Conventional with-profits

Your guide to how we manage our with-profits fund

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1 Introduction

This guide explains how we look after our with-profits fund. You'll find important information about how our life insurance, savings, investment and pension policies work – and how we manage them. At the end of this guide there is a helpful glossary of some of the financial and insurance terms we've used.

If you took out a conventional with-profits policy with us before 1997, you're invested in this fund and this guide applies to you. Also, if you have a With Profits Pension Annuity policy, this guide applies to you.

To put this guide into context, it might help to read it with your:

- Key Features (if available when your policy was sold)
- Policy Conditions
- Personal Illustration showing what you might get back in the future (if available when your policy was sold).

Please keep this guide safe along with your other policy documents.

2 What's our with-profits fund?

This is an investment fund where we combine your money with other investors' money, and manage it on your behalf. Different with-profits policies invest in different mixes of assets within Liverpool Victoria Friendly Society Limited (LVFS). Your policy is invested in the mix of assets that most of our legacy with-profits policies are invested in (which is referred to in this document as 'our with-profits fund', or 'the fund'). There are also other types of policies in LVFS, together with the inherited estate (see section 11).

We set the overall investment strategy of our with-profits fund, taking into account the current and projected financial strength of the fund and the expected returns available from different types of investment.

The asset management of our with-profits fund is currently undertaken on our behalf by Columbia Threadneedle Investments. They are responsible for the day-to-day management of the assets in our with-profits fund, operating in accordance with our investment strategy.

The investment performance of the fund and the outlook for different types of asset are regularly monitored. We also review our investment strategy in detail at least every three years, with less detailed reviews typically being performed annually.

Typical investments made by the fund include:

- the shares (also known as equities) of UK and overseas companies
- fixed-interest securities such as government bonds and corporate bonds
- property
- cash.

The proportions held in each type of asset can vary over time, for example the proportion held in shares can be reduced as a result of market conditions.

You can see the current and target mix of investments in our with-profits fund on our website at LV.com/asset-allocation. Here you can also see investment reports showing the performance of the fund. Alternatively you can also get this information by contacting our Head Office at: LV=, County Gates, Bournemouth BH1 2NF.

3 What's the aim of our with-profits fund?

First and foremost, we want to give you a fair return on your investment, allowing for any guaranteed benefits. We have different groups of with-profits policyholders – with different policies started at different times, and with different terms. We always try to treat our policyholders fairly where there are any conflicting interests between them.

4 What's a conventional with-profits policy?

A conventional with-profits policy simply means that we give you a guaranteed minimum investment return, as long as you pay the premiums you agreed when your policy started.

For whole-of-life policies you'll receive a guaranteed minimum lump sum on the death of the life assured under the policy. For savings policies you'll receive a guaranteed minimum lump sum at the end of the agreed savings period, for example 25 years, or on the earlier death of the life assured under the policy. For pension policies you'll receive a guaranteed minimum pension income at your chosen retirement date, for example when you reach age 65. For With Profits Pension Annuity policies, the amount you receive each year will be subject to a guaranteed minimum level.

However, it's important to understand that if you stop paying into your policy, or decide to cash it in, we may reduce the guaranteed minimum lump sum or income.

The guarantees that conventional with-profits policies have can be valuable, as they're generally more difficult to come by in other policies currently available.

5 How do we cushion you from the ups and downs of the stock market?

As explained earlier, the fund invests in a number of different types of asset, including in the shares of UK and overseas companies, commercial property and fixed-interest investments. Shares are often called equities and are bought and sold on stock markets throughout the world.

We believe it's important for us to invest in shares, as over the long term they tend to give a higher return than other safer investments, like government bonds and cash. We want to give you the potential for better returns in the long run, so we invest in the shares of UK and overseas companies and commercial property.

The downside to shares is that they can be more volatile than other investments. Their values can rise and drop sharply, sometimes quickly and in line with world events. We aim to smooth out the effects of some of the rises and drops in two ways.

- We invest in many different types of investment and limit the amount in any one type.
- Instead of just awarding large bonuses in good years and none at all in bad years, we hold back some of the profit in good years to award to our with-profits policies when times are tough. This is what we mean by a 'smoothed' return.

