

# Pensions Committee

27 March 2019

<b>Report Title</b>	Additional Voluntary Contributions Review	
<b>Originating service</b>	Pension Services	
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## Recommendation for decision:

The Committee is asked to approve:

1. The proposed changes to the default fund and investment options provided to members who hold Additional Voluntary Contribution accounts with the Fund's provider Prudential, as summarised in section 4.

## Recommendations for noting:

The Committee is asked to note:

1. The work undertaken to monitor, review and enhance the arrangements for members with Additional Voluntary Contribution accounts.
2. The update in relation to the Equitable Life legacy additional voluntary contributions arrangement, with communications set for issue to members in coming months.

## **1.0 Purpose**

- 1.1 To provide Committee with a summary of the review of the Fund's Additional Voluntary Contribution (AVC) arrangements and the proposed changes to ensure these provide good value and options for members.

## **2.0 Background**

- 2.1 Under the Local Government Pension Scheme (LGPS) Regulations, each LGPS Fund is required to provide access to an AVC arrangement where Fund members can elect to pay additional contributions to increase retirement savings and/or to provide additional life insurance. Although this is an individual choice, the administering authority is the policyholder for the group arrangement in place and, therefore, has associated responsibilities.
- 2.2 The Pension Regulator's Code of Practice states that Defined Contribution schemes, including AVC arrangements for Defined Benefit schemes such as the LGPS, should meet certain aims. They should be efficient, effective and give "value for members". These aims should be regularly evaluated to ensure this continues to be the case.
- 2.3 The market of AVC providers has been declining and contracting as a range of alternative options for tax-efficient and pension savings have emerged. There is limited competition and provision for the LGPS, which requires administrative functions to deal with the large volume of employers, is dominated by the Fund's provider Prudential. The Fund also has legacy arrangements with Equitable Life.
- 2.4 Fund officers regularly meet with Prudential (as primary AVC provider) and receive governance reports on a quarterly basis. Just over 5,000 members currently participate across the two the AVC arrangements. The last formal independent review of the AVC arrangements was undertaken in 2013. This most recent review commenced in 2017, following the introduction of pension Freedom and Choice, with conclusion delayed pending consultation and confirmation of changes to LGPS Regulations in relation to AVC arrangements. During this time, the Fund has engaged in an ongoing dialogue with Prudential on product charges and ancillary service arrangements.
- 2.5 The review of AVC arrangements, undertaken by the Fund's investment consultant, Hymans Robertson, has covered both Prudential and legacy arrangements (not open to new members) provided by Equitable Life.
- 2.6 Following review of the commentary and recommendation with Hyman's report, the Fund has proactively engaged with Prudential to further a number of these matters, as outlined below, before bringing final recommendations to Committee.

