Liverpool Victoria Financial Services Limited Main Fund ('LVFS Fund')

Principles and Practices of Financial Management (PPFM)

Version 25

1 September 2022

Contents

1. Introduction

1.1 Company information

Liverpool Victoria Financial Services Limited ("LVFS") was formed upon the conversion of Liverpool Victoria Friendly Society Limited into a company limited by guarantee on 2 January 2020 following a vote by its members. Its predecessor was originally founded in 1843 as a burial society. As a mutual organisation LVFS has no shareholders, instead being owned by its members.

LVFS is incorporated under the provisions of the Companies Act 2006 and is bound by its Articles of Association.

It is authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority ("FCA") and the PRA.

In this document where LVFS is used in a context that predates conversion, the reference is to Liverpool Victoria Friendly Society Limited.

The structure of LVFS is as follows:

- LVFS's main fund (referred to in this document as "the LVFS Fund" or "the Fund") which holds LVFS's business that sits outside the RNPFN Fund and the Teachers Assurance Fund;
- The RNPFN Fund, a ring-fenced sub-fund within LVFS which holds the remaining business transferred from the Royal National Pension Fund for Nurses on 31 December 2001; and
- The Teachers Assurance Fund, a ring-fenced sub-fund within LVFS which holds the remaining with-profits business transferred from Teachers Provident Society Limited on 1 June 2016.

1.2 Purpose of this document

As required by the FCA, this document sets out how the with-profits business within the LVFS Fund is managed and, in particular, how discretion is to be exercised. It is known as the Principles and Practices of Financial Management ("PPFM").

It excludes the RNPFN Fund and the Teachers Assurance Fund which are subject to their own PPFMs.

A glossary of the key words and phrases used in this document is included as Appendix 1.

1.3 Policies covered by this document

This document covers the with-profits policies invested in the LVFS Fund. A list of the types of policy covered is provided in Appendix 2 which comprise the following broad types:

- Conventional with-profits life policies;
- Conventional with-profits pension policies;
- First generation unitised with-profits policies;
- Second generation unitised with-profits policies;
- Third generation unitised with-profits policies;
- Accumulating with-profits policies; and
- With-profits annuity policies.

1.4 The Principles

The Principles are enduring statements of the standards LVFS follows when managing the LVFS Fund. These Principles cover duties to the with-profits policyholders in both current and future business and economic environments, compliance with relevant regulation and legislation and the need to be fair to all with-profits policyholders and all LVFS's other policyholders.

The Principles are not expected to change often. However, there are no restrictions on LVFS's ability to change them, where appropriate, subject to satisfying the relevant regulatory requirements, including notifying affected policyholders as stated in paragraph 1.7.

1.5 The Practices

The Practices are more detailed descriptions of how LVFS responds to short-term changes to the business and economic environment when managing the LVFS Fund. The practices may be changed from time to time and the information in this document only reflects current practice.

1.6 Monitoring compliance and governance

The Board of Directors of LVFS ("the Board") produces an annual report to with-profits policyholders (available on the LVFS website or on request) on LVFS's compliance with this PPFM. It is the responsibility of the Board to ensure that LVFS manages the LVFS Fund in accordance with the Principles and Practices set out in this document.

A With-Profits Actuary has been appointed to advise management and the Board on its exercise of discretion in managing the with-profits business in the LVFS Fund. A report from the With-Profits Actuary to with-profits policyholders is included within the Board's annual report.

LVFS also has a With-Profits Committee to consider the rights, interests and reasonable expectations of the with-profits policyholders in the LVFS Fund in their capacity as policyholders, members and customers of LVFS, and exercise independent judgement in advising the Board on the achievement of the fair treatment of those with-profits policyholders. This includes advising on material issues in the exercise of discretion and in assessing compliance with this PPFM. The With-Profits Committee may also include a report to with-profits policyholders within the Board's annual report if it deems it appropriate. The membership currently comprises three members who are independent of the LV Group (one of whom is the Chairman) and two non-executive directors from the Board.

1.7 Changes to the PPFM

The PPFM will be reviewed at least annually to ensure that it continues correctly to reflect the Principles and Practices that are applied to the LVFS Fund.

Any proposed changes will be reviewed by the With-Profits Committee and approved by the Board, after considering advice from the With-Profits Actuary, before the changes are implemented.

With-profits policyholders covered by this PPFM will be notified of material changes to any Principles in this document that affect them at least three months in advance. The FCA will also be notified of the changes.

With-profits policyholders covered by this PPFM will be notified of material changes made to any Practices in this document that affect them as soon as is reasonable.

1.8 Customer-friendly PPFM

Separate customer-friendly versions of the PPFM ("CFPPFMs") for different product groups are available on the LVFS website or on request. These documents contain key information from the PPFM. For the avoidance of doubt, in the event of a conflict, the PPFM will take precedence over the CFPPFMs.

1.9 Disclaimers

A Schedule of disclaimers is shown in section 12 of this document.

2. The methods used to guide the determination of the appropriate amount payable to individual with-profits members

2.1 Principles

2.1.1 As a minimum LVFS will pay the guaranteed benefits under each contract. The Board aims to treat all groups of policyholders fairly taking into account any conflicting interests between them. All the other principles below are subject to these requirements.

2.1.2 The aim of the methods used to guide the determination of the amount payable to with-profits members in the LVFS Fund is to pay them a fair return on their investment on maturity, surrender and, where applicable, on death, subject to a minimum of any guaranteed benefits.

2.1.3 The methods used will be applied to the extent appropriate to enable the Board to make reasonable decisions. This may mean the methods are applied by carrying out sample calculations. Any material changes to the current methods used will be approved by the Board.

2.1.4 The Board might change the historical assumptions or parameters relevant to the methods used if it can be clearly demonstrated that incorrect assumptions and parameters have been used.

2.2 Practices

2.2.1 LVFS generally considers Asset Shares to guide the determination of the amount payable to with-profits members in the LVFS Fund on maturity, surrender and, where applicable, on death. "Asset Share" means broadly, in relation to a with-profits policy, the accumulation, at rates of return achieved on investments, of premiums paid less charges for expenses incurred, taxation, the cost of benefits provided and any charges for the cost of guarantees or the use of capital. The assumptions and parameters used in the calculation of Asset Shares are described in paragraphs 2.2.10 to 2.2.16. For **third generation unitised with-profits policies**, the benefits payable to policyholders are determined by the number and value of units allocated to the policy under the policy conditions and LVFS does not use Asset Shares as a guide to determining the benefits payable. As a result, the practices in this section specifically relating to Asset Shares are not applicable to **third generation unitised with-profits policies**. A summary of certain aspects of the operation of these policies is included in paragraph 2.2.28.

2.2.2 The Board may use its discretion to increase the Asset Shares (or the units of **third generation unitised with-profits policies**) of eligible with-profits policies by allocating Miscellaneous Surplus (such as profits arising from LVFS business risks which are distributed from 2011 by way of Mutual Bonus, as described in paragraph 7.2.3).

2.2.3 Allocations made as Mutual Bonus may be reduced, removed or reinstated as described in paragraph 7.2.3. In addition, where permitted under policy conditions, in exceptional adverse circumstances (for example, in order to ensure the fair treatment of all policyholders in the LVFS Fund) deductions or charges can be made to Asset Shares (which includes Miscellaneous Surplus allocations made before 2011).

2.2.4 The Board may also use its discretion to uplift the Asset Share (allowing for any smoothing in accordance with section 5) at the time of any relevant claim (including partial payments and pension income) for eligible with-profits policies by an Exit Bonus, as described in paragraph 7.2.4.

2.2.5 For the following **conventional with-profits life and pension policies** (except for benefits calculated in accordance with paragraph 2.2.18), LVFS does not pay the individual Asset Share to each with-profits member on claim, but instead adds a final bonus to the guaranteed benefits, calculated using representative policies as follows:

- For **Ordinary Branch whole-of-life policies**, final bonus rates are based on a 'sample policy' basis for each calendar year of entry, and are calculated as the ratio of the aggregate projected Asset Shares to the aggregate projected guaranteed benefits, grouped by calendar year of entry, for those taxable policies which are premium-paying or have paid all premiums due and which are expected to claim (whether through death or surrender) during the period in question.
- For all **Industrial Branch conventional whole-of-life policies**, payouts from 1 August 2022 are set by reference to granular sample policy Asset Shares, calculated using historic and estimated or proxy parameters and assumptions designed to provide a fair value at that date, and then accumulated in accordance with the relevant paragraphs in section 2.
- For **conventional with-profits endowment policies**, final bonus rates are derived from the Asset Share and guaranteed benefits under sample taxable premium-paying policies for each curtate duration in-force, chosen so as to be representative of the policies expected to mature during the period in question.
- For **conventional with-profits pension policies** at vesting, final bonus rates are derived from the Asset Share and guaranteed benefits under sample premium-paying policies for each curtate duration in-force, chosen so as to be representative of the policies expected to vest during the period in question. For conventional with-profits pension policies in payment, other than at vesting, no asset share is calculated given the strength of the guaranteed annuity benefits.