As an example, if your policy ends on a day when the market fell drastically, the smoothing would help protect you from the sudden drop in value. If the opposite happens and the market rises sharply, the smoothing effect would mean that you wouldn't get the full amount of the rise. So investors in a fund that doesn't smooth returns might see their investments rise and fall more quickly than that of a fund with smoothed returns.

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.

6 How do we decide the return on your policy?

We want to make sure that every investor receives a fair return. To increase the value of your policy, we add regular bonuses from time to time and possibly a final bonus when you cash your policy in. You can find out more about these bonuses in the next section.

To calculate your overall return we take into account:

- the payments you've made
- our expenses
- tax and
- the investment returns from the fund.

As we've said in section 5 we try to smooth out the ups and downs of the stock market, and this also affects your return. We may also add discretionary amounts not generated by the policy itself, such as profits arising from business risks. From 2011 these are distributed as mutual bonus (see section 12).

Once your policy reaches the end of its term, we aim to pay out between 80% and 120% of the underlying value of the investments. Our long term aim is to pay out on average 100% of the underlying value of the investments.

7 What bonuses do we pay?

We might add a regular bonus to your policy each year and a final bonus at the end. For With Profits Pension Annuity policies, we may add a top up bonus to the income you receive, in place of a final bonus.

Regular bonuses

We aim to add a regular bonus to your policy each year. When setting regular bonus rates, we take into account the relationship between your policy's guaranteed benefits and the value of the investments underlying them, our current and projected financial strength and past policyholder communications. We also consider current gilt yields for With Profits Pension Annuity policies and expected future investment returns for other types of policy.

Once we've added a regular bonus we won't take it away, provided you continue to pay any regular premiums due under your policy. We review the size of the regular bonuses we add at least once each year.

We limit the growth in your policy's guaranteed benefits. This allows us to be more flexible with how we invest your policy. For example we can invest more in areas that offer the best potential returns such as shares.

Final bonuses

We want to make sure that you receive a fair return on your policy. If the annual bonuses you've had during your policy term are less than a fair return, we'll add a final bonus to increase your payout. We review final bonuses at least once a year and may do so up to four times a year. We don't add final bonuses to With Profits Pension Annuity policies, but may add a top up bonus from time to time, which we explain later on in this section.

For conventional with-profits policies rather than work out the value of each individual policy, we decide what level of final bonuses to pay by grouping similar policies together or by using representative policies. The level is then decided by comparing the guaranteed benefits for these policies with the value of the investments underlying them. We also consider smoothing and the current and projected financial strength of LVFS. For some policies, we may apply different methods to provide a fair payout, for example using final bonus rates calculated for one group of policies for another group.

Sometimes the final bonus can be a high proportion of the final value of your policy. This is because paying lower regular bonuses gives our fund managers more freedom to invest in areas that are likely to offer better returns in the long term.

Top up bonuses

For With Profits Pension Annuity policies we may add a top up bonus from time to time to ensure that you receive a fair return on your policy. This may temporarily increase the income we pay you. Top up bonuses are not a permanent increase to your income as we can withdraw or change them at any time, usually after 12 months. They reflect our investment performance, smoothing, and our own and industry mortality experience (which means we look at trends of when people die) and how we think they might change in the future.

8 How do we decide how much you get if you leave your policy early?

Conventional with-profits life policies

If you leave your policy early, this is called 'surrendering' your policy. We'll work out how much to pay you, being fair to both you and the policyholders staying in the fund. That means we may add a final bonus, as explained in section 7. However, we're also likely to reduce your guaranteed benefits.

We aim to pay out between 80% and 120% of the underlying value of the investments if you leave your policy early.

Conventional with-profits pension policies

Where lump sum benefits are paid rather than the guaranteed income available under your policy, we aim to pay out between 80% and 120% of the underlying value of the investments. Final bonuses are not used. This value will normally be subject to a minimum amount as follows:

- From age 55, this is the commuted value of your guaranteed yearly income. This also applies where retirement benefits are allowed before age 55 due to ill-health.
- For age 50-55, this is a blend of the commuted value of your guaranteed yearly income and the value of the underlying investments of your individual policy, taking account of smoothing. The blend provides a smooth transition from the value of the underlying investments at age 50 to the commuted value at age 55.
- There is no minimum amount payable before age 50, except for ill health retirements.

