Prudential Independent Governance Committee's Report 2020

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One page summary for Members

This is my fifth and final report as Chairman of the Independent Governance Committee (IGC) for Prudential. IGCs were set up by the Financial Conduct Authority, the UK's Financial Regulator, to ensure you get Value for Money from your workplace pension.

What happened in 2019?

2019 was a difficult year but one which ended well for Members. Your pension pot grew well in a year that was good for investments globally. The Prudential Dynamic Growth IV fund in which most Members are invested grew by 15.8% last year (and by an average of 6.8% over the last three years); the second most popular fund – With Profits – grew by 11.5% last year (and by an average of 7.3% over the last five years).

Clearly markets have suffered in recent months as a result of the Coronavirus. The important message here is that Pensions are a long-term investment and markets have always eventually recovered over time from previous downturns.

Charges are the second most important factor, after investment returns, in assessing Value for Money. During the year Prudential proposed an increase in charges for around half of Members. After the IGC raised its concerns with both Prudential's Board and the Financial Conduct Authority, I'm pleased to report that Prudential has decided not to go ahead with the increases for the moment. This is good news for Members.

Service levels have been inconsistent during the year. Prudential is changing its reporting systems, which show a trend of smaller backlogs, but with problems at call centres. Financial transactions are still processed promptly and the number of complaints received are still at acceptable levels.

Key Conclusion

You are getting good Value for Money from your Pension and better value than 5 years ago. Prudential has indicated that it may review it's position on increasing charges in the future. If they propose an increase, Employers and Members will need to be vigilant about the reduced pension and the impact on Value for Money.

Any questions?

If you want to find out more, please read the full report or leave us some **feedback**.

Lawrence Churchill CBE
Chairman, Independent Governance Committee

Prudential IGC Main Report 2020

Lawrence Churchill CBE, Independent Chairman

I am pleased to report another year of excellent investment returns, but Prudential's proposal to increase its charges for around half of Members, often substantially, served as a wake-up call. It is good news for Members that they have delayed the proposal.

1. Introduction and Summary

The introduction of Independent Governance Committees has been helpful to Members of pension schemes under IGC's remit. There is little doubt that charges would not have come down so quickly without pressure from IGCs. The responses to Pensions Freedoms or the elimination of duplicative and expensive fund choices would not have been as comprehensive. In the round, Value for Money is better now than it was five years ago.

This year has also brought the realisation that the Value for Money framework and its calibration needs further development. Three years ago, IGC was predominantly looking at the totality of Prudential's contract-based workplace pensions, with reference to the statutory charge cap for default funds under auto-enrolment schemes. The market has moved on competitively for auto-enrolment schemes and more up to date market comparisons are becoming available. This trend will benefit consumers and I echo the Work and Pensions Select Committee's call for the authorities to publish more frequent surveys.

Finally, I would like to thank the staff at Prudential for their help and support over the years, and my colleagues on IGC for their expertise and insight without which we would not have made as much progress for Members.

Michael Payne, Prudential Appointed Member

IGC is pleased to see that Prudential's charges remain consistent with the market.

2. Charges

2.1 Events in the year

The big event of the year which has dominated IGC's time and attention was Prudential's proposal to increase charges. There was intense discussion with Management, Prudential's Board and with the Financial Conduct Authority on possible communication to Employers and Members.

However, in March 2020 Prudential decided not to proceed. This is good news for Members and preserves their Value for Money.

2.2 Annual management charges for default funds

All charges are within the Government's charge cap, and benchmark surveys indicate that Prudential's charges are consistent with other providers in the market.

2.3 Higher charging funds

Prudential have continued to reduce charges on self-selected funds which charged more than 1%.

John Nestor, Independent Member

2019 has seen another good year from Prudential's investments. We now have transaction costs for the full year and the IGC continues to investigate potential outliers.

