

# AVC Monitoring Report

Clwyd Pension Fund

November 2022

**Hannah Long, Sandy Dickson**



# Contents

1.	Overview of AVCs	3
2.	Member Demographics	6
3.	Comments on AVC Providers	9
4.	Unit Linked Funds	12
5.	With Profit Funds	18
6.	Charges	22
7.	Recommendation and Next Steps	25
8.	Appendix	27

# Overview of AVCs



# Overview – Provider Data

Clwyd Pension Fund (The “Fund”)					
AVC Provider	Member numbers*	Asset Value	Fund range	Unit-linked / With profits	Guarantees applying
Utmost	49	£296,657	21 <sup>2</sup>	Unit-linked	No guarantees applied
Prudential**	603	£6,329,825 <sup>1</sup>	15 <sup>3</sup>	Unit-linked / With-profits	With profits guaranteed bonuses depending on date purchased
<b>Overall Total</b>	<b>652</b>	<b>£6,626,482</b>	<b>36</b>		

Source: Providers.

Utmost values as at August 2022.

Prudential values as at July 2022.

\*There are members invested in more than one fund.

\*\*Contributions are still being paid by Prudential policyholders.

<sup>1</sup> The asset value includes Terminal Bonus (c. £849,380) applied for the With Profit funds. This bonus, which is only applied at the time benefits become payable, is not guaranteed. The asset value also includes any Market Value Reduction.

<sup>2</sup> Members are only invested in 5 Unit-Linked funds.

<sup>3</sup> Members are only invested in 14 Unit-Linked funds and in the With Profits Accumulation Fund.

There were 16,996 active members and 17,361 deferred members in the Fund at 31 March 2022

# Overview of Contract Features

	Product Features			
AVC Provider	Lifestyle	Online access	Partial transfer options	Base contract charge
Utmost	Yes	No	Yes	n/a
Prudential	Yes	Yes	Yes	n/a

Source: Providers.

- 148 members at Prudential are invested in lifestyle strategies – 91 targeting cash and 57 targeting other options at retirement.

## AVCs at Retirement

- Members can take their AVCs as 100% tax free cash.
- Additionally, members can also choose to buy an annuity in the open market should they wish. Most, however, will either use as cash or re-invest back into the main fund for a fixed pension.