### **3.0 Prudential**

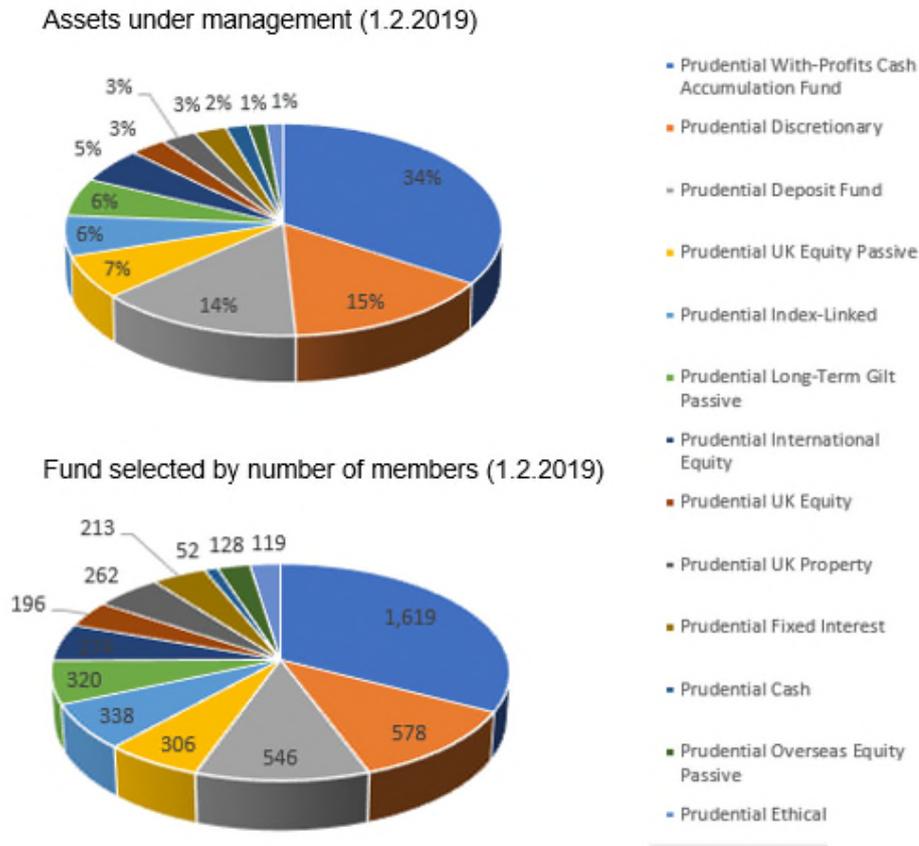
#### **Value for money (pricing) review**

- 3.1 In 2017, Prudential confirmed that a 10bps reduction would be applied to the Annual Management Charge (AMC) across the Unit Linked Funds range for West Midlands Pension Fund AVC scheme (this reduction was applied across the wider LGPS from 2018). The annual management charge covers the investment management services, the Administration and Communication services for the member, associated Administering Authority and employer administration and technical services and support. Following industry pressure and changes to DC regulations, exit charges applying to LGPS AVCs have been reviewed and are being phased out, having now ended for new payers and disappearing for all by March 2020.
- 3.2 In their report, Hymans Robertson, confirmed that, although Prudential's charges are slightly above average, they do represent good value when taking into account the package of services bespoke to the LGPS and options and associated cost of implementing change.
- 3.3 The Fund actively engaged with Prudential, in partnership with other large LGPS Funds over a number of months, culminating in a final letter from Prudential in late 2018 confirming that, following a comprehensive review of the scheme, they were unable to offer any further price reduction at this time.
- 3.4 Prudential have committed to keep the situation under review to include efficiencies made as a result of further digitalization over the following 18-24 months and the switch to a new administration partner, Diligenta, during 2018.
- 3.5 The Fund remains committed to ensuring our members receive the optimum value for money from AVC provision and as such, will continue to engage with Prudential on this matter.

#### **4.0 Investment (fund options) review**

- 4.1 The Fund has considered the range of fund options on offer to members with Prudential and the selection of the default fund. Included in this review was consideration of the performance of individual funds and the variety of funds available to members in terms of risk profiling.
- 4.2 The Fund currently offers a diverse range of Funds, with 12 open funds covering main asset classes and three Lifestyle options. It is notable, however, that the default remains a popular choice together with an alternative multi-asset and cash-based fund.
- 4.3 The charts below summarise the current assets under management (as at 1 February 2019) split across the various funds and the breakdown of the current membership, which totals 4,951 (active and deferred members). The default fund is currently the With Profits Fund. Less than 5% of members with AVCs currently utilise the Lifestyle

arrangements which target transition to cash and/or annuity from the target retirement date.



4.4 In terms of fund selection, key recommendations from the independent review are as follows:

- Update the lifestyle options, particularly in the expectation that members will take AVCs in cash.
- Update the fund range to accommodate more contemporary multi-asset funds as well as funds appropriate for the pension's freedoms.
- Rationalise the choice of equity funds.

