2022 Annual Report from the Board of
Liverpool Victoria Financial Services Limited
to its With-Profits Policyholders

You're about to read a summary of how we made decisions affecting the with-profits policyholders in the LVFS Fund in 2022.

We've gone into a lot of detail here to provide you reassurance that we're managing your money as we should.

When we're making decisions about our with-profits funds, we always follow our Principles and Practices of Financial Management. You can find the version for the LVFS Fund at **LV.com/wp-info**. But if you would like a shorter overview, 'Your guide to how we manage our with-profits business' is on the same page. We've done our best to keep it easy to read, but you can always get in touch if you have questions. You can find out how by clicking on 'contact us' at **LV.com/wp-info**.

And if you'd like more information about where we invest your funds, you can find details at **LV.com/asset-allocation**.

1. Summary

We describe the way in which we manage the with-profits business in the main fund of Liverpool Victoria Financial Services Limited ('LVFS Fund') in a formal document known as the 'Principles and Practices of Financial Management' (or 'PPFM'). Each year we review our compliance with the PPFM and report the results of that review to you.

This report to policyholders examines the management of the with-profits business within the LVFS main fund ('LVFS Fund') during 2022. It covers the governance arrangements, how we have exercised discretion and how any competing interests between different classes of policyholders were addressed. It does not apply to with-profits policies in the RNPFN Fund and the Teachers Assurance Fund (both ring-fenced funds within LVFS). These have their own Principles and Practices of Financial Management documents and separate reports on compliance with them.

In the opinion of its Board of Directors ('the Board'), Liverpool Victoria Financial Services Limited[1] ('LVFS') complied with the obligations set out in the PPFM during 2022 except in respect of the issues noted in section 4.11. These caused claim underpayments which were not rectified in 2022, but which are expected to be largely addressed in 2023.

The reasons for this opinion are outlined in this report. **The With-Profits Committee agrees with the opinion of the Board.**

2. Governance Arrangements

The Board is ultimately responsible for the LVFS Fund and for the management of with-profits business within it. The With-Profits Committee is a sub-committee of the Board, set up to provide independent advice relating to the exercise of discretion in respect of the business within the scope of this report. It also monitors compliance with the PPFM. At the

[1] Prior to its conversion to a mutual company limited by guarantee on 2 January 2020, the company was known as Liverpool Victoria Friendly Society Limited.

end of 2022, it comprised a Chairman who is independent of LVFS, two independent non-Executive Directors, and one independent member[2].

LVFS also has a With-Profits Actuary approved by the regulators, who provides advice to management and the Board on the exercise of discretion relating to matters affecting the with-profits business within the Fund. The current With-Profits Actuary is Mr Trevor Fannin and his report is annexed to this report**.** Mr Fannin replaced Mr Ian Farr in April 2023 who was With-Profits Actuary during 2022 and the first three months of 2023.

3. Overview of the LVFS Fund

Before we cover each area where we exercised discretion in 2022, we thought it would be useful to give you an overview of the LVFS Fund. Further information is also available in the documents mentioned at the start of this report at **LV.com/wp-info**.

3.1 Here's a reminder of what's included in the LVFS Fund

We've been looking after our customers' money since 1843.

All our own with-profits business[3] is held within the LVFS Fund. We combine your money with other investors' money and manage it on your behalf. There are other types of policies in the LVFS Fund, together with its 'inherited estate' (the assets that are in excess of the LVFS Fund's liabilities).

LVFS is a mutual company limited by guarantee which means we have no external shareholders but are owned by our members, such as yourself.

3.2 Regular bonuses may be added

We aim to add a regular bonus to your policy, where applicable, each year to increase guaranteed benefits.

3.3 Final (or similar) bonuses or market value reductions may be paid to ensure you get a fair return for the main policy benefits

We want to make sure that you receive a fair return on your policy. If the regular bonuses you've had during your policy term are less than a fair return, we'll add a final bonus or top up bonus to increase your payout.

Sometimes these bonuses can be a high proportion of the final value of your policy. For some policies we may apply a market value reduction rather than add a final bonus to ensure you receive a fair return.