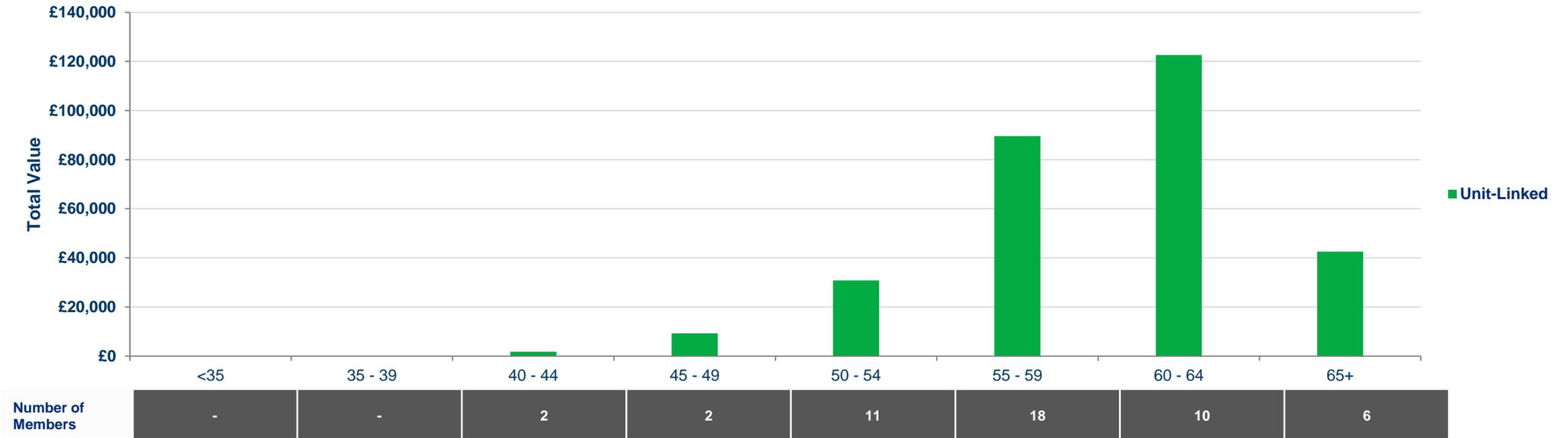
# Member demographics



# Appendix: Total Assets – Utmmost

## Member Demographics

Utmmost



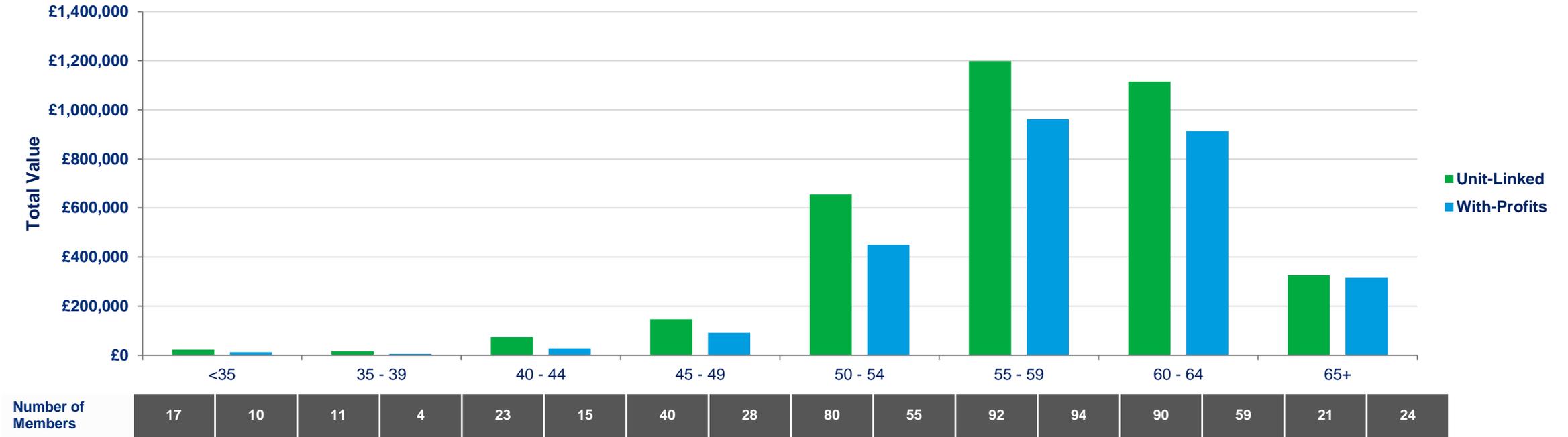
Values as at August 2022.

The Plan has 1 policy in place with Utmmost: E0095 with 49 policyholders. As at August 2022, there are 8 members who are invested in more than one fund.

# Appendix: Total Assets – Prudential

## Member Demographics

Prudential



Values as at July 2022.  
Prudential with profit values inclusive of terminal bonus.

The Fund has 1 policy in place with Prudential: L013 with 603 policyholders. As at July 2022, there are 336 members invested in more than one fund and 60 members holding both Unit-Linked and With-Profits funds.

# Comment on the AVC Providers



# Utmost Life and Pensions (ULP)

As at April 2022	<a href="https://www.utmost.co.uk">Home (utmost.co.uk)</a>
<b>Ownership and background</b>	ULP was established in 2017 by Utmost UK Group Holdings Ltd as a newly authorised UK life company 'run off' specialist – expected to be the operational base for further acquisitions of traditional books of life business. The first of these transactions was announced in June 2018 with the agreement with Equitable Life to transfer all of Equitable’s business to ULP – which completed on 1 January 2020 and significantly increased ULP's assets under management.
<b>Management of Funds</b>	JP Morgan Asset Management is Utmost’s investment partner, responsible for the design and management of the unit linked fund range.
<b>Current issues/recent developments</b>	Response times to requests for information can be lengthy. In common with most of their peers updates in respect of developments in respect of the fund range are intermittent.
<b>Sustainability</b>	Statement from their website: “The Utmost Group is an asset owner of £64bn of assets under administration, and our approach to managing investments can have a positive impact on the environment. The Group takes a pro-active approach to sustainable investing and is embedding a responsible investment approach throughout our portfolio. We are introducing a target to maintain a minimum average ESG score across our shareholder asset portfolio and are working to provide additional sustainable investment options to our customers.”

