



# The Scottish Borders Council Pension Fund

Review of AVC arrangements

July 2018

# Objectives and background

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## Objective

- This report is addressed to the Scottish Border Council ("the Council") as the administering authority of the Scottish Border Council Pension Fund ("the Fund"). The Council has requested that KPMG conduct a high level review of their additional voluntary contribution ('AVC') arrangements made available to Fund members.
- The Council requested that KPMG LLP ("KPMG") provide advice on a review in line with the new DC Code of Practice (the "Code") and governance requirements that apply to the Council. The Council specifically requested that this review be high level and form a proportionate approach in line with the Code.
- KPMG is providing advisory services to the Council and this report should not be relied upon by any other entities, organisations or persons other than the Council.

## Limitations

- This report is addressed to the Council. Whilst other parties may be provided with the report, it should not be relied upon by any other person or organisation. Any person or organisation other than the Council who chooses to rely on this report does so at their own risk. To the fullest extent permitted by law, KPMG accept no responsibility or liability to that party or organisation in connection with this report.
- The work carried out for this exercise falls outside the scope of the Technical Actuarial Standards issued by the Financial Reporting Council.

## Limitations (cont.)

- In producing this report we have relied upon the following information:
  - Information requested from Standard Life Aberdeen plc ("Standard Life").
  - Publicly available information (e.g. fund factsheets)
  - KPMG's independent view of the DC market

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# Executive summary

Background	<ul style="list-style-type: none"> <li>— Members of the Fund hold AVCs in a separate arrangement with Standard Life. Whilst the Fund is a Defined Benefit pension scheme, the AVCs are Defined Contribution (DC) benefits. This report considers these policies in more detail along with the implications of the Pensions Regulator's DC Code of Practice.</li> <li>— The Council need to consider a proportionate approach to monitoring its AVC investments. Taking a view on the importance of these benefits compared to a member's overall benefits in the Fund will help with this.</li> </ul>
AVC arrangements	<ul style="list-style-type: none"> <li>— The Funds AVCs arrangements are provided by Standard Life and both new and existing members can choose to make AVCs.</li> <li>— Standard Life is considered a strong provider in the defined contribution market and offers a range of investment options for members to chose from.</li> <li>— The Fund has 55 active members currently contributing and 71 deferred members. These members are invested in 12 funds with a total value of £1.1m, split between unit-linked funds (c.£0.95m) and with profits funds (c.£0.15m). Members have access to Standard Life's full range of funds (c.300 funds).</li> <li>— Standard Life fund management charges are set for each individual fund. For the funds members are invested in, charges are between 1.007% - 1.036% for unit linked funds and 1.150% - 1.750% for with profits funds before the agreed fund charge rebate. Members receive a fund charge rebate of 0.375%.</li> <li>— The with profits funds receive an annual return which is a combination of a guaranteed return and a bonus return deemed appropriate by the Standard Life. The bonus growth rate and total growth rate for three of the four with profits funds that members invest in have shown an increase from 0.50% in the prior year to 0.75% in the current year. There has been no change for one fund.</li> <li>— For the unit linked funds in which member invest, over the five year period analysed, four of the funds have outperformed their respective benchmarks and three have underperformed.</li> <li>— Based on KPMG's market experience, Standard Life are viewed as a relatively strong provider in the DC marketplace and we do not have any major concerns with their AVC offering.</li> </ul>
DC Code of Practice	<ul style="list-style-type: none"> <li>— The Pensions Regulator released a revised DC Code of Practice in July 2016. The DC Code cross references other codes of practice produced by the Pensions Regulator, in addition to a number of pieces of pensions legislation.</li> <li>— Subject to our comments on possible next steps, we believe that the Funds AVC arrangements are consistent with the DC Code of Practice and that no major revisions are required.</li> </ul>
Next steps	<ul style="list-style-type: none"> <li>— In terms of existing AVC investments, the current arrangement does not appear unreasonable. However, we have outlined below some considerations and recommendations of potential next steps.</li> <li>— We recommend that the Council liaise with Standard Life in order to discuss how Standard Life can further support both existing and potential AVC members, providing additional information and engagement methods and communicating key information such as current investment choices, associated performance statistics and charges information, further information on with-profit policies (if applicable) and highlighting the options available to members going forward.</li> <li>— A number of potential actions have been flagged by our analysis against the DC Code of Practice. As a minimum, we recommend that the Council undertake the high priority actions. Please see page 18 for a summary of these.</li> </ul>



