2021 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 2021.

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 2021. 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'), Liverpool Victoria Financial Services Limited[1] ('LVFS') complied with the obligations set out in the PPFMs during 2021 except in respect of the issues noted in section 4.11 causing claim underpayments which were not rectified in 2021 but which are expected to be addressed in 2022. In addition, as noted in section 4.14, there are a small number of areas of possible non-compliance that are being investigated and which will be reported on next year.

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

[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.

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 end of 2021, 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 Prudential Regulation Authority, 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 Ian Farr and his report is annexed to this report.

3. Overview of the LVFS Fund

Before we cover each area where we exercised discretion in 2021, 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 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 the final bonus 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 the accumulation of the premiums that have been paid, less charges taken (including for expenses and death benefits), tax (where applicable) at the investment returns earned on the with-profits fund.

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[2] The composition changed over 2021, with the Chair resigning and being replaced as Chair by an existing independent member, who currently has not been replaced.
[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 Guaranteed Bond Series 3 and Flexible Guaranteed fund Series 2). 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 and Flexible Guarantee Funds Series 2 policies we still 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. ‘Flexible Guarantee’ products are not eligible for exit bonus. These products contributed less to supporting the growth of our general insurance business.

4. How we used judgement to manage the LVFS fund in 2021

The areas where we exercised our discretion (i.e. used judgement) in relation to the with-profits business in the LVFS Fund during 2021 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.

For those groups of policies where the asset shares of the policies in the group are 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 98.0% of surrender claim payouts during the year were within the target payout range, with 99.2% 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:

- 'Flexible Guarantee' policies (as derivation of the payout is set out in the policy document);
- With Profits Pension Annuity and Pension Income Plus Annuity policies (as these policies do not have a single payout); and
- partial withdrawals for unitised policies (given there is more than one payout).

In accordance with the PPFM, methods other than asset shares are used to set payouts (and so no target range is set) for the following groups of policies:

- conventional endowment paid-up policies and whole-of-life policies made paid-up before 1 December 2018 (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);
- OB conventional whole-of-life policies sold before 1968 (which receive the final bonus rate for a policy sold in 1968); and
- tax-exempt conventional life policies (which receive a final bonus rate derived from equivalent taxable policies).

Payouts for conventional whole-of-life policies made paid-up on or after 1 December 2018 are calculated assuming that premiums are maintained in full, less a deduction for missed premiums.

LVFS was comfortable with the approach it used in regard to these policies during 2021.

Claims on certain conventional pension policies are not monitored against target range:

- those that have vested (as the value of the guaranteed benefits is currently above the asset share)
- those that have had death claims pre vesting (as the benefit is return of premiums paid).

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 2021.

There were not any significant changes made to the approach used to set payouts under with-profits policies during 2021.

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 2021[4] did not change except for With Profits Pension Annuity policies where the annual rate increased from 0.25% to 1.00% and Flexible Whole Life policies where the monthly rate decreased from 1.00% to 0.50%. Interim regular bonus rates for conventional policies were maintained at the same level as the regular bonus rates declared on 1 March 2021.

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).

4.3 We added final 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 2021 which changed claim payments from those dates. A top-up bonus declaration for With Profits Pension Annuity policies was made with effect from 1 February 2021, which changed payouts. A final bonus declaration for conventional with-profits pension policies was made with effect from 1 March, with the rates remaining unchanged (at zero).

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 2021, with no market value reductions being necessary (or applied) during 2021.

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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4 Except for With Profits Pension Annuity policies, where the declaration date was 1 February 2021.

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

A mutual bonus was declared for the calendar year 2020 as shown in the table below. This was included in claims paid from 1 March 2021 for most policies[5].

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 2021	0.2%

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 bonus. 'Flexible Guarantee' products are not eligible for exit bonus. The rates which were applicable during 2021 were:

Date	Rate
1 January 2021	5.75%
1 June 2021	5.00%
1 Sepember.2021	4.75%

The funds for exit bonus were initially invested in cash-based assets, and strong investment returns increased the policy values over which the funds for exit bonus have to be spread which reduce the percentage of exit bonus payable. This resulted in an exit bonus of 5.0% being declared from 1 June 2021, and 4.75% from 1 September 2021. Since mid-2021 the funds for exit bonus have been invested in similar assets that the main benefits for policies are invested in. This helps stabilise the exit bonus rates declared in future.