3. Investments

3.1 Investment Performance

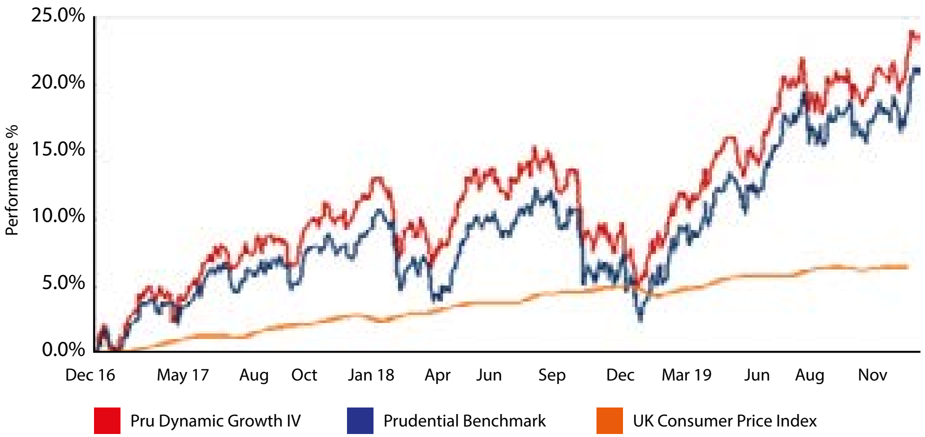
3.1.1 Unit linked Default Funds

2019 was another good year for investment performance. The value of investments in Prudential's flagship default fund grew by 15.8% during the year to December 2019 and has grown at an average annual rate of 6.8% over three years.

This performance is better than IGC's current value for money benchmark of 3% more than inflation, which over the last three years comes to 5.2% annualised.

In relative terms performance beat the fund benchmark as shown below:

3 year Gross Performance of Prudential's Dynamic Growth IV Fund:



The IGC benchmarking survey, conducted by Redington, also shows Prudential's default fund standing up well to the funds of other providers.

3.1.2 Some Employers had previously chosen their own default funds

Following the changes brought about by Pension Freedoms in 2015, a programme was launched to ensure the suitability of default investments and their compatibility with Pension Freedoms. This programme concluded in the second half of 2018, at that time only a small number of employers retained their own default investment strategies.

Over the last year all but one of these employers have chosen to further update their default strategy. In this case the default investment glidepath utilises two ethical equity investment funds and the Dynamic Growth II fund during its growth phase. The investments making up this bespoke default glidepath have outperformed the IGC's current value for money benchmark of CPI+3% by 2.4% over both the last year and the last three years annualised.

3.1.3 With Profits

Over £1.2 billion of workplace pension funds are invested in the With-Profits fund. The performance of this fund was also good during the year, coming in at 11.5% growth before charges. We can also confirm that the fund also exceeded IGC's long term performance objective of 3% better than inflation, and that charges, excluding the extra charges for guarantees, were less than 1%.

3.2 Default fund design

Prudential's default fund design is fully aligned with Pensions Freedoms and causes no concern for IGC.

3.3 Rationalisation of the fund range

The number of funds continues to be rationalised as duplicative and expensive funds are removed. At the time of writing, a further four funds were removed, with 18 further closures planned or in the process of being removed from Workplace Pensions throughout 2020.

3.4 Transaction Costs

We now have actual transaction costs for a full year, to summarise:

Transaction cost (bps)	No. of funds	% of IGC FUM
<10	66	38.0%
10 to 20	25	60.5%
20 – 30	6	0.8%
30 – 50	6	0.5%
>50	4	0.3%

3.4.1 Default funds

The main Default fund (Prudential Dynamic Growth Fund IV) had transaction costs of 14bps over the year. This was a large increase on the 5bps we reported last year, so we asked for the increase to be investigated. The increase was found to be down to a trading decision taken by the fund manager to avoid an adverse risk to performance. Prudential and the IGC are happy that Members benefitted from the decision of the fund manager.

3.4.2 With-Profits

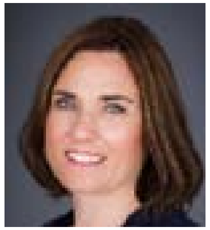
The with-profits fund had transaction costs between 5bps and 9bps, depending on which series of the fund you are invested in. This is slightly higher than what was reported last year (4.7bps) but is still within acceptable levels, given the broad range of investments within the fund. We will continue to closely monitor the transaction costs and challenge Prudential if the figures increase materially.

3.4.3 Self-select funds

Following on from work originally done by the Investment Association and updated for the prescribed FCA methodology, the IGC has accepted Prudential's proposal for using a level of 30bps to look for outliers, which may indicate potential value for money concerns.

At the last regular report there were 10 funds reported as outliers and Prudential are investigating and reporting back. At this stage, some of the explanations seem reasonable and some merit further scrutiny. This is a new process for us all and will take some time to bed down.

