Report of the Managing Director of West Yorkshire Pension Fund to the meeting of Joint Advisory Group to be held on 26 January 2023

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Subject: Local Government Pension Scheme Regulations update

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.

EQUALITY & DIVERSITY:
Not Applicable

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1 Background

1.1 An active scheme member may elect to pay additional voluntary contributions (AVCs) into a scheme established between the administering authority and an approved insurer.

1.2 WYPF has three AVC providers, Utmost Life and Pensions, Scottish Widows and Prudential.

The contributions paid during the year, fund values and membership information at 31 March 2022 are as follows:

	Utmost Life and Pensions	**Scottish Widows**	**Prudential**
Contributions	£14,784	£436,690	£8,501,941
Fund Value	£1,980,415	£10,239,878	£30,856,548
Members with an AVC Policy	350	747	1,368

1.2 The total number of members has decreased by c.29%, from 3,492 to 2,465 since 31 March 2020 (Aon did not report on the AVC arrangements in 2021).

Total assets under management increased by 31% since 31 March 2020 and the level of contributions paid increased by 46%.

1.3 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 The former Equitable Life AVC arrangement was transferred to Utmost Life and Pensions on 1 January 2020.

2.2 Utmost Life and Pensions is rated B (‘Strong’) by AKG (an independent organisation that assesses financial strength). The transfer of policies from Equitable Life to Utmost Life and Pensions resulted in an improvement in provider financial strength.

2.3 Utmost Life and Pensions offers 13 unit-linked funds and members invest in 11 of these, namely Global Equity, US Equity, UK Equity, UK FTSE All Share Index Tracking, Multi-Asset Moderate, Managed, Multi-Asset Captious, Sterling Corporate Bond, UK Government Bond and Money Market Funds.

2.4 The ‘Investing by Age’ Strategy was the ‘default’ strategy proposed by Equitable Life for funds transferred from the With Profits Fund when it closed. As at 31 March 2022, 92% of the assets held with Utmost Life and Pensions were invested in this strategy.

2.5 The underlying fund manager of the former Equitable Life funds is abrdn, whilst the new Utmost Life and Pension funds are managed by JP Morgan Asset Management. Aon's global investment manager research team do not research any of the funds members invest in. Their assessment of the quality and suitability of these funds is therefore based upon more general views of the investment managers and past performance analysis. Aon have no major concerns with respect to the overall investment capabilities of the underlying managers.

Performance of the majority of funds, relative to the ABI sector average reported here, has been strong. The Managed Fund was the only fund that under-performed over 3 and 5 years and the Sterling Corporate Bond Fund was the only actively managed fund to under-perform its sector average over the year. The FTSE All Share Tracker provided returns in line with its benchmark index before charges.

2.6 The Investing by Age Strategy provides an automatic de-risking strategy for members; however, it has some limitations:

- Asset allocation is determined by age attained rather than term to selected retirement age and
- It provides no flexibility for members to choose the age at which their fund is de-risked.

The strategy retains a multi-asset approach until members are age 75 and is therefore best suited to members who access their funds by flexi-access drawdown. Aon believe the Fund's members are more likely to access their AVC funds as cash at the same time they access their defined benefits. This means that the at-retirement asset allocation of this Strategy is not well-aligned to how members are expected to access funds. This strategy also exposes members' AVC funds to investment risk until they take benefits.

From a member point of view, the key investment objective of the multi-asset funds underlying the Investing by Age strategy is to provide sufficient returns to ensure members are not worse off at retirement than if they had remained invested in the With Profits Fund. Although the performance history is too short to draw any meaningful conclusions over the quality of these funds, Aon believe the asset allocation of these funds remains capable of achieving the returns required to meet the investment objective over the longer term.

2.7 The charging structure for this arrangement remains unchanged from that of the Equitable Life policy. They are not scheme-specific and so there is no scope for the Administering Authority to negotiate lower charges.

The TER is capped at the annual management charge ('AMC') so Utmost Life and Pensions absorb any additional expenses.

In Aon's experience, charges are higher than current market rates, but in line with the legacy arrangements of other providers.