# AVC Arrangements

## AVC background

### Overview

- AVCs are extra pension savings (typically on a money-purchase basis) paid by the pension scheme member to secure extra pension benefits beyond the scheme's standard pension provision.
- The Funds AVC arrangements are provided by Standard Life, and the two main types of arrangement which members have invested in are "With-profits" and "Unit-linked". These are described in more detail below.
- In practice, while members have access to the full range of Standard Life funds (c. 300 funds), they are only invested in twelve of the funds provided by Standard Life. Page 6, 7 and 8 provides further detail of the value of funds invested and their performance over the last five years against benchmark.

#### With-profits funds explained

- A with-profits fund can invest in a broad range of assets (equities, property, bonds etc) but declares its returns in a different way to the value of the underlying investments.
- Investors receive an annual return which may be a combination of:
  - A guaranteed return which cannot be removed, irrespective of future investment performance.
  - A bonus return deemed appropriate by the provider. Bonuses can either be paid at retirement (terminal bonus) or during the lifetime of the policy (regular bonus).
- Providers look to provide a return each year which is "fair" between different generations of policyholders. This means returns are smoothed and can vary significantly from the returns achieved on the underlying assets. For example, payments may be 'held back' during strong market upturns and then used to increase returns during a downturn. It is therefore not possible to benchmark a with-profits fund's performance against markets in a way that would give a fair comparison.

#### Unit-linked funds explained

- When investing into a unit-linked fund, contributions are used to buy individual units within the fund.
- Whilst with-profits funds normally invest in a range of asset classes, a variety of unit-linked funds exist which each focus on a different asset class/region.
- Because of the extensive universe of unit-linked funds covering a range of asset classes they can and do provide an essential role in giving members appropriate investment choice.

# Fund summary and investment performance

- The first table below summarises the funds members are invested in and their investment performance over the last five years against benchmark. We would note that it is not possible for the Council to decide whether members should be invested in alternative funds. Individual investors have different characteristics such as varying risk/return profiles and different retirement needs.
- The second table below summarises the bonus rates awarded by Standard Life over the last five years. It is difficult to compare the performance of with-profit funds given the varying methods used across providers to calculate such bonuses.

## Unit linked funds (based on fund factsheets made available as at 23 May 2018)

Fund Name	No. Members Invested	Total Fund Value	Total Expense Ratio	Rebate	1 Year (%)			3 Years (%)			5 Years (%)		
					Performance	Benchmark	Difference	Performance	Benchmark	Difference	Performance	Benchmark	Difference
Standard Life At Retirement (Multi Asset Univ) Pn *	11	79,783	1.0360	0.375	-2.90%	N/A	N/A	5.70%	N/A	N/A	18.50%	N/A	N/A
Standard Life Deposit and Treasury Pension Fund	17	130,629	1.0090	0.375	-0.70%	-0.30%	-0.40%	-1.90%	-0.70%	-1.20%	-2.90%	-1.00%	-1.90%
Standard Life Ethical Pension Fund	9	26,217	1.0100	0.375	6.40%	1.00%	5.40%	21.70%	15.30%	6.40%	46.30%	34.60%	11.70%
Standard Life Managed Pension Fund	57	394,356	1.0230	0.375	0.80%	1.00%	-0.20%	14.70%	15.30%	-0.60%	36.10%	34.60%	1.50%
Standard Life Money Market Pension Fund	31	146,254	1.0090	0.375	-0.50%	0.10%	-0.60%	-1.00%	0.50%	-1.50%	-1.50%	0.30%	-1.80%
Standard Life Multi Asset Mgd (20-60% Shares) Pn	21	159,210	1.0190	0.375	0.30%	0.00%	0.30%	11.70%	10.20%	1.50%	28.40%	23.90%	4.50%
Standard Life Stock Exchange Pension Fund	1	606	1.0260	0.375	1.00%	1.90%	-0.90%	19.30%	18.90%	0.40%	51.00%	42.30%	8.70%
Standard Life UK Equity Pension Fund	6	17,030	1.0070	0.375	-0.40%	1.30%	-1.70%	14.00%	14.90%	-0.90%	33.30%	38.00%	-4.70%

\*Performance benchmarks are not given for the Standard Life At Retirement (Multi Asset Univ) Pn fund. This fund is designed for individuals who have not yet decided what to do with their retirement income or those who intend to make use of flexible income (also known as drawdown).