# Prudential

As at April 2022	<a href="#">Prudential With-Profits Fund   Investment Guide</a>
<b>Ownership and background</b>	Prudential is the Life & Pensions provider within the M&G Group. With profits funds are offered alongside a range of mutual funds and bespoke segregated and pooled mandates.
<b>With Profits Fund</b>	Prudential Assurance Company Ltd With-Profits Sub-Fund is open and is the largest with profits fund in the UK. The Scottish Amicable Insurance Fund is now closed.
<b>Management of With Profits fund</b>	The Prudential Portfolio Management Group, part of the M&G Treasury and Investment Office, is responsible for the strategic and asset management of the with profits funds. Assets are managed by a range of external managers together with M&G Investment Managers. Governance oversight is provided by the With Profits Committee. The Committee is appointed by the Prudential Assurance Company Board and will have at least three members, all independent and external to PAC.
<b>Current issues/recent developments</b>	<p><b>Service Levels.</b> The vast majority of business is now being completed within acceptable SLA levels (on an end-to-end basis). Prudential acknowledge that the tail includes both complex and more basic requests. Call waiting times have been steadily improving since November 2021, after a period of significant issues over the summer months. Local Government clients continue to face significant, tech related issues with regard to Annual Benefit Statements. An action plan is in place to address.</p> <p>There are numerous projects ongoing which in totality, should deliver the required service level improvements needed whilst also evolving the Prudential proposition. A key focus for 2022 is to increase the level of on-line data provision and interaction with their clients that will include the planned launch of a self-service website by the end of the year.</p> <p>Prudential recently wrote to the Fund to inform them that there had been some issues with the lifestyle strategies that members are invested in, and members hadn't transferred to lower risk assets as they should have during 2022. This means that some members have higher or lower fund values than they should. Prudential are in the process of identifying the impacted members, calculate if any compensation is due, and will confirm to the Fund in November 2022.</p>
<b>Sustainability</b>	<p>Statement from their website: "As a life insurer, asset owner and manager, Prudential plc is a long-term steward of its clients' assets. We have a responsibility to our clients, the communities and environment in which we operate, to apply Environmental, Social &amp; Governance (ESG) considerations into our investment decisions and our fiduciary and stewardship duties.</p> <p>The purpose of the Group Responsible Investment Policy is to guide the Business Units within the Group to articulate how they consider ESG factors in their investment activities. Prudential believes that ESG considerations are increasingly important elements of good investment practices. The objective of the Responsible Investment Policy and guidelines is to manage ESG risks and improve long run returns on assets. While conflicts of interest could occur, Prudential believes that incorporating ESG considerations in investment decisions and engagement will produce better results for both clients and communities"</p>

## AKG ratings (out of 5) for the open With Profits fund

With Profits Funds	Financial Strength	Future Performance	Transparency
Prudential Assurance Company Ltd With-Profits Sub-Fund	5	5	5

The ratings shown above were originally prepared by AKG Financial Analytics Limited (AKG), and are contained within AKG's 2021 UK Life Office With Profits Report. They are shown here with AKG's prior consent. Further information on AKG's With Profits Report is available at: <https://www.agg.co.uk/information/reports/with-profits-reports>

# ESG Considerations

## Net Zero Targets

### Prudential

In May 2021, Prudential announced plans to decarbonise its portfolio of assets held on behalf of its insurance companies with the goal of **becoming “net zero” by 2050**.

These include:

- A **25 per cent reduction in the carbon emissions of all shareholder and policyholder assets by 2025**
- A commitment to accelerate the transition to a low-carbon economy by **engaging with the companies** responsible for 65 per cent of the emissions in our portfolio

### Utmost

Utmost Group (which Utmost Life & Pensions is part of) have committed to a **net zero by 2050 with a 50% reduction by 2030 aligned with a maximum temperature rise of 1.5°C above pre-industrial levels as outlined in the Paris Agreement**. Utmost Group is a signatory to the UN PRI and a member of the IIGCC and is a supporter of the Financial Stability Board’s TCFD and endorses its recommendations.

# Unit Linked Funds

# 4

# Unit Linked Funds

## What are Unit Linked Funds?

- Members purchase units in funds which invest according to their particular objective.
- Returns to members are in the form of changes in the value of the unit price.
- Members realise a profit or a loss from an investment when the units in the fund are sold.
- For Clwyd Pension Fund, members are invested in 19 unit linked funds across Utmost and Prudential.



