Prudential Independent Governance Committees Report 2022

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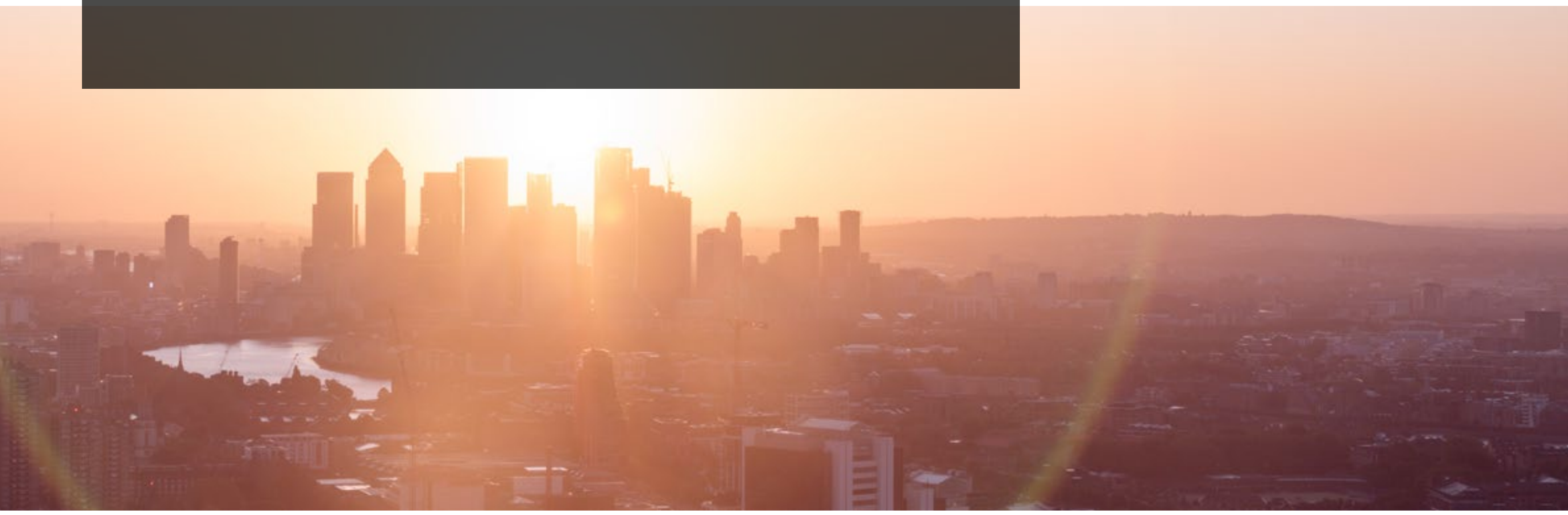


Summary

Bruce Rigby, Independent Chair

"2022 was a challenging year for Investments and Servicing but other areas, including With-Profits, performed relatively well"

Investment markets were generally weak in 2022 and, over the year, the Prudential Dynamic Growth IV fund (PDG IV) in which most members are invested reduced in value by 8.3% after charges. However, over the last 5 years, there has been growth of 2.6% per annum on average. The second most popular fund, With-Profits, reduced by 2.5% after charges last year but overall has grown by an average of 15.6% after charges per annum over the last 5 years, clearly demonstrating the significant value of smoothing of returns in a very difficult year

Charges are another important factor in assessing Value for Money and you can access the charges that apply to your scheme by going to the IGC's page on the Prudential website.

The third area of scrutiny when assessing Value for Money is service levels. Whilst still experiencing some difficulties, particularly in the customer interface area, 2022 has seen a marked improvement as compared with the previous year. The IGC continues to work with the company to monitor the evolving situation and has consistently challenged Prudential on the effectiveness of remedial actions.

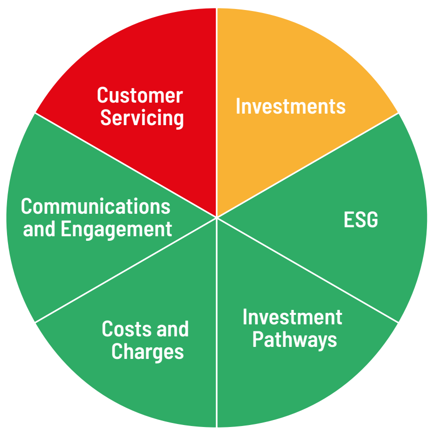
The IGC also continued its longstanding participation in the industry wide syndicated benchmarking which is designed to compare and contrast provider offerings. Again, this provided the IGC with a good comparison against a significant portion of the market in 2022 across the 3 areas described above, highlighting relative strengths and weaknesses of each provider. Results were broadly positive for Prudential in investment and costs/charges but predictably less so for customer servicing.

Overall, the IGC judges that you continue to receive Value for Money from your pension.

If you have any questions after you read this report, please leave us your feedback.

Bruce Rigby
Chair, Independent Governance Committee

IGC's VFM Framework and Scores for 2022



Overall Value for Money score:

Members Under IGC Review

£5.05bn

FUM

225k

Policies

184k

Customers

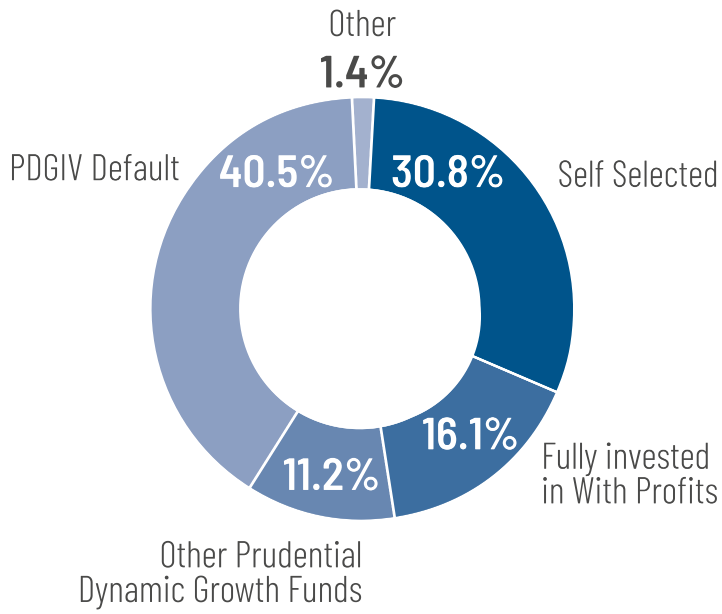
Total FUM for active members **£1.02bn**

(11% of our members make regular contributions)

51%

of customers are using a default strategy

Where our members are invested:



1. Chairman's Introduction

After 2 years of virtual meetings, the IGC were again able to meet in person during 2022. The Committee met on 9 occasions, either to cover the full range of IGC issues or to consider, in more depth, specific topics such as vulnerable customers, investment strategy, the company's business strategy and the industry benchmarking work. All members of the IGC played a full and active part, and I would like to thank them for their support and commitment.