The commuted value is the total of your guaranteed yearly income payments from your selected retirement date, with each one discounted back to the date of payment of the lump sum benefit and allowing for the probability that you will be alive to receive them. To calculate this we use the interest rate and mortality assumptions used to calculate the premium for your policy when it was taken out, or an appropriate alternative. Your guaranteed yearly income is the guaranteed annuity plus regular bonuses added to date.

If you're not taking benefits at your current selected retirement date, the commuted value assumes that your retirement date is the date of payment (or at your 55th birthday if you're between age 50 and 55 and are not in ill-health), and the guaranteed yearly income used is recalculated to reflect that date.

The minimum amount referred to above may be removed in extreme circumstances (for example because of a low level of financial strength of LVFS) and the basis used to calculate the commuted value may also be changed.

9 What expenses are charged to our with-profits fund?

As with any investment, there are certain costs involved in setting up and looking after a with-profits policy – including commission payments (where relevant), administration costs and other expenses. The charges taken from your policy are taken to cover these expenses. You can find out more about them in your Key Features document and Policy Conditions.

10 How do we decide what business risks to take?

In offering a with-profits fund, we face potential risks such as whether we have the right product design, the right selling and marketing practices, and fluctuating interest rates and investment returns.

We'll sometimes take other business risks and consider business opportunities that can provide a source of profit. For example, LVFS has a strategic holding in a general insurance company, which forms part of the inherited estate.

We're always careful about our investments, and our Board of Directors has to approve and monitor anything that poses a significant business risk. They'll only approve these if the expected benefits are at least as good as we could get from other opportunities.

Given its importance our Board of Directors review, typically annually, the benefits and risks to our policyholders of our investment in the general insurance business and any other material strategic investments.

LVFS is providing a capital support facility to the RNPFN Fund (a ring-fenced fund within LVFS for policies transferred from the Royal National Pension Fund for Nurses). This means that if the assets of the RNPFN Fund were insufficient to meet its liabilities and regulatory capital requirements, LVFS would add assets from its own funds into the RNPFN Fund up to a defined level. If this were to happen, it would reduce LVFS's inherited estate.

11 What's 'the inherited estate' and how do we use it?

The inherited estate is the amount of money we've built up from profits in LVFS that are in excess of its liabilities. This money has been building up since we began in 1843, from generations of policies, including where we've made more profit than we anticipated. For example, if a protection policyholder lived longer than we'd expected and priced the policy for, we'd make more profit. The money is used to support the fund and its day-to-day operations.

We don't currently try to increase the size of the inherited estate on purpose. However, we aren't obliged to distribute the inherited estate to the current generation of members. We use the estate to benefit our policyholders in a number of ways, including:

- to help us give you smoothed returns
- to give us more freedom to invest in ways we believe will offer better returns
- to help fund new business opportunities or risks which we believe will be profitable.

Keeping a reasonable level of inherited estate gives us the financial strength we need to invest more in shares, and so to give our with-profits policyholders the potential for better returns in the long run. However, if the inherited estate became relatively small then we might change the way we invest the fund and smooth the returns, and we might reduce the volume of new business.

12 What's mutual bonus?

The mutual bonus scheme is designed to reward eligible members for their ownership of LVFS.

The Board of Directors will consider the financial performance of our trading businesses and profits and losses on smoothing from LVFS with-profits policies each year along with LVFS's current and projected financial strength to determine whether, at what level, and in what form, we should declare any mutual bonus, and which members are eligible to receive it. They will also take into account the contribution made to LVFS by each group of products within it (for example the risks taken in supporting the establishment and growth of LVFS's trading businesses in life and general insurance).

Currently any such mutual bonus allocated to your policy is paid by increasing any final bonus. You will therefore receive it when your policy matures or is cashed in. For With Profits Pension Annuity policies, any mutual bonus is currently paid by increasing any top up bonus. For lump sum benefits paid on conventional with-profits pension policies it is included in the value of the investments underlying your policy.

