Conventional with-profits

Your guide to how we manage our with-profits business

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1 Introduction

This guide explains how we look after our with-profits business.

If you have one of the following conventional with-profits products this guide applies to you:

- conventional with-profits life policies
- conventional with-profits pension policies
- With Profits Pension Annuity

You'll find important information about how these products work and how we manage them. At the end of the guide there is a helpful glossary of some of the financial and insurance terms we've used. The terms in bold font are those that you'll find in the glossary.

There are separate guides available for our other with-profits policies and plans, and also for the with-profits business in the **RNPFN Fund** and **Teachers Assurance Fund**.

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.

You can download a copy from our website **LV.com/manage**. If you'd like us to send you one please contact us. You can email us at **LifeServicing@LV.com**, call us on **0800 681 6294** (we will record and/or monitor your calls for training and audit purposes) or write to us at LVFS, County Gates, Bournemouth, BH1 2NF.

2 Background on LVFS

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

All our with-profits business, such as the policies you invest with us, is held within Liverpool Victoria Financial Services Limited (LVFS). We combine your money with other investors' money and manage it on your behalf. There are other types of policies in **LVFS**, together with its **inherited estate** (explained in section 12).

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

3 What fund am I invested in and how is it invested?

Different with-profits policies invest in different mixes of assets within **LVFS**.

Your policy is invested in the mix of assets that we call our **'main with-profits fund'** (which is otherwise referred to in this document as 'the fund'). Most of our older with-profits policies are invested in this fund.

The aim of the investment strategy is to optimise the return to with-profits policyholders 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 policyholders. It will also take into account past communications to policyholders, developments in investment practice and requirements of specific product features. 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 **LVFS** and its ability to meet its regulatory capital requirements and the nature of its **liabilities**.

The general asset management of the fund is currently undertaken on our behalf by Columbia Threadneedle Investments. They are responsible for the day-to-day management of the **assets** in the 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 each year.

Typical investments made by the fund include:

- the **shares** (also known as equities) of UK and overseas companies
- **fixed-interest investments** 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 the with-profits fund on our website at **LV.com/asset-allocation**. Here you can also see investment information including the performance of the fund. Alternatively you can also get this information by contacting us – see section 1 above for the different ways we can be contacted.

4 What's the aim of our with-profits business?

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 when there are any conflicting interests between them.

5 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 (endowment) 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.

6 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 **assets**, including in the **shares** of UK and overseas companies, **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** and **property**, as over the long term they tend to give a higher return than other safer investments, like **government bonds** and cash.

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 the following ways:

- We invest in many different types of investment and limit the amount in any one type.
- We use various techniques to help reduce volatility. For example, for overseas investments, to reduce the risk of foreign currency fluctuations we can use currency hedging.
- We try and smooth out the ups and downs of the profits and losses we make in order to treat policyholders fairly. This is what we mean by a **smoothed return**.

As an example of the latter, 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**. In the long term the effect of smoothing is expected to be neutral.

LVFS does not set a period over which it expects smoothing of payouts to be neutral. Similarly, it does not set an overall limit to the accumulated profits or losses from smoothing.

We reserve the right to remove or reduce smoothing in exceptional circumstances in order to treat remaining with-profits policyholders fairly.

Different products use different approaches to providing a **smoothed return**. Our normal approaches for conventional with-profits polices are:

- For whole-of life policies we smooth investment returns over a two year period.
- For endowment policies we smooth investment returns over a five year period.
- For pension policies we smooth investment returns by limiting the investment return.
- For With Profits Pension Annuity (Series 1) we smooth investment returns over two and five year periods, using the period that gives the higher annuity amount.
- For With Profits Pension Annuity (Series 2 to 4) we smooth investment returns over a two year period.

7 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 premiums you've paid in
- the charges we've made for our expenses
- any charges to cover any life insurance cover we provide (whole-of-life and endowment policies)
- profits arising on similar policies to yours (conventional pensions and With Profits Pension Annuity policies)
- previous annuity payments (With Profits Pension Annuity policies)
- changes in our own and industry mortality experience (which means we look at the trends of how long people live) and how we think they may change in the future (With Profits Pension Annuity policies)
- the investment returns from the fund
- any tax paid by LV= in respect of your policy
- how we group policies together when we set final and **top up bonus** rates
- prior distributions of miscellaneous profits from **LVFS** business risks, including **mutual bonus** declared from 2011 (see section 13).

