



# Report of the Director West Yorkshire Pension Fund to the meeting of Joint Advisory Group to be held on 30 July 2020

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## Subject: Review of Additional Voluntary Contribution Providers

### Summary statement:

West Yorkshire Pension Fund has 3 Additional Voluntary Contribution Providers, namely:

- Utmost Life and Pensions (previously Equitable Life),
- Scottish Widows, and
- Prudential.

Annually the West Yorkshire Pension Fund ask Aon's AVC Team to review the performance of the Additional Voluntary Contribution Providers in terms of investment performance, financial strength, investment capabilities, charging structure and administration. This report outlines the findings of the review.

### Recommendation:

The Joint Advisory Group consider whether further advice is sought on the removal or replacement of the Prudential International Fund

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## 1. Background

- 1.1 An active scheme member may elect to pay additional voluntary contributions (AVC's) into a scheme established between the administering authority and an approved insurer.
- 1.2 WYPF has three AVC providers, Utmost Life and Pension, Scottish Widows and Prudential.

The contributions paid during the year, fund values and membership information at 31 March 2020 are as follows:

	<b>Utmost Life and Pensions</b>	<b>Scottish Widows</b>	<b>Prudential</b>
Contributions	£	£	£5,702,677
Fund Value	£	£	£20,084,192
<b>Scheme members with an AVC Policy</b>			
31/03/2020			2,110
31/03/2019	490	1,060	2,047

- 1.3 The Occupational Pension Scheme (Investment) Regulations 2005 require trustees to monitor AVCs in line with a number of criteria, including the security and quality of the arrangements in place. For best practice purposes Aon have used these regulations to assess the Fund's AVC arrangements.
- 1.4 Aon continue to view Scottish Widows and Prudential as appropriate providers. They have no concerns over the suitability of Utmost Life and Pensions as a legacy AVC provider at this time.

## 2. Review of Utmost Life and Pensions AVC Plan

- 2.1 As reported in last year's report, the proposed transfer of Equitable Life to Utmost Life and Pensions went ahead on 1 January 2020.
- 2.2 Utmost Life and Pensions has not provided its Annual Financial Statement. It is therefore not possible to provide information on contributions, fund values and membership numbers.
- 2.3 AKG Financial Analytics Ltd (AKG), rates Utmost Life and Pensions' financial strength



as B (strong) which represents an improvement in provider financial strength of Equitable Life (which was rated as B- (satisfactory)). Aon have no concerns over Utmost Life and Pensions' financial strength.

- 2.4 Utmost Life and Pensions provides access to an 'investing by age strategy' which replaced the Equitable Life With Profits Fund and a range of unit linked funds.
- 2.5 Utmost Life and Pensions' unit-linked funds are managed by JP Morgan Asset Management and Aberdeen Standard Investments. Although Aon's Global Investment Manager Research Team does not research the specific funds held by the Funds' members it has down-graded a number of Aberdeen Standard Investment's funds following what proved to be an extended merger process between Aberdeen Asset Management and Standard Life and what Aon considered to be an uncomfortable outcome from the need to continue to offer two philosophies to existing clients, while at the same time attempting to realise synergies from combining the two investment teams.
- 2.6 Utmost Life and Pensions offers access to a lifestyle - like strategy (the investing by age strategy) and a range of funds that provide access to the main liquid asset classes including the major developed equity markets, and four multi asset funds.

Though the investing by age strategy has its limitations (the asset allocation is determined by age attained rather than term to retirement, and it retains a multi-asset allocation throughout rather than targeting a particular benefit format at retirement) it does provide members with access to an investment strategy that automatically reduces risk as members get older, rather than members having to switch funds themselves, if this is important to them.

Aon consider the investment options to be suitable for an AVC arrangement, and likely to be capable of meeting members' investment needs.

- 2.7 Utmost Life and Pensions applies a universal charging structure to all arrangements and there is no scope to review the charges on the AVC arrangement. The annual management charges ('AMC') for the funds that members invest in are set out in the table below.

Fund	AMC (%)
Asia-Pacific	0.75
Fund of Investment Trusts	0.75
Managed	0.75
Money Market	0.5 <sup>1</sup>
Multi-Asset Moderate	0.75 <sup>1</sup>
Multi-Asset Cautious	0.75 <sup>1</sup>
Secure Cash Fund	0.5
US Equity	0.75
UK Equity	0.75



UK FTSE All Share Tracker	0.5
With Profits (until 1 January 2020)	1.5

- *Source: Utmost Life and Pensions & Equitable Life*
- <sup>1</sup>*These funds are the underlying funds in the investing by age strategy.*

Aon regard the charges paid on unit-linked funds by the Fund's AVC members to be in line with current market rates, considering the number of members and level of assets under management

- 2.8 Aon had no concerns over the quality of administration of Equitable Life policies. Equitable Life's Governance Assurance Arrangement quoted service standards of 5 to 10 working days for the vast majority of administration tasks. Aon's experience was that its turnaround times were in-line with peers and it operated within these standards.