Unpaid mutual bonus allocations do not form part of the guaranteed policy benefits, so might be taken away in the future. However, we would do so only in exceptional circumstances, for example if it were required to protect our financial solvency. Past allocations may subsequently be reinstated if the Board of Directors consider it appropriate.

Further information about the mutual bonus scheme can be found on our website at LV.com/members/mutual_bonus.

13 Could we ever close LVFS to new business?

Yes we could but we'll let people invest in LVFS as long as we feel it's in the interests of both our existing and new with-profits policyholders.

14 What would happen if we stopped accepting new business?

If we did ever stop accepting new business and closed LVFS, we'd share out the inherited estate over the lifetime of the remaining with-profits policies held in LVFS.

Our main concern would be to make sure this was fair to all remaining policyholders – to do this, we might change the way we invest the fund and smooth the returns.

15 How to find out more

We hope you've found this guide useful. To find out more about the technical details of our with-profits fund, please read our Principles and Practices of Financial Management (PPFM) booklet covering conventional with-profits policies and the With Profits Pension Annuity.

On our website at LV.com/manage you'll find the latest version of this guide, the more technical PPFM and annual reports on how we've managed the fund compared to our PPFM. If you would like us to send you a copy of any of these documents please let us know.

If you have any questions about what we've said in this document, please contact us or your financial adviser.

16 Glossary

Word/Phrase	Definition
Asset	An investment purchased with the prospect that it will increase in value and/or generate income. Examples of various types of asset are shares in companies, fixed-interest investments, commercial property and cash. Depending on the type of asset, the value can go up and down and any income produced by it may change from one year to the next.
Board of Directors	The individuals elected by LVFS members to oversee the management of LVFS on their behalf.
Commercial Property	An investment in assets such as offices, and retail and industrial premises, which generate income and whose value can go up or down.
Financial Solvency	The ability of an insurer to set aside capital to meet its future liabilities as they fall due.
Financial Strength	Financial strength is measured by how much the value of an insurer's assets exceed the value of its liabilities. It is an indicator of the insurer's ability to withstand adverse economic conditions.
Fixed-interest investments	Loans made to governments or companies for a set period, in return for a fixed rate of interest. The interest is paid regularly, with the face value of the loan being returned at the end of the period.
Government Bonds	Loans made to governments for a set period, usually in return for a fixed rate of interest. The interest is paid regularly, with the face value of the loan being returned at the end of the period. UK Government Bonds are also known as gilts.
Inherited Estate	This is the money that has been built up from profits from the fund that are in excess of the fund's liabilities, over the period that LVFS has been in business.
Insurer	A company or mutual organisation that provides life and/or general insurance products to the general public.
Liabilities	An insurer's debts or obligations that arise during the course of its operations. This includes the promises it makes to its policyholders to pay their claims.
LVFS	Liverpool Victoria Friendly Society Limited
Members	As a with-profits policyholder, you are also a member of LVFS. LVFS is owned by its members, who can have their say in the running of LVFS through its Annual General Meeting. Members can also receive other benefits. For full details, please see our website at LV.com/members.
Shares	A share represents a part ownership of a company and carries with it the entitlement to a proportion of the company's profits, paid as dividends. The value of shares can go up or down quickly, as they are influenced by national and world events. Shares are also known as equities.
Smoothed Return	We aim to pay customers a smoothed return in order to cushion the effects of volatile movements in the investments in the fund underlying their policies. We do this by holding back some of the profits we earn in good years and use them to supplement the returns we earn when times are tough.
Trading Business	In order to secure extra returns, LVFS invests in its life insurance business selling products such as life insurance, critical illness insurance, income protection and pensions, as well as investment products. It also has a strategic holding in a general insurance business selling products which protect the policyholder from losses due to accident, damage and theft on items such as cars, homes and pets.
Underlying Value of Investments	This is the actual value of the investments in the fund which we use to determine the value of your policy. However, when we actually pay out your policy, we also take into account how we smooth payouts and any guaranteed benefits that your policy has.
Unsmoothed Return	This is the actual return on the investments in the fund underlying your policy.

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

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