Merseyside Pension Fund

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Additional Voluntary Contribution (AVC) Schemes Review

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1. Introduction

This report is to review the three existing Additional Voluntary Contribution (AVC) contracts currently in place for the Merseyside Pension Fund; these are held with Standard Life, Equitable Life and Prudential. The report will consider a range of relevant issues; in particular, the following: the current AVC market, the terms of the existing contracts, the investment ranges available and the performance of the investments.

The information contained within the report is based upon the 2008 scheme information provided to HSBC Actuaries and Consultants Limited (HACL) by yourselves and additional information either obtained from the AVC scheme providers or, in the case of some investment performance information, third parties.

The purpose of the report is to review the existing schemes and to highlight areas of interest/concern for further discussion.

General Notes

This report is written based on the information supplied and on our understanding of current Law and HM Revenue & Customs (HMRC) practice, which may be subject to change. Any subsequent recommendations made as a result of this report are also made on this basis.

2. Additional Voluntary Contribution (AVC) Overview

AVC contracts have traditionally played an important part in the provision of Occupational Pension schemes to allow members to make additional pension savings to either top up or supplement the pension accrued in their main scheme.

The opportunity to increase pension savings has appealed to a wide range of individuals including: members with a small number of years service; members with gaps in service; members looking to fund tax-free cash lump sums (without reducing main scheme benefits) or members just keen to boost their level of income in retirement. What has linked all of these members, and continues to do so, is a desire to improve their financial prospects in retirement and a monetary commitment to achieve this.

Whilst the tax advantages of saving via a pension remain, Income Tax relief on contributions at the marginal rate (albeit now reduced for those earning over £150,000 p.a.) and virtually tax-free investment growth, the requirement for specific AVC schemes has been reduced by the changes made to Pensions legislation on 6 April 2006 (A-Day). These changes opened up the opportunity for Occupational scheme members to make additional savings to other pension arrangements rather than just designated AVC or Free Standing AVC (FSAVC) contracts.

However, AVC schemes can continue to offer important and valuable benefits to members beyond simply being a tax-efficient savings vehicle. It is these scheme specific advantages that mean that AVC schemes remain an important part of pension provision in the UK. In particular, the advantages available include:

- The ability to use an AVC fund to buy additional benefits in the main scheme at retirement.
- The option to use the AVC scheme to fund a member’s tax-free lump sum (thus, not reducing main scheme benefits).
- The opportunity to provide beneficial scheme terms through collective purchasing power.
- The opportunity for the Trustees to take a paternalistic stance in ensuring members’ contributions are held in an appropriate contract with suitable investment options.

Thus, taking the above into account, the provision of an AVC scheme remains a key issue for any employer providing an Occupational Pension scheme to its employees. In addition, given members' monetary commitment to an AVC arrangement, the employer also has to consider its responsibility to ensure that such arrangements are suitable and appropriate for members and to consider its role in educating and guiding members to help them understand and hopefully achieve their retirement objectives

3. Market Overview

HACL has a great deal of experience in establishing insured pension plans. Consequently, we have formulated panels of approved providers for differing insured pension contracts based upon specific criteria. The purpose of the panels is to identify the insurers best equipped to provide these long-term products.

The fundamental requirements for all new arrangements are the same; we should look to recommend a provider from our relevant panel based upon the criteria described below.

- Investment choice
- Charges
- Administration
- Financial strength, name awareness and commitment to the pensions market

Investment Choice

Any new contract should provide a wide range of both internally and externally managed investment funds for the client. This is essential in order that they can have access to market leading funds that match their investment requirements. The potential new contract should also allow free switching between funds as the client wishes. The ability to be able to switch the accumulated fund value and/or the ongoing contributions into other funds will give the individual the freedom to change the fund to match their attitude to investment risk.

It is also essential that the contract offers either a range of possible default selections or the ability to bespoke a default solution from the available fund range. This should include the ability to provide a ‘life-styled’ default option, where the level of investment risk the member is exposed to reduces over a set number of years approaching the members Selected Retirement Date (SRD).

Charges

Charges have an impact on an individual’s ultimate benefits and need to be reviewed to ensure ‘value for money’ is being achieved. It is therefore appropriate that the charges made on the contract are competitive against the general market place.

The key to a charging structure is that there is clarity for Trustees and members as to the full cost of the contract and the majority of modern contracts achieve this through a single Annual Management Charge (AMC) structure. The AMC applicable is derived from the investment fund or funds selected by a member, with different funds making different charges to reflect the complexity and costs of the investment strategy. Thus, the AMC may differ from member to member, but only in reflecting the costs of their differing investment fund selections.

The general AMC guideline is a charge of 1% of the fund value per annum for internal investment funds (those managed by the insurer providing the contract) with higher charges for externally or third party managed funds. Any group arrangement of significant size (100+ lives) would expect to receive a reduction on these standard terms, usually achieved by a rebate of part of the applicable AMC.

Administration

It is vital that any provider should have a good track record in administration so neither the Trustees or members are faced with a significant additional burden in this area. This often means that many aspects of communication are via the Internet and individual members will be able to view and amend their pension details using this route.

At the simplest level, it is vital that a system is established which allows the employer to deduct and remit contributions with minimum manual intervention. All of the providers we recommend offer an electronic payment facility. If a robust payment system can be established from the outset, there is every chance that administration will be simple and efficient on an ongoing basis, with resultant time/cost savings.

In particular, it is essential that the provider has experience and expertise in the processes involved in dealing with large employers, and the scale of any such arrangement and are able to offer dedicated service and communication for both trustees and members.

Financial Strength/Name Awareness

As a consequence of changes in legislation, and increasing competition for market share over the last decade, the pension's marketplace has seen lower charging structures become common place for pension contracts. The low charging bases now prevalent mean that a provider must be able to demonstrate good financial strength in order to operate in this market long-term.

Financial strength gives an indication of the long term viability of a company, as well as its potential ability to meet its future financial commitments.

Given current market and consumer concern over a number of financial institutions, in the wake of the continued repercussions of the global 'credit crunch', the importance of using a company with a sound financial strength rating is increasingly clear.

