

CLWYD PENSION FUND 2020 AVC REVIEW UPDATE

This paper is addressed to Flintshire County Council as the Administering Authority of the Clwyd Pension Fund (the “Fund”). This paper should be read in conjunction with our 2017 report. This update, building on our previous recommendations, primarily reviews the past performance information of the Fund’s Additional Voluntary Contribution (“AVC”) arrangements with Prudential and includes an update on current AVC issues, including Utmost Life and Pensions.

EXECUTIVE SUMMARY

The main findings from the 2020 annual review are:

Prudential

- Unit-linked investment performance was mixed over the 5 years to 30 September 2020. Based purely on the investment funds’ quartile performance, it may be appropriate to consider reviewing the Prudential Global Equity Fund. However, it is noted that the only similar alternative is likely to be Prudential’s new Dynamic Global Equity Passive Fund, which currently has limited track-record.
- The underlying investment performance of the With Profits Fund fell in 2018, though it bounced back in 2019 (though quartile-ranking data is limited at this time). Prudential reduced the equity content of the underlying assets of the With Profits Fund in the year to 31 December 2018 (by around 8%), moving much closer to average relative to other with profits funds.
- Prudential provides access to two of their “Dynamic Growth” lifestyle 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. Recent data has indicated that only 67 of the 613 members are using the lifestyle targeting 100% cash (and 27 are using the other lifestyle). Whilst Prudential makes some communication material available, it may be appropriate for the Fund to consider further communication with members.
- The 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. We recommend that further communication might be appropriate. Prudential closed a range of funds in late 2019 / early 2020 and further fund closures are expected in 2021. However, the funds expected to close are not currently in use by the Fund.

Utmost Life and Pensions

- Following the transition from Equitable Life to Utmost, the assets previously invested in the Equitable Life With-Profits Fund were initially reinvested in the Utmost Secure Cash Fund, which guarantees no reduction in the amount invested (including the “Uplifts” to the amount transferred). However, these assets had to be moved to alternative funds over the last six months of 2020. Since 1st July 2020, these assets have been transitioning to the Utmost Money Market Fund (unless a member has requested the use of an alternative fund(s)). This is only intended to be a temporary default, until the investment markets in the Covid19 environment become clearer.
- The member communication that the Fund issued, gave members with Utmost the option to select alternative investments with Utmost, or to transfer these assets to the Fund’s Prudential policy or outside of the Fund. Some members selected alternative investments within Utmost.

PAST PERFORMANCE SUMMARY

Prudential Unit Linked Funds

The table on the following page summarises the five-year performance details of the investment fund range. We suggest that two consecutive years of “bottom” quartile performance, at least, is classified as necessitating a closer monitoring and potential review.

- With effect from the 20 February 2020, the Prudential Ethical Fund was replaced by the Prudential Positive Impact Fund. The Prudential has not reported on the performance of this fund yet.
- The Prudential UK Property Fund is currently suspended.

