

## **Additional Voluntary Contributions (AVCs)**

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### **Background**

Introduced in 1986, Additional Voluntary Contributions (AVCs) were for many years the only vehicle available to members of occupational pension schemes wishing to make additional pension provision. However, following the introduction of 'concurrency' legislation in 2001, scheme members were permitted to contribute to an occupational pension scheme and a personal pension or stakeholder arrangement simultaneously. Further changes to the rules surrounding AVCs followed, with the requirement to offer AVCs finally being removed altogether on 6 April 2006 as part of the Pensions Act 2004.

As a result of the changing legislation, and compounded by the move from defined benefit to defined contribution (DC) pension arrangements, many occupational pension schemes now have 'paid-up' AVC arrangements, i.e. plans with no further contributions being paid to them.

### **Guidance from the Pensions Regulator**

In recent months the Regulator has issued guidance focusing on the good management of DC occupational pension schemes. One of these good practice guides relates to 'Member retirement options and the open market option', and applies not only to occupational DC schemes but also to AVC arrangements.

An open market option, as the name suggests, is the member's right to buy an annuity on the open market from a provider of their choice. In the past it was common practice for an annuity to simply be secured with the insurer where the funds had built up. However, going forward trustees must make members aware of their right to exercise the open market option and possibly obtain better annuity terms that reflect the member's own particular circumstances. For example, if the member is in poor health, an impaired life annuity can be purchased that provides a higher amount of income over a shorter expected remaining lifetime.

As the annuity purchase process is irreversible, it is essential that trustees ensure an efficient procedure is put in place to convert the AVC funds into retirement income. The Regulator's guidance also highlights the trustees' duty to ensure that the member has sufficient information and support to allow them to make an informed decision. As a minimum, trustees should be emphasising to the member the importance of seeking financial advice on the retirement planning process.

### **Other issues for AVCs**

More generally, trustees' duties and responsibilities also extend to investment issues for AVC funds. For example, the trustees must ensure that the investment fund choices offered by the AVC provider are appropriate to the needs of their members, with AVC arrangements being reviewed on a regular basis to ensure that charges and returns remain competitive. Where poor returns or excessive charges are identified, trustees should consider what alternatives providers are available and communicate the investment aspects to the AVC members.

## **Assignment of AVCs**

With increasing Regulator focus on good scheme governance, the list of trustee responsibilities and duties seems to be ever growing. However, there are various exercises which trustees can consider in order to streamline the management of their pension scheme arrangements and reduce or remove the liabilities. One such exercise is AVC assignment.

At present AVC policies are most commonly held in the name of the trustees for the benefit of the members. However, for many AVC arrangements it is possible to assign these policies to the individual members. By assigning AVC policies to individual members the trustees are no longer responsible for all of the duties associated with the management of the AVC arrangement. After the assignment it is the individual members who may wish to monitor the performance of their AVC funds and make changes as and when they see fit.

The requirements for assigning AVC policies do vary from provider to provider, but in some cases can be as simple as a letter of instruction from the trustees. Assuming that the provider is able to offer assignment, the trustees must establish what penalties or charges, if any, will be applied to members' funds. For AVC arrangements invested in with profits funds it is common for market value adjustments (MVAs) to apply on transfer or fund switch and possibly on assignment from one policy to another. If a MVA or other charge or penalty was to apply, the trustees may decide that an AVC assignment exercise is not in their members' interest. Careful consideration must also be given to AVC policies which offer guaranteed annuity rates, especially if these, often preferential, annuity rates will be lost on assignment.

## **Alternatives to AVC assignment**

As an alternative to assignment some members may prefer to transfer their AVC funds on an individual basis to another pension arrangement, perhaps a personal pension or stakeholder plan, or a new employer's occupational DC scheme. Many individuals may view this transfer as an opportunity to tidy up their pension arrangements and possibly secure greater flexibility in an alternative pensions vehicle, eg to allow consideration of income drawdown or phased retirement options which are not usually offered in standard AVC arrangements. Again, the trustees and members need to be aware of the impact of transfer charges or penalties.

A further alternative to AVC assignment is the exercise of an early retirement option. Early retirement is currently available to members over the age of 50, increasing to age 55 from 2010. A member's AVC fund can often be used alongside main scheme benefits to maximise cash and pension benefits available on retirement.

## **Communication with members**

The key to a successful AVC assignment or transfer exercise is a program of high quality communication with members by the trustees. It is important to remember that trustees are not authorised to provide investment advice, therefore it is vital to highlight to members the importance of seeking independent financial advice from an authorised adviser.

The information in this note should not be relied upon or taken as an authoritative statement of the law.