Equitable Life's employees and its administration system were transferred to Utmost Life & Pensions when the transfer took place therefore Aon expect no significant changes to administration standards, at least in the short term. However, in Aon's experience, Utmost Life and Pensions has adapted less well than some other providers to the requirement for remote working necessitated by COVID-19, and it believes this is largely a result of the functionality of the administration platform.

- 2.9 In regard to communication and reporting, Utmost Life and Pensions will continue to supply summary financial statements providing the information required for the Report & Accounts however Aon understand there will be some delays to usual timescales caused by Covid-19. Equitable Life was unable to provide scheme-specific governance reports and Aon believe this will also be the case for Utmost Life & Pensions.

Although members do not have online access to their policy, the Utmost Life and Pensions website includes a lot of useful information and is, in Aon's opinion, well set out and 'user friendly'.

### 3. **Review of Scottish Widows AVC arrangement**

- 3.1 Scottish Widows has not responded to Aon's requests for information. It is therefore not possible to provide information on contributions, fund values and membership numbers

- 3.2 Scottish Widows Limited is Lloyds' Banking Group's sole long-term insurance company. As at February 2020, AKG rated the overall financial strength of Scottish Widows Limited as B+ (very strong). It also commented that Scottish Widows Limited is a core component within Lloyds Banking Group and that it would expect the company to receive all necessary parental support, should it be required, to achieve its objectives.

Aon have no concerns over Scottish Widows' financial strength.



- 3.3 The range of funds offered through the Scottish Widows arrangement provides access to all the main asset classes and both active and passively managed funds, and an environmental fund.

Aon believe that the asset allocation of the bespoke lifestyle strategy at selected retirement age targets the format in which members are most likely to take these benefits and is therefore appropriate

In Aon's opinion, the range of investment options is likely to satisfy the investment objectives of most members.

- 3.4 The AVC arrangements benefit from a discount of 0.40% p.a. on Scottish Widows' standard total annual fund charge ('TAFC'). The TAFC is the sum of: a) the Scottish Widows Annual Management Charge, b) the External Fund Management Charge, if applicable c) the Multi-Manager Fund Management Charge, if applicable, and d) an allowance for any Other Expenses, if applicable.

Aon would regard the charges on the Scottish Widows AVC arrangement to be high compared to current market rates if it were considering the number of members and assets under management alone. However, the level of charges for LGPS arrangements also takes account of the fact that providers deal with multiple employers and payrolls and carry out a number of the duties typically undertaken by employers, such as joining new members. As such, Aon consider the level of charges paid by members to be reasonable.

- 3.5 Scottish Widows has experience of providing AVC arrangements to LGPS clients. It administers the AVC policies within the corporate pension servicing team.

Aon have generally found Scottish Widows to be rather slow and inflexible when responding to information requests. For example, it was told it would take 28 working days to provide the information it requested to complete the review.

Scottish Widows no longer allocates named individuals to manage schemes, and all requests are submitted to a central mailbox. In Aon's experience, this process has improved the speed and accuracy of dealing with information requests, though it may also reduce accountability for the services provided.

Despite Aon's criticism of Scottish Widows' reporting processes, it has no major concerns over standards of policy administration. As Scottish Widows carries out many of the tasks that would normally be performed by the employer. We continue to monitor service levels to make sure that members are receiving the service they expect.

- 3.6 Scottish Widows has invested heavily in its member website following feedback from its workplace pensions Independent Governance Committee and Aon believe the site has improved significantly.

In Aon's opinion, Scottish Widows' suite of communications tailored to LGPS clients is of a reasonably good quality and is accessible via the WYPF microsite, or via an internet search engine. Relevant information is set out in a clear manner. For



example, the total charges on unit-linked funds are very clearly disclosed in the charges calculator tool.

Scottish Widows provide governance reports for LGPS AVC arrangements on a quarterly basis. However, these appear to be very basic in terms of the management information provided and lack structure.