## With-profits funds (based on fund factsheets made available as at 23 May 2018)

Fund Name	No. Members Invested	Total Fund Value	Total Expense Ratio	Rebate	01/02/2018 until further notice			01/02/17 to 31/01/18		
					Guaranteed Growth Rate	Bonus Growth Rate	Total Growth Rate	Guaranteed Growth Rate	Bonus Growth Rate	Total Growth Rate
Pension Millennium With Profits Fund	26	61,636	1.1500	0.375	0.00%	0.75%	0.75%	0.00%	0.50%	0.50%
Pension Millennium With Profits 2006 Fund	9	16,765	1.2000	0.375	0.00%	0.75%	0.75%	0.00%	0.50%	0.50%
Pension With Profits Fund	18	76,167	1.7500	0.375	4.00%	0.00%	4.00%	4.00%	0.00%	4.00%
Pension With Profits One Fund	1	1,046	1.1500	0.375	0.00%	0.75%	0.75%	0.00%	0.50%	0.50%

# Standard Life (1)

— The table below and on the following providers further commentary on Standard Life as the Fund's AVC provider.

Key issue	Considerations
<b>Background</b>	<ul style="list-style-type: none"> <li>▪ Standard Life started off as the Life Insurance Company of Scotland, founded in 1825. In 1832 the Company changed its name to the Standard Life Assurance Company. In 2017, Standard Life and Aberdeen Asset Management unveiled a £11 billion merger, the resulting company is now responsible for £660 billion of investor assets.</li> <li>▪ Standard Life currently accept new business and will allow new members to contribute, at the Council's discretion.</li> </ul>
<b>Financial Strength</b>	<ul style="list-style-type: none"> <li>▪ Standard Life Aberdeen plc: Issuer Credit Rating A / Watch Neg. from Standard &amp; Poor's; Issuer Rating A3 / Stable from Moody's.</li> <li>▪ Standard Life Assurance Limited: Financial Strength Rating A+ / Watch Neg. from Standard &amp; Poor's; Insurance Financial Strength Rating A1 / Negative from Moody's.</li> <li>▪ See Appendix for details on the ratings.</li> </ul>
<b>Administration</b>	<ul style="list-style-type: none"> <li>▪ Standard Life aim to complete 90% of requests within 10 working days. Over the last 12 months Standard Life have completed 1 request within 5 working days, and 2 requests within 10 working days. Although a 10 working day turnaround is later than some other providers, Standard Life have completed all tasks within this timescale and therefore met their SLA. We would not expect the SLA to be a cause for concern for the Council.</li> <li>▪ Standard Life produce an annual audit report on audit quality standards. Annual audit reports can be produced on request from Standard Life and are provided within 10 working days of being requested. We have attached the latest report for the Fund AVC arrangement up to 31 March 2018.</li> <li>▪ Standard Life also confirmed that they do not hold the Audit and Assurance Faculty's Technical Release 01/06 report covering the design, implementation and operational effectiveness of controls. This is an administration quality assurance standard that providers are increasingly adopting this as an indicator of quality. We expect Standard Life may take steps to obtain this, but has not yet committed to do so.</li> <li>▪ Standard Life did however, provide a 'Pension Controls' document to confirm that their pensions administration is carried out in accordance with scheme rules, the requirements of the law and good standards of governance and internal control.</li> </ul>
<b>Data/ information security and business continuity</b>	<ul style="list-style-type: none"> <li>▪ We have not been provided with any information on Standard Life's policies in regards to these operational aspects of their proposition. The Council may wish to seek further information on this from Standard Life.</li> <li>▪ The Council should consider all their Providers as part of their General Data Protection Regulation and data review mapping exercises and therefore this may already have been provided.</li> </ul>
<b>Communications</b>	<ul style="list-style-type: none"> <li>▪ Standard Life provide members with annual statements. Standard Life have confirmed that due to GDPR they cannot share copies with us. However, we would expect these to show current fund values as a minimum.</li> <li>▪ The Fund also provides other information on request to members regarding their AVC options. We have not had sight of these communications, however, we would be happy to review these as required.</li> </ul>

