MERCER
MAKE TOMORROW, TODAY

CLWYD PENSION FUND
2018 AVC REVIEW UPDATE

This paper is addressed to Flintshire County Council as the Administering Authority of the Clwyd Pension Fund (the "Fund"). This paper is a summary of the full update within our April 2017 report, and should be read in conjunction with that report. This update, building on our previous recommendations, primarily reviews the past performance information of the Fund's AVC arrangements and also includes an update on current AVC issues.

EXECUTIVE SUMMARY

The main findings of this annual review are:

- Unit-linked investments performed well over the year to 31 March 2018, with upper quartile performance for many of them. No funds experienced "bottom" quartile returns for 2018, and only one (Prudential Ethical) returned 3rd quartile performance.

- Prudential has reduced its Annual Management Charge / total charges for their unit-linked funds by broadly 0.1% p.a. in most cases. These charges remain reasonably competitive within the AVC market based on our market data.

- The underlying investment performance of the With Profits Fund has continued to be good, comparing well to other With Profits funds held on Mercer's database (exceeding the average return by 11%).

- Following on from our full review last year, the Lifestyling options offered by Prudential have been updated. The three previous options are now closed to new members, and have been replaced by two of Prudential's "Dynamic Growth" strategies; one targeting retirement options for those who are unsure how they will draw these funds on retirement, and the other for those targeting 100% cash.

- Following on from our previous report, and subsequent steps taken, there is no longer a default fund for future new contributors. This was adopted given the Clwyd Fund provides access to communication material (directly and via the AVC provider) designed to assist members with making investment decisions.

- We understand that the Clwyd Pension Fund, together with Prudential, have sought to contact AVC members in order to remind them of the options available across a range of investment strategies.

- In May, Prudential announced that it would be ceasing to provide its member presentation and individual member meeting service for public sector AVC scheme clients. They will continue to provide pension products to their existing clients both in the public sector and private sector. The client management function will continue to support clients with governance reporting, investment

performance and overall relationship management. We understand that the Fund will be monitoring this situation, in particular via employer/member feedback and we fully support this approach at this time.

PAST PERFORMANCE SUMMARY

Unit Linked Funds

The table below summarises the 5 year performance details of the investment fund range under the Fund's AVC arrangement with Prudential. The benchmark/Index returns for each fund are also shown.

As previously, we suggest that two consecutive years of "bottom" quartile performance, at least, is classified as necessitating a closer monitoring and potential review.

Key: Quartile | Top | 2nd | 3rd | Bottom

Annualised Performance % to 31 March	2014	2015	2016	2017	2018
Prudential					
Prudential UK Equity Passive	9.21	6.34	-4.35	22.12	1.34
Index : FTSE All Share TR in GB	8.81	6.57	-3.92	21.95	1.25
Prudential Long Term Gilt Passive	-3.07	26.93	3.93	12.42	2.23
Index : FTSE Actuaries UK Conventional Gilts Over 15 Years	-3.14	26.96	4.03	12.32	2.21
Prudential Cash	0.40	0.46	0.46	0.26	0.26
London Interbank LIBID 7 Day Deposit Rate	0.40	0.40	0.40	0.20	0.20
Prudential Dynamic Growth IV			-2.45	24.65	2.66
Benchmark: ABI Mixed Investment 40-85% Shares	4.68	11.26	-2.95	17.94	0.76
Prudential Dynamic Growth II			-1.38	19.40	2.60
Benchmark: ABI Mixed Investment 0-35% Shares	2.05	9.79	-0.82	8.82	0.47
Prudential Ethical	13.42	8.09	-3.63	20.51	-0.82
Index : FTSE4Good UK TR in GB	9.83	7.86	-4.81	21.13	1.52
Prudential UK Equity	11.28	5.52	-2.92	22.14	2.24
Index : FTSE All Share TR in GB	8.81	6.57	-3.92	21.95	1.25
Prudential Global Equity*	9.54	9.06	-2.61	26.05	2.75
*Benchmark: ABI Global Equities**	6.91	15.69	-2.66	27.72	1.68
Prudential International Equity	8.21	17.14	-1.61	35.20	4.01
Benchmark: Prudential internal composite	7.20	18.50	-1.80	33.40	5.00
Prudential Index Linked	-4.03	21.69	2.69	22.53	1.41
Index : FTSE Actuaries UK Index Linked Gilts Over 5 Years	-4.45	21.05	1.86	22.01	0.69
Prudential Fixed Interest	-1.85	14.34	3.52	6.84	0.96
Index : FTSE Actuaries UK Conventional Gilts All Stocks	-2.56	13.91	3.25	6.64	0.46
Prudential Discretionary	7.89	10.86	-1.25	26.13	3.23
Benchmark: ABI Mixed Investment 40-85% Shares	4.68	11.26	-2.95	17.94	0.76
Prudential UK Property	8.24	23.25	11.03	-3.64	9.82
All Balanced Property Fund component of the AREF / IPD UK Quarterly Property Fund Index	11.90	16.60	10.60	3.70	10.00

