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CLWYD PENSION FUND
2019 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 and also includes an update on current AVC issues.

EXECUTIVE SUMMARY

The main findings from the 2019 annual review are:

- Unit-linked investments generally performed well over the year to 30 June 2019, with upper quartile performance for many of them and only two funds performing below median.
- Historically, any Local Government Pension Schemes ("LGPS") investments withdrawn from a Prudential policy within three years of receipt of the first contribution could incur an exit charge (other than on death or ill health early retirement). However, Prudential has advised that this exit charge has been fully removed with effect from 1st December 2018.
- The underlying investment performance of the With Profits Fund has continued to be positive, comparing well against other With Profits funds held on Mercer's database (exceeding the median return over the decade to 31 December 2017 by 10%). Prudential reduced the equity content of the underlying assets of the With Profits Fund in the year to 31 December 2018 (by around 8%) but benchmarking against the rest of the with profits market will not be available until early 2020.
- Following on from our full review in 2017, 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 The three previous options are now closed to new members, and have been replaced by two of Prudential's "Dynamic Growth" strategies; one targeting retirement options for those who are unsure how they will draw these funds on retirement, and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 that the Fund provides access to communication material (directly and via the AVC provider) designed to assist members with making investment decisions.
- We understand that 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.

- Prudential has announced that it will be closing a range of funds later in 2019 and further funds in 2020. The funds indicated are not currently in use by the Clwyd Fund.
- In May 2018, Prudential announced it would be ceasing to provide its member presentation and individual member meeting service for public sector AVC scheme clients, but focussing on a more digitally led service. There have been some developments in this area, as shown by Prudential's LGPS website.

PAST PERFORMANCE SUMMARY

Unit Linked Funds

The table below 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.

ABI Sector quartile ranking	Bottom	3rd	2nd	Top

Prudential

Performance in year to:	30/06/2015	30/06/2016	30/06/2017	30/06/2018	30/06/2019
Pru UK Equity S3 Pn	4.20	-0.81	22.01	10.38	-0.87
FTSE All Share	2.60	2.21	18.12	9.02	0.57
Pru Long Term Gilt Passive Pn S3	16.25	23.97	-1.75	4.14	7.34
FTSE Actuaries UK Conventional Gilts Over 15 Years	16.25	24.09	-1.83	4.24	7.17
Pru Cash S3 Pn	0.46	0.46	0.13	0.33	0.72
LIBID 7 day	0.36	0.36	0.14	0.27	0.56
Pru Dynamic Growth IV Pn S3	n/a*	8.85	17.94	4.99	6.79
Benchmark: Prudential internal composite		3.20	15.70	4.00	5.80
Pru Dynamic Growth II Pn S3	n/a*	8.46	13.91	3.55	6.77
Benchmark: Prudential internal composite		4.90	6.50	2.60	6.00
Pru Ethical Pn S3	4.66	0.68	17.86	7.70	4.90
FTSE4Good UK Equity Index	3.53	1.66	17.61	9.34	3.67
Pru UK Equity S3 Pn	4.20	-0.81	22.01	10.38	-0.87
FTSE All Share	2.60	2.21	18.12	9.02	0.57
Pru Global Equity S3 Pn	5.73	2.36	23.92	9.18	0.88
Benchmark: Prudential internal composite	9.30	3.60	19.00	8.60	2.70
Pru International Equity S3 Pn	8.79	10.68	28.33	6.70	4.76
Benchmark: Prudential internal composite	9.90	11.60	26.00	7.60	7.60
Pru Index Linked S3 Pn	15.90	18.41	7.43	2.66	8.95
FTSE Actuaries UK Index Linked Gilts Over 5 Years	15.80	17.00	7.10	2.00	9.10
Pru Fixed Interest S3 Pn	9.36	13.73	-0.19	2.40	4.61
FTSE Actuaries UK Conventional Gilts All Stocks ..	8.86	13.50	-0.86	1.93	4.90
Pru Discretionary S3 Pn	6.38	5.96	22.31	6.51	4.06
Benchmark: Prudential internal composite	6.80	5.00	14.80	6.50	5.00
Pru UK Property S3 Pn	23.14	10.14	-3.98	10.74	3.04
All Balanced Property Fund component of the AREF / IPD UK Quarterly Property Fund Index	15.50	7.20	6.00	9.70	3.40

* Annual data for 2015 is unavailable for this fund as the inception date was 27/02/2015.

The table shows that the funds being used by the members performed well over the year to 30 June 2019, with only two funds performing below median.