# Standard Life (2)

Key issue	Considerations
Investment options	<ul style="list-style-type: none"> <li>There are no restrictions on the funds that members can invest in. This gives members access to c.300 funds provided by Standard Life. In practice members have only made use of a small selection of these, investing in 12 funds.</li> <li>There are currently 126 members accessing these funds, and the majority of members invest across more than one fund with a total of 207 separate contributions between the 12 funds.</li> <li>Some consideration should be given to whether the funds invested by members are appropriate. This could be done through communications with members to ensure that they understand what options they have at retirement, and the investment options they have available.</li> </ul>
Investment performance	<ul style="list-style-type: none"> <li><u>With Profit Funds</u> <ul style="list-style-type: none"> <li>Invest in a wide range of assets including equities, property, bonds and cash deposits. It is expected that over a long term, equities and property will produce higher return but will be variable in a short term. For bonds and cash, the return are expected to be more stable but will be lower over the long term.</li> <li>The bonus growth rate and total growth rate for the Pension Millennium With Profits Fund, Pension Millennium With Profits 2006 Fund and the Pension with Profits One Fund have shown an increase from 0.50% in the prior year to 0.75% in the current year.</li> <li>The Pension with Profits Fund has shown no change between the prior year and current year. It has stayed at 4.00% for both the guaranteed growth rate and total growth rate.</li> </ul> </li> <li><u>Unit - Linked Funds</u> <ul style="list-style-type: none"> <li>On a 1 year cumulative performance basis, 2 of the funds have outperformed their respective benchmark figures, 4 have slightly underperformed and 1 has underperformed.</li> <li>On a 3 year cumulative performance basis, 3 of the funds have outperformed their respective benchmark figures, 2 have slightly underperformed and 2 have underperformed.</li> <li>On a 5 year cumulative performance basis, 4 of the funds have outperformed their respective benchmark figures and 3 have slightly underperformed.</li> </ul> </li> </ul>
Fees	<ul style="list-style-type: none"> <li>The funds in which members are invested have the following fund charges: <ul style="list-style-type: none"> <li>For the unit-linked funds, the fund charges range from 1.007% - 1.036%.</li> <li>For the with-profits funds, the fund charges range from 1.150% - 1.75%.</li> </ul> </li> <li>The Council should also note that a Market Value Reduction (MVR) may apply on voluntary exit from the With-Profits funds unless benefits are accessed at retirement or on death.</li> <li>Members receive a fund charge rebate of 0.375% on these charges. The overall charges incurred by members do not appear out of line with other AVC investments although these are generally higher than the wider DC market.</li> </ul>
At retirement options	<ul style="list-style-type: none"> <li>Members have the choice at retirement to use their AVC fund to fund all or part of their tax free cash lump sum or to access the full range of flexible retirement options.</li> <li>To access the flexible retirement options (e.g. annuity, drawdown etc.), members must do this outside of the Fund, either through Standard Life, or with another provider.</li> </ul>



# DC Code of Practice

# DC Code of Practice and AVCs (1)

## Introduction

The Pensions Regulator released a revised DC Code of Practice in July 2016. The DC Code cross references other codes of practice produced by the Pensions Regulator, in addition to a number of pieces of pensions legislation. The Code is divided into 6 sections:

- The trustee board
- Plan management skills
- Administration
- Investment governance
- Value for members
- Communicating and reporting

Whilst the Code itself is not a statement of the law and there is no direct penalty for not complying with it, clearly the legal elements underpinning the DC Code must be complied with. The DC Code is primarily aimed at trustees of trust-based DC pension schemes. With regard to its application for AVCs, the Regulator says that trustees should:

***“...consider the risks to members in the context of the significance of the value of AVCs relative to members’ overall benefits in the scheme, and where the law applies to AVCs, apply a proportionate approach to meeting the relevant standards in our DC code.”***

In light of this, the Council need to consider what represents a proportionate approach for the Fund.

In this Section we consider the elements within each of the 6 areas covered by the Code, interpret their relevance with regard to AVC arrangements and propose actions for the Council to take where relevant – the Council can then consider what should form part of their approach to complying with the Code.