The issue is more to do with fund manager effectiveness than any direct consumer harm. All funds are scrutinised for their performance net of all charges through other well established processes and any fund which does not pass a value for money test is put under special scrutiny.



Mary Kerrigan, Independent Member

Environmental, Social and Governance issues have been a particular focus for the IGC this year, with discussions between Prudential and the IGC focussing on Prudential's approach to the implementation of investment principles based on sustainable investment and the potential impact of climate change.

3.5 Environmental, Social & Governance (ESG)

This is the third year in which IGC have devoted a specific section to ESG. The FCA has now formally extended the remit of IGCs from April 2020 to comment on ESG policies and practices, stewardship, and how Members concerns are taken into account. We welcome this extension of IGC responsibilities.

During the last year, IGC has received extensive briefings and presentations at its 2019 March, September and 2020 January meetings. There is no doubt that attention to ESG has mushroomed across the investment industry. Prudential continues to develop and embed its approach but is well positioned to be an effective influence.

Recognising the evolving regulatory environment, Prudential are also making a number of short-term changes as the longer term view develops. As many customers are not actively engaged in selecting their own investments, Prudential believes it should take responsibility for ensuring the default solutions offered take appropriate account of ESG factors and to embed ESG strategy into default solutions. Prudential also plan to introduce a wider choice of investments for customers who wish to self-select with ESG and sustainability in mind.

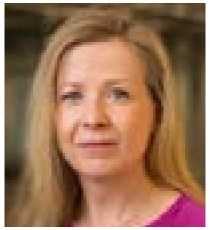
Work is also continuing on policy governance at an overall level and for asset owners and asset managers.

Prudential has developed a set of ESG principles and has used these to indicate to IGC how they apply to

- The firm's policies in relation to ESG financial considerations
- The firm's policies in relation to non-financial matters
- The firm's investment strategy and investment decisions
- The firm's policy in relation to Stewardship.

No concerns have arisen to date for IGC and, in line with the new responsibilities, a fuller section will be included in next year's IGC report.

Meanwhile have a read of the published ESG and Stewardship reports.



Jennifer Owens, Prudential Appointed Member

2019 has been a year of transition for the way service levels are reported.

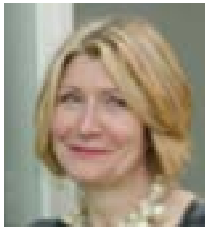
4. Service levels

In last year's report I mentioned that Prudential were changing their approach, moving away from "individual task" reporting to an "end to end" approach to try to get closer to what the customer experiences.

The new system of reporting is still bedding in, but shows that some historic backlogs are reducing. Beyond this, IGC has not seen a clear pattern of service performance from the new system of reporting.

Throughout the year, we received service level reports on the old basis. These showed continual underperformance on call handling and one or two periods of poor service on claims caused by computer system problems.

The benchmark survey, conducted by Redington, indicated that Prudential were "in the pack" in comparison to other providers, lagging a little on digital technology but scoring well on customer satisfaction.



Lesley Alexander, Independent Member

This year the IGC have continued to participate in ongoing benchmarking studies. We have not seen any breakthrough on the quality of customer engagement and have asked management to consider what can be addressed in parallel with the ongoing transformation programme.

5. Communication and Engagement

In common with the rest of the industry, we have not seen any breakthrough on the quality of customer engagement. Indeed the FCA reported earlier in the year that, across the industry, only 49% of Members read their annual benefit statements.

This year the IGC continued its participation in the ongoing Benchmarking syndicate work which now covers £100bn of assets under management across 6.8million Members. The 2019 programme consisted of two parts:

1. A VFM benchmarking study conducted by Redington for active workplace pension contributors, similar to the exercise completed in 2017 detailed in previous Chair Reports.
2. Further customer focussed research through the Institute of Customer Service to help us understand more about Member experiences with Prudential.

The benchmarking conducted through the Institute of Customer Service (ICS) was completed in common with five other leading providers. Themes to emerge were common across the industry and satisfaction levels were generally behind the banking and general insurance sectors. Prudential's results tended to be towards the lower end of the range and ICS highlighted some areas for focus

- Getting more right first time
- Improving online experience
- Maximising the impact of Annual Benefit Statements
- Communicating more proactively
- Being easier to contact.

We have asked management to consider what can be addressed in parallel with the ongoing computer system transformation.