Biographies of the IGC members can be found here

I would also like to thank the company and its staff who have helped and supported us through the year. Despite some difficult topics, the IGC has felt that the company seeks to constructively engage with us and does not seek to "sugarcoat" any of the messages.

The key areas on which the IGC focuses in assessing value for money for members are investment strategy and performance, costs and charges, scheme administration and communications. For each fund in which members invest, we monitor whether:

- Rolling 5-year net investment performance exceeds Consumer Price Inflation (CPI)
- Investment strategy for default funds is appropriate
- Annual management charges (AMC) for default funds are within the charge cap
- Direct and indirect costs, including transaction costs, are appropriate
- Core scheme financial transactions are processed promptly and accurately
- Administration service levels meet expectations
- Member engagement and communications are fit-for-purpose

To monitor all of the above, during the year, the IGC splits its work over a number of key work streams, each led by one of the Committee's members. These work streams are described in more detail in the following sections.

2. Investments

Overall rating: Amber

Mary Kerrigan, Independent Member

"2022 was an extremely difficult year for investment markets. High inflation meant that funds did not meet our inflationary performance measure"

The IGC continues to assess the investment performance of the funds in which members are invested relative to individual fund benchmarks, accounting for the level of investment risk taken and the amount of fees charged. We also look at performance relative to the Consumer Price Index (CPI) and relevant industry comparators. The performance metrics analysed over a 1, 3 and 5 year period are:

- Fund net return vs fund benchmark
- Tracking error vs fund benchmark
- Net information ratio
- Client share of outperformance
- Fund net return vs UK CPI
- Quartile ranking within ABI sector.

The IGC assign a Red, Amber or Green (RAG) rating to each of these performance metrics in order to highlight whether there are any material issues, concerns or major concerns in relation to each fund being assessed.

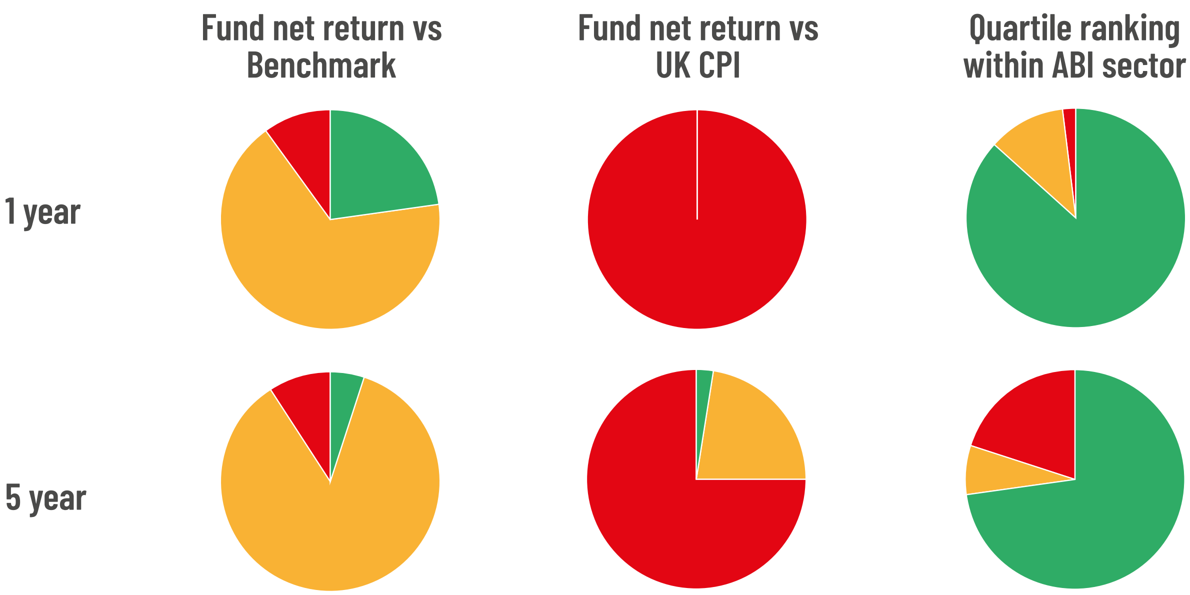
2.1 Overall investment performance

A summary of the key investment performance criteria for the 1-year and 5-year periods to 31 December 2022 is set out in the pie charts below.

The IGC's key concern is that the default funds retain their value as a minimum. However, with negative returns across most markets in 2022, almost all funds in which members were invested reduced in value during 2022.

We would ideally also like to see additional growth of 3% above inflation per year after charges. The effects of Covid 19 and the ongoing Russia/Ukraine conflict has meant that the UK and other global economies have experienced a sustained period of high inflation since April 2021 with an average figure of 11.6% during 2022. Therefore, the majority of funds have not kept pace with the increase in the CPI over the last 5 years. This is true across the industry as a whole.

Despite the negative absolute returns, most of the assets were invested in funds which performed relatively well compared to benchmarks and other funds across the industry over 1 year and 5 years, as can be seen from the charts below.



Note: These investment performance charts are an aggregated assessment of all funds available to IGC members, rated by % of assets under management (AUM). The rating can differ depending on which asset class the fund belongs to. Full details on the RAG rating (colours applied) for each of these three performance metrics (vs benchmark, vs UK CPI and within ABI sector) can be found in Appendix 1.