Market Review

The providers currently forming our Group Pension Panel are as follows:

- AEGON Scottish Equitable
- AXA
- Norwich Union
- Legal & General
- Scottish Life
- Scottish Widows
- Standard Life

Since the A-Day changes to UK Pension Provision, the need for AVC contracts (as opposed to a Group Personal or Group Stakeholder Pension contract) has not been as apparent. Thus, not all providers are currently offering a group AVC contract and we have approached the above (except for Standard Life who already provides one of the existing schemes) for confirmation of whether they are able to do so and, if so, for details of the contract.

Of the other 6 providers above, only AXA is not currently offering a Group AVC contract. The remaining 5 providers are all able to offer such a contract and all confirmed that the contract would include: a range of internal and external investment funds, a range of possible default investment funds (including either pre-designed or bespoke default funds) and Internet access for members. However, none of the providers are able to offer the option of discretionary life cover for members through the AVC scheme, as is currently available to members via Prudential and Equitable Life.

Thus, the contracts available would mirror the style of the current Standard Life scheme, with differentiation provided via: the fund range available, the default investment choices, the AMCs applicable, the administration support provided and the level of member Internet capability available.

4. Existing AVC Provision – Contract Review

As stated earlier, there are 3 AVC schemes currently in operation and these are held with Standard Life, Equitable Life and Prudential. Each scheme has its own unique features and, as such, it is appropriate to consider each in isolation. In this section of the report, I will focus on each scheme in turn considering: the size and membership, charging structure and investment range and default selection (including the weighting of member's investment selections). I will look at the performance of the 5 most popular funds within each scheme in the following section of the report.

The table below details the number of members, active and deferred, and the size of the fund holdings and contribution levels as per the 2008 data you provided.

Provider	No. of Members	No. of Active Members	No. of Deferred Members	Scheme Size in £	Contribution Level in £
Standard Life	857	363	494	£6,471,463.43 (as at 30/09/08)	£604,013.79 (as at 30/09/08)
Prudential	826	357	469	£3,619,321.61 (as at 31/03/08)	£605,092.53 (as at 31/03/08)
Equitable Life	907	885	22	£3,329,444.34 (as at 01/07/08)	£53,314.82 (as at 01/07/08)

I would make the following comments regarding each scheme:

STANDARD LIFE SCHEME

Whilst having a lower total number of members than the Equitable Life scheme (857), the Standard Life scheme has by far the highest total of monies held within it (approximately £2,850,000 more than the Prudential scheme and over £3,000,000 more than the Equitable scheme). The scheme is also receiving almost identical contribution levels to the Prudential scheme (approx £605,000 p.a.).

In terms of product features, the scheme offers an on-line employee-zone for members, which enables them to obtain policy information and make fund switching decisions (although switches are not 'real-time' automated switches but produce a request to be processed). The scheme does not offer a Life Assurance Option for members, unlike the other AVC schemes currently in place.

Charges

The charges applicable to this contract are detailed below.

- An AMC is applied for the management of the selected investment funds. This is a percentage of the fund value invested, ranging between 1% and 2% dependent upon the fund selected. For the majority of Standard Life's own funds, the charge is 1% p.a.; for more specialist or externally managed funds, the charge is higher.

- An AMC reduction is applied to the contract by the creation of additional units each month. Thus, Standard Life adds units to each member's contract to the value of 0.375% of the fund value each month. This has the effect of reducing the applicable base AMC from 1% to 0.625%. The additional units are also added if an externally managed fund is selected, reducing the applicable AMC accordingly.

It should also be noted that Standard Life does not currently charge for investment switches, however, they reserve the right to charge for any second or subsequent switches in a 12 month period.

Investment Choice and Default Fund

The Standard Life contract offers a range of both internally managed and externally managed investment funds. These are split between what Standard Life describes as their 'hands-off' and their 'hands-on' ranges.

The 'hands-off' range consists of multi-asset type funds of either a cautious, balanced or opportunity (previously referred to as adventurous) investment style. These are designed for members who do not wish to make active decisions in managing their pension fund. The 'hands-on' range consists of single asset, geographically specific funds from which a member can choose to create their own portfolio should they wish. Both ranges include actively and passively managed funds. Actively managed funds are where the fund manager makes the investment decisions (within the parameters of the fund's guidelines); passively managed funds (or tracker funds) are where the fund is invested to mirror a specific Index or mix of Indices and performance should follow that of the target Index.

Active fund managers aim to outperform sector averages through stock selection decisions; passive funds aim to mirror Index performance through asset replication.

Within the 'hands-off' range, there are 19 opportunity funds, 20 balanced funds and 20 cautious funds available, plus the With Profits option. Included within these options are Standard Life's Lifestyle Profiles, which are designed to amend a member's investment strategy to reflect their approach to retirement and the general wish to reduce risk as doing so.

Standard Life offers 4 Lifestyle Profiles, 3 internally managed profiles (cautious, balanced and global equity) and one externally managed profile run by Barclays Global Investors (BGI). The table below highlights how the Standard life Balanced Profile operates.

New versions of the 3 Standard Life Profiles are now also available, which offer the Standard Life Managed Cash Fund as an alternative to the Standard Life Sterling Fund.

Within the 'hands-on' range, there are a total of 105 different funds available, covering a range of different asset classes and geographical regions and offering a choice of investment house and style for the majority of asset classes.

I can confirm that from the data provided from Standard Life, scheme members are currently investing in 31 different funds in total; 8 of which are externally managed. However, approximately 75% of the total holdings are held within two funds: the With Profits One Fund (approximately 50%) and the Managed One Fund (approximately 25%).

Of the externally managed funds, the largest total held in any of the 8 funds (as at 30 September 2008) was £13,720.63 (0.2% of the total holdings) and the investment in the 8 external funds was by only 6 members of the scheme (0.7% of the membership).

At present, there is no nominated default fund on this scheme; as such, all members are required to actively select their own investment strategy, be that from the 'hands-on' or 'hands-off' range.