6. Plans for 2020

- Update and extend the Value for Money framework in the light of market developments.
- Assess the design of the new Investment Pathways and monitor their implementation in accordance with the extended IGC remit.
- Report more comprehensively on Prudential's policies and practices in relation to Environmental, Social and Governance issues set out in IGC 's extended remit.
- Improve significantly the processes through which IGC receives direct feedback from Members (particularly, but not limited to, their ESG concerns).
- Report on ESG issues as required by the regulations.
- Assess whether Communications are fit for purpose as required by the regulations.

Appendices

Appendix 1 – What is the IGC and how does it operate?

The IGC's overriding objective is to independently review the Value for Money of contract based defined contribution (DC) workplace pension schemes. External members are recruited through an open process run by the Chair and existing external members. Internal members are suggested by Prudential and interviewed by the external members. Internal members have their contracts of employment altered so that they act solely in the customers' interest in IGC discussions.

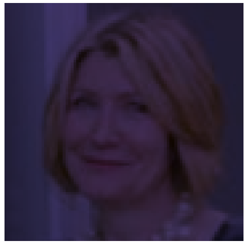
The IGC has met as a Committee for formal meetings on eight occasions during 2019. There were also a number of informal meetings, and individual members have met with staff, other IGC Chairs, subject matter experts and Prudential's regulators (FCA) outside of formal meetings.

Prudential dedicates significant resources to the support of the IGC. Assistance is provided from staff across the organisation from Corporate Pensions, Risk, Company Secretariat, Legal, Investment Office and Customer Services.

Appendix 2 – Who are the IGC Members?

The IGC is properly constituted with three independent members and two members from Prudential, whose biographies showing their qualifications for the role can be seen below.

Lawrence Churchill CBE, Independent Chairman



Lesley Alexander, Independent Member

John Nestor, Independent Member

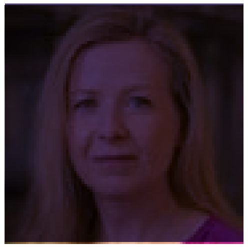
Lawrence has devoted his life to making financial services work for everyone.

Lawrence is currently Chairman of Clara Pensions Ltd and of the Pensions Policy Institute. He is also a NED at Embark Group.

He was previously Chairman of the Financial Services Compensation Scheme, the NEST Corporation and the Pension Protection Fund, the Senior Independent Director at Bupa, a member of the Board for Actuarial Standards, Chief Executive of Zurich Financial Services UK, Executive Chairman of UNUM, CEO of NatWest Life and Investments, and a Director of the Association of British Insurers.

Mary Kerrigan, Independent Member

Michael Payne, Prudential Appointed Member



Jennifer Owens, Prudential Appointed Member

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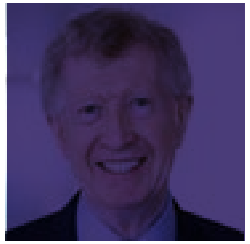

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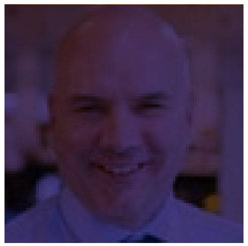

Michael Payne, Prudential Appointed Member

Jennifer Owens, Prudential Appointed Member

Lesley is the Strategic Partner of the employee communications company, Ferrier Pearce, a creative consultancy that specialises in pensions and employee benefits communications.

Lesley is Vice President, Fellow and council member of the Pensions Management Institute, also Chair of the UK Sustainable Investment and Finance Association and is the former CEO of the HSBC Bank Pension Trust (UK) Ltd.

Lesley's particular interest is in demonstrating how strong governance and engaging communications contributes to better outcomes for members of workplace pension.

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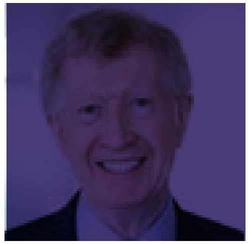

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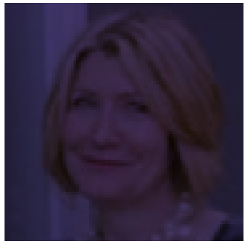

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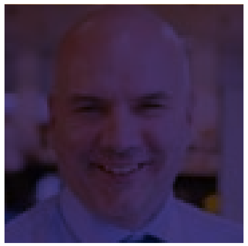

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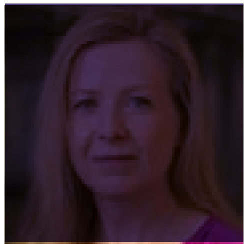

Jennifer Owens, Prudential Appointed Member

John brings considerable expertise in investment strategy and asset management, and therefore understands how well, and how reliably your pension fund should grow. In addition he is a Client Director of Capital Cranfield Pensions Trustees Limited and a Non-Executive Director of LGPS Central Limited.