- *The Global Equity Fund's benchmark returns (mix of FTSE and MSCI Regional Indices) are not readily available - sector performance therefore shown above.
- Performance objectives for the passive funds are to match the benchmark (mostly net of fees where stated); and for the active funds, to outperform the benchmark, generally by 0.75%-1.00% p.a., before charges on a rolling 3 year basis.
- Performance above is shown gross of charges (actual charges are shown overleaf).

The table shows that the funds being used by the members performed well over 2018, with upper quartile performance for many. No funds experienced bottom quartile returns for 2018, and only one (Prudential Ethical) returned 3rd quartile performance.

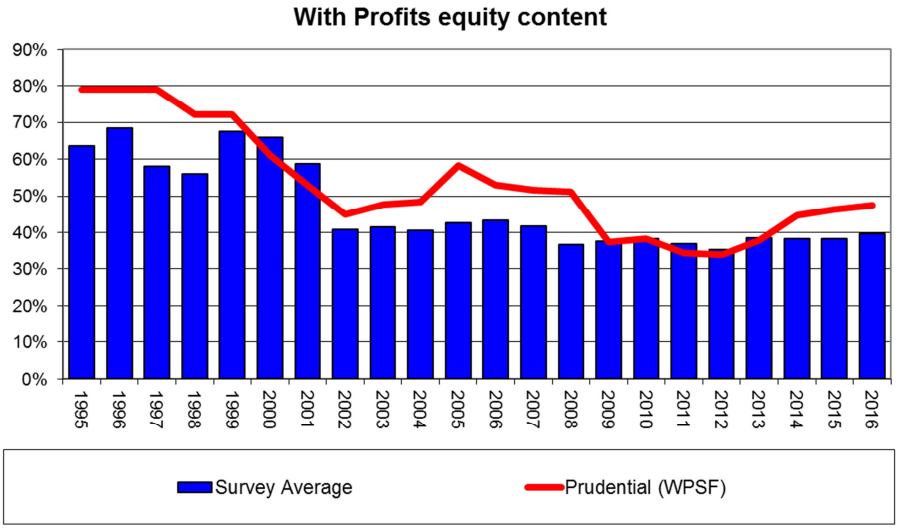
Lifestyle strategy options – During the last year, two Prudential Dynamic Growth IV Lifestyle strategies have been introduced. They provide what Prudential describe as medium risk investment during the "growth phase" and, over the final 10 year period before the anticipated retirement age, monies are gradually switched into the lower risk Prudential Dynamic Growth II Fund and the Prudential Cash Fund:

- One version (the lifestyle "targeting retirement options") is designed for members who are unsure how they will draw these funds on retirement, and
- The other ("the lifestyle targeting 100% cash") is entirely invested in the Prudential Cash Fund on retirement.

Annual Management Charges (AMC) – since last year, Prudential has confirmed that the annual management charge / total charges for their unit linked funds have reduced to 0.55% or 0.65% p.a. (a reduction of 0.10% in most cases). This is obviously an improvement, albeit disappointing that they still impose a 1% exit charge on contributions which started before 19 March 2017 if funds are withdrawn within 3 years i.e. a temporary issue.

With Profits Funds

The updated chart from our report below shows the With Profits equity content continues to be below 50%, albeit higher than the survey average.



Underlying investment performance

The underlying investment performance of the Prudential With Profits Fund has been good during the decade to 31 December 2016. This is shown by its quartile rankings relative to other With Profits Funds in the table below, and has exceeded the average return on the underlying assets of the With Profits funds in our database by 11%. The "index returns" row indicates the average return from the types of investment in which the With Profits Fund invests, allowing for the asset allocation at each year end. Effectively, this

shows Prudential has been very successful at managing the underlying investments, as the Fund has exceeded these index returns by 20% over the decade to 31 December 2016.