The AMC for each fund is shown in the table below:

Fund name	AMC (%)
Global Equity	0.75
US Equity	0.75
UK Equity	0.75
UK FTSE All Share Index Track	0.50
Multi-Asset Growth	
Multi-Asset Moderate	0.75
Managed	0.75
Multi-Asset Cautious	0.75
Sterling Corporate Bond	0.75
UK Government Bond	0.50
Money Market	

Source: Utmost Life and Pensions

2.8 In terms of administration, the Equitable Life administration team and administration platform was transferred to Utmost Life and Pensions and service standards have been maintained at 5 to 10 working days for most tasks. The team is relatively small and members are experienced and knowledgeable. In Aon's experience service has been relatively good, taking account of the challenges of operating an old administration platform remotely during lockdown and post-lockdown, as some administration support staff have continued to work remotely.

2.9 With regards to communications and reporting, The Utmost Life and Pensions website includes a lot of useful information and is, in Aon's opinion, well set out and 'user friendly'. Online access to policy information is not available to AVC members, but it has recently been introduced for personal pension policyholders, and Aon understand it may be offered to members of group schemes at some point in future.

2.10 Reporting by Utmost Life and Pensions is limited to the annual summary financial statement which provides the information required for the Report & Accounts.

3. Review of Scottish Widows AVC arrangement

3.1 AKG upgraded Scottish Widows' overall financial strength to A (superior) in August 2021, recognising that Scottish Widows Ltd represents the UK long term life insurance business of Lloyds Banking Group plc and is the key provider of life assurance and pensions in the Group. Furthermore, the purchase of the Zurich's workplace business is demonstrative of a growth and development focus in key customer areas and solvency coverage remained good throughout the COVID-19 pandemic.

This is the highest rating available and, as such, Aon have no concerns over Scottish Widows' financial strength.

3.2 Scottish Widows gradually replaced abrdn as its fund manager between 2018 and 2022, following the merger between Aberdeen Asset Management and Standard Life in 2017 (which it regarded as a competitor). Scottish Widows appointed Schroders as the active manager and BlackRock as the passive manager.

Aon's global investment manager research team do not research any of the Scottish Widows funds members invest in. Aon's assessment of the quality and suitability of the funds members invest in is therefore based upon our more general views of the investment managers and past performance analysis. However, Aon do 'buy' rate a number of Schroders strategies and all BlackRock passive equity and fixed income funds. Aon have no concerns over these manager's overall investment capabilities or processes.

The funds with a significant allocation to growth assets i.e., the Property, Consensus and Environmental funds, and the Indexed Stock fund provided a positive return over all periods reported. The Pension Protector, Corporate Bond, Indexed Stock and Cash Funds all under-performed their sector over all periods reported

With regards to the externally managed funds Aon have no concerns over State Street's passive fund management capabilities. Scottish Widows reports the performance of these funds against the relevant ABI sector average therefore Aon have sourced benchmark performance directly from State Street Global Advisors (SSgA) to show tracking differences.

All three SSgA funds provided positive returns in periods reported and performance was consistent with market returns.

3.3 Aon state the range of funds offered through the Scottish Widows arrangement provides access to all the main asset classes (including property), both active and passively managed funds, a responsible investment fund and a lifestyle strategy. Aon therefore believe the investment options are capable of satisfying most members' investment objectives.

3.4 The lifestyle strategy aligns relatively well with Aon's view that members should invest in growth assets, such as equities, in the early stages as these assets are expected to provide capital growth over the long term, and members are able to withstand the increased volatility associated with such investments, as their fund has time to recover before they take benefits. Aon also 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. However, the strategy has a fixed over-weight allocation (relative to market capitalisation) to UK equities in the growth phase. Aon believe this represents concentration risk and it has acted as a drag on performance in recent years. Aon therefore favour a more global approach to provide greater diversification and better long-term capital growth potential. Aon has previously recommended that the Administering Authority considers replacing the SSgA 50:50 Global Equity Index Fund within the bespoke lifestyle strategy.

Scottish Widows does not offer a passively managed global equity fund without fixed geographic weightings. So, although one solution would be to use both the SSgA International and UK Index Funds in the growth phase (if Scottish Widows was prepared to re-balance funds regularly), Aon believe a more pragmatic approach would be to consider a Scottish Widows 'off the shelf' lifestyle strategy, such as the Adventurous Pension Investment Approach targeting lump sum. Use of this lifestyle strategy would also address Aon's previous recommendation to introduce a transition phase to increase asset diversification as retirement approaches.

