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Dear Dr Buckner

Re. Acquisition of Liverpool Victoria by Bain Capital

Thank you for your letter of 2 December 2021 to Charles Randell setting out the concerns of a Liverpool Victoria Financial Services Limited ("LV", "LVFSL") with-profits policyholder who has contacted you.

Your letter raises points around ring-fenced funds, defined benefit pension schemes and concentration risk. In particular you invite comment as to how the FCA might ensure that LV members are presented with proposals that are set out in a clear, fair and not mis-leading way. I respond to these in turn below.

The nature of the proposed with-profits ring-fencing arrangement

As your letter notes, and the Member Explanatory Booklet sets out, in the event the proposed transaction completes, and a Part VII transfer is sanctioned, the With-Profits Fund will be ring-fenced through the Part VII Scheme.

The concept of Ring-fenced Funds arises under Solvency II regulation, and means that on a going-concern basis, assets within a ring-fenced with-profits fund are not available to cover the risks of the rest of the firm. Additionally, Bain Capital (or another party) would not have access to these assets. However, some of this protection may fall away in the event of extreme circumstances where the firm which owns the fund becomes insolvent. This position is not unique to the proposed transaction and the FCA do not consider that a non-standard definition has been used.

The FCA do however consider that this is important information. Reference is made to protection falling away in extreme circumstances in a number of places in the Member Explanatory Booklet sent to LV's members. As well as being noted on page 21 and in the Glossary of the Booklet as you state, this is explained on page 9 under the heading '*Will Bain Capital be able to access my money?*' and also on page 13, under the heading *'What do you mean by ring-fenced?'*. Where a fund is not ring-fenced the protections are potentially lesser.

Risks of the Defined Benefit (DB) pension schemes

The LVFS Main Fund (the current 'common fund' in which all but the Teachers Assurance and RNPFN policies are invested) already has responsibility for the DB pension schemes' liabilities. That with-profits policyholders would be exposed to the risks associated with these liabilities after the proposed transaction is thus not a change that would be brought about by the transaction, and with-profits policyholders are thus not taking on new risks in this regard, albeit that this risk exposure would potentially impact distributions more directly in the context of a ring-fenced with-profits fund that is in run-off.

The proposals that LV has asked members to vote on and which are set out in the Booklet, and assessed by the Independent Expert, take account of the pension schemes' liabilities. For instance, page 7 of the Booklet notes with respect to *'Option 3: The external transaction with Bain Capital'* that under the transaction *'LV= With-profits policyholders would retain the responsibility and associated risks in supporting the existing two staff defined benefit pension schemes, with capital set aside to support the schemes in the future. The remainder of the LV= Inherited Estate, released as a result of this transaction and after transaction costs, would then be available for distribution to all eligible LV= policyholders …'*. The Independent Expert notes that *'In respect of the two Defined Benefit Staff Pension Schemes, the Bain Capital Transaction TBEs [Terminal Bonus Enhancements] have been calculated using the existing funding valuations of LVFSL's two Defined Benefit Staff Pension Schemes.'.*

I would also draw your attention to Section 12 (particularly paragraphs 12.3 – 12.42) of the Independent Expert's report on the Bain Capital transaction, in which he provides his view on the run-off plan that would be put in place under the proposed transaction. The management of the longevity and credit risks associated with the DB pension schemes' liabilities is one of the key elements to ensure a fair run-off. The Independent Expert notes the most recent funding position of the DB schemes and the LV Board's decision to maintain an allowance of £50m to allow further de-risking actions (in addition to the annual contributions to fund the pension schemes to a buy-out position). He also covers the permitted management actions within the run-off plan to reduce risk in the fund in the event of adverse experience, breach of the With-Profits Fund's risk appetite or the regulatory solvency position being at risk.

Concentration risk of with-profits fund

The with-profits policyholder who has contacted you is concerned about asset concentration risk if the transaction with Bain Capital goes ahead.