4.5 Having considered the recommendation in the context of the current membership, utilisation of fund options and member elections on retirement (for which the vast majority take their AVC fund as cash), the following changes are proposed:

- Update the current lifestyle funds with two Dynamic Growth lifestyle funds targeting at retirement either 100% cash or retirement options.
- Remove the With Profits Fund as the 'default option' and replace with the Prudential Dynamic Growth IV lifestyle fund, targeting cash at retirement.

## 4.6 Lifestyle arrangements

4.6.1 Separate to the Fund's review and fund and Lifestyle arrangements, Prudential have recently confirmed that the existing lifestyle arrangements will be withdrawn across the LGPS on a phased basis. The Fund is scheduled on one of the latter phases with a decision of preferred future arrangement required from members by 30 May 2019. Prudential will arrange transition of the members' funds to the new lifestyle during September 2019. Prudential will cover any costs associated with writing to affected existing lifestyle members and again once the switch is completed. There are no actual switch costs involved with the transition.

4.6.2 The Fund proposes to replace the three existing lifestyle arrangements with two new lifestyle funds as follows:

- Prudential Dynamic Growth IV Lifestyle targeting cash at retirement
- Prudential Dynamic Growth IV Lifestyle targeting retirement options

4.6.3 The Prudential Dynamic Growth IV Lifestyle carries an equity weighting of between 40 to 80% actively managed by Prudential's in-house investment team "Prudential Portfolio Management Group Limited" (PPMG). This lifestyle fund is currently used by approximately 20 other LGPS funds and is anticipated to increase to 40-50 LGPS funds following the withdrawal of the existing lifestyle arrangements.

4.6.4 As noted above, it is proposed that the Lifestyle fund targeting cash at retirement becomes the default arrangement for the Fund.

4.6.5 In selecting two lifestyle options targeting different arrangements upon retirement, it provides members with choice and reflects the current member experience.

4.6.6 Prudential aim to issue communications to all members impacted by the withdrawal of the existing lifestyle funds on 22 July 2019. This will give members around 6 weeks to decide if they wish to move to the new lifestyle arrangement or select an alternative investment option(s).

## 4.7 Default fund

4.7.1 The Fund currently offers the With Profits Fund at its default option where members do not make an active investment decision.

4.7.2 Hyman's have noted that Prudential's With Profits Fund is in the almost unique position of still being strongly cash-flow positive, as a popular choice across the LGPS. This is in contrast to most of its peers which are cash-flow negative and hence, like many private sector DB schemes, have been forced to adopt more cautious investment strategies to protect their solvency.

- 4.7.3 However, there have been some concerns over the transparency of With Profits arrangements and members' understanding of how they ultimately operate. In addition, Hymans Robertson have highlighted that a significant proportion of the positive cash-flow comes from the retail IFA market, which might hold up for around another 10 years, but with potential for the prospective returns over the longer term to gradually decline.
- 4.7.4 Acknowledging that the With Profits Fund remains a popular choice amongst members and with good levels of relative return, the Fund proposes to retain this option and allow new members to continue to invest in it. However, given some of the concerns around transparency and also the longer-term potential for a decline in returns, the Fund proposes to replace the With Profits Fund as the default arrangement with the Dynamic Growth IV Lifestyle Fund targeting cash at retirement.
- 4.7.5 The Fund will ensure AVC literature is updated to confirm the replacement of the With Profits Fund with the Dynamic Growth IV Lifestyle Fund targeting cash at retirement as default with effect from 1 September 2019. The Fund will also be on hand to support the 183 lifestyle members, in conjunction with the communication issued by Prudential in July 2019, in terms of guidance on their options as required.