## DC Code of Practice and AVCs (2)

1. Trustee Board			
Aspect of Code	Interpretation for AVCs	Proposed action	Priority
Trustees are fit and proper persons	Assumed already comply with as part of being a well run scheme as these are existing legal requirements	None	N/A
Requirement to appoint a Chair			
Appointment of member nominated trustees			

# DC Code of Practice and AVCs (3)

2. Plan Management			
Aspect of Code	Interpretation for AVCs	Proposed action	Priority
Operate adequate internal controls to manage risk	Risks relating to AVC arrangements are recognised in risk register and mitigating action taken where required.	Check that AVCs are incorporated in the risk register  Check that internal controls ensure for oversight of the AVC plan and actions (e.g. review of provider and investment performance every 2/3 years for example).	Moderate
Trustee Knowledge and understanding	Ensure trustees understand key aspects of AVC provision e.g. impact of charges, nature of with-profits funds, ways that members can use DC benefits at retirement	High level review also provides high level education on key aspects  Short session on AVC's could be provided if required	Moderate
Be familiar with and understand impact of terms and conditions of service providers	Understand services delivered by AVC provider and charges incurred for this	Perform regular review of existing Provider and request update on terms	High
Working effectively with the employer	Little relevance specific to provision of AVC benefits	None. We would expect that the existing practice of the Fund should suffice.	N/A
Conflicts of interest			

# DC Code of Practice and AVCs (4)

3. Administration			
Aspect of Code	Interpretation for AVCs	Proposed action and explanation	Priority
Monitoring administration providers	Administration in relation to AVCs is indirectly monitored through the existing stewardship reports from scheme administrators as transactions where the administration team need to engage with the provider are caught by the existing report.	Ensure Fund stewardship reports provide necessary information.  Request specific Management Information report from Standard Life which reflects all transactional information for the plan.	Low
Core financial transactions are processed promptly and accurately	Transactions are likely to relate to either retirements, transfers out and AVC investment changes (although changes to investments are rare).	As per above, check core transactions within the management information report for consistencies	Low

# DC Code of Practice and AVCs (5)

4. Investment governance			
Aspect of Code	Interpretation for AVCs	Proposed action	Priority
Maintain Statement of Investment Principles	Ensure SIP fully reflects existing AVC arrangements	Check that statement of investment principles does accurately reflect the investment options of the AVC arrangement(s)	High
Consider interests of members when setting investment strategies	Ensure any lifestyle strategies that form part of the AVC arrangement remain appropriate and that members can access a range of investments that is likely to enable members to satisfy their risk-return preferences.	Check that members are aware of at retirement and investment options	Moderate
Reviewing investment performance	Ensure funds being used by members continue to perform in line with objectives	<p>Page 6 &amp; 7 shows a high level summary of recent performance of funds currently elected by members.</p> <p>Regular monitoring of investment performance should be undertaken (e.g. every 2/3 years). Consideration by the Council on whether this needs to be for all funds, or the funds elected by members only</p>	High
Regularly engage with members around the date they may wish to take their benefits and how they would prefer to take them	Members need to understand the retirement options specific to their AVC savings and how this interacts with their DB provision under the Fund.	<p>Thorough review of all communications issued to member of the Fund and those who have AVC plans and work with Standard Life to improve engagement</p> <p>Trustees could consider issuing their own AVC specific communications to those who currently invest in AVCs explaining options and charges.</p>	Moderate
Understand security of assets and communicate position to members	Understand position on failure of an AVC provider and scope of coverage by Financial Services Compensation Scheme.	<p>Consider the extent of FSCS protection under existing arrangement(s) and an appropriate approach to communicating this to members.</p> <p>Write to Standard Life to ask them to set out the position for their arrangements.</p>	Moderate

# DC Code of Practice and AVCs (6)

5. Value for members			
Aspect of Code	Interpretation for AVCs	Proposed action	Priority
Assessing value for members	<p>The key aspect of value for AVC arrangements is whether the investment performance offered is sufficient to justify the costs incurred by members. Second to this would be the support offered by the provider in making decisions at retirement in relation to how to use their DC benefits.</p> <p>Considering the size of AVC investments it may not be appropriate to undertake a formal value for members assessment, however, value should be considered when undertaking ongoing monitoring of AVCs.</p>	When undertaking any Value for Member assessment, ensure value of the AVC plan is considered as part of this (approach should be proportionate)	Moderate
Restrictions on costs and charges	Charge cap does not apply, but does provide a useful benchmark as part of considering value outlined above.	None	N/A