John is chair of trustees for Marylebone Cricket Club (MCC) Pension Scheme, and a trustee of the Royal Automobile Club Staff Pension Scheme.

He was managing director of both UBS Global Asset Management and Citigroup Asset Management.

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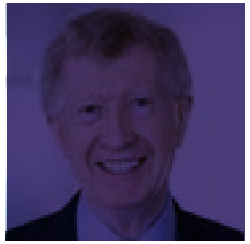

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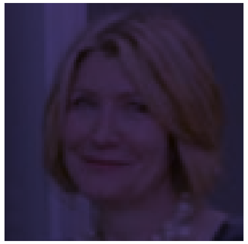

Lesley Alexander, Independent Member

John Nestor, Independent Member

Mary Kerrigan, Independent Member

Michael Payne, Prudential Appointed Member

Jennifer Owens, Prudential Appointed Member

Mary is an experienced investment professional, having previously been a senior consultant and partner with Willis Towers Watson. She is a qualified actuary with over 25 years' experience in the global investment and pensions industry. Mary is a Non-Executive Director of Just Retirement, Partnership Assurance Limited and New Ireland Assurance Company. She is also a Trustee of the London Irish Centre Charity. Mary is an expert on helping design, implement and monitor suitable investment strategies for your pension pot.

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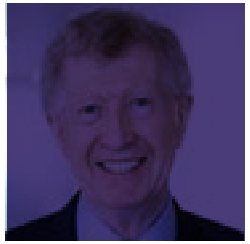

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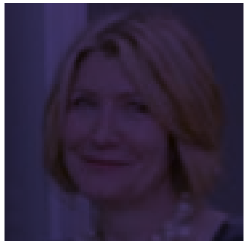

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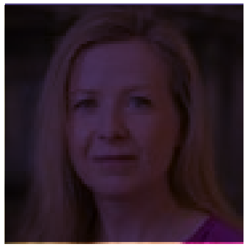

Jennifer Owens, Prudential Appointed Member

Michael is a qualified actuary with around 20 years of post-qualification experience, and around 30 years of experience of working in life assurance and pensions. Michael is currently the CFO for Customer and Distribution (C&D) at M&G plc, where he has Finance and Pricing responsibilities. Over his 13 years at M&G and Prudential, Michael has held a number of senior Actuarial and Finance roles, most recently being accountable for Regulatory and Legacy matters, and before that for all of financial reporting across UK and Europe. Before joining M&G (Prudential), Michael spent a number of years working at Scottish Widows now part of Lloyds Banking Group, Scottish Friendly, and Scottish Amicable, in a variety of senior positions.

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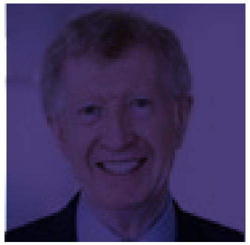

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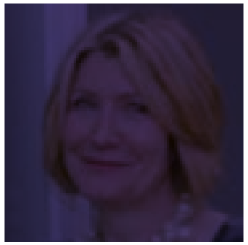

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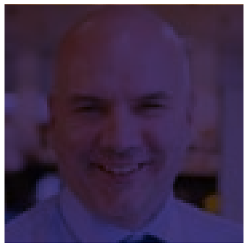

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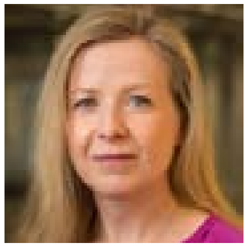


Jennifer Owens, Prudential Appointed Member

Jennifer joined Prudential as General Counsel UK & Europe in August 2017 and is currently Deputy General Counsel for the M&G PLC Group.

Jennifer started her career at Herbert Smith, an international law firm, advising corporates and banks on finance and banking matters, followed by over 20 years' experience in financial services. Her expertise includes corporate transactions in the UK and internationally, managing regulatory relationships, and advising on corporate governance matters, in both public and private companies.