#### 4. **Review of Prudential AVC Arrangement**

4.1 As at 31 March 2020 there were 2,110 active members in the Prudential AVC arrangement. In addition 1 member buys life assurance through this arrangement.

4.2 AKG currently rates Prudential's overall financial strength as A (superior). This is the highest rating available and, as such, Aon has no concerns over Prudential's financial strength.

4.3 There are currently 16 funds available to new and existing members and 1 fund (the Prudential Deposit Fund) available to existing contributors as at 31 May 2017 (when this fund closed to new money).

Based upon Aon's advice, the Prudential Positive Impact Fund (launched in February 2020) was added to the AVC fund range.

Two of the funds previously offered were replaced as a result of the fund closures Prudential made last year and earlier this year. Prudential has announced it intends to close three more of these funds during 2020, but the closure dates have not yet been confirmed.

There are also two lifestyle options available to members.

4.4 Members are now invested in eight funds managed by M&G Investments (the in-house manager of Prudential funds) if the Prudential Positive Impact Fund and the Prudential Dynamic Global Equity Passive Fund are included.

Aon regard M&G as a strong UK bond manager (relevant to the Index-Linked Passive Fund) and a reasonable property and money market manager (relevant to the UK Property Fund and the Cash Fund). Aon's manager research team do not currently undertake active research on any M&G equity strategies. They have met with M&G from time to time to discuss specific equity strategies but have not found these sufficiently compelling compared to their existing buy-rated equity managers to warrant further research.

The Prudential Index-Linked Passive Fund provided a return in line with its benchmark before charges over all periods reported above. Aon have no concerns over the quality or suitability of this fund.

Relative fund performance of actively managed funds over 1, 3 and 5 years to 31 March 2020 was generally disappointing with the Deposit Fund being the only Fund that did not under-perform its benchmark in all three periods.



The majority of Prudential actively managed funds have a specified out-performance target, relative to the benchmark before charges over a rolling three-year period. None of these actively managed funds met their out-performance targets over the three years to 31 March 2020.

The Prudential International Fund managed to provide a positive return over 5 years, though more recent performance has been particularly disappointing (the Fund under-performed its benchmark by 6.3% after charges over the year to 31 March 2020). Aon regard this level of under-performance to be significant and therefore recommend the Administering Authority removes or replaces this Fund.

The Prudential UK Equity Fund under-performed the FTSE All Share in all periods reported above, and relative performance appears to have deteriorated over more recent periods.

The Prudential UK Property Fund under-performed its benchmark after charges in all periods reported above but the level of under-performance has been relatively consistent. This Fund has been suspended since June 2019, so members are unable to switch in or out of the fund (except in the event of retirement, death or serious ill health). This was one of the first UK Property funds to be suspended but most other funds have since been suspended as a result of the COVID-19 pandemic.

The Prudential Dynamic Growth IV Fund has provided a positive return in all periods reported above, which is impressive considering the impact of COVID-19 on markets in the first quarter of 2020.

- 4.5 All externally managed funds available to members are passively managed. The fund performance reported by Prudential indicates a far higher tracking error than that reported by the underlying funds, particularly over the year to 31 March 2020 but Aon are satisfied with the explanation that Prudential provides for this discrepancy (i.e. the Prudential funds may hold an element of cash due to the short delay between new investments being received by the Prudential fund and being placed in the underlying investment).

**BlackRock Aquila Funds** - Aon have a high regard for BlackRock as a passive fund manager and their Global Investment Manager Research Team has confirmed its 'buy' rating for BlackRock's index tracking funds. BlackRock passive equity portfolios are managed by a deep and experienced investment staff dedicated to passive equity management and BlackRock's size and structure allow it to provide clients with broad diversification at low costs by replicating various equity indices. Aon believe the firm combines a strong culture of risk management with high quality systems.

**Legal & General Ethical Equity Index** – Aon rate Legal & General's capability as a passive fund manager highly and our Global Investment Manager Research Team has confirmed its 'buy' rating for its index tracking funds, including the Legal & General Ethical Global Equity Index.

**HSBC** – Aon's Global Investment Manager Research team do not research or monitor the HSBC Islamic Global Equity Index but it is the only Shariah-compliant fund



available through Prudential's contract. Although relative performance of this fund has been disappointing, it has provided a net return of 10.1% p.a. over the five years to 31 March 2020.