For most policies we use 'asset shares' to make sure you receive a fair payout e.g. when setting final bonuses or market value reductions. The 'asset share' is the underlying value of a policy and is calculated as the sum of the premiums that have been paid, less charges taken (including for expenses and death benefits), tax (where applicable), all accumulated at the investment returns earned on the with-profits fund.

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[2] The composition changed over 2022, with one independent member joining and another one leaving.
[3] With-profits policies sold by RNPFN and Teachers Assurance are held within separate ring-fenced funds within LVFS.

For Pension Income Plus Annuity policies ‘Declared Investment Returns’ are used to ensure a fair payout, and for lump sum benefits for conventional pensions we use the asset share directly.

3.4 We group similar policies together to set final bonus rates for conventional policies

For conventional policies, rather than work out the value of each individual policy we generally use representative policies, or combine policies together, to decide the level of final bonuses to pay.

3.5 We use a process called smoothing for some products to help protect with-profits policyholders

Smoothing helps protect policyholders from sudden changes in the value of the investments in the with-profits fund. Because we smooth pay outs, it’s possible that when you cash in your policy or your policy ends, the amount paid out is higher or lower than the underlying value of the investments. We reserve the right to remove smoothing in exceptional circumstances. Some policies have automatic rules for when smoothing is not used.

3.6 We may also pay mutual bonus and exit bonus

Since it was set up, our mutual bonus scheme has rewarded members with eligible policies for their support of the development and growth of our business.

Following the sale of our general insurance business, which completed at the end of 2019, we have decided to use part of the sale proceeds to continue to pay a mutual bonus on those with-profits policies which supported the growth of our general insurance business (all with-profits policies except Flexible Guarantee Bond Series 3, Flexible Guarantee Funds Series 2 and Smoothed Managed Funds). We aim to award you future mutual bonuses annually at a similar level to those in the past, though this is not guaranteed.

For Flexible Guarantee Bond Series 3, Flexible Guarantee Funds Series 2 and Smoothed Managed Funds policies we use the financial performance of our business (together with other measures) to set mutual bonus rates.

In addition, we decided to use some of the proceeds from the sale of our general insurance business to pay certain policies an exit bonus on claim though this is also not guaranteed. All Flexible Guarantee Bonds, Flexible Guarantee Funds and ‘Smoothed Managed Funds’ policies are ineligible for exit bonus. These products contributed less (or due to when they started didn’t contribute) to supporting the growth of our general insurance business.

4. How we used judgement to manage the LVFS fund in 2022

The areas where we exercised our discretion (i.e. used judgement) in relation to the with-profits business in the LVFS Fund during 2022 are covered in detail below, together with how our decisions comply with the PPFM of the Fund. We’ve also included information on other areas of interest: rectification, PPFM changes and business changes.

4.1 The claim amounts we paid are fair

During the year policy claim payouts for many policies were based on policy asset shares as a means of assessing a fair payout value, subject to a minimum payout of any guaranteed policy benefits that apply on exit.

For those groups of policies and claim types where the asset shares are used as a guide to set payouts, where it is relevant we aim to make payouts on maturing, surrendering and transferring policies that are within 80% and 120% of asset share (known as the target range). For these groups of policies, 91.9% of maturity claims and 92.2% of surrender claim payouts during the year were within the target payout range, with 98.6% of death claims during the year also being within the target payout range. In performing these assessments we take into account how we group conventional policies together.

Financial Conduct Authority regulation states that we may make payouts outside the target range if we have a good reason to believe 90% of payouts fall within the target range. LVFS is comfortable that it is reasonable for those payouts which are above or below target range to be so.

Though asset share is used to assess payout values, no target range is set for the following:

- With Profits Pension Annuity, Pension Income Plus Annuity policies and vested conventional with-profits pension policies (as these policies do not have a single payout that can be reasonably compared to asset share[4]); and
- partial withdrawals for unitised policies (as they reduce asset shares with the target range applying only on the final claim).

As detailed in the PPFM, methods other than asset shares are used to set payouts (and so no target range is set) for some groups of conventional with-profits policies. LVFS was comfortable with the approach it used in regard to these policies during 2022.

