UKSA
UK Shareholders' Association

Chislehurst Business Centre
1 Bromley Lane
Chislehurst, BR7 6LH

01689 856691
Email: uksa@uksa.org.uk
Web: www.uksa.org.uk

2 December

Mr Charles Randell
Chairman
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Dear Mr Randell

Acquisition of Liverpool Victoria by Bain Capital

I am policy director of UK Shareholders' Association (UKSA). UKSA is the oldest shareholder campaigning organisation in the UK, with 14,000 members. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.

I write with some concern after being contacted by a member who is a with-profits policyholder of Liverpool Victoria (LV). He has various concerns which I set out in detail in the appendix, and which I summarise as follows.

First, the brochure circulated to members implies that the With-Profits Fund will be 'ring-fenced', which under any standard reading means that the Fund is insulated from the insolvency of the Bain-owned company. But a careful reading of the brochure shows that the Fund is not thus insulated, and that if the parent were unable to meet its policyholder liabilities, the ring-fencing would break down and the company might have recourse to capital support from the With-Profits Fund.

This is highly misleading, analogous to selling a car on the basis that the brakes mostly work fine, but fail in 'extreme scenarios' such as going down steep hills. WP policyholders should not be asked to vote on the LV proposal until the intended meaning of the ring-fencing agreement is crystal clear to them.

Second, the post-Bain Capital Transaction structure will see the with-profits fund take on the liability for funding the two LVFSL defined benefit pension schemes. While this is clearly explained in the brochure and the Expert reports, policyholders have been given no information about the size of the DB schemes in the Expert reports, even though this information is crucial to understanding how the DB liabilities might dilute and rank ahead of with-profits expectations. Nor can I find any information about the quality of the assets in the scheme.

Third, the increased ‘concentration risk’ of the WP fund has not been clearly explained or quantified. The Expert report talks principally of liabilities, so it is not clear how the assets which currently form a single pool in the Common Fund would be split up. There are other important details that can be gleaned from Annual and Regulatory reports, but these are omitted from the brochure.

Our member has set out his concerns in a series of letters to the FCA, but the concerns have been dismissed. He was told that while there is a risk that media commentary “may cause some degree of confusion and uncertainty for LV members”, regulated firms need to ensure “that all their communications, including any press commentary, are clear, fair and not misleading,” and that the FCA *has taken action* to ensure that all LV members are presented with proposals that are set out in a clear, fair and not misleading way to enable members to make an informed decision.

I cannot see that the FCA has taken such action, given that the LV proposals are either misleading (using a non-standard definition of ‘ring fencing’) or so incomplete that members cannot make an informed decision (about the extent of concentration risk, for example).

This is an open letter. We invite comment from the Chair as to how the FCA might ensure that LV members are presented with proposals that are set out in a clear, fair and not misleading way.

Dr Dean Buckner, Director, UK Shareholders’ Association
Email: dean.buckner@uksa.org.uk

The nature of the proposed WP ring-fencing arrangement

The LV brochure sent to all members outlines options for them to consider. On the Board's recommended option (p.15), it says:

> The With-Profits Fund will be formally ring-fenced and independent of the non-profit business. Further information on what this means can be found on page 21.

On the non-preferred option it says

> The With-Profits Fund is not formally ring-fenced and although it is contractually separated it remains exposed, in extreme circumstances, to risks within the nonprofit business.

The natural reading is that with informal ring-fencing the WP fund is exposed to risks 'in extreme circumstances', so that, by implication, there is no such exposure in the case of formal ring-fencing.

However, page 21 refers the reader to a 'detailed definition' of the term 'ring-fenced' in the glossary on page 39, which states that the parent company (Bain capital) will not be able to access the assets within the fund "apart from in extreme circumstances, such as if the company that owns the fund was to become insolvent, whereby some of the protection provided by internal ring-fencing would fall away."

This is confirmed by the Independent Expert report,[1] which states:

> 4.145 The LVLC WPF would be a closed, ring-fenced fund in run-off and so would, *under all but extreme scenarios*, no longer be exposed to the risks associated with the non-profit business within LVFSL, nor would it be exposed to the risks associated with writing new business.