2.2.6 Representative policies calculated using approximate Asset Shares are used to set top-up bonus rates for **With Profits Pension Annuity** policies in accordance with paragraph 4.2.6 and declared investment returns for **Pension Income Plus Annuity** policies in accordance with paragraph 3.2.7.

2.2.7 For some types of **conventional with-profits life policies**, where the Board does not consider it appropriate to use Asset Shares because of historic practice or due to lack of data, other methods are used to assist the Board to assess a fair return on the with-profits members' investment. The policy types where this is the case and the methods used include:

- Industrial Branch and Ordinary Branch endowment policies that have ceased paying premiums early and have reduced guaranteed benefits, where final bonus rates are set to a rate determined from premium-paying policies of the same duration;
- Ordinary Branch whole-of-life policies that ceased paying premiums early and have reduced guaranteed benefits and this occurred before 1 December 2018, where final bonus rates are set to a rate determined from the aggregate of all premium-paying policies and policies that have paid all premiums due for the same calendar year of entry (as described in paragraph 2.2.5);
- Industrial Branch tax-exempt endowments, where final bonus rates are set to the rate for an equivalent taxable policy of the same duration;
- Ordinary Branch whole-of-life policies with entry dates prior to 1968, where final bonus rates are set to the rate for a taxable whole-of-life policy with an entry date in 1968; and
- Ordinary Branch tax-exempt whole-of-life policies with entry dates from 1968, where final bonus rates are set to the rate for an equivalent taxable policy of the same duration.

Payouts for Ordinary Branch conventional whole-of-life policies that have ceased paying premiums early and have reduced guaranteed benefits, and this occurred on or after 1 December 2018, are calculated assuming that premiums are maintained in full, less a deduction for missed premiums accumulated with interest, subject to a minimum of the guaranteed benefits which have been adjusted for premiums ceasing early.

2.2.8 For certain policy types, death benefits are calculated in accordance with policyholder expectations or policy conditions. For example:

- **Industrial Branch conventional whole-of-life policies**, where the death benefit is set at or above the surrender value, with the difference between them being defined by a surrender value factor (applied to the death benefit) which depends on the policyholder's age. The surrender value factors increase with age, and are set to 1.0 for ages 100 and above, so the surrender value and death benefit are equal at these ages. The factors were designed with the objective of the death benefit being supportable up to age 100 based on prudent assumptions as to future investment returns, expenses and mortality charges at the time they were set. The factors could be modified in the future, though this is not expected. The death benefit is subject to a minimum of the guaranteed death benefit.
- **conventional with-profits endowment policies**, where final bonus rates are set to those determined from maturing policies of the same duration; and
- **conventional with-profits pension policies**, where the payout on death is a return of the premiums paid.

2.2.9 Expenses are charged to the LVFS Fund in accordance with Section 8.

2.2.10 For **unitised and accumulating with-profits policies** and **with-profits annuities**, the charges made to Asset Shares are those set out in paragraph 8.2.2. The charges for the cost of benefits are determined in accordance with paragraphs 2.2.15 and 2.2.16.

2.2.11 For **conventional with-profits life and pension policies**, the charges made to Asset Shares for expense deductions are those set out in paragraph 8.2.3. The charges for the cost of benefits are in accordance with paragraphs 2.2.15 and 2.2.16.

2.2.12 The investment return allocated to particular Asset Shares of policies in the LVFS Fund is the investment return on the assets (the "Asset Pool") underlying those Asset Shares, adjusted for tax where appropriate. LVFS currently includes **all with-profits policies** (except **With Profits Income Bonds** and **second generation unitised with-profits policies**) in the same Asset Pool. **With Profits Income Bonds** have their own Asset Pool based on communications made to policyholders at issue. For **second generation unitised with-profits policies** different Asset Pools are available according to the type of product and the investment option selected by the policyholder. Investment returns are calculated as often as required in order to calculate Asset Shares, and are estimated if not available.

2.2.13 In Asset Share calculations, where relevant, LVFS allows for tax on investment income and capital gains, and tax losses or tax relief on expenses, using rates of tax appropriate to the type of business. Any difference between the total tax charge allocated to the LVFS Fund and the sum of the amounts within the individual Asset Share calculations is credited to or borne by the inherited estate of the LVFS Fund.

2.2.14 LVFS is a mutual with no shareholders, so there is no additional liability to tax on with-profits policies arising because of transfers to shareholders.

2.2.15 Charges for benefits provided such as mortality and morbidity risks are made to Asset Shares by deduction of appropriate amounts from Asset Shares, where relevant. For **conventional with-profits pension policies**, where the death benefit payable before vesting is lower than the Asset Share, an appropriate addition is made to the Asset Share. For **with-profits annuity policies**, LVFS's own and industry mortality experience and how they might change in future may be taken into account in the Asset Share calculations referred to in paragraph 2.2.6.

2.2.16 LVFS makes explicit charges to Asset Shares for the cost of policyholder selected term-related guarantees on **second generation unitised with-profits policies**. It does not otherwise currently make a charge for the cost of guarantees or for the use of capital in its Asset Share calculations other than for the costs implicitly included in the charges on **unitised with-profits policies, accumulating with-profits policies** and **with-profits annuity policies**.

2.2.17 Some **conventional with-profits life and pension policies** contractually became non-profit or were treated as non-profit (or received no further annual bonuses) by LVFS from the time premiums ceased being paid, namely:

- Industrial Branch endowment and whole-of-life policies that ceased paying premiums early;
- Industrial Branch whole-of-life policies that paid all premiums due (except for policies issued under Table 25);

- Ordinary Branch endowment and whole-of-life policies that ceased paying premiums early; and
- Retirement Annuity Contract pension policies that ceased paying premiums early.

From 2001 the Board exercised its discretion by deciding to recommence adding annual bonuses to all these policies (though not retrospectively for the period from the time premiums ceased being paid to 2000), and deciding all such policies could have a final bonus on claim. For the purposes of this PPFM, all these policies are treated as with-profits policies.

2.2.18 For **conventional with-profits pension policies**, from 1 April 2018 where a transfer value or surrender benefit is paid, it is calculated as follows:

- Before age 50 (except on ill-health retirement – see below), the amount payable is the Asset Share;
- From age 50 but below age 55 (except on ill-health retirement – see below), the amount payable is the greater of:
  a) (55-Age)/5 x Asset Share + (Age-50)/5 x the discounted value of the guaranteed annuity benefit (calculated assuming the benefits are taken at age 55); and
  b) Asset Share
- From age 55 (and on all ill-health retirements) the amount payable is the greater of:
  a) The discounted value of the guaranteed annuity benefit (calculated assuming the benefits are taken at the date of the calculation); and
  b) Asset Share

where

- the discounted value of the guaranteed annuity benefits is determined using the basis used to calculate the original guaranteed benefits (or, where the actual basis is not available, an appropriate proxy for this basis) and reflects the premiums actually paid; and
- the Asset Share is calculated in accordance with section 2 on a monthly basis, subject to smoothing referred to in section 5, with the exception that its value at 31 March 2018 is set to a minimum of the transfer value applying on that date, as calculated on the previous transfer basis.

At approximately annual intervals the Board reviews whether the discounted value of the guaranteed annuity benefits underpin to the Asset Share should be removed (for example, because of a low level of financial strength of the LVFS Fund) and reviews the basis used to calculate the discounted value.

2.2.19 No annual or final bonuses are added to **second and third generation unitised with-profits policies**. For **second generation unitised with-profits policies**, the value of the units allocated to the policy at outset is accumulated in line with the Asset Share through the unit price, using the approach to smoothing outlined in section 5. At the end of a guarantee term, if the guaranteed amount is higher than the surrender value of the policy, additional units are added to make the surrender value equal to the guaranteed amount. On certain products, the Asset Pool invested in by a policy may be switched to another on request of the policyholder by surrendering units in the current Asset Pool and purchasing units in a different Asset Pool. For **Flexible Guarantee Bond Series 3** and **Flexible Guarantee Funds Series 2** policies and **third generation unitised with-profits policies**, LVFS may delay buying, selling or switching units in accordance with the policy conditions of these products.

2.2.20 Where Asset Shares are used to guide the amount payable, LVFS manages the LVFS Fund with the long term aim of making total aggregate payouts of 100% of Asset Share.

2.2.21 Where Asset Shares are used to guide the amount payable, LVFS aims to make payouts on maturity, transfer, surrender or death for with-profits policies in the LVFS Fund that are between 80% and 120% of Asset Share (known as the target range) except in the circumstances listed in paragraph 2.2.23. This range is set taking into account the investment strategy, the smoothing approaches used, the frequency of reviews of final bonus and top-up bonus and the desire to minimise the risk of policyholders not receiving a fair payout. For **conventional with-profits policies**, the Asset Share used for the purpose of assessing payouts against the target range, reflects the methods used to set final bonus rates described in paragraph 2.2.5.

