

# As easy as AVC

## Why review your AVC provider?

With LGPS governance under increasing scrutiny it is becoming ever more important that funds are able to demonstrate how they are ensuring the best outcomes for their members. This includes ensuring that AVC funds are appropriate and relevant to their members' needs.

The Pensions Regulator's 2015 Code of practice no. 14 "Governance and administration of public service pension schemes" expects Pensions Boards to be "familiar" with their Fund's AVC arrangements. The Pensions Regulator has since raised the bar for AVC governance in the private sector and expressed the hope that LGPS funds will work towards meeting the governance standards in the 2016 DC Code<sup>1</sup>.

A growing number of funds are recognising the need to look at AVCs on a more regular basis. Areas to consider include: suitability of the investment options – particularly in the light of the pensions freedoms, value for members, security of assets, communication materials, AVC governance budget and legacy AVC provision (especially With Profits, where the rundown of several funds is at an advanced stage).

Below we set out how we can assist in this important area.

## Our credentials

- We are the leading consultant to the LGPS and its employers, advising 50% of the market.
- We are also a leading DC adviser and have carried out many AVC reviews for both local authorities and major private sector schemes in the last few years.
- Our Workplace Pensions Savings team includes experts in the AVC market, covering With Profits (which is so often a feature of older AVCs) and DC provider selection.

We understand the AVC market and have regular dealings with its major players.

## A cost effective approach

The number of providers competing in the AVC market has shrunk as private sector defined benefit schemes have closed to new entrants and future accrual. While there are still several AVC providers with large books of legacy AVCs, only a handful of providers are open to new AVC business – and then often quite selectively. We feel that "whole-of-market" surveys are rarely worthwhile.

So, we approach each AVC review from a pragmatic viewpoint with a change of provider being the last resort if there are too many issues to overcome with the present provider. We follow a step-by-step approach, identifying the issues and agreeing the priorities with you at each stage along the way, before undertaking any work. That way you can control budgets and focus on what matters most.

<sup>1</sup> <http://www.thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trust-based-schemes.aspx>

## The first stage to good AVC governance

“Proportionate” AVC governance, as defined by the Pensions Regulator, is about understanding how important AVCs are to each AVC payer’s overall benefit. Knowing this for your own Fund will help you to decide how much time should be spent on AVC governance.

The data gathering and analysis this requires also gives the first indications of where any potential issues lie and we will discuss these with you at the earliest opportunity. From this we can then agree with you a “shopping list” of priorities and how best they should be tackled on a bespoke basis rather than following a formulaic approach.

### What are the issues for AVCs likely to be?

The issues facing most funds often include in various permutations:

#### Core AVC provider

- Who among the fund’s current AVC providers is best placed to be the core provider?
- What support can the provider give to your Fund?
- What would happen if the provider, or the fund managers it uses, got into financial difficulties?

#### Investment options

The Pensions Regulator’s DC Code expects funds to offer a range of investment options which meet members’ needs and that the suitability of these investment options should be kept under review.

- Are the investment options still right for AVC members post pension freedoms?
- Are there new investment options available which offer a better balance between risk and return for AVC members?
- Should there be a default option?
- Are the investment options creating an unjustifiable governance burden?

#### Legacy AVC providers

- How many members have AVCs with legacy providers that are no longer fit-for-purpose?
- Can members be safely moved out of With Profits funds where many, but not all, give poor or non-existent investment returns?
- How valuable to members are the With Profits guarantees and other options under the provider’s AVC contract?
- What are the potential costs and benefits of moving AVCs from legacy providers to the core AVC provider?

#### Costs

- How much time should your Fund spend on AVC governance?
- Is the provider delivering value for your members?
- What can be done to contain costs for members and the Fund?

The importance of each of these issues varies from fund to fund – and so the solution should differ from fund to fund too.





## Communication

Effective member communication and engagement is a challenge for all defined contribution benefit provision.

### Helping members save for their retirement

Most members recognise the need to save for their retirement, but getting them to take action (and revisit their decisions every so often) is the challenge. It needs to be made easy for members to find information on AVCs and then to start paying AVCs.

Our specialist communication partner, Like Minds, can help improve member engagement with engaging pension specific surveys and communications.

### Choice, but not too much choice

Part of making it easy for members to save is offering a range of investment options which acknowledges members' differing levels of interest in investment matters.

While most members see choice as a good thing, most rarely use it. Both behavioural economics studies and our experience suggest that:

- Too much choice deters members from taking action – meaning they lose benefits that AVCs offer;
- Members rarely review their initial investment choices;
- Members often make investment choices without taking advice (especially when the amounts involved are relatively small).

These issues, which are part of human nature, are not easily surmounted. However, the structure of the AVC investment options, together with member education and communication tools, can help members get the most out of AVCs.

We're aware that some funds are reluctant to limit the choice of investment options their AVC providers offer, as that might be construed as advice. However, this can deter members from starting AVCs as well as complicating both member communications and AVC governance. Supported by the Pensions Regulator's DC Code and the Regulator's recent statement on what constitutes advice, best practice is to rationalise the choice of AVC investment options – the key being that members are offered a range of investment options across the risk/return and asset class spectrum.

Another key step for many funds has been the adoption of lifestyle strategies as a default option to manage the changing risks members face as they approach retirement - in some respects taking the place of With Profits as a "safe haven" for members' savings.

## Everyday support

Some AVC arrangements have suffered from being given a periodic “spring-clean” before being put back on the shelf for several years. The Pensions Regulator views inadequate governance of AVC and DC benefits as a risk to members’ interests. We can help LGPS funds sustain a realistic level of AVC governance with a flexible menu of support services:

- Quarterly investment manager reports;
- Annual research on major With Profits Funds;
- Annual overview of major AVC providers;
- Periodic “Value for Members” (VfM) assessments;
- Response to AVC issues;
- Attendance at meetings as required.

## Case studies

### Household name

A large private sector employer’s scheme had inherited a number of AVC arrangements through corporate acquisitions over the years. We helped identify and prioritise the issues with each provider and gradually worked through the issues, so that the scheme’s AVC arrangements were better focused on the lead provider and meeting members’ needs. This included updating investment options, rationalising providers and member communications on specific issues.

### Equitable Life

Many of our private and public sector clients have legacy AVCs with Equitable. Using our knowledge of the AVC market, and of With Profits funds in particular, we helped identify, prioritise and address the issues to look after members’ best interests. AVC members were unlikely to be aware of the changes Equitable has made over the last few years and so many schemes asked us to help draft member communications clearly setting out the options for unit-linked and With Profits funds with Equitable.

### Local authority

A local authority’s main AVC provider was competitive, but the investment options had not kept pace with market developments or how members use their AVCs at retirement. We put forward a revised lifestyle strategy and updated range of funds which, in particular, rationalised the number of similar equity funds on offer while adding more cautious funds better suited to the age profile of the membership.

### Household name #2

A large private sector employer’s schemes used two competitive AVC providers, but with disparate fund choices and services. Neither provider was interested in taking over all the AVC provision, so we helped to introduce greater consistency in the investment options and manage the different levels of service on offer.

### Value for Members

Private sector schemes are now required to carry out an annual “Value for Members” assessment for AVC and DC benefits, which is not simply about costs - it should also cover more subjective factors such as the quality of administration, communication and governance. We have developed an approach and benchmarking to help a number of schemes carry out their VfM assessments in a way which reinforces their governance processes.

## Contact us

If you are interested in discussing AVCs please speak to your usual Hymans contact.