## What should we consider when reviewing?

- Tracking error and performance, relative to stated benchmarks, of the funds.
- Any potential value-add from the managers e.g. online services etc.
- Fund charges.
- Mercer ratings, if available.



# Utmost – Policy Details

The table below shows the fund value associated with the policy as at August 2022.

## Unit-Linked Funds



Fund	Members <sup>1</sup>	Fund Value
UK Equity	1	£105
Managed Pension	10	£75,962
Multi-Asset Growth	2	£3,909
UK Government Bond	1	£186
Money Market	44	£216,495

<sup>1)</sup> Some members are invested in more one fund.

We recommend the Fund communicate annually with members to ensure selected retirement age is correct and to remind them of the need to regularly review their AVC investments.

# Utmost – Fund Performance

Utmost have confirmed that the following unit-linked funds are invested in by members of the Fund:

Fund	Annualised Performance (%)	1 Year (%)		3 Year (% p.a.)		5 Year (% p.a.)	
		Sector Comparator	Fund	Sector	Fund	Sector	Fund
UK Equity	ABI UK All Companies	-5.0	-15.3	-0.1	-1.9	1.0	-0.4
Managed	ABI Mixed Investments (40-85%)	-7.8	-9.9	0.3	1.3	1.9	2.7
Multi-Asset Growth <sup>1</sup>	ABI Flexible Investment	-10.9	-7.8	n/a	n/a	n/a	n/a
UK Government Bond	ABI UK Gilts	-24.5	-25.9	-10.0	-10.0	-3.8	-3.9
Money Market	ABI Deposit & Treasury	0.1	0.2	-0.1	0.0	0.0	0.0

Source: Utmost, from Provider website. Performance as at 30 September 2022 gross of fees for funds invested by members.

<sup>1</sup>) Performance not available for 3 and 5 years. Fund inception is 01/01/2020.

## Comments and Considerations

Performance for the unit linked funds has been broadly in line with or above the sector comparator over the last 5 years, with exception of the Managed Pension Fund which has underperformed its sector comparator over the period.

# Prudential – Policy Details

The table below shows the fund value associated with the policy as at July 2022.

## With-Profits Funds



Fund	Members	Fund Value	Terminal Bonus <sup>1</sup>	Transfer Value <sup>2</sup>
With Profits Cash Accumulation Fund <sup>3</sup>	289	£1,947,139	£849,380	£2,776,767

<sup>1</sup>The terminal bonus, which is only applied at the time benefits become payable, is not guaranteed. <sup>2</sup>Includes Market Value Reduction which would be applied to certain members if they transferred.

<sup>3</sup>Also includes the With Profits Accumulation Fund Series 2

## Unit-Linked Funds



Fund	Members <sup>1</sup>	Fund Value
Global Equity	38	£150,025
International Equity	33	£285,003
UK Equity	19	£56,746
UK Equity Passive	10	£46,864
Dynamic Growth I	30	£83,955
Dynamic Growth II	86	£502,108
Dynamic Growth IV	149	£505,968
Positive Impact	28	£216,729
Discretionary	54	£371,301
Index-Linked	29	£81,075
Fixed Interest	18	£57,571
Long-Term Gilt Passive	21	£67,209
Deposit Fund	29	£212,257
Cash Fund	104	£916,248

<sup>1</sup> Some members are invested in more one fund.

We recommend the Fund communicate annually with members to ensure selected retirement age is correct, to remind them of the need to regularly review their AVC investments and to ensure that members invested in with profits understand the guarantee they have in place and the structure/value of the terminal bonus.