2.2.22 A payout above target range may occur if a guaranteed benefit is payable. For **conventional with-profits pension policies**, payouts may occur above target range for benefits paid in accordance with paragraph 2.2.18. LVFS may also make a payout that falls outside the target range if it believes it might be fair, or fairer, to a particular policyholder or the other policyholders in the Fund to do so, for example due to the smoothing process employed or in extreme investment conditions

2.2.23 Though Asset Share is used as a guide to the amount payable, the target range is deemed not to apply on:

- **with-profits annuities** and in-payment **conventional with-profits pension policies**, as there is no single payout;
- **second generation unitised with-profits policies**, as (unless a guarantee applies) the nature of the smoothing and the product design mean that the payout will automatically fall within the target range; and
- partial payments for **all unitised with-profits policies** (which are described under paragraphs 5.2.5 and 5.2.6).

2.2.24 LVFS documents the methods, parameters and assumptions that it uses to determine the amount payable to with-profits members in the LVFS Fund.

2.2.25 Any proposed material changes to the current methods, or to the current parameters or assumptions relevant to a particular method, (or to historic parameters and assumptions) will be submitted to the Board for approval, and included in the documentation referred to above.

2.2.26 In the event of a deferral of interest or principal on the Subordinated Debt (e.g. as a result of reduced LVFS solvency coverage), no future Mutual Bonus or Exit Bonus can be distributed until the deferral of interest or principal had been made good. Otherwise, LVFS manages the LVFS Fund so that the discretionary benefits under with-profits policies (i.e. future annual bonuses declared or future bonuses declared which are based on Asset Shares or units for **third generation unitised with-profits policies** including past declarations of Mutual Bonus) are calculated and paid disregarding any liability to make payments under the Subordinated Debt.

2.2.27 For clarity, any profits or losses from payouts on maturity, transfer, surrender or death for with-profits policies in the LVFS Fund are not reflected in Asset Shares, beyond any charge or rebate made for the benefits provided under the policy. Instead, they accrue to the inherited estate of the LVFS Fund.

2.2.28 For **third generation unitised with-profits policies**, where we do not use Asset Shares as a guide to determining the benefits payable:

- The benefits payable are determined by the number and value of units attaching to the policy, and subsequently deducted at the point of claim (including in relation to any withdrawals);
- Units are allocated to policies from premiums paid, following the investment option selected by the policyholder;
- Units are deducted from policies to pay charges, including management, administration and policyholder-selected guarantee charges (see section 8);
- The units allocated to a policy may from time to time be switched to a different investment option;
- The unit prices applicable on claims, switches, and unit allocation or deduction, are set out in the policy conditions (allowing for smoothing if applicable – see section 5);
- The investment return on the policy is determined by the progression of the price of units allocated to the policy, as determined from fund valuations under the policy conditions. Where appropriate, taxation is allowed for in the prices of units determined from fund valuations;
- At the end of a guarantee term, if the guaranteed amount is higher than the surrender value of the policy, additional units are allocated to increase the surrender value to the guaranteed amount;
- LVFS may delay allocating, deducting or switching units in accordance with the policy conditions;
- Mutual Bonus is allocated to the policy as additional units, which are kept separate from the other units allocated to the policy (see section 7);
- No annual or final bonuses are added.

3. The approach to setting annual bonus rates

3.1 Principles

3.1.1 The rates of annual bonus for with-profits policies in the LVFS Fund will be reviewed at least annually. The general aim in setting annual bonus rates is to add bonuses at a prudent level having regard to market conditions, the rates of return expected from the underlying investments from time to time and the current and projected relative position of Asset Shares against guaranteed benefits. Account will also be taken of the current and projected financial strength of the LVFS Fund.

3.1.2 Different annual bonus rates may be used to the extent deemed appropriate by the Board for ranges or generations of policies. The Board will introduce a new bonus series where it deems it appropriate to do so.

3.2 Practices

3.2.1 In setting annual bonus rates on with-profits policies, LVFS has regard to:

- expected future investment returns;
- the current and projected relative position of Asset Shares against:
  - guaranteed benefits for **conventional with-profits life and pension policies** and **with-profits annuity policies**,
  - the value of units for **first generation unitised with-profits policies**,
  - the accumulation account for **accumulating with-profits policies**;
- the current and projected financial strength of the LVFS Fund;
- past practice; and
- past communications made to applicable with-profits policyholders.

3.2.2 For **With Profits Pension Annuity** policies, in addition to the factors in paragraph 3.2.1, the rate set has regard to current gilt yields of an appropriate duration and may vary by calendar year of entry. In addition, for Series 3 and 4 policies the annual bonus rate may be reduced if the Asset Share referred to in section 2.2 falls below 95% of the Asset Share subject to smoothing referred to in section 5.2.

3.2.3 LVFS re-sets or expects to re-set annual bonus rates once a year. LVFS may change annual bonus rates for **first generation unitised with-profits policies** more frequently than annually if the considerations described in paragraph 3.2.1 indicate a change is appropriate.

3.2.4 For **accumulating with-profits Flexible Whole Life policies** where no final bonus is paid, LVFS's current practice is not to alter monthly bonus rates by more than 0.5% over a twelve month period. For all other with-profits policies where annual bonus rates are declared, LVFS's current practice is not to alter annual bonus rates by more than 0.5% over a twelve month period.

3.2.5 LVFS sets its interim bonus rate for **conventional with-profits policies** at the same time it sets its annual bonus rates for these policies using the same practices. LVFS reserves the right to change its interim bonus rate before the next declaration of annual bonus rates if the considerations described in paragraph 3.2.1 indicate that a change is appropriate.

3.2.6 Subject to smoothing referred to in section 5, the annual bonus for **accumulating with-profits Flexible Whole Life policies** is set with the aim of paying out the Asset Share as calculated in section 2 as no final bonuses apply to these policies.

3.2.7 Pension Income Plus Annuity policies receive an annual declared investment return rather than an annual bonus. Subject to smoothing referred to in section 5, the declared investment return is set at the level required to pay out the Asset Share as calculated in accordance with section 2 over the expected lifetime of the policyholder. LVFS currently reviews the declared investment return up to four times a year. The most recent return is applied to an individual policy at its policy anniversary. It can vary by date of entry. The declared investment return is also taken into account when calculating any increase in the minimum level of income that is guaranteed under the policy.

3.2.8 The design of **second and third generation unitised with-profits policies** means no annual bonuses are added for these policies.

4. The approach to setting final bonus rates and top-up bonus rates

4.1 Principles

4.1.1 Final bonus rates and top-up bonus rates for with-profits policies in the LVFS Fund will be reviewed at least annually. They will be set such that total payouts on policies will, whenever possible, have regard to the amounts calculated under the methods referred to in section 2, subject to smoothing referred to in section 5. Account will also be taken of the current and projected financial strength of the LVFS Fund.

4.2 Practices

4.2.1 A final bonus may be added on maturities, deaths, transfers and surrenders to **conventional with-profits policies, first generation unitised with-profits policies** and **accumulating with-profits Appropriate Personal Pension policies**. It can also be added where an annuity is taken at vesting on **conventional with-profits pension policies**. LVFS's current approach to setting final bonus rates is such that total payouts on policies will broadly reflect the amounts calculated under the methods referred to in section 2, subject to smoothing referred to in section 5. Payouts may be reduced if there is evidence that significant smoothing losses are being incurred due to a high level of transfers and surrenders.

4.2.2 For **conventional with-profits whole-of-life policies**, LVFS expects to set its final bonus rates four times a year. From 1 August 2022 for each individual **Industrial Branch policy**, the final bonus rate is set to the level required to be applied to the guaranteed benefits to pay the death benefit for the policy. The surrender value is calculated as the death benefit multiplied by a surrender value factor (described in paragraph 2.2.8) which is set to the level required to pay the Asset Share of the granular sample policy described in paragraph 2.2.5, subject to smoothing referred to in section 5.

4.2.3 For **conventional with-profits endowment policies**, LVFS expects to set its final bonus rates four times a year. On surrender the same rate of final bonus is applied to the guaranteed benefits recalculated for the duration in force as would apply to a maturity claim for the same policy type and duration in force.

4.2.4 For **conventional with-profits pension policies**, LVFS expects to set its final bonus rates on an annual basis. However, it may change rates more frequently than this if the results of calculations performed in accordance with section 2, subject to smoothing referred to in section 5, indicate that a change is appropriate. If an annuity is taken at vesting, final bonus rates would be applied to the guaranteed annuity benefit in accordance with paragraph 4.2.1, though currently they are set to zero and are expected to remain so in future. For the avoidance of doubt the Asset Share used in calculating final bonus rates is not set to a minimum of the transfer value as described in paragraph 2.2.18. By design of the basis used to calculate transfer values and surrender benefits (as stated in paragraph 2.2.18) no final bonus rates are required.

4.2.5 For **first generation unitised with-profits policies** and **accumulating with-profits Appropriate Personal Pension policies**, final bonus rates are calculated as often as required. For individual **first generation unitised with-profits policies**, LVFS does not apply a Market Value Reduction (as described in paragraphs 5.1.4 and 5.2.3) at the same time a final bonus applies and vice-versa.

4.2.6 For **With Profits Pension Annuity** policies, a top-up bonus may be payable. Any top-up bonus will be applied as an increase to the basic annuity payable during the policy year. Top-up bonus rates may vary by calendar year of entry. The top-up bonus will broadly reflect the amounts calculated in accordance with section 2, subject to smoothing referred to in section 5.