# DC Code of Practice and AVCs (7)

6. Communicating and reporting			
Aspect of Code	Interpretation for AVCs	Proposed action	Priority
Communicating options at retirement, including risk warnings	Requirement to signpost members to Pension Wise in communications in relation to taking their AVC benefits.	Review of communications issued to members both by Council and administrator to ensure capture of regulatory requirements.	Moderate
Pension scams	Ensure administration process checks that any partial transfer out of AVCs is going to a registered scheme.	Review of internal procedures within the administration service provided.	Low
Chair's Statement	Not required where a scheme only DC provision is in the form of AVC benefits.	None.	N/A
Scheme Return	Existing process in place.		
Statement of Investment Principles	Already covered under 'investment governance' above.		



# Next Steps

## Next steps

We have identified a number of potential actions that could be undertaken by the Council to improve communications surrounding the Fund's AVC arrangement and to ensure the requirements of the DC Code of Practice are being met. Further details are set out below:

### 1. Liaise with Standard Life

- We recommend that the Council liaise with Standard Life in order to discuss how Standard Life can further support both existing and potential AVC members, providing additional information and engagement methods and communicating key information such as current investment choices, associated performance statistics and charges information, further information on with-profit policies (if applicable) and highlighting the options available to members going forward.

### 2. Communications

- If Standard Life are unable to provide any additional support, the Trustee may consider communicating with members directly to advise them of their current investments, associated performance statistics and charges information, highlighting the options available to members going forward.
- We would also recommend that this communication includes further information on with-profit policies (if applicable), informing members of their options in relation to these investments and highlighting the associated risks of making any changes.

### 3. DC Code of Practice

- A number of potential actions have been flagged by our analysis against the DC Code of Practice. However, some of this overlaps and can be picked up by a single action (e.g. liaising with Standard Life on engagement methods and carrying out regular reviews of the AVC arrangements). We summarise the proposed actions and priority levels overleaf. As a minimum, we recommend that the Council undertake the high priority actions.

### 4. Review of provider

- Ultimately, the Council could look to review the existing AVC provider, move to an alternative provider and transfer all existing assets from the current arrangement.
- This would incur additional costs and based on our experience in the market, the costs associated with such an exercise often outweigh the benefits.
- The majority of AVC providers in the market have drawbacks and overall Standard Life are not an unfit for purpose provider.
- There is also the potential for a Market Value Adjustment (MVA) to be applied to members' funds when transferring a with-profit investment. The potential impact on members funds is unique to each individual member's circumstance. It is therefore not possible to know this in advance and this is therefore another consideration when thinking about setting up with an alternative provider and transferring existing funds. There may also be special policy features that cannot be replicated under an alternative arrangement.
- We would be happy to look into this further if this is something the Council wish to explore.

# Next steps

Priority	Category	Area	Action
High	Plan Management	Be familiar with and understand impact of terms and conditions of service providers	Perform regular review of existing Provider and request update on terms
High	Investment Governance	Maintain Statement of Investment Principles	Check that statement of investment principles does accurately reflect the investment options of the AVC arrangement
High	Investment Governance	Reviewing investment performance	Regular monitoring of investment performance should be undertaken (e.g. every 2/3 years).
Moderate	Plan Management	Operate adequate internal controls to manage risk	Check that AVCs are incorporated in the risk register. Check that internal controls ensure for oversight of the AVC plan and actions (e.g. review of provider and investment performance every 2/3 years for example).
Moderate	Plan Management	Trustee Knowledge and understanding	High level review also provides high level education on key aspects. Short session on AVC's could be provided if required.
Moderate	Investment Governance	Consider interests of members when setting investment strategies	Check that members are aware of at retirement and investment options.
Moderate	Investment Governance	Regularly engage with members around the date they may wish to take their benefits and how they would prefer to take them	Thorough review of all communications issued to member of the Fund and those who have AVC plans and work with Standard Life to improve engagement. Trustees could consider issuing their own AVC specific communications to those who currently invest in AVCs explaining options and charges.
Moderate	Investment Governance	Understand security of assets and communicate position to members	Consider the extent of FSCS protection under existing arrangement(s) and an appropriate approach to communicating this to members. Write to Standard Life to ask them to set out the position for their arrangements.
Moderate	Value for Members	Assessing value for members	When undertaking any Value for Member assessment, ensure value of the AVC plan is considered as part of this (approach should be proportionate)
Moderate	Communicating and Reporting	Communicating options at retirement, including risk warnings	Review of communications issued to members both by Council and administrator to ensure capture of regulatory requirements.
Low	Administration	Monitoring administration providers	Ensure Fund stewardship reports provide necessary information. Request specific Management Information report from Standard Life which reflects all transactional information for the plan.
Low	Administration	Core financial transactions are processed promptly and accurately	Check core transactions within the management information report for consistencies.
Low	Communicating and Reporting	Pension scams	Review of internal procedures within the administration service provided.