As we've said in section 6 we try to smooth out the ups and downs of the stock market, and this also affects your return. We may also add an **exit bonus** (see section 13).

Once your policy ends 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**. Where there are guaranteed benefits, we'll always pay the guaranteed amount if that is higher.

8 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, rather than a **final bonus**. We may also add **mutual bonus** and **exit bonus** (see section 13). When we set bonuses, we take into account the current and projected **financial strength** of **LVFS**.

Regular bonuses

We aim to add a **regular bonus** to your policy each year. When setting **regular bonus** rates the general aim is for **regular bonus** rates to be added at a modest stable level, taking into account the relationship between your policy's guaranteed benefits and the **underlying value of the investments**. Changes in **regular bonuses** should be expected to be relatively infrequent.

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 don't set a maximum amount that **regular bonus** rates can be altered by each year. **Regular bonus** rates may be reduced to zero.

We may introduce a new series of **regular bonus** rates if otherwise there could be unfair treatment between groups of policyholders.

Final bonuses

We want to make sure that you receive a fair return on your policy. If the **regular bonuses** you've had during your policy term are less than a fair return, we'll add a **final bonus** to increase your payout on maturity or death. For endowments and Industrial Branch IB whole-of-life policies, the **final bonus** will include an uplift for any life insurance cover we provide. We review **final bonuses** at least once a year and may do so up to four times a year.

For conventional with-profits policies rather than work out the value of each individual policy, we decide what level of **final bonuses** to pay using a representative policy set by grouping similar policies together. For Industrial Branch IB whole-of-life policies, the representative policies used are at a more granular level, reflecting all key policy characteristics. 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.

Final bonuses on conventional pension policies can be added to increase guaranteed income, however they are currently zero and are expected to remain at this level in future.

Final bonuses are not guaranteed and can be reduced (including to zero).

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. To decide the level of **top up bonus** we group similar policies together.

9 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 'cashing-in' or 'surrendering' your policy. We'll work out how much to pay you, being fair to both you and the policyholders staying in the fund, using a similar approach to how we decide the level of **final bonuses**. The amount may be less than your guaranteed benefits.

Conventional with-profits pension policies

Where lump sum benefits are paid rather than the guaranteed income available under your policy, we pay out the **underlying value of the investments** for the individual policy, after allowing for smoothing. **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 **underlying value of the investments** of your individual policy, taking account of smoothing. The blend provides a smooth transition from the **underlying value of the 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.

10 What expenses are charged to your policy?

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 (if available when your policy was sold) and Policy Conditions.

11 What business risks can affect with-profits policies in LVFS?

The profits or losses from all business risks within **LVFS** are credited to or borne by the **inherited estate** and may, if the **LV= Board** determines to allocate such profits or losses, influence the amount payable on your policy.

Distributions of profits made since 2011 are currently added as **mutual bonus** and **exit bonus**.

In exceptional circumstances in order to treat all policyholders fairly, losses from business risks may result in deductions to payouts. We would remove **exit bonus** first, then reduce or remove expected future **mutual bonus**, before removing prior **mutual bonus**, and finally making deductions from the rest of the payout.

New business will only be accepted into **LVFS** if, in the opinion of the **LV= 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 **LVFS** nor threaten the ability of **LVFS** to meet its commitments to its **members**.

The other key business risks of **LVFS** arise from:

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

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

The **inherited estate** means the excess of the **assets** of **LVFS** over all its **liabilities**. It's money that has been building up since we began in 1843, from generations of policies where we've made more profit than we anticipated.

The **inherited estate** provides capital to meet the regulatory reserving requirements of **LVFS** and supports its business risks. In doing this the capital provided by the **inherited estate** supports **LVFS's** ability to invest in **assets** delivering higher returns to policyholders while maintaining guaranteed benefits, the smoothing of benefits paid to policyholders and the ability of **LVFS** to accept new business.

Other than in future distributions of **mutual bonus** and **exit bonus** (see section 13), there are currently no constraints on the **LV= Board's** freedom to deal with the **inherited estate** of **LVFS** or any obligation on the **LV= Board** to distribute the **inherited estate** to the current generation of **members**.

