2018 Annual Report from the Board of Liverpool Victoria Friendly Society Limited to its With-Profits Policyholders

1. Summary

We describe the way in which we manage the with-profits business in the main fund of Liverpool Victoria Friendly Society Limited ('LVFS' or 'the Society') 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 Society's main fund during 2018. It covers the governance arrangements, the exercise of 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'), the Society materially complied with the obligations set out in the PPFMs during 2018 subject to top-up payments to address some claims underpaid in 2018. The reasons for this opinion are outlined in this report. The With-Profits Committee concurs with this view.

2. Governance Arrangements

The Board is ultimately responsible for the management of the Society's with-profits business in its main fund. The With-Profits Committee is a sub-committee of the Board, set up to provide independent judgement relating to the exercise of discretion in respect of the business within the scope of this report. It also monitors compliance with the PPFM. Throughout 2018, it comprised[1] a Chairman who is independent of the Society, an independent non-Executive Director and two independent members.

The Society also has a With-Profits Actuary authorised by the Prudential Regulation Authority, who provides advice to the Board and the With-Profits Committee on the exercise of discretion relating to matters affecting the Society's with-profits business. The current With-Profits Actuary is Mrs Tamsin Abbey, who was formally approved on 10 December 2018, and who also acted in this capacity ahead of her approval from 12 September 2018. Her report is annexed to this report. For the period of 2018 up to this, the With-Profits Actuary was Mr Andrew Walton.

3. Compliance with PPFM in exercising discretion

There are a numbers of areas where discretion was exercised in relation to the with-profits business within the Society's main fund during 2018. These are discussed below.

[1] A member of management was also a member of the Committee during January 2018.

3.1 Amounts payable under a with-profits policy

During the year policy claim payouts 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.

For those groups of policies where their own asset share is used to set final bonus rates 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, 99.7% of maturity claims and 99.4% of surrender claim payouts during the year were within the target payout range[2], with 99.6% of death claims during the year also being within the target payout range. The Society is generally comfortable with those payouts falling outside the target range, and where it is not, is investigating them.

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

- the Flexible Guarantee Bond and similar policies (due to the mechanistic derivation of the payout, based, in normal conditions, on the investment return averaged over a rolling six-month period);
- With Profits Pension Annuity and Pension Income Plus Annuity policies (as these policies do not have a single payout); and
- partial withdrawal for unitised policies.

Other methods are used to set payouts (and so no target range is set) for the following groups of policies:

- conventional paid-up policies (which receive the same final bonus rate as a premium-paying policy of the same type and duration);
- IB whole-of-life policies sold before 1980 (which receive the final bonus rate for a taxable policy sold in 1980);
- tax-exempt IB whole-of-life policies sold from 1980 (which receive the final bonus rate for a taxable policy of the same duration);
- OB conventional whole-of-life policies sold before 1968 (which receive the final bonus rate for a policy sold in 1968);
- tax-exempt conventional endowment and OB whole-of-life policies sold from 1968 (which a final bonus rate derived from equivalent taxable policies); and
- conventional pension policies with annuity guarantees (the value of the guaranteed benefits on vesting is currently above the asset share, while cash benefits paid before 1 April 2018 were set using a historic basis).

The Society was comfortable with the approach it is currently using in regard to these policies during 2018.

The following significant changes were made to the approach used to set payouts under with-profits policies during 2018:

- from 1 March 2018 final bonus rates for conventional IB whole-of-life policies are calculated as the ratio of the aggregate projected Asset Share to the aggregate guaranteed benefits for those policies expected to claim during the period in question; and

[2] 90% is the minimum required under Financial Conduct Authority regulation.

- from 1 April 2018, the basis used for calculating cash benefits for conventional pension policies was amended. The cash benefit paid is the individual asset share of the policies, subject to smoothing. From age 50, in normal circumstances, this is subject to a minimum amount based on the commuted value of the guaranteed yearly income. Full details of the basis are in the PPFM.

3.2 Regular bonus rates

Regular bonus rates were reviewed during the year in accordance with the PPFM. The rates declared on 1 March 2018[3] remained the same as the previous year, except for With Profits Pension Annuity policies where the rate was decreased from 0.9% p.a. to 0.7% p.a.. Interim bonus rates for conventional policies were maintained at the same level as the regular bonus rates declared on 1 March 2018.