4.2.7 The design of **Flexible Whole Life policies** and **second and third generation unitised with-profits policies** means no final bonuses are added for these policies. For **second and third generation unitised with-profits policies** any Mutual Bonus is separately added to the final claim. Similarly, the design of **Pension Income Plus Annuity** policies means no top-up bonuses are added for these policies. For **Pension Income Plus Annuity** policies, any Mutual Bonus or Exit Bonus are added to payouts separately.

5. The approach to smoothing the value of with-profits policies

5.1 Principles

5.1.1 The aim of the LVFS Fund's smoothing policy is to protect with-profits policyholders in the LVFS Fund from temporary fluctuations in investment markets. It is not intended, over the long term, to be a material source of profit or loss.

5.1.2 Except where contractual, a similar approach to smoothing is adopted irrespective of the type of claim arising under the same type of with-profits policy in the LVFS Fund, although different approaches may apply to different types of with-profits policy.

5.1.3 The total scale or cost of smoothing in the LVFS Fund over the shorter term is not limited, except where permitted under policy conditions and as is necessary to preserve the ability of LVFS to meet its commitments to its members.

5.1.4 Market Value Reductions will only be applied to reflect movements in the value of assets held by the Fund. The decision whether or not to apply Market Value Reductions will take into account the level of surrenders and the expected cost of not applying a Market Value Reduction. The surrender bases for with-profits policies will only be changed to reflect movements in the value of assets held by the Fund, to reflect the level of transfers and surrenders, or in order to pay with-profits members a fair return on their investment.

5.2 Practices

5.2.1 LVFS does not set a period over which it expects smoothing to be neutral in the LVFS Fund. In addition, LVFS does not set a limit for the overall accumulated profits or losses from smoothing under the with-profits policies in the LVFS Fund. However, the accumulated cost under **Flexible Guarantee Bond Series 3** and **Flexible Guarantee Funds Series 2 policies** and **third generation unitised with-profits policies** is monitored for consideration as one factor in any decision to remove smoothing in accordance with the policy conditions. Any such decision would also consider the fair treatment of both the policyholders concerned and other policyholders in the LVFS Fund. Any profits or losses from smoothing are credited to or borne by the inherited estate of the LVFS Fund. Except where policy conditions constrain its actions, LVFS has the right to remove smoothing on all with-profits policies in exceptional circumstances.

5.2.2 LVFS uses different smoothing approaches for different types of policy in determining the amount that it is appropriate to pay, as follows:

- For **conventional with-profits whole-of-life policies**, the investment return is not smoothed but instead smoothing is normally applied by limiting the change in final bonus rates at a single review (typically quarterly) so that the immediate change in payout does not change by more than 5% (excluding Exit Bonus and new amounts added in respect of Mutual Bonus). For the declaration of final bonus rates for **Industrial Branch conventional whole-of-life policies** on 1 August 2022 which included an alteration to how payouts are set, no smoothing was applied to changes in final bonus rates in respect of the alteration, with the 5% limitation normally applied to other changes in final bonus rates allowed for approximately.
- For **conventional with-profits endowment policies**, smoothing is normally applied by smoothing investment returns and historic miscellaneous surplus taking the geometric average of these over the previous five years.
- For **conventional with-profits pension policies**, from 1 April 2018 smoothing is normally applied by limiting the investment return (positive or negative) used to calculate Asset Shares, with the balance being released in future months until extinguished. If the balance becomes large then the limit on the investment return can be amended to accelerate the release of the balance. Before 1 April 2018, the investment return applied is not smoothed.
- For **first generation unitised and accumulating with-profits policies** LVFS smooths the investment returns used over the previous two years taking the geometric average of the actual monthly investment returns. LVFS may introduce a new pricing series for top-up investments on **first generation unitised with-profits policies** at times of a sustained significant up-turn or down-turn in investment returns.
- For **second generation unitised with-profits policies**, LVFS smooths the investment return by using a unit price (known as the 'Averaged Price'), calculated as the arithmetic average over the previous 26 weeks of the unit price calculated using the actual investment return (known as the 'Underlying Price').

  When policyholders invest or switch Asset Pool, units are invested at the Underlying Price. During the first 26 weeks after this, payouts on all claims* are calculated using the Underlying Price.

  After 26 weeks for death and terminal illness claims, the Averaged Price is always used to calculate payouts.

  After 26 weeks for surrenders* and withdrawal claims, the Averaged Price is normally used to calculate payouts. However:

  - If the Underlying Price is 80% or less of the Averaged Price, then the Underlying Price is used to calculate payouts from this point. Payouts will revert to using the Averaged Price only when the Underlying Price has returned to the same level as the Averaged Price.
  - For **Flexible Guarantee Bond Series 3** and **Flexible Guarantee Funds Series 2** policies only, LVFS also has the right to calculate payouts using the Underlying Price in other exceptional circumstances as detailed in paragraph 5.2.1. Payouts will revert back to the Averaged Price when LVFS considers it appropriate and fair.

** A switch out of an Asset Pool after 26 weeks is treated as a surrender claim.*

- For **third generation unitised with-profits policies** (except for **LV= ISA**), LVFS smooths the investment return in accordance with the policy conditions by calculating three unit prices: a unit price reflecting the actual price of units determined from each fund valuation (known as the Underlying Price), a unit price (known as the Gradual Averaged Price), calculated as a lengthening average of the daily Underlying Price, for up to a 26 week period following the date of premium allocation (or fund switch), and a unit price (known as the Averaged Price), calculated as the arithmetic average over the previous 26 weeks of the daily Underlying Price.

  When policyholders invest, or switch investment option, units are allocated at the Underlying Price.

  In the first 26 weeks following investment or switching, payouts on death and terminal illness claims are always calculated using the Underlying Price on day 1 and the Gradual Averaged Price from day 2. These prices are also normally used to calculate payouts for surrender* and withdrawal claims.

  After 26 weeks the Averaged Price is always used to calculate payouts for death and terminal illness claims and is normally used to calculate payouts for surrenders* and withdrawal claims.

  However, smoothing on surrender* and withdrawal claims can be suspended at LVFS' discretion. This means that such payouts would be determined using a price different to those normally used, as described above (the Gradual Averaged Price in the first 26 weeks, and the Averaged Price thereafter).

  Suspension of smoothing would only be considered if either the Underlying Price is 80% or less of the Averaged Price, or in exceptional conditions. These exceptional conditions would be primarily if the cost of smoothing becomes higher than the Board feels it is reasonable to bear and suspension is considered prudent and necessary in the best interests of LVFS with-profits policyholders generally.

  If smoothing is suspended, payouts on surrender* and withdrawal will typically switch to use the Underlying Price until smoothing is reintroduced.

  As an alternative, at LVFS' discretion, payouts on surrender* and withdrawal may switch to using a daily Gradual Averaged Price with an appropriate averaging period of up to 26 weeks, instead of switching to the Underlying Price. For example, payouts might switch to be based on the Gradual Averaged Price methodology using an averaging period of say 13 weeks if it were believed that this would be fairer to the policyholders concerned and LVFS with-profits policyholders generally.

  If payouts on surrender* and withdrawal are switched to using a daily Gradual Averaged Price with a shorter averaging period, the averaging period will typically then increase daily up to 26 weeks. However, the averaging period may be maintained fixed at a period below 26 weeks before increasing in this way. In this scenario, payouts on surrender* and withdrawal may switch again to using the Underlying Price in exceptional conditions.

  Payouts on surrender* and withdrawal will revert back to the Averaged Price when appropriate and fair to the policyholders concerned after the price being used to value units (either the Underlying Price or Gradual Averaged Price) recovers to equal or exceed the Averaged Price. Payouts may alternatively, at LVFS' discretion, revert back to the Averaged Price at an earlier point.

  ** A switch out of an investment option after 26 weeks is treated as a surrender claim.*

- For the **LV= ISA**, LVFS smooths the investment return in accordance with the policy conditions by calculating two unit prices: a unit price reflecting the actual price of units determined from each fund valuation (known as the Underlying Price) for up to a 26 week period following the date of premium allocation (or fund switch), and a unit price (known as the Averaged Price), calculated as the arithmetic average over the previous 26 weeks of the daily Underlying Price.

  When policyholders invest, or switch investment option, units are allocated at the Underlying Price.

  In the first 26 weeks following investment or switching, payouts on death claims are always calculated using the Underlying Price. The Underlying Price is also used to calculate payouts for surrender* and withdrawal claims.

  After 26 weeks the Averaged Price is always used to calculate payouts for death claims and is normally used to calculate payouts for surrenders* and withdrawal claims.

  However, smoothing on surrender* and withdrawal claims can be suspended at LVFS' discretion. This means that such payouts would be determined using the Underlying Price to calculate payouts from this point.

  Suspension of smoothing would only be considered if either the Underlying Price is 80% or less of the Averaged Price, or in exceptional conditions. These exceptional conditions would be primarily if the cost of smoothing becomes higher than the Board feels it is reasonable to bear and suspension is considered prudent and necessary in the best interests of LVFS with-profits policyholders generally.