The portion of the **inherited estate** used to support future **exit bonus** distributions (which come from proceeds from the sale of **LVFS's** general insurance business) is currently invested using a blended approach based on cash and the mix of assets in the main with-profits fund with the aim that it becomes fully in line with the latter during 2024.

13 What are mutual bonus and exit bonus?

Our **mutual bonus** rewards eligible **members**, like you, for their support of the development and growth of Liverpool Victoria Financial Services (LV=). It is not a guaranteed benefit and the amount can vary.

Our aim is to distribute our profits - via the **mutual bonus** - in a broadly stable and sustainable way, by maintaining our profitability and capital position. The **LV= Board** has full discretion and freedom when deciding to award a **mutual bonus**. The decision to award a **mutual bonus** is guided by the **Board's** overriding responsibility to balance the need to deliver for **members** both today and in the future, against LV's investment needs and projected **financial strength** of the fund. The **Board** could make adjustments or significant changes to the rates if circumstances require it. For example, if the current performance or capital position of the business differs materially from the business plan. Any past **mutual bonuses** could be reduced or removed, though could be reinstated at a later date.

The rate of **mutual bonus** we will award for the policies in scope of this document is six times the level that we award for new with-profits policies. This reflects communications in 2020 regarding proceeds of the sale of the LV= General Insurance business and how the business has evolved since then.

We also use some of the sale proceeds to pay you an **exit bonus**. Each year the **LV= Board** will decide what **exit bonus** rate to award, considering what funds are still available from the sale proceeds, how investment markets perform, changes in the underlying value of policies, the number of active **members** who are eligible to receive it and our current and projected **financial strength**. The rate of **exit bonus** may be varied in future, including being set to zero in extreme circumstances. We currently expect to reduce the **exit bonus** before looking at potentially reducing past awards of **mutual bonus**.

Mutual bonus and **exit bonus** do not increase guaranteed benefits (including guaranteed income). They are paid as follows:

- For whole-of-life and endowment policies, by increasing any **final bonus** amount (or cash-in value) when your policy ends.
- For conventional pensions, by increasing any **final bonus** amount when you take your yearly income, or for lump sum benefits, they are added to the **underlying value of the investments** after allowing for smoothing, but not the commuted value of your guaranteed yearly income used in the minimum amount.
- For With Profits Pension Annuity policies, by increasing your **top up bonus** amount.

Further information about **mutual bonus** and **exit bonus** can be found at **LV.com/mutualbonus** and **LV.com/lvdifference**.

14 What would happen if we stopped accepting new business?

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 and doesn't threaten the ability of **LVFS** to meet its commitments to its **members**.

If we did ever stop accepting new business and closed **LVFS**, we'd share out the **inherited estate** in an equitable manner over the lifetime of the remaining with-profits policies held in **LVFS**. If this happened we might change the way we manage the fund, including the investment strategy and how we smooth 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 business, please read our Principles and Practices of Financial Management (PPFM) booklet.

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**, **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	The individuals elected by **LVFS members** to oversee the management of **LVFS** on their behalf.
Exit bonus	Information on exit bonus can be found in section 13 of this guide.
Final bonus	Information on final bonus can be found in section 8 of this guide.
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	Information on the inherited estate can be found in section 12 of this guide.
Insurer	A company or mutual organisation that provides 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 / LV=	Liverpool Victoria Financial Services 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**
Mutual bonus	Information on mutual bonus can be found in section 13 of this guide.
Property	An investment in **assets** such as offices, and retail and industrial premises, which generate income and whose value can go up or down.
Regular bonus	Information on regular bonus can be found in section 8 of this guide.
RNPFN Fund	The RNPFN Fund is a ring-fenced fund within **LVFS** which includes the RNPFN with-profits policies. **LVFS** took over the RNPFN business in 2001.
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.
Teachers Assurance Fund	The Teachers Assurance Fund is a ring-fenced fund within **LVFS** which includes Teachers with-profits policies. **LVFS** took over the Teachers business in 2016.
Top up bonus	Information on top up bonus can be found in section 8 of this guide.
Underlying value of the 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.

If you'd like us to send you this document or any future correspondence in another format, such as Braille or large print, please just let us know.

Liverpool Victoria Financial Services Limited: County Gates, Bournemouth, BH1 2NF.

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