Quartile ranking Bottom 3rd 2nd Top

Prudential

Performance in year to:		30/09/2016	30/09/2017	30/09/2018	30/09/2019	30/09/2020
Sector : ABI Mixed Investment 4085% Shares		17.29	7.86	5.03	5.21	-1.10
	Pru Discretionary S3 Pn*	20.54	14.81	7.04	3.29	-4.25
	Pru Dynamic Growth IV Pn S3*	24.28	10.89	4.83	6.47	-0.77
Sector : ABI Mixed Investment 2060% Shares		12.54	5.10	2.02	4.48	-2.53
	Pru Dynamic Growth II Pn S3*	19.87	7.72	3.01	7.98	1.98
Sector : ABI Deposit & Treasury		-0.12	-0.29	-0.13	0.13	-0.09
	Pru Cash S3 Pn	0.46	0.13	0.46	0.71	0.45
	Benchmark: LIBID 7 day	0.32	0.11	0.37	0.58	0.22
Sector : ABI Global Equities		26.51	13.68	10.05	5.51	2.22
	Pru Global Equity S3 Pn*	18.95	15.71	8.33	0.38	-9.42
	Pru International Equity S3 Pn*	29.74	19.36	8.66	2.03	-3.13
Sector : ABI UK All Companies		12.39	11.44	4.90	-0.55	-14.51
	Pru UK Equity Passive Pn S3	16.15	12.12	5.96	2.87	-16.54
	Pru UK Equity S3 Pn	14.64	14.20	8.13	-0.19	-14.00
	Benchmark: FTSE All Share	16.82	11.94	5.87	2.68	-16.59
Sector : ABI Sterling Fixed Interest		12.93	-3.52	-0.19	10.90	3.07
	Pru Fixed Interest S3 Pn	13.31	-3.08	0.77	12.95	4.63
	Benchmark: FTSE Actuaries UK Conventional Gilts All Stocks	12.64	-3.56	0.62	13.36	3.41
Sector : ABI UK Index Linked Gilts		25.55	-6.92	0.77	18.93	0.13
	Pru Index Linked S3 Pn	27.47	-3.01	1.91	19.39	0.79
	Benchmark: FTSE Actuaries UK Index-Linked Gilts over 5 Year	26.95	-4.23	1.41	20.28	0.42
Sector : ABI Sterling Long Bond		22.83	-5.96	0.48	19.33	5.26
	Pru Long Term Gilt Passive Pn S3	22.98	-6.18	1.46	22.77	5.36
	Benchmark: FTSE Actuaries UK Conventional Gilts Over 15 Years	23.01	-6.30	1.35	22.98	5.22
Sector : ABI UK Direct Property		-0.53	7.75	7.19	0.89	-5.90
	Pru UK Property S3 Pn	-2.49	8.37	10.44	0.92	-4.75

* These funds have a Prudential internal composite benchmark

The table shows that the funds being used by the members had mixed performance over the 5 years to 30 September 2020. It should also be born in mind that the above performance figures are gross of Prudential's Annual Management Charges. Based purely on the quartile performance, the Administering Authority may wish to consider reviewing the Prudential Global Equity Fund. Whilst Covid-19 has clearly affected this year's performance, the underperformance is in comparison with similar funds. However, Prudential is continuing to make changes to its fund range and the only similar alternative is likely to be their new Dynamic Global Equity Passive Fund.

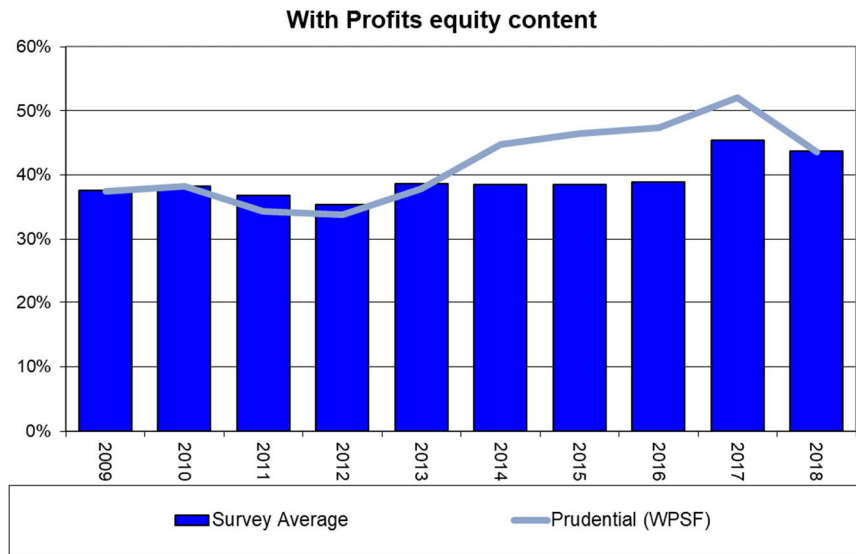
Lifestyle strategy options – During 2018, two Prudential Dynamic Growth IV Lifestyle strategies were introduced. They provide what Prudential describe as medium risk investment during the “growth phase” and, over the final ten year period before the anticipated retirement age, monies are gradually switched 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) – During 2018, Prudential confirmed that the AMC / total charges for their unit linked funds were reduced to 0.55% or 0.65% p.a. (a reduction of 0.10% in most cases). Additionally, later in 2018 they announced the removal of the 1% exit charge on contributions with effect from 1st December 2018.