  If smoothing is suspended, payouts on surrender* and withdrawal will switch to use the Underlying Price until smoothing is reintroduced.

  Payouts on surrender* and withdrawal will revert back to the Averaged Price when it is considered appropriate and fair to the policyholders concerned after the Underlying Price recovers to equal or exceed the Averaged Price. Payouts may alternatively, at LVFS' discretion, revert back to the Averaged Price at an earlier point.

  ** A switch out of an investment option after 26 weeks is treated as a surrender claim.*

- For **With Profits Pension Annuity (Series 1)** policies, LVFS smooths the investment returns used over the previous five years and two years, taking the geometric average of the actual investment returns, using the smoothing period that provides the higher annuity amount.
- For **With Profits Pension Annuity (Series 2 to 4)** policies, LVFS smooths the investment return used over the previous two years, taking the geometric average of the actual investment returns.

- For **Pension Income Plus Annuity** policies, smoothing is applied by limiting the change in the annuity at a single review of the declared investment return, rather than by smoothing the investment returns used to calculate Asset Shares.

5.2.3 For **first generation unitised with-profits policies** and **accumulating with-profits Flexible Whole Life policies**, if the amount determined in accordance with section 2.2 and paragraph 5.2.2 is below the value of the units allocated to the policy, then a Market Value Reduction may be applied, if permitted under the terms of the policy document, so as to bring the value of the units down to the amount payable. However the current practice is only to apply a Market Value Reduction, should it be relevant, on **first generation unitised with-profits bonds**.

5.2.4 LVFS applies the same approach to smoothing for each type of policy, irrespective of the type of claim, size of the claim or the entry-date of the policy subject to the distinctions in paragraphs 5.2.2 and 5.2.3.

5.2.5 Partial payments under **first generation unitised with-profits policies** are met by the cancellation of a proportion of the policy value such that the value of the proportion cancelled is equal to the amount of the partial payment. For this purpose, the value of the proportion cancelled will take into account any Market Value Reduction that is applicable to the partial payment. At the time of any partial payment, the value of that partial payment plus the residual policy value will be equal to the total surrender value immediately prior to the partial payment. For the avoidance of doubt, partial payments and the policy value used in the calculation includes any Exit Bonus.

5.2.6 Partial payments (also known as withdrawals) under **second and third generation unitised with-profits policies** are met by the cancellation of a proportion of the policy value such that the value of the proportion cancelled is equal to the amount of the partial payment. For this purpose, the value of the proportion cancelled will take into account any suspension of smoothing made in accordance with paragraph 5.2.2 that is applicable to the partial payment. At the time of any partial payment, the value of that partial payment plus the residual policy value will be equal to the total surrender value immediately prior to the partial payment. Any Mutual Bonus allocated to the policy is excluded from this calculation as it is only paid on final claim. For the avoidance of doubt, partial payments and the policy value used in the calculation includes any Exit Bonus if the policy type is eligible for it.

6. The significant aspects of the investment strategy

6.1 Principles

6.1.1 The aim of the investment strategy for the LVFS Fund is generally to optimise the return to with-profits members in the Fund while preserving a level of risk to the return which is consistent with our assessment of with-profits policyholders' expectations and the ability of LVFS to meet its commitments to its members. Alternative or additional aims for the investment strategy may be applied where these aims have been explicitly communicated to policyholders. In determining the mix of assets between different asset classes, the investment strategy will take account of the long-term expected returns available in the asset classes, their volatility and the benefits to be obtained from diversification, the current and projected financial strength of the LVFS Fund and its ability to meet its regulatory capital requirements and the nature of its liabilities.

6.1.2 LVFS does not rely on any assets outside the LVFS Fund in setting the Fund's investment strategy.

6.1.3 The LVFS Fund uses derivatives and other instruments for the purpose of efficient portfolio management or to hedge specific liabilities and not for speculation.

6.1.4 Some constraints on the investment strategy may be applied to match guarantees under certain policy types.

6.1.5 The exposure to single counterparties is limited to manage the degree to which a counterparty default would affect the investment return on the LVFS Fund.

6.1.6 LVFS holds subsidiary companies as assets in the LVFS Fund. Where material, the Board reviews these assets at least annually to ensure they remain appropriate.

6.1.7 The LVFS Fund provides a capital support facility to the RNPFN Fund.

6.2 Practices

6.2.1 The Board has overall responsibility for the investment strategy and risk management of the LVFS Fund taking advice from the With-Profits Actuary, the With-Profits Committee, the Life Chief Actuary and LVFS's management. The Board delegates approval of changes in investment strategy to its Investment Committee.

6.2.2 LVFS currently formally reviews the long-term investment strategy for each of the Asset Pools used for Asset Shares in the LVFS Fund at approximately annual intervals. The strategy may be reviewed more frequently e.g. if the external economic environment changes. The investment outlook, investment mix and performance are monitored periodically between formal reviews. The strategy allows the asset manager to make tactical asset decisions within agreed limits. Approval by the Investment Committee of the Board is required before tactical investment decisions outside the previously agreed long-term investment strategy can be implemented. For **third generation unitised with-profits policies**, Asset Shares are not used to guide policyholder payouts and references in the practices in this section to Asset Shares or Asset Pools should be interpreted as relating to the investment fund options available under these policies.

6.2.3 In determining the mix of assets for an Asset Pool, the investment strategy will take account of the description of the Asset Pool supplied to policyholders, our assessment of with-profits policyholders' expectations regarding a level of risk to the return, developments in investment practice and the requirements of specific product features as appropriate, as well as the principles set out in Section 6.1. The Board reserves the right to change the mix of assets on all Asset Pools in response to significant movements in market prices.

6.2.4 Details of the current long-term benchmark and actual investment mixes of the separate Asset Pools are available on the LVFS website at **LV.com** or can be obtained directly from LVFS.

6.2.5 Investments in non-UK assets may be currency-hedged if this is felt appropriate to reduce the level of risk.

6.2.6 The assets actually held for certain with-profits policies in the LVFS Fund can differ from those assumed to be held in the Asset Pool used to determine the investment return applied to their Asset Shares. Any profits or losses resulting from this are credited to or borne by the inherited estate of the LVFS Fund. The policy types where this is done are:

- **Conventional with-profits pension policies**, due to the strength of their guarantees in conjunction with the reassurance of the majority of the benefits;
- **With Profits Income Bonds**, due to the small size of the total Asset Shares for this product; and
- **All-In-1 Investment Bonds** and **Guaranteed Capital Bonds**, due to the small size of the total Asset Shares for these products.

6.2.7 Fewer assets are currently held than those underlying the Asset Pools so as to help hedge the LVFS Fund's asset based market exposures relating to charges, guarantees and smoothing. Any profits or losses resulting from this are credited to or borne by the inherited estate of the LVFS Fund.

6.2.8 LVFS seeks to maintain a reasonable level of liquidity in the LVFS Fund in either cash or short term credit to meet policy payouts as they arise. Cashflow projections are carried out to help ensure this.

6.2.9 The investment strategy for the inherited estate of the LVFS Fund takes into account the expectations of with-profits policyholders in relation to the future distributions of Mutual Bonus and Exit Bonus and the role of the inherited estate in supporting the risks falling on it, and their capital requirements. The portion of the inherited estate of the LVFS Fund used to support these distributions (which derives from proceeds from the sale of LVFS's general insurance business) has a similar asset mix to the Asset Pools supporting Asset Shares. This may be changed in future if considered appropriate in the interests of the policyholders in the Fund or to take account of the current or projected financial strength of the Fund.

6.2.10 Assets held in respect of guaranteed liabilities and non-profit liabilities in the LVFS Fund are invested appropriately with consideration for the duration of the liabilities and the overall risk appetite of the LVFS Fund.

6.2.11 Before investing in new types of investments, LVFS seeks formal approval from the Investment Committee. The Investment Committee will consider any proposals, and the associated risks, in the context of the overall investment strategy that has been adopted and the capability of LVFS to manage such investments. The Investment Committee will consider advice from LVFS's management, the Board's Risk Committee, the With-Profits Committee, the With-Profits Actuary and the Life Chief Actuary in making its decision.

6.2.12 At approximately annual intervals the Board reviews any material subsidiaries to confirm that they are unlikely to have any adverse effect on the interests of the with-profits policyholders in the Fund and are made in the best interests of all LVFS's policyholders.

6.2.13 The Asset Pools used to support Asset Shares for **with-profits policies excluding second generation unitised with-profits policies** currently include illiquid investments in private equity and direct property.

7. The exposure of the with-profits business to business risk

7.1 Principles

7.1.1 The profits or losses from all business risks within the LVFS Fund are credited to or borne by the LVFS Fund inherited estate and may, if the Board determines to allocate such profits or losses, influence the amount payable under a with-profits policy.

7.1.2 LVFS may only undertake significant additional business risk in the LVFS Fund after approval by the Board. The Board will only approve the taking on of such risks provided the expected benefits are no worse than the expected benefits available from alternative investment opportunities taking into account the results projected on a range of scenarios and its current and projected financial strength, and provided that the additional business risk will not have a material adverse impact on the policyholders in the Fund.