PRUDENTIAL SCHEME

Despite being the newest of the schemes, the Prudential scheme has a similar number of total members (826) to the other two schemes; just 81 less than the Equitable Life scheme and 31 less than the Standard Life scheme. However, of these, the majority are not active members, with only 357 actively contributing to the scheme. In my discussions with Prudential, they indicated that a key reason for this is the targeted transfer exercises they have undertaken to attract members to transfer benefits from the Equitable Life scheme. The number of active members and level of contributions to the scheme are almost identical to those for the Standard Life scheme.

Within the scheme is the option for members to purchase additional life cover at up to 2 x Salary level (subject to a minimum of £5,000). At present, 9 of the scheme members are utilising this facility.

Charges

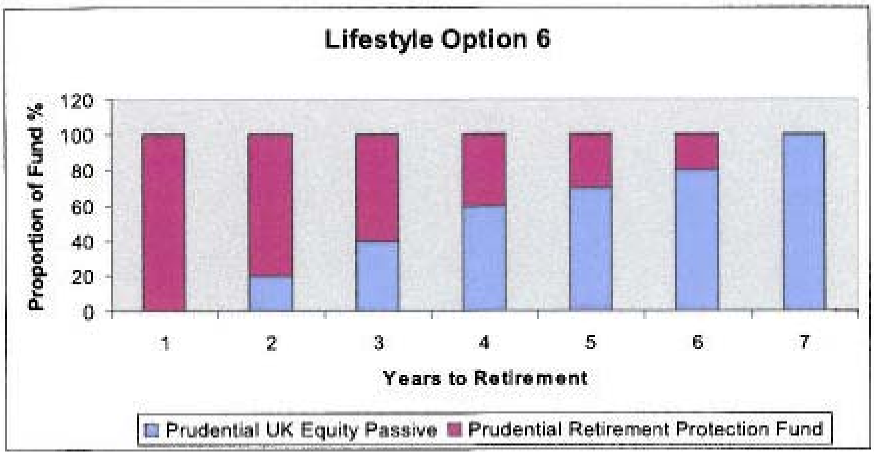
The charges applicable to this contract are detailed below;

- An AMC is applied for the management of the selected investment funds. This is a percentage of the fund value invested, ranging between 0.65% and 0.85% dependent upon the fund selected. For the majority of Prudential's own funds, the charge is 0.75% p.a.; for a few passively managed or lower risk funds, the charge is 0.65% and for those actively and externally managed funds available, the charge is 0.85%.

Investment Choice and Default Fund

The Prudential contract offers a range of predominantly internally managed investment funds with only a very few externally managed funds currently available. There are currently 19 funds available under this contract of which 17 are internally managed by Prudential. Of the 19 funds available, 16 are actively managed with 3 passively managed, 1 by an external manager. A further 33 investment funds are available from Prudential but these have not been authorised for use by the Trustees and, as such, are not open to the scheme members. Of these additional funds, 11 are managed by Prudential, including the With Profits Fund, and the other 22 are from a range of 6 different investment houses. These include another 11 passively managed funds; some by Prudential and some by external managers.

Within the contract, Prudential currently offers 3 Lifestyle strategies. All 3 strategies utilise the same 2 investment funds but vary the length of time from retirement that they begin to switch from the investment element to the protection element of the process. It is this number of years from retirement that is used for the fund's name and, as such, there is a 6 year, 8 year and 10 year option. The 2 funds used to provide the lifestyle investment are: the Prudential UK Equity Passive Fund for the investment option and the Prudential Retirement Protection Fund for the protection element. The table below highlights how the Lifestyle Option 8 Strategy operates.



It should be noted that Prudential has confirmed that it is possible to bespoke a lifestyle option to suit the needs of your members utilising a range of the funds available under the contract.

I can confirm that, from the data provided by Prudential, scheme members are currently investing in 21 different funds in total, 4 of which are externally managed. You will note that the number of funds is actually greater than that currently available and this is because some members continue to hold monies in two externally managed funds that are no longer open to new investors.

However, as with the Standard Life scheme, although there are 21 funds being used by members, the total monies held are concentrated in a very small number of funds. Indeed, approximately 73% of the total holdings are held in one fund, the Deposit Fund, which is used by 585 of the total 826 members. The Deposit Fund operates in the manner of a bank or building society account, guaranteeing that the total amount of a member's investment cannot fall and that any interest payments added to the fund are also guaranteed.

The rate of interest on the fund is not guaranteed and will fluctuate each month in line with the Bank of England Base Rate, which is currently 0.5% p.a.

Of the externally managed funds, the largest total held in any of the 4 funds (as at 31 March 2008) was £43,406.90 (1% of total holdings) and the investment in the 4 external funds was by only 13 members of the scheme (0.5% of the membership).

The Prudential Scheme does currently have a nominated default fund and this is the Deposit Fund. Whilst the Deposit Fund is by far the most populated of the investment options available through the scheme, Prudential was keen to stress that very few members held the investment as a result of the default option and, indeed, the vast majority had actively selected the fund.

EQUITABLE LIFE SCHEME

The Equitable Life scheme is the original AVC contract that the scheme offered and has been closed to new entrants for a number of years (with the exception of members transferring from another local authority who already have an Equitable AVC and wish to continue with this). Equitable Life classes the scheme as having 885 active members, however, this is not the actual number still contributing to the scheme, which is significantly lower. I have asked Equitable Life to confirm the number of members currently contributing to the scheme but am still awaiting this data.

Equitable Life has confirmed that this information should be available from the Investment Benefit Summary which has been recently issued to the Trustees. However, having now seen a copy of this, it is not possible from the information provided to accurately ascertain the number of members actively contributing to the plan. The ongoing contributions to this scheme are significantly below those being made to Standard Life and Prudential at only £53,300 p.a..

The Equitable Life scheme offers no on-line support for members, nor any dedicated administration contact for either members or Trustees. The scheme did offer additional life cover for members and a number of these are continuing to pay premiums to maintain this cover; the last figures available from Equitable Life showed this to be 135 members.

Charges

The charges applicable to this contract are detailed these below.