Quartile rankings	Top	2nd	3rd	Bottom

To 31st December:	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Performance over decade
Prudential (WPSF)	7.2%	-19.7%	18.7%	12.7%	2.1%	10.5%	10.3%	8.3%	3.6%	14.5%	84%
Index returns	2.0%	-16.2%	12.2%	10.7%	3.5%	7.3%	8.4%	9.5%	3.3%	13.1%	64%
75th percentile	5.6%	-8.8%	15.2%	12.9%	5.5%	10.4%	10.5%	9.7%	4.2%	13.4%	109%
Median	4.8%	-13.2%	11.5%	12.2%	3.2%	8.9%	9.0%	8.3%	2.4%	12.1%	73%
25th percentile	3.4%	-16.3%	9.0%	9.8%	1.0%	7.2%	5.0%	7.1%	1.3%	10.3%	41%

Deposit Fund

The main update here is that the Prudential Deposit Fund closed to new members on 31 May 2017. The unit-linked Prudential Cash Fund is still open to new members. However, whilst the performance results shown earlier indicate the marginally positive performance of the Cash Fund, this is gross of its (reduced) 0.55% annual management charge i.e. performance has been negative.

Annualised performance to the periods to 31 March 2018 is:

Quartile ranking	Top	2nd	3rd	Bottom

Annualised performance over periods to: 31/03/2018

	1 year	**3 years**	**5 years**
Prudential	0.35%	0.39%	0.44%
Providers in universe	6	6	6

The above fund provides capital security. Most Money Market (unitised cash) funds could go negative (particularly after charges).

We note that the Bank of England increased the bank base rate to 0.5% in November 2017 and this was reflected in the rate of interest provided from the Prudential Deposit Fund, 0.5% from December 2017.

CURRENT ISSUES UPDATE

"Freedom & Choice" Flexibilities

Tax Free Cash Implications

Members can:

- If they wait until they draw their main benefits from the Fund, receive the whole of their AVC fund tax free, or
- Utilise the "Freedom & Choice" flexibilities which, on or after age 55, enable them to draw their whole AVC fund as a lump sum. This payment would be subject to the member's marginal rate of PAYE tax on the excess over 25% of their fund. Payment will also limit future tax relieved pension contributions (from the employer and employee combined) to £4,000 p.a. (the "Money Purchase Annual Allowance")

towards a defined contribution arrangement, with the full Annual Allowance limit applying to all pension saving (inclusive of AVCs). This option would necessitate the member transferring their AVC fund outside of the Scheme.

The full legislation also gave members the right to transfer their AVCs outside of the Fund, regardless of the Fund's rules, whilst leaving their defined benefit pension behind. However, if a member requesting this option has any other DC assets within the arrangement, this legislation necessitates all the DC assets being transferred, including any AVCs.

Hence, members have multiple options; cash, purchasing an annuity and / or using income drawdown. Each of these options should impact on members' pre-retirement investment decisions.

Transaction Costs

The 2015 DC Minimum Governance legislation requires trustees to disclose information about charges and administration costs in their annual Chair's Statement. To facilitate compliance, the Financial Conduct Authority has placed a requirement on investment firms to disclose administration charges and transaction costs to trustees, on request, using a standard approach. This information has been required to be available on request from January 2018. "Investment firms", in the context of AVC arrangements, generally means the product provider.

In February 2018, the Government considerably expanded these requirements for any scheme which is required to publish a Chair's Statement in respect of scheme years ending after 5th April 2018.

Guidance Guarantee

Members with AVC and/or DC assets who are over age 50 are required to be "signposted" to Pension Wise, the Government sponsored provider of the "Guidance Guarantee".

Pension Scams

The Pensions Regulator is understandably concerned with the increase in pension scams. It is encouraging providing warnings regarding common scenarios, such as options to cash a fund in before age 55, transfers without obtaining regulated advice, cold callers and unsolicited emails and text messages: www.thepensionsregulator.gov.uk/pension-scams

The General Data Protection Regulation (GDPR)

As of May 25, 2018 the General Data Protection Regulation (GDPR) increased privacy rights for individuals and obligations for corporations while giving regulators greater enforcement powers.