# Prudential – Fund Performance

Prudential have confirmed that the following unit-linked funds are invested in by members of the Fund:

Fund	Cumulative / Annualised Performance (%) Benchmark	1 Year (%)		3 Year (% p.a.)		5 Year (% p.a.)	
		Fund	B'mark	Fund	B'mark	Fund	B'mark
Global Equity	Composite	-8.8	-5.6	1.9	2.5	2.9	3.7
International Equity	Composite	-4.3	-8.2	5.2	4.9	5.2	5.9
UK Equity	FTSE All-Share Index	-12.0	-4.0	9.3	0.8	7.1	2.2
UK Equity Passive	FTSE All-Share Index	-5.1	-4.0	0.4	0.8	2.0	2.2
Dynamic Growth I	Composite	-15.1	-14.9	-2.5	-3.1	0.6	0.2
Dynamic Growth II	Composite	-13.3	-13.7	-1.4	-2.2	1.3	0.9
Dynamic Growth IV	Composite	-10.6	-11.1	0.3	-0.2	2.4	2.2
Positive Impact <sup>1</sup>	MSCI ACWI Index	-6.1	-3.7	n/a	-	n/a	-
Discretionary	Composite	-11.3	-8.1	0.9	1.6	2.6	3.3
Index-Linked	FTSE Actuaries UK Index-Linked Gilts Over 5 Years Index	-31.7	-29.3	-11.1	-10.7	-3.1	-2.8
Fixed Interest	FTSE Actuaries UK Conventional Gilts All Stocks Index	-24.7	-23.3	-9.7	-9.6	-3.5	-3.4
Long-Term Gilt Passive	FTSE Actuaries UK Conventional Gilts Over 15 Years Index	-36.4	-35.5	-15.9	-15.5	-5.8	-5.6
Deposit Fund	Bank of England Base Rate	0.7	0.8	0.4	0.4	0.5	0.5
Cash Fund	SONIA 1W	0.7	0.6	0.4	0.2	0.5	0.3

Source: Prudential. Performance as at 30 September 2022 gross of fees for funds invested by members

1) Positive Impact fund does not have performance available for the 3 and 5 years period. Fund was launched in 20 February 2020.

## Comments and Considerations

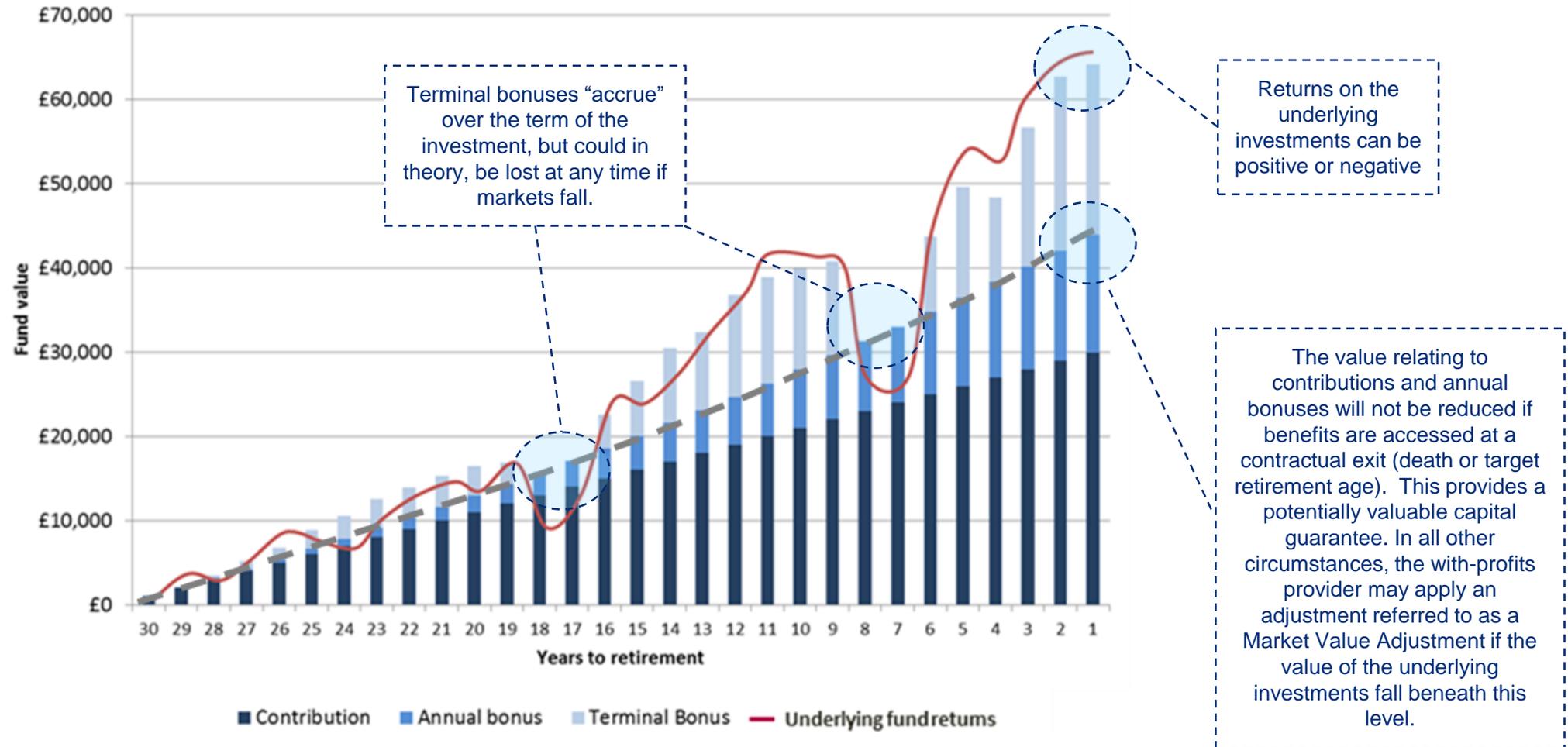
Performance for the unit linked funds has been broadly in line with their benchmarks over the last 5 years.