2.2 Investment performance of the main funds used in default strategies

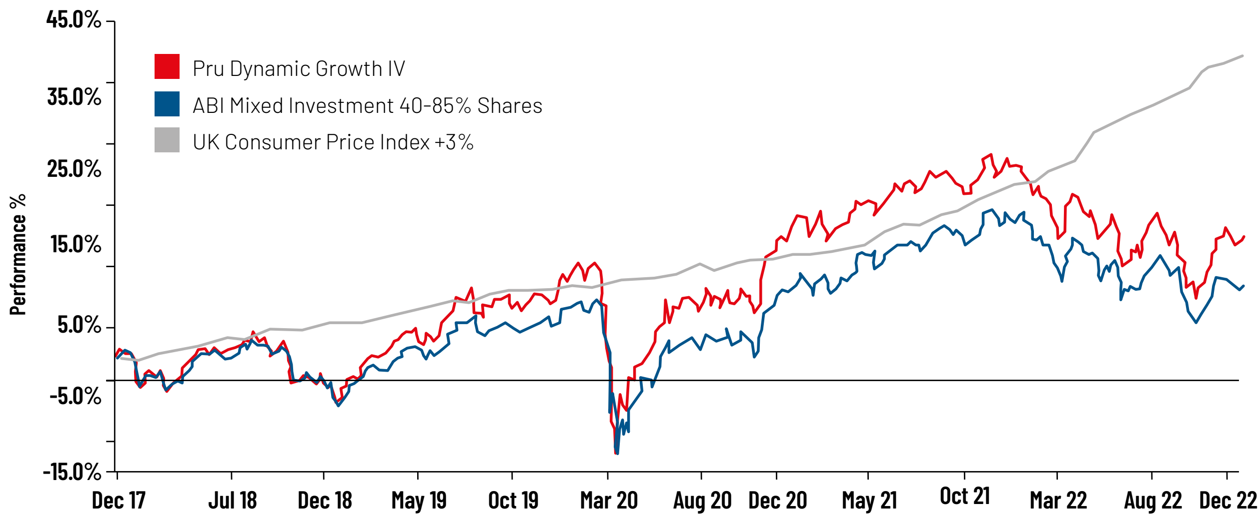
Prudential's default lifestyle strategy – Prudential Dynamic Growth IV – Targeting Retirement Options – uses three different funds as building blocks:

1. Prudential Dynamic Growth Fund IV (PDGIV)
2. Prudential Dynamic Growth Fund II (PDGII)
3. Prudential Cash Fund

Customers' investments are shifted gradually from higher to lower risk assets as expected retirement age approaches.

Prudential Dynamic Growth IV (PDGIV) reduced in value by 8.3% after charges during the year to December 2022 and has grown at an average annual rate of 1.1% over the last three years and 2.6% over the last five years. Consequently, over 3 and 5 years, performance for the flagship default fund is above the industry median for those type of funds. However, as noted above, given the recent emergence of increased inflation rates, the fund has underperformed against our inflationary (CPI+3%) performance measure as shown below.

5 year Gross Performance of Prudential's Dynamic Growth Fund IV



The table below shows the performance of the funds within the largest default lifestyle strategies for the period to 31 December 2022. In general, 1-year returns have been significantly weaker than 5 year returns.

		5 year (ann.)		1 year (ann.)	
Fund name	AUM (£m)	Net Performance vs Benchmark *	ABI ranking	Net Performance vs Benchmark *	ABI ranking
Dynamic Growth IV S3	1,797	-0.1%	2	-0.9%	2
Managed Ser A	337	-0.8%	4	2.0%	2
Dynamic Growth II S3	364	-0.1%	1	-0.4%	2
Prudential Long Term Bond S3	8	0.0%	2	0.3%	2
Prudential Cash S3	75	-0.4%	1	-0.5%	1
Prudential M&G Gilt and Fixed Interest Income Ser A	45	-0.7%	2	0.3%	1
Prudential Cash Ser A	28	-0.5%	2	-1.3%	4

* Performance figures are net of weighted average AMC and as at end of Q4 2022.

Over £1 billion of workplace pension funds are invested in the Prudential With-Profits Fund. It is designed to be more resilient in turbulent markets and returned -2.5% (net) during 2022. The longer-term results are also strong, averaging growth of 8.8% (net) per year over 3 years and 15.6% over 5 years.

2.3 Investment strategy for default funds

Prudential periodically carry out reviews of investment strategy for the main default funds and this was done in 2022, with the results of the review shared with the IGC. The methodology used to conduct these reviews was consistent with the methodology used to complete the last review of the PDG default lifestyles during 2020 where customer outcomes were provided with a RAG rating. The methodology focused on four key customer outcomes, whilst also considering Prudential's target market. Key customer outcomes being:

- Right solution
- Clear, timely and relevant information
- Good value
- Trusted provider

The reviews concluded that the lifestyle strategies remained broadly appropriate whilst identifying actions to further improve the proposition and customer outcomes. A key action was to consider introducing higher risk funds in the early years of Prudential Dynamic Growth IV – Targeting Retirement Options. This could potentially improve members' retirement outcomes by delivering increased returns for an appropriate increase in risk in the early years of their journey. This change has been approved and planning is underway by Prudential to agree how this change should be implemented.

Prudential are also considering the transition of existing equity sub-funds within the main default funds to ESG Equity Index funds managed by BlackRock. The purpose of the transition would be to ensure that assets managed on behalf of members appropriately take account of Environmental, Social and Governance (ESG) factors. Work is ongoing, supported by analysis by BlackRock, to better understand the most cost-effective route to implementation of ESG equity funds for the key default funds.

During 2022, Prudential have also investigated how additional real assets could be introduced to the key default funds to improve asset diversification and provide enhanced outcomes for members. This would also look at reducing risk, particularly during what are expected to be future periods of longer-term uncertainty in asset returns and the likelihood of prolonged high inflation. Work continues to determine the actual vehicles that would be used for investments and understand the cost implications.

In addition to the internal reviews above, the industry benchmarking study mentioned earlier also provided an assessment of the investment strategy of the key default funds relative to a number of comparators in the industry. The overall conclusion was that the funds compared relatively favourably to the peer group, although it was noted that a number of the peer group have a higher allocation to both alternative assets and ESG-tilted assets. These issues were raised by the IGC and are being addressed as set out above. The IGC will continue to monitor these during 2023 and beyond.