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 which changed rates at each declaration.

Regular bonus rates are not applied to Flexible Guarantee Bonds (and similar policies).

3.3 Final bonus and top-up bonus

A final bonus declaration for conventional with-profits policies was made with effect from 1 March 2018 which changed claim payments from that date. Top-up bonus rates for With Profits Pension Annuity policies were changed with effect from 1 February 2018. 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 old-style unitised with-profits policies. The Society operated in accordance with this practice during 2018, with no market value reductions being applied during 2018. For old-style UWP bonds the practice that payouts can be moved closer to the actual asset share (i.e. without smoothing of investment returns) was not applied in 2018.

In accordance with the PPFM, no final bonus is paid on Flexible Whole Life policies or Flexible Guarantee Bonds (and similar policies) and no top-up bonus is paid on Pension Income Plus Annuity policies.

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[3] Except for With Profits Pension Annuity policies, where the declaration date was 1 February 2018.

3.4 Mutual bonus

A mutual bonus was declared for the trading year 2017 as shown in the table below. This was included in claims paid from 1 March 2018 for most policies[4].

Policy group	Uplift %
Conventional with-profits policies and with-profits annuities	1.0%
Accumulating and unitised with-profits policies except Flexible Guarantee 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	0.0%

3.5 Surrender bases for conventional policies

Discretion is exercised in the methods and assumptions used to calculate surrender and early transfer values for conventional with-profits policies. For conventional endowment policies, the method used during 2018 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. For conventional whole-of-life policies the surrender value is set to be the same as the death benefit. For conventional pension policies, cash values included a prospective element based on the guaranteed benefits before 1 April 2018. Thereafter a basis that ensures at least individual asset share (subject to smoothing) is paid is used.

3.6 Smoothing of payouts

The Society uses various methods of smoothing depending on the type of policy as detailed in the PPFM. The Society operated in accordance with these methods during 2018.

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

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.

3.7 Investment strategy

In accordance with the PPFM, the investment strategy was monitored during 2018 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.

Detailed reviews of the investment strategy were conducted in 2017 for the mix of assets backing the asset shares for Flexible Guarantee Bonds/Flexible Guarantee Funds/Flexi Guarantee Plans, All-in-1 Investment Bonds/Guaranteed Capital Bonds and With Profits Income Bonds. A less detailed review was conducted in 2018 with no changes made.

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[4] On 1 April 2018 for Flexible Guarantee Bonds and similar bonds, on the policy anniversary on or after 1 February 2018 for With Profits Pension Annuity policies and on the policy anniversary on or after 1 May 2018 for Pension Income Plus Annuity policies.

A detailed review of the investment strategy for the mix of assets backing asset shares for other policies was carried out in 2018 to be implemented in 2019 which recommended making refinements to the target mix of assets to improve the expected return whilst keeping the overall level of investment risk similar to the current level.

Different investment strategies were maintained to manage the guaranteed annuity benefits of the conventional pensions, for the assets backing non-asset share related with-profit liabilities, for the assets backing the non-profit policies written by the Society and for its inherited estate.

Columbia Threadneedle Investments carried out the majority of the investment management of the Society's assets during 2018 (including all 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.

At the end of 2017, 49% of the Society's strategic investment in its General Insurance business was sold to the Allianz Group, with an agreement for a further 20.9% to be sold to the same purchaser in 2019. In addition, the Society has an option under which it can sell all or part of its remaining shares in the General Insurance business to Allianz. The Society has invested in Wealth Wizards (an automated financial advice company) since 2015.

The Board is comfortable that its continued partial holding of the General Insurance business and in Wealth Wizards in 2018 was likely to have no adverse effect on the interests of the with-profits policyholders in its main fund, and was made in the best interests of all the Society's policyholders.

3.8 Charges and expenses

The Society exercised discretion in the method used to apportion the expenses of the Society to different products and activities. For some policy types, these expenses are applied as charges to asset shares. For other policy types, the charges applied were in line with charges set out in policy conditions or similar documents. For older-style unitised policies, improvements in how the charges are communicated have been identified which are expected to be implemented in 2019.

The charges applied to asset shares were in accordance with the PPFM during 2018.

3.9 Business risk

Discretion was exercised in determining the amount of business risk taken by the Society during 2018 through writing with-profits and non-profit business and through the Society's subsidiary companies.