# With Profit Funds

# 5

# Overview of typical With Profit Funds

The chart below sets out the progression of a member's fund value throughout the lifetime of a typical with profits investment. The figures shown are for illustrative purposes only.



# Overview of typical With Profit Funds

## The Positives

- With profits funds are typically considered to be a fairly secure medium to long-term investment with reasonable potential performance from a pooled mix of assets including equities, property, bonds and cash.
- The costs of running with profits fund are largely deducted from the fund and what is left over is available to be paid to the with profits investors as “bonuses”:
  - **Annual (Reversionary) bonus**: which may or may not be partially guaranteed, and
  - **Terminal (Final) bonus**: a final bonus may be added on disinvestment (switch, transfer, retirement or death) depending on the performance of the underlying fund. These bonuses are payable by most (but not all) with profits funds.
- To avoid big changes in the size of bonuses each year, the insurer will hold back some of the return from ‘good’ years to provide a reasonable return during ‘bad’ years. This is known as “smoothing”.

## The Less Positives

- **Annual Bonuses** are a poor indicator of performance. Minimising guaranteed bonuses reduces the proportion of the with-profits fund which insurers have to invest cautiously (to protect their solvency position). On the other hand, low bonuses may just reflect poor underlying investment performance and/or low solvency reserves.
- **Terminal / Final bonuses** can be a huge proportion of the overall return and, in theory at least, they could be withdrawn overnight.
- Guarantees (within the with-profits fund rather than a specific policy) can necessitate a more cautious underlying investment strategy, to maintain the insurer’s solvency. This can severely restrain future investment performance for other policyholders too.
- Insurers can impose a **Market Value Reduction (MVR)** if disinvestment is other than (usually) the pre-selected retirement date or prior death. This could more than negate a terminal bonus and may be viewed by a member as a financial penalty on transfer.
- Historically, payout examples were provided via insurers’ regulatory returns, but these ceased to be available in 2017 due to the Solvency II Directive.

# With Profit Funds

## Valuation and bonuses

Fund	Members	Fund Value	Terminal Bonus <sup>1</sup>	Plan Value	Market Value Reduction	Transfer Value <sup>2</sup>
With Profits Cash Accumulation Fund <sup>3</sup>	289	£1,947,139	£849,380	£2,796,519	£19,752	£2,776,767

<sup>1</sup>The terminal bonus, which is only applied at the time benefits become payable, is not guaranteed. <sup>2</sup>Includes Market Value Reduction applied to certain members.

<sup>3</sup>Also includes the With Profits Accumulation Fund Series 2

- The Trustee's policy guarantees a minimum annual bonus of:
  - 4.75% p.a. in respect of contributions paid in Fund years ending before 15 March 1997;
  - 2.5% p.a. in respect of contributions paid into the Fund in years ending between 15 March 1997 and 30 December 2003 (inclusive); and
  - 0.01% p.a. in respect of contributions paid into the Fund in years ending after 30 December 2003.
- The annual bonus for 2020 was 1.25%, while for 2021 was 1.00%, where the higher guaranteed rates didn't apply.
- Members may receive a terminal bonus, however this is not guaranteed and could be reduced without notice.