The GDPR imposes increased or new obligations including, 72-hour breach notification to the regulators and the need to engage in "privacy by design" when developing new products, systems and processes. The Administering Authority is required to appoint Data Protection Officers to manage member information. The Administering Authority must also conduct 'Privacy Impact Assessments' for projects with higher privacy risks.

Additionally, the Administering Authority should ensure appropriate technical & security measures are in place; these may include steps like encryption and pseudonymization of data (where identifiable information is replaced with artificial identifiers).

Members will have a right to a detailed notice of what data is being collected and how it is being used. Members have the right to access and correct personal data as well as to object to certain uses of it.

The introduction of the GDPR will mean increased corporate obligations and the risk of fines of up to 4% of annual global revenue or €20 million (whichever is greater).

It is important that the Administering Authority is aware they will need to contact processors who handle members' personal information (e.g. AVC providers) separately for details of their processing of members personal information.

Prudential

On 9 May 2018, Prudential announced it would be ceasing to provide its member presentation and individual member meeting service for public sector AVC scheme clients. They will continue to provide pension products to their existing clients both in the public sector and private sector. The client management function will continue to support clients with governance reporting, investment performance and overall relationship management.

"Prudential is committed to the corporate pensions market and maintaining our leading presence in it, with a focus on providing a better experience for these existing clients. The changes we are making will allow us to concentrate our resources on areas where customer demand is much stronger".

Prudential is entering into a new partnership with Tata Consultancy Services (TCS) to streamline pensions administration. They say that the corporate pensions business will be developed and enhanced to deliver a focussed, digitally led, service. This is a core component of the transformation activity they are currently working on. Further information on these developments is awaited.

Equitable Life

Equitable Life has announced its intention to transfer all its policies to Reliance Life.

As part of this deal, the Equitable Life With Profits Fund will close and be disinvested into unit linked funds. The current 35% Capital Distribution, the enhancements to disinvestments from the With Profits Fund is expected to increase to 60%-70% but not until the "proposal" is implemented, probably towards the end of 2019. Further details are promised for "later this year" and it will then be subject to a vote by Members of the Society as well as High Court approval.

In our view there are a number of areas that Administering Authorities should consider following the announcement, which we set out below:

- Administering Authorities should urgently consider delaying any Equitable Life With Profits Fund disinvestments, including any in respect of retirees. If disinvestments from with profits cannot be deferred, those members potentially lose an additional 30% increase in value.

- As the substantially enhanced Capital Distribution probably will not be available until the sale of Equitable is approved by the High Court, which could be towards the end of 2019, the questions this raises include:

    - » Are your pending retirees permitted to defer their With Profits Fund disinvestment until the end of 2019 (to gain the enhanced Capital Distribution)?

    - » If yes, will disinvestment post retirement prevent any of the Equitable Life assets being drawn as tax-free cash (HMRC rules currently permit tax-free lump sums to be paid up to 6 months before or 12 months after the pension on which it is based comes into payment).

- You should consider whether your administration team can have a “flag” on the systems to ensure that they communicate this issue out to any members seeking to disinvest, whether on retirement, transfer or otherwise.

- Indeed, the Administering Authority should perhaps consider a general communication to all Equitable Life investors?

Important Notices

This document contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. We do not accept liability to any third party in respect of the advice contained in this paper; nor do we accept liability to the Administering Authority if the advice is used for any purpose other than that stated. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's written permission.

The findings, ratings and/or opinions expressed in this document are the intellectual property of Mercer Ltd and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualised investment advice.

Mercer's assessments of insurers' current financial strengths are based on the latest available regulatory returns (to the Prudential Regulation Authority in the case of a UK-based insurer) and any other relevant information the insurer has supplied to us. Mercer accepts no responsibility or liability, including for consequential or incidental damages or for a particular insurer's future solvency. Mercer does not undertake to carry out monitoring of an insurer's financial condition on behalf of clients after a contract is effected.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability, (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy contained within this third party information.

This report is not intended to convey any guarantees as to the future investment performance of these products. In addition:

Past performance is not necessarily a guide to the future. The value of investments may fall as well as rise and investors may not get back the amount invested. Income from the investment may fluctuate in value. The value of investments in a foreign currency will vary as a result of changes in the rates of exchange. Where charges are deducted from capital, the capital may be eroded or future growth constrained.