3.4 The AVC arrangement benefits from a discount of 0.40% p.a. on Scottish Widows' standard total annual fund charge ('TAFC'). The TAFC is the sum of:

1. the Scottish Widows Annual Management Charge,
2. the External Fund Management Charge, if applicable
3. the Multi-Manager Fund Management Charge, if applicable, and
4. an allowance for any Other Expenses, if applicable.

The TAFC on approved funds, including the 0.4% discount, are set out in the table below:

Fund name	TAFC (%)
BNY Mellon Global Equity	0.94
Invesco High Income	1.52
Property	0.85
Consensus	0.60
BNY Mellon Managed	0.796
abrdn Global Absolute Return Strategies	1.45
Environmental	0.60
Pension Protector	0.60

Corporate Bond	0.60
Indexed Stock	0.60
Cash	0.60
SSgA International Equity Index	0.605
SSgA 50:50 Global Equity Index	0.603
SSgA UK Equity Index	0.60

Source: Scottish Widows

The charges on the Scottish Widows AVC arrangement are high, relative to current market rates for non-LGPS arrangements. However, the level of charges members pay within LGPS AVC arrangements 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, we consider the level of charges paid by members of this arrangement to be reasonable.

3.5 When it comes to administration, Aon have generally found Scottish Widows to be rather slow and inflexible when responding to information requests. Our experience is that Scottish Widows has been slow to implement changes required to the Fund's AVC arrangements.

All service and information requests are submitted to a central mailbox now that Scottish Widows no longer allocates named individuals to manage schemes. 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 historic standards of policy administration.

Scottish Widows has historically administered AVC policies within the corporate pension servicing team however administration was migrated to the Diligenta platform in August 2022. The stated aim of this outsourcing is to improve members' digital experience and Aon acknowledge this may be achieved in the longer term however its current impact on service gives Aon and us cause for concern. The key issues appear to be identical to those experienced by Prudential when it migrated policies to Diligenta i.e., issues with allocating contributions to member accounts and severe delays to dis-investments. Scottish Widows has stated it expected issues to be resolved by the end of 2022 but based upon the length of time issues have persisted at Prudential, Aon believe there is a risk this could take far longer. We are acting on Aon's recommendation to monitor the situation to check that issues are resolved within the timescales proposed by Scottish Widows and that members receive an acceptable level of service.

3.6 In terms of communications and reporting, Scottish Widows has invested heavily in its member website in recent years, and one of the key reasons for migrating legacy policies to the Diligenta platform is improvement in members' digital experience.

Scottish Widows provides a microsite for the Fund, which is accessible via the WYPF microsite, or via an internet search engine. Unfortunately, a key document for members, the employee booklet, has not been available for many weeks. Scottish Widows has been slow to make and approve changes to AVC literature in the past, and this appears to be a further example of this, but Aon has not been able to verify this assumption with Scottish Widows.

In Aon's opinion, communication materials available through the microsite are of reasonably good quality and relevant information is set out in a clear manner but it is not particularly well tailored to LGPS, or occupational pension schemes in general. However, when carrying out this review we have identified a number of mistakes or potentially misleading information in the fund factsheets. Aon also fail to understand why Scottish Widows has not updated the names of the externally managed funds (from Newton to BNY Mellon, and from Standard Life Investments to abrdn), as this can make it difficult to find further information about the underlying funds.

Historically, Scottish Widows has provided governance reports for LGPS AVC arrangements on a quarterly basis. However, these were very basic in terms of the management information provided and lacked structure.

4. Review of Prudential AVC Arrangement

4.1 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.

4.2 The underlying fund manager of Prudential's internally managed funds is M&G Treasury & Investment Office, although many of the underlying component funds of the Dynamic Global Equity Passive, the Dynamic Growth IV and the Dynamic Growth II Funds are managed by BlackRock.

Aon's global investment manager research team does not currently undertake active research on any of the Prudential funds members invest in. Aon's assessment of the quality and suitability of these funds is therefore based upon more general views of the investment managers' capabilities and past performance analysis.

The actively managed International Equity and UK Equity funds have a specified outperformance target. Neither fund achieved its outperformance target over periods reported.