Some conventional with-profits life and pension policies contractually became non-profit or were treated as non-profit (or received no further regular bonuses) by LVFS from the time premiums ceased being paid. From 2001 LVFS exercised its discretion when the Board decided to recommence adding bonuses to all these policies, and this continued in 2022.

For All-In-1 Investment Bond, Guaranteed Capital Bond, Flexible Guarantee Bond and Flexible Guarantee Funds policies, policy conditions require asset shares which are subject to smoothing to be used to determine the benefits payable (except in defined situations) hence asset shares are not considered to be used as a guide to determining the benefits payable. Hence no target range is required to be set.

For Smoothed Managed Funds policies, the benefits payable to policyholders are determined by the number and value of units allocated to the policy under the policy conditions and so we do not use asset shares as a guide to determining the benefits payable. Hence no target range is required to be set.

There was a significant change to the payout methodology for Industrial Branch (IB) whole-of-life conventional with-profits policies on 1 August 2022. This was an improvement in the method to make the outcomes fairer to and between policyholders, and included a change to increase the death benefit above the cash-in value.

[4] In addition, for these vested conventional with-profits pension policies no asset share is calculated except at vesting given the strength of the guarantees.

4.2 Our regular bonus rates were reviewed during the year

Regular bonus rates were reviewed during the year in accordance with the PPFM. The rates declared on 1 March 2022[5] were at the same level as the previous year except for Flexible Whole Life policies which are covered in section 4.3. Interim regular bonus rates for conventional policies were maintained at the same level as the regular bonus rates declared on 1 March 2022. Discretion was exercised in deciding the rates.

Regular bonus rates are not applied to All-In-1 Investment Bond, Guaranteed Capital Bond, Flexible Guarantee Bond, Flexible Guarantee Funds and Smoothed Managed Funds policies.

4.3 We added final (or similar) bonuses to most claim payments, with no market value reductions

A final bonus declaration for conventional with-profits life policies was made with effect from 1 March, 1 June, 1 September and 1 December 2022 which changed claim payments from those dates. In addition, there was a declaration made on 1 August 2022 to introduce the new payout methodology for IB whole-of-life conventional with-profits policies.

A top-up bonus declaration for With Profits Pension Annuity policies was made with effect from 1 February 2022, which changed payouts. A final bonus declaration for conventional with-profits pension policies was made with effect from 1 March 2022, with the rates remaining unchanged (at zero).

Quarterly declarations were made in accordance with the PPFM in respect of the Declared Investment Return for Pension Income Plus Annuity policies, taking effect from 1 February, 1 May, 1 August and 1 November 2022 which changed rates at each declaration.

For Flexible Whole Life policies, where the regular bonus rate is used to target asset share subject to smoothing (unlike other policies with regular bonus), the monthly rate decreased from 0.50% to 0.20% on 1 March 2022.

The declarations were made in accordance with the PPFM. Discretion was exercised with regards to smoothing, the level of charges allocated to asset shares, the investment return used to project asset shares to the period covered by the review, tax (where applicable) and the choice of sample policies or grouping of policies to calculate aggregate asset shares (as relevant) used to translate the asset shares into final bonus or top-up bonus rates.

Final bonus rates and any market value reductions (where allowed under policy conditions) are calculated on an individual policy basis for Appropriate Personal Pension policies and first generation unitised with-profits policies. LVFS operated in accordance with this practice during 2022, with no market value reductions being necessary (or applied) during 2022.

In accordance with the PPFM, no final bonus is paid on Flexible Whole Life policies, All-In-1 Investment Bond, Guaranteed Capital Bond, Flexible Guarantee Bond, Flexible Guarantee Funds and Smoothed Managed Funds.

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[5] Except for With Profits Pension Annuity policies, where the declaration date was 1 February 2022.

4.4 We also reviewed and continued to add mutual bonus to all eligible policies

A mutual bonus was declared for the calendar year 2021 as shown in the table below. This was included in claims paid from 1 March 2022 for most policies[6].