- An administration charge of 2% is taken from each contribution to the With Profits Fund before the contribution is applied. This has the effect of reducing the amount of each contribution that is used to buy units to 98% of the original amount paid.

- A 2% bid/offer spread is applied to all contributions to Unit Linked Funds. The bid/offer spread is the difference between the price at which units are purchased (offer price) and sold (bid price). This effectively reduces the value of each contribution made by 2% upon purchasing units. Thus, the value of a contribution after units have been purchased is approximately 98% of the actual monetary amount paid to the contract.

- A charge of 2% of the fund value would be made on any monies switched out of the Building Society Fund, to reflect the fact that no charges are made on investing in this particular fund.

- An AMC is applied for the management of all selected investment funds with the exception of the Building Society Fund. This is a percentage of the fund value invested and is 0.5% for all funds.

In addition to the charges detailed above, it should be noted that Equitable Life will apply a charge in the event of switching or transferring benefits away from the With Profits Fund, except on retirement or death. This charge is currently 5% of the fund value, although it may change at any time without notice.

Investment Choice and Default Fund

The Equitable Life contract offers a relatively small range of internally managed investment funds. The scheme offers both the With Profits Fund and the Building Society Fund, plus a range of 19 unit linked investments managed by Equitable Life. Of these 19 funds, 2 are passively managed; the remainder actively managed. In addition, a further 7 unit linked funds managed by Clerical Medical can be made available to members, if Trustees wish.

The Equitable Life plan does not offer a life-styling option for members and it is not possible to put one in place for the scheme, as they do not allow this facility.

Of the 21 funds available, 16 are currently being used by members, although, again, investment is dominated by a small number of funds. The largest holding is in the With Profits Fund in which approximately 59% of the monies are held and 535 members are invested (60% of membership). Nearly all of the remaining holdings are within the Building Society Fund (19% of monies) and the Managed Fund (19% of monies). The Building Society Fund operates on a similar basis to the Prudential Deposit Fund, effectively behaving like a bank or building society account in protecting capital and adding interest. The interest rate applicable to this fund is the compound rate of interest offered by the Nationwide Building Society; at present, I believe this rate is also 0.5% p.a.

There is currently no default option in place for this scheme and as the scheme is closed to new members, it is unlikely that one can be put in place.

5. Existing AVC Providers – Investment Performance Review

In the following, I will review the performance of the most popular fund selections within the 3 AVC schemes with Standard Life, Prudential and Equitable Life.

By far, the largest fund holdings with both Standard Life and Equitable Life are the With Profits Funds available and given this and the unique nature of With Profits investments, I will focus on these first. Although the Prudential With Profits Fund is not currently available for members of the AVC (at the request of the Trustees), I have included details of their offering for comparative purposes.

With Profits Funds are a unique style of investment and, as such, I have attached an Appendix (Appendix I) looking at the exact manner of how this type of fund works, which you may wish to read before proceeding.

With regard to the specific With Profits Funds in question, I would make the following comments:

Standard Life – With Profits One Fund

According to the data provided by Standard Life, currently, 66% of the members in the Standard Life Scheme are investing in the With Profits One Fund, with a total holding of approximately £3,264,000.

The underlying assets of the fund are invested in line with Standard Life's Asset Mix 3, which as at 31 December 2008 was as follows;

Asset Class	% Held
Equities	33.5%
Property	18.8%
Fixed Interest	42.7%
Cash & Money Market	5.0%
Total	**100%**

Based upon the above, this gives the fund an Equity Backing Ratio (EBR) of 52.3%. Of the equity investment, 66% is in the UK, 16% in the US and the remainder split between other global equity markets. Of the Fixed Interest holdings, 65% is in Government Bonds and 35% in Corporate Bonds.

The current annual bonus rate for the fund, as declared on 1 February 2009, is 2%. The bonus rates declared for the fund over the last 5 years are detailed below.

	Annual Bonus Rate Paid for the year to 31 January				
Standard Life Fund	**2009**	**2008**	**2007**	**2006**	**2005**
Pension With Profits One	2.5%	2.0%	2.0%	2.5%	3.25%

Source: Standard Life Investment Bulletin – May 2009

The actual investment returns of the underlying assets over the last five years can be seen below;

	Discrete Annual Performance for Each Year Ending 31 December				
Standard Life Fund	**2008**	**2007**	**2006**	**2005**	**2004**
Asset Mix 3	-12.9%	5.6%	11.4%	17.8%	12.3%

Source: Standard Life Investment Bulletin – May 2009

Please note that past performance is no guarantee of future performance; the value of units can fall as well as rise.

Equitable Life – With Profits Fund

According to the data provided by Equitable Life, currently, 60% of the members in the Equitable Life Scheme (535 members) are investing in the With Profits Fund, with a total holding of approximately £1,959,000.

The underlying assets of the fund are invested in line with Equitable Life's asset allocation guidelines which are currently as follows:

Asset Class	Range as a %
Gilts & Corporate Bonds	75-90%
Property	0-15%
Equities	0-15%
Cash	0-5%

Based upon the above, this allows the fund a potential maximum EBR of 25% (the minimum fixed interest holding being 75%). However, at present, the fixed interest holding is likely to be nearer the top of the range (90%), leaving the EBR likely to be less than 10% of the fund's assets. Of the Fixed Interest holdings, Government Bonds (Gilts) are the core investment class, as the nature of these ties with the liability driven view of the fund management.

Each premium paid to Equitable Life, after the deduction of charges, secures a guaranteed benefit at retirement; the aggregate of these benefits is the minimum amount payable at the original SRD. Unlike the Standard Life Fund, the Equitable Life With Profits Fund has a guaranteed investment return; the rate by which the guaranteed benefit level increases each year, which is 3.5% p.a. for policies issued before 1 July 1996. In addition to this guaranteed investment return, the fund may provide reversionary bonuses which are also guaranteed. Equitable Life has stated that there are no reversionary bonuses currently payable or likely to be payable for the short to medium term future.