M&G makes active asset allocation decisions for the Dynamic Growth Funds but uses predominantly passively managed funds to achieve this. These funds have performed broadly in line with their benchmarks over 3 and 5 years. Over one year, they have not tracked the benchmark as well as Aon would expect but this does not give Aon cause for concern, in view of the levels of volatility seen in markets over this period.

The Positive Impact Fund under-performed its MSCI All World Index benchmark over the year, but this is expected, given its lack of exposure to the energy sector, which was the best-performing

The Index-Linked Passive Fund tracked its benchmark before charges over all periods reported, therefore returns were in line with expectations. Index-Linked Gilts significantly out-performed nominal gilts over the year to 31 March 2022 due to increased break-evens which were driven by expectations of more persistent inflation, however they have been subject to the volatility we have seen since then.

Only one-year performance is available for the Dynamic Global Equity Passive Fund and tracking difference from the benchmark has been higher than Aon would expect. However, as with the Dynamic Growth Funds, this does not give us cause for concern, in view of the levels of volatility seen in markets over this period.

With regards to the externally managed funds, these are now passively managed, as Prudential has gradually withdrawn access to external actively managed funds on its platform in recent years. Prudential cited high costs as the reason for these fund closures, however many of these funds had reduced their charges.

The fund performance reported by Prudential for the external passive funds indicates a far higher tracking difference than that reported by the underlying funds, particularly over the shorter term. However, 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). Aon also believe differences in the time of day the Prudential funds are priced, relative to the benchmark index is a factor here. This is a common issue for external passively managed funds and it does not give Aon cause for concern as long as a ‘look through’ to the underlying funds shows they are closely tracking their benchmark.

4.3 There are two bespoke lifestyle options available to members of the Prudential arrangement.

The passive lifestyle option invests in the Prudential Dynamic Global Equity Passive Fund in the 'growth' phase. It commences switching five years prior to a member's selected retirement age into the Cash Fund, such that 100% is invested in the latter fund at the member's selected retirement age.

The active lifestyle option available to members invests in the Prudential Dynamic Growth IV Fund in the 'growth' phase. It commences switching five years prior to a member's selected retirement age into the Cash Fund, so that 100% is invested in the latter fund at the member's selected retirement age.

Aon’s view remains that members investing through a lifestyle strategy should invest in growth assets, such as equities, in the early stages. These assets are expected to provide capital growth over the long term, and members are able to withstand the increased volatility associated with such investments, as their fund has time to recover before they take benefits. The passive lifestyle option offered through the AVC arrangement is therefore well-aligned with Aon’s investment thinking in this respect. The active lifestyle option uses the Dynamic Growth IV Fund in the growth phase and this Fund has an allocation to equities of up to 80%, which Aon consider acceptable, given the very limited range of actively managed growth funds available.

Aon feel the lifestyle strategies are relatively simple, with just two underlying funds. It believes better member outcomes could be achieved by the introduction of a transition phase which would also allow the switch to cash to take place closer to retirement. However, it is unlikely that Prudential will be willing to make changes to the lifestyle strategies at the current time.

4.4 Aon feel the investment options offered through the Prudential arrangement provide access to the main liquid asset classes, active and passive managed funds and lifestyle strategies, two ESG funds and a Shariah fund. Aon therefore believe they are capable of satisfying members' investment objectives. However, access to externally managed active funds has gradually been removed as a result of the fund closures made by Prudential in recent years. The only true actively managed funds are the Prudential International Equity and UK Equity funds, and neither of these funds met their performance targets over periods reported here. Furthermore, Prudential no longer offers a property fund.

4.5 Prudential offers LGPS-specific pricing for unit-linked funds, which is more competitive than its standard rates. In our experience, charges for unit-linked funds are in line with LGPS arrangements offered by other providers and with other providers' legacy arrangements.