3. Environmental, Social and Governance (ESG)

Overall rating: Green

Gareth McQuillan, Company Appointed Member

"The ESG framework evolved further in 2022, and the IGC continues to monitor its progress closely"

As in previous years, the IGC has been asked by the Financial Conduct Authority (FCA) to comment on Economic, Social and Governance (ESG) policies, practices, and stewardship and how the IGC takes account of the concerns of members in relation to these factors.

The IGC's oversight and engagement on this topic reflects the structure and framework which has been adopted by Prudential to the integration of ESG within its operations – which is summarised in its "10 point plan approach to sustainability", shown below:

3.1 ESG Beliefs and Framework

The IGC holds three core beliefs in relation to ESG:

1) That ESG financial considerations should not simply be a measure that is assessed after the fact, but should be fully embedded within the management of the in-scope propositions.
2) That active engagement with companies by investment managers is necessary to drive change and encourage better ESG practices.
3) That the IGC and Prudential's ESG and Stewardship policies should be appropriate to the needs of our customers.

These views are informed by research presented to the IGC during 2020 and 2021, on customers' attitudes to ESG topics, how it applies to investment, and how they want providers to communicate with them on these issues.

While the research indicates that many customers have not thought much about ESG in the context of their pension, its relative importance to customers varies significantly depending on their life stage. In particular, whereas most customers believed that pension and investment providers should prioritise achieving the best return, a much smaller proportion were happy to pay higher fees in order to invest in an environmentally and socially responsible way. However most customers did hope their asset managers are taking a 'responsible' approach to their investments, and expect that principles are in place to guide pension companies to avoid "unscrupulous" investments. This research has led the IGC to focus on the default investment solutions, ensuring the most 'passive' members benefit from ESG investing.

In doing so, the IGC focuses on three key areas:

Environment/Climate

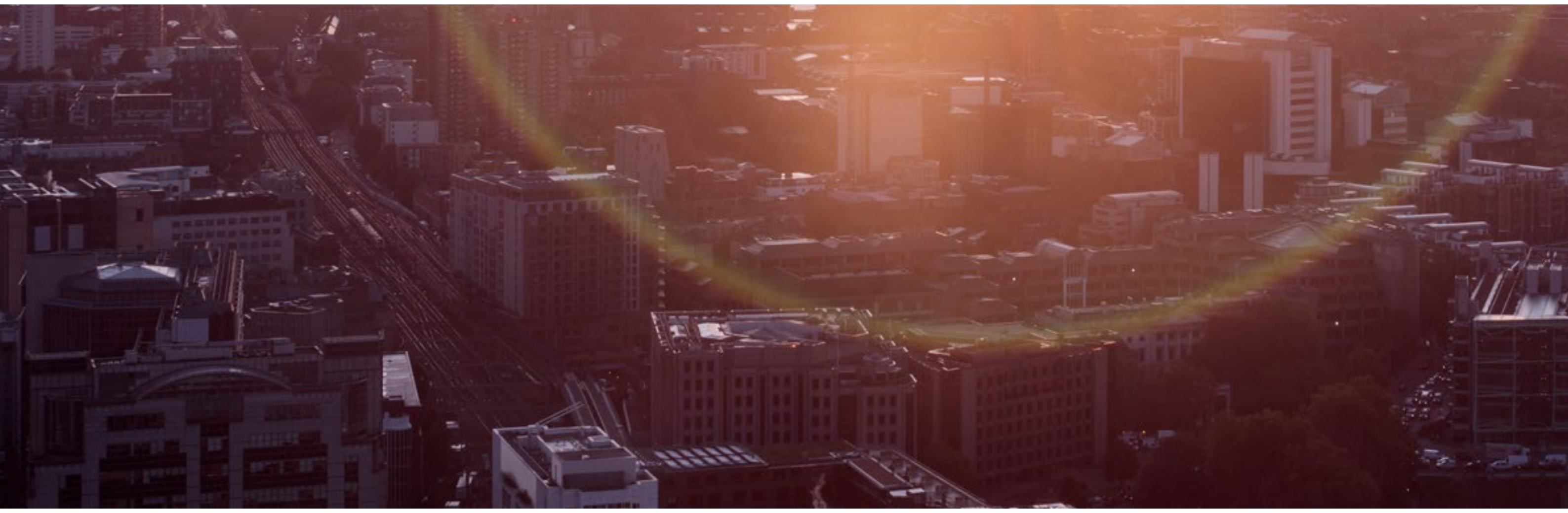
- Greenhouse gas emissions
- Investment exposure to fossil fuel reserves
- Business activity screens to show exposure to the most carbon intensive activity
- How the company's management is preparing for climate related issues
- How the company's carbon reduction target compares versus a sector benchmark

Social impact

- Biodiversity and Natural Capital
- Human Rights and Labour Standards
- Board effectiveness
- Corporate diversity