She spent nine years at GE Capital, including leading the legal team for M&A transactions across Europe, and as Legal and Compliance Director of the UK consumer finance business. She has held senior legal, compliance and governance roles at Towergate Insurance, investment bank and fund manager Execution Noble, and William Hill plc.

Appendix 3 – Members under IGC Review

FUM

£5.8bn

212k

CUSTOMERS

260k

POLICIES

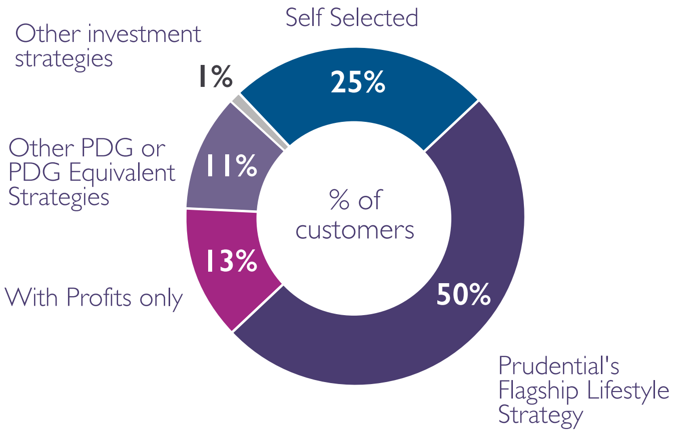
£1.6bn

FUM ACTIVELY PAYING MEMBERS

63%

OF CUSTOMERS ARE USING A DEFAULT STRATEGY

WHERE OUR MEMBERS ARE INVESTED



99%

OF FUM IN GROWTH FUNDS IS EXCEDING THE IGC GROWTH MEASURE

Appendix 4 – How do we measure Value for Money (VfM)?

Three years ago, IGC was predominantly looking at the totality of Prudential's contract-based workplace pensions, with reference to the statutory charge cap for default funds under auto-enrolment schemes. The market has moved on competitively for auto-enrolment schemes and more up to date market comparisons are becoming available. In 2019 then, the IGC has started to consider the Value for Money framework and its calibration, with the intention of further developing this in the near future.

The IGC's current approach to VfM takes account of a range of factors, including charges, performance, service and communications. These have been weighted to reflect our view that what ultimately matters is the outcome for Members.

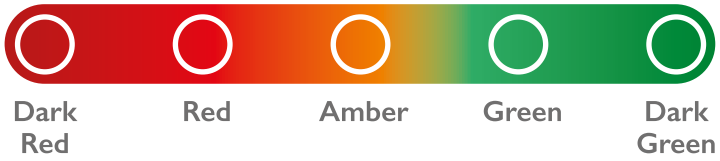
On the basis that good financial outcomes that lead to higher retirement income are the most important, we prioritise investment returns and charges as being the most important elements of VfM. We then look at a number of secondary service quality features, placing particular emphasis on the swift and accurate processing of contributions, the level of performance in dealing with complaints, and the quality of communications. We anticipate more work on the quality of communications in the years ahead. With regard to the primary financial components of VfM, it is important to note that:

a) for investment returns, we have given priority to actual outcomes as well as looking at forecast returns for an appropriate risk exposure in the design of default investment strategies. We have used an externally benchmarked reference point for fund performance of inflation (measured by the Consumer Price Index – CPI) +3% per year (after charges) over a sustained period. If fund performance has been delivered at this level or above, we believe that VfM concerns do not arise in relation to investment returns or charges. We measure performance over 1, 3 and 5 years, where the fund has been in existence for that long.

b) For charges, we have continued to use the following reference points to identify where VfM concerns might arise:

- 0.75% per year for default strategy charges in schemes used for auto enrolment (or the equivalent limits set by DWP for schemes with combination charges)
- 1.00% per year for unit-linked schemes not used for auto-enrolment
- 1.25% per year for With Profits investments where the benefits of smoothing and guarantees bring extra value to Members. We review both the cost of the investment and the cost of these guarantees separately, scrutinizing the value offered by both. Our reference point represents the combined cost of both elements.

IGC's VfM Framework and Colour Coding



Our scaling runs from Dark red to Dark green. Colours can be rated light or dark depending if results are just beating or comfortably beating the calibration set for the colour.