LV have different asset classes backing different liabilities. The current Principles and Practices of Financial Management (PPFM) document for the LV Main Fund notes in the section on investment strategy that: *'A portion of the inherited estate of the LVFS Fund has similar asset mixes to those held in the Asset Pools supporting Asset Shares…Different asset mixes are held in respect of guaranteed liabilities, in respect of the liabilities of the non-profit policies in the LVFS Fund and the remainder of the inherited estate of the Fund.'.*

As such, leaving aside any distributions of inherited estate, we would expect payouts on with-profits policies to reflect the investment performance of the assets supporting the with-profits asset shares and to not be directly impacted by the investment performance of asset pools backing other liabilities. Hence we would not expect a loss of diversification benefit to policyholders from removing the assets backing the non-profit liabilities from the overall fund. (Absent the proposed transaction, the profits and losses of the non-profit business (including any investment profit/loss associated with these liabilities) accrue to the inherited estate and hence with-profits payouts could be impacted indirectly in this way through an impact on mutual bonuses or terminal bonus enhancements).

In relation to the assets backing the with-profits liabilities we might expect a mix of assets so as to benefit from diversification *within* a particular asset pool. More information about LV's current asset allocations can be found on their website. The Independent Expert notes in his report that '*If the Bain Capital Transaction were to proceed, whether via the completion of the LVFSL Part VII Scheme or via the Backstop Arrangement, there would be no change to the investment strategy for the assets backing the LVFSL with-profits business.'* Hence, in our view, the asset split required to separate the with-profits and non-profit liabilities would not be expected to result in a 'dilution of benefit expectations' as you note.

We note that the assets required in respect of the DB pension schemes are in a separate asset pool from the assets backing policyholder benefits. This position is unchanged by the proposed transaction. While as noted above the Pension Scheme liabilities are factored into the proposals, the Member Explanatory Booklet notes that any changes to funding requirements would have an impact on with-profits distributions. Funding requirements may change as a result of divergence from assumptions made about future investment returns on the pension scheme assets or longevity of scheme members.

For further detail regarding your question on the relative rankings of the pension scheme liabilities we would again draw your attention to Section 12 (particularly paragraphs 12.3 – 12.42) of the Independent Expert's report on the Bain Capital transaction, in which he provides his view on the run-off plan that would be put in place under the proposed transaction. As noted above, the management of the longevity and credit risks associated with the DB pension schemes' liabilities is one of the key elements to ensure a fair run-off. He also covers the permitted management actions within the run-off plan to reduce risk in the fund including in the event of adverse experience such as in respect of the pension schemes. Paragraph 12.32 sets out the order of management actions if it were necessary to reduce future estate distributions in the event of adverse experience

Finally, we also note that the equity release mortgages are allocated to the Non-Profit Fund under the Part VII Transfer.

Role of the FCA

The FCA recognises the importance of its consumer protection role in this and other transfers or schemes of arrangement, and I'd like to assure you that the proposed transaction between LV and Bain Capital has received extensive scrutiny from the FCA. This resulted in our decision not to object to LV proceeding to take its proposals to its members to vote and also to the Court with respect to the Scheme of Arrangement (as set out in our published letter of 26 October).

It is important to note that our role is not to approve any of these aspects for this or any other transaction, as responsibility for this sits with the Board of the firm, and in the case of the Scheme of Arrangement it is the Court that decides after the member vote. Rather, our role is to intervene if we regard any aspect of the proposals, the communications, or the process being followed as unfair to LV members and customers or if we have any concerns regarding their impact on competition in the interests of consumers. In order to arrive at this position for this proposed transaction, we reviewed in detail over a number months certain key documents, including providing detailed feedback and questions and seeing multiple versions of them over time. As with the point above, we do not approve these documents, but rather we reviewed them both as part of the audience for which they are intended and also to inform our overall review and decision as to whether to object to LV proceeding to member votes and the Courts. Some of the key documents we reviewed in this way are:

- both reports of the Independent Expert, including the summary version of these

- both reports of the With-Profits Actuary, including the summary version of these
- a report from the Chief Actuary
- the member vote pack, including the Explanatory Booklet and accompanying letter.

We have set out information above in relation to the points you raise. While the matters are complex, we continue to consider LV's communications of its proposals to members to be clear, fair and not mis-leading.

Yours sincerely

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