# Charges

6

# Utmost – Fund Charges

Utmost have confirmed that the following unit-linked funds are invested in by members of the Fund:

Charges to 30 September 2022	AMC (% p.a.)	TER (% p.a.)
UK Equity	0.75	0.75
Managed	0.75	0.75
Multi-Asset Growth	0.75	0.75
UK Government Bond	0.50	0.50
Money Market	0.50	0.50

Source: Utmost, from provider's website, as at 30/09/2022. These figures may not reflect the charges faced by the members.

In addition, Utmost offer several other fund options which are available to members.

# Prudential – Fund Charges

Prudential have confirmed that the following unit-linked funds are invested in by members of the Fund:

Charges to April 2022	AMC (% p.a.)	TER (% p.a.)	Transaction costs (% p.a.) <sup>1</sup>
Global Equity	0.65	0.66	0.06
International Equity	0.65	0.68	0.01
UK Equity	0.65	0.66	0.07
UK Equity Passive	0.55	0.56	0.12
Dynamic Growth I	0.62	0.64	0.00
Dynamic Growth II	0.62	0.64	0.05
Dynamic Growth IV	0.62	0.63	0.05
Positive Impact <sup>1</sup>	0.65	0.66	0.01
Discretionary	0.65	0.67	0.06
Index-Linked	0.65	0.66	-0.14
Fixed Interest	0.65	0.66	0.15
Long-Term Gilt Passive	0.55	0.56	-0.01
Deposit Fund	N/A	N/A	0.00
Cash Fund	0.55	0.55	0.00

Source: Prudential. AMC and TER as at April 2022

<sup>1</sup>) Transactions cost as at March 2022

In addition, Prudential offer several other fund options available including lifestyle options.

# Recommendations & Next steps



# Recommendation & Next Steps

We have not considered a transfer away from Utmost or Prudential in this report, given that the AVC market is extremely limited and there are unlikely to be providers who will offer to open a new AVC arrangement. While consolidation between the two providers is possible, given the charges from Utmost it would only be appropriate to consolidate to Prudential.

## Unit-Linked Funds

- Unit-linked fund performance has been broadly good for Utmost and Prudential over the period shown.
- We recommend the Fund write to members to remind them of the need to regularly review their AVC investments and remind members over 50 of their benefits and the help available to consider the best options for them.
- We also recommend that the Fund's administrators confirm that the members with AVCs have not already drawn their Defined Benefit pension.
- There is currently no ESG-integrated fund available to members. Prudential do have several which could be added to the fund line up if appropriate.

## With Profits Funds

- Members with Prudential have terminal bonuses currently applying on their policies. Depending on when the funds were purchased, members may have guaranteed annual bonuses. We note that terminal bonuses are not guaranteed and could be withdrawn with no notice.
- We recommend the Fund communicate with members to ensure their selected retirement ages are correct and to ensure that members understand the guarantee(s) they have in place and the structure/value of the terminal bonus and consideration of the impact of any MVA.

Given the challenges in the AVC market, the only option for consolidation would be to move the Utmost members to Prudential, however given the challenges experienced from Prudential at the moment we do not recommend this at this time.

We therefore recommend that AVC members are sent a communication to remind them about the funds they are holding and the implications of moving funds before retirement; highlighting the Lifestyle strategies at Prudential that target cash.

Please note: This report does not contain regulated investment advice or regulated non-investment related advice. It sets out recommendations deemed appropriate based on the analysis provided in this presentation. Any actions to be taken from these recommendations need to be accompanied by regulated advice in accordance with Section 36 of the Pensions Act 1995.

# Appendix

# AVCs – Why this requires attention

## Case Study

Client had a 1,000 person DB Scheme. AVC arrangements were not reviewed over many years

The Scheme had AVCs with:

- Aviva
- Prudential
- Phoenix Life

AVC investments with Phoenix Life were invested in Deposit Funds, and had been since 1998 without the Trustee undertaking a review on suitability

A Phoenix Life member made a complaint through his IFA citing the Trustee not delivering the required level of AVC governance

The Ombudsman ruled in favour of the member which involved significant investigative time from Trustees (in this case) and their advisors

An agreed compensation amount was paid to the member by the Trustee. All other members invested in the Deposit Fund over this period of time were also included for a compensation payment.

The cost of investigation work to resolve the complaint was £35,000.