## **5.0 Communication and marketing**

- 5.1 As reported to Committee on 20 June 2018, on 11 May 2018 M&G Prudential announced a company-wide transformation programme designed to modernise the business. As part of this programme changes were made to the Corporate Pensions Team which provides member presentations and individual meetings in the workplace.
- 5.2 As a result of these changes, member presentations and individual meetings are no longer provided by Prudential, across LGPS funds
- 5.3 The Fund has actively engaged with Prudential regarding these changes and has incorporated raising awareness of AVC arrangements within our own member presentations provided by the Fund's dedicated Member Services Team. These presentations will complement the existing range of online services and telephony support provided by Prudential's Retirement Specialist Team.
- 5.4 In addition, the Fund is working with Prudential to better understand the pre-retirement advisory services they can provide and whether this would be a valued addition to member communication and engagement.
- 5.5 As a result of the withdrawal of presentations by Prudential, the Fund has noticed a slight decrease in the number of new AVC accounts from c20 per month to c8 per month following the announcement. This fall in new member registrations is likely to reflect the contrast between the active sales and marketing approach previously undertaken by Prudential versus the awareness of AVCs as presented by the Fund.

## 6.0 Equitable Life

- 6.1 The Equitable Life arrangement is currently closed to new members with around 300 existing members remaining.
- 6.2 A summary of the Hymans Robertson recommendations with regards to the Equitable Life arrangement is as follows:
- Encourage members to consider taking advantage of the uplift in non-guaranteed With Profits values
  - Rationalising the unit linked funds
  - Where it may be in some AVC members' interests, consider switch to funds available with Prudential, given the overlap in options and lower charges.
- 6.3 Equitable Life wrote to all LGPS funds in summer 2018 to confirm that an agreement had been reached to transfer the Society and all of its policies to Reliance Life. As part of this transfer, Equitable Life were able to confirm an enhancement from a 35% capital distribution on With Profits to 60-70%
- 6.4 All With Profits policyholders will be asked to vote on the transfer proposal before it can go ahead with the vote expected mid-2019 and then the proposal will be placed before a High Court judge for approval.
- 6.5 As a result of this latest announcement, the Fund does not propose to make any changes to the Equitable Life arrangement until such time that the results of the vote and any required approval are confirmed. In particular, dependent on the outcome of the vote, careful consideration will be need to be given to individual member benefits in the context of a capital distribution (for instance, it may not be in members' interests to make an individual transfer elsewhere in light of the potential uplift).
- 6.6 By the end of April 2019, Equitable Life will write to all affected members with information on their proposal, the new investment funds and Reliance Life. This information will also be made available on their website. Eligible policyholders will be entitled to vote on the proposal and Equitable Life will contact members if they are eligible with full details on how to have their say. The Fund's customer services team have been updated and literature is being prepared to assist with member enquires on receipt of these letters.
- 6.7 Between May and the end of August 2019, Equitable Life will send a communications pack with an explanatory booklet and voting forms. An investment choice pack will also be issued to policyholders, detailing the unit-linked funds available to select.
- 6.8 Between September and December 2019, if the votes are in favour and with court approval, the Equitable Life proposal (to include policy uplift and transfer to Reliance Life) will be implemented.

6.9 The Fund will consider issuing communications to members, in accordance with the process outlined above and to support communication provided by Equitable Life, to ensure they are kept fully informed.

## **7.0 Financial implications**

7.1 The report contains financial information which should be noted.

7.2 Active members of the Local Government Pension Scheme are eligible to contribute a percentage of their pensionable pay to additional voluntary contributions as specified in the Regulations.

7.3 There are management fees applied by AVC providers.

## **8.0 Legal implications**

8.1 The report contains no direct legal implications.

## **9.0 Equalities implications**

9.1 The report contains no direct equalities implications.

## **10.0 Environmental implications**

10.1 The report contains no direct environmental implications.

## **11.0 Human resources implications**

11.1 The report contains no direct human resources implications.

## **12.0 Corporate landlord implications**

12.1 The report contains no direct corporate landlord implications.

## **13.0 Schedule of background papers**

13.1 Customer Engagement update report 20 June 2018

13.2 Hymans Robertson AVC Review

13.3 Prudential New Standard Lifestyle arrangements

## **14.0 Schedule of Appendices**

14.1 None