The RNPFN Fund benefits from a capital support facility provided by the Society. This requires a contingent loan to be advanced to the RNPFN Fund should a deficit arise. No such loan was advanced in 2018.

3.10 Rectification

Rectification for issues identified in previous years continued in 2018 and is expected to continue into 2019. During 2018 it was decided to backdate the implementation of the new basis for cash benefits for conventional pension policies to 1 April 2017 and remediate any underpayments resulting from this. It was also concluded compensation was due for the use of final bonus factors on old-style unitised policies before 2017 (where it was concluded in some circumstances their use was not appropriate). In addition, compensation for some underpayments in 2018 (and earlier) on conventional life business was identified. Work to progress these is commencing.

3.11 Changes to the PPFM

The current version of the PPFM is on our website together with a summary of all changes. During 2018 the separate PPFMs for Flexible Guarantee Bonds (and other similar policies) and for other policies were combined into one document. In addition the following lists the more notable changes made during 2018. There were no material changes to Principles.

Material changes to Practices:

- Various amendments required for the introduction of a new cash benefit basis for conventional pension policies to apply from 1 April 2018;
- An amendment has been made in respect of a change to calculate final bonus rates for conventional IB whole-of-life policies from 1 March 2018 using an aggregate approach;
- Amendments were made to simplify the approach used to review annual bonus and interim bonus rates;
- A change was made to reflect the new practice of monitoring the accumulated cost of smoothing under Flexible Guarantee Bond Series 3 and Flexible Guarantee Funds Series 2 policies with the intention of removing smoothing subject to the fair treatment of the policyholders concerned should the accumulated cost reach an amount that is agreed by the Board;
- An addition was made to the practice to reflect that smoothing profits and losses on policies may contribute to any Mutual Bonus. A change has been made for Flexible Guarantee Bond Series 3 and Flexible Guarantee Fund Series 2 policies to clarify that while Mutual Bonus is expected to be zero at shorter policy durations, consideration would then be given to paying a Mutual Bonus; and
- A new practice was added to clarify that some conventional with-profits policies were treated as non-profit from the time premiums ceased and that from 2001 the Board decided to fully treat them as with-profits.

4. Competing or conflicting rights, interests or expectations of policyholders

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

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
- different types of claim on a policy (for example, on maturity, death or surrender).

Potential conflicts can occur between the Society's main fund 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 LVFS with-profits policyholders are treated fairly in balancing their respective interests, throughout 2018 the Society exercised discretion between these groups of policyholders through:

- the choice as to how policy benefits are smoothed;
- maintaining different series of annual bonus rates for different policy types;
- the method used to group policies when allocating investment returns, tax (where applicable) and charges to asset shares; and
- the management of the Society's capital resources.

5. Conclusion

The Board can confirm that, in its opinion, the exercise of discretion, as detailed in section 3, materially complied with the PPFM of the Society's main fund during 2018. This was reviewed by the With-Profits Committee and by the With-Profits Actuary.

The Board can also confirm that, in its opinion, potentially competing or conflicting rights, interests or expectations of policyholders in the Society's main fund detailed in section 4 were managed in accordance with its PPFM during 2018, treating its 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 Friendly Society Limited
18 April 2019

Annex

Report from the With-Profits Actuary to the With-Profits Policyholders of Liverpool Victoria Friendly Society Limited

I was formally approved as the With-Profits Actuary of Liverpool Victoria Friendly Society Limited on 10 December 2018 and acted in this capacity ahead of my approval from 12 September 2018. It is my responsibility as With-Profits Actuary of Liverpool Victoria Friendly Society Limited ('the Society') to advise the Society's Board of Directors on the management of the Society's with-profits business, and to report annually to with-profits policyholders on the exercise of discretion in relation to that business.

In my opinion the Board's report and the discretion exercised by the Society's Board of Directors in relation to its main fund in 2018 may be regarded as having taken the interests of with-profits policyholders into account in a reasonable and proportionate manner.

In reaching this opinion I have taken into account the information and explanations provided to me by the Society, and relied upon Mr Andrew Walton who held this role until 12 September 2018 for the period up to that date, 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[5].

Tamsin Abbey
With-Profits Actuary
18 April 2019

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[5] TAS 100 and TAS 200