The compensation cost for all affected members was £140,000

All AVC arrangements were subsequently reviewed. Issues identified were AVC members that had taken main scheme benefits, members who had died, unsuitable investment choices, poor member communications.

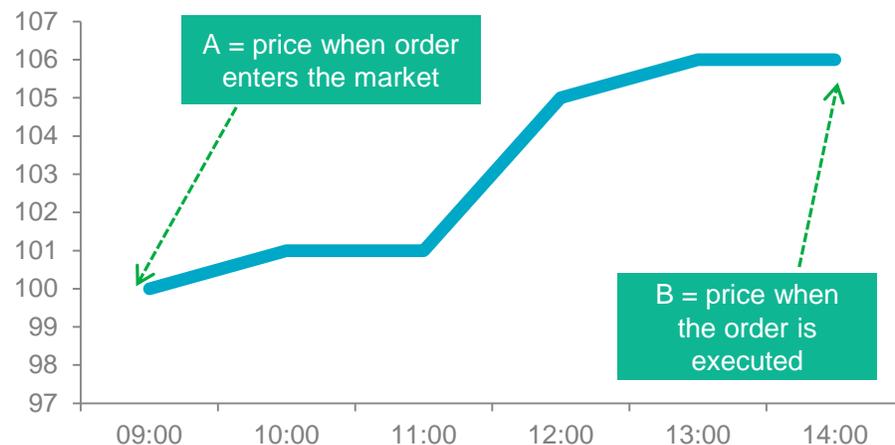
Changes were made as a result of the AVC review including consolidating to 2 AVC providers. Members achieved better outcomes and risks to Trustees reduced.



# Transaction Costs

## Slippage cost method

- Since April 2015, there has been a need to calculate and assess transaction costs as part of the DC value for money requirements and legislative disclosures in the annual Chair Statement.
- However, until 2018/2019 there was limited guidance as to how these costs should be calculated.
- It has now been clarified that in calculating of the transaction costs associated with buying and selling, managers must use the 'slippage cost methodology', as shown below.



$$\text{Slippage costs} = (\text{Execution price} - \text{Arrival price}) \times n$$

*Arrival Price = A*

*Execution Price = B + all charges, commissions, taxes and other payments associated with the transaction*

### EXAMPLE

A fund manager wishes to buy 1,000 shares. If the order goes in at 9am but the shares are not purchased until 2pm, the price of those shares could have moved in those 5 hours.

In the chart, the price has moved from 100p to 106p, meaning the price change is £60 for 1,000 shares. Also, some commissions and taxes will have been experienced (e.g. £5).

**Therefore, the overall 'slippage cost' is £65.**

- Slippage costs seek to capture the change in value when an investment is traded. This takes account of explicit and implicit costs associated with market movements. However, slippage costs can be positive or negative depending on how the market moves between arrival and execution and depends on the time period used.
- This makes comparisons across peers meaningless. At this stage it is therefore not possible to benchmark transaction costs against other arrangements. However, based on our review of the data we consider the transaction costs to be broadly as expected and similar to those observed by other schemes.

# Important Notices

- References to Mercer shall be construed to include Mercer LLC and/or its associated companies.  
© 2022 Mercer LLC. Mercer retains all copyright and other intellectual property rights in the report.
- This report contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission. Unless agreed otherwise, no additional work will be performed after the date of this report nor will it be updated to take account of any events or circumstances arising hereafter.
- Where AVC arrangements are established as a long-term insurance contracts, although Mercer only recommends the placing of business with insurers that it considers have a sufficient degree of financial strength, it accepts no responsibility or liability, including for consequential or incidental damages, for a particular insurer's insolvency. Mercer does not undertake to carry out monitoring of an insurer's financial condition on behalf of clients and makes no representations or warranties, expressed or implied, concerning the financial condition, solvency, or application of policy wordings of insurers or reinsurers.
- The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and could 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.
- Information contained herein has been obtained from a range of third party sources and Mercer has not sought to verify this information independently. 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 in the data supplied by any third party.
- This report does not contain regulated investment advice in respect of actions you should take. No investment decision should be made based on this information without obtaining prior specific, professional advice relating to your own circumstances.



Mercer Limited is authorised and regulated by the Financial Conduct Authority. Registered in England and Wales No. 984275. Registered Office: 1 Tower Place West, Tower Place, London EC3R 5BU