# Appendices

# Appendix 1: Issues concerning With-Profit Funds

## General views relating to With-Profits funds

- **Returns** - In recent years, guaranteed and bonus returns have fallen significantly from historical levels, partly due to increased reserve requirements from new financial regulation and partly due to lower expected returns from some assets. Overall when applied the effect of smoothing results in members seeing less volatility in investment returns.
- **Lack of transparency** – The underlying returns and charges are not transparent and can lead to uncertainties over whether members have received a fair return that reflects market performance. There is little direct link between investment returns achieved by the fund and bonuses declared.
- **Cost of guarantees** – Many with-profits policies contain a guarantee that no reductions in fund values will apply when the benefits are taken on a contractual date (e.g. the normal retirement date under the main scheme). This guarantee often comes at a disproportionate cost.
- **Investor misunderstandings** – Many investors believe their investments are low-risk and will not fall in value, which is not always the case. The bonuses declared are not directly linked to the investment returns achieved. Discretion is exercised by the provider when distributing the bonuses that determine payouts and members may not understand the relationship between: investment returns, fund values and what they may ultimately receive.
- **Market Value Reduction (MVR)** - There is the potential for a Market Value Reduction (MVR) or a Final Bonus to be applied to members' funds when transferring a with-profit investment from one of these providers. The potential reductions or enhancements to funds are unique to each individual member's circumstance. It is therefore not possible to consider whether it is beneficial for members to transfer without considering the individual transfer values.

## Our view

- These issues mean that with-profits policies have become much less popular with investors and are rarely made available under new arrangements.
- They also complicate the review of arrangements and increase associated costs, which can outweigh any benefits of potential for restructuring.
- Despite our concern around with profits policies in general, the difficulties associated with removing these funds (and the related costs of doing so) should be considered within a review of these arrangements.
- Any guarantees included in the terms of with profits funds should be carefully considered as part of any review.

# Appendix 2: Financial Strength

## The Standard and Poor's definitions are:

- AAA: An insurer rated 'AAA' has an EXTREMELY STRONG capacity to meet its financial commitments. 'AAA' is the highest credit rating granted by Standard and Poor's
- AA: An insurer rated 'AA' has a VERY STRONG capacity to meet its financial commitments and differs from the highest-rated insurers only in small degree.
- A: An insurer rated 'A' has a STRONG capacity to meet financial commitments but is somewhat more susceptible to adverse economic conditions than higher-rated categories.

## The Moody's definitions are:

- Aaa: Insurance companies rated Aaa offer exceptional financial security. While the financial strength of these companies is likely to change, such changes as can be visualised are most unlikely to impair their fundamentally strong position
- Aa: Insurance companies rated Aa offer exceptional financial security. Together with the Aaa group, they constitute what are generally known as high-grade companies. They are rated lower than Aaa companies because long-term risks appear somewhat larger. Within this category, a further numerical ranking is provided with Aa1 being at the top of the scale in terms of financial security
- A: Insurance companies rated A offer good financial security. However, elements may be present which suggest a susceptibility to impairment sometime in the future
- Baa: Insurance companies rated Baa offer adequate financial security. However, certain protective elements may be lacking or may be characteristically unreliable over any great length of time
- Ba: Insurance companies rated Ba offer questionable financial security. Often the ability of these companies to meet policyholder obligations may be very moderate and thereby not well safeguarded in the future
- B: Insurance companies rated B offer poor financial security. Assurance of punctual payment of policyholder obligations over any long period of time is small



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