As well as the guaranteed value, each policy also has a second value, called the 'Policy Value'. Unlike the guaranteed value the policy value can increase or decrease and is designed to represent a policy's fair share of the investment fund. This value is the starting point for calculating any pay-out from the fund. Upon death or retirement at the original SRD, the higher of the guaranteed value or the policy value will be paid; on exiting the fund at any other time, the guaranteed value will not apply and the policy value, minus any applicable penalty or plus any final bonus, will be the value used. Equitable Life has confirmed that a 5% penalty currently applies on exiting the fund at any time other than the original SRD or on death.

The most recent data available from Equitable Life on the overall rates of return declared for the fund is detailed below.

	Overall Rate of Return for Calendar year				
Fund	**2007**	**2006**	**2005**	**2004**	**2003**
Pension With Profits	5.0%	5.0%	4.5%	3.5%	2.0%

Source: Equitable Life PPFM – July 2008

Please note that past performance is no guarantee of future performance; the value of units can fall as well as rise.

Prudential - With Profits Fund

As stated above, the Prudential With Profits Fund is not currently available via the scheme, however, it could be made available at Trustee discretion.

The underlying assets of the fund are invested in line with Prudential's published guidelines and as at 31 December 2008 were as follows:

Asset Class	% Held
Equities	51%
Property	14%
Fixed Interest	29%
Cash & Money Market	6%
Total	**100%**

Based upon the above, this gives the fund an EBR of 65%. Of the 51% invested in Equities, 34% is in the UK, with the other 17% split between other global equity markets.

The current annual bonus rate for the fund, as declared on 15 March 2009, is 2.75%. The bonus rates declared for the fund over the last 5 years are detailed below.

	Annual Bonus Rate Paid for the year to 14 March				
Prudential Fund	**2009**	**2008**	**2007**	**2006**	**2005**
Pension With Profits One	3.25%	3.00%	3.00%	3.00%	3.00%

Source: Prudential Investment Bulletin – March 2009

Please note that past performance is no guarantee of future performance; the value of units can fall as well as rise.

Unit Linked Performance

The following table highlights the performance of the most popular unit linked fund selections from the 3 providers. Where appropriate, I have grouped similar funds together and compared these to the appropriate sector averages. All data used in the table is taken from Trustnet – A Financial Express Website.

Fund	Discrete Performance for the Calendar Year 2008	2007	2006	2005	2004
Standard Life Managed One	-20.8%	7.5%	12.3%	22.0%	10.8%
Equitable Life Managed	-17.6%	3.9%	8.5%	17.5%	10.2%
Balanced Managed Sector Average	**-20.8%**	**5.5%**	**10.4%**	**19.6%**	**9.8%**
Standard Life Cautious Managed One	-8.9%	4.0%	9.6%	16.4%	10.3%
Cautious Managed Sector Average	**-15.7%**	**1.2%**	**8.1%**	**13.2%**	**8.5%**
Standard Life Stock Exchange One	-24.6%	8.3%	15.7%	26.1%	10.6%
Prudential Discretionary	-19.0%	6.2%	10.6%	21.7%	11.1%
Flexible Managed Sector Average	**-24.6%**	**6.6%**	**11.7%**	**22.4%**	**11.2%**
Standard Life Property One	-20.8%	-13.0%	18.2%	15.8%	18.6%
Prudential Property	-16.8%	-9.6%	12.4%	14.1%	14.1%
Property Sector Average	**-19.8%**	**-12.2%**	**15.9%**	**15.6%**	**16.1%**
Prudential Cash	0.2%	4.7%	3.9%	4.4%	4.2%
Money Market Sector Average	**4.3%**	**4.7%**	**3.8%**	**4.0%**	**3.5%**
Prudential Retirement Protection	13.1%	1.9%	-0.7%	10.1%	8.0%
Sterling Long Bonds Sector Average	**4.6%**	**1.2%**	**-0.5%**	**10.8%**	**7.7%**
Prudential UK Equity Passive	-29.9%	4.3%	14.7%	21.0%	12.5%
UK All Companies Sector Average	**-31.7%**	**2.4%**	**16.8%**	**21.3%**	**13.5%**
Equitable Life Ethical	-20.7%	15.4%	6.6%	22.2%	8.2%
Global Equities Sector Average	**-24.1%**	**9.5%**	**7.5%**	**24.1%**	**8.1%**
Equitable Life High Income	-25.6%	5.4%	14.9%	22.6%	13.7%
UK Equity Income Sector Average	**-28.2%**	**-0.1%**	**17.9%**	**20.7%**	**16.4%**

I would make the following comments regarding these funds:

Standard Life Managed One

This fund has a stated aim of providing long term capital growth by investing in a wide portfolio of assets including equities, fixed interest securities and property that are domiciled both within the UK and overseas. The fund currently holds approximately 71% of assets in equities with the largest holdings in UK equities (approximately 40%).

This is in keeping with the norm for the Balanced Managed sector. In performance terms, the fund has consistently matched or bettered the sector average over the last 5 calendar years.

Equitable Life Managed Fund

The fund aims to maximise returns from a range of investments including equities, fixed interest and property. The fund currently invests predominantly in the fixed interest markets, taking a lower risk profile than is the norm within the Balanced Managed sector. This lower risk strategy is reflected in the fund's performance, which has been below the sector average in years when markets were rising (2005, 2006 and 2007) but above the sector average in the falling markets of 2008.

Standard Life Cautious Managed One Fund

The fund aims to provide long term growth through investing in a range of assets, whilst looking to reduce risk (in comparison to a balanced managed fund) by increasing the investment in lower risk assets. The fund currently invests approximately 55% in fixed interest investments, predominantly in the UK (44.5%), with approximately 32% in equity holdings; again, mainly in the UK (27%). The fund has consistently outperformed the sector average in each of the last 5 calendar years, often significantly so.

Standard Life Stock Exchange One Fund

The fund is actively managed with a bias towards equity investment, although the fund can also hold fixed interest investments. The fund currently holds approximately 75% in equities with the largest holding again in the UK (37%). The fixed interest holdings are currently at the higher end of the potential range of holdings, reflecting the uncertainty of markets in recent times. The fund is rated as being in the Flexible Managed Sector, which allows a higher equity holding than the classification for the Balanced Managed Sector. The fund has consistently performed either at or above the sector average with only 1 year's performance below the sector average (2004). As with the Standard Life Managed One Fund, the fund's performance against its peer group has been strongest in rising markets and poorest in falling markets.