7.1.3 The control over existing business risk is monitored at least annually by the Board and takes account of the current and projected financial strength of the LVFS Fund and any expected benefit from that risk exposure.

7.2 Practices

7.2.1 The current restrictions that LVFS applies in relation to business risk from acquiring and maintaining non-profit and with-profits policies in the LVFS Fund are those set out in section 10. LVFS does not currently set fixed limits on the amount of the Fund that may be invested in any subsidiary companies. Instead it applies the principles set out in section 7.1 of this document.

7.2.2 The key other business risks of the LVFS Fund arise from variations in the following:

- funding costs arising from shortfalls in the LVFS Staff Pension Scheme and the Ockham Pension Scheme, which in turn will be dependent on the actual and expected longevity of members of the schemes, as well as the actual and expected returns on the assets held by the schemes;
- demographic experience and assumptions, including in particular the proportions taking up cash or guaranteed annuity benefit options under **conventional with-profits pensions policies**;
- experience and assumptions regarding the proportion of policies in-force that are not expected to claim where we have lost contact with the policyholder;
- compensation to policyholders and associated costs resulting from mis-selling and maladministration;
- the value of the investments of the inherited estate of the LVFS Fund;
- exceptional costs charged to the LVFS Fund and differences between the expenses charged to the LVFS Fund and the expense charges made to Asset Shares;
- costs related to guarantees and options attaching to policies;
- costs resulting from the smoothing of policy payouts and bonuses;
- the cost of meeting the obligations under any subordinated debt allocated to the LVFS Fund; and
- the performance of subsidiaries held as assets of the LVFS Fund.

In addition, business risks include risks deriving from the RNPFN Fund and the Teachers Assurance Fund as follows:

- the risk that the RNPFN Fund and the Teachers Assurance Fund cannot meet their liabilities (after appropriate management actions were taken within those funds with a view to avoiding such a result). In connection with this, the LVFS Fund provides a capital support facility to the RNPFN Fund that would be called on if the RNPFN Fund failed to comply with its Solvency Capital Requirement. The maximum amount of capital support varies in line with the value of the assets attributable to the with-profits business in the RNPFN Fund subject to a cap of £100 million. The capital support would, however, be repaid to the LVFS Fund, together with the investment return thereon, unless the RNPFN Fund cannot meet its liabilities. Further details of the terms of the facility (including the charge levied on the RNPFN Fund for it) are given in the PPFM for the RNPFN Fund;
- the risk that any increase in the expenses of LVFS in relation to the business of the RNPFN Fund and the Teachers Assurance Fund cannot be charged in full to these Funds given the requirements of the RNPFN Scheme of Transfer and the Teachers Instrument of Transfer;
- the risk that the LVFS Fund will have to rebate part of the investment costs incurred in respect of the Teachers Assurance Fund in the circumstances detailed in the PPFM of the Teachers Assurance Fund;
- the risk that compensation to policyholders and associated costs resulting from mis-selling and maladministration in respect of the RNPFN Fund and/or Teachers Assurance Fund cannot be charged to those Funds given the requirements of the RNPFN Scheme of Transfer and the Teachers Instrument of Transfer; and
- risks arising from the merger with the LVFS Fund of either of the RNPFN Fund or the Teachers Assurance Fund.

The expected future outcome of these factors, where relevant, is reflected in the assessment of the size of inherited estate of the LVFS Fund.

7.2.3 From calendar year 2011, profits from business risks in the LVFS Fund have been allocated as Miscellaneous Surplus to members with eligible policies at the discretion of the Board through the declaration of Mutual Bonus, the level being reviewed annually. Once declared, Mutual Bonus is added to the Asset Share (or to the units of **third generation unitised with-profits policies**) of with-profits policies in the LVFS Fund held by such members in accordance with paragraph 2.2.2 and so becomes part of policy benefits. The Board has exercised its discretion and includes eligible with-profits policies owned by non-members in the declaration of Mutual Bonus as it believes this is a fair outcome.

For **second and third generation unitised with-profits policies** and **Pension Income Plus Annuity** policies Mutual Bonus is added explicitly to relevant policy payouts. For **accumulating with-profits Flexible Whole Life policies** it is added as an increase to the accumulation account. For all other **with-profits policies** it is added by increasing any final bonus or top-up bonus (or reducing any Market Value Reduction) that otherwise would be paid, except for transfer and surrender benefits on **conventional with-profits pension policies** where it is included in the Asset Share calculated in accordance with paragraph 2.2.18.

From calendar year 2020, in deciding what rate of Mutual Bonus to declare the LVFS Board will take into account:

For **Flexible Guarantee Bond Series 3** and **Flexible Guarantee Funds Series 2** policies and **third generation unitised with-profits policies**:

- the financial performance of the business conducted in LVFS and its subsidiaries;
- past communications to policyholders; and;
- the LVFS Fund's current and projected financial strength.

For **all other with-profits policies**:

- the portion of the proceeds from the sale of LVFS's general insurance business used to support the paying of future Mutual Bonus that has not yet been allocated, allowing for investment returns on that portion;
- the comparative levels of Mutual Bonus declared for different groups of policies in the past;
- changes in policy Asset Shares since the last declaration;
- the number of in-force policies eligible to receive Mutual Bonus; and
- the LVFS Fund's current and projected financial strength.

As a result, the rate of Mutual Bonus declared may be varied in future, including being set to zero, if the Board considers it appropriate at the time.

For **Flexible Guarantee Bond Series 3** and **Flexible Guarantee Funds Series 2** policies and **third generation unitised with-profits policies** no Mutual Bonus is declared until a policy has been in force for at least 12 months. For **third generation unitised with-profits policies** originally taken out on a non-profit basis, no Mutual Bonus is declared until a policy has been in force for at least 12 months from the date the policy converted to with-profits.

Prior allocations of Mutual Bonus may be reduced or removed in the future (along with any investment return allocated to them) if the Board considers it appropriate, having taken account of the current and projected financial strength of the LVFS Fund at the time and the aim to treat all groups of its members fairly. Past allocations that have been removed may subsequently be reinstated if the Board considers it appropriate, though currently no past allocations have been removed.

7.2.4 From 2020, an Exit Bonus may be declared at the discretion of the Board for members with **with-profits policies in the LVFS Fund** (except **second generation Flexible Guarantee unitised with-profits policies** and **third generation unitised with-profits policies**) in respect of the distribution of part of the proceeds from the sale of LVFS's general insurance business. The Board has exercised its discretion and includes eligible with-profits policies owned by non-members in the declaration of Exit Bonus as it believes this is a fair outcome. The initial declaration of Exit Bonus in 2020 was backdated to apply to claims from 28 November 2017. Exit Bonus uplifts the Asset Share and any death benefits dependent on the Asset Share (allowing for any smoothing in accordance with section 5) at the time of any relevant claim calculation (including partial payments and pension income) by the most recently approved rate and, in doing so becomes part of policy benefits at the time it is paid out. It is not added to monetary guaranteed benefits, or the guaranteed annuity benefits underpin for surrender values of **conventional with-profits pension policies** detailed in paragraph 2.2.18. Hence, Exit Bonus increases any final bonus or top-up bonus, or reduces any market value reduction, that would otherwise be paid.

In deciding what rate of Exit Bonus to declare, the LVFS Board will take into account:

- the portion of the proceeds from the sale of the LVFS's general insurance business used to support the paying of Exit Bonus that has not yet paid out, allowing for investment returns on that portion;
- changes in policy Asset Shares since the last declaration;
- the number of in-force policies eligible to receive Exit Bonus; and
- the LVFS Fund's current and projected financial strength.

As a result, the rate of Exit Bonus applied may be varied in future, including being set to zero, if the Board considers it appropriate at the time. It is currently expected that a reduction in the rate of Exit Bonus would be implemented ahead of Mutual Bonus being reduced. The level of Exit Bonus is reviewed at least annually.

7.2.5 The LVFS Fund would only charge losses from business risks against Asset Shares in exceptional circumstances, and only once future Mutual Bonus and Exit Bonus have been reduced to zero and prior allocations of Mutual Bonus had been removed. However, losses from one source may be offset against profits from another.

8. The application of charges for expenses to with-profits policies

8.1 Principles

8.1.1 The charges applied to **all unitised with-profits policies, accumulating with-profits policies** and **with-profits annuity policies** in the LVFS Fund will be the charges set out in the policy conditions, Key Features or similar document. This includes a fund-based charge applied to **accumulating with-profits Appropriate Personal Pension policies**.

8.1.2 For **conventional with-profits life and pension policies** in the LVFS Fund, the aim of LVFS's approach to apportioning expenses and applying charges is to reasonably reflect the underlying experience of the LVFS Fund. In applying such charges and expenses different groups of policies and generations of members will be considered together and therefore cross-subsidies between individual policyholders will occur.

8.1.3 The basis on which LVFS apportions its actual expenses or applies charges may be changed, where permitted under the terms of a policy, in the light of new information and changes in economic conditions.

8.2 Practices

8.2.1 Where the level of a charge is not guaranteed, it may be varied by LVFS, subject to the requirement to treat its policyholders fairly.