Stewardship

- Total votes cast
- Breakdown of votes for and against
- Resolutions raised



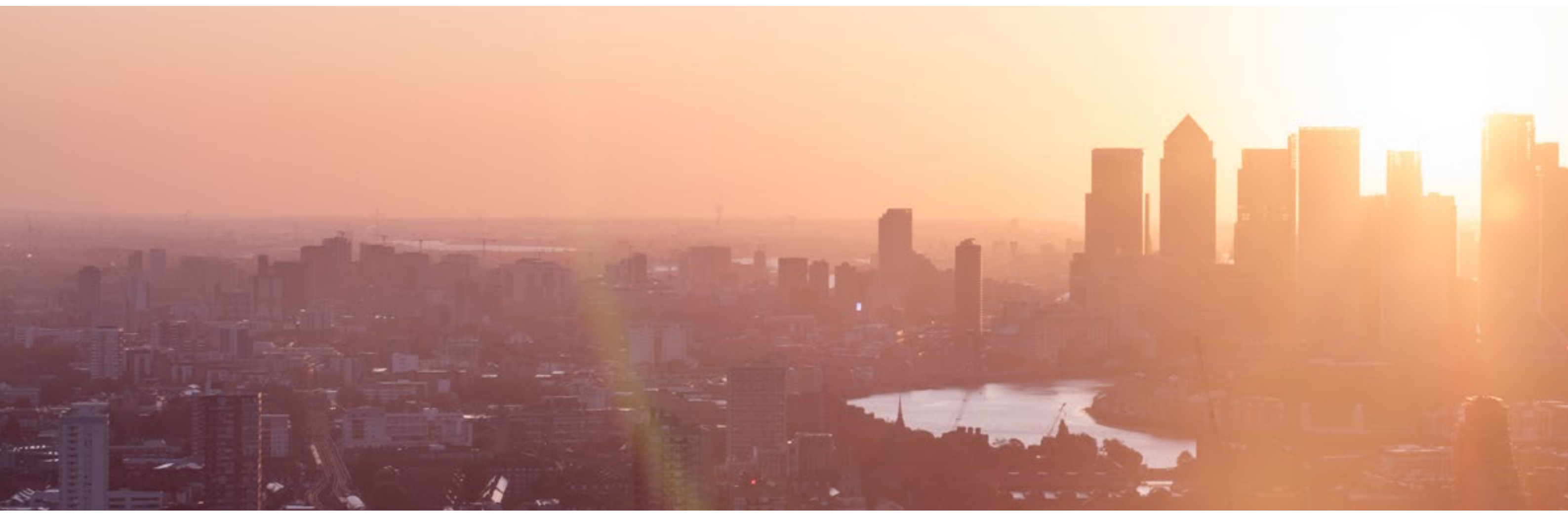
3.2 Progress in 2022

During 2022, the IGC continued to receive in-depth presentations, progress updates and further evidence of the deployment of the ESG policies and processes of those organisations which manage the investments of our customers. The involvement of Prudential's senior management in championing all aspects relating to ESG continues to be very evident to the IGC. The approach taken by Prudential to its ESG policies does not only seek to exclude investing in companies with certain negative criteria, but considers a range of different issues on how a company is governed, its employment practices and how its activities may be contributing to, or affected by, issues like climate change. Prudential's investment managers now seek to engage with management and companies to drive positive changes in corporate behaviour.

The presentations and updates from the business to the IGC during the year included general updates on the integration of ESG within investment mandates, industry initiatives (including Task Force on Climate Related Financial Disclosures, UK Stewardship Code, Institutional Investors Group on Climate Change and Accountability for Sustainability), and specific updates on topics including:

- **Decarbonisation** – as part of its membership of the United Nations' Net-Zero Asset Owner Alliance (NZAOA), Prudential published its target commitments for reducing carbon emissions intensity by 2030. These targets range from 25% in the aviation and shipping sectors, up to 60% in the utilities sector
- **Modern Slavery** – through its screening, the company has identified individual holdings with whom it is now engaging on a "find it, fix it, prevent it" basis
- **ESG Optimised Funds** – the IGC received a number of updates in relation to the oversight and management of these funds, which is undertaken by a 3rd party fund manager (Blackrock)
- **Benchmark research** – as part of its benchmarking research, the IGC received useful information which will be used to ensure that the oversight it performs on ESG matters is in line with best practice

Finally, while it took place after the period covered by this report, the IGC also notes that on 1 July 2023, Prudential published its first report that aligns with the recommendations of the Task Force on Climate Related Financial Disclosures (TCFD), including disclosures that cover a number of the key funds invested in by Prudential's workplace pensions customers (e.g. the Prudential Dynamic Growth series of funds). This reporting will continue to be enhanced to make it useful and helpful for customers in future years.



4. Costs and Charges

Overall rating: Green

Pat Healy, Independent Member

"The IGC is satisfied that Prudential's charges are generally fair to customers and represent value for money. Nevertheless, the IGC continues to press Prudential to make its offerings as competitive as possible"

The IGC's primary role is to ensure that customers get Value for Money from their pension products provided by Prudential. As set out in other parts of this report, some of the key elements of Value for Money are investment returns, suitability of the products, customer servicing and communications. In this section, we will consider another key element, namely, the costs and charges associated with your pension products.

The IGC monitors all the costs and charges applied to all products under its remit including annual management charges and transaction costs. In addition, the IGC is required by the FCA to benchmark Prudential's charges against other providers in order to assess whether comparable schemes benefit from lower charges. The IGC's findings on these matters are set out in the following paragraphs.

4.1 Rules on publishing and disclosing costs and charges

The FCA has had rules in place since 2020 in relation to the disclosing and publishing of costs and charges for workplace pension scheme members. We are happy to report that Prudential continues to fully meet these requirements and the relevant information is available to you here.

4.2 Benchmarking of costs and charges

We reported in some detail last year on the further steps the FCA has taken in relation to benchmarking of pension charges against other providers' schemes. The IGC, together with Prudential, commissions an external independent firm to carry out this detailed benchmarking against a range of other pension provider's offerings. This study compares the charges on schemes of similar size across the market. The conclusions from the most recent study are similar to last year and are as follows:-

1. Most Prudential policyholders are in charge bands 0.30% to 0.60% which is similar to most other providers. This means that these customers are charged between £3 and £6 per £1,000 of fund value per annum.
2. Prudential does not have any customers in the lowest charge band (0% to 0.30%) whereas many of the other participants in the study do. Larger schemes within the Prudential book appear to be charged slightly higher than others within the study.
3. Prudential has a larger percentage of schemes in the higher charge bands but these only account for a small number of policyholders.

The IGC has considered these findings in detail and is satisfied that where there are lower cost offerings from other providers, there is usually a less comprehensive investment or service offering and that the higher charge from Prudential in these cases is justified by the specific benefits of the Prudential offering.