Prudential Discretionary Fund

The fund aims to achieve capital growth through investing in a range of assets with a weighting towards equities (75%) and in particular UK equities (39%). The fund is rated as being in the Flexible Managed Sector (allowing up to 100% investment in equities) but appears to take a more cautious approach than the investment limits would allow with a consistently high (comparatively for the sector) holding in lower risk assets. This approach is reflected in performance below the sector average in years of rising markets but significant out-performance during 2008 when the markets were falling.

Standard Life Property One Fund

The fund aims to provide long term returns from direct investment in UK commercial property, however, it may also invest in European properties and derivatives to achieve efficient portfolio management. Due to the nature of property as an asset class, it may at times be difficult for the fund to liquidate assets and, as such, the fund manager has the right to impose delays on investor's encashing their holdings. Following sustained and significant falls in the property market, Standard Life is currently imposing a 180 day waiting period on withdrawals from this fund. The fund has exhibited out-performance versus the sector average in rising markets and under-performance in subsequent falling markets.

Prudential Property Fund

As with the Standard Life Fund, this aims to achieve long term returns through direct investment in property. The fund has recently altered its permitted investments to also allow indirect investment and the use of derivatives. This opens the fund manager's mandate and provides him with the opportunity to make shorter term investments to try and combat longer term market issues. Potentially, this could change the investment structure of the fund, although I expect that direct property investment will remain the core element to the fund. In performance terms, the fund has produced returns on the cautious side of the sector average, under-performing in rising markets and out-performing in falling markets.

Prudential Cash Fund

The fund is a money market fund, aiming to provide security to investors with returns ahead of those available on deposit. Whilst entitled a 'Cash Fund', the manager will not only use deposits within the fund but will also invest in money market instruments, both short and longer dated, such as Floating Rate Notes and Asset Backed Securities. These investments carry both a default risk and the risk that the market value of the investment can fluctuate during the period of holding the investment. Thus, it is possible that if the manager is forced to encash these investments before maturity, they may return a lower value than at maturity.

This risk, and the market valuation of these investments, can lead to not only falls in returns to the fund but also falls in the value of existing holdings in the fund. As such, the fund is not as secure as the Deposit Fund offered by Prudential, but does potentially offer greater returns. The fund has significantly under-performed the sector average over 2008 (0.2% growth versus the average of 4.3%) and this is likely to be as a direct result of the holdings in these longer term investments. The fund currently holds approximately 15.5% of its assets in Asset or Mortgage Backed Securities. It should be noted that it was holdings in these types of assets that caused the well documented problems in the Standard Life Sterling Fund earlier this year, although the levels of these assets in the Sterling Fund were far higher than those in the Prudential Fund.

Prudential Retirement Protection Fund

The fund is passively managed and invests wholly in UK Gilts with over 15 years to maturity. It is designed to provide a low risk, safe return environment for investors and, as such, is used as the protection element of Prudential's life-styling process. The fund has historically performed at or around the average for the sector, but in 2008, vastly out-performed the sector average. The Gilt market at this time was a high demand sector, due to a flight to safety attitude to investment, and clearly, the fund benefited from this. However, investment in long dated Gilts does offer greater volatility than a Deposit Fund and this can be highlighted by the fact that the year to date performance for the fund (at 27 May 2009) has been -9.3% (against a sector average of -5.9%). This reflects the changing view of the Gilt market as the UK Government undertakes a process of 'quantitative easing' to increase the money supply in the economy.

Prudential UK Equity Passive Fund

This fund is designed to passively track the FTSE All Share Index, providing long term growth through exposure to UK equities. The fund tracks the Index by fully replicating the FTSE 100 and using representative sampling of the remainder of the Index. By not fully replicating the full Index, the fund will produce some tracking errors in comparison to the Index; depending upon the performance of the sampled stocks selected, this may be a positive or negative variance. The fund is wholly invested in UK equities and, as such, has produced the most volatile returns of the funds reviewed, which is in keeping with the expectation for a fund focusing on one higher risk asset class.

Equitable Life Ethical Fund

The fund aims to achieve long term growth through investment in a range of global equities, whilst applying an ethical screening criterion to stock selection. The majority of holdings are based in the US (53%) with the second highest holdings being in the UK (15%). The fund has produced volatile results as would be expected from a fund that invests approximately 92% in equity markets. Performance has swung from under-performing the global equities sector for 2005 and 2006 to significantly out-performing the sector in 2007 and 2008.

Equitable Life High Income Fund

The fund aims to produce a high level of income and some capital appreciation through holding a portfolio of UK stocks which produce regular dividends and fixed interest holdings, predominantly corporate issues. The fund has out-performed the market over the last two years, as values have fallen, but generally under-performed in the rising markets. Again, this would indicate a more cautious approach in stock selection and asset allocation than the sector average.

6. Areas of Interest

Having fully considered the 3 schemes available, I feel that the areas detailed below are those that the Trustees should be considering for further review or action.

1) Default Fund Provision

The Trustees should give serious consideration to the introduction of a default fund with Standard Life and a review of the appropriateness of the Deposit Fund for a default fund with Prudential. Whilst the Prudential Deposit Fund offers members a secure investment (which has looked attractive over the last 2 years), the long term growth prospects for the fund are well below those of equity based funds. Whilst equity based funds carry higher risk levels, members with a medium to long term to retirement (5 years+) generally have sufficient time to make the investment risk less relevant due to the potential term for recovery.

If properly communicated to members (both new and existing), a default fund can offer a valuable guide for members to an appropriate investment strategy and can be used to provide members with a strategy that develops and changes with their changing needs.

When establishing a default fund, HACL would advocate that life-styling is used to enable the investment strategy to maximise potential returns in the early years and then reduce risk automatically (without the need for member activity) as the member approaches retirement. The key to any life-styling strategy is the appropriateness of the underlying investments and the time period used to phase investments from the performance element to the protection element of the strategy.