Policy group	Uplift %
Conventional with-profits policies and with-profits annuities	1.0%
Accumulating and unitised with-profits policies except Flexible Guarantee Bonds (and similar policies)	1.0%
Flexible Guarantee Bonds Series 1 and 2 / Flexi Guarantee Plan / Flexible Guarantee Funds Series 1	0.5%
Flexible Guarantee Bonds Series 3 / Flexible Guarantee Funds Series 2 in force for more than 12 months as at 31 March 2022	0.2%

No Smoothed Managed Funds policies were eligible for mutual bonus for calendar year 2021.

4.5 We continue to add exit bonus

As noted section 3.6, in 2020 we decided to use some of the proceeds from the sale of our general insurance business to pay you an exit bonus on claim, normally through an increased final (or similar) bonus. All Flexible Guarantee Bonds, Flexible Guarantee Funds and Smoothed Managed Funds policies are ineligible for exit bonus. During 2022 the Board exercised its discretion and maintained the exit bonus at **4.75%**.

During most of 2022 the funds for exit bonus were invested in similar assets that the main benefits for policies are invested in. Since December 2022, the funds for exit bonus have been invested in cash-based assets, which protects their value from volatile markets and reduces our regulatory capital requirements. However this also means that if strong investment returns increase the policy values over which the funds for exit bonus have to be spread, the exit bonus percentage can be expected to reduce.

4.6 Our surrender payouts for conventional with-profits policies were fair

Discretion is exercised in the methods and assumptions used to calculate surrender and cash/transfer values for conventional with-profits policies.

For conventional endowment policies, the method used applies the same rate of final bonus to the recalculated guaranteed benefits as would apply to a maturity or death claim for the same policy type and duration in force which is considered to provide a fair payout.

For conventional whole-of-life policies the surrender value is set to be the same as the death benefit (except for IB policies from 1 August 2022 where the surrender value is set at a level designed to pay asset share subject to smoothing with the death benefit being higher).

For conventional pension policies, the basis used for cash or transfer values ensures at least individual asset share is paid (subject to smoothing). These methods were all used in 2022 in accordance with the PPFM.

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6 The exceptions are: 1 April 2022 for Flexible Guarantee Bonds and similar bonds, on the policy anniversary on or after 1 February 2022 for With Profits Pension Annuity policies and on the policy anniversary on or after 1 May 2022 for Pension Income Plus Annuity policies.

4.7 We continued smoothing pay-outs to give policyholders a fair outcome

LVFS uses various methods of smoothing depending on the type of policy as detailed in the PPFM. LVFS operated in accordance with these methods during 2022. This included amendments to the smoothing method for conventional endowments in 2022. In addition, in connection with the new payout methodology for IB whole-of life conventional policies referred to in section 4.1, no smoothing was applied to changes in final bonus rates in respect of the change in methodology itself.

The methods used give a reasonable level of smoothing to with-profits policyholders invested in LVFS, given the asset mix of the asset share pools. They balance the needs of those leaving with the need to protect policyholders remaining in the LVFS Fund.

Where it applies, the target range from 80% to 120% of the asset share used for LVFS with-profits policies is appropriate taking into account the investment strategy, the smoothing methods and the frequency of reviews of final bonuses.

LVFS reserves the right to remove, suspend or reduce smoothing on all with-profits policies (except where contractual) in exceptional circumstances. This right was not exercised in 2022.

4.8 We monitored and reviewed the investment strategy during 2022

In accordance with the PPFM, the investment strategy was monitored during 2022 to ensure that it remained appropriate. Discretion was exercised with respect to the types of investment held and the proportions invested in different types of asset.

A review of the target mixes of assets backing with-profits policy asset shares was undertaken at the end in March 2022 and implemented in June 2022. The current target mixes of assets is shown at **LV.com/asset-allocation**.

Different investment strategies were maintained to manage guaranteed liabilities and non-profit liabilities in LVFS.

Columbia Threadneedle Investments carried out the majority of the investment management of the LVFS Fund assets during 2022 (including the assets which back the asset shares of those policies within the scope of this report). Information was provided by them to demonstrate that asset holdings were within limits prescribed by the Board.