The Total Expense Ratio ('TER') for each fund is shown in the table below:

Fund name	TER (%)
Prudential Dynamic Global Equity Passive	0.54
BlackRock Aquila UK Equity Index	0.62
BlackRock Aquila World ex.UK Index	0.63
HSBC Islamic Global Equity Index	0.80
LGIM Ethical Global Equity Index	0.85
Prudential UK Equity	0.66
Prudential International Equity	0.68
BlackRock Aquila Emerging Markets Equity	0.80
Prudential Positive Impact	0.66
BlackRock Aquila Consensus	0.63

Prudential Dynamic Growth I	0.64
Prudential Dynamic Growth II[1]	0.64
Prudential Dynamic Growth IV	0.62
BlackRock Aquila All Stocks Corporate Bond Index[2]	0.63
Prudential Index Linked Passive	0.56
BlackRock Aquila Over 15 Years UK Gilt Index[4]	0.62
Prudential Deposit Fund	Not applicable[3]
Prudential Cash	0.55

Source: Prudential

Prudential has a reputation for relatively high charges compared to other insurers for non- LGPS AVC arrangements. However, within the LGPS, AVC providers deal with multiple employers and payrolls and carry out a number of the duties typically undertaken by employers, such as joining new members. This makes LGPS AVC arrangements more expensive to administer, and less commercially attractive to providers. In view of this, Aon regard the charges on the arrangement to be reasonable, given the complexity of LGPS arrangements and the additional tasks carried out by Prudential.

4.6 In terms of administration, Prudential's outsourcing model of operation is relatively mature, including increasing volumes of administration offshored to India. Prudential initially outsourced policy administration to Capita in 2008. In 2018, it announced it was replacing Capita as its outsource partner with Diligenta (the Financial Conduct Authority-regulated business of TATA Consultancy Services). This move was a key part of Prudential's ambition to become a lower-cost digital organisation, with Diligenta also becoming responsible for some of Prudential's IT infrastructure.

Migration to the Diligenta BANCS platform took place in Q4 2020. Resulting IT issues have taken many months to resolve, creating a significant backlog and resulting in poor standards of administration and service. Prudential has been very difficult to engage with during this time. Telephone helpline wait times for clients and members have been in excess of an hour, and this has been exacerbated by the lack of client relationship managers.

Prudential reported itself to the Pensions Regulator and has been proactive paying financial redress to members dis-advantaged by poor service and delays.

[1] This Fund is not part of the fund range, but is held within the arrangement as a result of a transfer in.

[2] Prudential previously announced that it intended to close this Fund but has taken no action to do so to date

[3] The Prudential Deposit Fund is not subject to any explicit charges, the rate of interest declared is net of the costs of running th

However, Aon believe the length of time poor service has persisted indicates that Prudential may not have sufficient control over third party operations. We continue to monitor Prudential's standards of service.

4.7 With regards to communications and reporting, the Fund's members benefit from Prudential's customisation to the LGPS. Aon believe the suite of communications tailored to LGPS clients is of good quality, with relevant information 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.

Prudential stopped offering worksite marketing services to participating employers a number of years ago and has since significantly reduced the number of account managers available to support employers and Administering Authorities.

Reporting has been impacted by the wider service issues resulting from the administration platform migration, such that many reports have been issued late or not at all. Prudential has given no indication that its level of commitment to LGPS AVCs has fallen, though it is likely its offering will remain pared back compared to what has been provided historically, as it focuses on reducing costs.

5. OTHER CONSIDERATIONS

None

6. FINANCIAL & RESOURCE APPRAISAL

None

7. RISK MANAGEMENT AND GOVERNANCE ISSUES

None

8. LEGAL APPRAISAL

None

9. OTHER IMPLICATIONS

9.1 SUSTAINABILITY IMPLICATIONS

None

9.2 GREENHOUSE GAS EMISSIONS IMPACTS

None

9.3 COMMUNITY SAFETY IMPLICATIONS

None

9.4 HUMAN RIGHTS ACT

None

9.5 TRADE UNION

None

9.6 WARD IMPLICATIONS

None

9.7 AREA COMMITTEE ACTION PLAN IMPLICATIONS (for reports to Area Committees only)

None

9.8 IMPLICATIONS FOR CORPORATE PARENTING

None

9.9 ISSUES ARISING FROM PRIVACY IMPACT ASSESEMENT

None

10. NOT FOR PUBLICATION DOCUMENTS

None

11. OPTIONS

None

12. RECOMMENDATION

To instruct Scottish Widows to replace WYPF's bespoke LifeStyle strategy with its Adventurous Pension Approach Strategy Targeting Lump Sum.

13. APPENDICES

None