With Profits Funds

The updated chart from our report below shows the With Profits equity content continues to be modest, though not dissimilar to survey average.



Underlying investment performance

The underlying investment performance of the Prudential With Profits Fund has been good during the decade to 31 December 2017 (this is the most recent available data including the market average). 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 10%. 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 16% over the decade to 31 December 2017.

	Quartile ranking										Performance over decade		
	Top	2nd	3rd	Bottom	2009	2010	2011	2012	2013	2014		2015	2016
To 31st December:													
Prudential (WPSF)	18.7%	12.7%	2.1%	10.5%	10.3%	8.3%	3.6%	14.5%	10.3%	-2.8%			129%
Index returns	11.9%	10.6%	3.6%	7.3%	8.7%	9.5%	3.4%	13.6%	8.5%	-1.7%			105%
75th percentile	15.2%	12.9%	5.5%	10.4%	10.5%	9.7%	4.2%	13.4%	9.3%	-1.5%			133%
Median	11.5%	12.2%	3.2%	8.9%	9.0%	8.3%	2.4%	12.1%	8.1%	-2.3%			101%
25th percentile	9.0%	9.8%	1.0%	7.2%	5.0%	7.1%	1.3%	10.4%	6.2%	-2.8%			68%

Pay-out examples

Unsurprisingly in the current Covid-19 environment Prudential, and many other insurers, has started applying Market Value Reductions (“MVRs”) on early disinvestment from its With Profits Fund. The amount is variable depending on when contributions were invested, and does not currently apply on all cases. However, more surprisingly, Prudential had for many years stated in its Key Features document that it did not intend applying MVRs on disinvestments on early retirement. Whilst it added that this was not guaranteed in future, this clause was removed earlier in the year.

The actual pay out examples continue to be quite good. The quartile rankings are based on comparison with other providers’ with profits funds within our database. Comparison with other types of investment has also been good, particularly based on the examples below:

Quartile ranking	Top	2nd	3rd	Bottom
Annualised performance over periods to: 01/03/2019				
	3 yrs	5 yrs	10 yrs	20 yrs
£10,000 single premium	3.6%	5.1%	6.7%	-
£10,000 single premium		5.1%	6.7%	-
£200 pm		5.1%	6.7%	5.7%
				Surrender Payouts
				Maturity Payouts
				Maturity Payouts
ABI Money Market	-0.1%	-0.1%	0.0%	2.0%
ABI UK Gilts	1.6%	3.7%	4.1%	4.1%
ABI Global Equities	12.2%	9.0%	11.9%	5.4%

Deposit Fund

The Prudential Deposit Fund was 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 indicated 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.

However, the Deposit Fund has no explicit charges:

Quartile ranking	Top	2nd	3rd	Bottom
Annualised performance over periods to: 31/07/2020				
	1 year	3 years	5 years	
Prudential	0.19%	0.46%	0.42%	
Providers in universe	6	6	6	

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

The Bank of England bank base rate was 0.75% p.a. in August 2018, but this reduced to 0.25% p.a. on 11th March 2020 and to 0.10% on the 19th March 2020. The Prudential Deposit Fund does not guarantee to track Bank of England Base Rate in future, but it has done so historically for many years.