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 early 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. For conventional pension policies, a basis for cash values that ensures at least individual asset share (subject to smoothing) is paid is used. These methods were all used in 2021 in accordance with the PPFM.

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 2021.

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[5] The exceptions are: 1 April 2021 for Flexible Guarantee Bonds and similar bonds, on the policy anniversary on or after 1 February 2021 for With Profits Pension Annuity policies and on the policy anniversary on or after 1 May 2021 for Pension Income Plus Annuity policies.

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 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.

It is noted the right is reserved to remove smoothing on all with-profits policies (except where contractual) in exceptional circumstances. This right was not exercised in 2021.

4.8 We monitored and reviewed the investment strategy during 2021

In accordance with the PPFM, the investment strategy was monitored during 2021 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 of 2020 and implemented during 2021. 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. The portion of the inherited estate of the LVFS Fund that is used to support mutual bonus and exit bonus (deriving from the sale of our general insurance business) now all has a similar asset mix to those backing with-profits policy asset shares (after the change referred to in 4.5 above).

Columbia Threadneedle Investments carried out the majority of the investment management of the LVFS Fund assets during 2021 (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) 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.

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 2021.

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 may, if the Board determines to allocate such profits or losses, influence the amount payable.

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 2021 through writing with-profits and non-profit business and through its subsidiary companies.

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 2021. The rectification of these errors expected to be completed in 2022.

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 changes. A number of changes to the LVFS PPFMs were made during 2021 in order to:

- reflect that miscellaneous surplus allocations made before 2011 now rank the same as core asset shares for the purpose of determining loss absorbency for business risks;
- clarify LVFS has the right to make asset share charges in exceptional adverse circumstances;
- clarify aspects of mutual bonus and exit bonus;
- clarify that in the event of deferral of interest or principal on the Subordinated Debt, no further Mutual Bonus or Exit Bonus can be distributed until the deferral of interest or principal had been made good;
- clarify that past practice is a factor when setting regular bonus rates;
- reflect that the long-term investment strategy is now reviewed at approximately annual intervals;
- clarify that investments in non-UK assets may be currency-hedged to reduce risk;

- reflect that a portion of the inherited estate now has a similar asset mix to the Asset Pools supporting Asset Shares in order to support future distributions of mutual bonus and exit bonus.

4.13 Business Changes

At the end of 2020 we announced that LVFS had reached an agreement on the terms of a transaction with Bain Capital Credit to acquire our business. The proposal was subject to the approval of LV='s members at a Special General Meeting held in 2021, but was not approved by the majority needed to continue with the transaction.

In order to continue to manage the RNPFN Fund fairly for its remaining with-profits policyholders in Q4 2021 we moved all the annuities and unit-linked policies (and the assets they invest in) out of the RNPFN Fund into the main fund of LVFS. The LVFS Fund paid a fair value for the transferred policies to the RNPFN Fund.

4.14 Possible areas of non-compliance

There are a small number of areas of possible non-compliance with the PPFM that are currently being investigated. The investigation is expected to conclude in 2022 and its conclusions will be provided in the 2022 annual report from the Board to its with-profits policyholders.

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 2021 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 2021 except in respect of the issues identified causing claim underpayments which were not rectified in 2021 which are expected to be addressed in 2022. In addition, there are a small number of areas of possible non-compliance that are being investigated and which will be reported on next year. 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 2021, 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 Financial Services Limited
23 May 2022

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 of 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.

In my opinion the discretion exercised by the Board of Directors in relation to the main fund of LVFS (the 'LVFS Fund') in 2021 may be regarded as having taken the interests of with-profits policyholders into account in a reasonable and proportionate manner. While there have been some errors causing claim underpayments in prior years, these were not rectified in 2021 but are expected to be paid in 2022. In addition, there are a small number of areas of possible non-compliance that are being investigated and which will be reported on next year.

In reaching this opinion 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[6].

Ian Farr
With-Profits Actuary
23 May 2022

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

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[6] TAS 100 and TAS 200