4.9 Charges and expenses taken were in accordance with the PPFM

LVFS exercised discretion in the method used to apportion the maintenance expenses of LVFS to the LVFS Fund. For some policy types, we applied these expenses, together with investment management fees (inclusive of Value Added Tax) as charges to asset shares. For other policy types, the charges applied to asset shares were in line with charges set out in policy conditions or similar documents. Tax on investment returns and tax relief on expenses was applied, as appropriate. Changes were made in the way expenses were charged to asset shares for IB whole-of-life conventional with-profits policies in connection with the change in payment methodology referred to in section 4.1.

Any difference between the charges applied to asset shares and the actual expenses charged to the LVFS Fund is borne by the inherited estate. Costs of strategic projects (e.g. due to changes in legislation or regulation) are not applied to asset shares but are charged to the inherited estate.

Mortality, morbidity and guarantee charges were applied for certain types of policies.

The expenses charged to the Fund and the charges applied to asset shares were in accordance with the LVFS PPFM during 2022.

4.10 How the LVFS Fund is exposed to business risk

The profits or losses from all business risks within the LVFS Fund are credited to or borne by its inherited estate and therefore may influence the amount payable to with-profits policyholders, if the Board determines to allocate such profits or losses to their policies.

New business will only be accepted into the LVFS Fund if, in the opinion of the Board of Directors, the terms on which the business is effected are likely to have no adverse effect on the interests of the existing with-profits policyholders in LVFS nor threaten the ability of LVFS to meet its commitments to its members.

The other key business risks of the LVFS Fund arise from:

- variations in such factors as policy longevity, annuity take-up rates and the proportion of policies in-force that are not expected to claim and expenses;
- higher contributions associated with staff defined benefit pension schemes;
- exceptional or unexpected expenses;
- compensation to policyholders, resulting from mis-selling and maladministration;
- variations in costs of guarantees, options and smoothing;
- the value of the investments of the inherited estate of LVFS; and
- the risk that the RNPFN Fund and the Teachers Assurance Fund cannot meet their liabilities.

Discretion was exercised in determining the amount of business risk taken by LVFS during 2022 through writing with-profits and non-profit business and through its subsidiary companies.

Discretion was also exercised by the Board with the decisions to convert existing Smoothed Managed Funds non-profit policies into with-profits policies, and that new Smoothed Managed Funds policies are written on a with-profits basis.

4.11 Rectification: we still have some work to do

Some rectification work for some previously identified long-standing errors resulting in some claims being underpaid remained outstanding at the end of 2022. In addition some new errors were found in 2022 which also remain outstanding at the end of 2022. The rectification of these errors is expected to be largely completed during 2023.

4.12 A summary of changes to the PPFM are on our website

The current version of the PPFM is on our website together with a summary of all recent changes. A number of changes to the LVFS PPFMs were made during 2022. The more material changes were to:

- reflect that "preserving a level of risk to the return which is consistent with our assessment of with-profits policyholders' expectations" is an aim of the investment strategy for the pool of assets backing asset shares;
- reflect changes to the smoothing approach for conventional with-profits endowment policies;
- reflect the conversion of existing Smoothed Managed Funds non-profit policies into with-profits policies, and that new Smoothed Managed Funds policies are written on a with-profits basis. This includes details of their eligibility for Mutual Bonus, and that they are not eligible for exit bonus;
- reflect that for Smoothed Managed Funds, alternative or additional aims for the investment strategy (other than optimising investment returns) are allowed where these have been communicated to policyholders;
- reflect the change in payout methodology for IB whole-of-life conventional with-profits policies including the details referred to in sections 4.1, 4.6, 4.7 and 4.9;
- clarify references to policyholders and members;
- clarify the reasons why the Board may change historical assumptions
- reflect the change in asset mix for the With Profits Income Bond;
- clarify which policy and claim types use asset shares as a guide, or use asset shares directly or where asset shares are not used;
- clarify the situations where the long term aim to make total aggregate payouts of 100% of asset share applies and where the intention that smoothing over the long term is not a material source of profit or loss applies;
- clarify the right to remove, reduce or suspend smoothing in exceptional circumstances, and what factors would be taken into account in determining this;
- reflect that the aim in setting regular bonus rates is that they would be modest and stable, and that a maximum amount by which regular bonuses can change has not been set;
- reflect that asset share cover is now the primary consideration when reviewing levels of regular bonus;
- reflect the change th regular bonus rates for Appropriate Personal Pension policies may be reviewed more frequently than annually.