8.2.2 The charges applied to the Asset Shares of **first and second generation unitised with-profits policies, accumulating with-profits policies** and **with-profits annuity policies** (or to the units of **third generation unitised with-profits policies**) in the LVFS Fund are the charges set out in the policy conditions, Key Features or similar document, as appropriate (including any changes to the charges made in accordance with these documents). Since 1 May 2017 a fund-based charge is applied to **accumulating with-profits Appropriate Personal Pension policies**, equal to the actual investment costs (including any asset allocation fees or any performance fee paid to the asset manager) allowing for Value Added Tax and other taxes.

8.2.3 The charges in respect of expenses applied to the Asset Shares of **conventional with-profits life and pension policies** are as follows:

- the relevant charges for maintenance expenses in accordance with paragraph 8.2.4, adjusted for tax relief at the appropriate rate where applicable; and
- investment management fees (allowing for any Value Added Tax) at the rates applicable to the relevant Asset Pool together with other on-going investment related expenses, adjusted for tax relief at the appropriate rate where applicable.

8.2.4 Other than investment management fees, the total expenses incurred by LVFS and its subsidiaries are apportioned into a number of different categories (e.g. acquisition expenses, maintenance expenses and project costs) for groupings of similar products. Per policy maintenance expenses for each product grouping are then calculated using the number of policies in force. The calculated per-policy maintenance expenses are then applied as charges to Asset Shares for the policy types detailed in paragraph 8.2.3 except:

- From 1 April 2018 the expenses incurred for all **conventional with-profits pension policies** are totalled and then converted to an equivalent fund-based charge applied to the Asset Share of individual policies.
- In the Asset Share calculations used for payouts for all **Industrial Branch conventional whole-of-life policies** from 1 August 2022, the expenses incurred from 1 January 2022 are totalled and converted to equivalent fund-based charges, applied to the Asset Shares of granular taxable and tax-exempt sample policies described in paragraph 2.2.5, with the charge for tax-exempt policies being higher than that for taxable policies (in recognition of difference in average sizes of the policies).

8.2.5 LVFS obtains a range of out-sourced services from independent suppliers. The more material contracts are either for fixed terms and contain provisions enabling LVFS to terminate the contract and implement an agreed exit plan where there has been a breach of specified conditions in the contracts or are for no fixed term where the services can be ceased with immediate effect.

8.2.6 LVFS currently outsources the investment management of the majority of the assets in the LVFS Fund to Columbia Threadneedle Investments under an arrangement which has an end date of 2023, though it can be terminated earlier, subject to 12 months' notice. Certain specialised assets are currently outsourced to other third parties. The performance of the asset managers is reviewed on a regular basis against agreed performance benchmarks. LVFS is able to terminate all or parts of the arrangements without compensation with immediate effect if the manager persistently fails to meet agreed criteria.

8.2.7 As a mutual, LVFS has no shareholders. No judgement is therefore required in applying charges and apportioning expenses between LVFS and shareholder-owned funds, firms or service companies. Judgement is required in apportioning expenses between the different categories and between different types of policy in LVFS including those in the RNPFN Fund and the Teachers Assurance Fund.

8.2.8 The inherited estate of the LVFS Fund is credited with or bears:

- **For the RNPFN Fund:** The difference between the expenses incurred in respect of the Fund and the expenses charged to the Fund under the RNPFN Scheme of Transfer;
- **For the Teachers Assurance Fund:** The difference between the expenses incurred in respect of the Fund and the expenses charged to the Fund under the Teachers Instrument of Transfer;
- **For acquisition expenses, maintenance expenses and investment-related expenses in respect of with-profits policies in the LVFS Fund:** The difference between the expenses incurred and the charges deducted from the asset shares (or from the units of **third generation unitised with-profits policies**) of those policies in respect of those expenses;
- **For acquisition expenses, maintenance expenses and investment-related expenses in respect of non-profit policies in the LVFS Fund:** The difference between the expenses incurred and the charges (if any) deducted from those policies under their policy conditions; and
- All other expenses incurred by the LVFS Fund.

9. The management of the inherited estate

9.1 Principles

9.1.1 The inherited estate means the excess of the value of the assets of the LVFS Fund over a realistic assessment of the liabilities. The Board manages the Fund's inherited estate through regular monitoring of its size and its ability to fulfil its role as described below whilst preserving the ability of LVFS to meet its commitments to its members.

9.1.2 The role of the inherited estate is to provide capital to meet regulatory reserving requirements in excess of a realistic assessment of the liabilities of the LVFS Fund, and to support the risks and associated capital requirements of the business in the Fund.

9.1.3 In fulfilling this role, the capital provided by the inherited estate supports the LVFS Fund's ability to invest in assets delivering higher returns to policyholders while maintaining guaranteed benefits, the smoothing of benefits paid to policyholders and the Fund's ability to write new business.

9.1.4 LVFS monitors the ratio of the regulatory capital resources of the LVFS Fund (including its inherited estate) to the level of regulatory capital it is required to hold against a range agreed by the Board.

9.1.5 There is no formal division of the inherited estate between any classes of business within the Fund. However, the Board has chosen to differentiate among different groups of with-profits policyholders in future distributions of Mutual Bonus and Exit Bonus fairly over time.

9.1.6 Other than in future distributions of Mutual Bonus and Exit Bonus, there are currently no constraints on the Board's freedom to deal with the inherited estate of the LVFS Fund or any obligation on the Board to distribute the inherited estate to the current generation of members.

9.2 Practices

9.2.1 Other than the monitoring described in paragraph 9.1.4, LVFS does not have any current guidelines in place as to the size or scale of the inherited estate or as to how the firm would manage the inherited estate and over what time period if it became too large or too small.

9.2.2 At least once a year the Board determines (after receiving advice from the Life Chief Actuary) whether there is a surplus within the LVFS Fund which exceeds the reasonable capital requirements of the Fund. These capital requirements are determined as the higher of the regulatory capital which LVFS is required to hold and any capital provision at LVFS Fund's risk appetite, with the addition in each case of any additional surplus required to support new business. If such an excess surplus exists, the Board must determine whether it is fair to retain that excess surplus as part of the inherited estate and, if not, to make a distribution from that surplus.

9.2.3 With-profits policyholders in the LVFS Fund are not eligible for any distributions from the inherited estates of either the RNPFN Fund or the Teachers Assurance Fund. With-profits policyholders in the RNPFN Fund or the Teachers Assurance Fund are not eligible for any distributions from the inherited estate of the LVFS Fund.

10. Volumes of new business and arrangements on stopping taking new business

10.1 Principles

10.1.1 New business will only be accepted into the LVFS Fund if, in the opinion of the Board, 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 the Fund nor threaten the ability of LVFS to meet its commitments to its members. The volume of new business deemed acceptable will allow for the characteristics of the business written, including whether it is with-profits and/or non-profit business.

10.1.2 In the event of the LVFS Fund permanently ceasing to take on new business of any significant amount and not carrying out any other business activity, the Board would seek to distribute the inherited estate of the Fund in an equitable manner over the remaining lifetime of the with-profits policies in the Fund. If such an event occurred, all of the Practices and some of the Principles, including the approach taken to investment strategy and smoothing, may be changed.

10.2 Practices

10.2.1 The Board monitors at least annually the current and projected financial strength of the LVFS Fund and uses this to determine the volume of new business and any particular limits on classes of business, including non-profit business, accepted into the Fund.

10.2.2 LVFS does not currently set a minimum proportion or scale of new business of a with-profits type to justify the Fund staying open to new business.

11. Equity between the LVFS Fund and any shareholders

11.1 Principles

11.1.1 LVFS is a mutual with no shareholders and therefore all distributed profit in the LVFS Fund is available for all its members in accordance with its Articles of Association.

11.2 Practices

11.2.1 The LVFS Fund is managed by reference to the Principles in section 11.1. There are no Practices in addition to these Principles.

12. Schedule of disclaimers

None of the contents of this document forms part of, or varies, the terms or conditions of any policy under which Liverpool Victoria Financial Services Limited is the insurer. In the event of any inconsistency between the contents of this document and any policy, the terms and conditions of the policy prevail.

This document is intended to assist knowledgeable with-profits members and other interested parties to understand the way in which the with-profits business in the LVFS Fund is conducted and the material risks and rewards involved in effecting or maintaining a with-profits policy in the LVFS Fund. It is not a comprehensive explanation either of the management of the with-profits business of the LVFS Fund or of every matter which may affect that business. In addition, no part of the document should be read as a recommendation to policyholders or potential policyholders or their advisers in relation to the effecting or maintaining of a with-profits policy.

Statements in this document in relation to the risks and rewards involved in effecting and maintaining a with-profits policy in the LVFS Fund are by their nature forward-looking statements that are subject to a variety of uncertainties. Readers of this document should read such forward-looking statements in that context.

The contents of this document may change as the circumstances of LVFS and the business environment changes. The document may also change to reflect changes made by LVFS to the management of the with-profits business, as detailed in Section 1.