4.3 Annual Management Charges

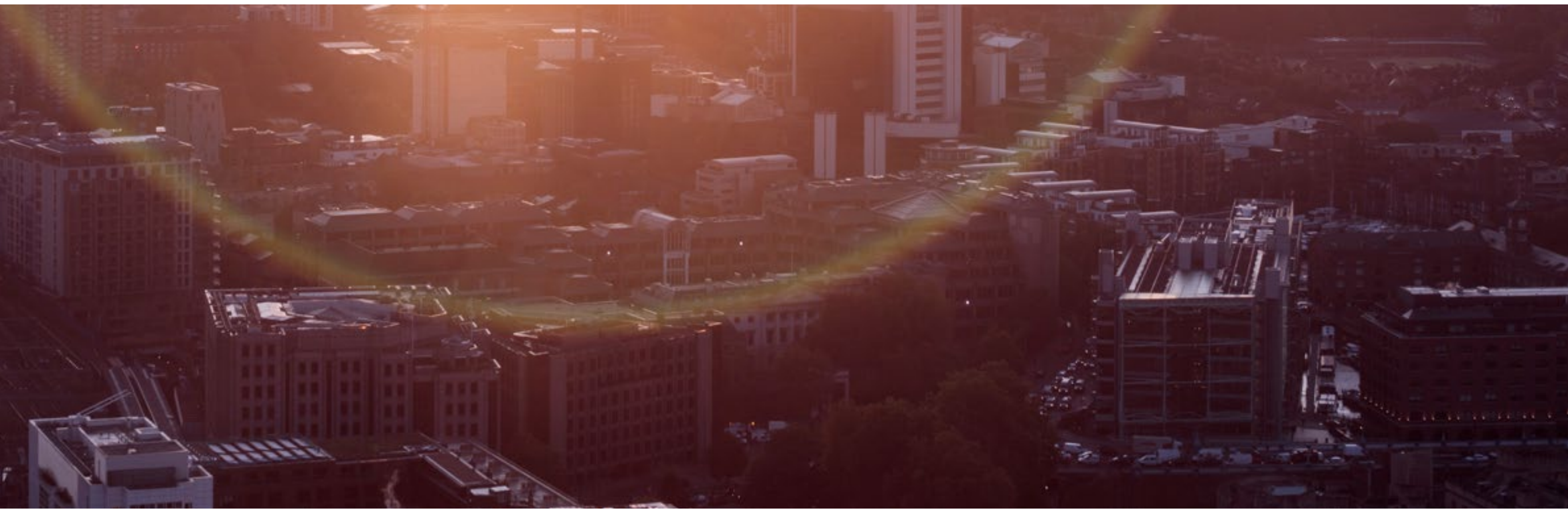
Based on the data provided and on the results of the benchmarking study, the IGC is satisfied that the annual management charges remain appropriate and the charges for default funds are within the charge cap.

4.4 Transaction charges

Transaction charges occur when investments in customer funds are purchased or sold. They vary from fund to fund depending on the nature of the underlying assets and on the level of activity that is required. The IGC receives and reviews comprehensive quarterly reports on the transaction charges applied to all funds in scope. In the vast majority of cases transaction charges are low and the IGC is satisfied that they are completely appropriate. Any deviations are challenged by the IGC and we are satisfied with their appropriateness following discussions with Prudential.

4.5 Breakdown of charges for investment and administration

In addition to the overall level of charges, the IGC has focused during the year under review on the amount of the charge allocated to investment costs as compared to administrative costs. The IGC believes that certain modest changes to the investment strategy could benefit customers in the long run but such a reallocation would result in higher investment charges. The IGC continues to press Prudential to reduce administrative costs in order to provide for a higher allocation of charges to investments that would enhance overall returns and value for money for customers.



5. Communications and Engagement

Overall rating: Green

Kelly Iles, Company Appointed Member

"Servicing issues have impacted customer satisfaction and have diverted resources to fixing these problems. This has resulted in less customer engagement but there are a number of very encouraging initiatives underway"

With a difficult operational start to the year, Prudential's focus was rightly on improving its servicing position as it was clear that some customers were not receiving the right help and support when required. Whilst some progress was made, more still needs to be done to encourage greater proactive customer engagement. Conversely, Prudential's continued commitment to building their self-serve offering, as well as providing support to customers with vulnerabilities, are positive examples of their commitment and desire to make a step change in providing the best outcome for all members.

1. Voice of the customer feedback

During 2022, the Voice of the Customer programme continued to evolve and now includes competitor comparisons against Prudential's Customer Satisfaction performance. This is reported regularly to the Committee and also utilised within the business to drive remedial action and focus.

In terms of performance, Customer Satisfaction measures were disappointingly low during 2022 following the earlier period of operational instability – demonstrating the strong impact that contact availability can have on customers overall experience. This improved in line with service performance towards the end of 2022 with satisfaction levels outperforming the 2021 year end position. Improvements were seen in core customer journey related attributes such as 'completing the request in a timely manner' and 'keeping the customer informed' but 'the initial contact experience' continued to lag overall performance.

2. Improvements to customer communications

In 2022, Prudential has continued to make improvements to both online and offline customer communications, as well as increasing engagement through an active focus on driving digital adoption. Prudential has seen a steady increase in self-serve engagement with registrations for the online service growing from 16% (54k) to 22% (74k) (across all corporate pensions customers). With still more to do in this space, 2023 plans will include more targeted activity aimed at actively encouraging customers to engage with their pension planning.

The industry benchmarking report (referenced earlier) highlighted that whilst the quality of communications was at least as good as that of other providers (scoring above the median for the annual statement and retirement communications), there is more for Prudential to do when it comes to proactively engaging with customers. The report states that few engagement communications were sent to members over and above the digital activity (mentioned above) compared to competitors who communicated regularly with their customers on subjects such as Investment Options and Pension Consolidation.

For 2023, plans are in place to proactively work with employers and trustees to provide customers with valuable educational information. In addition, Prudential will be conducting more comprehensive testing of their communications to better understand how communications can be improved to ensure they are being understood and prompt the right engagement.

3. Customer vulnerability programme updates

Overall, Prudential continue to make good progress with their Vulnerable Customer strategy. Activity under the Vulnerable Customer programme has been aligned to and compliments their Group wide focus on improving customer outcomes as well as being an integral part of the Consumer Duty delivery coming into force from July 2023.

Tangible deliverables have included the adoption of company-wide Vulnerable Customer principles and standards which have been integrated into Proposition, Servicing and Communications frameworks. It is encouraging to see that the vulnerable customers strategy is not a standalone programme but part of an enduring customer focus across Prudential.