Investment Performance – Actual

Growth Funds achieve the following after charges over each period measured:

- Inflation (CPI) + 3% per year
- Inflation (CPI) +1% per year
- Less than CPI +1% per year

The value of CPI +3% at Q4 2019 is **7.3%** over a 1 year period, **8.2%** over a 3 year annualised period and **7.7%** over a 5 year annualised period

Investment Performance – Relative

- Funds Beat their Benchmark
- Funds underperform their Benchmark by 7.5%
- Funds underperform their Benchmark by more than 7.5%

Investment Performance – Prospective

Under development

Investment Strategy Design

Are Default Fund Glide Paths consistent with Pension Freedoms?

Yes **Materially** **No**

Are the Risks/Implied Volatility of the strategy made clear?

Yes **Materially** **No**

Are the Risk/returns of the strategy close to the Efficient Frontier?

Yes **Reasonably Close** **No**

Has the Default Fund Strategy been stochastically modeled?

Yes **No**

IGC's VfM Framework and Colour Coding

Dark Red | Red | Amber | Green | Dark Green

Our scaling runs from Dark red to Dark green. Colours can be rated light or dark depending if results are just beating or comfortably beating the calibration set for the colour.

Annual Management Charges

- Most frequent charge applied less than 0.5%
- All member borne charges less than or equal to reference points
- Between 0% and 5% FUM above reference point
- More than 5% of funds under management are above reference point

Annual Management Charges are also a likely area where we may wish to further develop the framework. One option would be to aim for greater precision in our assessments by considering the most appropriate way in which to split the book of business, and by following the recent DWP analysis of costs and charges for contract based schemes.

Transaction Costs

(NOTE: The FCA quoted 0.5% as the average level of transaction Costs in their Market Study)

- Default fund less than 0.2%
80% of Funds under management incur costs of less than 0.2%
- 80% of Funds under management incur costs between 0.2-0.5%
- More than 20% of Funds under Management incur costs of more than 0.5%

Service Levels

- All service levels met
- Between 50%-100% of Service levels met
- More than half Service levels not met

Communication and Engagement

An overall intuitive assessment was made for 2019. In the future we will look to more explicitly consider:

- The Annual Benefit Statement (ABS) is simply communicated and received majoritively positive feedback.
- Communications of investment pathways are simple, relevant and well written.
- Feedback from Members is systematic, shows high levels of satisfaction and captures ESG concerns.

Appendix 5 – Jargon explained

AMC – Annual Management Charge: the charge made over the year by fund managers and product providers to cover the expenses associated with running the investment fund and administering the pension plan. Although shown as an annual percentage figure, the charge is usually taken from the fund daily.

FUM – Funds under Management. Total Market Value of assets managed by the investment firm for their investors.

BPs – Basis points. One basis point is equal to 1/100th of 1%, or 0.01%.

COBS – Conduct of Business Sourcebook (in other words, the FCA's rule book that sets out the requirements for Independent Governance Committees).

CPI – The Consumer Prices Index: CPI is the official measure of inflation of consumer prices of the United Kingdom.

ESG – Environmental, social and governance (ESG) refers to the three key factors when measuring the sustainability and ethical impact of an investment in a business or company.

FCA – The Financial Conduct Authority.

Guarantees – An investment guarantee is a special provision designed to protect investors from incurring overall losses.

Growth Funds – Funds that invest in equities, multi assets or property

IGC – Independent Governance Committee.

Pension Freedoms – In April 2015 tax rules were changed to allow individuals in defined contribution pensions (also known as money purchase pensions) to choose whether they use their pension to provide a lump sum, a series of lump sums, a guaranteed income for life or to place their money in a drawdown plan.

Prudential – "Prudential" is a trading name of The Prudential Assurance Company Limited, the provider of the workplace pensions.

Reference Point – A level of charge for a fund above which IGC believes Value for Money concerns might arise.

Smoothing – The use of accounting techniques to level out fluctuations in investment returns from one period to the next (aiming to 'smooth' the peaks and troughs of market movements).

VfM – Value for Money, see appendix 4 for more information.

Transaction Costs – Expenses incurred when buying or selling a good or service. Costs include broker charges and spreads, which are the differences between the price the dealer paid and the price the buyer pays.

Watch List – Funds are added to this watch list if they are under performing or if there are additional causes for concern (e.g. significant unexpected changes in the market). These funds are then monitored closely and reviewed on a regular basis.

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