A particular issue for the scheme is the likelihood that many members will be aiming to use all of their AVC fund to provide a tax-free cash lump sum and, as such, any life-styling process used should look to phase 100% into cash investments, as opposed to the standard 25% cash holding of most existing life-style systems. As such, it would appear appropriate to look to bespoke default solutions with both Standard Life and Prudential to meet this design (the ability to bespoke a default fund with Standard Life would require discussion with them, but given the size of the fund, they should be prepared to be flexible in the provision).

A further consideration would be the most suitable funds for use in providing the life-styling and whether a passive or active management style is most appropriate. A number of studies have shown that over the longer term, passively managed funds outperform the vast majority of actively managed funds, although active management offers the potential for short term out-performance. The crux of this being that a single manager is unlikely to consistently beat the market year in, year out, over a 10 year+ period, although they may well have periods where they do so over a shorter period (perhaps 3-5 years). When considering that many pension investors are looking at a 30+ term to retirement, the indicators are that unless active managers are to be regularly reviewed and replaced when deemed necessary (which can be costly, time consuming and difficult to achieve) then passive management appears the more appropriate style. The use of a passive manager for the underlying investments would also potentially allow a degree of uniformity to be struck between the Standard Life and Prudential schemes by selecting the same underlying funds.

2) Available Fund Ranges

At present, all 3 schemes offer a range of investment choices to members, albeit the range available with Standard Life is considerably larger than that with the other two providers. The opportunity exists with Prudential and, to a lesser extent, Equitable Life to expand the fund range available; alternatively, there is the option to limit the range available with each of the 3 providers.

It is clear from the investment information provided by each insurer that the monies with each are heavily concentrated in a very small number of funds and this would indicate that only a very small proportion of members would be affected by the restriction of the fund ranges to a small range, of perhaps 5 funds per scheme. However, this would be in contrast to the industry norm which is currently to offer greater range and choice to members to allow those who wish to have the opportunity to make their own decisions to do so. The main reason for restricting the investment choice would be to prevent members investing in low quality, high risk or niche funds without sufficient knowledge to support the decision. Given the data available, it appears that this is not the case with the scheme, as the majority of investors are sticking to mainstream funds.

I would suggest that, in the main, the funds being heavily used by members are competitive against their peer groups as shown in the previous section (any exceptions will be covered in points later in this section) but that the greater issue is one of whether members are investing in the right assets.

My view is that rather than the restriction of the fund ranges, members would gain greater benefit from communication exercises on the investment options available and the potential returns from different asset classes. Such communication could be tied to any decisions taken regarding introducing default funds and there are a number of options available regarding the form of communication to best suit the scheme membership. One option could be a regular (annually or more frequent) AVC investment update, covering the most popular of the investment funds, providing basic performance details and some commentary. Other options can include: articles in your internal newsletters, payslip inserts, targeted written communications or member presentations.

3) With Profits Funds

There are significant numbers of members with holdings in With Profits Funds with both Standard Life and Equitable Life.

The reality is that for those members with Equitable Life With Profits benefits, they are unlikely to be able to match the guaranteed value available at retirement if they choose to transfer their benefits away. As the guaranteed benefit provides a guaranteed investment return also, these members will continue to receive a ‘return’ on their monies, although the actual value at retirement is highly unlikely to exceed the guaranteed sum. The Trustees could choose to undertake a transfer review process of the Equitable Life With Profits holdings (comparing transfer values coupled with projected potential growth rates against the guaranteed values) but this exercise is likely to be expensive and it is unlikely that many members would be expected to benefit from a transfer.

For those members investing in the Standard Life With Profits Fund, the current bonus rates remain relatively low and the prospects for these to increase in the short term are reasonably poor given the underlying investment performance; however, the fund continues to offer security of capital value provided the benefits are held to retirement.

Given current investment conditions, many members of the scheme are now likely to be in a position of facing Market Value Reductions (MVRs) should they wish to exit the fund at the present time, although this could only be established by obtaining member by member fund and transfer values. I would suggest that a targeted communication could be provided to all members in the Standard Life With Profits Fund highlighting the pertinent issues of With Profits investment and looking to clarify the potential problems and benefits members may have.

4) Equitable Life – Members still contributing

Whilst Equitable Life has been unable yet to confirm the number of members still contributing to the scheme, it is at least 130 who continue to pay for life assurance cover. Given that the Equitable Life scheme has additional charges applicable to contributions that the other schemes do not, it may be worth undertaking a full review of the contributing membership to establish if there are any members who may benefit from switching their contributions elsewhere.

Whilst those Equitable Life members paying into the With Profits Fund are likely to benefit from continuing to do so (as commented on above), it may be possible to review whether those members continuing to pay contributions to maintain life assurance could achieve a comparative deal from the Prudential scheme. Comparisons of the levels of cover and costs would need to be undertaken between the two schemes to establish if those members would benefit or not from switching providers.

If there are any members who are still paying to Equitable Life who are not With Profits investors and do not have life assurance cover through the AVC, they are highly likely to benefit from switching their contributions to one of the other providers.

5) Prudential Cash Fund

There are a small number of investors (16) with holdings in this fund. As detailed previously, the fund is not a Deposit Fund but is, indeed, a money market fund, which holds some investments with potentially volatile values, thus the value of the fund can fall as well as rise.

It is quite possible that the investors in this fund are aware of this distinction, however, equally they may mistakenly believe they are invested in the Deposit fund. As a precautionary measure the trustees may wish to use a targeted communication to highlight this point to the affected members.

6) Standard Life Sterling One Fund/Managed Cash Fund

As with the Prudential Cash Fund, the Standard Life Sterling Fund has a number of investors holding money within it (figures indicated approximately 21 members holding £166,622) who may be unaware that the fund is not a Deposit Fund but in fact has a variable capital value which may fall as well as rise. Standard Life has now made the Managed Cash Fund available which is a lower risk money market fund, without the longer dated investments of the Sterling Fund, as an alternative investment for members looking for security. Again, a targeted communication to these members could be appropriate to ensure that they are aware of the distinction between the funds.