Readers of this document should read the whole document. Reading only selected sections or paragraphs in isolation may result in a misleading impression of the way in which the with-profits business of the LVFS Fund is conducted and the material risks and rewards involved in effecting and maintaining a with-profits policy in the LVFS Fund. The Principles and their associated Practices set out in this document should in particular be read together.

UK life insurance businesses are subject to a number of inherent risks that arise from a range of factors. For the LVFS Fund the key risks are described in Section 7. There can be no assurance that all risks that might emerge have been identified. In addition, the risks to which the with-profits businesses are exposed can change over time.

Although Asset Shares are used as a broad guide for payouts on with-profits policies, policyholders have no entitlement to receive the Asset Shares on their policies. Asset Shares can also decrease as well as increase and, at any time, an Asset Share may be greater or less than the contractual guaranteed benefits due under the policy. Asset Shares are defined in detail in Section 2.2.

Appendix 1 Glossary

The "Board"

The Board of Directors of Liverpool Victoria Financial Services Limited.

Accumulating With-Profits Policy

These are a type of with-profits policy which have an 'accumulation account' which is a fund that increases as premiums are paid and regular bonuses are added, and decreases as any charges are taken. The accumulation account for **Appropriate Personal Pension policies** may be increased with a final bonus when it is paid out. The accumulation account for **Flexible Whole Life policies** may be reduced by a Market Value Reduction when it is paid out.

Annual Bonus

An annual distribution of surplus which is guaranteed at the maturity date of the policy (or at a specified encashment date) and/or on death provided certain conditions are met. It is also known as **regular bonus**, **reversionary bonus** or **declared bonus**.

For **conventional with-profits life and pension policies** the rate of annual bonus declared is multiplied by the original guaranteed benefits (or the reduced original guaranteed benefits if premiums have ceased early) and the result is then added to the current guaranteed benefits.

For **accumulating with-profits life policies** the rate of annual bonus declared gradually increases the value of the accumulation account over the year.

For **first generation unitised with-profits policies** the rate of annual bonus declared gradually increases the unit price over the year.

For **With Profits Pension Annuity** policies the rate of annual bonus declared increases the current basic annuity.

Asset Share

The accumulation, at investment rates of return, of premiums paid less charges for expenses incurred, taxation, the cost of benefits provided and any charges for the cost of guarantees or the use of capital. Discretionary additions for Miscellaneous Surplus (including Mutual Bonus) may also be included.

Asset Pool

The assets underlying Asset Shares. For certain with-profits policies the assets held can differ from those assumed to be held in the Asset Pool used to determine the investment return applied to their Asset Shares.

Conventional With-Profits Policy

An older-style with-profits policy which guarantees a minimum level of benefits on death or maturity as long as premiums are maintained. The guarantee can be reduced if premiums cease early or the policy is cashed in.

Declared Investment Return

The rate used to recalculate the income paid on a **Pension Income Plus Annuity** policy at a policy anniversary.

Exit Bonus

For eligible with-profits policies, Exit Bonus, at the most recently approved rate, uplifts the Asset Share at the time of any relevant claim (including partial payments and pension income). Paragraph 7.2.4 provides further details.

Final Bonus

An addition made to the guaranteed benefits of a **conventional with-profits life or pension policy** (or the unit value of a **first generation unitised with-profits policy**, or the accumulation account of an **accumulating with-profits Appropriate Personal Pension policy**) to achieve a fair level of payout when a claim arises. It is not guaranteed and may change at any time. It is also known as **Terminal Bonus**.

Inherited Estate

The inherited estate means the excess of the value of the assets of the LVFS Fund over a realistic assessment of the liabilities.

Interim Bonus

A bonus that may be added on the encashment of a conventional with-profits policy to allow for part or all of an annual bonus that has been earned by the policy but not yet added to it. The rate declared is multiplied by the original guaranteed benefits (or the reduced original guaranteed benefits if premiums have ceased early) and the result is then added to the current guaranteed benefits.

LVFS

Liverpool Victoria Financial Services Limited, the company formed upon the conversion of Liverpool Victoria Friendly Society Limited into a company limited by guarantee.

LVFS Fund

LVFS's main fund which holds LVFS's business that sits outside the RNPFN Fund and the Teachers Assurance Fund.

Life Chief Actuary

The Life Chief Actuary is a regulatory role with the responsibility for advising the Board in relation to LVFS's ability to meet the liabilities to policyholders for its life business.

Market Value Reduction (MVR)

A reduction to the unit value of a **first generation unitised with-profits policy** (or to the accumulation account for an **accumulating with-profits Flexible Whole Life policy**) that may be made if the policyholder takes money out of the LVFS Fund. It is used to achieve a fair level of payouts and to be fair to the remaining with-profits policyholders in the Fund. There may be MVR-free events for the policy such as specific points during its term, when an MVR is guaranteed not to be applied. The policy conditions will specify when these arise.

Miscellaneous Surplus

A discretionary addition to Asset Share (or to units of **third generation unitised with-profits policies**) made by LVFS to an eligible policy, such as profits arising from LVFS business risks which are distributed from 2011 by way of Mutual Bonus.

Mutual Bonus

A discretionary addition to Asset Share (or to units of **third generation unitised with-profits policies**) made by LVFS from 2011 to allocate profits from business risks to eligible with-profits policies. It is not guaranteed and past allocations can be reduced or removed. Paragraph 7.2.3 provides further details.

Non-profit policy

A life or pensions policy with fixed benefits, or benefits that change in a fixed manner with no contractual bonuses applied, or a unit-linked policy where the value of the benefits is measured by reference to a number of units allocated to the policy at the date of calculation with no contractual bonuses applied.

Policyholder

The owner of any policy insured by Liverpool Victoria Financial Services Limited. These include the with-profits policies covered by this document, and other with-profits and non-profit policies insured by LVFS. For the purposes of this document, it does not refer to an owner of a policy insured by any subsidiary of LVFS.

Solvency Capital Requirement

This is the amount of capital required to be held by insurance companies under Solvency II regulation as a buffer against adverse experience.

Subordinated Debt

A type of capital raised by LVFS from external investors.

Top-up Bonus

An addition made to the basic annuity payable under **With Profits Pension Annuity** policies. It is not guaranteed and may change at any time.

Unitised With-Profits Policy

A type of with-profits policy where the value of the benefits is measured by reference to a number of units allocated to the policy at the date of calculation. For first generation unitised with-profits policies this value may be increased by the addition of a final bonus, or reduced by the application of a Market Value Reduction when a claim arises.

With-Profits Actuary

The With-Profits Actuary is a regulatory role with responsibility for advising management and the Board in relation to its exercise of discretion as it affects with-profits policyholders.

With-Profits Committee

A committee that provides independent advice to the Board on the fair treatment of with-profits policyholders. Further details are in paragraph 1.6.

Appendix 2 Policies covered by this document

This Appendix provides a list of all the types of with-profits policy covered by this document. All policies were originally written by LVFS, except for historic Industrial Branch business acquired from other Friendly Societies within the product types indicated by an asterisk.

Conventional with-profits life policies

Generic policy types are used for this category as there are a large number of product names and rate series.

Industrial Branch:

- Tax-exempt whole-of-life *
- Tax-exempt whole-of-life with regular cash payments *
- Taxable whole-of-life
- Taxable whole-of-life with regular cash payments
- Tax-exempt endowment
- Taxable endowment

Ordinary Branch:

- Tax-exempt whole-of-life
- Taxable whole-of-life
- Tax-exempt endowment
- Taxable endowment
- Low cost endowment

Conventional with-profits pension policies (deferred and in-payment annuities)

- Retirement Account Contract aka Ordinary Branch Pension-Annuity
- Personal Pension Policy (two rate series)
- Free-Standing Additional Voluntary Contribution Policy (two rate series)

First generation unitised with-profits policies

Bonds:

- Flexible Investment Bond
- Mutual Investment Bond (two versions)
- With Profits Investment Bond (two versions)
- With Profits Growth Bond (two versions)
- With Profits Income Bond
- Bank of Ireland/Liverpool Victoria Group With Profits Bond

Other policy types:

- Tax Free Savings Plan
- Regular Savings Plan
- Mortgage Savings Plan (two versions)
- Flexible Savings Plan (two versions)
- MAX
- Family and Legacy Fund
- With Profits Life ISA
- Top-Up Company Pension Plan
- Flexible Personal Pension Plan
- With Profits Retirement Plan

Second generation unitised with-profits policies

- All-In-1 Investment Bond
- Guaranteed Capital Bond
- Flexible Guarantee Bond (series 1-3)
- Flexi Guarantee Plan
- Flexible Guarantee Funds aka Flexible Guarantee Trustee Investment Plan (series 1-2)

Third generation unitised with-profits policies

- Smoothed Managed Funds Bond Series 1 (including bonds originally sold on a non-profit basis and subsequently converted to with-profits)
- LV= ISA (including plans originally sold on a non-profit basis and subsequently converted to with-profits)

Accumulating with-profits policies

- Appropriate Personal Pension policy
- Flexible Whole Life policy aka Flexible Whole Life Assurance policy

With-profits annuity policies

- With Profits Pension Annuity (series 1-4)
- Pension Income Plus Annuity

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

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