A good example of this relates to the work done to help customers with the cost of living challenges currently being faced. Recognising this, Prudential created a dedicated online hub containing helpful financial related content on a number of topics ranging from pension contributions and managing money in times of crisis to estate planning and how to protect from scams. The articles were intentionally short and written in a customer friendly style.

The hub also included signposts to additional external support, including national debt line, step change and pension credit, where customers on low incomes can find out more about potential benefits they could be claiming.

This is encouraging to see and goes some way to addressing the reduced level of targeted engagement activity this year.

6. Customer Servicing

Overall rating: Red

Bruce Rigby, Independent Chairman

"There have been definite signs of improvement but we want to see more consistency"

Service delivery in 2022 was significantly improved from the 2021 position as a result of the recovery and monitoring activity which the company put in place. However, before improving the rating for this area of activity, the IGC would like to see greater consistency in the delivery of customer service.

Servicing is split into 3 areas: (1) Back Office, dealing with processing of the necessary administrative tasks, (2) Voice, providing the direct interface with customers, and (3) Complaints, where customers have been unhappy with the service provided.

6.1 Back Office

Service improved over 2022, with the time to respond to customer requests reducing by over 50% across the year. This reflected a strong focus on improving "the customer journey". Having stabilised the service, the focus for 2023 is to continue to improve performance.

Performance of Individual Service Areas:

Key Telephony Measures	Achieved		Targets
Call Abandon Rate	14.7%		<=5%
Average speed to Answer (minutes)	7m 56s		<=2min 9 sec

Customer Journey Measures	% closed within target		Target (days)
New Business	97.0%		43
Claims	95.7%		43
Customer Servicing	95.2%		48
Bereavements	92.1%		154

6.2 Voice

At the beginning of the year, the time taken to answer and handle customer calls was in line with the results experienced at the end of 2021. The number of customers abandoning their call was below the 5% target in both January and February. However, in March service performance was impacted by IT and staffing issues which resulted in a marked deterioration in response times.

Performance remained challenging throughout Q2 and a number of measures were implemented to support improvements, including further recruitment, increased on site IT support and targeted coaching to support Learning and Development.

Performance in Q3 improved and, by the end of Q4, a stable service was being delivered. Plans are in place to ensure that this continues throughout 2023.

The table below shows a detailed breakdown of the monthly performance in Voice across 2022.

Month [2022]	Abandon rate [target <=5%]
January	4.4%
February	2.9%
March	18.6%
April	35.1%
May	13.4%
June	10.4%
July	7.9%
August	7.2%
September	3.1%
October	5.4%
November	1.0%
December	0.3%

6.3 Complaints

Customer complaints remained stable throughout Q1 and the majority of Q2. However, the knock-on impact from the issues described above in Voice resulted in an increase in Complaints by the end of June. Volumes remained high throughout Q3 but reduced in Q4 by 42% on the previous quarter to BAU levels by the end of the year.

7. Investment Pathways

Overall rating: Green

Pat Healy, Independent Member

"The IGC believes that Prudential's Pathways are a good tool for customers in their transition towards full drawdown of retirement income and we are keen to see more customers availing of them"

Following the FCA Retirement Outcomes Review, Investment Pathways were introduced by Prudential in February 2021 and have now been operating for just over two years. Investment Pathways are structured around generic approaches to how customers might view their future drawdown needs in retirement. The FCA defined four different customer objectives as follows:-

Pathway 1

I have no plans to touch my money in the next five years

Pathway 2

I plan to use my money to set up a guaranteed income (annuity) within the next five years

Pathway 3

I plan to start taking my money as a long-term income within the next five years

Pathway 4

I plan to take out all my money in the next five years

7.1 The Role of the IGC

The role of the IGC in Investment Pathways is similar to its role in relation to workplace pensions in general. The IGC is required to ensure:-

1. That each Pathway option is clearly communicated to customers to enable them to select the appropriate option
2. That the investment solution underlying each Pathway is appropriate to the timeline and risk profile inherent in that Pathway
3. That the total charges associated with each Pathway solution meet regulatory requirements and are reasonable in the context of the specific solution

7.2 Take-up of Investment Pathways by customers

Investment Pathways are available to non-advised customers in Prudential's Retirement Account and in the Pension Choices Plan. The number of customers availing of Pathways is still very small, although the number increased in 2022. A significant number of customers availed of the online and voice journeys but most chose to remain with their existing product.

Where customers selected specific Pathway options, the majority indicated that they planned to take their money as a long-term income within the next five years (Pathway 3). The next most popular option was Pathway 1—I have no plans to touch my money in the next five years.

The IGC believes that Prudential's Pathways offer a good route to decumulation for customers and continues to have discussions with the company in relation to the reasons for low take-up.

7.3 Value for Money Assessment

The IGC role set out above is largely about assessing the Value for Money of the Pathway options and this is considered under the following headings.

7.4 Communications and Service

The IGC has reviewed the communications material presented to customers considering Pathways and is satisfied that the material is useful, clear and easily understandable.

Prudential's Risk Function carries out a detailed annual review of the performance of the voice and online journeys for customers availing of Pathways. This assessment has been provided to the IGC and we are satisfied that, with a small number of exceptions, the servicing performance has been effective and satisfactory. The servicing difficulties for other products referred to elsewhere in this report have not been generally experienced in relation to Pathways.

7.5 Investment Solutions

In this section we consider the appropriateness of the investment solutions offered under Pathways and the specific performance of those solutions.

Prudential has carried out a detailed review of the investment proposition supporting each Pathway and discussed its findings with the IGC. The Company is proposing a change to one of the Pathways—the plan to take a guaranteed income/annuity. Due to the fundamental change in the outlook for inflation in the UK and elsewhere that has materialized over the last eighteen months, Prudential is proposing to invest 15% of Pathway 2 funds in inflation-linked bonds and to correspondingly reduce the allocation to corporate and government bonds. The IGC supports this proposal.

For the other Pathways, Prudential's review concludes that the current investment solution continues to be appropriate and, following careful consideration, the IGC fully supports this view.