- 4.6 The range of funds offered through the Prudential arrangement provides access to all the main asset classes; both active and passively managed funds and lifestyle strategies, two ESG funds and a Shariah fund. Aon therefore believe it is capable of satisfying members' investment objectives, although the range of external actively managed funds has reduced significantly as a result of the fund closures made by Prudential in recent years.
- 4.7 Fund members can use their AVCs to provide their tax-free cash entitlement from the LGPS and/or use AVCs to provide additional pension from the LGPS. Aon therefore believe the asset allocation of the lifestyle options at retirement targets the format in which members are most likely to take these benefits (i.e. cash) and is therefore appropriate.

Aon's view remains that members investing through a lifestyle strategy should invest in growth assets, such as equities, in the early stages as these assets are expected to provide good levels of growth over the long term, and members are able to withstand the increased volatility associated with such investments. The passive lifestyle option offered through the AVC arrangement is therefore well-aligned with our investment thinking in this respect.

The active lifestyle option now invests in the Prudential Dynamic Growth IV Fund until 5 years before selected retirement age, then switches to the Prudential Cash Fund. Aon do not research or actively monitor the Dynamic Growth IV Fund and cannot therefore comment on it's conviction it will meet its investment objectives in future. However, it appears to offer a well-diversified investment strategy and has achieved positive returns after charges in all periods reported above.

- 4.8 Prudential operates a standard charging structure for all LGPS AVCs, although it has previously indicated it may consider scheme-specific pricing in future, there have been no further announcements regarding this development over the last year.

All fund replacements made by Prudential over the last 12 months, have reduced the level of charges members pay from their fund.

Current charges are shown in the table below:

Fund	AMC (%)
Prudential Cash	0.55
Prudential Deposit	N/A <sup>2</sup>
Prudential Index-Linked Passive	0.55 <sup>3</sup>
Prudential Dynamic Growth IV	0.62 <sup>3</sup>
Prudential UK Property	0.65 <sup>4</sup>
Prudential UK Equity	0.65 <sup>3</sup>
Prudential International Equity	0.65 <sup>3</sup>





Prudential Dynamic Global Equity Passive	0.54 <sup>3</sup>
Prudential Positive Impact	0.65
BlackRock Aquila Emerging Markets Equity	0.80
BlackRock Aquila World ex-UK Index	0.65
BlackRock Aquila UK Equity Index	0.65
BlackRock Aquila Consensus	0.65
BlackRock Aquila All Stocks Corporate Bond Index	0.65
BlackRock Aquila Over 15 Years UK Gilt Index	0.65
HSBC Islamic Global Equity Index	0.80
LGIM Ethical Global Equity Index	0.85

<sup>2</sup> There are no explicit charges on this Fund.

<sup>3</sup> There are additional expenses of 0.01% p.a. on these Funds.

<sup>4</sup> The additional expenses on this Fund are 0.53% p.a. on this fund making the total explicit charge 1.18% p.a.

Although Prudential has a reputation for relatively high charges compared to other insurers, for LGPS arrangements the provider deals with multiple employers and payrolls and carries out a number of the duties typically undertaken by employers, such as joining new members, and this makes policies more expensive to administer. Aon therefore regard the current level of charges to be reasonable.

- 4.10 Prudential transferred policy administration from Capita to Diligenta with effect from 1 July 2018. Although Aon has experienced some issues during the transition, it is not aware of any issues with the Fund's AVC arrangement. Over the longer term, Aon expect this change to provide significant improvements in technology (straight-through processing) and reduce manual processes, as well as providing members with better online access to their AVC policy.

Like all providers, Prudential's turn-around times have been impacted by COVID-19. However Aon consider its business continuity plans to have been relatively effective in prioritising core financial transactions and maintaining an acceptable level of service to clients throughout. This has been helped by the client account managers who have taken ownership of a number of tasks that would normally be delegated to the administration teams.

- 4.11 Aon believes Prudential's suite of communications tailored to LGPS clients is of very good quality. Aon regard Prudential's literature as informative and well written, and the Fund's members benefit from its customisation to the LGPS. Relevant information is set out in a clear manner. For example, the total charges on unit-linked funds are very clearly disclosed in the Fund-specific investment guide.

In 2018 Prudential withdrew its worksite marketing services to participating employers. However, it is still able to support the Administering Authority with a range of additional communication materials, such as flyers to include with annual benefit statements, wording for member newsletters, emails and case studies.



The Fund receives a governance report on an annual basis and Aon consider this frequency of reporting to be appropriate; given the number of members and assets under management. Prudential is also happy to attend meetings to present its governance reports.

## **6. Recommendations**

- 6.1 The Joint Advisory Group consider whether further advice is sought on the removal or replacement of the Prudential International Fund.