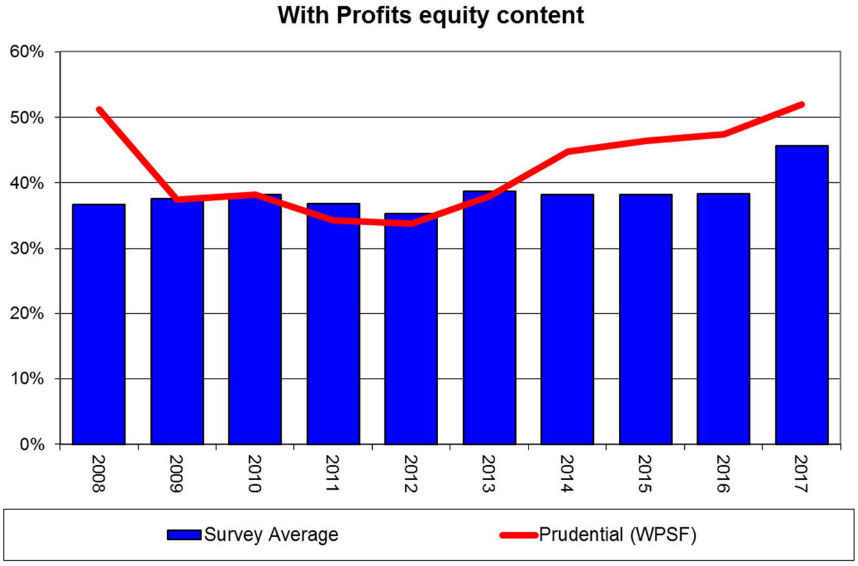
Lifestyle strategy options – During 2018, two Prudential Dynamic Growth IV Lifestyle strategies were introduced. They provide what Prudential describe as medium risk investment during the "growth phase" and, over the final ten year period before the anticipated retirement age, monies are gradually switched 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 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 2017. 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	Top	2nd	3rd	Bottom

To 31st December:	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Performance over decade
Prudential (WPSF)	-19.7%	18.7%	12.7%	2.1%	10.5%	10.3%	8.3%	3.6%	14.5%	10.3%	89%
Index returns	-16.1%	12.0%	10.6%	3.4%	7.2%	8.3%	9.2%	3.1%	13.5%	8.6%	73%
75th percentile	-8.8%	15.2%	12.9%	5.5%	10.4%	10.5%	9.7%	4.2%	13.5%	9.4%	116%
Median	-13.2%	11.5%	12.2%	3.2%	8.9%	9.0%	8.3%	2.4%	12.1%	8.1%	79%
25th percentile	-16.3%	9.0%	9.8%	1.0%	7.2%	5.0%	7.1%	1.3%	10.5%	6.2%	45%

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: 31/08/2019

	1 year	3 years	5 years
Prudential	0.75%	0.49%	0.49%
Providers in universe	3	3	3

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

The Bank of England increased the bank base rate to 0.75% in August 2018 and this was reflected in the rate of interest provided from the Prudential Deposit Fund.

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 impact on 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 will be developed and enhanced to deliver a focussed, digitally led, service. Some progress has been seen.

However, Prudential has recently announced that a number of funds will be closing in November 2019, and more are planned for 2020. They have indicated that these closures reflect their efforts to simplify the fund range by removing similar funds, and removing funds which have not achieved sufficient scale. The funds indicated are not currently in use by the Clwyd Fund.

In October 2019 Prudential demerged from M&G plc. This was described as being mainly to enable Prudential's Asia operations to be more fully valued by the market, as well as giving M&G more freedom to invest and grow its business". It is not expected to have a material impact on the UK operations.

Equitable Life

Equitable Life's closure Proposal is progressing and policyholders overwhelmingly voted in favour of the Proposal. Hence, the proposal now awaits High Court approval at the end of November and, assuming that is received, the transition to Utmost Life and Pensions Limited is expected to happen on 1st January 2020. 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 enhancement to disinvestments from the With Profits Fund, is expected to increase to 60%-70% for policies with a "just" a capital guarantee, and 60%-100% for those with a 3.5% guaranteed interest rate.

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

- The attraction of the closure to policyholders and to investors in the With Profits Fund is primarily dependent on:
  - The "Critical Yield", the net interest rate that a new investment would need to achieve to match each investors "Guaranteed Value" that they are contractually entitled too. Equitable has distributed data showing the Critical Yield required for each investor, but only at the Normal retirement age shown on Equitable Life's records.
  - What will the options for reinvestment be? Utmost's Investment Choice Booklet describes a default which will apply where policyholders / investors do not select a new investment option. Whilst Utmost has said "we believe [this default] would be appropriate for the needs of most policyholders and pension scheme members", we question this, at least for members who are close to retirement. How will Administering Authorities resolve this?
  - The LGA recently circulated Council's Opinion regarding administering authorities' "fiduciary duty" to vote on the Equitable proposal. The same logic applies to whether Utmost is the most suitable ongoing provider. For example, should members be reminded of their opportunity to transfer from Utmost to Prudential? Or even compulsorily transferred?

– A communication to members is obviously appropriate, as a general update as well as helping members to consider their future investment options, but a default position will still be needed in the event of no response.

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