Utmost Life and Pensions Unit linked Funds

The performance of the funds currently in use with Utmost is shown below:

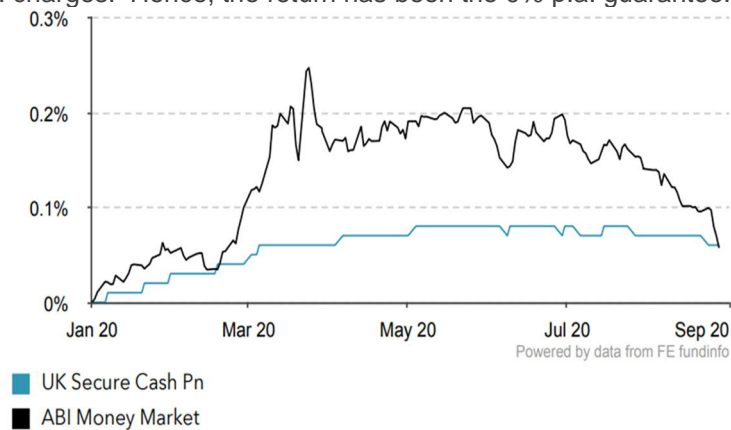
Quartile ranking Bottom 3rd 2nd Top

Utmost

	Performance in year to: 30/09/2016	30/09/2017	30/09/2018	30/09/2019	30/09/2020	AMC(%)
Sector : ABI Mixed Investment 4085% Shares	17.29	7.86	5.03	5.21	-1.10	
Utmost Managed Pension	15.85	9.80	6.49	2.93	-7.64	0.75
Sector : ABI Europe excluding UK Equities	19.44	20.38	2.19	1.77	2.17	
Utmost European Equity Pension	19.27	25.36	1.38	4.86	-0.68	0.75
Sector : ABI Money Market	0.15	-0.27	-0.08	0.26	0.04	
Utmost Money Market Pension	0.08	-0.14	0.04	0.35	0.04	0.50
Sector : ABI North America Equities	31.17	13.93	19.20	7.76	8.37	
Utmost US Equity Pension	33.52	13.91	20.07	7.07	8.02	0.75
Sector : ABI UK All Companies	12.39	11.44	4.90	-0.55	-14.51	
Utmost UK Equity Pension	15.82	12.02	6.10	0.19	-17.30	0.75
Sector : ABI UK Gilts	12.32	-5.26	-0.33	12.30	3.15	
Utmost UK Government Bond Pension	13.34	-5.11	0.56	12.65	4.34	0.50

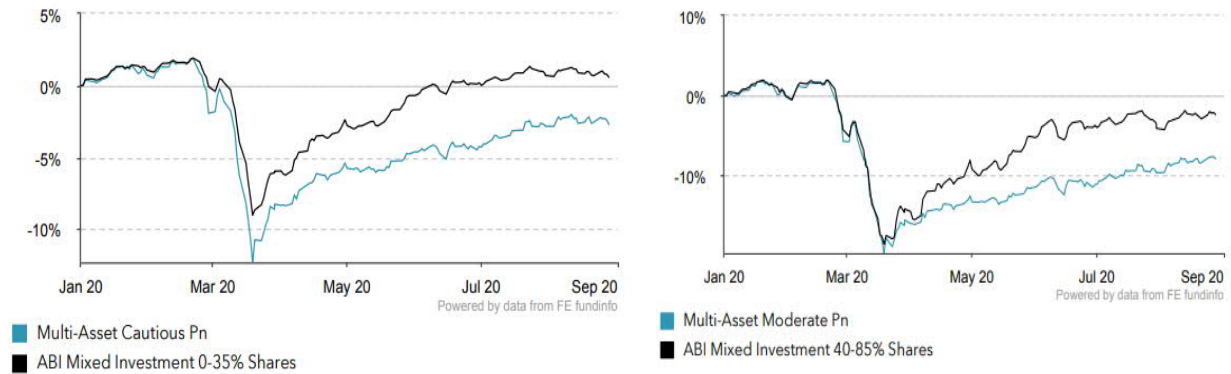
1. Source: Utmost, net of the fees shown in the table
2. The quartile rankings are based on performance relative to the ABI Sector.
3. The ABI Sector / Index performance figures are averages, so will not necessarily correspond with the quartile rankings.