My emphasis. The nature of the 'extreme scenarios' is given below:

> 7.42 In extreme scenarios, such as in the event that the LVLC NPF were to be unable to meet its policyholder liabilities, the ring-fencing of assets may break down and the LVLC NPF may have recourse to capital support from the LVLC WPF, the Teachers Assurance Fund and the RNPFN Fund (and vice versa).

Risks of the DB pension scheme

The post-Bain Capital Transaction structure will see the with-profits fund WPF (currently the 'notional' WPF) take on the liability for funding the two LVFSL defined benefit pension schemes. Thus WPF policyholders will take on the longevity risk and credit spread risk associated with the schemes.

[1] "The Member Vote on the transaction between Bain Capital and Liverpool Victoria Financial Services Limited", Oliver Gillespie, November 2021.

However, I cannot find information about the size of the DB schemes in the Expert reports, even though this information is crucial to understanding how the DB liabilities might dilute and rank ahead of with-profits expectations. The information is available in LV annual reports, see e.g. AR 2020 p. 150 which gives plan assets of £1.7bn and liabilities of £1.6bn. The liabilities form a significant proportion of the proposed WPF Best Estimate Liabilities of £5.6bn, so why was the information not provided in the Expert reports?

Nor can I find information about the quality of the assets in the scheme. The regulatory report (*Solvency and Financial Condition Report* 2020 p.40) refers to equity risk, but no numbers are given. The standard approach is to decompose assets into credit, property and equity exposure, with credit assets divided by rating, and with some classification of the property and equity exposure by risk factor. None of this information is available in the AR or IE reports.

There is no up to date valuation for the pension scheme. Will that be available before the Part VII scheme is submitted for approval? It seems unfair to members to be asked to vote blind on this aspect of the proposals in circumstances where the updated valuation should be available in a matter of months and certainly well before the final stage of this transaction is expected to be completed.

Worryingly, the 2020 Annual Report p. 153 states "The Trustee's primary funding objective is to reach full funding on the Technical Provisions basis, with a long-term target of moving towards being fully funded on a Gilts +0.25% liability valuation basis *by 2028*." If the Scheme is 'moving towards' a fully funded basis, what impact does that move have on the expectations of WP policyholders? I cannot see how the move can be achieved without further injection of capital, presumably from the capital in the whole WP fund, but this needs to be spelled out.

Concentration risk of With Profits Fund

As a result of the split between the proposed NPF and WPF, the concentration to credit, market and other risk factors will increase for both funds. (When pooled together, both funds benefit from the diversification of asset risk). But there is almost no quantitative information in the IE reports about the loss of this diversification benefit.

The Expert reports talk principally of liabilities, so it is not clear is how the assets which form a single pool in the Common Fund would be split up. The Bain Capital Transaction report (4.163) says that "the Estate of the LVLC WPF would initially be invested such that it would have the same asset mix as used for the underlying policy asset shares", but this conflicts with the regulatory report (*Solvency and Financial Condition Report* 2020 p.40) which states that "equity risk arises primarily from the defined benefit pension schemes and the Group's with profits business."[2] Is the risky equity component to be divided equally between the WP and NP funds? Then WP policyholders have a lowered expectation of the benefits from equity growth. Or is all equity exposure to be allocated to the WPF? Then WP policyholders lose the diversification benefit of the current arrangement. Either way, there seems to be a dilution of benefit expectations.

I note also that LV has invested member policyholder funds in equity release mortgages. How would these assets be allocated as between the non profit and with-profits funds? Are any of these earmarked for the defined benefit pension funds?

There is no information I can find in the IE reports about the relative rankings of pension liabilities and each of (a) declared bonuses, (b) "promised" enhancements from the Allianz and proposed Bain transactions and (c) future expectations of with-profits member policyholders. Such information is essential to understanding the risk (and possible rewards) of the proposed allocation.[3]

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[2] See also BCT IE report 4.162: "Assets backing asset shares for the with-profits business are currently invested in an investment mix of equities, property, government, and corporate bonds."

3 The BCT IE report (para 7.8) states that the assets and liabilities of the LVFSL Common Fund were notionally split between the NNPF and the NWPF in Q3 2020), so information about the split has been available to LV (and Bain?) for over a year. Given that the information is material, why has it not been made available to members?