertakings arise from three main areas:

1. Solvency capital requirements at subsidiary undertaking level.
2. Ring-fenced funds and the Matching Adjustment Portfolio.
3. Regulatory restrictions in relation to subordinated liabilities and in previous years, net deferred tax assets and minority interest.

The organisation does not have any material own funds issued by an equivalent third country insurance or reinsurance undertaking.

E.2 SCR and MCR

E.2.1 Group SCR and MCR

The Group calculates its SCR using the accounting consolidation-based method set out as Method 1 in Article 230 of Directive 2009/138/EC. This values the Group on a look through basis, where the risks of all insurance subsidiaries are considered as if they belonged to the same legal entity. Capital requirements for regulated non-insurance subsidiaries are then added on separately.

The SCR for the Group as at 31 December 2021 was £796m (31 December 2020: £787m). The small increase in SCR over the period was driven in part by higher equity exposure from the investment of assets in asset share to back future exit bonus distributions and a number of other offsetting factors.

The minimum consolidated Group SCR as at 31 December 2021 was £228m (31 December 2020: £232m). The minimum consolidated Group SCR is the sum of MCRs of the individual entities (see sections E.2.1 of the Solo SFCRs for further information).

The reason for the decrease in the minimum consolidated Group SCR over the year is the fall in SCR for LVFS on a Solo basis.

E.2.2 Group SCR split by risk

The Group uses a Standard Formula approach for calculating its regulatory SCR, although it maintains its own internal view of capital. The following table shows the breakdown of the SCR by risk on the Standard Formula basis. In line with the construction of the Standard Formula SCR, the amounts for each risk module contain some diversification allowance within that module. For example, the market risk line includes diversification between equity and interest rate risk. The individual modules also include an allowance for the loss absorbing capacity of technical provisions.

The below figures allow for the structure of the Group, and specifically RNPFN and Teachers ring-fenced funds contained within LVFS. The capital requirements for these funds are calculated in isolation and added to the remaining part of LVFS, with no credit being taken for diversification between them.

Risk Module (all figures in £m)	2021	2020
Market risk	601	507
Credit counterparty risk	33	41
Life underwriting risk	320	388
Health underwriting risk	102	95
Total before diversification	1,056	1,031
Diversification	(242)	(240)
Basic Solvency Capital Requirement	814	791
Operational risk	37	41
Loss absorbing capacity of deferred taxes	(55)	(45)
Solvency Capital Requirement	796	787

The market risk SCR has increased over the period. An increase in equity exposure from investments into asset share to hedge future exit bonus distributions has driven an increase in SCR. See section C.3.2 for further details.

Life underwriting risk SCR has decreased over the period driven by a decrease in persistency risk capital from the increase in the yield curve over the year, together with the natural run-off of capital-intensive and closed lines of business. There were no material changes to life underwriting risk other than the reduction in lapse risk weighting from the increase in interest rates (see Section C.2.2). Lapse risk remains the main source of life underwriting risk for the Group.

There have been no material changes in non-life underwriting risk SCR, operational risk and the loss absorbing capacity of deferred taxes over the year. Credit counterparty risk has decreased over the year as improved credit outlook has reduced exposure.

E.2.3 Diversification benefit

Diversification benefit within the SCR emerges from relative sizes of the risks and the correlation assumptions between them. As a result of using the Standard Formula approach to assess the Group SCR, the stress assumptions used to calculate the risk capital amounts, and the level of correlation between risks, are prescribed by Solvency II regulations.

The Group's SCR has material sources of diversification benefits arising from the life business written directly by the Group, which diversifies within itself. For example, the Group's with-profits business diversifies against its protection business due to the different risks to which these businesses are exposed.

Diversification is not permitted between the Matching Adjustment Portfolio and the rest of the business.

E.2.4 Basis of calculation

The Group uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive (see Section E.2.1). The Group is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

The Group has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as the Group does not use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

The Group has been compliant with the MCR and SCR throughout the reporting period.

E.6 Any other material information

Stress testing under a Coronavirus scenario has not been performed in 2021 due to the limited adverse demographic experience attributed to Covid-19 since March 2020. Furthermore market volatility is believed to be adequately captured by existing economic sensitivity analysis.

Further details on the insurance entities within the LV= Group can be found in the relevant SFCRs.