7) Provider Support to members

We understand that there is a significant difference between the support to members provided by Prudential and Standard Life. Whilst Prudential has financial advisers available to meet with scheme members, Standard Life support is on a remote basis via helpdesks and on-line services.

Face-to-face contact is generally preferred by scheme members and this is clearly reflected in the numbers of new joiners to Prudential; significantly outstripping those choosing Standard Life. We understand from Standard Life that there is no intention currently to make field advisers available to support their AVC schemes.

Whilst this may not be a major concern for the Trustees at the current time, there are some issues which should be considered:

a) Over time, AVC provision is likely to be dominated by Prudential, as their direct support clearly influences joiner behaviour. This is only an issue if the Trustees feel members should make choices from a level playing field.

b) Although members have a choice of AVC providers, the Prudential adviser is only allowed to advise on the Prudential scheme. It is therefore important that members understand that they will not be advised about all available AVC options, just those available from Prudential.

7. Conclusion

I believe that this report is a fair and accurate review of; the need for AVC schemes, the AVC marketplace, the existing schemes in place and the investments available through those schemes.

Comparison to the current market place indicates that the two schemes still open to new entrants are competitive in their charging structure, investment options and performance and website provision. The Equitable Life scheme is not competitive with the current marketplace but due to the constraints on With Profits holders and members with Life Assurance cover, it appears appropriate to maintain as a closed scheme.

Whilst the schemes in general appear 'fit for purpose', the previous section of the report (Section 6) aims to draw out the specific issues I expect to be of particular relevance for the Trustees. I feel it appropriate to draw attention to these, having considering the arrangements in place and my understanding of the Trustees' aims and objectives. These points are intended to highlight issues or anomalies that may be of concern or interest for the Trustees and to propose rough guidelines on how these areas could be approached.

Should the Trustee group wish to pursue any of these points further, or discuss the issues or suggestions raised, I would of course be happy to assist in doing so. For the majority of these issues, further discussion and investigation of specific aspects would be required before proceeding with any course of action.

Appendix I – With Profits Funds

With Profits Funds are a form of collective investment, where investors pool their funds together for the fund manager to invest into a diverse range of investments, including company shares, Government securities, fixed interest securities and property.

The aim of the investment manager is to smooth the investment returns by declaring annual bonuses, which are then added to the value of the policy. Once these annual or reversionary bonuses have been added to the policy, they cannot then be taken away and so With Profits Funds have a certain level of security not available in some other types of fund. However, this extra security comes at a price; the investment manager will not apply the full value of increases on the underlying investments as an annual bonus because the aim is to hold back part of the profits made in the good years in order to support bonus payments in years when investment conditions prove more difficult.

A Terminal Bonus may also be paid when benefits are taken, transferred from the With Profits Fund and in the event of earlier death or surrender. Terminal Bonus is generally expressed as a percentage of the fund at maturity or claim date; the level of this bonus reflects the underlying values of the fund's assets and is reviewed regularly and is designed to ensure that policyholders receive their fair share of the fund.

Although the fund is designed to smooth major fluctuations in investment values, a shortfall may arise if the value of the assets underlying the fund is reduced by unfavourable market conditions at the time of encashment. This is particularly so if large numbers of investors withdraw their investments in unfavourable market conditions. With Profits providers, therefore, reserve the right to apply a Market Value Reduction (MVR) to their With Profits Funds, which could reduce the cash value of any funds transferred thus protecting those investors remaining in the With Profits Fund.

As with all asset backed investments, the nature of the With Profits Fund means that its underlying value (i.e. the assets into which the fund invests) can vary and this will determine the fund managers view of terminal bonus and MVRs. If the fund value on a member's annual statement includes the terminal bonus, their fund can be worth less at the end of a year when compared to the beginning.

MVRs may or may not be present on a member's investment at any time and it is important that individuals check whether one is imposed on them before transferring or switching their fund, or withdrawing their investment altogether.

Fund managers will impose MVRs when they need to but will also reduce them or withdraw them when market conditions allow. So, in some circumstances, it may be appropriate to wait until an MVR is withdrawn rather than having it reduce the value of an investment (if timing is not an issue).

Should the member keep their With Profits investment until the stated retirement age then they would not be penalised by the application of an MVR at that specific time. However, they would lose this guarantee if they transfer their fund or take benefits from the With Profits Fund, either before or after the selected retirement age.

All With Profits providers publish a guide as to how they manage these policies; this is known as the 'Principles and Practices of Financial Management (PPFM)'. The full document can normally be viewed on the provider's website.

A key component of the PPFM is confirmation of the funds intended investment strategy and its current asset split. The proportion of assets held in equities and property is known as the Equity Backing Ratio (EBR). Equities and, to a lesser extent, property assets generally have more variable values but, over the longer term, are expected to provide higher returns. Fixed interest and cash deposits have more stable values but, over the longer term, are expected to provide lower returns.

A Word of Caution

i) All information contained herein is based on HSBC Actuaries and Consultants Limited's understanding of current tax law and HM Revenue & Customs practice, which may of course be subject to future changes.

ii) The value of unit linked investments and the income from them may fall as well as rise, and you may not get back your initial investment in some circumstances.

iii) Changes in rates of currency exchange may have an adverse effect on the Sterling value or price of overseas linked investments.

iv) Bonuses accruing on With Profits contracts are dependent upon the life office's policy as regards their distribution, whether this be at maturity, death or early surrender. Bonus rates may change and past performance is no guarantee of future returns.

v) You are advised to read any instructions, Key Features documents, Terms and Conditions, Notes and Technical Details attached which give fuller information on products. In particular, I would draw your attention to the sections on risks, commissions, charging structure and cancellation rights.

vi) Past Performance is no guarantee of future returns. Following the Budget of July 1997, pension funds can no longer reclaim the tax credit of UK equity dividends. Please consider this when reviewing past performance.

vii) Please note that at times, funds invested in property can be difficult to sell, so you may not be able to sell/cash in your investment when you want to. We may have to delay acting on your instructions to sell your investment. Also, the value of property is generally a matter of a valuer's opinion rather than fact.

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