The current PPFM and a full list of changes are on the website.

4.13 Possible areas of non-compliance

Last year's report mentioned that there were a small number of areas of possible non-compliance with the PPFM which were being investigated. The investigation has concluded. One area of non-compliance was identified with rectification being required, as mentioned in section 4.11.

5. When competing or conflicting rights, interests or expectations of policyholders occur

The LVFS Fund is run as a mutual which therefore avoids having any competing or conflicting interests with shareholders.

Potential conflicts can occur between the main fund of LVFS and the RNPFN Fund and the Teachers Assurance Fund (for example, regarding expenses). Where these occur, the With-Profits Committee and With-Profits Actuary provide advice to the Board to ensure that with-profits policyholders in both funds are fairly treated. If a material potential conflict were to arise, consideration would be given to the need for independent external advice.

Potentially competing or conflicting rights, interests or expectations of with-profits policyholders may come about, for example, between:

- different types of policy;
- policies with varying benefits and policy conditions;
- policies with different terms or of different sizes;
- policies with different entry or maturity dates; and/or
- different types of claim on a policy (for example, on maturity, death or surrender).

To ensure that LVFS Fund with-profits policyholders are treated fairly in balancing their respective interests, throughout 2022 LVFS exercised discretion between these groups of policyholders through:

- the choice as to how policy benefits are smoothed;
- maintaining different series of regular bonus and mutual bonus rates for different policy types;
- the choice of LVFS with-profits policies that are eligible for exit bonus;
- the method used to group policies when setting final bonus rates and when allocating investment returns, tax (where applicable) and charges to asset shares; and
- the management of LVFS's capital resources.

6. Conclusion

The Board can confirm that, in its opinion, the exercise of discretion, as detailed in section 4, complied with the PPFM of the LVFS Fund during 2022 except in respect of the issues identified causing claim underpayments which were not rectified in 2022, but which are expected to be largely addressed in 2023. The With-Profits Committee and the With-Profits Actuary agree with this opinion.

The Board can also confirm that, in its opinion, potentially competing or conflicting rights, interests or expectations of policyholders in the LVFS Fund detailed in section 5 were managed in accordance with its PPFM during 2022, thereby treating with-profits policyholders fairly. The advice of the With-Profits Actuary was given with regard to these issues, which were also reviewed by the With-Profits Committee.

The Board of Directors
Liverpool Victoria Financial Services Limited
25 May 2023

Annex

Report from the With-Profits Actuary to the With-Profits Policyholders of Liverpool Victoria Financial Services Limited

It is my responsibility as With-Profits Actuary ('WPA') for Liverpool Victoria Financial Services Limited ('LVFS') to advise the Board of Directors on the management of LVFS' with-profits business, and to report annually to with-profits policyholders on the exercise of discretion in relation to that business.

As an employee of Willis Towers Watson, I was engaged as Designate WPA by LVFS in April 2023, and after regulatory approval was formally appointed as WPA in May 2023. My predecessor Ian Farr, who was WPA during 2022, was involved in consideration of all the matters referred to in the attached report on LVFS's compliance with its Principles and Practices of Financial Management. This covers the period from 1 January 2022 to 31 December 2022 inclusive.

In my opinion, based on the information and explanations provided to me by LVFS, the discretion exercised by LVFS over the period took your interests into account in a reasonable and proportionate manner, and was consistent with disclosures to customers and the PPFM.

While there have been some errors causing claim underpayments in prior years, these were not rectified in 2022 but are expected to be largely addressed in 2023.

In reaching this opinion I have relied on reports and information provided to me by the company and my predecessor, and I have taken into account the relevant rules and guidance issued by the Prudential Regulation Authority and the Financial Conduct Authority and applicable standards and guidance issued by the Financial Reporting Council[7].

Trevor Fannin
With-Profits Actuary for LVFS
25 May 2023

You can get this and other documents from us in Braille or large print by contacting us.

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[7] TAS 100 and TAS 200