The Utmost Secure Cash Fund and Multi-Asset Growth Fund are also in use but only opened in in January 2020, hence annual performance is unavailable. However, the following chart for the Secure Cash Fund indicates that the gross return over the year to 30 September 2020 has been marginally positive, but this is before it's 0.50% p.a. charges. Hence, the return has been the 0% p.a. guarantee.

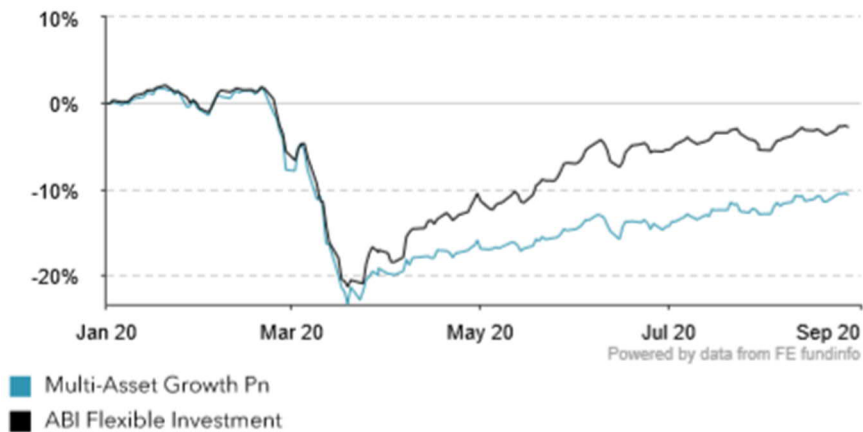


However, the guarantee has enabled members to avoid the substantial turbulence in global investment markets, particularly around March 2020.

If the Fund had adopted Utmost's Investing By Age Journey, their proposed default, the assets would have been largely invested in their Multi-Asset Cautious and Moderate Funds, which would have led to a very different scenario:



The Multi-Asset Growth Fund is also in use:



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 (“DC”) arrangement. Unless the Fund’s rules have been amended, this option would necessitate the member transferring their AVC fund (and any DC assets) outside of the Fund.

The 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 trust, 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 affect members’ pre-retirement investment decisions.

Guidance Guarantee

Members with AVC and/or DC assets who are over age 50 are required to be “signposted” to the recently renamed Money and Pensions Advice Service (following the merger of the Money Advice Service, The Pensions Advisory Service and 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

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 entered into a new partnership with Tata Consultancy Services (TCS) to streamline pensions administration. They said that the corporate pensions business would be developed and enhanced to deliver a focussed, digitally led, service. Some progress has been seen and a new online platform is due to go live imminently. The impact on the current LGPS member online services has not been communicated yet.

Utmost Life and Pensions

Equitable Life's closure and the transition to Utmost Life and Pensions Limited happened on 1st January 2020. As part of this deal, the Equitable Life With Profits Fund closed and was reinvested into unit-linked funds:

- The Uplifts to the reinvested assets of the With Profits Fund were substantially higher than previously anticipated. These assets were initially reinvested in the Utmost Secure Cash Fund, which provided material protection of these assets from the market falls in March 2020. In the absence of members making an alternative decision, these assets have started transitioning to the Utmost Money Market Fund over the last 6 months of 2020. The Administering Authority selected this fund, following advice from Mercer, given the market uncertainty created by Covid-19. The intention was to review the usage of this "default" when the markets were considered to start becoming more (positively) predictable. This seems unlikely to be before next year.
- As a part of the Equitable Life closure process, the LGA circulated Counsel's Opinion regarding administering authorities' "fiduciary duties", as the policyholder to the members. The same logic applies to whether Utmost is the most suitable ongoing provider. Indeed, logically its application is very wide.

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