The funds underlying the two most popular Pathway options are the PruFund 2 and PruFund 3. These funds have continued to perform well against their benchmarks due to their broad asset base and their exposure to growth assets. They have however performed badly against the inflation target because of the strong surge in inflation experienced over the last two years. The IGC is monitoring this closely and is in regular communication with Prudential's asset managers to ensure the best outcome for customers.

7.6 Costs and Charges

The IGC receives regular reports from Prudential on the total costs and charges applied to Pathway products. The IGC also has access to independent costs comparisons with other providers. The IGC is satisfied that the charges on Prudential Investment Pathways meet regulatory requirements.

It is important to note, as we pointed out in last year's report, that the most relevant Prudential investment products supporting Pathways have valuable features such as smoothing and multi-asset investment structures that are costly to provide. Because of this, Prudential's charges are sometimes at the higher end of the range of available products but the IGC believes that the charges are appropriate for the product features involved.

Products with lower charges are available from other providers but these do not generally provide the same range of benefits as the Prudential products. The IGC continues to challenge Prudential on its charges and particularly for those associated with administration costs.

7.7 Summary

As was the case last year, the IGC is comfortable that Pathway customers are receiving value for money. The IGC is comfortable that communications and service, investment solutions and costs and charges are of an appropriate standard. While investment performance is underperforming against inflation, the IGC believes this is a market-wide problem and Prudential's Pathway funds are performing well against comparable funds. The IGC believes this is a good product for customers and would like to see higher volumes of customers availing of Pathways.

8. Other governance items and plans for 2023

As part of its oversight of Prudential, the IGC has confirmed that it is comfortable with the financial strength of the company, details of which can be found in the publicly available Annual Report and Accounts for M&G plc. The IGC also received a report on the company's cyber security arrangements, including an attestation from management confirming the adequacy of those arrangements.

The IGC has developed its 2023 business plan which includes the following:

- **Investment and Investment proposition**: review of strategic and tactical allocation, PDG lifestyles and member behaviour at retirement
- **ESG**: review of progress in all three areas (Environmental, Social & Governance)
- **Industry comparison**: continued participation in benchmarking study
- **Consumer duty**: review impact of the new regulations
- **Costs and charges**: continued detailed monitoring

Appendix 1: How do we measure Value for Money (VfM)?

The IGC's current approach to VfM takes account of a range of factors, including investment performance, costs and charges, and 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 lead to higher retirement income, 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. With regard to the primary financial components of VfM, it is important to note that:

a) for investment returns the IGC believe it is appropriate to not only look at investment returns compared with CPI (Consumer Price Inflation), but also performance relative to industry benchmarks, the level of risk taken and fees charged. The performance metrics analysed over 1,3 and 5 year periods are:

- Fund net return vs benchmark
- Tracking error vs benchmark
- Net information ratio
- Client share of outperformance
- Fund net return vs UK CPI
- Quartile ranking within ABI sector.

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.

The IGC's VfM framework:

Red Amber Green

Acceptable	No material issues. Performance is in line with expectations. However, there may still be some areas for further improvement.
Requires Closer Monitoring	Some concerns. There may be a group of customers for whom improvements are required or specific areas that require attention.
Take Action	Major concerns. Performance is at a level below which the IGC feels is appropriate, or below alternatives available in the market. Urgent action will be considered.

Investment Performance – Retrospective

Return Metric			
Net return vs benchmark	Varies by fund type / asset class (ref below)		
Client share of outperformance	>60%	30-60%	<30%
Tracking error	Varies by fund type / asset class (ref below)		
Net information ratio	>0.2	-0.67 to 0.2	<-0.67
Net return vs UK CPI	>=3%	0 to 3%	<0%
ABI Sector Quartile Ranking	1, 2	3	4

Click to reveal further information

Investment Pathways

Does each Investment Strategy have a clear statement of aims and objectives?

Yes No

Are Default Fund Glide Paths consistent with Pensions 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 modelled?

Yes No

Investment Strategy Design

Are Default Fund Glide Paths consistent with Pensions 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

Environment and Social Governance

The IGC will review three key areas of focus, these being Environment/Climate, Social Impact and Stewardship. IGC will select a rating for each key area based on the following:

Are ESG financial considerations fully embedded within the management of the in scope propositions?

Yes Materially No

Is there active engagement with companies by asset managers to help drive corporate change and encourage better ESG practices?

Yes Materially No

Are Prudential's ESG and Stewardship policies appropriate to the needs of the customer?

Yes Materially No

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

Transaction Costs

- 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%

Communication and Engagement

Are relevant communications (off line and on-line) provided at an appropriate point (e.g. key life stage/ key event)?

Yes Materially No

Are these communications useful, clear and easy to understand?

Yes Materially No

Do Prudential provide quality self-service and additional support material to suit member's needs and objectives?

Yes Materially No

Service Levels

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

Appendix 2: Jargon Explained

ABI Sector – The 'Absolute Breadth Index '(ABI) Fund Sectors is a system for the classification of unit-linked life and pension funds with similar investment strategies. It is designed to group together funds that are similar, so that they can be compared on a like-for-like basis.

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.

Asset Diversification – A strategy that mixes a wide variety of investments within a portfolio in order to better manage investment risk.

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

FUM – Funds under Management. Sometimes called assets under management (see above).

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.

Glide Path – A formula that defines the asset allocation mix of an investment fund. The mix is based on the number of years left until a customer's target retirement date.

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.

Investment Pathway – A relatively new initiative from the FCA aimed at providing customers with an investment solution to match a particular objective in drawdown.

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

Net Information Ratio – The information ratio (IR) is a measurement of portfolio returns beyond the returns of a benchmark.

Net Zero – Refers to the balance between the amount of greenhouse gas produced and the amount removed from the atmosphere. We reach net zero when the amount we add is no more than the amount taken away.

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).

Tracking Error – The tracking error identifies the level of consistency in which a portfolio "tracks" the performance of an index. A low tracking error means the portfolio is beating the index consistently over time. A high tracking error means that the portfolio returns are more volatile over time and not as consistent in exceeding the benchmark.

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.

VfM – Value for Money, see appendix 1 for more information.

Value Style – An investment approach that aims to identify stocks & shares trading below their estimated 'fair value' and then profit as the share price adjusts.

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.

PRUAG100613501 09/2023_WEB